



1 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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2 of 163 DOCUMENTS

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3 of 163 DOCUMENTS

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4 of 163 DOCUMENTS

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5 of 163 DOCUMENTS

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6 of 163 DOCUMENTS

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7 of 163 DOCUMENTS

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8 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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Publication Information

10 Real Estate Brokerage Law and Practice Preface

Preface

While the legal principles governing the rights and duties of real estate brokers, their principals and third parties with whom they interact, are generally considered to be well established, the law reports perennially include suits by and against real estate brokers. The law of real estate brokerage, it seems, has always been something of an enigma, even to the real property specialist, and judging by a growing volume of real estate brokerage litigation in recent years, it remains so today. The ever-increasing flow of brokerage litigation, whatever its causes, has provided the courts the opportunity to rethink some of the well settled common-law rules that govern the broker's rights and obligations.

In the field of residential real estate brokerage, for example, the consumer protection movement, as reflected in both statutory and case law developments, has contributed to a strong judicial movement towards a "no closing-no commission" viewpoint. Federal, state and local governments have also entered the brokerage picture, in the form of statutory and regulatory developments in civil rights, antitrust and consumer protection. Other factors of significance that have contributed to changes in the law in this field are the growth of multiple listing services, the development of national real estate brokerage franchises, rapid changes in mortgage lending and the advent of new forms of ownership, such as the condominium, cooperative and time-sharing arrangement.

This work is designed to make available in one place the relevant business practices governing those engaged in real estate and allied forms of brokerage. The authors have attempted to present the subject in its modern guise. Statutory provisions and judicial precedents from throughout the United States, illustrative forms, and trial materials have been included to present a national view of the subject. A comprehensive bibliography, arranged topically, has also been included. The authors hope that this work will be of service to both attorneys and brokers, whether expert or neophyte, by serving as a comprehensive guide to this significant area of commerce.

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New York, New York
October 1, 1985



9 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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Professors Patrick J. Rohan and Charles S. Bobis took primary responsibility for day-to-day manuscript preparation. Bernard H. Goldstein, Esquire, a senior partner in Tenzer, Greenblatt, Fallon & Kaplan, New York, New York, provided resource material and suggestions, gleaned from his many years of experience as a practitioner and lecturer on the subject of real estate brokerage. He also generously consented to incorporation into the book of materials on the subject previously prepared by him. Other scholars who contributed directly to the book are, Professors Joseph J. Beard, Edward D. Cavanaugh, Bernard E. Gegan and Alan D. Scheinkman, of St. John's University School of Law, and Nancy Alexander, of the New York Bar, who enriched the text by preparing individual chapters. The generous cooperation of the National Association of Realtors(R) must also be recognized, as well as that of attorneys and real estate professionals too numerous to mention, who contributed time and expertise toward the effort to make this work truly national in outlook and in content. Thomas P. Rohan III and Caroline Donovan, members of the New York Bar, also made extensive contributions. Their generosity and encouragement is deeply appreciated by the authors.

Research assistance, source checking and countless other technical tasks were professionally attended to by Anthony J. Cornicello and Tonianne Florentino of the St. John's Law Review, Marisa Guardo, Christopher Nenninger and Michelle Sheehen of the St. John's University School of Law Faculty Research Assistants Program, and Ted J. Abbruzzo, Michael R. Herman, Cheryl N. Khaner, Norman D. Lipton, Robert H. Liquerman, Glenn M. Mitchell, Brian T. Moriarity, Albert A. Ngwana, Jacqueline M. Poole, Lisa A. Schneider and Robin Kelly Sheares, research assistants at the Law School. Dolores Alonso and Odette Belasco cheerfully and accurately prepared the manuscript for the printer. Julius J. Marke and Ralph A. Monaco, Law Librarians of St. John's University School of Law, as well as their professional staff, rendered invaluable assistance in gathering data from all over the United States.

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10 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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What's New

1 Real Estate Brokerage Law and Practice Scope

Scope

HIGHLIGHTS

Release 25 September 2010

Updates and **New** sections throughout the treatise on such topics as

Economic Loss Rule (**ch. 3**)

Realtor Code of Ethics and the Model Definition of the Practice of Law (**ch. 7**)

RESPA Reform Effort (**ch. 11**)

Interstate Land Sales Full Disclosure Act (**ch. 14**)

Chinese Drywall (**ch. 15**)

Green Marketing Claims (**ch. 15**)

Additional Updates added throughout the treatise are the latest statutory, regulatory and case law developments

Economic Loss Rule. With the vast economic downturn since 2008 claims against brokers, lenders and developers have found many footholds. The economic loss rule is sometimes raised as a defense when a broker or agent is sued by a client. Not all courts apply the economic loss rule in the context of a real estate licensee's abrogation of his or her duties. This new section has been added to discuss the traditional role this doctrine and present its applicability under recent case law. (See § 3.39).

Realtor Code of Ethics and the Model Definition of the Practice of Law. This section has completely revised former '§ 7.05 Lawyer-Broker Accords' to cover the recent revisions by the National Association of Realtors(R) of Article 13 of its Code of Ethics and Standard of Practice. (See § 7.05) .

Updates to Chapter 10, *The Impact of Electronic Commerce on the Real Estate Brokerage Business* and Chapter 8, *Real Estate Brokers and Antitrust Laws* contributed by **Robert D. Butters, Esq.** of **Arnstein & Lehr**, include updates throughout these chapters and provides broad discussion of recent cases including in *Tamburo d/b/a Man's Best Friend Software v. Dworkin, et al* Case No. 08-2406 (7th Cir., April 8, 2010) which discusses the reach of personal jurisdiction for persons using internet communications media; *Dawes-Ordonez v. Realtors Association of Greater Fort Lauderdale*,

Case No. 09-60335-Civ-Cohn/Seltzer (S.D. Fla., May 5, 2010) which discusses the right of a multiple listing service property to re-display property photos in the event the property is subsequently relisted with another broker; and also *In re Valdez*, 2010 U.S. Dist. LEXIS 30160 (E.D.N.Y. Mar. 26, 2010), a case which covers the use of photos in the context of federal and state copyright domains.

Updates throughout Chapter 11, ***Mortgage Brokers***, contributed by **Robert M. Jaworski, Esq.**, of **Reed Smith, LLP** include the most up to date and recent additions to the sections throughout the chapter and including:

- **RESPA Reform--the New Rule.** --updated information and FAQs since the New Rule went into effect January 1, 2010 despite the many efforts to postpone or invalidate the New Rule's implementation. (§ 11.09).

Revisions to Chapter 15, ***Real Estate Brokers and Environmental Laws***, contributed by **Ralph Holmen** of **The National Association of Realtors**, provide updated discussion on the issue of Chinese drywall. The CPSC initiated an investigation and has now established a "Drywall Information Center" including various reports and information about the problem. A new section has been added that discusses this new environmental hazard and various responses from local and federal agencies. See § 15.03[2A]. **J. Cullen Howe** of **Arnold & Porter, LLP**, provided an annual update to this chapter in **Green Building Issues Affecting Real Estate Brokers..** Valuable additions have been added to provide discussion and analysis relating to green building issues affecting real estate brokers including:

- **Green Buildings Defined**--presented here is a new discussion which provides information and background analysis of an expanding awareness of the energy buildings consume and the public policy concerns that are shaping the definition of 'green buildings'. (new § 15.06[1]).

- **Green Building Rating Systems**--this section reviews the increasing use of the EPA's Energy Star program (new § 15.06[4]]).

- **Green Marketing Claims**--this new section discusses the 'Green Guides' that provide the guidelines regarding claims made about a building's environmentally friendly status. Many real estate developers are marketing their buildings as such and in general, developers are prohibited by law from making any false or misleading statements about their buildings. (See new § 15.06[9]]).

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11 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART I General Principles

CHAPTER 1 Introduction

10-1 Real Estate Brokerage Law and Practice 1.syn

§ 1.syn Synopsis to Chapter 1: Introduction

§ 1.01 The Subject Matter

§ 1.02 Scope and Organization of the Treatise



12 of 163 DOCUMENTS

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PART I General Principles

CHAPTER 1 Introduction

10-1 Real Estate Brokerage Law and Practice § 1.01

§ 1.01 The Subject Matter

The law of real estate brokerage has always been something of an enigma, even to the real property specialist. Almost any first-year law student can state the agency, contract, fiduciary, and property law principles that govern the rights of brokers, principals and the third parties with whom they interact. Nevertheless, the advance sheets reflect a growing quantity of litigation involving the very same parties. It may well be that this tendency to wind up in litigation stems from the human desire to acquire as much wealth as possible (or to hold on to the same), lack of communication, poor drafting of brokerage agreements, the infinite variety of circumstances in which the parties find themselves, or a combination of all these factors. This ample supply of grist for the judicial mill has, in turn, led to slow but perceptible changes in the common law. Perhaps of greater significance, statutory and regulatory developments in such diverse areas as consumer protection, antitrust, environmental protection, and product liability have brought federal, state and local governments into the brokerage picture as an omni-present factor. The growth of multiple listing services and the advent of nationwide real estate brokerage franchises have also left their mark. Moreover, rapid changes in mortgage lending, as well as the onslaught of new forms of ownership (such as condominium, cooperative and time-sharing arrangements), have had a major impact upon the field. In the pages that follow, the authors have attempted to trace these developments and to present the subject of real estate brokerage in its modern guise.



13 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART I General Principles

CHAPTER 1 Introduction

10-1 Real Estate Brokerage Law and Practice § 1.02

§ 1.02 Scope and Organization of the Treatise

In formulating these materials, the authors have attempted to pinpoint trends in the law and to bring together in one place the myriad areas of specialized law practice that bear upon the general subject. The text treatment has been subdivided into five Parts, in what the authors hope will prove to be a logical and serviceable treatment. Part I of this work includes an omnibus chapter designed to acquaint the reader with the structure of the brokerage industry on the national, state, and local levels. Included are definitions of various types of brokerage transactions, as well as the different contractual arrangements under which the broker may be employed. Chapter 2 concludes with an in-depth analysis of multiple listing services, which form the backbone of the residential brokerage industry. Part II analyzes the contractual rights and duties of the broker and the fiduciary obligations that arise from the nature of the broker-client relationship. It examines a broker's duty to disclose (Ch. 3A) and includes a directory listing disclosure laws and regulatory agencies (*Appendix 3A-1*). This segment concludes with an analysis of the elements that the broker must prove in order to be successful in any litigation to recover a brokerage commission. Part III is devoted to legal restraints imposed upon the industry by licensing authorities and governmental agencies charged with enforcing public policy in the areas of antitrust, civil rights, and the unauthorized practice of law. It includes a chapter discussing the impact of electronic commerce on the real estate brokerage business (Ch. 10). Part IV is devoted to specialized types of brokerage activity, namely, mortgage brokerage, business brokerage and finders. It includes a chapter that focuses on a broker's involvement in lease transactions (Ch. 13A). Also considered are brokerage transactions involving condominiums, cooperatives, and time-sharing interests. The text concludes with Part V, which is devoted to an examination of a variety of legal developments (both national and local) that bear directly upon brokers' obligations to their clients, prospective customers, and the public at large. Chapters 15 and 15A focus on environmental issues affecting brokers. Immediately following Chapter 17, on alternative dispute resolution, are helpful checklists, which include the client interview and a drafting guide for a listing agreement. Following those checklists, Appendix A to the treatise consists of a bibliography of secondary sources.



14 of 163 DOCUMENTS

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PART I General Principles

CHAPTER 2 Overview of Brokerage Practice and the Organization of the Brokerage Industry *

10-2 Real Estate Brokerage Law and Practice 2.syn

§ 2.syn Synopsis to Chapter 2: Overview of Brokerage Practice and the Organization of the Brokerage Industry

*

§ 2.01 Overview of the Brokerage Industry

[1] Trade Associations

[a] National Association of Realtors(R) (NAR)

[b] State Associations of Realtors(R)

[c] Local Boards of Realtors(R)

[d] Non-Realtor(R) Trade Associations

[2] History of the Realtor(R) Organizations and System of Brokerage

[3] Residential Real Estate Brokerage Firms

[a] Traditional Predominance of Small Firms

[b] Entry

[c] Growth and Entry of Large Corporations and Franchises

[4] Commercial Real Estate Brokerage Firms

[a] Traditional Role

[b] Entry

§ 2.02 Brokers, Salespersons and Finders--Definitions, Descriptions and Distinctions

- [1] Brokers
- [2] Salespersons
- [3] Finders
- [4] Cases Addressing the Broker and Middleman/Finder Dichotomy
- [5] Broker Activities Versus Marketing Activities

§ 2.03 The Brokerage Contract

- [1] In General
- [2] Types
 - [a] Open Listing
 - [b] Net Listing
 - [c] Exclusive Agency
 - [d] Exclusive Right to Sell
 - [e] Multiple Listing
- [3] Statute of Frauds
- [4] Broker's Authority to Sign Contract

§ 2.04 Study of Multiple Listing Service (MLS) Programs

- [1] In General
- [2] History of the MLS
- [3] The Original Reasons for and Effects of Multiple Listing
 - [a] Open Listing Competition
 - [i] In General.
 - [ii] Listing Broker Competition.
 - [iii] Seller Competition.
 - [iv] Duplication of Effort.
 - [b] Making a Market

[c] Information on Housing Prices

[d] Commission Rates

[e] Advantages to the Board

[f] Cooperation and Ethics

[4] Analysis of MLS History

[5] Membership Requirements of MLSs

[a] In General

[b] Board of Realtors(R) Membership

[i] Description of Condition.

[ii] Analysis of Condition.

[c] Real Estate License

[i] Description of Condition.

[ii] Analysis of Condition.

[d] Submission of Disputes to Arbitration

[i] Description of Condition.

[ii] Analysis of Condition.

[e] Initiation Fees

[i] Description of Condition.

[ii] Analysis of Condition.

[f] Other Membership Requirements

[g] Conclusion

[6] Listing Requirements

[a] In General

[b] Mandatory Submission of Listings

[i] Description of Requirement.

[ii] Analysis of Requirement.

[c] Required Use of Exclusive Listing Agreements

[i] Description of Requirement.

[ii] Analysis of Requirement.

[7] Commission Rate and Split Schedules

[8] Commission Split Uniformity

[9] Data Dissemination

[a] In General

[b] Property Information

[c] Seller Information

[d] Listing Broker Information

[e] Analysis of Data Dissemination

[f] MLS Disclaimers

[10] Selling Requirements

[a] In General

[b] Anti-Solicitation Rules

[i] Description of Requirement.

[ii] Analysis of Requirement.

[c] Subagency of Cooperating Brokers

[11] NAR Multiple Listing Policy--"The Fourteen Points"

§ 2.05 Code of Ethics and Standards of Practice of the National Association of Realtors(R)

§ 2.06 Professional Designations

§ 2.07 Errors and Omissions Insurance



15 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART I General Principles

CHAPTER 2 Overview of Brokerage Practice and the Organization of the Brokerage Industry *

10-2 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 2 discusses the real estate brokerage industry and the business practices common to this industry. While the public (including some courts) freely uses the term Realtor(R), this term is a registered collective membership mark that identifies a real estate professional who is a member of the National Association of Realtors(R). This organization is the largest trade and professional organization in the United States. Chapter 2 discusses the history of broker organizations and multiple listing services (§ 2.01[2]) and the traditional role of brokerage firms in the residential and commercial markets (§ 2.01[3], [4]). The functions of brokers, salespersons, and finders within the industry are discussed (§ 2.02) as are the various types of commonly used brokerage contracts (§ 2.03). Chapter 2 contains a detailed discussion of the multiple listing service (MLS) programs and includes coverage of:

- the history of the MLS (§ 2.04[2]),
- the original reasons for and effects of multiple listing (§ 2.04[3]),
- membership requirements (§ 2.04[5]),
- listing requirements (§ 2.04[6]),
- commission rates and split schedules (§ 2.04[7]),
- commission split uniformity (§ 2.04[8]),
- data dissemination by the MLS (§ 2.04[9]),
- selling requirements (§ 2.04[10]),
- the National Association of Realtors(R) multiple listing policy (§ 2.04[11]).

Chapter 2 concludes with discussion of the Code of Ethics and Standards of Practice of the National Association of

Realtors(R) (§ 2.05).



16 of 163 DOCUMENTS

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PART I General Principles

CHAPTER 2 Overview of Brokerage Practice and the Organization of the Brokerage Industry *

10-2 Real Estate Brokerage Law and Practice § 2.01

§ 2.01 Overview of the Brokerage Industry

[1] Trade Associations

The National Association of Realtors(R) (NAR) and its affiliated state associations and local boards of realtors together comprise the principal trade organizations in the real estate brokerage industry. This section presents an introductory description of the NAR and its affiliates, followed by a brief introduction to the other smaller groups. The section also traces the history of the Realtor(R) organizations and recurring themes in that history. The "Realtor(R)" system is a tripartite trade organization consisting of the National Association, fifty state associations, and local boards of realtors(R) and the associations of the various states and U.S. territories.

[a] National Association of Realtors(R) (NAR)

The National Association of Realtors(R) is the parent organization and national component of the Realtors(R) system. Founded in 1908 in its headquarters location, Chicago, Illinois, the organization was known until 1972 as the National Association of Real Estate Boards (NAREB). The NAR's 2008 statistic of nearly 1.3 million members n1 makes it the largest trade organization in the nation. The majority of NAR's members are primarily engaged in residential brokerage as opposed to commercial brokerage or other forms of practice. The authors have located no precise statistics on the Realtor's(R) share of the real estate brokerage services market. However, data from the FTC Consumer and MLS (Multiple Listing Service) Surveys suggest that an overwhelming percentage of all broker-assisted residential housing transactions in the U.S. involve a Realtor(R).

The NAR charts the state and local units, maintains its code of ethics, licenses the collective service mark "Realtor(R)," helps establish Realtor(R) policies, and performs a wide range of services for its members.

Brokers or salespersons who wish to participate in any Realtor(R) organization must join all three branches: a local board of realtors(R), the state association, and the NAR. Only after payment of annual dues to all three branches and a pledge to abide by the Code of Ethics n1.1 and other regulations can a broker call him/herself a "Realtor(R)." Salesperson members are known as "Realtor(R)-Associates." If a broker belongs to the NAR, all the salespersons affiliated with the broker must join, or the member broker must pay dues for the salespersons in lieu of their joining.

Over the years the NAR has played an increasingly complex and important role in the brokerage industry. During its

over one hundred-year history, the NAR has significantly influenced such major developments as the "safe harbor" income tax rules of independent contractors, the development and regulation of the MLS, the evolution of standards of brokerage practice, agency disclosure rules, and seller disclosure statements.

The NAR considers itself the nation's "spokesman for real estate." It performs the central public relations functions for the Realtors, including producing a large range of publications and media efforts.

The NAR plays a role in ensuring compliance with the Realtor(R) Code of Ethics and other standards. Failure to comply can result in the revocation of a Board or Association charter, revocation of use of the "Realtor(R)" mark, and termination of important services such as insurance. n1.2

The National Association also provides member services of all kinds. Educational and information services, including an unequaled real estate library, training courses and materials, and advanced designations for specialists are among the most widely used NAR offerings.

The National Association of Realtors(R) offers various professional designations and certifications including the following:

- Accredited Buyer Representative (ABR(R)).
- Accredited Buyer Representative Manager (ABRM(R)).
- Accredited Land Consultant (ALC(R)).
- Certified Commercial Investment Member (CCIM(R)).
- Certified International Property Specialist (CIPS(R)).
- Certified Property Manager (CPM(R)).
- Certified Real Estate Brokerage Manager (CRB(R)).
- Certified Residential Specialist (CRS(R)).
- Counselor of Real Estate (CRE(R)).
- General Accredited Appraiser (GAA(R)).
- Residential Accredited Appraiser (RAA(R)).
- Green Designation.
- Graduate REALTOR(R) Institute.
- Performance Management Network (PMN(R)).
- Realtor(R) Association Certified Executive (RCE(R)).
- Seniors Real Estate Specialist (SRES(R)).

- Society of Industrial and Office REALTORS(R) (SIOR(R)).
- At Home with Diversity Certification.
- e-Pro(R).
- Real Estate Professional Assistants Certification (REPA(sm)).
- Resort & Second-Home Property Certification (RSPS(R)).
- Transnational Referral Certification.

These designations and certifications are discussed in greater detail in § 2.06, *below*.

The term "Realtor(R)" is a trademark of the National Association of Realtors(R) and should only be used by licensees who belong to this group. n2 Some states subject licensees who use this trademark without the authority to do so to disciplinary proceedings. n3 It should be noted, however, that many courts use the term Realtor(R) as though it referred to any real estate licensee. This is incorrect. Only licensees who are a Realtor(R) member in a Realtor(R) association are automatically licensed by the National Association of Realtors(R) to use this mark to identify themselves.

[b] State Associations of Realtors(R)

The state associations are the middle link in the tripartite structure. In most ways the development of the state associations has followed and paralleled that of the NAR. Each state association is incorporated separately in its state and is composed of all the boards, Realtors(R), and Realtor(R) -associates located in the state. Members elect a state board of directors and other officials to preside over each state association. Each state association maintains a professional staff. The California Association of Realtors(R), by far the largest state association, has nearly 158,000 members, 117 member boards and a budget of \$27 million. Most state associations are much smaller. Each state association generally has a governing framework and a system of committees that parallels that of the NAR.

The state association functions are also in many ways parallel to those of the NAR. Most state associations are active in political affairs and generally coordinate with the NAR for fund-raising and legislative activities in national matters. The larger associations perform public relations functions. Most maintain active political action committees and coordinate legal efforts with the NAR when appropriate. The state groups are particularly active in the education and training of members and in the development and publication of state-specific standardized forms, including listing and offer forms. State associations also provide support service for the boards, such as aid with bylaws and procedures and inter-board arbitration, and member services, such as insurance and pension programs.

[c] Local Boards of Realtors(R)

A local board of Realtors(R) is associated with the state association of Realtors(R), which in turn is associated with the National Association of Realtors(R). Historically, a real estate licensee had to be a member of his or her local board of Realtors(R) in order to obtain access to that board's multiple listing service. If membership in the local board was not required for this access, the non-member was typically charged a higher fee for such access. The trend is for multiple listing services to exist at a regional level. In some regions, the multiple listing service is owned by a separate entity rather than by a local board of Realtors(R). Many multiple listing services allow prospective purchasers to have some access to the service.

The local boards of Realtors(R) provide the organizational structure for enforcement of the Code of Ethics promulgated by the National Association of Realtors(R) and enforcement of arbitration as a means of settling disputes between

Realtors(R). n4 Local boards of Realtors(R) also engage in public relations, advertising and political lobbying on behalf of their members.

[d] Non-Realtor(R) Trade Associations

The National Association of Real Estate Brokers (NAREB(R)) is comprised of African American professionals in the real estate industry. NAREB is the oldest minority trade association in America and was founded in 1947. This association refers to its members as Realtists(R). NAREB(R) has stated that although it is composed principally of African Americans, NAREB(R) embraces all qualified real estate practitioners who are committed to achieving the ideals of "Democracy in Housing." NAREB(R) may be contacted at: 9831 Greenbelt Road, Suite #309, Lanham, MD 20706; Telephone: 301-552-9340; Website: <http://www.nareb.com>.

The National Association of Hispanic Real Estate Professionals (NAHREP) is a trade association with 15,000 members in over 60 affiliate chapters in 48 states. NAHREP's mission is to increase Hispanic homeownership rates by empowering the advisors that serve them. NAHREP may be contacted at: 5414 Oberlin Drive #230, San Diego, Ca 92121; Telephone: 858-622-9046; Website: <http://www.nahrep.org>.

The Asian Real Estate Association of America (AREAA), founded in 2003, is a trade organization dedicated to promoting sustainable homeownership opportunities in Asian American communities by creating a national voice for housing and real estate professionals that serve this market. AREAA may be contacted at: 5963 La Place Court, Suite 312, Carlsbad, CA 92008; Telephone: 760-918-9162; Website: <http://www.areaa.org>.

The National Association of Real Estate Consultants(R) (NAREC) was founded in 1999. NAREC promotes fee-for-service compensation plans rather than the traditional commission compensation plan. NAREC has offices in Idaho and Florida. NAREC may be contacted at: 2758 West River Drive, Lenore, ID 83541; Telephone: 208-746-7963; Website: <http://www.narec.com>.

[2] History of the Realtor(R) Organizations and System of Brokerage

Today's brokerage structures and practices are often viewed as the only possible system of brokerage. However, they have evolved over many years in response to the specific problems and needs of the industry. These structures and practices were not implemented arbitrarily, nor were they imposed by an outside force. They were, for the most part, developed and instituted by the industry members themselves.

The primary factor in the evolution of the brokerage industry and the Realtor(R) organizations has been the continual increase in the size and complexity of local housing markets. Generally, search costs increase as these markets increase in size. Search costs decrease as the concentration of the market-making systems, such as MLSs, increases. The history of the Realtor(R) organizations is, in large part, the story of the development of structures to solve the problem of increased search costs.

While the practice of real estate is generally local, the structures and practices of brokerage developed in parallel fashion throughout the country. The most complete record of the Realtors(R) is contained in the journals of the California Association of Realtors(R) (*California Real Estate*). The California Association of Realtors(R) (CAR) is the one state association which pre-dates the national organization. Not only has the California Association literature traced the national developments in brokerage throughout the country, but the California Association has also been a leader in most of those developments. California structures and practices have often been models for others throughout the United States. In addition, California brokers have long been a major portion of the industry. Today California contains approximately one-fifth of the nation's licensees and Realtors. As early as 1925, the CAR accounted for approximately one-sixth of the total national membership.

10-2 Real Estate Brokerage Law and Practice § 2.01

Until the mid-Nineteenth Century, the principal intermediaries in the real estate sales transaction were lawyers and other business persons not specialized in real estate. The creation of the real estate associations and the advent of brokerage as a separate occupation coincided. As the size and complexity of the market, and therefore the complexity of the function of brokerage increased, specialization in brokerage became increasingly common.

Brokers have probably always held informal meetings. The first formal association of brokers is generally believed to be one formed in New York in 1847. That group's primary function was to serve as a forum for the exchange of information on properties for sale. It also established standards of practice for those participating in the exchange. The first group to call itself a "realty board" was established in San Diego in 1887.

As population moved westward, local boards or exchanges were established and patterned after the New York exchange. The common objectives of these local associations were to exchange listing information more efficiently and to establish standards of practice. The first state association in continuous operation was the California Association, formed in 1905.

In 1908 the National Association of Real Estate Exchanges was formed in Chicago. Present at the initial meeting were 19 local boards and the California Association. These brokers and officials were just beginning to see the "possibility of self-government" for the real estate industry. The challenge was to organize the industry.

The National Association of Real Estate Exchanges later changed its name to the National Association of Real Estate Boards, or NAREB. This name was used until 1972. In 1972, the National Association adopted the name National Association of Realtors. This was done, in part, to stress the term "Realtor," which some Realtor(R) officials felt was in danger of becoming a generic substitute for the word "broker."

In 1913 the first Code of Ethics was drafted by the National Association. The code, although amended many times, has retained much of its original content.

In the early years of the associations, the most pressing task was to hold the organizations together. Association officials at the time looked forward to the day when licensing laws would help this effort. In 1917, the California Association succeeded in its campaign to persuade the California legislature to pass the first state licensing law. This original law was overturned by the California courts on constitutional grounds. In 1919 the modified statute became the first real estate license law to take effect in the United States. This early license law incorporated into a regulatory statute the essence of the Realtor's ethics. Many practicing brokers at that time who were not Realtors(R) were apparently not in favor of this legislation.

In 1923 the first Association of State Real Estate Commissioners was formed. This Association, working closely with the National Association of Real Estate Boards, helped coordinate the various state activities. By 1949, thirty-six states, two United States territories, and three Canadian provinces had adopted license laws. Most of these laws were based upon the California law.

During the 1920's, the structures and principles which now dominate the industry evolved rapidly. The state licensing laws and the Realtor(R) associations facilitated the development of a single, organized industry. The advantages of cooperation in marketing also bound together the otherwise fragmented industry. This is reflected most strikingly in the development of the multiple listing services. In 1921 there were only ten boards in the country with multiple listing services. By 1923 there were more than 120. By 1926, a National Association survey indicated that a majority of boards throughout the country operated multiple listing services. The average length of time of operating such service was three years. The maximum time was eight years. For those Boards that operated MLSs, an average of seventy percent of board members belonged.

By the end of the 1920's, most of today's brokerage structures had been developed and were in fairly wide use. The most

dramatic change since that time has been the increasing dominance of the Realtor's system of brokerage. This has been reflected most clearly in the increased use of the multiple listing services.

[3] Residential Real Estate Brokerage Firms

[a] Traditional Predominance of Small Firms

The residential real estate brokerage industry traditionally has been dominated, in terms of numbers of firms and volume of sales, by small brokerage firms. Surveys conducted by the NAR have found that more than fifty percent of all firms employ ten or fewer brokers and salespersons. Single-office firms predominate, with almost two-thirds of all firms having only one office. The predominance of relatively small firms is generally explained by a combination of the few economies of scale available to firms, the cyclical nature of business, and the relatively easy entry into the industry.

Traditionally, there have been few economies of scale in the real estate brokerage business. The one function that does involve enormous economies is the MLS. However, this function generally is undertaken by the associations for the benefit of all of the member firms. Therefore, it is not an economy that one firm can use to gain an advantage over other firms.

There are some economies of scale in advertising and otherwise attracting buyers and sellers, particularly for the large regional and national firms who market their services under a common name. Even here, however, surveys indicate that referrals in one form or another are the principal means by which buyers and sellers become aware of brokers. Advertising by firms in the media, which may involve economies of scale, appears to account for less than fifteen percent of listings and sales.

The cyclical nature of the real estate brokerage market may also contribute to its fragmented structure. The smaller firms appear to have an advantage in adjusting to market fluctuations. They are also characterized by lower overhead. This includes few fixed assets and relatively fewer salaried employees.

Regardless of the size of the *firm*, the relatively small *office* appears to have an advantage. The geographic market in which salespersons conduct most of their business are local in nature. The salespersons' primary expertise consists of their knowledge of these local markets. The small office advantage is illustrated by the trend in franchise operations to grant exclusive territories with a radius of only about one mile. These territories are based on populations per franchise of approximately 30,000 to 50,000, and the preferred radii may be getting smaller with time.

[b] Entry

New residential real estate brokerage firms are formed continuously. In fact, the increase in the number of real estate firms appears to have kept pace with the substantial increase in average home prices.

Entry at the firm level generally involves an experienced broker leaving an established firm and starting his or her own firm. Perhaps because of the role that referrals play in obtaining business and the availability of MLS listings to the smallest brokerage firms, the owner of even a small firm may make a personal income very close to what he or she might earn in a larger operation.

[c] Growth and Entry of Large Corporations and Franchises

In recent years it has been fashionable to predict that eight to ten large national corporations and franchises will soon dominate the residential brokerage market. These predictions have been caused by two relatively recent phenomena. First, the spectacular rise in home prices combined with a stable or rising commission rate has meant a corresponding rise in total industry revenues. These revenues have attracted the attention of large national corporations, several of which have investigated the field. A few undertook the process of entry through purchases of local, traditional

brokerage firms. Second, there has been very rapid growth in real estate franchising in recent years.

At present, the largest corporate chain of residential brokerage offices is Coldwell Banker. Coldwell Banker, Prudential and other large corporations attempting to enter or expand rapidly in the residential brokerage industry have generally done so by purchasing existing businesses. Acquisitions are preferred because entry at the local market level requires knowledge of the local market conditions. However, entry through such purchases has been quite difficult for at least two reasons. Because the primary assets of the firm are local management and a sales force with a knowledge of local conditions, it is very difficult to assign a dollar value to such corporations. If the talented people leave, the prospective corporate owner may have nothing left but an empty shell. Second, the taxation consequences of an acquisition to the broker-owners of traditional firms appear to be such that they often prefer to remain independent.

While the picture of rapidly escalating corporate growth through acquisition of existing firms may be somewhat exaggerated, the growth of the franchise systems has indeed been spectacular. Century 21 has been, at least in terms of number of franchisees, the most successful franchise system. This system was founded in 1972.

A new theory in real estate franchising emerged in 1973 with the emergence of a new company called RE/MAX. RE/MAX, which started as a "high-commission, full support" company, developed a system whereby licensees keep 100% of their individual commissions after sharing overhead costs. In 1977, RE/MAX began to franchise its offices. RE/MAX has since become a leader in several major markets including Denver, Chicago, Kansas City, San Antonio, Toronto and Ottawa. It has also become a major competing company in Anchorage, Dallas, Atlanta, Detroit, Washington, D.C., Edmonton, Calgary and Montreal.

By the beginning of the 1990s, a small number of national real estate franchise organizations dominated the U.S. home sale market. These franchise organizations control 35.7% of all U.S. home sales closed by brokerage companies in 1990. RE/MAX was the only major franchise operation to gain in the number of transactions over the previous year, boasting an 8.1% increase in the number of transactions from 1989. All other franchises suffered a decrease, ranging from a 1.9% loss for Prudential to an 11.4% loss for Better Homes and Gardens. RE/MAX capitalizes on hiring experienced real estate brokers who are willing to pay a nominal overhead (*e.g.*, \$1,000 per month) in return for 100% of the commissions they generate.

Advertising, and the image identification it creates, appears to be the most important economy of scale available to large brokerage firms or franchises. Sellers, in selecting a firm or broker with which to list their houses for sale, rate honesty and integrity as the most important attributes of such firm or broker. In seeking these attributes, sellers traditionally have selected brokers and firms on the basis of personal contacts or referrals, or by community reputation. Image identification established by mass advertising, however, is making inroads into this consumer search process. Consumers may place trust in a familiar name with a presumed reputation to protect regardless of the source of that familiarity--a pattern familiar in consumer goods marketing.

With a perceived increase in the importance of mass advertising, smaller local firms have felt some pressure to go beyond such symbols of presumed quality as the Realtors' service mark and associate themselves with organizations that can economically utilize modern marketing tools in establishing an image. Thus, the franchise systems create and also respond to the demands of small local brokers increasingly concerned about the potential advantages and economies available to the brokerage chains.

In addition to the economies of scale available in establishing image identification, there are economies available to both franchise organizations and corporations relating to recruiting and training of personnel. Large firms very often are affiliated with or operate pre-licensing schools for prospective real estate agents. These schools can return a net profit to the parent company, and sometimes even use salespersons of marginal quality recruited from their own schools, because sellers often list with a brokerage firm for which a friend or relative works. (A common method of competing for listings is having a steady turnover of the largest number of salespersons manageable.) Because salespersons are

generally paid only when they produce, *i.e.*, on a commission basis, such a form of competition for listings can sometimes be successful.

[4] Commercial Real Estate Brokerage Firms

[a] Traditional Role

The commercial real estate brokerage industry has traditionally been dominated by regional brokerage firms. The regional brokerage firms tend to employ between twenty and fifty brokers with a regional impact that is somewhat larger than the residential brokerage firms. There are a number of brokerage networks wherein commercial brokerage firms network with other firms from other regions. While statistics are not available as to the percentage and market share, number of transactions and overall effectiveness of the regional firms, practice has tended to show that the effectiveness of the regional firms has been their ability to penetrate buyer's markets. Residential markets tend to concentrate on the amount of listings and sales available, because the number of buyers largely depends on the demographics of a given residential area. Commercial markets, however, tend to depend on the number of buyers available in a given market for the amount of commercial real estate available for sale. That is, there are a smaller number of buyers in the commercial market and the concentration in this market produces better overall results.

[b] Entry

Entry into commercial real estate markets tends to be highly specialized. Commercial markets are dominated by organizations such as Society of Industrial and Office Realtors, Realtors(R) National Marketing Institute and the Institute of Real Estate Management. As stated above, commercial markets tend to depend on the number of buyers available in a given market for the amount of commercial real estate available for sale. Specialization, the result of years of experience, education and expertise, does have its rewards. However, success in commercial markets seems to be a longer, harder pursuit because the demand is smaller and requirements for expertise much higher than in the competitive residential real estate brokerage industry.

FOOTNOTES:

(n1)Footnote 1. National Association of REALTORS(R) 2008 Annual Report.

(n2)Footnote 1.1. *See* § 2.05 *infra*.

(n3)Footnote 1.2. *See generally* *Sing v. John L. Scott, Inc.*, 134 Wash.2d 24, 40-41, 948 P.2d 816, 824 (1997) (discussing the Code of Ethics), citing this Treatise.

(n4)Footnote 2. *See Pope v. Mississippi Real Estate Com.*, 872 F.2d 127, 132 (5th Cir. 1989) .

(n5)Footnote 3. *See Mont. Code* 37-51-321(1)(d).

(n6)Footnote 4. *Cf. Morf v. N. Central Mississippi Board of Realtors, Inc.*, 27 So. 3d 1188, 1195 (Miss. Ct. App. 2009) (The MLS and Board can discipline members for violating professional conduct standards found in their governing documents. Before a fine can be imposed, they must have a schedule of maximum fines that may be imposed to which schedule each member has agreed to be bound by joining the association.), *writ denied*, 27 So. 3d 404 (Miss. 2010) .

* This chapter was revised by Charles J. Jacobus, Esq., a partner in the law firm of Jacobus, Boltz, Melamed & Witherspoon, Houston, Texas. Sections 2.06 and 2.07 were written by Sandra Bullington, who has contributed additional updates throughout the chapter.



17 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART I General Principles

CHAPTER 2 Overview of Brokerage Practice and the Organization of the Brokerage Industry *

10-2 Real Estate Brokerage Law and Practice § 2.02

§ 2.02 Brokers, Salespersons and Finders--Definitions, Descriptions and Distinctions

[1] Brokers

All states have provided a statutory definition of the term "real estate broker." The National Association of Real Estate License Law Officials (NARELLO) Model of Real Estate License Law defines "broker" as:

an individual or professional association while acting for another for commissions or other compensation with a promise thereof, or a licensee under this chapter while acting in his or her own behalf who:

- (1) Sells, exchanges, purchases, rents, or leases real estate.
- (2) Offers to sell, exchange, purchase, rent or lease real estate.
- (3) Negotiates, offers, attempts or agrees to negotiate the sale, exchange, purchase, rental or leasing of real estate.
- (4) Lists, offers, attempts or agrees to list real estate for sale, lease or exchange.
- (5) Auctions, offers, attempts or agrees to auction real estate.
- (6) Buys, sells, offers to buy or sell or otherwise deals in options on real estate or improvements thereon.
- (7) Collects, offers, attempts or agrees to collect rent for the use of real estate.
- (8) Advertises or holds himself out as being engaged in the business of buying, selling, exchanging, renting or leasing real estate.
- (9) Assists or directs in the procuring of prospects, calculated to result in the sale, exchange, lease or rental of real estate.

10-2 Real Estate Brokerage Law and Practice § 2.02

(10) Assists or directs in the negotiation of any transaction calculated or intended to result in the sale, exchange, leasing or rental of real estate.

(11) Engages in the business of charging an advance fee in connection with any contract whereby he undertakes to promote the sale or lease of real estate either through its listing in a publication issued for such purpose or for referral of information concerning such real estate to brokers or both.

(12) Performs any of the foregoing acts as an employee of, or on behalf of, the owner of, or any person who has a real or equitable interest in, real estate for compensation.

Though not all statutory definitions of the term "broker" are this verbose, these definitions tend to be broadly worded.

As generally defined, a real estate broker is an agent who, for a commission or fee, is employed by a principal to negotiate the sale, purchase, lease or exchange of real property to a third party. n1 A determination of whether a particular individual is acting within a capacity which is to be considered a "real estate broker" is a factual issue. n1.1 One key element of most definitions of a broker is that the party is engaging in the conduct for compensation or the expectation of compensation. n1.2

Brokers do not individually do all the selling, listing and other duties associated with the functioning of a real estate brokerage firm. Instead, brokers operate through licensed agents, who are formally affiliated with the broker. n1.3 Usually, the applicable state law requires that a licensed real estate agent be associated with a licensed real estate broker. n1.4 Typically, real estate agents are not employees of the broker, but instead work as independent contractors. n1.5

A broker has been said to be an intermediary or middleman whose function and duty is to bring together the buyer and seller or owner and lessee. n2 There is, however, a distinction between a middleman and a broker, and it has been held that any person's participation in negotiating a sale makes such a party a real estate broker and not a mere middleman, regardless of how slight the participation, where such person was employed in connection with the sale. n3

Individuals employed by real estate developers are often found not to be brokers or agents even though their services may incidentally result in a real estate brokerage transaction. For example, an individual who oversaw the marketing expenses of a developer in order to save the developer money was not found to be a broker. n4 This individual also was responsible for marketing the properties by preparing budgets for advertising, creating advertisements, and soliciting bids for the furnishing of model homes. n5

In the typical brokerage situation there are two contracts involved: (1) the contract between the principal and the third party and (2) the contract between the broker and the principal. While the broker generally represents the owner or seller in the sale or leasing of real property, a broker may be employed by a buyer or lessee and, in fact, may conceivably be employed at the same time by both the buyer and seller or owner and lessee. n6

The agency of a real estate broker is special in that the broker's powers are limited and are narrowly restricted within the terms of that agency. n7 The real estate broker is only authorized to do what is specifically assigned in his or her contract of employment. n8 If the broker acts outside the scope of the broker's authority, the principal will not be bound n9 and the broker may be open to personal liability. n10 The authority of the broker ends as soon as the purpose for which the broker was employed has been accomplished.

In order to recover a brokerage commission, the broker must, initially, prove a contract of employment. Many states

now require the brokerage contract to be in writing. n11 As a general rule, moreover, the states require a real estate broker to be licensed, n12 and the broker cannot recover a commission unless the broker was licensed at the time of rendering the services for which the commission is claimed. n13 This rule is strictly applied. A further prerequisite for recovery of a commission is that the broker be the procuring and efficient cause of a sale. n14

The brokerage business is very labor-intensive. Almost sixty percent of a brokerage firm's gross revenues typically are paid to brokers and salespersons in the form of fees and commissions. Generally, a firm's principal assets are considered to be its sales personnel and their knowledge of the local market. With each firm providing a customary range of brokerage services, job mobility of successful brokers and salespeople is fostered, and real estate firms become, in effect, flexible collections of independent, skilled, semi-autonomous contractors. n15

Because of the relative unimportance of "the firm" when compared to either the MLS or the individual broker or salesperson, a perennial problem faced by all firms is finding and keeping successful brokers and salespersons. Firms compete in terms of the percentage of the total commission that the broker or salesperson will receive for acquiring a listing or completing a sale. n16 These "internal splits" vary among firms, communities, and according to market conditions. Typically they range from ten percent to thirty percent to the listing broker, forty percent to sixty percent to the selling broker or cooperating firm, and the remainder to the firm. They are also frequently progressive--that is, as a broker produces more listings or more sales per year, the percentage he or she receives increases. A successful broker who sells his or her own listing can sometimes receive seventy percent of the total commission.

The use of brokers and salespersons and their relative importance to the firms can be seen in the internal split structure. First, the ability of inexperienced salespersons to obtain the listings of friends and relatives usually is reflected in the relatively low split given for listing the first several properties. The relative importance and difficulty of converting a prospective buyer to an actual buyer is reflected in the larger split given for that function. Furthermore, the progressively higher splits for increasing numbers of transactions per year reflect the rewards reaped by those individual brokers and salespersons with the ability to quickly obtain listings from or make sales to people outside their circle of friends and relatives.

The fees and commission paid to brokers and salespersons by clients are almost always contingent in nature. The contingent form of payment is a major inducement for the broker or salesperson to persuade the buyer and seller to complete the transaction. It also facilitates the use of marginally productive salespersons and part-timers because their time is viewed by many as being "cheap" or even "free" to the firm.

Profiles of representative real estate brokers have been compiled from surveys conducted by the Realtors' associations. The typical Realtor-broker is a man approximately forty-eight years old who has been associated with the real estate business for at least ten years, having worked for at least two different brokerage firms, who specializes in selling single-family homes, who works more than forty hours per week. While this picture has remained somewhat constant over the years, there is a trend toward Realtor(R) brokers who are more highly educated. By 1987, 66.1% of the Realtor-brokers had some level of college education. While organized real estate and full-time real estate brokers generally believe part-time brokers are less able to give quality service to consumers, almost forty-five percent of the firms use them.

The various state licensing requirements are not considered serious barriers to entry. The numbers of licensees have been found to vary according to various indirect measures of demand when comparing different market areas, and the numbers of licensees both in absolute numbers and as a percentage of population have generally increased.

There are no accurate statistics on the number of brokers and salespersons actively involved in brokerage, as opposed to the total number of licensees registered with the states. Most observers believe the number of licensees greatly exceeds the number of people actually engaged in brokerage. Local surveys attempting to measure the actual percentage of licensees who are full-time practitioners, however, have produced results ranging from approximately thirty percent to

eighty percent of licensees.

Brokers are generally considered to be in a fiduciary relationship with their principals, requiring a high degree of loyalty and good faith. Brokers, moreover, have a duty not to act negligently with respect to their principals' interests. n17 As a consequence, if the principal should sustain a loss due to the broker's negligence, the broker may be held personally liable. n18

[2] Salespersons

A salesperson, as distinguished from a broker, is defined by most statutes as an agent of the broker, n19 receives his or her commission from the broker n20 and is precluded from receiving compensation from any third party for services rendered in a transaction. The salesperson may not collect a commission directly from the broker's clients. A salesperson's right to a commission, if any, must be enforced against the broker and this right is not affected by the broker's litigation against the buyer or seller. n21 While a state's statute of frauds usually requires that principal's agreements authorizing or employing an agent or broker to purchase or sell real estate for compensation be in writing, there is usually no prohibition of oral agreements between brokers or between a broker and a salesperson or agent to share a commission. n22

Salespersons must be associated with a broker. Most licensing statutes provide that the salesperson's license is held by his or her broker. n23 Typically, salespersons work as independent contractors of their broker; however, it is possible for them to be employees. n24

For a discussion of statutes of frauds in relation to real estate broker employment contracts, *see § 2.03[3] infra*.

[3] Finders

A broker may be employed as a "finder," *i.e.*, his or her job may be to find a prospective purchaser, introduce the parties and leave the negotiations, etc., to the buyer and seller. n25 "Finders" may be exempt from real estate licensing requirements if none of the functions of a broker are performed. n26 In California, for example, it has been held that one acting merely as an intermediary or middleman in finding and introducing two parties to a real estate transaction does not act as a "broker" for purposes of the state's real estate licensing laws. n27 However, if the "finder" takes any part in the negotiations, no matter how slight, he or she will be considered a "broker" and must be licensed to collect a commission. n28 Of course, whether a broker was employed as a "broker" or as a "finder" will at times be a question of fact depending upon the agreement between the parties. n29

It has been stated that the distinction between a broker and a middleman is significant in the determination of whether a fiduciary relationship existed between the middleman and the principal. n30

At least one court has refused to recognize a "middleman" exception to the real estate broker's duty of full disclosure, stating that there is no exception for finders or middlemen who merely bring parties together to negotiate a contract, and who have no power to, and do not, negotiate the terms on which the principals deal. n31

The descriptive term--"finder" or "middleman"--does not mean the exclusion of the party from the operation of licensing requirements applicable to brokers. n32 It is the activity that counts, not the name. n32.1 The activity of the party may bring that party within the licensing law even if that party uses the self-description of "finder" or "middleman," as the discussion below points out.

A "middleman" has been defined as a person who "is employed for the mere purpose of bringing the possible buyer and seller together so that they may negotiate their own contract." n33 The middleman has only limited authority and has no power to, and does not, negotiate the terms of the transaction for the principals. n34

Likewise, a "finder" is an intermediary who contracts to find and bring the parties together but leaves the negotiation of the transaction to the principals. n35 Since a middleman or finder is merely involved in introducing the parties to each other, it follows that there is no fiduciary relationship to the principals. n36

The limited role and liability of a middleman is perceived by the courts as constituting a narrow exception to the general principle that one who participates, for compensation, in assisting the negotiation or consummation of a real estate transaction is a broker and is liable as a broker. If the person has engaged in *any* negotiation to consummate the transaction, the person is viewed as a broker, not a mere middleman or finder. n37 The reason for this limitation is apparent: all brokers are involved in bringing the parties together and, if a more liberal interpretation of the terms "middleman" or "finder" were sanctioned, the exception would swallow the rule. A broader construction would be inconsistent with the principle that the imposition of duties and responsibilities upon brokers, including licensing requirements, is to protect the public from unqualified and unscrupulous people. n38 As one court explained:

The essential feature of a broker's employment is to bring the parties together in an amicable frame of mind, with an attitude toward each other and toward the transaction in hand which permits their working out the terms of their agreement. They may reach that agreement without his aid or interference. Indeed, in a transaction of any magnitude, the terms would never be settled beforehand or negotiated finally by the broker

This does not mean that the broker has not negotiated the transaction If the statute does not apply to such a situation, then it is a toothless enactment. Every unlicensed broker will make the same argument that the plaintiff here has made, that he did not have to bring the parties to actual agreement upon all the details, that that phase was something for the parties themselves to determine. In short, every unlicensed broker will be enabled to carry on his business just as he did before the statute came into existence, simply by calling himself a finder, an originator, an introducer, instead of a broker. This would be an absurd limitation of the statute and one unfounded in reason or policy. n39

[4] Cases Addressing the Broker and Middleman/Finder Dichotomy

In one Utah case, a corporation entered into a written "finders agreement" under which another corporation was afforded the right to act as finder for the purchase of property from the corporation and was to receive a percentage of the sales price. The would-be "finder" thereafter brought an action to recover the agreed-upon compensation, with the court granting summary judgment to the defendant on the ground that the plaintiff's activity was real estate brokerage and the plaintiff could not recover as the plaintiff was not licensed. n40

In an Illinois case, a plaintiff, not licensed as a broker, attempted to recover a fee for services in the negotiation of a commercial lease by claiming that he acted merely as a finder. n41 The facts were that the defendant-seller contacted the plaintiff and asked him to look for a tenant for her store building, without discussion at any time of the fee to be paid for such service. The court denied recovery, reasoning that the negotiation of a store lease is a form of real estate brokerage, and the plaintiff was precluded from receiving compensation for having done so without benefit of license. n42

Of major importance is the decision of the Supreme Court of California in *Batson v. Strehlow*. n43 In *Batson*, a real estate agent, accused of improper conduct, sought to avoid the return of a commission by labeling himself a middleman. There, the guardian of an incompetent's estate mailed a real estate listing to a large number of brokers. The listing described the property, offered to sell it on specified terms and solicited bids. The listing offered to pay a commission to the real estate broker who submitted the accepted bid, provided that the sale was completed after court approval had been obtained. The defendant-broker submitted a bid on behalf of a development company in which he and his wife owned all of the shares. The bid was the highest one received and was accepted after court approval. The defendant was

paid a commission. Thereafter, an action was commenced to recover the commission. The proof showed that the development company, in whose name the bid was submitted, did not provide the consideration for the purchase of the property. The money was provided by the defendant-broker and business associates. In fact, after the sale, the property was conveyed by the development company to a partnership consisting of the broker and his two associates. The plaintiff's theory of recovery was that the defendant was not a broker in the transaction but a principal. The defendant countered with the contention that he was entitled to a commission, not as a broker, but as a middleman who had brought the parties together.

The Supreme Court of California unanimously concluded that the defendant was a broker, not a mere middleman. The court declared that the distinction between a finder or middleman and a broker often turns on whether the intermediary was invested with authority or duties beyond merely bringing the parties together. n44 In *Batson*, at all times the defendant was referred to or described as a broker and, under applicable provisions of the California Probate Code, only a bona fide agent or broker could receive compensation for securing a purchaser for property owned by an estate. n45 Thus, the compensation paid the defendant was lawful only if he were a bona fide agent or broker. Moreover, disregarding what the defendant was called, the court declared that "the role he played" was that of a broker. n46 The court did not explicitly describe what particular conduct engaged in by the defendant was broker conduct. Although there were no face-to-face negotiations with the seller, who relied upon written bid submissions, the defendant apparently engaged in the preparation of the bid that was accepted. Bid preparation necessarily would entail the use of judgment and discretion and the investment in the bid preparer of at least limited authority to speak for the bidder. Hence, there was sufficient activity on the part of the broker that evinced that his role was not merely that of "bringing the parties together." n47

The *Batson* case was followed in the subsequent California case of *Whitehead v. Gordon* n48 which involved a proceeding by a broker to review the revocation of his brokerage license. The proof revealed that the broker, on two occasions, submitted offers to purchase realty from estates. The offers were submitted in the name of the broker's brother-in-law, with the relationship of the offeror to the broker undisclosed. The broker received commissions from the estates and, afterwards, title to the subject properties was transferred to corporations in which the broker had substantial interests. The trial court annulled the revocation of the license. Though the court acknowledged that there had been an attempt to deceive, it reasoned that the deception was "unnecessary." The broker owed no duty to the sellers, as the broker had been acting solely as a middleman. The California Court of Appeals reversed, n49 citing *Batson*. As in *Batson*, the court concluded that the activities involved in *Whitehead* constituted real estate brokerage and, consequently, the obligations imposed by law upon brokers attached.

Another California case, *Montoya v. McLeod*, n50 involved a constructive fraud action which was brought by a couple against a licensed real estate salesperson who had solicited a loan on behalf of her employer, an investment broker. The court determined that the salesperson, acting in her capacity as "investment counselor," was not a mere "middleperson." The court noted that the salesperson had negotiated the loan and executed a promissory note in the couple's favor, which established an agency (fiduciary) relationship despite the absence of a written agency agreement.

In sum, courts have severely limited the concept of a non-broker middleman or finder. While broker liability may fairly be disclaimed where the intermediary does no more than introduce the parties to each other, any greater activity on the part of the intermediary will likely result in the conclusion that the intermediary was a broker and liable as such. Given the stated principle of protecting the public from the consequences of improper acts by unscrupulous intermediaries, the courts will resolve even doubtful cases by holding the intermediary to be a broker.

[5] Broker Activities Versus Marketing Activities

Another scenario where a seller tries to avoid paying compensation arises when a developer engages an unlicensed party to handle the marketing of the developer's project. If the developer subsequently reneges on the parties' compensation agreement, the developer may allege that payment of the compensation would violate a statutory prohibition against

paying real estate commissions to an unlicensed person. n51

This argument was asserted in *Schickedanz Bros.-Riviera, Ltd. v. Harris*. n52 The compensation agreement contained an incentive bonus based on maintaining marketing expenses below a certain percentage of gross real estate sales. The duties of the unlicensed parties involved the preparation of budgets for advertising, the creation of advertisements, and the solicitation of bids for the furnishing of model homes. n53 In holding that providing oversight of the marketing budget and paying for these services with a fee incentive did not transform the services into brokerage services, the court contrasted its decision with an earlier decision where an unlicensed individual was deemed to be a real estate broker or salesman. In the prior case, however, a telephone solicitor was paid not only an hourly rate, but also a \$3 bonus for each person whom she successfully solicited to visit the developer's property. The fact that this individual had direct contact with the purchasers was a factor in the decision, as was the fact that she played an active part in the procurement of identified prospective customers. n54 In contrast, the unlicensed parties in the case before the court merely provided oversight of the marketing budget. The fact that a fee incentive was tied to keeping marketing expenses below a certain percentage of real estate sales did not transform those services into brokerage services. The court stated that it was the nature of the services rendered, rather than a characterization of whether purchasers of real property are directly or indirectly procured by the services, which distinguished the cases. n55

FOOTNOTES:

(n1)Footnote 1. See Section 2(4) of the NARELLO Model License Law, ch. 6 *infra* .

California: Horning v. Shilberg, 130 Cal. App. 4th 197, 203, 29 Cal. Rptr. 3d 717, 723 (2005) .

New York: In 1992, New York R.P.L. § 440(1) [Definitions] was amended to provide that in connection with the sale of a business, the term "real estate broker" shall not include a person, firm or corporation registered pursuant to the provisions of New York's General Business Law, Article 23-A or federal securities laws.

Michigan: G.C. Timmis & Co. v. Guardian Alarm Co., 468 Mich. 416, 427-428, 662 N.W.2d 710, 716-717 (2003) .

Wyoming: In *Walter v. Moore*, 700 P.2d 1219 (Wyo. 1985) , the Wyoming Supreme Court held that the vendor's daughter-in-law, who was not acting as a real estate broker in the transaction, was not liable for fraud even though the purchasers discovered after the sale that they could not install a septic tank or build a new home on the land as they has planned because of zoning regulations. Seller placed an advertisement in the classified section of the newspaper to sell her house trailer and river-front property. The purchasers purchased the property after seeing the advertisement and seller stated to them that her daughter-in-law was a real estate agent who would assist in the details of the transaction. The real estate agent mentioned that she would assist the purchasers as a favor to her mother-in-law and that she was not accepting a commission on the sale. Approximately six months after the purchasers had moved onto the property, the septic system stopped working. Subsequently they were informed by a sanitation engineer that the property was in a floodplain zone which precluded the installation of a septic system. Building a new home on the land was also precluded. Accordingly, they brought suit against the real estate agent for fraud. The court stated that the agent could not be held liable in fraud, because she had not acted as a broker in the sale.

(n2)Footnote 1.1. See *Kidd v. Mull*, 595 S.E.2d 308, 317-318 (W. Va. 2004) .

(n3)Footnote 1.2. See, e.g., Idaho Code § 54-2004(33)(a).

(n4)Footnote 1.3. See *Proa v. NRT Mid Atlantic, Inc.*, 618 F. Supp. 2d 447, 460 (D. Md. 2009) , reconsideration granted in part, 633 F. Supp. 2d 209 (D. Md. 2009) ; *Montgomery County Ass'n of Realtors, Inc. v. Realty Photo Master Corp.*, 783 F. Supp. 952, 954 and n.3 (D. Md. 1992) , aff'd, 993 F.2d 1538 (4th Cir. 1993) , cert. denied, 510 U.S. 964, 114 S. Ct. 440, 126 L. Ed. 2d 374 (1993) .

(n5)Footnote 1.4. See, e.g., *N.Y. Real Prop. Law* § 442-a.

(n6)Footnote 1.5. See *Proa v. NRT Mid Atlantic, Inc.*, 618 F. Supp. 2d 447, 460 (D. Md. 2009) , reconsideration granted in part, 633 F. Supp. 2d 209 (D. Md. 2009) ; *Verdecchia v. Douglas A. Prozan, Inc.*, 274 F. Supp. 2d 712, 721-23 (W.D. Pa. 2003) ; *Montgomery County Ass'n of Realtors, Inc. v. Realty Photo Master Corp.*, 783 F. Supp. 952, 954 and n.3 (D. Md. 1992) , aff'd, 993 F.2d 1538 (4th Cir. 1993) , cert. denied, 510 U.S. 964, 114 S. Ct. 440, 126 L. Ed. 2d 374 (1993) ; *Locations, Inc. v. Hawaii Dep't of Labor & Indus. Relations*, 79 Haw. 208, 218, 900 P.2d 784, 794 (Haw. 1995) ; *Anderson v. Wiegand*, 223 Mich. App. 549, 556, 567 N.W.2d 452, 455 (1997) .

(n7)Footnote 2.

Alabama: Ex Parte Ledford, 761 So. 2d 990, 995 (Ala. 2000) (a real estate broker brings together those selling real estate and those buying it and assists in the negotiation of the sale-purchase transaction).

See:

California: Ryan v. Walker, 35 Cal. App. 116, 169 P. 417 (1917) .

Minnesota: In Relocation Realty Servs. v. Carlson Cos., 264 N.W.2d 643 (Minn. 1978) , it was held that a company was a "real estate broker" within the purview of the state licensing statute, where the company provided services to employers in transferring and relocating executive personnel and held itself out to be engaged in the purchase and sale of real estate for a fee.

Cf. Horning v. Shilberg, 130 Cal. App. 4th 197, 204, 29 Cal. Rptr. 3d 717, 723 (2005) (person acting on his or her own behalf in a real estate transaction is not a broker within the meaning of *Cal. Bus. & Prof. Code* § 10131.).

(n8)Footnote 3. See *West v. Touchstone*, 620 S.W.2d 687 (Tex. Civ. App. 1981) writ of error refused no reversible error (Sept. 28, 1981), rehearing of writ of error overruled (Oct. 28, 1981).

See also *Preach v. Rainbow*, 16 Cal. Rptr. 2d 320 (Cal. Ct. App. 1993) (where a person alleged to be a finder engages in not only bringing the parties together, but also in negotiations, his actions constituted those of a broker, not a finder).

(n9)Footnote 4. See *Schickedanz Bros.-Riviera v. Harris*, 800 So. 2d 608, 611 (Fla. 2001) .

(n10)Footnote 5. See *Schickedanz Bros.-Riviera v. Harris*, 800 So. 2d 608 (Fla. 2001) .

(n11)Footnote 6. See Section 20(14) of the NARELLO Model License Law, ch. 6 *infra* .

(n12)Footnote 7. See:

California: Van Nguyen v. Hung Tran, 157 Cal. App. 4th 1032, 1038, 68 Cal. Rptr. 3d 906, 910 (2007) (broker is a special agent with limited powers).

Kentucky: Garnes v. Murphy, 239 S.W.2d 453 (Ky. 1951) .

New Jersey: Sammarone v. Bovino, 395 N.J. Super. 132, 139, 928 A.2d 140, 144 (App. Div. 2007) , cert. denied, 193 N.J. 275, 937 A.2d 977 (2007) .

Washington: Peoples Nat'l Bank v. Brown, 37 Wash. 2d 49, 221 P.2d 530 (1950) .

(n13)Footnote 8. See *Martin v. Vincent*, 181 Mont. 247, 593 P.2d 45 (Mont. 1979) .

See also *Peebles v. Sneed*, 207 Ark. 1, 179 S.W.2d 156 (1944) (a broker's authority is such as is specifically conferred on him either expressly or by necessary implication).

(n14)Footnote 9. See, e.g.:

Illinois: In Schermerhorn v. Department of Registration & Ed., 185 Ill. App. 3d 883, 542 N.E.2d 42 (1989) , review denied, 128 Ill. 2d 672, 139 Ill. Dec. 522, 548 N.E.2d 1078 (1990) , cert. denied, 495 U.S. 948, 110 S. Ct. 2208, 109 L. Ed. 2d 534 (1990) the court upheld a decision of the Department of Registration and Education placing real estate licensees on probation for two years for improperly commingling funds when they took money from a property management account, placed it in commercial paper investment, and deposited interest on the investment into a separate operating account used for the benefit of the licensees' corporation. The court stated that the interest earned on the investment should have been deposited into the company's tax account for property management customers and not in the company's operating account. Accordingly, the licensees violated the Real Estate License Act for commingling the money or property of others with their own.

North Dakota: Hudson v. Wells and Dickey Co., 31 N.D. 395, 154 N.W. 193 (1915) .

(n15)Footnote 10. See *Cryder Well Co. v. Brown*, 257 Iowa 296, 136 N.W.2d 519 (1965) , holding a real estate agent personally liable for the cost of a new well where the agent contracted for the well without authority from the owners to do so. See ch. 3 *infra* for a detailed discussion of the broker's duties and liabilities.

(n16)Footnote 11. For further treatment of the various states which now require written brokerage agreements, see § 2.03[3] *infra*.

(n17)Footnote 12. A discussion of licensing statutes is found in ch. 6 *infra* .

(n18)Footnote 13. See, e.g.:

Georgia: Northside Realty Assocs, Inc. v. MPI Corp., 245 Ga. 321, 265 S.E.2d 11 (1980) (defendant agent was not entitled to a commission upon the sale of realty where it was not a licensed broker either at the time the subject property was listed for sale or at the time it negotiated and signed the sales contract).

Texas: David Gavin Co. v. Gibson, 780 S.W.2d 833 (Tex. Ct. App. 1989) , where the court held that an unlicensed broker was not entitled to a commission. There, an individual hired an unlicensed broker to assist in locating and acquiring an automobile dealership. The unlicensed broker located a dealership and brought the parties together in fulfillment of his contract. The sale never closed and the broker sued for his commission. To determine whether a commission is earned on the sale of property, consisting in part of real estate, the court examined the laws governing a real estate commission. In Texas, the broker selling real estate must possess a real estate broker's license. The contract was not deemed divisible for the purpose of enabling the unlicensed broker to collect a fee for the sale of the business but not the real

estate. The court applied the rule that if one part of a contract is illegal, the entire contract is void and the unlicensed broker does not collect any commission.

Ackerman & Co. v. Cox, 768 S.W.2d 475 (Tex. Ct. App. 1989) (the failure of the broker to allege in his pleadings that he was a duly licensed real estate broker at the time the services were commenced necessitated the denial of any commissions).

Utah: Diversified General Corp. v. White Barn Golf Course, Inc., 584 P.2d 848 (Utah 1978) .

(n19)Footnote 14. *See, e.g.:*

Georgia: Nestle Co., Inc. v. J. H. Ewing & Sons, 153 Ga. App. 328, 265 S.E.2d 61 (1980) (broker may be deemed the "procuring cause" of a sale when he shows that negotiations were initiated through his efforts and that he performed every service required by his employment).

Louisiana: Farnsworth, Samuel Ltd. v. Grant, 470 So. 2d 253 (La. Ct. App. 1985) .

See also:

South Dakota: Kahler, Inc. v. Weiss, 539 N.W.2d 86 (S.D. 1995) (the term "sale" may be given a narrow or broad meaning depending upon the circumstances and the parties' reasonable intentions).

See ch. 4 infra for a discussion of when the broker's commission is earned.

(n20)Footnote 15. Salespersons and agents are not always considered independent contractors. *See Re/Max v. Wausau Ins. Cos.*, 162 N.J. 282, 744 A.2d 154, 158 (2000) (sales agents were employees for purpose of calculating workers' compensation premiums).

(n21)Footnote 16. *See, e.g.:*

Connecticut: Lerner v. Ceslik, 17 Conn. App. 369, 553 A.2d 1142 (1989) , in which the court held that a real estate agent satisfied the requirements for entitlement to the 25% listing and sales commissions set forth in her contract with her employer by bringing the property to the owner's attention, and was therefore entitled to recover the 25% sales and listing commissions.

Wisconsin: Stauffacher v. Portside Properties, Inc., 150 Wis. 2d 242, 441 N.W.2d 328 (1989) , where the court held that where the term "accrual of a listing agent's right to a commission" was used in an independent contractor agreement, it was sufficiently ambiguous in determining when the agent was entitled to a commission to defeat a motion for summary judgment.

(n22)Footnote 17. *See, e.g.:*

Louisiana: Tres' Chic in A Week, L.L.C. v. Home Realty Store, 993 So. 2d 228, 231-32 (La. Ct. App. 2008) .

Missouri: Gallaher-Smith-Feutiz Realty, Inc. v. Circle Z Farm, Inc., 545 S.W.2d 395 (Mo. App. 1976) .

Wyoming: Kelly v. Roussalis, 776 P.2d 1016 (Wyo. 1989) , where the court held that a real estate agent

acting on behalf of a friend was not relieved of the high standard of care required of real estate agents, and was thus subject to liability to the friend for malpractice. In *Kelly*, the agent attended a foreclosure auction with a friend and bid for him on a piece of property. Both parties mistakenly believed that the agent had previously shown the property. After the property was paid for, it was learned that the friend had purchased a different piece of property. It was established that the agent had available to him the information necessary to discover the mistake. Instead of confirming the identity of the property being sold at the auction, the agent assumed it was the property he had previously shown. The trial court found the agent liable in tort. On appeal, the agent relied on the fact that he was acting as a friend when he attended the foreclosure auction, and that the standard of care he owed was not the high standard ordinarily expected of real estate agents. The appellate court rejected this argument, holding that even if agent's services were volunteered or gratuitously undertaken, his conduct must be measured against a standard more demanding than mere reasonableness. On the facts in the present case, the court added, there was no doubt that the agent had been negligent in the handling of his friend's purchase. He was therefore liable for malpractice. In addition, the court held that the broker's right to control the agent created a master-servant relationship. The broker was therefore liable for the agent's malpractice committed while the agent acted within the scope of his employment.

(n23)Footnote 18. See, e.g., *Veach v. Meyeres Real Estate, Inc.*, 599 P.2d 746 (Alaska 1979) .

See ch. 3 *infra* for a discussion of the duties and liability of the broker.

(n24)Footnote 19. *Bedow v. Watkins*, 539 N.W.2d 414 (Minn. App. 1995) (a real estate sales agent is a person who is not a broker and therefore has to be connected to a broker in order to deal legitimately in real estate).

(n25)Footnote 20. In *DiLorenzo v. Sbarra*, 124 A.D.2d 446, 507 N.Y.S.2d 548, 1986 N.Y. App. Div. LEXIS 61432 (3d Dept. 1986) , the court found that where a real estate salesperson did not expressly consent to a commission loan agreement between the broker and the purchaser, the salesperson's commission was owed to him. The commission was made at the closing and substituted the purchaser's debt for the broker's commission due from the seller. The broker maintained that the salesperson agreed to the postponement of his own commission because he was silent during the contract closing. The court, however, found that the salesperson was unaware of the transaction because he arrived at the closing long after the exchange of checks had occurred. Moreover, he could not have impliedly consented to the arrangement.

In New York, where a real estate salesperson leaves the service of a real estate broker, the broker must file a termination of association notice, the fee for which is \$10. The salesperson's license may be endorsed to a new sponsoring broker upon establishment of a new record of association with the Department of State, the filing fee for which is also \$10.

(n26)Footnote 21. See *Corris v. White*, 29 A.D.2d 470, 289 N.Y.S.2d 371, 1968 N.Y. App. Div. LEXIS 4300 (4th Dept 1968) .

(n27)Footnote 22. See, e.g., *Lane v. Floyd*, 213 Ore. App. 215, 159 P.3d 1240 (2007) , review denied, 344 Ore. 43, 178 P.3d 247 (2008) *Fowler v. Taylor*, 554 P.2d 205 (Utah 1976) .

(n28)Footnote 23. See, e.g., *City of Washington v. Barnhart*, 93 S.W.3d 743, 745 (Mo. Ct. App. 2002) , citing Mo. Code Regs., Ann. tit. 4, § 250-4.050(2). *Axtmann v. Chillemi*, 2007 ND 179, 740 N.W.2d 838, 845 (N.D. 2007) .

(n29)Footnote 24. See Mo. Rev. Stat. § 339.010.2. *Walker v. Johnson*, 278 Ga. App. 806, 812, 630 S.E.2d 70, 76 (2006) , reconsideration dismissed, overruled in part, *Kleber v. City of Atlanta*, 2008 Ga. App. LEXIS 396, at *15 (Mar. 28, 2008) (on other grounds) Cf. *Kakides v. King Davis Agency, Inc.*, 283 F. Supp. 2d 411, 416 (D. Mass. 2003)

applying federal and Massachusetts law (agent was an independent contractor); *Carson v. Seacoast Realty, Inc.*, 2003 Del. Super. LEXIS 386, at *14-*15 (Del. Super. Ct. Oct. 3, 2003) *aff'd*, 2004 Del. LEXIS 371 (Del. Aug. 23, 2004) (real estate salespersons are excluded from the definition of employee under Delaware workers' compensation laws); *Fayne v. Vincent*, 2004 Tenn. App. LEXIS 508, at *8-*10 (Tenn. Ct. App. Aug. 5, 2004) (real estate agent was an independent contractor).

(n30)Footnote 25. See, e.g., *Fuller v. Alberts*, 382 So. 2d 113 (Fla. DCA 1980) ; *PKG Associates, Inc. v. Dubb*, 306 A.D.2d 333, 760 N.Y.S.2d 681, 682 (2d Dept. 2003) . *Brochu v. Santis*, 939 A.2d 449, 453 (R.I. 2008) .

A broker was entitled to the reasonable value of his services under a quantum meruit theory, where a commercial purchaser, although not expressly agreeing to a brokerage contract, (1) evinced a willingness to pay the broker a finder's fee for information leading to the purchase of a 3-million-dollar commercial building, (2) the purchaser accepted the broker's services with a reasonable opportunity to reject them and with the knowledge that the broker expected a commission, (3) the broker was the procuring cause of the sale and (4) the broker supplied the purchaser with information about the subject property with the expectation that the purchaser would pay a brokerage fee, and the purchaser himself admitted at trial that he always intended to compensate the broker for his services. Given these circumstances, denying the broker a commission would unjustly enrich the purchasers. *Weichert Co. Realtors v. Ryan*, 128 N.J. 427, 608 A.2d 280 (N.J. 1992) . See ch. 12 *infra* for a discussion of "finders."

(n31)Footnote 26. See, e.g., *Berchenko v. Fulton Fed. S & L Ass'n*, 244 Ga. 733 , S.E.2d 643 (1979). *But see Amedeus Corp. v. McAllister*, 2009 Colo. App. LEXIS 221, at *7 (Colo. Ct. App. Feb. 19, 2009) (Colorado's statutory definition of real estate broker does not recognize any distinction between a broker and a finder.).

(n32)Footnote 27. See *Tyrone v. Kelley*, 9 Cal. 3d 1, 106 Cal. Rptr. 761, 507 P.2d 65 (1973) .

(n33)Footnote 28. See:

Federal: Shinberg v. Bruk, 875 F.2d 973 (1st Cir. 1989) , in which the court held that: (1) under New Hampshire Law, a finder of real estate is treated as a broker rather than a finder and is required to comply with the real estate licensing law in order to obtain a commission; and (2) under Massachusetts law, one who assists or directs in the procuring of prospects intended to result in the sale, exchange, purchase, leasing or renting of any real estate, is required to comply with the state licensing statute in order to obtain a commission. In *Shinberg*, plaintiff was an attorney but was not licensed as a real estate broker. A Massachusetts buyer agreed to pay the attorney a finders fee of 10% of the purchase price of any real estate that attorney found in New Hampshire that was suitable for a shopping mall development. Attorney found a potential site, notified buyer, met with the seller and introduced the two parties. Buyer and seller conducted the negotiations and attorney did nothing further. Buyer purchased the land and refused to pay the attorney a finders fee. The district court found that the attorney could not recover under either New Hampshire or Massachusetts law. In affirming, the appellate court applied New Hampshire law but noted that attorney would not be entitled to a commission under either state's law. The court rejected attorney's argument that under New Hampshire law he was a finder as opposed to a broker and was therefore not required to be licensed in order to receive a finders fee. The court stated that a finder is a special type of broker that deals in personal property (e.g., securities, mergers, mortgage financing, business acquisitions). Therefore, under New Hampshire law, a finder of real estate is treated as a real estate broker, and an unlicensed broker is barred from recovering a commission under the state's licensing statute. Under Massachusetts law, a broker is defined, inter alia, as one who "assists or directs in the procuring of prospects ... intended to result in the sale, exchange, purchase, leasing or renting of any real estate." The court found that the attorney's services fell within this definition. Therefore, in order to receive a finders fee, he was required to comply with the licensing requirements imposed.

California: Rees v. Department of Real Estate, 76 Cal. App. 3d 286, 142 Cal. Rptr. 789 (1977) .

New York: Berg v. Wilpon, 180 Misc. 2d 956, 692 N.Y.S.2d 600, 602-603 (1999) .

Texas: David Gavin Co. v. Gibson, 780 S.W. 2d 833 (Tex. Ct. App. 1989) writ denied (Apr. 11, 1990); *West v. Touchstone*, 620 S.W.2d 687 (Tex. Civ. App. 1981) . writ of error refused no reversible error (Sep. 28, 1981), reh'g of writ of error overruled (Oct. 28, 1981).

For a discussion of licensing statutes, see ch. 6 *infra*.

(n34)Footnote 29. See *Tenzer v. Superscope, Inc.*, 39 Cal.3d 18, 31, 216 Cal. Rptr. 130,137, 702 P.2d 212, 219 (1985) . See also *Fisch's Parking, Inc. v. Independence Hall Parking, Inc.*, 432 Pa. Super. 263, 638 A.2d 217 (1994), reh'g denied (Mar. 22, 1994), appeal denied, 542 Pa. 669, 668 A.2d 1132 (1995), in which the court held that a consultant hired to find a buyer for a parking lot was not a real estate broker. The consultant did not engage in negotiations regarding the sale, confined himself to communicating information between the parties, and was retained because of his expertise in managing parking lot operations.

(n35)Footnote 30.

California: Batson v. Strehlow, 68 Cal. 2d 662, 68 Cal. Rptr. 589, 441 P.2d 101 (1968) .

New Mexico: Watts v. Andrews, 98 N.M. 404, 649 P.2d 472, 474 (1982) .

(n36)Footnote 31. See *Property House, Inc. v. Kelley*, 68 Haw. 371, 715 P.2d 805 (1986) reconsideration denied, 68 Haw. 688 (Haw. 1986) .

(n37)Footnote 32. See *Berg v. Wilpon*, 180 Misc. 2d 956, 692 N.Y.S.2d 600, 602-603, 1999 N.Y. Misc. LEXIS 249 (1999) . See also *Swor v. Tapp Furniture Co.*, 146 S.W.3d 778, 782 (Tex. App. 2004) (The fee for handling a sale that includes real estate is considered a real estate commission. The definition of real estate broker covers compensation labeled as a finder's fee.).

(n38)Footnote 32.1. See *Nein v. HostPro, Inc.*, 174 Cal. App. 4th 833, 848-49, 95 Cal. Rptr. 3d 34, 47-48 (2009) .

(n39)Footnote 33.

California: McConnell v. Cowan, 44 Cal. 2d 805, 285 P.2d 261 (1955) .

New Mexico: Barber's Super Markets, Inc. v. Stryker, 84 N.M. 181, 188, 500 P.2d 1304, 1311 (N.M. Ct. App.) cert. denied, 84 N.M. 180, 500 P.2d 1303 (1972) .

New York: Futersak v. Perl, 897 N.Y.S.2d 886, 2010 N.Y. Misc. LEXIS 612, at *11-*12 (N.Y. Sup. Ct. 2010)

(n40)Footnote 34. *Barber's Super Markets, Inc. v. Stryker*, 84 N.M. 181, 500 P.2d 1304, 1311 (N.M. Ct. App. 1972) cert. denied, 84 N.M. 180, 500 P.2d 1303 (N.M. 1972) .

(n41)Footnote 35.

Federal: Bittner v. American-Marietta Co., 162 F. Supp. 486, 488 (E.D. Ill. 1958) .

California: Tyrone v. Kelley, 9 Cal. 3d 1, 8-9, 106 Cal. Rptr. 761, 765-766, 507 P.2d 65, 69-70 (1973) .

Illinois: Kilbane v. Dyas, 33 Ill. App. 3d 439, 441-442, 337 N.E.2d 217, 220 (1975) .

Utah: Sachs v. Lesser, 163 P.3d 662, 670, 2007 UT App 169 (2007) , rev'd, 2008 UT 87, 2008 Utah LEXIS 197 (Utah 2008) (on other grounds) reh'g denied, 2009 Utah LEXIS 116 (Apr. 17, 2009) .

(n42)Footnote 36. See *Langford v. Issenhuth*, 28 S.D. 451, 463, 134 N.W. 889, 893-894 (1912) .

(n43)Footnote 37. See *Kilbane v. Dyas*, 33 Ill. App. 3d 439, 442, 337 N.E.2d 217, 220 (1975) .

(n44)Footnote 38. See *Diversified Gen. Corp. v. White Barn Golf Course*, 584 P.2d 848, 851-852 (Utah 1978) . See also *Kavian v. Vernah Homes Co.*, 19 A.D.3d 649, 650, 799 N.Y.S.2d 75, 76, 2005 N.Y. App. Div. LEXIS 7326 (2005) (licensing requirement protects public from inept, inexperienced, or dishonest persons who might perpetrate or aid in perpetration of fraud); *Arnold v. Bowman*, 2005 Tenn. App. LEXIS 363, at *33 (June 23, 2005) , appeal denied, 2005 Tenn. LEXIS 1054 (Dec. 5, 2005) (Real Estate Broker License Act of 1973 was created to protect public from irresponsible or unscrupulous persons dealing in real estate).

(n45)Footnote 39. *Baird v. Krancer*, 138 Misc. 360, 362-363, 1930 N.Y. Misc. LEXIS 1650, 246 N.Y.S. 85, 88 (N.Y. Sup. Ct. 1930) , cited with approval in:

Illinois: Kilbane v. Dyas, 33 Ill. App. 3d 439, 441-442, 337 N.E.2d 217, 220 (1975) .

New Jersey: Corson v. Keane, 4 N.J. 221, 225-226, 72 A.2d 314, 316 (1950) .

Utah: Diversified General Corp. v. White Barn Golf Course, Inc., 584 P.2d 848, 850-851 (Utah 1978) .

(n46)Footnote 40. *Diversified General Corp. v. White Barn Golf Course, Inc.*, 584 P.2d 848, 850-851 (Utah 1978) . For another Utah case discussing the difference between finders and brokers see *Sachs v. Lesser*, 163 P.3d 662, 670-71, 2007 UT App. 169 (2007) , rev'd, 2008 UT 87, 2008 Utah LEXIS 197 (Utah 2008) (on other grounds) reh'g denied, 2009 Utah LEXIS 116 (Apr. 17, 2009) .

(n47)Footnote 41. *Kilbane v. Dyas*, 33 Ill. App. 3d 439, 337 N.E.2d 217 (1975) .

(n48)Footnote 42. 33 Ill. App. 3d at 442-443, 337 N.E.2d at 220-221 .

(n49)Footnote 43. 68 Cal. 2d 662, 68 Cal. Rptr. 589, 441 P.2d 101 (1968) .

(n50)Footnote 44. 68 Cal. 2d at 668, 68 Cal. Rptr. at 594, 441 P.2d at 106 .

(n51)Footnote 45. 68 Cal. 2d at 671, 68 Cal. Rptr. at 595-596, 441 P.2d at 107-108 , citing Cal. Prob. Code § 760.

(n52)Footnote 46. 68 Cal. 2d at 670, 68 Cal. Rptr. at 595, 441 P.2d at 107 .

(n53)Footnote 47. 68 Cal. 2d at 669, 68 Cal. Rptr. at 594, 441 P.2d at 106 .

(n54)Footnote 48. 2 Cal. App. 3d 659, 82 Cal. Rptr. 778 (1969) . See also *Wilson v. Donze*, 692 S.W.2d 734 (Tex. App. 1986) .

(n55)Footnote 49. 82 Cal. Rptr. at 780 .

(n56)Footnote 50. *176 Cal. App. 3d 57, 221 Cal. Rptr. 353 (1985)* .

(n57)Footnote 51. *See Fla. Stat. § 475.42(1)(d)*.

(n58)Footnote 52. *See 800 So. 2d 608 (Fla. 2001)* .

(n59)Footnote 53. *800 So. 2d 608, 608-609 (Fla. 2001)* .

(n60)Footnote 54. *See Schickedanz Bros.-Riviera, Ltd. v. Harris, 800 So. 2d 608, 610-11 (Fla. 2001)* , discussing *Alligood v. Florida Real Estate Commission, 156 So.2d 705 (Fla. Dist. Ct. App. 1963)* .

(n61)Footnote 55. *See Schickedanz Bros.-Riviera, Ltd. v. Harris, 800 So. 2d 608, 611 (Fla. 2001)* .

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18 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART I General Principles

CHAPTER 2 Overview of Brokerage Practice and the Organization of the Brokerage Industry *

10-2 Real Estate Brokerage Law and Practice § 2.03

§ 2.03 The Brokerage Contract

[1] In General

A real estate brokerage contract or listing agreement is a contract between a real estate broker and a seller which covers the broker's efforts to find a buyer for the seller's real estate. n1 Typically, a brokerage or listing agreement contains provisions which address

- the identification of the property subject to the agreement,
- the price at which the property will be offered for sale. *But cf. Vision Realty, Inc. v. Kohler, 214 Ore. App. 220, 225, 164 P.3d 330, 332 (2007)* (The listing agreement provided that the broker was due a 6% commission on the lease of the property, but failed to state the rent amount sought for the property. The property owner refused to pay the broker's commission when a tenant was procured through the broker's efforts. The agreement at issue was the listing agreement, not the lease. The failure to include the lease terms in the listing agreement did not affect the validity or the enforceability of the listing agreement.).
- the terms of sale acceptable to the seller,
- how long the agreement will remain in effect (*i.e.*, the term),
- the compensation to be paid to the broker for finding a buyer (usually referred to as a commission),
- the broker's use of a Multiple Listing Service in marketing the real estate, and
- the use of a lockbox to allow brokers and agents to show the property when neither the listing broker nor the owner are present to show the property to potential purchasers.

Many states statutorily list the contents of a valid listing agreement. A court applying such a statute may hold that the substantial compliance doctrine applies to listing agreements governed by such a statute. n1.1

10-2 Real Estate Brokerage Law and Practice § 2.03

In discussing listing agreements, the issue of what it means "to list" a property may arise. Listing a property has been defined to mean using a compiled and published list of properties and their descriptions in an effort to meet the individual needs of some specifically identified seller, buyer, landlord, or tenant. n1.2 It has been stated that a listing agreement is an agency agreement wherein the agent agrees to expose a property to the market in consideration of payment of a commission if a sale is made. n1.3 Real estate is not listed when a broker is not permitted to disclose the sale of the property to the general public, but is only permitted to privately disclose the sale to those persons the broker considers to be potential buyers. n1.4

A real estate brokerage contract is generally characterized as a contract for personal services rather than a contract conveying an interest in land. n1.5 These contracts are generally interpreted according to principles of contract law. n1.6 It is the brokerage contract or listing agreement, along with statutory and regulatory law, that establishes the brokerage relationship between the licensed broker and the property owner/seller.

The real estate broker owes certain duties to his or her principal which are essentially the same as any agent would owe to a principal. n1.7 The broker usually acts as a negotiator. n2 The broker is not obligated to advise on the sales contract's terms and has no duty to collect the purchase price unless he or she has expressly agreed to do so. n3 In all cases, it is the broker's duty to follow instructions and to act according to and within the scope of his or her authority. n4

One of the requisites to recovery of a commission by a real estate broker is the existence of a brokerage contract, n5 which many states require to be in writing. n6 Generally, the burden of proving that an employment relationship exists between the broker and the property owner is on the broker. n7 In the absence of an employment contract, the landowner is not obligated to pay a commission, even if the broker is the cause of a sale that is later consummated. n8 When the parties have entered into a written listing agreement, each party will be presumed to have consented to the contents of the document and cannot avoid the obligations imposed by the listing agreement by claiming that he or she failed to read or understand the agreement. n8.1

The contract of employment between the broker and the party from whom the broker is claiming a commission may be implied from the conduct of the parties. n9 An implied contract was held to exist, for example, where the property owner knew that the broker was attempting to effect a sale and expected to receive compensation for his services, and where the owner encouraged the broker to aid in the sale and led the broker to believe he would receive compensation. n9.1 In the alternative, an implied contract can hold a broker liable for a breach of fiduciary duty when the seller can prove that an implied contract existed and an unintentional agency or "accidental" agency was created. n10 In some circumstances, the parties' agreement will be a unilateral contract where the broker makes no promise and is under no obligation to do anything. Such an agreement provides that the seller will pay a commission only if the broker produces the purchaser. n10.1

Generally, where a broker enters into a special contract with a property owner conditioned on the sale or lease of property at a certain price or upon certain terms, a broker will not be entitled to a commission unless the particular price or terms are met by a buyer. n11 The seller, however, may elect to waive the particular price or terms, thereby entitling the broker to a commission. n12 In sum, the broker's right to a commission is controlled by the provisions of his or her employment contract with the principal. n13

As a general rule, the validity and enforceability of a brokerage contract is governed by the law of the state where the contract was made, that is, the state where the last act necessary to make it a binding agreement took place. n14 However, where a brokerage contract is made in one state but its performance is clearly contemplated in another state, the law of the place of performance governs the validity of the contract. In such case, if the contract is invalid under the laws of the state of performance, *e.g.*, for failure of the broker to obtain the required license, it will be unenforceable in the state where the contract was made even though no law of that state was violated. n15

The duration of a brokerage contract will depend on the type of contract involved. Some states, for example, require a

definitive termination date in exclusive listing contracts. n16 Even if the listing is statutorily required to have a definite expiration date, the substantial compliance doctrine may save a listing agreement that does not comply with this or other requirements. In such a case, the listing agreement may be found to be an agreement terminable at will. n16.1 Another possibility, when the agreement lacks a specific termination date, is for the contract to continue for a reasonable time, which will vary according to the circumstances in the particular case. Prior to such time, either party acting in good faith may terminate the contract. n17 An owner, however, may not terminate an agency for the purpose of depriving a broker of his or her commission. n18

A listing agreement's term can also be extended by implication even though the stated termination date in the written listing agreement has passed. n18.1

Some statutes provide that a brokerage relationship which is not performed expires at the earlier of:

- (1) the date of expiration agreed upon by the parties;
- (2) any termination or relinquishment of the relationship by the parties; or
- (3) one year after the date of the engagement. n18.2

It has been held that such a statute defines the relationship and that only in the absence of completion of performance (i.e., a sale of the property) within the terms of the agreement do the statutory alternatives apply. Thus, the one-year limit on the brokerage term does not apply to all agreements. A brokerage agreement can contain automatic renewal provisions that extend the agreement beyond one year. n18.3

It is possible for the time limit in a listing agreement to be expressly waived by the seller, or impliedly waived by the seller's conduct. n18.4 Listing agreements may also be worded such that the execution of a sales contract for the subject property automatically extends all rights and obligations of the listing agreement through the date of the closing of the sales contract. n18.5

Generally, ambiguities in a contract are more strictly construed against the drafter. n18.6 This rule is especially true where the drafter stands in a position of trust, or has greater professional or business knowledge, as does a real estate broker. n19 If there is ambiguity in a brokerage contract, parol evidence may be admissible to clarify the intention of the parties. n20 If the listing agreement is jointly drafted by both the seller and broker, questions arising due to ambiguous language in the agreement will become issues for the jury to decide. n20.1

Some brokerage agreements contain indemnification provisions whereby the client agrees to indemnify the broker for liability arising from the parties' relationship and property which is the subject of the parties' agreement. Such an indemnification provision has been upheld in a case involving a commercial property where misrepresentations were made to a tenant regarding the adequacy of the parking. n20.2 It should be expected that such an indemnity provision would face stricter scrutiny in a brokerage agreement involving a residential property.

[2] Types

Against this framework, the different types of brokerage contracts will now be discussed. Often, the employment contract will be reduced to a writing. This is sometimes called a listing agreement. Even in jurisdictions where there is no statute of frauds requirement, n21 it is preferable to have an agreement reduced to writing, where possible, to avoid misunderstandings as to compensation and agreed terms. n22

It should be noted that the term brokerage agreement encompasses more than listings for the sale of real estate. For example, a broker can agree to procure a buyer without listing the property. n22.1 Consequently, a listing agreement

should be viewed as one type of brokerage agreement rather than being viewed as being synonymous with the term listing agreement.

The written agreement should contain, at the minimum, the following information: (1) the names of the parties; (2) a description of the property; n23 (3) the amount of compensation; (4) any conditions to be satisfied before a commission is earned; (5) any additional specific provision that may be applicable, *e.g.*, whether there is an exclusive agency or right to sell. n24 It is prudent for both parties (the property owner and the broker) to sign the listing agreement. n24.1

[a] Open Listing

Most informal verbal listing agreements fall within the category of "open listings," through which the owner retains the right to sell the property himself and to hire other brokers in the absence of an express provision to the contrary. Obviously, this type of agreement can generate quarrels where several brokers are involved. Under such circumstances, it is the broker who is the efficient cause of the sale who is entitled to the commission. This right is not affected by the circumstance that such broker sells to one whose attention to the property had been originally directed by another broker. In sum, with an open listing, a commission is payable not to the broker who first speaks of the property to a prospect, but to the broker who is the procuring cause of the sale, whether he is the first or second to engage the attention of a purchaser. n25

An open listing is also referred to as a non-exclusive listing. n25.1 An open or non-exclusive listing has been described as an invitation to the broker to attempt to find a buyer. This type of listing does not create a contractual relationship but instead approximates an offer by the owner which may be withdrawn by the owner at any time. Such a listing leaves the owner free to list the property with other brokers, or for the owner to make a sale. n25.2

A broker's authority under an open listing is terminated by express revocation or by the sale of the property. n25.3 However, once a broker has produced a buyer who is ready, willing, and able to purchase the property upon the terms stated in the listing, the seller may no longer revoke the broker's authority under the open listing and be relieved of the obligation to pay the commission. n25.4 A broker's right to compensation for producing a ready, willing able purchaser is discussed in Chapter 5, *below*.

[b] Net Listing

The term "net listing" has been defined as an agency or other agreement whereby a prospective seller of real property lists the property for sale at a specified net amount to be paid to the seller and authorizes the broker to retain as commission, compensation or otherwise, the difference between the price at which the property or interest is sold and the specified net amount to be received by the seller. n26 In some jurisdictions such agreements have been prohibited, n27 apparently to prevent overreaching and unfair dealing on the part of the broker. n28

Even if they are not considered illegal, difficulties may arise with respect to net listing agreements as to what was actually intended by the owner. In an early Texas decision, for example, brokers brought suit for compensation of \$500 where the brokers sold property for \$8,000 and the owners were to receive "\$7,500 net." The court held that the term "net" as used in the contract meant that the property had to bring to the owner at least \$7,500 free of all expenses and deductions and that the broker was only entitled to the going rate of commission (2-1/2 percent of \$8,000), together with interest. n29

It has been held that in order to establish entitlement to a commission under the terms of a non-exclusive agency contract to sell real estate for a stated price "net to seller," there must be some showing that, absent interference by the seller, the agent could have realized something in excess of the stated net price. n30

[c] Exclusive Agency

An exclusive agency is an agreement under which a particular broker is employed and no other. n31 This type of agreement is favored by brokers over open listings because it offers them a certain degree of protection. While under an open listing contract more than one broker may be hired and only the first broker who produces a ready, willing and able buyer is entitled to a commission, n32 under an exclusive agency the particular broker is protected for the duration of the employment contract. It has been held in this regard that a state real estate commission may, by rule, expressly prohibit (under threat of license suspension or revocation) a broker or salesperson from negotiating or even attempting to negotiate a sale of property directly with the owner, where the licensed broker or salesperson knows of the existence of an outstanding exclusive listing contract on the property. n33

It should be noted, however, that the exclusive agency does not afford absolute protection to a broker in that the owner still has the right to sell the property. n34 The right of an owner to sell his own real estate is inherent and this right is retained even when a broker is employed, unless the contract provides in unequivocal terms or by necessary implication that the owner's right to sell has been relinquished. n35 In the event the owner does sell on his own, the agency is terminated and the owner has no liability to the broker for a commission.

Many states require that exclusive listing contracts provide a specific termination date. n36 Extension clauses, however, may provide that the broker is entitled to a commission notwithstanding the expiration of the term n37 if the property is sold to one with whom the broker, prior to such expiration, negotiated or had some other form of dealing described in the agreement. n38 The purpose of such extension clauses, the validity and enforcement of which have been universally upheld, is to protect the broker by preventing the owner from postponing acceptance until the listing agreement has expired and thereby circumventing the broker's right to compensation. n39

These extension clauses have also been referred to as override clauses n39.1 or extender clauses. n39.2 Typically, an extension or override clause requires that the broker provide the seller with a list of individuals to whom the broker showed the property. This list has been referred to as a protective list. n39.3 It has been held that a subsequent sales contract will not preserve the broker's commission if the listing agreement required a protective list and the broker failed to comply with this provision. n39.4 An extension or override clause will not entitle a broker to a commission when a sale to a listed individual occurs beyond the extension period. n39.5 However, it has also been held that a statutorily provided override remedy was intended to provide an alternative to, but not to abrogate, the court's equitable authority to use the procuring cause remedy where necessary to do complete equity. n39.6

When a listing agreement includes an extension clause, but does *not* require that the broker supply the seller with a list of individuals to whom the broker has shown the property, courts differ on whether the seller owes a commission to the broker if a sale occurs to a protected party during the time period covered by the extension clause. Under one view, the broker has a duty to advise the seller of the names of potential buyers who carry commission exposure, even though the agreement does not state this duty. n39.7 Other courts, however, have held that the seller should know that the buyer may have resulted from the broker's efforts and that the seller should communicate with the broker regarding any commission liability which may arise from a sale to a particular buyer. n39.8

State licensing statutes may require that a broker supply a client with a copy of an exclusive sales or rental listing at the time of the execution of the listing contract. n40 A New Jersey case has held in this regard that failure to abide by such a statutory directive may bar a broker's right to recovery of a commission. n41

[d] Exclusive Right to Sell

Under an exclusive right to sell contract, only the named broker can sell the property during the period specified in the contract. The broker is made the sole agent for the sale of the property and receives a commission if the property is sold by himself, the owner, or anyone else. n42 The broker should exercise care in drafting such a contract in that some courts may require clear and unequivocal language to create such a right. n43

A designated party listing is an exclusive right to sell that specifies that the broker earns a commission if the property is sold to certain named parties. Designated party listing agreements add the complexity of limiting the field of prospective buyers to those parties identified in the agreement. n43.1

[e] Multiple Listing

The "multiple listing" is an arrangement whereby individual real estate brokers in a particular area pool their exclusive listing. n44 A multiple listing service (MLS) has been defined "as a means of making the orderly dissemination and correlation of listing information available to its members so that Realtors(R) may better serve the buying and selling public." n45 The MLS is a mechanism whereby information concerning individual listings can be distributed to all MLS participants. Basic procedures for operating an MLS are as follows: An MLS member compiles certain listing information from a seller on a particular piece of property and the listing is submitted--generally within forty-eight hours--to the MLS office, where it is coordinated with listings from other members. n46 The listings are then published to all MLS members, any of whom may sell any listed property. If a sale of property is made by someone other than the broker who took the listing initially, the commission is divided between the listing and selling broker. n47 A service fee is then paid to the MLS. n48 In a suit for a commission against a property owner, it has been held that only the original broker may sue, regardless of who sells the listing, since the original broker is the only broker in contractual privity with the owner. n49

Multiple listing services have been very successful and greatly increase the proportion of listings sold. n50 The majority of MLSs that exist today are sponsored by local real estate boards, which are trade associations ostensibly organized for the purpose of improving the real estate business through education, cooperation and exchange of information by its members, and through the establishment and enforcement of ethical standards of practice for the benefit of the public. n51 Generally, use of a multiple listing service in selling listed properties is limited to members of the MLS, who must also be members of the sponsoring local board. Thus, many licensed brokers and sales people who are not real estate board members are denied use of the MLS. This leaves them at a considerable competitive disadvantage in light of the increasing power and importance of multiple listing services. n52 One result has been suits challenging restrictions on MLS membership as illegal restraints of trade.

One of the earliest cases to involve MLS membership as exclusionary and subject to boycotting was *Grempler v. Multiple Listing Bureau of Harford County*, n53 wherein the Maryland Court of Appeals upheld the exclusion of MLS membership to individuals who were members of the territory that the MLS agency serviced. In that case, a bylaw requirement provided that in order to be a member of the Harford County MLS, the member had to have a principal place of business in Harford County. In upholding the exclusion, the court noted that local and regional societies are frequently limited to persons whose principal place of business is within the territory which is served by that society. Other restrictions, however, were doomed to failure.

In *Collins v. Main Line Board of Realtors*, n54 the plaintiff's application was rejected because she had falsely, improperly and unethically brought charges on behalf of one of her clients against the Board. In upholding the plaintiff's complaint as a restraint of trade, the Pennsylvania Supreme Court held that when the Real Estate Department of Pennsylvania licensed the applicant, it determined that she was trustworthy and competent pursuant to the governing Pennsylvania statute. For the Board or MLS to hold otherwise would be a preemption of the approval of the Department of Real Estate, thereby creating an unreasonable restriction on membership.

In *Marin County Board of Realtors, Inc. v. Palsson*, n55 the California Supreme Court reviewed a limitation on membership for the Marin County Board of Realtors. The Board membership criteria included a provision which limited membership to those persons who were primarily engaged in the real estate business, effectively eliminating membership for part-time brokers. The court upheld the "rule of reasonableness" for the boycotting criteria of the Board, but noted the competitive disadvantages to non-member brokers and the severe hardship placed on part-time

sales people. The Board could find no empirical support for the Board's position to support the exclusion of part-time brokers, and therefore it failed the "rule of reasonableness" test.

Similarly, the Justice Department challenged MLS criteria in *United States v. Realty Multi-List, Inc.* n56 The Fifth Circuit acknowledged the pro-competitive and efficiency-creating impact of MLS on the real estate market. However, the court discussed criteria for MLS membership which it deemed to be "facially unreasonable," which is illegal unless it can be shown to be justified by competitive needs of the MLS. The court concluded that the requirements for favorable credit reports and business reputation in this case were too subjective to permit exclusion. Requiring new applicants to have their offices open during customary hours and to purchase thousands of dollars worth of MLS stock was also held to be facially unreasonable.

Boards may have also attempted to eliminate competition by amending the fee splitting provisions of their bylaws to "discount" brokers. In *Penne v. Greater Minneapolis Board of Realtors*, n57 the Board initiated a fee splitting policy for "discount" brokers (brokers who took listings based on a simple fee arrangement rather than the traditional percentage of gross sales price) which limited the brokers to half of their normal fees rather than half of the more lucrative six to eight percent fees charged by other member brokers. The Eighth Circuit held that this was "punitive fee splitting."

The basic criteria for establishing the "rule of reasonableness" or "facial reasonableness" is a balancing test, based on whether or not the rules for exclusion can be supported by reasonable pro-competitive conduct. If the exclusion can be based upon reasonable criteria for membership, the exclusion may be supportable. One case has even upheld the exclusion based on copyright protection. n58 It should be noted that the burden of proof is still upon the plaintiff in these cases to prove the conspiracy of the Board and that the conduct complained of is not merely a result of the independent judgment of the brokers who happen to be members of the Board. n59

[3] Statute of Frauds

The general statutes of fraud typically address contracts for the sale of real estate. n60 While some of these general statutes include within their purview agreements authorizing an agent or broker to buy or sell real estate, n60.1 some of these statutes do not specifically address the various brokerage contracts that can exist between real estate licensees and their clients and customers. n60.2 A failure to list such contracts within a general statute of frauds does not obviate the need for written agreements between licensees and their customers and clients, however. Some jurisdictions have a specific statute which requires that certain brokerage agreements be written. n60.3 In addition, the rules of many of the real estate commissions require that listing agreements be written. n60.4

A requirement that brokerage agreements be in writing has more to do with a party's right to enforce the agreement or the fact that disciplinary action taken may be taken against a licensee for failing to obtain a written agreement when this is a statutory or regulatory requirement. Just as is the case with other oral contracts which fall within a statute of frauds, a requirement that the contract be written does not mean that oral contracts cannot be made and performed. A failure to comply with a statute of frauds typically means that enforcement will be difficult, or impossible, because such an oral contract is void or voidable if it is within the statute of frauds. n60.4.1

If the writing requirement is in a licensing act or a disciplinary provision, licensees may face disciplinary proceedings with their licensing agency, as well as have difficulty establishing that they adhered to a standard of practice in a litigated case.

The issue of whether brokerage agreements should be written should not be an issue for licensees who are Realtors(R) due to the National Association of Realtors'(R) Code of Ethics. Specifically, Article 9 provides:

Realtors for the protection of all parties, shall assure whenever possible that agreements shall be in writing, and shall be in clear and understandable language expressing the specific terms, conditions,

obligations, and commitments of the parties. A copy of each agreement shall be furnished to each party upon their signing or initialing.

Regardless of whether a statute, a regulation or a code of ethics requires that brokerage agreements be written, the best advice for licensees to follow is to use written contracts. Any alterations, or modifications, to the original agreement should likewise be written. n60.4.2 Oral agreements and oral modifications of written agreements are a fertile ground for litigation. Reducing an agreement to a writing signed by the parties can avoid disputes.

Some courts have found that the sales contract or lease may contain the essential terms of the brokerage agreement such that the seller's or lessor's attempt to avoid paying the broker a commission based on a statute of frauds argument will be defeated. n60.4.3

In *Mitchell v. Rawls*, n60.5 a dispute arose as to whether a listing agreement had been orally extended. The Mississippi judge commented on the licensee's business practices:

You cannot be in the real estate business and operate out of your back pocket. It is just as simple as that. There was a time in my lifetime it could have been done. It can no longer be done. n60.6

Prudent conduct of a brokerage firm mandates that all brokerage contracts be written and signed by the parties even when there is no statutory or regulatory requirement that such contracts be written.

PRACTICE NOTE:

A prospective seller or buyer who refuses to enter into a written brokerage agreement should raise a red flag for licensees. Even if the applicable law permits oral brokerage agreements, licensees should seriously consider not representing that party no matter how much the commission is needed or how expedient an oral agreement may appear at the time.

It has been stated that statutes which require that contracts for the employment of brokers be written are in derogation of the common law and should be strictly construed. n60.7 New York's statute of frauds, n61 for example, specifically provides that it "shall not apply to a contract to pay compensation to an auctioneer, an attorney at law, or a duly licensed real estate broker or real estate salesman." n62

While New York's statute is clearly limited in its application to the transactions specifically described in it, it would, however, prevent an *unlicensed* real estate broker from collecting a commission under an oral employment contract for the sale of shares in a cooperative, for example, because in reality there is a sale of an interest in the cooperative leasehold. n63 The writing requirement of New York's General Obligations Law would also apply to others not exempted by the enactment, *e.g.*, business brokers, finders, etc. The New York statute makes oral agreements for services that fall within the statute completely unenforceable n64--there is no exception if the agreements are fully executed; n65 nor may recovery be had on a theory of *quantum meruit*. n66 This is the general view held by the various jurisdictions, under their several statutes of frauds, *i.e.*, if the statute of frauds bars recovery under an oral agreement, the broker may not recover for the value of his or her services. n67

It is important to note that even in those states such as New York which do not require licensed real estate brokers or salespersons to have written contracts with their principals, the statute of frauds may still prove fatal to recovery under an oral agreement. An agreement, for example, whereby the broker would receive an interest in the land involved as compensation for his or her services may be held to fall within the statute. n68 If the transaction, moreover, cannot be completed within one year, it would have to be in writing under New York's statute of frauds. n69 This is important where the broker procures a lessee who is given an option to buy on which the broker claims an agreement to pay a commission and the option cannot be exercised within one year. In such a case, the broker could not recover upon an oral agreement where the lessee thereafter exercised the option. n70 This is also important in lease arrangements

involving commissions for renewals or commissions to be paid as a percentage of rentals over the term of the lease. n71

A number of states have a provision within their statute of frauds that specifically embraces a broker's contract of employment. n72 For example, California's statute of frauds, which makes certain contracts invalid unless there exists some note or memorandum in writing signed by the party to be charged, expressly covers "an agreement authorizing or employing an agent, broker, or any other person to purchase or sell real estate, or to lease real estate for a longer period than one year, or to procure, introduce, or find a purchaser or seller of real estate or a lessee of real estate where such lease is for a longer period than one year, for compensation or a commission." n73

California, like New York, n74 does not require an agreement between brokers or finders to share in a commission to be in writing. n75 The writing in California need not contain all the terms of the employment agreement but should be evidence that an employment contract exists. n76 The writing, moreover, need not state the amount of compensation. n77 The writing should, however, identify the broker, n78 indicate the broker's employment n79 and authority n80 and contain a description of the property. n81 It has been held that the essential part of a contract to employ a real estate broker is the matter of employment and that broker's contracts in California "are not to be declared void merely because of a defect, ambiguity or uncertainty in the description of the property to be sold when such defect can be cured by allegations and proof of extrinsic facts and circumstances." n82

A few states have relatively detailed statute of frauds requirements as to brokers. n83 The Alaska and Oregon statutes of frauds are similar and essentially provide that if the note or memorandum of the agreement contains a description of the property sufficient for identification, authorizes or employs the agent or broker named in it to sell the property, and expresses with reasonable certainty the amount of the commission or compensation to be paid the agent or broker, the agreement of authorization or employment is not unenforceable for failure to state a consideration. n84

New Jersey statutorily permits a broker to collect a commission if, within five days after making an oral agreement, the broker provides a writing to the principal who enlisted his or her services, stating the terms of the oral agreement and the rate or amount of commission to be paid. n84.1 This statute represents a strong statement of public policy by the legislature that cannot be ignored. n84.2 Thus, New Jersey, even though allowing an oral agreement initially, still requires a writing of some type before a commission is due to a broker.

While Nebraska statutorily requires that brokerage agreements be written, n84.3 the Supreme Court of Nebraska has found that this statutory provision does *not* operate as a statute of frauds. n84.4 In coming to this conclusion, this court stated that Neb. Rev. Stat. § 76-2422 and its related statutes contain no language that would render a brokerage agreement void. Instead, § 76-2422 discusses the need for a written agreement in certain circumstances. This provision is part of a larger scheme to regulate real estate licensees, and a violation of a statute in this section may result in administrative action under the Nebraska Real Estate License Act. n84.5

[4] Broker's Authority to Sign Contract

A real estate broker does not enjoy general authority, but is only authorized to do what is specifically assigned in his or her contract of employment. n85 The broker's obligation is merely to provide a purchaser or lessee and the broker has no authority, unless specifically agreed, to enter into binding contracts on behalf of his or her principal. n86 Accordingly, a real estate listing agreement which gave an agent an exclusive "right to sell" property and which set a sales price, fixed a commission and provided an expiration date for the listing, did not confer authority on the real estate agent to enter into a contract binding on the owner to convey the property. n87 The general rule is that a real estate agent has no implied authority to contract on behalf of his or her principal. Any apparent authority must be founded on the principal's actions since the agent, by his or her acts, cannot create evidence of authority. n88

FOOTNOTES:

(n1)Footnote 1. *See Tom Heal Commercial Real Estate, Inc. v. York*, 167 P.3d 523, 526, 2007 UT App 265 (2007)

10-2 Real Estate Brokerage Law and Practice § 2.03

Fairbourn Commercial, Inc. v. American Housing Partners, Inc., 68 P.3d 1038, 1041 (Utah Ct. App. 2003) *aff'd*, 2004 UT 54, 94 P.3d 292 (Utah 2004) . See also *Hubbell Commercial Brokers, L.C. v. Fountain Three*, 652 N.W.2d 151, 156 (Iowa 2002) (listing agreements are between brokers or licensees and property owners who seek to sell or lease their property).

(n2)Footnote 1.1. See *Rosenberg v. Heritage Renovations, LLC*, 685 N.W.2d 320, 325 (Minn. 2004) , rehearing denied, 2004 Minn. LEXIS 535 (Minn. Aug. 19, 2004) .

(n3)Footnote 1.2. See *State by Spannaus v. Beslanowitch*, 311 Minn. 56, 248 N.W.2d 286, 288 (Minn. 1976) .

(n4)Footnote 1.3. See *Leo Eisenberg & Co. v. Payson*, 152 Ariz. 390, 732 P.2d 1128, 1130 (Ariz. Ct. App. 1987) ; *Leiter v. Fleetwood Realty Corp.*, 95 Ill. App.3d 212, 214, 50 Ill. Dec. 411, 419 N.E.2d 519, 521 (1981) ; *Stewart v. Sisson*, 711 N.W.2d 713, 718 (Iowa 2006) .

(n5)Footnote 1.4. See *Stewart v. Sisson*, 711 N.W.2d 713, 718-19 (Iowa 2006) .

(n6)Footnote 1.5. See *Coldwell Banker & Co. v. Karlock*, 686 F.2d 596, 599 (7th Cir. 1982) , applying Illinois and Indiana law; *Richland Development Co. v. Staples*, 295 F.2d 122, 125 (5th Cir. 1961) , applying Alabama law; *Aritex Land Co. v. Arnold*, 16 Ariz. App. 547, 494 P.2d 747, 748 (1972) .

(n7)Footnote 1.6. See *Coldwell Banker & Co. v. Karlock*, 686 F.2d 596, 599 (7th Cir. 1982) , applying Illinois and Indiana law.

(n8)Footnote 1.7. See *Bennett v. Thompson*, 126 Ark. 61, 66, 189 S.W. 363, 364 (Ark. 1916) ; *Polo v. Lordi*, 261 N.Y. 221, 224, 185 N.E. 80, 81 (1933) . See also *Perkins v. Thorpe*, 106 Idaho 138, 140, 676 P.2d 52, 54 (Idaho Ct. App. 1984) (real estate broker, as an agent, owes a fiduciary duty to the principal, his client.).

(n9)Footnote 2. See, e.g., *Kitchen v. Lloyd*, 14 S.W.2d 335 (Tex. Civ. App. 1928) .

(n10)Footnote 3. See *Tarbell v. Bomes*, 48 R.I. 86, 135 A. 604 (1927) .

(n11)Footnote 4. See, e.g.:

Minnesota: Olson v. Penkert, 252 Minn. 334, 90 N.W.2d 193 (1958) .

Vermont: E.A. Strout Realty Agency, Inc. v. Wooster, 118 Vt. 66, 99 A.2d 689 (1953) .

The "scope of authority" frequently creates a conflict as most listing agreements are not detailed as to the type of work to be performed. Among the factors to be considered in determining the scope of employment are the following: (1) whether the act was committed within the time and space limits of the employment; (2) whether the act was committed at least in part by serving the principal; and (3) whether the act is incidental to or part of the authorized conduct of the agent. *Phillips v. JCM Dev. Corp.*, 666 P.2d 876 (Utah 1983) and *Barker v. Francis*, 741 P.2d 548 (Utah Ct. App. 1987) .

(n12)Footnote 5. See:

New York: Julien J. Studley, Inc. v. New York News Inc., 122 A.D.2d 633, 505 N.Y.S.2d 419 (N.Y. App. Div. 1986) *aff'd*, 70 N.Y.2d 628, 518 N.Y.S.2d 779, 512 N.E.2d 300 (N.Y. 1987) , reconsideration denied, 70 N.Y.2d 748, 519 N.Y.S.2d 1035, 514 N.E.2d 393 (N.Y. 1987) , where the court held that a broker was not entitled to his commission where the broker failed to establish an implied-in-fact brokerage contract. In *Studley*, an action was brought by the plaintiff-broker to recover his commission. The defendants

sought a dismissal of the action on the ground that they never employed the plaintiff broker. However, plaintiff claimed that "it had performed a service which benefitted defendants, and that defendants knew or had reason to believe that such service was rendered with an expectation of payment" In holding that "any expectation on plaintiff's part that it was to be paid by defendants was wholly unwarranted," the court reasoned that (1) a mere volunteer without authority is not entitled to a commission "merely because he has inquired the price which an owner asks for his property, and has then sent a person to him who consents to take it"; and (2) a contract "cannot be implied *in fact* where the facts are inconsistent with its existence."

Rhode Island: Judd Realty, Inc. v. Tedesco, 400 A.2d 952 (R.I. 1979) (an offer to pay a commission to a real estate broker upon production of a purchaser is an offer to enter into a unilateral contract).

(n13)Footnote 6. See § 2.03[3] *infra*.

Absent corroboration, partial performance of a brokerage agreement does not excuse compliance with the requirement that there be a written brokerage agreement naming the broker. Moreover, the sale of real property does not corroborate the name of a broker when the name is not supplied by a memorandum of the agreement between the broker and the person who is to pay the commission. *Boyer v. Tauber*, 834 S.W.2d 60 (Tex. 1992) .

(n14)Footnote 7. See *Deer Run Props., L.L.C. v. Keys to the Lake Lodgings, Co., L.L.C.*, 2010 Mo. App. LEXIS 519 (Apr. 26, 2010) ; *Kohn v. Cohn*, 567 S.W.2d 441 (Mo. App. 1978) .

(n15)Footnote 8. See:

Connecticut: In Real Estate Auctions, Inc. v. Senie, 28 Conn. App. 563, 611 A.2d 452 (Conn. App. Ct. 1992) , a plaintiff-auctioneer entered into an exclusive real estate auction agreement with the defendants, providing that it would find a buyer, with a "cooperating realtor," for the defendant's property. The property was sold at auction for \$625,000, resulting in an alleged commission of \$43,750, which the defendants refused to pay, alleging that they had been cheated out of a reasonable price for the property. The defendants argued that the plaintiff-auctioneer had pressured them to auction the property "without reserve" and that summary judgment should be had, because the listing agreement was invalid, failing to state the names and addresses of all the parties, and because it had not been signed by one of the owners. Affirming the trial court's grant of summary judgment for defendants, on the basis of an invalid brokerage agreement, the court held that, by statute, the names and addresses of every party to the agreement must be affixed thereto, and the agreement must be signed by all the owners or their agents.

Florida: Cushman & Wakefield of Florida, Inc. v. Williams, 551 So. 2d 1251 (Fla. DCA 1989) , wherein the court denied commissions to real estate representatives under their employment contract. The court stated that the "First Amendment to the Lease Agreement" which was the new lease did not entitle the sales representatives to a commission under their contract. The court further stated that because the tenants did not exercise the option to renew the original lease, the new lease entered into by them contained significantly different terms extinguishing the representatives' right to commission. The fact that the representatives resigned prior to the execution of the new lease had no bearing on the outcome.

Missouri: Ham v. Morris, 711 S.W.2d 187 (Mo. 1986) ; *Deer Run Props., L.L.C. v. Keys to the Lake Lodgings, Co., L.L.C.*, 2010 Mo. App. LEXIS 519 (Apr. 26, 2010) ; *Kohn v. Cohn*, 567 S.W.2d 441 (Mo. App. 1978) .

(n16)Footnote 8.1. See *Barnett v. Saizon*, 994 So. 2d 668, 673 (La. Ct. App. 2008) .

(n17)Footnote 9.

Illinois: In *Louis v. Lexington Dev. Corp.*, 253 Ill. App. 3d 73, 192 Ill. Dec. 329 625 N.E.2d 289 (Ill. App. 1993) , a brokerage contract existed between the parties when the evidence showed that (1) the buyer placed an advertisement in a trade paper soliciting certain types of properties and providing for brokerage protection; (2) the broker approached the buyer and was informed that "brokerage protection" meant that once a piece of property was presented by the broker for the first time, the buyer would not exclude that broker from negotiations regarding the presented property in order to protect the broker's commission; and (3) the broker subsequently presented several properties to the buyer, including one that the buyer ultimately purchased. Under the circumstances, an agreement clearly existed between the parties providing that the buyer would protect the broker's commission for the sale of the property by virtue of not excluding the broker from negotiations concerning the purchase of the property.

But see Idaho Code § 54-2084 (no type of agency representation may be created orally or by implication).

(n18)Footnote 9.1. An implied contract exists when the owner knows that the broker is endeavoring to effect a sale and expects to receive compensation for his services, and the owner encourages the broker to aid in the sale and leads the broker to believe that he will, in fact, receive compensation. Thus, when an estate's agent notified brokers that they would receive a 3% commission upon procuring a successful bidder at auction, the broker procured a buyer at a price acceptable to the estate, albeit not at the first auction but at a later auction, and the estate did not make any effort to disclaim the broker's right to a commission at the second auction, there was an implied contract to pay the broker's commission upon the sale. *In re Estate of Vallerius*, 624 N.E.2d 459 (Ill. App. 1993) .

A broker and commercial purchaser have not mutually manifested assent to the essential terms of a brokerage contract where (1) the purchaser never expressly assented to the terms of the broker's offer, (2) the purchaser's mere indication of interest in the subject property and willingness to meet with the broker to learn more about the transaction, did not establish the "unqualified acceptance" necessary to manifest express assent to the agreement and (3) the purchaser refused to agree to the broker's 10% fee when it was first mentioned and repeatedly thereafter rejected that term of the agreement. *Weichert Co. Realtors v. Ryan*, 128 N.J. 427, 608 A.2d 280 (N.J. 1992) .

(n19)Footnote 10. *See:*

Colorado: *Lester v. Marshall*, 352 P.2d 786 (Colo. 1960) .

Illinois: *Arthur Rubloff & Co. v. Drovers Nat'l Bank*, 80 Ill. App. 3d 867, 36 Ill. Dec. 194, 400 N.E.2d 614 (1980) .

Nevada: In *Morrow v. Barger*, 737 P.2d 1153 (Nev. 1987) , it was held that a promise to pay the reasonable value of a broker's services may be implied and a real estate agent may recover under the theory of quantum meruit an amount equal to the value of services rendered, unless the parties have executed an exclusive listing agreement that is violative of *Nev. Rev. Stat. § 645.320*. That statutory provision requires that every exclusive listing set forth in its terms a "definite, specific and complete termination."

Texas: *Wilson v. Donze*, 692 S.W.2d 734 (Tex. Civ. App. 1986) .

But see *D.B. Corkey Co., Inc. v. Koplin*, 176 Ill. App. 3d 1096, 126 Ill. Dec. 417, 531 N.E.2d 1044 (1988) , in which the court held that neither an express nor an implied-in-fact brokerage contract existed

between a commercial real estate brokerage firm and a property owner, where the seller never expressly promised to pay a commission and the evidence revealed the intent throughout negotiations that the buyer, not the seller, would pay the commission.

(n20)Footnote 10.1. *See Southampton Development Corp. v. Palmer Realty Group, Inc.*, 769 So. 2d 1113, 1115 (Fla. App. 2000) .

(n21)Footnote 11. *Cline v. Yamaga*, 97 Cal. App. 3d 239, 158 Cal. Rptr. 598 (1979) .

See also Williams Real Estate Co. v. Douglas A. Edwards, Inc., 73 A.D.2d 860, 423 N.Y.S.2d 492, 1980 N.Y. App. Div. LEXIS 9748 (1st Dept 1980) , *aff'd*, 52 N.Y.2d 779, 436 N.Y.S.2d 618, 417 N.E.2d 1006 (1980) .

(n22)Footnote 12. *See, e.g., Mary Adams & Assocs. v. Rosenblat*, 539 So. 2d 860 (La. App. 1989) , wherein the court held that the president of a company had the authority to amend a sales agreement to extend the time for passing the act of sale, and therefore the broker was due her commission as provided in original contract. In this case, the broker found a purchaser for seller's property and a sales agreement was executed. The contract was conditioned on the purchaser's ability to borrow a sum of money within a prescribed period. The purchaser agreed to make a good faith effort to obtain the loan, and a commitment by any lender to make the loan would satisfy the condition. The purchaser had difficulty in obtaining the loan within the time prescribed and, consequently, the president of the purchasing corporation executed an amendment of the sales agreement which extended the time for obtaining the loan and the time for passing the act of sale. The sellers agreed to the extension. The purchaser, however, was unable to find a lending institution to make the loan within the extended time limit. Thereafter, the sellers agreed to make the loan themselves, therefore satisfying the contract condition. The purchaser then refused to take title to the property. The real estate broker sought a commission against the purchaser since the purchaser defaulted on its agreement to purchase. The purchaser claimed that the original sales contract expired and the broker was therefore not entitled to any commission. The court held that a principal will be bound for the actions of its agents if the principal has given an innocent third party a reasonable belief that the agent had authority to act for the principal. Here, the broker had reason to believe that the president had authority to extend the sales agreement. Not only was he president of the purchasing corporation, but he represented the corporation in almost all the sale negotiations, and the broker was told at the first sale meeting that the president had authority to sign for the corporation. The broker thus earned her commission when the seller agreed to make the purchaser the required loan within the extended time.

(n23)Footnote 13. *See:*

Federal: J.C. Nichols Co. v. Osborn, 12 F. Supp. 2d 1196, 1199 (D. Kan. 1998) (applying Kansas law).

Connecticut: Nugent v. Del Vecchio, 415 A.2d 1339 (1980) .

Nevada: Craig v. Margrave, 84 Nev. 638, 446 P.2d 653 (1968) .

New York: Lerner Organization, Inc. v. Clairidge's Co., 118 A.D.2d 402, 499 N.Y.S.2d 412 (1st Dept. 1986) *appeal dismissed without opinion* 68 N.Y.2d 910, 508 N.Y.S.2d 1029, 501 N.E.2d 602 (N.Y. 1986) , in which the broker and a lessor agreed that installment of a brokerage commission was due the broker from the lessor upon the event of a tenant's curing of a default in payment of rent and continued payment of the rent by the tenant thereafter, when due. The court held that the tenant, following cure of a default, was not required to pay in a timely fashion the following month's rent before the second installment was owed the broker.

(n24)Footnote 14. *See Robert v. Construction General, Inc.*, 40 Md. App. 78, 388 A.2d 168 (Md. Ct. Spec. App.

1978) , *cert. denied*, 283 Md. 737 (Md. 1978) .

But see Weston Funding Corp. v. Lafayette Towers, Inc., 550 F.2d 710 (2d Cir. 1977) , where a New York corporation obtained a loan commitment from a New Jersey bank for financing of New Jersey property by a New Jersey corporation owned solely by a New Jersey resident and the transaction's only link to New York was that the original brokerage agreement between the parties was signed in New York. Under New York's "center of gravity" conflict of laws test, New Jersey law would govern a dispute arising from the brokerage agreement.

(n25)Footnote 15. *See Weston Funding Corp. v. Lafayette Towers, Inc.*, 550 F.2d 710 (2d Cir. 1977) ; *Robert v. Construction General, Inc.*, 40 Md. App. 78, 388 A.2d 168 (Md. Ct. Spec. App. 1978) , *cert. denied*, 283 Md. 737 (Md. 1978) .

(n26)Footnote 16. *See* § 2.03[2][c] *infra*.

(n27)Footnote 16.1. *See Rosenberg v. Heritage Renovations, LLC*, 685 N.W.2d 320, 325-326 (Minn. 2004) , *rehearing denied*, 2004 Minn. LEXIS 535 (Minn. Aug. 19, 2004) .

(n28)Footnote 17. For a case dealing with the issue of waiver of a time limitation in a brokerage contract, *see James Myers v. National Dev. Co.*, 722 S.W.2d 491 (Tex. Ct. App. 1986) , in which the court held that a genuine issue of material fact as to whether the parties waived a time limitation in a brokerage contract precluded summary judgment. In determining whether a time limitation has indeed been waived, the court noted the following factors, among others, to be considered:

(a) Whether the principal accepts the services of the broker and recognizes the contract as still in force

(b) Whether the principal tacitly or expressly encouraged the broker to continue his efforts to effect a sale

(c) Whether the prior acts and conduct between the parties would lead the broker to believe that adherence to the time frame would not be insisted upon.

But see Barnett v. Saizon, 994 So. 2d 668 (La. Ct. App. 2008) (owner's efforts to terminate an exclusive listing agreement failed, the owner owed the agent a commission despite the owner's belief that the agreement had been terminated).

(n29)Footnote 18. *See, e.g., Snyder v. Schram*, 274 Or. 539, 547 P.2d 102 (1976) (a vendor must act in good faith in terminating a brokerage contract and cannot terminate the contract solely to avoid liability for the broker's commission while continuing to negotiate with a prospective purchaser secured by the broker). *Grommet v. Newman*, 2009 WY 150, 220 P.3d 795, 802 (Wyo. 2009) (listing can be extended orally or by conduct).

(n30)Footnote 18.1. *See Wieneke Properties, Inc. v. Thiessen*, 94 Ore. App. 306, 310-311, 765 P.2d 815, 817 (1988) (seller encouraged broker to continue its efforts to consummate a deal with the buyer; seller and the broker impliedly extended the agreement to the date of closing), *review denied*, 307 Ore. 514, 770 P.2d 595 (1989) .

(n31)Footnote 18.2. *Colo. Rev. Stat. § 12-61-809(1)*; *Ga. Code Ann. § 10-6A-9(a)*.

(n32)Footnote 18.3. *See Property Asset Brokerage, LLC v. Magna Assocs. Liquidating Trust*, 992 P.2d 654, 657 (Colo. App. 1999) , *cert. denied* 2000 Colo. LEXIS 21 (Jan. 24, 2000) .

(n33)Footnote 18.4. *See Carolantic Realty, Inc. v. Matco Group, Inc.*, 151 N.C. App. 464, 469-470, 566 S.E.2d

134, 138 (N.C. Ct. App. 2002) . See generally Annot., *Broker's Right to Commission on Sales Consummated After Termination of Employment*, 27 A.L.R.2d 1348 (1953) .

(n34)Footnote 18.5. See *Wood/Fay Realty Group, Inc. v. New Aquarius Corp.*, 842 So. 2d 914, 917 (Fla. Dist. Ct. App. 2003) , *reh'g denied*, 2003 Fla. App. LEXIS 7082 (Apr. 16, 2003) .

(n35)Footnote 18.6. See *Premier Realty, LLC v. I.T.J. Investments, Inc.*, 42 Kan. App. 2d 148, 153, 209 P.3d 741, 746 (2009) ; *DiSalle Real Estate Co. v. Howell*, 117 Ohio App. 3d 113, 690 N.E.2d 25, 28 (1996) .

(n36)Footnote 19. See:

Connecticut: A broker must exercise due diligence to ascertain if the language in a listing agreement is accurate. Thus, even where the listing agreement was replete with provisions requiring the seller to give accurate information, and the seller provided inaccurate information, the doctrine of equitable estoppel was unavailable as a defense to the broker's noncompliance with statutory mandates governing the content of brokerage agreements. *Real Estate Auctions, Inc. v. Senie*, 28 Conn. App. 563, 611 A.2d 452 (Conn. App. Ct. 1992) (inaccurate names and addresses).

Florida: *Planck v. Traders Diversified, Inc.*, 387 So. 2d 440, 442 (Fla. DCA 1980) *petition dismissed*, 394 So. 2d 1153 (Fla. 1981) .

Indiana: In a suit for a brokerage commission, the court will not apply the rule that an ambiguous contract will be construed against its drafter unless all other rules of construction have failed. *Bishop v. Sanders*, 624 N.E.2d 64, 68 (Ind. Ct. App. 1993) , *reh'g denied* (Jan. 28, 1994), *transfer denied* (June 2, 1994).

Maine: *Gendron Realty v. New Jersey Gendron Lumber Co.*, 519 A.2d 723 (Me. 1987) , in which a real estate broker sought, unsuccessfully, to recover a commission on the sale of a property by a second broker who was hired by the seller subsequent to the expiration of the broker's one-year "exclusive right to sell" agreement. The agreement provided that the plaintiff-broker would be entitled to his sales commission if within six months of the expiration of the brokerage agreement a sale was consummated by the seller that resulted from the broker's negotiations with a prospective buyer. Prior to the expiration of the exclusive sales agreement, the plaintiff-broker showed the seller's property to a prospective purchaser. No further actions or discussions were undertaken relative to this prospect by the broker. After the expiration of the exclusive sales agreement, but prior to the expiration of the six-month extension period, the property was sold by seller's new broker to the same purchaser to whom the plaintiff-broker had shown the property. The plaintiff-broker commenced the instant action against the seller claiming that the sale by the subsequent broker during the plaintiff's six-month extension was attributable to the negotiations of the plaintiff-broker, and that the plaintiff was entitled to his commission under the terms of the agreement. The court, in holding against the plaintiff-broker, stated the following:

[I]n the absence of extrinsic evidence suggesting that the parties to such a contract intended a contrary meaning, the term "negotiating" in the context of the extension clause of a real estate broker's contract means a dialogue aimed at the adjustment or resolution of differences in order to strike a bargain. It involves more than the mere showing of property that is offered for sale or the unilateral provision of information concerning the property.

Cf. Judd Realty, Inc. v. Tedesco, 400 A.2d 952 (R.I. 1979) (only where contract terms are ambiguous are they construed against the drafter).

(n37)Footnote 20. See:

Alabama: Davis v. Sherrill, 540 So. 2d 708 (Ala. 1989) , in which the court held that where material issues of fact exist as to whether a commission-splitting agreement was limited to a particular offer or not, summary judgment cannot be granted. In the case at bar, a dispute over real estate brokerage fees arose. The court found that the contract signed by both parties was ambiguous, inasmuch as it did not make clear whether the parties to the contract intended a commission to be paid regardless of the sale price. Accordingly, genuine issues of material fact existed which required resolution by a fact finder. As a result, the lower court's grant of summary judgment was in error and the case was remanded for a new trial.

In *ERA Commander Realty, Inc. v. Harrigan*, 514 So. 2d 1329 (Ala. 1987) , the Supreme Court of Alabama held that where there is an inconsistency in a brokerage agreement, the specific, unambiguous, type-written provisions of the addendum prevailed over the general printed language of the preamble.

South Dakota: Dail v. Vodicka, 89 S.D. 600, 237 N.W.2d 7 (1975) .

Generally, where typed portions of a brokerage contract are at variance or in conflict with printed provisions, the typed portions take precedence and are controlling. See *Planck v. Traders Diversified, Inc.*, 387 So. 2d 440, 442 (Fla. DCA 1980) petition dismissed, 394 So. 2d 1153 (Fla. 1981) .

In Texas, however, parol evidence may not be supplied to identify a broker, where the reference in the subject real estate brokerage agreement is merely to "outside brokers." Thus, a document in which a purchaser of commercial property acknowledged a debt to "outside brokers," but did not provide a listing of their names, fails to narrow down the universe of potential brokers, so that the name of a particular broker is not being supplied entirely by parol evidence. Thus, in such a case, parol evidence may not be used to identify a broker. *Boyert v. Tauber*, 834 S.W.2d 60, 35 Tex. Sup. Ct. J. 1092 (Tex. 1992) .

(n38)Footnote 20.1. See *Glenlakes Realty Co. v. Norwood*, 721 So. 2d 174, 179 (Ala. 1998) .

(n39)Footnote 20.2. See *Grubb & Ellis Management Services, Inc. v. 407417 B.C., L.L.C.*, 138 P.3d 1210, 1216 (Ariz. Ct. App. 2006) (The parties' management agreement with respect to commercial property "clearly and unequivocally" stated the landlord's obligation to indemnify the broker for its negligent management of the premises.), review denied, 2007 Ariz. LEXIS 5 (Jan. 9, 2007) .

(n40)Footnote 21. See § 2.03[3] *infra*.

(n41)Footnote 22. The written contract would resolve any possible differences as to the nature and extent of the broker's authority. It would also be important in a suit for a commission where there was a disagreement as to the broker's function, *i.e.*, as a finder or as a broker.

(n42)Footnote 22.1. See *Stewart v. Sisson*, 711 N.W.2d 713, 717 (Iowa 2006) .

(n43)Footnote 23. It has been observed that a majority of jurisdictions adhere to the rule that a land description in a broker's contract need only show that the property attempted to be described in the contract is the same property to be listed by the broker.

See *Morris v. Savannah Valley Realty, Inc.*, 233 Ga. App. 762, 505 S.E.2d 259, 262 (Ga. App. 1998) (property description in broker's listing agreement does not need to be as definite and complete as that which should be made in deeds of conveyance); *Orr v. Smith*, 102 Ga. App. 40, 115 S.E.2d 601 (1960) . A listing agreement which describes the

property by reference to its ownership, location and approximate size has been held to sufficiently describe the property. See *Callies v. O'Neal*, 147 Idaho 841, 216 P.3d 130 (Idaho 2009), *reh'g denied*, 2009 Ida. LEXIS 155 (Aug. 20, 2009); *Central Idaho Agency, Inc. v. Turner*, 92 Idaho 306, 442 P.2d 442 (1968), cited in *Brazo v. Real Estate Comm'n*, 177 Conn. 515, 418 A.2d 883, 889 (1979).

See generally Note, *Sufficiency of a Property Description in a Real Estate Broker's Listing Agreement*, 11 Willamette L.J. 308 (1975).

(n44)Footnote 24. Even in states that do not have a provision in their statute of frauds requiring brokerage contracts to be in writing, the state licensing statute or rules and regulations covering brokers may require written listing agreement.

(n45)Footnote 24.1. Cf. *Commercial Ventures, Inc. v. The Rex M. & Lynn Lea Family Trust*, 177 P.3d 955, 963 (Idaho 2008) (brokerage agreement requires the signature of both the owner and broker as it is not a unilateral contract the broker can accept by full performance.), *reh'g denied*, 2008 Ida. LEXIS 36 (Idaho Feb. 15, 2008).

(n46)Footnote 25. See:

Connecticut: *Real Estate Listing Service, Inc. v. Connecticut Real Estate Commission*, 179 Conn. 128, 133, 425 A.2d 581, 584-85, 17 A.L.R.4th 753 (1979); *New England Retail Properties, Inc. v. Maturo*, 102 Conn. App. 476, 479 n. 2, 925 A.2d 1151, 1155 n. 2 (2007), *appeal denied*, 284 Conn. 912, 931 A.2d 932 (2007).

Florida: *Osheroff v. Rauch Weaver Millsaps & Co.*, 882 So. 2d 503, 505 (Fla. Dist. Ct. App. 2004), *rehearing denied*, 2004 Fla. App. LEXIS 15617 (Fla. Dist. Ct. App. 4th Dist., Sept. 22, 2004), *review denied*, 2005 Fla. LEXIS 511 (Fla., Mar. 3, 2005).

Georgia: *Quantum Trading Corp. v. Forum Realty Corp.*, 278 Ga. App. 485, 629 S.E.2d 420 (2006) (procuring cause issues arise in cases involving open rather than exclusive listing arrangements.) *cert. denied*, 2006 Ga. LEXIS 740 (Sept. 18, 2006).

Illinois: *Lord v. Melton*, 80 Ill. App. 3d 1057, 36 Ill. Dec. 127, 400 N.E.2d 547 (1980).

New York: In *Re Fox's Will*, 126 N.Y.S.2d 158 (Surr. Ct. Jeff. Co. 1953).

(n47)Footnote 25.1. See *Daigle Commer. Group, Inc. v. St. Laurent*, 1999 ME 107, 734 A.2d 667, 673 (Me. 1999). See also *Heaton v. Boulders Properties*, 132 N.H. 330, 332, 566 A.2d 1127, 1128 (N.H. 1999) (using both terms).

(n48)Footnote 25.2. See *Antrim, Piper, Wenger, Inc. v. Lowe*, 37 Kan. App. 2d 932, 935, 159 P.3d 215, 219 (2007) *Daigle Commer. Group, Inc. v. St. Laurent*, 1999 ME 107, 734 A.2d 667, 673 (Me. 1999).

(n49)Footnote 25.3. See *Mapes v. City Council of the City of Walsenburg*, 151 P.3d 574, 579 (Colo. Ct. App. 2006), *cert. denied*, 2007 Colo. LEXIS 44 (Jan. 16, 2007); *W.W. Chambers, Inc. v. Audette*, 385 A.2d 10, 14 (D.C. 1978).

(n50)Footnote 25.4. See *Mapes v. City Council of the City of Walsenburg*, 151 P.3d 574, 579 (Colo. Ct. App. 2006), *cert. denied*, 2007 Colo. LEXIS 44 (Jan. 16, 2007); *W.W. Chambers, Inc. v. Audette*, 385 A.2d 10, 14 (D.C. 1978).

(n51)Footnote 26. See 19 N.Y.C.R.R. § 175.19(a).

Utah: *Wardley Corp. v. Welsh*, 962 P.2d 86, 88 n. 2 (Utah Ct. App. 1998).

See also:

Connecticut: New England Land Co. v. DeMarkey, 213 Conn. 612, 569 A.2d 1098 (1990) , the court held that a listing contract which did not identify the particular price at which the property was to be offered for sale, or a formula by which the price could be determined, failed to comply with statutory requirements. The court further found that the listing contract was devoid of any facts indicating any reservation to the seller in determining the sale price of the property. Upon these facts, the lower court erred by denying the seller's motion to dissolve or to vacate an *ex parte* prejudgment real estate attachment obtained by the brokerage company in conjunction with a claim for real estate commission.

New York: Bishop Estates v. Murphy, 41 Misc. 2d 719, 246 N.Y.S.2d 73, 1964 N.Y. Misc. LEXIS 2206 (1964) (there was held to be no "net listing" contract within the meaning of Section 175.19 where there was an agreement for brokers to sell real property for \$21,000 with sellers to receive \$20,000).

(n52)Footnote 27. *See, e.g.:*

Massachusetts: Mass. Gen. Laws Ann. § 112:87AAA(1).

New York: 19 N.Y.C.R.R. § 175.19(6).

Utah: Wardley Corp. v. Welsh, 962 P.2d 86, 88 n. 2 (Utah Ct. App. 1998) .

(n53)Footnote 28. *See Express Realty Co. v. Zinn*, 39 Misc. 2d 733, 241 N.Y.S.2d 954, 1963 N.Y. Misc. LEXIS 1882 (1963) , barring an action for commission by a brokerage firm which made a "net listing" to sell defendant's home. *See also Poritzky v. Graff*, 98 Misc. 2d 1112, 415 N.Y.S.2d 375, 1979 N.Y. Misc. LEXIS 2202 (1979) , *aff'd*, 103 Misc. 2d 903, 431 N.Y.S.2d 232, 1980 N.Y. Misc. LEXIS 2218 (1980) .

(n54)Footnote 29. *See Turnley v. Michael*, 15 S.W. 912 (Tex. Civ. App. 1891) .

See also Boysen v. Robertson, 70 Ark. 56, 68 S.W. 243 (1902) .

(n55)Footnote 30. *See Valley, Inc. v. Ward Parkway Bldg. Co., Inc.*, 3 Kan. App. 2d 131, 590 P.2d 1100 (1979) .

(n56)Footnote 31. In *Joseph M. Silverman, Inc. v. Harrison*, 498 A.2d 193 (D.C. App. 1985) , a subsequent sale of an apartment house through another broker gave rise to liability where the listing provided that the broker "will be considered the exclusive real estate broker in connection with the renting, leasing, or sale of the managed property and entitled to receive the customary real estate commission in connection with such service." In such case, the court held, the damages were to be measured by the facts which established what a "customary" commission was.

(n57)Footnote 32. *See § 2.03[2][a] supra* for a discussion of open listings.

(n58)Footnote 33. *See Brazo v. Real Estate Comm'n*, 177 Conn. 515, 418 A.2d 883 (1979) . *Cf. Colli v. Real Estate Comm'n*, 169 Conn. 445, 364 A.2d 167 (1975) (state real estate commission lacked jurisdiction to revoke or suspend licenses of real estate brokers who negotiated for sale of property with an owner known to have an exclusive agency listing agreement with another real estate agency, where the brokers negotiated not in their capacity as brokers but as principals).

(n59)Footnote 34. *See, e.g.:*

10-2 Real Estate Brokerage Law and Practice § 2.03

Florida: Fearick v. Smugglers Cove, Inc., 379 So. 2d 400, 403 (Fla. 1979) (if the sale, however, is to a ready, willing and able buyer procured by the broker, the owner is liable for the broker's commission) *Fischer-Gaeta-Cromwell, Inc. v. Oakwood St. Enters., LLC*, 997 So. 2d 1271, 1272 (Fla. Dist. Ct. App. 2009) .

Georgia: Dover Realty Co. v. Pecce, 295 Ga. App. 221, 222-23, 671 S.E.2d 257, 259 (2008) ; *Dolvin Realty Co. v. Jones*, 63 Ga. App. 351, 352, 11 S.E.2d 105, 106 (1940) .

Illinois: Flynn v. La Salle Nat'l Bank, 9 Ill. 2d 129, 137 N.E.2d 71, 76 (1956) .

Kansas: Premier Realty, LLC v. I.T.J. Investments, Inc., 42 Kan. App. 2d 148, 157, 209 P.3d 741, 748 (2009) (no express agreement to pay a commission if the property was gifted during the listing period).

Louisiana: Hebert v. Lebouef, 487 So. 2d 1272 (La. Ct. App.) , cert. denied, 491 So. 2d 384 (La. 1986) , in which the court addressed the impact of a lease-purchase agreement, made by the owner of the subject property with a third party, on the broker's right to commission under an exclusive listing contract. In this case, Herbert secured an exclusive listing to sell Lebouef's home. Prior to the expiration of the listing contract, Lebouef was approached by Broussard to negotiate an acquisition of the house. The negotiations which occurred during the period of the exclusive listing agreement resulted in "an agreement for [a] lease-purchase contract." During the negotiations, a deposit was paid by Broussard to Lebouef. A written agreement was later executed by Lebouef and Broussard after the expiration of the exclusive listing. When Broussard exercised his option to buy two years later, Herbert sued for his commission. Lebouef put forth two arguments to defeat Herbert's claim for commission. First, Lebouef argued that any agreement with Broussard was made with "no effort on the part of Herbert" and, furthermore, Herbert knew about the arrangement with Broussard and such knowledge placed some duty on Herbert to contact Broussard. Second, Lebouef argued that the arrangement between Lebouef and Broussard was not a sale and consequently no commission was due. In rejecting both of these arguments, the court explained that the listing contract clearly stated in unequivocal language that the agent was due a commission even if the property was sold by the owner. The court further stated that when the sale was ultimately consummated through the exercise of the option, the agent's commission became due. In this regard the court expressly adopted the reasoning of the trial judge, stating that a different construction of the facts of the case "would invite parties to conspire intentionally to deprive real estate agents of commissions due them pursuant to contract by permitting them to enter into lease purchase agreements for a period of time until the Realtor's contract has in fact expired."

New Mexico: Clodfelter v. Plaza Ltd., 102 N.M. 544, 698 P.2d 1 (1985) , wherein the court held that an exclusive agency granted by a property owner to a broker restricts the right of a property owner to engage the services of another broker. Here, a real estate broker brought an action against property owners to recover the commission due on the sale of certain property in Taos which was sold through a second broker. The court stated that although the brokerage agreement provided that the broker would not receive a commission if the property was sold solely through the efforts of the owners, this merely meant that the owners themselves must arrange the sale and not another broker. Accordingly, the owners' action of selling the property through a second broker constituted a breach of contract.

New Jersey: Kislak Co., Inc. v. Geldzahler, 210 N.J. Super. 255, 509 A.2d 320 (1986) , where the Superior Court of New Jersey held that a vendor violated an exclusive sales agreement with a real estate broker by failing to report what the vendor termed a "non-serious" inquiry. The agreement between the vendor and the real estate broker provided that *only* the broker would have the right to sell the vendor's house, and that any inquiries made to the vendor by an interested buyer would also be conveyed to the

broker. A buyer contacted the vendor, but the vendor maintained that this buyer was not serious and hence he did not tell the broker. The court held that the agreement between the vendor and broker did not distinguish between a serious and "non-serious" buyer, hence the vendor was in violation of the agreement, entitling the broker to the commission as stipulated in the agreement.

New York: Solid Waste Institute, Inc. v. Sanitary Disposal, Inc., 120 A.D.2d 915, 502 N.Y.S.2d 835, 1986 N.Y. App. Div. LEXIS 57000 (3d Dept. 1986), wherein an appellate court found that where a seller sold his own property, and the broker had no unequivocal exclusive right to sell, the broker was not entitled to a commission on the sale of the seller's business. The agreement between the broker and the seller included a heading and preamble entitled "exclusive right to sell." However, the term "exclusive right to sell" was not defined and there was a provision in the agreement which stated that the commission would be earned "if consultant delivers a ready, willing and able buyer." 120 A.D.2d at 916-17. The court found that this statement was inconsistent with an entitlement to a commission upon an independent sale by the owner.

(n60)Footnote 35. *Dorman Realty & Insurance Co., Inc. v. Stalvey*, 264 S.C. 94, 212 S.E.2d 591 (S.C. 1975).

(n61)Footnote 36. See, e.g., Nev. Rev. Stat. § 645.320(2).

(n62)Footnote 37. Cf. *Hearrold v. Gries*, 115 Ariz. 560, 566 P.2d 1036 (Ariz. 1977) (broker not entitled to a commission on a sale that took place after the broker's exclusive listing had expired, even though the sale was to one whom the broker had procured).

(n63)Footnote 38. *Mellos v. Silverman*, 367 So. 2d 1369 (Ala. 1979). See *Exit A Plus Realty v. Zuniga*, 395 N.J. Super. 655, 663-64, 930 A.2d 491, 496 (App. Div. 2007). See also *Roberts v. Coldwell Banker Kinard Realty*, 286 Ga. App. 7, 9-10, 648 S.E.2d 442, 444-45 (2007) (Broker failed to meet the listing agreement's requirement that the buyer was "introduced to the property by the Broker" while the agreement was in effect.). Cf. *Business Consulting Services, Inc., v. Wicks*, 703 N.W.2d 427, 431 (Iowa 2005) (broker entitled to commission under an extension clause if the broker can establish a causal connection between the broker's actions and the purchaser) *Burkett & Associates, Inc. v. Teymer*, 318 Wis. 2d 525, 531-33, 767 N.W.2d 623, 627, 2009 WI App 67 (2009) (discussing what constitutes negotiation in the context of a protected buyer). See generally J.R. Kemper, Annot., *Construction of Provision in Real-Estate Broker's Listing Contract that Broker Shall Receive Commission on Sale After Expiration of Listing Period to One with Whom Broker Has "Negotiated" During Listing Period*, 51 A.L.R.3d 1149 (1973).

(n64)Footnote 39. 367 So. 2d at 1371. See also *Eitel v. Owen*, 284 S.W.3d 147, 148 (Ky. Ct. App. 2008) (where the listing agreement covers a definite time, the broker may recover a commission when a sale outside this time occurs and there is evidence that the owner deferred the sale until that time period for the purpose of circumventing the broker's right to the commission).

(n65)Footnote 39.1. Such an extension clause have also been referred to as a "tail." See *Rosenberg v. Heritage Renovations, LLC*, 685 N.W.2d 320, 323-324 (Minn. 2004), rehearing denied, 2004 Minn. LEXIS 535 (Minn. Aug. 19, 2004); *Prudential Kahler Realtors v. Schmitendorf*, 673 N.W.2d 663, 664, 2003 SD 148 (S.D. 2003); *Roger Crane & Associates, Inc. v. Brooks*, 74 Wn. App. 769, 774-775, 875 P.2d 705, 708 (1994).

(n66)Footnote 39.2. See *Easton Business Opportunities, Inc. v. Town Executive Suites*, 2010 Nev. LEXIS 14, at *2 (2010).

(n67)Footnote 39.3. See *Douglas v. Schuette*, 607 N.W.2d 142, 145-146 (Minn. App. 2000), review denied 2000 Minn. LEXIS 301 (2000).

(n68)Footnote 39.4. See *Douglas v. Shuette*, 607 N.W.2d 142, 146 (Minn. App. 2000), review denied 2000 Minn.

LEXIS 301 (2000) ; *Realty House, Inc. v. Grimm*, 460 N.W.2d 917, 919-920 (Minn. App. 1990) . See also *Gattermeir-Elliott Real Estate Co., L.L.C. v. K.H., Inc.*, 184 S.W.3d 188, 193 (Mo. Ct. App. 2006) (broker failed to notify seller of potential lessee via certified or registered mail as required in the listing agreement, broker was not entitled to commission when the property was leased after the listing expired). Cf. *Sonday v. Dave Kohel Agency, Inc.*, 2006 WI 92, 293 Wis. 2d 458, 477, 718 N.W.2d 631, 640 (2006) (A provision entitling a broker to commission after the listing has expired is read strictly against the broker). But cf. *Reece & Nichols Realtors v. Zoll*, 201 S.W.3d 516, 519-20 (Mo. Ct. App. 2006) (A buyer's broker was allowed to recover a commission against a buyer because the broker had substantially complied with the brokerage agreement with respect to the buyer's purchase of a home after the agreement had expired).

(n69)Footnote 39.5. See *The Huffines Co., LLC v. Lockhart*, 365 S.C. 178, 194-195, 617 S.E.2d 125, 133 (S.C. Ct. App. 2005) , rehearing denied, 2005 S.C. App. LEXIS 190 (S.C. Ct. App., Aug. 26, 2005) cert. denied, 2007 S.C. LEXIS 35 (S.C. Jan. 18, 2007) ; *Trimble v. Wescom*, 267 Neb. 224, 230, 673 N.W.2d 864, 868 (2004) .

(n70)Footnote 39.6. See *Rosenberg v. Heritage Renovations, LLC*, 685 N.W.2d 320, 323-324 (Minn. 2004) , rehearing denied, 2004 Minn. LEXIS 535 (Minn. Aug. 19, 2004) , citing Minn. Stat. § 82.195; Norwood and Hyde, *Extension Clauses in Louisiana Listing Agreements*, 42 La. L. Rev. 1011, 1012-13 (1982) (footnote omitted). See also *Telluride Real Estate Co. v. Penthouse Affiliates, LLC*, 996 P.2d 151, 154 (Colo. App. 1999) , cert. denied, 2000 Colo. LEXIS 499 (Colo. 2000) . (court rejected the argument that a statute regulating the relationships between real estate brokers and sellers was intended to supplant existing common law; the statute did not eliminate the common law procuring cause remedy).

(n71)Footnote 39.7. See *Mayo v. Century 21 Action Realtors, Inc.*, 823 S.W.2d 466, 469 (Ky. Ct. App. 1992) ; *King v. Dean*, 19 Ohio St. 2d 17, 48 Ohio Op. 2d 10, 249 N.E.2d 45, 47 (1969) . See also *Easton Business Opportunities, Inc. v. Town Executive Suites*, 2010 Nev. LEXIS 14, at *19-*20 (2010) (calling this the minority view).

(n72)Footnote 39.8. See *Shands v. Wm R. Winton, Ltd.*, 91 P.3d 416, 419 (Colo. Ct. App. 2003) , reh'g denied, 2003 Colo. App. LEXIS 1964 (Colo. Ct. App. Dec. 18, 2003) , cert denied, 2004 Colo. LEXIS 431 (Colo. May 24, 2004) ; *Monadnock Ins. Agency v. Manning*, 117 N.H. 508, 510-511, 374 A.2d 961, 963 (1977) ; *Easton Business Opportunities, Inc. v. Town Executive Suites*, 2010 Nev. LEXIS 14, at *20-*22 (2010) (adopting this view and calling it the majority view).

(n73)Footnote 40. See, e.g., N.J. Stat. Ann. § 45:15-17(f).

(n74)Footnote 41. See *Carnell v. Watson*, 176 Mont. 344, 578 P.2d 308 (1978) (real estate broker's failure to furnish seller copy of listing agreement required by a statute barred broker's recovery of commission).

(n75)Footnote 42. See, e.g.:

Federal: Van Schaack Land Co. v. Hub & Spoke Ranch Co., 244 F. Supp. 2d 1231, 1249 (D. Kan. 2003) , applying Kansas law.

Alaska: Dahl v. Griffin, 652 P.2d 84 (Alaska 1982) .

Arkansas: Atkins v. L.L. Cole & Sons, Inc., 79 Ark. App. 124, 84 S.W.3d 899 (Ark. Ct. App. Sept. 18, 2002) .

Georgia: OTI Shelf, Inc. v. Schair & Assocs., Inc., 238 Ga. App. 12, 517 S.E.2d 542, 544 (1999) .

Illinois: In Hammel v. Degenhardt, 139 Ill. App. 3d 241, 93 Ill. Dec. 742, 487 N.E.2d 409 (1985) , the court held that property transferred by warranty deed in consideration for cancellation of a debt was

"sold" so as to entitle the broker to the commission. Moreover, a written real estate listing contract was deemed by the court to be an instrument of writing entitling the broker to pre-judgment interest. The property was sold during the time allotted in the exclusive right to sell agreement, although the deed was executed one day after the expiration of the exclusive agreement.

In *Bolger v. Danley Lumber Co., Inc.*, 77 Ill. App. 3d 207, 32 Ill. Dec. 685, 395 N.E.2d 1066 (1979), it was found that a broker had a right to a commission under an agreement that specifically provided for the broker to earn a commission if the subject property was sold by the broker, the vendor or "by or through any other person" during the exclusive listing period. The broker in the instant case was not the procuring cause of the sale and the vendor and vendee did not transform their agreement into writing until after expiration of the exclusive listing period.

Flynn v. La Salle Nat'l Bank, 9 Ill. 2d 129, 137 N.E.2d 71 (1956) .

Nebraska: Kerry-Rand & Associates v. Peddicord, 215 Neb. 798, 340 N.W.2d 880 (1983) .

South Carolina: Wilbur Smith, etc. v. National Bank of S.C., 263 S.E.2d 643 (S.C. 1980) .

South Dakota: Berven Co. v. Newman, 281 N.W.2d 268 (S.D. 1979) .

(n76)Footnote 43. See, e.g.:

Iowa: Hedges Co. v. Shanahan, 195 Iowa 1302, 190 N.W.957 (1922) .

Wyoming: E & E Mining, Inc. v. Flying "D" Group, Inc., 718 P.2d 58 (Wyo. 1986) .

But see *Torrey and Dean, Inc. v. Coyle*, 138 Or. 509, 7 P.2d 561 (1932) .

(n77)Footnote 43.1. See *Shands v. Winton*, 91 P.3d 416, 2003 Colo. App. LEXIS 1783, at *7 (Colo. Ct. App. Nov. 20, 2003), rehearing denied, 2003 Colo. App. LEXIS 1964 (Colo. Ct. App., Dec. 18, 2003) .

(n78)Footnote 44. Exclusive agency listings are agreements under which a particular broker is employed and no other. See § 2.03[2][c] *supra*. See also § 2.03[2][d] *supra* (discussing the "exclusive right to sell").

(n79)Footnote 45. See National Association of Realtors(R) (NAR), Membership Policy and Procedures Manual 7 (1973). See also extensive coverage of the MLS at § 2.04 *infra* .

(n80)Footnote 46. See Comment, *Exclusion of Real Estate Multiple Listing Services as Antitrust Violations*, 14 Calif. W.L. Rev. 300, 302 (1978).

(n81)Footnote 47. *Id.* See also *Frisell v. Newman*, 71 Wash. 2d 520, 527, 429 P.2d 864, 868 (1967) .

(n82)Footnote 48. See Comment, *Exclusion of Real Estate Multiple Listing Services as Antitrust Violations*, 14 Calif. W.L. Rev. 300, 302 (1978). Participating brokers generally pay an initial participation fee to the MLS and a basic participation charge payable periodically. *Id.* at 302, n. 31.

(n83)Footnote 49. See *Goodwin v. Glick*, 139 Cal. App. 2d Supp. 936, 294 P.2d 192 (1956) .

(n84)Footnote 50. See *Evanston-North Shore Bd. of Realtors v. United States*, 320 F.2d 375 (U.S. Ct. Cl. 1973), cert. denied, 376 U.S. 931 (1964) .

See also Austin, *Real Estate Boards and Multiple Listing Systems as Restraints of Trade*, 70 Colum. L. Rev. 1325, 1330 (1970), where the author observes that:

The use of the multiples has ... had a significant positive impact on the individual sales transaction. The transactional benefits are fairly evenly distributed among the broker, the buyer, and the seller. In the absence of the multiple, a seller has three alternatives: first, he can sell the property himself, a course of action requiring facilities and expertise which most home owners do not possess; second, he can use an open listing; third, he can give a broker the exclusive right to sell. The multiple allows him to combine the advantages of the last two alternatives and to avoid the dangers of the first. The buyer benefits from the wider selection of purchase opportunities than would be available from the office of a single broker. In addition, there is a time-saving factor: 'The buyer often has to spend only a short time in the office selecting properties to inspect, merely by carefully screening the MLS sheets.' The broker is particularly benefited by having immediate access to a large number of listings and at the same time by being furnished with a method for quickly and expansively exposing his own listings to a broader market. The likelihood of the interlinking of all multiple listing systems dramatizes the present and future value of this technique. The success of multiple listing has been described in the following terms:

'Never before in the history of selling has a selling service of this magnitude been offered to the property owner A great proportion of listings filed with the organization are sold. It is estimated that the average individual real estate broker cannot expect to sell more than 1% of the listings he receives; whereas this cooperative service has consistently been instrumental in selling 30-45% of the listings filed.' (Footnotes omitted).

(n85)Footnote 51. See National Association of Realtors, Handbook on Multiple Listing Policy 77 (1975). Local boards commonly are associated with a state and national organization, the national organization being the National Association of Realtors(R) (NAR). The NAR promulgates a constitution, by-laws, and code of ethics for member boards to follow. See Comment, *Exclusion of Real Estate Multiple Listing Services as Antitrust Violations*, 14 Calif. W.L. Rev. 300 (1978).

(n86)Footnote 52. See Comment, *Exclusion of Real Estate Multiple Listing Service as Antitrust Violations*, 14 Calif. W. L. Rev. 300, 302 (1978).

(n87)Footnote 53. 266 A.2d 1 (Md. App. 1970) .

(n88)Footnote 54. 304 A.2d 493 , cert denied, 414 U.S. 979 (1973) .

(n89)Footnote 55. 16 Cal. 3d 920, 130 Cal. Rptr. 1, 549 P.2d 833 (Cal. 1976) .

(n90)Footnote 56. 629 F.2d 1351 (5th Cir. 1980) .

(n91)Footnote 57. 604 F.2d 1143 (8th Cir. 1979) .

(n92)Footnote 58. See *Supermarket of Homes, Inc. v. San Fernando Valley Bd. of Realtors*, 786 F.2d 1400 (9th Cir. 1986) .

(n93)Footnote 59. See *Park v. El Paso Bd. of Realtors*, 764 F.2d 1053, 1061 (5th Cir. 1985) , cert. denied, 474 U.S. 1102, 106 S. Ct. 884, 88 L. Ed. 2d 919 (1986) .

(n94)Footnote 60. See, e.g., Miss. Code Ann. § 15-3-1(c).

10-2 Real Estate Brokerage Law and Practice § 2.03

(n95)Footnote 60.1. *See, e.g., Ariz. Rev. Stat. § 44-101(7); Cal. Civ. Code § 1624(a)(3) and (4).*

(n96)Footnote 60.2. *See Strategic Alliance Partners, LLC v. Dress Barn, Inc.*, 386 F. Supp. 2d 312, 316 (S.D. N.Y. 2005) , applying New York law ("An oral brokerage agreement is enforceable under New York law and does not violate the Statute of Frauds."); *Cloverleaf Plaza, Inc. v. Cooper & Co.*, 565 So. 2d 1147, 1149 (Ala. 1990) . ("[I]n Alabama, a contract between a seller and real estate broker, whereby the broker is to procure a purchaser for realty, need not be in writing.").

(n97)Footnote 60.3. *See, e.g., Alaska Stat. § 08.88.341* (real estate listings and management contracts); *D.C. Code Ann. § 42-1705* (listing contract); *Neb. Rev. Stat. § 36-107* (contracts for the sale of lands between the owner and any broker or agent employed to sell the same must be written) *Brochu v. Santis*, 939 A.2d 449, 453 (R.I. 2008) , citing *R.I. Gen. Laws § 9-1-4 (6)*. *But see Rocky Top Realty, Inc. v. Young*, 2010 Tenn. App. LEXIS 37, at *10 (Jan. 13, 2010) (In Tennessee a brokerage agreement may be oral.).

(n98)Footnote 60.4. *See, e.g., 24 Del. Code Regs. § 7.1.1* which states, "Listing Agreements for the rental, sale, lease or exchange of real property, whether exclusive, co-exclusive or open shall be in writing and shall be signed by the seller or owner."

(n99)Footnote 60.4.1. *But see Scheerer v. Fisher*, __ N.C. App. __, 688 S.E.2d 472, 475 (2010) (Oral brokerage agreement was not void. The fact that regulations required that the agreement be in writing had no effect on the agreement's validity. Instead, the oral agreement may subject the licensee to discipline by the Real Estate Commission).

(n100)Footnote 60.4.2. *See Matthews v. Olympus Construction, Inc. (In re Olympus Constr., LC)*, 173 P.3d 192, 196, 2007 UT App 361 (2007) , *aff'd in part, rev'd in part*, 2009 UT 29, 215 P.3d 129 (2009) .

(n101)Footnote 60.4.3. *See Uhar & Co. v. Jacob*, 2010 U.S. Dist. LEXIS 43025, at *18-*19 (D.D.C. May 3, 2010) ; *C. Porter Vaughan, Inc. v. DiLorenzo*, 689 S.E.2d 656, 660-61, 2010 Va. LEXIS 33 (Va. 2010) ; *Murphy v. Nolte & Co., Inc.*, 226 Va. 76, 81, 307 S.E.2d 242, 245 (1983) .

(n102)Footnote 60.5. 493 So. 2d 361 (Miss. 1986) .

(n103)Footnote 60.6. 493 So. 2d 361, 365 (Miss. 1986) .

(n104)Footnote 60.7. *See In re Estate of Grimm*, 705 N.E.2d 483, 492 (Ind. App. 1999) , *rehearing denied by, Grimm v. Kruse*, 1999 Ind. App. LEXIS 2373 (Ind. Ct. App. Mar. 26, 1999) , *transfer denied by, Grimm v. Kruse*, 726 N.E.2d 302, 1999 Ind. LEXIS 770 (Ind. 1999) .

(n105)Footnote 61. *N.Y. Gen. Oblig. L. § 5-701.*

(n106)Footnote 62. *N.Y. Gen. Oblig. L. § 5-701(a)(10)*. The statute does include contracts to pay compensation for "services rendered in negotiating a loan, or in negotiating the purchase, sale, exchange, renting or leasing of any real estate or interest therein, or of a business opportunity, business, its good will, inventory, fixtures or an interest therein."

The foregoing would appear to be neutralized by the requirement for licensing (*N.Y. Real Prop. L. § 440 et seq.*) and its only sensible reading would suggest that it emphasizes the exclusion of licensed real estate brokers from the ambit of the statute--the only ones permitted to engage in brokerage negotiating activity (*N.Y. Real Prop. L. § 440 et seq.*).

In *L.B. Kaye Assocs. v. Jews for Jesus*, 677 F. Supp. 160 (S.D.N.Y. 1988) , the court held that plaintiff broker, due to an oral brokerage agreement, was entitled to a \$30,000 commission, even though the deal did not close, since the defendants willfully defaulted. In the case at bar, the plaintiff produced a ready, willing and able purchaser in the defendant. The parties reached an oral agreement that the defendants would purchase the building and pay a brokerage commission to the plaintiff. The plaintiff delivered a standard form letter confirming the oral commission agreement,

stating that the commission would become due in the event of closing or willful default. The defendant never appeared at the scheduled closing, and did not offer any reason for refusal to close. The court found that the letter was a "mere memorialization of terms" that the parties agreed to in the oral agreement. The court held that the defendant willfully defaulted and refused to close title; therefore, plaintiff was entitled to receive its commission.

See also *Strategic Alliance Partners, LLC v. Dress Barn, Inc.*, 386 F. Supp. 2d 312, 316 (S.D.N.Y. 2005), applying New York law ("An oral brokerage agreement is enforceable under New York law and does not violate the Statute of Frauds."); *Hampton Realty of Bridgehampton, Inc. v. Conklin*, 631 N.Y.S.2d 887 (2d Dept. 1995) appeal denied, 87 N.Y.2d 805, 640 N.Y.S.2d 878, 663 N.E.2d 920 (N.Y. 1996) (buyer's alleged oral promise to "protect" the broker's commission was not in itself sufficient to create or preserve the broker's right to a commission).

(n107)Footnote 63. In *Wolf v. Wohl*, 103 Misc. 2d 1044, 431 N.Y.S.2d 743, 1980 N.Y. Misc. LEXIS 2249 (1980), it was held that a contract to pay compensation for services rendered in negotiating the sale of shares in a cooperative apartment came within the purview of Gen. Oblig. L. § 5-701. The court reasoned that a lease is both a contract and a conveyance of an estate or interest in land and a lease and occupancy of a cooperative apartment are inextricably related to the sale of shares in a cooperative corporation. Accordingly, where the plaintiff seeking compensation was not a licensed real estate broker or a salesperson and the agreement to pay a commission was not in writing, the plaintiff could not recover a commission.

It should be noted, of course, that an unlicensed broker would also be barred under the New York licensing statute from collecting his or her commission.

(n108)Footnote 64. See *Bottner v. Petchers*, 9 Misc. 2d 702, 170 N.Y.S.2d 570, 1957 N.Y. Misc. LEXIS 3011, *aff'd*, 16 Misc. 2d 671, 170 N.Y.S.2d 573, 1957 N.Y. Misc. LEXIS 1937 (1957). See also *Kassis Management, Inc. v. Milstein*, 198 A.D.2d 51, 603 N.Y.S.2d 458, 1993 N.Y. App. Div. LEXIS 10453 (1st Dept. 1993) (an oral brokerage agreement was unenforceable when the lease and executed contract of sale provided that the prospective purchaser could not exercise its option to purchase for at least six years after execution of the oral agreement).

But see *Cron v. Hargro Fabrics, Inc.*, 91 N.Y.2d 362, 670 N.Y.S.2d 973, 694 N.E.2d 56 (1998) (employment contract) ("New York law provides that an agreement will not be recognized or enforceable if it is not in writing and (subscribed by the party to be charged therewith(when the agreement ([b]y its terms is not to be performed within one year from the making thereof((General Obligations Law § 5-701 [a] [1])). We have long interpreted this provision of the Statute of Frauds to encompass only those contracts which, by their terms, (have absolutely no possibility in fact and law of full performance within one year((citation omitted). As long as the agreement may be (fairly and reasonably interpreted(such that it may be performed within a year, the Statute of Frauds will not act as a bar however unexpected, unlikely, or even improbable that such performance will occur during that time frame ... (citations omitted)."), discussed in J. Wicks & E. Penzer, *Now Brokers May Be Able to Enforce Unwritten Long-Term Agreements*, N.Y.L.J., July 1, 1998, at 1.

(n109)Footnote 65. See, e.g., *Schwartz v. Mayer*, 198 Misc. 210, 97 N.Y.S.2d 773, 1950 N.Y. Misc. LEXIS 1703 (1950) (business broker).

(n110)Footnote 66. See *Klein v. Smigel*, 44 A.D.2d 248, 354 N.Y.S.2d 117, 1974 N.Y. App. Div. LEXIS 5316 (1st Dept 1974), *aff'd*, 36 N.Y.2d 809, 370 N.Y.S.2d 897, 331 N.E.2d 679 (1975) (finder's fee in acquisition of corporation); *Minichiello v. Royal Business Funds Corp.*, 18 N.Y.2d 521, 277 N.Y.S.2d 268, 223 N.E.2d 793 (1966), *cert denied*, 389 U.S. 820 88 S. Ct. 41, 19 L. Ed. 2d 72 (1967) (action in *quantum meruit* to recover reasonable value of services rendered in procuring an investment opportunity).

(n111)Footnote 67. See, e.g.:

Federal: In *Amato & Stella Assocs., Inc. v. Florida North Investments, Ltd.*, 678 F. Supp. 445 (D. Del. 1988), the court dismissed a breach of contract claim where the underlying oral listing agreement was

unenforceable. In the case at bar, the defendant contracted with the plaintiff, a licensed Delaware real estate broker, with regard to selling his apartment complex. According to the plaintiff, the parties reached an oral listing agreement. Plaintiff found a buyer and reduced his commission in order to consummate the deal. According to the plaintiff, the parties reached an agreement by signing three documents: a contract for deed, a management agreement and a supplementary agreement. After executing the documents, the defendant agreed to sell the apartment complex to another buyer who could give an immediate down payment. The defendant did not inform the plaintiff or the initial prospective buyer. The plaintiff brought suit to recover the commission from defendant. The court looked at the relevant Delaware statute and held that the contract for deed, a management agreement and a supplementary agreement did not amount to a contract nor a binding option since no consideration was exchanged. The court, using Delaware precedent, found that one of the purposes of the statute is to protect the public, and thus while oral listing agreements were not void, they were voidable if a proper objection is made. The court also properly refused a claim for recovery premised on quantum meruit grounds.

California: The Supreme Court of California has abandoned the rule that unlicensed finders in the sale of a business which includes the transfer of real estate cannot avail themselves of traditional equitable remedies such as estoppel to plead the statute of frauds, where the underlying commission agreement is oral and thus unenforceable under the California statute of frauds. *See Tenzer v. Superscope, Inc.*, 39 Cal. 3d 18, 216 Cal. Rptr. 130, 702 P.2d 212 (1985) (en banc). In *Superscope*, the court noted that the rules withholding traditional equitable remedies from licensed real estate brokers who fail to secure a written commission agreement, and are thus barred by the California statute of frauds from receiving a commission, have been vigorously criticized as unjust in today's real estate market. However, the court stated as follows: "[W]hether or not there is merit in these arguments, we reserved for another day the question whether licensed brokers may invoke equitable remedies to avoid the sometimes harsh results of the statute of frauds." 216 Cal. Rptr. at 135, n.6 .

See also Beazell v. Schrader, 59 Cal. 2d 577, 30 Cal. Rptr. 534, 381 P.2d 390 (1963) .

Idaho: *Johnson v. McPhee*, 147 Idaho 455, 462, 210 P.3d 563, 570 (Idaho Ct. App. 2009) (part performance does not apply to statutes regulating real estate licensees), *review denied*, 2009 Ida. LEXIS 130 (July 8, 2009) .

Indiana: *Young v. Adams*, 830 N.E.2d 138, 143-145 (Ind. Ct. App. 2005) , *transfer denied*, 841 N.E.2d 189 (Ind. 2005) (part performance doctrine inapplicable to oral brokerage agreements which violate the statute of frauds); *Gerardot v. Emenhiser*, 173 Ind. App. 353, 363 N.E.2d 1072 (1977) .

Rhode Island: *Heyman v. Adeack Realty Co.*, 102 R.I. 105, 228 A.2d 578 (1967) .

A minority view permitted a broker to recover his expenses and the value of his services on the theory that the property owner would otherwise be unjustly enriched. *See Clinkinbeard v. Poole*, 266 S.W.2d 796 (1954) , overruled in *Louisville Trust Co. v. Monsky*, 444 S.W.2d 120, 122 (Ky. 1969) .

See Annot., *Real Estate Broker's Right to Recover in Quantum Meruit for Services Although Contract Is Not in Writing as Required by Statute*, 4 A.L.R.2d 905 .

(n112)Footnote 68. *See Russell v. Briggs*, 165 N.Y. 500, 59 N.E. 303 (1901) .

(n113)Footnote 69. *See N.Y. Gen. Oblig. L. § 5-701(a)(1)*.

See also *Gurney, Becker & Bourne, Inc. v. Simon*, 89 A.D.2d 795, 453 N.Y.S.2d 513, 1982 N.Y. App. Div. LEXIS 17912 (4th Dept. 1982), dismissing a broker's claim for a commission where the broker agreed to receive the commission over a ten-year period.

(n114)Footnote 70. If the lessee, however, could have exercised the option at any time and thus made the completion of the transaction possible within one year, the statute would not bar recovery. See, e.g., *Greiner-Maltz Co. v. Stevens*, 66 Misc. 2d 79, 319 N.Y.S.2d 512, 1971 N.Y. Misc. LEXIS 1741 (1971).

Note that to sustain a commission for an option or a renewal there would be need for an agreement to pay such a commission. It does not flow automatically from the initial transaction. See *Allwin Realty Co. v. Barth*, 161 App. Div. 568, 1914 N.Y. App. Div. LEXIS 5437, 146 N.Y.S. 960 (1st Dept. 1914); *Mullen & Woods, Inc. v. 615 W. 57th St., Inc.*, 146 Misc. 599, 1933 N.Y. Misc. LEXIS 1497, 262 N.Y.S. 467 (1933). Cf. *Zaniewski v. Mancinone* 37 Conn. Supp. 698, 701, 435 A.2d 50, 51-52 (1981), where broker's agreement called for the payment of a commission on renewals. See generally *Broker's Commission, Renewal of Lease*, 79 A.L.R.2d 1063 (1961).

Texas:

See *McDade & Co. v. Friendswood Dev. Co.*, 911 S.W.2d 541 (Tex. App. Beaumont 1995) affirmed in part and reversed in part, 926 S.W.2d 280 (Tex. 1996), rehearing of cause overruled, (Aug. 16, 1996) (requirement set forth in the Texas Real Estate License Act, that an action for the recovery of a commission may not be brought unless the promise or agreement upon which the action is based is in writing, barred the broker's suit, notwithstanding that the broker pled the suit as an action for breach of an agency agreement and not as an action for recovery of a commission).

(n115)Footnote 71. See, e.g., *Mosberg v. Judson Enterprises, Inc.*, 139 N.Y.S.2d 780, 1955 N.Y. Misc. LEXIS 3045 (1955). Cf. *Raymond Babtkis Assocs., Inc. v. Tarazi Realty Corp.*, 34 A.D.2d 754, 310 N.Y.S.2d 343, 1970 N.Y. App. Div. LEXIS 4940 (1st Dept 1970).

(n116)Footnote 72. The following jurisdictions have provisions in their statutes of frauds requiring a broker's employment contract to be in writing and signed by the party to be charged:

Alaska: Ala. Stat. § 09.25.010[8].

Arizona: Ariz. Rev. Stat. Ann. § 44-101[7].

California: Cal. Civ. Code § 1624(a)(4).

Hawaii: Hawaii Rev. Stat. § 656-1[6].

Idaho: Idaho Code § 9-508.

Indiana: Ind. Code Ann. § 32-21-1-10.

See also *Otto v. Pelis*, 640 N.E.2d 712 (Ind. App. 1994) (real estate salesperson was not barred by statute of frauds from bringing action against principal broker for nonpayment of commission on basis of oral contract; pertinent section of the statute of frauds applied only to contracts with owners of the real property).

Kentucky: Ky. Rev. Stat. § 371.010[8].

Michigan: Mich. Comp. Laws § 566.132[e].

Montana: Mont. Rev. Code Ann. § 28-2-903[e].

Nebraska: Neb. Rev. Stat. § 36-107.

See also Weiner v. Hazer, 230 Neb. 53, 430 N.W.2d 269 (Neb. 1988), in which the Supreme Court of Nebraska held that an oral contract for a commission was unenforceable as a result of the failure to satisfy the Nebraska statute of frauds. In *Weiner*, the seller offered certain real estate for sale. The broker presented to the seller a purchaser for the property, at which time the seller assured the broker that the usual six percent broker's commission would be paid when the transaction closed. The sale, however, never occurred. Thereafter, the broker produced another buyer for the real estate. This purchaser was ready, willing and able to purchase the property. The seller again assured the broker that he would receive his six percent commission at the time of closing. However, this commission agreement was not put in writing, and when the seller failed to pay the broker his commission, the broker brought an action to recover it. Relying on *Neb. Rev. Stat. § 36-107*, the Nebraska statute of frauds, the court dismissed the broker's suit for failure to state a cause of action. According to the Nebraska statute of frauds, every contract for a brokerage commission for the sale of land must be in writing, must be signed by both land owner and broker, must describe the land to be sold, and must set forth the compensation to be paid to the broker in the event of a sale by the broker. In this case, the amount of compensation the broker was to receive (i.e., six percent) was never put in writing as required by the statute. A mere statement by the seller that he will pay a commission, without specifying the amount of the commission or means to determine the commission, does not satisfy the statute of frauds. In the absence of a provision for compensation, the purposes of the statute would be ignored if oral testimony were allowed to establish any missing material term. In addition, the doctrine of equitable estoppel is not applicable. The broker was a licensed real estate broker and therefore charged with knowledge of Section 36-107 and its writing requirement for a specified real estate commission. Having this knowledge, broker could not have, in good faith, relied on an oral contract for his brokerage commission. Finally, although equitable enforcement of a contract may be available when a contract has been fully performed by one party and nonfulfillment of the contract would amount to a "fraud" on the performing party, here the broker only alleged full performance, which by itself is insufficient for such equitable relief.

In *Marathon Realty Corp. v. Gavin, 224 Neb. 458, 398 N.W.2d 689 (1987)*, the Supreme Court of Nebraska held that every contract between an owner of real property and any broker or agent employed to sell land in Nebraska is void unless the contract is in writing and subscribed by both the owner and the broker or agent. The court added that the contract must also describe the land to be sold and set forth the compensation to be allowed by the owner in case of sale by the broker or agent, citing *Neb. Rev. Stat. § 36-107*.

New Jersey: N.J. Stat. § 25:1-16.

See also A.S. Goldstein Co. v. Bloomfield Plaza Assocs., 272 N.J. Super. 59, 639 A.2d 347 (App. Div. 1994) cert. denied, 137 N.J. 309, 645 A.2d 138 (N.J. 1994) (commission on a lease is not a commission on a sale or exchange of real estate, and therefore is not governed by the statute of frauds).

New Mexico: N.M. Stat. Ann. § 70-1-43.

Oregon: Or. Rev. Stat. § 41.580(1)(g).

10-2 Real Estate Brokerage Law and Practice § 2.03

Rhode Island: R.I. Gen. Laws § 9-1-4[6].

Utah: Utah Code Ann. § 25-5-4(1)(e).

See also Machan Hampshire Properties, Inc. v. Western Real Estate & Dev. Co., 779 P.2d 230 (Utah Ct. App. 1989). The court held that a broker was not entitled to a commission where written correspondence between the broker and the sellers regarding the commission did not specify the elements of the contract, and thus did not satisfy the statute of frauds. In this case, the sellers and the broker exchanged correspondence regarding a parcel of land on which Omega Light Industrial Park was located. The broker was advised by the sellers that the property was for sale and that an offer had been accepted, but if the broker wished to show the property to prospective purchasers, then their offers would be back-up offers. The broker orally advised the sellers that it would keep a record of those people to whom it showed the property, and would forward to the sellers, by letter, the names of these people. The sellers orally agreed to this system. In the correspondence that followed, the broker periodically advised the sellers of the names of persons to whom the property was shown. One of these was a company by the name of Birtcher Investments. When the first offer to purchase the property fell through, the sellers notified the broker that Birtcher had been contacted prior to receipt of the broker's letter. Thereafter, the sellers entered into an agreement with Birtcher for the sale of the property. The broker then brought suit for breach of contract against the sellers, alleging that the written correspondence between the parties set forth an agreement. The trial court granted the sellers' motion for summary judgment, holding that the broker's claim was barred by the statute of frauds. In affirming, the court of appeals held that since the writings did not mention that a contract had been entered into by the parties whereby a commission would be paid by the sellers to the broker if the property were sold to Birtcher, the writing did not specify the elements of the contract and thus did not satisfy the statute of frauds. Although the letters could be read together as one memorandum, the court held that evidence of an agreement with respect to Birtcher was lacking, and that in fact, sellers expressly rejected the possibility of the existence of an agreement with respect to Birtcher when it advised the broker that Birtcher had been previously contacted.

Virginia: Va. Code Ann. § 11-2(7).

Washington: Wash. Rev. Code Ann. § 19.36.010[5].

Wisconsin: Wis. Stat. Ann. § 240.10.

Writing requirements in some states may be found, not in the jurisdiction's statute of frauds, but in the licensing statutes or in administrative rules and regulations governing real estate brokers and salespersons. *See, e.g.:*

Connecticut: Conn. Gen. Stat. Ann. § 20-325a (licensing statute, requiring a written contract in order to recover a commission).

Minnesota: Minn. Stat. Ann. § 82.18 (licensing statute, requiring a written listing before action for a commission may be commenced).

See also Poser v. Abel, 510 N.W.2d 224 (Minn. App. 1994) review denied, 1994 Minn. LEXIS 139 (Minn. Feb. 24, 1994) (a brokerage agreement that has not been signed by the party seeking enforcement may be enforceable if the party has agreed to, and has acted in conformity with, the contract).

Nevada: Nev. Rev. Stat. § 645.320 (1), requiring exclusive listing agreements to be in writing.

South Carolina: S.C. Code Ann. § 40-57-137(C) and (H), requiring all listing agreements to be in writing.

But see Marcotte Realty and Auction, Inc. v. Schumacher, 225 Kan. 193, 589 P.2d 570 (1979), holding that a regulation of the Kansas Real Estate Commission that required all listing agreements to be in writing was an attempt by the Commission to legislate that which was clearly beyond its authority to regulate and the regulation was void. The court observed that the Kansas statute of frauds (Kan. Stat. Ann. § 33-106) does not bar collection of a Realtor's commission under an oral agreement and thus, if a broker obtained a purchaser pursuant to an oral listing agreement, the broker would be entitled to the commission agreed upon.

(n117)Footnote 73. *Cal. Civ. Code § 1624(a)(4).*

In Phillippe v. Shapell Indus., Inc., 43 Cal. 3d 1247, 241 Cal. Rptr. 22, 743 P.2d 1279 (Cal. 1987) cert. denied, 486 U.S. 1011, 108 S. Ct. 1742, 100 L. Ed. 2d 205 (1988), rehearing denied, 487 U.S. 1243, 108 S. Ct. 2919, 101 L. Ed. 2d 950 (1988), the Supreme Court of California held that a licensed real estate broker could not, absent a showing of actual fraud, assert equitable estoppel against a statute of frauds defense in an action to recover a brokerage commission. In the instant case, there was no writing between the real estate broker and purchaser concerning a commission agreement sufficient to satisfy the statute of frauds (Cal. Civ. Code § 1624(d)). The only writing signed by the purchaser referred to different property. Otherwise, found the court, there was a total lack of meaningful terms and conditions of a commission agreement. The court found that the fact that the real estate broker's principal did not pay for the broker's services under an oral contract did not constitute unjust enrichment sufficient to support equitably estopping the principal from asserting the statute of frauds defense.

(n118)Footnote 74. *See Dura v. Walker, Hart & Co., 27 N.Y.2d 346, 318 N.Y.S.2d 289, 267 N.E.2d 83 (1971).*

(n119)Footnote 75. *See, e.g.:*

California: Wilson v. Anderson, 208 Cal. App. 2d 62, 25 Cal. Rptr. 105 (1962).

Florida: In Futch v. Head, 511 So. 2d 314 (Fla. DCA 1987) review denied, 518 So. 2d 1275 (Fla. 1987), the court held that an oral commission agreement between two brokers was enforceable and not governed by the statute of frauds because it did not involve the transfer of land from a party thereto and could be performed within one year. Plaintiff-cobroker entered into an oral agreement to assist the defendant-broker in the sale of property for what was determined to be a ten percent share of the broker's twenty percent interest in the property in issue. (The broker had received a twenty percent interest in the sold property as compensation for her efforts in consummating the sale). The court found the cobrokers to have been joint venturers and that the cobroker's performance of his promise under the agreement to introduce the broker to the purchasers entitled him to his ten percent share.

For decisions from other jurisdictions holding the state's statute of frauds inapplicable to agreements to share commissions *see:*

Rhode Island: Weiss v. G. L. & H. J. Gross Inc., 119 R.I. 600, 382 A.2d 170 (R.I. 1978) (broker and salesperson employee).

Utah: Fowler v. Taylor, 554 P.2d 205 (Utah 1976).

See also *Eggleston v. Johnson*, 524 S.E.2d 761, 762-763 (Ga. App. 1999) (court enforced an oral contract providing for an equal split of a commission between agents); *Jones v. Lee*, 126 N.M. 467, 971 P.2d 858, 867, 1999 NMCA 8 (N.M. App. 1998) (there is no requirement that agreements between brokers to share commissions be in writing).

(n120)Footnote 76. See, e.g., *Franklin v. Hansen*, 59 Cal. 2d 570, 30 Cal. Rptr. 530, 381 P.2d 386 (1963) . See also *In re Baldwin's Estate*, 34 Cal. App. 3d 596, 110 Cal. Rptr. 189 (1973) .

Compare the strict rule of construction adopted by the Supreme Court of Rhode Island in *Kates Corp. v. Kirshenbaum*, 122 R.I. 486, 409 A.2d 540 (1979) , which held that a real estate vendor's memorandum to a real estate broker, which failed either to state or to adapt from another writing the commission rate to be paid the broker, was inadequate to satisfy the statute of frauds.

(n121)Footnote 77. See *Beazell v. Schrader*, 59 Cal. 2d 577, 30 Cal. Rptr. 534, 381 P.2d 390 (1963) .

(n122)Footnote 78. See, e.g., *Barcelon v. Cortese*, 263 Cal. App. 2d 517, 69 Cal. Rptr. 657 (1968) .

The actual brokerage agreement need not always identify the broker if extrinsic evidence clarifies the broker's identity. See *Poser v. Abel*, 510 N.W.2d 224 (Minn. App. 1994) review denied, 1994 Minn. LEXIS 139 (Minn. Feb. 24, 1994) .

(n123)Footnote 79. See *Babcock v. Houston*, 33 Cal. App. 3d 858, 109 Cal. Rptr. 454 (1973) .

(n124)Footnote 80. See, e.g., *Barcelon v. Cortese*, 263 Cal. App. 2d 517, 69 Cal. Rptr. 657 (1968) .

(n125)Footnote 81. See *Woodbridge Realty v. Plymouth Dev. Corp.*, 130 Cal. App. 2d 270, 278 P.2d 713 (1955) .

(n126)Footnote 82. *Babcock v. Houston*, 33 Cal. App. 3d 858, 864, 109 Cal. Rptr. 454, 457-58 (1973) .

See:

Alaska: In *Ranier Fund, Inc. v. Blomfield Real Estate*, 717 P.2d 850 (Alaska 1986) , the court held that the Alaska statute of frauds was satisfied by a real estate brokerage commission agreement consisting of a letter from the lessor regarding the lessor's policy on brokerage commissions and a brokerage agreement to which the letter referred. The documents, found the court, satisfied the statute of frauds requirement in its description of the space to be leased and in its statement of the brokerage commission to be paid, which was delineated in terms of an amount payable per square foot to net rentable area. The letter and agreement, noted the court, both indicated that space would be leased in a new fourteen-story building even though they did not contain an exact description of what or how much space in the building would be leased.

California: *Babcock v. Houston*, 33 Cal. App. 3d 858, 109 Cal. Rptr. at 457-458 (1973) , holding that the description of property in a written exclusive real estate broker's contract as "Pacific Island Village No. III" was sufficient to satisfy the statute of frauds where it appeared that all the parties to the written contract knew the exact location and boundaries of the tract. See also *Kilroy v. Douglas Furniture of Calif., Inc.*, 25 Cal. Rptr. 2d 752 (Cal. App. 1993) (extrinsic evidence established a broker's entitlement to a commission for any modifications or extensions of the lease for up to 30 years).

Connecticut: In *Sticklor v. Woodland House Condominium, Inc.*, 9 Conn. App. 293, 518 A.2d 949 (1986) cert. denied, 202 Conn. 807, 520 A.2d 1288 (1987) , it was held that a broker could maintain an action

for a commission despite the broker's failure to identify specific units of his principal's condominium complex to be sold and the failure to set forth the sales price for those units. The defendant-owner of the condominium complex had argued that under Conn. Gen. Stat. § 20-325a(b), the above information had to be included in the brokerage agreement for the broker to be entitled to compensation. Under the statute a brokerage agreement must "contain the conditions of such contract or authorization." The appellate court found for the broker, stating that the provision in Section 20-325a(b) requiring that the written listing agreement contain "the conditions of such contract or authorization" referred to "the conditions of the listing contract and not to those of the sales contract. For the listing contract it suffices to identify the property being offered for sale and the price at which it is to be listed." 518 A.2d at 951. Therefore, it was not necessary that the contract specify the particular location and price of the units in order to comply with Section 20-325a(b)(4).

Minnesota: Poser v. Abel, 510 N.W.2d 224 (Minn. App. 1994) review denied, 1994 Minn. LEXIS 139 (Feb. 24, 1994) (where the brokerage agreement did not mention the party who was to receive the commission, a counter-offer that identified the specific broker entitled to the commission was read together with the brokerage agreement to provide all the essential terms of the agreement).

In New York, business finders' contracts are explicitly required to be in writing where the negotiation concerns a business opportunity or the purchase of real estate. *See also Link-Hellmuth, Inc. v. Carey*, 101 Ohio App. 3d 604, 656 N.E.2d 358 (Ohio App. 2d Dist. 1995) (in which the court, noting that Ohio has no such requirement, commented favorably upon the New York approach).

See generally: Sufficiency of a Property Description in a Real Estate Broker's Listing Agreement, 11 *Williamette L.J.* 308 (1975).

(n127)Footnote 83. *See, e.g.:*

Alaska: Alaska Rev. Stat. § 09.25.010[8].

Oregon: Or. Rev. Stat. § 41.580(1)(g).

Wisconsin: Wis. Stat. Ann. § 240.10.

(n128)Footnote 84.

Alaska: Alaska Rev. Stat. § 09.25.010[8].

Oregon: Or. Rev. Stat. § 41.580(1)(g).

While it can be seen that there are many jurisdictions that will allow a broker recovery under an oral agreement, the better practice for the broker would be to reduce the agreement to writing in all cases. Reference is here made to the suggestions for minimum requirements of a written agreement set out above in the introductory paragraph of § 2.03[2].

(n129)Footnote 84.1. *N.J. Stat. Ann. § 25:1-16(d)*.

(n130)Footnote 84.2. *See Schettino v. Roizman Dev., Inc.*, 310 N.J. Super. 159, 708 A.2d 446, 449 (N.J. Super. 1998) *aff'd*, 158 N.J. 476, 730 A.2d 797 (1999).

(n131)Footnote 84.3. See Neb. Stat. § 76-2422.

(n132)Footnote 84.4. See *McCully, Inc. v. Baccaro Ranch*, 279 Neb. 443, 448, 778 N.W.2d 115, 119 (2010) .

(n133)Footnote 84.5. See *McCully, Inc. v. Baccaro Ranch*, 279 Neb. 443, 448, 778 N.W.2d 115, 119-20 (2010) .

(n134)Footnote 85. *Martin v. Vincent*, 181 Mont. 247, 593 P.2d 45 (Mont. 1979) .

(n135)Footnote 86. See *Carroll v. Action Enters., Inc.*, 206 Neb. 204, 292 N.W.2d 34 (1980) .

See generally Annot., *Power of Real Estate Broker to Execute Contract of Sale in Behalf of Principal*, 43 A.L.R.2d 1014 .

(n136)Footnote 87. *Forbis v. Honeycutt*, 301 N.C. 699, 273 S.E.2d 240 (N.C. 1980) .

Authority in Writing: In New York, by statute, an agreement executed by an agent which affects real property is void unless the agent's authority is in writing. See *N.Y. Gen. Oblig. L. § 5-701(a)(1)*; *Lane-- The Real Estate Dept. Store, Inc. v. Lawlett Corp.*, 28 N.Y.2d 36, 319 N.Y.S.2d 836, 268 N.E.2d 635 (1971) *remitter denied*, 29 N.Y.2d 552 (1971) (section applies only where the agreement sought to be enforced is the main agreement that is within the statute of frauds and the party sought to be charged is the agent's principal; it does not apply to the right of a broker to his commission).

(n137)Footnote 88. See *Gresser v. Hotzler*, 604 N.W.2d 379, 385 (Minn. App. 2000) .

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19 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART I General Principles

CHAPTER 2 Overview of Brokerage Practice and the Organization of the Brokerage Industry *

10-2 Real Estate Brokerage Law and Practice § 2.04

§ 2.04 Study of Multiple Listing Service (MLS) Programsn*

[1] In General

Multiple Listing Services are organizations created by, and composed of, real estate brokers who do business in local geographic areas. n1 These organizations function to make information concerning the contracts to sell property ("listings") of each participating MLS broker known to all other MLS brokers. Multiples are structured as formal organizations with requirements for membership and participation.

The basic function of the real estate brokerage industry is to match buyers and sellers. n1.1 In relatively small residential real estate markets, the matching process can be accomplished by an individual broker. In such markets, the number of brokers and the number of houses for sale are sufficiently limited that brokers are able to obtain fairly complete information without the aid of a formal, centralized, market information-sharing mechanism. In larger markets, however, it becomes more difficult for individual brokers to gather complete information about the housing market. MLSs accomplish this necessary market information exchange. With ninety-two percent of surveyed sellers who used brokers indicating that their properties were listed on the MLS, the importance of these facilities as the primary marketing mechanism in residential real estate is apparent.

As facilities which link brokers in a common undertaking, the MLSs significantly affect the performance of the residential brokerage industry. In order to analyze the purposes and effects of these facilities and their various rules and regulations, this section examines the history of the MLS. Next, the section examines the structure and operation of MLSs; their membership and listing requirements; requirements relating to commission rates, split schedules, and the dissemination of competitive information; and requirements governing the selling of MLS listings.

[2] History of the MLS

In 1924, the Chairman of the MLS Committee for the California Real Estate Association characterized the MLS as follows:

The multiple listing service, the new system of conducting the real estate business, is a radical departure from the old system, or no system, as has been and still is practiced by those who have not adopted it. In order to understand this system, we must examine some of the things that called it forth.

Some of the things that were making a joke out of the business, instead of raising it to the high plane where it rightfully belongs. Competition was increasing to the extent that it was very difficult to get a real listing on any property. An exclusive listing was almost a thing of the past, and a signed listing was getting to be a scarcity.

While brokers had been cooperating on an informal basis for some time, the MLS had a number of advantages, including efficiency and the elimination of much competition. Where successfully organized, it proved to be very profitable to both the member and the local Board of Realtors.

The exchange by brokers of housing information has taken place for many years. Early real estate "exchanges," later to become known as "Boards," accomplished this function by providing a place where the local brokers could meet, usually once a week, and announce to other brokers what listings they were offering for sale.

Shortly after the turn of the century this exchange function was reduced to a system of distributing the written listing information from a central office. The term "Multiple Listing" was first used to describe this new, more formal system in 1907.

MLSs developed very rapidly in the 1920's. However, while many multiples were formed during this time, they were not all successful. The most successful multiples were associated with the well-organized Boards.

After a lull of activity during the 1930's, MLSs again began to increase in importance during the post-World War II period. As late as 1950, however, MLSs represented significant sales sources only in some large urban areas. In 1950, a National Association survey indicated that roughly fifty percent of brokerage offices still accepted both exclusive and open listings. Open listings, generally not accepted by MLSs, were therefore still quite common.

In comparing the real estate office of 1953 with that of 1977, Professor Fred Case of UCLA concludes that perhaps the most important change relates to MLS membership. By 1977 an average of ninety-three percent of firms were members.

A 1973 study of Dr. R. Erler found that virtually all Boards of Realtors(R) and all board members in urban areas had access to MLSs. Furthermore, the firms that did not participate in the MLSs were usually not the large firms, but were smaller, single-office firms. While the study did not focus on why these firms did not belong, some appeared to be concentrating on other than residential sales. Non-member firms were unable to demonstrate that they were more successful or profitable because of their non-member status. Those large non-MLS brokers examined had noticeably fewer sales per salesperson than did the large MLS-member brokers.

By the late 1960s and early 1970s, MLSs had been named in a number of private antitrust actions and Justice Department investigations. Justice Department investigations culminated in fifteen consent orders banning price fixing and other alleged anti-competitive activities. In response to these legal problems, the National Association of Realtors(R) developed and enforced a list of policy points. The NAR's November 15, 1971 statement, setting out and mandating these policies on the Realtor(R) MLSs, is referred to in the industry as the "Fourteen Points." In explaining to the association members why the Fourteen Points had become necessary, the chairman of the national association's MLS Policy Committee summarized the importance and growth of MLSs as follows: "Marketing experts tell us that the greatest problem in our economic system is the complication in the buyer search. MLS has served this problem well" While sharing of listings had been around since the 1880's or 1890's in some form, "the impact has been dramatically felt in the residential field for the last twenty-five years. MLS has in most areas of the country become a way of life both for the home owner and the broker."

[3] The Original Reasons for and Effects of Multiple Listing

[a] Open Listing Competition

[i] In General. The concept of multiple listing was based upon the need to devise an efficient method for marketing exclusive listings. With an exclusive listing only one broker had direct rights and incentives to sell the house. By the 1920's, however, sellers had become aware of the advantages of obtaining exposure through many brokers. For this reason exclusive listings had become nearly impossible for the brokers to obtain. The open listing was the general rule. From the broker's point of view, open listings were associated with a number of problems. These problems related to competition among listing brokers, competition with sellers, and duplication of effort by brokers.

[ii] Listing Broker Competition. Competition among brokers due to the open listings was associated with two somewhat distinct phenomena.

First, commission cutting by brokers had become a common method of inducing sellers to list with and sell through such brokers. Multiple listing and the exclusive listing contract "solved" this problem wherever they were applied as a remedy and faithfully practiced.

Second, competition among brokers was associated with the inability to cooperate in marketing listings. Brokers with open listings were reportedly afraid to tell other brokers about properties for fear that these other brokers would go straight to the sellers. Furthermore, even if brokers did want to cooperate, there were frequent disagreements over how a broker originally received information relating to a house for sale and over how any resulting commission should be divided--broker A might allege that broker B got the information from him or her, while broker B might insist that the information came straight from the seller. Finally, with open listings as opposed to exclusives, no particular broker was absolutely assured of a commission upon sale. Any one of several competing brokers might spend time, effort, or funds to advertise and promote the sale of a property, claim to be the sole procuring cause of a sale, and try to claim the entire commission. But the seller might claim that he or she had found the buyer on their own. The general use of open listings was, therefore, believed to make both cooperation and predictable success in obtaining a commission very difficult.

The MLSs and exclusive listing agreements, when used together, reduced the problems presented by unfettered competition. With an exclusive listing, only one broker could claim the commission. Other brokers could not work directly with the seller. Cooperation of other brokers with the exclusive listing broker (someone with whom they could anticipate dealing cooperatively on many different future sales and therefore with whom they could establish an ongoing professional relationship) was the basis of the new marketing system.

[iii] Seller Competition. Open listings were also associated with competition with the seller. Substantial numbers of sellers at that time were making direct sales to buyers even after listing their homes with a broker who spent time and effort to sell it. The MLSs and the exclusive-right listing agreement helped to stop this. The MLSs would accept only exclusive-right listings, and the exclusive-right listings most brokers came to insist upon in most transactions guaranteed the broker a commission even if the seller procured the buyer.

[iv] Duplication of Effort. Open listings sometimes might be given to as many as twenty brokers. Many of these brokers might spend time trying to sell the property only to find that they could not deliver the property to a prospective buyer. Either the property had been sold, withdrawn from the market, or the price had gone up. Listings were considered the broker's inventory, the stock on his shelves. Open listings, however, were analogized to perishable goods. A broker had no certainty that they would remain viable, saleable listings.

This waste of time and the inability to deliver properties even if purchasers were found are problems which brokers still associate with open listings. The exclusive contracts required by most MLSs eliminated these perceived problems by binding the seller to a specific listing period and a specific price. Further, with an exclusive, the listing broker receives some protection from other brokers and from the seller. Even if another, cooperating broker or the owner sells the listing, the initial listing broker will receive a substantial portion of the commission.

[b] Making a Market

While the individual brokers may have been primarily concerned with the competitive problems associated with open listings, sellers appear to have preferred open listings. Sellers at the time appeared to be well aware of the advantages of maximum exposure of their properties. With no MLS, open listings allowed sellers to substantially increase exposure on their properties. However, the market was so fragmented that, even with open listings, both sellers and buyers faced the inconvenience of trying to deal with many brokers and the uncertainty of not knowing whether they were reaching the entire market. One of the primary selling points of the MLS system for buyers and sellers was the convenience of being able to reach the "entire" market by dealing with only one broker.

The market-making function was especially important for the smaller broker. In fact, some commentators at the time felt that it was a saving factor for such a broker. Some felt the small broker could not continue to survive without the MLS. In a fragmented market, large brokerage offices are presumed to have an advantage because of their size. With each firm being, in effect, an independent market, those with the largest inventory have the best chance of having an appropriate property for a particular buyer.

If the smaller, or less efficient broker was at a disadvantage relative to the large broker under the open listing system, the lack of a system for sharing listings also made it difficult to persuade the public to grant exclusive contracts. Sellers would never give exclusives to a firm without some assurance of adequate exposure. The small broker, with a small sales force, would have little hope of persuading sellers that properties would get adequate exposure without the MLS, and very few individual firms in very few markets were likely to be large enough to overcome the perceived advantage of giving an open listing to each of many firms. With the MLS, however, not only could the small broker assure the seller of adequate exposure, but the small broker could claim that he was able to give the same exposure as the larger offices. The small broker could assure the seller that, in theory at least, the entire system was working for the seller, and the scale efficiencies of larger firms could, at the same time, largely be "merged" out of existence. Where the MLSs were successful, not only did they make possible the obtaining of exclusive listings by small firms, but obtaining them became relatively easy.

The market-making effect of the MLSs probably exceeded even the founders' expectations. Real estate listed on MLSs became much easier to sell. Brokers using the MLS found that fewer property owners tried to sell on their own and brokers, therefore, were listing many more properties. When the public learned of the advantages of the MLS, they often insisted upon it. One investigation of the MLS system of selling concluded that use of the MLS doubled the probability of a property selling, and the perceived value of the MLSs often was reflected in a practice of charging a one percent higher commission rate when the MLS was used.

[c] Information on Housing Prices

The MLS, by accumulating in one place information relating to all of the houses for sale in an area, created an excellent centralized source of information regarding housing values. Many brokers have expressed the opinion that MLSs might be worthwhile for this information alone.

The superiority of the housing information provided by the MLSs gave brokers another tool by which they could persuade sellers not to try selling on their own but instead to list their properties with brokers. As one broker wrote in 1925, "if we are to meet direct dealing successfully, it is desirable to pool all of our knowledge so that every Realtor(R) may know infinitely more about value and trends than the readers of the daily papers."

[d] Commission Rates

An explicit purpose of the MLSs in the 1920's was to ease the price competition among brokers that was associated with open listings. As we have noted, the MLS is a means of lessening the competitive advantages of larger firms. The MLS also appeared to be a most successful tool for stabilizing commission rates. The Chairman of the California Association's Multiple Listing Committee, in reviewing the progress of multiples in California in 1924, for example,

discovered that the San Francisco board, which felt that multiple listing was a panacea, nonetheless was not taking full advantage of its MLS:

I was ... surprised to find that they were working on an inadequate commission for services rendered. The commission for sales on all multiple listing contracts should be five percent, no more and no less The service rendered through the multiple listing is well worth that fee. It should be one of the main objects of the multiple listing service to establish this rate of commission every place where it is in operation, and it is the only agency that we have at present that will be able to do it.

While the multiples may have had many advantages, no doubt the most important inducement for brokers to join the multiple was that they were exceptionally profitable.

[e] Advantages to the Board

Establishing MLSs provided a number of advantages to the boards of realtors. First, the MLS fees, especially in the large cities, generated revenues in excess of cost. This provided a new source of financing for the boards. More importantly, the MLSs, as services provided by the boards, made the boards much more valuable to brokers. As one broker stated in 1926, the MLS "changes the board from a social organization to a business organization as well, operating for the financial betterment of its members." Before the MLSs, many boards had problems recruiting members. Some multiple listing officials and industry commentators have expressed the opinion that without the MLSs, the brokers' associations would not exist. With control of the MLSs, the boards gained more control over practices in the real estate business.

[f] Cooperation and Ethics

Increased cooperation among board members was widely considered to be one of the primary benefits of multiple listing. The multiple listing system was felt to shift the basis of the business from competition to cooperation. The system created a "bond of mutual interest," which in turn facilitated cooperation.

Many brokers at the time felt that the MLS, with its binding together of the membership, did more than anything to improve ethics. In the case of Realtors, ethics are, in part, rules aimed at facilitating cooperation.

[4] Analysis of MLS History

The development and growth of the MLSs appear to have had a substantial effect on the residential real estate brokerage industry. While making the market for houses more efficient in terms of the availability of housing information, the MLSs also appear to be associated with substantially reduced competition in several respects. The reduction of the competition associated with open listings, including price competition, was one of the primary purposes and effects of the MLSs, according to their Realtor-founders.

The founders clearly understood that the MLS changed the basic character of the industry. The MLSs made each local brokerage industry a single, cooperative marketing system. Furthermore, control of the MLS system substantially increased the ability of the associations to regulate brokerage practices.

While the practices and restrictions imposed by the MLSs today may be different from those in the 1920's, the history of the MLSs, as stated by the Realtors(R) who early founded them, gives valuable insight into the power and importance of the MLS in today's residential brokerage industry. The realtors' journals indicate that the early MLSs had the power to raise and maintain commission rates. Furthermore, the MLSs were considered by at least some of their founders to be the only tool available to brokers which could accomplish this.

[5] Membership Requirements of MLSs

[a] In General

All MLSs have membership requirements--usually contained in by-laws, rules, or regulations--which can have the purpose or effect of eliminating dishonest brokers, setting minimum professional standards, or standardizing contract terms and other broker behavior.

MLSs are private associations which have the right to discipline members for violations of standards of professional conduct as set out by the constitution, bylaws, rules and regulations of the MLS. n1.2 However, an MLS cannot behave in an arbitrary manner in disciplining its members. n1.3

This section discusses those requirements that are not apparently necessary to the operation of the MLS and that have either an apparent anti-competitive effect, or have been alleged by alternative brokers or others to have been used from time to time in an anti-competitive manner.

[b] Board of Realtors(R) Membership

[i] Description of Condition. For board-affiliated MLSs, board membership is generally a requirement for participation in the MLS. For most MLSs the membership requirements for the MLS are the same as the membership requirements for the Board of Realtors. n2

The NAR Membership Policy and Procedures Manual states that the National Association of Realtors(R) is unequivocally committed to the principle that board membership is a reasonable condition of participation in the Board's Multiple Listing Service. Providing membership in the Board is readily available to all eligible and qualified individuals on reasonable and nondiscriminatory terms and conditions.

The NAR has an eight-point set of membership criteria that establishes the most rigorous qualifications a board of realtors may require of an applicant for active Realtor(R) membership. These membership criteria, adopted in 1974, were developed in an effort to establish reasonable and non-discriminatory written requirements for membership. The basic requirements are as follows:

- (1) A valid real estate license (and actively engaged in the real estate business and its recognized branches) ...
- (2) A place of business within board jurisdiction ...
- (3) A place of business in compliance with local zoning regulations ...
- (4) A favorable business reputation in the community ...
- (5) A sound credit rating ...
- (6) Completed the board indoctrination course ...
- (7) Signified his intention to abide by the National Association of Realtors' Code of Ethics ...
- (8) Signified his intention to abide by the constitution, bylaws, policy, and rules and regulations of the local board, the state association, and the National Association of Realtors.

While *United States v. Realty Multi-List, Inc.* n3 discussed *supra*, implicitly sanctioned NAR's eight-point membership criteria, the eight-point criteria was specifically upheld by the Iowa Supreme Court in *Miller v. Cedar Rapids Board of*

Realtors. n4

The NAR Membership Policy and Procedures Manual provides definitions of the terms "actively engaged," "favorable business reputation," and "sound credit rating." It also recommends that each board seek a court declaratory judgment affirming its decision whenever the board declines to accept an applicant on the basis of these qualifications.

Often the Board membership requirements which may restrict use of the MLSs are imposed also by non-Realtor(R) MLSs. They are discussed as separate MLS requirements below. Certain of the code of ethics provisions and rules and regulations of the realtors that affect MLSs are also discussed separately below as listing and selling requirements of the MLSs.

While Realtor(R) MLSs generally require board membership, there are exceptions. In California, the courts have opened Realtor(R) MLSs to non-Realtor(R) licensees. n4.1 California, however is the only jurisdiction in which participation by non-Realtors(R) in Realtor(R) multiples is widespread.

[iii] Analysis of Condition. Whether Realtor(R) membership is a reasonable condition to MLS access has received considerable attention in the courts and in the legal literature. It is clear that whether or not Realtor(R) membership *per se* is a reasonable requirement does not answer the question of what specific requirements aid--as opposed to suppress--competition. As pointed out earlier, Realtor(R) membership itself consists of many requirements, some of which are also common to non-Realtor(R) MLSs. These are analyzed separately below.

In addition to MLS-related membership conditions, there are elements of board membership which have no apparent relation to the MLS. For example, there are board dues which are allocated to functions other than the operation of the MLS. Other requirements, such as a sound credit rating and reputation, and a required indoctrination course, appear not to relate directly to the efficient operation of an MLS, but to set quality and ethical standards in addition to those already established by the state real estate licensing laws.

If interdependence among competitors accounts for any performance problems that may be observed, then membership requirements which increase that interdependence may deserve scrutiny. The requirements imposed by the Realtors(R) which are in need of close scrutiny are those which may lessen head-to-head competition and create a mechanism for possible coercion against deviations in competitive behavior by specific brokers. A requirement of arbitration before a panel of competitors arguably might fit this description.

[c] Real Estate License

[i] Description of Condition. Both the Realtors(R) and all non-Realtor(R) MLSs require a valid real estate license in order to be a participating broker in the MLS. This excludes direct access to the multiple by buyers and sellers.

[ii] Analysis of Condition. Some industry critics believe that consumer access to an MLS is a key to a price-competitive brokerage industry. That is, if a real estate license were not required for access to the MLS, consumers could directly list their properties and directly search for homes. Industry spokespersons, however, claim this would "destroy" an MLS. With no MLSs, which do allow consumer access, it is difficult to assess the validity of either side of this issue. Restrictions on direct consumer access do, however, appear to have at least some justification.

Being licensed as a real estate agent may help in the proper use of the MLS. In the training needed to obtain a license, brokers no doubt learn the industry terminology and other information which perhaps relates to MLS use. However, the difficulty and expense of requiring the proper filling out of an MLS property data form to list a home on the MLS would appear to be nominal.

From the MLSs' and cooperating brokers' points of view, there are more serious problems, such as whether and under what circumstances a cooperating broker could be sure that he or she had an enforceable contract to sell a house at a

specific price; who would have authority to enforce any contract offer made by a seller--the MLS or a broker; whether a private seller could be required to agree to some form of binding arbitration in the event of disputes prior to using the MLS; how fines and penalties for misuse of the MLS would be set and enforced; how fees for MLS service would be determined; and so forth.

Such issues as these are, in a sense, mechanical ones. A willing broker could, in theory, offer to sell assistance to an inexperienced seller in meeting formal requirements, and the contractual and financial arrangements needed to protect the interests of other users of an MLS do not seem beyond the ordinary range of human ingenuity to devise. Addressing such issues, however, means being prepared to live with both complexity and the risk of new and more varied forms of competition.

If the real estate brokerage industry were commonly competitive, we would expect to discover that some listing brokers had already carved out a market niche for themselves by offering sellers a service limited to assistance in meeting formal MLS requirements for posting and servicing a listing. The absence of such specially tailored offerings from every local market simply lends additional credence to suspicions that normal competition of the sort observable in other markets (whether for goods or services) is not present in real estate brokerage.

[d] Submission of Disputes to Arbitration

[i] Description of Condition. MLSs usually require, directly or through affiliated board rules, that members submit disputes with each other to arbitration. These arbitration proceedings commonly are conducted by the MLS itself or by the affiliated board. The hearings are generally before a panel composed of MLS and/or board members.

Some alternative brokers have mentioned abuses of the arbitration requirement as a barrier to their effective use of an MLS. These brokers did not express concern with arbitration in the abstract. Rather, they claimed, as they did in the case of proceedings for enforcement of code of ethics requirements by the boards, that arbitration that takes place before a panel composed of other and more traditional brokers in their community may result in biased proceedings.

Most of the MLSs follow the arbitration procedures established by the NAR. Article 14 of the NAR's code of ethics provides that the Realtor(R) shall submit disputes with other Realtors(R) to arbitration. The NAR has standardized the arbitration process for Realtor(R) MLSs and boards by providing local boards with an arbitration manual. The manual instructs the boards with respect to both arbitration and ethics grievance proceedings.

While arbitration decisions usually are made by a panel of MLS members, some boards and MLSs have used other methods. For example, board-affiliated MLSs in California must permit non-Realtor(R) brokers access to the MLS. Non-Realtors(R) may not have agreed to abide by the NAR's code of ethics and may object to an arbitration proceeding where the decision is made by Realtors. One local board, in coping with this problem, reports the following solution: "If a dispute is between an MLS participant who is not a member of the board and a board member it is referred to the American Arbitration Association."

[ii] Analysis of Condition. Required submission of disputes to arbitration before a panel of competitors may be one method which the local group can use to address (and sometimes to suppress) behavior considered injurious to the industry. Arbitration of disputes may save members substantial time and money. However, in an industry where competitor interdependence appears to be a primary characteristic, placing disputes in the hands of a firm's competitors may add significantly to the general pressures for uniformity.

[e] Initiation Fees

[i] Description of Condition. Most MLSs charge some initial fee for joining the MLS. These initial membership fees varied considerably. The membership fees of Realtor(R) MLSs are supposed to be cost-related. However, the local board determines how the revenues needed to operate the MLS will be generated. Local boards, therefore, are largely

free to set the initial membership fees according to their discretion. The NAR recommends a \$250 maximum fee unless the board takes a cost-justified position. These costs can include training and other expenses of establishing service for a new member. In addition to initiation fees, MLSs generally charge a fee for each listing submitted and/or a periodic membership fee. Periodic fees for most MLSs are modest, although some charge substantial annual fees.

[ii] Analysis of Condition. Initiation fees vary widely, with no apparent relationship to variations in the actual operating costs of MLSs. There appear to be few major expenses associated with adding a new member. Substantial charges in excess of a nominal initiation fee are probably not based upon the cost of adding such new member, and if the fee is not based on cost, then it would seem to be a condition of membership more restrictive than needed to operate the facility.

While even a \$250 fee may not be substantial compared with other initial costs of establishing a business, the burden may be multiplied if a broker seeks to do business in a metropolitan area served by many MLSs. There may also be times when a Realtor(R) wants to do occasional business in another board's territory. Excessive initial fees may discourage that. When an MLS applicant already is trained in the use of the MLS, for example, as would be a member of another local MLS, high initiation fees are very hard to justify. Either in purpose or effect, they may result in the protection of the local members from outside competition.

[f] Other Membership Requirements

In the past, multiples in various parts of the country have employed a number of membership requirements to exclude certain classes of people. Such requirements commonly have included restrictions on part-timers and residency requirements.

In recent years, however, the Realtors(R) have made an effort to eliminate unreasonable or discriminatory membership conditions. Requirements such as having a "favorable business reputation" have been interpreted by NAR in a manner designed to avoid subjective, arbitrary application. However, many MLSs still condition membership upon the approval of current members or the approval of the board of directors. These requirements appear on their face to be primarily subjective.

[g] Conclusion

It is difficult to assess the actual impact of MLS membership requirements on the competitiveness of the industry. The MLS clearly is essential to most brokers in order to market their properties efficiently. The vast majority of houses for sale are now listed on an MLS. Exposure of a property for sale and cooperation are so important in reducing selling time and finding buyers, that some industry commentators believe that a listing broker's refusal to offer cooperation to other brokers through the MLS in attempting to sell a listing may constitute a violation of his or her duty to the seller to sell the house for the highest price possible. The actual number of denials of MLS membership appears to be relatively small, and the membership requirements do not appear to be a substantial bar to entry into the industry.

While MLS membership requirements may not involve barriers to entry, conditions such as required arbitration before a panel of competitors may add substantially to the pressures for uniformity. Because the state of competition in the industry in general appears to relate more to conditions and structures which have the effect of restricting the form and variety of competition, and less to restrictions that impede the flow of resources into the industry, membership requirements which add to interdependence or otherwise restrict vigorous competition are the most questionable.

Various other MLS rules and regulations that may restrict competition are discussed below. While many of these could also be considered "membership requirements," they have been categorized by how they functionally relate to the brokerage transaction.

[6] Listing Requirements

[a] In General

Every multiple has a number of requirements which must be met by participating brokers in order to enter listings on the MLS. Some of these requirements, such as payment of a fee for each listing submitted, clearly are necessary to the operation of the multiple. Others, a matter of custom or convenience and not clearly related to the successful functioning of the MLS, may not be necessary. This section is concerned primarily with two such requirements widely imposed by MLSs throughout the country: mandatory submission of listings and restriction of MLS service to exclusive listing contracts.

[b] Mandatory Submission of Listings

[i] Description of Requirement. The NAR describes multiple listing services as being of two basic types: "mandatory" and "voluntary." Mandatory MLSs are available to board members on a voluntary basis, but once the member has decided to participate, he or she must submit to the MLS all listing contracts specified by the MLS. In a voluntary MLS, members have the option not to submit certain of their listings, regardless of the type of listing contract.

Prior to 1971, the NAR allowed its affiliated MLSs to require that all designated types of listings (for example, exclusive-right-to-sell listings) be submitted to the MLS without exception. However, Policy Point 11 in the NAR's "Fourteen Points" requires that an MLS not prohibit or discourage a member from accepting a listing from a seller preferring to give an "office exclusive."

"Office exclusives" are those exclusive-right listings where the seller has specified that the listing not be submitted to the MLS. The NAR's concern that this decision be made by the seller and not the participating broker is indicated by the NAR's Suggested Rules, Section 1.3. This rule requires that office exclusives be filed with the MLS and that they be accompanied by certification signed by the seller that he or she does not desire the listing to be placed on the MLS.

An essential part of a mandatory multiple is that brokers submit listings soon after obtaining them from the sellers. If a time limit were not set, the mandatory multiples would be, in effect, no different from the voluntary multiples. The most common time requirement is submission to the MLS within forty-eight hours after obtaining the listing from the seller.

The purpose of a mandatory listing requirement is, of course, to require brokers to submit all of their exclusive-right listings. From the seller's point of view, this ensures that the seller's listing receives the exposure that it should have to obtain the best price possible. From the MLS's point of view, this requirement ensures that the MLS will not simply be a repository for difficult-to-sell listings. If these purposes are served by the mandatory listing requirement, one would expect the mandatory MLSs to contain, on average, easier-to-sell listings than the voluntary MLSs. These relatively easier-to-sell listings should sell more quickly than others, on average. The MLS survey results are consistent with this hypothesis. Mandatory MLSs show a shorter average time-on-the-market for their listings than do voluntary MLSs. Mandatory MLSs with a submission time of seventy-two hours or longer show a longer average time-on-the-market for their listings than do the mandatory MLSs with shorter required submission times.

[ii] Analysis of Requirement. On its face, requiring that MLS members submit all of their listings of a designated type restricts the competitive freedom of the broker-members. Alternative methods of selling houses are effectively foreclosed. However, Realtor(R) MLSs following the NAR's Policy Point 11 may have ameliorated any competitive injury which would otherwise have resulted from "mandatory" submissions of listings. Where "office exclusives" are allowed, that is, where the seller can specify that his or her listing not be placed on the MLS, the broker and seller appear to be free to contract as they see fit. In effect, therefore, the distinction between "voluntary" and "mandatory" MLSs simply becomes a distinction between whether the broker, without the seller's authorization, can decide to withhold a seller's listing from the MLS, or whether the broker must obtain the specific authorization of the seller in order to withhold such listing.

While there may be cases where a seller does not want his or her listing submitted to the MLS, the MLS remains the most efficient method of maximizing exposure of a property in large markets. Historically, however, a common problem for sellers and for the MLSs has been "vest pocket" listings. An ability to easily withhold under-priced listings may increase the incentives of some brokers to undervalue listings initially.

[c] Required Use of Exclusive Listing Agreements

[i] Description of Requirement. MLSs generally will not accept and distribute all types of listings. Typically, for example, Realtor(R) MLSs will accept and distribute only exclusive right-to-sell or exclusive agency listings for residential properties.

NAR representatives feel that open listings are inconsistent with their view of the MLS as a system of unilateral offers of subagency, because open listings generally do not authorize the listing broker to appoint subagents.

Exclusive agency listing agreements also are not usually accepted by Realtor(R) MLSs. With an exclusive agency listing, unlike an exclusive right-to-sell, the seller has the right to find and deal with a buyer directly and avoid paying a commission. NAR representatives feel that exclusive agency listings might lead to controversies, in that buyers may view the property with a broker and then attempt to deal with the seller directly. A controversy might thus arise over whether a broker was the "procuring cause" of the sale. Because the seller has not agreed to arbitration, as have participating MLS brokers, such a controversy ultimately could involve judicial proceedings.

While most MLSs accept and disseminate only exclusive-right listings, there are exceptions. Some MLSs, rather than require a certain type of contract, require that a specific MLS listing contract form be used.

[ii] Analysis of Requirement. Effectively restricting the type of listing that a broker can negotiate with a seller is, on its face, a restraint of trade. Exclusive agency listings, which allow the seller to find a buyer, sell the property on his or her own, and avoid the commission, may cause some advertising and other expenses of the broker to be wasted. Overall, therefore, they may be less profitable to the broker than exclusive-right listings, all else being equal. However, brokers operating in their own self-interest theoretically should be free to negotiate such contracts. To the extent there may be possible controversies between brokers and sellers, brokers ought to be able to account for this in setting their fees.

Individual brokers might find that offering exclusive agency listings provide a significant competitive advantage. There appears to be some consumer demand for such contracts. Where allowed, a significant portion of MLS listings are exclusive agencies. This is probably because the use of exclusive agency listings could save some consumers substantial commission expenses. While use of a broker is the most common method by which buyers find homes, a significant percentage of buyers initially become aware of their homes through some other means. Thus, for those sellers who feel competent to handle the sale of their own home, but also want MLS exposure, there appears to be the potential for substantial savings. From the MLS's point of view, there appears to be only minimal risk in allowing exclusive agencies. A minority of MLSs already do, and they appear to operate successfully.

Open listings on the MLS may present a more difficult problem for MLSs than do exclusive agency listings. While authorization for the listing broker to appoint subagents may be a technical requirement, it is easily solved simply by requiring that open contracts contain such authorization before they are accepted for listing. A more serious problem might arise if two brokers who have open listings on the same home both filed those listings on the MLS. If a cooperating broker were to procure a buyer for the home, determining which listing broker would qualify for the commission could lead to disputes. If open listings are allowed on an MLS, it would seem reasonable for the MLS to have appropriate rules that dealt with this sort of problem in order to reduce the cost and burden of arbitration proceedings.

In spite of much mystification to the contrary, it should be noted that from cooperating brokers' point of view, all MLS listings are already effectively "open." The MLS allows all MLS brokers to compete against one another in an attempt to sell the listing. Even with exclusive-right listings, cooperating brokers regularly compete in an effort to be the first to procure a buyer. Often there is wasted time and effort, and two or more competing cooperating brokers may both claim to have been the procuring cause of a particular buyer. When such a dispute arises, the issue of "procuring cause," therefore, would seem to generally be the same no matter what kind of listing is involved. The difference among different types of listings in that context is only whether the disputed issue ultimately has to be resolved by arbitration or by a court proceeding, and that is a matter which can be covered by contract.

Decisions relating to the forms of listing contracts discussed above, like decisions as to commission rates and commission splits, are in fact competitive decisions that probably could be made by individual brokers without hampering the operation of the MLS facility.

[7] Commission Rate and Split Schedules

In the past, many state associations of Realtors(R) as well as the National Association of Realtors(R) recommended fee schedules. Many of the local boards and MLSs enforced these or other commission rate schedules in addition to schedules concerning the split of the commission between the listing broker and the cooperating brokers.

Today, such schedules are rarely found. The NAR banned mandatory commission rate schedules in 1961. In 1971 the NAR issued its "Fourteen Points" Multiple Listing Policy Statement. This banned both recommended commission rate schedules and commission split schedules. Few MLSs today appear to have commission rate or split schedules. But the past use of these schedules by the Associations and MLSs may still be relevant to understanding today's industry.

The schedules, especially those dealing with the full commission rates, explain, in part, how the rates reached their current levels. Historically, the rates were administered by the associations. There appear to be very strong cooperative pressures that keep rates uniform within local markets once they are set. Commission rates today commonly are found to be essentially at the levels they were when they last were fixed.

[8] Commission Split Uniformity

Within any MLS market area splits tend to be highly uniform. That is, in a very high percentage of residential sales, listing brokers will offer the same split to cooperating brokers, often fifty/fifty or sixty/forty.

Industry spokespersons explain this uniformity in terms of the unilateral incentives of brokers. Cooperating brokers may not show those properties which pay them less than the going rate as aggressively as those that pay the prevailing split. Further, while a larger than normal split to the cooperating broker might induce even more selling action, listing brokers are reluctant to give cooperating brokers more than the going rate because they generally do not need to do so in order to sell the property, and they may need the remainder of the commission to pay expenses, effectively compete for additional listings, and realize a reasonable profit. While brokers do not generally compete in price, non-price competition to obtain listings may, of course, be intense.

The very low percentage of cooperative sales reported by alternative, discount brokers particularly when they offer a lower than customary split generally may be explained in part by an apparent steering by other brokers away from such listings. In fact, this may be a primary cause of the alternatives' general lack of success. Even dominant firms appear unable to consistently, unilaterally alter splits in their own favor.

[9] Data Dissemination

[a] In General

The purpose of the MLS is the orderly collection, correlation, and dissemination of listing information to MLS members. The primary purpose of information dissemination is to facilitate cooperative sales among brokers. To do this, MLSs disseminate information relating not only to the property involved but also to the seller and the listing broker. A question sometimes raised is whether the dissemination of some information not relating directly to the property could be both unnecessary and injurious to the parties or to competition.

[b] Property Information

MLSs typically disseminate information which describes the property for sale. This includes the seller's asking price, the address of the property, and various details relating to, for example, the size and type of house. Most MLSs also include a photograph of the property.

[c] Seller Information

MLSs often disseminate information not only identifying the seller involved, but also providing certain information about the seller, such as his or her name and telephone number. The status of the seller's loan or mortgage also often is disseminated by MLSs.

MLSs also often provide for the dissemination of information relating to seller's reason for selling. Whether this information is disseminated is usually at the listing broker's discretion.

[d] Listing Broker Information

Listing brokers are agents of the seller. n5.1 The listing broker's name and telephone number generally are disseminated by MLSs. Some MLSs, however, choose to disseminate the listing broker's name in a coded form.

Most MLSs formerly required or provided for the dissemination of information relating the listing broker's full commission rate. However, the NAR suggested new rules and regulations to the MLSs calling for the dissemination only of the dollar amount or percentage of selling price to be offered to cooperating brokers. These new rules state the policy of the NAR as follows: "Board Multiple Listing Services shall not disclose in any way the total commission negotiated between the seller and the listing broker."

The NAR's policy still appears to anticipate that MLS participants will inform potential cooperating brokers of the split to be offered on the particular listing. The NAR's suggested rules and regulations state that the listing broker shall specify, on each listing submitted to the MLS, a split of commission which is applicable to such listing. While the MLSs do not control the amount of the split, the NAR Handbook recognizes that the amount of the split will affect the incentive of cooperating brokers to sell a particular listing.

[e] Analysis of Data Dissemination

MLSs disseminate information which could be abused to cause injury both to seller and to competition. Information relating to the house is clearly needed by cooperating brokers. However, information relating to the seller's financial position and reasons for selling could, in a buyer's hands, substantially compromise the seller's position in negotiations. Seller information relating to his or her loan status also could compromise the seller's negotiating position. Under the traditional industry view that all brokers are agents of the seller, this is, in theory, not a problem. All brokers are supposed to be negotiating for the seller. However, this may not be entirely realistic since brokers do have an incentive to make a sale, and a cooperating broker may always be tempted to act as less than a fiduciary.

While dissemination of full commission rate information may have facilitated policing by other MLS members against discounters, it is doubtful that under the NAR rule there will be a major change in any plight perceived by discount brokers. Brokers in a community generally are well aware of the identity of the local discounters. Brokers who choose

to compete by lowering their rates must advertise that fact to consumers. Other MLS brokers will also see these ads and, if they choose, steer away from the listings of those brokers. Disseminating the name of the broker, therefore, may be as effective a policing device as disseminating the commission rate.

The dissemination of the listing broker's identity and the amount of the split raise difficult questions. Disclosure of this competitive information may allow the MLS to be used as an anti-competitive, collusion-facilitating device. Yet, an MLS probably could not work well without such information.

When cooperating brokers are paid on the basis of a split from the seller as opposed to a contract with the buyer, and as long as cooperating brokers also act as listing brokers in other transactions, brokers will probably continue to be subject to incentives which militate against price competition and may individually use MLS information to reduce such competition.

[f] MLS Disclaimers

MLS listings typically have a disclaimer such as this statement: "The information contained in these listings is deemed reliable but is not guaranteed." Broker websites are often constructed so that a user must click on an "I agree to these terms" type of agreement before proceeding to listings. This agreement page typically contains this disclaimer. Printouts of MLS listings typically contain this disclaimer. These standard disclaimers can protect the real estate licensees should the MLS information prove to be inaccurate.

Disputes which raise the issue of the effect of the typical MLS disclaimer often involve alleged misrepresentations regarding lot size or square footage. As a general rule, it appears that when the buyer had the right to inspect and measure the subject property, this disclaimer tends to support a finding of no liability on the part of the real estate licensees particularly when the licensees were unaware of an error in the MLS description, the error was not obvious or intentional, and the buyer failed to exercise his or her right to inspect or measure the property. ⁿ⁶ Courts usually consider provisions found in other documents involved in the sale in coming to this conclusion. For example, the sales documents often contain a provision advising the buyer of the right and importance of having an independent inspection of the property performed.

California statutorily addresses MLS listings. *California Civil Code § 1088* states:

A listing may not be placed in a multiple listing service unless authorized or directed by the owner in the listing.

If an agent or appraiser places a listing or other information in the multiple listing service, that agent or appraiser shall be responsible for the truth of all representations and statements made by the agent or appraiser of which that agent or appraiser had knowledge or reasonably should have had knowledge to anyone injured by their falseness or inaccuracy.

Furla v. Jon Douglas Co. ⁿ⁷ involved the sale of a California home represented in the MLS listing as containing 5,500 square feet. This listing contained the words "Information Deemed Reliable But Not Guaranteed." When the buyer learned that the home contained roughly 4,300 feet, he sued the seller and the seller's broker and agent alleging negligent misrepresentation. The trial court had granted summary judgment to the defendants because the court found that the defendants had reasonable grounds to believe the house was 5,500 square feet, defendants breached no duty toward plaintiff in failing to discover the house was not 5,500 square feet, and plaintiff did not justifiably rely on defendants' representations. ⁿ⁸ The appellate court reversed finding that there were factual issues which could not be resolved by a motion for summary judgment. The court recognized the juxtaposition of arguments regarding a buyer's reliance on statements made by the seller and the seller's representatives.

Ordinarily a buyer is entitled to rely upon a seller's representations concerning the area of the property being sold, and is not required to hire an expert to discover the falsity of the seller's representations. However, a buyer is not relieved of the duty to exercise reasonable care to protect himself or herself, including those facts which are known to or within the diligent attention and observation of the buyer and a buyer is held to be aware of obvious and patent conditions. n9 Whether the buyer unreasonably failed to protect himself and unjustifiably failed to discover true conditions depended upon all the circumstances thereby presenting an issue of fact for the trier of fact. A jury might reasonably conclude that plaintiff was justified in relying on defendant's representation of the square footage, that the truth was not obvious and patent to plaintiff and could be determined only by an expert measurement which plaintiff was not required to hire in order to discover defendants' misrepresentations. n10

[10] Selling Requirements

[a] In General

All MLSs have rules and regulations concerning appropriate selling procedures. These requirements often reiterate sections of the Realtor's code of ethics or deal with administrative functions. Many of these rules appear to be relatively non-controversial and will not be covered here. The most commonly used rules and regulations, those suggested by the NAR, are contained in the NAR's Handbook on Multiple Listing Policy.

Two MLS selling requirements relating to cooperating brokers are relevant to this investigation. First, MLSs prohibit the solicitation of the seller by other MLS members. Second, cooperating brokers are usually considered subagents of the seller and listing brokers.

[b] Anti-Solicitation Rules

[i] Description of Requirement. Section 4.3 of the NAR's suggested rules and regulations states as follows: "Participants shall not solicit a listing on property filed with Service unless such solicitation is consistent with Article 21 of the Realtors(R) Code of Ethics, its Standards of Practice and its Case I interpretation."

In explaining this rule the NAR Handbook notes as follows:

This section is intended to encourage sellers to permit their properties to be filed with the Service by protecting them from being solicited, prior to the expiration of the listing, by brokers and salespersons seeking the listing upon its expiration.

This is, in effect, an elaboration upon the Realtor's code of ethics, Article 21. Article 21 specifies that a Realtor(R) "shall not engage in any practice or take any action inconsistent with the agency of another Realtor." Standard of Practice 21-3 interprets this article as including a ban on soliciting future business from sellers who have exclusive listings with other brokers during the term of that listing, if the nature and the term of the listing are fully disclosed.

[ii] Analysis of Requirement. Any ban on solicitation for business is, on its face, a restriction on competition. In the context of the MLS, an argument has been made that a very narrowly drawn and interpreted restriction may be reasonable, if reasonably enforced.

This argument is to the effect that a brokerage firm's list of properties for sale is, in effect, also its customer list. Customer lists are generally considered valuable assets by any business. If competing brokers are allowed to use these customer lists directly as lists of potential clients to be individually and personally solicited, this, in theory, might create a general incentive not to put listings on the MLS, even though the MLS is essential to the operation of an efficient real estate brokerage market.

The experience reported by alternative brokers may be relevant here. Among the major problems they have alleged have

been lost or cancelled listings resulting from personal disparagement of their businesses and direct solicitation of their clients, urging those clients to break their contracts. These problems are claimed to be substantially more severe for those alternative brokers who list their properties on the MLS.

Nonetheless, the breadth of the present prohibition is such that it may discourage many firms from legitimate direct advertising and targeted mass media campaigns that do not rely for their success upon any arguable abuse of "confidentially disclosed" information.

[c] Subagency of Cooperating Brokers

The MLS is fundamentally a clearing house of listing information. n10.1 There appears to be nothing in the structure of the MLS or in the state laws which requires cooperating brokers to be subagents of the sellers and the listing brokers. n11 Furthermore, it is the policy of the NAR not to interfere in the relationships between brokers and their clients, including potential purchasers.

Courts have often referred to the relationship between brokers who represent sellers and those who represent buyers on the MLS as a subagency. n11.1 Courts have also described the publication of a listing in the MLS as a unilateral offer of a subagency to other brokers. n11.2 This ability to create subagencies has been called "an essential part of the real estate brokerage business." n11.3 Subagency is discussed in § 3.10, *below*.

On the other hand, the NAR does view the MLS as a system of unilateral offers of subagency from listing brokers to potential cooperating brokers. The Handbook on Multiple Listing Policy states as follows:

In the Multiple Listing Service of the Board of Realtors, the cooperating broker in a cooperative real estate transaction is the subagent of the listing broker and not the agent of the buyer, unless there is an agreement to the contrary between the cooperating broker and the buyer which is fully disclosed to all parties to the contract and to all brokers involved.

Standard of Practice 22-1 also specifies as follows: "It is the obligation of the selling broker as subagent of the listing broker to disclose immediately all pertinent facts to the listing broker prior to as well as after the contract is executed." n12

[11] NAR Multiple Listing Policy--"The Fourteen Points"

The "Fourteen Points," the multiple listing policy of the National Association of Realtors(R) approved by the board of directors November 15, 1971, states, in relevant part, as follows:

A multiple listing service shall not enact or enforce any rule which restricts, limits or interferes with the actions of its members in their relations with each other or in their realtor/client relationship or in the conduct of their business, including, but not limited to the following:

- (1) MLS shall not: Fix, control, recommend, suggest or maintain commission rates or fees for services to be rendered by members (Interpretation number fourteen).
- (2) MLS shall not: Fix, control, recommend, suggest or maintain any percentage division of commissions or fees between cooperating members and between members and non-members.
- (3) MLS shall not: Require financial support of multiple listing service operations by any formula based on commission or sales price.

(4) MLS shall not: Require or use any form which establishes or implies the existence of any contractual relationship between the multiple listing service and the client (buyer or seller).

(5) MLS shall not: Make any rule relating to the posting or use of signs (Interpretation number twenty-six).

(6) MLS shall not: Make any rule prohibiting nor discouraging cooperation with non-members.

(7) MLS shall not: Limit or interfere with the terms of the relationship between a member and his salesmen (Interpretations numbers sixteen and seventeen).

(8) MLS shall not: Prohibit or discourage any members from political participation or activity (Interpretation number fifteen).

(9) MLS shall not: Make any rule granting blanket consent to selling member to negotiate directly with the seller (owner) (Interpretation number ten).

(10) MLS shall not: Make any rule regulating the advertising or promotion of any listing (Interpretations numbers six and twenty-six).

(11) MLS shall not: Prohibit or discourage a member from accepting a listing from a seller (owner) preferring to give "office exclusive."

(12) MLS shall not: Adopt any rule denying a listing member from controlling the posting of "sold signs."

(13) MLS shall not: Reject any exclusive listing submitted by a member on the basis of the quality or price of the listing.

(14) MLS shall not: Adopt rules authorizing the modification or change of any listing without the express written permission of the listing member.

FOOTNOTES:

(n1)Footnote *. The material set forth in this section has been abstracted from 1 F.T.C. Los Angeles Regional Office Staff Report. *The Residential Real Estate Brokerage Industry*, 108 *et seq.* (1983) (footnotes omitted).

(n2)Footnote 1. See Bird, *Coordination of Brokers in Sales of Real Estate*, N.Y.L.J., March 16, 1988, which discusses a lawyer's role in coordinating various sales-brokers due to the lack of a multiple-listing service in Manhattan.

But cf. Freeman v. San Diego Ass'n of Realtors(R), Nos. 01-56199, 01-56231, 2003 U.S. App. LEXIS 7731, at *32 (9th Cir. Mar. 10, 2003) , *cert. denied, motion granted*, 124 S. Ct. 355, 157 L. Ed. 2d 253, 2003 U.S. LEXIS 7339 (U.S. 2003) ("Before 1994, rules of the National Association of Realtors(R) required an agent to join the association in the geographical area where the agent's office was located. But that year NAR adopted the 'board of choice' system, which allows agents to choose their association.").

(n3)Footnote 1.1. *Cf.* Freeman v. San Diego Ass'n of Realtors(R), Nos. 01-56199, 01-56231, 2003 U.S. App. LEXIS 7731, at *2 (9th Cir. Mar. 10, 2003) , *cert. denied, motion granted*, 124 S. Ct. 355, 157 L. Ed. 2d 253, 2003 U.S.

LEXIS 7339 (U.S. 2003) ("Real estate agents make a living matching buyers and sellers.").

(n4)Footnote 1.2. See *Multiple Listing Service, Inc. v. Century 21 Cantrell Real Estate, Inc.*, 390 So. 2d 982, 986 (Miss. 1980) ; *Morf v. North Central Mississippi Board of Realtors, Inc.*, 27 So. 3d 1188, 1191 (Miss. Ct. App. 2009) , writ denied, 27 So. 3d 404 (Miss. 2010) . See also *ND-Sell, Inc. v. Greater Springfield Bd. of Realtors, Inc.*, 224 S.W.3d 623 (Mo. Ct. App. 2007) (MLS member disciplined for allowing a client to have her Multilist lock box key to tour homes when the MLS member was not present.).

(n5)Footnote 1.3. *ND-Sell, Inc. v. Greater Springfield Bd. of Realtors, Inc.*, 224 S.W.3d 623 (Mo. Ct. App. 2007) .

(n6)Footnote 2. In *Pope v. Mississippi Real Estate Comm'n*, 872 F.2d 127 (5th Cir. 1989) , the court held that the exclusion of nonmembers from the multiple listing service or from use of the term "realtor" by the county board of realtors was not a violation of antitrust statutes where membership was denied to real estate brokers for failure to pay required dues. The court determined that the fee schedule requiring larger agencies to pay a greater fee because they employ more real estate agents was reasonable. The court further held that, even assuming that the state governmental agency regulations calling for cautionary letters to a real estate broker and a suspended sanction against him constituted a deprivation of a liberty or property interest, the agency's notice and post-deprivation remedy of judicial review afforded adequate due process. In the instant case, the court found: (1) a real estate broker's brochure contrasting his services with other brokers, which were in part misleading, and his advertisement of an educational real estate course as one approved by state agency when the course was not approved, were not protected commercial speech under the *First Amendment*; (2) a broker's drawing of legal descriptions, which under state law is tantamount to practicing law without a license, were not protected commercial speech under the *First Amendment*; (3) preventing a broker from using the term "realtor" to describe their operations did not violate *First Amendment* rights because "realtor" is a registered trademark; and (4) a state statute which prevents rebates or commissions paid by third parties to a real estate agent, and gifts paid by an agent to another, only when the payment creates conflict of interest to the client's detriment, does not violate the *First Amendment*.

(n7)Footnote 3. 629 F. 2d 1351 (5th Cir. 1980) .

(n8)Footnote 4. 300 N.W.2d 127 (Iowa 1981) .

(n9)Footnote 4.1. See *Marin County Bd. of Realtors v. Palsson*, 16 Cal. 3d 920, 937-938, 130 Cal. Rptr. 1, 11-12, 549 P.2d 833, 843-844 (Cal. 1976) .

(n10)Footnote 5. 1985 Hawaii Sess. Laws ch. 467, Act 176 allows Hawaii brokers to share commissions with brokers engaged in the brokerage business in foreign countries. See *Haw. Rev. Stat. § 467-14(14)(B)*.

(n11)Footnote 5.1. See *Van Nguyen v. Hung Tran*, 157 Cal. App. 4th 1032, 1038, 68 Cal. Rptr. 3d 906, 910 (2007) .

(n12)Footnote 6. See *Karlsson v. FDIC*, 942 F. Supp. 1022 (E.D. Pa. 1996) , *aff'd without opinion*, 107 F.3d 862 (3d Cir. 1997) ; *Tres' Chic In A Week, L.L.C. v. Home Realty Store*, 993 So. 2d 228 (La. Ct. App. 2008) (square footage); *Lopata v. Miller*, 122 Md. App. 76, 712 A.2d 24, 1998 Md. App. LEXIS 119 (1998) , *cert. denied*, 351 Md. 286, 718 A.2d 234 (1998) (lot size); *Abbott v. Loss Realty Group*, 2005 Ohio 5876, 2005 Ohio App. LEXIS 5296 (Nov. 4, 2005) ; *Schnellmann v. Roettger*, 373 S.C. 379, 645 S.E.2d 239 (S.C. 2007) ; *The Cadco, LLC v. Barry*, 2006 Tenn. App. LEXIS 37 (Jan. 18, 2006) , *appeal denied*, 2006 Tenn. LEXIS 813 (Sept. 5, 2006) .

(n13)Footnote 7. 65 Cal. App. 4th 1069, 76 Cal. Rptr. 2d 911 (1998) .

(n14)Footnote 8. 65 Cal. App. 4th 1069, 1077, 76 Cal. Rptr. 2d 911, 915 (1998) .

(n15)Footnote 9. 65 Cal. App. 4th 1069, 1079, 76 Cal. Rptr. 2d 911, 916 (1998) , citing Cal. Civ. Code § 2079.5.

(n16)Footnote 10. 65 Cal. App. 4th 1069, 1079, 76 Cal. Rptr. 2d 911, 917 (1998) .

(n17)Footnote 10.1. See *Market Force, Inc. v. Wauwatosa Realty Co.*, 706 F. Supp. 1387, 1388 (E.D. Wis. 1989) , *aff'd*, 906 F.2d 1167 (7th Cir. 1990) ; *Derish v. San Mateo-Burlingame Bd. of Realtors*, 136 Cal. App. 3d 534, 539, 186 Cal. Rptr. 390, 393 (1982) .

(n18)Footnote 11. Cf. *Van Nguyen v. Hung Tran*, 157 Cal. App. 4th 1032, 1037, 68 Cal. Rptr. 3d 906, 910 (2007) (The purchase agreement lists cooperating brokers as the agents of the buyers.).

(n19)Footnote 11.1. See *People v. National Association of Realtors*, 155 Cal. App. 3d 578, 588, 202 Cal. Rptr. 243, 250 (1984)

(n20)Footnote 11.2. See *Market Force, Inc. v. Wauwatosa Realty Co.*, 706 F. Supp. 1387, 1388 (E.D. Wis. 1989) , *aff'd*, 906 F.2d 1167 (7th Cir. 1990) ; *Supermarket of Homes, Inc. v. San Fernando Valley Bd. of Realtors*, 1983 U.S. Dist. LEXIS 14113, at *3-*4 (C.D. Cal. Sept. 1, 1983) .

(n21)Footnote 11.3. *Supermarket of Homes, Inc. v. San Fernando Valley Bd. of Realtors*, 1983 U.S. Dist. LEXIS 14113, at *3-*4 (C.D. Cal. Sept. 1, 1983) . This court also stated, "[S]ince it is virtually impossible for one broker to have sufficient contracts to find enough matching sellers and buyers to earn adequate commissions, some brokers contend that they could not make a living without the MLS."

(n22)Footnote 12. In *Bozzelli v. Hollenbaugh*, 594 N.E.2d 782 (Ind. 1992) , a broker had an exclusive listing entered in the local MLS. Although not an MLS member, another broker approached the MLS broker in possession of the exclusive listing, and stated that she had a buyer. The MLS broker thought the other broker was also an MLS member and that she was entitled to the standard MLS commission, governed by MLS rules, which was 1.6% of the total sales price. After the execution of the sale, however, the MLS broker, who learned that her colleague was not in the MLS, refused to pay the non-MLS broker her share of the commission. Reversing the court of appeals, the supreme court held that since the non-MLS broker held herself out as an MLS broker, equity required the commission paid under MLS trade practices. The court affirmed the trial court's approach, granting the non-MLS member an equitable fee in quantum meruit, albeit less than the commission that would have been paid had she been an MLS member.

* This chapter was revised by Charles J. Jacobus, Esq., a partner in the law firm of Jacobus, Boltz, Melamed & Witherspoon, Houston, Texas. Sections 2.06 and 2.07 were written by Sandra Bullington, who has contributed additional updates throughout the chapter.



20 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART I General Principles

CHAPTER 2 Overview of Brokerage Practice and the Organization of the Brokerage Industry *

10-2 Real Estate Brokerage Law and Practice § 2.05

§ 2.05 Code of Ethics and Standards of Practice of the National Association of Realtors(R)

As discussed in § 2.01 *above*, the pledge to abide by the National Association of Realtors(R) (NAR's) code of ethics and standards of practice is a requirement of membership in the NAR. Failure to comply with the code can result in the revocation of a Board or Association charter, revocation of use of the "Realtor(R)" mark, and termination of important services such as insurance.

The Code of Ethics and Standards of Practice of the National Association of Realtors(R) can be obtained from the website maintained by the National Association of Realtors(R) (see <<<http://www.nar.realtor.com>>> (click on Code of Ethics) (site visited May 8, 2001)). The Preamble reads (effective January 1, 2001):

Preamble

Under all is the land. Upon its wise utilization and widely allocated ownership depend the survival and growth of free institutions and of our civilization. REALTORS(R) should recognize that the interests of the nation and its citizens require the highest and best use of the land and the widest distribution of land ownership. They require the creation of adequate housing, the building of functioning cities, the development of productive industries and farms, and the preservation of a healthful environment.

Such interests impose obligations beyond those of ordinary commerce. They impose grave social responsibility and a patriotic duty to which REALTORS(R) should dedicate themselves, and for which they should be diligent in preparing themselves. REALTORS(R), therefore, are zealous to maintain and improve the standards of their calling and share with their fellow REALTORS(R) a common responsibility for its integrity and honor.

In recognition and appreciation of their obligations to clients, customers, the public, and each other, REALTORS(R) continuously strive to become and remain informed on issues affecting real estate and, as knowledgeable professionals, they willingly share the fruit of their experience and study with others. They identify and take steps, through enforcement of this Code of Ethics and by assisting appropriate regulatory bodies, to eliminate practices which may damage the public or which might discredit or bring dishonor to the real estate profession. REALTORS(R) having direct personal knowledge of conduct that may violate the Code of Ethics involving misappropriation of client or customer funds or property,

willful discrimination, or fraud resulting in substantial economic harm, bring such matters to the attention of the appropriate Board or Association of REALTORS(R).

Realizing that cooperation with other real estate professionals promotes the best interests of those who utilize their services, REALTORS(R) urge exclusive representation of clients; do not attempt to gain any unfair advantage over their competitors; and they refrain from making unsolicited comments about other practitioners. In instances where their opinion is sought, or where REALTORS(R) believe that comment is necessary, their opinion is offered in an objective, professional manner, uninfluenced by any personal motivation or potential advantage or gain.

The term REALTORS(R) has come to connote competency, fairness, and high integrity resulting from adherence to a lofty ideal of moral conduct in business relations. No inducement of profit and no instruction from clients ever can justify departure from this ideal.

In the interpretation of this obligation, REALTORS(R) can take no safer guide than that which has been handed down through the centuries, embodied in the Golden Rule, "Whatsoever ye would that others should do to you, do ye even so to them."

Accepting this standard as their own, REALTORS(R) pledge to observe its spirit in all of their activities and to conduct their business in accordance with the tenets set forth below.

* This chapter was revised by Charles J. Jacobus, Esq., a partner in the law firm of Jacobus, Boltz, Melamed & Witherspoon, Houston, Texas. Sections 2.06 and 2.07 were written by Sandra Bullington, who has contributed additional updates throughout the chapter.



21 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART I General Principles

CHAPTER 2 Overview of Brokerage Practice and the Organization of the Brokerage Industry *

10-2 Real Estate Brokerage Law and Practice § 2.06

§ 2.06 Professional Designations

Many real estates agents and brokers place letters after their names or use the trademark REALTOR(R) following their names. These letters indicate a professional certification which the agent or broker has earned through a trade organization. Typically, a professional designation indicates that the individual has furthered his or her education in specific areas of the real estate industry in order to provide specialized services to customers and clients. The more common of these designations are shown below:

- **ABR: Accredited Buyer Representative.** This designation is offered by the Real Estate Buyer's Agent Council of the National Association of Realtors(R). Earning this designation requires completion of a two-day course in buyer representation and obtaining a passing grade on the written examination. In addition, the agent must demonstrate practical experience by completing and closing five real estate transactions in which the agent functioned as a buyer's representative. These transactions must be completed and closed anytime prior to and up to 36 months after completing the ABR(R) course. Agents with this designation must also maintain membership in and be in good standing with the National Association of REALTORS(R) and with the Real Estate Buyer's Agent Council. More information on this program can be obtained at <<<http://www.rebac.net>>> (site visited May 4, 2001).

- **ABRM: Accredited Buyer Representative Manager.** This designation is offered by the Real Estate Buyer's Agent Council for brokers, owners, and managers. Requirements for this designation are similar to that for the ABR. However, the prospective designee must certify that he or she has overseen a minimum of 25 real estate transactions that involved a buyer's agent or has more than 2 years of experience in the oversight of buyer's representatives. This designation requires membership in and good standing with the National Association of REALTORS(R) and with the Real Estate Buyer's Agent Council. More information on this program can be obtained at <<<http://www.rebac.net>>> (site visited May 4, 2001).

- **ALC: Accredited Land Consultant.** This designation is awarded to Realtors(R) with land sales experience who complete educational courses through the Realtors(R) Land Institute which is an affiliate of the National Association of REALTORS(R). Licensees earning this designation have focused on land brokerage transactions of five specialized types: (1) farms and ranches; (2) undeveloped tracts of land;

(3) transitional and development land; (4) subdivision and wholesaling of lots; (5) site selection and assemblage of land parcels. More information on this designation may be obtained at <<<http://www.riland.com>>> (site visited May 4, 2001).

■ **CCIM: Certified Commercial Investment Member.** This designation is offered by the Commercial Investment Real Estate Institute for real estate professionals involved in commercial real estate brokerage, leasing, asset management valuation, and investment analysis. The Commercial Investment Real Estate Institute has been conferring the CCIM designation since 1969. This designation requires 240 hours of graduate-level curriculum. This Institute is an affiliate of the National Association of Realtors(R) (NAR). The CCIM designation was established by the California Association of Realtors(R) in 1954 under the name Certified Property Exchanger (CPE). In 1967, the designation became subject to administration by a division of the National Association of Realtors(R). In 1969, the designation was renamed Certified Commercial Investment Member (CCIM). A council was established to administer the designation and in 1991 it was granted institute status as an affiliate of NAR. More information about this designation may be obtained at <<<http://www.ccim.com>>> (site visited May 4, 2001).

■ **C-CREC: Consumer-Certified Real Estate Consultants.** The National Association of Real Estate Consultants (NARC) is the sponsor organization of the C-CREC designation. NARC states that this designation "is the first international designation focused on results-oriented skills required by consumers--not what the real estate industry chooses to deliver to them." More information can be obtained about this designation at <<<http://www.ccrec.com>>> (site visited May 4, 2001).

■ **CIPS: Certified International Property Specialist.** This designation is offered the Certified International Property Specialist Network of the National Association of Realtors(R) for Realtors(R) who work with buyers and sellers from different countries and cultures. More information about this designation can be obtained at <<<http://www.cipsnetwork.com>>> (site visited May 4, 2001).

■ **CPM: Certified Property Manager.** This designation is offered by the Institute for Real Estate Management. This professional designation is for individuals involved in property management. More information about this designation can be obtained at <<<http://www.irem.org/cpm.htm>>> (site visited May 4, 2001).

■ **CRB: Certified Real Estate Brokerage.** This designation is offered by the Real Estate Brokerage Managers Council. This designation is intended to be a symbol of excellence in brokerage management. More information about this designation can be obtained at <<<http://www.crb.com>>> (site visited May 4, 2001).

■ **CRP: Certified Relocation Professional.** This designation is awarded by the Employee Relocation Council to individuals who have extensive knowledge on the principles and practices of relocation. This organization also offers a Senior Certified Relocation Professional designation which is based on receiving the Council's Distinguished Service Award. More information about these designations can be obtained at <<<http://www.erc.org>>> (site visited May 4, 2001).

■ **CRS: Certified Residential Specialist.** This designation is offered by the Residential Sales Council of the National Association of REALTORS(R) (NAR). This Council is the largest not-for-profit affiliate of the NAR. Designees must complete advanced study in residential listing and selling. More information can be obtained about this designation at <<<http://www.crs.com>>> (site visited May 4, 2001).

■ **e-Pro: Internet Professionals.** This designation is offered by the National Association of REALTORS(R) (NAR). The NAR Website states that the vision of the e-PRO Certification is to create a well-trained, core group of real estate professionals who are thriving in the online-based real estate industry. More information about this designation can be obtained at <<<http://nar.realtor.com/epro/home.htm>>> (site visited May 4, 2001).

■ **GRI: Graduate REALTOR(R) Institute.** Only members of the National Association of REALTORS(R) (NAR) can obtain the GRI designation. Earning this professional designation requires completion of three five-day programs, GRI I-Residential Real Estate, GRI II-Advanced Residential Real Estate, and GRI III-Specialty Real Estate.

■ **LTG: (Leadership Training Graduate).** This professional designation is offered by the Women's Council of REALTORS(R). More information about this designation can be obtained at <<<http://www.wcr.org>>> (site visited May 4, 2001).

■ **SIOR: Society of Industrial and Office REALTORS(R).** This designation is offered by the Society of Industrial and Office REALTORS(R) which is an affiliate of the National Association of Realtors(R). This designation is intended for top producers in the areas of industrial and office real estate brokerage. More information about this designation can be obtained at <<<http://www.sior.com>>>.

■ **CRE: Counselor of Real Estate.** The Counselors of Real Estate was founded in 1953 and serves roughly 1,100 members who hold the "CRE" designation. The CRE Designation is awarded only to individuals who are invited by their peers into the membership of The Counselors of Real Estate. More information can be obtained about this designation at <<<http://www.cre.org>>>.

■ **Green Designation.** The Green Resource Council of the National Association of Realtors(R) was established by the Real Estate Buyer's Agent Council (REBAC) in order to make the knowledge of green real estate practices available to real estate agents and property managers, consumers, tenants, developers, and building owners. More information can be obtained about this designation at <<<http://www.greenresourcecouncil.org>>>.

■ **SRES: Seniors Real Estate Specialist.** This designation is offered by the Senior Advantage Real Estate Council(R). This designation focuses on the senior citizen population. More information about this designation can be obtained at <<<http://www.seniorsrealestate.com>>>.

■ **EcoBroker(R):** EcoBroker International offers the professional designation of EcoBroker(R). This entity is a Built Green Educational Partner. A licensee seeking this designation must complete this entity's energy, environmental, and marketing training program. EcoBroker International may be reached at 29029 Upper Bear Creek Rd., Suite 202 Evergreen, CO 80439; Telephone: 303-674-7770; Website: <http://www.ecobroker.com>.

* This chapter was revised by Charles J. Jacobus, Esq., a partner in the law firm of Jacobus, Boltz, Melamed & Witherspoon, Houston, Texas. Sections 2.06 and 2.07 were written by Sandra Bullington, who has contributed additional updates throughout the chapter.



22 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART I General Principles

CHAPTER 2 Overview of Brokerage Practice and the Organization of the Brokerage Industry *

10-2 Real Estate Brokerage Law and Practice § 2.07

§ 2.07 Errors and Omissions Insurance

A minority of states require that agents and brokers carry errors and omissions insurance. However, it appears that mandating such insurance coverage is a growing trend. Colorado, n1 Idaho, n2 Iowa, n3 Kentucky, n4 Louisiana, n5 Nebraska, n6 New Mexico, n7 North Dakota, n8 Rhode Island, n9 South Dakota n10 and Tennessee n11 had mandatory insurance requirements for real estate brokers and agents. Some states with mandatory insurance requirements offer licensees coverage under a state group plan. For example, Alabama offers a state group plan. Licensees, however, are free to obtain the required insurance elsewhere.

Most laypersons think of errors and omissions insurance as malpractice insurance. n12 Errors and omissions insurance for brokers and agents is similar to insurance carried by attorneys, physicians, accountants, architects, and other professionals. Typically, a broker's or agent's insurance will be a "claims made" insurance policy which means that if the claim is made during the policy period the insured agent or broker is covered. If the claim is made outside of the policy period the agent or broker is not insured, unless the agent or broker purchased an extended reporting endorsement commonly referred to as "tail coverage." Tail insurance coverage protects the insured for a period of time after the insurance policy expires. Prior acts coverage, which is also known as retroactive date coverage, is also available. Under a prior acts provision the policy contains a prior acts date, which is the earliest date that a wrongful act may be committed and be covered under the policy.

Errors and omissions insurance protects the agent or broker against certain covered losses and should cover legal expenses incurred in defending a lawsuit. Such policies typically cover claims that arise from an error, omission, or negligence. These policies typically exclude coverage for:

- Dishonest or criminal conduct. n13
- Environmental pollution.
- Known wrongful acts.
- Prior wrongful acts.

- Breach of employment contracts.
- Listing, selling, or managing real estate that is owned, built or developed by an insured who has over a 25% ownership interest in said real estate.
- Securities transactions.
- Failure to obtain or maintain insurance for managed property.
- Discrimination.
- Activities that fall outside of real estate brokerage such as acting as a mortgage banker or correspondent; escrow agent; construction manager; property developer; or appraiser (some policies allow appraiser coverage to be added by endorsement).
- Contract liability (assumed under any contract or agreement).
- Real estate promotion (investment contract, syndication as a partner, joint venture, etc.).
- Nuclear energy.

In addition, errors and omissions policies typically do not cover intentional business torts. n14

The amount of coverage varies depending on the policy purchased. These policies often have two deductibles: one for defense costs and one for damages. It appears that the most common claim is a failure to disclose an item that a buyer felt was material.

Some brokers offer their agents and salespersons insurance coverage or a legal defense plan should they be sued. However, such coverage can present a conflict of interest as the interests of the broker and its agent or salesperson may differ. If an insurer undertakes a defense for an agent or salesperson, it may protect its position by reserving its rights under the policy. A reservation of rights consists of the insurer notifying the insured that the insurer will defend the suit, but the insurer reserves all rights it has based on noncoverage under the policy. However, if the insurer fails to take prompt action to reserve its rights, it may be forced to provide coverage to the agent or broker. n15

An errors and omissions policy may cover a broker's unintentional violation of the Real Estate Settlement and Procedures Act of 1974 (12 U.S.C. §§ 2601 et seq.). n16

FOOTNOTES:

(n1)Footnote 1. *Colo. Rev. Stat. § 12-61-103.6.*

(n2)Footnote 2. *Idaho Code § 54-2013.*

(n3)Footnote 3. *Iowa Admin. Code Chapter 193E, § 19.2.*

(n4)Footnote 4. *Ky. Rev. Stat. Ann. § 324.395.*

(n5)Footnote 5. *La. Rev. Stat. Ann. § 37:1466.*

(n6)Footnote 6. *Neb. Rev. Stat. § 81-885.55.*

(n7)Footnote 7. *N.M. Admin. Code § 16.61.5.8.*

(n8)Footnote 8. *N.D. Cent. Code § 43-23-19.*

(n9)Footnote 9. *R.I. Gen. Laws § 5-20.5-25.*

(n10)Footnote 10. *S.D. Codified Laws §§ 36-21A-119 to 36-21A-123.*

(n11)Footnote 11. *Tenn. Comp. R. & Regs. Rule 1260-1-15.*

(n12)Footnote 12. *See generally* Tucker, Annot., *Real-Estate Agents' and Brokers' Professional Liability Insurance*, 35 A.L.R.5th 83 (1996) .

(n13)Footnote 13. *See Murray v. Greenwich Ins. Co.*, 533 F.3d 644, 647 (8th Cir. 2008) ; *United Fire & Casualty*, 105 Ill. App. 3d 1048, 1050, 61 Ill. Dec. 799, 435 N.E.2d 496, 498 (1982) .

(n14)Footnote 14. *See, e.g., Crum and Forster Managers Corp. v. Resolution Trust Corp.*, 156 Ill. 2d 384, 189 Ill. Dec. 756, 620 N.E.2d 1073, 1081 (1993) .

(n15)Footnote 15. *See Britton v. Smythe, Cramer Company*, 139 Ohio App. 3d 337, 743 N.E.2d 960, 968-969 (2000) , *appeal denied*, 91 Ohio St.3d. 1419, 741 N.E.2d 145 (2001) .

(n16)Footnote 16. *Cf. Beyer v. Heritage Realty, Inc.*, 251 F.3d 1155, 1158 (7th Cir. 2001) (policy must be read to cover unintentional violations of RESPA, court refused to read the exclusion of violations of deceptive trade practices law as covering a broker's failure to disclose its affiliation with a title service company).

* This chapter was revised by Charles J. Jacobus, Esq., a partner in the law firm of Jacobus, Boltz, Melamed & Witherspoon, Houston, Texas. Sections 2.06 and 2.07 were written by Sandra Bullington, who has contributed additional updates throughout the chapter.



23 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

10-3 Real Estate Brokerage Law and Practice 3.syn

§ 3.syn Synopsis to Chapter 3: The Broker's Duties and Liabilities *

§ 3.01 Public Trust Has Shaped Brokerage Law

§ 3.02 Regulation of Real Estate Licensees

§ 3.03 Sources of Brokerage Law

§ 3.04 Application of the Caveat Emptor Doctrine in Real Estate Brokerage

§ 3.05 National Association of Realtors(R) Code of Ethics

§ 3.06 Megan's Laws and Real Estate Brokers

[1] History of Megan's Laws

[2] "Megan's Laws"--History and Purposes

[3] The Effect of Megan's Laws Upon Licensee Disclosure Obligations

[4] State Megan's Laws

§ 3.07 Common Law of Agency

[1] Creation of an Agency Relationship

[2] Commencement of Fiduciary Duties

[3] An Agent's Duties

[4] Duty to Perform

[5] Duty to Exercise Reasonable Care and Skill

[6] Duty of Disclosure to the Principal

[7] Duty to Effect a Sale to the Principal's Best Advantage

[8] Duty to Follow the Principal's Instructions

[9] Duty to Account

[10] Duty to Present All Offers

[11] Duty of Loyalty

[12] Duty to Advise

[13] Broker Cannot Have an Interest in the Agency's Subject Matter Without the Principal's Consent

§ 3.08 Duties Owed to the Seller by a Buyer's Broker

§ 3.09 Negligence

§ 3.10 Subagency

[1] Duties of a Subagent

[2] Selling Broker's Relationship with Seller and Purchaser

[3] Agency Law Applied to Selling Broker and Purchaser

[4] Gratuitous Agency

§ 3.11 Insider Trading

§ 3.12 When Do a Broker's Duties Terminate?

§ 3.13 Breach of a Broker's Duty Under Agency Law

[1] Damages for Breach of a Broker's Duty

[2] Effect of a Breach of a Broker's Duty Upon the Broker's Right to Compensation

[3] Damages Arising from a Broker's Self-Dealing

§ 3.14 Common Law Defense of Manager's Privilege

§ 3.15 A Broker's Use of an Independent Inspector's Report as a Defense in a Buyer's Action

§ 3.16 Duties Owed to a Buyer by a Seller's Broker

[1] A Seller's Broker Must Deal Honestly and Fairly with a Buyer

[2] Duty to Investigate

[3] Negligent Misrepresentation

[4] Innocent Misrepresentation

[5] Intentional or Fraudulent Misrepresentation

[6] Fraudulent Concealment

[7] Defenses Against a Buyer's Misrepresentation Claims

[8] Recovery of Damages for Misrepresentations

[9] Duty to Present the Buyer's Offer

[10] Duty to Inspect

[a] Residential Property in California

[b] Duty to Inspect in Other States

§ 3.17 Duties of a Buyer's Broker to Provide the Buyer with a Seller Disclosure Statement

§ 3.18 "As Is" Clauses in Sales Contracts

§ 3.19 Duties Unique to Common Interest Properties

§ 3.20 Single-Party and Single Agent Brokers

§ 3.21 Dual Agency

[1] Dual Agency Is Problematic

[2] Common Law and Dual Agency

[3] Statutory Authorization of Dual Agency

[4] Duties of a Dual Agent

[5] Remedies for Failure to Disclose Dual Agency

[6] Representation of Competing Buyers by Agents Associated with the Same Broker

§ 3.22 Transactional Brokers and Facilitators

[1] Transaction Brokers Are Not Agents of Either Party

[2] Duties of a Transaction Broker

[3] Transaction Brokers Are Liable Only for Damages Their Conduct Causes

[4] Statutory Duty to Provide a Disclosure Statement Regarding the Parties' Relationship

§ 3.23 Implied Covenant of Good Faith and Fair Dealing

§ 3.24 Duty to Provide a Residential Property Disclosure Statement

§ 3.25 Duties with Respect to Earnest Money Deposits

§ 3.26 Powers of Attorney

§ 3.27 Are Brokers Professionals for Malpractice Statutes of Limitations?

[1] What Is a Professional?

[2] Courts Holding that Brokers Are Not Professionals

[3] Courts Holding that Brokers Are Professionals or Can Commit Malpractice

[4] Statutory Requirements When Suing a Broker

§ 3.28 Duties Owed to Third Party Holders of Security Interests

§ 3.29 Duties and Obligations Arising from Lock Boxes

§ 3.30 Broker's Duty with Respect to Open Houses and Property Showings

§ 3.31 Broker Duties Under Consumer Protection Laws

§ 3.32 Duties and Liabilities Arising from Broker Referrals of Third Parties

§ 3.33 Brokers Acting in Several Capacities

§ 3.34 Negligent Hiring of Agents and Salespersons

§ 3.35 Valuation Opinions

§ 3.36 Unauthorized Practice of Law May Constitute Negligence

§ 3.37 Exculpatory Clauses

§ 3.38 Integration, Merger and Disclaimer Clauses

§ 3.39 Economic Loss Rule



24 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 3 The Broker's Duties and Liabilities *

10-3 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

A real estate broker's duties depend upon the broker's role in the underlying real estate transaction. In turn, who the broker represents, the client's goals, and the type of relationship entered into by the broker and client determine the broker's role. A broker representing a seller is going to owe different duties to his or her client and other parties involved in the transaction than a broker representing a buyer. A broker who has entered into a fiduciary relationship will have greater duties than a broker who has entered into a non-fiduciary relationship.

Traditionally, brokers and agents usually represented sellers. With lesser frequency, brokers and agents represented buyers. When all parties were apprised of the facts and consented, a broker or agent could represent the buyer and the seller. At common law, a broker was a fiduciary subject to the same duties as any other fiduciary. When a broker functions as a fiduciary, the broker has a position of great trust and confidence commanding the utmost good faith and loyalty toward the principal.

The advent of brokerage relationship acts has altered a broker or agent's duties as these acts typically specify a licensee's duties and obligations and address the application of the common law to brokerage relationships that arise after passage of the act. While these acts have sought to remove the confusion and misunderstandings of consumers with respect to brokerage relationships, they have often complicated determining a broker's duties and obligations. If a situation arises that is not covered by the act, courts often turn to the common law of agency in determining the consequences. In some instances an act will specify a broker's duties, but will fail to state the remedies available for a violation of these duties. In this situation, courts often look to common law.

Statutes and regulations regarding a broker's duties and obligations vary from state to state. This makes it difficult to make generalizations that apply uniformly. Readers are advised to review the specific statutes and regulations that apply to their case. Furthermore, case law regarding a broker's duties and obligations is also far from uniform.

The extent of a broker's duties will also be affected by whether a residential or commercial transaction is involved and the level of sophistication of the client. These are factors that make the facts and circumstances of each case relevant to a court's decision when a broker is alleged to have committed a tort or a breach of contract.

This Chapter covers duties that arise from the broker's relationship with his or her client as well as duties owed to third

parties involved in the transaction or affected by the brokerage relationship. Though real estate licensees go by various terms (broker, agent, salesperson), this Chapter will often use the broader term of licensee.



25 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART I. Evolution of Real Estate Brokerage Law

10-3 Real Estate Brokerage Law and Practice § 3.01

§ 3.01 Public Trust Has Shaped Brokerage Law

Though courts disagree on whether real estate licensees are professionals (*see § 3.27, below*), the public reposes trust in these licensees. One court summed up the unique position that licensees occupy:

Real estate brokers are often in a very commanding position with respect to both sellers and buyers of residential property. The real estate broker's relationship to the buyer is such that the buyer usually expects the broker to protect his interest. This trust and confidence derives from the potential value of the broker's service; houses are infrequently purchased and require a trained eye to determine value and fitness. In addition, financing is often complex. Unlike other commodities, houses are rarely purchased new and there are virtually no remedies for deficiencies in fitness. In some respects the broker-buyer relationship is akin to the attorney-client relationship; the buyer, like the client, relies heavily on another's acquired skill and knowledge, first because of the complexity of the transaction and second because of his own dearth of experience. n1

This "commanding position" has shaped the contours of regulatory, statutory and judicial law with respect to real estate licensees. Abuses of the trust inherent in this commanding position were frequent enough to require regulation of this industry.

Brokers essentially operate in a state-created monopoly. n2 For example, unlicensed individuals are typically denied the right to sue for a commission on the sale of real estate (*see § 4.05, below*). The advent of multiple listing services (MLS) added to the monopoly feel of the real estate brokerage industry. Consumers can only access the MLS through an individual real estate broker. Thanks to the MLS, brokers possess a virtually unparalleled knowledge concerning available homes and their listing and actual sales prices. n3 One court has stated:

Parties to real estate transactions frequently do not deal on equal terms. Real estate brokers are licensed professionals, possessing superior knowledge of the realty they sell and the real estate market generally. Prospective purchasers recognize this expertise and tend to rely on a broker's representations. Just as purchasers are entitled to rely on an owner's representations, [citation omitted] purchasers should be entitled to rely on the broker's representations. n4

Given the high degree of reliance, if not dependence, upon brokers, a broker's failings, real or imagined, in a deal gone sour may serve as a lightning rod for dispute. Lawsuits against brokers have increased and this growth has been attributed to a combination of factors. The broker may be the only professional in the transaction, with the principals being consumers. n5 The broker's high visibility in the transaction, coupled with the maintenance of an ongoing business which can pay judgments, make the broker "an easy target for an unhappy buyer or seller." n6

FOOTNOTES:

(n1)Footnote 1. *Lane v. Oustalet*, 850 So. 2d 1143, 1151 (Miss. Ct. App. 2002) rehearing denied, 840 So. 2d 716 (Miss. Ct. App. 2002) , *aff'd in part, rev'd in part*, 873 So. 2d 92 (Miss. 2004) , quoting Comment, *A Reexamination of the Real Estate Broker-Buyer-Seller Relationship*, 18 Wayne L. Rev. 1343 (1972).

(n2)Footnote 2. *See Menzel v. Morse*, 362 N.W.2d 465, 474 (Iowa 1985) .

(n3)Footnote 3. *Cf. Asleson v. Westbranch Land Co.*, 311 N.W.2d 533, 538 (N.D. 1981) ("The Multiple Listing Service is a corporation whose members, by way of a daily listing sheet, exchange information on real estate they have for sale.").

(n4)Footnote 4. *Bevins v. Ballard*, 655 P.2d 757, 763 (Alaska 1982) .

(n5)Footnote 5. *See Bevins v. Ballard*, 655 P.2d 757 (Alaska 1982) ; Henszey, *Broker's Liability Cause for Concern*, 8 Real Est. Rev. 57, 58 (1978-79).

(n6)Footnote 6. *See Bevins v. Ballard*, 655 P.2d 757 (Alaska 1982) ; Henszey, *Broker's Liability Cause for Concern*, 8 Real Est. Rev. 57, 58 (1978-79).

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26 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART I. Evolution of Real Estate Brokerage Law

10-3 Real Estate Brokerage Law and Practice § 3.02

§ 3.02 Regulation of Real Estate Licensees

Historically, the common law of agency applied to real estate brokers and the doctrine of caveat emptor was the primary rule between the seller and the buyer. Since the broker was an agent of his or her principal, the protective cloak of the caveat emptor doctrine often protected the broker as well as the broker's principal.

When states began licensing those who brokered real estate transactions for compensation, additional laws affected brokers and agents. These laws typically address the licensee's qualification and conduct. The licensing of real estate professionals has been required in many states for more than a century. n1 Through licensing, legislatures sought to keep unscrupulous individuals out of the real estate brokerage industry. Courts have recognized the potential for brokers to act in their own interest rather than that of their client. One court in addressing the potential for mischief stated:

The intrinsic nature of the [real estate] business combines with practice and tradition to attest the need of regulation. The real estate broker is brought by his calling into a relation of trust and confidence. Constant are the opportunities by concealment and collusion to extract illicit gains. We know from our judicial records that the opportunities have not been lost. n2

Licensing seeks to protect the public from dishonest brokers. n3 Typically, under a state's licensing laws, real estate licensees must meet high standards of honesty, integrity, trustworthiness and competency and the licensing act must be construed in the light of an obvious purpose of protecting the public in the handling of real estate transactions. n4

While the licensing laws affected who could work in the real estate industry, the application of agency law to brokers and agents remained largely unchanged. n5 However, the licensing of real estate professionals helped to remove the protective cloak of the caveat emptor doctrine from these licensees. Generally, the rule of caveat emptor does not apply to those dealing with a real estate licensee. Even though not usually occupying a fiduciary relationship with prospective purchasers, a real estate licensee hired by the seller is expected to be honest, ethical, and competent and is answerable at law for breaches of his or her statutory duty to the public. n6

The regulation of real estate professionals expanded when states added educational requirements and testing for initial licensure and continuing educational requirements for renewal of licenses. The goal of such statutes and regulations is

to protect the public by assuring the initial competency and continued competency of licensees.

More recent statutes affecting the real estate brokerage industry have included brokerage relationship acts aimed at clarifying the duties and responsibilities real estate licensees owe to those with whom they deal. n7 Such acts, however, have made it more difficult to state broad generalizations that apply in all jurisdictions. Some of these acts supplant the common law of agency. Some of these acts provide that the common law of agency continues to apply so long as it does not contradict the act. Some of these acts leave the common law of agency intact.

Typically these brokerage relationship acts specify a licensee's duties. These duties will vary depending upon the type of relationship entered into between the parties. Since many statutorily authorize non-agency relationships, they clearly affect a licensee's duties since a non-agency relationship, by definition, would not be subject to agency law. These acts are discussed in greater detail in Chapter 2A, *above*. However, these acts are discussed in this Chapter in the context of a broker's duties and liabilities.

Residential seller disclosure acts also affect a licensee's duties and liabilities. Many of the disclosure acts statutorily mandate the disclosure form sellers must provide to prospective purchasers. Many of these acts also specifically state that the representations made in the disclosure statement are that of the sellers and not the seller's broker or agent. One effect of these acts has been to provide a defensive shield to the broker and agent when a buyer is disgruntled after the sale and files a lawsuit based upon an alleged misrepresentation in the disclosure document. n8

The regulation of the real estate brokerage industry has attempted to place duties and obligations upon real estate licensees that are commiserate with the trust the public places in these licensees. Licensing laws, brokerage relationship statutes, and residential real estate disclosure laws have affected the duties and liabilities of real estate licensees. This is particularly true with respect to residential real estate. No longer can brokers operate subject only to the constraints of the common law. Furthermore, the contours of real estate brokerage law will continue to change as courts apply brokerage relationship acts.

FOOTNOTES:

(n1)Footnote 1. *Cf. Roman v. Lobe*, 243 N.Y. 51, 55, 152 N.E. 461, 463 (N.Y. 1926) ("For the better part of a century, real estate brokers in many States, even though not subjected to a test of character and competence, have been prohibited from doing business without a preliminary license."); Dallon, *Theories of Real Estate Broker Liability and the Effect of the "As Is" Clause*, 54 Fla. L. Rev. 395, 396 (2002) ("The occupation of real estate broker or real estate agent ... began in the early nineteenth century.").

(n2)Footnote 2. *Roman v. Lobe*, 243 N.Y. 51, 54, 152 N.E. 461, 462 (N.Y. 1926).

(n3)Footnote 3. *See Smith v. Sullivan*, 419 So. 2d 184, 187 (Miss. 1982); *Roman v. Lobe*, 243 N.Y. 51, 56, 152 N.E. 461, 463 (N.Y. 1926).

(n4)Footnote 4. *See Tres' Chic In A Week, L.L.C. v. Home Realty Store*, 993 So. 2d 228, 231-32 (La. Ct. App. 2008); *Hagar v. Mobley*, 638 P.2d 127, 136 (Wyo. 1981).

(n5)Footnote 5. *Cf. Carleton v. Tortosa*, 14 Cal. App. 4th 745, 755, 17 Cal. Rptr. 2d 734, 740 (Cal. Ct. App. 1993), review denied, 1993 Cal. LEXIS 3609 (Cal. July 1, 1993) (brokers are subject to two sets of duties: those imposed by regulatory statutes, and those arising from the general law of agency).

(n6)Footnote 6. *See Dugan v. Jones*, 615 P.2d 1239, 1248 (Utah 1980).

(n7)Footnote 7. *See Killearn Partners, Inc. v. Southeast Properties, Inc.*, 2004 Ga. App. LEXIS 425, at *5 (Ga. Ct. App. March 24, 2004) (apparent purpose of Georgia Brokerage Relationships in Real Estate Transactions Act was to codify duties owed by a real estate broker to a landlord, buyer, seller, or tenant and to codify a broker's responsibilities

to clients and customers, the act is a statute in derogation of the common law, it is axiomatic that statutes adopted in derogation of the common law must be strictly construed and not extended beyond their plain and explicit terms).

See generally Olazabal, *Redefining Realtor Relationships and Responsibilities: The Failure of State Regulatory Responses*, 40 Harv. J. on Legis. 65 (2003).

(n8)Footnote 8. Cf. *Sherman v. Elkowitz*, 130 S.W.3d 316, 2004 Tex. App. LEXIS 1609, at *18-*19 (Tex. Ct. App. Feb. 19, 2004) (sellers' agent knew about a prior lawsuit where the sellers had sued the prior owner for property defects, court held that this earlier lawsuit was not required to be disclosed on the Seller's Disclosure Notice, and that the agent and broker could not be liable for nondisclosure of this lawsuit); Dallon, *Theories of Real Estate Broker Liability and the Effect of the "As Is" Clause*, 54 Fla. L. Rev. 395, 428 (2002) ("The real estate industry viewed [Residential Property Disclosure Acts] as means to limit the liability of real estate brokers by imposing affirmative disclosure requirements upon sellers and limiting brokers' duties to investigate or disclose."); Pancak et al., *Residential Disclosure Laws: The Further Demise of Caveat Emptor*, 24 Real Est. L.J. 291, 310 (1996) ("Statutory seller disclosure legislation is largely the result of the real estate brokerage community's attempt to limit the expansion of a broker's duty to the buyer to inspect and disclose.").

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27 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART I. Evolution of Real Estate Brokerage Law

10-3 Real Estate Brokerage Law and Practice § 3.03

§ 3.03 Sources of Brokerage Law

For most of the twentieth century, real estate licensees were subject to two sets of duties: those imposed by regulatory statutes (such as licensing laws), and those arising from the general law of agency. n1 Application of general agency law entailed a consideration of the agreement between the parties which established the parties' relationship. Historically, a broker had a fiduciary relation with his or her principal and as long as that relation continued, the broker was under a legal obligation as well as a moral duty to give the principal loyal service. n2

During the 1990s, however, most states adopted brokerage relationship acts which specifically address relationships with real estate licensees and the duties and liabilities arising from these relationships. n3 These statutes define the types of relationships a broker can enter into, how these relationships are created, and specify the duties that arise with each type of relationship. Many brokerage relationship acts contain a provision declaring that a broker's duties are as specified in the statute or in rules of the state real estate commission and that such statutes and rules supersede any duties the broker owed to a party to a real estate transaction which are based upon common law principles of agency to the extent that those common law duties are inconsistent with the duties of licensees as specified in this broker statute. n4 Some brokerage relationship acts essentially abrogate the common law claim for breach of fiduciary duty. n5 Consequently, the determination of a broker's duties in most jurisdictions requires an examination of the contract between the parties, the applicable brokerage relationship act, and in some cases, the law of agency. However, the brokerage act will usually take precedence over any conflicts with the law of agency.

Some brokerage relationship acts were enacted to create a statutory agency in order to take the typical real estate agency relationship out of the realm of common law agency. n6 For example, *Missouri Revised Statutes § 339.840* specifically provides that the statutory provisions addressing brokerage relationships supersede "the common law of agency with respect to whom the fiduciary duties of an agent are owed in a real estate transaction, but do not limit civil actions for negligence, fraud, misrepresentation or breach of contract." n7

In determining a broker's duties and liabilities the crucial initial question will be what type of relationship exists between the parties. Though agency law principles will continue to apply to some brokerage relationships, many states allow non-agency brokerage relationships. This non-agency relationship is usually referred to as a transaction broker (see § 3.22, *below* for a discussion of this type of relationship). The non-agency brokerage relationship allows a broker

to reap the benefits (i.e., collect his or her commission) without the heavy burden of complying with the high scruples and ethics imposed upon traditional agents (i.e., acting as a fiduciary).

Though provisions stating legislative intent in passing these brokerage relationship statutes advises that a primary goal is disclosure and a better understanding of brokerage relationships, the reality is often that the combination of existing regulatory law and the common law of agency which governed brokerage relationships prior to the passage of the brokerage relationship statute was more rigorous. One court has stated:

We believe the common law existing at the time of the present transaction imposed a greater burden on statutory agents than that imposed by [Brokerage Relationships in Real Estate Transactions Act] BRRETA. The pre-BRRETA license law required real estate brokers to disclose what they knew as well as everything they should have known about the condition of the property. On the other hand, BRRETA requires brokers to disclose only what they actually know and to suggest to real estate consumers that they use independent third-party inspections on matters that are outside the real estate broker's expertise. (citations omitted) n8

Despite the enactment of brokerage acts which allow brokers to enter into non-agency relationships with their clients, brokers may continue to serve in relationships which are generally subject to the law of agency by specifically serving as a seller's agent or a buyer's agent. Some states continue to hold that brokers are fiduciaries. n9 Prudent buyers and sellers will opt for a relationship involving fiduciary responsibilities on the part of their broker, rather than entering into a non-agency relationship.

Whether a broker's duties arise from the common law of agency, a brokerage relationship act, or a combination of these laws, the precise duties of a real estate broker must be determined by an examination of the nature of the task the real estate agent undertakes to perform and the agreements the broker makes with the involved parties. n10

Readers are directed to Chapter 2A, *above* , for a discussion of the brokerage laws of each state and to Chapter 3A, *below* , for a discussion of a seller and broker disclosure obligations in each state.

FOOTNOTES:

(n1)Footnote 1. *See Carleton v. Tortosa*, 14 Cal. App. 4th 745, 755, 17 Cal. Rptr. 2d 734, 740 (Cal. Ct. App. 1993) , review denied, 1993 Cal. LEXIS 3609 (Cal. July 1, 1993) . *See also Hercules v. Robedaux, Inc.*, 110 Wis. 2d 369, 329 N.W.2d 240, 242 (Wis. 1982) (essential feature underlying relation of broker to his employer is that of agency, principles of the law of agency apply throughout).

(n2)Footnote 2. *See Owen v. Shelton*, 221 Va. 1051, 1054, 277 S.E.2d 189, 191 (Va. 1981) (quoting *Olson v. Brickles*, 203 Va. 447, 450, 124 S.E.2d 895, 898 (Va. 1962)) .

(n3)Footnote 3. *See generally Olazabal, Redefining Realtor Relationships and Responsibilities: The Failure of State Regulatory Responses*, 40 Harv. J. on Legis. 65 (2003).

(n4)Footnote 4. *See, e.g., Ala. Code § 34-27-87.*

(n5)Footnote 5. *See Bhayani v. Sood (In re Bhayani)*, 293 B.R. 911, 915 (Bankr. N.D. Ill. 2003) , applying Illinois law.

(n6)Footnote 6. *See Lowdermilk v. Vescova, Building and Realty Co., Inc.*, 91 S.W.3d 617, 629 (Mo. Ct. App. 2002) , quoting from Sherry A. Mariea and Timothy T. Sigmund, *Real Estate Agents Bid Farewell to Common Law*, JMOB 96 (March-April 1998).

(n7)Footnote 7. *Mo. Rev. Stat. § 339.840.*

(n8)Footnote 8. *White v. The J.D. Reece Co.*, 29 Kan. App. 2d 226, 230-231, 26 P.3d 701, 705 (Kan. Ct. App. 2001) .

(n9)Footnote 9. *See, e.g., Brown v. Roth*, 133 N.C. App. 52, 54, 514 S.E.2d 294, 296 (N.C. Ct. App. 1999) .

(n10)Footnote 10. *See Cousins v. Realty Ventures, Inc.*, La. App. 2001-1223, 844 So. 2d 860, 868 (La. Ct. App. 2003), *on reh'g amended and aff'd*, La. App. 2001-1223, 844 So. 2d 860 (La. Ct. App. 2003), *cert. denied*, La. 2003-1583, 855 So. 2d 316 (La. 2003), *cert. denied*, La. 2003-1584, 855 So. 2d 317 (La. 2003). *See also Mitchell Realty Group, LLC v. Holt*, 266 Ga. App. 217, 218, 596 S.E.2d 625, 626 (2004) (Georgia's Brokerage Relationships in Real Estate Transactions Act imposes on brokers a duty to perform the terms of the brokerage engagement made with a seller or buyer).

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28 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART I. Evolution of Real Estate Brokerage Law

10-3 Real Estate Brokerage Law and Practice § 3.04

§ 3.04 Application of the Caveat Emptor Doctrine in Real Estate Brokerage

The doctrine of caveat emptor protects certain parties (in particular, sellers and sellers' agents) from claims based upon nondisclosure of readily discoverable defects and declares reliance on certain misrepresentation by other persons to be unreasonable as a matter of law. n1 Under this doctrine, a seller or seller's agent has an obligation to disclose only those defects known by the seller that could not be readily discovered by a reasonable inspection. n2 It has been stated that without the doctrine, nearly every sale would invite litigation instituted by a disappointed buyer. n3

Pursuant to the doctrine of caveat emptor, a duty falls upon the purchaser to make inquiry and examination. n4 This doctrine also states that a buyer has no right to rely on certain representations regarding the property when the true facts are equally open to both parties. n5 The doctrine of caveat emptor therefore precludes the buyer's recovery against a seller when:

- (1) the defect or condition was open to observation or discoverable on reasonable inspection;
- (2) the purchaser had unimpeded opportunity to examine the property; and
- (3) the seller did not engage in affirmative misrepresentation or concealment so reprehensible in nature as to constitute fraud. n6

One of the underlying rationales governing the caveat emptor doctrine is that parties to a real estate transaction generally do not have a special relationship with each other that would occasion a special duty to make disclosures or permit reliance on such representation. n7 However, a real estate licensee does not occupy the position of a lay vendor of property since a broker must meet standards of honesty, integrity, truthfulness, reputation, and competency. n8 Thus, the rule of caveat emptor usually does not apply to those dealing with a real estate licensee. Even though the licensee may not occupy a fiduciary relationship with prospective purchasers, a broker is expected to be honest, ethical, and competent and is answerable at law for breaches of his or her statutory duty to the public. n9

Even if a broker has no disclosure obligations with respect to a property, a broker is generally expected to respond honestly to any direct inquiry. Generally, if the seller's broker is questioned directly about specific defects, or if the

broker has knowledge of specific defects that affect health or safety and the defect is not known to or readily observable by the buyer, the broker has a duty to disclose and is liable for damages for nondisclosure. n10

Despite the rejection of the caveat emptor doctrine in the context of brokers and agents and the widespread requirement of residential real estate seller disclosure statements (*see* Chapter 3A, *below*), the doctrine of caveat emptor continues to be viable in some jurisdictions even when a broker or agent is involved. For example, even though sellers of Ohio residential real estate are statutorily required to provide various residential property disclosures, the disclosure statute has not eliminated the common-law doctrine of caveat emptor. n11

Readers are advised to consult applicable law to determine the status of the doctrine of caveat emptor as the validity of this doctrine varies from jurisdiction to jurisdiction and may be affected by whether the subject property is residential or non-residential. Application of this doctrine may also be affected by the status of the property as either new or used real estate. n12

FOOTNOTES:

(n1)Footnote 1. *Allison v. Cook*, 139 Ohio App. 3d 473, 487, 744 N.E.2d 254, 263 (Ohio Ct. App. 2000) . *Bowman v. Presley*, 2009 OK 48, 212 P.3d 1210, 1221 (Okla. 2009) *See generally* Dallon, *Theories of Real Estate Broker Liability and the Effect of the "As Is" Clause*, 54 Fla. L. Rev. 395, 412-413 (2002).

(n2)Footnote 2. *See Blake v. John Doe 1*, 89 Ohio App. 3d 130, 133, 623 N.E.2d 1229, 1231 (Ohio Ct. App. 1993) .

(n3)Footnote 3. *See Layman v. Binns*, 35 Ohio St. 3d 176, 177, 519 N.E.2d 642, 644 (Ohio 1988) .

(n4)Footnote 4. *See Layman v. Binns*, 35 Ohio St. 3d 176, 177, 519 N.E.2d 642, 644 (Ohio 1988) *Niermeyer v. Cook's Termite & Pest Control, Inc.*, 2006 Ohio 640, 2006 Ohio App. LEXIS 579, at *14 (Feb. 16, 2006) .

(n5)Footnote 5. *See Layman v. Binns*, 35 Ohio St. 3d 176, 177, 519 N.E.2d 642, 643-644 (Ohio 1988) .

(n6)Footnote 6. *See Layman v. Binns*, 35 Ohio St. 3d 176, 177, 519 N.E.2d 642, 644 (Ohio 1988) .

(n7)Footnote 7. *Allison v. Cook*, 139 Ohio App. 3d 473, 487, 744 N.E.2d 254, 263 (Ohio Ct. App. 2000) .

(n8)Footnote 8. *See Dugan v. Jones*, 615 P.2d 1239, 1248 (Utah 1980) .

(n9)Footnote 9. *See Dugan v. Jones*, 615 P.2d 1239, 1248 (Utah 1980) .

(n10)Footnote 10. *See Gaulden v. Mitchell*, 849 So. 2d 192, 196 (Ala. Ct. App. 2002) .

(n11)Footnote 11. *See Pettit v. Hughes*, 177 Ohio App. 3d 344, 348-49, 894 N.E.2d 738, 741-42 (2008) , *discretionary appeal not allowed*, 120 Ohio St. 3d 1488, 2009 Ohio 278, 900 N.E.2d 198 (2009) ; *Rogers v. Hill*, 124 Ohio App.3d 468, 471, 706 N.E.2d 438, 440 (Ohio App. 1998) ; *Nunez v. J.L. Sims Co., Inc.*, 2003 Ohio 3386, 2003 Ohio App. LEXIS 3075, at *16-*18 (Ohio Ct. App. June 27, 2003) , *discretionary appeal denied*, 100 Ohio St. 3d 1471, 2003 Ohio 5772, 2003 Ohio LEXIS 2865 (2003) , *reconsideration denied*, 100 Ohio St. 3d 1550, 2003 Ohio 6879, 800 N.E.2d 754, 2003 Ohio LEXIS 3564 (2003) . *See also* Ohio Rev. Code § 5302.30(J) ("The disclosure requirements of this section do not bar, and shall not be construed as barring, the application of any legal or equitable defense that a transferor of residential real property may assert in a civil action commenced against the transferor by a prospective or actual transferee of that property."). *See also Blaylock v. Cary*, 709 So. 2d 1128, 1130 (Ala. 1997) (Because Alabama adheres to the caveat emptor rule in the sale of used residential property, a seller ordinarily has no duty to disclose to the purchaser any defects in the property.). *Daly v. Kochanowicz*, 67 A.D.3d 78, 91, 884 N.Y.S.2d 144, 153 (2009) (New York adheres to the doctrine of caveat emptor and imposes no duty on the seller or the seller's agent to disclose information concerning the premises when the parties deal at arm's length, unless there is some conduct on the part of the seller or the seller's agent which constitutes active concealment.).

(n12)Footnote 12. *Cf. Moore v. Prudential Residential Services Limited Partnership*, 849 So. 2d 914, 923 (Ala. 2002) , *rehearing denied*, 2002 Ala. LEXIS 379 (Ala. Nov. 15, 2002) (Although Alabama has abrogated the rule of caveat emptor in the sale of new real estate, that rule still applies in the sale of used real estate. In the sale of used real estate, a seller or the seller's agent generally has no duty to disclose to the purchaser any defects in the property.).

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29 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART I. Evolution of Real Estate Brokerage Law

10-3 Real Estate Brokerage Law and Practice § 3.05

§ 3.05 National Association of Realtors(R) Code of Ethics

Courts have turned to published ethical standards and practices of real estate brokers to determine the requisite skill and knowledge, and acceptable practices, of members in good standing in that occupation. n1 The Code of Ethics of The National Association of Realtors(R) has been found in some state real estate commission manuals. n2

The National Association of Realtors(R) (NAR) Code of Ethics requires that Realtors(R) disclose material facts to buyers and sellers. n3 This Code of Ethics has also been applied in other contexts with respect to a licensee's duties. n4

FOOTNOTES:

(n1)Footnote 1. *See Menzel v. Morse*, 362 N.W.2d 465, 472 (Iowa 1985) ; *Durbin v. Ross*, 276 Mont. 463, 476, 916 P.2d 758, 766 (Mont. 1996) .

See also:

Arizona: Baker v. Leight, 91 Ariz. 112, 117-18, 370 P.2d 268, 271 (1962) ("It is immaterial as to whether the broker is a member of the National Association if it is definitely established that this Association's Code of Ethics has been adopted and is applicable to those in the real estate profession in this state.").

California: Pepper v. Underwood, 48 Cal. App. 3d 698, 714, 122 Cal. Rptr. 343, 355 (1975) , overruled on other grounds by, *Stout v. Turney*, 22 Cal. 3d 718, 730, 150 Cal. Rptr. 637, 644, 586 P.2d 1228, 1235 (1978) ("Upon proper proof that the Canons of Ethics adopted by the National Association of Real Estate Agents, established standards of conduct to be adhered to and which were adhered to by real estate brokers and agents in the Santa Barbara area, such canons would be admissible as rebuttable evidence of such standard of care.").

Montana: Hoefer v. Wilckens, 210 Mont. 218, 226-227, 684 P.2d 468, 472 (1984) (Trial court's findings of specific acts or omissions constituting broker malpractice "based largely on the standard of care required of realtors in Lake County under the Code of Ethics and Standards of Practice of the National

Association of Realtors.' ").

New York: Costanzo v. Long Island Board of Realtors, 143 A.D.2d 625, 532 N.Y.S.2d 904, 905, 1988 N.Y. App. Div. LEXIS 9514 (1988) (A hearing was held before the Professional Standards Committee which subsequently dismissed charges that the petitioners had interfered with another licensee's listings, but sustained a charge that the petitioners violated article 3 of the National Association of Realtors(R) Code of Ethics by failing to inform the public that they were brokers in their solicitation notice. A fine of \$ 500 was imposed. Court affirmed the order dismissing the petitioners' action seeking a review of the Board's determination that they violated the National Association of Realtors(R) Code of Ethics.)

Washington: Burien Motors, Inc. v. Balch, 9 Wash. App. 573, 578, 513 P.2d 582, 586 (1973) , review denied, 83 Wash. 2d 1005, 1974 Wash. LEXIS 971 (1974) ("The evidence also showed that under the 'Standards of Practice and the Code of Ethics of the Seattle-King County Real Estate Board,' to which [the broker] subscribed, he was required to check city or county zoning regulations applicable to real property to be sold or leased and to endeavor to keep informed concerning information substantially affecting those interests.' ").

(n2)Footnote 2. *Cf. Menzel v. Morse*, 362 N.W.2d 465, 472 (Iowa 1985) (1978 Real Estate Manual issued by the Iowa Real Estate Commission contains the National Association of Realtor Code of Ethics).

(n3)Footnote 3. *See Bazal v. Rhines*, 600 N.W.2d 327, 329 (Iowa Ct. App. 1999) . *See also Crutchley v. First Trust & Sav. Bank*, 450 N.W.2d 877, 880 (Iowa 1990) (proof of breach of standards specified in Code of Ethics establishes a violation of realtor's duties under Listing Agreement with seller).

(n4)Footnote 4. *See Menzel v. Morse*, 362 N.W.2d 465, 473 (Iowa 1985) (violation of NAR Code of Ethics Article 17 banning the unauthorized practice of law is evidence upon which a trier of fact may find negligence).

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30 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART I. Evolution of Real Estate Brokerage Law

10-3 Real Estate Brokerage Law and Practice § 3.06

§ 3.06 Megan's Laws and Real Estate Brokers

[1] History of Megan's Laws

Passage of legislation commonly called "Megan's Laws" began in 1994 when Congress enacted the Jacob Wetterling Crimes Against Children and Sexually Violent Offender Registration Program. n1 Under this legislation, the Attorney General of the United States was required to establish guidelines for state programs requiring persons convicted of crimes against minors or crimes of sexual violence to register a current address with state law enforcement officials. n2 The federal law gave the states three years from September 1, 1994, to comply. n3 Failure to implement a registration program would result in the loss of some federal funding. n4 The various state Megan's Law seek to protect the community from the dangers of recidivism by sexual offenders. n5

The resulting state laws provide for sex offender registration and community notification by law enforcement authorities of the residence addresses of certain sex offenders. In the federal Megan's Law, Congress requires that states notify the public when sexually violent offenders are released from prison or paroled, and their expected addresses. Federal law leaves the procedure and mechanics of implementation up to the states, including the definition of degree of danger imposed and type of notification required.

This section discusses Megan's laws in the context of real estate brokerage. This discussion identifies the state Megan's laws and addresses related disclosure issues affecting real estate brokers. Nearly half the states have addressed the disclosure of a real estate licensee with respect to the presence of registered sex offenders in the vicinity of residential property they are selling. For those jurisdictions yet to address this issue, the discussion concludes with suggestions of ways for real estate brokers to approach the question of whether there is a duty to disclose information about the presence of sex offenders in the community.

[2] "Megan's Laws"--History and Purposes

The issue of community notification of the addresses of sex offenders catapulted into the national news with the October 1994 passage of "Megan's Law" by the New Jersey legislature. The lawmakers named the Sex Offender Registration and Community Notification Act in memory of Megan Kanka, a seven-year-old girl who was raped and murdered by a convicted sex offender. Unknown to Megan's parents, neighbors and the local police, the offender was a

roommate of one of the Kankas' neighbors in suburban Trenton, New Jersey. After Megan's death, her parents took their cause to the New Jersey legislature, contending that they could have prevented their daughter's death if there had been a way to warn them that this man was living in their community. The Kanka family urged the state to adopt a sex offender registration and community notification law.

Registries containing the home addresses of released criminals for use by law enforcement personnel were authorized by law before the passage of the Megan's laws, but community notification was a new concept. The broad purpose of these statutes is law enforcement, crime control, and crime prevention. Preventing convicted sex offenders from repeating their crimes is a critical goal. Studies have shown that sex offenders whose victims are children or young people under age 18 have a higher rate of recidivism than other types of offenders. n6 Heightened community awareness of convicted and paroled sex offenders living in the vicinity is an important role in crime prevention. Since many convicted sex offenders and sexual predators are on parole, it is crucial to have an effective system of community notification of the residence addresses of convicted and released sex offenders. Community notification offers potential victims, and those responsible for potential victims, information that might alert them to the nearby presence of a released known sex offender and thus enable them to take precautions for their safety.

Megan's Laws have generated much litigation since their passage. Most litigation has concerned the constitutionality of these laws as written or as applied to the offender. n7 Megan's laws highlight the competing interests between the right of people to be safe in their homes and neighborhoods and the privacy rights of the individual convicted, but released, sex offender. The courts have upheld sex offender and community notification laws as constitutional in the great majority of jurisdictions where convicted sex offenders have challenged them. n8 In the few cases in which the courts have stricken the community notification portions of these laws as unconstitutional, it has been, primarily, on the ground that the laws cannot be retroactively applied. n9 These rulings have not eliminated sex offender registries, but instead have limited the earliest information available to the public to the effective date of the community notification laws.

[3] The Effect of Megan's Laws Upon Licensee Disclosure Obligations

The effect of these laws on the residential real estate industry is an unintended result of legislative action and the demand for increased disclosures in the sale of residential property. Essentially, the issue raised by the sex offender registries is whether a known sex offender living in the vicinity of a residence is an off-site hazard that must be disclosed to the prospective purchaser. Megan's Laws, in and of themselves, do not impose any statutory duty on real estate licensees to disclose the contents of the sex offender registry to buyers or tenants of residential property as such statutes do not address real estate transactions. Since information about registered sex offenders is publicly available, the disclosure issues that arise are whether, when, and what information a licensee must or should disclose when a registered sex offender lives in the area of a real estate sale or rental.

Nearly half the state have addressed a licensee's disclosure obligations with respect to Megan's law disclosures. (Such obligations are summarized in Chapter 3A, *Federal and State-by-State Summary of Broker's Duty to Disclose*, under alphabetical state headings, *below*.) The basic approaches to the disclosure of a registered sex offender in the vicinity of residential property for sale can be summarized as follows:

- The licensee or the seller must inform a **prospective purchaser to contact law enforcement officials for information about the presence of a registered sex offender** in the vicinity of the property if this is a matter of concern to them. This approach places the burden of discovering this information upon the prospective purchaser. Essentially, the licensee gives the prospective purchaser guidance on how to find this information should it be of interest to them. This type of disclosure at least points out that this may be an issue the prospective purchaser should consider. States adopting this approach include **Alaska, California, Colorado, Louisiana, Minnesota, Montana, New Jersey, and Virginia** (see Ch. 3A *below* for statutory citations under alphabetical state headings).

■ A state may provide that **no cause of action can be filed against a licensee for failing to disclose that the property is located in the vicinity of a registered sex offender**. This approach is similar to the approach adopted by many states with respect to psychologically stigmatized property. Indeed, some states include this provision in their psychologically impacted property law. Often, statutes adopting this approach also state that if a prospective purchaser makes a direct inquiry about this issue, the seller and licensee must be truthful in their response. States adopting this approach include **Arizona, Georgia, Idaho, Michigan, Nevada, North Dakota, and South Carolina** (see Ch. 3A below for statutory citations under alphabetical state headings).

■ A state may statutorily provide that **data from a sex offender registry is not an adverse material fact or material fact**. Since many states require that licensees disclose adverse material facts or material facts known by the licensee, this type of provision directly affects a licensee's disclosure obligation. Some states adopting this approach bar a licensee from knowingly making a false statement regarding the presence of a registered sex offender. States adopting this approach include **New Mexico and North Carolina** (see Ch. 3A below for statutory citations under alphabetical state headings).

■ A state may statutorily provide that a **licensee has no duty to disclose information regarding registered sex offenders**. States adopting this approach include **Kentucky, n10 Oklahoma, Oregon, Pennsylvania, South Dakota, Texas, and Wisconsin n11** (see Ch. 3A below for statutory citations under alphabetical state headings).

■ A state may require that a licensee disclose any actual knowledge that he or she has of sexual or violent offender registration that pertains to the property in question. Montana has taken this approach. n12

In states that have not addressed a licensee's obligations with respect to sex offenders in the vicinity of a subject property, readers should communicate with the state Realtors(R) associations as some of these organizations have provided guidance to their members on how to deal with this disclosure obligation. Readers are also directed to Chapter 3A, below, for additional disclosure information for each state.

[4] State Megan's Laws

All states and the District of Columbia have passed sex offender registration laws. Most, but not all, states have also provided for community notification. Readers desiring a brief synopsis of the Megan's laws can communicate with KlaasKids Foundation, P.O. Box 925, Sausalito, CA 94966, telephone: (415) 331-6867, fax: (415) 331-5633, E-Mail: klaaskids@pacbell.net, Internet: <http://www.klaaskids.org/>.

To review the states' sex offender registration and community notification statutes, readers are directed to the following statutes:

Alabama: Ala. Code § 15-20-21;

Alaska: Alaska Stat. § 12.63.010;

Arizona: Ariz. Rev. Stat. § 13-3821;

Arkansas: Ark. Code Ann. § 12-12-901;

California: Cal. Penal Code § 290;

Colorado: Colo. Rev. Stat. § 16-22-101, et seq.

Connecticut: Conn. Gen. Stat. § 54-102r;

Delaware: Del. Code Ann. tit. 11, § 4120;

District of Columbia: D.C. Code Ann. § 22-4001 et seq. ;

Florida: Fla. Stat. § 775.21;

Georgia: Ga. Code Ann. § 42-9-44.1;

Hawaii: Haw. Rev. Stat. § 846E-1, et seq. ;

Idaho: Idaho Code § 18-8301, et seq. ;

Illinois: Ill. Comp. Stat. § 730-150/1, et seq.;

Indiana: Ind. Code § 5-2-12-1, et seq. ;

Iowa: Iowa Code § 692A.1 et seq. ;

Kansas: Kan. Stat. Ann. § 22-4901, et seq. ;

Kentucky: Ky. Rev. Stat. Ann. § 17-510;

Louisiana: La. Rev. Stat. Ann. § 15-540, et seq.

Maine: Me. Rev. Stat. Ann. tit. 34-A § 11201, et seq.

Maryland: Md. Code Ann., Crim. Proc. § 11-701, et seq. ;

Massachusetts: Mass Gen. Laws ch. 6, § 178C, et seq. ;

Michigan: Mich. Comp. Laws § 28.721, et seq. ;

Minnesota: Minn. Stat. § 243.166;

Mississippi: Miss. Code Ann. § 45-33-21, et seq. ;

Missouri: Mo. Rev. Stat. § 589.400, et seq. ;

Montana: Mont. Code Ann. § 46-23-501, et seq. ;

Nebraska: Neb. Rev. Stat. §§ 29-4001-29-4013;

Nevada: Nev. Rev. Stat. §§ 179B.010 to 179B.300;

New Hampshire: N.H. Rev. Stat. Ann. §§ 651-B:1 to 651-B:10;

New Jersey: N.J. Stat. Ann. § 2C:7-1, et seq. ;

New Mexico: N.M. Stat. Ann. §§ 29-11A-1 to 29-11A-8;

New York: N.Y. Correct. Law § 168, et seq. ;

North Carolina: N.C. Gen. Stat. § 14-208.5, et seq. ;

North Dakota: N.D. Cent. Code § 12.1-32-15;

Ohio: Ohio Rev. Code Ann. §§ 2950.01 to 2950.99;

Oklahoma: Okla. Stat. tit. 57, § 581, et seq. ;

Oregon: Or. Rev. Stat. § 181.585, et seq. ;

Pennsylvania: Pa. Cons. Stat. tit. 42, ch. 97H, § 9791, et seq.;

Rhode Island: R.I. Gen. Laws §§ 11-37.1-1 to 11-37.1-20;

South Carolina: S.C. Code Ann. § 23-3-400, et seq. ;

South Dakota: S. D. Codified Laws § 22-22-30, et seq. ;

Tennessee: Tenn. Code Ann. §§ 40-39-101 to 40-39-111;

Texas: Tex. Crim. Proc. Code, art. 62.01, et seq.

Utah: Utah Code Ann. § 77-27-21.5;

Vermont: Vt. Stat. Ann. tit. 13, § 5401, et seq. ;

Virginia: Va. Code Ann. §§ 9.1-900 to 9.1-920;

Washington: Wash. Rev. Code § 9A.44.130;

West Virginia: W. Va. Code §§ 15-12-1 to 15-12-10;

Wisconsin: Wis. Stat. § 301.45;

Wyoming: Wyo. Stat. Ann. §§ 7-19-301 to 7-19-307.

While the sex offender registration laws of each state vary, the statute typically contains definitions of sexual predators, sex offenders, and the particular sexual crimes that cause a convicted offender to be required to register upon parole or release. Generally, a sex offender registration board or commission is established to supervise the sex offender registry.

Community notification is the most pertinent part of the Megan's Laws for real estate licensees engaged in residential real estate transactions. How the community notification system works, the amount and quality of the information that can be obtained, and who has access varies from state to state, and may influence brokers' decisions about how to deal

with sex offender disclosure issues in those states that have not addressed a licensee's disclosure obligation regarding registered sex offenders.

The sex offender board is also charged with developing guidelines for law enforcement personnel regarding dissemination of sex offender registry information. The community notification component of the states' Megan's Laws typically defines what agency in state government is in charge of maintaining the sex offender registry, and also provides for a county agency or official to maintain a county's sex offender list. The information to be given to the public must be adequate to warn members of the public of potential danger. In some states, tiers (or levels) of notification based on the level of violence of the prior offense(s) and the likelihood of the offender to repeat a sexual offense are established. Some states limit the information from the sex offender registry to name, address, and photograph or description of the offender. The offense for which the offender was convicted may be given. In general, the victim's name is not disclosed (identities of incest victims are occasionally protected by having the crime listed as "sexual offense").

While the procedure for obtaining registry information also varies from state to state, as does the amount of information available for public access, a majority of states provide access to their registry via an Internet Website. If a state has not specifically addressed a licensee's disclosure obligation with respect to registered sex offenders in the vicinity of residential real estate for sale, it is prudent to provide prospective purchasers with information on where and how they can obtain information from that state's registry.

A registered sex offender residing in the vicinity of a subject property is an off-site condition. If a state has not specifically addressed a licensee's disclosure obligations with respect to registered sex offenders, and if form contracts and property disclosures are commonly used, these forms should be reviewed and revised to specify that it is within the buyer's (or tenant's) duty to exercise due diligence to discover facts about off-site conditions if such facts are material to the buyer. Such forms should include a disclaimer of any and all duty of a licensee to investigate off-site conditions, including, but not limited to sex offenders, attractive nuisances, and all other conditions that might cause harm to the buyer or tenant, his or her family, and guests, unless the broker has expressly consented in a writing to do so. These forms should also contain a disclaimer of any and all duty to disclose facts about such off-site conditions, unless the broker has actual knowledge and the buyer cannot discover such facts in the exercise of due diligence. Forms should also include, where relevant, the buyer's acknowledgment and waiver of such efforts on the part of the licensee as are disclaimed in the form. Unless required by statute or regulation, property disclosure statements should not include any disclosure of off-site conditions, and the same disclaimer as described above should be included.

Real estate licensees should acquire a basic, working knowledge of what the Megan's Law in their own states requires in order to give intelligent answers to questions from their clients and customers about the Megan's Law. Licensees should also know where to go for sex offender registry information, be aware of the amount and nature of the information that is available, and be familiar with the procedure for getting the information.

Litigation regarding Megan's laws has primarily centered on the constitutionality of these laws. There are few cases that directly address issues of concern to brokers. One such case is *Mulligan v. Panther Valley Property Owners Association*,ⁿ¹² which involved a private common-interest residential community (hereafter "community") that had amended its Declarations and bylaws. One amendment declared, in substance and effect, that no individual registered as a Tier 3 offender under New Jersey's Megan's Lawⁿ¹³ could reside in the community. Tier 3 is the highest classification within New Jersey's Megan's Law.ⁿ¹⁴ The appellate court reversed the trial court's decision upholding the validity of this amendment as the record before it was insufficient to determine whether this amendment was contrary to public policy. The court stated that the record did not disclose the number of common interest developments in New Jersey and whether they had adopted comparable restrictions, or whether the association performed quasi-municipal functions.ⁿ¹⁵ Though this case raised an issue that would be of direct interest to brokers, the case provided no clear cut substantive answers.

FOOTNOTES:

(n1)Footnote 1. Pub. L. 103-322, title XVII, Sec. 170101, *108 Stat. 2038* (Sept. 13, 1994) (codified at 42 U.S.C. §§ 14071, *et seq.*). See 3.06[4] below for discussion of state Megan's Laws. The effect of Megan's Laws on disclosure requirements for real estate brokers is summarized in Chapter 3A, *Federal and State-by-State Summary of Broker's Duty to Disclose*, under alphabetical state headings, below.

(n2)Footnote 2. See 42 U.S.C. § 14071(a)(1)(A).

(n3)Footnote 3. See 42 U.S.C. § 14071(f)(1).

(n4)Footnote 4. See 42 U.S.C. § 14071(f)(2)(A) (1994).

(n5)Footnote 5. See *In re Registrant C.A.*, 146 N.J. 71, 80, 679 A.2d 1153, 1157 (N.J. 1996), citing N.J. Stat. Ann. 2C:7-1a.

(n6)Footnote 6. See, e.g., Turvey, M.S., Brent E., *Dangerousness: Predicting Recidivism in Violent Sex Offenders* (Knowledge Solutions, LLC, 1997) (*Internet*: <http://www.corpus-delicti.com/danger.html>)).

Cf. Connecticut Dept. of Public Safety v. Doe, 538 U.S. 1, 3, 123 S. Ct. 1160, 1162, 155 L. Ed. 2d 98, 103 (2003) (sex offenders are a serious threat in this nation, victims of sex assault are most often juveniles, when convicted sex offenders reenter society they are much more likely than any other type of offender to be re-arrested for a new rape or sex assault).

(n7)Footnote 7. See generally Heaphy, Comment, *Megan's Law: Protecting the Vulnerable or Unconstitutionally Punishing Sex Offenders?*, 7 *Seton Hall Const. L.J.* 913 (1997).

(n8)Footnote 8. See, e.g., *Smith v. Doe*, 538 U.S. 84, 105-106, 123 S. Ct. 1140, 1154, 155 L. Ed. 2d 164, 185 (2003) (Alaska Sex Offender Registration Act); *Connecticut Dept. of Public Safety v. Doe*, 538 U.S. 1, 7-8, 123 S. Ct. 1160, 1164-1165, 155 L. Ed. 2d 98, 105 (2003) (Connecticut's sex offender registry); *A.A. v. State of New Jersey*, 341 F.3d 206, 214 (3rd Cir. 2003) (registrants challenged the creation of a public internet registry posting personal information about convicted sex offenders, court held that state's compelling interest in preventing sex offenses substantially outweighs any interest the registrants may have in not having public yet scattered information compiled); *Cutshall v. Sundquist*, 193 F.3d 466, 483 (6th Cir. 1999) (Tennessee Sex Offender Registration and Monitoring Act is not unconstitutional either in its registration provision or its notification provision); *Roe v. Office of Adult Probation*, 125 F.3d 47 (2d Cir. 1997) (Connecticut Megan's Law does not violate Ex Post Facto Clause); *E.B. v. Verniero*, 119 F.3d 1077 (3d Cir. 1997) (New Jersey Megan's Law does not violate Ex Post Facto or Double Jeopardy Clauses. Due Process Clause requires state to afford registrant an opportunity to challenge classification and notification plan; state has burden of persuasion at a hearing.); *Russell v. Gregoire*, 124 F.3d 1079 (Washington Megan's Law does not violate Ex Post Facto, Due Process Clauses, or right to privacy).

(n9)Footnote 9. Article I, § 10 of the U.S. Constitution (the "ex post facto" clause) prohibits the states from enacting any law "which imposes a punishment for an act which was not punishable at the time it was committed or imposes additional punishment to that then prescribed." *Cummings v. Missouri*, 430 U.S. 277 (4 Wall.), 325-26 (1867). See, e.g., *Rowe v. Burton*, 884 F. Supp. 1372 (D. Alaska 1994) (holding registration scheme is punitive where dissemination of information will result).

(n10)Footnote 10. Ky. Rev. Stat. § 324.162 provides that licensees have no affirmative disclosure duties outside of federal and Kentucky Revised Statutes Chapter 324.

(n11)Footnote 11. In Wisconsin, if a licensee is asked about sex offenders or the registry, the licensee must disclose any knowledge that the licensee actually has. The licensee is granted immunity from liability if the licensee provides the person with certain information about the registry. See Wis. Stat. § 452.24.

(n12)Footnote 12. *Mont. Code Ann. § 37-51-105*, discussed in *Montana* summary of Chapter 3A below .

(n13)Footnote 12. *337 N.J. Super. 293, 766 A.2d 1186 (N.J. Super. Ct. App. Div. 2001)* .

(n14)Footnote 13. *See N.J. Stat. Ann. § 2C:7-8(c)(3)*.

(n15)Footnote 14. *337 N.J. Super. 293, 298, 766 A.2d 1186, 1189 (N.J. Super. Ct. App. Div. 2001)* . According to the court, in order for an individual to be classified as a Tier 3 registrant, that individual must be a sex-offender who has been deemed to pose a high risk of re-offending. Factors that inform the decision whether an individual poses a high risk of re-offending include whether the conduct involved repetitive and compulsive behavior, whether the individual served the maximum term of confinement, and whether the sexual offense was committed against a child. Because such an individual poses a substantial risk to the community, the statute directs that notification of the presence of a Tier 3 offender within the community be more widespread than that provided in the instance of Tier 1 or Tier 2 offenders, who have been deemed to pose low and moderate risks of re-offending.

(n16)Footnote 15. *337 N.J. Super. 293, 305-307, 766 A.2d 1186, 1192-1194 (N.J. Super. Ct. App. Div. 2001)* .

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31 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART II. Brokers as Fiduciaries

10-3 Real Estate Brokerage Law and Practice § 3.07

§ 3.07 Common Law of Agency

[1] Creation of an Agency Relationship

The broker will be considered an agent if the brokerage contract and applicable law creates an agency relationship. Inherently, the creation of a principal and agency relationship creates a fiduciary relationship. When a broker is considered an agent, the duties owed by a broker to his or her principal are the same as those owed by any agent to a principal. n1

Generally, an agency relationship exists when there is

- (1) a manifestation of consent by one person that another shall act on the former's behalf and subject to the former's control and
- (2) the consent of the latter to so act. n2

The key to determining whether an agency relationship exists is the principal's right of control. n3 There is no presumption that an agency exists; a person is presumed to be acting for himself or herself and not as the agent for another. n4

Historically, a broker with whom property was listed for sale became the agent of the seller for the purpose of finding a purchaser. n5 Under agency law, when a broker lists property for sale, the broker owes a duty not to act as the buyer's agent without the seller's consent, and a concomitant duty, if it is considering acting as the buyer's agent, to inform the seller and obtain consent. n6

Brokered transactions often have involved a listing agent and a selling agent. In this situation, the selling agent works with the buyer, but is typically an agent or subagent of the seller. n7 Particular circumstances, however, can warrant different conclusions. If either the listing agent or selling agent expressly or impliedly forms an agency relationship with the buyer, he or she will be an agent of the buyer, in addition to or in lieu of being an agent or subagent of the seller. n8

Prior to the enactment of brokerage relationship acts, it was well settled law that a broker representing a purchaser or seller in a real estate transaction owed a fiduciary duty to the client based upon the agency relationship itself. n9 Even with the passage of broker relationship acts, some states continue to consider brokers who specifically act as a seller's agent to be fiduciaries. n10 However, some states expressly abrogated all common-law fiduciary duties owed to a party employing the broker when the broker is functioning in particular statutorily defined roles. n10.1

As an agent, the broker will be governed by the laws of agency which create a fiduciary obligation upon the part of the broker. As a fiduciary, the broker has a position of great trust and confidence commanding the utmost good faith. n11 A broker cannot put himself or herself in a position that is antagonistic to the principal's interests. n12 The duties imposed on a broker are as exacting as those imposed upon a trustee in favor of beneficiary. n13

The formation of an agency relationship is typically created by a written listing agreement between the seller and the broker, or an equivalent agreement if the principal is a buyer. If the principal is a seller, the object of the agency is to produce a buyer who is ready, willing, and able to purchase the property on the seller's terms. If the principal is a buyer, the object of the agency is to procure a property that meets the buyer's needs on terms set by the buyer.

Prior to the enactment of the broker relationship acts, a broker could find himself or herself in a fiduciary relationship even though the broker and principal did not have a written agreement specifying that an agency relationship had been created between the parties. n14 A agency relationship could arise out of an informal relationship if both parties understood that a special trust had been reposed. By virtue of their license, real estate brokers have been held to a higher standard of competency and fairness than a member of the general public.

Most brokerage relationship acts require a written agreement before there can be an agency relationship between the parties. However, even with the advent of brokerage relationship acts, in some jurisdictions a broker can still find himself or herself in a fiduciary relationship even though there is no written listing or representation agreement. n15

[2] Commencement of Fiduciary Duties

The fiduciary relationship between broker and client ordinarily does not exist prior to the time the parties enter into an agency agreement. n16 The broker is not generally subject to a fiduciary duty in deciding upon terms with a prospective client as to the broker's compensation. n17 In *Action Real Estate Corp. v. Bulechek*, n18 the Iowa Supreme Court rejected the seller's effort to impose fiduciary obligations upon a broker in the negotiation and preparation of a listing agreement. In that case, the sellers had listed their farm for sale with a broker. After listing the farm, one of the sellers met an individual who expressed interest in purchasing the farm. When this prospective purchaser examined the farm, the broker was on hand to help show him around. After the transaction closed, the sellers refused to pay a commission. They charged that the broker failed to explain or reveal to them that the listing agreement gave the sellers the right to reserve four prospective buyers from the listing. Likewise, they contended that the broker did not explain the meaning of the term "best efforts" nor the amount of commission to be paid or the method of withdrawing the listing. The broker sued for the commission and, at trial, the sellers requested that the court charge the jury that the broker was subject to special duties by reason of his fiduciary capacity. The trial court's refusal to give that charge was affirmed. The Iowa Supreme Court concluded that the "fiduciary relationship did not exist at the time of the claimed omissions." n19

It is important to note that an agency relationship *may* arise before the listing agreement is signed where confidential information is given to a real estate licensee because of a consumer's reliance on the former's licensure by the state and reputation for being honest and trustworthy. n20

[3] An Agent's Duties

A broker's duty under agency law principles includes the following:

- The broker will owe a duty of good faith and loyalty to his or her principal. n21
- The broker has a legal responsibility to secure for the principal the best bargain that the broker's skill, judgment and diligence can obtain. n22
- A broker has a duty not to conceal from the principal any material information and to make full, open disclosure of all such information. n23
- A broker cannot, without violating his or her general duty of good faith, act for persons having interests adverse to those of the principal, unless the broker acts with the consent the principal who has been given full knowledge of the facts. n24

The precise duties of a real estate broker must be determined by an examination of the nature of the task the broker undertakes to perform and the agreements the broker makes with the involved parties. n25 In fulfilling these duties, the broker must act with reasonable diligence and with such skill as is ordinarily possessed by persons who are regularly engaged in the real estate brokerage business. n26 Courts have turned to published ethical standards and practices of real estate brokers to determine the requisite skill and knowledge, and acceptable practices, of members in good standing in that occupation. n27 The degree of care and skill required of a broker ordinarily is a question of fact and may require expert testimony. n28 A broker's duty of reasonable skill and care is discussed further in § 3.07[5] below .

When the relationship of principal and agent exists, the ultimate good faith is required in all transactions of the agent towards his or her principal and the agent cannot put himself or herself in a position adverse to that of his principal. Where the agent, employed to purchase for the principal, purchases for himself or herself, all the profits and advantages gained in the transaction belong to the principal and the agent will be held to have taken the property as trustee for his or her principal. n29 Consequently, the broker must refrain from obtaining any advantage over the principal derived from the relationship. n30

The general rule is that brokers have no implied authority to contract on behalf of their principals. A broker's apparent authority must be founded on the principal's actions since a broker cannot by his or her act create evidence of authority. n31

[4] Duty to Perform

The duty to perform concerns the broker's efforts to accomplish the principal's goal. If the broker represents the seller, the goal is to sell the property for the best price possible and on the best terms for the seller. n32 If the broker represents the buyer, the goal is to find a property for the buyer to purchase and pursue the purchase at the best price possible and on the best terms for the buyer. The broker is expected to act to accomplish the principal's goal.

A typical scenario where the issue of a broker's duty to perform arises is where a seller's broker obtains the listing to sell a property and then does nothing. Normally, a seller's broker would enter the property into the Multiple Listing Service, advertise the property in appropriate publications, respond to inquiries about the property, and show the property to prospective purchasers. A seller's broker who does nothing other than obtain the listing has violated the duty to perform.

A broker's duty to perform is often at issue in suits by brokers to collect commissions (see Chapter 4, below for more information on commissions). Courts generally hold that a broker is entitled to the commission stated in the parties' contract if the broker substantially performed the contract through the expenditure of time, effort, or money in marketing the property. n33

The duty to perform has been held to include the duty to use the broker's best efforts to resolve any problems which arise prior to closing so that the transaction can close. n34 A New Jersey court has found that an agent who represented

sellers was negligent in failing to monitor the progress of the buyers' mortgage loan application. n35

However, it has also been held that there was no authority for a seller's assertion that a broker's alleged failure to prepare documents in time for closing constituted a breach of fiduciary duty. The contracts stated that the seller would provide evidence of good title, would convey the property by warranty deed, and would pay all taxes which would be prorated on the day of closing. Neither the contracts nor the listing agreement expressly required the broker to prepare documents for closing. The court stated that while brokers frequently performed these services for their clients, the court would not imply such a duty where none was expressed. n36

Statler v. Banker Multiple Line Insurance Company n37 dealt with the issue of whether the words, "I'll look into it" obligated a broker to perform certain services. The broker stated that he would look into a piece of property for the plaintiffs. When the plaintiffs would communicate with the broker about this parcel, he would respond that he was busy, but he would look into it. The land was sold to a third party. The plaintiffs sued alleging that the broker had deprived them of the opportunity to bid on and purchase the property. The court found that the casual phrase, "I'll look into it" was not the basis of a contract nor did it obligate the broker to do more than research the property and attempt to contact the plaintiffs. The court affirmed the trial court's decision which found that the broker had not breached any standard of care that may have been applicable. n38

[5] Duty to Exercise Reasonable Care and Skill

A real estate broker is a professional n39 who holds himself or herself out as trained and experienced to render a specialized service in real estate transactions. n40 A broker who is employed by a principal to act as an agent in a transaction must exercise reasonable care and skill, or the care and skill ordinarily possessed and used by other persons employed in a similar undertaking. n41 However, it has also been stated that an agent has a duty to use the degree of diligence and care which a reasonable prudent person would ordinarily exercise in the transaction of his or her own business. n42

In assessing the broker's performance of his or her fiduciary duty, it is appropriate to consider the education and understanding of the principal. n43 Brokers representing unsophisticated clients are expected to fully explain terms and conditions to such clients. This duty may not exist to the same extent when the client is an experienced and sophisticated real estate investor. n44

In assessing whether a broker has exercised reasonable skill and care, courts often consider the usual and customary practices of brokers in the subject area. In one case, the seller's broker ordered the survey required for closing shortly before this event was to occur. Because of this timing, an encroachment was discovered only two days prior to closing. This encroachment eventually caused this sale to collapse. The sellers contended that the timing of ordering the survey was a breach of the broker's fiduciary duty. The court rejected this argument because a witness had testified that it was customary for brokers to delay ordering a survey until shortly before the closing in order to avoid an unnecessary expense if the sale did not close. n45

[6] Duty of Disclosure to the Principal

A person employing a broker bargains for the skill, diligence and zeal of the broker for his or her exclusive benefit. n46 As a fiduciary, the real estate agent or broker must reveal all facts within his or her knowledge to the principal that might affect the principal's decisions, rights, and interests. n47 Such disclosures should be made in a timely fashion. Because of the affirmative obligations arising from the fiduciary relationship, the defense of caveat emptor does not apply when a broker fails to disclose to his or her clients facts known by the broker that are material to the transaction. n48

A broker's fiduciary duty to his or her client can be substantially more extensive than a nonfiduciary duty codified in a

statute. n49 A fiduciary who fails to share material information with his or her principal has committed constructive fraud, which is a term of art obviating the need to show fraudulent intent. n50 Constructive fraud is a unique species of fraud applicable to a fiduciary or confidential relationship. n51 This tort consists of 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 or her 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. Consequently, in contrast to actual fraud, it is easier to prove constructive fraud since there is no need to prove intent to defraud. n52

Brokers acting for sellers have a duty to give to the principal such information as the broker may have of the prospective purchaser's financial situation. If the broker has no knowledge thereof, it is the broker's duty to disclose this fact to the principal, so that the latter may investigate the prospective purchaser's financial situation. n53

A broker's failure to communicate information which might influence the conduct of his principal is a breach of the fiduciary relationship owed to the principal. n54 With respect to a broker's disclosure duties, however, one court has stated that to require that the broker give the principal notice of any conceivable information which might possibly influence the principal would create an oppressive burden on the broker. n55

Despite numerous courts stating that a broker had a duty to communicate all material information affecting the transaction to his or her principal, a Washington court has held that a broker was not required to communicate with its principals, the sellers, that the brokers had guaranteed the loan that the buyers needed to buy the property. The brokers had also failed to disclose to the sellers the lender's reluctance to make the loan or the loan guaranty. The court reasoned that the sellers did not have a right to approve or disapprove the manner in which the buyers acquired a loan. n56

Despite a broker having a duty to disclose information known by him or her to the principal, this does not create a duty for the broker to learn everything about the property. Buyers are responsible for discerning material facts that are unknown to the broker or outside the broker's expertise or expected area of inquiry. n57

For a detailed discussion of a broker's disclosure obligations, see Chapter 3A *below* as well as Appendix 3A-1, *Disclosure Law and Regulatory Agency Directory* and Appendix 3A-2, *Significant Disclosure Cases* (both appendices are organized alphabetically by state).

[7] Duty to Effect a Sale to the Principal's Best Advantage

Brokers owe a duty of good faith and loyalty to their principal which results in an obligation to exercise reasonable due care and diligence to effect a sale to the principal's best advantage. n58 If the broker represents the seller, getting a deal to the principal's best advantage means procuring a sale at the highest price and on the terms most favorable to the seller. n59 Conversely, if the broker represents the buyer, getting a deal to the principal's best advantage means procuring a sale at the lowest price and on terms most favorable to the buyer. This is the essence of the broker's duty to perform the agreement between the broker and his or her principal. n60

In an effort to obtain the best deal for his or her principal, the broker need not disclose that a principal who is a seller will accept a lower price for the property. Conversely, a broker representing a buyer need not disclose that the buyer is willing to pay more than initially offered for the property. Thus, a representation by a seller's broker that the seller will not sell for less than a stated sum, knowing that the principal would take less rather than miss the sale, is not a misrepresentation of a material fact that will justify the rescission and cancellation of a contract. n61

A seller's broker must act entirely in good faith and in the interest of the principal; and if the broker induces the prospective buyer to believe that the property can be bought for less, the broker has failed to discharge that duty and

forfeits the right to a commission. n62 Such conduct is a breach of faith and contrary to the interests of the principal, and, therefore, is a violation of the fiduciary relationship existing between agent and principal which will preclude the agent from recovering a commission therefrom. n63

A broker is obligated to act solely for the benefit of the principal in all matters connected with the agency; the broker cannot act for the benefit of a third party to the detriment of the principal. n64 To do so will violate the broker's duty to obtain the best deal for the principal.

The Supreme Court of Montana has held that a buyer agent breaches the agent's statutory obligations to a buyer when a buyer agent simultaneously represents more than one buyer competing for the same property. n65 *Montana Code § 37-51-313(4)(a)* obligates a buyer agent to "act solely in the best interests" of the buyer. The court stated that a conflict of interest was created when a buyer agent simultaneously represents multiple-buyers for the same property in at least two ways. First, if the buyer agent was prevented from revealing confidential information, the buyer agent was prevented from revealing the most important piece of information the agent had to her buyers, i.e., the other buyer's competing bid. n66 Second, assuming the buyer agent was allowed to inform one buyer of another buyer's bid, the buyer agent would be able to drive up the price by pitting the buyers against each other thereby allowing the agent to receive a higher commission. n67 Therefore, a buyer agent, due to inherent conflicts of interest, cannot act solely in the best interests of competing buyers. n68

Though a seller's broker must act in the principal's best interest, this does not necessarily mean that the broker must obtain the highest possible price. An Arizona court declined to hold as a matter of law that a broker or agent must obtain the highest price possible for the property being sold. n69 In doing so, this court stated that though such language had been used in prior opinions, such was not the law in Arizona. The court, quoting from an earlier case stated:

The law requires that a real estate agent, employed to sell land, must act in entire good faith and in the interest of his employer. [citation omitted] To this end he must exact from the purchaser the price, the terms, and conditions of sale which his employer has fixed. [citation omitted] n70

Other than dictum in some cases, the court stated that it could not find any other authority for the proposition that the broker is obligated as a matter of law to obtain the highest price possible for the property. n71 The court noted that there are a variety of reasons why a seller would be willing to sell property for a price under the optimum price available. A seller may be willing to accept less due to tax considerations, quicker liquidity, concession from the purchaser, or a desire to expedite a sale.

However, this court also discussed the broker's duty to inform the seller of any changes in the property's value which might influence the seller's decision to sell. The court stated this was a question of fact as to whether a broker's actions breached duties of good faith, integrity, honesty, and loyalty. The court concluded that such a duty may exist as a sub-duty of the broker's other fiduciary duties, but a breach depended upon the facts of the case, and the jury was entitled to look at the agent's knowledge and any special arrangements or instructions between the principal and agent. n72

[8] Duty to Follow the Principal's Instructions

A broker is bound to act in compliance with the instructions of his or her principal. n73 The broker must be obedient and follow reasonable instructions. n74

The broker is not, however, liable for alleged duties not performed which are not within the contemplation of the agency contract, and the broker has no obligation to the principal by reason of the nonperformance of the contract by the other party. n75 Nor is the broker liable for a mere mistake in judgment which does not result from a failure to know or do that which a person of ordinary prudence under similar circumstances would know or do. n76 Generally, the burden

of proof is on the principal to prove an allegation that the broker is guilty of misconduct of failing to follow instructions.
n77

A broker is entitled to no compensation for conduct which is disobedient or is a breach of the broker's duty of loyalty.
n78 When such conduct constitutes a willful and deliberate breach of the parties' contract of service, the conduct disentitles the broker to compensation for even properly performed services. n79 One court stated that this rule received recognition where a broker, unknown to his principal, was paid a commission by both parties to a sale. In such a situation, the danger is that the broker may secure a lower price for his principal's property in order to make it worthwhile for the other party also to pay a commission. This court stated that in some jurisdictions, the principal had been allowed to recover the amount of both commissions. n80

[9] Duty to Account

Most state brokerage licensing statutes and regulations provide for strong controls over accounting procedures to be maintained by licensees. Such statutes and regulations help prevent the possibility of fraud as well as actual fraud. n81 These statutes and regulations also reflect a legislative intent that licensees engaging in advance fee transactions have a duty to account to their principals. n82

"To account for" had been held to mean to pay to the one entitled thereto monies coming into his or her possession which belong to others. n83 Any funds coming into a licensee's hands must be separately accounted for and cannot be commingled with the broker's funds. Real estate brokers are generally required to maintain trust accounts in a banking institution in the licensing state for the sole purpose of depositing earnest money deposits, rental monies, and other monies in which the client or other persons with whom the broker is dealing has an interest. n84

A broker does not need to act with bad faith or malfeasance in order to be in violation of a statute or regulation regarding the broker's handling of client funds. n85

[10] Duty to Present All Offers

A selling broker's failure to present all sales offers to the seller will constitute a breach of the broker's fiduciary duties.
n86

This particular duty may pose problems if a client has instructed the broker not to present offers below a certain dollar amount or with certain contingencies or other terms. The Oklahoma Attorney General has addressed such a situation. In Oklahoma Attorney General Opinion 02-8, n87 the question posed involved a broker who has entered into a listing agreement with a seller whereby the seller has requested that no offers less than the listing price be presented to the seller. This issue was whether such a broker could comply with this instruction. The answer given was, "No." Oklahoma law requires that transaction brokers and single-party brokers timely present all written offers and counteroffers. n88 With respect to single-party brokers, a broker is also required to obey the specific instructions of the party for whom the single-party broker is performing services if such instructions are not contrary to applicable statutes and rules or contrary to the terms of a contract between the parties. n89 Oklahoma's Attorney General stated that Oklahoma statutory law does not contain any exceptions to its mandate that a broker must present all written offers to a seller with whom he or she has a listing agreement. Since a single-party broker is not required to obey directions from a seller that are contrary to applicable statutes and rules and a broker is required to present all bona fide offers, a broker cannot comply with a seller's request not to present below-listing-price offers.

A broker representing a seller may also be liable to the seller for damages caused by the broker's failure to transmit a seller's offer of financing to the purchaser. n90

Virginia's high court has held that a prospective purchaser does not have a cause of action against a seller's broker for

failing to convey the prospective purchaser's offer to the seller. n91 However, a Massachusetts court has found that the failure of a seller's broker to submit a purchase offer made by a buyer's broker would support a cause of action filed by the buyer's broker against the seller's broker for violation of Massachusetts General Laws chapter 93A, § 11 (this is part of Massachusetts Consumer Protection law). n92

[11] Duty of Loyalty

A broker owes a fiduciary duty of loyalty to the principal he or she represents. n93 Loyalty is the chief virtue required of a broker. n94 The duty of loyalty requires that the broker act solely for the benefit of the principal in all matters connected with the agency. n95 Generally, a broker will forfeit all rights to a commission if the broker breaches his or her fiduciary duty of loyalty. Embodied in the duty of loyalty is the requirement that the broker keep the principal fully informed of all pertinent facts and that the broker act in good faith and promote the principal's best interests. n96

The following conduct by a broker has been held to violate the broker's duty of loyalty to the principal:

- In a plan to aid a buyer with poor credit, the broker had a condominium purchased by her client titled in the name of the broker's daughter and subsequently the broker evicted the buyer. n97
- Informing a prospective purchaser of the fact that the seller is anxious to sell and that the seller will accept less than the listed price. n98
- Informing a prospective purchaser that the seller wished to sell quickly for health reasons. n99
- Failing to deliver all offers to the sellers. n100
- Playing one group of sellers against the other when the broker was dealing with sellers who had separate interests in the property. n101
- Returning an earnest money deposit to a defaulting purchaser without the seller's authorization when the sales contract gave the seller the right to declare a forfeiture of the purchaser's deposit upon the purchaser's default. n102
- Where the broker knew the principal's financial position and that the principal was relying on the broker to explain the terms of a transaction, failing to fully disclose the material facts of the transaction, especially the fact that after the selling costs, taxes, and commission were paid the principal would have minimal cash from the down payment. n103
- Changing a material term of the listing agreement to the broker's benefit without telling the sellers. n104
- Ordering extensive survey work to benefit the buyer, but then having the cost of the survey work charged to the sellers. n105
- Failing to disclose a substantially higher offer made prior to closing, but after a contract for sale was made with a buyer. n106
- Returning a buyer's earnest money deposit without the seller's knowledge and in violation of the listing agreement. n107

A broker's alleged failure to procure and prepare documents in time for closing was held not to constitute a failure to

fulfill the broker's duty of loyalty to the principal. The court refused to imply a duty to procure and prepare these documents when the contracts did not expressly require that the broker undertake this responsibility. n108

A broker's return of earnest money deposit is not a breach of the duty of loyalty if the sale is not consummated because of the seller's default. n109

Perhaps most significantly, a real estate broker can represent more than one principal at a time and can show multiple properties to the same prospective buyer, without breaching the broker's duty of loyalty. n110 The fiduciary rules which bar undisclosed dual agency, do not extend to bar simultaneous representation of several sellers who are rivals for the same customer. n111 To hold otherwise would mean that a broker could only have on the broker's list of lands for sale one property at a time. n112 To restrict a broker's ability to show a prospective purchaser numerous properties would render it impossible for brokers to do business. n113

It is not to be expected that, if a prospective purchaser is dissatisfied with one piece of property the broker has for sale, the broker will decline to show the prospective purchaser other properties. n114 In the absence of a special restrictive contract in the agreement between the broker and the principal, the broker is free to offer the properties of all his or her principals to a prospective customer. n115 However, a broker is not allowed to ignore a potential buyer's interest in one seller's property and steer that buyer to another seller's property. n115.1

A corollary to this proposition for buyers represented by a buyer's agent is that unless a brokerage firm and principal specifically agree otherwise, the firm is not obligated to insure that its affiliated licensees forego making offers on behalf of other buyers for property on which the principal has already bid. n116 While disclosure and consent are not prerequisites to a competing offer in this circumstance, an individual agent may not represent multiple buyers bidding on the same property without making disclosure and obtaining consent.

[12] Duty to Advise

Brokers have a duty to advise their clients regarding proposed transactions. n117 For example, Wyoming statutorily provides that "failing to advise the buyer and seller of all terms of the proposed sale at the time an offer is presented including estimated discounts and closing costs" is a breach of the broker's duty to his client. n118 This duty to advise extends not only to those terms contained in the initial offer, but also those added by the broker in the contract for sale, even if they are part of the boiler plate language of a form contract. n119 Brokers do not fulfill their duty to advise their principal by simply handing the principal a document to sign and making cursory remarks about the document. n120

In order to protect the principal's interest, the broker must make a full, fair and understandable explanation to the principal before having the principal sign any contracts, particularly when those contracts are with the broker. The broker's explanation should be commensurate with the principal's education and understanding. If the broker is unable to give competent advice the broker should allow the principals to obtain the advice elsewhere. n121 Whether a sufficient explanation has been made is a question of fact to be determined from the totality of the surrounding circumstances. n122

California recognizes that brokers are not the appropriate individuals to be rendering legal or tax advice to sellers and buyers with respect to real estate transactions. The disclosure form (Disclosure Regarding Real Estate Agency Relationship) in *California Civil Code § 2079.16* advises the recipient: "You should carefully read all agreements to assure that they adequately express your understanding of the transaction. A real estate agent is a person qualified to advise about real estate. If legal or tax advice is desired, consult a competent professional." A California broker should not be liable to his or her client should a real estate transaction have adverse tax consequences since brokers are not expected to render such advice. n123

An issue that can arise with respect to a broker's duty to advise is whether the rendering of the advice in question will

constitute the unauthorized practice of law. n124 This issue is discussed in greater detail in Chapter 7, *below* .

[13] Broker Cannot Have an Interest in the Agency's Subject Matter Without the Principal's Consent

A broker or agent cannot, either directly or indirectly, have an interest in the subject matter of the agency without the principal's consent, freely given, after full knowledge of every matter known to the agent which might affect the principal. n125 A broker or agent who deals with the agency's subject-matter so as to make a profit for himself or herself will be held to account in equity as a trustee for all profits and advantages acquired by the broker or agent in such dealings. n126 Furthermore, a broker or agent who fails to disclose to the principal every material fact in the transaction which is the subject-matter of the agency is guilty of bad faith, and may not retain anything acquired by him or her either in the performance or violation of the agency relationship. n127

Whenever a broker or an agent breaches his or her duty to the principal by becoming personally interested in the subject of the agency agreement without the principal's full knowledge, the contract is voidable at the principal's election. n128

FOOTNOTES:

(n1)Footnote 1. *See*:

Federal: Barnsdall Oil Co. v. Willis, 152 F.2d 824, 828 (5th Cir. 1946) , *rehearing denied* 153 F.2d 784 (5th Cir. 1946) .

California: Warren v. Merrill, 143 Cal. App. 4th 96, 109, 49 Cal. Rptr. 3d 122, 131 (2006) (real estate agent has same obligation of undivided service and loyalty that is imposed on a trustee in favor of a beneficiary).

Minnesota: Olson v. Penkert, 252 Minn. 334, 341, 90 N.W.2d 193, 199 (Minn. 1958) .

Nebraska: Schepers v. Lautenschlager, 173 Neb. 107, 117, 112 N.W.2d 767, 773 (Neb. 1962) .

Wyoming: Zwick v. United Farm Agency, Inc., 556 P.2d 508, 511-512 (Wyo. 1976) .

(n2)Footnote 2. *See, e.g., Nava v. Truly Nolen Exterminating*, 140 Ariz. 497, 500, 683 P.2d 296, 299 (Ariz. Ct. App. 1984) ; *St. Paul Ins. Co. v. Industrial Underwriters Ins. Co.*, 214 Cal. App. 3d 117, 122, 262 Cal. Rptr. 490, 493 (Cal. Ct. App. 1989) ; *Benson v. Webster*, 593 N.W.2d 126, 130 (Iowa 1999) .

(n3)Footnote 3. *See*:

Iowa: Gardin v. Long Beach Mortgage Co., 661 N.W.2d 193, 199 (Iowa 2003) .

Virginia: Allen v. Lindstrom, 237 Va. 489, 496, 379 S.E.2d 450, 454 (Va. 1989) , *cert. denied*, 493 U.S. 849, 110 S. Ct. 145, 107 L. Ed. 2d 104 (1989) .

(n4)Footnote 4. *See*:

Virginia: Allen v. Lindstrom, 237 Va. 489, 496, 379 S.E.2d 450, 454 (Va. 1989) , *cert. denied*, 493 U.S. 849, 110 S. Ct. 145, 107 L. Ed. 2d 104 (1989) .

(n5)Footnote 5. *See, e.g., Holst v. Fireside Realty, Inc.*, 89 Wash. App. 245, 254, 948 P.2d 858, 862 (Wash. Ct.

App. 1997) ; *Ward v. Coldwell Banker/San Juan Properties, Inc.*, 74 Wash. App. 157, 161, 872 P.2d 69, 71 (Wash. Ct. App. 1994) , corrected 1994 Wash. App. LEXIS 257 (Wash. Ct. App. June 7, 1994) , review denied, 125 Wash. 2d 1006, 886 P.2d 1133, 1994 Wash. LEXIS 670 (1994) .

(n6)Footnote 6. See, e.g., *Holst v. Fireside Realty, Inc.*, 89 Wash. App. 245, 254-255, 948 P.2d 858, 863 (Wash. Ct. App. 1997) .

(n7)Footnote 7. See *Stortroen v. Beneficial Finance Co.*, 736 P.2d 391, 396 (Colo. 1987) ; *Winston Financial Group, Inc. v. Fults Management, Inc.*, 872 P.2d 1356, 1994 Colo. App. LEXIS 4, at *2 (Colo. Ct. App. 1994) , rehearing denied; *Holst v. Fireside Realty, Inc.*, 89 Wash. App. 245, 256, 948 P.2d 858, 863 (Wash Ct. App. 1997) .

(n8)Footnote 8. See, e.g., *Holst v. Fireside Realty, Inc.*, 89 Wash. App. 245, 256, 948 P.2d 858, 863-864 (Wash. Ct. App. 1997) . Cf. *Messler v. Phillips*, 867 P.2d 128, 133 (Colo. Ct. App. 1993) , rehearing denied (even though the agent did not formally contract to act as the buyer's agent for the townhome purchase, the agent may be held responsible for violation of an assumed duty of care in representing buyer's interests in the townhome closing).

(n9)Footnote 9. See, e.g., *John v. Robbins*, 764 F. Supp. 379, 389 (M.D. N.C. 1991) , applying North Carolina law. *Proctor v. Holden*, 75 Md. App. 1, 19, 540 A.2d 133, 141-42 (1988) , cert. denied sub nom. *Holden v. Freeman & Kagan*, 313 Md. 506, 545 A.2d 1343 (1988) , citing this Treatise. Cf. *Rockefeller v. Grabow*, 136 Idaho 637, 642, 39 P.3d 577, 582 (Idaho 2001) ("A real estate broker is an agent standing in a fiduciary relation to his principal.").

(n10)Footnote 10. See *Heaven v. Timber Hill, LLC*, 96 Conn. App. 294, 303, 900 A.2d 560, 567 (2006) . Cf. *Petenbrink v. Superior Home Builders, Inc.*, 1999 Del. Super. LEXIS 461, at *9 (Del. Sup. Ct. 1999) (Real estate brokers and salesman are fiduciaries, who are charged with full disclosure of all material facts to those who repose confidence in them.) *Wheat v. Lindsley*, 906 So. 2d 782, 786 (Miss. Ct. App. 2004) , rehearing denied, en banc, 2005 Miss. App. LEXIS 196 (Miss. Ct. App., Mar. 15, 2005) cert. denied, 904 So. 2d 184 (Miss. 2005) (agency relationship between broker and owner is personal and fiduciary, real estate brokers have a duty to act solely for the benefit of their principals in all matters connected with the agency). *Land Man Realty, Inc. v. Faraone*, 70 A.D.3d 1246, 1247, 895 N.Y.S.2d 247, 248 (2010) (In New York, a real estate broker is a fiduciary.); *Mathews Partners, LLC v. Lemme*, 2009 Tenn. App. LEXIS 667, at *27 (Tenn. Ct. App. Oct. 2, 2009) ; *Si Kyu Kim v. Harstan, Ltd.*, 286 S.W.3d 629, 634 (Tex. App. 2009) , review denied, 2010 Tex. LEXIS 66 (Jan. 15, 2010) ; *Shister v. Patel*, 776 N.W.2d 632, 637, 2009 WI App 163 (2009) (Statutory duties supersede brokers' duties under common law only to the extent that they are inconsistent.).

(n11)Footnote 10.1. See *Huffman v. Cohen*, 2009 U.S. Dist. LEXIS 38329, at *38-*39 (N.D. Okla. Apr. 29, 2009) (Oklahoma specifying the statutory duties owed by transaction brokers and single-party brokers), reconsideration denied, 2009 U.S. Dist. LEXIS 51912 (N.D. Okla. June 19, 2009) .

(n12)Footnote 11. See

Iowa: Action Real Estate Corp. v. Bulechek, 309 N.W.2d 502, 504 (Iowa 1981) ; *Miller v. Iowa Real Estate Comm'n*, 274 N.W.2d 288, 292 (Iowa 1979) .

New Jersey: Mango v. Pierce-Coombs, 370 N.J. Super. 239, 256, 851 A.2d 62, 72 (N.J. Super. Ct. App. Div. 2004) .

New Mexico: Swallows v. Laney, 102 N.M. 81, 83, 691 P.2d 874, 876 (1984) .

(n13)Footnote 12. See, e.g., *Bedwell v. Schmitt*, 2002 Ohio 6909, at P43, 2002 Ohio App. LEXIS 6731, at *14 (Ohio Ct. App. 2002) , appeal denied 98 Ohio St. 3d 1540, 2003 Ohio 1946, 786 N.E.2d 902 (Ohio 2003) .

(n14)Footnote 13. See:

California: Batson v. Strehlow, 68 Cal. 2d 662, 674, 68 Cal. Rptr. 589, 597, 441 P.2d 101, 109 (Cal. 1968) ; *Roberts v. Lomanto*, 112 Cal. App. 4th 1553, 1562-1563, 5 Cal. Rptr. 3d 866, 873 (Cal. Ct. App. 2003) , review denied, 2004 Cal. LEXIS 1784 (Cal. Feb. 24, 2004) ; *Montoya v. McLeod*, 176 Cal. App. 3d 57, 64, 221 Cal. Rptr. 353, 358 (Cal. Ct. App. 1985) ; *Ziswasser v. Cole & Cowan, Inc.*, 164 Cal. App. 3d 417, 421, 210 Cal. Rptr. 428, 429 (Cal. Ct. App. 1985) .

Missouri: Martin v. Hieken, 340 S.W.2d 161, 165 (Mo. Ct. App. 1960) .

(n15)Footnote 14. See *Depugh v. Ohio Dept. of Commerce, Division of Real Estate*, 128 Ohio App. 3d 528, 715 N.E. 2d 622, 625-626 (Ohio App. 1998) , appeal dismissed, 83 Ohio St. 3d 1448, 700 N.E. 2d 332 (Ohio 1998) .

(n16)Footnote 15. Cf. *Kirkruff v. Wisegarver*, 297 Ill. App. 3d 826, 830-831, 231 Ill. Dec. 852, 697 N.E.2d 406, 410 (1998) (facts could be established which would support imposition of a fiduciary duty upon a prospective agent).

(n17)Footnote 16. See *Century Land Dev., L.P. v. Weits*, 2009 U.S. Dist. LEXIS 7031 (S.D. Fla. Jan. 30, 2009) (applying Florida law); *Harrouk v. Fierman*, 291 Ga. App. 818, 820, 662 S.E.2d 892, 894 (2008) .

(n18)Footnote 17. See Restatement (Second) of Agency § 390E.

(n19)Footnote 18. 309 N.W.2d 502 (Iowa 1981) .

(n20)Footnote 19. 309 N.W.2d 502, 504 (Iowa 1981) .

But see *Lyle v. Moore*, 183 Mont. 274, 278, 599 P.2d 336, 338 (Mont. 1979) (broker's duty of full disclosure includes the duty to reveal the nature and extent of the broker's fees to the client, because of the fiduciary relationship the broker must make a full and understandable explanation to the client before having the client sign any contracts particularly when the contracts are with the broker himself); *Rushing v. Stephanus*, 64 Wash. 2d 607, 611, 393 P.2d 281, 284 (Wash. 1964) (broker must fully reveal the nature and extent of his fees to the client for whom he acts, and the failure to do so will render him liable).

(n21)Footnote 20.

Montana: Lyle v. Moore, 183 Mont. 274, 278, 599 P.2d 336, 338 (Mont. 1979) .

Washington: Rushing v. Stephanus, 64 Wash. 2d 607, 611, 393 P.2d 281, 284 (Wash. 1964) .

Cf. *Messler v. Phillips*, 867 P.2d 128, 133 (Colo. App. 1993) reh'g denied (Dec. 16, 1993) (An assumed duty of care arose, notwithstanding the lack of a formal contract to act as a broker/agent, where the defendant promised or undertook affirmative acts to render a service to the plaintiff that was reasonably calculated to prevent the harm that befell the plaintiff at the closings, and the plaintiff relied on the defendant to perform the service or the defendant's undertaking increased the risk to the plaintiff.)

(n22)Footnote 21. See, e.g., *Rupp v. Ayres (In re Fabbro)*, 411 B.R. 407, 424 (Bankr. D. Utah 2009) , applying Utah law; *Haldiman v. Gosnell Development Corp.*, 155 Ariz. 585, 588, 748 P.2d 1209, 1212 (Ariz. Ct. App. 1987) *Axtmann v. Chillemi*, 2007 ND 179, 740 N.W.2d 838, 845 (N.D. 2007) .

(n23)Footnote 22. See, e.g.:

Arizona: Haldiman v. Gosnell Development Corp., 155 Ariz. 585, 588, 748 P.2d 1209, 1212 (Ariz. Ct.

App. 1987).

North Carolina: Spence v. Spaulding & Perkins, Ltd., 82 N.C. App. 665, 667, 347 S.E.2d 864, 865-66 (1986).

Texas: Riley v. Powell, 665 S.W. 2d 578, 580 (Tex. App. 1984), writ of error refused no reversible error, (Jun. 13, 1984), rehearing of writ of error overruled, (Jul. 18, 1984).

(n24)Footnote 23. See, e.g.,

Arizona: Haldiman v. Gosnell Development Corp., 155 Ariz. 585, 588, 748 P.2d 1209, 1212 (Ariz. Ct. App. 1987).

North Carolina: Spence v. Spaulding & Perkins, Ltd., 82 N.C. App. 665, 667, 347 S.E.2d 864, 865-66 (1986).

(n25)Footnote 24. See, e.g., *Chumley v. Today's Realty, Inc.*, 995 So. 2d 676, 682 (La. Ct. App. 2008); *Schepers v. Lautenschlager*, 173 Neb. 107, 118, 112 N.W.2d 767, 773 (Neb. 1962).

(n26)Footnote 25. See *Crandall v. Grbic*, 36 Kan. App. 2d 179, 189-90, 138 P.3d 365, 374 (2006); *Latter & Blum v. Richmond*, 388 So. 2d 368, 372 (La. 1980); *Chumley v. Today's Realty, Inc.*, 995 So. 2d 676, 682 (La. Ct. App. 2008); *Baker v. Delhomme*, 929 So. 2d 877, 880 (La. Ct. App. 2006).

(n27)Footnote 26. See, e.g.:

California: Smith v. Rickard, 205 Cal. App. 3d 1354, 1359, 254 Cal. Rptr. 633, 635 (Cal. Ct. App. 1988), review denied.

Kentucky: Smith v. Fidelity & Columbia Trust Co., 227 Ky. 120, 122, 12 S.W.2d 276, 277 (Ky. 1928).

Louisiana: Mallet v. Maggio, 503 So. 2d 37, 38 (La. 1987), writ denied, 504 So. 2d 880 (1987).

Nebraska: Tetherow v. Wolfe, 223 Neb. 631, 635-636, 392 N.W. 2d 374, 378 (1986); *Firmature v. Brannon*, 223 Neb. 123, 127, 388 N.W. 2d 119, 121 (1986).

New Jersey: Farrell v. Janik, 225 N.J. Super. 282, 289, 542 A.2d 59, 63 (N.J. Super. Ct. 1988).

Wyoming: Zwick v. United Farm Agency, Inc., 556 P.2d 508, 511-512 n. 4 (Wyo. 1976).

(n28)Footnote 27. See *Menzel v. Morse*, 362 N.W.2d 465, 472 (Iowa 1985); *Durbin v. Ross*, 276 Mont. 463, 476, 916 P.2d 758, 766 (Mont. 1996).

(n29)Footnote 28. See *Carleton v. Tortosa*, 14 Cal. App. 4th 745, 754-755, 17 Cal. Rptr. 2d 734, 740 (Cal. Ct. App. 1993), review denied, 1993 Cal. LEXIS 3609 (Cal. July 1, 1993); *Farrell v. Janik*, 225 N.J. Super. 282, 290-291, 542 A.2d 59, 63 (N.J. Super. Ct. 1988).

(n30)Footnote 29. See *Doyle v. Maruszczak*, 834 So. 2d 307, 309 (Fla. Dist. Ct. App. 2003).

(n31)Footnote 30. *See, e.g.:*

California: Jorgensen v. Beach "N" Bay Realty, 125 Cal. App. 3d 155, 161, 177 Cal. Rptr. 882, 886 (Cal. 1981) .

Texas: Southern Cross Industries, Inc. v. Martin, 604 S.W. 2d 290, 293 (Tex. App. 1980) , writ of error refused no reversible error, (Dec. 31, 1980), rehearing of writ of error overruled, (Jan. 21, 1981).

Washington: Mersky v. Multiple Listing Bureau of Olympia, Inc., 73 Wash. 2d 225, 232, 437 P. 2d 897, 901 (Wash. 1968) .

Wyoming: Myer v. Miller, 631 P. 2d 441, 443-444 (Wyo. 1981) .

(n32)Footnote 31. *See*

Louisiana: Tresch v. Kilgore, 2003 La. App. LEXIS 3060, at *9-*10 (La. Ct. App. Nov. 7, 2003) .

Minnesota: Gresser v. Hotzler, 604 N.W.2d 379, 385 (Minn. Ct. App. 2000) .

New Jersey: Busciglio v. Dellafave, 366 N.J. Super. 135, 140, 840 A.2d 897, 900 (N.J. Super. Ct. App. Div. 2004) .

North Dakota: Argabright v. Rodgers, 2003 ND 59, 659 N.W.2d 369, 371 (N.D. 2003) .

(n33)Footnote 32. *See Southern Cross Industries, Inc. v. Martin*, 604 S.W.2d 290, 292 (Tex. Civ. App. 1980) , writ of error refused no reversible error (Dec. 31, 1980), rehearing of writ of error overruled (Jan. 21, 1981).

(n34)Footnote 33. *See, e.g., Schlossman & Gunkelman, Inc. v. Tallman*, 1999 ND 89, 593 N.W.2d 374, 382-383 (N.D. 1999) .

(n35)Footnote 34. *See Bazal v. Rhines*, 600 N.W.2d 327, 329 (Iowa Ct. App. 1999) ; *Farrell v. Janik*, 225 N.J. Super. 282, 288, 542 A.2d 59, 61 (N.J. Super. Ct. 1988) .

(n36)Footnote 35. *See Farrell v. Janik*, 225 N.J. Super. 282, 290-292, 542 A.2d 59, 63-64 (N.J. Super. Ct. 1988) .

(n37)Footnote 36. *See Gordon v. Bauer*, 177 Ill. App. 3d 1073, 1099, 127 Ill. Dec. 26, 532 N.E.2d 855, 871-872 (Ill. App. Ct. 1988) , cert. denied, 125 Ill. 2d 564, 130 Ill. Dec. 480, 537 N.E.2d 809 (Ill. 1989) .

(n38)Footnote 37. 727 So. 2d 594 (La. App. 1998) , appeal denied, 743 So. 2d 667 (1999) .

(n39)Footnote 38. 727 So. 2d 594, 596-597 (La. App. 1998) , appeal denied, 743 So. 2d 667 (1999) .

(n40)Footnote 39. The term "professional" is used in a general sense to refer to someone who is engaged in a specific activity as a source of livelihood. This term is also used in a narrower sense to refer to individuals engaged in certain activities requiring a college degree, special training, and licensing by the state. Not all courts consider real estate licensees to be professionals in the latter sense. This issue is discussed in § 3.27 below.

(n41)Footnote 40. *See Hughes v. Goodreau*, 836 So. 2d 649, 660 (La. Ct. App. 2002) , writ denied, 841 So. 2d 793 (La. 2003) ; *Farrell v. Janik*, 225 N.J. Super. 282, 288-289, 542 A.2d 59, 62 (N.J. Super. Ct. 1988) .

(n42)Footnote 41. See *Rupp v. Ayres (In re Fabbro)*, 411 B.R. 407, 424 (Bankr. D. Utah 2009) , applying Utah law; *Cashion v. Ahmadi*, 345 So. 2d 268, 269-270 (Ala. 1977) ; *Carver v. Lykes*, 262 N.C. 345, 354-355, 137 S.E.2d 139, 147 (N.C. 1964) . See also *Jenkins v. Strauss*, 931 A.2d 1026, 1035 (D.C. 2007) (agent who fails to exercise standard care and commits an act not authorized by his principal is liable for damages arising from that act.). *Farrell v. Janik*, 225 N.J. Super. 282, 289, 542 A.2d 59, 63 (N.J. Super. Ct. 1988) ("Since the realtor held itself out as a specialist in the sale of real estate it was required to employ not merely the skill of a salesperson, but that special degree of skill normally possessed by the average realtor licensed in New Jersey who has devoted special study and experience in the field of real estate sales.").

(n43)Footnote 42. See *Lane v. Oustalet*, 850 So. 2d 1143, 1150 (Miss. Ct. App. 2002) , rehearing denied, 840 So. 2d 716 (Miss. Ct. App. 2002) ; *aff'd in part, rev'd in part*, 873 So. 2d 92 (Miss. 2004) .

(n44)Footnote 43. See *Rose v. Showalter*, 108 Idaho 631, 633, 701 P.2d 251, 253 (Idaho Ct. App. 1985) , review denied, 116 Idaho 466, 776 P.2d 828 (Idaho 1985) .

(n45)Footnote 44. Cf. *Prall v. Gooden*, 226 Ore. 554, 561, 360 P.2d 759, 762 (Or. 1961) (A real estate broker must make a full, fair and understandable explanation to the client before having him sign any contracts, particularly when those contracts are with the broker himself. The broker should make his explanation commensurate with the education and understanding of the people he is dealing with, and if he is unable to give competent advice he should allow them to obtain it elsewhere).

(n46)Footnote 45. See *Cavagnaro v. Coldwell Banker Alfonso Realty, Inc.*, 995 So. 2d 754, 758 (Miss. Ct. App. 2008) *cert. denied*, 997 So. 2d 924, 2008 Miss. LEXIS 534 (2008) .

(n47)Footnote 46. See *Yerkie v. Salisbury*, 264 Md. 598, 603, 287 A.2d 498, 501 (Md. 1972) .

(n48)Footnote 47. See, e.g.,

Federal: Rupp v. Ayres (In re Fabbro), 411 B.R. 407, 424 (Bankr. D. Utah 2009) , applying Utah law.

California: Gravillis v. Coldwell Banker Residential Brokerage Co., 143 Cal. App. 4th 761, 777, 49 Cal. Rptr. 3d 531, 542 (2006) , rehearing denied, 2006 Cal. App. LEXIS 1775 (Oct. 20, 2006) .

Indiana: Nichols v. Minnick, 885 N.E.2d 1, 3-4 (Ind. 2008) , *reh'g denied*, 2008 Ind. LEXIS 544 (June 30, 2008) .

Louisiana: Chumley v. Magee, No. 44,860-CA, 2010 La. App. LEXIS 220, at *8 (Feb. 17, 2010) (buyer's agent).

New Mexico: Swallows v. Laney, 102 N.M. 81, 83, 691 P.2d 874, 876 (1984) .

North Carolina: Spence v. Spaulding & Perkins Ltd., 82 N.C. App. 665, 667, 347 S.E.2d 864, 865-66 (1986) .

Vermont: Foster and Gridley v. Winner, 169 Vt. 621, 623, 740 A.2d 1283, 1286 (Vt. 1999) ; *Quechee Lakes Rental Corp. v. Boggess*, 158 Vt. 258, 262, 608 A.2d 39, 41 (Vt. 1992) .

(n49)Footnote 48. See *Finomore v. Epstein*, 18 Ohio App. 3d 88, 90, 481 N.E.2d 1193, 1196, 18 Ohio B. 403 (1984) .

(n50)Footnote 49. See *Michel v. Moore & Associates, Inc.*, 156 Cal. App. 4th 756, 762, 67 Cal. Rptr. 3d 797, 802 (2007) (broker can be professionally competent under Cal. Civ. Code § 2079 without satisfying the greater duty of a fiduciary.); *Field v. Century 21 Klowden-Forness Realty*, 63 Cal. App.4th 18, 25, 73 Cal. Rptr. 2d 784, 789 (1998) (fiduciary duty owed by brokers to their clients is substantially more extensive than the non-fiduciary duties codified in Cal. Civ. Code § 2079.), review denied, 1998 Cal. LEXIS 4685 (Cal. July 15, 1998) .

(n51)Footnote 50. See *Michel v. Moore & Associates, Inc.*, 156 Cal. App. 4th 756, 762, 67 Cal. Rptr. 3d 797, 802 (2007) .

(n52)Footnote 51. See *Harmon v. Kobrin (In re Harmon)*, 250 F.3d 1240, 1249 n. 10 (9th Cir. 2001) ; *Michel v. Moore & Associates, Inc.*, 156 Cal. App. 4th 756, 763, 67 Cal. Rptr. 3d 797, 802 (2007) ; *Halkey-Roberts Corp. v. Mackal*, 641 So. 2d 445, 447 (Fla. Dist. Ct. App. 1994) ; *Brookshire v. Digby*, 224 Ga. App. 512, 516, 481 S.E.2d 250, 254-55 (1997) , reh'g denied, 224 Ga. App. 903 (1997) .

(n53)Footnote 52. See *Michel v. Moore & Associates, Inc.*, 156 Cal. App. 4th 756, 763, 67 Cal. Rptr. 3d 797, 802 (2007) .

(n54)Footnote 53. See:

Virginia: R.A. Poff & Co. v. Ottaway, 191 Va. 779, 785, 62 S.E. 2d 865, 868 (Va. 1951) .

Washington: Farrell v. Score, 67 Wash. 2d 957, 961, 411 P.2d 146, 149 (Wash. 1966) .

(n55)Footnote 54. See

Alaska: Veach v. Meyeres Real Estate Real Estate, Inc., 599 P.2d 746, 748-749 (Alaska 1979) .

Indiana: Nichols v. Minnick, 885 N.E.2d 1, 3-4 (Ind. 2008) , reh'g denied, 2008 Ind. LEXIS 544 (June 30, 2008) .

Virginia: R.A. Poff & Co. v. Ottaway, 191 Va. 779, 785, 62 S.E. 2d 865, 868 (Va. 1951) .

(n56)Footnote 55. See *Musselman v. Southwinds Realty Co.*, 146 Ariz. 173, 177, 704 P.2d 814, 818 (Ariz. Ct. App. 1995) .

(n57)Footnote 56. See *Ward v. Coldwell Banker/San Juan Properties, Inc.*, 74 Wash. App. 157, 167-168, 872 P.2d 69, 74 (Wash. Ct. App. 1994) , corrected 1994 Wash. App. LEXIS 257 (Wash. Ct. App. June 7, 1994) , review denied, 125 Wash. 2d 1006, 886 P.2d 1133, 1994 Wash. LEXIS 670 (1994) . It should be noted that Justice Baker dissented and stated that the broker was in a divided loyalty situation which required obtaining its principals' consent before guaranteeing the buyers' loan. The broker's guaranty was clearly in the buyers' interest, enabling them to obtain financing and purchase the house. The broker's guaranty also furthered its own interest in ensuring that its commission would be paid at closing without having to expend the effort to find another, possibly more qualified, buyer. The broker was only entitled to act in its own and the buyers' interest without prior consent from its principals as long as doing so was not potentially adverse to the principals' interests.

(n58)Footnote 57. Cf., e.g., *Quinlan v. Clasby*, 71 Mass. App. Ct. 97, 104, 879 N.E.2d 703, 709 (2008) (broker did not violate Mass. Gen. Laws ch. 93A by advertising a house as a three-family dwelling when, and without the broker's knowledge, the home as configured violated zoning laws; broker had no obligation in the circumstances presented to verify compliance with zoning law and without such knowledge could not be liable under Mass. Gen. Laws ch. 93A).

(n59)Footnote 58. *See, e.g.:*

Federal: Coleman v. Watts, 87 F. Supp. 2d 944, 954 (D. Ariz. 1998) , applying Arizona law.

Texas: Riley v. Powell, 665 S.W.2d 578, 580 (Tex. App. 1984) , writ of error refused no reversible error, (Jun. 13, 1984), rehearing of writ of error overruled, (Jul. 18, 1984).

(n60)Footnote 59. *See Mannix v. Hildreth*, 2 App. D.C. 259, 274 (Ct. App. D.C. 1894) .

(n61)Footnote 60. *See Riley v. Powell*, 665 S.W. 2d 578, 580 (Tex. Civ. App. 1984) , writ of error refused no reversible error, (Jun. 13, 1984), rehearing of writ of error overruled, (Jul. 18, 1984).

(n62)Footnote 61. *See Duvall v. Walton*, 107 Fla. 60, 63, 144 So. 318, 319 (1932) ; *Pryor v. Oak Ridge Development Corp.*, 97 Fla. 1085, 119 So. 326, 328 (Fla. 1928) ; *Evans v. Gray*, 215 So. 2d 40, 41-42 (Fla. Dist. Ct. App. 1968) , cert. denied, 222 So. 2d 748 (Fla. 1969) .

(n63)Footnote 62. *See Haymes v. Rogers*, 70 Ariz. 257, 259, 219 P.2d 339, 340 (Ariz. 1950) , modified, 70 Ariz. 408, 222 P.2d 789 (Ariz. 1950) .

(n64)Footnote 63. *See Haymes v. Rogers*, 70 Ariz. 257, 259, 219 P.2d 339, 340 (Ariz. 1950) , modified, 70 Ariz. 408, 222 P.2d 789 (Ariz. 1950) .

(n65)Footnote 64. *See, e.g., Lee Hawkins Realty, Inc. v. Moss*, 724 So.2d 1116, 1119 (Miss. Ct. App. 1998) .

(n66)Footnote 65. *See Zuazua v. Tibbles*, 335 Mont. 181, 188, 2006 MT 342, 150 P.3d 361, 365-66 (2006) .

(n67)Footnote 66. *See Zuazua v. Tibbles*, 335 Mont. 181, 184-85, 2006 MT 342, 150 P.3d 361, 363 (2006) .

(n68)Footnote 67. *See Zuazua v. Tibbles*, 335 Mont. 181, 185, 2006 MT 342, 150 P.3d 361, 363 (2006) .

(n69)Footnote 68. *See Zuazua v. Tibbles*, 335 Mont. 181, 186, 2006 MT 342, 150 P.3d 361, 364 (2006) .

(n70)Footnote 69. *See Musselman v. Southwinds Realty Co.*, 146 Ariz. 173, 175, 704 P.2d 814, 816 (Ariz. Ct. App. 1995) .

(n71)Footnote 70. *Musselman v. Southwinds Realty Co.*, 146 Ariz. 173, 175, 704 P.2d 814, 816 (Ariz. Ct. App. 1995) .

(n72)Footnote 71. *See Musselman v. Southwinds Realty Co.*, 146 Ariz. 173, 175, 704 P.2d 814, 816 (Ariz. Ct. App. 1995) .

(n73)Footnote 72. *See Musselman v. Southwinds Realty Co.*, 146 Ariz. 173, 175, 704 P.2d 814, 816 (Ariz. Ct. App. 1995) .

(n74)Footnote 73. *See, e.g., Rupp v. Ayres (In re Fabbro)*, 411 B.R. 407, 424 (Bankr. D. Utah 2009) , applying Utah law; *Lowrance v. Swaffield*, 123 S.C. 331, 333, 116 S.E. 278 (S.C. 1923) . *See also Jenkins v. Strauss*, 931 A.2d 1026, 1035 (D.C. 2007) (An agent who commits an act not authorized by his principal is liable for damages arising from that act.).

(n75)Footnote 74. *See Restatement (Second) of Agency* § 385.

(n76)Footnote 75. *See Zwick v. United Farm Agency, Inc.*, 556 P.2d 508, 512 (Wyo. 1976) .

(n77)Footnote 76. *See Zwick v. United Farm Agency, Inc.*, 556 P.2d 508, 512 (Wyo. 1976) .

(n78)Footnote 77. *See:*

Federal: Bangs v. Hornick, 30 F. 97, 99 (C.C.D. Minn. 1887) (failure of agent to follow instructions).

Arizona: Secan v. Dunbar, 139 Ariz. 503, 505, 679 P.2d 526, 528 (Ariz. Ct. App. 1983) (failure to deliver an offer).

Minnesota: Young v. Yeates, 153 Minn. 366, 368-369, 190 N.W. 791 (Minn. 1922) .

Texas: Lemons v. Davis, 306 S.W.2d 224, 227 (Tex. Civ. App.1957) , writ of error refused no reversible error, (1958).

See also Restatement (Second) of Agency comment b to § 379 (burden of proof is on principal to show agent's negligence).

(n79)Footnote 78. *See Jenkins v. Strauss*, 931 A.2d 1026, 1038 (D.C. 2007) *Jackson v. Williams*, 510 S.W.2d 645, 647 (Tex. Civ. App. 1974) , writ of error refused no reversible error, rehearing of writ of error overruled; Restatement (Second) of Agency § 469.

(n80)Footnote 79. *See*

California: Tackett v. Croonquist, 244 Cal. App. 2d 572, 577, 53 Cal. Rptr. 388, 391 (Cal. Ct. App. 1966) .

Washington: Merkley v. MacPherson's, Inc., 69 Wash. 2d 776, 778, 420 P.2d 205, 207 (Wash. 1966) .

(n81)Footnote 80. *See Tackett v. Croonquist*, 244 Cal. App. 2d 572, 577, 53 Cal. Rptr. 388, 391 (Cal. Ct. App. 1966) .

(n82)Footnote 81. *See Burch v. Argus Properties, Inc.*, 92 Cal. App. 3d 128, 132, 154 Cal. Rptr. 485, 487 (Cal. Ct. App. 1979) .

(n83)Footnote 82. *See Burch v. Argus Properties, Inc.*, 92 Cal. App. 3d 128, 132, 154 Cal. Rptr. 485, 487 (Cal. Ct. App. 1979) .

(n84)Footnote 83. *See Texas Real Estate Commission v. Bentley*, 253 S.W.2d 325, 328 (Tex. Civ. App. 1952, no writ) .

(n85)Footnote 84. *See, e.g., Cal. Bus. & Prof. Code § 10146.*

(N86)Footnote 85. *See Burch v. Argus Properties, Inc.*, 92 Cal. App. 3d 128, 132, 154 Cal. Rptr. 485, 487 (Cal. Ct. App. 1979) ; *De St. Germain v. Watson*, 95 Cal. App.2d 862, 867, 214 P.2d 99, 103 (Ct. Ct. App. 1950) .

(n87)Footnote 86. *See Mabry v. Tom Stanger & Co.*, 33 P. 3d 1206, 1209-1210 (Colo. Ct. App. 2001) , rehearing denied 2001 Colo. App. LEXIS 605 (Colo. Ct. App. Apr. 5, 2001) , cert. denied 2001 Colo. LEXIS 927 (Colo. Nov. 13, 2001) .

(n88)Footnote 87. 02-8, 2002 Okla. AG LEXIS 10 (Feb. 19, 2002).

(n89)Footnote 88. See *Okla. Stat. tit. 59, §§ 858-353 and 858-354*.

(n90)Footnote 89. See *Okla. Stat. tit. 59, § 858-354*.

(n91)Footnote 90. See *Burdon v. Harvey*, 385 So. 2d 514, 517-518 (La. Ct. App. 1980) , rehearings denied, cert. denied, 393 So. 2d 742 (La. 1980) .

(n92)Footnote 91. See *Allen v. Lindstrom*, 237 Va. 489, 498, 379 S.E.2d 450, 456 (Va. 1989) , cert. denied, 493 U.S. 849, 110 S. Ct. 145, 107 L. Ed. 2d 104 (1989) . Cf. *Harrouk v. Fierman*, 291 Ga. App. 818, 821-22, 662 S.E.2d 892, 894-95 (2008) (A prospective purchaser complained that the broker failed to notify him that property he desired had become available for sale. Since the purchaser had failed to engage the broker as defined in the Brokerage Relationship in Real Estate Transaction Act, the broker did not owe the purchaser the same duties that would be owed to a buyer who was a client.).

(n93)Footnote 92. See *Saab v. Keenan*, 2003 Mass. App. Div. 100, 102, 2003 Mass. App. Div. LEXIS 38, at *7-*10 (Mass. Ct. App. June 10, 2003).

(n94)Footnote 93. See *Rupp v. Ayres (In re Fabbro)*, 411 B.R. 407, 424 (Bankr. D. Utah 2009) , applying Utah law; *United Investors, Inc. v. Tsotsos*, 132 Ill. App. 3d 175, 179, 87 Ill. Dec. 439, 477 N.E.2d 40, 43 (Ill. Ct. App. 1985) *Premier Realty, LLC v. I.T.J. Investments, Inc.*, 42 Kan. App. 2d 148, 163, 209 P.3d 741, 752 (2009) ; *Browne v. Faulkner*, 2006 N.Y. Misc. LEXIS 3918, at *4 (Dec. 20, 2006) ; *Axtmann v. Chillemi*, 2007 ND 179, 740 N.W.2d 838, 845 (N.D. 2007) *Weaver v. McCarter*, 2006 Tenn. App. LEXIS 369, at *28 (June 6, 2006) .

(n95)Footnote 94. See

Idaho: Rose v. Showalter, 108 Idaho 631, 633, 701 P.2d 251, 253 (Idaho Ct. App. 1985) review denied, 116 Idaho 466, 776 P.2d 828 (Idaho 1985) .

Washington: Moon v. Phipps, 67 Wash. 2d 948, 954, 411 P.2d 157 (Wash. 1966) .

(n96)Footnote 95. See Restatement (Second) of Agency § 387. See also *Chumley v. Today's Realty, Inc.*, 995 So. 2d 676, 682 (La. Ct. App. 2008) (A real estate licensee should not use his or her position to gain an advantage over his or her client.).

Cf. *Queens Structure Corp. v Jay Lawrence Associates, Inc.*, 304 A.D.2d 736, 737, 758 N.Y.S.2d 664, 666, 2003 N.Y. App. Div. LEXIS 4295 (N.Y. App. Div. 2003) (brokers working for sellers had an affirmative duty not to act for the purchaser or the purchaser's assignee unless the sellers had full knowledge of the facts).

(n97)Footnote 96. See *United Investors, Inc. v. Tsotsos*, 132 Ill. App. 3d 175, 179-180, 87 Ill. Dec. 439, 477 N.E.2d 40, 43 (Ill. Ct. App. 1985) .

(n98)Footnote 97. See *Warren v. Merrill*, 143 Cal. App. 4th 96, 111, 49 Cal. Rptr. 3d 122, 133 (2006) . This court stated that the "evidence ... was more than sufficient to show an egregious violation of the duties of loyalty and undivided interest by a fiduciary toward her principal, as well as a deliberate plan to defraud him out of his down payment and the property."

(n99)Footnote 98. See *Haymes v. Rogers*, 70 Ariz. 257, 219 P.2d 339, 340 (Ariz. 1950) , modified, 70 Ariz. 408, 222 P.2d 789 (Ariz. 1950) .

(n100)Footnote 99. See *Beckwith v. Clevenger Realty Co.*, 89 Ariz. 239, 241-242, 360 P.2d 596, 598 (Ariz. 1961) .

(n101)Footnote 100. See *Mabry v. Tom Stanger & Co.*, 33 P.3d 1206, 1210-1211 (Colo. Ct. App. 2001) , rehearing denied 2001 Colo. App. LEXIS 605 (Colo. Ct. App. Apr. 5, 2001) , cert. denied 2001 Colo. LEXIS 927 (Colo. Nov. 13, 2001) .

(n102)Footnote 101. See *Mabry v. Tom Stanger & Co.*, 33 P.3d 1206, 1210-1211 (Colo. Ct. App. 2001) , rehearing denied 2001 Colo. App. LEXIS 605 (Colo. Ct. App. Apr. 5, 2001) , cert. denied 2001 Colo. LEXIS 927 (Colo. Nov. 13, 2001) .

(n103)Footnote 102. See *United Investors, Inc. v. Tsotsos*, 132 Ill. App. 3d 175, 180, 87 Ill. Dec. 439, 477 N.E.2d 40, 43 (Ill. Ct. App. 1985) .

Illinois: United Investors, Inc. v. Tsotsos, 132 Ill. App. 3d 175, 180, 87 Ill. Dec. 439, 477 N.E.2d 40, 43 (Ill. App. Ct. 1985) .

Kentucky: Crabtree v. Board of Trustees, 512 S.W.2d 311, 313 (Ky. 1974) .

Maryland: Prince Georges Properties, Inc. v. Rogers, 275 Md. 582, 591-592, 341 A.2d 804, 809-810 (Md. 1975) .

Minnesota: Lake Co. v. Molan, 269 Minn. 490, 499, 131 N.W.2d 734, 740 (Minn. 1964) .

Missouri: United Farm Agency, Inc. v. Murphy, 596 S.W.2d 730, 734 (Mo. App. 1980) ; *Herb Tillman Co., Inc. v. Sissel*, 348 S.W.2d 819, 825 (Mo. Ct. App. 1961) .

See generally Annot., *Broker's Return of Deposit to Purchaser as Waiver of Right to Demand Commission from Seller*, 69 A.L.R.2d 1244 (1960) .

(n104)Footnote 103. See *Wesco Realty, Inc. v. Drewry*, 9 Wash. App. 734, 738, 515 P.2d 513, 516-517 (Wash. Ct. App. 1973) .

(n105)Footnote 104. See *Rose v. Showalter*, 108 Idaho 631, 633, 701 P.2d 251, 253 (Idaho Ct. App. 1985) . Cf. *Bienert v. Dickerson*, 276 Ga. App. 621, 625, 624 S.E.2d 245, 249 (2005) (business broker). (The broker testified that she owed the seller a fiduciary duty of allegiance to put the seller's interests above her own. The seller was awarded compensatory and punitive damages and attorney's fees when the broker falsified the sales agreement to show that she was a party and a signatory thereto. As a result of a commission dispute, the broker used the falsified document to support a UCC financing statement to place a lien on the business's assets so as to stymie the deal.).

(n106)Footnote 105. See *Rose v. Showalter*, 108 Idaho 631, 633-634, 701 P.2d 251, 253-254 (Idaho Ct. App. 1985) .

(n107)Footnote 106. See *Moore & Co. v. T-A-L-L, Inc.*, 792 P.2d 794, 800 (Colo. 1990) .

(n108)Footnote 107. See *Re/Max Realty 100 v. Basso*, 667 N.W.2d 857, 861, 2003 WI App 146 (Wis. Ct. App. 2003) .

(n109)Footnote 108. See *Gordon v. Bauer*, 177 Ill. App. 3d 1073, 1099, 127 Ill. Dec. 26, 532 N.E.2d 855, 871-872 (Ill. App. Ct. 1988) , cert. denied, 125 Ill. 2d 564, 130 Ill. Dec. 480, 537 N.E.2d 809 (Ill. 1989) .

(n110)Footnote 109. See *United Investors, Inc. v. Tsotsos*, 132 Ill. App. 3d 175, 180, 87 Ill. Dec. 439, 477 N.E.2d 40, 43 (Ill. Ct. App. 1985) .

(n111)Footnote 110. See:

Arizona: Coldwell Banker Commercial Group v Camelback Off. Park, 156 Ariz 226, 230, 751 P.2d 542, 546 (Ariz. 1988) , reconsideration denied (1988).

Massachusetts: McEvoy v. Ginsberg, 345 Mass. 733, 737, 189 N.E.2d 546 (Mass. 1963) .

New York: Sonnenschein v. Douglas Elliman-Gibbons & Ives, 274 A.D.2d 244, 247, 713 N.Y.S.2d 9, 12, 2000 N.Y. App. Div. LEXIS 8864 (N.Y. App. Div. 2000) , affirmed by, certified question answered by, *Sonnenschein v. Douglas Elliman-Gibbons & Ives*, 96 N.Y.2d 369, 729 N.Y.S. 2d 62, 753 N.E.2d 857 (2001) .

See generally Annot., *Right of Real Estate Broker to List Competing Properties of Different Owners*, 71 A.L.R. 699 .

(n112)Footnote 111. See:

Iowa: Foley v Mathias, 211 Iowa 160, 162, 233 NW 106, 107 (Iowa 1930) .

New York: Sonnenschein v. Douglas Elliman-Gibbons & Ives, 274 A.D.2d 244, 247-248, 713 N.Y.S.2d 9, 12, 2000 N.Y. App. Div. LEXIS 8864 (N.Y. App. Div. 2000) , affirmed by, certified question answered by, *Sonnenschein v. Douglas Elliman-Gibbons & Ives*, 96 N.Y.2d 369, 729 N.Y.S. 2d 62, 753 N.E.2d 857 (2001) .

(n113)Footnote 112. See *Gaty v Sack*, 19 Mo. App. 470, 475 (Mo. Ct. App. 1885) .

(n114)Footnote 113. See *Sonnenschein v. Douglas Elliman-Gibbons & Ives*, 274 A.D.2d 244, 248, 713 N.Y.S.2d 9, 12, 2000 N.Y. App. Div. LEXIS 8864 (N.Y. App. Div. 2000) , affirmed by, certified question answered by, *Sonnenschein v. Douglas Elliman-Gibbons & Ives*, 96 N.Y.2d 369, 729 N.Y.S. 2d 62, 753 N.E.2d 857 (2001) .

(n115)Footnote 114. See:

Massachusetts: McEvoy v Ginsberg, 345 Mass 733, 737, 189 N.E. 2d 546 (Mass. 1963) .

Michigan: Lemon v Macklem, 157 Mich 475, 478, 122 N.W. 77, 78 (Mich. 1909) .

New York: Sonnenschein v. Douglas Elliman-Gibbons & Ives, 274 A.D.2d 244, 247-248, 713 N.Y.S.2d 9, 12, 2000 N.Y. App. Div. LEXIS 8864 (N.Y. App. Div. 2000) , affirmed by, certified question answered by, *Sonnenschein v. Douglas Elliman-Gibbons & Ives*, 96 N.Y.2d 369, 729 N.Y.S. 2d 62, 753 N.E.2d 857 (2001) .

(n116)Footnote 115. See *McEvoy v Ginsberg*, 345 Mass 733, 737, 189 N.E. 2d 546, 547 (Mass. 1963) .

(n117)Footnote 115.1. See *NRT New Eng., Inc. v. Indiciani*, 2009 Mass. App. Div. 186, 2009 Mass. App. Div. LEXIS 51 (2009) .

(n118)Footnote 116. See *Rivkin v. Century 21 Teran Realty LLC*, 10 N.Y.3d 344, 356, 858 N.Y.S.2d 55, 887 N.E.2d 1113, 1121 (2008) .

(n119)Footnote 117. *Cf. Leigh v. Loyd*, 74 Ariz. 84, 87, 244 P.2d 356, 358-359 (Ariz. 1952) (seller's broker was held liable for intentionally remaining silent while his principal signed legal instruments under a serious misapprehension of the instrument's true nature).

(n120)Footnote 118. *See Wyo. Stat. Ann. § 33-28-111(a)(x)*.

(n121)Footnote 119. *See Snyder v. Lovercheck*, 992 P.2d 1079, 1090 (Wyo. 1999) .

(n122)Footnote 120. *See Duncan v. Barbour*, 188 Va. 53, 62-63, 49 S.E.2d 260, 265 (Va. 1948) (broker denied a commission when an amended purchase was offered to the principal without the broker disclosing that the offer failed to accord with the principal's wishes in three crucial respects). *But see Si Kyu Kim v. Harstan, Ltd.*, 286 S.W.3d 629, 634 (Tex. App. 2009) (A broker does not have a duty to disclose the contents of a contract that the principal is obligated to read before he or she signs it.), *review denied*, 2010 Tex. LEXIS 66 (Jan. 15, 2010) .

(n123)Footnote 121. *See Prall v. Gooden*, 226 Ore. 554, 561, 360 P.2d 759, 762 (Or. 1961) .

(n124)Footnote 122. *See Snyder v. Lovercheck*, 992 P.2d 1079, 1090 (Wyo. 1999) .

(n125)Footnote 123. *See Carleton v. Tortosa*, 14 Cal. App. 4th 745, 758-759, 17 Cal. Rptr. 2d 734, 743 (Cal. Ct. App. 1993) *review denied*, 1993 Cal. LEXIS 3609 (Cal. July 1, 1993) ; *Santos v. Wing*, 197 Cal. App. 2d 678, 684, 17 Cal. Rptr. 457, 460 (Cal. Ct. App. 1961) . *See also Minn. Stat. § 82.41 subd. 11* (Licensees shall not guarantee or affirmatively encourage another person to guarantee future profits or earnings that may result from the purchase or lease of the real property unless the guarantee and the assumptions upon which it is based are fully disclosed and contained in the contract.)

(n126)Footnote 124. *Cf. Morley v. J. Pagel Realty & Insurance*, 27 Ariz. App. 62, 550 P.2d 1104, 1107 (Ariz. Ct. App. 1976) (under circumstances that arose in this case, a broker would not engage in the unauthorized practice of law by telling his clients that the purchase price of their property should be secured by a mortgage). *Gjonaj v. Sines*, 69 A.D.3d 1188, 1189-90, 896 N.Y.S.2d 176, 178-79 (2010) (Brokers can provide limited assistance to their clients with contract forms. There was no evidence that the broker engaged in the unauthorized practice of law. Appropriate warning of the form contract's legal effect was provided by language in capital letters appearing immediately below the broker's address at the top of the first page.).

(n127)Footnote 125. *See, e.g.:*

Hawaii: Jenkins v. Wise, 58 Haw. 592, 603, 574 P.2d 1337, 1344 (Haw. 1978) .

Louisiana: Jenkins v. Wise, 58 Haw. 592, 603, 574 P.2d 1337, 1344 (Haw. 1978) .

Missouri: Rosenfeld v. Glick Real Estate Company, 291 S.W.2d 863, 872 (Mo. 1956) .

Nebraska: Schepers v. Lautenschlager, 173 Neb. 107, 118, 112 N.W.2d 767, 773 (Neb. 1962) .

New York: Howard v. State, 161 A.D.2d 1075, 1077, 557 N.Y.S.2d 631, 632, 1990 N.Y. App. Div. LEXIS 6652 (1990) ; *Browne v. Faulkner*, 2006 N.Y. Misc. LEXIS 3918, at *5 (Dec. 20, 2006) .

North Carolina: Gosai v. Abeers Realty & Development and Marketing, Inc., 166 N.C. App. 625, 629, 605 S.E.2d 5, 9 (N.C. Ct. App. 2004) .

(n128)Footnote 126. *See Doyle v. Maruszczak*, 834 So. 2d 307, 309 (Fla. Dist. Ct. App. 2003) ; *Schepers v. Lautenschlager*, 173 Neb. 107, 120, 112 N.W.2d 767, 775 (Neb. 1962) .

See also, Gosai v. Abeers Realty & Development and Marketing, Inc., 166 N.C. App. 625, 630, 605 S.E.2d 5, 9 (N.C. Ct. App. 2004) (plaintiff was allowed to rescind the contract and recover damages).

(n129)Footnote 127. *See Schepers v. Lautenschlager*, 173 Neb. 107, 120, 112 N.W.2d 767, 775 (Neb. 1962) .

(n130)Footnote 128. *See*

Hawaii: Jenkins v. Wise, 58 Haw. 592, 603, 574 P.2d 1337, 1344 (Haw. 1978) .

Texas: Riley v. Powell, 665 S.W. 2d 578, 581 (Tex. Civ. App. 1984) , writ of error refused no reversible error, (Jun. 13, 1984), rehearing of writ of error overruled, (Jul. 18, 1984).

* Revised by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues, including licensing issues, has practiced in the areas of tax, business and probate law, and is licensed as a C.P.A. in the State of Maryland.



32 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART II. Brokers as Fiduciaries

10-3 Real Estate Brokerage Law and Practice § 3.08

§ 3.08 Duties Owed to the Seller by a Buyer's Broker

There are relatively few cases that address the duty a buyer's agent owes to a seller. This is probably because in a transaction involving a seller's broker and a buyer's broker, each broker would typically owe fiduciary duties to his or her respective client. Both seller and buyer would have a broker engaged to solely to represent his or her interest. If both brokers fulfill their fiduciary duties to their respective clients, neither the seller or the buyer should have an actionable complaint against the other party's broker.

One such case addressing the duty owed by a buyer's agent to a seller is *Lombardo v. Albu*.ⁿ¹ The buyer's agent in this case was sued by the seller for failing to inform the seller that the buyer might be unable to perform because of financial difficulties. The sellers, who were also in a difficult financial situation, ultimately lost the equity in their home at a trustee's sale. The sellers' complaint alleged that the buyer's agent failed to disclose material facts about the buyer's ability to perform that were relevant to the sellers' decision to agree to reschedule closing dates and to refrain from terminating the contract. The trial court granted summary judgment to the buyer's agent and concluded that as a matter of law, a buyer's agent owed the seller no legal duty. The intermediate appellate court affirmed.ⁿ²

The Supreme Court of Arizona reversed. This court began its analysis by considering the duties of the buyer and the seller to each other and then turning to the duties of their agents. The court observed that the buyer and seller had legal duties to each other arising out of their contractual relationship and that among these duties was the covenant of good faith and fair dealing which required that buyers and sellers deal fairly with each other. The buyer and the sellers had duties to each other to disclose facts that were material to the transaction. Where a seller knew of facts materially affecting the value of the property and knew that the facts were not known to the buyer, the seller had a legal duty to disclose such facts.ⁿ³

The court stated that the duties were not a one-way street and that the major consideration flowing from the buyer to the seller was the price. The buyer could not present himself or herself as a ready, willing, and able buyer if the buyer knew that there was a significant risk that the deal would never close because of the buyer's inability to perform. The court found that this would violate the buyer's duty to deal fairly under the contract and the legal duties imposed by Restatement (Second) of Contracts § 161 and Restatement (Second) of Torts § 551.ⁿ⁴

The sellers agreed that the only fiduciary duty an agent owed was to the agent's client. But the buyer's agent argued that because she owed no fiduciary duty to the sellers, she had no duty at all to the sellers. The buyer's agent also argued that a duty to disclose to the seller would conflict with her fiduciary duty not to disclose her client's confidential information. The court stated, "The fallacy in this argument, as we have already seen, is that the client herself has a duty to the seller to disclose facts critical to her ability to perform. Thus, the financial wherewithal of the buyer to perform the contract is not confidential information." n5

The court found that the buyer's ability to perform "goes to the heart of the transaction, and thus is not confidential information," and even if it were, "an agent is privileged to reveal information confidentially acquired by him in the course of his agency in the protection of a superior interest of himself or of a third person." n6 The court held that since the buyer had a duty to disclose, the buyer's agent also had a duty to disclose. The court stated that the performance of an agent's fiduciary duty to its principal was compatible with the agent's duty to deal fairly with all parties to the transaction. In coming to this conclusion the court had considered a regulation issued by the Arizona Department of Real Estate which specifically stated that a licensee owed a fiduciary duty to his or her client, the licensee was required to protect and promote the interests of the client and the licensee was required to deal fairly with all other parties to a transaction. n7 The court stated that this regulation was essentially a codification of the common law which acknowledged the agent's fiduciary duty to its principal, but also acknowledged the agent's non-fiduciary duty to other parties to the transaction. This regulation imposed a duty to disclose any information relating to the seller's or the buyer's inability to perform. The trial courts judgment was reversed and the case was remanded. n8

FOOTNOTES:

(n1)Footnote 1. 199 Ariz. 97, 14 P.3d 288 (Ariz. 2000) .

(n2)Footnote 2. 199 Ariz. 97, 98, 14 P.3d 288, 289 (Ariz. 2000) .

(n3)Footnote 3. 199 Ariz. 97, 99, 14 P.3d 288, 290 (Ariz. 2000) .

(n4)Footnote 4. 199 Ariz. 97, 99, 14 P.3d 288, 290 (Ariz. 2000) .

(n5)Footnote 5. 199 Ariz. 97, 99-100, 14 P.3d 288, 290-291 (Ariz. 2000) .

(n6)Footnote 6. 199 Ariz. 97, 100, 14 P.3d 288, 291 (Ariz. 2000) , quoting Restatement (Second) of Agency § 395 cmt. f

(n7)Footnote 7. The regulation was Ariz. Admin. Code R4-28-1101.

(n8)Footnote 8. 199 Ariz. 97, 100-101, 14 P.3d 288, 291-292 (Ariz. 2000) .

* Revised by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues, including licensing issues, has practiced in the areas of tax, business and probate law, and is licensed as a C.P.A. in the State of Maryland.



33 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART II. Brokers as Fiduciaries

10-3 Real Estate Brokerage Law and Practice § 3.09

§ 3.09 Negligence

A broker is under a duty to use ordinary care under the circumstances presented. A failure to use ordinary care constitutes negligence for which the broker may be held liable. n1 When a seller claims that a real estate agent's negligence caused a financial loss on the property sale, the seller must show that but for the agent's negligence, he or she would have sold the property on terms more advantageous than those of the eventual sale. n1.1

If a seller intends to assert a claim of professional negligence against a broker, the court may require that the seller submit expert testimony to prove the standard of care of a real estate broker. The failure to provide expert testimony on this issue may justify the dismissal of a seller's claim of professional negligence. n2

The Supreme Court of Virginia has considered whether expert testimony was necessary to prove claims of negligence and breach of contract against an agent when a sales contract required conveyance of a parcel larger than that which the owners retained the real estate agent to sell. n3 The agent had listed the property by its street address and when showing the property, orally told the buyers that only part of the lot was being sold. The agent also showed the buyers where the intended boundary line was located. n4 The buyers asserted that they had not been advised of the boundary line adjustment prior to submitting their contract offer, and that they were entitled to acquire the entire original lot as bounded prior to the adjustment. Alternatively, the buyers indicated their willingness to consider a reduction in the contract sale price. The sellers refused to consider a price reduction and tendered a deed for the reduced lot. The buyers sued for specific performance contending that the contract's reference to the street address as the property's legal description meant that the property shown as that address in the city's land records and, thus, that the contract required conveyance of the entire original lot. The buyers were successful in their suit. The sellers sued their agent alleging negligence and breach of contract. The trial court struck the evidence against the agent and dismissed the complaint on the basis of the sellers' failure to adduce evidence through expert testimony with respect to the standard of care owed by a licenced agent to his clients. n5

Virginia's high court reversed. The court noted the applicable statutory provision which required that agents "[p]erform in accordance with the terms of the brokerage relationship" and "[e]xercise ordinary care." n6 The court found that the existence of this statutory duty and standard of care did not dictate that a trier of fact always required expert assistance to understand the appropriate practices of agents. The court recognized that there may be instances in which the acts of

an agent, as with other professionals, involve transactions or matters beyond the capacity of persons of ordinary intelligence to comprehend and, thus, to form an intelligent opinion about them without the assistance of expert testimony. But the court stated, "We need not formulate a bright line rule applicable to all cases involving the alleged negligence of realtors." n7 The court found that expert testimony was unnecessary when the alleged negligent acts or omissions of certain professionals lie within the range of the common knowledge and experience of the trier of fact. A case-by-case approach to the requirement for expert testimony was appropriate in cases involving the alleged negligence of brokers and agents.

With respect to the fact situation before it, the court stated:

In the present case, it is manifest that any person of ordinary intelligence would grasp that a realtor should take care not to offer for sale property which he has not been contractually authorized to sell, nor should a realtor present to his client a contract which clearly fails to sufficiently reflect the accurate legal description of the property to be conveyed. The failure of a realtor in either regard is negligence. Similarly, it is not beyond the realm of common knowledge and understanding that when a contract gives authority to an agent to sell a specific portion of property, and the agent then offers for sale and procures a buyer for more than that portion of the property within his authority to sell, he has breached his contract with his principals. n8

It should be noted, however, that three Justices dissented. They disagreed with how the majority had framed the issue. They reframed the issue as whether the agent's use of the street address as the sole description of the property to be sold, and the agent's reliance on his oral communications and the buyers' visual inspection, violated his professional duty to "[p]erform in accordance with the terms of the brokerage relationship" and to "[e]xercise ordinary care," found in Virginia Code §§ 54.1- 2131(A)(1) and -2131(A)(4), or breached the terms of the listing agreement. n9 These three justices concluded that this question could not be answered without expert testimony. In the dissenters' opinion, Justice Kinser stated that the sufficiency of the property description in the written agreements was not a matter within the common knowledge of lay persons. n10 Determining whether the agent had violated the standard of care for his profession or breached the listing agreement with the sellers meant that the trier of fact had to determine whether the agent should have used a different legal description of the property, and if so, what description; whether he should have attached a copy of the plat to the relevant agreements; or whether the agent was justified in merely relying on his oral communications and the property's visual appearance to identify what portion of the lot was being sold. Justice Kinter wrote, "All those matters require information beyond the common knowledge and experience of lay persons." n11

FOOTNOTES:

(n1)Footnote 1.

New York: Murph & Fritz's Place, Inc. v. Loretta, 112 Misc. 2d 554, 447 N.Y.S.2d 205 (1982) N.Y. City Ct. (brokers are under a duty to exercise that degree of diligence, judgment, care, and skill ordinarily used by persons of common capacity engaged in the same business, failing in that duty, the broker is answerable to his principal for consequential damages flowing from his handling of the matter).

Washington: Mattielligh v. Poe, 57 Wash. 2d 203, 205, 356 P.2d 328, 330 (Wash. 1960) .

Wyoming: Kelly v. Roussalis, 776 P.2d 1016, 1018-1019 (Wyo. 1989) .

(n2)Footnote 1.1. *See Boguch v. Landover Corp.*, 153 Wn. App. 595, 599, 224 P.3d 795, 798 (2009) .

(n3)Footnote 2. *See May v. ERA Landmark Real Estate of Bozeman*, 2000 MT 299, 15 P.3d 1179, 1188 (Mont. 2000) .

But cf. Bedwell v. Schmitt, 2002 Ohio 6909, at P40, 2002 Ohio App. LEXIS 6731, at *12 (Ohio Ct. App. 2002) , *appeal denied*, 98 Ohio St. 3d 1540, 2003 Ohio 1946, 786 N.E.2d 902 (Ohio 2003) (Ohio Ct. App. 2002) (agents are held to a higher standard of care than laypersons, expert testimony may be required to demonstrate a breach of this standard, but no Ohio court has required expert testimony in cases involving agents); *Polyzos v. Cotrupi*, 264 Va. 116, 122, 563 S.E.2d 775, 778 (Va. 2002) (Expert testimony is unnecessary when the alleged negligent acts or omissions of certain professionals clearly lie within the range of the common knowledge and experience of the trier of fact. A case-by-case approach to the requirement for expert testimony is appropriate in cases involving the alleged negligence of real estate licensees.)

(n4)Footnote 3. *See Polyzos v. Cotrupi*, 264 Va. 116, 119-120, 563 S.E.2d 775, 776-777 (Va. 2002) .

(n5)Footnote 4. *See Polyzos v. Cotrupi*, 264 Va. 116, 119, 563 S.E.2d 775, 776 (Va. 2002) . The sellers had erected a fence and installed landscaping along the new boundary line, but they did not record the plat showing the revision because their attorney had advised them that doing so would accelerate their mortgage debt.

(n6)Footnote 5. *See Polyzos v. Cotrupi*, 264 Va. 116, 120, 563 S.E.2d 775, 777 (Va. 2002) .

(n7)Footnote 6. Va. Code Ann. § 54.1-2144.

(n8)Footnote 7. *Polyzos v. Cotrupi*, 264 Va. 116, 122, 563 S.E.2d 775, 778 (Va. 2002) . It should be noted that this court loosely used the term Realtor(R) as if it were a generic word. It is not.

(n9)Footnote 8. *Polyzos v. Cotrupi*, 264 Va. 116, 122-123, 563 S.E.2d 775, 778 (Va. 2002) .

(n10)Footnote 9. *Polyzos v. Cotrupi*, 264 Va. 116, 124, 563 S.E.2d 775, 779 (Va. 2002) . Dissent of Justice Kinser, with whom Justice Lacy and Justice Lemons joined.

(n11)Footnote 10. *Polyzos v. Cotrupi*, 264 Va. 116, 124-125, 563 S.E.2d 775, 779-780 (Va. 2002) . Dissent of Justice Kinser, with whom Justice Lacy and Justice Lemons joined. It was noted that this was not a situation where a broker merely used an incorrect lot number or street address in the relevant contracts.

(n12)Footnote 11. *Polyzos v. Cotrupi*, 264 Va. 116, 125, 563 S.E.2d 775, 780 (Va. 2002) . Dissent of Justice Kinser, with whom Justice Lacy and Justice Lemons joined.

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34 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART II. Brokers as Fiduciaries

10-3 Real Estate Brokerage Law and Practice § 3.10

§ 3.10 Subagency

[1] Duties of a Subagent

Typically, the seller and broker enter into some type of listing agreement (listing agreements are discussed in Chapter 2, *above*). The broker who is a party to the listing agreement is commonly referred to as a listing broker. As part of his or her duties to perform under the listing agreement, the listing broker has a responsibility to inform others of the seller's desire to sell the property. The listing broker often accomplishes this by registering the property with a multiple listing service ("MLS"). Access to the MLS is one of the most important services a broker offers to a client.

Listing property in the Multiple Listing Service, absent a contrary written agreement, is an offer of subagency, and therefore, cooperating brokers are agents of the listing brokers and in a line of agency with the seller. n1 Generally, a subagent owes the principal--the seller--the same duties as those which an agent owes the principal. n2 A sub-agent, lawfully appointed, represents the principal in like manner with the original agent. n3 A subagent is liable to the principal for negligence in performing or failing to perform duties undertaken for the principal. A subagent must also account for anything received for the principal and is liable as a fiduciary for any breach of a fiduciary duty. n4

A principal can recover from the subagent money received by the latter for the principal. A subagent can be held liable to the principal for disobeying orders and for committing a breach of fiduciary duty. n5

As a result of the subagent relationship, the agent will usually be liable to the principal for the subagent's actions regarding agency matters. n6 However, there are courts which hold that a subagency under a MLS agreement is not a subagency for such liability. n7

[2] Selling Broker's Relationship with Seller and Purchaser

A clear distinction exists between the listing broker and the selling broker in terms of their relationship to the interested parties. It is the seller of real property who usually initiates the relationship with the listing broker, while the purchaser typically initiates the relationship with the selling broker. Absent a specific contractual relationship, the selling broker is usually considered the seller's subagent and not the purchaser's agent. n8 Therefore, the selling broker typically owes no fiduciary obligation to the purchaser. n9

The selling broker's primary obligation to the purchaser is to deal honestly and fairly with him or her. n10 This obligation, rather than emanating from an agency relationship, arises primarily from the position of public trust which brokers occupy, state licensing laws, and brokerage relationship acts. Instead, the selling broker owes a fiduciary duty to the seller.

Courts have based their decisions regarding subagency in real estate transactions on two different theories. Some courts have stated that a real estate broker performs discretionary functions on the seller's behalf and, therefore, the broker may delegate his or her duties to a subagent only if the seller has given specific authorization.

The Colorado Supreme Court expressed the majority position in *Stortroen v. Beneficial Finance Co.* n11 In *Stortroen*, the court, in determining the time sequence of acceptances and counteroffers, was presented with the issue of whether a cooperating broker under an MLS was the listing broker's subagent and, therefore, the seller's agent. n12 The court gave several traditional reasons for finding that the selling broker was the seller's agent. The court reasoned that if a listing agreement allows the listing broker to register the property with a multiple listing service, the listing broker, by placing the property with a MLS, offers a subagency to any selling or cooperating broker who can procure a purchaser. n13 The court relied on the fact that the entire business structure of a real estate transaction would emanate from the agreement between the listing broker and all of the other MLS members. n14

A second reason advanced by the court was that if one were to find indicia of an agency relationship between the selling broker and the purchaser, one inevitably would find a dual agency relationship involving the seller and purchaser as the principals and the selling broker as the dual agent. n15 The *Stortroen* court stated that a dual agency in such transactions is fraught with potential conflicts of interest. n16

Finally, the court reasoned that a finding of an agency relationship between the selling broker and the purchaser based solely on the parties' interactions may not benefit the purchaser. In support of this conclusion, the court proffered two examples. Traditionally, a purchaser may rescind an agreement with the seller because of the misrepresentation of the seller's agent, if the seller ratifies the agent's acts. If the selling broker is deemed the purchaser's agent, but is also the party responsible for such misrepresentation, the purchaser would have no such remedy against the seller since the reclassification of the parties would render the ratification doctrine inapplicable. n17

Agency law also provides that if an agent breaches a duty to the principal, the principal may, as one remedy, require the agent to return all compensation that the agent received for the particular transaction. However, the *Stortroen* court noted that as the purchaser does not pay the real estate commission, the purchaser's legal position would not be enhanced by the finding of an agency relationship. n18

Therefore, based on the above, the *Stortroen* court refused to find an agency relationship between the selling broker and the purchaser without an express written agreement. n19 To reach this conclusion, the court reasoned that "[t]he prevailing perception of the broker as an agent of the seller is too firmly embedded in the real estate business to permit such a finding [of agency between the selling broker and the purchaser] on the basis of conduct alone." n20

While some courts have accepted the proposition that a broker has a duty to exercise reasonable care so as to protect the interests of those whom the broker is attempting to persuade to enter into the contemplated transaction, n21 this duty falls short of that which is owed by an agent to his or her principal. Therefore, these holdings do not afford the purchaser the same protection that the seller typically receives from an agent.

Some of the more difficult cases involve the sharing of liability between the listing agent and the selling agent. One court has held that the negligence of the cooperating selling agent cannot be imputed to the listing agent. n22 Similarly, the negligence of the listing agent may not be imputed to the selling agent. n23 However, there are courts that have held that a listing agent and selling agent are jointly and severally liable for damages to a third-party purchaser. n24

A subagent is liable to the principal for negligence in performing or failing to perform duties undertaken for the principal. A subagent must also account for anything received for the principal and is liable as a fiduciary for any breach of a fiduciary duty. n25 A principal can recover from the subagent money received by the latter for the principal. A subagent can be held liable to the principal for disobeying orders and for committing a breach of fiduciary duty. n26

This sharing of liability between the listing agent and the selling agent may remain a gray area of the law since there is little scope of control of the listing agent over the selling agent and vice versa, although they are both, by traditional theories, representing the same party. The seller, in most circumstances, has no scope of control nor ability to direct the services of the selling agent. As a practical matter, the advent of brokerage relationship acts and the common use of transaction brokers may make issues of subagency moot in many transactions.

[3] Agency Law Applied to Selling Broker and Purchaser

In a real estate transaction, the purchaser commits numerous acts from which one may reasonably infer that the purchaser intends for the selling broker to act on the purchaser's behalf. Usually, it is the purchaser who contacts the broker, informs the broker of specific property which interests the purchaser, or engages in a discussion with the broker about the purchaser's desires and needs. The purchaser seeks the selling broker's assistance in acquiring the information about specific property or in locating property. The purchaser seeks the selling broker's assistance in determining the property's fair market value. The purchaser relies on the selling broker's expertise in determining what to include in the offer, such as financing terms, inspection and repair procedures, and other contingencies. In doing so, the purchaser reveals to the selling broker personal aspects of the purchaser's financial condition. Thereafter, the purchaser authorizes the selling broker to deliver an offer to the seller on the purchaser's behalf. Once the seller accepts the offer, the purchaser often seeks and relies on the selling broker's advice on financing, inspections, and the like. The purchaser relies on the selling broker's assistance as he or she "walks through" the property on or about the sale date to determine the property's condition for the last time before sale. Thus, the purchaser's actions, from the purchaser's viewpoint, reasonably support the inference that the selling broker is acting on the purchaser's behalf. n27

The first question in considering whether an agency relationship exists between the selling broker and the purchaser is whether the purchaser manifests an intent that the selling broker shall act for him or her. There is usually no formal agreement between the purchaser and the selling broker that the latter shall act for the purchaser. One must, therefore, look to the selling broker's and purchaser's activities to determine whether an agency relationship exists between them.

Several informal manifestations by principals that may constitute an expression of this intent have been identified. In *Duffy v. Setchell*, n28 the court noted that where a purchaser requests the broker's assistance in obtaining a particular piece of property, the broker is the purchaser's agent for that purpose and those activities involved in that transaction, even though it is the seller who will pay the broker's fee. n29 In determining that the broker was the purchaser's agent in this case, the court relied on the following factors:

- (1) the purchaser initiated the contact with the broker;
- (2) the purchaser asked the broker to approach the property owners to see if they would sell the parcel at the offered price;
- (3) the broker had no prior relationship with the sellers regarding the property;
- (4) the purchaser considered the broker to be her agent; n30
- (5) the broker approached the sellers as the purchaser requested; and (6) the broker negotiated the terms of the sale until the parties agreed. n31

The second question is whether the selling broker acts in such a way as to indicate reasonably to the purchaser that the selling broker is consenting to act for the purchaser. Courts have identified various circumstances under which one may reasonably determine that an agent has impliedly accepted the principal's offer for the agent to act on the principal's behalf. ⁿ³² *Duffy v. Setchell* ⁿ³³ addressed this issue where the broker's actions clearly manifested his consent to act on the purchaser's behalf.

Like the agent in *Duffy*, the selling broker's involvement often begins with the purchaser contacting the broker; the broker arranging and negotiating the sale; and generally conducting himself or herself in such a way as to lead the purchaser to believe that the broker is acting for the purchaser's benefit.

Additional acts of the selling broker indicate to the purchaser that the broker is acting as the purchaser's representative. As noted, the selling broker determines the purchaser's wants and needs and attempts to match them with available property. Nevertheless, the broker, unbeknownst to the purchaser, often attempts to direct the purchaser first to the broker's property listings. The broker creates the impression that he or she is attempting to help the buyer find what the buyer needs. When the broker finally searches the MLS listings, the broker again is indicating to the purchaser that the broker is attempting to locate a property that meets the purchaser's needs. If the purchaser and broker locate a property, the broker provides the purchaser with all available information posted with the MLS. If requested by the purchaser, the broker will inform him of pertinent data concerning recent properties sold. The selling broker generally advises the purchaser as to how to include terms in the offer, such as those relating to financing, conditions of title, inspections and repairs, and the like. At the purchaser's direction, the selling broker presents the offer to the listing broker and seller. In so doing, the broker negotiates with the seller in order to establish terms under which the seller and purchaser may reach an agreement. Once the parties enter into a purchase and sale agreement, the selling broker advises the purchaser of the available financing and any other relevant information. The selling broker advises the purchaser of available and reputable inspection companies and title agents.

In determining the existence of an agency relationship, the final question is whether an understanding exists between the purchaser and the selling broker concerning the purchaser's right to control the venture. Such control does not necessarily include supervision or direction over the specific steps in the process. Since the broker usually has more knowledge than the purchaser in this field, it would be ludicrous to presume that the principal will direct the broker's actions in detail. To find an agency relationship, the control need only relate to the general course or direction of the agency, and, unless agreed otherwise, the principal need only have the right to terminate the agency relationship. ⁿ³⁴ In a real estate transaction, the seller retains the right to control the relationship in that the seller has the right to revoke the offer to sell prior to an unconditional acceptance. ⁿ³⁵

Likewise, the purchaser has the right to control the relationship with the selling broker. From the outset, the purchaser's goals provide the selling broker with direction, whether it involves a specific property or a search of property in a MLS. The purchaser decides which property to investigate, whether to make an offer, and the offer's terms. Furthermore, the purchaser may withdraw the offer before the seller accepts it ⁿ³⁶ or may accept or reject any counteroffer. ⁿ³⁷ Therefore, by exercising or failing to exercise approval of the agreements, the purchaser exerts his or her right to control the relationship in the same manner as the seller would.

The question of the extent to which one needs to retain the right to control the venture for purposes of agency was addressed in *Fort Myers Airways, Inc. v. American States Insurance Co.*, ⁿ³⁸ where the court recognized that the principal must only retain the right to control the relationship and not the agent's specific and actual actions. ⁿ³⁹ To determine whether an agency existed, the court noted that the principal determined when the purported agent's actions would occur on his behalf; received the benefits of the agent's actions; and retained the power to revoke the authority he extended to the agent. ⁿ⁴⁰ Thus, the court concluded that the flying instructor was the airplane owner's/flying student's agent while instructing the owner/student in his airplane. ⁿ⁴¹ The court emphasized that, in light of the agent's superior skill and knowledge, it would be a "folly" to have expected the principal to exert significant control over the agent's

specific actions. n42

The purchaser is not usually present when the selling broker presents the offer. The purchaser does not make the appointment for the presentation nor does the purchaser take part in the discussion during the presentation which the selling broker traditionally does with or through the listing broker. Nevertheless, the purchaser, as principal, determines the time when the selling broker, as agent, may initiate the activities to make the presentation. Also, the purchaser receives the benefits of the selling broker, as agent, initiating the activities to make the presentation. Also, the purchaser receives the benefits of the selling broker's actions. Further, unless the purchaser is legally prohibited, the purchaser can terminate the relationship. n43 Throughout the real estate transaction, the purchaser retains sufficient power to control the direction of the relationship with the selling broker to find a non-gratuitous agency.

Even if one were to view the transaction provincially and assert that the selling broker is acting gratuitously towards the purchaser, the broker's actions encourage the purchaser to refrain from obtaining alternative counseling and expertise at least until the seller and buyer have signed the sales contract, and it is then too late to obtain expert assistance in negotiating and finalizing the contract. It must be readily apparent to the broker that this is the likely result, even if the selling broker is not intentionally encouraging the purchaser to refrain from such activity, since so many purchasers sign purchase and sale agreements without seeking alternative counseling and advice. Therefore, as long as the selling broker continues to act in such a fashion without advising the purchaser that the broker is not acting on the buyer's behalf, the broker appears to do so as the purchaser's agent.

[4] Gratuitous Agency

Gratuitous agency relationships pose difficult problems. A gratuitous relationship arises when an individual makes a promise or engages in other conduct which

- (1) the individual should realize will cause another reasonably to rely upon the performance of definite acts of service by the individual as the other's agent, and,
- (2) which causes the other to refrain from having such acts done by other available means. n44

Once the gratuitous agency relationship is created, some courts hold that fiduciary duties are also created. n45 The gratuitous real estate agent has fiduciary duties but, in many circumstances, is ineligible for compensation or a commission for his or her services because of the lack of an agreement in writing as is required by most states.

In order for an agent to be a non-gratuitous agent, one need be acting as another's agent for consideration. n46 There appears to be no prerequisite for the principal to pay the agent in order to find an agent to be acting for consideration, although this certainly would be one of several facts to consider in determining whether the agency exists. In the usual real estate transaction, the selling broker works for a commission. Therefore, there is evidence that the selling broker is acting as a non-gratuitous agent.

Even if one were to require that the principal compensate the agent for his or her acts on the principal's behalf, one must recognize that the purchaser indirectly pays some, if not all, of the broker's commission. By agreeing to pay for the property, the purchaser effectively agrees to compensate the broker. Furthermore, because the broker receives a commission based on the purchase price, there is motivation for the broker to facilitate the contract execution and the closing. The broker, therefore, aids the purchaser's ability to close in order to receive his full commission.

It should also be noted that regardless of whether one finds the agency relationship to be non-gratuitous or gratuitous, the finding of an agency relationship between the selling broker and the purchaser arises, at least partially, from the realization that the agent's power to alter the principal's relationship with third parties exists between a selling broker and purchaser as well as between a listing broker and a seller. When delivering the purchaser's offer to the seller and

listing broker, the selling broker places the purchaser in the position of being bound to the seller who accepts the offer as tendered and in the required manner. However, even if the listing broker delivers to the seller an offer identical to the terms under which the seller listed the property, the seller may refuse to accept the offer. The seller would be liable for the broker's commission but would not be bound to the prospective purchaser.

Some jurisdictions require by statute that agreements employing real estate brokers to sell or purchase real estate for compensation must be in writing and executed by the party against whom it is enforced. However, it appears that the primary purpose of such a requirement is to regulate the brokers' activities rather than to bar an agency relationship from forming unless there is a writing signed by the party to be charged. n47 Therefore, this type of statutory requirement should not inhibit a court's finding that the selling broker would be the purchaser's agent under the appropriate circumstances.

FOOTNOTES:

(n1)Footnote 1. *See*:

Federal: United States v. Realty Multi-List, Inc., 629 F.2d 1351, 1377, 1980-81 Trade Cas. (CCH) P63624 (5th Cir. 1980) .

Arkansas: Fennell v. Ross, 289 Ark. 374, 378, 711 S.W.2d 793, 795 (Ark. 1986) .

Colorado: Stortroen v. Beneficial Finance Co., 736 P.2d 391, 396 (Colo. 1987) ; *People ex rel. Woodard v. Colorado Springs Bd. of Realtors*, 692 P.2d 1055, 1059 (Colo. 1984) (en banc).

Iowa: Iowa v. Cedar Rapids Bd. of Realtors, 300 N.W.2d 127, 128-129 (Iowa 1981) .

North Dakota: Asleson v. Westbranch Land Co., 311 N.W.2d 533, 538-539 (N.D. 1981) .

Washington: Pilling v. Eastern & Pacific Enterprises, 41 Wash. App. 158, 162, 702 P.2d 1232, 1235-1236 (Wash. Ct. App. 1985) , review denied, 104 Wash. 2d 1014, 1985 Wash. LEXIS 1443 (Wash. 1985) .

(n2)Footnote 2. *See Rayden Engineering Corp. v. Church*, 337 Mass. 652, 661, 151 N.E.2d 57, 62-63 (Mass. 1958)

(n3)Footnote 3. *See, e.g.*, Cal. Civ. Proc. § 2351.

(n4)Footnote 4. *See Marra v. Katz*, 74 Misc. 2d 1010, 1013, 347 N.Y.S.2d 143, 146, 1973 N.Y. Misc. LEXIS 1671 (N.Y. Sup. Ct. 1973) .

(n5)Footnote 5. *See Marra v. Katz*, 74 Misc. 2d 1010, 1013, 347 N.Y.S.2d 143, 147, 1973 N.Y. Misc. LEXIS 1671 (N.Y. Sup. Ct. 1973) .

(n6)Footnote 6. *See, e.g.*:

Federal: Demian Ltd. v. Frank Assoc., 671 F.2d 720, 723 (2d Cir. 1982) .

Massachusetts: Rayden Engineering Corp. v. Church, 337 Mass. 652, 661, 151 N.E.2d 57, 62 (1958) .

See also Restatement (Second) of Agency § 406 (absent agreement to the contrary, the agent is responsible to the principal for the subagent's conduct with reference to the principal's affairs).

(n7)Footnote 7. *See, e.g., Wise v. Dawson*, 353 A.2d 207, 209 (Del. Super. Ct. 1975) .

(n8)Footnote 8. *See:*

Arkansas: Fennell v. Ross, 289 Ark. 374, 379, 711 S.W.2d 793, 796 (1986)

Colorado: Rohauer v. Little, 736 P.2d 403, 407 (1987) (*en banc*).

See also Sinclair, The Duty of the Broker to Purchasers and Prospective Purchasers of Real Property in Illinois, 69 Ill. B.J. 260 (1981) (the broker traditionally owes a fiduciary duty only to the seller).

(n9)Footnote 9. *See Olsen v. Vail Associates Real Estate, Inc.*, 935 P.2d 975, 980 (Colo. 1997) ; Comment, *The Real Estate Broker-Purchaser Relationship: Louisiana and Common Law*, 52 Tul. L. Rev. 157, 160-61 (1977) (in theory, if the vendor engaged the broker to find property, there would be no fiduciary duty to anyone but the vendor).

Cf., e.g., Proctor v. Holden, 75 Md. App. 1, 20-21, 540 A.2d 133, 142 (1988) , *cert. denied* 313 Md. 506, 545 A.2d 1343 (1988) (testimony from broker that he was working to find the buyers' realty was insufficient to constitute a fiduciary relationship between the broker and purchasers **citing this Treatise**).

See generally Wolf and Jennings, Seller/Broker Liability in Multiple Listing Real Estate Sales: A Case for Uniform Disclosure, 20 Real Est. L.J. 22 (Summer 1991).

But see:

Georgia: Siler v. Gunn, 117 Ga. App. 325, 326, 160 S.E.2d 427, 428-29 (1968) (a fiduciary relationship existed between the broker and the purchaser).

(n10)Footnote 10. *See, e.g., Gerber v. Keyes Co.*, 443 So. 2d 199, 200 (Fla. Dist. Ct. App. 1983) .

(n11)Footnote 11. 736 P.2d 391 (Colo. 1987) (*en banc*). For a case holding similarly where there was no MLS listing involved, *see Kruse v. Miller*, 143 Cal. App. 2d 656, 659, 300 P.2d 855, 857-58 (Cal. Ct. App. 1956) (cooperating broker acted at listing broker's request).

(n12)Footnote 12. 736 P.2d 391, 395 (Colo. 1987) .

(n13)Footnote 13. 736 P.2d 391, 397 (Colo. 1987) .

(n14)Footnote 14. 736 P.2d 391, 397 (Colo. 1987) . The court realized that the business relationship between the seller, listing broker, and MLS members was derived from the listing contract, whereas the purchaser was bound by no such relationship. 736 P.2d at 397-98 .

(n15)Footnote 15. 736 P.2d 391, 398 (Colo. 1987) .

(n16)Footnote 16. 736 P.2d 391, 398 (Colo. 1987) .

(n17)Footnote 17. 736 P.2d 391, 398-399 (Colo. 1987) . Note, however, that this does not mean that the purchaser would have no action against the broker for the misrepresentation. *See also* Restatement (Second) of Agency § 100 (effects of ratification).

(n18)Footnote 18. 736 P.2d 391, 399 (Colo. 1987) .

(n19)Footnote 19. 736 P.2d 391, 400 (Colo. 1987) .

(n20)Footnote 20. 736 P.2d 391, 400 (Colo. 1987) .

(n21)Footnote 21. See:

California: Easton v. Strassburger, 152 Cal. App. 3d 90, 102, 199 Cal. Rptr. 383, 390 (Cal. Ct. App. 1984) ; *Merrill v. Buck*, 58 Cal. 2d 552, 562, 25 Cal. Rptr. 456, 463, 375 P.2d 304, 311 (Cal. Ct. App. 1962) .

New Mexico: Amato v. Rathbun Realty, Inc., 98 N.M. 231, 232, 647 P.2d 433, 434 (N.M. Ct. App. 1982)

(n22)Footnote 22. See *Sullivan v. Jefferson*, 167 N.J. Super. 282, 289-290, 400 A.2d 836, 839-840 (N.J. Super. Ct. 1979) .

(n23)Footnote 23. *Asleson v. Westbranch Land Co.*, 311 N.W.2d 533, 546 (N.D. 1981) But the court in this case noted that it was not a typical listing agent - selling agent transaction.

(n24)Footnote 24. See *First Church of The Open Bible v. Cline J. Dunton Realty, Inc.*, 19 Wash. App. 275, 574 P.2d 1211, 1214-1215 (1978) .

(n25)Footnote 25. See *Marra v. Katz*, 74 Misc. 2d 1010, 1013, 347 N.Y.S.2d 143, 146, 1973 N.Y. Misc. LEXIS 1671 (N.Y. Sup. Ct. 1973) .

(n26)Footnote 26. See *Marra v. Katz*, 74 Misc. 2d 1010, 1013, 347 N.Y.S.2d 143, 147, 1973 N.Y. Misc. LEXIS 1671 (N.Y. Sup. Ct. 1973) .

(n27)Footnote 27. See *Romero, Theories of Real Estate Broker Liability: Arizona's Emerging Malpractice Doctrine*, 20 Ariz. L. Rev. 767, 772 (1978).

(n28)Footnote 28. 38 Ill. App. 3d 146, 347 N.E.2d 218 (1976) .

(n29)Footnote 29. 38 Ill. App. 3d at 149, 347 N.E.2d at 221 .

(n30)Footnote 30. 38 Ill. App. 3d at 148, 347 N.E.2d at 220 . Note, however, that the principal's opinion that the agent is her agent is insufficient to create the relationship, unless the factors necessary for an agency are present.

(n31)Footnote 31. 38 Ill. App. 3d at 148, 347 N.E.2d at 221 . Additionally, the court recognized that the broker may also become the seller's agent in the same transaction. For a discussion of the dual agency concept, see § 3.21 below.

(n32)Footnote 32. See, e.g.,

Colorado: Butler v. Colorado Int'l Pancakes, Inc., 510 P.2d 443, 445 (Colo. Ct. App. 1973)

Iowa: Popejoy v. Eastburn, 241 Iowa 747, 753, 41 N.W.2d 764, 768 (1950) .

(n33)Footnote 33. 38 Ill. App. 3d 146, 148, 347 N.E.2d 218, 221 (1976) .

(n34)Footnote 34. See:

Florida: Fort Myers Airways, Inc. v. American States Ins. Co., 411 So. 2d 883, 886 (Fla. Dist. Ct. App. 1982) , review denied, 418 So. 2d 1278 (Fla. 1982) .

(n35)Footnote 35. See:

California: Smith v. Holmwood, 231 Cal. App. 2d 549, 552-553, 41 Cal. Rptr. 907, 909-910 (1965) .

Georgia: Donohue v. Monroe, 147 Ga. App. 835, 250 S.E.2d 571, 572 (Ga. Ct. App. 1978) .

Kansas: Wycoff Realty Co. v. Grover, 198 Kan. 139, 143, 422 P.2d 943, 946 (Kan. 1967) .

Rhode Island: Ardente v. Horan, 117 R.I. 254, 259, 366 A.2d 162, 165 (1976) .

(n36)Footnote 36. See *Smith v. Holmwood*, 231 Cal. App. 2d 549, 552, 41 Cal. Rptr. 907, 909 (1965) .

(n37)Footnote 37. See *Smith v. Holmwood*, 231 Cal. App. 2d 549, 553, 41 Cal. Rptr. 907, 910 (1965) .

(n38)Footnote 38. 411 So. 2d 883 (Fla. Dist. Ct. App. 1982) .

(n39)Footnote 39. 411 So. 2d at 886 .

(n40)Footnote 40. 411 So. 2d at 886 .

(n41)Footnote 41. 411 So. 2d at 886 .

(n42)Footnote 42. 411 So. 2d at 886 (citation omitted).

(n43)Footnote 43. See *Fort Myers Airways, Inc. v. American States Ins. Co.*, 411 So. 2d 883, 886 (Fla. Dist. Ct. App. 1982) .

(n44)Footnote 44. See *Lee Hawkins Realty, Inc. v. Moss*, 724 So. 2d 1116, 1119 (Miss. Ct. App. 1998) ; Restatement of Agency, § 378.

(n45)Footnote 45. See *Ramey v. Myers*, 111 Cal. App. 2d 679, 685, 245 P.2d 360, 364 (Cal. Ct. App. 1952) ; *Shevel v. Warter*, 256 Wis. 503, 505, 41 N.W.2d 603, 605 (Wis. Ct. App. 1950) . But see *Faulkner v. Hood*, 246 Ga. App. 714, 718, 539 S.E.2d 886, 889 (Ga. Ct. App. 2000) , reconsideration denied, 246 Ga. App. 714, 2000 Ga. App. LEXIS 1475 (Ga. Ct. App. 2000) (While an agent for hire owes his principal a duty of "diligence, loyalty, and absolute good faith," a gratuitous agent is liable "only for gross neglect.").

(n46)Footnote 46. See Comment, *A Reexamination of the Real Estate Broker-Buyer-Seller Relationship*, 18 Wayne L. Rev. 1343 (1972).

(n47)Footnote 47. See, e.g.:

Minnesota: PMH Properties v. Nichols, 263 N.W.2d 799, 802, n.3 (Minn. 1978) and statutes cited therein.

Montana: Carnell v. Watson, 176 Mont. 344, 347, 578 P.2d 308, 310-11 (Mont. 1978) .

* Revised by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues, including licensing issues, has practiced in the areas of tax, business and probate law, and is licensed as a C.P.A. in the State of Maryland.



35 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART II. Brokers as Fiduciaries

10-3 Real Estate Brokerage Law and Practice § 3.11

§ 3.11 Insider Trading

Brokers and agents often know the particulars of offers made on property. Due to this inside knowledge, they are in an advantageous position if they desire to acquire the property. With such knowledge, they can successfully outbid others interested in the property. While such a situation would appear to be improper, the Supreme Court of Washington, in *Sing v. John L. Scott, Inc.*,ⁿ¹ found that such conduct did not create any tort liability nor did this conduct violate that state's Consumer Protection Act.

This case involved undeveloped property listed for sale with John L. Scott (Scott) through its agent, Judy Prongay. The listing price was \$45,000. Another Scott agent, Bob Pennock, showed this property to Peter Sing, a real estate investor. Sing told Pennock that he would pay full price or more for the property, because if the trees were cut the property would have a view of Seattle. Pennock helped Sing create a purchase offer. Sing offered \$41,000 with a \$500 earnest money deposit and a 45-day contingency period to determine if the property was suitable for development. The offer was presented on Friday, August 18th. That day the sellers counteroffered for the full purchase price, a \$2,000 earnest money deposit and a 21-day contingency period. Pennock brought the counteroffer to Sing. Sing said he would sign the counteroffer, but because he was going out of town for the weekend, he preferred to sign the counteroffer on Sunday evening or Monday morning. Pennock testified that Sing wanted to wait because it would give him more time on the investigation and feasibility study contingency since the time limit began when both parties signed the agreement. On Saturday, August 19th, Pennock left a written message for Prongay that Sing was out of town for the weekend but that he would probably accept the sellers' counteroffer Sunday night or Monday morning when he returned.

The next day, on Sunday, August 20th, another Scott agent, Maureen Buckley and her husband presented a written offer to purchase the property. They offered \$42,000, \$500 earnest money, and an 11-day feasibility study period and a shorter closing period than Sing's offer. Prongay testified that the sellers preferred Buckley's offer because of the shorter feasibility period and closing time. However, they still wanted full price and decided to make a counteroffer. Before doing so, however, they had to determine whether Sing had accepted their prior counteroffer. Prongay called Pennock who stated that Sing had not returned nor had he signed the counteroffer. Prongay then informed Pennock that the sellers were withdrawing their counteroffer and instructed him to so notify Sing as soon as possible. Pennock called Sing's home and left a message on his answering machine. The sellers then made a counteroffer of \$45,000 to the Buckleys, which was accepted. Pennock subsequently informed Sing that someone else had purchased the property.

Prongay and Buckley knew and worked with each other for many years and Prongay's desk was adjacent to Buckley's office. There was no direct evidence that Buckley used Sing's offer to gain an advantage in the transaction. But Prongay testified that she kept her listing file on her desk and Buckley testified that a couple of weeks before she made the offer to purchase the property, she looked for a plat map of the property in Prongay's listing file, but could not find it. Buckley asked Prongay if she had any maps and Prongay gave her one. Aside from this request, Prongay and Buckley did not discuss this property, nor did they discuss Sing's offer. However, Buckley was aware of the value of potential view property as a result of her prior contact with Sing. In a footnote the court stated:

Just a few weeks prior to the eventual sale of the [subject] property, Buckley had sold property to Sing. On a tour of the property, Sing told Buckley that with the increasing prices of waterfront property, hilltop property would become increasingly valuable, especially where trees could be cleared to provide views. n2

The sale closed in September. In February of the following year, the Buckleys resold the property for \$137,500. At the time of trial, the tax assessor's records estimated the property's value at \$182,500.

Sing sued Scott and the Buckleys alleging intentional interference with a contract of business expectancy, misrepresentation, and violation of the Consumer Protection Act (CPA). At trial, Sing abandoned his misrepresentation claim. At trial, the jury found by special verdict that:

- (1) Sing did not have a valid contractual relationship of business expectancy with the probability of future economic benefit;
- (2) Scott violated the CPA; and
- (3) Buckley did not violate the CPA.

The jury found Scott caused damages to Sing and awarded him damages of \$25,000. Sing was also awarded an additional \$7,500 in treble damages, \$50,863.59 in attorneys' fees and \$122.60 in costs. The trial court's decision was affirmed by the Court of Special Appeals. However, in an en banc decision, the Supreme Court of Washington reversed.

Sing had asserted that it was unfair for Scott to allow its brokers access to files containing third-party purchase offers listed with the agency, and then allow that broker to compete for the purchase of that property with knowledge of another prospective buyer's offer. The court found that there was no duty to keep Sing's offer confidential since both Prongay and Pennock's primary fiduciary duty was at all times to the seller. The court stated that a listing agent could disclose information about an offer to a prospective purchaser to establish a higher price or better terms for the seller. In addition, there was no statute preventing real estate agents from purchasing property listed with their own agency where another buyer had already made an offer. n3

Justice Talmadge dissented as he believed that the majority opinion did not adequately convey the "insider trading" present in the case. n4 He observed that the majority ignored the duties owed by real estate brokers and agents to sellers and buyers, and that they condoned insider trading practices by Scott and its agents forbidden for nearly identical policy reasons in securities transactions. He believed that the majority's central and fatal error was assuming that Maureen Buckley was in the same legal position as a total stranger in purchasing this property. n5 After citing this Treatise, n6 Justice Talmadge stated:

[B]ased on traditional Washington analysis of the duty owed by a real estate broker to a seller or to a purchaser, Scott violated its duty to Sing by virtue of the self-dealing of its agent. Scott breached its fiduciary duty to the [sellers] in failing to disclose to them the possibility of two offers from purchasers

who would pay at least the listing price, and perhaps more, for their property. As a fiduciary of the [sellers], Scott had a duty to initiate a "bidding war" between Buckley and Sing to secure the best possible price for the sale of the property. Additionally, Scott breached its fiduciary duty to the sellers in this case when Buckley acquired significant information about investment view property on Bainbridge Island that she did not disclose to the [sellers]. The [sellers] would have benefitted from Buckley's knowledge that their property, with the trees cleared to allow a Seattle view, was more valuable than they thought. As a subagent of Scott, any valuable knowledge Buckley possessed and used in developing the offer to the [sellers] should have been given to the [sellers]; this knowledge was imputable to Scott. Buckley used her knowledge of insider information, ironically acquired from Sing, to engage in a transaction that resulted in a profit after only a few months of \$92,500. n7

In a footnote, Justice Talmadge noted that it was unclear from the record whether the sellers filed an action against Scott or the Buckleys to require them "to disgorge any of the profits obtained in this transaction."

Justice Talmadge also believed that the broker's actions constituted a fraud on the market. On this issue he stated:

When a broker and its agents use insider status to, in effect, pull the rug out from under a buyer so as to prevent the seller from getting the best possible price for the sale of property and to deprive the buyer of a fair opportunity to compete for the property, the marketplace is disrupted artificially and a fraud on the market has occurred. n8

While Justice Talmadge was the lone dissenter, his opinion better accords with notions of fair play and justice. In this writer's opinion, allowing Buckley to profit from the sellers' ignorance of the potential value of their property makes a mockery of the fiduciary concept of loyalty. Buckley misappropriated information and used it to her own distinct advantage without regard to the interests of the sellers or Sing. n9

FOOTNOTES:

(n1)Footnote 1. 134 Wash. 2d 24, 948 P.2d 816 (1997) (en banc) *citing this Treatise*.

(n2)Footnote 2. 948 P.2d 816, 818 (1997) .

(n3)Footnote 3. 948 P.2d 816, 820 (1997) .

(n4)Footnote 4. 948 P.2d 816, 821 (1997) .

(n5)Footnote 5. 948 P.2d 816, 822 (1997) .

(n6)Footnote 6. 948 P.2d 816, 824 (1997) .

(n7)Footnote 7. 948 P.2d 816, 825-826 (Wash. 1997) .

(n8)Footnote 8. 948 P.2d 816, 827 (Wash. 1997) .

(n9)Footnote 9. 948 P.2d 816, 827 (Wash. 1997) .

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36 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART II. Brokers as Fiduciaries

10-3 Real Estate Brokerage Law and Practice § 3.12

§ 3.12 When Do a Broker's Duties Terminate?

A broker's duties to his or her clients terminate when the subject matter of the agency is sold or otherwise disposed of. n1 Generally, the agency relationship is terminated for a seller's broker when the property has been sold; the duty of loyalty does not survive termination of an agent's employment. n2 However, the broker's fiduciary duty to the seller does not end when the broker procures a ready, willing and able buyer on the seller's terms. n3 Broker misconduct occurring subsequent to the broker's production of a buyer has been held to violate the broker's fiduciary obligation. n4 It has been stated that a broker's fiduciary duties to a seller did not terminate on the expiration date of the listing agreement, but, instead, continued until performance or completion of the agreement by which the broker was engaged. n5

Even if the broker or an relative or associate of the broker purchases the property, the broker's fiduciary duties continue even though the broker may be a principal in the transaction. Therefore, once an agency relationship has been created, the broker is not absolved of fiduciary duties merely because the broker is the buyer. A broker who deals with the subject matter of the agency with the consent of the principal, cannot take advantage of the principal by withholding information secured by means of the agency relationship. n6

Once the listing agreement and fiduciary relationship have been terminated, brokers may act for themselves or for the other party to the transaction, provided they do not hinder, interfere with or delay a transaction that the original listing agreement was intended to bring about. n7 However, it is not always clear when the agency relationship was terminated. The conduct of the parties can extend the relationship beyond the stated termination date in a listing agreement or a buyer-broker agreement. Factual issues are presented if there is uncertainty as to when a relationship was terminated. n8

Even though a broker may have terminated an agency relationship with the client, fiduciary obligations may continue because of the broker's unique access to confidential information. It has been held that a fiduciary's duty to a former client does not cease when the broker becomes a principal in the transaction. n9

For instance, the agency may have expired by its own terms (*e.g.*, in ninety days), but the broker already knows confidential information shared during that relationship. If the broker then purchases the principal's property, a court may determine that the broker was in a unique position to take advantage of the principal's confidential information.

FOOTNOTES:

(n1)Footnote 1. *See*

California: Robinson v. Grossman, 57 Cal. App. 4th 634, 646, 67 Cal. Rptr. 2d 380, 387 (Cal. Ct. App. 1997) .

Pennsylvania: Shank v. Kaufman, 12 Pa. D. & C.3d 793, 795 , 1979 Pa. D. & C. LEXIS 328, at *3 (Pa. D & C Ct. Dec. 14, 1979).

See also Ga. Code Ann. § 10-6A-9 (broker relationship continues until completion of performance of the engagement, expiration of the parties' agreement, an authorized termination of the relationship).

(n2)Footnote 2. *See Foster and Gridley v. Winner*, 169 Vt. 621, 624, 740 A.2d 1283, 1287 (Vt. 1999) ; Restatement (Second) of Agency § 396.

(n3)Footnote 3. *But see Pilling v. Eastern & Pacific Enterprises*, 41 Wash. App. 158, 165, 702 P.2d 1232, 1237 (Wash. Ct. App. 1985) , *review denied*, 104 Wash. 2d 1014, 1985 Wash. LEXIS 1443 (Wash. 1985) (there is no legal basis for asserting that the seller-broker agency relationship extends beyond the time when the broker has earned his commission).

(n4)Footnote 4. *See*

Vermont: Quechee Lakes Rental Corporation v. Boggess, 158 Vt. 258, 264, 608 A.2d 39 (Vt. 1992) .

Washington: Wesco Realty, Inc. v. Drewry, 9 Wash. App. 734, 739, 515 P.2d 513, 517 (Wash. Ct. App. 1973) .

Cf. Moore & Co. v. T-A-L-L, Inc., 792 P.2d 794, 799 (Colo. 1990) (where agency agreement authorizes broker to sell property, broker's fiduciary obligation continues through closing); *Wallace v. Odham*, 579 So. 2d 171, 175 (Fla. Dist. Ct. App. 1991) , *review denied*, 589 So. 2d 291 (Fla. 1991) (breach of fiduciary duty provided ground to bar commission even though acts of breach occurred after broker abandoned agency contract).

(n5)Footnote 5. *See Mabry v. Tom Stanger & Co.*, 33 P.3d 1206, 1210 (Colo. Ct. App. 2001) , *rehearing denied* 2001 Colo. App. LEXIS 605 (Colo. Ct. App. Apr. 5, 2001) , *cert. denied* 2001 Colo. LEXIS 927 (Colo. Nov. 13, 2001) .

(n6)Footnote 6. *See Roberts v. Lomanto*, 112 Cal. App. 4th 1553, 1563, 5 Cal. Rptr. 3d 866, 873 (Cal. Ct. App. 2003) , *review denied*, 2004 Cal. LEXIS 1784 (Cal. Feb. 24, 2004) .

(n7)Footnote 7.

Arizona: Coldwell Banker Commercial Group, Inc. v. Camelback Office Park, 156 Ariz. 226, 231, 751 P.2d 542, 547 (1988) .

Florida: Portell Int'l Realty, Inc. v. Jacobson, 802 So. 2d 431, 433 (Fla. Ct. App. 2001) .

Maryland: Hardy v. Davis, 223 Md. 229, 233-234, 164 A.2d 281, 283-284 (1960) .

(n8)Footnote 8. *See Walker v. Woodworth*, 160 Or. App. 636, 642-643, 981 P.2d 1282, 1286 (1999) .

(n9)Footnote 9.

New Mexico: Swallows v. Laney, 102 N.M. 81, 84, 691 P.2d 874, 877 (N.M. 1984) .

Texas: Southern Cross Indus., Inc. v. Martin, 604 S.W.2d 290, 292-293 (Tex. Civ. App. 1980) , writ of error refused no reversible error (Dec. 31, 1980), rehearing of writ of error overruled (Jan. 21, 1981).

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37 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART II. Brokers as Fiduciaries

10-3 Real Estate Brokerage Law and Practice § 3.13

§ 3.13 Breach of a Broker's Duty Under Agency Law

[1] Damages for Breach of a Broker's Duty

A principal alleging a breach of fiduciary duty must plead and prove the breach, and must show that the breach caused an identifiable loss or resulted in injury to the principal. n1 Whether a fiduciary duty has been breached is a question for the fact finder. n2 A broker or agent is subject to any losses incurred from his or her breach of duty. n3

A broker's measure of liability for negligence in collecting claims due the principal is the amount of damages sustained by the principal, and this is prima facie the amount of the debt or claim. n4 When a prima facie case has been made, the burden is on the broker to show facts relieving the broker from liability. n5 Therefore, after a principal has made a prima facie showing, the burden then rests on the defendant agent to show that there was no damage or that the damage was less than claimed. n6

Some courts have held that a plaintiff injured by a fiduciary who commits fraud, is not limited to out-of-pocket losses. If the breach does not arise from contract, the measure of damages is the amount which will compensate for all the detriment proximately caused thereby, whether it could have been anticipated or not. n7

[2] Effect of a Breach of a Broker's Duty Upon the Broker's Right to Compensation

As a general rule, a broker or agent's right to compensation will be affected by a violation of his or her fiduciary duties. n8 Some courts hold that a broker who breaches his or her duty must forfeit the entire commission as a matter of law. n9 Typically cases finding a total forfeiture of commission involve a single, specific transaction. Courts adopting this view hold that when a broker breaches a fiduciary duty to a principal, the broker is not entitled to receive a commission if some potential harm to the principal may have been caused by the breach, even though no actual harm was shown. n10

Total forfeiture of the broker's commission is a severe remedy. Generally courts are willing to apply this remedy when the broker's conduct constitutes willful disobedience of lawful and reasonable instructions whereby such conduct shows a complete disregard of the fundamental obligations of the parties' relationship and a disloyalty to the principal's interests. n11

A broker's negligence, without a violation of the fiduciary relationship arising from being the principal's agent, usually limits the principal's remedy to damages rather than a total forfeiture of the broker's commission. n12 Breaches involving negligence without bad faith generally result in courts holding that the broker, while liable for whatever damages the negligent conduct has caused, does not also automatically lose his or her commission. n13 This more tolerant view results from the viewpoint that an automatic forfeiture rule is to deter intentional misconduct by brokers. n14 These courts find that where there is no intentional misconduct, any damages caused by the broker's failings can be rectified by a negligence action. Consequently, it is not always necessary or fair to require that the broker also forego the commission. n15 However, gross negligence on the broker's part is likely to result in a total forfeiture of the broker's commission. n16

Section 469 of the Restatement (Second) of Agency provides that:

An agent is entitled to no compensation for conduct which is disobedient or which is a breach of his duty of loyalty; if such conduct constitutes a willful and deliberate breach of his contract of service, he is not entitled to compensation even for properly performed services for which no compensation is apportioned.

One court, in explaining why this section does not result in automatic forfeiture, reasoned that the word "entitled" meant "to give a right to." By applying this definition, the court found that § 469 indicated that a disloyal agent does not have a right to compensation since the agent breached the agent's duty of loyalty, "but a breach does not exclude the exercise of the court's discretion granting him compensation." n17

If a court does not follow the rule of automatic forfeiture of the entire commission, the court should consider the following factors in determining the broker's right to any commission: the seriousness and timing of the violation; the willfulness of the breach; the potential for, or actual harm to the principal; and whether the agent completed a divisible portion of his contract duties before the breach occurred for which compensation can be determined. n18 The Texas Supreme Court has rejected the theory of automatic full forfeiture because such a result would deprive the remedy of its equitable nature. n19 Instead, the court held that Texas law requires a consideration of several factors in determining the amount of forfeiture, including: "the gravity and timing of the violation, its willfulness, its effect on the value of the [agent's] work for the [principal], and other threatened or actual harm to the [principal] and the adequacy of other remedies." n20

[3] Damages Arising from a Broker's Self-Dealing

It is considered axiomatic that a broker who deals with the principal's property cannot acquire a secret profit. If the broker violates the relationship in this manner, whatever secret profit the broker receives belongs to that principal and the broker must account to the principal for all that the broker received. n21 The equitable doctrine of constructive trusts is available where a broker takes improper advantage of a client. n22

If a broker is accused of violating his or her duty of loyalty to the principal by engaging in self-dealing, the principal in an action for breach of the broker's fiduciary duty need only bear the burden of proving that the broker acted on the broker's own behalf in a transaction connected with the agency. This alone establishes the breach of the duty. The burden of proof then falls on the agent to prove that the principal knew or did not care to know that the broker was acting on the broker's own behalf in the transaction. Full disclosure in this situation, effectively serves as an affirmative defense to the prima facie breach of the duty created by the conflict of interest. n23

Where a broker did not inform the sellers of the existence of an offer from a third party but, using a corporate entity, purchased the property from the sellers at a lower price and contemporaneously sold the property to the third party at the higher price, the broker was held liable for the difference between what the broker paid for the property and what the broker sold the property for to a third party. n24

Where the broker's breach of fiduciary duty is found to be wilful and malicious, recovery of exemplary n25 or punitive damages have been awarded. n26

Not all self-dealing results in the broker earning a profit at the client's expense. It has been held that if a broker purchases the client's property without a full disclosure of all the facts, the sale is voidable at the seller's option. n27 Computation of the seller's damages becomes an issue if the seller voids the contract as illustrated by *Flatau v. Dover* (In re Sanders). n28 The listing broker in this case failed to disclose the existence of a purchase offer to the sellers and instead presented only its offer of purchase which the sellers accepted. The sellers chose not to settle and instead sold the property through another broker. The sellers' Chapter 7 trustee sued seeking a turn over of estate property alleging that the broker's offer constituted a breach of fiduciary duty and tortious interference with contractual relations between the sellers and the persons who made the undisclosed offer. The trustee alleged that the estate was entitled to recover a judgment against the broker.

The broker showed that its offer netted the sellers \$236.50 more than what the sellers would have received on the undisclosed offer. The broker moved for summary judgment claiming that the complaint failed to state a cause of action because the sellers suffered no damages as a result of the broker's conduct. The court denied the motion. It stated that the broker's contract was not relevant to the determination of the seller's damages. It stated, "The use of the [broker's] Contract as evidence which would serve to limit the [sellers'] damages would create an element of enforceability for the contract where none exists under Georgia law." n29 This case illustrates that a broker's self-dealing, even if it nets the client more money, may not protect the broker from a claim for damages based upon the breach of fiduciary duty and any other torts that occur.

To avoid liability for self-dealing, the broker need only make full disclosure to the principal. n30

FOOTNOTES:

(n1)Footnote 1. See *Lindland v. United Business Investments, Inc.*, 298 Ore. 318, 327, 693 P.2d 20, 25 (Or. 1984) (en banc), *rehearing denied* (1985).

(n2)Footnote 2. See *Musselman v. Southwinds Realty Co.*, 146 Ariz. 173, 175, 704 P.2d 814, 816 (Ariz. Ct. App. 1995) .

(n3)Footnote 3. See *Cogan v. Kidder, Mathews & Senger, Inc.*, 97 Wn.2d 658, 667, 648 P.2d 875, 880 (Wash. 1982) ; *Meerdink v. Krieger*, 15 Wash. App. 540, 545, 550 P.2d 42, 46 (Wash. Ct. App. 1976) , *review denied*, 87 Wash. 2d 1011, 1976 Wash. LEXIS 816 (1976) ; Restatement (Second) of Agency § 401.

(n4)Footnote 4. See *Merkley v. MacPherson's, Inc.*, 69 Wash. 2d 776, 780, 420 P.2d 205, 208 (Wash. 1966) .

(n5)Footnote 5. See *Merkley v. MacPherson's, Inc.*, 69 Wash. 2d 776, 780, 420 P.2d 205, 208 (Wash. 1966) .

(n6)Footnote 6. See *Merkley v. MacPherson's, Inc.*, 69 Wash. 2d 776, 780, 420 P.2d 205, 208 (Wash. 1966) ; Restatement (Second), Agency § 401.

(n7)Footnote 7. See *Fragale v. Faulkner*, 110 Cal. App. 4th 229, 238, 1 Cal. Rptr. 3d 616, 623 (Cal. Ct. App. 2003) . See also Cal. Civ. Code § 3333.

(n8)Footnote 8. See *Rockefeller v. Grabow*, 136 Idaho 637, 642, 39 P.3d 577, 582 (Idaho 2001) .

(n9)Footnote 9. See *Rockefeller v. Grabow*, 136 Idaho 637, 642, 39 P.3d 577, 582 (Idaho 2001) ; *Cooke v. Iverson*, 94 Idaho 929, 934, 500 P.2d 830, 835 (1972) .

(n10)Footnote 10. See *Quechee Lakes Rental Corporation v. Boggess*, 158 Vt. 258, 265, 608 A.2d 39 (Vt. 1992) .

See *Nichols v. Minnick*, 885 N.E.2d 1 (Ind. 2008), reh'g denied, 2008 Ind. LEXIS 544 (June 30, 2008) (broker who breaches his fiduciary duty to disclose material information to his client loses his right to receive a commission for his services).

(n11)Footnote 11. See, e.g.,

California: Harvey v. Berger, 91 Cal. App. 165, 167, 266 P. 829, 830 (Cal. Ct. App. 1928) .

Oregon: Atherton v. Collins, 240 Or. 265, 267, 401 P.2d 15, 16 (Or. 1965) ("An agent is not entitled to compensation when he breaches his duty to his principal during the performance of his services.").

Restatement (Second) of Agency § 469.

(n12)Footnote 12. See, e.g.,

California: Harvey v. Berger, 91 Cal. App. 165, 167, 266 P. 829, 830 (Cal. Ct. App. 1928) .

(n13)Footnote 13. See, e.g., *Tackett v. Croonquist*, 244 Cal. App. 2d 572, 53 Cal. Rptr. 388, 392 (Cal. Ct. App. 1966) ; *Monty v. Peterson*, 85 Wash. 2d 956, 540 P.2d 1377, 1378 (1975) . See also *Menzel v. Morse*, 362 N.W.2d 465, 474-475 (Iowa 1985) (broker is liable for all losses directly resulting from his failure to exercise the standard of skill and care imposed on him by law).

(n14)Footnote 14. See *Veach v. Meyeres Real Estate Real Estate, Inc.*, 599 P.2d 746, 748-749 (Alaska 1979) ; *Greenberg v. Meyer*, 50 Ohio App. 2d 381, 4 Ohio Op. 3d 353, 363 N.E.2d 779, 781 (Ohio Ct. App. 1977) .

(n15)Footnote 15. See *Veach v. Meyeres Real Estate Real Estate, Inc.*, 599 P.2d 746, 749 (Alaska 1979) .

(n16)Footnote 16. See, e.g., *Harvey v. Berger*, 91 Cal. App. 165, 167, 266 P. 829, 830 (Cal. Ct. App. 1928) .

(n17)Footnote 17. See *Williams v. Queen Fisheries, Inc.*, 2 Wash. App. 691, 469 P.2d 583, 588 (Wash. Ct. App. 1970) .

(n18)Footnote 18. See *Rockefeller v. Grabow*, 136 Idaho 637, 643, 39 P.3d 577, 583 (Idaho 2001) .

(n19)Footnote 19. See *Burrow v. Arce*, 997 S.W.2d 229, 241 (Tex. 1999) .

(n20)Footnote 20. 997 S.W.2d 229, 243 (1999) .

See also *Marnon v. Vaughan Motor Co.*, 184 Or. 103, 194 P.2d 992, 1020-21 (Or. 1948) (general rule is that a disloyal agent forfeits all right to recover for services rendered on his principal's behalf, but this rule is not an inflexible one, whether compensation is denied a fiduciary ultimately rests in the court's discretion) (quoting *Shulkin v. Shulkin*, 301 Mass. 184, 16 N.E.2d 644, 652 (Mass. 1938)) .

(n21)Footnote 21. See:

Minnesota: Jensen v. Peterson, 264 N.W. 2d 139, 142-143 (Minn. 1978) .

Oregon: Atherton v. Collins, 240 Ore. 265, 270, 401 P.2d 15, 18 (Or. 1965) ; *Stone v. Leonard*, 120 Or 427, 437-438, 251 P. 299, 302 (Or. 1927) .

(n22)Footnote 22. See *Nguyen v. Scott*, 206 Cal. App. 3d 725, 740, 253 Cal. Rptr. 800, 809 (Cal. Ct. App. 1988) , review denied; *Whitman v. Forbes*, 55 N.C. App. 706, 712, 286 S.E.2d 889, 893 (N.C. Ct. App. 1982) .

(n23)Footnote 23. See *Lindland v. United Business Investments, Inc.*, 298 Ore. 318, 324, 693 P.2d 20, 23-24 (Or. 1984) (en banc), rehearing denied (1985); Restatement (Second) of Agency § 389 comment e and § 390 comment g.

(n24)Footnote 24. See *Jensen v. Peterson*, 264 N.W.2d 139, 142 (Minn. 1978) . For a case involving similar facts, see *Real Estate Licensing Bd. v. Gallman*, 52 N.C. App. 118, 277 S.E.2d 853 (1981) .

(n25)Footnote 25. See, e.g., *Wilson v. Donze*, 692 S.W.2d 734, 740 (Tex. Ct. App. 1985) .

(n26)Footnote 26. See, e.g., *Phillips v. Lynch*, 101 Nev. 311, 313, 704 P.2d 1083, 1084 (1985) (broker not only breached the listing contract, but also committed a fraudulent act of misconduct that sounded in tort, a claim for punitive damages, as well as compensatory damages, was justified).

(n27)Footnote 27. See *Dolvin Realty Co. v. Holley*, 203 Ga. 618, 621, 48 S.E.2d 109, 112 (Ga. 1948) .

(n28)Footnote 28. 233 B.R. 168 (Bkrcty. M.D. Ga. 1999) , applying Georgia law.

(n29)Footnote 29. 233 B.R. 168, 170 (Bkrcty. M.D. Ga. 1999) , applying Georgia law.

(n30)Footnote 30. See *Rodes v. Shannon*, 222 Cal. App. 2d 721, 726, 35 Cal. Rptr. 339, 343 (Cal. Ct. App. 1963) ("One employed as agent violates no duty to the principal by acting for his own benefit if he makes a full disclosure of the facts to an acquiescent principal and takes no unfair advantage of him.").

* Revised by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues, including licensing issues, has practiced in the areas of tax, business and probate law, and is licensed as a C.P.A. in the State of Maryland.



38 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART II. Brokers as Fiduciaries

10-3 Real Estate Brokerage Law and Practice § 3.14

§ 3.14 Common Law Defense of Manager's Privilege

In some cases, a real estate licensee may be accused of tortiously interfering with a contract between a buyer and a seller. If so, the licensee may be protected by the manager's privilege if the licensee was an agent of one of the parties. This privilege has also been interchangeably referred to as the "agent's privilege" as well as the "manager's privilege." This section will use the term "manager's privilege."

The manager's privilege provides that a manager or agent may, with impersonal or disinterested motive, properly endeavor to protect the interests of his or her principal by counseling the breach of a contract with a third party which the manager or agent reasonably believes to be harmful to the principal's best interests. n1 Initially, this privilege was applied to managers of business entities, but has been expanded to include agents of natural persons. n2 This privilege can be absolute or qualified and if qualified, application of the privilege may be tested by applying a mixed motive test or a predominant motive test. Consequently, there are three formulations of the managers privilege:

- (1) absolute,
- (2) mixed motive, and
- (3) predominant motive. n3

If this privilege is absolute, it is based solely on the manager's status as the manager or agent of the breaching party, without regard to the manager or agent's motives or state of mind. Under the mixed motive formulation, the privilege applies as long as the manager or agent is motivated, at least in part, by a desire to benefit the principal. Under the predominant motive formulation a manager or agent has the privilege of interfering with a principal's contract only when the manager's predominant motive is to serve the interest of the principal. The predominant motive formulation is the most restrictive of the three. n4 Several high courts have adopted the predominant motive test. n5

FOOTNOTES:

(n1)Footnote 1. *See., e.g., Huynh v. Vu, 111 Cal. App. 4th 1183, 1194, 4 Cal. Rptr. 3d 595, 604 (Cal. Ct. App. 2003) . See generally Comment, Boxing Basinger: Oral Contracts and the Manager's Privilege on the Ropes in Hollywood, 9*

UCLA Ent. L.Rev. 285, 287-291 (2002); Note, *Main Line v. Basinger and the Mixed Motive Manager: Reexamining the Agent's Privilege to Induce Breach of Contract*, 46 *Hastings L.J.* 609, 626 (1995).

(n2)Footnote 2. See., e.g., *Huynh v. Vu*, 111 *Cal. App. 4th* 1183, 1195, 4 *Cal. Rptr. 3d* 595, 605 (*Cal. Ct. App.* 2003) .

(n3)Footnote 3. See *Halvorsen v. Aramark Uniform Services, Inc.*, 65 *Cal. App.4th* 1383, 1391, 77 *Cal. Rptr. 2d* 383 (*Cal. Ct. App.* 1998) , review denied, *Supreme Court Minute* 11-17-1998, 1998 *Cal. LEXIS* 7535 (*Cal. Nov.* 17, 1998) .

(n4)Footnote 4. See., e.g., *Huynh v. Vu*, 111 *Cal. App. 4th* 1183, 1195, 4 *Cal. Rptr. 3d* 595, 605 (*Cal. Ct. App.* 2003) .

(n5)Footnote 5. See: *Huynh v. Vu*, 111 *Cal. App. 4th* 1183, 1195, 4 *Cal. Rptr. 3d* 595, 605 (*Cal. Ct. App.* 2003) , citing *Geolar, Inc. v. Gilbert/Commonwealth*, 874 *P.2d* 937, 940-941 (*Alaska* 1994) ; *Jones v. Lake Park Care Center, Inc.*, 569 *N.W.2d* 369, 376-378 (*Iowa* 1997) ; *Nordling v. Northern States Power Co.*, 478 *N.W.2d* 498, 507 (*Minn.* 1991) ; *Trau-Med of America, Inc. v. Allstate Ins. Co.*, 71 *S.W.3d* 691, 701-702 & fn. 5 (*Tenn.* 2002) .

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39 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART II. Brokers as Fiduciaries

10-3 Real Estate Brokerage Law and Practice § 3.15

§ 3.15 A Broker's Use of an Independent Inspector's Report as a Defense in a Buyer's Action

When the buyer discovers a material defect after the transaction has closed, the buyer may sue the brokers involved in the transaction. If the buyer obtained an independent inspection report from a competent third party, the broker may assert that this report bars any claim against the broker for failing to disclose a defect. In some jurisdictions, this fact pattern would entitle the broker to a favorable summary judgment. n1

If a statute or regulation allows a broker to interpose the existence of an independent inspector's report as a defense in a claim that the broker failed to disclose a defect, such a report should not serve as a defense to allegations of breach of other duties. n2

In the landmark case of *Leko v. Cornerstone Home Inspection* n3 a California intermediate appellate court held that a real estate agent who is sued for negligent nondisclosure of defects in real property may seek equitable indemnity from a home inspection company that allegedly breached its duty to the purchaser to discover and disclose the same defects. The real estate agents were aided by California statute which imposes a duty on home inspection companies to "conduct a home inspection with the degree of care that a reasonably prudent home inspector would exercise." n4 California law also imposes a substantially similar duty on real estate licensees involved in the sale of residential property as they statutorily owe a duty to conduct a "reasonably competent and diligent visual inspection of the property offered for sale and to disclose to [a] prospective purchaser all facts materially affecting the value and desirability of the property that an investigation would reveal ..." n5 The court stated that when a purchaser of residential real property was damaged by the nondisclosure of a defect that both the inspector and the real estate agent or broker were obligated to discover and disclose, it was fair to apportion the damages between the two.

Leko involved a home inspector who had inspected the home for the purchasers, but it also involved a home inspector who had prepared a report for a different prospective purchaser, in connection with a previous transaction involving the same property. The court found that a real estate agent or broker could also seek equitable indemnity from such an inspector so long as the home inspector intended or knew with substantial certainty that his or her report would be used in subsequent transactions involving the property. n6

FOOTNOTES:

(n1)Footnote 1. *See Lim v. Lomeli*, 2007 Tex. App. LEXIS 6932, at *11 (Aug. 29, 2007) (Since the buyers hired professional inspectors and obtained and reviewed their reports, the buyers, as a matter of law, cannot establish that they detrimentally relied on their agent's alleged misrepresentations.) *Conell v. Coldwell Banker Premier Real Estate, Inc.*, 181 Wis. 2d 894, 901-902, 512 N.W.2d 239, 243 (Wis. Ct. App. 1994) (statute relieved the broker from the duty to disclose information related to the condition of the property where an inspection was conducted by a qualified third party, administrative code allowed broker to rely on a third-party inspection, thereby relieving the broker from the duty to inspect the property).

(n2)Footnote 2. *See Johnson v. Neuville*, 226 Wis. 2d 365, 373, 595 N.W.2d 100, 105 (Wis. Ct. App. 1999) .

(n3)Footnote 3. 86 Cal. App. 4th 1109, 103 Cal. Rptr.2d 858, 865-866 (Cal. Ct. App. 2001) , review denied Supreme Court Minute 05- 02-2001, 2001 Cal. LEXIS 3146 (Cal. May 2, 2001) .

(n4)Footnote 4. Cal. Bus. & Prof. Code § 7196.

(n5)Footnote 5. Cal. Code §§ 2079, subd. (a); 2079.16. *See also* Cal. Civ. Code § 1106.

(n6)Footnote 6. 86 Cal. App. 4th 1109, 103 Cal. Rptr.2d 858, 867-868 (2001) , review denied Supreme Court Minute 05- 02-2001, 2001 Cal. LEXIS 3146 (Cal. May 2, 2001) .

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40 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART III. Duties Owed to Buyers

10-3 Real Estate Brokerage Law and Practice § 3.16

§ 3.16 Duties Owed to a Buyer by a Seller's Broker

[1] A Seller's Broker Must Deal Honestly and Fairly with a Buyer

When a seller's broker has no agency relationship with the buyer, the broker does not owe any fiduciary duties to the buyer. This does not mean, however, that the broker is free to act however he or she chooses in an effort to benefit the broker's principal. Real estate brokers have been held accountable for failing to deal fairly and honestly with a purchaser while serving as the seller's agent. n1

Real estate licensing acts often require that licensees treat all customers honestly and that they not negligently or knowingly give customers false information. n2 This duty typically requires that a licensee engaged by a seller must timely disclose to customers who are prospective buyers all latent material adverse facts pertaining to the property's physical condition that are actually known by the licensee and that could not be discovered by a customer's reasonably diligent inspection of the property. n3 Some licensing acts provide that a licensee is not liable for providing false information to the buyer if the false information was provided to the licensee by the licensee's client and the licensee did not have actual knowledge that the information was false. n4 Some licensing acts address when a private right of action arises under the licensing act. n5

Buyers typically sue the seller's broker when they believe they have been misled or deceived by statements or omissions made by the broker. Depending on the circumstances, the buyer may allege negligent misrepresentation or fraudulent misrepresentation. Justifiable reliance is an essential element of both torts. n6 In some cases, buyers have even alleged innocent misrepresentation.

Even before the advent of brokerage relationship acts, a licensee who knew of a serious latent defect in a property listed by the licensee, had a duty to see that the purchaser was informed of the defect. n7

It is generally held that a seller's broker may be liable to a buyer if the broker makes material misrepresentations with regard to the fitness or habitability of residential property or fails to disclose defects or conditions in the property that substantially affect its value or habitability, of which the broker is aware or reasonably should be aware, but the buyer is unaware and would not discover by a reasonably diligent inspection. n8 It must be shown that the misrepresentation or

concealment was a substantial factor in inducing the buyer to buy the property.

One court has held that a broker can protect himself or herself from misrepresentation allegations by disclaiming knowledge of the property's defects and having a buyer (or seller) acknowledge such disclaimer. This court specifically held that such protection was not against public policy and helped clarify the law and the role of those involved in real estate matters. n9

In order to bring a suit under a licensing law with respect to a misrepresentation, it is not necessary that the misrepresentation involve a physical characteristic of the property. n10

[2] Duty to Investigate

The applicable laws and regulations are the first place to look in determining whether a seller's broker has a duty to investigate on behalf of the buyer. Absent such a statutory or regulatory duty, it would appear that most courts have held that in the absence of any reason to perform an investigation, there was no duty imputable to a broker that would compel the broker to investigate the seller's home for concealed or latent impairments or defects. n11

Brokers should not make assumptions regarding matters of considerable importance to their clients. Particularly with respect to the representation of a buyer, making an assumption regarding a material fact can lead to liability on the broker's part. It can be argued that brokers have a duty to investigate and verify material facts instead of knowingly making an assumption and relaying this assumption to the client when the broker knows that the client will rely upon this information in making a purchase decision. n12

[3] Negligent Misrepresentation

A common tort alleged against seller's brokers by buyers is that of negligent misrepresentation. The typical scenario leading to a suit alleging this tort is that after the transaction has settled, the buyer discovers flaws and defects in the property which leads to a lawsuit against the seller and the seller's broker. A broker who commits the tort of negligent misrepresentation may be liable for pecuniary loss caused to the buyer by the buyer's justifiable reliance upon incorrect information, if the broker failed to exercise reasonable care or competence in obtaining or communicating the information. n13 To prove negligent misrepresentation, the plaintiff must prove

- (1) a misrepresentation or omission of a fact;
- (2) that the representation is material or significant;
- (3) a failure to exercise reasonable care on the part of the defendant;
- (4) the plaintiff's reasonable reliance on the misrepresentation or omission; and
- (5) damages as a direct result of such reasonable reliance. n14

Negligent misrepresentation has been called a form of actual fraud, consisting of a "positive assertion, in a manner not warranted by the information of the person making it, of that which is not true, though he believes it to be true." n15 There can be no finding of negligent misrepresentation by a party's mere omission. n16

In California, a real estate agent has a statutory liability for negligence as *California Civil Code § 1088* provides in part that: "[i]f an agent ... places a listing or other information in the multiple listing service, that agent ... shall be responsible for the truth of all representations... of which that agent... had knowledge or reasonably should have had

knowledge to anyone injured by their falseness or inaccuracy." n17

Wyoming's high court has limited negligent misrepresentation claims when the sales contract contains a disclaimer clause. n18 This court has stated that the initial question posed by a claim for negligent misrepresentation was whether a plaintiff may bring an action which arises out of a contract and call it a tort action, thereby rendering the plaintiff's statement in the contract null and void. Courts have two predominant views on this issue. The first view is that the contractual relationship controls, and parties are not permitted to assert tort actions in an attempt to circumvent their agreed upon bargain. The second view assumes that a tort action is permissible, and that the parol evidence rule does not apply, and, therefore, the action may be maintained. n19

According to the Wyoming high court, courts which adopt the second view have structured the issue as whether the parol evidence rule bars admission of the prior representations in the face of merger and disclaimer clauses. n20 The Wyoming court adopted the first view. This court stated the contract clearly and unambiguously stated that the buyer was not relying on any representations made by the agent or the sellers. The court found that the clause validly allocated the risk of loss resulting from the buyer's reliance on the seller's representations. The court stated,

The parties were free to contract for whatever terms they wished, and they chose to allocate the risk of loss to [the buyer]. [The buyer's] claim that he did not read or understand the terms to which he was agreeing falls on deaf ears. Under the circumstances, we are aware of no duty that the law would impose upon the [sellers] either to ensure that [the buyer's] representation of non-reliance was genuine or to protect [the buyer] poorly allocating the risk of loss. n21

The court held that summary judgment was appropriate as the buyer was barred from asserting a claim for negligent misrepresentation.

In a case involving an alleged negligent misrepresentation of a boundary line by a real estate agent, the Supreme Court of Connecticut had held that the law of comparative negligence applies to this claim. n22 In this particular case, the buyer failed to obtain a survey. The jury below found that the buyer was 60% contributorily negligent and was therefore not entitled to damages. This decision was affirmed.

[4] Innocent Misrepresentation

A few courts have recognized a cause of action against a seller who innocently misrepresents the property's condition to the purchaser. n23 The recognition of a tort in this situation is based on the belief that owners are presumed to know the character and attributes of the land conveyed and buyers are consequently entitled to rely on the seller's reasonable representations. n24 Consequently, a seller cannot hide behind the doctrine of caveat emptor. The seller is expected to be both truthful and informed in making representations. n25

If the seller can be liable for an innocent misrepresentation, the question that arises is whether the seller's broker can likewise be liable for stating the same misrepresentation? Most courts addressing this issue have recognized a cause of action by the purchasers of property against the broker for the latter's innocent misrepresentation. n26 The policy favoring liability for innocent misrepresentation is found on a recognition that purchasers should be entitled to rely on a broker's representations. n27 One court in finding that a broker can be liable for an innocent misrepresentation stated:

Parties to real estate transactions frequently do not deal on equal terms. Real estate brokers are licensed professionals, possessing superior knowledge of the realty they sell and the real estate market generally. Prospective purchasers recognize this expertise and tend to rely on a broker's representations. Just as purchasers are entitled to rely on an owner's representations, (citation omitted) purchasers should be entitled to rely on the broker's representations. Any other rule would permit brokers to use misleading statements in selling the property, yet remain immune from liability by simply remaining ignorant of the

property's true characteristics. Accordingly, we hold that a purchaser who relies on a material misrepresentation, even though innocently made, has a cause of action against the broker originating or communicating the misrepresentation. n28

This court also stated that brokers could protect themselves from liability by investigating the seller's statements, by disclaiming knowledge, or by requiring the seller to sign at the time of listing a statement setting forth representations which will be made, certifying that they are true and providing for indemnification if they are not. n29 However, a dissenting justice in this case stated that allowing an innocent misrepresentation action against the broker was close to imposing strict liability and there was no reason to make the broker the "insurer" of the seller's representation. n30

Alaska provides a good example of how the new generation of seller disclosure laws has affected the application of common law to real estate brokerage. While Alaska had previously recognized that both sellers and brokers could commit the tort of innocent misrepresentation, the requirement that sellers of residential property provide buyers with a disclosure form has altered the status of this tort in Alaska. Prior to the enactment of Alaska Stat. § 34.70, sellers were not required to make any representations about the property. However, sellers were strictly liable for those representations they made. n31 Under the disclosure statute a seller of residential property must make representations about a wide range of the property's features and characteristics. Alaska's high court has concluded that the legislature intended to offset the seller's increased disclosure responsibilities by the lower liability standard for misrepresentations. n32 The court found that this conclusion was supported by the fact that the legislature in *Alaska Statutes § 34.70.090(b)* had explicitly adopted a negligence standard of liability. Consequently, this standard had implicitly rejected liability based on lesser gradations of fault. The court observed that since the statute required that sellers make disclosures "in good faith," n33 the legislature intended no liability to attach for an inaccurate statement on the disclosure form if made in good faith. Therefore, the court found that Alaska Statutes § 34.70 precluded claims of innocent misrepresentation as to residential property concerning conditions included in the mandatory disclosure form. To be actionable, misrepresentations in the disclosure form had to at least be negligently made. n34 If a seller cannot be liable for an innocent misrepresentation, surely the seller's broker should be similarly protected.

[5] Intentional or Fraudulent Misrepresentation

It is generally held that a broker who makes fraudulent misrepresentations or who conceals a material fact when there is a duty to speak is personally liable to the purchaser notwithstanding that the broker was acting as the seller's broker. n35 However, the duty to speak applies only to material facts known to the broker and to representations made by the broker. n36 A broker who makes a fraudulent misrepresentation or who intentionally conceals a fact which should be disclosed, is typically subject to a disciplinary action by the state licensing agency (*See § 6.05, below* for a discussion of disciplinary actions).

The elements of common law fraud or fraudulent misrepresentation are:

- (1) a false statement of a material fact;
- (2) the defendant's knowledge that the statement was false;
- (3) the defendant's intent that the statement induce the plaintiff to act;
- (4) the plaintiff's reliance upon the truth of the statement; and
- (5) the plaintiff's damages resulting from reliance on the statement. n37

The difference between fraudulent misrepresentation and negligent misrepresentation is that in fraudulent misrepresentation, one becomes liable for breaching the general duty of good faith or honesty. In a claim of negligent

misrepresentation, one may become liable even though acting honestly and in good faith if one fails to exercise the level of care required under the circumstances. n38

Generally, a broker will not be held liable for fraud for merely relaying information concerning the condition of a home, without proof that there was knowledge that the statement was false. Therefore, a failure to plead allegations that a broker knew that his or her statements were false will be fatal to the plaintiff's fraud claim. n39

The selling broker usually has no duty to volunteer any knowledge about the property unless it involves a specific defect affecting health or safety. However, a broker must respond honestly to direct inquiries. n40

A California court has held that exculpatory clauses in standardized forms used in sale of real estate do not bar a claim for intentional misrepresentation brought by buyers against the sellers' brokers. n41 The buyers alleged that the brokers intentionally misrepresented the property could be subdivided. n42 However, the contract contained a hand-written term stating that the buyers were to satisfy themselves regarding warranties or representations as to use. The brokers asserted that the buyers could not show justifiable reliance as a matter of law due to this term found in the sales contract. The court disagreed and held that such exculpatory clauses do not preclude, as a matter of law, the buyers' showing of justifiable reliance. The court stated that it is well established in California that in an action for fraud or deceit, negligence on the part of the plaintiff in failing to discover the falsity of the defendant's statement is no defense when the misrepresentation was intentional. n43

[6] Fraudulent Concealment

In order to maintain an action based on fraudulent concealment, the plaintiff must allege and prove the following elements:

- (1) that the defendant concealed or suppressed a material fact;
- (2) that the defendant had knowledge of this material fact;
- (3) that this material fact was not within the reasonably diligent attention, observation, and judgment of the plaintiff;
- (4) that the defendant suppressed or concealed this fact with the intention that the plaintiff be misled as to the true condition of the property;
- (5) that the plaintiff was reasonably so misled; and
- (6) that the plaintiff suffered damage as a result. n44

[7] Defenses Against a Buyer's Misrepresentation Claims

A number of legal defenses may be raised against allegations of misrepresentation. The most basic defense, if the facts support it, is that the representation was never made. n45 Another defense is that the agent may have made misrepresentations about the property, but they were not specific enough to be actionable; thus, the agent's use of such words as "good buy" or statements that the purchaser would "probably" have no problems may not be specific enough to support a cause of action. n46

Another possible defense arises when the misrepresentation involves an allegedly hidden defect. Such a claim should fail if the defect was discoverable by a simple inspection and the purchaser inspects the property prior to its purchase. n47

Brokers may also assert that the information regarding the property was a matter of public record. Whether or not this defense will protect a broker will depend on the specific statutory obligation to disclose and may also depend upon whether a reasonable person would be able to find and understand the publicly-available information. One court, in applying Oregon law, stated that the duty to disclose material facts is an affirmative duty imposed on a seller's agent. The court found that the policy underlying this duty is to ensure that real estate buyers have available to them all material information needed to make an informed decision to purchase. The court found that this policy was effectuated by requiring that a seller's agent disclose all known material information to the prospective buyer. A statutory exception to this duty arose when the information was readily apparent or readily ascertainable to the buyer. The court construed this exception to mean that the information had to be capable of being easily perceived through the physical senses of the buyer or easily discovered by the buyer. In this case, the court upheld the reprimand of a seller's agent for failing to disclose to the buyers that the property was located in a 100-year floodplain. The fact that public documents disclosed this information did not protect the agent since a reasonable person would not know where to find a publicly available flood map nor would the reasonable person understand these public documents or the terminology used in the documents. n48

The defendant or the agent may also plead successfully that information unknown to him or her could not be revealed, n49 although this defense probably would be considered in light of whether or not the licensee could reasonably have known about the falsity or the inaccuracy of the information. This has also proved to be a good defense when the plaintiff did not rely on the agent's representations because of the buyer's inspections of the property prior to acquisition of the property.

Brokers can also protect themselves from misrepresentation claims by investigating the seller's statements. Another means of protection would be for the broker to require that the seller sign a statement stating the representations that will be made, certifying that they are true and providing for indemnification if they are not. n50

Brokers have also used statements signed by purchasers, whereby a purchaser states that no important representations concerning the property's condition made to them by the seller's broker were relied upon. One court considered whether such an agreement was contrary to public policy. The agreement in question stated:

1. I HAVE CAREFULLY INSPECTED THE PROPERTY. SUBJECT TO ANY INSPECTIONS ALLOWED UNDER MY CONTRACT WITH SELLER, (And repairs to be made as therein required), I AGREE TO PURCHASE THIS PROPERTY IN ITS PRESENT CONDITION ONLY, WITHOUT WARRANTIES OR GUARANTEES OF ANY KIND BY THE SELLER OR ANY REALTOR CONCERNING THE CONDITION OR VALUE OF THE PROPERTY.

2. I AGREE TO VERIFY ANY OF THE ABOVE INFORMATION THAT IS IMPORTANT TO ME BY AN INDEPENDENT INVESTIGATION OF MY OWN. I HAVE BEEN ADVISED TO HAVE THE PROPERTY EXAMINED BY PROFESSIONAL INSPECTORS.

3. I ACKNOWLEDGE THAT NEITHER SELLER NOR ANY REALTOR INVOLVED IN THIS TRANSACTION IS AN EXPERT AT DETECTING OR REPAIRING PHYSICAL DEFECTS IN THE PROPERTY. I STATE THAT *NO IMPORTANT REPRESENTATIONS CONCERNING THE CONDITION OF THE PROPERTY ARE BEING RELIED UPON BY ME EXCEPT AS DISCLOSED ABOVE OR AS FULLY SET FORTH AS FOLLOWS:* n51

This court found that no public policy outweighed the contractual disclaimer before it. The court reasoned that competent parties could make contracts on their own terms provided they are neither illegal nor contrary to public policy. In the absence of fraud, mistake or duress, a party who fairly and voluntarily enters into such a contract is bound. n52 Specifically with respect to a broker's liability for negligent misrepresentations, the court stated:

We further conclude that real estate brokers may protect themselves from negligent misrepresentation actions by disclaiming knowledge of the property's defects and having a buyer or seller acknowledge such disclaimer. Such protection is not against public policy and, in fact, helps clarify the law and the role of those involved in real estate matters. n53

In this particular case, the court found that the disclaimer was unambiguous and there was no reason to allow the buyers to present parol evidence.

Some brokers have asserted that merger and disclaimer clauses in the underlying sales contracts preclude the purchaser's assertion of a fraud claim. A disclaimer provision specifically tailored to the sales transaction may preclude a fraud action. n54 One court so holding stated that if the language at issue before it was not sufficient to estop a party from claiming that he entered the contract because of fraudulent representations, then no language can accomplish that purpose. n55 This court stated, "To hold otherwise would be to say that it is impossible for two businessmen dealing at arm's length to agree that the buyer is not buying in reliance on any representations of the seller as to a particular fact." n56

Other courts have refused to follow the reasoning of these courts and have held that a seller is not precluded from asserting a claim for fraudulent misrepresentation by either merger or disclaimer clauses. n57 The reasoning for this holding is that the "perpetrator of fraud cannot close the lips of his innocent victim by getting him blindly to agree in advance not to complain against it." n58 One court has stated that to refuse relief would open the door to a multitude of frauds and would thwart the general policy of law. n59

Some states statutorily prevent a broker from relying on a waiver. For example, *Arizona Revised Statutes Annotated* § 32-2185.06 states in part: "If the transaction involves a lot or parcel offered for present or future residential use, the contract, agreement or lease shall not waive or disclaim liability for prior material representations relied upon by the purchaser made by the seller and such seller's agents concerning the subdivision and lot or parcel involved, and any provision attempting to waive or disclaim liability is void."

A purchaser's reliance upon his or her inspector may also provide a defense for a broker accused of making a misrepresentation. n60 In one case partially involving a claim of fraudulent misrepresentation, the broker and seller argued that since the buyers hired an engineer to inspect the house, one had to conclude that the buyers did not believe the sellers' representations regarding a roof. The court agreed and found that the buyers could not recover on a fraudulent misrepresentation claim. n61 However, a purchaser's reliance upon a home inspector is not absolute protection for a broker accused of fraud and negligence.

Another possible defense arises when the purchase agreement states that the buyer purchases the property in its "as is" physical condition. In this case some courts have held that the seller and the broker have no duty to disclose latent defects. One court held that the "as is" disclaimer bars suit for passive nondisclosure, but does not protect a seller from action alleging positive misrepresentation or concealment. n62 "As is" clauses are discussed in § 3.18, *below*.

The statute of limitations may also provide a defense if the plaintiff is late in asserting a claim. n63 The applicable real estate broker licensing law may contain a statute of limitations provision which controls claims brought under the licensing law. n64

An issue may arise as to when the statute of limitations begins to run when the buyers allege fraud or misrepresentation concerning property defects. The issue often turns on when the buyers discovered or should have discovered the defects. In a case where the buyers asserted that the sellers and the parties' dual agent had failed to disclose defects in the property, the court found that the trial court had erred when it found as a matter of law that the statute of limitations period accrued prior to the closing date. The trial court had granted summary judgment to the seller and the agent. The court stated that whether the buyers knew or should have known of the defects prior to closing was a disputed fact. n65

[8] Recovery of Damages for Misrepresentations

In the typical misrepresentation, the broker repeated statements made by the seller. Sometimes the broker believes the representation to be true, while in other instances the broker either knows or should know that the representation is false. In these situations a jury frequently finds both the seller and the broker liable for the misrepresentation and may apportion the damages between the seller and the broker. n66 A state's comparative negligence act may enter into a purchaser's recovery of damages as shown by *Keller v. Re/Max Centre Realty* n67 where home purchasers who had received a verdict for deceit n68 in their favor, against the seller and the broker, attempted to collect the entire judgment from the broker.

At trial, the jury had apportioned 45% of the damages against the seller and 55% of the damages against the broker. The issue was whether Pennsylvania's Comparative Negligence Act permitted recovery of the entire verdict from the broker. The Act states that if recovery is allowed against more than one defendant, each defendant is liable for that proportion of the total dollar amount awarded as damages in the ratio of the amount of his causal negligence to the amount of causal negligence attributed to all defendants against whom recovery is allowed. However, the plaintiff is allowed to recover the full amount of the allowed recovery from any defendant against whom the defendant is not barred from recovery. But, the Act applies only to damages for negligence resulting in death or injury to person or property. n69

The court found that the purchaser was not entitled to collect the entire amount of the judgment from the broker. The Act by its very terms applies only to actions sounding in negligence and only to negligence resulting in death or injuries to persons or damage to property. The Act did not apply because the alleged negligence was the fraudulent failure to disclose defects in a septic system and the damage occurred prior to the failure to disclose. The purchasers were stayed from executing since the prerequisites for application of the recovery provisions of the Act were not met. n70

The comparative negligence theory can also enter into damage computations and reduce the damages due from a broker. When a party in the transaction or a party affected by the transaction fails to take reasonable steps to protect his or her interest, the damages should be apportioned between the broker and the party. The party should have damages apportioned to him or her to the extent by which the damages were proximately caused by the party's negligence. The amount of such apportionment is a factual issue for the trial court to decide. n71

In considering damages for misrepresentation, courts generally consider the diminution in the property's value as a limiting factor on the damage award. Therefore the buyer generally cannot recover the amount to remedy or restore the defect that was the subject of the misrepresentation if that amount exceeds the diminution in market value. But there may be some flexibility in applying this limitation if the property has intangible value in its original state for reasons of personal taste to the injured party. n72

[9] Duty to Present the Buyer's Offer

Virginia's high court has held that a prospective purchaser does not have a cause of action against a seller's broker for failing to convey the prospective purchaser's offer to the seller. n73

[10] Duty to Inspect

[a] Residential Property in California

Easton v. Strassburger n74 is a seminal case with respect to the duty of a seller's broker to inspect the property and disclose any defects. The court found that, "the duty of a real estate broker, representing the seller, to disclose facts ... includes the affirmative duty to conduct a reasonably competent and diligent inspection of the residential property listed for sale and to disclose to prospective purchasers all facts materially affecting the value or desirability of the property that such an investigation would reveal." n75

In *Easton*, agents of the seller's broker observed conditions indicative of soils problems, but did not obtain a soils report or inform the buyer there were potential soils problems. n76 The purchaser sued after movement of fill soils caused damages. The jury found that the broker and others had been negligent. n77 In finding that the jury's verdict was supported by substantial evidence, the court stated:

Real estate agents hold themselves out to the public as professionals, and, as such, are required to make reasonable use of their superior knowledge, skills and experience within the area of their expertise. Because such agents are expected to make use of their superior knowledge and skills, which is the reason they are engaged, and because the agents in this case were or should have been alert to the signs of soils problems earlier described, the jury was well within the bounds of reason when it concluded that a reasonably diligent and competent inspection of the property would have included something more than a casual visual inspection and a general inquiry of the owners. n78

The California legislature reacted to *Easton* by statutorily defining the duty of care found to exist by the holding of *Easton* and the manner of its discharge. n79 The California legislature made it clear that it was codifying the holding of *Easton* in *California Civil Code § 2079*. n80 *California Civil Code § 2079(a)* states that is a broker's duty to a prospective purchaser of residential real property to conduct a reasonably competent and diligent visual inspection of the property offered for sale and to disclose to the prospective purchaser all facts materially affecting the value or desirability of the property that an investigation would reveal. n81 The duty imposed by § 2079 is a twofold duty of conducting a visual inspection, and of disclosing the facts that such an inspection would reveal. n82

The inspection required by *California Civil Code § 2079* does not include or involve an inspection of areas that are reasonably and normally inaccessible to such an inspection. When the subject property is a condominium, a cooperative, or in a planned development, the inspection required by § 2079 does not include an inspection of more than the unit offered for sale. n83

The standard of care imposed upon licensees is that which "a reasonably prudent real estate licensee would exercise and is measured by the degree of knowledge through education, experience, and examination, required to obtain a license" n84

A buyer is not relieved of the duty to exercise reasonable care to protect himself or herself, including those facts which are known to or within the diligent attention and observation of the buyer. n85

A broker's to inspect pursuant to California law does not extend to non-residential property. n86 The presence of a residence on a property did not impose a duty to inspect the property's commercial groves upon the broker selling the property. n87

California Civil Code § 2079.4 contains a two-year statute of limitations. n88 It has been held that this brief statute of limitations does not apply to actions for intentional fraud. n89 However, this statute of limitations has been held to apply an action for negligent misrepresentation, despite the fact that the law views that tort as "a species of fraud or deceit." n90 Even though a cause of action is labeled as negligent misrepresentation, if it is derived from the statutory duty to inspect and disclose, it is subject to the two-year limitation. n91

The two-year statute of limitations found in *California Civil Code § 2079.4* has been held to be inapplicable to a buyer's agent. An action by a buyer against a broker who exclusively represented the buyer in a real estate purchase transactions was found not to be limited by the two-year time-bar of § 2079.4 which, by its terms, is limited to claims for breaches of duty imposed by *California Civil Code §§ 2079 through 2079.24*. n92 The court found that the duties arising under § 2079 were imposed upon sellers' brokers and cooperating brokers, but these statutory duties were not imposed on buyers' brokers. n93 The court also found that the fiduciary duty of a broker, who contracts to exclusively represent a

purchaser of real property to investigate for its client, is independent of the separate obligation imposed on a seller's broker to conduct a reasonable visual inspection of the marketed property for a buyer's protection, as announced in *Easton v. Strassburger* and incorporated into § 2079. n94

This statutory inspection duty imposed upon a broker interacts with another article to the California Civil Code entitled "Disclosures Upon Transfer of Residential Property." n95 Before executing a sales contract, the seller must deliver a statutory real estate transfer disclosure statement to the buyer, which contains a checklist to give notice of problems or potential problems with the property, and advises that the representations are made by the sellers, not the real estate agents, and that the potential buyers may wish to obtain professional advice or inspections of the property. n96 An agent representing the seller must also complete a portion of the disclosure form. These disclosures must be made in good faith which is defined as meaning "honesty in fact in the conduct of the transaction." n97

A California court has held that *California Civil Code § 2079's* disclosure duty imposed upon real estate licensees does not include a duty to independently verify or disclaim the accuracy of the seller's representations in the disclosure form. n98 This court stated that in enacting § 2079, the legislature sought to foster availability of professional negligence insurance by eliminating the implication in *Easton* that a seller's agent could have negligence liability for relying in good faith on the seller's representations or failing to discharge a vague obligation to obtain professional inspections or reports to confirm those representations. The court stated, "[U]nder the post-Easton statutory scheme, once the sellers and their agent make the required disclosures, it is incumbent upon the potential purchasers to investigate and make an informed decision based thereon. In making the required disclosures, the sellers' agent is required only to act in good faith and not convey the seller's representations without a reasonable basis for believing them to be true." n99

California Civil Code § 2079's inspection and disclosure duties of residential real estate brokers and their agents apply exclusively to prospective buyers. This duty does not extend to other persons who are not parties to the real estate transaction. Consequently, only a transferee, that is, the ultimate purchaser, can recover from a broker or agent for breach of these duties. n100

[b] Duty to Inspect in Other States

In the absence of a confidential relationship or statutory duty, n101 the law generally does not impose brokers and agents representing sellers the duty to conduct a reasonable investigation of the property and to disclose defects to the buyer. n102

With respect to the duty to verify the seller's representations, one court has stated:

Real estate brokers and agents are marketing agents, not structural engineers or contractors. They have no duty to verify independently representations made by a seller unless they are aware of facts that "tend to indicate that such [representations are] false." n103

This statement is equally applicable to a broker's duty to inspect since most brokers are not licensed home inspectors.

If an agent is questioned directly about the condition of a home, and the agent assumes the obligation to inspect the house and to disclose the findings to the buyer; the law imposes on the agent the duty to truthfully disclose all material facts revealed by the inspection. n104

Some courts have found that a showing agent has no duty to inspect, investigate or verify information. n105 However, one court has found that a broker has a fiduciary duty to his or her client to refrain from making representations of facts material to the client's decision to buy the property without advising the client that the broker is merely passing on information received from the seller without verifying its accuracy. n106

FOOTNOTES:

(n1)Footnote 1. *See Aranki v. RKP Investments, Inc.*, 194 Ariz. 206, 208, 979 P.2d 534, 536 (Ariz. Ct. App. 1999) .

(n2)Footnote 2. *See, e.g.*, 225 ILCS 454/15-25(a).

(n3)Footnote 3. *See, e.g.*, 225 ILCS 454/15-25(a) *Tanzillo v. Edwards*, 2007 Ohio 497, 2007 Ohio App. LEXIS 441, at *10 (Feb. 6, 2007) .

(n4)Footnote 4. *See, e.g.*, 225 ILCS 454/15-25(a).

(n5)Footnote 5. *See, e.g.*, 225 ILCS 454/15-25(c).

(n6)Footnote 6. *See C.F.R. Foods, Inc. v. Randolph Development Co.*, 107 N.C. App. 584, 588, 421 S.E.2d 386, 389 (N.C. Ct. App. 1992) , *disc. review denied*, 333 N.C. 166, 424 S.E.2d 906 (N.C. 1992) .

(n7)Footnote 7. *See, e.g.*, *Cooper v. Jevne*, 56 Cal. App. 3d 860, 866, 128 Cal. Rptr. 724, 727 (Cal. Ct. App. 1976) (structural deficiencies in a condominium); *Saporta v. Barbagelata*, 220 Cal. App. 2d 463, 474, 33 Cal. Rptr. 661, 667 (Cal. Ct. App. 1963) (termite and fungus infestation); *Crum v. McCoy*, 41 Ohio Misc. 34, 39-40, 70 Ohio Op. 2d 76, 322 N.E.2d 161, 165 (Ohio Mun. Ct. 1974) (water system problems).

(n8)Footnote 8. *See, e.g.*,

California: Easton v. Strassburger, 152 Cal. App. 3d 90, 99, 199 Cal. Rptr. 383, 387 (Cal. Ct. App. 1984) .

Hawaii: Shaffer v. Earl Thacker Co., Ltd., 6 Haw. App. 188, 193, 716 P.2d 163, 166 (Haw. Ct. App. 1986) .

Minnesota: Berryman v. Riegert, 286 Minn. 270, 275-276, 175 N.W.2d 438, 442 (Minn. 1970) .

New Mexico: Gouveia v. Citicorp Person-to-Person Fin. Ctr., Inc., 101 N.M. 572, 576, 686 P.2d 262, 266 (N.M. Ct. App. 1984) .

North Carolina: Johnson v. Beverly-Hanks & Assoc., Inc., 328 N.C. 202, 210, 400 S.E.2d 38, 43 (N.C. 1991) .

Pennsylvania: Smith v. Renaut, 387 Pa. Super. 299, 305, 564 A.2d 188, 191 (Pa. Super. Ct. 1989) .

Washington: Hoffman v. Connall, 108 Wash. 2d 69, 77-78, 736 P.2d 242, 246 (Wash. 1987) .

Cf. Terway v. Real Estate Agency, 223 Ore. App. 501, 196 P.3d 1022 (2008) (Real estate salesperson who acted for a seller was reprimanded for failing to disclose to the buyers that the property was located in a 100-year flood plain.).

(n9)Footnote 9. *See Hamil v. J.C. Nichols Real Estate*, 22 Kan. App. 2d 809, 814, 923 P.2d 513, (Kan. Ct. App. 1996) .

(n10)Footnote 10. *See Capiccioni v. Brennan Naperville, Inc.*, 339 Ill. App. 3d 927, 941-942, 274 Ill. Dec. 461, 791 N.E.2d 553, 565 (Ill. Ct. App. 2003) , *rehearing denied*, 2003 Ill. App. LEXIS 941 (Ill. App. Ct. July 16, 2003) (misrepresentation regarding the school district in which the property was located).

(n11)Footnote 11. *See, e.g.*, *Harkala v. Wildwood*, 200 Ill. App. 3d 447, 454, 146 Ill. Dec. 232, 558 N.E.2d 195,

200 (Ill. App. Ct. 1990) ; *Hagans v. Woodruff*, 830 S.W.2d 732, 736 (Tex. Ct. App. 1992) .

See also:

Federal: Herbert v. Saffell, 877 F.2d 267, 276 (4th Cir. 1989) (seller's agent owed no duty to buyers under Maryland law to exercise care in investigating the soil conditions and other terrain features that might impede use of a septic system).

Alabama: Naramore v. Duckworth-Morris Realty Co., 669 So. 2d 946, 949 (Ala. Civ. App. 1995) (In the absence of a confidential relationship, the law does not impose upon real estate agents representing sellers the duty to conduct a reasonable investigation of the property and to disclose defects to the buyer.).

Arizona: Aranki v. RKP Invs., Inc., 194 Ariz. 206, 208, 979 P.2d 534, 536 (Ariz. Ct. App. 1999) (duty of fair dealing does not include investigations to discover defects in the sellers' property).

Kansas: Crandall v. Grbic, 36 Kan. App. 2d 179, 190, 138 P.3d 365, 374-75 (2006) .

Maryland: Lewis v. Long & Foster Real Estate, Inc., 85 Md. App. 754, 763, 584 A.2d 1325, 1330 (Md. Ct. Spec. App. 1991) , cert. denied, 323 Md. 34, 591 A.2d 250 (Md. 1991) (A real estate broker has no duty to investigate and report on defects which might exist in property.)

(n12)Footnote 12. Cf. *Vagias v. Woodmont Properties, L.L.C.*, 384 N.J. Super. 129, 136, 894 A.2d 68, 72 (2006) (The broker relied upon a builder's incorrect representation of which school district the home was located in. "Given the importance of location in the purchasing decision, buyers are entitled to expect that the realtors who are assisting them in their housing search will know where the houses are actually located. A realtor's misrepresentation on that critical issue is a serious matter and violates the [Consumer Fraud] Act.").

(n13)Footnote 13. See *Messler v. Phillips*, 867 P.2d 128, 132-133 (Colo. Ct. App. 1993) , rehearing denied; quoting the Restatement (Second) of Torts § 552. See also *Jeffries-Baxter v. Incognito*, 2005 Phila. Ct. Com. Pl. LEXIS 438, at *8 (Sept. 26, 2005) ("Real estate agents are responsible for misrepresentations, both willful and negligent.").

(n14)Footnote 14. See:

Illinois: Capiccioni v. Brennan Naperville, Inc., 339 Ill. App. 3d 927, 938, 274 Ill. Dec. 461, 791 N.E.2d 553, 562, (Ill. Ct. App. 2003) , rehearing denied, 2003 Ill. App. LEXIS 941 (Ill. App. Ct. July 16, 2003) .

Mississippi: Lane v. Oustalet, 850 So. 2d 1143, 1148 (Miss. Ct. App. 2002) , rehearing denied, 2002 Miss. App. LEXIS 657 (Miss. Ct. App., Nov. 5, 2002) , *aff'd in part, rev'd in part*, 873 So. 2d 92 (Miss. 2004) .

New Jersey: Vagias v. Woodmont Properties, L.L.C., 384 N.J. Super. 129, 134, 894 A.2d 68, 71 (2006) (If the agent provided buyers with affirmative misinformation on what the agent knew was a critical issue in their decision to purchase the house, the agent violated the Consumer Fraud Act. The agent's intent was not an issue for purposes of the act.).

(n15)Footnote 15. See *Furla v. Jon Douglas Co.*, 65 Cal. App. 4th 1069, 1078, 76 Cal. Rptr. 2d 911, 915-916 (Cal. Ct. App. 1998) , citing Cal. Civ. Code § 1572, subd. 2.

(n16)Footnote 16. See *Ingaharro v. Blanchette*, 122 N.H. 54, 57, 440 A.2d 445, 447 (N.H. 1982) .

(n17)Footnote 17. See *Furla v. Jon Douglas Co.*, 65 Cal. App. 4th 1069, 1078, 76 Cal. Rptr. 2d 911, 915-916 (Cal. Ct. App. 1998) .

(n18)Footnote 18. See *Snyder v. Lovercheck*, 992 P.2d 1079, 1083 (Wyo. 1999) The sales contract stated: "Purchaser is not relying upon any representations of the Seller or Seller's agents or sub-agents as to any condition which Purchaser deems to be material to Purchaser's decision to purchase this property[.]" The contract also contained an "as is" clause, a merger clause, a liberal inspection clause, and a specific objection procedure.

(n19)Footnote 19. See *Snyder v. Lovercheck*, 992 P.2d 1079, 1087 (Wyo. 1999) . For other courts cited as adopting the first view, see *Isler v. Texas Oil & Gas Corp.*, 749 F.2d 22, 23-24 (10th Cir. 1984) ; *Ford Motor Credit Co. v. Suburban Ford*, 237 Kan. 195, 203-204, 699 P.2d 992, 998-999 (Kan. 1985) , cert. denied, 474 U.S. 995, 106 S. Ct. 409, 88 L. Ed. 2d 360 (1985) ; *Rio Grande Jewelers Supply, Inc. v. Data General Corp.*, 101 N.M. 798, 800, 689 P.2d 1269, 1271 (N.M. 1984) (Uniform Commercial Code case).

(n20)Footnote 20. See *Snyder v. Lovercheck*, 992 P.2d 1079, 1087 (Wyo. 1999) . Courts cited as following the second view include *Formento v. Encanto Business Park*, 154 Ariz. 495, 499-500, 744 P.2d 22, 26-27 (Ariz. Ct. App. 1987) ; *Keller v. A.O. Smith Harvestore Products, Inc.*, 819 P.2d 69, 72-73 (Colo. 1991) ; *Gilliland v. Elmwood Properties*, 301 S.C. 295, 301-302, 391 S.E.2d 577, 580-81 (S.C. 1990) ; and *Stamp v. Honest Abe Log Homes, Inc.*, 804 S.W.2d 455, 457 (Tenn. Ct. App. 1990) .

(n21)Footnote 21. See *Snyder v. Lovercheck*, 992 P.2d 1079, 1089 (Wyo. 1999) .

(n22)Footnote 22. See *Kramer v. Petisi*, 285 Conn. 674, 676, 940 A.2d 800, 802 (2008) .

(n23)Footnote 23. See *Cousineau v. Walker*, 613 P.2d 608, 616 (Alaska 1980) .

(n24)Footnote 24. See *Sorenson v. Adams*, 98 Idaho 708, 571 P.2d 769, 776 (Idaho 1977) , overruled by, *Owen v. Boydston*, 102 Idaho 31, 624 P.2d 413 (Idaho 1981) (on other grounds), quoted in *Cousineau v. Walker*, 613 P.2d 608, 615 n.14 (Alaska 1980) .

(n25)Footnote 25. See *Bevins v. Ballard*, 655 P.2d 757, 762 (Alaska 1982) .

(n26)Footnote 26. See: *Bevins v. Ballard*, 655 P.2d 757, 762 (Alaska 1982) , citing: *Sodal v. French*, 35 Colo. App. 16, 531 P.2d 972, 973 (Colo. App. 1974) , aff'd, 190 Colo. 411, 547 P.2d 923 (Colo. 1976) ; *Spargnapani v. Wright*, 110 A.2d 82, 85 (D.C. Mun. Ct. App. 1954) ; *Pumphrey v. Quillen*, 165 Ohio St. 343, 59 Ohio Op. 460, 135 N.E.2d 328, 331 (Ohio 1956) , aff'd, 165 Ohio St. 343, 59 Ohio Op. 460, 135 N.E.2d 328 (1956) ; *Berryman v. Riegert*, 286 Minn. 270, 275-276, 175 N.W.2d 438, 442 (Minn. 1970) ; *Lawlor v. Scheper*, 232 S.C. 94, 101 S.E.2d 269, 271 (S.C. 1957) ; *Polk Terrace, Inc. v. Harper*, 386 S.W.2d 588, 593 (Tex. App. 1965) , writ of error refused no reversible error, (Apr. 21, 1965), rehearing of writ of error overruled, (May. 19, 1965).

(n27)Footnote 27. See *Bevins v. Ballard*, 655 P.2d 757, 763 (Alaska 1982) .

(n28)Footnote 28. See *Bevins v. Ballard*, 655 P.2d 757, 763 (Alaska 1982) .

(n29)Footnote 29. See *Bevins v. Ballard*, 655 P.2d 757, 763 (Alaska 1982) .

(n30)Footnote 30. See *Bevins v. Ballard*, 655 P.2d 757, 764 (Alaska 1982) (dissent of J. Connor).

(n31)Footnote 31. See *Cousineau v. Walker*, 613 P.2d 608, 616 (Alaska 1980) .

(n32)Footnote 32. See *Amyot v. Luchini*, 932 P.2d 244, 246 (Alaska 1997) .

(n33)Footnote 33. *Alaska Statutes § 34.70.060.*

(n34)Footnote 34. *See Amyot v. Luchini*, 932 P.2d 244, 247 (Alaska 1997) .

(n35)Footnote 35. *See Lightle v. State of Alaska, Real Estate Commission*, 146 P.3d 980 (Alaska 2006) ; *Johnson v. Beverly-Hanks & Assoc.*, 328 N.C. 202, 210, 400 S.E.2d 38, 43 (N.C. 1991) .

In some jurisdictions, a principal involved in the sale of property is liable for a broker's representations whether they were made with or without the principal's knowledge or consent. *See Weems v. Montgomery*, 126 S.W.3d 479, 486 (Mo. Ct. App. 2004) .

(n36)Footnote 36. *See Clouse v. Gordon*, 115 N.C. App. 500, 508, 445 S.E.2d 428, 432-33 (N.C. Ct. App. 1994) .

(n37)Footnote 37. *See, e.g.,*

Illinois: Connick v. Suzuki Motor Co., 174 Ill. 2d 482, 221 Ill. Dec. 389, 675 N.E. 2d 584 (Ill. 1996) , rehearing denied, (Ill. 1997); *Capiccioni v. Brennan Naperville, Inc.*, 339 Ill. App. 3d 927, 933, 274 Ill. Dec. 461, 791 N.E.2d 553, 558 (Ill. Ct. App. 2003) , rehearing denied, 2003 Ill. App. LEXIS 941 (Ill. App. Ct. July 16, 2003) .

Nebraska: Gibb v. Citicorp Mortgage, Inc., 246 Neb. 355, 360, 518 N.W.2d 910, 916 (Neb. 1994) .

(n38)Footnote 38. *See Gibb v. Citicorp Mortgage, Inc.*, 246 Neb. 355, 371, 518 N.W.2d 910, 921 (Neb. 1994) .

(n39)Footnote 39. *See Capiccioni v. Brennan Naperville, Inc.*, 339 Ill. App. 3d 927, 933, 274 Ill. Dec. 461, 791 N.E.2d 553, 558 (Ill. Ct. App. 2003) , rehearing denied, 2003 Ill. App. LEXIS 941 (Ill. App. Ct. July 16, 2003) .

(n40)Footnote 40. *See Gaulden v. Mitchell*, 849 So. 2d 192, 197 (Ala. Civ. App. 2002) .

(n41)Footnote 41. *See Manderville v. PCG&S Group, Inc.*, 146 Cal. App. 4th 1486, 1489, 55 Cal. Rptr. 3d 59, 61 (2007) , review denied, 2007 Cal. LEXIS 3614 (Apr. 11, 2007) .

(n42)Footnote 42. The MLS listing on the subject property stated that the property could be subdivided.

(n43)Footnote 43. *See Manderville v. PCG&S Group, Inc.*, 146 Cal. App. 4th 1486, 1502, 55 Cal. Rptr. 3d 59, 72 (2007) , review denied, 2007 Cal. LEXIS 3614 (Apr. 11, 2007) .

(n44)Footnote 44. *See Gibb v. Citicorp Mortgage, Inc.*, 246 Neb. 355, 361, 518 N.W.2d 910, 916 (Neb. 1994) .

(n45)Footnote 45. *See Loya v. Howard Hanna Smyth, Cramer Co.*, 2009 Ohio 448, 2009 Ohio App. LEXIS 497, at *6-*8 (Feb. 4, 2009) .

(n46)Footnote 46. *Cf.*

Indiana: Bischoff Realty, Inc. v. Ledford, 562 N.E.2d 1321, 1324 (Ind. Ct. App. 1990) (To have the force and effect of a fraudulent misrepresentation, a representation must be unqualified.)

(n47)Footnote 47. *See Long v. Bruns*, 727 So. 2d 664, 669 (La. App. 1999) , appeal denied, 742 So. 2d. 881 (1999) ; *Richards v. ABN AMRO Mortgage Group, Inc.*, 261 S.W.3d 603, 611 (Mo. Ct. App. 2008) , transfer denied, 2008 Mo. LEXIS 186 (Sept. 30, 2008) . *See also Sierra Assoc. Group, Inc. v. Hardeman*, 2009 Tex. App. LEXIS 1181, at *19 (Tex. App. Feb. 20, 2009) (a party cannot succeed on a fraud claim when he acted in reliance on his judgment derived from an

independent investigation or the advice of his agents).

Cf. Hanlon v. Thornton, 218 Ga. App. 500, 502, 462 S.E.2d 154, 156-157 (Ga. App. 1995), *cert. denied*, 1996 Ga. LEXIS 211 (Ga. Jan. 5, 1996) (broker was not liable for fraudulent representation and concealment, where the buyer could easily have discovered the defects and the problems complained of upon an exercise of due diligence).

(n48)Footnote 48. See *Terway v. Real Estate Agency*, 223 Ore. App. 501, 196 P.3d 1022 (2008).

(n49)Footnote 49.

Alabama: Commercial Credit Corp. v. Lisenby, 579 So. 2d 1291, 1294 (Ala. 1991), *rehearing denied*, 1991 Ala. LEXIS 570 (Ala. Apr. 11, 1991) (seller and agent did not owe buyers any duty to disclose a latent defect of which they were unaware, knowledge of previous problems and repair of earlier difficulties does not impute or constitute knowledge of present problems).

Texas: Sutton v. Ebby Halliday Real Estate, Inc., 279 S.W.3d 418 (Tex. App. 2009).

(n50)Footnote 50. See *Bevins v. Ballard*, 655 P.2d 757, 763 (Alaska 1982).

(n51)Footnote 51. *Hamtil v. J.C. Nichols Real Estate*, 22 Kan. App. 2d 809, 923 P.2d 513, 515 (Kan. Ct. App. 1996).

(n52)Footnote 52. 22 Kan. App. 2d 809, 923 P.2d 513, 517 (1994).

(n53)Footnote 53. 22 Kan. App. 2d 809, 923 P.2d 513, 517 (1994).

(n54)Footnote 54. See *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 184 N.Y.S.2d 599, 157 N.E.2d 597, 600 (N.Y. 1959). See also *LaFazia v. Howe*, 575 A.2d 182, 186 (R.I. 1990) (court applied reasoning of *Danann Realty Corp.* to a disclaimer specifically denying reliance upon the seller's representations as to the profitability of the business being sold).

(n55)Footnote 55. See *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 184 N.Y.S.2d 599, 157 N.E.2d 597, 600 (N.Y. 1959). The provision at issue is shown at 157 N.E.2d 598.

(n56)Footnote 56. *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 184 N.Y.S.2d 599, 157 N.E.2d 597, 600 (N.Y. 1959).

(n57)Footnote 57. See *Snyder v. Lovercheck*, 992 P.2d 1079, 1086 (Wyo. 1999).

See also

Schmiedebusch v. Rako Realty, Inc., 2005 Ohio 4884 (Sept. 16, 2005) (The doctrine of merger merges prior agreements and representations made by parties into the deed. Since the seller's agent was not a party to the agreement that led to the execution of the deed or a party to the deed itself, the doctrine of merger did not bar the buyer's claim of negligent misrepresentation against the seller's agent.).

(n58)Footnote 58. *Baylies v. Vanden Boom*, 40 Wyo. 411, 278 P. 551, 556 (1929) (quoting *Arnold v. National Aniline & Chem. Co.*, 20 F.2d 364 (2d Cir. 1927)).

(n59)Footnote 59. See *Bates v. Southgate*, 308 Mass. 170, 31 N.E.2d 551, 558 (1941).

(n60)Footnote 60. See *Crandall v. Grbic*, 36 Kan. App. 2d 179, 192-93, 138 P.3d 365, 376-77 (2006) ; *Eiland v. Coldwell Banker Hunter Realty*, 122 Ohio App. 3d 446, 702 N.E.2d 116, 123-124 (Ohio App. 1997) .

(n61)Footnote 61. See *Alfa Realty, Inc. v. Ball*, 733 So. 2d 423, 425 (Ala. Civ. App. 1998) , rehearing denied, 1999 Ala. Civ. App. LEXIS 147 (Ala. Civ. App. Mar. 5, 1999) , dismissed, 776 So. 2d 218 (Ala. Civ. App. 1999) .

(n62)Footnote 62. See *Eiland v. Coldwell Banker Hunter Realty*, 122 Ohio App. 3d 446, 702 N.E.2d 116, 123 (Ohio App. 1997) .

(n63)Footnote 63. See *Loewe v. Commons at Willowbrook, Inc.*, 2008 Tex. App. LEXIS 9294, at *10-*16 (Tex. App. Dec. 11, 2008) (fraud claims and Texas Real Estate License Act were filed after expiration of the applicable statutes of limitations).

(n64)Footnote 64. Cf., e.g., *Tex. Occ. Code Ann. § 1101.605* (A claim brought under the Texas Real Estate License Act is subject to a two-year statute of limitations.).

(n65)Footnote 65. See *Fletcher v. Lyles*, 999 So. 2d 1271, 1277 (Miss. 2009) .

(n66)Footnote 66. See *Sanchez v. Braun & May Realty, Inc.*, 795 So. 2d 1006, 1007 (Fla. Dist. Ct. App. 2001) (damages apportioned between the sellers, agent, broker, and purchaser).

(n67)Footnote 67. 719 A.2d 369 (Pa. Super. 1998) .

(n68)Footnote 68. The deceit involved fraudulent concealment of a malfunctioning septic system. 719 A.2d 369, 370 (Pa. Super. 1998) .

(n69)Footnote 69. 42 Pa. Cons. Stat. § 7102(b).

(n70)Footnote 70. 719 A.2d 369, 372 (Pa. Super. 1998) .

(n71)Footnote 71. See *Norman I. Krug Real Estate Investments, Inc. v. Praszker*, 220 Cal. App. 3d 35, 44-45, 269 Cal. Rptr. 228, 232 (Cal. Ct. App. 1990) , rehearing denied, 220 Cal. App. 3d 1226A, 1990 Cal. App. LEXIS 605 (Cal. Ct. App. 1990) .

(n72)Footnote 72. See *Bartholet v. Carolyn Riley Realty, Inc.*, 131 Ohio App. 3d 23, 721 N.E.2d 474, 477 (Ohio App. 1998) .

(n73)Footnote 73. See *Allen v. Lindstrom*, 237 Va. 489, 498, 379 S.E.2d 450, 456 (Va. 1989) , cert. denied, 493 U.S. 849, 110 S. Ct. 145, 107 L. Ed. 2d 104 (1989) .

(n74)Footnote 74. 152 Cal. App. 3d 90, 199 Cal. Rptr. 383, 46 A.L.R.4th 521 (1984) .

(n75)Footnote 75. See *Easton v. Strassburger*, 152 Cal. App. 3d 90, 102, 199 Cal. Rptr. 383, 390 (Cal. Ct. App. 1984) .

(n76)Footnote 76. See *Easton v. Strassburger*, 152 Cal. App. 3d 90, 96, 199 Cal. Rptr. 383, 385-386 (Cal. Ct. App. 1984) .

(n77)Footnote 77. See *Easton v. Strassburger*, 152 Cal. App. 3d 90, 97, 199 Cal. Rptr. 383, 385 (Cal. Ct. App. 1984) .

(n78)Footnote 78. *Easton v. Strassburger*, 152 Cal. App. 3d 90, 104-105, 199 Cal. Rptr. 383, 392 (Cal. Ct. App. 1984) .

(n79)Footnote 79. See *California Civil Code* §§ 2079 to 2079.6.

(n80)Footnote 80. See *Williams v. Wells & Bennett Realtors*, 52 Cal. App. 4th 857, 862, 61 Cal. Rptr. 2d 34, 37 (Cal. Ct. App. 1997) .

(n81)Footnote 81. See *Furla v. Jon Douglas Co.*, 65 Cal. App. 4th 1069, 1078, 76 Cal. Rptr. 2d 911, 915-916 (Cal. Ct. App. 1998) .

(n82)Footnote 82. See *Loken v. Century 21-Award Properties*, 36 Cal. App. 4th 263, 271, 42 Cal. Rptr. 2d 683, 688 (Cal. Ct. App. 1995) , review denied, 1995 Cal. LEXIS 5944 (Cal. Sept. 21, 1995) , cert. denied, 516 U.S. 1113, 116 S. Ct. 912, 133 L. Ed. 2d 843 (1996) .

(n83)Footnote 83. See *Pagano v. Krohn*, 60 Cal. App. 4th 1, 9-10, 70 Cal. Rptr. 2d 1, 5 (Cal. Ct. App. 1997) ; Cal. Civ. Code § 2079.3.

(n84)Footnote 84. Cal. Civ. Code § 2079.2.

(n85)Footnote 85. Cal. Civ. Code § 2079.5.

(n86)Footnote 86. See *Smith v. Rickard*, 205 Cal. App. 3d 1354, 1360, 254 Cal. Rptr. 633, 636 (Cal. Ct. App. 1988) (avocado orchard).

(n87)Footnote 87. See *Smith v. Rickard*, 205 Cal. App. 3d 1354, 1363, 254 Cal. Rptr. 633, 638 (Cal. Ct. App. 1988) review denied (avocado orchard).

(n88)Footnote 88. This provision states in part: "[i]n no event shall the time for commencement of legal action for breach of duty imposed by [section 2079 et seq.] exceed two years from the date of possession, which means the date of recordation, the date of close of escrow, or the date of occupancy, whichever occurs first."

(n89)Footnote 89. See *Williams v. Wells & Bennett Realtors*, 52 Cal. App. 4th 857, 861-862, 61 Cal. Rptr. 2d 34, 36 (Cal. Ct. App. 1997) .

(n90)Footnote 90. *Loken v. Century 21- Award Properties*, 36 Cal. App. 4th 263, 272, 42 Cal. Rptr. 2d 683, 688-689 (Cal. Ct. App. 1995) , depublication denied, 1995 Cal. LEXIS 5944 (Cal. Sept. 21, 1995) , cert. denied, 516 U.S. 1113, 116 S. Ct. 912, 133 L. Ed. 2d 843 (1996) .

(n91)Footnote 91. See *Williams v. Wells & Bennett Realtors*, 52 Cal. App. 4th 857, 865, 61 Cal. Rptr. 2d 34, 38 (Cal. Ct. App. 1997) .

(n92)Footnote 92. See *Field v. Century 21 Klowden-Forness Realty*, 63 Cal. App. 4th 18, 20-21, 73 Cal. Rptr. 2d 784, 786 (Cal. Ct. App. 1998) , cert. denied, 1998 Cal. LEXIS 4685 (Cal. July 15, 1998) .

(n93)Footnote 93. See *Field v. Century 21 Klowden-Forness Realty*, 63 Cal. App. 4th 18, 27, 73 Cal. Rptr. 2d 784, 790 (Cal. Ct. App. 1998) , cert. denied, 1998 Cal. LEXIS 4685 (Cal. July 15, 1998) .

(n94)Footnote 94. See *Field v. Century 21 Klowden-Forness Realty*, 63 Cal. App. 4th 18, 27, 73 Cal. Rptr. 2d 784, 790 (Cal. Ct. App. 1998) , cert. denied, 1998 Cal. LEXIS 4685 (Cal. July 15, 1998) .

(n95)Footnote 95. See Cal. Civ. Code § 1102, et seq.

(n96)Footnote 96. See Cal. Civ. Code §§ 1102.3, 1102.6.

(n97)Footnote 97. See Cal. Civ. Code § 1102.7.

(n98)Footnote 98. See *Robinson v. Grossman*, 57 Cal. App. 4th 634, 643-644, 67 Cal. Rptr. 2d 380, 385 (Cal. Ct. App. 1997) .

(n99)Footnote 99. See *Robinson v. Grossman*, 57 Cal. App. 4th 634, 644, 67 Cal. Rptr. 2d 380, 385-386 (Cal. Ct. App. 1997) .

(n100)Footnote 100. See *Coldwell Banker Residential Brokerage Co. v. Superior Court*, 117 Cal. App. 4th 158, 165, 11 Cal. Rptr. 3d 564, 569-570 (2004) , review denied, 2004 Cal. LEXIS 9462 (Cal. Sept. 29, 2004) .

(n101)Footnote 101. Cf. Wis. Adm. Code RL 24.07 (A listing agent, prior to execution of the listing contract, shall conduct a reasonably competent and diligent inspection of accessible areas of the structure and immediately surrounding areas of the property to detect observable, material adverse facts).

(n102)Footnote 102. See

Alabama: Blackmon v. First Real Estate Corp., 529 So. 2d 955, 956 (Ala. 1988) (no confidential relationship); *Naramore v. Duckworth-Morris Realty Company, Inc.*, 669 So. 2d 946, 949 (Ala. Civ. App. 1995) (no confidential relationship).

South Carolina: Chastain v. Hiltabidle, 381 S.C. 508, 519-520, 673 S.E.2d 826, 832 (S.C. Ct. App. 2009) . *reh'g denied*, 2009 S.C. App. LEXIS 462 (Mar. 24, 2009) In a case involving a dual agent, the court stated that a real estate licensee does not have a duty to inspect or investigate the physical condition of a piece of property for the purpose of confirming or denying statements made by a seller in a disclosure statement. The legislature placed the duty of performing such an inspection or investigation on the buyer.

Texas: Steptoe v. True, 38 S.W.3d 213, 219 (Tex. App. 2001) (a licensee has no duty to inspect, even if such inspection would have uncovered facts that would materially affect the property's value); *Hagans v. Woodruff*, 830 S.W.2d 732, 736 (Tex. App. 1992) (broker has no legal duty to inspect listed property and disclose all facts which might materially affect its value or desirability).

West Virginia: Teter v. Old Colony Co., 190 W. Va. 711, 719, 441 S.E.2d 728, 736 (W. Va. 1994) .

See also *Lopata v. Miller*, 122 Md. App. 76, 91-92, 712 A.2d 24, 31 (Md. Ct. Spec. App. 1998) , *cert. denied*, 351 Md. 286, 718 A.2d 234 (1998) (agents did not owe the homeowners a duty to verify the lot size information and as there was no duty established, the agents could not have been negligent).

(n103)Footnote 103. *Provost v. Miller*, 144 Vt. 67, 69-70, 473 A.2d 1162, 1164 (Vt. 1984) , citing *Lyons v. Christ Episcopal Church*, 71 Ill. App. 3d 257, 27 Ill. Dec. 559, 389 N.E.2d 623 (Ill. App. Ct. 1979) .

(n104)Footnote 104. See *Hope v. Brannan*, 557 So. 2d 1208, 1211 (Ala. 1989) , *rehearing denied*, 1990 Ala. LEXIS 58 (Ala. Jan. 26, 1990) ; *Fennell Realty Co. v. Martin*, 529 So. 2d 1003, 1005 (Ala. 1988) ; *Naramore v. Duckworth-Morris Realty Company, Inc.*, 669 So. 2d 946, 949 (Ala. Civ. App. 1995) .

(n105)Footnote 105. See *Baker v. Surman*, 361 N.W.2d 108, 111 (Minn. Ct. App. 1985) (directed verdict for showing agent who relied upon listing information, only visited property once and informed buyers of his source of information); *Krout v. Woods*, 2 Pa. D. & C.4th 349, 358 (Pa. Common Pleas Court 1989) ; *Provost v. Miller*, 144 Vt. 67, 473 A.2d 1162 (Vt. 1984) (no duty to verify absent awareness of falsity).

(n106)Footnote 106. See *Salahutdin v. Valley of California, Inc.*, 24 Cal. App. 4th 555, 562, 29 Cal. Rptr. 2d 463,

466 (Cal. Ct. App. 1994) , review denied sub nomine, *Salahutdin v. Alcantara*, 1994 Cal. LEXIS 4560 (Cal. Aug. 18, 1994) (buyer's broker was liable for damages resulting from a failure to tell the buyer he had not verified the accuracy of the acreage and boundary information obtained from the seller, although the broker knew this information was material to the buyer's decision to purchase). See also *Wilson v. Hisey*, 147 Cal. App. 2d 433, 439, 305 P.2d 686, 690 (Cal. Ct. App. 1957) (substantial evidence supported trial court's finding that buyer's brokers were negligent in failing to ascertain truth of seller's statements pertaining to title and encumbrances).

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41 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART III. Duties Owed to Buyers

10-3 Real Estate Brokerage Law and Practice § 3.17

§ 3.17 Duties of a Buyer's Broker to Provide the Buyer with a Seller Disclosure Statement

The advent of statutorily mandated seller disclosure statements for residential real estate has raised the issue of what duty a buyer's broker has to insure that his or her client receives this statement. Typically, the disclosure statement acts impose the duty to provide the statement upon the seller or the seller's agent.

At least one court had held that a buyer's agent had a duty to inform the agent's clients of the seller's responsibility to provide them (i.e., the buyers) with a disclosure statement. The applicable disclosure law specifically placed the duty to provide the disclosure statement upon the seller. n1 In coming to this conclusion, this court stated:

Not unlike the requirement of other professionals to inform their clients, real estate agents are expected to advise their principals on the rules and procedures involved in a real estate transaction. Why have realty agents for buyers, if agents, supposedly knowledgeable in real estate transactions, have no obligation to tell clients that sellers are required by law to give a disclosure statement? Such disclosure is legally mandated for the protection of buyers. It can reveal matters that may materially influence a decision whether to purchase a home. n2

The buyer's agent therefore had a duty to inform the buyers that the seller was legally required to provide a disclosure statement.

FOOTNOTES:

(n1)Footnote 1. The statute at issue was *S.D. Codified Laws § 43-4-38* which states: "The seller of residential real property shall furnish to a buyer a completed copy of the disclosure statement before the buyer makes a written offer. If after delivering the disclosure statement to the buyer or the buyer's agent and prior to the date of closing for the property or the date of possession of the property, whichever comes first, the seller becomes aware of any change of material fact which would affect the disclosure statement, the seller shall furnish a written amendment disclosing the change of material fact."

(n2)Footnote 2. *Saiz v. Horn*, 668 N.W.2d 332, 336, 2003 SD 94 (S.D. 2003) .

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42 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART III. Duties Owed to Buyers

10-3 Real Estate Brokerage Law and Practice § 3.18

§ 3.18 "As Is" Clauses in Sales Contracts

Astute buyers view "as is" clauses as a signal that there may be a material defect or defects in the property. Despite the implications of an "as is" clause, such a clause does not shield a seller or the seller's agent from liability for affirmative misrepresentations. n1 Some courts also find that an "as is" clause will not shield a broker from claims based on negligence and misrepresentation when a real estate sales agent has made affirmative representations about an aspect of the property. n2 However some courts hold that an "as is" clause protects a seller from claims of negligent nondisclosure. n3

One court in considering a claim for negligent nondisclosure in a case involving an "as is" sales contract, observed that even though the position that such a clause protects a seller from negligent nondisclosure claims has been referred to as a minority one, n4 an examination of the cases cited in support of this assertion did not directly address the issue in regard to negligent nondisclosure. This court asserted that these cases supported the assertion that an "as is" clause bars a claim for a seller's negligent nondisclosure. The court stated that cases that were supposedly contrary to the minority position disclosed that each involved fraud or misrepresentation, not negligent nondisclosure. n5 In adopting the "minority position" in a case involving a well containing sediment, Wisconsin's high court found that the burden of discovering defects in the property was placed upon the buyers as the contract stated that the "Purchaser accepts the property in its entirety in 'as is, where is' condition without any implied or express warranty by Seller or Agent." The contract also provided for inspections by experts hired by the buyers and the buyers failed to take advantage of this right. The buyers also failed to look at the water system, ask about the condition of the well, or even turn on a faucet. The buyers were provided an opportunity to obtain information on the house; and in their rush to purchase, they failed to do so. Since the burden of discovery was placed on the buyers under the contract, they were barred from seeking relief based on negligent nondisclosure. n6

A Florida court had found that an "as is" clause should not protect a seller if applicable law requires that a seller disclose to a buyer all known facts that materially and adversely affect the value of the property being sold and that are not readily observable. An "as is" clause in a contract for the sale of residential real property does not waive this duty. n7 Nor will an "as is" clause insulate a broker from liability to the buyer for negligence since the effect of the disclaimer in this context is a question of fact subject to the jury's determination of what was reasonable under the circumstances. n8

While an "as is" clause is not a complete bar to fraud and misrepresentation claims, such a clause effectively puts the burden upon a buyer to determine the condition of the property purchased. This shifting of the burden, by itself, protects a seller and the seller's broker from claims premised upon nondisclosure. n9

In Alabama, the rule of *caveat emptor* has been abrogated with respect to new real estate, but applies to the sale of used real estate. n10 Consequently, in Alabama, in a sale of used real estate, a seller or a seller's agent generally has no duty to disclose property defects to the purchaser. It has been held that a fraud claim is precluded in Alabama by sales contract language indicating that the purchase is "as is." The rationale is that an "as is" sales contract bars a purchaser's fraud claims because the "as is" clause negates the element of reliance essential to any claim of fraud or fraudulent suppression. In Alabama, this rule applies to a claim of intentional fraud as well as to claims of fraud committed by mistake. n11

An "as is" clause can operate as an absolute defense to the claim of mutual mistake should the seller and seller's broker be sued by the buyer. Pursuant to such a clause, the risk of loss is borne by the buyers. If the "as is" clause is to have meaning, it must be interpreted to refer to those defects that were unknown at the time that the contract was executed. An "as is" clause serves to allocate the risk of loss for such unknown defects to the buyer. n12

FOOTNOTES:

(n1)Footnote 1. *See, e.g.,*

California: Wilson v. Century 21 Great Western Realty, 15 Cal. App. 4th 298, 304, 18 Cal. Rptr. 2d 779, 782 (Cal. Ct. App. 1993) , review denied, 1993 Cal. LEXIS 3894 (Cal. July 22, 1993) .

Kansas: Brennan v. Kunzle, 37 Kan. App. 2d 365, 391, 154 P.3d 1094, 1111 (2007) , review denied, 2007 Kan. LEXIS 629 (Oct. 1, 2007) .

Nebraska: Gibb v. Citicorp Mortgage, Inc., 246 Neb. 355, 365, 518 N.W.2d 910, 918 (Neb. 1994) .

Nevada: Mackintosh v. Jack Matthews & Co., 109 Nev. 628, 855 P.2d 549, 552-53 (Nev. 1993) .

West Virginia: Logue v. Flanagan, 213 W. Va. 552, 556-557, 584 S.E.2d 186, 190-191 (W.Va. 2003) .

Cf. Van Camp v. Bradford, 623 N.E.2d 731 (Ohio Ct. App. 1993) ("as is" disclaimer clauses bar suit for passive nondisclosure, but will not protect a defendant from positive misrepresentation or concealment).

See generally Dallon, *Theories of Real Estate Broker Liability and the Effect of the "As Is" Clause*, 54 Fla. L. Rev. 395, 396 (2002); Wozniak, Annot., *Construction and Effect of Provision in Contract for Sale of Realty by Which Purchaser Agrees to Take Property "As Is" or in its Existing Condition*, 8 A.L.R.5th 312 (1992) .

But cf. Moore v. Prudential Residential Services Limited Partnership, 849 So. 2d 914, 924 (Ala. 2002) , rehearing denied, 2002 Ala. LEXIS 379 (Ala. Nov. 15, 2002) ("Where a purchaser's direct inquiry would otherwise impose a duty of truthful disclosure, this Court has held that a purchaser's fraud claim is precluded by language in a sales contract stating that the purchase is 'as is.' ").

(n2)Footnote 2. *See Grube v. Daun*, 173 Wis. 2d 30, 45, 496 N.W.2d 106, 111 (Wis. Ct. App. 1992) , review denied. *See also Carter v. Bernard*, 2006 Ohio 7058, 2006 Ohio App. LEXIS 6986, at *24 (Dec. 28, 2006) ("[A]lthough a realtor

may only be liable to the buyer for fraud in an 'as is' contract, the realtor can be liable to his own principal for negligence if completion of a duty could have avoided the principal's liability for fraud."), *discretionary appeal not allowed*, 2007 Ohio 2208, 2007 Ohio LEXIS 1184 (May 16, 2007) .

(n3)Footnote 3. *See*

Ohio: Van Camp v. Bradford, 623 N.E.2d 731 (Ohio Ct. App. 1993) ("as is" disclaimer clauses bar suit for passive nondisclosure, but will not protect a defendant from positive misrepresentation or concealment); *Kaye v. Buehrle*, 8 Ohio App. 3d 381, 457 N.E.2d 373, 375-76 (Ohio Ct. App. 1983) (an "as is" contract, coupled with a right to inspect clause, placed the risk of a leaky basement on the buyer).

Wisconsin: Richey v. Patrick, 904 P.2d 798, 804 (Wyo. 1995) , *rehearing denied* 904 P.2d 798 (Wyo. 1995) (absent an allegation of fraud, an "as is" clause bars a claim for nondisclosure).

(n4)Footnote 4. *Richey v. Patrick*, 904 P.2d 798, 803 (Wyo. 1995) , *rehearing denied* 904 P.2d 798 (Wyo. 1995) , citing Wozniak, Annot., *Construction and Effect of Provision in Contract for Sale of Realty by Which Purchaser Agrees to Take Property "as is" or in its Existing Condition*, 8 A.L.R. 5th 312, § 4 (1992).

(n5)Footnote 5. *See*

Richey v. Patrick, 904 P.2d 798, 803 (Wyo. 1995) , *rehearing denied* 904 P.2d 798 (Wyo. 1995) , citing *Gopher Oil Co., Inc. v. Union Oil Co.*, 955 F.2d 519 (8th Cir. 1992) (fraud); *V.S.H. Realty, Inc. v. Texaco, Inc.*, 757 F.2d 411 (1st Cir. 1985) ; *Wilson v. Century 21 Great Western Realty*, 15 Cal. App. 4th 298, 18 Cal. Rptr. 2d 779 (Cal. Ct. App. 1993) , *review denied* 1993 Cal. LEXIS 3894 (Cal. July 22, 1993) (fraud); *Rayner v. Wise Realty Co.*, 504 So. 2d 1361 (Fla. Dist. Ct. App. 1987) (misrepresentation and fraudulent nondisclosure); *Ferguson v. Cussins*, 713 S.W.2d 5 (Ky. Ct. App. 1986) (fraudulent inducement); *Sheehy v. Lipton Industries, Inc.*, 24 Mass. App. Ct. 188, 507 N.E.2d 781 (Mass. App. Ct. 1987) , *review denied*, 400 Mass. 1103, 509 N.E.2d 1202 (Mass. 1987) (misrepresentations); *Wagner v. Cutler*, 232 Mont. 332, 757 P.2d 779 (Mont. 1988) (misrepresentations); *Holmes v. Couturier*, 452 N.W.2d 135 (S.D. 1990) (fraud in the inception); *Stemple v. Dobson*, 184 W. Va. 317, 400 S.E.2d 561 (W.Va. 1990) (fraud).

(n6)Footnote 6. *See Richey v. Patrick*, 904 P.2d 798, 804 (Wyo. 1995) , *rehearing denied* 904 P.2d 798 (Wyo. 1995) .

(n7)Footnote 7. *See Syvrud v. Today Real Estate, Inc.*, 858 So. 2d 1125, 1129 (Fla. Dist. Ct. App. 2003) .

(n8)Footnote 8. *See Syvrud v. Today Real Estate, Inc.*, 858 So. 2d 1125, 1130 (Fla. Dist. Ct. App. 2003) .

(n9)Footnote 9. *See, e.g., Grube v. Daun*, 173 Wis. 2d 30, 61, 496 N.W.2d 106, 117 (Wis. Ct. App. 1992) , *review denied*.

(n10)Footnote 10. *See Moore v. Prudential Residential Services Limited Partnership*, 849 So. 2d 914, 923 (Ala. 2002) , *reh'g denied*, 2002 Ala. LEXIS 379 (Nov. 15, 2002) ; *ERA Class.com, Inc. v. Stoddard*, 2007 Ala. Civ. App. LEXIS 641, at *7-*8 (Oct. 5, 2007) .

(n11)Footnote 11. *See ERA Class.com, Inc. v. Stoddard*, 2007 Ala. Civ. App. LEXIS 641, at *18 (Oct. 5, 2007) (purchaser bought property believing it was zoned for commercial use when the property was zoned only for residential use).

(n12)Footnote 12. *See Maloney v. Sargisson*, 18 Mass. App. 341, 465 N.E.2d 296, 299-300 (Mass. App. Ct. 1984) ; *Lenawee County Board of Health v. Messerly*, 417 Mich. 17, 31-32, 331 N.W.2d 203, 210 (Mich. 1982) ; *Atkins v. Kirkpatrick*, 823 S.W.2d 547, 553-554 (Tenn. Ct. App. 1991) .

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43 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART III. Duties Owed to Buyers

10-3 Real Estate Brokerage Law and Practice § 3.19

§ 3.19 Duties Unique to Common Interest Properties

One issue that can arise when the subject property is located in a common interest community is whether the licensee has a duty to disclose any pending litigation regarding construction defects in the units or common property.

A California court has found that a broker and agent were not liable for failing to disclose such litigation with respect to a planned unit development. The court held that the trial court properly granted summary judgment for the broker and agent since there was no extended inspection duty under *California Civil Code § 2079.3*. The court also rejected imposing liability on the broker and agent on nonstatutory grounds such as negligence and breach of fiduciary duty. n1 The court stated that the agent could not disclose what he did not know, nor was the agent on notice of facts putting him under a duty to inquire about the homeowners association's knowledge of pending litigation, in order to verify what the sellers disclosed or did not disclose. The court also stated that the agent should not be deemed to have such a duty as a matter of law simply because this property was located in a planned unit development. n2

California Civil Code § 2079 codifies the duties of a real estate broker or salesperson to inspect property offered for sale and disclose material facts about the property to a prospective buyer. Specifically, a real estate broker or salesperson involved in a purchase/sale transaction has a duty "to conduct a reasonably competent and diligent visual inspection of the property offered for sale and to disclose to that prospective purchaser all facts materially affecting the value or desirability of the property that an investigation would reveal... ." n3 However, this section states that if the property being sold is a condominium, a cooperative, or in a planned development, the inspection to be performed under section 2079 "does not include an inspection of more than the unit offered for sale, if the seller or broker complies with the provisions of Section 1368." n4 *California Civil Code § 1368* requires that a prospective buyer be provided certain documents such as a copy of the governing laws of the development and various documents relating to assessments. When buyers have been apprised of the essential facts concerning a defect in the condominium project, the broker should have no liability to the buyer for not investigating such defects or any lawsuits against the developer pertaining to the lawsuit. n5

FOOTNOTES:

(n1)Footnote 1. See *Padgett v. Phariss*, 54 Cal. App. 4th 1270, 1282-1286, 63 Cal. Rptr. 2d 373, 379-381 (Cal. Ct. App. 1997) , review denied, 1997 Cal. LEXIS 4493 (Cal. July 16, 1997) .

(n2)Footnote 2. *See Padgett v. Phariss*, 54 Cal. App. 4th 1270, 1286, 63 Cal. Rptr. 2d 373, 381 (Cal. Ct. App. 1997) , *review denied*, 1997 Cal. LEXIS 4493 (Cal. July 16, 1997) .

(n3)Footnote 3. *Cal. Civ. Code* § 2079(a).

(n4)Footnote 4. *Cal. Civ. Code* § 2079.3.

(n5)Footnote 5. *See Padgett v. Phariss*, 54 Cal. App. 4th 1270, 1286, 63 Cal. Rptr. 2d 373, 381 (Cal. Ct. App. 1997) , *review denied*, 1997 Cal. LEXIS 4493 (Cal. July 16, 1997) .

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44 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART IV. Duties Arising Under Brokerage Relationship Acts

10-3 Real Estate Brokerage Law and Practice § 3.20

§ 3.20 Single-Party and Single Agent Brokers

Oklahoma has statutorily eliminated the concept of agents and has replaced this designation with the single-party broker. n1 Pursuant to *Oklahoma Statutes title 59, § 858-351(3)*, a single-party broker is defined as a broker who has entered into a written brokerage agreement with a party in a transaction to provide services for the benefit of that party. A broker must enter into a written brokerage agreement prior to providing services as a single-party broker. n2 The single-party broker has the same duties and responsibilities as the transaction broker (*see § 3.22, below* for a discussion of transaction brokers) plus the following duties and responsibilities:

- (1) performing all brokerage activities for the benefit of the party for whom the single-party broker is performing services unless prohibited by law.
- (2) obeying the specific directions of the party for whom the single-party broker is performing services that are not contrary to applicable statutes and rules or contrary to the terms of a contract between the parties to the transaction. n3

Though other jurisdictions do not use the term single-party broker, many embody a similar concept in their brokerage relationship act. For example, pursuant to *Colorado Revised Statutes § 12-61-802(4)*, a single agent is defined as a broker who is engaged by and represents only one party in a real estate transaction. A single agent includes the following:

- A buyer's agent which is a broker who is engaged by and represents the buyer in a real estate transaction.
- A landlord's agent which is a broker who is engaged by and represents the landlord in a leasing transaction.
- A seller's agent which is a broker who is engaged by and represents the seller in a real estate transaction.

- A tenant's agent which means a broker who is engaged by and represents the tenant in a leasing transaction.

Florida law allows a single agent relationship where the licensee's duties owed to the buyer or seller engaging the licensee include the following:

- Dealing honestly and fairly.
- Loyalty.
- Confidentiality.
- Obedience.
- Full disclosure.
- Accounting for all funds.
- Skill, care, and diligence in the transaction.
- Presenting all offers and counteroffers in a timely manner, unless a party has previously directed the licensee otherwise in writing.
- Disclosing all known facts that materially affect the value of residential real property and are not readily observable. n4

Florida single agents must make a full written disclosure to the buyer or seller prior to entering into a listing agreement or an agreement for representation or before the showing of property, whichever occurs first. When incorporated into other documents, the required notice must be of the same size type, or larger, as other provisions of the document and must be conspicuous in its placement so as to advise customers of the duties of a single agent. n5

Pursuant to *Florida Statutes § 475.278(3)(c)(1)*, Florida single agents must provide the following disclosure form to their clients:

SINGLE AGENT NOTICE

IMPORTANT NOTICE

FLORIDA LAW REQUIRES THAT REAL ESTATE LICENSEES PROVIDE THIS NOTICE TO POTENTIAL SELLERS AND BUYERS OF REAL ESTATE.

You should not assume that any real estate broker or sales associate represents you unless you agree to engage a real estate licensee in an authorized brokerage relationship, either as a single agent or as a transaction broker. You are advised not to disclose any information you want to be held in confidence until you make a decision on representation.

SINGLE AGENT RELATIONSHIP

FLORIDA LAW REQUIRES THAT REAL ESTATE LICENSEES OPERATING AS SINGLE AGENTS DISCLOSE TO BUYERS AND SELLERS THEIR DUTIES.

As a single agent, _____ [*name of Real Estate Entity and its Associates*] owe to you the following duties:

- (1) Dealing honestly and fairly;
- (2) Loyalty;
- (3) Confidentiality;
- (4) Obedience;
- (5) Full disclosure;
- (6) Accounting for all funds;
- (7) Skill, care, and diligence in the transaction;
- (8) Presenting all offers and counteroffers in a timely manner, unless a party has previously directed the licensee otherwise in writing; and
- (9) Disclosing all known facts that materially affect the value of residential real property and are not readily observable.

_____ [Date]

_____ [Signature]

Additional disclosure obligations are imposed upon single agents who are changing the relationship to that of a transaction broker relationship. The licensee must obtain the principal's written consent to the change in relationship. n6

Readers are advised to consult the applicable statutes and regulations to determine the duties and obligations of a licensee who represents only one party in the transaction.

FOOTNOTES:

(n1)Footnote 1. Pursuant to *Okla. Stat. tit. 59, § 858-361*, a broker is permitted to use the word "agent" in a trade name.

(n2)Footnote 2. *See Okla. Stat. tit. 59, § 858-354(A)*.

(n3)Footnote 3. *See Okla. Stat. tit. § 858-354(B)*. *Huffman v. Cohen*, 2009 U.S. Dist. LEXIS 51912 (N.D. Okla. June 19, 2009) , applying Oklahoma law.

(n4)Footnote 4. *See Fla. Stat. § 475.278(3)(a)*.

(n5)Footnote 5. *See Fla. Stat. § 475.278(3)(b)(1)*. The first sentence of the required disclosure must be printed in uppercase and bold type.

(n6)Footnote 6. *See Fla. Stat. § 475.278(3)(b)(2)* and *Fla. Stat. § 475.278(3)(c)(2)*.

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45 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART IV. Duties Arising Under Brokerage Relationship Acts

10-3 Real Estate Brokerage Law and Practice § 3.21

§ 3.21 Dual Agency

[1] Dual Agency Is Problematic

As a general rule, dual agency is contrary to public policy and the contract is voidable upon the application of either party. n1 Under the common law of agency, a broker's acting as a dual agent without the consent of all parties warranted forfeiture of the commission. n2 While this result was harsh it was justified on the ground that if damages were measured solely by the loss to the principal, often there would be little disincentive to the agent for assuming undisclosed conflicting responsibilities. If the commission itself was subject to forfeiture, however, agents will be disinclined to "blithely" assume conflicting responsibilities without disclosure to and the consent of both principals. n3 The exception to this rule occurred when all parties knew of the dual agency. n4

Dual agency is problematic because a dual agent attempts to serve parties with conflicting interests. n5 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. n6 That is why the law requires that dual agents obtain the informed consent of all parties. n7

One problem inherent in dual agency is that brokers must exercise reasonable due care and diligence to effect a sale to the principal's best advantage. n8 This goal is problematic in many respects, but perhaps is most noticeable with respect to the selling price of the property. The seller seeks the highest sales price possible, while the buyer seeks the lowest sales price possible. Therefore, a sale to the seller's best advantage is not a sale to the buyer's best advantage and *vice versa*. n9

[2] Common Law and Dual Agency

It is a generally accepted rule that a broker may not represent adverse parties in the same transaction, absent the consent of all parties. n10 It has been held that the contract between the principals, brought about by a broker who was not authorized to represent both parties, is voidable. n11 The principle underlying these rules was stated with great force as follows:

The interests of the buyer and the seller are naturally antagonistic to each other. The broker, in

undertaking to arrange terms between them, if he favors the buyer, is necessarily disregarding the interest of the seller, and, if he favors the seller, is necessarily disregarding the interest of the buyer. A circus rider may ride two horses at once around the ring, if they are going in the same direction, but he would meet with disaster if the horses were going in different directions. In Holy Writ it is said: "Ye cannot serve God and mammon." ... A broker representing both sides to a real estate transaction may properly introduce the buyer to the seller and arrange for each to examine the respective properties in case of exchange, but there is little else that he may do without becoming disloyal to one or the other of the contracting parties. It is only where full disclosure of the dual agency is made by the broker to the parties and a full understanding of his activities and their legitimate limits that he may be permitted to represent both sides and exact a commission from each of the contracting parties. n12

While dual agency is not proscribed, a broker who undertakes to represent both parties is held to a high standard of care. A Missouri court has stated as follows:

A broker so unwise as to place himself in the anomalous position of representing adverse parties must scrupulously observe and fulfill his duties to both. And, among other duties which a broker owes to his principal is that of keeping his customer fully informed of all facts pertinent to the transaction. n13

It has been held that the defense of caveat emptor does not apply when a real estate agent acting as a dual agent fails to disclose to his or her clients facts known to the agent that are material to the transaction. In this particular case the dual agent failed to disclose to the buyer nonconfidential information known to the seller. n14

Unless there are unusual circumstances, dual agency should be an unsatisfactory choice for the buyer or seller since a dual agent cannot fully represent either party. For example, a dual agent cannot by law give the buyer the same degree of loyalty as an agent who acts on behalf of the buyer. Dual agency inherently invites a conflict of interest. n15

[3] Statutory Authorization of Dual Agency

It appears that most brokerage relationship acts statutorily authorize dual agency. n16 These acts define the parameters of this relationship and the duties that arise from it. Typically under such acts, a dual agency arises when:

- (1) an individual licensee represents both the seller and the buyer in the same transaction; or
- (2) a licensee associated with a broker acts as an agent for the seller and another licensee associated with the same broker acts as an agent for the buyer. n17

This latter arrangement is referred to as a designated agency. n18

Though dual agency is legal when the relationship is established properly, the inherent common law problem of one party being able to service two principals continues. The Oklahoma Supreme Court has stated:

Sellers' agents and dual agents do not and cannot by law give a buyer the same degree of loyalty as an agent who acts on behalf of a buyer. Sellers' agents owe their allegiance to the seller. Dual agency invites a conflict of interest. A buyer who relies on the seller's agent or on dual agency does not receive the same degree of legal protection as that afforded by an agent acting solely on behalf of the buyer. n19

Even if a brokerage relationship act does not specifically authorize dual agency, a licensee can function as a dual agent under common law if this fact is fully disclosed to and consented to by all principals.

[4] Duties of a Dual Agent

A dual agent has a duty first and foremost to disclose his or her intent to act as a dual agent and to obtain the consent of all principals. Without this full disclosure and the consent of all principals, the licensee will be in breach of his or her duties to the principals or clients.

A principal's consent to use a dual agent should be a meaningful consent, which has been given before the agent started acting on behalf of another party with an adverse interest. The licensee should call attention to the fact that he or she is seeking to act as a dual agent and should not assume that the principal has read a disclosure statement advising the principal of this fact. n20

Assuming that all principals are fully informed of the dual agency situation and have consented to it, the broker owes all principals certain duties. While the applicable statute is the authority on the parameters of a dual agency and statutes vary in the duties imposed, the following duties are frequently imposed:

1. A dual agent must treat all clients (i.e., the seller and the buyer) honestly. n21
2. A dual agent must provide information about the property to the buyer or tenant. n22
3. The dual agent must disclose all latent material defects in the property that are known to the agent. n23
4. The dual agent must disclose the financial qualification of the buyer or tenant to the seller or landlord. n24
5. The dual agent must explain real estate terms. n25
6. The dual agent must help the buyer or tenant arrange for property inspections. n26
7. The dual agent must explain closing costs and procedures. n27
8. The dual agent must help the buyer compare financing alternatives. n28
9. The dual agent must provide information about comparable properties that have sold so both clients may make educated decisions on what price to accept or offer. n29

Dual agents are typically prohibited from doing any of the following:

- (1) The dual agent may not disclose confidential information that licensee may know about a client, without that client's permission. n30
- (2) The dual agent may not disclose the price the seller or landlord will take other than the listing price without permission of the seller or landlord. n31
- (3) The dual agent may not disclose the price the buyer or tenant is willing to pay without permission of the buyer or tenant. n32
- (4) The dual agent may not recommend or suggest a price the buyer or tenant should offer. n33
- (5) The dual agent may not recommend or suggest a price the seller or landlord should counter with or accept. n34
- (6) The dual agent may not reveal a confidential negotiating strategy not disclosed in an offer as terms of

a sale. n35

(7) The dual agent may not disclose the seller's motivation for selling property or the buyer's motivation for buying property. n36

Generally, a dual agent has fiduciary duties to both the buyer and seller. n37 Whether a fiduciary duty has been breached depends on the facts and circumstances of each case. n38

Dual agents should avoid treating their principals differently. In one case involving a dual agent, the agent reported an unfavorable termite inspection to the seller, but not the buyers. This failure to disclose all facts to all parties constituted a breach of the agent's fiduciary duties. n39

Under Colorado statutory and regulatory law, in order for a real estate broker to represent both the seller and buyer in a transaction, there must be a written agency agreement signed by both the seller and buyer. n40 Without such a written agreement, the agent is considered only the agent of the seller and there is no fiduciary duty owed to the buyer. However, Colorado real estate brokers have been held accountable for failure to deal fairly and honestly with a purchaser while serving as the seller's agent. n41

[5] Remedies for Failure to Disclose Dual Agency

The remedy for failing to disclose a dual agency will depend upon whether common law applies or whether an applicable brokerage relationship act provides a statutory remedy. In *Huijers v. DeMarrais*, n42 the court considered the remedy or a licensee's failure to disclose to the seller that she was a dual agent. The statutorily mandated agency disclosure statement was required to be given to the sellers prior to signing the listing agreement. Instead, the sellers learned of their agent's status when they signed a purchase contract. Prior to settlement, the sellers rescinded the contract. In considering the remedy for the agent's untimely delivery of the agency disclosure statement, the court stated that *California Civil Code § 2374* provided no remedy for a licensee's failure to comply. The court stated, "A statute without a remedy might as well be written in invisible ink." n43 The court concluded that the common law provided a remedy for a failure to comply with § 2374.

In considering the agency disclosure statement required by *California Civil Code § 2374*, the court stated that the purpose of the requirement of providing a disclosure prior to signing the listing agreement was to allow the seller to make a more intelligent decision about whether to sign the listing agreement. n44 The court stated that this protection that the Legislature intended to provide to the seller cannot be achieved if the listing agent fails to provide the disclosure form prior to entering into the listing agreement. Since the statute's reasonable objective is to give the seller information prior to signing the listing agreement, providing a disclosure form after the seller signs the agreement is not substantial compliance. n45

In addressing the remedy for the licensee's failure to timely provide the agency disclosure statement, the court relied upon *California Civil Code § 2382* which states: "Nothing in this article shall be construed to either diminish the duty of disclosure owed buyers and sellers by agents and their associate licensees, subagents, and employees or to relieve agents and their associate licensees, subagents, and employees from liability for their conduct in connection with acts governed by this article or for any breach of a fiduciary duty or a duty of disclosure." The court found that while the legislative scheme added statutory duties to the common law duties of disclosure, it also left the common law remedies for failure to disclose intact.

At common law the remedy for a real estate agent's breach of a duty to disclose a dual agency was that the principal was not liable to pay the agent's commission, and the principal may avoid the transaction. n46 The court rejected an argument that the legislature intended the remedy for violation of the statute to be confined to discipline by the Commissioner of Real Estate. The court found that while the agent's failure to disclose the dual agency prior to entering

into the listing agreement relieved the seller from having to pay the commission, it did not necessarily relieve them from their obligation under the sales contract since the disclosure statement was given to the sellers before they signed the purchase contract. The case was remanded for a determination of whether the particular facts of this case would allow the sellers to rescind the purchase contract. This court warned, however, that it was not holding that the failure to provide a disclosure form will always result in a voidable listing agreement. If a seller had sufficient knowledge concerning the information contained in the disclosure form, the seller could be held to the listing agreement even though he or she did not receive the agency disclosure form. n47

[6] Representation of Competing Buyers by Agents Associated with the Same Broker

The use of a buyer's agent is a relatively recent phenomena n48 and few courts have considered whether there is a conflict and a resulting breach of the licensees' duty when buyers' agents associated with the same broker, represent separate buyers seeking to purchase the same property. The New York high court has addressed this issue. In doing so, this court considered the agency disclosure form mandated by *New York Real Property Law § 443*, and found that this disclosure requirement was enacted to eliminate confusion as to whether a broker was acting in the interest of a seller, a buyer, or both. This disclosure requirement was not enacted to disclose whether a brokerage firm might represent multiple buyers or sellers with competing interests. The disclosure form states that the fiduciary duty is owed by an individual licensee and not the firm. The court stated that two buyer's agents affiliated with the same real estate brokerage firm and acting on behalf of different buyers bidding on the same property generally do not present risks comparable to that presented when one agent represents multiple clients bidding on the same property. There is no incentive for these agents to represent their clients less than zealously, consistent with their fiduciary duties under Real Property Law § 443(4)(a) and common law particularly since they only earn commissions for sales to their own clients. In this situation the agents, though associated with the same brokerage firm, have every reason to negotiate in their clients' best interest. n49

New York's high court noted that would-be buyers know that they are competing with other potential buyers, including those represented by other agents affiliated with the firm that they have retained. Unless a broker and principal specifically agree otherwise, a brokerage firm is not obligated to insure that its affiliated licensees forego making offers on behalf of other buyers for property on which the principal has already bid. Disclosure and consent are not prerequisites to a competing offer in this circumstance. An individual agent, however, may not represent multiple buyers bidding on the same property without making disclosures and obtaining consents. n50

FOOTNOTES:

(n1)Footnote 1. *See Snider v. Oklahoma ex rel. Oklahoma Real Estate Commission*, 1999 OK 55, 987 P.2d 1204, 1208 (Okla. 1999) .

(n2)Footnote 2. *See Anderson v. Anderson*, 293 Minn. 209, 216, 197 N.W.2d 720, 724 (Minn. 1972) ; *Allied Sec., Inc. v. Clocker*, 185 Neb. 524, 527, 176 N.W.2d 914, 917 (Neb. 1970) ; *Cogan v. Kidder, Mathews & Senger, Inc.*, 97 Wn.2d 658, 668, 648 P.2d 875, 880 (Wash. 1982) .

(n3)Footnote 3. *Cogan v. Kidder, Mathews & Segner, Inc.*, 97 Wash. 2d 658, 668, 648 P.2d 875, 880 (Wash. 1982)

(n4)Footnote 4. *See, e.g.,*

Alabama: Fisher v. Comer Plantation, Inc., 772 So. 2d 455, 465 (Ala. 2000) .

Oklahoma: Snider v. Oklahoma ex rel. Oklahoma Real Estate Commission, 1999 OK 55, 987 P.2d 1204, 1208 (Okla. 1999) .

See generally J. Clark Pendergrass, *The Real Estate Consumer's Agency and Disclosure Act: The Case*

Against Dual Agency, 48 Ala. L. Rev. 277, 287-90 (1996) (discussing dual agency under Alabama common law).

(n5)Footnote 5. See *L. Byron Culver & Associates v. Jaoudi Industrial Corp.*, 1 Cal. App. 4th 300, 305, 1 Cal. Rptr. 2d 680, 682-683 (Cal. Ct. App. 1991), review denied, 1992 Cal. LEXIS 1054 (Cal. Mar. 11, 1992); *Snider v. Oklahoma ex rel. Oklahoma Real Estate Commission*, 1999 OK 55, 987 P.2d 1204, 1208 (Okla. 1999).

(n6)Footnote 6. *Brown v. FSR Brokerage, Inc.*, 62 Cal. App. 4th 766, 768-769, 72 Cal. Rptr. 2d 828 (Cal. Ct. App. 1998), review denied, Supreme Court Minute 07-08-1998 (Cal. July 8, 1998).

(n7)Footnote 7. See *Snider v. Oklahoma ex rel. Oklahoma Real Estate Commission*, 1999 OK 55, 987 P.2d 1204, 1208 (Okla. 1999).

(n8)Footnote 8. See *Coleman v. Watts*, 87 F. Supp. 2d 944, 954 (D. Ariz. 1998), applying Arizona law.

(n9)Footnote 9. Cf. *Coleman v. Watts*, 87 F. Supp. 2d 944, 954 (D. Ariz. 1998), applying Arizona law. The inference to be drawn from the broker's dual representation, the conflicting interests of the buyers and sellers, and the broker's failure to negotiate the price on behalf of the buyer, is that the broker negligently misrepresented the buyers by failing to effect the sale to the buyer's best advantage.

(n10)Footnote 10. For a discussion of the types of conduct constituting double-hiring on the part of the purchaser, see *Simon v. Allied Chem. Corp.*, 35 A.D.2d 273, 315 N.Y.S.2d 919, 1970 N.Y. App. Div. LEXIS 3405 (1970), *aff'd*, 29 N.Y.2d 861, 278 N.E.2d 340 (1971).

(n11)Footnote 11. *Brockman v. Delta Mfg. Co.*, 184 Okla. 357, 87 P.2d 968, 969 (Okla. 1939).

(n12)Footnote 12. *Nahn-Heberer Realty Co. v. Schrader*, 89 S.W.2d 142, 144-145 (Mo. Ct. App. 1936).

(n13)Footnote 13. *Martin v. Hieken*, 340 S.W.2d 161, 165 (Mo. Ct. App. 1960).

(n14)Footnote 14. See *Allison v. Cook*, 139 Ohio App. 3d 473, 744 N.E.2d 254, 265 (2000).

(n15)Footnote 15. See *Snider v. State of Oklahoma Real Estate Commission*, 1999 Okla. 55, 987 P.2d 1204, 1209 (1999).

(n16)Footnote 16. Colorado, Florida and Kansas have outlawed dual agency. Instead, a licensee can represent both parties only as a transaction broker. See:

Colorado: Olsen v. Vail Real Estate Associates, Inc., 935 P.2d 975, 980 (Colo. 1997). *Colo. Rev. Stat. § 12-61-806(1)* ("A broker shall not establish dual agency with any seller, landlord, buyer, or tenant.").

Florida: Fla. Stat. § 475.278 (1)(A) ("A real estate licensee may not operate as a disclosed or nondisclosed dual agent.") and *(2)(A)* ("A transaction broker provides a limited form of representation to a buyer, a seller, or both in a real estate transaction but does not represent either in a fiduciary capacity or as a single agent.").

Kansas: Kan. Stat. Ann. § 58-30, 103(a) ("A licensee shall not act as a dual agent or in a dual capacity of agent and undisclosed principal in any transaction.").

(n17)Footnote 17. For one example of such a statutory definition see N. M. Stat. Ann. § 16.61.19.11.

(n18)Footnote 18. *See, e.g., Va. Code Ann. § 54.1-2130.*

(n19)Footnote 19. *Snider v. Oklahoma ex rel. Oklahoma Real Estate Commission*, 1999 OK 55, 987 P.2d 1204, 1209-1210 (Okla. 1999) .

(n20)Footnote 20. *See Brown v. FSR Brokerage, Inc.*, 62 Cal. App. 4th 766, 777-778, 72 Cal. Rptr. 2d 828, 834 (Cal. Ct. App. 1998) , *review denied*, Supreme Court Minute 07-08-1998 (Cal. July 8, 1998).

(n21)Footnote 21. *See, e.g.,*

California: Cal. Civ. Code § 2079.16.

Illinois: 225 ILCS 454/15-45(a).

(n22)Footnote 22. *See, e.g.,*

Illinois: 225 ILCS 454/15-45(a).

(n23)Footnote 23. *See, e.g.,*

Illinois: 225 ILCS 454/15-45(a).

(n24)Footnote 24. *See, e.g.,*

Illinois: 225 ILCS 454/15-45(a).

(n25)Footnote 25. *See, e.g.,*

Illinois: 225 ILCS 454/15-45(a).

(n26)Footnote 26. *See, e.g.,*

Illinois: 225 ILCS 454/15-45(a).

(n27)Footnote 27. *See, e.g.,*

Illinois: 225 ILCS 454/15-45(a).

(n28)Footnote 28. *See, e.g.,*

Illinois: 225 ILCS 454/15-45(a).

(n29)Footnote 29. *See, e.g.,*

Illinois: 225 ILCS 454/15-45(a).

(n30)Footnote 30. *See, e.g.,*

Illinois: 225 ILCS 454/15-45(a).

(n31)Footnote 31. *See, e.g.,*

California: Cal. Civ. Code §§ 2079.16 and 2079.21.

Illinois: 225 ILCS 454/15-45(a).

South Carolina: S.C. Code § 40-57-137(M)(2)(a).

(n32)Footnote 32. *See, e.g.,*

California: Cal. Civ. Code § 2079.16.

Illinois: 225 ILCS 454/15-45(a).

South Carolina:

S.C. Code § 40-57-137(M)(2)(b).

(n33)Footnote 33. *See, e.g.,*

Illinois: 225 ILCS 454/15-45(a).

(n34)Footnote 34. *See, e.g.,*

Illinois: 225 ILCS 454/15-45(a).

(n35)Footnote 35. *See:*

South Carolina: S.C. Code § 40-57-137(M)(1)(b)(iii).

(n36)Footnote 36. *See:*

South Carolina: S.C. Code § 40-57-137(M)(1)(b)(iv).

(n37)Footnote 37. *See Assilzadeh v. California Federal Bank, FSB, 82 Cal. App. 4th 399, 414, 98 Cal. Rptr. 2d 176, 185 (Cal. Ct. App. 2000) , review withdrawn, Supreme Court Minute 10-25-2000, 2000 Cal. LEXIS 8285 (Cal. Oct. 25, 2000) . Cf. Varnado v. Alfonso Realty, Inc., 16 So. 3d 746, 750 (Miss. Ct. App. 2009) (dual agent must serve both*

masters' interests fully).

(n38)Footnote 38. See *Assilzadeh v. California Federal Bank, FSB*, 82 Cal. App. 4th 399, 414, 98 Cal. Rptr. 2d 176, 185 (Cal. Ct. App. 2000) , review withdrawn, *Supreme Court Minute 10-25-2000*, 2000 Cal. LEXIS 8285 (Cal. Oct. 25, 2000) ; *Waddles v. Lacour*, 950 So. 2d 937, 942 (La. Ct. App. 2007) , rehearing denied, 2007 La. App. LEXIS 538 (Mar. 21, 2007) and 2007 La. App. LEXIS 540 (Mar. 21, 2007) writ denied, 959 So. 2d 496 (La. 2007) and 959 So. 2d 498 (La. 2007) .

(n39)Footnote 39. See *Lane v. Oustalet*, 850 So. 2d 1143, 1153-1155 (Miss. Ct. App. June 4, 2002) , *aff'd in part, rev'd in part*, 873 So. 2d 92 (Miss. 2004) . See also *Waddles v. Lacour*, 950 So. 2d 937, 941-42 (La. Ct. App. 2007) , rehearing denied, 2007 La. App. LEXIS 538 (Mar. 21, 2007) and 2007 La. App. LEXIS 540 (Mar. 21, 2007) writ denied, 959 So. 2d 496 (La. 2007) and 959 So. 2d 498 (La. 2007) (dual agents gave preference to sellers by failing to disclose to buyers that the house was built around a mobile home).

(n40)Footnote 40. See *Messler v. Phillips*, 867 P.2d 128, 132 (Colo. Ct. App. 1993) , rehearing denied.

(n41)Footnote 41. See *Messler v. Phillips*, 867 P.2d 128, 132 (Colo. Ct. App. 1993) , rehearing denied.

(n42)Footnote 42. 11 Cal. App. 4th 676, 14 Cal. Rptr. 2d 232 (Cal. Ct. App. 1992) , review denied (1993).

(n43)Footnote 43. *Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 678-679, 14 Cal. Rptr. 2d 232, 234 (Cal. Ct. App. 1992) , review denied (1993).

(n44)Footnote 44. *Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 684-685, 14 Cal. Rptr. 2d 232, 238 (Cal. Ct. App. 1992) , review denied (1993).

(n45)Footnote 45. *Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 685, 14 Cal. Rptr. 2d 232, 238 (Cal. Ct. App. 1992) , review denied (1993).

(n46)Footnote 46. *Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 685-686, 14 Cal. Rptr. 2d 232, 238 (Cal. Ct. App. 1992) , review denied (1993).

(n47)Footnote 47. *Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 686, 14 Cal. Rptr. 2d 232, 239 (Cal. Ct. App. 1992) , review denied (1993).

(n48)Footnote 48. See *Rivkin v. Century 21 Teran Realty, LLC*, 494 F.3d 99, 103 (2007) (This is a recent phenomena in New York. The defendant in this case advertised in 2001 that it was the first firm in Ulster County to work as a buyer's agent.); *Rivkin v. Century 21 Teran Realty LLC*, 10 N.Y.3d 344, 352-53, 858 N.Y.S.2d 55, 887 N.E.2d 1113, 1118 (2008) , quoting Ronald Benton Brown, Joseph M. Grohman and Manuel R. Valcarcel, *Real Estate Brokerage: Recent Changes in Relationships and a Proposed Cure*, 29 *Creighton L Rev.* 25, 42 (1995) ("The trend of representing buyers began primarily on the west coast in the mid-1980's when states enacted the first agency disclosure laws making the practice viable").

(n49)Footnote 49. See *Rivkin v. Century 21 Teran Realty LLC*, 10 N.Y.3d 344, 356, 858 N.Y.S.2d 55, 887 N.E.2d 1113, 1120 (2008) .

(n50)Footnote 50. See *Rivkin v. Century 21 Teran Realty LLC*, 10 N.Y.3d 344, 356-57, 858 N.Y.S.2d 55, 887 N.E.2d 1113, 1120-21 (2008) .

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46 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART IV. Duties Arising Under Brokerage Relationship Acts

10-3 Real Estate Brokerage Law and Practice § 3.22

§ 3.22 Transactional Brokers and Facilitators

[1] Transaction Brokers Are Not Agents of Either Party

Many states recognize a brokerage nonagency relationship. Various terms are used to refer to this type of relationship including transaction broker, n1 facilitator, intermediary n1.1 and a nonagent brokerage. n1.2 Though statutory definitions vary, a transaction broker essentially helps the buyer and the seller with the paperwork and formalities of the real estate transaction. A transaction broker is not an agent of either party. n2 Consequently, transaction brokers have been referred to as "a non-agent real estate broker." n3 A transaction broker provides limited representation to a buyer, a seller or both, in a real estate transaction, but does not represent either in a fiduciary capacity or as a single agent. n4 The concept of a transaction broker is a significant departure from the traditional common law view of agency relationships in real estate transactions. n5

In some states, the parties' relationship is presumed to be that of a transaction broker unless stated otherwise. n6 In some jurisdictions, the absence of a written agreement with the licensee results in their relationship being that of a transaction brokerage. n7

Instead of acting as an agent, a transaction broker assists one or more parties throughout a contemplated real estate transaction with communication, interposition, advisement, negotiation, contract terms, and the closing of such real estate transaction without being an agent or advocate for the interests of any party to the transaction. n8 Florida statutorily provides that transaction brokers provide a limited form of nonfiduciary representation to a buyer, seller, or both in a real estate transaction. n9

While a transaction broker agreement is not a traditional form of brokerage contract, a transaction broker's obligations are not merely gratuitous. n10 Since a buyer or seller contracts with a transaction broker to perform certain services and obligations and the transaction broker is entitled to a commission pursuant to the parties' agreement for performing such services, the buyer or client is entitled to expect that a transaction broker will perform his or her obligations.

The effect of allowing the transaction broker relationship is that this form of brokerage has been replacing disclosed dual agency and has also reduced the number of subagencies. n11

[2] Duties of a Transaction Broker

The duties of a transaction-broker are usually dictated by statute. n12 For example, Colorado statutorily states that a transaction-broker must perform the terms of any written or oral agreement made with any party to the transaction and exercise reasonable skill and care in:

- (1) Presenting all offers and counteroffers in a timely manner regardless of whether the property is subject to a contract for sale or lease or letter of intent;
- (2) Advising the parties regarding the transaction and suggesting that such parties obtain expert advice as to material matters about which the transaction-broker knows but the specifics of which are beyond the expertise of such broker;
- (3) Accounting in a timely manner for all money and property received;
- (4) Keeping the parties fully informed regarding the transaction;
- (5) Assisting the parties in complying with the terms and conditions of any contract including closing the transaction;
- (6) Disclosing to all prospective buyers or tenants any adverse material facts actually known by the broker including but not limited to adverse material facts pertaining to the title, the physical condition of the property, any defects in the property, and any environmental hazards affecting the property required by law to be disclosed; n13
- (7) Disclosing to any prospective seller or landlord all adverse material facts actually known by the broker including but not limited to adverse material facts pertaining to the buyer's or tenant's financial ability to perform the terms of the transaction and the buyer's intent to occupy the property as a principal residence; and
- (8) Informing the parties that as seller and buyer or as landlord and tenant they shall not be vicariously liable for any acts of the transaction-broker. n14

Colorado also statutorily provides that a transaction broker may not disclose the following information without the informed consent of all parties:

- (1) That a buyer or tenant is willing to pay more than the purchase price or lease rate offered for the property;
- (2) That a seller or landlord is willing to accept less than the asking price or lease rate for the property;
- (3) What the motivating factors are for any party buying, selling, or leasing the property;
- (4) That a seller, buyer, landlord, or tenant will agree to financing terms other than those offered;
- (5) Any facts or suspicions regarding circumstances which may psychologically impact or stigmatize any real property pursuant to *Colorado Revised Statutes § 38-35.5-101*; or
- (6) Any material information about the other party unless disclosure is required by law or failure to disclose such information would constitute fraud or dishonest dealing. n15

A transaction-broker in Colorado has no duty to conduct an independent inspection of the property for the benefit of the buyer or tenant and has no duty to independently verify the accuracy or completeness of statements made by the seller, landlord, or independent inspectors. n16

A Colorado transaction-broker may do the following without breaching any obligation or responsibility:

- Show alternative properties not owned by the seller or landlord to a prospective buyer or tenant.
- List competing properties for sale or lease.
- Show properties in which the buyer or tenant is interested to other prospective buyers or tenants.
- Serve as a single agent or transaction-broker for the same or for different parties in other real estate transactions. n17

Pursuant to Colorado statutory law, there is no imputation of knowledge or information between any party and the transaction-broker or among persons within an entity engaged as a transaction-broker. n18 A Colorado transaction-broker may cooperate with other brokers, but shall not engage or create any subagents. n19

Significantly, although Colorado statutorily prescribes these duties, the statute fails to prescribe any remedy for nonperformance of these obligations. n20 Colorado is not the only jurisdiction to omit a statutory remedy for failure to comply with a brokerage relations act. One court in addressing this issue concluded that common law provided a remedy for the statutory noncompliance. n21

There is limited case law on the duties attendant to this type of brokerage relationship. One court has found that a transaction broker is not required to inform a buyer or seller of changing market conditions that would affect the value of the property. n22

n23Typically, a transaction broker must supply the seller or buyer with some type of form or publication that explains this type of relationship. Maine Real Estate Commission Advisory Ruling No. 1-95 (August 10, 1995) provides a good synopsis of the duties typically imposed upon a transaction broker (or agent). This Ruling provides that transaction brokers have a duty to:

- Provide a specific disclosure form to prospective buyers or sellers.
- Account for monies.
- Act honestly and competently.
- Furnish copies of offers and contracts to all parties at the time of their signatures.
- Obtain and provide information necessary to make property disclosures.
- Keep the terms of an offer, counter offer or contract confidential during the pendency of the transaction.
- Make no substantial misrepresentation by omission or commission.
- Avoid error, exaggeration or concealment of pertinent information.

- Keep the designated broker fully informed of all activities conducted on behalf of the agency.
- Comply with Federal, state or local laws, rules, regulations, ordinances related to real estate brokerage, including fair housing and civil rights laws or regulations.

This Ruling specifically states that transaction brokers may not:

- Promote the interests of one party to the transaction over the interests of the other party.
- Disclose the willingness or ability of the seller to accept less than the asking price, without the seller's express permission.
- Disclose the willingness or ability of the buyer to pay more than what has been offered, without the buyer's express permission.
- Disclose negotiating strategy not disclosed in the sales offer as terms of the sale, without the express permission of the party making the offer.
- Disclose the motivation of the seller for selling and the motivation of the buyer for buying, without the express permission of the seller or buyer.

[3] Transaction Brokers Are Liable Only for Damages Their Conduct Causes

Traditionally, a remedy frequently applied when a broker violated his or her duty of loyalty to the principal was forfeiture of his or her commission. Since a transaction broker is not an agent of either party, there is no duty of loyalty owed to any party. The traditional remedy of forfeiture of commission appears not to apply to a transaction broker even if the transaction broker fails to perform certain statutory duties. n24 Instead it would appear that a party harmed by the failure of a transaction broker to perform statutorily mandated duties would be entitled to damages caused by such nonperformance. n25

[4] Statutory Duty to Provide a Disclosure Statement Regarding the Parties' Relationship

Many brokerage relationship statutes require that in a residential transaction, the broker make certain disclosures about the broker's duties to the parties and about which party or parties the broker is representing in the transaction. n26 Typically, this disclosure must be made before the parties enter into a listing agreement. n27 Requiring a disclosure prior to signing the listing agreement allows the seller to make a more intelligent decision about whether to sign. One court has given this example to illustrate this concept: A property owner who is asked to sign a listing agreement because the broker has a buyer for the property may not fully comprehend that the broker intends to act as a dual agent. Because the seller pays the broker's commission, the seller may reasonably believe the broker has only the seller's best interest at heart and is working exclusively for the seller. The disclosure form tells the property owner that a broker can act as a dual agent. Thus advised, the seller may wish to sell the property through his or her own agent or to seek independent advice on the price and terms of the listing. n28

In a case where the broker failed to deliver the disclosure statement in a timely fashion and where the disclosure statement statute failed to provide a remedy, the court found that the common law provided the remedy. The listing agreement was found to be void at the seller's option. n29

A Florida court has held that *Florida Statute § 475.278* replaces the common law fiduciary duty owed by a transaction broker to its clients with a more narrowly-defined set of statutory duties and that these statutory duties apply even when

the transaction broker fails to meet the statute's notice requirement which would have advised the plaintiffs of the duties of limited representation owed by a transaction broker. Consequently, a Florida transaction broker's failure to provide the statutorily required disclosure document does not rebut or affect the statutory presumption that the parties' relationship is that of a transaction broker unless a single agent or no brokerage relationship is established in writing with the customer. n30

FOOTNOTES:

(n1)Footnote 1. See Ala. Code § 34-27-82(a); Colo. Rev. Stat. § 12-61-801, et seq.; *Fla. Stat.* § 475.278(2); Ga. Code Ann. § 10-6A-14; Kansas Stat. Ann. § 58-30,113; Okla. Stat. tit. 59, §§ 858-351(5) and 858-355.

(n2)Footnote 1.1. See Wyo. Stat. 33-28-305.

(n3)Footnote 1.2. See Idaho Code 54-2086; *Johnson v. McPhee*, 147 Idaho 455, 461, 210 P.3d 563, 569 (Idaho Ct. App. 2009) , review denied, 2009 Ida. LEXIS 130 (July 8, 2009) .

(n4)Footnote 2. See *Barfield v. Hall Realty, Inc.*, 2010 Colo. App. LEXIS 448, at *10 (Colo. Ct. App. Apr. 1, 2010) . Cf., e.g., *Fla. Stat.* § 475.278(2)(a) (a transaction broker does not represent either party in a fiduciary capacity); *Burchfield v. Realty Executives*, 971 So. 2d 138, 139 (Fla. Dist. Ct. App. 2007) (no cause of action is available against a transaction broker for common law breach of an implied fiduciary duty) review denied, 982 So. 2d 684 (Fla. 2008) .

(n5)Footnote 3. *Sussman v. Stoner*, 143 F. Supp. 2d 1232, 1237 (D. Colo. 2001) . See generally Patricia A. Wilson, *Nonagent Brokerage: Real Estate Agents Missing in Action*, 52 Okla. L. Rev. 85, 90 (1999).

(n6)Footnote 4. See *Barfield v. Hall Realty, Inc.*, 2010 Colo. App. LEXIS 448, at *10-*11 (Colo. Ct. App. Apr. 1, 2010) ; *Hoff & Leigh, Inc. v. Byler*, 62 P.3d 1077, 1078 (Colo. Ct. App. 2002) ; *Read v. Taylor*, 832 So. 2d 219, 223 (Fla. Dist. Ct. App. 2002) ; *Fla. Stat. Ann.* § 475.01(1)(m).

Cf. *The Realty Store v. Tarl Partnership*, 153 S.W.3d 366, 370-371 (Tenn. Ct. App. 2004) , appeal denied, 2004 Tenn. LEXIS 1146 (Tenn. Dec. 20, 2004) (A general partner of the seller could not be a facilitator or transaction broker because a facilitator or transaction broker represents the interest of neither seller nor buyer. The general partner could not meet the statutory definition for this type of relationship because he was not acting as a neutral party, but as a party advancing his own interest.).

(n7)Footnote 5. See *Sussman v. Stoner*, 143 F. Supp. 2d 1232 (D. Colo. 2001) , applying Colorado law; *Hoff & Leigh, Inc. v. Byler*, 62 P.3d 1077, 1078 (Colo. Ct. App. 2002) . See generally G. Lane Earnest & J. Marcus Painter, *The New Brokerage Legislation: The Demise of "Agency by Surprise"*, 22 Colo. Law. 1919 (Sept. 1993) .

(n8)Footnote 6. See *Sussman v. Stoner*, 143 F. Supp. 2d 1232, 1237 (D. Colo. 2001) ; *Johnson Realty v. Bender*, 39 P.3d 1215, 1217 (Colo. Ct. App. 2001) , cert. denied 2002 Colo. LEXIS 138 (Colo. Feb. 11, 2002) ; (a broker who assists parties in a real estate transaction without a written agreement is deemed to be a transaction-broker, not an agent of either party); Pancak, Miceli and Sirmans, *Real Estate Agency Reform: Meeting the Needs of Buyers, Sellers, and Brokers*, 25 Real Estate L. J. 345, 355 (1997).

(n9)Footnote 7. See *Johnson Realty v. Bender*, 39 P.3d 1215, 1217 (Colo. Ct. App. 2001) , cert. denied, 2002 Colo. LEXIS 138 (Colo. Feb. 11, 2002) .

(n10)Footnote 8. See, e.g., Colo. Rev. Stat. § 12-61-802(6).

(n11)Footnote 9. See *Fla. Stat.* § 475.272(4).

(n12)Footnote 10. See *Read v. Taylor*, 832 So. 2d 219, 223 (Fla. Dist. Ct. App. 2002) .

(n13)Footnote 11. See Walt Abro, *Transaction Brokerage: Is Colorado's New Approach Working?*, Today's Realtor, Feb. 1996, p. 52 (National Association of Realtors).

(n14)Footnote 12. Cf. *Burchfield v. Realty Executives*, 971 So. 2d 138, 139 (Fla. Dist. Ct. App. 2007) (Fla. Stat. § 475.278 unequivocally replaces the fiduciary duty owed by real estate brokers at common law with a more narrowly defined set of statutory duties).

(n15)Footnote 13. See *Michel v. Moore & Associates, Inc.*, 156 Cal. App. 4th 756, 762-63, 67 Cal. Rptr. 3d 797, 802 (2007) .

(n16)Footnote 14. Colo. Rev. Stat. § 12-61-807(2). See also Fla. Stat. § 475.278(2) (similar statutory duties).

(n17)Footnote 15. Colo. Rev. Stat. § 12-61-807(3).

(n18)Footnote 16. Colo. Rev. Stat. § 12-61-807(4). See *Barfield v. Hall Realty, Inc.*, 2010 Colo. App. LEXIS 448, at *12 (Colo. Ct. App. Apr. 1, 2010) .

(n19)Footnote 17. Colo. Rev. Stat. § 12-61-807(6).

(n20)Footnote 18. Colo. Rev. Stat. § 12-61-807(7).

(n21)Footnote 19. Colo. Rev. Stat. § 12-61-807(8).

(n22)Footnote 20. See *Hoff & Leigh, Inc. v. Byler*, 62 P.3d 1077, 1079 (Colo. Ct. App. 2002) . The statute in question is Colo. Rev. Stat. § 12-61-811.

(n23)Footnote 21. See *Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 678, 14 Cal. Rptr. 2d 232, 234 (Cal. Ct. App. 1992) , review denied.

(n24)Footnote 22. See *Sussman v. Stoner*, 143 F. Supp. 2d 1232, 1238-1239 (D. Colo. 2001) .

(n25)Footnote 23. [Reserved].

(n26)Footnote 24. See *Hoff & Leigh, Inc. v. Byler*, 62 P.3d 1077, 1079 (Colo. Ct. App. 2002) .

(n27)Footnote 25. See *Hoff & Leigh, Inc. v. Byler*, 62 P.3d 1077, 1079 (Colo. Ct. App. 2002) (dicta).

(n28)Footnote 26. See, e.g., Fla. Stat. § 475.278.

(n29)Footnote 27. See, e.g., Colo. Rev. Stat. § 12-61-808; Ga. Code § 10-6A-10.

(n30)Footnote 28. See *Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 685-686, 14 Cal. Rptr. 2d 232, 238 (Cal. Ct. App. 1992) , review denied (1993).

(n31)Footnote 29. See *Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 679, 14 Cal. Rptr. 2d 232, 234-235 (Cal. Ct. App. 1992) , review denied, (1993).

(n32)Footnote 30. See *Burchfield v. Realty Executives*, 971 So. 2d 138, 140 (Fla. Dist. Ct. App. 2007) . (Fla. Stat. § 475.278 creates a presumption that all Florida real estate licensees "are operating as transaction brokers unless a single agent or no brokerage relationship is established, in writing, with a customer").

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47 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.23

§ 3.23 Implied Covenant of Good Faith and Fair Dealing

Many jurisdictions statutorily provide for an implied covenant of good faith and fair dealing in contracts. n1 Furthermore, the implied duty of good faith and fair dealing is recognized in the Restatement (Second) of Contracts, the Uniform Commercial Code, and common law. The Restatement provides, in part, that "[e]very contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement." n2 The Comments to the Restatement state that "[g]ood faith performance or enforcement of a contract emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party." n3

Compliance with this implied covenant of good faith and fair dealing may require expert testimony if the allegation asserts a failure to observe reasonable commercial standards of fair dealing in the brokerage trade. However, if the allegation asserts dishonesty, expert testimony should not be required. n4

FOOTNOTES:

(n1)Footnote 1. *See, e.g., Mont. Code Ann. § 28-1-211. See also Prudential Stewart Realty v. Sonnenfeldt*, 285 N.J. Super. 106, 109, 666 A.2d 589, 591 (N.J. Super. Ct. App. Div. 1995), *cert. denied* ("Under settled principles of law, there exists in every contract an implied covenant of good faith performance and fair dealing.").

(n2)Footnote 2. Restatement (Second) of Contracts § 205.

(n3)Footnote 3. Restatement (Second) of Contracts § 205 comment a.

(n4)Footnote 4. *See May v. ERA Landmark Real Estate of Bozeman*, 2000 MT 299, 15 P.3d 1179, 1188 (Mont. 2000).

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48 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.24

§ 3.24 Duty to Provide a Residential Property Disclosure Statement

The majority of jurisdictions require that the seller of residential real property provide prospective purchasers with a disclosure statement that provides information about the property's condition. These statements often address the condition of various components of the property such as the roof, foundation, electrical, plumbing, and heating and air conditioning systems. Applicable law determines when such a statement must be provided and the consequences that flow from such a statement. The requirements of the various states with respect to this type of residential real property disclosure statement are discussed in Chapter 3A, *below*.

Some jurisdictions impose a duty upon a licensee to provide a prospective buyer with such a statement. n1 Since the requirement that sellers of residential property provide prospective purchasers with property disclosure statements were primarily enacted during the 1990s, there are relatively few cases addressing the consequences of failing to supply such a statement or supplying a fraudulent statement. There are even fewer cases addressing a real estate licensee's duties and liabilities with respect to such statements.

In *Ikola v. Schoene*, n2 a buyer's agent not only failed to provide her client with the sellers' property disclosure statement, the agent intentionally withheld the statement from her client. The court stated that the agent had a duty under *Georgia Code Annotated § 10-6A-7(a)(2)(C)* to disclose material facts of which she had actual knowledge. The court observed that one method by which the buyer is informed of defects in the property is the sellers' disclosure statement. The court found that this code section necessarily implied a duty on the agent's part to provide the disclosure statement to the buyer. The lower court had granted the agent's motion for summary judgment on the buyer's breach of contract and fraud claim against the agent. The court found that there was evidence that not only did the agent fail to provide the statements to the buyer, the agent intentionally withheld them from the buyer. This evidence raised a factual issue as to whether the agent breached the duty to disclose material facts affecting the property. n3

The court in *Ikola* also stated that the overriding duty of a buyer's agent under Georgia's Brokerage Relationships in Real Estate Transaction Act was to promote the buyer's interests. There was evidence that the agent attempted to force the buyer to proceed with an "as-is" sale and actively discouraged her from obtaining a professional inspection. The court stated that a jury could find from this evidence that Schoene acted adversely to the buyer's interests and thereby breached the duty to promote them. A jury could find from this evidence that the agent acted adversely to the buyer's

interests and thereby breached the duty to promote them. The summary judgement on this issue was reversed. n4

Since most brokerage relationship acts impose a duty upon a single party agent to promote the interests of the agent's client, the logic applied by this Georgia court should be equally applicable to other jurisdictions which require that sellers of residential real estate provide prospective buyers with property disclosure statements.

FOOTNOTES:

(n1)Footnote 1. *Cf. Okla. Stat. tit. 59, § 858-354(B)(4)(f)* which states that a single-party broker has a duty to disclose information pertaining to the property as required by that state's Residential Property Condition Disclosure Act. Section 858-353 imposes a similar duty upon Oklahoma transaction brokers.

(n2)Footnote 2. *264 Ga. App. 338, 340, 341 590 S.E.2d 750, 752 (Ga. Ct. App. 2003)* .

(n3)Footnote 3. *264 Ga. App. 338, 340, 341-342, 590 S.E.2d 750, 753 (Ga. Ct. App. 2003)* .

(n4)Footnote 4. *264 Ga. App. 338, 340, 342 590 S.E.2d 750, 753 (Ga. Ct. App. 2003)* .

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49 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.25

§ 3.25 Duties with Respect to Earnest Money Deposits

Brokers must handle earnest money deposits in accordance with the guidelines promulgated by their state real estate commission. Even minor infractions of such guidelines can result in disciplinary action. For example, in one case the broker clipped a purchaser's \$100 check to the file until it was returned to the purchaser approximately nine days later. The broker was found to have committed professional misconduct for failing to deposit the \$100 into a trust account. The broker's license was suspended for one month. n1 Disciplinary actions are discussed in more detail in §§ 6.02 and 6.05, *below* .

Statutes and regulations addressing a broker's handling of earnest money must be carefully read and strictly followed. Brokers and their counsel should adopt a conservative interpretation of any applicable laws or regulations. n2

Earnest money deposits can pose problems for the broker when a sale does not go through as planned. In this situation, both parties may claim the earnest money deposit. Brokers who are entrusted with earnest money have a fiduciary duty to remain the neutral agent of both parties even though the broker may be the agent of one of the parties in the underlying transaction. Consequently, the broker cannot act contrary to the rights or interests of either of the parties in the earnest money. In re Appeal of Sheaffer n3 illustrates the trouble a broker can encounter if he or she fails to remain impartial. This case involved \$2,000 earnest money in the sale of residential property. The funds had been placed in the escrow account of the buyer's broker. Pursuant to an inspection clause, the buyers were entitled to a return of their deposit if the sellers did not repair defects found in the house. In addition, the sales agreement contained a clause specifically addressing earnest money default. This provision stated in part:

If the closing does not occur because of Seller's default or because any condition of this contract is not satisfied or waived, Purchaser shall be entitled to the earnest money. If Purchaser defaults, Seller shall be entitled to the earnest money. The parties acknowledge, however, that the Broker will not make a determination as to which party is entitled to earnest money. Instead, the Broker shall release the earnest money from the trust account only (a) in accordance with the joint written instructions of Seller and Purchaser, or (b) in accordance with the following procedure: if the closing does not occur for any reason (including the default of either party), the Broker holding the earnest money may notify Seller in writing that the earnest money will be returned to Purchaser unless Seller makes a written demand for the

earnest money within 20 days after the date of the Broker's notice. If the Broker does not receive a written demand from the Seller within the 20 day period, the Broker shall return the earnest money to Purchaser. If a written demand from Seller is received by the Broker within the 20 day period, the Broker shall retain the earnest money deposit until i) Seller and purchaser have settled the dispute; ii) disposition has been ordered by a final court order; or iii) the Broker deposits the earnest money with the court pursuant to applicable court procedures. n4

A dispute arose between the sellers and buyers over an acceptable radon level in the house and the buyers asserted a right to the earnest money under the failure-to-repair cancellation provision. The broker returned the earnest money to the buyers.

The sellers filed a formal complaint against the broker with the Ohio Department of Commerce of Real Estate (DRE) alleging that the broker breached his fiduciary duty to the sellers when he returned the earnest money to the buyers in a manner inconsistent with the terms of the earnest money default clause contained in the primary sales agreement. In the administrative hearing, it was determined that the broker believed he had the authority to return the earnest money deposit pursuant to the inspection addendum. The DRE found that when there was a conflict over who was entitled to earnest money, the dispute must be either mutually resolved or decided by a court of competent jurisdiction. It stated that "To maintain the status quo of funds held on deposit reflects a neutral position of a fiduciary awaiting ambiguous instructions." n5 The DRE held that any interpretation of the terms of a contract by a licensee that resulted in the release of earnest money deposit was misconduct. It suspended the broker's license for thirty days. n6

The appellate court affirmed the DRE's suspension of the broker. It stated that a broker owed duties to both the buyer and the seller when the broker accepts earnest money. The court stated:

Brokers who have been entrusted with earnest money have a fiduciary duty to remain the neutral agent of both parties even though the broker may also be the agent of one of the parties in the underlying transaction. Because the broker is to remain impartial with regard to the earnest money, the broker may not act contrary to the rights or interests of one of the parties in the earnest money. n7

The court also stated that the broker's return of the earnest money was in this case an act adverse to the sellers' rights. The broker's actions resulted in an abandonment of his fiduciary duty not to act adversely to the interest or rights of one or both of the parties. This conduct was found to be sufficient for DRE to base its finding of broker misconduct.

Selling brokers also often encounter difficulties when they fail to handle earnest money deposits as required by the listing agreement. Such a failure will typically constitute a breach of the contract with the seller and a breach of the broker's duty of loyalty. n8

Some sales agreements give the seller the right to declare a forfeiture of the purchaser's earnest money upon the purchaser's default. Under this type of contract, a broker who returns the earnest money to a defaulting purchaser without the seller's authorization has breached the fiduciary duty of loyalty owed to the principal and is thereby precluded from recovering his or her commission. n9

Negligence claims can arise with respect to a broker's handling of deposits. Clients may object to the broker's failure to deposit funds or the broker's failure to fully communicate information regarding the deposit. Even if the client objects to the broker's handling of the deposit, the client must still prove the elements of negligence in order to prevail in an action. For example, in *Claire-Ann Co. v. Christenson & Christenson* n10 the client was unable to prove proximate cause. The broker in this case received a deposit from a purchaser, but allegedly failed to deposit it in its escrow account in a timely manner. When this check was deposited it was returned for insufficient funds. The seller sued, claiming in part that the broker had been negligent in failing to timely deposit the check, account for the earnest money, and in failing to immediately notify the seller that the buyer's check had bounced. The court rejected this claim as the seller

had failed to prove that the broker's actions were the proximate cause of the seller's injury as the seller failed to prove that sufficient funds existed in the drawer's account to cover the instrument at the time the broker received the check or at any time before its deposit. n11

In a New York case, n12 a seller was presented by a broker with a written purchase offer that provided for a deposit with the offer and the making of a down payment after the seller's acceptance. The broker did not tell the seller that the deposit, which ostensibly accompanied the offer, had not been paid. The seller signed the contract. While the broker then made efforts to obtain the down payment, the broker did not reveal to the seller that, after repeated requests, the down payment had not been provided. Thereafter, the purchaser, tendering the deposit for the first time, presented demands for material alterations in the contract, which demands were refused. The seller was then told that the deposit on the original offer had not been timely provided and that the down payment had not been tendered at all. Upon advice of the broker's attorney, the seller then made arrangements to sell the property to a third party. Those efforts were stalled when the original purchaser commenced an action for specific performance and filed a notice of pendency. That suit was finally resolved in favor of the seller, but only after sixteen months elapsed. The seller thereafter sued the broker for the damages sustained by the delay in the sale, claiming that it was the broker's negligence that induced the seller to enter into a defective contract with the original purchaser.

The court ruled that a real estate broker is under a duty to "exercise that degree of diligence, judgment, care, and skill ordinarily used by persons of common capacity, engaged in the same business." n13 The court stated that the broker was negligent in not informing the seller that the deposit, which was supposed to accompany the offer, had not been made. Had the seller been made aware of that fact, the seller could have avoided all of the ensuing difficulty by rejecting the offer and not signing it. Moreover, the broker was negligent in not promptly informing the seller that the down payment had not been paid following the seller's acceptance of the offer. Indeed, the purchaser's withholding of the down payment, coupled with the seller's apparent inaction, gave the purchaser the "courage to thereafter attempt to renegotiate." Thus, the broker's negligence set in motion the chain of events that led to the collapse of the transaction and the ensuing litigation between the seller and purchaser. n14 However, the seller was at fault in relying upon the advice of the broker's counsel and in not retaining his own attorney. Moreover, the seller did not attempt to enforce the original agreement and entered into the second contract knowing that it was fraught with danger. Thus, the court found the seller and broker equally at fault and allowed the seller to recover only half of the damages. n15

FOOTNOTES:

(n1)Footnote 1. *See Depugh v. Ohio Dept. of Commerce, Division of Real Estate*, 128 Ohio App. 3d 528, 715 N.E.2d 622, 626 (Ohio App. 1998) , appeal dismissed, 83 Ohio St. 3d 1448, 700 N.E.2d 332 (1998) .

(n2)Footnote 2. *Cf.* Michigan Attorney General Opinion No. 7064, Oct. 27, 2000. Michigan requires that brokers deposit earnest money deposits within two banking days after a broker has been notified that an offer to purchase has been accepted by all parties. The Attorney General opined that a broker cannot accept an earnest money in the form of a check made payable to a third party such as a title insurance company. Since the broker cannot negotiate this type of check, the broker cannot comply with the legal obligation to timely deposit the check. The seller and buyer can agree that the earnest money deposit will be held in an escrow account maintained with a title insurance company, but the broker cannot facilitate or handle such a deposit.

(n3)Footnote 3. 116 Ohio App. 3d 98, 686 N.E.2d 1382 (1996) .

(n4)Footnote 4. 116 Ohio App. 3d 98, 102, 686 N.E.2d 1382, 1385 (1996) .

(n5)Footnote 5. 116 Ohio App. 3d 98, 108, 686 N.E.2d 1382, 1389 (1996) .

(n6)Footnote 6. 116 Ohio App. 3d 98, 108, 686 N.E.2d 1382, 1389 (1996) . The DRE's determination that brokers are to resist making legal determinations is based on *Richard T. Kiko Agency, Inc. v. Ohio Dep't of Commerce, Div. of Real Estate*, 48 Ohio St. 3d 74, 549 N.E.2d 509 (Ohio Ct. App. 1990) .

(n7)Footnote 7. 116 Ohio App. 3d 98, 110, 686 N.E.2d 1382, 1390 (1996) .

(n8)Footnote 8. See *Re/Max Realty 100 v. Basso*, 667 N.W.2d 857, 860-861, 2003 WI App 146 (Wis. Ct. App. 2003) . Cf. *Vicki Bagley Realty, Inc. v. Laufer*, 482 A.2d 359, 364-365 (D.C. App. 1984) (brokers liable to seller for liquidated damages when brokers held onto checks which subsequently bounced and for failing to disclose information about the buyer's financial situation).

(n9)Footnote 9. See:

Illinois: United Investors, Inc. v. Tsotsos, 132 Ill. App. 3d 175, 180, 87 Ill. Dec. 439, 477 N.E.2d 40, 43 (Ill. App. Ct. 1985) .

Kentucky: Crabtree v. Board of Trustees, 512 S.W.2d 311 (Ky. 1974) .

Maryland: Prince Georges Properties, Inc. v. Rogers, 275 Md. 582, 591-592, 341 A.2d 804, 809-810 (Md. 1975) .

Minnesota: Lake Co. v. Molan, 269 Minn. 490, 131 N.W.2d 734 (Minn. 1964) .

See generally Annot., *Broker's Return of Deposit to Purchaser as Waiver of Right to Demand Commission from Seller*, 69 A.L.R.2d 1244 (1960).

(n10)Footnote 10. 223 Mich. App. 25, 566 N.W.2d 4 (1997) .

(n11)Footnote 11. 223 Mich. App. 25, 566 N.W.2d 4, 7 (1997) . See also *Früge v. Onob, Inc.*, No. 09-1028, 2010 La. App. LEXIS 357, at *10-*11 (La.App. 3 Cir. Mar. 10, 2010) (Broker had no duty to place the \$ 10,000.00 into escrow absent a properly executed agreement to purchase or sell.).

(n12)Footnote 12. *Murph & Fritz's Place Inc. v. Loretta*, 112 Misc. 2d 554, 447 N.Y.S.2d 205, 1982 N.Y. Misc. LEXIS 3165 (1982) .

(n13)Footnote 13. 447 N.Y.S.2d at 207 .

(n14)Footnote 14. 447 N.Y.S.2d at 208 .

(n15)Footnote 15. 447 N.Y.S.2d at 209 .

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50 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.26

§ 3.26 Powers of Attorney

Though not a common occurrence, a seller may execute a power of attorney (usually a limited power) to allow the broker to attend closing and execute documents necessary to consummate the sale. In such a case, the broker could potentially face liability for failing to comply with duties imposed upon the seller. n1

Without an appropriate power of attorney, the broker should not have authority to enter into sales contracts on the seller's behalf. Most listing and commission agreements do not expressly authorize the broker to sell the property. Consequently, a sales contract signed only by the seller's broker should not be enforceable against the seller. n2

FOOTNOTES:

(n1)Footnote 1. *Cf. Gilman v. Maine Mutual Fire Insurance Co.*, 830 A.2d 71, 2003 VT 55 (Vt. 2003) (Agent had a limited power of attorney at closing, giving him authority to execute and deliver on the seller's behalf documents required to consummate the sale. The trial court improperly granted the agent's motion to dismiss this claim. Under the power of attorney, it could have been argued that the agent had the responsibility to deliver to the homeowners the smoke detector certificate required by *Vt. Stat. Ann. tit. 9, § 2883*.)

(n2)Footnote 2. *See Bowling v. Pedzik*, 302 A.D.2d 343, 344, 754 N.Y.S.2d 653, 654, 2003 N.Y. App. Div. LEXIS 800 (N.Y. App. Div. 2003) .

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51 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.27

§ 3.27 Are Brokers Professionals for Malpractice Statutes of Limitations?

[1] What Is a Professional?

Many states provide a shorter statutes of limitation period for professional malpractice as opposed to other torts. In some cases a broker may argue that he or she is a professional covered by such a statute. It appears that the courts that have considered this issue are split as to whether a broker qualifies as a professional.

In addressing the issue of whether a real estate broker is a professional, it should be noted that courts in dicta often refer to brokers as "professionals." But these statements often use the word "professional" to indicate that the individual's livelihood is made as a broker rather than using the term "professional" as a state of art. n1 Though brokers and agents must obtain some education and training in order to become licensed, it is clear that the educational requirements are far less than that required of others such as attorneys, physicians, and veterinarians, who are widely accepted as being "professional."

Traditionally the term profession has been interpreted as encompassing a vocation requiring specialized knowledge and intensive preparation in skills as well as the scholarly principles underlying such skills. n2 In the context of a real estate appraiser, the Supreme Court of Florida examined the criteria for what makes a livelihood a profession in *Garden v. Frier*. n3 The Florida court stated that the requirements for professional status included the following requirements:

1. A profession is any vocation requiring at a minimum a four-year college degree before licensing in Florida is possible. There is no equivalency exception. n4
2. The only relevant criteria for determining if a vocation is a profession are those applicable to first-time applicants who have never been licensed in another state or nation to practice the particular vocation in question. n5
3. A profession comes into being on the date the appropriate licensing body requires a four-year college degree or a graduate degree of all future admittees. A profession ceases to exist on the date that any future admittees no longer need hold either a four-year undergraduate degree or graduate degree. n6

Policy dictates that prior admittees be grandfathered in as professionals. n7

4. A vocation is not a profession if there is any alternative method of admission that omits a required four-year undergraduate degree or graduate degree. n8

5. A vocation is not a profession if a state license is not required at all. n9

6. Persons are not considered a professional merely because they hold a four-year degree if they are not absolutely required to hold the degree as a condition of licensing. n10

This court stated that persons involved in more than one vocation fall under the professional malpractice statute only for acts performed while engaged in those vocations that actually qualify as professions. The professional malpractice statute of limitations statute also applies only if the alleged tortious conduct arose from the practice of a vocation qualifying as a profession at the moment in time when the conduct caused a completed injury or loss recognized under tort-law principles. n11

The issue of whether a broker is considered a professional is further muddled by the fact those discussing errors and omissions insurance carried by brokers often use the term "malpractice." n12 That term is most frequently applied to the negligent conduct of professionals such as lawyers and doctors.

Some courts have found that a broker has committed professional malpractice without even raising the issue of whether or not a broker can be considered a professional. n13 Courts also appear to confuse expectations of customer confidence and licensing requirements with being a professional. There are many vocations where the customer places trust in the licensed individual. And there are many vocations which take years of training to achieve the highest licensing status. However, most individuals will not argue that a cosmetologist or a licensed electrician is a professional. While it can be asserted that the increasing regulation of the real estate brokerage industry is pushing brokers toward the status of becoming a professional endeavor, n14 the majority view is that brokers are not professionals.

[2] Courts Holding that Brokers Are Not Professionals

Several jurisdictions have held that real estate brokers are not professionals. Frequently, these holdings have come in cases involving interpretations of zoning law, while cases that hold that brokers are professionals often occur in the context of a sales transaction. The Supreme Court of Nebraska has stated that the clear majority of judicial holdings that a real estate broker is not a professional are in cases involving interpretations of zoning law. n15 A Connecticut court has stated, "A plethora of decisions from other jurisdictions clearly indicates that a real estate broker simply cannot be categorized as a professional person." n16 Despite these statements, however, as is discussed in the next subsection, some courts have found that a broker is a professional or that a broker can commit malpractice.

In one of the earliest decisions to consider this issue, the Michigan Supreme Court stated:

Real estate agencies are no more professions than any other business agencies. A commission merchant, or an agent for the sale of any particular kind of personal property acts in an analogous capacity. Any one can assume and lay down such business at pleasure, and any one can conduct it in his own way on such terms and conditions as he sees fit to adopt. There is nothing in our laws which would enable any court to draw a line between such business agencies. They are not classed as professions by popular usage or by law. n17

Perhaps one factor that has made this issue less clear cut in modern times is that laypersons often treat brokers as though they were professionals which may influence some courts to accord brokers this status under the law.

Courts that have held that brokers are not professionals include the following:

California: Jones v. Robertson, 79 Cal. App. 2d 813, 816, 180 P.2d 929, 931 (1947) .

Connecticut: Dlugos v. Zoning Bd. of Appeals of Trumbull, 36 Conn. Supp. 217, 219-20, 416 A.2d 180, 182 (1980) .

Florida: Century Land Dev., L.P. v. Weits, 2009 U.S. Dist. LEXIS 7031 (S.D. Fla. Jan. 30, 2009) . See also *Moransais v. Heathman*, 744 So. 2d 973, 976 (Fla. 1999) (a profession is any vocation requiring at a minimum a four-year college degree before licensing is possible in Florida), *reh'g denied*, 1999 Fla. LEXIS 1925 (Fla. Nov. 4, 1999) .

Idaho: Sumpter v. Holland Realty, Inc., 140 Idaho 349, 352, 93 P.3d 680, 683 (Idaho 2004) , *reh'g denied*, 2004 Ida. LEXIS 151 (Idaho July 12, 2004) (including real estate agents as rendering professional services would be inconsistent with legislative intent in establishing a definition of professional services).

Illinois: Village of Riverside v. Kuhne, 335 Ill. App. 547, 560, 82 N.E. 2d 500, 506 (1948) (real estate brokers are not professionals as that term is defined for purposes of Illinois zoning laws).

Iowa: Cummings v. Penn. Fire Ins. Co., 153 Iowa 579, 588, 134 N.W. 79, 82 (1912) (dicta) ("One who operates a real estate agency is not engaged in a professional employment.").

Massachusetts: Seaman v. Zoning Board of Appeals of Holliston, 340 Mass. 488, 489, 165 N.E.2d 97, 98 (1960) (zoning case).

Michigan: Pennock v. Fuller, 41 Mich. 153, 155, 2 N.W. 176, 177 (1879) ; *Coats v. Uhlmann*, 87 Mich. App. 385, 393 n. 7, 274 N.W.2d 792, 796 n. 7 (1978) (Michigan's malpractice statute of limitations included only licensed professionals as opposed to any licensed occupation).

Nebraska: Tylle v. Zoucha, 226 Neb. 476, 480-481, 412 N.W.2d 438, 441 (1987) .

New Hampshire: Hackett v. Gale, 104 N.H. 90, 92, 179 A.2d 451, 453 (1962) (zoning case); *Hancock v. Concord*, 111 N.H. 413, 414, 285 A.2d 791, 792 (1971) .

New Jersey: Capman v. Long Beach Township, 95 N.J. Super. 523, 526, 231 A.2d 852, 853 (1967) (zoning case).

[3] Courts Holding that Brokers Are Professionals or Can Commit Malpractice

It appears that a minority of courts have held that a broker is either a professional or can commit malpractice. Such holdings may benefit brokers when the statute of limitations for malpractice is shorter than the general statutory period for other torts. In such a case, a broker may escape any potential liability due to the running of the shorter statute of limitations period. Courts that have held that a broker can commit malpractice do not always address the issue of whether a broker can be a professional. Instead, these courts seem to assume that a broker is a professional.

Courts that have held that a broker can either be considered a professional or can commit malpractice include the following:

Arizona: Morley v. J. Pagel Realty & Insurance, 27 Ariz. App. 62, 65-66, 550 P.2d 1104, 1107-1108 (1976) ("Our holding today is a narrow one ... Having achieved ... the right to prepare any and all instruments incident to the sale of real property, including promissory notes, real estate brokers and salesmen 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.").

Georgia: Pennington v. Braxley, 224 Ga. App. 344, 345 n. 2, 480 S.E.2d 357, 359 n. 2 (Ga. Ct. App. 1997), cert. denied 1997 Ga. LEXIS 487 (Ga. May 2, 1997) (real estate brokers and salespersons are licensed professionals subject to malpractice claims); *Allen v. ReMax North Atlanta*, 213 Ga. App. 644, 646-647 n. 2, 445 S.E.2d 774 (Ga. Ct. App. 1994), cert. denied 1994 Ga. LEXIS 1113 (Ga. Oct. 17, 1994) (same).

Indiana: Bartlett v. Pugh (In re Pugh), 2008 Bankr. LEXIS 2991, at *9-*15 (Bankr. S.D. Ind. Nov. 6, 2008) (applying Indiana law); *Craig v. ERA Mark Five Realtors*, 509 N.E.2d 1144, 1149 (Ind. Ct. App. 1987) (zoning case, Ind. Code § 34-1-2-2(1), the two-year statute of limitations for legal malpractice claims, applied to a claim of broker negligence).

Wyoming: Hulse v. BHJ, Inc., 2003 WY 75, 71 P.3d 262, 268-269 (Wyo. 2003) (Claims of professional negligence included claims asserted under Wyo. Stat. Ann. § 33-28-303(c) for negligent misrepresentation against real estate professionals by non-client buyers.); *Rawlinson v. Greer*, 2003 WY 28, 64 P.3d 120, 125 (Wyo. 2003) (A claim against a Realtor(R) has always been a claim for professional negligence. Realtors(R) are licensed or certified professionals within the scope of Wyo. Stat. Ann. § 1-3-107(a), and the two-year limitation period applies to claims against Realtors(R).).

[4] Statutory Requirements When Suing a Broker

When filing an action against a real estate licensee, plaintiffs must comply with any statutory requirements. As an example, *Colorado Revised Statutes § 13-20-602* requires that a plaintiff suing a "licensed professional," must file a certificate of review within sixty days of the service of the complaint as to any claim against a licensed professional based upon allegations of professional negligence since such a claim will require expert testimony to establish a prima facie case. The certificate's purpose is to demonstrate that the plaintiff has consulted with a person who has expertise in the area and that the expert consulted has concluded that the claim does not lack substantial justification. n18 A failure to file a certificate of review, when one is required, will result in the dismissal of the underlying claims. n19 Such a certificate must be filed when the claim involves negligence based upon the alleged professional negligence of a licensed professional. n20 This statute requires proof of professional negligence as a predicate to recovery, whatever the claim's formal designation may be. n21

In a case involving a plaintiffs' claim alleging that seller's broker breached a statutory duty of disclosure owed to prospective buyers under the provisions of *Colorado Revised Statutes § 12-61-804(3)(a)*, the court found that no certificate of review was required as that statute limited a seller's broker's duty to disclose to adverse facts as are "actually known" by the broker. Consequently, to establish this claim, the plaintiffs only needed to prove that broker had actual knowledge of adverse material facts pertaining to the physical condition of the residence and that the broker failed to disclose such facts to plaintiffs. No expert testimony was necessary to establish a statutory standard involving a particular broker's actual knowledge. n22

In some jurisdictions a dissatisfied buyer or seller who decides to sue a broker may be faced with multiple statutes of limitations that each apply to particular types of actions. Plaintiffs must heed these statutes and any case law interpreting their applications. If the jurisdiction has a statute of limitations covering suits seeking to recover the use, rents, and profits of real property, a suit against a broker for negligent performance of his or her duties may not fall under such a statute, but may instead be covered by a statute addressing torts and negligence. n23

FOOTNOTES:

(n1)Footnote 1. See, e.g., *Hurney v. Locke*, 308 N.W.2d 764, 768 (S.D. 1981). This court considered allegations of fraud and breach of fiduciary duty arising from a listing agreement and a subsequent sale. Clearly one can have fiduciary duties without being a professional. However, the court stated: "A real estate agent is a licensed professional holding himself out as trained and experienced to render a specialized service in real estate transactions. Clients rely on the agent's expertise and expect the agent to act in their best interests. For these reasons, the relationship between real

estate agent or broker and the principal is confidential and fiduciary. (citations omitted)"

(n2)Footnote 2. See *Kuntz v. Muehler*, 1999 N.D. 215, 603 N.W. 2d 43, (N.D. 1999) , quoting from *Jorgensen v. State National Bank & Trust Company*, 255 Neb. 241, 583 N.W.2d 331, 334-35 (Neb. 1998) .

(n3)Footnote 3. 602 So. 2d 1273 (Fla. 1992) .

(n4)Footnote 4. 602 So. 2d 1273, 1275 (Fla. 1992) .

(n5)Footnote 5. 602 So. 2d 1273, 1275 (Fla. 1992) .

(n6)Footnote 6. 602 So. 2d 1273, 1276 (Fla. 1992) .

(n7)Footnote 7. 602 So. 2d 1273, 1276 n. 4 (Fla. 1992) .

(n8)Footnote 8. 602 So. 2d 1273, 1276 (Fla. 1992) .

(n9)Footnote 9. 602 So. 2d 1273, 1276 (Fla. 1992) .

(n10)Footnote 10. 602 So. 2d 1273, 1276 (Fla. 1992) .

(n11)Footnote 11. See *Garden v. Frier*, 602 So. 2d 1273, 1276 (Fla. 1992) .

(n12)Footnote 12. Cf. *Loken v. Century 21- Award Properties*, 36 Cal. App. 4th 263, 272 42 Cal. Rptr. 2d 683, 688 (Cal. Ct. App. 1995) , review denied, 1995 Cal. LEXIS 5944 (Cal. Sept. 21, 1995) , cert. denied, 516 U.S. 1113, 116 S. Ct. 912, 133 L. Ed. 2d 843 (1996) (under Cal. Ins. Code § 11589.5, insurers that provide malpractice insurance for real estate licensees cannot exclude from coverage liability stemming from the breach of duty arising under Cal. Civil Code § 2079 et seq.)

(n13)Footnote 13. See *Lakeside, Inc. v. Demetz*, 621 N.E.2d 1149, 1150-51 (Ind. Ct. App. 1993) . *Throckmartin v. Century 21 Top Realty*, 2010 WY 23, 226 P.3d 793, 805 (Wyo. 2010) .

(n14)Footnote 14. See *Fisher v. Kahler*, 2002 S.D. 30, 641 N.W.2d 122,126 (S.D. 2002) ("[T]hese statutes go far toward making the occupation of realtor a professional one."). Cf. *Menzel v. Morse*, 362 N.W.2d 465, 473 (Iowa 1985) ("A cursory examination of the Real Estate Manual issued by the Iowa Real Estate Commission discloses a determined effort to lift the real estate business to a professional status.").

(n15)Footnote 15. *Tylle v. Zoucha*, 226 Neb. 476, 412 N.W.2d 438, 439 (1987) .

(n16)Footnote 16. *Dlugos v. Zoning Bd. of Appeals of Trumbull*, 36 Conn. Supp. 217, 416 A.2d 180, 182 (1980) .

(n17)Footnote 17. *Pennock v. Fuller*, 41 Mich. 153, 155, 2 N.W. 176, 177 (1879) .

(n18)Footnote 18. See *State v. Nieto*, 993 P.2d 493, 502 (Colo. 2000) ; *Baumgarten v. Coppage*, 15 P.3d 304, 306 (Colo. Ct. App. 2000) . Colo. Rev. Stat. § 13-20-602.

(n19)Footnote 19. See *Baumgarten v. Coppage*, 15 P.3d 304, 306-307 (Colo. Ct. App. 2000) . *Kelton v. Ramsey*, 961 P.2d 569 (Colo. App. 1998) ; Colo. Rev. Stat. § 13-20-602(4).

(n20)Footnote 20. See *Baumgarten v. Coppage*, 15 P.3d 304, 306-307 (Colo. Ct. App. 2000) .

(n21)Footnote 21. See *Martinez v. Badis*, 842 P.2d 245, 251 (Colo. 1992) ; *Baumgarten v. Coppage*, 15 P.3d 304, 307 (Colo. Ct. App. 2000) .

(n22)Footnote 22. *See Baumgarten v. Coppage*, 15 P.3d 304, 307 (Colo. Ct. App. 2000) .

(n23)Footnote 23. *See Lakeside, Inc. v. Demetz*, 621 N.E.2d 1149, 1150-1151 (Ind. Ct. App. 1993) .

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52 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.28

§ 3.28 Duties Owed to Third Party Holders of Security Interests

Actions against brokers typically involve either a seller or buyer as the plaintiff. However, other parties can be affected by a real estate transaction. Generally, most jurisdictions require that licensees deal honestly and fairly with all parties in the sale transaction. This duty is not confined to the seller and buyer, but is also owed to third parties in the transaction such as holders of security interests. The extent of the duty owed to third parties is determined by weighing a number of factors, including the extent the transaction was intended to affect the third party, the foreseeability of harm, the degree of certainty that the third party would suffer injury, the moral blame attached to the broker's conduct, and the policy of preventing future harm. n1

A third party holding a security interest in the property being sold should be protected if the lien is properly recorded in a timely manner. Issues of duty towards a security interest holder can arise when the recording is imperfect or the security interest is not recorded. When a broker knows of an imperfectly recorded security interest or an unrecorded security interest, the broker has a duty to disclose the security interest. One court has stated, "The imposition of a duty on a realtor to disclose a known unrecorded lien interest is supported by standards already existing in the industry." n2

A California court considered a broker's duty toward the holder of an unrecorded security interest. The court stated that the most important step in determining if a broker owes a duty of care to a third party is to examine whether a reasonable person would have foreseen an unreasonable risk of harm to the third person and whether in view of such risk the broker exercised ordinary care under the circumstances. In the case before the court, the broker knew about the unrecorded security interest, knew that the seller has fallen on financial hard times, knew or should have known that the sale would not satisfy the subject outstanding indebtedness, and knew that there was a significant risk that the third party's security would be destroyed if the sale went through without disclosure of this security interest. The court found that the broker had a duty to disclose to the buyer the existence of the unrecorded third deed of trust or inform the lienholder of the impending escrow. n3

FOOTNOTES:

(n1)Footnote 1. *See Norman I. Krug Real Estate Investments, Inc. v. Praszker*, 220 Cal. App. 3d 35, 42, 269 Cal. Rptr. 228, 230-231 (Cal. Ct. App. 1990) , rehearing denied, 220 Cal. App. 3d 1226A, 1990 Cal. App. LEXIS 605 (Cal. Ct. App. 1990) .

(n2)Footnote 2. *See Norman I. Krug Real Estate Investments, Inc. v. Praszkner*, 220 Cal. App. 3d 35, 42, 269 Cal. Rptr. 228, 231 (Cal. Ct. App. 1990) , rehearing denied, 220 Cal. App. 3d 1226A, 1990 Cal. App. LEXIS 605 (Cal. Ct. App. 1990) citing the Code of Ethics of the National Association of Realtors(R).

(n3)Footnote 3. *See Norman I. Krug Real Estate Investments, Inc. v. Praszkner*, 220 Cal. App. 3d 35, 43, 269 Cal. Rptr. 228, 231 (Cal. Ct. App. 1990) , rehearing denied, 220 Cal. App. 3d 1226A, 1990 Cal. App. LEXIS 605 (Cal. Ct. App. 1990) .

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53 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.29

§ 3.29 Duties and Obligations Arising from Lock Boxes

A lock box allows a key to be left on the premises in a locked container so that brokers and agents can enter the property without the necessity of the seller or the seller's broker being present to open the door. Lock box authorization is routinely used in listing agreements with sellers. Liability issues regarding lock boxes can arise when a third party improperly accesses the lock box contents in order to burglarize or vandalize the home.

Lockboxes are typically obtained through and regulated by the local Realtors(R) association. Realtors(R) are expected to abide by the rules and regulations promulgated by the association pertaining to the use of the lockboxes. Realtors(R) who violate such rules and regulations may be subject to fines and suspension from the multiple listing service. n1

Agreements regarding lock boxes often contain an exculpatory provision stating that the lock box owner will be held harmless from any claims resulting from negligent acts of the lock box owner's employees. Listing agreements and lock box authorization typically provide similar exculpatory provisions to protect the broker regarding the lock box. n2

While exculpatory clauses are generally valid, it is a well established rule of construction that a contract provision exempting one from liability for his or her negligence will never be implied but must be clearly and explicitly stated. n3

Adloo v. H.T. Brown Real Estate, Inc. n4 considered the construction of exculpatory provisions found in the listing agreement and the lock box authorization. The listing broker received a telephone call from a man who identified himself as an agent with another broker. Without verifying the bona fides of the caller, his identity and affiliation with the named broker, the broker's staff member gave the caller the combination for the lock box. According to the records of the Maryland Real Estate Commission, no real estate license had been issued in the name given by the caller, and the number given by the caller was incorrect. Subsequently, property totaling nearly \$ 40,000 was taken from the sellers' home. n5

The pertinent clauses stated in part:

Neither REALTOR nor his agents or sub-agents are responsible for vandalism, theft or damage of any nature whatsoever to the property, nor is REALTOR responsible for the custody of the property, its

management, maintenance, upkeep or repair.

SELLER further acknowledges that neither Listing or Selling BROKER nor their agents are an insurer against the loss of personal property; SELLER agrees to waive and releases BROKER and his agents and/or cooperating agents and brokers from any responsibility therefore [sic].

The court found that these provisions were ambiguous and did not exculpate the broker from liability with respect to the burglary. With respect to the provision, the court stated, "Because it does not clearly, unequivocally, specifically, and unmistakably express the parties' intention to exculpate the respondent from liability resulting from its own negligence, the clause is insufficient for that purpose." n6 One sentence recited that the respondent was not an insurer against the loss of the petitioners' personal property. The other sentence relieved the broker of the responsibility for any such loss. The court found that the clause could logically be interpreted as applying only to those situations in which, without negligence on the broker's part, a person to whom the house was being shown stole the sellers' property. The court found that there was nothing in the clause that would suggest a different or broader intent. The court concluded that the exculpatory clause did not address thefts occurring as a result of the broker's negligence. n7

In another case, the multiple listing service (MLS) which owned the lock box knew of burglaries that had occurred during the previous year in its area where the lock box was used in committing the crime. The MLS board made a deliberate decision to withhold information from its member brokers concerning other lock box burglaries. A seller whose home was subsequently burglarized sued several defendants including the MLS. The court held that since the MLS corporation's alleged liability was predicated on its own official actions as a corporation rather than on the negligence of individual employees, the MLS was not shielded from liability by the indemnity clause. n8 With respect to the negligence issue, the court also found that a factual issue existed as to whether the MLS had breached a duty to the sellers by failing to exercise due care in maintaining the integrity of its box system and preventing unauthorized access to them. n9 In this same case, with respect to the broker, the court reversed a summary judgment in the broker's favor. It found that the trial court erred in concluding as a matter of law that the broker owed no duty of care to the seller. n10

Ohio's high court considered whether a seller's final judgment against an agent for stealing personal property by using the lock box could be paid out of the Ohio Real Estate Recovery Fund (the "Fund"). The court held that this judgment was not the type of judgment that could be paid from the Fund because the judgment was not obtained on the grounds of conduct associated with an act or transaction of a broker or salesman. Even though it was clear that the agent obtained entry to the seller's house by using the key in the lock box and that the agent garnered the information necessary to do so through his job as a real estate salesperson, there was nothing in the record to suggest that the burglary had anything to do with the agent's job as a real estate salesperson. n11

FOOTNOTES:

(n1)Footnote 1. *Cf. ND-Sell, Inc. v. Greater Springfield Board of Realtors, Inc.*, 224 S.W.3d 623, 628-29 (Mo. Ct. App. 2007) . A Realtors(R) association suspended and fined a Realtor(R) member for giving a client her lock box key to tour homes when the Realtor(R) was not present. The court affirmed the association's imposition of these sanctions under its rules.

(n2)Footnote 2. *Cf. Adloo v. H.T. Brown Real Estate, Inc.*, 344 Md. 254, 257, 686 A.2d 298, 300 (Md. 1996) . The provision in the listing agreement involved in this case stated in part: "Neither REALTOR nor his agents or sub-agents are responsible for vandalism, theft or damage of any nature whatsoever to the property, nor is REALTOR responsible for the custody of the property, its management, maintenance, upkeep or repair."

(n3)Footnote 3. *See:*

Missouri: Poslosky v. Firestone Tire and Rubber Co., 349 S.W.2d 847, 850 (Mo. 1961) .

(n4)Footnote 4. 344 Md. 254, 257, 686 A.2d 298, 300 (Md. 1996) .

(n5)Footnote 5. 344 Md. 254, 258-259, 686 A.2d 298, 300 (Md. 1996) .

(n6)Footnote 6. 344 Md. 254, 267, 686 A.2d 298, 305 (Md. 1996) .

(n7)Footnote 7. 344 Md. 254, 267-268, 686 A.2d 298, 305 (Md. 1996) .

(n8)Footnote 8. See *Moore v. Harry, Norman, Inc.*, 199 Ga. App. 233, 236, 404 S.E.2d 793, 795-796 (Ga. Ct. App. 1991) , cert. denied, 1991 Ga. LEXIS 696 (Ga. May 15, 1991) , cert denied 1991 Ga. LEXIS 764 (Ga. May 15, 1991) .

(n9)Footnote 9. See *Moore v. Harry, Norman, Inc.*, 199 Ga. App. 233, 235, 404 S.E.2d 793, 795 (Ga. Ct. App. 1991) , cert. denied, 1991 Ga. LEXIS 696 (Ga. May 15, 1991) , cert denied 1991 Ga. LEXIS 764 (Ga. May 15, 1991) .

(n10)Footnote 10. See *Moore v. Harry, Norman, Inc.*, 199 Ga. App. 233, 235, 404 S.E.2d 793, 795 (Ga. Ct. App. 1991) , cert. denied, 1991 Ga. LEXIS 696 (Ga. May 15, 1991) , cert denied 1991 Ga. LEXIS 764 (Ga. May 15, 1991) .

(n11)Footnote 11. See *Harbeitner v. Superintendent, Ohio Department of Commerce, Division of Real Estate*, 77 Ohio St. 3d 281, 282, 1997 Ohio 270, 673 N.E.2d 1309, 1310 (Ohio 1997) .

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54 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.30

§ 3.30 Broker's Duty with Respect to Open Houses and Property Showings

Early decisions did not establish real estate brokers as the possessor of property for purposes of imposing liability for injuries incurred by those touring property offered for sale. n1 However, the trend appears to be to impose liability upon real estate brokers and agents holding open houses as though they were the possessor of the property. For example, in *Hopkins v. Fox & Lazo Realtors*, n2 the Supreme Court of New Jersey held that a real estate broker has the duty, through reasonable inspection and warning, to ensure the safety of potential home buyers and visitors who tour an open house. Other courts have also held that brokers may be liable for injuries incurred by prospective purchasers touring properties for sale. n3

A licensee's liability with respect to open houses or showings of properties is governed by premises liability law. n4 The key factor in assessing whether the licensee will be liable for injury suffered by a third party is the licensee's control over the premises. In a case of first impression for an Indiana court, the court declined to impose, on real estate agents who do not control a premises, a duty to inspect properties for sale and to warn prospective buyers of dangerous conditions they discover. n5 However, this court held that a broker has a duty to warn a prospective buyer of a latent defect of which the broker is aware. n6

In *Anderson v. Wiegand*, n7 a visitor to an open house sued the homeowners, the agent and the broker for a fall she incurred when she slipped on ice. The homeowners had cleared the sidewalks the day before the fall and left town, allowing their agent to conduct the open house. The court affirmed summary judgment granted in their favor, finding that because the sidewalk had been cleared of snow the day before and there had been no new snow, the homeowners' conduct had been reasonable as a matter of law. This court stated that pursuant to the general rule that an employer of an independent contractor is not liable for the contractor's negligence, it found that homeowners were not liable for any negligence of the real estate agent. n8 However, the summary judgment granted in favor of the agent and the broker was reversed. It had been asserted that the ice the visitor slipped on was a result of the snow melting during the day and then refreezing. The court stated that there was a genuine issue of material fact as to whether the agent took reasonable steps within a reasonable time after the forces of nature reasserted themselves and melted snow began freezing as ice on the sidewalk where the visitor fell. n9

A Delaware court has found no precedent or support for imposing a similar duty upon a buyer's agent with respect to the

condition of a property being shown to a prospective buyer. This court stated that the affirmative duty of a seller's real estate agent to take reasonable care to inspect the premises and either make them safe or warn invitees of any dangerous condition rests on the theory that the seller's agent is in possession of the property which that agent has undertaken to sell. This court concluded that as a matter of Delaware law, a buyer's real estate agent has no duty for the safety of the buyer while on a seller's property. n10

The reason for requiring that a broker holding an open house or showing a property warn of nonobvious or unreasonable dangers is to provide prospective purchasers with the opportunity to decide whether or not to accept the invitation to view the property or alternatively to protect themselves against the danger if they accept the invitation to view the property. Thus, a broker who warned the prospective purchaser of the presence of a vicious dog fulfilled her duty; the broker did not have a duty to secure or remove the dog before showing the property. n11

Other courts have found that real estate licensees showing a house under a listing agreement with the owner are either possessors of the property or are acting on behalf of the possessors of the property and, therefore, may be held liable for injuries sustained by customers inspecting the property. n12 However, while touring property individuals are expected to exercise the prudence the ordinarily careful person would use in a like situation. A failure to exercise this level of care may result in the injured person receiving no damages for injuries suffered at an open house. n13

Placing a for sale sign on property sometimes results in third parties being on the premises without the broker or agent being present for an official showing. A Maryland court has considered a case involving injury to the plaintiffs when they toured property which had a for sale sign posted. The court found that the plaintiffs were trespassers and held that the broker was not liable to the plaintiffs. The court stated that it would be unreasonable to suggest that every time an owner or real estate company placed a sale sign outside a house, the owner or company was "inviting" people to come in. The court affirmed the trial court which found that the plaintiffs were trespassers, or at best, bare licensees, and therefore, were owed only the duty to refrain from willful or wanton misconduct. A for sale sign did not constitute an implied invitation to enter and inspect the premises or that if one were posted in that case that the prospective purchasers would be deemed to be invitees. n14

A Massachusetts court came to a similar holding. In that case, the property owner had listed a house for sale with a broker. A sign was placed in the front window. The plaintiffs contacted the broker and obtained the house keys, inspected the property, and returned the keys. When the plaintiffs returned to the house and stood on the back door platform, the railing gave way and injuries occurred. The court stated:

The building was closed so far as the reception of prospective buyers was concerned. This condition of the property, even though it was on the market for sale, would not constitute an invitation to the general public, or even to those who might be desirous of becoming owners, to enter upon the premises for the purpose of inspecting them without any consent or any further action by the owner. The situation is entirely different from that of a storekeeper, the maintenance of whose shop creates a continuous invitation during the usual business hours to all members of the public who desire to trade with him. Here, the owner retained the right to select the persons who should go upon the land and examine the house. Even though the plaintiffs were still considering the purchase of the property when they made the second visit, they did not acquire the status of invitees in the absence of some conduct upon the part of the defendant which induced them to make this visit. n15

Likewise, a Georgia court considered a case where in response to a newspaper advertisement and without first contacting the broker, the plaintiff fell down the stairs in a dark hallway as she attempted to inspect the premises. In upholding the trial court's dismissal of the complaint, the court stated the advertisement contained no express invitation to the public to inspect any of the premises listed in the advertisement, and that candor required the view that the advertisement held out no implied invitation. The advertisement merely called the reader's attention to the fact that certain unfurnished apartments were available for leasing. Without an express invitation, the advertisement did not carry

with it the implication that the reader was invited to inspect the premises without first communicating with the broker.
n16

Razink v. Krutzig, n17 presented an unusual case involving a real estate agent's sign. This plaintiff in this tort action was a speeding, drunken, trespassing snowmobiler who was injured when he ran into the sign. The court found that the agent and other defendants were not protected by a recreational-land-use statute n18 aimed at providing immunity to a landowner who had given written or oral permission for the use of his or her land. Since the plaintiff was a trespasser, there was no immunity since no permission had been given. However, the court found that the defendants were entitled to summary judgment on the ground that there was no evidence that they breached a duty to the snowmobiler with regard to the sign as there was no evidence that the defendants had any knowledge that the sign was placed in the path of an established snowmobile trail.

FOOTNOTES:

(n1)Footnote 1. *See Christopher v. McGuire*, 179 Or. 116, 121, 169 P.2d 879, 881 (Or. 1946) (refusing to attribute duty to broker showing sole customer residence in which neither party had ever been previously present); *Turner v. Carneal*, 156 Va. 889, 895, 159 S.E. 72, 74 (Va. 1931) (real estate agent is not in the same position as the owner or occupant of the premises).

(n2)Footnote 2. 132 N.J. 426, 445, 625 A.2d 1110, 1119 (1993) .

(n3)Footnote 3. *See Coughlin v. Harland L. Weaver, Inc.*, 103 Cal. App. 2d 602, 605-606, 230 P.2d 141, 144 (Cal. Ct. App. 1951) ; *Jarr v. Seeco Constr. Co.*, 35 Wash. App. 324, 330, 666 P.2d 392, 396 (Wash. Ct. App. 1983) . *See generally* Norris, *Torts--Hopkins v. Fox & Lazo Realtors : Imposing a Duty Upon Real Estate Brokers to Warn of Reasonably Discoverable Defects When Conducting Open Houses--Is the Broker Akin to a "Possessor"?*, 25 U. Mem. L. Rev. 807 (1995).

(n4)Footnote 4. *See Masick v. McColly Realtors, Inc.*, 858 N.E.2d 682, 685-86 (Ind. Ct. App. 2006) .

(n5)Footnote 5. *See Masick v. McColly Realtors, Inc.*, 858 N.E.2d 682, 687 (Ind. Ct. App. 2006) .

(n6)Footnote 6. *See Masick v. McColly Realtors, Inc.*, 858 N.E.2d 682, 687 (Ind. Ct. App. 2006) . *See also* *Campbell v. Fed. Home Loan Mortg. Corp.*, 2009 U.S. Dist. LEXIS 11290, at *14 (S.D. Ind. Feb. 13, 2009) (same).

(n7)Footnote 7. 223 Mich. App. 549, 567 N.W.2d 452 (Mich. App. 1997) .

(n8)Footnote 8. 223 Mich. App. 549, 567 N.W.2d 452, 454-455 (Mich. App. 1997) .

(n9)Footnote 9. 223 Mich. App. 549, 567 N.W.2d 452, 456 (Mich. App. 1997) .

(n10)Footnote 10. *See Johnson v. Chupp*, 2003 Del. Super. LEXIS 39, at *7 (Del. Super. Ct. Feb. 11, 2003) .

(n11)Footnote 11. *See Miller v. Fickett*, 48 Mass. App. Ct. 654, 724 N.E.2d 354. 356-357 (2000) , *aff'd* 432 Mass. 1028, 738 N.E.2d 352, 2000 Mass. LEXIS 704 (2000) .

See also *Gibson v. Rezvanpour*, 268 Ga. App. 377, 601 S.E.2d 848 (Ga. Ct. App. 2004) , *cert. denied*, 2004 Ga. LEXIS 904 (Ga., Oct. 12, 2004) (A prospective buyer was bitten by the sellers' dog. The court affirmed the dismissal of the claims against the brokers and agents as there was no evidence that any of the agents and brokers had any knowledge that the dogs were dangerous. Under Georgia law, there is a presumption that dogs are harmless. There was no authority suggesting that real estate professionals should not be allowed to rely on that presumption.).

(n12)Footnote 12. *See*:

California: Coughlin v. Harland L. Weaver, Inc., 103 Cal. App. 2d 602, 230 P.2d 141, 144 (Cal. Ct. App. 1951) .

Tennessee: Smith v. Inman Realty Investment Co., 846 S.W.2d 819, 823 (Tenn. Ct. App. 1992) , *rehearing denied*, 1992 Tenn. App. LEXIS 781 (Tenn. Ct. App. Sept. 30, 1992) (showing of a house under construction).

Washington: Jarr v. Seeco Constr. Co., 35 Wash. App. 324, 666 P.2d 392, 395 (Wash. Ct. App. 1983) .

(n13)Footnote 13. *See Parker v. Welborn*, 236 Ga. App. 344, 511 S.E.2d 917, 918-919 (Ga. Ct. App. 1999) (plaintiff fell down stairs at an open house, she mistook a doorway leading to the basement for a bathroom door).

(n14)Footnote 14. *See Wells v. Polland*, 120 Md. App. 699, 714-718, 708 A.2d 34, 42-44 (Md. Ct. Spec. App. 1998) .

(n15)Footnote 15. *Wilkie v. Randolph Trust Co.*, 316 Mass. 267, 55 N.E.2d 466, 467-468 (Mass. 1944) .

(n16)Footnote 16. *Mortgage Commission Servicing Corp. v. Brock*, 60 Ga. App. 695, 4 S.E.2d 669, 672 (Ga. Ct. App. 1939) .

(n17)Footnote 17. 746 N.W.2d 644 (Minn. 2008) .

(n18)Footnote 18. The statute at issue was *Minn. Stat. § 604A.25*.

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55 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.31

§ 3.31 Broker Duties Under Consumer Protection Laws

Brokers may be liable under consumer protection laws for misrepresentations that they make. n1 In one Illinois case, n2 it was alleged that a broker misrepresented the interest rate on a mortgage that the purchasers were to assume and also misrepresented the length of time the property had been on the market. The court noted that, under applicable Illinois precedents, the purchasers could not recover under the common law without proving that the broker knew that the statements were false. The court declared, however, that the misrepresentation of the interest rate was actionable under consumer-fraud prevention legislation. The representation as to the length of time the property had been on the market was not actionable as there was no claim that the purchasers were misled into believing that they were getting a greater value than the value they ultimately received. n3

A violation of a consumer protection law has also been found to occur in connection with an earnest money agreement. In *Edmonds v. John L. Scott Real Estate, Inc.* n4 a dispute arose as to whether a purchaser was in default. Without conducting an investigation, the broker unilaterally determined that default had occurred. The broker then disbursed half the deposit to the seller and half to itself. This conduct was found to be a violation of Washington's Consumer Protection Act. The broker was also found to have been negligent in preparing the earnest money agreement. With respect to earnest money agreements, this court stated: "Licensed real estate brokers and salespersons, when completing earnest money agreements, are required to comply with the standard of care of a practicing attorney." n5 The broker in this case was also found to have breached its fiduciary duty to the purchaser.

Washington's Consumer Protection Act found at *Washington Revised Code § 64.06.060* reflects the intent of the legislature to preclude agents and brokers from liability under the Consumer Protection Act for fraudulent concealment arising directly from the agents' and brokers' conduct in completing the seller disclosure statement. n6 However, it is possible for a broker or agent's fraudulent concealment which occurs independently from a seller disclosure violation, to constitute a violation of the Consumer Protection Act. n7

Maryland's Consumer Protection Act explicitly exempts real estate salespersons and brokers. n8 Consequently, a legally sufficient claim cannot be stated against a broker or salesperson under this Act. n9

Partly as a result of the consumer protection statutes, the courts have been more inclined to hold brokers liable for

innocent misrepresentations, the general theory being that the purchaser is hurt and has suffered damages regardless of whether or not the broker knew the representation was false. n10

A Massachusetts court has found that the failure of a seller's broker to submit a purchase offer made by a buyer's broker would support a cause of action filed by the buyer's broker against the seller's broker for violation of Massachusetts General Laws chapter 93A, § 11. n11 Similarly, a Louisiana court has found a listing agent liable under the Louisiana Unfair Trade Practices and Consumer Protection Law n12 for failing to submit a prospective buyer's offer to the seller. n13

FOOTNOTES:

(n1)Footnote 1. *See, e.g.:*

Delaware: Young v. Joyce, 351 A.2d 857, 859 (Del. 1975) (court affirmed judgment against brokers in consumer fraud action for misrepresenting that the basement of the house did not have a water leakage problem).

Hawaii: Cieri v. Leticia Query Realty, Inc., 80 Haw. 54, 68, 905 P.2d 29, 43 (Haw.1995) (broker allegedly failed to disclose plumbing problems, court affirmed trial court's judgment in favor of buyers holding that buyers qualified as "consumers" who committed money in a personal investment and therefore had standing to bring an action under Haw. Rev. Stat. ch. 480).

Illinois: Perkins v. Collette, 179 Ill. App. 3d 852, 856-857, 128 Ill. Dec. 707, 534 N.E.2d 1312, 1315 (1989), where the court held that a broker who told purchasers that they could build upon a parcel of property, and who had himself previously applied for a building permit which was denied, committed fraud in violation of the Consumer Fraud and Deceptive Business Practices Act; therefore the purchaser had a cause of action for rescission of the sales contract.

New Jersey: Gennari v. Weichert Co. Realtors, 148 N.J. 582, 608-610, 691 A.2d 350, 355-357 (N.J. 1997) (the court upheld the imposition pursuant to the New Jersey Consumer Fraud Act of strict liability and treble damages upon a real estate broker for material misrepresentation of fact to real estate purchasers).

Tennessee: Stanfill v. Mountain, 301 S.W.3d 179, 194-95 (2009), reh'g denied, 2010 Tenn. LEXIS 19 (Tenn., Jan. 15, 2010); *Fayne v. Vincent*, 301 S.W.3d 162, 173 (Tenn. 2009).

Vermont: Vastano v. Killington Valley Real Estate & Contemporary Assocs., 2010 VT 12, 2010 Vt. LEXIS 14 (2010); *Vastano v. Killington Valley Real Estate*, 182 Vt. 550, 929 A.2d 720, 2007 VT 33 (2007).

See also Carter v. Gugliuzzi, 168 Vt. 48, 716 A.2d 17, 21-22 (Vt. 1998) (broker was a seller involved in commerce within meaning of the Vermont Consumer Fraud Act).

(n2)Footnote 2. *Beard v. Gress*, 90 Ill. App. 3d 622, 46 Ill. Dec. 8, 413 N.E.2d 448 (1980).

(n3)Footnote 3. 413 N.E.2d at 450-452.

(n4)Footnote 4. 87 Wash. App. 834, 942 P.2d 1072 (1997), review denied 134 Wash. 2d 1027, 958 P.2d 313 (1998). The dispute involved a wet basement.

(n5)Footnote 5. 87 Wash. App. 834, 853, 942 P.2d 1072, 1082 (1997), review denied, 134 Wash. 2d 1027, 958

P.2d 313, 1998 Wash. LEXIS 314 (1998) .

(n6)Footnote 6. *See Svendsen v. Stock, 143 Wash. 2d 546, 555, 23 P.3d 455, 460 (Wash. 2001) .*

(n7)Footnote 7. *See Svendsen v. Stock, 143 Wash. 2d 546, 558-559, 23 P.3d 455, 461 (Wash. 2001) .*

(n8)Footnote 8. *Md. Code Ann., Com. Law § 13-104.*

(n9)Footnote 9. *See Dyer v. Criegler, 142 Md. App. 109, 120, 788 A.2d 227, 234 (2002) , aff'd sub nom., Dyer v. Otis Warren Real Estate Co., 371 Md. 576, 810 A.2d 938 (2002) .*

(n10)Footnote 10.

Washington: Mersky v. Multiple Listing Bureau of Olympia, Inc., 73 Wash. 2d 225, 233, 437 P.2d 897, 901 (Wash. 1968) .

(n11)Footnote 11. *See Saab v. Keenan, 2003 Mass. App. Div. 100, 102, 2003 Mass. App. Div. LEXIS 38, at *7-*10 (Mass. Ct. App. June 10, 2003). See also NRT New Eng., Inc. v. Indiciani, 2009 Mass. App. Div. 186, 2009 Mass. App. Div. LEXIS 51 (2009) (steering buyer interested in the plaintiff's property to another seller's property violated the Massachusetts Consumer Protection Act).*

(n12)Footnote 12. This law is found at *La. Rev. Stat. § 51:1401, et seq.*

(n13)Footnote 13. *See Harris v. Poche, 930 So. 2d 165 (La. Ct. App. 2006) , writ denied, 938 So. 2d 74 (La. 2006) .* The prospective buyers were entitled to damages measured as the difference between the purchase price of the home in November 2001, and the appraised value of the home at the time of trial.

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56 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.32

§ 3.32 Duties and Liabilities Arising from Broker Referrals of Third Parties

Brokers and agents are often called upon to recommend other professionals such as appraisers, home inspectors, and builders. n1 While normally passing on a referral should not generate liability on the broker's part, n2 this result may change if the broker receives compensation for the referral or if the broker becomes involved in the subsequent transaction.

In *Sparks v. Re/Max Allstar Realty, Inc.*, n3 the buyers discovered termite infestation and damage in their home shortly after they purchased it, even though the home had been inspected prior to purchase. The buyers sued the broker (among other defendants) claiming that the broker had breached its duty to them by recommending a termite control company. When the buyers were informed of the need for a termite inspection prior to closing, one of the buyers sought advice from the agent. The agent mentioned three companies, including the one used by the buyers. The buyers argued that the agent breached her fiduciary duty to them as their real estate agent by suggesting that the company they used could adequately inspect and, if necessary, treat the house they intended to purchase. The court affirmed a grant of summary judgment in the broker's favor. The court stated that making a recommendation did not amount to a guarantee of performance. After observing that professionals make recommendations to their clients, the court found that by making the recommendation, the agent was not accepting any responsibility for the work that the selected company would perform nor providing a guarantee. n4

One court has considered the following specific issue: "Who, in the triangular relationship between a real estate agent, a builder, and a landowner, owes that landowner a duty to disclose that the realtor's recommendation of the contractor may have been influenced by the receipt of a finder's fee from the builder?" n5 In dictum, this court found that the agent had an affirmative duty to disclose to the client any fees the broker was paid for referring those clients to particular builders. The court stated that the agent's duty to disclose referral fees was settled "black-letter" law. n6

West Virginia's high court has held that while a broker bears no responsibility to conduct an independent investigation of a latent defect, when a broker volunteers to secure an inspection of the premises (or some part of the premises such as the heating system), by retaining on behalf of the buyer a third party to conduct the inspection, then that broker may be held liable to the buyer for damages if the broker in retaining said third party is negligent in the selection and retention of the third party and if such negligence proximately causes harm to the buyer. This court qualified its ruling by stating

that it did not impose upon a real estate broker the affirmative duty to conduct a comprehensive inquiry into the credentials of an individual hired as an independent contractor. Where the independent contractor selected is a licensed, reputable individual or firm, for instance, the broker is not obligated to engage in a personal inquiry into the credentials or training of the contractor. However, where the exercise of reasonable diligence would disclose facts demonstrating that the contractor was clearly incompetent for the particular task contemplated, a reasonably prudent broker should not retain the contractor. n7

A Texas court addressed allegations that agents were negligent for selecting a non-bonded inspector to do a termite and dry rot inspection. The court affirmed a directed verdict for the broker on the ground that the home buyer had failed to show that the agents' failure to select a bonded inspector proximately caused the damage the buyers sustained. n8

There is at least some support for the proposition that if a broker represents the buyer, the broker has a duty to assist in procuring a good, qualified inspection. It would behoove a buyer's agent to recommend an inspection by a competent inspector or other professional (such as an engineer or architect) particularly if the sales contract will contain an "as is" clause. In this situation, the contract should be contingent upon the receipt of a satisfactory inspection report. One commentator has asserted that the inclusion of an "as is" clause in a sales agreement sets up a liability trap for a buyer's agent since the inclusion of such a clause conflicts with the agent's duty of loyalty to his or her client. n9

The general rule is that if one person contracts with a competent person to do work, not in itself unlawful or intrinsically dangerous in character, and exercises no control over the work contracted for, that person cannot be liable for the negligence of the independent contractor or that contractor's servants in the performance of the work. n10 There are exceptions to this rule, however. Some jurisdictions have allowed a cause of action to proceed for negligent hiring, reasoning that negligently securing the services of an independent contractor falls within one of the severally typically recognized exceptions to the rule that an employer is not liable for the actions of the employer's independent contractor. n11

The tort of negligent hiring can come into play since brokers often engage an inspector at the behest of the prospective purchaser to determine that the premises is structurally sound or to determine that a component of the premises (e.g., the furnace) is functioning properly. n12

FOOTNOTES:

(n1)Footnote 1. Some jurisdictions require that the licensee assist the buyer in obtaining a home inspection. See *Waddles v. Lacour*, 950 So. 2d 937, 943 (La. Ct. App. 2007) , rehearing denied, 2007 La. App. LEXIS 538 (Mar. 21, 2007) and 2007 La. App. LEXIS 540 (Mar. 21, 2007) writ denied, 959 So. 2d 496 (La. 2007) and 959 So. 2d 498 (La. 2007) (Although La. Rev. Stat. § 9:3897(A)(6) requires the agent to help the buyer arrange for a property inspection, this provision does not require the agent to arrange the property inspection when the client does not want one.). See also *Crandall v. Grbic*, 36 Kan. App. 2d 179, 190, 138 P.3d 365, 374-75 (2006) (Licensees have a duty to recommend professional inspections, but they do not have a duty to perform a home inspection for their clients.).

(n2)Footnote 2. See, e.g., *Carleton v. Winter*, 901 A.2d 174, 178-79 (D.C. 2006) (Agent's recommendation of a home inspector was not a misrepresentation to the buyers nor was it a violation of the D.C. Consumer Protection Procedures Act.).

(n3)Footnote 3. 55 S.W.3d 343 (Ky. Ct. App. 2000) .

(n4)Footnote 4. 55 S.W.3d 343, 349 (Ky. Ct. App. 2000) .

(n5)Footnote 5. *Petenbrink v. Superior Home Builders, Inc.*, 1999 Del. Super. LEXIS 461, at *4 (Del. Sup. Ct. 1999) .

(n6)Footnote 6. *Petenbrink v. Superior Home Builders, Inc.*, 1999 Del. Super. LEXIS 461, at *4 (Del. Sup. Ct.

1999) .

(n7)Footnote 7. *See Thomson v. McGinnis*, 195 W. Va. 465, 472, 465 S.E.2d 922, 929 (W. Va. 1995) .

(n8)Footnote 8. *See Voye v. Ragan*, 616 S.W.2d 673, 675 (Tex. Civ. App. 1981) .

(n9)Footnote 9. *See Moore, The Buyer's Agent and the "As Is" Clause: A Liability Trap?*, 27 Real Est. L.J. 374 (1999).

(n10)Footnote 10. *See Thomson v. McGinnis*, 195 W. Va. 465, 465 S.E.2d 922, 928 (W.Va. 1995) .

(n11)Footnote 11. *See Chapman v. Mutual Service Casualty Ins. Co.*, 35 F. Supp. 2d 699, 706-707 (E.D. Wis. 1999) , applying Wisconsin law; *Payne v. Lee*, 686 F. Supp. 677, 679 (E.D. Tenn. 1988) , *aff'd without opinion*, 872 F.2d 1027 (6th Cir. 1989) ; *Sullivan v. St. Louis Station Assocs.*, 770 S.W.2d 352, 354-355 (Mo. Ct. App. 1989) ; *Thomson v. McGinnis*, 195 W. Va. 465, 465 S.E.2d 922, 929 (W. Va. 1995) . *See generally* Restatement (Second) of Torts, § 411. This section requires that physical harm result from the negligence.

(n12)Footnote 12. *Cf. Heller v. D. W. Fish Realty Co.*, 93 Conn. App. 727, 731, 890 A.2d 113, 117 (2006) . (The agent hired an unqualified individual to perform a well inspection for buyers. The agent was found to have breached the parties(contract, committed negligence in the performance of her duties and the agent had violated the Connecticut Unfair Trade Practices Act.); *Mango v. Pierce-Coombs*, 370 N.J. Super. 239, 256, 851 A.2d 62, 72 (N.J. Super. Ct. App. Div. 2004) (buyer unsuccessfully sued agent for negligent hiring with respect to a party hired to inspect a home's septic system).

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57 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.33

§ 3.33 Brokers Acting in Several Capacities

Brokers sometimes attempt to act in several different capacities in one transaction. For example, a broker who is also a builder may sell buildings that he or she constructed. The best advice for a broker or agent who is attempting to act in several different capacities is to always comply with the high standards imposed upon agents and brokers. To do otherwise is to risk suspension or revocation of their broker or agent's license. If compliance is not possible, the broker or agent should reconsider wearing several hats in the same transaction.

In *White v. Department of Business and Professional Regulation* n1 the court affirmed the revocation of a broker's license for failing to deposit funds in an escrow account in accordance with a sales contract. The broker contended that he was not acting in his capacity as a real estate broker in this transaction, but rather as a builder and a seller of a lot when he accepted monies from purchasers to begin construction. The contract provided that the broker was acting as a broker and that the deposit would be held in escrow in his realty company. The court stated that while the broker wore several "hats" in the transaction, the evidence supported the conclusion that one of the hats worn was that of a licensed real estate broker. n2

FOOTNOTES:

(n1)Footnote 1. 715 So. 2d 1130 (Fla. Dist. Ct. App. 1998) .

(n2)Footnote 2. 715 So. 2d 1130, 1131 (Fla. App. 1998) .

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58 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.34

§ 3.34 Negligent Hiring of Agents and Salespersons

A majority of jurisdictions recognize the direct liability of an employer to third parties who are injured by unfit, incompetent, or unsuitable employees. n1 The origin of the doctrine making an employer liable for negligent hiring, as well as negligent retention, arose out of the common law fellow-servant law which imposed a duty on employers to select employees who would not endanger fellow employees by their presence on the job. n2 This concept was expanded to include the recognition of a duty to exercise reasonable care for the safety of members of the public. n3

The concept of direct employer liability for negligent hiring is recognized by Restatement (Second) of the Law of Agency § 213 which states in part:

A person conducting an activity through servants or other agents is subject to liability for harm resulting from his conduct if he is negligent or reckless ... (b) in the employment of improper persons or instrumentalities in work involving risk of harm to others.

Liability is predicated on the employer's negligence in placing a person with known propensities or propensities that should have been discovered by reasonable investigation, in an employment position in which, because of the circumstances of the employment, it should have been foreseeable that the hired individual posed a threat of injury to others. n4 Direct liability can be imposed on the employer for the employee's criminal acts, such as assaults, since the basis of the liability is the employer's negligence in selecting or supervising the employee. n5

The torts of negligent hiring, negligent supervision, and negligent retention usually involve employees. Typically, agents and salespersons are independent contractors of their brokers. This can raise an issue of whether the broker can be liable for these torts since those who hire independent contractors generally are not liable for the negligence of the independent contractor. However, liability can occur under the particular risk doctrine or on a theory that the defendant was negligent in hiring the contractor. n6

In *Pruitt v. Pavelin*, n7 a broker was found liable on a theory of negligent hiring. The salesperson the broker had hired had previously forged a signature, had been convicted of passing bad checks, and had lied to the company about obtaining a license, and was unlicensed.

FOOTNOTES:

(n1)Footnote 1. See, e.g., *Svacek v. Shelley*, 359 P.2d 127, 130-131 (Alaska 1961) ; *Evan v. Hughson United Methodist Church*, 8 Cal. App. 4th 828, 10 Cal. Rptr. 2d 748, 753 (Cal. Ct. App. 1992) , review denied; *Connes v. Molalla Transport System*, 831 P.2d 1316, 1320-1321 (Colo. 1992) (en banc); *Petrik v. New Hampshire Insurance Company*, 379 So.2d 1287, 1290-1291 (Fla. Dist Ct. App. 1979) , cert. denied, 400 So. 2d 8 (Fla. 1981) ; *Joiner v. Mitchell County Hospital Authority*, 125 Ga. App. 1, 186 S.E.2d 307, 309 (Ga. Ct. App. 1971) , aff'd, 229 Ga. 140, 189 S.E.2d 412 (Ga. 1972) ; *Tindall v. Enderle*, 162 Ind. App. 524, 528, 320 N.E.2d 764, 767 (Ind. Ct. App. 1974) ; *Godar v. Edwards*, 588 N.W.2d 701, 709 (Iowa 1999) ; *Murray v. Modoc State Bank*, 181 Kan. 642, 313 P.2d 304, 309-312 (Kan. 1957) ; *Oakley v. Flor-Shin, Inc.*, 964 S.W.2d 438, 442 (Ky. Ct. App. 1998) ; *Copithorne v. Framingham Union Hospital*, 401 Mass. 860, 520 N.E.2d 139, 142-143 (Mass. 1988) ; *Ponticas v. K.M.S. Investments*, 331 N.W.2d 907, 911 (Minn. 1983) ; *Di Cosala v. Kay*, 91 N.J. 159, 450 A.2d 508, 516 (N.J. 1982) ; *Pleasants v. Barnes*, 221 N.C. 173, 19 S.E.2d 627, 629 (N.C. 1942) ; *Coath v. Jones*, 277 Pa. Super. 479, 419 A.2d 1249, 1250 (Pa. Super. Ct. 1980) ; *Welsh Manufacturing v. Pinkerton's*, 474 A.2d 436, 438-439 (R.I. 1984) ; *Stone v. Hurst Lumber Co.*, 15 Utah 2d 49, 386 P.2d 910, 911-912 (Utah 1963) ; *Haverly v. Kaytec, Inc.*, 169 Vt. 350, 738 A.2d 86, 91 (Vt. 1999) ; *J. v. Victory Tabernacle Baptist Church*, 236 Va. 206, 372 S.E.2d 391, 394 (Va. 1988) ; *Carlsen v. Wackenhut Corp.*, 73 Wash. App. 247, 868 P.2d 882, 886 (Wash. App. Ct. 1994) , review denied, 124 Wash. 2d 1022, 881 P.2d 255 (1994) . See also Restatement (Second) Agency § 213. See generally Patrinelis, Annot., *Liability of Employer, Other than Carrier, for a Personal Assault Upon Customer, Patron, or Other Invitee*, 34 A.L.R.2d 372 (1954) .

(n2)Footnote 2. See Loftus, *Employer's Duty to Know Deficiencies of Employees*, 16 Clev.-Mar. L. Rev. 143, 145 (1967).

(n3)Footnote 3. See *Ponticas v. K.M.S. Investments*, 331 N.W.2d 907, 911 (Minn. 1983) .

(n4)Footnote 4. See *Ponticas v. K.M.S. Investments*, 331 N.W.2d 907, 911 (Minn. 1983) . See also *Connes v. Molalla Transport System, Inc.*, 831 P.2d 1316, 1320 (Colo. 1992) (en banc) (tort of negligent hiring is based on the principle that a person conducting an activity through employees is subject to liability for harm resulting from negligent conduct in the employment of improper persons in work involving risk of harm to others).

(n5)Footnote 5. See *Wegner v. Delly-Land Delicatessen, Inc.*, 270 N.C. 62, 153 S.E.2d 804, 807 (N.C. 1967) .

(n6)Footnote 6. See generally Zamore, *Business Torts*, § 5.34.

(n7)Footnote 7. 141 Ariz. 195, 201-203, 685 P.2d 1347, 1353-1355 (Ariz. Ct. App. 1984) .

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59 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.35

§ 3.35 Valuation Opinions

Real estate brokers and agents routinely suggest listing prices for properties that they list. Such activities clearly involve an estimate of a property's fair market value. It is more common for a real estate seller to rely on the broker or agent in determining a listing price than for a seller to hire an appraiser to determine a listing price. Some laws or regulations recognize that offering this type of advice to their clients is routinely done by brokers and agents. For example, Mississippi Code § 73-34-5 (2), which is part of a chapter regarding appraisers, allows a real estate salesperson, in the ordinary course of business, to offer an opinion as to the "price of real estate for the purpose of a prospective listing or sale" but such opinion may not be referred to as an appraisal, no compensation may be charged for the service and the opinion may not be used to establish a property value. n1

Surprisingly, there appears to be little litigation involving brokers or agents offering their advice as to the fair market value of property. *Duhl v. Nash Realty, Inc.* n1.1 is one such case wherein an agent advised home sellers on what the lowest possible price was that their home would bring in a quick sale. As a result they listed the home for sale with the agent and her broker for \$167,500, and they purchased another home. The net proceeds from the old home would be the only source of equity for the purchase of the new home. The old home did not sell and eventually they listed it for sale with another broker at a price of \$144,000. This price was subsequently dropped to \$137,000. They sued the broker and agent for fraud, negligence, breach of contract, and violation of Consumer Fraud and Deceptive Practices Act. As of the date of their amended complaint, they had received no offers on their old home.

The court found that there was no breach of contract. The court held that the plaintiff's remedy for the error in valuing the home lay in tort. With respect to the fraud claim the court found that even though the representations were an opinion as to value, the complaint had stated a cause of action for fraud because the brokers knew that the home buyers were relying on this opinion when they purchased the new home. n2 The home buyers had also stated a cause of action under the Consumer Fraud and Deceptive Business Practices Act since the complaints for common-law fraud were based on intentional misrepresentation of present facts. n3

Some jurisdictions are willing to permit a valuation opinion in an eminent domain proceeding from a real estate licensee (broker, agent, or salesperson) who is not licensed as a real estate appraiser. n4

The use of a real estate broker or agent's valuation opinion outside of the context of determining a listing or offer price is often limited. In a case involving a divorce, the trial court rejected the wife's "appraisal" which had been prepared by a licensed real estate agent who was not also a licensed real estate appraiser. In affirming the rejection of this testimony, the court stated, "Estimating the fair market value of property is the specialized function of licensed appraisers. ... While experienced real estate brokers undoubtedly know a great deal about property values, the specialized scope of the realtors' profession is not property appraising and may well be beyond the legal authorization afforded the profession."
n5

FOOTNOTES:

(n1)Footnote 1. This language is also found in Rule IV (A) of the Mississippi Real Estate Commission.

(n2)Footnote 1.1. *102 Ill. App. 3d 483, 57 Ill. Dec. 904, 429 N.E.2d 1267 (Ill. App. 1982)* . See also *Century Land Dev., L.P. v. Weits*, 2009 U.S. Dist. LEXIS 7031, at *11 (S.D. Fla. Jan. 30, 2009) , applying Florida law (real estate agent had a duty to provide property valuation information using skill, care and diligence).

(n3)Footnote 2. *102 Ill. App. 3d 483, 57 Ill. Dec. 904, 429 N.E.2d 1267, 1274-1275 (Ill. App. 1982)* .

(n4)Footnote 3. *102 Ill. App. 3d 483, 57 Ill. Dec. 904, 429 N.E.2d 1267, 1277 (Ill. App. 1982)* .

(n5)Footnote 4. See *McGaffic v. Redevelopment Authority of Newcastle*, 732 A.2d 663, 673 (Pa. Cmwlth.) , *appeal denied*, 560 Pa. 733, 745 A.2d 1226 (1999) and 561 Pa. 663, 747 A.2d 903 (1999) ; *King v. West Penn Power Co.*, 946 A.2d 184, 188 (Pa. Commw. 2008) , *appeal denied*, 598 Pa. 776, 958 A.2d 1049 (2008) .

(n6)Footnote 5. *Katner v. Katner*, 28 So. 3d 566, 572 (La. App. 2009) .

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60 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.36

§ 3.36 Unauthorized Practice of Law May Constitute Negligence

It has been recognized that a violation of Article 17 of the National Association of Realtors(R) Code of Ethics, n1 which bans the unauthorized practice of law by Realtors(R), is evidence upon which a trier of fact may find negligence. n2 Because of the interrelationship between negligence and breach-of-contract issues, it has also been concluded that a breach of this standard of professional conduct would also establish a violation of an agent's duties under the listing agreement with the broker. n3

The Supreme Courts of Nebraska n4 and Washington n5 have ruled that a broker could be found negligent for defects in the preparation of a real estate contract. In the Nebraska case, the boundary line between the seller's land and that of a neighbor was unclear. When the sellers went to sell their land, they informed the broker that they wanted the neighbors to have the right to obtain an area containing a driveway and a certain grove of trees. The listing and contract, prepared by the broker, simply provided for the sale to a third party of "40 acres more or less." Much litigation thereafter ensued over boundary disputes, and the court held that the broker had breached his duties in the drafting and performance of the real estate contract. n6

In the Washington case, the broker prepared a sales contract that varied, in many respects, from the instructions given him. When the variations were discovered, the seller and purchaser agreed to rescind the contract and the seller brought an action against the broker to recover the commission. The court declared that "[i]f the negligence, ignorance, stupidity, incompetence or fraud of a broker causes the rescission of a sale negotiated by the broker, the principal is entitled, among other items of damage, to recover the commission paid." n7

A more limited rule was developed by the Supreme Court of Oklahoma in *Ellis v. Hollis*. n8 There, a real estate broker was retained to sell a farm property. Through the broker's services, the farmer/seller was able to satisfy existing mortgages on the property for a discount. A purchaser was found who, according to the seller, was supposed to pay \$7,200 for the farm (\$4,000 in cash from the sale of the purchaser's property and a purchase money mortgage for the balance). However, the broker drafted a sales contract that contained terms that allegedly were different from those agreed upon and that were ambiguous, indefinite and uncertain. The farmer confronted the purchaser, who agreed to rescission. Thereafter, the broker sued the farmer for the value of the services rendered in negotiating the settlement of the mortgages. The farmer counterclaimed, contending that the broker's negligence prevented the sale of the farm for

\$7,200 and that the farm could not thereafter be sold for more than \$5,200. The court sustained the dismissal of the counterclaim. It held that the farmer's inability to sell his property to the prospective purchaser was not "the natural and proximate result" of the allegedly negligent preparation of a real estate contract by the broker. The court noted that the inability to sell the farm at the stated price resulted from the agreement between the seller and the purchaser to cancel the contract. n9 A dissenting judge, citing the Washington decision discussed above, argued that if the broker had negligently prepared the contract and thus frustrated the sale, the broker should be held liable for the damage. n10

Another Washington court has stated with respect to earnest money agreements: "Licensed real estate brokers and salespersons, when completing earnest money agreements, are required to comply with the standard of care of a practicing attorney." n11

Brokers should approach the drafting of any document with care and when uncertain they should consult an attorney. Brokers should also take care that their conduct does not constitute the unauthorized practice of law. n12

Brokers should exercise particular care and consider consulting their own counsel when the property is described by referencing its street address even though less than the entire parcel is being sold. Should the buyer assert that they are purchasing the entire parcel, the broker may find himself or herself a defendant in a negligence action. n13

FOOTNOTES:

(n1)Footnote 1. Article 17 of the National Association of Realtors(R) Code of Ethics states: "The Realtor shall not engage in activities that constitute the unauthorized practice of law and shall recommend that legal counsel be obtained when the interest of any party to the transaction requires it."

(n2)Footnote 2. *See Menzel v. Morse*, 362 N.W.2d 465, 473 (Iowa 1985) .

Cf. Mattielligh v. Poe, 57 Wash. 2d 203, 204, 356 P.2d 328, 329 (Wash. 1960) ("When a broker undertakes to practice law, he is liable for negligence.").

(n3)Footnote 3. *See Crutchley v. First Trust and Savings Bank*, 450 N.W.2d 877, 880 (Iowa 1990) , rehearing denied.

(n4)Footnote 4. *Wisnieski v. Harms*, 188 Neb. 721, 199 N.W.2d 405 (Neb. 1972) .

(n5)Footnote 5. *Mattielligh v. Poe*, 57 Wash. 2d 203, 356 P.2d 328 (Wash. 1960) .

(n6)Footnote 6. *Wisnieski v. Harms*, 188 Neb. 721, 199 N.W.2d 405, 408 (Neb. 1972) .

See also Tetherow v. Wolfe, 223 Neb. 631, 392 N.W.2d 374 (Neb. 1986) , the Supreme Court of Nebraska held that a real estate broker was negligent in representing the interests of his seller/principal where the broker's agent had a buyer execute an improper form of contract in the sale of property. The seller had retained the broker for the purpose of selling his property on an "all cash" basis. The broker's agent had the buyer execute a sales contract which included a paragraph making the sale subject to the buyer's ability to obtain a mortgage from a designated bank. The broker's agent assured the seller that, although the contract contained a mortgage contingency clause, the deal was still all cash and there would be no problems with the contract form. The broker's agent further informed the seller that a "correct form" would be prepared at a later time. The seller, in reliance upon the statements of the broker's agent, executed the contract with the mortgage contingency clause intact. The buyer was unable to obtain a mortgage and subsequently demanded and received from the seller the return of the buyer's down payment. The seller instituted an action against the broker claiming that the broker's agent was negligent in using the wrong form of contract and in representing to the seller that the contract permitted the sellers to hold the purchasers to an unconditional cash sale. The court held in favor of the seller, awarding him damages equal to the "benefit of the sale which would otherwise have been realized but for the fact that the purchaser was not obliged to complete the purchase." The court, in awarding attorney fees to the seller, stated:

One who through the tort of another has been required to act in the protection of his interests by bringing or defending an action against a third person is entitled to recover reasonable compensation for loss of time, attorney fees and other expenditures thereby suffered or incurred in the earlier action.

(n7)Footnote 7. *Mattieligh. v. Poe*, 57 Wash. 2d 203, 356 P.2d 328, 330 (Wash. 1960) .

(n8)Footnote 8. 1965 OK 15, 398 P.2d 832 (Okla. 1965) .

(n9)Footnote 9. 398 P.2d at 834 .

(n10)Footnote 10. 398 P.2d at 837 .

(n11)Footnote 11. *Edmonds v. John L. Scott Real Estate, Inc*, 87 Wash. App. 834, 853, 942 P.2d 1072, 1082 (Wash. Ct. App. 1997) .

(n12)Footnote 12. See Ch. 7 below for a discussion of the unauthorized practice of law by real estate brokers. See generally Goudey, *Too Many Hands in the Cookie Jar: The Unauthorized Practice of Law by Real Estate Brokers*, 75 Or. L. Rev. 889 (1996); Lee, *The Limited Ability of Real Estate Brokers to Prepare Contracts*, 69 N.Y. St. B. J. 32(Mar./Apr. 1997).

(n13)Footnote 13. See *Polyzos v. Cotrupi*, 264 Va. 116, 123, 563 S.E.2d 775, 778-779 (Va. 2002) .

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61 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.37

§ 3.37 Exculpatory Clauses

As a general rule, courts have long recognized that, subject to certain exceptions, parties may contract that one shall not be liable for his or her negligence to another. n1 Exculpatory clauses are invalid and will not be enforced in three situations:

- (1) when a party to the contract attempts to avoid liability for intentional conduct or harm caused by reckless, wanton, or gross behavior;
- (2) when the contract results from grossly unequal bargaining power; and
- (3) when the transaction is one adversely affecting the public interest. n2

In determining whether an exculpatory clause affects the public interest, courts often consider the following six criteria:

- (1) Whether the clause concerns a business of a type generally thought suitable for public regulation.
- (2) Whether the party seeking exculpation is engaged in performing a service of great importance to the public, which is often a matter of practical necessity for some members of the public.
- (3) Whether the party holds himself or herself out as willing to perform this service for any member of the public who seeks it, or at least for any member coming within certain established standards.
- (4) Whether as a result of the essential nature of the service, in the economic setting of the transaction, the party invoking exculpation possesses a decisive advantage of bargaining strength against any member of the public who seeks the services.
- (5) Whether in exercising a superior bargaining power the party confronts the public with a standardized adhesion contract of exculpation, and makes no provision whereby a purchaser may pay additional reasonable fees and obtain protection against negligence.

(6) Whether as a result of the transaction, the person or property of the purchaser is placed under the control of the seller, subject to the risk of carelessness by the seller or the seller's agents. n3

An exculpatory clause in a home inspector's contract with a customer has been found to be against public policy and hence unenforceable. n4

The broker may argue that an exculpatory clause within the purchase agreement protects the broker from any liability when the broker is sued by the buyer. n5 If the buyer can prove that the purchase agreement was fraudulently induced, an exculpatory clause in the purchase agreement should not protect the broker since such clauses are only enforceable when they are knowingly and willingly made and are free from fraud. n6

One court has held that an exculpatory clause in a form purchase contract would not protect the buyer's agents. The court concluded that these release provisions did not immunize the buyer's brokers from liability because the clause did not appear to be a negotiated term. n7 If a jurisdiction requires that exculpatory provisions be a negotiated term in order for the provision to be enforceable, the fact that the provision is boilerplate in a pre-printed form will weigh against a conclusion that the provision was negotiated. n8

In another case, the purchase contract provided in part that: "Buyer hereby expressly waives any and all claims for damages because of any representation made by any person whomsoever other than contained in this agreement" The court found that this did not protect the seller's brokers from a misrepresentation regarding the size of the land sold. The court stated that the fallacy of the broker's argument that this clause protected him from liability was that the specific representation relied upon by the buyers was that the property contained 7.8 acres and that such a representation was typed in the very same agreement containing the exculpatory clause. The court stated that the language of the purported exculpatory clause did not relieve the seller's brokers from written recitals contained in the agreement itself. n9

FOOTNOTES:

(n1)Footnote 1. *See, e.g., Crawford v. Buckner*, 839 S.W.2d 754, 756 (Tenn. 1992) , *application denied*, 1994 Tenn. LEXIS 213 (Tenn. June 27, 1994) .

(n2)Footnote 2. *See Adloo v. H.T. Brown Real Estate, Inc.*, 344 Md. 254, 260, 686 A.2d 298, 301 (Md. 1996) .

See also Crawford v. Buckner, 839 S.W.2d 754, 760 (Tenn. 1992) , *application denied*, 1994 Tenn. LEXIS 213 (Tenn. June 27, 1994) (finding an exculpatory clause in a residential lease contract to be contrary to public policy); *Olson v. Molzen*, 558 S.W.2d 429, 432 (Tenn. 1977) (holding an exculpatory clause in a contract for medical treatment is contrary to public policy).

(n3)Footnote 3. *See Russell v. Bray*, 116 S.W.3d 1, 5-6 (Tenn. Ct. App. 2003) , *appeal denied*, 2003 Tenn. LEXIS 822 (Tenn. Sept. 2, 2003) .

(n4)Footnote 4. *See Russell v. Bray*, 116 S.W.3d 1, 8 (Tenn. Ct. App. 2003) , *appeal denied*, 2003 Tenn. LEXIS 822 (Tenn., Sept. 2, 2003) .

(n5)Footnote 5. *See, e.g., Laeroc Waikiki Parkside, LLC v. K.S.K. (Oahu) Ltd. Partnership*, 115 Haw. 201, 221-27, 166 P.3d 961, 981-87 (Haw. 2007) (nonrecourse provision is a type of exculpatory clause). A nonrecourse provision in a hotel sales agreement limited the buyer's damages for contract default to the sale proceeds. Since the buyer did not raise contentions that implicated fraud, a criminal act, or willful misconduct, the buyer's fiduciary duty claims were precluded by the nonrecourse provision.

(n6)Footnote 6. *See Dawson v. Hummer*, 649 N.E.2d 653, 660 (Ind. Ct. App. 1995) . *See also Allen v. Overturf*,

234 Ark. 612, 616, 353 S.W.2d 343, 345 (Ark. 1962) (If a party is guilty of fraud in making a contract, he cannot exculpate himself from the consequences of his own wrong by a provision in writing that his fraudulent oral representations shall not be used as evidence against him in a case in which fraud and deceit is the gist of the cause.).

(n7)Footnote 7. *See Aranki v. RKP Investments, Inc.*, 194 Ariz. 206, 209-210, 979 P.2d 534, 537-538 (Ariz. Ct. App. 1999) .

(n8)Footnote 8. *See Evans v. Singer*, 518 F. Supp. 2d 1134, 1138 (D. Ariz. 2007) (applying Arizona law).

(n9)Footnote 9. *See Carrel v. Lux*, 101 Ariz. 430, 442, 420 P.2d 564, 576 (Ariz. 1966) .

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62 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.38

§ 3.38 Integration, Merger and Disclaimer Clauses

An integration clause is a specific provision stating in substance that the document embodies the parties' entire agreement. n1 A sample integration clause is shown below:

The parties have incorporated in this Agreement their entire understanding. No oral statement or prior written matter extrinsic to this Agreement shall have any force or effect. The parties are not relying upon, and specifically herein repudiate, any representations other than those expressly set forth herein. All prior agreements between the parties, whether written or oral, are hereby revoked and held for not. n2

Many real estate sales contracts contain such a clause. n3 These clauses are also referred to as merger clauses. n4

Disclaimer clauses, though not the same as an integration or merger clause, have a similar effect. A disclaimer clause essentially provides that the buyer and seller have not relied on the broker's advice or representations and that they waive any claims against the broker arising out of such statements. n5

The effect of merger and disclaimer clauses on pre-contractual misrepresentations poses significant questions of public policy. There are two prevailing views on the effect of these clauses. One view is based on the sanctity of the right to contract, and holds that a party is bound by a specific disclaimer even if the contract was fraudulently obtained. The other view is based on the proposition that fraud vitiates all contracts. Under this view, a party to a contract is not bound by a disclaimer if it was fraudulently obtained. n6

The majority of courts hold that merger and disclaimer clauses do not preclude actions for fraudulent misrepresentations. n7 However, a handful of courts have allowed such clauses to bar even fraudulent misrepresentation claims when the disclaimer clause was specifically tailored. n8

Some jurisdictions hold that a seller's broker may enforce the integration clause and any other exculpatory provision in the written agreement between a seller and a buyer. n9 However, the general rule is that an integration clause which negates the existence of any representations not incorporated into the contract may not be used to escape liability for misrepresentations. n10

In one case a court found that an entire agreement clause in the sales contract barred a home buyer from asserting a malpractice claim against the seller's real estate agent based on the agent's failure to disclose that the home was infested with bats. However, the court noted that in certain circumstances the seller's real estate agent could be liable to the buyer if the agent was aware of defects in the property but failed to disclose them. n11 However, another court has held that a disclaimer and merger clause in a sales contract did not bar the buyer's action against her agent since the agent's duties were found in the Georgia Brokerage Relationships in Real Estate Transaction Act. n12

An entire agreement clause in a sales contract does not equate to an exculpatory clause. Exculpatory clauses limit liability, generally for negligent acts, while entire agreement clauses generally concern contractual liability, and provide that all oral representations have merged into the written contract. While an entire agreement provision may, in some instances, result in a waiver of claims, the parties ultimately control its effect by reducing all vital terms of their contract to writing. Furthermore, a party signing a contract containing an entire agreement clause is not absolutely bound by it. If that party later learns of a fraud that induced the contract but is not reflected in the contract's terms, the party has the choice of rescinding the contract and suing on the fraud or affirming the contract and being bound by its terms. The entire agreement clause will bar the fraud claim only in the latter instance. n13

FOOTNOTES:

(n1)Footnote 1. See, e.g., *E.G. L. Gem Lab Ltd. v. Gem Quality Inst., Inc.*, 90 F. Supp. 2d 277, 303 (S. D. N.Y. 2000) *aff'd*, 4 Fed. Appx. 81, 2001 U.S. App. LEXIS 2542 (2d Cir. 2001) . See also *Tiburzi v. Department of Justice*, 269 F.3d 1346, 1354 (Fed. Cir. 2001) , citing Black's Law Dictionary 812 (7th ed. 1999) (an integration clause is a contractual provision stating that the contract represents the parties' complete and final agreement and supersedes all informal understandings and oral agreements relating to the subject matter of the contract).

(n2)Footnote 2. This clause is taken from *Roll ex rel. Ralph D. Kaiser Co. v. Rothenberg (In re Rothenberg)*, 203 B.R. 827, 829-830 (Bankr. D.C. 1996) .

(n3)Footnote 3. Cf. *Tiburzi v. Department of Justice*, 269 F.3d 1346, 1354 (Fed. Cir. 2001) ("All well-drafted contracts contain integration clauses.").

(n4)Footnote 4. See *Billingham v. Dornemann*, 55 Mass. App. Ct. 166, 175, 771 N.E.2d 166, 173 (Mass. App. Ct. 2002) . See also *Tusch Enterprises v. Coffin*, 113 Idaho 37, 44 n. 3, 740 P.2d 1022, 1029 n. 3 (Idaho 1987) (a merger clause has been defined as a provision in a contract to the effect that the written terms may not be varied by prior or oral agreements because all such agreements have been merged into the written document).

(n5)Footnote 5. See *Ikola v. Schoene*, 264 Ga. App. 338, 340, 341 590 S.E.2d 750, 752 (Ga. Ct. App. 2003) .

(n6)Footnote 6. *Snyder v. Lovercheck*, 992 P.2d 1079, 1084 (Wyo. 1999) .

(n7)Footnote 7. See *Bates v. Southgate*, 308 Mass. 170, 31 N.E.2d 551, 558 (1941) ; *Snyder v. Lovercheck*, 992 P.2d 1079, 1084 (Wyo. 1999) .

(n8)Footnote 8. See *Danann Realty Corp. v. Harris*, 5 N.Y.2d 317, 184 N.Y.S.2d 599, 157 N.E.2d 597, 598 (N.Y. 1959) ; *LaFazia v. Howe*, 575 A.2d 182, 186 (R.I. 1990) .

(n9)Footnote 9. See *Blumenstock v. Gibson*, 811 A.2d 1029, 1038-1039, 2002 PA Super 339 (Pa. Super. Ct. 2002) , *appeal denied*, 573 Pa. 714, 828 A.2d 349 (Pa. 2003) ; *Bowman v. Meadow Ridge, Inc.*, 419 Pa. Super. 511, 615 A.2d 755, 758 (Pa. Super. 1992) .

(n10)Footnote 10. See *Grube v. Daun*, 173 Wis. 2d 30, 45, 496 N.W.2d 106, 111 (Wis. Ct. App. 1992) , *review denied*.

(n11)Footnote 11. *See Pennington v. Braxley*, 224 Ga. App. 344 (480 S.E.2d 357) (1997) , *cert. denied* 1997 Ga. LEXIS 487 (Ga. May 2, 1997) .

(n12)Footnote 12. *See Ikola v. v. Schoene*, 264 Ga. App. 338, 340, 341 590 S.E.2d 750, 752 (Ga. Ct. App. 2003) .

(n13)Footnote 13. *See Pennington v. Braxley*, 224 Ga. App. 344, 347, 480 S.E.2d 357, 360 (Ga. Ct. App. 1997) , *cert. denied* 1997 Ga. LEXIS 487 (Ga. May 2, 1997) .

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63 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3 The Broker's Duties and Liabilities *

PART V. Other Duties, Responsibilities and Liabilities

10-3 Real Estate Brokerage Law and Practice § 3.39

§ 3.39 Economic Loss Rule

The economic loss rule is a judicially created doctrine that seeks to preserve the distinction between contract and tort. This rule is often applied in products liability cases. Pursuant to this rule, a party to a contract may not recover economic losses in a tort action unless there is physical injury or property damage. This rule was developed to prevent disproportionate liability and to allow parties to allocate risk via their contract.

Generally, in order to preclude application of the economic loss rule, the property damage must involve property other than that which is the subject of the contract. This rule prevents the recovery of tort damages for what is essentially a breach of contract action. This rule is based on the premise that contracting parties have allocated their respective rights and remedies via their contract and it is thus inappropriate to introduce tort remedies.

The economic loss rule is sometimes raised as a defense when a broker or agent is sued by a client. Not all courts apply the economic loss rule in the context of a real estate licensee's abrogation of his or her duties. ⁿ¹⁴ For example, this rule does not apply to tort actions for professional malpractice. ⁿ¹⁵ Real estate licensees usually have a statutory duty to conduct themselves in an honest and competent manner. Tort liability can arise from a violation of these duties.

In the context of a real estate transaction, this rule has been found to not bar a tort claim against a seller's agent by the buyer since there was no contractual relationship between these parties. ⁿ¹⁶

FOOTNOTES:

(n1)Footnote 14. *See Jackowski v. Borchelt*, 151 Wash. App. 1, 209 P.3d 514, 519-520 (2009) , review granted, 168 Wash.2d 1001, 226 P.3d 780 (2010) .

(n2)Footnote 15. *See Shister v. Patel*, 776 N.W.2d 632, 637, 2009 WI App 163 (2009) .

(n3)Footnote 16. *See Shister v. Patel*, 776 N.W.2d 632, 637, 2009 WI App 163 (2009) .

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64 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *

10-3A Real Estate Brokerage Law and Practice 3A.syn

§ 3A.syn Synopsis to Chapter 3A: Disclosure Obligations Imposed on Real Estate Licensees *

§ 3A.01 Disclosures Regarding Brokerage Relationships Seek to Avoid Misunderstandings

§ 3A.02 National Association of Realtors'(R) Recommendations

§ 3A.03 Brokerage Relationships

[1] Disclosures Seek to Inform the Consumer of Each Parties' Rights and Obligations

[2] Types of Brokerage Relationships

[a] Single Agency

[b] Dual Agency

[c] Designated Agency

[d] Facilitators and Transaction Brokers

[e] Minimum Service or Limited Service Brokers

§ 3A.04 Common Elements of Brokerage Relationship Disclosure Acts

[1] Application to Residential and Non-residential Real Property Transactions

[2] Common Terms: Customers and Clients

[3] Agency Relationship Disclosures Must Be Written

[4] When Must the Disclosure Be Made?

10-3A Real Estate Brokerage Law and Practice 3A.syn

- [5] Brokers Must Adopt Office Policies Addressing Disclosure
- [6] Acknowledgment of Receiving the Disclosure
- [7] Disclosure that Commissions Are Negotiable
- [8] No Assumed Relationships
- [9] Default or Baseline Relationship
- [10] Dual Agency Disclosures
- [11] The Effect of Common Law on Brokerage Relationships
- [12] Vicarious Liability for Misrepresentations Is Usually Abolished
- [13] Termination of the Relationship

§ 3A.05 Violations of Brokerage Relationship Disclosure Acts

- [1] Brokerage Relationship Act Compliance
- [2] Disciplinary Proceedings
- [3] Failing to Provide an Agency Disclosure Statement May Result in a Voidable Brokerage Agreement

§ 3A.06 Introduction

§ 3A.07 Seller Disclosure Statements

- [1] Seller Disclosure Statements for Residential Properties Are Widely Used
- [2] Contents of a Seller Disclosure Form
- [3] Disappearance of the Caveat Emptor Doctrine for Residential Property Sales
- [4] Common Elements of Residential Realty Disclosure Laws
 - [a] The Sales Contract and Other Disclosure Obligations
 - [b] The Disclosure Statement Is Not a Warranty or a Home Inspection Substitute
 - [c] Common Exclusions from the Seller's Disclosure Obligation
 - [d] The Disclosures Are the Seller's Representations
 - [e] The Seller's Disclosure Statement Is to Be Completed in Good Faith
 - [f] "As Is" Transfers and Disclaimer Statements

10-3A Real Estate Brokerage Law and Practice 3A.syn

- [g] Pre-Printed Disclosure Forms and Statutorily Mandated Forms
- [h] Delivery of the Disclosure Statement
- [i] The Disclosure Statement Must Be Kept Current Through Amendments and Supplements
- [j] Approximations and Estimates May Be Used
- [k] Information Obtained from Public Sources
- [l] Information Obtained from Professionals Hired to Inspect the Property
- [m] Other Parties Entitled to Receive a Copy of the Disclosure Form
- [n] A Buyer's Rescission Rights
- [o] Violations of the Residential Property Seller Disclosure Laws
- [p] Disclosure Acts May Contain a Statute of Limitations
- § 3A.08 Licensee Liability with Respect to a Disclosure Statement
- § 3A.09 Other Disclosure Obligations and Issues

- [1] Closing Costs
- [2] Methamphetamine Labs and Other Illegal Drug Activities
- [3] Square Foot Disclosures
- [4] Lot or Parcel Size Disclosures
- [5] Disclosure of Homeowners Association
- [6] Off-Site Conditions
- [7] Mold
- [8] Radon
- [9] Sewage Disposal and/or Water Supplies
- [10] Insulation
- [11] Other Disclosures Arise from Local Issues
- § 3A.10 A Broker's Statutory Duty to Inspect
- [1] California Licensees Have a Statutory Duty to Inspect

[2] Other Jurisdictions Reject the Imposition of an Explicit Statutory Duty to Inspect

§ 3A.11 The Effect of a Home Inspection Report on a Licensee's Disclosure Obligations

§ 3A.12 "As Is" Clauses in Sales Contracts

§ 3A.13 Psychologically Stigmatized Properties

§ 3A.14 Properties Located Near Sex Offenders

§ 3A.15 Prospectus and Public Offering Reports

§ 3A.16 Disclosures Mandated by Federal Law

[1] The Fair Housing Act

[2] The Residential Lead-Based Paint Hazard Reduction Act

[3] Labeling and Advertising of Home Insulation

[4] Notices Regarding Formaldehyde

[5] The Interstate Land Sales Full Disclosure Act



65 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *

10-3A Real Estate Brokerage Law and Practice Scope

Scope

SCOPE NOTE

Disclosure laws affecting real estate licensees and real estate transactions vary from jurisdiction to jurisdiction. There is no uniform act. While this Chapter does not discuss the details of each jurisdiction's disclosure laws, commonly required disclosures and common elements of disclosure laws are discussed. (See Appendix 3A-1 *below* for citations to state disclosure laws, alphabetically by state. See Appendix 3A-2 *below* for citations to significant disclosure cases, also alphabetically by state. See § 3A.16 *below* for discussion of and citations to federal law mandating disclosures.)

The first type of disclosure obligation imposed upon licensees is to disclose the types of brokerage relationships that licensees may enter into and to advise a consumer of the type of relationship that the consumer has entered into with the licensee. Each jurisdiction statutorily regulates the relationships that may exist between licensees and members of the public. Required disclosures often include a statement of the licensee's duties and obligations toward the consumer. These disclosures are discussed in Part I.

The second type of disclosure involves a licensee's obligation to disclose material facts and defects of the property of which the licensee is aware. Disclosure obligations with respect to a property's condition are usually imposed upon licensees in transactions involving residential real estate. The principle of "caveat emptor" is still largely in place for buyers and sellers of non-residential real estate.

Part II addresses disclosures regarding a property's condition and defects. Required disclosure obligations are generally extensive enough that a licensee cannot keep knowledge of material facts about the property to himself or herself. This information must be adequately and timely conveyed to the purchaser. An overwhelming majority of states impose such an obligation upon a licensee regardless of which party in the transaction the licensee represents.

A licensee's disclosure obligation regarding a property's condition may be intertwined with the residential real estate seller's statutory obligation to provide buyers with a written statement that discloses material facts that might affect a buyer's decision to buy or the price a buyer might offer to pay. A substantial majority of jurisdictions require that sellers provide residential buyers with a written seller disclosure statement that details the residence's condition and that discloses any known defects. Most after-closing claims by buyers against sellers and licensees involve allegations of misrepresentations regarding the property's condition. Though this second type of disclosure is usually imposed upon sellers, licensees may have a statutory obligation to advise the seller and/or the buyer of the obligation to provide a

buyer with a required property disclosure statement.

As mentioned above, this Chapter contains two Appendices. Appendix 3A-1 directs the reader to disclosure laws and the regulatory agency for each state and the District of Columbia. Appendix 3A-2 contains a brief summary of significant disclosure cases. Both appendices are organized by jurisdiction.

Many states impose specific disclosure requirements upon the sellers of condominium units, cooperatives, and timeshares. This Chapter does not address the disclosure requirements that are unique to these types of property ownership.



66 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
 CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *
 PART I. Brokerage Relationship Act Disclosures

10-3A Real Estate Brokerage Law and Practice § 3A.01

§ 3A.01 Disclosures Regarding Brokerage Relationships Seek to Avoid Misunderstandings

Two primary factors have led to the enactment of disclosure laws regarding brokerage relationships. The first factor is that brokers have traditionally represented sellers. n1 Even the broker who was considered the procuring cause of the sales transaction was considered to be a subagent of the seller's agent. n2 This meant that both the listing and selling brokers were the seller's agents and both owed fiduciary duties to the seller. Typically, the listing and selling brokers were compensated by a commission paid by the seller which was split between the two brokers involved in the transaction. n3

The second factor is that buyers did not understand the first factor. Consumer confusion often led to a buyer placing trust and confidence in the seller's agent. n4 Too many buyers wrongly assumed that the broker who showed them properties was acting on the buyer's behalf. Specifically, buyers often assumed that the polite broker who showed them house after house was acting in the buyer's best interest. n5 Buyers often worked with a single broker who showed them numerous houses. It was not unusual for this broker to assist the buyer in locating financing and in completing the documents necessary for the transaction to proceed to settlement. Buyers trusted the selling broker when such trust was unmerited and buyers sometimes disclosed confidential information to the seller's brokers. n6

This misunderstanding sometimes led to litigation when buyers believed that misrepresentations had been made with respect to the property. It was not unusual for a buyer to argue that the seller's broker had entered into an agency relationship with the buyer thereby creating a dual agency. Courts usually found that such reliance by a buyer upon the licensee was misplaced as it was generally held that a licensee acted as the seller's agent. n7 Even so, a few courts had characterized the broker's duty to a buyer as being a fiduciary one. n8 Most courts, however, were unwilling to impose fiduciary obligations upon brokers with respect to buyers and typically found that the seller's broker had not entered into an agency relationship with the buyer.

Legislators have explicitly recognized the paradoxical relationship that often evolved between the seller's agent and the buyer. For example, a provision of the Revised Statutes of Nebraska states:

The Legislature finds, determines, and declares that (1) the application of the common law of agency to the relationships between real estate brokers or salespersons and persons who are sellers, landlords,

buyers, or tenants of rights and interests in real property has resulted in misunderstandings and consequences that are contrary to the best interests of the public, (2) the real estate brokerage industry has a significant impact upon the economy of the State of Nebraska, and (3) it is in the best interests of the public to codify in statute the relationships between real estate brokers or salespersons and persons who are sellers, landlords, buyers, or tenants of rights and interests in real property. n9

The primary goal of a brokerage relationship law is to dispel these misunderstandings through timely and adequate disclosure as to who the broker represents in a transaction. An overwhelming majority of states have adopted such laws. Typically, these laws require that the broker make statutorily mandated disclosures to the individual(s) involved in buying, selling or leasing real estate. These disclosures usually inform the recipient of the disclosure of the broker's responsibilities to each of the participants in the transaction. These disclosures typically apply to all real estate transactions involving a licensee, both residential and non-residential.

Besides clearing up misconceptions of buyers when dealing with a seller's broker, another objective of brokerage disclosure statutes is to allow the seller to make a more intelligent decision about whether to enter into a brokerage relationship and what type of brokerage relationship they should enter into with a licensee. n10 These statutes define the types of representation relationships between brokers and consumers (i.e., buyers, sellers, landlords and tenants). n11 These statutes typically provide for disclosure to all parties in a real estate transaction and the obligations of licensees to their customers and clients.

Some brokerage relationship acts also address a licensee's obligation to provide information regarding the physical condition and defects of the subject property. n12 This aspect of these acts is discussed in Part II of this Chapter.

FOOTNOTES:

(n1)Footnote 1. *See, e.g., Snider v. Oklahoma*, 1999 OK 55, 987 P.2d 1204, 1209 (Okla. 1999) .

(n2)Footnote 2. *See, e.g., Market Force, Inc. v. Wauwatosa Realty Co.*, 706 F. Supp. 1387, 1388 (E.D. Wis. 1989) , *aff'd*, 906 F.2d 1167 (7th Cir. 1990) ; *Fennell v. Ross*, 289 Ark. 374, 378, 711 S.W.2d 793, 711 S.W.2d 793, 795-796 (Ark. 1986) . *See generally* Matthew M. Collette, *Note: Sub-Agency in Residential Real Estate Brokerage: A Proposal to End the Struggle with Reality*, 61 S. Cal. L. Rev. 399 (1988).

(n3)Footnote 3. *See, e.g., Market Force, Inc. v. Wauwatosa Realty Co.*, 706 F. Supp. 1387, 1389 (E.D. Wis. 1989) , *aff'd*, 906 F.2d 1167 (7th Cir. 1990) ; *Lerner v. Ceslik*, 17 Conn. App. 369, 372, 553 A.2d 1142, 1143 (1989) .

(n4)Footnote 4. *See generally* Michael K. Braswell & Stephen L. Poe, *The Residential Real Estate Brokerage Industry: A Proposal for Reform*, 30 Am. Bus. L.J. 271, 282 (1992) (discussing the confusion created by traditional real estate agency); J. Clark Pendergrass, *The Real Estate Consumer's Agency and Disclosure Act: The Case Against Dual Agency*, 48 Ala. L. Rev. 277 (1996) (same).

(n5)Footnote 5. *Cf.* Brown and Grohman, *Real Estate Brokers: Shouldering New Burdens*, Property & Probate 14 (May/June 1997), in which the authors state: "Buyers generally thought of the brokers who helped them locate property as 'their' brokers. But as a subagent of the seller, a selling broker had a fiduciary duty only to the seller. A selling broker had no duty to the buyer other than the duty not to act in a tortious manner that one member of the public owes to another. That notion was very difficult for buyers to understand or remember, especially when they actively worked with selling brokers to find the right property."

(n6)Footnote 6. *See generally* Gretchen D. Coles, Comment, *The Pennsylvania Real Estate Licensing Act: The "Miranda Warning" of Real Estate*, 107 Dick. L. Rev. 119, 129-130 (2002); Vernon L. Jarboe, *Brokerage Relationships in Real Estate Transaction Act*, J. Kan. B.A., May 1999, at 36, 37.

(n7)Footnote 7. At common law, the broker represented the seller. Thus, the broker's duty to disclose was no

greater than that of the broker's principal, the seller. *See generally* Restatement (Second) of Agency § 343 (1958).

(n8)Footnote 8. *See Funk v. Tiff*, 515 F.2d 23, 25-26 (9th Cir. 1975) (broker has a fiduciary duty to deal honestly and fairly with buyer); *Harper v. Adamez*, 142 Conn. 218, 225, 113 A.2d 136, 139 (Conn. 1955) (broker breached fiduciary duty to buyer when broker failed to disclose buyer's offer to seller); *Siler v. Gunn*, 117 Ga. App. 325, 326-327, 160 S.E.2d 427, 428-429 (Ga. Ct. App. 1968) (fiduciary relationship existed between seller's broker and buyer).

(n9)Footnote 9. *Neb. Rev. Stat. § 76-2401. See generally* Ronald Benton Brown, Joseph M. Grohman & Manuel R. Valcarcel, *Real Estate Brokerage: Recent Changes in Relationships and a Procedure*, 29 Creighton L. Rev. 25 (1995).

(n10)Footnote 10. *See Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 684, 14 Cal. Rptr. 2d 232, 238 (Cal. Ct. App. 1992) , *review denied* (Mar. 11, 1993).

(n11)Footnote 11. *Cf. Mitchell Realty Group, LLC v. Holt*, 266 Ga. App. 217, 218, 596 S.E.2d 625, 626 (Ga. Ct. App. 2004) (Georgia's Brokerage Relationships in Real Estate Transactions Act regulates the relationship between sellers, buyers, and real estate brokers to the extent not governed by specific written agreements between and among the parties.).

(n12)Footnote 12. *See Fitzmorris v. Demas*, 34 Kan. App. 2d 267, 272, 116 P.3d 764, 767 (Kan. Ct. App. 2005) .

* Written by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues.



67 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
 CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *
 PART I. Brokerage Relationship Act Disclosures

10-3A Real Estate Brokerage Law and Practice § 3A.02

§ 3A.02 National Association of Realtors'(R) Recommendations

The National Association of Realtors(R) (NAR), together with individual state Realtors(R) Associations, was instrumental in the passage of agency disclosure statutes and regulations. n1 NAR has supported state laws to clarify the law of agency as applied to real estate brokerage relationships. NAR also supported the creation of the designated agency where a broker may appoint an individual licensee to represent the seller and another licensee to represent the buyer in the same transaction without creating a dual agency relationship. Between 1988 and 2000, forty-nine states and the District of Columbia have passed agency disclosure statutes/regulations. As of the end of 2005, it appears that Arizona is the only state that has not done so. The NAR recommendations for agency disclosure contained the following nine elements:

- Licensees' duties should be well defined.
- Real estate brokerage relationships should be clarified by creating a statutory agency relationship and a statutory agent presumption unless otherwise agreed to in writing.
- Disclosed dual agency should be specifically acknowledged. The procedure for establishing disclosed dual agency and licensees' responsibilities should be clear.
- Brokers should be able to designate individual licensees in an in-company transaction to represent the seller and buyer without creating a dual agency relationship.
- Consumer's vicarious liability for licensees' acts should be eliminated or modified.
- Agency disclosure forms and rules should be promulgated to ensure meaningful, timely, and mandatory written disclosure.
- An explanation of how agency relationships end and a description of licensees' duties following termination should be included.

- Licensees' duties and liability for property condition disclosure should be addressed.
- The common law of agency should be abrogated. n2

Though the NAR's recommendations influenced enactment of brokerage relationship disclosure laws, there is no uniform law. Each state (with the exception of Arizona n3) has adopted its own version of a brokerage relationship act. n4

FOOTNOTES:

(n1)Footnote 1. See Ronald Benton Brown, Joseph M. Grohman & Manuel R. Valcarcel, *Real Estate Brokerage: Recent Changes in Relationships and a Procedure*, 29 *Creighton L. Rev.* 25, 28-29 (1995).

(n2)Footnote 2. National Association of Realtors(R), State Agency Legislation--Status Report dated Sept. 1999.

(n3)Footnote 3. The Arizona Association of Realtors publishes a form titled, "Real Estate Agency Disclosure and Election." It appears that use of this form by Arizona licensees is voluntary.

(n4)Footnote 4. Cf. Ann Morales Olazabail, *Redefining Realtor Relationships and Responsibilities: The Failure of State Regulatory Responses*, 40 *Harv. J. on Legis.* 65, 112 (2003) ("While forty-nine states now formally require agents to disclose some information about agency relationships in a residential real estate transaction, there is an almost absolute lack of uniformity in the way that this disclosure is accomplished.").

* Written by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues.



68 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *
PART I. Brokerage Relationship Act Disclosures

10-3A Real Estate Brokerage Law and Practice § 3A.03

§ 3A.03 Brokerage Relationships

[1] Disclosures Seek to Inform the Consumer of Each Parties' Rights and Obligations

The primary purpose of a brokerage relationship statement is the education of a buyer or seller about the relationship the consumer will have with the broker providing the disclosure. The disclosure informs the consumer of what he or she can expect from the licensee. The disclosure statement will typically list the consumer's rights and the broker's duties and responsibilities. By having a disclosure of rights, duties and responsibilities, consumers should realize in whom they can place trust or confidence.

If there were only seller's brokers, disclosures would be relatively simple. However brokerage relationships are not confined to seller's brokers. Licensees can also serve as buyer's brokers, dual agents, designated agents and transaction or facilitator brokers. In some states, licensees are offering a new category of service referred as flat fee brokers or limited service brokers. It should be anticipated that disclosures will be modified to accommodate these newer types of relationships.

Brokerage relationship acts have simplified proving the relationship that existed between a licensee and a client or customer should a dispute occur. If the licensee followed the applicable law, the disclosure form will have specified the type of relationship into which the parties intended to enter.

This section briefly considers the types of brokerage relationships. Listing agreements and the brokerage industry are discussed in greater detail in Chapter 2, *above*.

[2] Types of Brokerage Relationships

[a] Single Agency

A single agency involves a licensee who represents only one party in a transaction. In many jurisdictions, this is the remaining brokerage relationship that entails the traditional fiduciary duties owed by an agent to his or her principal. However, in some jurisdictions, the duties and obligations owed by a licensee to a client are not fiduciary in nature; fiduciary obligations arise only if greater duties are specifically agreed to in writing between the licensee and a client.

n1

The traditional single agency relationship was that of a seller's broker. A seller's broker represents only the seller and owes fiduciary duties to the seller. A seller's broker has a duty to sell the client's property for the highest price possible. n2 The relationship between a seller's broker and a seller was historically based upon the common law of agency. Though some brokerage relationship acts have attempted to statutorily alter application of the common law to single agencies (*see § 3A.05[11], below*), courts tend to look to common law when addressing a situation that is not addressed in the brokerage relationship act.

Under a single agency relationship, even when the licensee represents the seller, most jurisdictions require that the licensee must timely disclose to all parties with whom the licensee is working, all adverse material facts pertaining to the physical condition of the property that are known by the licensee and that could not be discovered by a reasonably diligent inspection of property by the buyer. n3

The newer single agency relationship is that of a buyer's broker or agent. Though this type of relationship existed prior to the enactment of brokerage relationship acts, brokerage relationship acts have formalized the concept of buyer representation and have delineated the rights and obligations of this type of representation. The relationship between a buyer's broker and the buyer typically mirrors the relationship between a seller's broker and the seller.

A buyer's broker is expected to be loyal to the buyer and act in the buyer's best interest. n4 A buyer's broker is expected to help the buyer find a suitable property and to buy the property at the lowest price possible. n5 A licensee representing a buyer does not breach his or her duties by showing the same properties to other buyers or by acting as an agent or subagent for other buyers, or as an agent or subagent for sellers. n6

[b] Dual Agency

A dual agent acts for both the seller and the buyer. There is an inherent conflict in a broker trying to represent both the buyer and seller. n7 A seller's broker has a duty to try to obtain the highest price for the seller, while a buyer's broker has a duty to help the buyer purchase at the lowest possible price. These goals are mutually exclusive. When both the buyer and seller are represented by the same broker, neither can receive full representation from the broker due to the inherent conflict. n8

Nearly every state statutorily addresses dual agency. n9 Commentators have stated that the numerous revisions to brokerage relationship laws resulted in part because of two lawsuits in the early 1990s involving dual agency, which resulted in settlements totaling \$ 19.9 million. n10

Statutes addressing dual agency typically require the written consent of all parties in the transaction. Many states also have specific disclosure statements that must be given to buyers and sellers involved in transactions involving a dual agent. Many brokerage relationship acts specifically subject licensees to disciplinary proceedings for failing to provide required disclosures when the licensee is acting as a dual agent n11 or for failing to ensure that all parties have consented to the dual agency. n12

Timely provision of dual agency disclosures is crucial. A licensee's delay in providing the disclosure can result in disciplinary proceedings against the licensee. For example, in one case an agent's license was suspended and he was fined for violating a professional code of conduct. The agent had entered into an oral agreement with the seller of a property to represent the seller in the sale. The next day, the agent showed the buyer the house, but the agent did not have the buyer sign an agency disclosure form before showing the house, although the agent was statutorily required to do. After the buyer decided to buy the house, but before negotiating the contract, the agent completed a dual agency form, which both the buyer and seller signed. The buyer later filed a complaint with the licensing agency. In affirming the agency's decision, the court referred to the hearing officer's observations that from the time of the initial showing of

the property through the development of the purchase offer, the buyer needed to know the agent's status relative to her interest in the subject property in order to know what approach the buyer should take in discussing personal confidential information with the agent, to understand the agent's restrictions in disclosing information about the property's condition and in what leeway the agent had in discussing the seller's situation in selling the property. In agreeing with the agency's decision, the court stated that the agent had violated the statute controlling agency disclosure and the agent's later compliance did not make up for his omission. n13

Brokerage relationship acts usually address the imputation of knowledge to the principals when a dual agent is involved. These acts recognize that the common law rule imputing such knowledge is problematic when a dual agent is involved. One court summed up this quandary as follows:

The problem with rigidly imputing knowledge of the agent to both principals in a dual agency context is clear. Simply put, if everyone is responsible, then no one is responsible. In such a situation, the imputation, based on the presumption that the agent will do what is expected of him becomes a fiction which interferes with rather than promotes commerce and the interest of full disclosure. A proper analysis requires that we recognize that in a dual agency two distinct agencies are vested in the agent with separate duties and responsibilities as to each principal. n14

This court observed that if dual agents failed to communicate required information to the buyers, then the seller breached his or her contract through the neglect of his or her agents. However, if the seller delivered the information to the dual agents, the buyers were deemed to have received it and had no complaint against the seller. The court stated further, "The arguments become circular and cannot lead to a resolution of the equities between the buyers and the sellers. No doubt, this can create special difficulties for the dual agent, but they are difficulties inherent in choosing to serve two masters." n15 This court found that it could not establish a bright line for all cases as to whether knowledge held by the dual agent was to be imputed to either or both principals. Instead, there were factual circumstances the court found best left to the trier of facts. Dual agencies are fraught with special problems and require a heightened standard of conduct on the part of the agents in assuring that both masters are well served and that the agents' responsibilities are fully performed as to all. n16

Many brokerage relationship acts resolve the issues inherent in a rule imputing knowledge between a dual agent and the principals by providing that each client and broker and their respective licensees possess only actual knowledge and information; there is no imputation of knowledge or information among or between the clients, brokers, or their affiliated licensees. n17

[c] Designated Agency

Designated agency occurs when a broker has an in-house dual agency where an individual agent in the brokerage firm is appointed (or "designated") to represent only the interests of the seller and another agent is appointed to represent only the interests of the buyer. In jurisdictions that recognize designated agency, this is an optional way to approach dual agency. In theory, designated agency allows both the buyer and seller to receive more complete representation than can be achieved with a single disclosed dual agent. Just as with a disclosed dual agent, both the seller and buyer must consent to a designated agency. It has been observed that a downfall to designated agency is that there is a greater chance for breach of confidentiality when the agents involved in a transaction are housed in the same office. n18

[d] Facilitators and Transaction Brokers

Colorado was the first state to create a non-agent real estate broker. n19 Pursuant to Colorado statutory law, although a licensee may still act as an agent for a buyer or seller, unless a different relationship is established by the parties in writing, it is presumed that a broker is acting as a nonagent transaction broker. n20 In Colorado, the transaction broker is essentially the default relationship. Many other states have followed suit by adopting statutory provisions allowing for

this type of relationship. Other jurisdictions have likewise adopted this as the default relationship when the parties have not elected some other form of brokerage relationship (*see § 3A.05[9], below*).

A transaction-broker is not an agent for either party. n21 A transaction broker provides limited representation to a buyer, a seller or both, in a real estate transaction, but does not represent either in a fiduciary capacity or as a single agent. n22 Instead, a transaction broker assists one or more parties throughout a contemplated real estate transaction with communication, interposition, advisement, negotiation, contract terms, and the closing of such real estate transaction without being an agent or advocate for the interests of any party to such transaction. n23 A real estate broker who serves as a transaction-broker is not in a fiduciary relationship with either party to a real estate transaction. n24 However, a transaction broker still owes a statutory duty of care to the persons for whom the broker acts. n25

Duties owed by a transaction broker to a buyer or seller are usually statutorily determined and often include:

1. Dealing honestly and fairly;
2. Accounting for all funds;
3. Using skill, care, and diligence in the transaction;
4. Disclosing all known facts that materially affect the value of the property and are not readily observable to the buyer;
5. Presenting all offers and counteroffers in a timely manner, unless a party has previously directed the licensee otherwise in writing;
6. Limited confidentiality unless waived in writing by a party;
7. Any additional duties that are entered into by this or by separate written agreement. n26

Limited confidentiality typically will prevent disclosure that the seller will accept a price less than the asking or listed price, that the buyer will pay a price greater than the price submitted in a written offer, the motivation of any party for selling or buying property, that a seller or buyer will agree to financing terms other than those offered, or of any other information requested by a party to remain confidential. n27

[e] Minimum Service or Limited Service Brokers

A minimum service broker places a listing in the applicable multiple listing service (MLS) and does little or nothing more to assist in the sale. This service assists a homeowner who wants to sell his or her house with the advertising benefit provided by the MLS. The homeowner pays for any additional services that the homeowner needs from the broker. Some states are addressing this type of brokerage relationship. Generally, states that have addressed minimum service brokers through statute or regulation have imposed the following requirements on brokers accepting such listings:

- The licensee must accept and present all offers and counteroffers.
- The licensee must assist the client in developing, communicating and presenting all offers and counteroffers.
- The licensee must answer the client's questions relating to the offers and counteroffers. n28

FOOTNOTES:

(n1)Footnote 1. *See Idaho Code § 54-2094.*

(n2)Footnote 2. *See Roberts v. Lomanto*, 112 Cal. App. 4th 1553, 1568, 5 Cal. Rptr. 3d 866, 877 (2003) , review denied, 2004 Cal. LEXIS 1784 (2004) .

(n3)Footnote 3. *See Walker v. Johnson*, 278 Ga. App. 806, 811-12, 630 S.E.2d 70, 76 (2006) , overruled in part, *Kleber v. City of Atlanta*, 2008 Ga. App. LEXIS 396, at *15 (Mar. 28, 2008) (on other grounds) citing Ga. Code § 10-6A-5 (b) (1); *Dasher v. Davis*, 274 Ga. App. 788, 790, 618 S.E.2d 728, 730 (2005) , cert. denied, 2006 Ga. LEXIS 59 (Jan. 17, 2006) .

(n4)Footnote 4. *See, e.g., Ohio Rev. Code § 4735.65(A).*

(n5)Footnote 5. *Cf. Ohio Rev. Code § 4735.65(A)(1)* (licensee representing a purchaser is to seek a property at a price and with purchase or lease terms acceptable to the purchaser).

(n6)Footnote 6. *See, e.g., Ohio Rev. Code § 4735.65(B).*

(n7)Footnote 7. *See, e.g., Winter v. Carey*, 127 Mo. App. 601, 603, 106 S.W. 539 (1907) . *See generally* J. Clark Pendergrass, *The Real Estate Consumer's Agency and Disclosure Act: The Case Against Dual Agency*, 48 Ala. L. Rev. 277, 290-296 (1996) (discussion of the conflict inherent in dual agency).

(n8)Footnote 8. *Cf. Snider v. Oklahoma*, 1999 OK 55, 987 P.2d 1204, 1209 (Okla. 1999) ("Sellers' agents and dual agents do not and cannot by law give a buyer the same degree of loyalty as an agent who acts on behalf of a buyer.").

(n9)Footnote 9. Not all states allow dual agency. Among those states which do not allow dual agency are Florida and Kansas. *See* K.S.A. § 58-30, 110 (a)(1); Ronald Benton Brown and Joseph M. Grohman, *Goodbye Dual World Real Estate Brokerage Changes Again, But Not Enough*, 71 Fla. Bar J. 54 (Nov. 1997).

(n10)Footnote 10. *See* Rocy de R. Barondes & Carlos Slawson, Jr., *Examining Compliance with Fiduciary Duties: A Study of Real Estate Agents*, 84 Or. L. Rev. 681, 682 (2005). The cases cited are *Bokusky v. Edina Realty, Inc.*, No. 3-92 CIV. 223 (D. Minn. Aug. 6, 1993); *Dismuke v. Edina Realty, Inc.*, No. 92-8716, (Dist. Ct. Minn. June 17, 1993). *See also* Ronald Benton Brown, Joseph M. Grohman & Manuel R. Valcarcel, *Real Estate Brokerage: Recent Changes in Relationships and a Procedure*, 29 Creighton L. Rev. 25, 28 (1995) (discussing these two cases); Vickie J. Brady, Comment, *The "Brokerage Relations" Addition to the Illinois Real Estate License Act: The Case of the Legalized Conflict of Interest*, 22 S. Ill. U. L. J. 725, 729-730 (1998) (discussing these two cases).

(n11)Footnote 11. *See La. R.S. 37:1455(21).*

(n12)Footnote 12. *See, e.g., Ariz. Rev. Stat. § 32-2153(A)(2).*

(n13)Footnote 13. *See Habeeb v. Ohio Dept. of Commerce*, 2004 Ohio 138, 2004 Ohio App. LEXIS 130, at *1-*9 (Jan. 15, 2004) , appeal denied, 102 Ohio St. 3d 1472, 2004 Ohio 2830, 809 N.E.2d 1158 (2004) .

(n14)Footnote 14. *Lane v. Oustalet*, 873 So. 2d 92, 97 (Miss. 2004) .

(n15)Footnote 15. *Lane v. Oustalet*, 873 So. 2d 92, 97 (Miss. 2004) .

(n16)Footnote 16. *See Lane v. Oustalet*, 873 So. 2d 92, 99 (Miss. 2004) .

(n17)Footnote 17. *See, e.g., Ga. Code Ann. § 10-6A-12(d).*

(n18)Footnote 18. Ann Morales Olazabail, *Redefining Realtor Relationships and Responsibilities: The Failure of*

State Regulatory Responses, 40 Harv. J. on Legis. 65, 82 (2003).

(n19)Footnote 19. *See Stearns v. McGuire*, 354 F. Supp. 2d 1188, 1190 (D. Colo. 2004) , *aff'd*, 2005 U.S. App. LEXIS 24577 (10th Cir. Nov. 14, 2005) , *citing*, Patricia A. Wilson, *Nonagent Brokerage: Real Estate Agents Missing in Action*, 52 Okla. L. Rev. 85, 90 (1999).

(n20)Footnote 20. *See Stearns v. McGuire*, 354 F. Supp. 2d 1188, 1190 (D. Colo. 2004) , *aff'd*, 2005 U.S. App. LEXIS 24577 (10th Cir. Nov. 14, 2005) , *citing* Katherine A. Pancak, Thomas J. Miceli & C.F. Sirmans, *Real Estate Agency Reform: Meeting the Needs of Buyers, Sellers, and Brokers*, 25 Real Estate L.J. 345, 355 (1997).

(n21)Footnote 21. *See Sussman v. Stoner*, 143 F. Supp. 2d 1232, 1237 (D. Colo. 2001) , applying Colorado law. *See generally* Ronald Benton Brown, Joseph M. Grohman & Manuel R. Valcarcel, *Real Estate Brokerage: Recent Changes in Relationships and a Procedure*, 29 Creighton L. Rev. 25, 44-45 (1995); Earnest and Painter, *The New Brokerage Legislation: The Demise of "Agency by Surprise,"* 22 Colo. Law. 1919 (Sept. 1993) ; Patricia A. Wilson, *Nonagent Brokerage: Real Estate Agents Missing in Action*, 52 Okla. L. Rev. 85, 90 (1999). *But cf.* *Doyle v. Maruszczak*, 834 So. 2d 307, 309 (Fla. Dist. Ct. App. 2003) . Even though the licensee and his clients had signed a transaction broker agreement, the court found that the licensee was the clients' agent and that a fiduciary relationship existed between the parties.

(n22)Footnote 22. *See Read v. Taylor*, 832 So. 2d 219, 223 (Fla. Dist. Ct. App. 2002) , *citing* Fla. Stat. § 475.01(1)(m).

(n23)Footnote 23. *See Stearns v. McGuire*, 354 F. Supp. 2d 1188, 1190 (D. Colo. 2004) , *aff'd*, 2005 U.S. App. LEXIS 24577 (10th Cir. Nov. 14, 2005) , *quoting*, Colo. Rev. Stat. § 12-61-802(6).

(n24)Footnote 24. *See Hoff & Leigh, Inc. v. Byler*, 62 P.3d 1077, 1078 (Colo. Ct. App. 2002) .

(n25)Footnote 25. *See Read v. Taylor*, 832 So. 2d 219, 223 (Fla. Dist. Ct. App. 2002) .

(n26)Footnote 26. *See Read v. Taylor*, 832 So. 2d 219, 223 (Fla. Dist. Ct. App. 2002) , *citing* Fla. Stat. § 475.278 (1997).

(n27)Footnote 27. *See Read v. Taylor*, 832 So. 2d 219, 223 (Fla. Dist. Ct. App. 2002) .

(N28)Footnote 28. *See* 225 ILCS 454/15-75; Ala. § 34-27-84 (c).

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69 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
 CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *
 PART I. Brokerage Relationship Act Disclosures

10-3A Real Estate Brokerage Law and Practice § 3A.04

§ 3A.04 Common Elements of Brokerage Relationship Disclosure Acts

[1] Application to Residential and Non-residential Real Property Transactions

The title of some brokerage relationship acts would appear to indicate that they apply to transactions involving residential real property. For example, the Alabama Act is titled the "Real Estate Consumer's Agency and Disclosure Act." n1 Despite this title, this act's definition of a real estate transaction is not limited to residential transactions and this act's breadth appears to be much broader as a real estate transaction is defined as "The purchase, sale, lease and rental, option, or exchange of an interest in real estate." n2

A few states have specifically limited the brokerage relationship act disclosures to residential transactions. n3 A few acts are also drafted with definitions that specifically address residential real estate. n4 By definition, these disclosure acts would appear to be restricted in their application. Other acts are broadly written such that a licensee's disclosure obligations are not restricted to those involving residential real estate transactions. n5

An act's provision that defines terms and any provisions addressing to whom disclosures must be made should be examined to determine whether the act applies only to residential real estate transactions or whether it applies to all real estate transactions involving a licensee. It appears that the majority of brokerage relationship acts apply to all transactions that involve a licensee.

[2] Common Terms: Customers and Clients

Though there is no uniform brokerage relationship disclosure act, most acts have adopted terms to distinguish between the party with whom the licensee has entered into a relationship and other parties. Two terms commonly used in brokerage disclosure acts to distinguish between these parties are "client" and "customer." n6 A client is usually defined in some manner to mean someone who has formed a brokerage relationship with a broker. n7 In a broker-client relationship, the broker represents the client and typically acts as the client's representative in buying, selling, or leasing.

A customer is usually defined to mean someone who does not have a brokerage relationship with the broker in question. n8 In a broker-customer relationship, the broker is not representing the customer. In most jurisdictions, the broker can assist a customer or non-client by performing ministerial acts. n9 Acts a broker may be able to perform with a customer

usually include showing properties that are for sale or lease, providing pre-printed real estate documents, preparing real estate contracts at the customer's direction, and assisting the customer find a lender.

Many brokerage relationship acts provide that unless a licensee enters into a brokerage relationship, it is presumed that an individual is a customer of the licensee rather than a client. n10 Brokerage relationship acts often delineate the duties a licensee owes to clients and to customers. Another common element is that when dealing with a customer or other party who has no brokerage relationship with the broker, the licensee has a duty to treat the customer fairly and honestly. n11 Often licensees have a duty to disclose all facts known to the licensee which materially affect the value or desirability of the property that are not known to, or within the diligent attention and observation of the parties. n12

[3] Agency Relationship Disclosures Must Be Written

The most uniform element of the various brokerage relationship disclosure acts is the requirement that the statutorily required disclosure must be made through a written disclosure statement given to the customer or client. n13 Many jurisdictions either statutorily mandate a specific disclosure form or authorize that jurisdiction's real estate commission to prepare a form for use by licensees. n14

[4] When Must the Disclosure Be Made?

Under brokerage relationship acts, the responsibility to disclose and the execution of a brokerage agreement often occurs simultaneously or within a short time of each other. Licensees should understand and follow the required agency disclosure procedures to which they are subjected. Many acts require that the brokerage relationship disclosure be made at the earliest practicable opportunity during or following the first substantial contact with a seller, landlord, buyer, or tenant who has not entered into a written agreement for services. n15 Typically the disclosure must be given to a seller prior to entering into a listing agreement. If the licensee is dealing with a customer, the disclosure may be required to be made upon substantial contact or before any confidential information can be conveyed by the customer to the licensee. n16

Another commonly imposed time for making this disclosure is when the licensee enters into a brokerage agreement with the client. Some jurisdictions require that the disclosure be made with or incorporated in a prospective buyer's offer to purchase. n17 A brokerage relationship disclosure may not be required if the individual is represented by another licensee. n18

The disclosure obligation generally must occur prior to or simultaneously with the execution of a brokerage agreement. Receiving the disclosure after entering into a brokerage agreement may be a meaningless gesture. One court has explained the purpose of requiring agency disclosure prior to entering into a listing agreement as being:

... to allow the seller to make a more intelligent decision about whether to sign. For example, the property owner who is asked to sign a listing agreement because the broker has a buyer for the property may not fully comprehend that the broker intends to act as a dual agent. Because the seller pays the broker's commission, the seller may reasonably believe the broker has only the seller's best interest at heart and is working exclusively for the seller. The disclosure form tells the property owner that a broker can act as a dual agent. Thus advised, the seller may wish to sell the property through his or her own agent or to seek independent advice on the price and terms of the listing. n19

The common goal is that disclosure should be made when it is meaningful. Disclosure does little good to protect a consumer if it is made after contracts have been executed. Often, when a buyer is involved, the licensee must make the disclosure prior to presenting the buyer's offer to purchase to a seller. n20

[5] Brokers Must Adopt Office Policies Addressing Disclosure

Several states require that brokers must adopt a written office policy regarding the disclosures made under a brokerage relationship act. n21 Some states require that the broker give a copy of the policy to the prospective seller, landlord, buyer, or tenant. n22 Even if a broker is not required to adopt a written office policy, this practice may prevent mistakes.

Georgia requires that brokers develop and enforce an office brokerage relationship policy among affiliated licensees which either specifically permits or rejects the practice of disclosed dual agency. n23 Indiana also specifically allows a broker to permit or reject the practice of disclosed limited agency. n24

[6] Acknowledgment of Receiving the Disclosure

Another common element in brokerage relationship acts is that the licensee must obtain a signed acknowledgment of receipt from the customer or client which confirms that this individual has received the required disclosure form. n25 If the individual will not sign such a receipt, the licensee is usually instructed to document this refusal. n26 One way to document such a refusal is for the licensee to note that fact on a copy of the disclosure form and to retain this copy. n27

Some brokerage relationship acts impose record retention requirements by obligating licensees to retain these acknowledgments for a set time period. n28

[7] Disclosure that Commissions Are Negotiable

There is a misconception by some consumers that the amount of commission charged by licensees is statutorily determined. This is not true; the commission rate is negotiable between the licensee and the client. Some jurisdictions require that licensees disclose to consumers the fact that the rate of the licensee's commission is a negotiable term between the parties. n29 In Illinois, a disclosure must be made regarding the sharing of the commission with other brokers. n30 Some jurisdictions require that notices regarding a licensee's compensation be highlighted in some manner. n31

[8] No Assumed Relationships

Brokerage relationship disclosure acts often provide that an agency relationship cannot be assumed, implied, or created upon an initial contact with a consumer. n32

[9] Default or Baseline Relationship

Some brokerage relationship acts provide for what could be considered a default or baseline relationship if the parties fail to enter into a specific relationship. n33 For example, in Colorado, a broker is considered a transaction-broker unless a single agency relationship is established through a written agreement between the broker and the party or parties to be represented by such broker. n34 In Tennessee, until a licensee enters into a specific written agreement to establish an agency relationship, the licensee is considered to be a facilitator and not an agent or advocate of any party to the transaction. n35

[10] Dual Agency Disclosures

At common law, a real estate broker had to refrain from dual representation in a sale transaction unless the broker obtained the consent of both principals after full disclosure. n36 This rule has been justified on several grounds including the following: (1) An undisclosed dual agent puts himself or herself in a position where the agent's duty to one principal conflicts with the agent's duty to the other principal. (2) The agent's own interests may tempt him or her to be unfaithful to both principals. (3) Undisclosed dual agency is a position which is against sound public policy and good morals. n37 Even before the widespread enactment of brokerage relationship acts, the general rule had been that unless both principals knew of the dual agency at the time of the transaction, the agent could not recover a commission from

either principal. n38

Under brokerage relationship acts, most jurisdictions specifically allow disclosed dual agency relationships. However, the disclosures for this type of relationship are stringent. All parties to the transaction must be aware of the licensee's dual agency status. The licensee usually must obtain written consent from all principals to the transaction. n39 The purpose of the dual agency disclosure requirements is to ensure that the parties are aware of the potential conflict of interest their agent may face in the negotiations, and consent to continued representation even though this potential for conflict exists. n40

[11] The Effect of Common Law on Brokerage Relationships

The recommendations of the National Association of Realtors(R) (NAR) included the abrogation of the common law of agency. Some jurisdictions have followed this recommendation. n41 However, despite the passage of agency disclosure statutes/regulations in fifty jurisdictions, not all have followed this NAR recommendation. n42

In the jurisdictions that do not specifically abrogate or supercede the common law of agency, it would appear that licensees may be subject to both the state's common law of agency and the agency disclosure statute and/or regulations. n43 A significant number of acts do not address the common law of agency and its application or non-application to brokerage relationships. This facet of agency disclosure is problematic if a dispute arises over whether licensees have performed their duties and obligations to a seller or buyer. Few courts have interpreted the statutory and regulatory requirements in light of the common law of agency.

The Restatement (Second) of Agency defines agency as the fiduciary relation that results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control, and consent by the other so to act. Under the common law, licensees have the burden of proving that:

- (1) the sellers or buyers manifested the licensee to work on their behalf,
- (2) the licensee accepted the proposed undertaking, and
- (3) both the sellers or buyers and the licensee understood that the licensee was in charge to establish an agency relationship and recover damages. n44

Brokerage relationship statutes and regulations eliminate this step in proving an agency relationship. Strict adherence to the agency disclosure procedural steps will establish an agency relationship if that is the type of relationship into which the parties have entered. If an agency relationship is not established, a licensee owes no fiduciary or disclosure duties to a client. n45 In some jurisdictions, it would appear that a licensee who agrees to act as a finder rather than an agent may not be obligated to provide disclosures pursuant to the applicable brokerage relationship act. n46

Even in those jurisdictions that have attempted to limit or restrict applying the common law of agency to brokerage relationships, n47 such efforts are often qualified or tempered. For example, Alabama's Real Estate Consumer's Agency and Disclosure Act n48 states in part:

The duties of licensees as specified in this article or in rules promulgated by the Alabama Real Estate Commission shall supersede any duties of a licensee to a party to a real estate transaction which are based upon common law principles of agency *to the extent that those common law duties are inconsistent with the duties of licensees as specified in this article* (emphasis added). n49

This provision does not abrogate the application of the common law of agency with respect to Alabama brokerage relationships. Instead, it remains to the courts to determine the extent to which the common law is inconsistent with a

licensee's duties under the Alabama Real Estate Consumer's Agency and Disclosure Act. Many jurisdictions have provisions similar to that of Alabama. n50 Other jurisdictions have likewise attempted to achieve a partial or limited abrogation of common law. n51

Ohio has adopted the opposite stance in its brokerage relationship law by stating that except to the extent the duties of a real estate agent are specifically stated or are otherwise modified by the parties' agreement, the duties of a real estate agent are determined by the common law. n52

In at least one jurisdiction, a brokerage relationship act has been found to impose a lesser burden upon licensees than the common law of agency which was applied prior to the enactment of the brokerage relationship act. n53 However, a brokerage relationship act may also allow a licensee and his or her client to enter into written agreements which creates an agency relationship in which the duties and obligations are greater than those provided in the brokerage relationship act. n54

Generally, statutes in derogation of common law are strictly construed in accordance with the statutory language. n55 Courts following this rule, usually adhere to the literal words of the statute and refuse to read any exceptions into the law. One court in interpreting a brokerage relationship act applied this statutory rule of construction and stated that the act in question did not regulate real estate commissions or remuneration payments, but was instead concerned primarily with the question of whether and under what circumstances a client or a customer relationship arises, and what duties are owed within the context of each. The court held that the legislature did not address the availability of remedies at common law, which were authorized when the brokerage relationship law was enacted. Therefore, the court found that it was bound to construe that act so as to maintain the viability of common law theories of recovery such as quantum meruit or procuring cause. n56

[12] Vicarious Liability for Misrepresentations Is Usually Abolished

Most brokerage relationship disclosure acts have abolished vicarious liability. n57 Typically, a client or broker will have liability for misrepresentations made by the other only if the client or broker had actual knowledge of the misrepresentation or should have known of the falsity of the representation. n58

Several states have statutes that address a broker's liability for failing to disclose information or for making a misrepresentation. n59 These statutes usually protect the broker when the client has supplied the broker with false information that the broker does not know is false. Usually, these statutes also protect the client from liability should the broker make a misrepresentation of which the client is unaware. n60 Some states narrow the protection offered to a broker by limiting liability only in situations in which the broker has engaged another broker. In these statutes, the broker is protected from misrepresentations made by the sub-broker. A few states have statutorily altered the common-law rule which imputes the knowledge of the agent to the principal. n61

[13] Termination of the Relationship

Many of the brokerage relationship acts also have a provision addressing the termination of the brokerage relationship. Typically, such a provision addresses when the relationship is considered to have ended and whether any duties are owed to the client after that termination. n62

FOOTNOTES:

(n1)Footnote 1. *Ala. Code § 34-27-80.*

(n2)Footnote 2. *Ala. Code § 34-27-81(14).*

(n3)Footnote 3. *See Fla. Stat. § 475.274, Minn. Stat. § 82.22 subd. 2; N.Y. Real Prop. Law § 443.*

(n4)Footnote 4. *See Cal. Civ. Code § 2079.13(j)* which states that " 'Real property' means any estate specified by subdivision (1) or (2) of Section 761 in property which constitutes or is improved with one to four dwelling units, any leasehold in this type of property exceeding one year's duration, and mobilehomes, when offered for sale or sold through an agent pursuant to the authority contained in Section 10131.6 of the Business and Professions Code."

(n5)Footnote 5. *See Conn. Gen. Stat. § 20-325d.*

(n6)Footnote 6. *See, e.g., Ga. Code Ann. § 10-6A-3(6) and (8); Va. Code § 54.1-2130.*

(n7)Footnote 7. *See, e.g., Ga. Code Ann. § 10-6A-3(6); Va. Code Ann. § 54.1-2130.*

(n8)Footnote 8. *See, e.g., Ga. Code Ann. § 10-6A-3(8); Va. Code Ann. § 54.1-2130.*

(n9)Footnote 9. Ministerial acts are routine acts that a licensee can perform for a person which do not involve discretion or the exercise of the licensee's own judgment. *See, e.g., Ga. Code Ann. § 10-6A-3(12); Idaho Code § 54-2086; Ohio Rev. Code § 4735.69; S.C. Code Ann. § 40-57-137(L); Va. Code § 54.1-2130.*

(n10)Footnote 10. *See, e.g., Va. Code § 54.1-2130.*

(n11)Footnote 11. *See, e.g., Fla. Stat. § 475.278. See also Or. Rev. Stat. §§ 696.805 and 696.810* (imposing affirmative obligation of honest dealing and disclosure).

(n12)Footnote 12. *See, e.g., Cal. Civ. Code § 2079.16.*

(n13)Footnote 13. *See, e.g., Ala. Code § 34-27-82(c); Cal Civ Code § 2079.14.*

(n14)Footnote 14. *See, e.g., Cal. Civ. Code § 2079.16* (stating the contents of the disclosure form); *Me. Rev. Stat. tit. 32, § 13279* (disclosure form as defined and mandated by rules adopted by the commission).

(n15)Footnote 15. *See, e.g., Mo. Rev. Stat. § 339.770(1).*

(n16)Footnote 16. *See, e.g., Del. Code Ann. tit. 24, § 2931(b)* (disclosure must be made at the first substantive contact between the licensee and the person the licensee does not represent); *D.C. Code Ann. § 42-1703(h)(1)* (disclosure must be made upon having a substantive discussion about a specific property or properties with an actual or prospective buyer or seller who is not the client of the licensee).

(n17)Footnote 17. *See Ala. Code § 34-27-8(c); Conn. Gen. Stat. § 20-325d.*

(n18)Footnote 18. *See, e.g., Conn. Gen. Stat. § 20-325d.*

(n19)Footnote 19. *Huijers v. DeMarrais, 11 Cal. App. 4th 676, 684-685, 14 Cal. Rptr. 2d 232, 238 (1992), review denied* (Mar. 11, 1993).

(n20)Footnote 20. *See, e.g., Cal. Civ. Code § 2079.14.*

(n21)Footnote 21. *See, e.g., Ala. Code § 34-27-83; Colo. Rev. Stat. Ann. § 12-61-808(1); Ind. Code Ann. § 25-34.1-10-13(a); Idaho Code § 54-2090; Ind. Code Ann. § 25-34.1-10-13; Mo. Rev. Stat. § 339.760; Ohio Rev. Code Ann. § 4735.54; S.C. Code Ann. § 40-57-137(B); S.D. Codified Laws § 36-21A-147.*

(n22)Footnote 22. *See Ind. Code Ann. § 25-34.1-10-13(b)* (must be provided at the beginning of an agency relationship). *See also Ohio Rev. Code Ann. § 4735.54* (broker must provide a copy of its policy to each client or prospective client upon request).

(n23)Footnote 23. *See Ga. Code Ann. § 10-6A-12 (f).*

(n24)Footnote 24. See *Ind. Code Ann. § 25-34.1-10-13(a)*.

(n25)Footnote 25. See, e.g., *Cal. Civ. Code § 2079.14*; *Conn. Gen. Stat. Ann. § 20-325d*; *Ky. Rev. Stat. § 324.360(4)*. But cf. *Moody Realty Co., Inc. v. Huestis*, 237 S.W.3d 666, 677-78 (Tenn. Ct. App. 2007), appeal denied, 2007 Tenn. LEXIS 702 (Tenn. Aug. 13, 2007) (Although the Tenn. Code provisions addressing representation by real estate agents require a written bilateral agreement that establishes the agreed-upon terms and conditions for an agency relationship to arise, these provisions do not expressly require both parties' signatures on the written agreement.).

(n26)Footnote 26. See *R.I. Gen. Laws § 5-20.6-5*.

(n27)Footnote 27. See *Colo. Rev. Stat. Ann. § 12-61-808*.

(n28)Footnote 28. See, e.g., *D.C. Code Ann. § 42-1703(h)(4)* (copies of disclosures relative to fully executed purchase contracts must be kept for 3 years); N.H. Admin. Rules, Rea 701.01(e) (3 year retention period for disclosure forms on which the licensee has noted the third party's failure to sign); *N.Y. Real Prop. Law § 443(e)* and *(f)* (3 year retention period for both signed and unsigned acknowledgments).

(n29)Footnote 29. See *Cal. Bus. & Prof. Code § 10147.5*; *Conn. Gen. Stat. § 20-325b*.

(n30)Footnote 30. See 225 ILCS 454/15-35(a)(3).

(n31)Footnote 31. See *Conn. Gen. Stat. § 20-325b* (not less than 10-point boldface type or a manner that significantly stands out from the other text).

(n32)Footnote 32. See *Ala. Code § 34-27-82(b)*; *Idaho Code § 54-2084(1)*; *N.M. Stat. Ann. § 61-29-10.1*; *Tenn. Code Ann. § 62-13-401*.

(n33)Footnote 33. See Ann Morales Olazabail, *Redefining Realtor Relationships and Responsibilities: The Failure of State Regulatory Responses*, 40 Harv. J. on Legis. 65, 91-99 (2003) (discussing the various default models and which states follow them).

(n34)Footnote 34. See *Colo. Rev. Stat. § 12-61-803(2)*.

(n35)Footnote 35. See *Tenn. Code Ann. § 62-13-401*. See also *Realty Store, Inc. v. Tarl Partnership, L.P.*, 153 S.W.3d 366, 371 (Tenn. Ct. App. 2004), appeal denied, 2004 Tenn. LEXIS 1146 (Dec. 20, 2004) (a broker cannot be a facilitator once a written agency agreement is involved.).

(n36)Footnote 36. See, e.g., *Sierra Pacific Industries v. Carter*, 104 Cal. App.3d 579, 581-582, 163 Cal. Rptr. 764, 766 (1980) .

(n37)Footnote 37. See *L. Bryon Culver & Associates v. Jaoudi Industrial & Trading Corp.*, 1 Cal. App. 4th 300, 305, 1 Cal. Rptr. 2d 680, 682-682 (1991), review denied, 1992 Cal. LEXIS 1054 (Mar. 11, 1992) .

(n38)Footnote 38. See, e.g., *L. Byron Culver & Assocs. v. Jaoudi Indus. & Trading Corp.*, 1 Cal. App. 4th 300, 305 and 306 n.4, 1 Cal. Rptr. 2d 680, 682 and 683 n.4 (1991), review denied, 1992 Cal. LEXIS 1054 (Mar. 11, 1992) .

(n39)Footnote 39. *Alaska Stat. § 08.88.396(c)*.

(n40)Footnote 40. See *Highlands Business Park, LLC v. Grubb & Ellis Co.*, 2005 Ohio 3139, 2005 Ohio App. LEXIS 2938, at *18 (June 23, 2005) (commission was earned on a commercial lease).

(n41)Footnote 41. See *Mont. Code Ann. § 37-51-313(1)* (the act is intended to replace the common law as applied to brokerage relationships); *Okla. Stat. Ann. tit. 59, § 858-360* (the act replaces and abrogates fiduciary or other duties

of a broker to a party based on common law principles of agency).

(n42)Footnote 42. *See, e.g., N.Y. Real Prop. Law § 443(6)* which provides that nothing in that section shall be construed to limit or alter the application of the common law of agency with respect to residential real estate transactions. *See generally Philip Lucrezia, New York's Property Condition Disclosure Act: Extensive Loopholes Leave Buyers and Sellers of Residential Real Property Governed by the Common Law*, 77 St. John's L. Rev. 401 (2003).

(n43)Footnote 43. *See S.C. Code Ann. § 40-57-137(Q)* which states in part, "The provisions of this section which are inconsistent with applicable principles of common law supersede the common law, and the common law may be used to aid in interpreting or clarifying the duties described in this section."

(n44)Footnote 44. *See Wardley Corporation v. Welsh*, 962 P.2d 86, 89 (Utah Ct. App. 1998) .

(n45)Footnote 45. *See Wardley Corp. v. Welsh*, 962 P.2d 86, 90 (Utah Ct. App. 1998) .

(n46)Footnote 46. *Cf. Wardley Corp. v. Welsh*, 962 P.2d 86, 89-90 (Utah Ct. App. 1998) . The licensee owed no written disclosures to the seller about their agency relationship because there was no agency relationship. There was no listing agreement.

(n47)Footnote 47. *See, e.g., Idaho Code § 54-2094; Polyzos v. Cotrupi*, 264 Va. 116, 122, 563 S.E.2d 775, 778 (Va. 2002) .

(n48)Footnote 48. *Ala. Code §§ 34-27-80 through 34-27-88. See generally J. Clark Pendergrass, Commentary: The Real Estate Consumer's Agency and Disclosure Act: The Case Against Dual Agency*, 48 Ala. L. Rev. 277 (1996).

(n49)Footnote 49. *Ala. Code § 34-27-87. See also Ind. Code Ann. § 25-34.1-10-15* which states, "The duties and obligations of a licensee set forth in this chapter supersede any fiduciary duties of a licensee to a party based on common law principles of agency to the extent that those common law fiduciary duties are inconsistent with the duties and obligations set forth in this chapter."

(n50)Footnote 50. *See, e.g., D.C. Code Ann. § 42-1703(n); Va. Code Ann. § 54.1-2144.*

(n51)Footnote 51. *See, e.g., S.D. Codified Laws § 36-21A-149; Wis. Stat. § 452.139(1).*

(n52)Footnote 52. *See Ohio Rev. Code § 4735.52.*

(n53)Footnote 53. *See Ikola v. Schoene*, 264 Ga. App. 338, 341, 590 S.E.2d 750, 752 (2003) . *See also* Ronald Benton Brown, Joseph M. Grohman & Manuel R. Valcarcel, *Real Estate Brokerage: Recent Changes in Relationships and a Procedure*, 29 Creighton L. Rev. 25, 28 (1995) ("Common law agency imposes a greater fiduciary duty on brokers than current statutory law."); Ann Morales Olazabail, *Redefining Realtor Relationships and Responsibilities: The Failure of State Regulatory Responses*, 40 Harv. J. on Legis. 65, 67 (2003) ("Beginning in the mid-1990s, many state legislatures and administrative agencies began to limit realtor liability by creating statutory safe harbors and by explicitly defining realtors' duties to both clients and non-clients."). *See generally* Sullivan, *Brokerage Relationships in Real Estate Transactions: Provide Codification of the Relationships Between Real Estate Brokers and Consumers of Brokerage Services*, 10 Ga. St. U. L. Rev. 23, 26 (1993).

(n54)Footnote 54. *See Idaho Code § 54-2094.*

(n55)Footnote 55. *See Killearn Partners, Inc. v. Southeast Properties, Inc.*, 279 Ga. 144, 146, 611 S.E.2d 26, 28 (2005) . *Killearn* was overruled in part by *Amend v. 485 Properties, Inc.*, 280 Ga. 327, 627 S.E.2d 565 (2006) , but only to the extent that *Killearn* suggested that a broker could recover based on quantum meruit without proving that the broker was the procuring case.

(n56)Footnote 56. *See Killearn Partners, Inc. v. Southeast Properties, Inc.*, 279 Ga. 144, 147, 611 S.E.2d 26, 29 (2005) . *See also Telluride Real Estate Co. v. Penthouse Affiliates, LLC*, 996 P.2d 151, 154 (Colo. Ct. App. 1999) , *cert. denied* 2000 Colo. LEXIS 499, 2000 Colo. J. C.A.R. 1840 (2000) (The expressed purpose of the Colorado Act Concerning Brokerage Relationships in Real Estate Transactions is to protect consumers in their interactions with real estate professionals. This Act does not comprehensively address commissions. The court concluded that the Act did not eradicate the common law concept of procuring cause.).

(n57)Footnote 57. *See, e.g., Ala. Code § 34-27-86; La. Rev. Stat. § 9:3899; Mo. Rev. Stat. §§ 339.810 and 339.830; Mont. Code Ann., § 37-51-315; Okla. Stat. Ann. tit. 59, § 858-362.*

(n58)Footnote 58. *See, e.g., Ala. Code § 34-27-86, Kan. Stat. Ann. § 58-30, 111(a).*

(n59)Footnote 59. *See, e.g., Kan. Stat. Ann. § 58-30, 111(b) and (c).*

(n60)Footnote 60. *See, e.g., Ala. Code § 34-27-86.*

(n61)Footnote 61. *See, e.g., Wash. Rev. Code § 18.86.100; Va. Code Ann. § 54.1-2142.*

(n62)Footnote 62. *See Kan. Stat. Ann. § 58-30, 104; La. Rev. Stat. § 9:3895; Mo. Rev. Stat. § 339.790; Va. Code Ann. § 54.1-2137.*

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70 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
 CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *
 PART I. Brokerage Relationship Act Disclosures

10-3A Real Estate Brokerage Law and Practice § 3A.05

§ 3A.05 Violations of Brokerage Relationship Disclosure Acts

[1] Brokerage Relationship Act Compliance

Brokerage relationship acts are generally straightforward. Typically, licensees must make certain written disclosure aimed at informing the public of the types of brokerage relationships that are available and the consequences of entering into a brokerage relationship. The applicable statute typically specifies when the disclosure must be made, to whom the disclosure must be made and the contents of the disclosure document. Many jurisdictions statutorily mandate the contents of the disclosure statement or require that the jurisdiction's real estate commission draft and distribute a disclosure form for use by licensees. n1 Though complying with a brokerage relationship act adds paperwork, it is a relatively simple matter.

There is a dearth of judicial guidance on complying or failing to comply with a brokerage relationship act. The lack of judicial guidance likely stems from the fact that compliance with these acts is so simple. Another reason for the lack of judicial guidance may arise from the fact that if the parties dealing with the licensee are satisfied with the licensee's services, they may not complain even if they later learn that required brokerage relationship disclosures were omitted.

Possible consequences for a failure to comply with such an act would include a disciplinary proceeding against the licensee by the licensing agency n2 and the client's right to void the brokerage agreement. The effect of noncompliance becomes more complicated if the licensee's client discovers the noncompliance after a sales contract has been executed with a third party. n3 A licensee can also violate a brokerage relationship act by failing to make required disclosures to a third party (typically a customer) which whom the licensee is dealing.

Another potential consequence that could be imposed for a licensee's failure to make disclosures under a brokerage relationship act would be to deny the licensee his or her commission should the underlying transaction proceed to the point where a commission would be due to the licensee.

[2] Disciplinary Proceedings

Imposing disclosure obligations upon licensees is of limited use if the licensing agency has no means to enforce a licensee's disclosure obligations. One effective means of achieving compliance is for there to be a punishment or

disadvantage for licensees who fail to comply. Typically, if a licensee fails to make a required brokerage relationship disclosure or fails to make the required disclosure in a timely manner, the licensee will be subject to the disciplinary authority of the licensing agency. n4

Licensees are frequently subject to disciplinary proceedings for failing to provide their client with a copy of a listing agreement n5 or for acting as a dual agent without the knowledge of all parties to the transaction. n6 These failures also stem from a lack of adequate disclosure.

[3] Failing to Provide an Agency Disclosure Statement May Result in a Voidable Brokerage Agreement

A broker's failure to provide an agency disclosure form to a seller may result in a voidable listing agreement which is voidable at the seller's discretion. n7 One court in addressing a licensee's untimely delivery of an agency disclosure statement stated that the full measure of protection that the legislature intended to provide to the seller could not be achieved if the listing agent failed to provide the disclosure form prior to entering into the listing agreement. Providing the agency disclosure form after the listing contract was signed did not constitute substantial compliance with the disclosure statute. n8

Whether or not a failure to make a timely disclosure regarding brokerage relationships will allow a seller to void a listing agreement will likely depend upon the facts and circumstances of the case. For example, a seller with sufficient knowledge concerning the information contained in the disclosure form may be held to the listing agreement even though the seller did not receive the disclosure form. n9 Voiding a brokerage agreement after the client has entered into a sales contract with a third party makes this option problematic; this is another fact to consider if this issue arises.

One court has found that providing disclosure statements regarding brokerage relationships to a seller with respect to other properties constituted substantial compliance with the licensee's disclosure obligations with respect to another property listing for which no brokerage relationship disclosure statement had been provided. n10 The facts and circumstances of this case were likely crucial to this holding as the seller in this case was a sophisticated owner of real estate worth millions of dollars and the property involved was not the seller's personal residence. n11

FOOTNOTES:

(n1)Footnote 1. *See Wash. Rev. Code § 18.86.120* for an example of statutorily mandated informational pamphlet on the law of real estate agency.

(n2)Footnote 2. *See Habeeb v. Ohio Dept. of Commerce, 2004 Ohio 138, 2004 Ohio App. LEXIS 130, at *1-*9 (Jan. 15, 2004) , appeal denied, 102 Ohio St. 3d 1472, 2004 Ohio 2830, 809 N.E.2d 1158 (2004) (agent fined and suspended for failing to timely comply with disclosure regarding dual agency).*

(n3)Footnote 3. *Cf. Huijers v. DeMarrais, 11 Cal. App. 4th 676, 686, 14 Cal. Rptr. 2d 232, 238 (1992) , review denied (Mar. 11, 1993).* A dual agent's failure to disclose prior to entering into the listing agreement, relieved the sellers from the obligation to pay their agent's commission. This failure to disclose, however, did not in itself relieve the sellers from their obligation under the purchase contract because the disclosure statement was given to them just before they signed the purchase contract. The case was remanded to consider whether the sellers could rescind based upon a misrepresentation.

(n4)Footnote 4. *See, e.g., Ala. Code § 34-27-88; Ark. REC Regulations § 8.4; Colo. Rev. Stat. Ann. § 12-61-811; Mich. Comp. Laws Ann. § 339.2512(b); Miss. REC Reg. IV(E)(1); S.C. Code Ann. § 40-57-145(A)(13).*

(n5)Footnote 5. *See Conn. Gen. Stat. Ann. § 20-320(7).*

(n6)Footnote 6. *See, e.g., Conn. Gen. Stat. Ann. § 20-320(3); Habeeb v. Ohio Dept. of Commerce, 2004 Ohio 138, 2004 Ohio App. LEXIS 130, at *1-*9 (Jan. 15, 2004) , appeal denied, 102 Ohio St. 3d 1472, 2004 Ohio 2830, 809*

N.E.2d 1158 (2004) (agent fined and suspended for failing to make timely disclosure regarding dual agency).

(n7)Footnote 7. *See Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 679, 14 Cal. Rptr. 2d 232, 234-235 (1992) , review *denied* (Mar. 11, 1993).

(n8)Footnote 8. *See Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 685, 14 Cal. Rptr. 2d 232, 238 (1992) , review *denied* (Mar. 11, 1993).

(n9)Footnote 9. *See Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 686, 14 Cal. Rptr. 2d 232, 239 (1992) , review *denied* (Mar. 11, 1993).

(n10)Footnote 10. *See Roney v. B.B.C. Corp.*, 2004 WY 113, 98 P.3d 196, 204 (Wyo. 2004) .

(n11)Footnote 11. *See Roney v. B.B.C. Corp.*, 2004 WY 113, 98 P.3d 196, 198 (Wyo. 2004) .

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71 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *

PART II. Licensee Disclosure Obligations Regarding the Property's Condition

10-3A Real Estate Brokerage Law and Practice § 3A.06

§ 3A.06 Introduction

From a buyer's perspective, it would be ideal to know the property's complete history including all prior and current defects and the property's repair history. For older properties this might be a voluminous amount of information. Few sellers are even able to provide such a detailed history. Some sellers are unwilling to disclose all that they know about their property even when such information is readily and conveniently available. Furthermore, there are sellers who will intentionally conceal defects. Because accurate detailed histories are typically unavailable for properties, buyers must rely upon other means to determine the structural soundness and condition of a property.

Property defects provide a fertile ground for litigation against both sellers and their brokers and agents. Buyers are particularly prone to litigation over a property's condition when they believe that misrepresentations have been egregious and/or intentional and the defect materially affects the property's value, safety or usability. For example, a buyer who moves into a home only to have the septic field experience a total system failure one week after settlement is apt to believe that the seller intentionally misrepresented the property and that the seller was fully aware of the imminent septic failure. In such a scenario, it is quite possible that the seller knew of the problem, but chose not to fix the problem prior to sale and chose not to disclose this problem to prospective purchasers.

Licensees typically have not lived in the properties they sell nor have they managed these properties. They do not have the knowledge about the property that the owner often has. Licensees typically pass on representations which their client has made to them regarding a property's condition and history.

Due to the varying facts and circumstances involved in buying and selling property, it is difficult, if not impossible, to determine bright line tests regarding misrepresentations regarding a property. Many factors affect these cases. Issues considered include the severity of the defect, the timing of when the buyer discovered the defect, the sophistication of the parties, whether any specific representations were made regarding the aspect of the property which later proves to be defective and whether a home inspection was performed. A seller's liability for misrepresentation may be affected by the contents of the disclosure statement and whether the house was sold "as is."

The potential liability of a licensee when a buyer is discontent with the residence is likewise not subject to any hard and fast rules due to the fact that the individual circumstances of these cases greatly affect the outcomes. In some cases, the

licensee knew of the issue but failed to disclose the information to the buyer. When this occurs, the licensee's duty to make such a disclosure and any resulting liability to the buyer may be affected by the relationship between the parties and whether the buyer was represented by another licensee in the transaction. Though it is likely that the licensee will be liable for failing to disclose a material fact if the licensee had actual knowledge of the defect and failed to inform the buyer, n1 there are some defects where a court might find that the property condition was so open and obvious that the licensee will be found to have had no obligation to make a disclosure. In other cases, the licensee will have no knowledge of the defect, but the buyer may allege that the licensee should have known about the defect. There are also instances where the licensee had no knowledge of the defect and no reasonable way of discovering the defect if the seller actively concealed the defect. n2

All states provide for disciplinary actions against brokers who intentionally misrepresent the real property involved in the transaction. Some states recognize the tort of negligent misrepresentation. There are even cases in which brokers have been held liable for innocent misrepresentations. n3 More difficult issues arise when a broker fails to disclose facts regarding a property. This issue is further complicated by the fact that in some instances the broker is unaware of the condition that later becomes the subject of a dispute. If the broker is unaware of the physical defect, the buyer often asserts that the broker should have been aware of the defect. This in turn raises the issue of whether the broker had a duty to investigate the property's condition.

FOOTNOTES:

(n1)Footnote 1. *See, e.g., 68 Pa. C.S. § 7310* which states, "An agent of a seller or a buyer shall not be liable for any violation of this chapter unless the agent had actual knowledge of a material defect that was not disclosed to the buyer or of a misrepresentation relating to a material defect." *Cf. Gordon v. Skopos, 2005 Ohio 4900, 2005 Ohio App. LEXIS 4414*, at *9 (Sept. 16, 2005) (knowledge of a defect is a necessary element to an action for fraudulent nondisclosure).

(n2)Footnote 2. It is possible for a seller to hide certain defects in such a manner that even a professional home inspector would be unable to detect the problem without tearing out walls or other structural elements of the home in order to view the defect.

(n3)Footnote 3. *See Bevins v. Ballard, 655 P.2d 757, 763 (Alaska 1982)* . *See generally* Hagglund and Weimer, *Caveat Realtor: The Broker's Liability for Negligent and Innocent Misrepresentations*, 20 Real Est. L.J. 149 (1991). *See generally* Diane M. Allen,, Annot., *Real-Estate Broker's Liability to Purchaser for Misrepresentation or Nondisclosure of Physical Defects in Property Sold*, 46 A.L.R.4th 546 (1986) .

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72 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
 CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *
 PART II. Licensee Disclosure Obligations Regarding the Property's Condition

10-3A Real Estate Brokerage Law and Practice § 3A.07

§ 3A.07 Seller Disclosure Statements

[1] Seller Disclosure Statements for Residential Properties Are Widely Used

More than forty states and the District of Columbia require that the seller provide the residential property buyer with a disclosure statement addressing the condition of the property. n1 Some of these states allow the seller to use a disclaimer form if the property is being sold "as is." n2 Even if a state has not statutorily mandated the use of a residential real property seller disclosure form, the state association of Realtors(R) may distribute a similar form for voluntary use by its members' clients. n3

The majority of seller disclosure statutes apply to residential sales even when no licensee is involved. A small minority of jurisdictions, however, restrict these acts to residential sales involving a licensee. n4

Though a statutory disclosure obligation with respect to residential property is imposed upon the seller, n5 a few states impose a duty on a seller's broker to inform the seller of this disclosure obligation. n6 However, licensees are not obligated to verify the accuracy of the seller's disclosure statement. n7

Even if the disclosure obligation is specifically imposed upon the seller, a disgruntled buyer may sue the seller's broker and agent in addition to the seller if the buyer's suit is based on a failure to disclose conditions and defects of the subject property. However, most jurisdictions statutorily provide that a licensee representing a seller is not liable for any error, inaccuracy, or omission in a property disclosure document, unless the licensee had actual knowledge of the error, inaccuracy, or omission by the seller. n8

A few jurisdictions impose an obligation upon a licensee representing a buyer to inform the buyer of his or her rights and obligations under a seller disclosure law. n9 If the buyer is not represented by a licensee, a licensee representing a seller may have an obligation to inform such a buyer of the buyer's rights and obligations under a seller disclosure law. n10

Under some acts, the seller is able to deliver the disclosure statement to a licensee representing the buyer. n11 The licensee representing the buyer may also have a statutory obligation to provide the buyer with a copy of the statement.

n12

[2] Contents of a Seller Disclosure Form

Though some seller disclosure statements are brief and not extremely detailed, most seller disclosure statements request information about the major components of the home. n13 Often the statement is presented in a format where the seller answers questions regarding the condition or status of these systems or components. Though required disclosures obligations imposed on the sale of residential real estate from jurisdiction to jurisdiction, n14 the trend had been to require more disclosure rather than less. Some of these forms address non-physical factors such as easements and off-site conditions.

Often these acts define what constitutes a defect or material fact which should be disclosed. Typically, the following items are subject to disclosure obligations: (1) a condition that would have a significant adverse effect on the value of the property, (2) a condition that would significantly impair the health or safety of future occupants of the property, or (3) a condition that if not repaired, removed, or replaced would significantly shorten or adversely affect the expected normal life of the premises. n15

[3] Disappearance of the Caveat Emptor Doctrine for Residential Property Sales

When a seller must provide residential real estate buyers with a disclosure statement regarding the condition of the property, the traditional principle of "caveat emptor" has been usurped. n16 The trend to eliminate the caveat emptor doctrine has stemmed from the movement to protect consumers. n17 In modern times, many courts have criticized the ancient principle of "caveat emptor." n18 It has been stated that this ancient doctrine has been virtually eliminated in the realm of residential real estate. n19 Even where the caveat emptor principle remains to some degree, n20 disgruntled buyers are often willing to challenge this doctrine by suing the real estate licensees and the seller.

Some jurisdictions allow a seller to provide a disclaimer form in lieu of a seller disclosure statement. n21 The disclaimer form, like the disclosure form, may be prepared by the jurisdiction's real estate commission. n22 If this is allowed, many sellers opt to sell the property "as is" and provide the disclaimer rather than the disclosure form. The widespread use of a disclaimer form essentially eviscerates any disclosure statute and effectively restores the principle of caveat emptor. n23

[4] Common Elements of Residential Realty Disclosure Laws**[a] The Sales Contract and Other Disclosure Obligations**

A few disclosure laws provide that the disclosure statement becomes part of the purchase agreement. n24 A few disclosure laws also provide that the buyer must acknowledge receipt of the disclosure statement in the real estate purchase contract or in any addendum attached to the contract, or in a separate document. n25

Louisiana's disclosure law specifically provides that the information contained within the property disclosure document is for disclosure purposes only and is not intended to be a part of any contract between the purchaser and seller. n26

Generally, the disclosures made under a seller disclosure law do not limit any other disclosure obligations which the seller may have under another statute or under the common law. n27

[b] The Disclosure Statement Is Not a Warranty or a Home Inspection Substitute

Most disclosure laws contain a provision providing that the disclosure statement is not a warranty made by the seller or the seller's broker n28 nor is the disclosure form intended to be a substitute for an inspection. n29 Some statutes require that the disclosure inform the purchaser that the disclosure statement is not a substitute for a home inspection. n30

Some disclosure laws also provide that the seller and any licensee representing the seller have no liability for defects which occur after the transfer has occurred. n31

[c] Common Exclusions from the Seller's Disclosure Obligation

Most residential disclosure laws apply to the typical sale of a residence. However, not all transfers of residences are subject to disclosure laws. *Virginia Code § 55-518* is typical of statutory provisions that exempt certain transfers from the disclosure requirements. This provision exempts the following transfers of residential real property from the disclosure requirements:

1. Transfers pursuant to a court order.
2. Transfers to a beneficiary of a deed of trust by a trustor or successor in interest who is in default; transfers by a trustee under a deed of trust pursuant to a foreclosure sale, or transfers by a beneficiary under a deed of trust who has acquired the real property at a sale conducted pursuant to a foreclosure sale under a deed of trust or has acquired the real property by a deed in lieu of foreclosure.
3. Transfers by a fiduciary in the course of the administration of a decedent's estate, guardianship, conservatorship, or trust.
4. Transfers from one or more co-owners solely to one or more other co-owners.
5. Transfers made solely to any combination of a spouse or a person or persons in the lineal line of consanguinity of one or more of the transferors.
6. Transfers between spouses resulting from a decree of divorce or a property settlement stipulation.
7. Transfers made by virtue of the record owner's failure to pay any federal, state, or local taxes.
8. Transfers to or from any governmental entity or public or quasi-public housing authority or agency.
9. Transfers involving the first sale of a dwelling. n32

Though most residential property seller disclosure laws contain exemptions, the typical sale facilitated by a licensee will not be exempt.

[d] The Disclosures Are the Seller's Representations

These statutes often contain a provision that makes the disclosure statement a representation of the seller, but not the seller's broker or agent. n33 The seller's licensee is not responsible for preparing the disclosure statement. n34 Many disclosure laws specifically state that a licensee is not liable for any error, inaccuracy or omission in any information delivered to a buyer unless the licensee knowingly acted in concert with the seller to commit fraud. n35

Some jurisdictions also provide that the licensee has no liability for a seller's failure to deliver a disclosure statement or for the seller's violation of the disclosure law. n36 Other jurisdictions impose a higher standard of responsibility upon licensees. For example, Hawaii provides that when a seller's agent cannot obtain the disclosure statement and does not have written assurances from the buyer that the disclosure statement was received, the seller's agent must notify the buyer in writing of the buyer's rights to the disclosure statement and rights of rescission. n37

Though seller disclosure laws are not intended to serve as a shield to protect licensees, n38 it appears that some statutory provisions function as shields and effectively reduce a licensee's potential liability. n39 The National Association of Realtors(R) (NAR) and the various state Realtors(R) associations were major proponents of seller disclosure laws. n40 As the primary industry organizations representing licensees, it is logical to conclude that the support of these laws by the NAR's and its state counterparts resulted from self-interest. The NAR argued sellers should have the burden to disclose information concerning their property because sellers were in a superior position to provide this information. The NAR argued that the disclosure would result residential sale prices market value. The NAR also argued that requiring seller disclosure of defects would shelter licensees from liability. n41

Disclosure laws arguably will shelter licensees from liability or at least make it more difficult for a buyer to successfully sue a licensee as these laws include provisions that benefit licensees. Disclosure laws often state that the licensee owes no duty to conduct an independent inspection of the property. Furthermore, these acts often indicate that the licensee typically owes no duty to independently verify the accuracy or completeness of any statement made by the seller. While the licensee cannot ignore statements on a disclosure statement that they know or should know are false, by the same token, they are not expected to verify the truthfulness of the disclosures. n41.1

When alleging fraud or misrepresentation against a licensee, a disclosure statement may make it more difficult if not impossible for a buyer to prove justifiable reliance. A common scenario is for a seller to disclose a defect which is either alleged to be minor or one which the sellers allege has been corrected. Even if the disclosed defect later proves to be material and the seller's disclosure was incomplete and/or inaccurate, the disclosure will have alerted the buyer to the need for further investigation. In this situation, a court may find that the licensee has no liability to the buyer. n42

[e] The Seller's Disclosure Statement Is to Be Completed in Good Faith

Many residential seller disclosure acts expressly require that the disclosures be made in good faith. n43 Some jurisdictions define good faith in this context to mean honesty in fact in the making of the disclosure or the in the conduct of the transaction. n44 Jurisdictions vary in the wording of the provision requiring that the seller exercise good faith in completing the disclosure statement. For example, Hawaii requires that sellers "prepare the disclosure statement in good faith and with due care." n45 The gist of these provisions, no matter how worded, is that the seller should act honestly and carefully in preparing and presenting the disclosure statement.

One court in addressing disclosure forms stated that "disclosure forms are not, as implied by the [sellers] today, meaningless exercises--they surely give rise to enough litigation. You don't just slip into them." n46 Though some licensees and sellers may treat seller disclosure statements as "meaningless exercises," the statutory obligation to prepare these forms in good faith belies this belief. Another court has stated that "By requiring a 'good faith effort' to disclose material defects, the maxim of caveat emptor, 'let the buyer beware', is effectively eliminated." n47

[f] "As Is" Transfers and Disclaimer Statements

Some states allow a seller to opt out of providing a detailed disclosure statement if the seller provides the purchaser with a disclaimer statement. n48 Such disclaimer statements essentially are a declaration that the property is being sold "as is" with the seller making no specific representation about the property's condition. A jurisdiction may limit the use of a disclaimer statement to sellers who have not lived in the property being sold. n49

When a seller is permitted to provide a disclaimer statement rather than a disclosure statement, it may become for the norm for sellers to routinely issue the disclaimer statement. n50 When this becomes an accepted practice in a market, this practice essentially eviscerates the protection that a disclosure statement was meant to provide. The widespread use of a disclaimer statement essentially makes the sale an "as is" sale.

Rather than allowing "as is" sales, some jurisdictions allow the parties to agree in writing that the transfer will not be

covered under the disclosure law. n51

Some jurisdictions do not permit a waiver of a buyer's right to receive a disclosure statement. n52 Some jurisdictions also do not allow a seller to avoid providing a disclosure statement by designating the sale "as is." n53

If a property is being sold "as is," it appears that it would be improper for the seller to provide a seller disclosure statement if the jurisdiction permits the seller to provide a disclaimer statement instead of a disclosure statement. One court faced with this situation has stated that while Virginia law permitted an owner to provide the buyer with a disclaimer which made clear that the purchaser was receiving the property "as is," the seller could not have it both ways by enticing a buyer with a disclosure while simultaneously using an "as is" clause. n54

[g] Pre-Printed Disclosure Forms and Statutorily Mandated Forms

Most states, either through statute or regulation, provide the disclosure statement through the state's real estate commission. n55 Such pre-printed forms tend to be comprehensive. If alternative forms are allowed, the alternative form usually must contain the same information as is on the statutory form. n56 The seller disclosure form usually addressed the condition of the home's structural components and appliances. n57 This statement often includes either a checklist of various property conditions and improvements, such as the foundation, electrical system, roof, plumbing, etc. or a series of questions regarding these elements of the residence. It is intended to inform the buyer of any and all problems with the property. Most forms include boilerplate language that states that the statement is not a warranty of any kind by the seller, and that it is not a substitute for any inspection or warranties the buyer may wish to obtain. In contrast to pre-printed forms supplied by a jurisdiction's real estate commission, some statutory provisions contain the form of the disclosure statement which the sellers must use. n58

Illinois has an unusual requirement; a copy of the Residential Real Property Disclosure Act (except for section 35 (765 ILCS 77/35) which contains the disclosure form to be used), must be printed on or as a part of the Residential Real Property Disclosure Report form. n59

Some jurisdictions require that licensees make copies of the form available to members of the public. n60

[h] Delivery of the Disclosure Statement

Jurisdictions vary in their determination of when a buyer is entitled to receive the seller disclosure statement. Sometimes this statement must be delivered before a buyer makes an offer. n61 Some disclosure laws require that the disclosure be made before the parties have entered into a sales contract. n62 Another possible delivery deadline is sometime before the transfer of title. n63 Other jurisdictions require that this statement be delivered after the buyer has made an offer. If the delivery of the statement occurs after an offer has been made, the buyer is typically given a time period in which the buyer can withdraw his or her offer as a result of information disclosed in the statement. n64

Indiana requires that the seller complete and sign a disclosure form and submit the form to a prospective buyer before an offer is accepted. n65 Prior to closing, an accepted offer is not enforceable against the buyer until the seller and the prospective buyer have signed the disclosure form. However, after closing, the seller's failure to deliver a disclosure statement form to the buyer does not by itself invalidate a real estate transaction. n66

In Kentucky, a seller using a licensee is required to complete and sign the disclosure form when the seller executes any listing agreement or similar agreement by which a licensee intends to market the property. In turn, the listing agent is required to provide a copy of the disclosure form to any prospective buyer or a buyer's authorized representative upon request. In addition, a copy of the form must be delivered by the listing agent to any prospective purchaser or the purchaser's representative within seventy-two (72) hours of the listing agent's receipt of a written and signed offer to purchase. n67

One commentator has asserted providing disclosures to buyers early in the buying process increases the efficiency of seller disclosure laws. n68 When buyers receive the disclosures after they have made an offer, buyers often will not withdraw from the transaction. With respect to when a buyer receives the seller disclosure statement, this commentator has concluded as follows:

Latecoming disclosure reduces the ability of buyers to negotiate rationally and to withdraw from unfavorable transactions. The efficacy of disclosure is particularly important because of the significant costs that mandatory disclosure entails. When market failure or noneconomic concerns prompt disclosure requirements, early disclosure creates a more effective provision of information to justify these costs. In the example of residential real estate defect disclosure, buyers who learn of defect information following their submission of an offer, or even shortly before the closing, are likely to negotiate inadequate price discounts and persist in unfavorable transactions. Requiring disclosure prior to the buyer's offer or during the initial search process can ameliorate these information processing biases and improve the efficacy of defect disclosure. n69

A majority of states with seller disclosure laws do not require disclosure prior to a buyer making an offer. Requiring disclosure at an earlier time would provide buyers with information they would be more likely to effectively use in formulating an offering price. n70 Once a buyer has psychologically committed to buying a particular property, the buyer may be reluctant to withdraw an offer even though the disclosure statement would make withdrawal of the offer prudent. n71

Some disclosure laws specify how the statement should be delivered to the buyer. Means specified often include mail and personal delivery. n72 Some jurisdictions allow delivery by facsimile. n73 Typically, delivery to the buyer's spouse is considered to be delivery to the buyer. n74 Illinois law specifically state that the disclosure statement can be delivered by a private delivery service. n75

In Iowa, if the seller is represented by a licensee, it is the licensee's responsibility to deliver the disclosure statement to the buyer, unless the seller or buyer has instructed the licensee otherwise in writing. n76

A licensee who fails to deliver a seller disclosure statement to a buyer or who intentionally withholds such a statement from a buyer will be found to have breached the licensee's duties to the buyer. n77

[i] The Disclosure Statement Must Be Kept Current Through Amendments and Supplements

Seller disclosure statements are prepared based upon the seller's knowledge at the time the statement is completed by the seller. n78 Most disclosure laws require that if information in a disclosure statement becomes inaccurate after the disclosure statement is delivered to the buyer, the resulting inaccuracy does not violate the law, but the seller must deliver an amendment for the disclosure statement to the buyer. n79 Such an amendment typically extends any rescission period that the buyer has. n80 This period also typically cover the time after the statement is delivered to the buyer, but prior to settlement. n81 The right to rescind may be limited however, to the information contained in the amendment. n82

Though most seller disclosure acts require that disclosure forms be amended to reflect new information or corrections, not all acts impose an obligation to update the disclosure statement. For example, the Ohio's disclosure act imposes no obligation to update the statement; that disclosure act only requires that the disclosure statement be an accurate statement of the seller's knowledge of the condition of the house as of the date the form was signed. n83

Most states require that amendments to the disclosure statement be in writing. n84

[j] Approximations and Estimates May Be Used

Most disclosure statement laws provide that if an item that is required in the disclosure statement is unknown or is unavailable to the seller, an approximation of the information may be used but the approximation must be reasonable, clearly identified as an approximation, based on the best information available to the seller, and not used to avoid the disclosure requirements. n85

[k] Information Obtained from Public Sources

Many disclosure laws provide that the seller is not liable for any error, inaccuracy, or omission of any information required to be delivered to the prospective buyer if the error, inaccuracy, or omission was not within the seller's actual knowledge or was based on information provided by a public agency. n86 These provisions typically provide that the seller and the seller's licensee are relieved from any further duty with respect to that item of information. n87

[l] Information Obtained from Professionals Hired to Inspect the Property

Many disclosure laws provide that the seller is not liable for any error, inaccuracy, or omission of any information required to be delivered to the prospective buyer if the error, inaccuracy, or omission was not within the actual knowledge of the owner or was based on information provided by another person with a professional license or special knowledge who provided a written or oral report or opinion that the seller reasonably believed to be correct. n88 Under these provisions, the delivery of a report or opinion prepared by a professional hired to inspect the property in connection with the proposed sale is considered to be sufficient compliance for application of this exemption from liability. n89

[m] Other Parties Entitled to Receive a Copy of the Disclosure Form

Indiana statutorily provides that an appraiser retained to appraise the residential real estate for which the disclosure form has been prepared must be given a copy of the form upon request. n90 This requirement applies only to appraisals made for the buyer or an entity from which the buyer is seeking financing. n91

It should be anticipated that appraisers and home inspectors in other jurisdictions may request a copy of the seller disclosure statement.

[n] A Buyer's Rescission Rights

Typically, disclosure laws allow a purchaser to rescind the sale if the purchaser receives the disclosure statement after a sales offer has been made or accepted but before the transaction has closed and title has been transferred. n92 The law usually specifies the time frame in which the rescission must be made. n93 The disclosure law usually provides that a buyer's rescission must be accomplished via a written document delivered to the seller or the seller's licensee. n94 The disclosure law may require that the buyer base his or her rescission on a specific objection to a disclosure in the disclosure statement. n95 The buyer may also be required in his or her notice of rescission to specifically identify the disclosure objected to by the buyer. n96 If the buyer exercises his or her right to rescind, the buyer incurs no legal liability to the seller because of the rescission and the buyer is entitled to a return of any deposits that the buyer has made. n97

In some jurisdictions, rescission is not an available remedy if the buyers made their offer and entered into a sales contract after they received the seller disclosure statement. n98 When this rule applies, a buyer's primary remedy will be an action for damages. n99

Even if a buyer, by written document in accordance with the statute, rescinds the sales contract or his or her offer, the buyer's overall conduct may be such that a court will conclude that the contract was not rescinded. n100 If a buyer

rescinds the contract through a written document, the buyer should ensure that his or her conduct is consistent with the rescission.

[o] Violations of the Residential Property Seller Disclosure Laws

Seller disclosure laws usually address a purchaser's possible remedies for a violation of the disclosure law. Often such laws provide that a transfer is not invalidated because a seller failed to comply with the disclosure law. n101 Many of these disclosure laws provide that the purchaser can recover any actual damages caused by any misrepresentations made on the disclosure statement. n102 Often this is the only and sole remedy under a seller disclosure act. n103 Some jurisdictions allow an aggrieved buyer to recover in excess of actual damages if the seller's violation was wilful. n104 Some disclosure laws also allow the successful party to recover attorney's fees and costs. n105

The specific statutory provision must be read in order to determine what constitutes a violation of the disclosure law when the alleged violation involves some type of misstatement. For example, the Iowa Real Estate Disclosure Act n106 states that the transferor "shall not be liable for [any] error, inaccuracy, or omission in information required in a disclosure statement, unless that person has actual knowledge of the inaccuracy, or fails to exercise ordinary care in obtaining the information." n107 In interpreting this provision, the Supreme Court of Iowa stated that a plaintiff had to show actual knowledge of a problem that was required to be disclosed, but not did not have to prove fraud. n108 A seller could be found liable under the act for something less than a knowingly inaccurate disclosure, i.e., if the seller failed to exercise ordinary care in obtaining the information to be put on the disclosure form. n109

Under some acts, a buyer's sole remedy may be the right to cancel a sales contract based upon disclosures made in a disclosure statement. A court interpreting the North Carolina Residential Property Act n110 found that there was no separate action for damages under that act as the sole remedy provided for was cancellation of the contract. n111 Unlike similar acts in other jurisdictions, the North Carolina act lacked a provision allowing a buyer to recover actual damages caused by a violation of the act. n112

In New York, if a seller fails to timely deliver a disclosure statement, the buyer is entitled to receive upon the transfer of title a credit of five hundred dollars against the agreed upon purchase price of the residential real property. n113 If a New York seller makes willful misrepresentations on the disclosure statement, the seller may be held liable for the buyer's actual damages. n114

An issue that can arise is the purchaser's right to rely upon the disclosure statement. In one case, the sellers argued that the defects were patent and therefore could not be made the subject of a misrepresentation on their disclosure statement. The court rejected the notion that the defects were patent because it took a person with knowledge of construction to discern the defects. This court also rejected the sellers' argument that the purchasers could not rely on the representations made in the disclosure statement because they had conducted their own investigation of the house. The court stated that the reason this argument "does not stand is because there are three well-recognized exceptions that practically swallow up the general rule that a party who conducts an independent investigation will not be permitted to say he relied on another's misrepresentation." n115 The court found that each exception applied to this case. First, if the party making the independent investigation makes a partial rather than a full investigation, and relies on the misrepresentations as well as the investigation, the party may maintain an action for fraud. This exception applied because the purchasers did not conduct a structural inspection. Therefore, they only partially inspected the house, even though they viewed the house themselves, had the house appraised, and had it inspected for mechanical problems. Second, if facts are peculiarly within the knowledge of the party making the representations, the buyer may rely on such representations if the buyer does not stand on "equal footing" with the seller and the truth is difficult for the buyer to ascertain. In this case, the parties did not stand on equal footing because the sellers had lived in the house. The court stated, "In the vast majority of cases, a seller, who has lived in a property, as opposed to a mere investor, would have knowledge which is superior to a buyer's knowledge concerning the property's condition." n116 The third exception is that if the seller makes a distinct and specific representation, then the buyer has the right to rely on that representation,

even if the parties stand on equal footing or have equal knowledge or means of information. In this case, the sellers made distinct and specific representations in the disclosure statement. Therefore, there was no merit to their argument that the purchasers could not have relied on the representations because they could have had a structural inspection, but chose not to undertake this type of inspection. n117

The effect of the disclosure statements has been to shift the focus of litigation between sellers and disgruntled purchasers who believe that the seller knowingly passed off a defective house. A frequent fact situation involves a disclosure statement that indicates that the home has no defects when the statement is prepared. Shortly after the purchaser closes on the sale and moves in, he or she experiences a major problem (e.g., a flooded basement). Through discovery, the purchaser learns that the seller had experienced the same problem and that the seller's "repairs" hid any visible signs of the prior problem. The seller alleges that he or she repaired the problem when it first occurred many years ago and that the seller had not experienced any problems since the repair. Some sellers appear to be reluctant to disclose any problems they experienced with the home, instead opting to claim a successful repair if the problem recurs after the sale.

The particular facts of the particular case and the specifics of the disclosure law will determine a court's decision when the purchaser pursues litigation alleging a misleading, inaccurate or incomplete disclosure statement. If the defects the seller has failed to disclose are egregious or the facts clearly indicate bad faith and lack of fair dealing, courts appear inclined to find on behalf of purchasers. For example, in one case the sellers represented that there had been few problems with the home they were selling. In fact, the sellers had previously sued the prior owners of the house alleging numerous structural problems. The prior litigation and damning testimony given by one of the sellers in a deposition connected with this prior litigation showed that the sellers knew that their home had serious defects which they intentionally failed to disclose. In fact, it was the purchasers' subsequent knowledge of this deposition from the prior litigation that caused them to rescind the sales contract. When the sellers sued, the court found that the purchasers were entitled to rescind the sales contract. n118

When the facts are not as egregious, courts are more willing to take more of a caveat emptor approach to the disclosure statement. One court stated that the Georgia disclosure law does not require that sellers disclose every past repair made to their homes; rather, they must inform potential buyers of current defects of which they are aware. n119 However, it should be noted that the alleged defects in this case involved a swimming pool, the disclosure statement did not address the swimming pool, and there was no active concealment of the pool's condition.

Litigation regarding property disclosure statements will raise issues of merger and whether the disclosure statement is part of the parties' contract. A merger or entire agreement clause may bar purchasers from asserting reliance on the alleged misrepresentation not contained within the contract. n120 However, a merger clause usually cannot be used as a defense by a seller against a buyer's tort actions of fraud and negligent misrepresentation. n121

In some jurisdictions disgruntled purchasers will have the option of pursuing a claim concerning misrepresentations made on a seller's disclosure statement in small claims court if the damages claimed do not exceed the jurisdictional limits of this court. n122

[p] Disclosure Acts May Contain a Statute of Limitations

Residential property disclosure acts often have a specific statute of limitations period that is relatively short. n123 Frequently, a buyer has a one-year period in which to file suit. n124 The applicable statute must be examined to determine when the statute begins to run. For example, in Illinois, the one-year period commences from the earlier of the date of possession, date of occupancy, or date of recording of an instrument of conveyance of the residential real property. n125 In Virginia, the one-year period begins on the date the buyer received the disclosure or disclaimer statement. n126

The shorter statute of limitations may provide both licensees and sellers with a defense should the buyer sue them over property defects and the seller disclosure statement. n127

FOOTNOTES:

(n1)Footnote 1. See Katherine A. Pancak et al., *Residential Disclosure Laws: The Further Demise of Caveat Emptor*, 24 Real Est. L.J. 291, 298-99 (1996) (reporting that a little more than half the states have enacted mandatory seller disclosure legislation).

(n2)Footnote 2. See Md. Code Ann., Real Prop. § 10-702(c)(1) (vendor of single family residential real property must complete and deliver to each purchaser either a written residential property condition disclosure statement or a written residential property disclaimer statement); N.C. Gen. Stat. 47E-4(a)(2) (disclosure statement may state that the owner makes no representations as to the characteristics and condition of the real property or any improvements to the real property except as otherwise provided in the real estate contract); Tenn. Code Ann. § 66-5-202 (the owner of the residential property shall furnish to a purchaser either a residential property disclosure statement or a disclaimer statement); Va. Code Ann. § 55-519(A) (the owner of the residential real property shall furnish to a purchaser either a residential property disclosure statement or a residential property disclaimer statement).

(n3)Footnote 3. Arizona is such a jurisdiction. The Arizona Association of Realtors(R) publishes a Residential Seller's Property Disclosure Statement with Seller Advisory. This form may be obtained on this association's website at: <http://www.aaronline.com/>.

(n4)Footnote 4. See Ky. Rev. Stat. Ann. § 324.360 (applying to sales of single-family residential dwellings if any person licensee receives compensation); Miss. Code Ann. § 89-1-501 (applying only to transfers only when the transfer is by, or with the aid of, a duly licensed real estate broker or salesperson); Okla. Stat. tit. 60, § 832(2) (providing that disclosure or disclaimer statement is required only if seller is represented by real estate licensee or if requested by purchaser).

(n5)Footnote 5. See, e.g., Neb. Rev. Stat. § 76-2, 120(3)(i).

(n6)Footnote 6. See La. Rev. Stat. Ann. § 9:3199(A); Md. Code Ann., Real Prop. § 10-702(m)(1); N.Y. Real Prop. § 466; N.C. Gen. Stat. § 47E-8; S.C. Code Ann. § 27-50-70; Tenn. Code Ann. § 66-5-206; Va. Code Ann. § 55-523. See also Okla. Stat. tit. 60, § 836(A) (A licensee representing or assisting a seller must obtain from the seller a disclaimer statement or a disclosure statement and any amendment required by the Residential Property Condition Disclosure Act and make the statement available to potential purchasers prior to acceptance of an offer to purchase.).

(n7)Footnote 7. See Neb. Rev. Stat. § 76-2, 120(10).

(n8)Footnote 8. See La. Rev. Stat. Ann. § 9:3199(B).

(n9)Footnote 9. See Md. Code Ann., Real Prop. § 10-702(m)(2); N.Y. Real Prop. § 466; N.C. Gen. Stat. § 47E-8; Tenn. Code Ann. § 66-5-206; Va. Code Ann. § 55-523. See also Neb. Rev. Stat. § 76-2, 120(10) (only obligation of a buyer's agent under the disclosure law is to assure that a copy of the statement is delivered to the buyer on or before the effective date of any purchase agreement which binds the buyer to purchase the property subject to the disclosure statement); Okla. Stat. tit. 60, § 836 (B) (licensee representing the purchaser must obtain and make available to the purchaser a disclaimer statement or a disclosure statement prior to the acceptance of an offer to purchase).

(n10)Footnote 10. See Va. Code Ann. § 55-523.

(n11)Footnote 11. See Minn. Stat. § 513.55.

(n12)Footnote 12. See Minn. Stat. § 513.55.

(n13)Footnote 13. *See, e.g., N.C. Gen. Stat. § 47E-4; 68 Pa. C.S. § 7304.*

(n14)Footnote 14. Some states impose minimal disclosure obligations while others impose extensive disclosure obligations. California appears to have the largest number of required disclosures. California statutorily requires written disclosures regarding natural hazards, Mello-Roos bonds and taxes (special assessment districts), ordinance location, earthquake guides, smoke detectors, lead-based paint hazards, environmental hazards, advisability of title insurance, water heater's security against earthquake, locations of registered sex offenders (Megan's law), visual inspection by agents, agency relationship disclosure, negotiability of real estate commissions and common interest ownership.

(n15)Footnote 15. *See Ind. Code Ann. § 32-21-5-4; La. Rev. Stat. § 9:3196; Me. Rev. Stat. tit. 33, § 171.*

(n16)Footnote 16. *See Snow v. Opal, 2002 Del. C.P. LEXIS 26, at *12 (May 20, 2002) ; Arthur v. Brick, 565 N.W.2d 623, 625 (Iowa Ct. App. 1997) ; Parmely v. Hildebrand, 603 N.W.2d 713, 716, 1999 SD 157 (S.D. 1999) ; Engelhart v. Kramer, 570 N.W.2d 550, 554, 1997 SD 124 (1997) . See also Rogers v. Meiser, 2003 OK 6, 13, 68 P.3d 967, 976 (Okla. 2003) (The Residential Property Condition Disclosure Act gives the buyer a remedy in situations where under the common law there would be no remedy because of application of the doctrine of caveat emptor.). See generally George Lefcoe, *Property Condition Disclosure Forms: How the Real Estate Industry Eased the Transition from Caveat Emptor to "Seller Tell All,"* 39 *Real Prop. Prob. & Tr. J.* 193 (2004); Roberts, *Disclosure Duties in Real Estate Sales and Attempts to Reallocate the Risk*, 34 *Conn. L. Rev.* 1 (2001); Washburn, *Residential Real Estate Condition Disclosure Legislation*, 44 *DePaul L. Rev.* 381 (1995). *But cf.* Craig W. Dallan, *Theories of Real Estate Broker Liability and the Effect of the "As Is"*, 54 *Fla. L. Rev.* 395, 405 (2002) ("Caveat emptor in the sale of real property, depending upon the jurisdiction and the authority consulted, is alternatively (1) still the rule, (2) abandoned, or (3) still relevant, but partially abandoned. Most courts and commentators probably would agree that caveat emptor has been sharply limited but continues to play a role in real property sales in most jurisdictions.").*

(n17)Footnote 17. *Cf. Idaho Code § 55-2502* which states, "In order to promote the public health, safety and welfare and to protect consumers; it is the purpose of the provisions of this chapter to require sellers of residential real property as defined in this chapter to disclose certain defects in the residential real property to a prospective buyer."

(n18)Footnote 18. *See, e.g., Beavers v. Lamplighters Realty, Inc. 1976 OK CIV APP 48, 556 P.2d 1328, 1331 (Okla. Ct. App. 1976)* where the court stated that caveat emptor was "one of the less admirable hand-me-downs of our Anglo-Saxon common law heritage...that exalts deceit, condemns fair dealing, and scorns the credulous."

(n19)Footnote 19. Murray, *AIDS, Ghosts, Murder: Must Real Estate Brokers and Sellers Disclose?*, 27 *Wake Forest L. Rev.* 689 (1992). *See Parmely v. Hildebrand, 603 N.W.2d 713, 716, 1999 SD 157 (1999)* ("In South Dakota, 'caveat emptor' is a doctrine of the past when it comes to transferring real property."). *Cf. Moore v. Prudential Residential Services Limited Partnership, 849 So. 2d 914, 923 (Ala. 2002) , rehearing denied, 2002 Ala. LEXIS 379 (Ala. Nov. 15, 2002)* ("Although Alabama has abrogated the rule of caveat emptor in the sale of new real estate, that rule still applies in the sale of used real estate."), *Pines v. Persson, 14 Wis. 2d 590, 596, 111 N.W.2d 409, 412 (Wis. 1961)* (residential landlord-tenant case) ("The need and social desirability of adequate housing for people in this era of rapid population increases is too important to be rebuffed by that obnoxious legal cliché, caveat emptor.").

(n20)Footnote 20. Ohio is one state where the caveat emptor principle remains.

(n21)Footnote 21. *See Va. Code Ann. § 55-519.* Oklahoma allows a seller to use a disclaimer form if the seller has never occupied the property. *See Okla. Stat. tit. 60, § 833(A)(1).*

(n22)Footnote 22. *See Md. Code Ann., Real Prop. § 10-702(c)(2).*

(n23)Footnote 23. Virginia allows residential sellers to sell property "as is" and provide a disclaimer form. In many regions of Virginia, this is the norm and a seller who provides the disclosure statement is rare. *See Va. Code Ann. § 55-519.*

(n24)Footnote 24. See *Del. Code Ann. tit. 6, § 2573*. See also N.Y. Real Prop. § 462 ("A copy of the property condition disclosure statement containing the signatures of both seller and buyer shall be attached to the real estate purchase contract.").

(n25)Footnote 25. See *Haw. Rev. Stat. §§ 508D-4 (2) and 508D-12*; *Mich. Comp. Laws § 565.954 (2)*; *R.I. Gen. Laws § 5-20.8-2(c)*. See also *Idaho Code § 55-2509* (form recipient signs and dates a copy of the form).

(n26)Footnote 26. See *La. R.S. § 9:3198(D)(1)*.

(n27)Footnote 27. See *Idaho Code § 55-2514*; *765 ILCS 77/45*; *La. Rev. Stat. § 9:3200*; *Me. Rev. Stat. tit. 33, § 178*; *Mich. Comp. Laws § 565.961*.

(n28)Footnote 28. See, e.g., *Del. Code Ann. tit. 6, § 2574*; *Idaho Code § 55-2507*; *Ind. Code Ann. § 32-21-5-9*; *La. Rev. Stat. § 9:3198(D)(2)*; *Md. Code Ann., Real Prop. § 10-702(e)(3)(iv)*; *Nev. Rev. Stat. Ann. § 113.140*; *Okla. Stat. tit. 60, § 833(B)(2)*.

(n29)Footnote 29. See *Del. Code Ann. tit. 6, § 2574*; *La. Rev. Stat. § 9:3198(D)(2)*.

(n30)Footnote 30. See *Idaho Code § 55-2507*; *Md. Code Ann., Real Prop. § 10-702(e)(3)(ii)*; *Ohio Rev. Code Ann. 5302.30(D)(1)*, *Okla. Stat. tit. 60, § 833(B)(2)*.

(n31)Footnote 31. See *Del. Code Ann., tit. 6, § 2575*.

(n32)Footnote 32. These sample exemptions are taken from *Virginia Code § 55-518*.

(n33)Footnote 33. See *D.C. Code § 42-1311*; *Ore. Rev. Stat. § 105.480*.

(n34)Footnote 34. See *Haw. Rev. Stat. § 508D-7(b)*.

(n35)Footnote 35. See *D.C. Code § 42-1311*; *Iowa Code § 558A.6*; *Mich. Comp. Laws § 565.964*. See also *Gardner v. Wandersee*, 2007 Iowa App. LEXIS 375, at *4-*5 (Iowa Ct. App. Apr. 11, 2007) (With respect to the seller's disclosure statement, a licensee is subject to liability if the licensee had actual knowledge of the inaccuracy, or failed to exercise ordinary care in obtaining the information. A licensee's standard of reporting is one of good faith;), citing *Iowa Code § 558A.3(1)*; *Garza v. Wells Fargo Home Mortg., Inc.*, 2004 Tex. App. LEXIS 7590 (Tex. Ct. App. Aug. 25, 2004), review denied, 2005 Tex. LEXIS 80 (Tex. Jan. 21, 2005) (The disclosure notice required by *Tex. Prop. Code Ann. § 5.008* is a disclosure by the seller only, and not by the seller and broker regardless of whether the broker has also signed the disclosure notice. The listing broker and realty company could not be held liable for any alleged misrepresentations or nondisclosures in the seller's disclosure notice.).

(n36)Footnote 36. See *D.C. Code § 42-1311*.

(n37)Footnote 37. See *Haw. Rev. Stat. § 508D-7(b)*.

(n38)Footnote 38. Cf. *Idaho Code § 55-2518* ("Nothing contained in this chapter shall in any way limit or reduce the duties that a real estate licensee owes to his or her client or to the general public.").

(n39)Footnote 39. Cf. *Walker v. Johnson*, 278 Ga. App. 806, 811, 630 S.E.2d 70, 75-76 (2006) overruled in part, *Kleber v. City of Atlanta*, 2008 Ga. App. LEXIS 396, at *15 (Mar. 28, 2008) (on other grounds) (The disclosure statement was limited to representations made by the seller. Summary judgment was properly granted to the real estate agent on the buyers' claims of fraud.), reconsideration dismissed; Dallon, *Theories of Real Estate Broker Liability and the Effect of the "As Is" Clause*, 54 Fla. L. Rev. 395, 428 (2002) ("Many of these [seller disclosure] statutes were introduced and supported by real estate brokers concerned about their own potential liability to purchasers. (footnote omitted) The real estate industry viewed these statutes as means to limit the liability of real estate brokers by imposing

affirmative disclosure requirements upon sellers and limiting brokers' duties to investigate or disclose."); Kenneth M. Nakasone, *Recent Developments: Seller Beware: New Law Protects Hawaii Home Buyers*, 18 *Hawaii L. Rev.* 981, 1007 (1996), quoting T.J. Howard, *Seller Disclosure Lets Buyer Know the Score*, *Chicago Tribune*, May 14, 1993, at C3 ("The fact that the National Association of Realtors is the champion of seller disclosure indicates the trade association expects the new law to benefit real estate agents.").

(n40)Footnote 40. See Leroy Gatlin II, *Note: Reforming Residential Real Estate Transactions: An Analysis of Oklahoma's Disclosure Statute*, 22 *Okla. City U.L. Rev.* 735, 743-744 (1997); Stephanie Stern, *Temporal Dynamics of Disclosure: The Example of Residential Real Estate Conveyancing*, 2005 *Utah L. Rev.* 57, 61-62 (2005).

(n41)Footnote 41. See Leroy Gatlin II, *Note: Reforming Residential Real Estate Transactions: An Analysis of Oklahoma's Disclosure Statute*, 22 *Okla. City U.L. Rev.* 735, 743-744 (1997).

(n42)Footnote 41.1. See *White v. Bowman*, 304 S.W.3d 141, 149-150 (2009) .

(n43)Footnote 42. For such a factual scenario where the licensee was found to have no liability to the buyers over a failed septic system, see *Dasher v. Davis*, 274 Ga. App. 788, 789-790, 618 S.E.2d 728, 730-731 (2005) , cert. denied, 2006 Ga. LEXIS 59 (Jan. 17, 2006) . See also *Kramer v. Eagle Eye Home Inspections, Inc.*, 14 Neb. App. 691, 716 N.W.2d 749 (2006) overruled in part by, *Tracy Broad. Corp. v. Telemetrix, Inc.*, 17 Neb. Ct. App. 112, 756 N.W.2d 742 (2008) . (The sellers indicated on the property condition disclosure statement that there had not been damage due to wood-destroying insects, but that there had been treatment for wood-destroying insects. The buyer could not show that he reasonably relied on the disclosure statement and that he suffered damage as a result, because the buyer had a termite inspection and treatment done on the home prior to closing and received a credit on the sale price for such treatment.) overruled in part by *Tracy Broad. Corp. v. Telemetrix, Inc.*, 17 Neb. Ct. App. 112, 121, 756 N.W.2d 742, 750 (2008) (on other grounds); *Niermeyer v. Cook's Termite & Pest Control, Inc.*, 2006 Ohio 640, 2006 Ohio App. LEXIS 579 at *14-*23 (Feb. 14, 2006) (When buyers had notice of prior termite infestation, buyers had a duty to make further a investigation. The first purchase contract fell through because the issue of termites was not resolved. All parties had signed a mutual release. The parties subsequently signed a second purchase agreement, at a reduced price, providing in part that the buyers had completed a home inspection and accepted the house "as is." The buyers could not prove that the licensees had caused the damages claimed.).

(n44)Footnote 43. See *Alaska Stat.* § 34.70.060; *D.C. Code* § 42-1306; *Iowa Code* § 558A.3; *Mich. Comp. Laws* § 565.960; *Minn. Stat.* § 513.55; *Miss. Code Ann.* § 89-1-511.

(n45)Footnote 44. See *D.C. Code* § 42-1306; *Idaho Code* § 55-2515; *Mich. Comp. Laws* § 565.960; *Miss. Code Ann.* § 89-1-511; *Ohio Rev. Code Ann.* 5302.30(A)(1); *Wis. Stat.* § 709.06.

(n46)Footnote 45. *Haw. Rev. Stat.* § 508D-9.

(n47)Footnote 46. *Behniwal v. Mix*, 133 Cal. App. 4th 1027, 1031, 35 Cal. Rptr. 3d 320, 331 (2005) . This court also stated that cashing a check or initialing a small change in escrow instructions "does not require nearly the sort of mind-wracking deliberation that a disclosure form does (or should)."

(n48)Footnote 47. *Snow v. Opal*, 2002 Del. C.P. LEXIS 26, at *12 (May 20, 2002) , quoting *Osciak v. Coppol*, Del. CCP, C.A. No. 97-04-311, 1998 Del. C.P. LEXIS 65, at *4 , James, J. (Jan. 9, 1998).

(n49)Footnote 48. See *Md. Code Ann., Real Prop.* § 10-702(c). See also *Tenn. Code Ann.* § 66-5-202 (seller may provide a disclaimer form if the buyer waives the required disclosure statement). Cf. *S.C. Code Ann.* § 27-50-110 (disclosure act is not intended to prevent parties from entering into agreements for the sale of real property "as is").

(n50)Footnote 49. See *Okla. Stat. tit. 60, § 833 (A)(1)*.

(n51)Footnote 50. This has become the practice in parts of Virginia since the seller can opt to provide the disclaimer statement.

(n52)Footnote 51. *See Alaska Stat. § 34.70.110; Minn. Stat. § 513.60; Nev. Rev. Stat. Ann. § 113.150(6). See also Wash. Rev. Code § 64.06.020* (disclosure statement must be provided unless the buyer has expressly waived the right to receive the disclosure statement); *Wis. Stat. § 709.08* (buyer may waive right to receive the disclosure statement, waiver must be written).

(n53)Footnote 52. *See Cal Civ Code § 1102.1. See also Md. Code Ann., Real Prop. § 10-702(k)(1)* (purchaser's rights under the seller disclosure law may not be waived in the contract of sale and any attempted waiver is void).

(n54)Footnote 53. *See Cal Civ Code § 1102.1.*

(n55)Footnote 54. *See Zirkle v. Cendant Mobility Servs. Corp.*, 61 Va. Cir. 3, 2003 Va. Cir. LEXIS 26, at *4 (Jan. 7, 2003), citing *Va. Code Ann. § 55-519*.

(n56)Footnote 55. *See, e.g., Alaska Stat. § 34.70.050; Del. Code Ann. tit. 6, § 2578; Ind. Code Ann. § 32-21-5-7; La. Rev. Stat. § 9:3198; Bergen v. Baker*, 264 Mich. App. 376, 383, 691 N.W.2d 770, 775 (2004).

(n57)Footnote 56. *See Idaho Code § 55-2506.*

(n58)Footnote 57. *See, e.g., Ind. Code Ann. § 32-21-5-7; Okla. Stat. tit. 60, § 833.*

(n59)Footnote 58. *See 765 ILCS 77/35; Mich. Comp. Laws § 565.957; N.Y. Real Prop. Law § 462; Tenn. Code Ann. § 66-5-210; Tex. Prop. Code § 5.008.*

(n60)Footnote 59. *See 765 ILCS 77/65.*

(n61)Footnote 60. *See Mich. Comp. Laws § 565.958.*

(n62)Footnote 61. *See Alaska Stat. § 34.70.010; S.D. Codified Laws § 43-4-38.*

(n63)Footnote 62. *See 765 ILCS 77/20; Ind. Code Ann. § 32-21-5-10; Mich. Comp. Laws § 565.954(1)(a); Minn. Stat. § 513.55. See also N.C. Gen. Stat. § 47E-5*(no later than the time the purchaser makes an offer).

(n64)Footnote 63. *See Miss. Code Ann. § 89-1-503; Nev. Rev. Stat. Ann. § 113.130.*

(n65)Footnote 64. *See Alaska Stat. § 34.70.020, Me. Rev. Stat. tit. 33, § 174; Mich. Comp. Laws § 565.954(3); N.C. Gen. Stat. § 47E-5.*

(n66)Footnote 65. *See Ind. Code Ann. § 32-21-5-10(a).*

(n67)Footnote 66. *See Ind. Code Ann. § 32-21-5-10(c).*

(n68)Footnote 67. *See Ky. Rev. Stat. § 324.360(4).*

(n69)Footnote 68. *See Stephanie Stern, Temporal Dynamics of Disclosure: The Example of Residential Real Estate Conveyancing*, 2005 Utah L. Rev. 57, 60 (2005).

(n70)Footnote 69. *Stephanie Stern, Temporal Dynamics of Disclosure: The Example of Residential Real Estate Conveyancing*, 2005 Utah L. Rev. 57, 94-95 (2005).

(n71)Footnote 70. *See Stephanie Stern, Temporal Dynamics of Disclosure: The Example of Residential Real Estate Conveyancing*, 2005 Utah L. Rev. 57, 67 (2005).

(n72)Footnote 71. See Stephanie Stern, *Temporal Dynamics of Disclosure: The Example of Residential Real Estate Conveyancing*, 2005 *Utah L. Rev.* 57, 81 (2005), where this author states, "Receiving information in the middle or final stages of a transaction, rather than at the outset, has two primary effects. First, consumers are less likely to negotiate for appropriate discounts in pricing when they receive latecoming information about defects. This has a distorting effect on real estate markets and suggests that consumers will overpay in states that allow disclosure to occur midstream or even end-game in a transaction. Second, late disclosure encourages persistence in transactions so that a subset of consumers will complete real estate purchases that they would not have otherwise completed. The cognitive persistence effect is not an absolute or exclusive factor in decision making, but it is an important one. Consumers will consider costs and benefits, market conditions, and personal goals, but will underweight latecoming information in this calculus. These biases are likely heightened by the highly personal nature of home buying and the emotional context of these decisions. (footnotes omitted).

(n73)Footnote 72. See *Cal. Civ. Code* § 1102.10; *Idaho Code* § 55-2510; 765 *ILCS* 77/50; *Iowa Code* § 558A.2; *Mich. Comp. Laws* § 565.963.

(n74)Footnote 73. See *D.C. Code* § 42-1309; *Idaho Code* § 55-2510; 765 *ILCS* 77/50; *Mich. Comp. Laws* § 565.963.

(n75)Footnote 74. See *Cal. Civ. Code* § 1102.10; *Iowa Code* § 558A.2.

(n76)Footnote 75. See 765 *ILCS* 77/50.

(n77)Footnote 76. See *Iowa Code* § 558A.5 (2). See also *Miss. Code Ann.* § 89-1-521 (broker who obtains an offer must deliver the statement to the buyer).

(n78)Footnote 77. See *Ikola v. Schoene*, 264 *Ga. App.* 338, 341-343, 590 *S.E.2d* 750, 753-754 (*Ga. Ct. App.* 2003) *Palmer v. Miss. Real Estate Comm'n*, 14 *So. 3d* 67, 72-73 (*Miss. Ct. App.* 2008) (*en banc*), *reh'g, en banc, denied*, 2009 *Miss. App. LEXIS* 157 (Mar. 24, 2009) .

(n79)Footnote 78. See *Minn. Stat.* § 513.55.

(n80)Footnote 79. See *Alaska Stat.* § 34.70.040; *Haw. Rev. Stat.* § 508D-13; *Iowa Code* § 558A.3; *Me. Rev. Stat. tit. 33, § 175*; *Minn. Stat.* § 513.58. See also 765 *ILCS* 77/30 (seller must provide a written supplement to correct a previously delivered disclosure statement); *N.Y. Real Prop. § 464* (seller must provide a revised property condition disclosure statement).

(n81)Footnote 80. See *Haw. Rev. Stat.* § 508D-13; *Idaho Code* § 55-2513; *Ind. Code Ann.* § 32-21-5-13.

(n82)Footnote 81. See *Rock v. Voshell*, 397 *F. Supp. 2d* 616, 626 (*E.D. Pa.* 2005) *reconsideration denied*, 2005 *U.S. Dist. LEXIS* 36942 (*E.D. Pa.* Dec. 29, 2005) , applying Pennsylvania law.

(n83)Footnote 82. See *Idaho Code* § 55-2513.

(n84)Footnote 83. See *Hearty v. First Merit Bank, N.A.*, 1999 *Ohio App. LEXIS* 5544, at *11 (Nov. 24, 1999) , *discretionary appeal denied*, 88 *Ohio St. 3d* 1448, 725 *N.E.2d* 287 (2000) .

(n85)Footnote 84. See, e.g., *Alaska Stat.* § 34.70.080; *Cal Civ Code* § 1102.9; *D.C. Code* § 42-1308; *Minn. Stat.* § 513.58.

(n86)Footnote 85. See *Alaska Stat.* § 34.70.040; *Idaho Code* § 55-2512; *Iowa Code* § 558A.3.

(n87)Footnote 86. See *Idaho Code* § 55-2511(2); 765 *ILCS* 77/25; *Ind. Code Ann.* § 32-21-5-11; *Mich. Comp. Laws* § 565.955; *Wis. Stat.* § 709.07.

(n88)Footnote 87. See *Idaho Code* § 55-2511(2); 765 ILCS 77/25.

(n89)Footnote 88. See *Idaho Code* § 55-2511(1); *Ind. Code Ann.* § 32-21-5-11; *Mich. Comp. Laws* § 565.955; *Wis. Stat.* § 709.07.

(n90)Footnote 89. See *Idaho Code* § 55-2511(3).

(n91)Footnote 90. See *Ind. Code Ann.* § 32-21-5-10(b).

(n92)Footnote 91. See *Ind. Code Ann.* § 32-21-5-10(b).

(n93)Footnote 92. See *Bharodia v. Pledger*, 340 Ark. 547, 554-557, 11 S.W.3d 540, 545-546 (2000) .

(n94)Footnote 93. See, e.g., *Haw. Rev. Stat.* § 508D-5(b) (15 calendar days after receipt of the statement), See *Idaho Code* § 55-2515 (3-day rescission period); 765 ILCS 77/40 (3 business days).

(n95)Footnote 94. See *Idaho Code* § 55-2515; 765 ILCS 77/40.

(n96)Footnote 95. See *Idaho Code* § 55-2515.

(n97)Footnote 96. See *Idaho Code* § 55-2515.

(n98)Footnote 97. See *Idaho Code* § 55-2515; 765 ILCS 77/40.

(n99)Footnote 98. See *Zappitelli v. Miller*, 2006 Ohio 279, 2006 Ohio App. LEXIS 239, at *18 (2006) , citing *Ohio Rev. Code.* § 5302.30(K)(3)(d).

(n100)Footnote 99. Cf. *Zappitelli v. Miller*, 2006 Ohio 279, 2006 Ohio App. LEXIS 239, at *18 (2006) . The buyers in this case sought rescission after the sale had settled. The buyers alleged fraud, breach of contract, and negligence and were awarded damages. The buyers request for rescission was denied.

(n101)Footnote 100. See *Patterson v. Amundson*, 201 Ore. App. 486, 498, 119 P.3d 264, 271-272 (2005) . The court granted the buyers' request for specific performance even though the buyer had earlier attempted to rescind the contract.

(n102)Footnote 101. See, e.g., *Alaska Stat.* § 34.70.090(a); *Cal Civ Code* § 1102.13; *D.C. Code* § 42-1310; *Haw. Rev. Stat.* § 508D-2; *Idaho Code* § 55-2517; 765 ILCS 77/55; *Iowa Code* § 558A.8.; *Mich. Comp. Laws* § 565.964; *Minn. Stat.* § 513.59; *Miss. Code Ann.* § 89-1-523; *Neb. Rev. Stat.* § 76-2, 120(11).

(n103)Footnote 102. See *Alaska Stat.* § 34.70.090(b); *Cal Civ Code* § 1102.13; *Haw. Rev. Stat.* § 508D-16; *Idaho Code* § 55-2517; *Iowa Code* § 558A.6.

(n104)Footnote 103. Cf. *Green v. Jacobson*, 1998 OK CIV APP 121, 963 P.2d 26, 27 (1998) (The Residential Property Condition Disclosure Act provides the sole and exclusive remedy for its violation is an action for actual damages, including the cost of repairing the defect, suffered by the purchaser as a result of a defect existing in the property as of the date of acceptance by seller of an offer to purchase.).

(n105)Footnote 104. See *Alaska Stat.* § 34.70.090(c) (seller's liability to the transferee for up to three times the actual damages suffered as a result of the violation or failure).

(n106)Footnote 105. See *Haw. Rev. Stat.* § 508D-16; 765 ILCS 77/55; *S.D. Codified Laws* § 43-4-42.

(n107)Footnote 106. *Iowa Code* chapter 558A.

(n108)Footnote 107. *Iowa Code § 558A.6.*

(n109)Footnote 108. *See Jensen v. Sattler*, 696 N.W.2d 582, 587 (Iowa 2005) , rehearing overruled, 2005 Iowa Sup. LEXIS 79 (Iowa, June 1, 2005) .

(n110)Footnote 109. *See Jensen v. Sattler*, 696 N.W.2d 582, 586 (Iowa 2005) , rehearing overruled, 2005 Iowa Sup. LEXIS 79 (Iowa, June 1, 2005) .

(n111)Footnote 110. *See N.C. Gen. Stat. § 47E-1 et seq .*

(n112)Footnote 111. *See Little v. Stogner*, 162 N.C. App. 25, 32-33, 592 S.E.2d 5, 10-11 (N.C. Ct. App. 2004) .

(n113)Footnote 112. The remedy provision is found at *N.C. Gen. Stat. § 47E-5(b).*

(n114)Footnote 113. *See N.Y. Real Prop. § 465. See generally Bishop v Graziano*, 10 Misc. 3d 342, 804 N.Y.S. 2d 236, 2005 N.Y. Misc. LEXIS 2289 (N.Y. Sup. Ct. 2005) for a case discussing this provision.

(n115)Footnote 114. *See Fleischer v. Morreale*, 810 N.Y.S.2d 624, 629-630, 2006 N.Y. Misc. LEXIS 383, at *13-*15 (N.Y. Sup. Ct. Jan. 31, 2006) . *Cf. Malach v. Chuang*, 194 Misc. 2d 651, 657-658, 754 N.Y.S.2d 835, 840-841, 2002 N.Y. Misc. LEXIS 1723 (N.Y. Civ. Ct. 2002) (The seller disclosure statute does not provide relief if the seller either intentionally or negligently misrepresents the property's condition. If an action is brought under a common-law theory, the buyer would be entitled to actual damages.).

(n116)Footnote 115. *Groothand v. Schlueter*, 949 S.W.2d 923, 929 (Mo. Ct. App. 1997) .

(n117)Footnote 116. *Groothand v. Schlueter*, 949 S.W.2d 923, 930 (Mo. Ct. App. 1997) , quoting *Colgan v. Washington Realty Co.*, 879 S.W.2d 686, 691 (Mo. Ct. App. 1994) .

(n118)Footnote 117. *Groothand v. Schlueter*, 949 S.W.2d 923, 930 (Mo. Ct. App. 1997) .

(n119)Footnote 118. *Groothand v. Schlueter*, 949 S.W.2d 923, 925-926 and 930 (Mo. Ct. App. 1997) .

(n120)Footnote 119. *Ainsworth v. Perreault*, 254 Ga. App. 470, 563 S.E.2d 135, 2002 Ga. App. LEXIS 109, at *10 (2002) , cert. denied, 2002 Ga. LEXIS 783 (Sept. 6, 2002) .

(n121)Footnote 120. *See, e.g., Kiser v. Peacock*, 272 Ga. App. 83, 85, 611 S.E.2d 747, 749 (Ga. Ct. App. 2005) .

(n122)Footnote 121. *See Yeager v. McLellan*, 177 S.W.3d 807, 809-810 (Ky. 2005) ; *Slack v. James*, 364 S.C. 609, 619, 614 S.E.2d 636, 641 (S.C. 2005) ; *Brown v. Johnson*, 109 Wn. App. 56, 60, 34 P.3d 1233 (Wash. Ct. App. 2001) . *See generally* Morgan H. Rogers, *Slack v. James: Can South Carolina's Real Estate Industry Rely on Non-Reliance Clauses?*, 57 S.C. L. Rev. 583 (2006).

(n123)Footnote 122. *See Flint v. Hopkins (In re Flint)*, 720 N.E.2d 1230, 1231-1232 (Ind. Ct. App. 1999) .

(n124)Footnote 123. *Cf. Minn. Stat. § 513.57* (action must be commenced within two years after the date on which the prospective buyer closed the purchase or transfer); *Nev. Rev. Stat. Ann. § 113.150(4)* (action must be commenced not later than 1 year after the purchaser discovers or reasonably should have discovered the defect or 2 years after the conveyance of the property to the purchaser, whichever occurs later).

(n125)Footnote 124. *See 765 ILCS 77/55; Va. Code Ann. § 55-524(C).*

(n126)Footnote 125. *See 765 ILCS 77/55.*

(n127)Footnote 126. *See Va. Code Ann. § 55-524(C).*

(n128)Footnote 127. See Kenneth M. Nakasone, Recent Developments: Seller Beware: New Law Protects Hawaii Home Buyers, *18 Hawaii L. Rev.* 981, 1012 (1996). This author notes that the Hawaii statute of limitations is six years for fraudulent or negligent misrepresentation and breach of contract. The statute of limitations under Hawaii Revised Statutes section 508D limits claims for non-disclosure to two years.

* Written by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues.



73 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *

PART II. Licensee Disclosure Obligations Regarding the Property's Condition

10-3A Real Estate Brokerage Law and Practice § 3A.08

§ 3A.08 Licensee Liability with Respect to a Disclosure Statement

Licensees normally incur no liability with respect to a seller disclosure statement since the representations are being made by the seller. Many seller disclosure acts specifically provide that a licensee has no liability with respect to the statement unless the licensee knew that representations on that statement were false and the licensee either was silent when the licensee had a duty to speak and disclose the misstatement or the licensee participated in the misrepresentation. It should be emphasized that silence or nondisclosure may constitute misrepresentation only when there is a duty to speak. n1 Whether a duty to speak exists in a tort context is a question of law. n2

If the problem is disclosed in the seller disclosure statement, a court may find that the seller has fulfilled his or her disclosure obligation even if the buyer believes that the defect is far worse than what was disclosed. n3 Presumably, this logic would also apply to a licensee.

A licensee may create liability for himself or herself through malfeasance in the delivery of the disclosure statement when the statement contains representations which would have caused the buyer to rescind the offer or cancel the sales contract. For example, delivery of a disclosure statement disclosing defects after the transaction has closed is ineffective and typically negates the buyer's options for dealing with unfavorable disclosures.

When a licensee has either not delivered the disclosure statement or has delivered the statement after closing, the licensee may still have no liability even though the statement contains negative disclosures if the buyers timely learned of the disclosed defect through another source. For example, in one case the licensees failed to provide the buyers with a copy of the seller's condition report indicating a leaking basement prior to their purchase of a house. The court found that an independent third-party inspection of the property which disclosed the problems with the basement relieved the licensees from their duties to inspect and disclose adverse conditions related to the basement. n4

Licensees are also typically not subject to liability when the defect is disclosed on the seller disclosure statement. Once the buyer is alerted to a possible defect, a purchaser may not ignore the disclosure and then raise the buyer's lack of expertise when a problem arises. When a buyer is aware of a possible problem, the buyer has a duty to either to (1) make further inquiry of the owner who is under a duty not to engage in fraud, or (2) seek the advice of someone with sufficient knowledge to appraise the defect. n5

FOOTNOTES:

(n1)Footnote 1. See, e.g., *Richard Brown Auction & Real Estate, Inc. v. Brown*, 583 So. 2d 1313, 1316 (Ala. 1991) ; *In re Estate of Lecic*, 104 Wis.2d 592, 604, 312 N.W.2d 773, 779 (Wis. 1981) .

(n2)Footnote 2. See, e.g., *Ex parte Walden*, 785 So. 2d 335, 338 (Ala. 2000) ; *Lesikar v. Rappeport*, 33 S.W.3d 282, 299 (Tex. App. 2000) , petition for review denied (Aug. 23, 2001), motion for rehearing on petition for review denied (Nov. 29, 2001); *Ollerman v. O'Rourke Co.*, 94 Wis.2d 17, 27, 288 N.W.2d 95, 100 (Wis. 1980) .

(n3)Footnote 3. See *Steinberg v. Rowe (In re Steinberg)*, 270 B.R. 831, 836 (Bankr. E.D. Mich. 2001) , applying federal and Michigan law.

(n4)Footnote 4. See *Conell v. Coldwell Banker Premier Real Estate, Inc.*, 181 Wis. 2d 894, 895-896, 512 N.W.2d 239, 240 (Wis. Ct. App. 1994) .

(n5)Footnote 5. See *Durica v. Donaldson*, 2000 Ohio App. LEXIS 789, at *10-*11 (Mar. 3, 2000) , quoting, *Tipton v. Nuzum*, 84 Ohio App. 3d 33, 38, 616 N.E.2d 265 (1992) .

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74 of 163 DOCUMENTS

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *

PART II. Licensee Disclosure Obligations Regarding the Property's Condition

10-3A Real Estate Brokerage Law and Practice § 3A.09

§ 3A.09 Other Disclosure Obligations and Issues

[1] Closing Costs

A few jurisdictions impose upon licensees an obligation to provide the licensee's client with a complete estimated closing statement. n1 This is a redundant disclosure since the federal Real Estate and Settlement Procedures Act requires that lenders provide borrowers with a good faith estimate of settlement costs. n2

[2] Methamphetamine Labs and Other Illegal Drug Activities

Using a residence to manufacture methamphetamine raises two significant issues. First, a methamphetamine lab uses hazardous materials so there is the possibility that the property is contaminated. Second, there is the issue of the psychological impact on the property's value because a methamphetamine lab was located there. n3

A minority of states specifically require that residential sellers disclose if methamphetamine had been manufactured at the residence. n4 A few states include this disclosure on the residential seller disclosure form. n5 This disclosure obligation may extend to the manufacture of other illegal drugs. n6 Disclosure of the past presence of these activities may give the purchaser a period of time in which the offer to buy may be withdrawn or the sales contract may be canceled. n7 Even if there is no specific statute requiring disclosure of this information or a specific question on the seller disclosure form, it is clearly a material fact which would affect a buyer's decision. A licensee who knows that a property was used for methamphetamine production and who fails to disclose this information to a buyer is in violation of the duty to disclose all material facts about a property.

Nevada statutorily provides that a seller's agent or buyer's agent has no liability for failing to disclose that a felony occurred on the subject property. However, an exception to this nonliability provision exists for a crime that involved the manufacturing of methamphetamine. n8 However, the fact that the property had been used for the manufacturing of methamphetamine is not material to the transaction if all materials and substances involving methamphetamine have been removed from or remediated on the property by an entity certified or licensed to do so or the property has been deemed safe for habitation by a governmental entity. n9 Utah has similar provisions. n10

North Dakota's Attorney General Letter Opinion 2001-L-51, n11 addresses whether state or federal law requires real

estate agents to reveal to a prospective buyer that the home has been used as a methamphetamine manufacturing lab. North Dakota's Attorney General concluded that real estate brokers should disclose to any potential purchasers that the lab was present so that the purchasers may take appropriate action to protect themselves. The Attorney General stated that the prior existence of a methamphetamine lab in a property may also cause a prospective purchaser emotional or psychological disturbance or concerns that could potentially influence whether the prospective purchaser will purchase the property. Thus, the prior existence of the lab probably would make a property psychologically impacted, and require a real estate agent to respond to an inquiry in the manner provided in *N.D. Admin. Code § 70-02-01-20*. If a licensee violated that rule, he or she may be subject to disciplinary action.

[3] Square Foot Disclosures

A property's square footage affects the property's value. In particular, buyers and appraisers are concerned with the amount of heated and cooled living space. Despite the crucial nature of this figure, there is no one well-defined and generally accepted measurement method for residential property which has been adopted nationwide. n12 One court in considering a dispute over a house's square footage observed that "[I]n determining the square footage of a house, exactness is not required and not always possible, and that some discrepancies can be expected depending upon which of the accepted methods is used to calculate square footage." n13 Square foot determinations become even more complex if the house's footprint is other than a simple geometric shape such as a square or rectangle. n14

PRACTICE NOTE:

One standard for measuring residential properties which has been adopted by some of the agencies regulating appraisers is the American National Standards Institute (ANSI) Z765-2003, which describes the procedures to be followed in measuring and calculating the square footage of detached and attached single-family dwellings, including townhouses, rowhouses, and other side-by-side houses. n15

Some state real estate commissions have recognized the importance of this figure in the context of residential properties. For example, the North Carolina Real Estate Commission has published a "Residential Square Footage Guidelines." This particular guideline states:

It is often said that the three most important factors in making a homebuying decision are "location," "location," and "location." Other than "location," the single most-important factor is probably the size or "square footage" of the home. Not only is it an indicator of whether a particular home will meet a homebuyer's space needs, but it also affords a convenient (though not always accurate) method for the buyer to estimate the value of the home and compare it with other properties. n16

The North Carolina Real Estate Commission advises brokers not to rely on square footage information determined by the property owner or included in property tax records. A licensee is also advised not to rely on square footage information included in a listing, appraisal report or survey prepared in connection with an earlier transaction. n17

Inaccurate square footage numbers can result from several factors including the following:

- Licensees often use a square foot figure obtained from a third source without verifying its accuracy. A common example is the use of a square foot number from the local governmental agency handling real property assessments. It is not uncommon for such records to contain inaccurate square footage figures. n17.1
- When a property is sold, the square footage number may be rounded up. For instance, a 1,900 square foot home might be represented as "approximately 2,000 square feet." The next owner might represent that the home has "more than 2,000 square feet," even though this owner has done no additions. Minor misrepresentations that are akin to puffery can add up if several consecutive owners engage in such

conduct.

- An inaccurate square footage number can result from a simple math error.

Many after-closing claims against sellers and licensees allege misrepresentation of square footage. Buyers often relate square footage to value and a significant shortfall in square footage often results in a buyer feeling as though they have been cheated even when an appraisal prepared using an accurate square foot figure values the property as being worth the contract price. These feelings often lead to litigation by the buyer against both the seller and the licensee.

Proving the tort of misrepresentation in a case involving a square footage overstatement is not as easy as it might seem. Whether the claim is for negligent misrepresentation, or intentional misrepresentation, the buyer must prove as part of its prima facie case that the information is incorrect and that the buyer reasonably relied on the incorrect information. n18

Sales agreements often contain a provision stating that the buyer and seller acknowledge that they have not relied upon any advice, representations, or statements of the broker and that they waive and shall not assert any claims against the broker. Such a provision goes against any argument that the buyer relied upon a broker's square foot representation.

Square footage is often expressly given as an estimate. When the figure is specifically shown as being an estimate, courts have been often loathe to find that a misrepresentation occurred. n19

In some jurisdictions, a broker may rely upon a square foot figure found in an appraisal. A broker's reliance on a reliable appraiser for the computation of the square footage of a house, when the broker represents the buyer, has been found to be some evidence of the broker's compliance with his or her standard of care; however, such evidence is not conclusive as a matter of law. n20

Another factor that often hinders a buyer's case is the fact that the buyer often had ample opportunity to measure the building and perform his or her own square footage calculation. n20.1

When the buyer is financing the purchase with a traditional mortgage or deed of trust, the lender often requires an appraisal of the property before the loan is made. The appraisal often lists the property's square footage and provides notice to the buyer of any potential shortfall in the square foot number. In addition, lenders often will not make a loan unless the appraisal shows that the property has a fair market value at least equal to the parties' sales price. When this is the case, the buyer has received the benefit of the bargain even though the buyer may believe he or she has been shorted in square footage. Arguments that the buyer has still suffered damages and that the amount of damages should be the square foot shortfall multiplied by a per square foot value have almost always failed. n21

While some courts have found that the seller received the "benefit of the bargain" when the mis-measured house appraised at or above the sales price, this is not a proper application of the benefit of the bargain rule. Under the benefit of the bargain rule, the damages are measured by the difference between what the plaintiff *would have received* if the defendant's representations had been true and the value the plaintiff *actually received*, together with any proximately caused consequential or special damages. Under this rule, even if the property appraised out at the sales price, the buyer may still be due damages. n21.1

The Supreme Court of Oklahoma has adopted a minority viewpoint regarding both duty and damages in cases involving square footage misrepresentations in a residential transaction. In *Bowman v. Presley*, n21.2 this court held that a buyer of real property may rely upon the positive representations of real estate licensees and sellers about the size of the property to be conveyed. When a real estate licensee or seller of real property makes material representations to a purchaser about the property's size, a determination of whether those representations were fraudulently or substantially misrepresented and whether the purchaser may have thereby been harmed lie within the arena of disputed facts to be

found by a trial of the issues. n21.3 The buyers in this cause thought they were buying a 2,890 square foot house for \$145,000, which resulted in a \$50 per square foot price. Instead, the house had 2,187 square feet. The buyers argued that they were damaged by the square footage shortage. At \$50 per square foot, the buyers computed their injury at \$35,150 which was the value of the missing 703 square feet which had been represented by the broker, the agent and the sellers. The defendants countered with several arguments including the assertion that despite the diminished size, the appraised value of the home (\$146,697) exceeded the purchase price. The court stated that the question of damages cannot be resolved based upon the estimations of value contained in the mortgage appraisal alone since an appraisal can give only an approximate value that is perceived by the appraiser. The value must be determined by the trier of fact. The jury is the sole and final arbiter. n21.4

The Oklahoma high court also found that the defendants could not rely on the doctrine of caveat emptor to avoid liability for fraudulent misrepresentations made to purchasers about the size of the property to be conveyed. n21.5 This court stated:

The representation of a building's dimensional size, capable of precise expression in square feet, involves neither a readily discoverable defect or flaw nor "the mere expression of an opinion." It is a statement of material fact. A buyer of property may rely on its accuracy because the making of the clear and unequivocal assurance itself discourages buyers from conducting additional investigation. To declare otherwise would permit a seller to fabricate plausible material "facts" and then avoid liability for the misrepresentations by later recasting them as mere "opinions" that the buyer should never have believed. (footnotes omitted) Representations of the size of real property are statements of material fact, not expressions of opinion, and a buyer need not conduct a separate investigation to ascertain their truth. If the buyer later alleges fraudulent misrepresentation against the realtor or seller, questions of whether the buyer was in fact deceived and suffered detriment because of the misrepresentation must be decided by the trier of fact. A real estate licensee is in such instances also bound by a professional duty to treat all parties with honesty. n21.6

Thus, in Oklahoma a real property buyer may rely on the positive representations made by real estate licensees about the property's size.

The Oklahoma court's viewpoint is more reflective of the portrayal in advertising of Realtors(R) as "professionals" to the public. It should be expected that such professionals can get a basic fact about the property correct before using that fact to promote the sale of a home. If this fact cannot be determined, mere estimates (which are sometimes significantly wrong) should not be used as a selling feature since so many buyers rely on this representation. If the issue is the lack of a standard measurement system, the solution is the promulgation of a measurement system rather than to permit real estate licensees to make square footage representations in order to make sales, while allowing the same licensees to disclaim any liability for material errors in these affirmative representations. n21.7

[4] Lot or Parcel Size Disclosures

If a jurisdiction applies the caveat emptor theory, fraud and misrepresentation claims related to land size or lot boundaries may be dismissed when the true size or boundaries are readily discoverable or otherwise made known to the purchasers during the transaction. n22 Such dismissals have been granted even when the seller or seller's agent misrepresented the size of the subject property. n23

Courts have held that a buyer who makes no attempt to discover the boundaries of the property cannot be said to have justifiably relied on a misrepresentation by the seller regarding those boundaries. n24 Under this viewpoint, a buyer generally will not be justified in relying solely upon the description of the boundaries given by the sellers. Buyers may be required to ascertain for themselves the actual property lines.

Part of the difficulty typically found in a buyer's case alleging misrepresentation regarding lot size arises from the fact that buyers often have surveys prepared or have the opportunity to obtain a survey which would have shown the discrepancy. Most buyers also have ample opportunity to walk the boundary lines. Often there are other facts present which should alert the buyer to a potential discrepancy in the lot or parcel size. n25 When these factors are present, a court may find that the buyer did not justifiably rely upon representations regarding the lot or parcel size or boundaries.

[5] Disclosure of Homeowners Association

Some jurisdictions require disclosure of specific information regarding a homeowners association. n26 Many seller disclosure statements contain a question regarding homeowners associations. For example, the Tennessee Seller Disclosure Statement asks, "Are You (Seller) Aware of Any of the Following? ... A Homeowners Association (HOA) which has any authority over the subject property?" n27

[6] Off-Site Conditions

Some states require specific disclosures with respect to the use of nearby properties which may affect a buyer's decision to purchase. These disclosures may be found on a seller disclosure statement. In some states, the licensee is required to tell the buyer that it is the buyer's responsibility to determine the existence of certain potential nuisance.

Required off-site disclosures have included the following:

- Agricultural facilities. In Alaska, licensees must inform buyers that the buyers are responsible for determining whether the property they are interested in buying is near an agricultural facility which might produce odor, fumes, dust, blowing snow, smoke, burning, vibrations, noise, insects, rodents, the operation of machinery including aircraft, and other inconveniences or discomforts as a result of lawful agricultural operations. n28
- Hazardous waste facilities. In Connecticut, licensees and sellers must provide buyers with written notice, prior to entering into a contract, of the availability of a list of hazardous waste facilities. n29
- Airports. n30 Several states require disclosures regarding nearby airports.
- Lack of electric service. In New York, sellers of real property for which electric service is unavailable must disclose this fact to a prospective purchaser or the prospective purchaser's agent. n31

With respect to new residential construction, New Jersey licensees must provide the purchaser with a notice of the availability of the lists of the off-site conditions (*i.e.*, conditions which may materially affect the property's value) that exist not only within the boundaries of the municipality in which the residential real estate is located but also within any other municipality located within one-half mile of the residential real estate. n32

[7] Mold

A minority of jurisdictions have enacted statutory provisions which specifically require that sellers make disclosures regarding the existence of mold in the property. n33 Some jurisdictions have statutorily or by regulation included on their residential seller disclosure form questions and disclosures regarding the existence of mold. n34

The Louisiana Real Estate Commission publishes a pamphlet on mold which licensees may voluntarily distribute to buyers. n35 If a Louisiana licensee delivers this pamphlet to the buyer, the licensee is not required to provide any additional information concerning mold; the information contained pamphlet is deemed to be adequate to inform the buyer regarding common mold-related hazards that can affect real property. n36

[8] Radon

A minority of jurisdictions have statutes which specifically require disclosure regarding the presence of radon or the potential hazard that this gas presents. n37 In addition, some residential seller disclosure forms are statutorily required to contain a question or require a statement regarding radon gas. n38

[9] Sewage Disposal and/or Water Supplies

Some jurisdictions impose specific disclosure or certification requirements with respect to a property's sewage disposal system or water system. n39 Typically these requirements are imposed upon properties with septic fields and wells. For example, Maine has a detailed disclosure on its residential property disclosure statement. With respect to the property's private waste disposal system the seller must disclose:

- A. The type of system;
- B. The size and type of the tank;
- C. The location of the tank;
- D. Any malfunctions of the tank;
- E. The date of installation of the tank;
- F. The location of the leach field;
- G. Any malfunctions of the leach field;
- H. The date of installation of the leach field;
- I. The date of the most recent servicing of the system; and
- J. The name of the contractor who services the system. n40

Wells supplying drinking water to a residence are also often the subject of specific seller disclosures. For example, Minnesota requires that before signing an agreement to sell or transfer real property, the seller must disclose in writing to the buyer information about the status and location of all known wells on the property. n41

[10] Insulation

A seller disclosure statement may ask if there are any defects with respect to the insulation n42 or it may ask other questions regarding the insulation such as the type and location of the insulation. n43

There have been health concerns regarding the use of formaldehyde foam insulation. Very few jurisdictions have specifically addressed this type of insulation, perhaps because it is no longer used for insulating residences. However, Massachusetts has statutorily provided that no cause of action shall arise or be maintained against a seller, lessor, real estate broker or salesperson, lender or mortgagee of real property for failure to disclose to a buyer or tenant that the real property has been insulated with urea formaldehyde foam insulation. n44

New Hampshire sellers are required to make disclosures regarding the type and location of insulation in a residence. n45 New Hampshire, by regulation, requires that licensees, when listing residential property, must ask the seller for at least

the following information: (1) the type of insulation; and (2) the location of the insulation. n46

Though there appear to be relatively few statutes and regulations that specifically address insulation, it should be anticipated that the type, quality and amount of insulation may become of more interest to legislators and regulators if the cost of heating and cooling homes increases significantly.

[11] Other Disclosures Arise from Local Issues

Unique disclosure obligations may arise due to conditions specific to a geographic area or deceptive practices that are found to occur in a specific region. n47 The seller disclosure form promulgated by a regulatory agency may also be aimed at disclosing facts which have led to problems in that jurisdiction. An example would be construction materials that were believed to be sound when used in constructing a home, but which have proven over time to be problematic. A specific example of a construction product that sometimes proved to be defective in actual use would be the various artificial stuccos used on the exterior of homes which has led to litigation over the water intrusion problems associated with this product. Colorado on its Seller's Property Disclosure form (SPD 19-10-05) asks if the property has exterior artificial stucco.

Some jurisdictions have other types of unique or uncommon disclosures obligations. For example, in Maryland, licensees providing competitive market analysis must include the following statement, conspicuously printed, on the first page of the analysis:

COMPETITIVE MARKET ANALYSIS DISCLOSURE

This analysis is not an appraisal. It is intended only for the purpose of assisting buyers or sellers or prospective buyers or sellers in deciding the listing, offering, or sale price of the real property. n48

In an unreported Wisconsin case, the court rejected an unhappy buyer's claim that the seller's broker should have disclosed that the house was owner-built. In rejecting this argument, the court stated a broker has no duty to report that a home was owner-built absent knowledge or reason to know that faulty construction was the cause of a defect in the premises. n49

A few states also impose disclosure obligations with respect to lead-based paint. n50 Statutorily mandated seller disclosure statements may contain questions regarding lead-based paint. n51 Disclosure obligations regarding lead-based paint are discussed in greater detail in § 3A.17[2], *below* and Chapter 15A, *below*.

Another disclosure issue that may arise concerns underground storage tanks. n52

FOOTNOTES:

(n1)Footnote 1. *See Ala. Admin. Code r. 790-X-3-.04.*

(n2)Footnote 2. *See 12 U.S.C. § 2604.*

(n3)Footnote 3. *See North Dakota Attorney General Letter Opinion 2001-L-51, 2001 N.D. AG LEXIS 66 (Nov. 28, 2001).*

(n4)Footnote 4. *See Ariz. Rev. Stat. § 12-1000; Mo. Rev. Stat. § 441.236; Or. Admin. R. 333-040-0100.*

(n5)Footnote 5. *See S.D. Codified Laws § 43-4-44.*

(n6)Footnote 6. *See Ariz. Rev. Stat. § 12-1000 (ecstasy or LSD).*

(n7)Footnote 7. *See* *Ariz. Rev. Stat. § 12-1000(F)(1)*.

(n8)Footnote 8. *See* *Nev. Rev. Stat. § 40.770(1)(b)*.

(n9)Footnote 9. *See* *Nev. Rev. Stat. § 40.770(5)*.

(n10)Footnote 10. *See* *Utah Code Ann. §§ 57-1-1(4) and 57-1-37*.

(n11)Footnote 11. *2001 N.D. AG LEXIS 66* (Nov. 28, 2001) .

(n12)Footnote 12. It appears that seller disclosure statements do not ask the seller to state the square footage of the residence. Perhaps real estate commissions recognize the inherent difficulties with this determination.

(n13)Footnote 13. *Glanton v. Bob Parks Realty, Inc.*, 2005 *Tenn. App. LEXIS 263*, at *23-*24 (Tenn. Ct. App. Apr. 27, 2005) , *appeal denied*, 2005 *Tenn. LEXIS 916* (Tenn. Oct. 24, 2005) .

(n14)Footnote 14. *See* *John v. Robbins*, 764 *F. Supp.* 379, 385-386 (*M.D. N.C. 1991*) , *applying* North Carolina law (discussing difficulty posed in measuring a a contemporary house with triangular offsets).

(n15)Footnote 15. For example, Kentucky has adopted this measurement standard. *See* 201 *Ky. Adm. Reg.* 30:040.

(n16)Footnote 16. This guideline can be found on the Website of the North Carolina Real Estate Commission at <http://www.ncrec.state.nc.us/publications-bulletins/sqft.html>. The Colorado Real Estate Commission has also issued Rule E-43 which addresses square footage measurement of residential property.

(n17)Footnote 17. *See* *Brown v. Roth*, 133 *N.C. App.* 52, 56, 514 *S.E.2d* 294, 297 (1999) .

(n18)Footnote 17.1. *Cf. Pleasant v. Bradford*, 260 *S.W.3d* 546, 550 (*Tex. App. Austin 2008*) , *review denied*, 2008 *Tex. LEXIS 1173* (Dec. 19, 2008) (seller's agent took an incorrect square footage figure from the county's real estate tax records).

(n19)Footnote 18. *See, e.g. Hardcastle v. Harris*, 170 *S.W.3d* 67, 82 n.25 (*Tenn. Ct. App. 2004*) , *appeal denied*, 2005 *Tenn. LEXIS 500* (Tenn. May 23, 2005) .

(n20)Footnote 19. *See* *The Cadco, LLC v. Barry*, 2006 *Tenn. App. LEXIS 37*, at *10 (Jan. 18, 2006) *appeal denied*, 2006 *Tenn. LEXIS 813* (Sept. 5, 2006) .

(n21)Footnote 20. *See* *Brown v. Roth*, 133 *N.C. App.* 52, 56, 514 *S.E.2d* 294, 297 (1999) .

(n22)Footnote 20.1. *See* *Schnellmann v. Roettger*, 373 *S.C.* 379, 645 *S.E.2d* 239 (*S.C. 2007*) .

(n23)Footnote 21. *Cf. Royer v. Remodeling Service, Inc.*, 648 *So. 2d* 995, 1000 (*La. Ct. App. 1994*) (In a dispute arising from a square footage error, the court found that the buyers had not proven any actual property damages based on the fact that they paid \$ 143,000.00 for the property and the property was appraised for \$ 144,000.00.).

(n24)Footnote 21.1. *See* *Schnellmann v. Roettger*, 373 *S.C.* 379, 383, 645 *S.E.2d* 239, 241 (*S.C. 2007*) (*dicta*) *Pleasant v. Bradford*, 260 *S.W.3d* 546, 558-561 (*Tex. App. Austin 2008*) , *review denied*, 2008 *Tex. LEXIS 1173* (Dec. 19, 2008) .

(n25)Footnote 21.2. 2009 *OK 48*, 212 *P.3d* 1210 (*Okla. 2009*) .

(n26)Footnote 21.3. 2009 *OK 48*, 212 *P.3d* 1210, 1214 (*Okla. 2009*) .

(n27)Footnote 21.4. 2009 *OK 48*, 212 *P.3d* 1210, 1218-19 (*Okla. 2009*) .

(n28)Footnote 21.5. *2009 OK 48, 212 P.3d 1210, 1220 (Okla. 2009)* .

(n29)Footnote 21.6. *2009 OK 48, 212 P.3d 1210, 1222 (Okla. 2009)* .

(n30)Footnote 21.7. A standard measurement system could be promulgated by the National Association of Realtors(R) for use by its members.

(n31)Footnote 22. *See Schmiedebusch v. Rako Realty, Inc., 2005 Ohio 4884, 2005 Ohio App. LEXIS 4441, at *11 (Sept. 15, 2005)* . *But cf. McRae v. Hagaman, 2006 Tenn. App. LEXIS 550, at *9-*13 (Aug. 22, 2006)* (The seller's agent and buyer failed to discover that a portion of the property that they thought was part of the sale was not included. The court held that both the buyer and the seller's broker could be liable for a portion of fault in a negligent misrepresentation case; one of the buyers was found to have been 25 percent at fault and the seller's broker was found to be 75 percent at fault.). *But cf. Bowman v. Presley, 2009 OK 48, 212 P.3d 1210, 1221 (Okla. 2009)* (doctrine of caveat emptor does not apply to a positive misrepresentation of material fact such as a firm square footage figure).

(n32)Footnote 23. *See Ralston v. Grinder, 8 Ohio App.2d 208, 37 Ohio Op. 2d 213, 221 N.E.2d 602 (1966)* . The purchasers' fraud action was based upon false oral representations by the defendant seller and seller's agent that the property purchased contained three acres when, in fact, it contained less than 1.5 acres.

(n33)Footnote 24. *See Peacock v. Kiser, 272 Ga. App. 83, 85, 611 S.E.2d 747, 750 (Ga. Ct. App. 2005)* .

(n34)Footnote 25. *Cf., e.g., Hoel v. Rose, 125 Wash. App. 14, 20, 105 P.3d 395, 398-399 (Wash. Ct. App. 2004)* (Preclosing appraisal was at variance with the seller's representations regarding the property's dimensions. A map showed a lot size that differed from the seller's representations. The buyer did nothing to reconcile these differences. The court found there was no substantial evidence to support a conclusion that the buyer had justifiably relied on the seller's representations regarding acreage and dimensions.).

(n35)Footnote 26. *See Ariz. Rev. Stat. § 33-1806; Fla. Stat. § 720.401; La. Rev. Stat. Ann. § 9:3198(A)(2); Tex. Prop. Code § 5.012; Va. Code Ann. § 55-511.*

(n36)Footnote 27. *Tenn. Code Ann. § 66-5-210.*

(n37)Footnote 28. *See Alaska Stat. § 34.70.050(3). See also Cal. Civ. Code § 1710.2* (no disclosure duty when a prior occupant's death from certain causes occurred more than 3 years prior to the date of transfer). *See also N.Y. Real Prop. Law § 333-c(1)* (similar disclosure law).

(n38)Footnote 29. *See Conn. Gen. Stat. § 20-327f.*

(n39)Footnote 30. *See, e.g., Ind. Code Ann. § 32-21-5-7 (4)* (sellers must disclose that an airport is located within a geographical distance from the property as determined by the Indiana real estate commission).

(n40)Footnote 31. *See N.Y. Real Prop. Law § 242.*

(n41)Footnote 32. *See N.J. Stat. § 46:3C-1, et seq .*

(n42)Footnote 33. *See*

California: Cal. Health and Safety Code §§ 26140, 26141, 26146, 26147 and 26148. Montana: Mont. Code Anno. §§ 70-16-701 to 70-16-703. See generally Elizabeth L. Perry, Comment, Why Fear the Fungus? Why Toxic Mold Is and Is Not the Next Big Toxic Tort, 52 Buffalo L. Rev. 257 (2004); Walter G. Wright, Jr. and Stephanie M. Irby, The Transactional Challenges Posed by Mold: Risk Management and Allocation Issues, 56 Ark. L. Rev. 295 (2003).

(n43)Footnote 34. See *Cal. Civ. Code* § 1102.6; *Ohio Adm. Code Ann.* 1301:1-4-10.

(n44)Footnote 35. See *La. R.S.* § 37:1470 (A).

(n45)Footnote 36. See *La. R.S.* § 37:1470 (B).

(n46)Footnote 37. See *Fla. Stat.* § 404.056(5); *Mont. Code Ann.* § 75-3-601, et seq.; *N.H. Rev. Stat. Ann.* § 477:4-a; *N.J. Stat.* § 26:2D-73. See generally Karen Hoyden Curtin, *Indoor Radon: Regulating a Blameless Cause*, 3 *Buff. Env't'l. L.J.* 181 (1995); Paul A. Locke and Patricia I. Elliott, *Caveat Broker: What Can Real Estate Licensees Do About Their Potentially Expanding Liability for Failure to Disclose Radon Risks in Home Purchase and Sale Transactions?*, 25 *Colum. J. Env't'l. L.* 71 (2000).

(n47)Footnote 38. See *Me. Rev. Stat. Ann. tit. 33*, § 173(4); *N.C. Gen. Stat.* § 47E-4; *Ohio Rev. Code Ann.* § 5302.30(D)(1); *S.C. Code Ann.* § 27-50-40(A)(6); *Va. Code Ann.* § 55-519.

(n48)Footnote 39. See *Ariz. Admin. Code* §§ R18-9-A304 and R18-9-A316; *Me. Rev. Stat. Ann. tit. 33*, § 173(3) (part of the property disclosure statement); *Minn. Stat.* § 115.55, *Subd. 6(a)* (disclosure regarding individual sewage treatment systems), *N.H. Rev. Stat. Ann.* § 477:4-c.

(n49)Footnote 40. See *Me. Rev. Stat. tit. 33*, § 173(3). If the systems is located within shoreland zones, the seller must make additional disclosures on septic systems as required by *Me. Rev. Stat. tit. 30-A*, § 4216. Furthermore, pursuant to *Me. Rev. Stat. tit. 33*, § 173-A, unless a transaction is exempt, the seller must provide to the purchaser certain information regarding arsenic in private water supplies and arsenic in treated wood.

(n50)Footnote 41. See *Minn. Stat.* § 103I.235.

(n51)Footnote 42. See *D.C. Code* § 42-1305 (1)(B).

(n52)Footnote 43. See *Me. Rev. Stat. tit. 33*, § 173 (2).

(n53)Footnote 44. See *Mass. Gen. Laws ch. 255*, § 12J. Ohio also requires disclosures regarding urea-formaldehyde foam insulation. See *Ohio Rev. Code Ann.* § 5302.30(D)(1).

(n54)Footnote 45. See *N.H. Rev. Stat. Ann.* § 477:4-d.

(n55)Footnote 46. See *N.H. Code Admin. Rules Rea.* § 701.04.

(n56)Footnote 47. For example, the voluntary seller disclosure form promulgated by the Arizona Association of Realtors(R) asks: "Are you aware of or have you observed any of the following on the Property? (Check all that apply):
 _____Scorpions _____Rabid animals _____Bee swarms _____Rodents _____Owls _____Reptiles _____Other:
 _____."

(n57)Footnote 48. *Code of Maryland Regulations* § 09.11.02.02(F).

(n58)Footnote 49. See *Willard v. Weinberg*, 192 Wis. 2d 766, 532 N.W.2d 470, 1995 Wisc. App. LEXIS 383, at *8 (Mar. 21, 1995).

(n59)Footnote 50. See *Md. Code Ann., Envir.* § 6-801.

(n60)Footnote 51. See, e.g., *Or. Rev. Stat.* § 105.464, the provision prescribing the form of seller's property disclosure statement, which includes the following inquiry: "Has any portion of the property been tested or treated for asbestos, formaldehyde, radon gas, lead-based paint, mold, fuel or chemical storage tanks or contaminated soil or water?" Cf. The voluntary seller disclosure form promulgated by the Arizona Association of Realtors(R) asks whether

the seller is aware of any lead-based paint on the property.

(n61)Footnote 52. For example, the voluntary seller disclosure form promulgated by the Arizona Association of Realtors(R) asks whether the seller is aware of any underground storage tanks on the property.

* Written by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues.



75 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *

PART II. Licensee Disclosure Obligations Regarding the Property's Condition

10-3A Real Estate Brokerage Law and Practice § 3A.10

§ 3A.10 A Broker's Statutory Duty to Inspect

[1] California Licensees Have a Statutory Duty to Inspect

A leading case addressing a broker's duty to inspect is *Easton v. Strassburger*, where a California Court of Appeal that held that a broker's duty to disclose material facts included the affirmative duty to conduct a reasonably competent and diligent inspection of residential property listed for sale with the broker and to disclose to prospective buyers all facts materially affecting the value or desirability of the property that such an inspection would reveal. n1 The California Legislature subsequently codified this duty. n2

The statutory rule in California provides that it is the duty of a licensed real estate broker to a prospective purchaser of residential real property to conduct a reasonably competent and diligent visual inspection of the property offered for sale. The broker must then disclose to that purchaser all facts revealed by the inspection that materially affect the property's value or desirability. This duty arises if the broker has a written contract with the seller to find or obtain a buyer. n2.1 This duty likewise applies to another broker acting in cooperation with a contracting broker. n3

The standard of care owed by a broker in exercising the duty to inspect is the degree of care that a reasonably prudent real estate licensee would exercise. It is measured by the degree of knowledge obtained through education, experience, and examination that is required to obtain a real estate license. n4 A California licensee's disclosure duty does *not* include a duty to independently verify or disclaim the accuracy of the seller's representations. Once the sellers and their agent make the required disclosures, it is the purchasers responsibility to investigate and make an informed decision based thereon. In making the required disclosures, the sellers' agent is required to act in good faith and not convey the seller's representations without a reasonable basis for believing them to be true. n5

The duty to inspect the property is limited to a visual inspection. n6 The inspection is not required to include or involve areas that are reasonably and normally inaccessible to inspection. It also need not include inspection of off-site areas or public records or permits concerning the title or use of the property. n7 Neither is there a duty to find additional matters, such as pending litigation, that have not been revealed in the course of the required visual inspection; n8 nor is there a duty to independently verify or disclaim the accuracy of representations made by the seller. n9

The statutory duty of inspection is considered a nonfiduciary dutyⁿ¹⁰ which is subject to a two-year statute of limitations. The two-year period commences on the date of possession which means the date of recordation, the date of close of escrow, or the date of occupancy, whichever occurs first.ⁿ¹¹

The statutory duty of a licensed real estate broker to conduct a visual inspection of the subject property and disclose to the buyer all material facts discovered does not relieve a buyer or a prospective buyer of his or her duty to exercise reasonable care to protect himself or herself, including those facts that are known to, or within the diligent attention and observation of the buyer or prospective buyer.ⁿ¹²

[2] Other Jurisdictions Reject the Imposition of an Explicit Statutory Duty to Inspect

Many jurisdictions have specifically refused to statutorily impose an inspection duty upon licensees.ⁿ¹³ Even if a jurisdiction has specifically stated that a licensee has no statutory duty to inspect property, the practical reality is that licensees have an inherent duty to inspect the properties. An overwhelming majority of jurisdictions require that licensees disclose material facts known to them about a property.ⁿ¹⁴ Courts often state that a licensee can be liable for negligent misrepresentation for failing to disclose a latent defect to the buyer, if the licensee knew of or should have known of the latent defect.ⁿ¹⁵ Whether a licensee should have discovered a defect is determined according to the facts and circumstances of the case. This is an area where bright line rules do not exist. Presumably, a licensee should be held to a higher standard in observing defects than would expected of the average home buyer.

If a defect is visible, there is a strong argument that such a defect is a material fact for which the licensee has a disclosure obligation particularly if it is a type of defect that the buyer may not notice or if noticed, the buyer may fail to understand the significance of the defect. This is an area where the facts and circumstances of the case will often determine whether the licensee had a duty and whether that duty was breached. For example, a licensee should advise his or her client when a water mark from repeated flooding is distinctly visible in a basement. In contrast, a licensee would not be expected to inspect for such water marks when the seller has intentionally hidden such water marks by the erection of a wall.

Even if a licensee is considered to have a duty to inspect, this does not relieve the buyer of his or her own obligation to inspect the property. A buyer cannot ignore open and obvious defects and then seek to hold a licensee responsible for the buyer's decision to purchase despite the defects.

A few states have explicitly recognized a buyer's obligation to protect his or her interest by inspecting the property. For example, a provision in South Carolina's statute regarding brokerage relationships states, "Nothing in this chapter limits the obligation of the buyer to inspect the physical condition of the property which the buyer may purchase."ⁿ¹⁶

FOOTNOTES:

(n1)Footnote 1. *Easton v. Strassburger*, 152 Cal. App. 3d 90, 99-100, 199 Cal. Rptr. 383 (Cal. Ct. App. 1984) .

(n2)Footnote 2. *See Cal. Civ. Code* §§ 2079-2079.5.

(n3)Footnote 2.1. *See Michel v. Moore & Associates, Inc.*, 156 Cal. App. 4th 756, 761 n. 5, 67 Cal. Rptr. 3d 797, 801 n. 5 (2007) (Cal. Civ. Code § 2079, by its own terms, imposes a duty only from the listing broker who is selling the property to the buyer; it does not impose a duty on the buyer's own broker.).

(n4)Footnote 3. *Cal. Civ. Code* § 2079.

(n5)Footnote 4. *Cal. Civ. Code* § 2079.2.

(n6)Footnote 5. *See Robinson v. Grossman*, 57 Cal. App. 4th 634, 644, 67 Cal. Rptr. 2d 380, 385 (Cal. Ct. App. 1997) .

(n7)Footnote 6. *Cal. Civ. Code § 2079(a)*. See *Smith v. Richard*, 205 Cal. App. 3d 1354, 1359 n.2, 254 Cal. Rptr. 633, 636 n. 2 (1988) , review denied.

(n8)Footnote 7. *Cal. Civ. Code § 2079.3*.

(n9)Footnote 8. See *Padgett v. Phariss*, 54 Cal. App. 4th 1270, 1282, 63 Cal. Rptr. 2d 373, 379 (1997) , review denied, 1997 Cal. LEXIS 4493 (Cal. July 16, 1997) .

(n10)Footnote 9. See *Robinson v. Grossman*, 57 Cal. App. 4th 634, 641-642, 67 Cal. Rptr. 2d 380 (1997) .

(n11)Footnote 10. See *Field v. Century 21 Klowden-Forness Realty*, 63 Cal. App. 4th 18, 25, 73 Cal. Rptr. 2d 784, 789 (1998) , review denied, 1998 Cal. LEXIS 4685 (July 15, 1998) .

(n12)Footnote 11. See *Cal. Civ. Code § 2079.4*.

(n13)Footnote 12. *Cal. Civ. Code § 2079.5*.

(n14)Footnote 13. See Kan. Stat. Ann. § 58-30, 106(d)(2); *Okla. Stat. tit. 60, § 836 (E)*; *S.C. Code Ann. § 27-50-80*.

(n15)Footnote 14. See, e.g., *Williams v. Wells & Bennett Realtors*, 52 Cal. App. 4th 857, 863, 61 Cal. Rptr. 2d 34, 37 (1997) (broker has a duty to disclose known material facts); *Baumgarten v. Coppage*, 15 P.3d 304, 307 (Colo. Ct. App. 2000) (citing statute and discussing broker's duty to disclose adverse material facts actually known by broker); *Zimmerman v. Northfield Real Estate, Inc.*, 156 Ill. App. 3d 154, 162, 109 Ill. Dec. 541, 510 N.E.2d 409, 413-414 (1987) , appeal denied, 116 Ill. 2d 578, 113 Ill. Dec. 320, 515 N.E.2d 129 (1987) (brokers had duty to speak regarding known material information); *Bazal v. Rhines*, 600 N.W.2d 327, 329 (Iowa Ct. App. 1999) (finding duty to disclose material facts); *Binette v. Dyer Library Ass'n*, 688 A.2d 898, 905 (Me. 1996) (citing regulations and stating that broker has duty to disclose known material defects); *Weintraub v. Krobatsch*, 64 N.J. 445, 453-454, 317 A.2d 68, 74 (1974) (noting rule that broker is liable for nondisclosure of defects known to him but unknown to buyer); *Gordon v. Skopos*, 2005 Ohio 4900, 2005 Ohio App. LEXIS 4414, at *7 (Sept. 16, 2005) (a real estate agent has a statutory duty to disclose any material defects of which the agent has knowledge); *Stebbins v. Wells*, 766 A.2d 369, 373 (R.I. 2001) (holding broker had duty to disclose known deficient conditions); *Teter v. Old Colony Co.*, 190 W. Va. 711, 441 S.E.2d 728, 734-35 (1994) (agreeing that broker may be liable for failure to disclose known material defects); *Eddy v. B.S.T.V., Inc.*, 696 N.W.2d 265, 2005 WI App 78 (2005) , review denied, 2005 WI 134, 282 Wis. 2d 722, 700 N.W.2d 274 (2005) (every real-estate broker has a duty to disclose to each party all material adverse facts that the broker knows and that the party does not know or cannot discover through reasonably vigilant observation, unless the disclosure of a material adverse fact is prohibited by law).

(n16)Footnote 15. See, e.g., *Flowers v. ERA Unique Real Estate, Inc.*, 227 F. Supp. 2d 998, 1000-1001 (N.D. Ill. 2002) .

(n17)Footnote 16. See *S.C. Code Ann. § 40-57-137 (G)*.

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76 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *

PART II. Licensee Disclosure Obligations Regarding the Property's Condition

10-3A Real Estate Brokerage Law and Practice § 3A.11

§ 3A.11 The Effect of a Home Inspection Report on a Licensee's Disclosure Obligations

Typically, a home inspection report prepared by a third party protects not only the home buyer, but also the licensees involved in the transaction. n1 Licensees are not expected to have the expertise of a professional home inspector. n2 This does not mean that a licensee can be oblivious to a home's condition, however. Even when a home inspection will be performed, a licensee should not assume that the buyer notices defects, particularly if the defect affects a major component of the home or will entail costly repairs to remedy. Facts and circumstances play a major role if not deciding role in property defect cases. A licensee who fails to inform a buyer that a bathroom faucet handle is broken is not comparable to a licensee who to inform a buyer that the basement floods every time there is rain.

Licensees can find themselves liable to home buyers in two primary situations with respect to a home inspection report. First, licensees can incur liability when they assume the responsibility for obtaining or delivering the home inspection report and they fail to do so or perform this task negligently or fraudulently. n3 Second, licensees can incur liability when a licensee knows that an unfavorable home inspection report had previously been prepared for a prior prospective purchaser and the licensee fails to inform the buyer of this significant fact. A licensee is likely to face litigation if they fail to inform the current prospective buyer that a prior sales contract did not settle because the home "failed" a prior home inspection. Even if the licensee believes that the defects have been repaired, this is a material fact which a buyer should be aware of so that the buyer can investigate to verify that proper repairs were made.

Courts have been reluctant to hold sellers liable, much less the licensees that represent them, when the buyer plaintiff failed to perform any reasonable or meaningful inspection of the home prior to purchasing and closing on the home. A buyer's failure to conduct or obtain a meaningful inspection will be considered a failure to exercise due diligence. n4 Many courts have held that a buyer cannot be permitted to claim that he or she was deceived by false representations about which the buyer could have learned the truth of the matter and could have avoided damage through an inspection. n5

A licensee's advising a buyer to obtain a professional home inspection may protect the licensee from liability under a brokerage relationship disclosure act. One court has found that a suit against a licensee was barred under that state's brokerage relationship disclosure law. n6

FOOTNOTES:

(n1)Footnote 1. See, e.g., *Johnson v. Neuville*, 226 Wis. 2d 365, 376, 595 N.W.2d 100, 106 (Wis. Ct. App. 1999) (Wis. Stat. Ann. § 452.23(2)(b) relieves a broker from the duty to disclose information related to the property's physical condition where an inspection is conducted by a qualified third-party who prepares a report). Cf. *Leko v. Cornerstone Building Inspection Service*, 86 Cal. App. 4th 1109, 1112, 103 Cal. Rptr. 2d 858, 861 (Cal. Ct. App. 2001) , review denied, 2001 Cal. LEXIS 3146 (Cal. May 2, 2001) (A licensee who is sued for negligent nondisclosure of defects in real property may obtain equitable indemnity from a home inspection company that allegedly breached its duty to the purchaser to discover and disclose the same defects. A licensee may also seek equitable indemnity when the home inspection company prepared its report for a different prospective purchaser, in connection with a previous transaction involving the same property so long as the home inspection company intended or knew with substantial certainty that its report would be used in subsequent transactions involving the property.).

(n2)Footnote 2. Professional is used in the sense that there are individuals who inspect homes as a vocation. It is not used in the technical sense to refer to a profession such as law or medicine. Some jurisdictions license and regulate home inspectors. See, e.g., Ark. Code Ann. §§ 17-52-301 to 17-52-322; Ind. Code Ann. §§ 25-20.2-1-1 to 25-20.2-9-3.

(n3)Footnote 3. See *McLellan v. Raines*, 36 Kan. App. 2d 1, 14, 140 P.3d 1034, 1042 (2006) ; *White v. The J.D. Reece Co.*, 29 Kan. App. 2d 226, 233-234, 26 P.3d 701 , 706 Kan. Ct. App. 2001). Cf. *Johnson v. Beverly-Hanks & Associates, Inc.*, 328 N.C. 202, 210-212, 400 S.E.2d 38, 43-44 (N.C. 1991) (broker and agent not entitled to summary judgment as buyers presented triable facts issues as to whether or not broker had engaged in deceptive acts by concealing the fact that a home inspector had previously found problems with the house).

(n4)Footnote 4. See, e.g., *Clark v. Bryant (In re Bryant)*, 241 B.R. 756, 767 (Bankr. M.D. Fla. 1999) , applying federal and Georgia law.

(n5)Footnote 5. See, e.g., *Hanlon v. Thornton*, 218 Ga. App. 500, 502, 462 S.E.2d 154, 156-57 (1995) , cert. denied, 1996 Ga. LEXIS 211 (Ga. Jan. 5, 1996) .

(n6)Footnote 6. See *McLellan v. Raines*, 36 Kan. App. 2d 1, 17, 140 P.3d 1034, 1044 (2006) .

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77 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *

PART II. Licensee Disclosure Obligations Regarding the Property's Condition

10-3A Real Estate Brokerage Law and Practice § 3A.12

§ 3A.12 "As Is" Clauses in Sales Contracts

Some residential sellers have sought to minimize their liability with respect to the disclosure of property defects and conditions by relying on "as is" clauses. n1 An "as is" clause essentially functions as an exculpatory clause to protect the seller from defects and hazards the property may contain. n2 Despite the fact that an "as is" clause is primarily for the seller's benefit, these clauses may also offer licensees protection under some circumstances. n2.1 However, brokerage relationship acts typically obligate licensees to disclose to the buyer all material facts regarding the subject property. A licensee's silence may lead to liability for the licensee even though the sales contract contains an "as is" clause if the licensee knew of defects and failed to disclose the defects to a buyer. n3 A licensee can commit fraud by silence. n4 However, a condition to invocation of the fraud by silence doctrine is that there must be a duty to make a disclosure. n5 If a seller and/or the licensee have no knowledge of a defect, there will be no duty to disclose the problem. Since there is no duty in this situation, silence cannot be construed as a misrepresentation.

Litigation often ensues when a seller and/or the broker have verbally assured the buyer that the property is sound even though the sales contract contains an "as is" clause. Another scenario that often leads to litigation involves a residential seller or broker who discloses a defect or condition while at the same time verbally minimizing the severity of the disclosed defect or condition or understating the cost of repairing the defect or condition. The use of an "as is" clause in this situation is not guaranteed to prevent litigation from a disgruntled buyer. If a seller intends to use an "as is" clause, he or she should review the applicable disclosure law to determine what effect this clause will have on the seller's disclosure obligations.

Part of the difficulty of an "as is" clause is that many buyers do not understand the import of such a clause. Furthermore, the individual who decides to insert this clause in the sales contract in some cases may be the seller's broker. Buyers often rely on verbal representations of the seller or the seller's broker to support their decision to buy the property, not realizing that an "as is" clause should be seen as a red flag. At the very least, buyers should obtain a home inspection by a competent inspector so that they know with what problems the home may be afflicted.

A buyer often has a hard time arguing that the seller or a licensee made misrepresentations when the contract contained an "as is" clause and the buyer had many opportunities to inspect the property. n6 In one case involving this scenario, the court stated that when a buyer claiming fraud in the sale of property has repeated opportunities to inspect the

property, the buyer will be charged with the knowledge of conditions that a reasonable inspection would have disclosed.
n7

An "as is" clause is not a total shield for the seller and any licensees involved in the transaction. Courts generally agree that "as is" clauses do not preclude claims for fraud or intentional misrepresentations. n8

Cases involving "as is" clauses--like many other issues that arise with disclosure duties--are heavily dependent upon the facts and circumstances of the individual case. n9 An "as is" clause is apt to be found to be valid and the sellers and licensees free from liability when parties are sophisticated, when the parties deal at arm's length, when the parties voluntarily enter into the sales contract containing an "as is" clause and when there was no knowing misrepresentation or concealment of a known fact. n10 An "as is" clause is also more likely to be enforced if the clause was an important part of the basis of the bargain as opposed to just boilerplate and when the parties are in relatively equal bargaining positions. n11

FOOTNOTES:

(n1)Footnote 1. *See generally* Dallan, *Theories of Real Estate Broker Liability and the Effect of the "As Is" Clause*, 54 *Fla. L. Rev.* 395 (2002).

(n2)Footnote 2. *See generally* Craig W. Dallan, *Theories of Real Estate Broker Liability and the Effect of the "As Is"*, 54 *Fla. L. Rev.* 395, 440 (2002).

(n3)Footnote 2.1. *Cf. ERA Class.com, Inc. v. Stoddard*, 2007 Ala. Civ. App. LEXIS 641, at *18 (Oct. 5, 2007) ("as is" clause in the sales contract protected the broker from the buyer's claims of negligence, wantonness, fraud, and suppression where buyers bought property believing it was zoned for commercial use when in fact property was zoned only for residential use).

(n4)Footnote 3. *Cf. Larsen v. Carlene Langford & Associates, Inc.*, 41 S.W.3d 245 (Tex. App. 2001) , *petition for review denied* (Jul. 26, 2001) (The statement made by the seller's licensee referencing the seller's disclosure form that the house needed some leveling was not a misrepresentation of material fact because even if the buyers attached significance to this statement, there is no evidence whatsoever in the record that the licensee knew or had any reason to suspect that the seller's disclosure form was not correct. A statement is not fraudulent unless the maker knew it was false when made or made it recklessly without knowledge of the truth. Because the buyers presented no evidence that the licensee's statement to the buyers was fraudulent, it cannot be grounds for avoiding the "as is" agreement on the basis they were fraudulently induced to sign the contracts.).

(n5)Footnote 4. *See Mahler v. Keenan Real Estate, Inc.*, 255 Kan. 593, 596, 876 P.2d 609, 611 (Kan. 1994) (referring to claims against seller and licensee as fraud by silence). *See also Ensminger v. Terminix Int'l Co.*, 102 F.3d 1571, 1573-1574 (10th Cir. 1996) , *applying* Kansas law (listing elements of the tort of fraud by silence); *Bergen v. Baker*, 264 Mich. App. 376, 382, 691 N.W.2d 770, 774-775 (2004) (under the silent fraud doctrine a cause of action is established when there is a suppression of material facts and there is a legal or equitable duty of disclosure); *Weintraub v. Krobatsch*, 64 N.J. 445, 454, 317 A.2d 68, 73 (N.J. 1974) ("[O]ne may be guilty of fraud by his silence, as where it is expressly incumbent upon him to speak concerning material matters that are entirely within his own knowledge."). *See generally* Craig W. Dallan, *Theories of Real Estate Broker Liability and the Effect of the "As Is"*, 54 *Fla. L. Rev.* 395, 419-420 (2002).

(n6)Footnote 5. *See, e.g., Rowe v. Steinberg (In re Steinberg)*, 270 B.R. 831, 835 (Bankr. E.D. Mich. 2001) , *applying* federal and Michigan law.

(n7)Footnote 6. *See Larsen v. Carlene Langford & Associates, Inc.*, 41 S.W.3d 245, 254-255 (Tex. App. 2001) , *petition for review denied* (Jul. 26, 2001).

(n8)Footnote 7. *See Eiland v. Coldwell Banker Hunter Realty*, 122 Ohio App. 3d 446, 459, 702 N.E.2d 116, 124 (1997) .

(n9)Footnote 8. *See, e.g., Wilson v. Century 21 Great W. Realty*, 15 Cal. App. 4th 298, 304, 18 Cal. Rptr. 2d 779, 782 (Cal. Ct. App. 1993) , review denied, 1993 Cal. LEXIS 3894 (Cal. July 22, 1993) ; *Gibb v. Citicorp Mortgage, Inc.*, 246 Neb. 355, 364, 518 N.W.2d 910, 918 (Neb. 1994) ; *Mackintosh v. Jack Matthew & Co.*, 109 Nev. 628, 632, 855 P.2d 549, 551-52 (Nev. 1993) ; *Silva v. Stevens*, 156 Vt. 94, 112, 589 A.2d 852, 862 (Vt. 1991) ; *Alexander v. Meduna*, 2002 WY 83, 47 P.3d 206, 216 (2002) . *See generally* J. Wozniak, Annot., *Construction and Effect of Provision in Contract for Sale of Realty by Which Purchaser Agrees to Take Property "As Is" or in Its Existing Condition*, 8 A.L.R.5th 312 (1992) .

(n10)Footnote 9. *See Cole v. Johnson*, 157 S.W.3d 856, 862 (Tex. App. 2005) .

(n11)Footnote 10. *See Larsen v. Carlene Langford & Associates, Inc.*, 41 S.W.3d 245, 252 (Tex. App. 2001) , petition for review denied (Jul. 26, 2001).

(n12)Footnote 11. *See Cole v. Johnson*, 157 S.W.3d 856, 862 (Tex. App. 2005) .

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78 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *

PART II. Licensee Disclosure Obligations Regarding the Property's Condition

10-3A Real Estate Brokerage Law and Practice § 3A.13

§ 3A.13 Psychologically Stigmatized Properties

Duties of disclosure raise the question of what must be disclosed. While brokers must generally disclose material facts, n1 this becomes a difficult determination when the fact does not concern the property's physical attributes, but facts regarding the property's prior occupants that may negatively impact or stigmatize the property. n2 For example, is the fact that the prior resident was infected with acquired immune deficiency syndrome (AIDS) a material fact which must be disclosed to a prospective purchaser, or, even if a material fact, one that cannot be disclosed? As a result, many states have enacted statutes that specifically address psychologically stigmatized property. In general, such statutes grant immunity from civil suits to owners or their licensees in residential real property transactions in which the owners or agents fail to disclose certain facts. More than thirty states and the District of Columbia have enacted provisions that address psychologically stigmatized or impacted properties.

A psychologically stigmatized property is one where an event occurred which would make some buyers uncomfortable even though the occurrence had no physical effect on the property. n3 Examples of events that can leave a property psychologically stigmatized include:

- That an occupant of real property is now or has been suspected to be infected or is infected or has been infected with Human Immunodeficiency Virus or diagnosed with Acquired Immune Deficiency Syndrome, or any other disease which has been determined by medical evidence to be highly unlikely to be transmitted through the occupying of a dwelling place.
- That the real property was the site of a homicide, other felony, or suicide.
- That the real property is reputed to be "haunted" by ghosts or spirits or other alleged parapsychological or supernatural phenomenon.

The common element of these events is that they typically do not physically affect the property.

Most statutory and regulatory provisions addressing psychologically stigmatized properties provide that the fact that one of the listed events occurred at the property is not a material fact which must be disclosed to a prospective purchaser. n4

These statutes and regulations often provide that the seller and licensees cannot be sued for failing to disclose the occurrence of a listed event at the subject property. Some states include the fact that a property is located in the vicinity of a sex offender as another stigmatizing event which is not subject to disclosure. n5

Another approach with respect to stigmatized property is to impose a limited disclosure duty upon a licensee for certain events. For example, in Alaska, a licensee must disclose that a murder or suicide occurred on the subject real estate if the event occurred within one year of the licensee's first showing of the subject property to the buyers and if the licensee knew of the murder or suicide. n6

Some jurisdictions have statutory provisions which allow a buyer or the buyer's licensee to inquire about events which could stigmatize a property. Even without specific reference to a buyer's right to inquire, typically, if the buyer or the buyer's licensee ask, the seller and the seller's licensee are obligated to either provide a truthful answer or decline to answer. n7 Sometimes the inquiry must be submitted in writing. The manner in which this scenario is addressed varies from state to state. n8 A buyer who believes this is an important issue should take a refusal to answer the question as cause for further investigation before making an offer to purchase.

Many statutes provide that a licensee is not required to answer any question if answering such question or providing such information is prohibited by or constitutes a violation of any federal or state law or rule or regulation, expressly including without limitation the federal Fair Housing Act. n9

The majority of stigmatized property cases occurred prior to the enactment of statutes and regulations which specifically address stigmatized properties. Typically, discontent buyers were unsuccessful in their efforts, except when the seller had previously publicly promoted the property's status as being "haunted," yet failed to inform the buyer of this "fact." n10

FOOTNOTES:

(n1)Footnote 1. *See, e.g., Iowa Code Ann. § 543B.56(1)(c).*

(n2)Footnote 2. According to one author, the term "stigmatized property" originated with the National Association of Realtors,(R) which defined the term as "property psychologically impacted by an event which occurred or was suspected to have occurred on the property, such event being one that has no physical impact of any kind." *See Morgan, The Expansion of the Common Law Duty of Disclosure in Real Estate Transactions: It's Not Just for Sellers Anymore, 68 Fla. B.J. 28, 31 (Feb. 1994).*

One commentator has asserted that properties can suffer stigma damages with respect to physical problems such as termites or mold or chemical contamination, even when the problem has been repaired or remediated. *See Stephen T. Etheredge, Making the Plaintiff-Property Owner Whole: The Recovery of Stigma Damages, 67 Ala. Law. 260 (July 2006).*

(n3)Footnote 3. *See generally* Ronald Benton Brown & Thomas H. Thurlow III, *Buyers Beware: Statutes Shield Real Estate Brokers and Sellers Who Do Not Disclose that Properties Are Psychologically Tainted*, 49 Okla. L. Rev. 625 (1996); Ross R. Hartog, *Note: The Psychological Impact of AIDS on Real Property and a Real Estate Broker's Duty to Disclose*, 36 Ariz. L. Rev. 757 (1994); Marianne M. Jennings, *Buying Property from the Addams Family*, 22 Real Est. L.J. 43 (1993); Paula C. Murray, *AIDS, Ghosts, Murder: Must Real Estate Brokers and Sellers Disclose?*, 27 Wake Forest L. Rev. 689 (1992); Daniel M. Warner, *Caveat Spiritus: A Jurisprudential Reflection Upon the Law of Haunted Houses and Ghosts*, 28 Val. U.L. Rev. 207 (1993).

(n4)Footnote 4. *See Conn. Gen. Stat. § 20-329cc.*

(n5)Footnote 5. *See Ariz. Rev. Stat. § 32-2156.*

(n6)Footnote 6. *See Alaska Stat. § 08.88.615(c).*

(n7)Footnote 7. *See Del. Code Ann. tit. 24, § 2930; Ga. Code Ann. § 44-1-16.*

(n8)Footnote 8. Jurisdictions which statutorily address a buyer's right to ask about stigmatizing events include Connecticut (*Conn. Gen. Stat. § 20-329ee*) and Idaho (*Idaho Code § 55-2803*).

(n9)Footnote 9. *See, e.g., Ga. Code Ann. § 44-1-16(a)(2).*

(n10)Footnote 10. *See, e.g., Stambovsky v. Ackley, 169 A.D.2d 254, 258-259, 572 N.Y.S.2d 672, 675-676, 1991 N.Y. App. Div. LEXIS 9873 (1991)* . The purchaser of a haunted house could seek rescission since "the most meticulous inspection and search would not reveal the presence of poltergeists." With respect to the house's status as being "haunted," the court stated, "Whether the source of the spectral apparitions seen by defendant seller are parapsychic or psychogenic, having reported their presence in both a national publication (Readers' Digest) and the local press (in 1977 and 1982, respectively), defendant is estopped to deny their existence and, as a matter of law, the house is haunted."

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79 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *

PART II. Licensee Disclosure Obligations Regarding the Property's Condition

10-3A Real Estate Brokerage Law and Practice § 3A.14

§ 3A.14 Properties Located Near Sex Offenders

With the advent of Megan's Laws, n1 the definition of "psychological impact" has been expanded by some states to include public safety issues, such as notification that convicted sex offenders reside in a neighborhood (an off-site condition, rather than the traditional onsite definition found in older statutes). n2 Many states, however, have addressed notification requirements with respect to the presence of a sex offender in a statutory provision distinct and apart from the psychologically impacted provision. n3 Generally, most statutory provisions impose no notification requirements upon a real estate licensee with respect to the presence of sex offenders. Instead, mandatory disclosure typically consist of a licensee's obligation to inform a buyer of the existence of the sex offender registry in that jurisdiction and where to obtain information about sex offenders. The buyer must then research the sex offender registry if he or she is concerned about this issue. n4 A majority of jurisdictions have statutory provisions, regulations or other guidance that specifically address a licensee's disclosure obligations (or lack thereof) in this context.

FOOTNOTES:

(n1)Footnote 1. See *A.A. v. The State of New Jersey*, 341 F.3d 206, 208 (3d Cir. 2003) . "In 1994, seven year old Megan Kanka was abducted, raped, and murdered near her New Jersey home by a neighbor who had previously been convicted of sex offenses against young girls. Thereafter, Congress passed the Jacob Wetterling Crimes Against Children and Sexually Violent Offender Registration Act, title 17, § 170101, 108 Stat. 2038, as amended, 42 U.S.C. § 14071, which conditions certain federal funds for law enforcement on the States' adoption of a Megan's Law, so named after Megan Kanka. By 1996, every State, the District of Columbia, and the Federal Government had passed a Megan's Law. While these laws vary from State to State, they generally require convicted sex offenders to register with law enforcement officials, who then notify community members of the registrants' whereabouts."

(n2)Footnote 2. Comment, *For Sale: Two-Bedroom Home with Spacious Kitchen, Walk-In Closet, and Pervert Next Door*, 27 Seton Hall L. Rev. 668 (1997).

(n3)Footnote 3. See generally Flavio L. Komuves, Comment, *For Sale: Two-Bedroom Home with Spacious Kitchen, Walk-in Closet, and Pervert Next Door*, 27 Seton Hall L. Rev. 668 (1997); Thomas D. Larson, Comment, *To Disclose or Not to Disclose: The Dilemma of Homeowners and Real Estate Brokers Under Wisconsin's "Megan's Law,"* 81 Marq. L. Rev. 1161 (1998); Philip Lucrezia, *New York's Property Condition Disclosure Act: Extensive Loopholes Leave Buyers and Sellers of Residential Real Property Governed by the Common Law*, 77 St. John's L. Rev. 401 (2003);

Lori A. Polonchak, *Comment: Surprise! You Just Moved Next to a Sexual Predator: The Duty of Residential Sellers and Real Estate Brokers to Disclose the Presence of Sexual Predators to Prospective Purchaser s*, 102 *Dick. L. Rev.* 169 (1997); Shelley Ross Saxer, *"Am I My Brother's Keeper?": Requiring Landowner Disclosure of the Presence of Sex Offenders and Other Criminal Activity*, 80 *Neb. L. Rev.* 522 (2001); Tracey A. Van Wickler, H.B. 2564: *The Real Estate Disclosure Act Threatens Arizona's Children with Becoming "Megan" Victims*, 32 *Ariz. St. L.J.* 367 (2000).

(n4)Footnote 4. Many sex offender registries can be researched online.

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80 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *

PART II. Licensee Disclosure Obligations Regarding the Property's Condition

10-3A Real Estate Brokerage Law and Practice § 3A.15

§ 3A.15 Prospectus and Public Offering Reports

In some jurisdictions, when the licensee is showing certain lots, parcels, or units for which a public offering report or prospectus is available, the licensee is the individual obligated to provide a prospective purchaser with a copy of the document. n1 The licensee may also be obligated to obtain a signed receipt from the individual in order to prove compliance with this disclosure obligation. n2

FOOTNOTES:

(n1)Footnote 1. *See Conn. Gen. Stat. § 20-329h(b).*

(n2)Footnote 2. *See Conn. Gen. Stat. § 20-329h(b).*

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81 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *

PART II. Licensee Disclosure Obligations Regarding the Property's Condition

10-3A Real Estate Brokerage Law and Practice § 3A.16

§ 3A.16 Disclosures Mandated by Federal Law

[1] The Fair Housing Act

Fair Housing Act regulations require that a fair housing poster be displayed at any place of business where a single-family dwelling is offered for sale or rental through a real estate broker, agent, salesperson, or person in the business of selling or renting dwellings [see 24 C.F.R. § 110.10(a)]. If multiple single-family dwellings are offered for sale or rent in a group, the poster can be displayed at the model dwelling instead of at each of the individual dwellings [see 24 C.F.R. § 110.10(a)(2)(ii)]. In this situation, the fair housing poster must be posted at the beginning of construction and maintained throughout the period of construction and sale or rental [see 24 C.F.R. § 110.10(a)(3)]. However, a poster need not be displayed on vacant land [see 24 C.F.R. § 110.10(b)(1)]. In addition, all persons subject to sections 805 and 806 of the Fair Housing Act must post and maintain a fair housing poster at all their places of business [see 24 C.F.R. § 110.10(c), (d)]. These posters may be obtained at any HUD regional or area office [see 24 C.F.R. § 110.20]. A facsimile may be used if the poster and the lettering are equivalent in size to the poster available from the Department [see 24 C.F.R. § 110.20]. A failure to display the fair housing poster as required is deemed prima facie evidence of a discriminatory housing practice [see 24 C.F.R. § 110.30].

The general consensus among fair housing experts is that it is discriminatory under the federal Fair Housing Act, as well as under state fair housing and privacy laws, to disclose the race, color, age, gender, national origin, handicap or disability, familial status, or religion of a seller or owner of residential real estate as well as of a potential purchaser or tenant of residential real estate. The fact that a person has acquired immune deficiency syndrome (AIDS) or has tested positive for the human immunodeficiency virus (HIV-positive) has been held to be within the fair housing definition of handicap, and thus, disclosure that a seller or owner of residential property has AIDS or is HIV-positive is unlawful. n1

[2] The Residential Lead-Based Paint Hazard Reduction Act

Real estate brokers, sellers, and landlords have a duty to ensure compliance with federal disclosure requirements related to the residential use of lead-based paint [see discussion of such requirements in Chapter 15A below]. Failure to comply will result in severe civil and criminal penalties, as discussed in Chapter 15A. A few states also have enacted lead-based paint disclosure statements that may affect real estate licensees. n2

The federal disclosure requirements relating to lead-based paint are found in The Residential Lead-Based Paint Hazard Reduction Act, 42 U.S.C. §§ 4851 through 4856 and the joint rule issued by EPA and HUD, codified in duplicate at 24 C.F.R. pt. 35 and 40 C.F.R. pt. 745.

[3] Labeling and Advertising of Home Insulation

Pursuant to the Federal Trade Commission's regulations found at 16 C.F.R. Part 460, disclosures must be made by members of the home insulation industry. This includes individuals, firms, partnerships, and corporations. The regulations cover manufacturers, distributors, franchisors, installers, retailers, utility companies, trade associations, advertisers, advertising agencies, labs doing tests for industry members, and sellers of new homes to consumers [see 16 C.F.R. § 460.3].

This regulation defines insulation as any material mainly used to slow down heat flow. Insulation may be mineral or organic, fibrous, cellular, or reflective (aluminum foil). Insulation may be in rigid, semirigid, flexible, or loose-fill form. Home insulation is for use in old or new homes, condominiums, cooperatives, apartments, modular homes, or mobile homes. However, insulation does not include pipe insulation or any kind of duct insulation except for duct wrap [see 16 C.F.R. § 460.2].

New home sellers must put the following information in every sales contract: The type, thickness, and R-value of the insulation that will be installed in each part of the house. An exception to this disclosure requirement exists for a buyer who signs a sales contract before the new home seller knows what type of insulation will be put in the house, or if there is a change in the contract [see 16 C.F.R. § 460.16].

Violation of the rules regarding insulation disclosure is considered an unfair and deceptive act or practice or an unfair method of competition under section 5 of the Federal Trade Commission Act. Violators can be fined up to \$10,000 plus an adjustment for inflation for each violation [see 16 C.F.R. § 460.1].

[4] Notices Regarding Formaldehyde

Federal regulation found in 24 C.F.R. § 3280.309(a) requires that a Health Notice on Formaldehyde Emissions be prominently displayed in a temporary manner in the kitchen (i.e., countertop or exposed cabinet face) of each manufactured housing unit. The Notice must read as follows:

Important Health Notice

Some of the building materials used in this home emit formaldehyde. Eye, nose, and throat irritation, headache, nausea, and a variety of asthma-like symptoms, including shortness of breath, have been reported as a result of formaldehyde exposure. Elderly persons and young children, as well as anyone with a history of asthma, allergies, or lung problems, may be at greater risk. Research is continuing on the possible long-term effects of exposure to formaldehyde.

Reduced ventilation resulting from energy efficiency standards may allow formaldehyde and other contaminants to accumulate in the indoor air. Additional ventilation to dilute the indoor air may be obtained from a passive or mechanical ventilation system offered by the manufacturer. Consult your dealer for information about the ventilation options offered with this home.

High indoor temperatures and humidity raise formaldehyde levels. When a home is to be located in areas subject to extreme summer temperatures, an air-conditioning system can be used to control indoor temperature levels. Check the comfort cooling certificate to determine if this home has been equipped or designed for the installation of an air-conditioning system.

If you have any questions regarding the health effects of formaldehyde, consult your doctor or local health department.

The notice must be legible and typed using letters at least 1/4 inch in size. The title shall be typed using letters at least 3/4 inch in size [see 24 C.F.R. § 3280.309(b)]. This notice cannot be removed by any party until the entire sales transaction has been completed [see 24 C.F.R. § 3280.309(c)]. A copy of the notice must also be included in the Consumer Manual [see 24 C.F.R. § 3280.309(d)].

Some states require a similar notice. For example, *Me. Rev. Stat. Ann. tit. 10, § 9006-B* requires that a copy of the federal notice shown above be provided to a purchaser of a new mobile home at the time of execution of the purchase and sales agreement, and that each purchaser sign a certification, provided at the bottom of that notice, that the purchaser has read and understood the contents of the notice before signing the purchase and sales agreement. Some states require that a seller disclose in a property disclosure statement the presence of formaldehyde in all types of residential property. n3

[5] The Interstate Land Sales Full Disclosure Act

The Interstate Land Sales Full Disclosure Act, 15 U.S.C. §§ 1701-1720, which applies to the sale or lease of any lot not exempt from the act, makes it unlawful for any developer or agent, n4 directly or indirectly, to use any means or instruments of interstate commerce or the mails:

- (1) to sell or lease any lot unless a statement of record is in effect;
- (2) to sell or lease any lot unless a printed property report has been furnished to the purchaser or lessee in advance of signing any contract or agreement by such purchaser or lessee;
- (3) to sell or lease any lot where any part of the statement of record or property report contains an untrue statement of material fact or omits to state a material fact;
- (4) to display or deliver to prospective purchasers or lessees advertising and promotional material which is inconsistent with information required to be disclosed in the property report. n5

There are numerous exemptions to this Act. The exemptions are set forth in 15 U.S.C. § 1702. One of the major exemptions is for the sale or lease of any improved land on which there is a residential, commercial, condominium, or industrial building, or the sale or lease of land under a contract obligating the seller or lessor to erect such a building thereon within a two-year period [see 15 U.S.C. § 1702(a)(2)]. 15 U.S.C. § 1705 lists the information that must be contained in or accompany a statement of record. The property report is addressed in 15 U.S.C. § 1707. For further discussion of the Interstate Land Sales Full Disclosure Act, see § 14.15 below.

FOOTNOTES:

(n1)Footnote 1. See 24 C.F.R. § 100.201 for a definition of handicap and physical or mental impairment which includes persons with the Human Immunodeficiency Virus infection. See also Texas A.G. Opinion No. JM-1093 (9-5-89), 1989 Tex. AG LEXIS 95, to the effect that it is a violation of Fair Housing Act provisions on disability to disclose in a real estate transaction the fact that an owner or occupant has AIDS or is HIV-positive.

(n2)Footnote 2. See, e.g., Maryland Lead Poisoning Prevention Act found at *Maryland Code Ann., Envir. § 6-801, et seq.*

(n3)Footnote 3. See Wash. Rev. Code § 64.06.020 which shows that state's statutory seller disclosure form. Question 7E on this form requires disclosure of information regarding the presence of formaldehyde in the subject

property. *But see Mass. Gen. Laws ch. 255, § 12J* (no liability for failing to disclose formaldehyde foam insulation).

(n4)Footnote 4. *15 U.S.C. § 1701(6)* defines an agent as any person who represents, or acts for or on behalf of, a developer in selling or leasing, or offering for sale or lease, any lot or lots in a subdivision. This term does not include an attorney at law whose representation of another person consists solely of rendering legal services.

(n5)Footnote 5. *See 15 U.S.C. § 1703(a)(1)*.

* Written by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues.



82 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees * APPENDIX 3A-1 Disclosure Law and Regulatory Agency Directory

10-3A Real Estate Brokerage Law and Practice APPENDIX 3A-1

Scope

This Appendix contains statutory references where readers can find the main disclosure laws affecting real estate licensees and their clients. This Appendix also contains contact information for the various regulatory agencies. This Appendix is organized alphabetically by jurisdiction.

Alabama

The Real Estate Consumer's Agency and Disclosure Act is found at *Alabama Code §§ 34-27-80 to 34-27-88*. Regulations implementing this act can be found at *Ala. Admin. Code r. 790-X-3-.13* and *Ala. Admin. Code r. 790-X-3-.14*.

The regulatory agency is the Alabama Real Estate Commission, 1201 Carmichael Way, Montgomery, Alabama 36106; Telephone: 334-242-5544; Fax: 334-270-9118; Website: <http://www.arec.alabama.gov>.

Alaska

The statutory provisions addressing brokerage relationships and required disclosures are found at *Alaska Statutes §§ 08.88.600 to 08.88.695*.

Statutory provisions addressing disclosure obligations imposed upon the seller of residential real estate are found at *Alaska Statutes §§ 34.70.010 to Alaska Stat. 34.70.200*.

Disclosures requirements regarding psychologically stigmatized properties are found at *Alaska Statutes § 08.88.615(c)*.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *Alaska Statutes § 34.70.050*.

Alaska Statutes § 34.70.050(3) requires that sellers must make disclosures regarding agricultural facilities in the vicinity of the subject property.

The regulatory agency is the Department of Community and Economic Development, Division of Occupational Licensing, Real Estate Commission, Robert B. Atwood Building, 550 West 7th Avenue, Suite 1950, Anchorage, Alaska 99501; Telephone: 907-269-8162, Fax: 907-269-1066; Website: <http://www.dced.state.ak.us/occ/prec.htm>.

Arizona

It does not appear that Arizona has enacted any statutory provisions specifically addressing brokerage relationships and required disclosures.

It also does not appear that Arizona statutorily requires any seller disclosure statement for residential properties. Instead, the Arizona Association of Realtors(R) publishes a Seller's Property Disclosure Statement (SPDS) which states that, "Sellers are obligated by law to disclose all known material (important) facts about the property to the buyer." The obligation to provide the SPDS does not arise from statute or regulation, but instead appears to arise from case law. Specifically, *Hill v. Jones* n1 requires that if a seller knows of facts materially affecting the value of the property that are not readily observable and that are not known to the buyer, the seller has a duty to disclose those facts to the buyer. The SPDS appears to be a voluntary trade association effort to comply with this requirement.

Disclosures regarding psychologically impacted properties and sex offenders located in the vicinity of the subject property are addressed in *Arizona Revised Statutes § 32-2156*.

Arizona Revised Statutes § 33-1806 addresses disclosures a seller must make with respect to the homeowners association if the residence is located in a planned community.

Arizona Revised Statutes § 33-434.01 provides that an owner of property that has been subject to soil remediation (conducted pursuant to *Arizona Revised Statutes § 49-104(B)(16)*) must make certain disclosure prior to transferring the property.

Arizona Revised Statutes § 12-1000 (F) requires that certain disclosures be made if the property being sold had been used as a site to manufacture methamphetamine, ecstasy or LSD.

Arizona Revised Statutes § 28-8486 requires that the Department of Real Estate maintain and make available to the public on request a map showing the exterior boundaries of each territory in the vicinity of a public airport.

The regulatory agency is the Arizona Department of Real Estate, 2910 N. 44th Street, Suite 100, Phoenix, Arizona 85018; Telephone: 602-771-7799, Website: <http://www.re.state.az.us/>.

Arkansas

Arkansas Code Annotated § 17-42-108 requires that in every real estate transaction involving a licensee, the licensee must clearly disclose to all parties or to their agents which party the licensee is representing. Regulations implementing this disclosure obligation are found at Arkansas Real Estate Commission *Regulations §§ 8.1 to 8.5*.

The regulatory agency is the Arkansas Real Estate Commission, 612 South Summit Street, Little Rock, AR 72201; Telephone: 501-683-8010, Fax: 501-683-8020; Website: <http://www.state.ar.us/arec/arecweb.html>.

California:

Statutory provisions regarding licensees disclosure obligations with respect to brokerage relationships are found at *California Civil Code §§ 2079.14 to 2079.17*

California Civil Code § 2079(a) n2 imposes on a licensed broker or salesperson a duty to a prospective purchaser of residential real estate to conduct a reasonably competent and diligent visual inspection of the property offered for sale.

California Business & Professions Code § 10147.5 requires that licensees disclose that commissions are not statutorily fixed, but instead are negotiable.

California Business & Professions Code § 10141 provides that within one month after the close of escrow for the transfer of title to real property or the sale of a business opportunity through a real estate broker, the broker must inform the buyer and seller in writing of the selling price.

Cal. Bus. & Prof. Code §§ 10232.4 and 10232.5 provides that licensees involved in negotiating a loan to be secured by a lien on real property or on a business opportunity must make certain disclosures.

Statutory provisions addressing disclosure obligations imposed upon the seller of residential real estate are found at *Cal. Civ. Code §§ 1102 to 1102.17*.

California sellers are subject to numerous disclosure obligations including the following:

- Disclosure of natural hazards. *See Cal. Civ. Code § 1103 to § 1103.14*
- Smoke detector statement of compliance. *See Cal. Health & Safety Code § 13113.8.*
- Earthquake hazards disclosure for certain residences built prior to January 1, 1960. *See Cal. Gov Code § 8897.1.*
- Water Heater Certification. Sellers must certify in writing to a prospective buyer that the water heater has been braced, anchored or strapped to resist falling or horizontal movement due to earthquake motion. *See Cal. Health & Safety Code § 19211.*
- Toxic mold. The Toxic Mold Protection Act of 2001, which contains disclosure requirements, applies to residential, commercial and industrial property. *See Cal. Health & Safety Code § 26100 to § 26157.*

The Department of Real Estate publishes an extensive booklet, titled "Disclosures in Real Property Transactions," which addresses disclosures which must be made in connection with the sale of real estate. This document is available online at http://www.dre.ca.gov/pub_disclosures.html

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *Cal. Civ. Code § 2079.10a*.

Disclosures requirements regarding psychologically stigmatized properties are found at *Cal. Civ. Code § 1710.2*.

The regulatory agency is the California Department of Real Estate, 2201 Broadway Sacramento, CA 95818; (Mailing address: P.O. Box 187000, Sacramento, CA 95818-7000) Telephone: 916-227-0931; Fax number: 916-227-0925; Website: <http://www.dre.ca.gov>. The Department of Real Estate has offices in Sacramento, Fresno, Los Angeles, Oakland, and San Diego.

Colorado

Statutory provisions regarding licensees disclosure obligations with respect to brokerage relationships are found at *Colo. Rev. Stat. §§ 12-61-801 to 12-61-811*.

Pursuant to the Colorado Division of Real Estate Rule F-7, real estate brokers must use Commission-approved forms as appropriate to a transaction or circumstance to which a relevant form is applicable. Among those forms is a Seller's Property Disclosure form which indicates that it is for all properties. Rule E-43 addresses square footage measurement of residential property. The regulatory agency also publishes forms lead-based paint disclosure forms for both sales and rentals.

Colo. Rev. Stat. § 38-35.7-101 states that every contract for the purchase and sale of residential real property must contain a disclosure statement regarding special taxing districts.

With respect to the disclosure of sex offenders in the vicinity of the subject property, It is the position of the regulatory agency that licensees should inform a potential buyer to contact local law enforcement officials for further information if the presence of a registered sex offender concerns the buyer.

Disclosures requirements regarding psychologically stigmatized properties are found at *Colo. Rev. Stat. § 38-35.5-101*.

The regulatory agency is the Colorado Department of Regulatory Agencies, Division of Real Estate, 1560 Broadway, Suite 925, Denver, Colorado 80202; Telephone: 303-894-2166 or 303-894-2185; Fax: 303-894-2683; Website: <http://www.dora.state.co.us/real-estate>.

Connecticut

Conn. Gen. Stat. § 20-325d requires disclosures regarding brokerage relationships.

Conn. Gen. Stat. § 20-327b requires that sellers provide a written residential condition report to the prospective purchaser.

Conn. Gen. Stat. § 20-327f requires disclosures regarding the existence of hazardous waste facilities.

Disclosures requirements regarding psychologically stigmatized properties are found at *Conn. Gen. Stat. §§ 20-329ccc to 20-329eee*.

The regulatory agency is the Department of Consumer Protection, Occupational and Professional Licensing Division, 165 Capitol Avenue, Hartford, Connecticut 06106; Telephone: 860-713-6150; Fax: 860-713-7243; Website: <http://www.state.ct.us/dcp>

Delaware

Del Code Ann. tit. 24, § 2931 requires agency disclosure.

The Buyer Protection Act, which requires that residential buyers be provided with a Seller's Disclosure of Real Property Condition Report is found at *Del Code Ann. tit. 6, §§ 2570 to 2578*.

Disclosures requirements regarding psychologically stigmatized properties are found at *Del. Code Ann. tit. 24, § 2930*.

The regulatory agency is the Real Estate Commission, Cannon Building, 861 Silver Lake Blvd., Suite 203, Dover, Delaware 19904; Telephone: 302-744-4500; Fax: 302-739-2711; Website: <http://dpr.delaware.gov/boards/realestate/index.shtml>

District of Columbia

D.C. Code § 42-1703 and *D.C. Code § 47-2853.196* require disclosures regarding brokerage relationships.

D.C. Code §§ 42-1301 to 42-1311 require residential real property seller disclosures.

Disclosures requirements regarding psychologically stigmatized properties are found at *D.C. Code § 47-2853.198*.

The regulatory agency is the Board of Real Estate, 941 North Capitol Street, N.E., Washington, DC 20002; Telephone: 202-442-4340; Fax: 202-442-4528; Website: <http://www.dcre.dc.gov/> (This is the Website for the Department of Consumer and Regulatory Affairs. The Real Estate Board can be reached via a link on this home page by first clicking on Business Resources and then clicking on Real Estate Board.).

Florida

Fla. Stat. § 475.278 requires disclosures regarding brokerage relationships.

Fla. Stat. § 161.57 requires disclosures regarding properties located in coastal areas.

Fla. Stat. § 404.056(5) requires disclosures regarding radon. This disclosure appears to apply to all properties.

Fla. Stat. § 720.401 requires disclosures in connection with properties subject to homeowners association membership.

Disclosures requirements regarding psychologically stigmatized properties are found at *Fla. Stat. § 689.25*.

The regulatory agency is the Division of Real Estate, 400 W. Robinson Street, Suite N308, Orlando, Florida 32801; Telephone: 850-487-1395; Fax: 407-317-7245; Website: <http://www.myflorida.com/dbpr/re/index.html>.

Georgia

The Brokerage Relationships in Real Estate Transactions Act is found at *Ga. Code Ann. §§ 10-6A-1 to 10-6A-16*.

Disclosures requirements regarding psychologically stigmatized properties and sex offenders in the vicinity of the subject property are found at *Ga. Code Ann. § 44-1-16*.

The regulatory agency is the Real Estate Commission, Suite 1000 -International Tower, 229 Peachtree Street N.E., Atlanta, Georgia 30303; Telephone: 404-656-3916; Fax: 404-656-6650; Website: <http://www.grec.state.ga.us>.

Hawaii

Haw. Rev. Stat. §§ 508D-1 to 508D-19 requires seller disclosures in residential real estate transactions.

Disclosures requirements regarding psychologically stigmatized properties are found at *Haw. Rev. Stat. § 467-14(18)* and *Haw. Rev. Stat. § 508D-8*.

The regulatory agency is the Department of Commerce & Consumer Affairs, Real Estate Branch, King Kalakaua Building, 335 Merchant Street, 3rd Floor, Room 333, Honolulu, HI 96813; Telephone: 808-586-2643; Fax: 808-586-2650; Website: <http://hawaii.gov/hirec/>.

Idaho

Idaho Code § 54-2085 requires disclosures regarding brokerage relationships.

Idaho Code §§ 55-2501 to 55-2518 contains the Property Condition Disclosure Act.

Disclosures requirements regarding psychologically stigmatized properties and sex offenders in the vicinity of the subject property are found at *Idaho Code § 55-2801*.

The regulatory agency is the Real Estate Commission, 633 North Fourth Street (Post Office Box 83720, Zip Code: 83720-0077), Boise, Idaho 83720; Phone: 208-334-3285; Fax: 208-334-2050; Website: <http://www.irec.idaho.gov/>.

Illinois

Brokerage relationships disclosure requirements are found at *225 ILCS 454/15-5, et seq.*

The Residential Real Property Disclosure Act is found at *765 ILCS 77/1, et seq.*

Radon testing and disclosure requirements with respect to residential property transactions are found at *420 ILCS 46/10*.

Disclosures requirements regarding psychologically stigmatized properties are found at *225 ILCS 454/15-20*.

The regulatory agency is the Office of Banks and Real Estate, Division of Professional Regulation, 500 East Monroe Street, Suite 200, Springfield, Illinois 62701; Telephone: 217-785-9300; Website: <http://www.obre.state.il.us>.

Indiana

Brokerage relationship disclosure requirements are found at *Ind. Code Ann. § 25-34.1-1-1, et seq.*

Ind. Code Ann. §§ 32-21-5-1 to 32-21-5-13 requires seller disclosures in residential real estate transactions.

Disclosures requirements regarding psychologically stigmatized properties are found at *Ind. Code Ann. § 32-21-6-3*.

The regulatory agency is the Professional Licensing Agency, Attn: Indiana Real Estate Commission, 402 West Washington Street, Room W072, Indianapolis, Indiana 46204; Telephone: 317-234-3009; Fax: 317-232-2312; Website: <http://www.in.gov/pla>.

Iowa

Brokerage relationship disclosure requirements are found at *Iowa Code § 543B.55 to § 543B.64*.

Iowa Code §§ 558A.1 to 558A.8 require seller disclosures in residential real estate transactions.

The regulatory agency is the Real Estate Commission, 1920 SE Hulsizer Avenue, Ankeny, Iowa 50021; Telephone: 515-281-7393 or 515-281-5910; Fax: 515-281-7411; Website: <http://www.state.ia.us/government/com/prof/index.html>.

Kansas

Brokerage relationship disclosure requirements are found at *Kan. Stat. Ann. § 58-30,101 to § 58-30,113*. *Kan. Adm. Reg. No. 86-3-26* addresses the real estate brokerage relationships brochure.

Kansas Attorney General Opinion No. 2004-10, *2004 Kan. AG LEXIS 12* (Apr. 24, 2004) addresses a licensee's disclosure obligations with respect to sex offenders in the vicinity of the subject property. This opinion states in part, "... [the Brokerage Relationships in Real Estate Transactions Act] does not impose a duty on a broker to disclose the fact that a registered sex offender resides in the neighborhood.

The regulatory agency is the Real Estate Commission, Three Townsite Plaza, Suite 200, 120 SE 6th Avenue, Topeka, Kansas 66603; Telephone: 785-296-3411; Fax: 785-296-1771; Website: <http://www.accesskansas.org/krec>.

Kentucky

Brokerage relationship disclosure requirements are found at 201 Ky. Admin. Regs. 11:400.

Ky. Rev. Stat. Ann. § 324.360 requires seller disclosures in residential real estate transactions involving a licensee who receives compensation. The form used for making seller's disclosures is found at 201 Ky. Admin. Regs. 11:350.

Disclosures requirements regarding psychologically stigmatized properties are found at *Ky. Rev. Stat. § 207.250*.

The regulatory agency is the Real Estate Commission, 10200 Linn Station Road, Suite 201, Louisville, Kentucky 40223, Telephone: 502-429-7250; Fax: 502-429-7246; Website: <http://krec.ky.gov/>.

Louisiana

Brokerage relationship disclosure requirements are found at *La. Rev. Stat. § 37:1467*.

La. Rev. Stat. §§ 9:3196 to 9:3200 require seller disclosures in residential real estate transactions.

Disclosures regarding psychologically stigmatized properties are found at *La. Rev. Stat. § 37:1468*.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *La. Rev. Stat. § 37:1469*.

Optional mold disclosures are addressed in *La. Rev. Stat. § 37:1470*.

The regulatory agency is the Real Estate Commission, Post Office Box 14785, Baton Rouge, Louisiana 70898; Street Address: 9071 Interline Avenue, Baton Rouge, LA 70809; Telephone: 225-925-1923, Fax: 225-925-4501; Website: <http://www.lrec.state.la.us>.

Maine

Brokerage relationship disclosure requirements are found at *Me. Rev. Stat. Ann. tit. 32, § 13279*.

Me. Rev. Stat. Ann. tit. 33, §§ 171 to 179 require seller disclosures in residential real estate transactions.

The regulatory agency is the Real Estate Commission, 35 State House Station, Augusta, Maine 04333; Telephone: 207-624-8518; Fax: 207-624-8637; Website: <http://www.maine.gov/pfr/olr/categories/cat38.htm>.

Maryland

Brokerage relationship disclosure requirements are found at *Md. Code Ann., Bus. Occ. & Prof. § 17-530*.

Md. Code Ann., Real Prop. § 10-702 requires seller disclosures in residential real estate transactions.

Md. Code Ann., Real Prop. § 10-705 imposes disclosure requirements regarding property encumbered by a conservation easement.

Disclosure requirements regarding psychologically stigmatized properties are found at *Md. Code Ann., Bus. Occ. & Prof. § 17-322.1*.

The regulatory agency is the Real Estate Commission, 500 N. Calvert Street, Baltimore, Maryland 21202; Telephone: 410-230-6230; Fax: 410-333-0023. This agency's webpage may be reached from this webpage: <http://www.dllr.state.md.us/> by clicking on Occupational & Professional Licensing and then clicking on Real Estate Commission.

Massachusetts

Brokerage relationship disclosure requirements are found in regulations at 254 CMR 3.00(13).

Mass. Gen. Laws ch. 112, § 87AAA3/4 addresses agency disclosures when the property is intended for use as 1 to 4 residential dwellings or the intended purchase or sale of land on which a building is intended to be constructed for use as 1 or 2 residential dwellings.

The Massachusetts Consumer Protection Act applies to real property. This Act is found at *Mass. Gen. Laws Ann. ch. 93A, § 1 et seq.* A broker may have disclosure obligations pursuant to this Act. n3

Mass. Gen. Laws ch. 111, § 197A, requires that prospective purchasers of premises be notified about the hazards of lead in paint, plaster or other accessible structural material in premises and the requirements for their abatement or containment.

Mass. Gen. Laws ch. 255, § 12J provides that no cause of action shall arise or be maintained against a seller, lessor, real estate broker or salesperson, lender or mortgagee of real property by statute or at common law, for failure to disclose to a buyer or tenant that the real property has been insulated with urea formaldehyde foam insulation.

Disclosure requirements regarding psychologically stigmatized properties are found at *Mass Gen. Laws Ann. ch. 93, § 114*.

The regulatory agency is the Division of Professional Licensure, Real Estate Board, 239 Causeway Street, Suite 500, Boston, Massachusetts 02114; Telephone: 617-727-2373; Website: <http://www.mass.gov/dpl/>.

Michigan

Brokerage relationship disclosure requirements are found at *Mich. Comp. Laws § 339.2517*.

The Michigan Seller Disclosure Act, which requires seller disclosures on the transfer of residential real estate, is found at *Mich. Comp. Laws §§ 565.951 to 565.966*.

Disclosure requirements regarding psychologically stigmatized properties and sex offenders in the vicinity of the subject property are found at *Mich. Comp. Laws § 339.2518*.

The regulatory agency is the Department of Energy, Labor & Economic Growth, Michigan State Board of Real Estate

Brokers & Salespersons, 2501 Woodlake Circle, Okemos, Michigan 48865; Telephone: 517-373-7353; Fax: 517-373-1044; Website: www.michigan.gov/realestate.

Minnesota

Brokerage relationship disclosure requirements are found at *Minn. Stat. § 82.22*.

Disclosures regarding a licensee's compensation are found at *Minn. Stat. § 82.21*.

Minn. Stat. §§ 513.52 to 513.60 require seller disclosures in residential real estate transactions.

Disclosure requirements regarding psychologically stigmatized properties and sex offenders in the vicinity of the subject property are found at *Minn. Stat. § 513.56*.

Minn. Stat. § 103I.235, Subd. (1)(a) requires that before the parties sign an agreement to sell or transfer real property, the seller must disclose in writing to the buyer information about the status and location of all known wells on the property.

Minn. Stat. § 115.55, Subd. 6(a) requires that before the parties sign an agreement to sell or transfer real property, the seller or transferor must disclose in writing to the buyer or transferee information on how sewage generated at the property is managed.

The regulatory agency is the Minnesota Department of Commerce, 85--7th Place East, St. Paul MN 55101, Telephone: 651-296-6319; Website: <http://www.state.mn.us/> (click on "more" under licensing and forms and then click on "Department of Commerce License Lookup").

Mississippi

Brokerage relationship disclosure requirements are found at Code of Mississippi Rules § 50-025-001(IV)(E).

Miss. Code Ann. §§ 89-1-501 to 89-1-527 require seller disclosures in residential real estate transactions.

Disclosure requirements regarding psychologically stigmatized properties and sex offenders in the vicinity of the subject property are found at *Miss. Code Ann. § 89-1-527*.

The regulatory agency is the Real Estate Commission, Post Office Box 12685, Jackson, Mississippi 39236 (Street address: 2506 Lakeland Drive, Suite 300, Flowood, MS 39232); Telephone: 601-932-6770; Fax: 601-932-2990; Website: <http://www.mrec.state.ms.us/>.

Missouri

Brokerage relationship disclosure requirements are found at *Mo. Rev. Stat. § 339.770*.

Mo. Rev. Stat. § 260.213 provides that no person may knowingly sell, convey or transfer title to any property that contains a permitted or unpermitted solid waste disposal site or demolition landfill, without disclosing to the buyer early in the negotiation process the existence and location of the site.

Disclosure requirements regarding psychologically stigmatized properties are found at *Mo. Rev. Stat. § 442.600*.

Disclosure requirements regarding the sale or transfer of property used as a site for methamphetamine production are

found in *Mo. Rev. Stat. § 442.606*.

The regulatory agency is the Real Estate Commission, Post Office Box 1339, 3605 Missouri Blvd., Jefferson City, MO 65102; Telephone: 573-751-2628; Fax: 573-751-2777; Website: <http://pr.mo.gov/realestate.asp>.

Montana

Brokerage relationship disclosure requirements are found at *Mont. Code Ann. § 37-51-314*.

The Montana Mold Disclosure Act is found at *Mont. Code Ann. § 70-16-701, et seq.* This act provides that a seller, landlord, seller's agent, buyer's agent, or property manager may provide a voluntary disclosure statement found in the act to a buyer or tenant. This act uses the term inhabitable real property which is defined to mean any real property that includes a building affixed to land. The building must be designed to be primarily occupied by humans, either as a dwelling or as a place of business.

The Montana Radon Control Act is found at *Mont. Code Ann. § 75-3-601, et seq.* This act provides for the notification of the presence of radon to persons acquiring or selling real estate. A radon disclosure statement must be provided on at least one document, form, or application executed prior to or contemporaneously with an offer for the purchase and sale of inhabitable real property.

Disclosure requirements regarding psychologically stigmatized properties are addressed indirectly at *Mont. Code Anno., § 37-51-102(2)(b)* which concerns what constitutes an adverse material fact.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *Mont. Code Ann. § 37-51-105*.

The regulatory agency is the Board of Realty Regulation, Post Office Box 200513, 301 South Park Avenue, Helena, Montana 59620; Telephone: 406-444-2961; Fax: 406-841-2323; Website: <http://mt.gov/>.

Nebraska

Brokerage relationship disclosure requirements are found at *Neb. Rev. Stat. §§ 76-2420 and 76-2422*.

Neb. Rev. Stat. Neb. § 76-2,120 requires seller disclosures in residential real estate transactions.

Nebraska's Attorney General has issued No. 98051, 1998 *Neb. AG LEXIS 53* (Dec. 7, 1998), states that the presence of a registered sex offender in the vicinity of the property listed for sale does not appear to be included within the list of adverse material facts found in *Neb. Rev. Stat. § 76-2417(3)(a)*. In a subsequent opinion, No. 99006, 1999 *Neb. AG LEXIS 23* (Feb. 24, 1999), the Nebraska Attorney General opined that a dual agent does not have a duty to disclose to clients the nearby presence of a registered sex offender.

The regulatory agency is the Real Estate Commission, 1200 N Street, Suite 402, Post Office Box 94667, Lincoln, Nebraska 68509; Telephone: 402-471-2004; Fax: 402-471-4492; Website: <http://www.nrec.state.ne.us>.

Nevada

Nev. Rev. Stat. Ann. §§ 113.100 to 113.150 require seller disclosures in residential real estate transactions.

Nev. Rev. Stat. Ann. § 113.060 requires that certain sellers to give notice of rates for water and sewerage services.

Nev. Rev. Stat. Ann. § 113.065 requires disclosure upon the sale of a home or improved lot adjacent to open range.

Nev. Rev. Stat. Ann. § 113.070 requires disclosures by certain sellers relating to zoning classifications and designations in master plan regarding land use.

Nev. Rev. Stat. Ann. § 113.080 requires disclosures by certain sellers in county whose population is 400,000 or more relating to gaming enterprise districts.

Disclosure requirements regarding psychologically stigmatized properties are found at *Nev. Rev. Stat. Ann. § 40.770*.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *Nev. Rev. Stat. Ann. § 40.770*.

The regulatory agency is the Department of Business & Industry, Real Estate Division, 2501 E. Sahara Ave., Suite 102, Las Vegas, Nevada 89104; Telephone: 702-486-4033; Fax: 702-486-4275; Website: <http://www.red.state.nv.us>.

New Hampshire

Brokerage relationship disclosure requirements are found at N.H. Code Admin. R. Ann. Part Rea 701.

N.H. Rev. Stat. Ann. § 477:4-a requires that prior to executing a contract for the purchase and sale of real estate that includes a building, the seller, or the seller's agent, must provide disclosures regarding radon gas and lead paint.

N.H. Rev. Stat. Ann. § 477:4-c requires disclosure of certain information regarding a property's water supply and sewage disposal system.

N.H. Code Admin. Rules § 701.04 requires certain disclosures regarding insulation.

Disclosure requirements regarding psychologically stigmatized properties are found at *N.H. Rev. Stat. Ann. § 477:4-e*.

Disclosure requirements regarding the sale or lease of property which had had been used for methamphetamine production are found at *N.H. Rev. Stat. Ann. § 477:4-g*.

The regulatory agency is the Real Estate Commission, State House Annex, 25 Capitol Street, Room 434, Concord, New Hampshire 03301, Telephone: 603-271-2701; Website: <http://www.nh.gov/nhrec/>.

New Jersey

N.J. Admin. Code § 11:5-6.9 requires that brokers deliver to individuals involved in residential transactions a Consumer Information Statement which addresses agency relationships. The New Jersey Real Estate Commission recommends the use of seller disclosure statements, but there is no requirement that such forms be used.

The New Residential Construction Off-Site Conditions Disclosure Act, found at *N.J. Stat. Ann. §§ 46:3C-1 to 46:3C-12* requires that lists of certain "off-site conditions" in the municipality, which may affect the value of newly constructed residential real estate, be available at each Municipal Clerk's office within each municipality.

The Real Estate Full Disclosure Act is found at *N.J. Stat. Ann. § 45:15-16.27 et seq.* Regulations implementing this Act are found at *N.J. Admin. Code §§ 11:5-9.1 through 11:5-9.19*. This Act applies to subdivisions and subdivided lands offered for sale as part of a common promotional plan of advertising and sale [see *N.J. Stat. Ann. §§ 45:15-16.30 and 45:15-16.36*; *N.J. Admin. Code. § 11:5-9.2*].

N.J. Stat. Ann. § 26:2D-73 provides in part that in the case of a prospective sale of a building which has been tested for radon gas and radon progeny, the seller must provide the buyer, at the time the contract of sale is entered into, with a copy of the results of that test and evidence of any subsequent mitigation or treatment, and any prospective buyer who contracts for the testing shall have the right to receive the results of that testing.

Disclosure requirements regarding psychologically stigmatized properties are found at *N.J. Admin. Code § 11:5-6.4(d)*.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *N.J. Admin. Code § 11:5-6.4(d) and (e)*.

The regulatory agency is the New Jersey Department of Banking and Insurance, Real Estate Commission, 20 West State Street, Post Office Box 328, Trenton, New Jersey 08625-0328; Telephone: 609-292-7272; Fax: 609-292-0944; Website: <http://www.state.nj.us/dobi/remnu.shtml>.

New Mexico

Brokerage relationship disclosure requirements are found at *N.M. Stat. Ann. § 61-29-10.1*.

Disclosure requirements regarding psychologically stigmatized properties are found at *N.M. Stat. Ann. § 47-13-2*.

Though New Mexico licensees have a duty to disclose adverse material facts actually known by the licensee about the property or the transaction, the term "adverse material facts" does not include data from sex offender registry or the existence of group homes [N.M. Admin. Code tit. 16, § 16.61.19.8(H)].

The regulatory agency is the Real Estate Commission, 5200 Oakland Ave. NE Albuquerque, NM 87113; Telephone: 505-222-9820; Fax: 505-222-9886; Website: <http://www.rld.state.nm.us/RealEstateCommission/>.

New York

Brokerage relationship disclosure requirements are found at *N.Y. Real Prop. Law § 443*.

The Property Condition Disclosure Act, which is found at *N.Y. Real Prop. Law §§ 460 to 467*, requires seller disclosures in residential real estate transactions.

N.Y. Real Prop. Law § 242 requires that sellers of real property to which no utility electric service is provided must provide written notice of this fact to the prospective purchaser or to the prospective purchaser's agent. Other related notices are required under this provision.

N.Y. Real Prop. Law § 333-c provides that certain disclosures must be made when any purchase and sales contract is presented for the sale, purchase, or exchange of real property located partially or wholly within an agricultural district established pursuant to the provisions of article 25-AA of the Agriculture and Markets Law.

Disclosure requirements regarding psychologically stigmatized properties are found at *N.Y. Real Prop. Law § 443-a*.

The regulatory agency is the Division of Licensing Services, Street Address: Alfred E. Smith Office Building, 80 S. Swan Street, 10th Floor, Albany, NY 12210; Mailing Address: P.O. Box 22001, Albany, NY 12201-2001; Telephone: 518-474-4429; Fax: 518-473-6648; Website: <http://www.dos.state.ny.us/lcns/licensing.html>.

North Carolina

Brokerage relationship disclosure requirements are found at *N.C. Admin. Code tit. 21, § 58A.0104*.

General Statutes of North Carolina chapter 47E contains the Residential Property Disclosure Act.

Disclosure requirements regarding psychologically stigmatized properties and sex offenders in the vicinity of the subject property are found at *N.C. Gen. Stat. § 39-50*.

The regulatory agency is the North Carolina Real Estate Commission, Post Office Box 17100, 1313 Navaho Drive, Raleigh, North Carolina 27619-7100; Telephone: 919-875-3700; Fax: 919-877-4221; Website: <http://www.ncrec.state.nc.us>.

North Dakota

Brokerage relationship disclosure requirements are found at *N.D. Cent. Code § 43-23-12.1*.

North Dakota Attorney General Letter Opinion 2001-L-51, 2001 *N.D. AG LEXIS* 66 (Nov. 28, 2001) discusses disclosure obligations with respect to properties formerly used as methamphetamine labs.

Disclosure requirements regarding psychologically stigmatized properties are found at *N.D. Admin. Code § 70-02-01-19*.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *N.D. Cent. Code § 43-23-08.3*.

The regulatory agency is the Real Estate Commission, 200 East Main Avenue, Suite 204, Bismarck, North Dakota 58502-0727; Mailing address: P.O. Box 727, Bismarck ND 58502-0727; Telephone: 701-328-9749; Fax: 701-328-9750; Website: <http://www.realestatend.org/>.

Ohio

Brokerage relationship disclosure requirements are found at *Ohio Rev. Code Ann. § 4735.57*.

Ohio Rev. Code Ann. § 5302.30 requires seller disclosures in residential real estate transactions.

Ohio Rev. Code Ann. § 5301.253 provides that the owner of any property who has received written notice that the property is in violation of any building or housing code must give the purchaser or grantee of the property written notice of the code violations prior to entering into an agreement for the transfer of title to the property.

The Residential Property Disclosure Form distributed by the Ohio Department of Commerce contains the following notice with respect to sex offenders in the vicinity of the subject property:

Owner makes no representations with respect to any offsite conditions. Purchaser should exercise whatever due diligence purchaser deems necessary with respect to offsite issues that may affect purchaser's decision to purchase the property. Purchaser should exercise whatever due diligence purchaser deems necessary with respect to Ohio's Sex Offender Registration and Notification Law (commonly referred to as "Megan's Law"). This law requires the local Sheriff to provide written notice to neighbors if a sex offender resides or intends to reside in the area. The notice provided by the Sheriff is a public record and is open to inspection under Ohio's Public Records Law. If concerned about this issue, purchaser assumes responsibility to obtain information from the Sheriff's office regarding the notices

they have provided pursuant to Megan's Law.

The regulatory agency is the Ohio Department of Commerce, Division of Real Estate and Professional Licensing, 77 South High Street, 20th Floor, Columbus, Ohio 43215-6133; Telephone: 614-466-4100; Website: <http://www.com.ohio.gov/real/>.

Oklahoma

Brokerage relationship disclosure requirements are found at *Okla. Stat. tit. 59, § 858-356*.

The Residential Property Condition Disclosure Act, which is found at *Okla. Stat. tit. 60, §§ 831 to 839*, requires seller disclosures in residential real estate transactions.

Disclosure requirements regarding psychologically stigmatized properties are found at *Okla. Stat. tit. 59, § 858-513*.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *Okla. Stat. tit. 59, § 858-514*.

The regulatory agency is the *Real Estate Commission, Shepherd Mall, 2401 N.W. 23rd, Suite 18, Oklahoma City, Oklahoma 73107*, Telephone: 405-521-3387; Fax: 405-521-2189; Website: www.orec.state.ok.us.

Oregon

Brokerage relationship disclosure requirements are found at *Or. Rev. Stat. § 696.820*.

Or. Rev. Stat. §§ 105.462 to 105.490 require seller disclosures in residential real estate transactions.

Or. Admin. R. 333-040-0100 requires disclosures with respect to property used as an illegal drug manufacturing site.

Disclosure requirements regarding psychologically stigmatized properties are found at *Or. Rev. Stat. § 93.275*.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *Or. Rev. Stat. §§ 93.275 and 696.880*.

The regulatory agency is the Oregon Real Estate Agency, 1177 Center Street NE, Salem, Oregon 97301-2505; Telephone: 503-378-4170; Fax: 503-378-3256; Website: <http://www.rea.state.or.us>.

Pennsylvania

Brokerage relationship disclosure requirements are found at *63 Pa. Stat. § 455.606a*.

The Real Estate Seller Disclosure Law, found at *68 Pa. C.S. §§ 7301 to 7315*, requires seller disclosures in residential real estate transactions.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *42 Pa. C.S. § 9799.7*.

The regulatory agency is the State Real Estate Commission, P.O. Box 2649, Harrisburg, Pennsylvania 17105; Telephone: 717-783-3658; Fax: 717-787-0250; Website: www.dos.state.pa.us/estate.

Rhode Island

Brokerage relationship disclosure requirements are found at *R.I. Gen. Laws* §§ 5-20.6-3 and 5-20.6-8.

R.I. Gen. Laws §§ 5-20.8-1 to 5-20.8-12 require seller disclosures in residential real estate transactions.

Disclosure requirements regarding psychologically stigmatized properties are found at *R.I. Gen. Laws* § 5-20.8-6.

The regulatory agency is the Department of Business Regulation, Division of Commercial Licensing and Regulation, Real Estate, 1511 Pontiac Avenue, Cranston, RI 02920, Telephone: 401-462-9500; Fax: 401-462-9532; Website: <http://www.dbr.state.ri.us/>.

South Carolina

Brokerage relationship disclosure requirements are found at *S.C. Code Ann.* § 40-57-139.

The Residential Property Condition Disclosure Act, found at *S.C. Code Ann.* §§ 27-50-10 to 27-50-110, requires seller disclosures in residential real estate transactions.

Disclosure requirements regarding psychologically stigmatized properties and sex offenders in the vicinity of the subject property are found at *S.C. Code Ann.* § 27-50-90.

The regulatory agency is the Department of Labor Licensing & Regulation, Real Estate Commission, Post Office Box 11847, Columbia, South Carolina 29211; Street Address: Synergy Business Park, Kingstree Building, 110 Centerview Dr., Suite 201, Columbia, SC 29210; Telephone: 803-896-4400; Fax: 803-896-4404; Website: <http://www.llronline.com/POL/REC/>.

South Dakota

Brokerage relationship disclosure requirements are found at *S.D. Codified Laws* § 36-21A-130.

S.D. Codified Laws §§ 43-4-37 to 43-4-44 require seller disclosures in residential real estate transactions.

With respect to psychological impacts, the Seller's Property Condition Disclosure Statement shown in *S.D. Codified Laws* § 43-4-44 contains the following questions:

Within the previous twelve months prior to signing this document, are you aware of any of the following occurring on the subject property?

a. A human death by homicide or suicide? Yes _____ No _____

If yes,
explain: _____

b. Other felony committed against the property or a person on the property? Yes _____ No _____

If yes, explain:

This disclosure statement also whether the property has been used for the production of methamphetamine.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *S.D. Codified Laws § 36-21A-134.1*.

The regulatory agency is the Real Estate Commission, 221 W. Capitol Suite 101, Pierre, South Dakota 57501; Telephone: 605-773-3600; Fax: 605-773-4356; Website: <http://www.state.sd.us/sdrec/>.

Tennessee

Brokerage relationship disclosure requirements are found at *Tenn. Code Ann. §§ 62-13-401 to 62-13-405*.

Tenn. Code Ann. §§ 66-5-201 to 66-5-212 require seller disclosures in residential real estate transactions.

Disclosure requirements regarding psychologically stigmatized properties are found at *Tenn. Code Ann. § 66-5-207*.

The regulatory agency is the Real Estate Commission, 500 James Robertson Parkway, Nashville, Tennessee 37243; Telephone: 615-741-2273; Fax: 615-741-0313; E-mail: trec@state.tn.us; Website: <http://www.state.tn.us/commerce/boards/trec/>.

Texas

Brokerage relationship disclosure requirements are found at *Tex. Occ. Code § 1101.558*.

Tex. Prop. Code § 5.008 requires seller disclosures in residential real estate transactions.

Texas has some unique disclosure requirements including the following:

- Seller's disclosure of location of conditions under the surface of unimproved real property are found at *Tex. Prop. Code § 5.013*.
- Seller's disclosure regarding potential annexation are found at *Tex. Prop. Code § 5.011*.
- Seller's duty to provide notice of obligations related to membership in property owners' association is found at *Tex. Prop. Code § 5.012*.
- A possible duty to provide documents in a foreign language with respect to an executory contract is found at *Tex. Prop. Code § 5.068*.

Additional disclosure duties regarding executory contracts are found at *Tex. Prop. Code §§ 5.069 to 5.071* (disclosure duties regarding the property's condition, tax payments, insurance coverage and financing terms).

Disclosure requirements regarding psychologically stigmatized properties are found at *Tex. Occ. Code § 1101.556*.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *Tex. Code Crim. Proc. art. 62.056(e)*.

The regulatory agency is the Real Estate Commission, Post Office Box 12188, Austin, Texas 78711-2188 (Street address: 1101 Camino La Costa, Austin, TX 78752); Telephone: 512-459-6544; Fax: 512-465-3910; Website: <http://www.trec.state.tx.us>.

Utah

10-3A Real Estate Brokerage Law and Practice APPENDIX 3A-1

Brokerage relationship disclosure requirements are found at *Utah Admin. Code Rule 162-6-2*.

Disclosure requirements regarding psychologically stigmatized properties are found at *Utah Code Ann. § 57-1-37*.

The regulatory agency is the Division of Real Estate, Post Office Box 146711, Salt Lake City, Utah 84114 (Street address: *Heber M. Wells Building, 160 East 300 South, 2nd Floor*, Salt Lake City, UT 84111); Telephone: 801-530-6747; Fax: 801-526-4387; Website: <http://www.commerce.utah.gov/> (then click on "Real Estate").

Vermont

Code of Vt. Reg. 04-030-290, R. 4.6(a) states that Vermont licensees must provide a written consumer disclosure form that includes the content established by the Commission to any unrepresented person with whom an agent of the brokerage firm has substantial contact.

The regulatory agency is the Vermont Real Estate Commission, Office of Professional Regulation, National Life Building, North FL2, Montpelier, VT 05620-3402; Telephone: 802-828-3228; Fax: 802-828-2368; Website: http://www.vtprofessionals.org/opr1/real_estate/.

Virginia

Brokerage relationship disclosure requirements are found at *Va. Code Ann. § 54.1-2138*.

The Virginia Residential Property Disclosure Act is found at *Va. Code Ann. §§ 55-517 to 55-525*.

Disclosure requirements regarding psychologically stigmatized properties are found at *Va. Code Ann. § 55-524 (A)*.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *Va. Code Ann. § 55-519 (C)*.

The regulatory agency is the Department of Professional and Occupational Regulation, 9960 Mayland Drive, Suite 400, Richmond, Virginia 23233; Telephone: 804-367-8500; Fax: 804-527-4298; Website: <http://www.state.va.us/dpor/>.

Washington

Brokerage relationship disclosure requirements are found at *Wash. Rev. Code § 18.86.030*.

Wash. Rev. Code §§ 64.06.005 to 64.06.900 require seller disclosures in residential real estate transactions.

Disclosure requirements regarding psychologically stigmatized properties are indirectly found at § 18.86.010(9), which defines "material fact" in a manner so as to exclude events which would psychologically impact a property.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *Wash. Rev. Code §§ 64.06.020 and 64.06.021*.

The regulatory agency is the Department of Licensing, Business and Professions Division, Real Estate Program, Post Office Box 9015, Olympia, Washington 98507 (Street address: 2000 4th Avenue West, Olympia, WA 98502); Telephone: 360-664-6500; Fax: 360-586-0998; Website: <http://www.dol.wa.gov/business/realestate/index.html>.

West Virginia

Brokerage relationship disclosure requirements are found at *W. Va. Code § 30-40-26(d)*.

W. Va. Code § 60A-11-3 requires that the Department of Health and Human Resources establish requirements for property owners, sellers and landlords to disclose the existence of any former clandestine laboratory site or activity to any potential occupant of the residential property.

W. Va. Code § 22-18-21 provides that the grantor in a deed or other instrument of conveyance or any lessor in any lease or other instrument whereby any real property is let for a period of time shall disclose the fact that such property or the subsurface of the property was used for the storage, treatment or disposal of hazardous waste.

The regulatory agency is the Real Estate Commission, 300 Capitol Street, Suite 400, Charleston, West Virginia 25301; Telephone: 304-558-3555; Fax: 304-558-6442; Website: <http://www.wvrec.org/>.

Wisconsin

Brokerage relationship disclosure requirements are found at *Wis. Stat. § 452.135*.

Wis. Stat. §§ 709.01 to 709.08 require seller disclosures in residential real estate transactions.

Disclosure requirements regarding psychologically stigmatized properties are found at *Wis. Stat. § 452.23(2)(a)*.

Disclosure requirements regarding sex offenders in the vicinity of the subject property are found at *Wis. Stat. § 452.24*.

The regulatory agency is the Wisconsin Department of Licensing and Regulation, P.O. Box 8935, Madison, WI 53708-8935 (Street address: 1400 E. Washington Avenue, Madison Wisconsin 57503); Telephone: 608-266-2112; Fax: 608-261-7083; E-mail: web@drl.state.wi.us; Website: <http://drl.wi.gov/index.htm>.

Wyoming

Brokerage relationship disclosure requirements are found at *Wyo. Stat. Ann. § 33-28-306*.

With respect to disclosures regarding psychologically impacted properties, pursuant to regulations, psychological factors such as health problems and crimes are not material facts that must be disclosed [see Wyoming Real Estate Commission, Rules and Regulations, Chapter II, § 3(h) (Weil's Code of Wyoming Rules 024-018-202 § 3(h))].

The regulatory agency is the Real Estate Commission, 2020 Carey Avenue, Suite 702, Cheyenne, Wyoming 82002-0180; Telephone: 307-777-7141; Website: <http://realestate.state.wy.us>.

FOOTNOTES:

(n1)Footnote 1. *151 Ariz. 81, 725 P.2d 1115 (Ariz. Ct. App. 1986)* .

(n2)Footnote 2. *Cal. Civ. Code § 2079(a)* codifies the California Court of Appeal's decision in *Easton v. Strassburger*, *152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984)* .

(n3)Footnote 3. See generally Isaaco, A Massachusetts Real Estate Broker's Duty to Disclose: The Quandary Presented by AIDS Stigmatized Property, *27 New. Eng. L. Rev. 1211 (1993)*. This author states, "[T]he real estate broker now has a much higher duty [of disclosure] than existed before the passage of Chapter 93A, and has a much higher duty than the privately selling homeowner."



83 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
 CHAPTER 3A Disclosure Obligations Imposed on Real Estate Licensees *
 APPENDIX 3A-2 Significant Disclosure Cases

10-3A Real Estate Brokerage Law and Practice APPENDIX 3A-2

Scope

This Appendix contains cases relevant to broker and seller disclosures regarding the condition of the property. This Appendix is organized alphabetically by jurisdiction.

Alabama

Moore v. Prudential Residential Services Limited Partnership, 849 So. 2d 914 (Ala. 2002), rehearing denied, 2002 Ala. LEXIS 379 (Ala. Nov. 15, 2002) (a real estate agent cannot be held liable for either fraud or negligence where the agent serves as a "conduit of information" between the seller and the buyer).

Potter v. First Real Estate Company, Inc., 844 So. 2d 540 (Ala. 2002) (dual agent looked at an almost illegible document and incorrectly represented to buyers that the property was not in the flood plain, under evidence before the court, the dual agent was not acting merely as a conduit but was rather a direct source of information).

Ex parte Farmers Exchange Bank (In re: *Sara Cole v. Farmers Exchange Bank*), 783 So. 2d 24 (Ala. 2000) ("Because a lender that is merely lending money to finance the purchase of a house has no duty to inform the buyer of any defects in the house that the lender may have knowledge of, in the absence of a specific request to the lender for information regarding those defects, the trial court properly entered the summary judgment for the Bank.").

Gaulden v. Mitchell, 849 So. 2d 192 (Ala. Civ. App. 2002) (citing *Nolan v. Melton*, 740 So. 2d 1096 (Ala. Civ. App. 1999) for the statement: "Generally, an agent will not be held liable for fraud for merely relaying information concerning the condition of a home, without proof that there was knowledge that the statement was false.").

Alaska

Beaux v. Jacob, 30 P.3d 90 (Alaska 2001) (discusses reasonable care in completing the Real Property Transfer Disclosure Form and the damages arising from a violation of this duty).

Cole v. Bartels, 4 P.3d 956 (Alaska 2000) (court allowed enhanced attorney's fees because the transferor was statutorily

obligated to make a good faith effort to disclose any defects; transferor was aware of defective walls in sunroom of the home she sold).

Arizona

Lombardo v. Albu, 199 Ariz. 97, 14 P.3d 288 (Ariz. 2000) (en banc) (buyer's agent had a duty to disclose to sellers the financial inability of the buyers to perform).

The S Development Company v. Pima Capital Management Co., 201 Ariz. 10, 31 P.3d 123 (Ariz. Ct. App. 2001) (in a case involving the sale of an apartment complex the court held that latent defects in a property sold "as is" that were known to the vendor had to be disclosed to the purchaser; a vendor may be held liable for negligent nondisclosure of facts basic to the transaction when the purchaser was precluded by the vendor from discovering those facts).

Alaface v. National Inv. Co., 181 Ariz. 586, 892 P.2d 1375 (Ariz. Ct. App. 1994) (seller of subdivision lot was subject to the notification requirements of the subdivision reporting statutes at Ariz. Rev. Stat. § 32-2181, et seq., as a successor in interest to lots within a subdivision, seller breached the statutes by failing to provide an accurate water report, since the subdivision reporting statutes were enacted for the protection and safety of the public, the seller, by violating the statutes, was guilty of negligence per se).

Arkansas

Bharodia v. Pledger, 340 Ark. 547, 11 S.W.3d 540 (2000) . Although the buyers did not list the sellers' failure to deliver the sellers' disclosure statement as a reason for terminating the sales contract, the buyers were not estopped from raising the sellers' breach of contract at a later time. The court found no estoppel should have been imposed to prevent the buyers from exercising the right to terminate the agreement due to the sellers' breach of the conditions of the contract requiring the delivery of a sellers' disclosure statement.

Stouffer v. Kralicek Realty Co., 2005 Ark. App. LEXIS 239 (Ark. Ct. App. Mar. 16, 2005) (unpublished opinion). The home buyer sued the seller's real estate agent alleging breach of an implied warranty of habitability, civil-conspiracy, and negligent misrepresentation, in regard to a home defect. The court, in affirming summary judgment for the agent, held that the implied-warranty claim was waived when the buyer purchased the house "as is," and that the agent had no knowledge of any defects in the property.

Riley v. Hoisington, 80 Ark. App. 346, 96 S.W.3d 743 (Ark. Ct. App. 2003) . The seller acknowledged that information regarding prior flooding incidents was not revealed in the disclosure statement. The seller conceded it was reasonable for the buyers to rely upon the disclosure statement. The court found that there was sufficient evidence presented to support the trial court's finding that the seller intentionally misrepresented the condition of the house to the purchase.

Jeter v. Pianalto, 50 Ark. App. 249, 905 S.W.2d 71 (Ark. Ct. App. 1995) . The court reversed summary judgment in favor of an agent in a suit brought by home buyers. The court found the agent's statement that his brother had built the house and that there were no problems with the house could be considered more than a general statement of opinion. The buyers also relied upon a seller disclosure form.

California

Coldwell Banker Residential Brokerage Co., Inc. v. Superior Court, 117 Cal. App. 4th 158, 165, 11 Cal. Rptr. 3d 564, 569-570 (Cal. Ct. App. 2004) , review denied, 2004 Cal. LEXIS 9462 (Cal. Sept. 29, 2004) . Pursuant to Cal. Civil Code § 2079, the inspection and disclosure duties of residential real estate brokers and their agents apply exclusively to prospective buyers, and not to other persons who are not parties to the real estate transaction. Only the purchaser can recover from a broker or agent for breach of these duties. Because the buyer's minor child was not a prospective buyer

or a transferee, the broker did not owe the minor child a duty of care.

Realmuto v. Gagnard, 110 Cal. App. 4th 193, 1 Cal. Rptr. 3d 569 (Cal. Ct. App. 2003) . Providing the buyers with a real estate transfer disclosure statement as required by Cal. Civ. Code § 1102, et seq., was a condition precedent to the buyers' duty to perform. The buyers could not waive their right to a disclosure statement. The seller's failure to deliver a disclosure statement precluded seller's action against buyers for specific performance and breach of contract.

Leko v. Cornerstone Home Inspection, 86 Cal. App. 4th 1109, 103 Cal. Rptr. 2d 858 (Cal. Ct. App. 2001) , review denied, 2001 Cal. LEXIS 3146 (Cal. May 2, 2001) . A real estate agent who is sued for negligent nondisclosure of defects in real property can obtain equitable indemnity from a home inspection company that allegedly breached its duty to the purchaser to discover and disclose the same defects even when the home inspection company prepared its report for a different prospective purchaser, in connection with a previous transaction involving the same property so long as the home inspection company intended or knew with substantial certainty that its report would be used in subsequent transactions involving the property.

Johnson v. Siegel, 84 Cal. App. 4th 1087, 101 Cal. Rptr. 2d 412 (Cal. Ct. App. 2000) , review denied, 2001 Cal. LEXIS 1121 (Cal. Feb. 14, 2001) . The seller's transfer disclosure statement failed to disclose a flooding problem. Even though the contract required arbitration, the buyer pursued a judicial remedy which resulted in summary judgment for the seller. The appellate court held that the dispute must be arbitrated, notwithstanding the fraud allegations. However, the buyer was not prevented from arbitrating even though he had unsuccessfully sought a judicial remedy.

Assilzadeh v. California Federal Bank, 82 Cal. App. 4th 399, 98 Cal. Rptr. 2d 176 (Cal. Ct. App. 2000) , review withdrawn, 2000 Cal. LEXIS 8285 (Cal. Oct. 25, 2000) . A seller of condominium unit was exempt from providing a transfer disclosure statement. The disclosure by the seller and dual agent of the existence of lawsuit regarding defective construction litigation satisfied the seller's common law and statutory disclosure obligations.

Colorado

Olsen v. Vail Associates Real Estate, Inc., 935 P.2d 975 (Colo. 1997) . A seller's broker did not breach a fiduciary duty by failing disclose the terms of sale of land adjacent to the seller's when the broker did not know the terms of sale between the seller's buyer and a third party.

Burman v. Richmond Homes Ltd., 821 P.2d 913 (Colo. Ct. App. 1991) . The brokers did not owe a duty to the purchaser to disclose that properties were located in general improvement districts which could result in increased taxes where the brokers and purchasers had no contract and the brokers were subagents of seller.

Connecticut

Giametti v. Inspections, Inc., 76 Conn. App. 352, 824 A.2d 1 (Conn. App. Ct. 2003) . The seller's residential property condition disclosure report indicated that, to the best of her knowledge, the house was not subject to any insect infestation. At the vendor's urging, the buyer had the home professionally inspected. No insect infestation was discovered. Later the buyer discovered carpenter ants throughout the house. The court held that the vendor had no liability under Conn. Gen. Stat. § 20-327b, which applied only to a knowing misrepresentation in the report. While § 20-327b did not preclude existing common-law actions for misrepresentations, the trial court erred in finding the vendor guilty of negligent misrepresentation. Its implicit finding that the buyer reasonably relied on representations in the report was not supported by the record, in light of evidence that the buyer, at the behest of the vendor, had the house professionally inspected.

Parker v. Shaker Real Estate, 47 Conn. App. 489, 498, 705 A.2d 210 (Conn. App. Ct. 1998) . The plaintiffs failed to present any expert testimony to establish the standard of care required of defendant real estate agencies with respect to

disclosure in the circumstances of this case.

Delaware

Gutridge v. Iffland, 2005 Del. LEXIS 518 (2005) . The buyer offers no evidence that the sellers knew of a plumbing problem before settlement. The only evidence presented was that the main sewer line backed up into the basement approximately two and a half months after the parties closed on the property. The buyer also pointed to the sellers' untruthful disclosures about the roof and electrical system, suggesting that it can be inferred from those disclosures that the sellers lied throughout their entire disclosure statement. That inference is not reasonable. Even giving the buyer the benefit of favorable inferences as to the nature and timing of the sewage back-up, without some evidence that the sellers actually knew of the plumbing problem, the buyer's claim must fail.

Heller v. Kiernan, 2002 Del. Ch. LEXIS 17 (Del. Ch. 2002) , aff'd, 806 A.2d 164, 2002 Del. LEXIS 481 (Del. 2002) (without opinion). Any broker who has any personal interest in a transaction must disclose his or her status to all persons with whom he or she is transacting such business prior to the execution of any agreements. A broker's duty to a buyer includes a written disclosure acknowledging the broker's fiduciary responsibilities to be made in any contract prepared for the purchase of real estate.

Liberto v. Bensinger, 1999 Del. Ch. LEXIS 241 (Del. Ch. 1999) . A nondisclosure may qualify as a misrepresentation only when the nondisclosure is with respect to a fact known to the person accused of making the non-disclosure. A buyer is expected to use his or her senses and not rely blindly on the maker's assertion.

Petenbrink v. Superior Home Builders, 1999 Del. Super. LEXIS 461 (Del. Super. Ct. 1999) . Since a builder did not have duty to disclose to homebuyers that it paid referral fee to homebuyers' agent, homebuyers were not entitled to refund of fee from builder in their action to recover money paid to builder.

Murphy v. Berlin Constr. Co., 1999 Del. Super. LEXIS 5 (Del. Super. Ct. 1998) . A general contractor had no duty to disclose to homebuyers that their contract included a commission for the homebuyers' agent where the contractor owed homebuyers no fiduciary duty and contractor made no statements that might have been misleading).

Rosenberg v. White, 2003 Del. C.P. LEXIS 25 (Del. Ct. Common Pleas Aug. 12, 2003) . A seller's disclosure report wrongly indicated that the sewage disposal system was a cesspool and that all windows were in working order and had storm windows and screens. The court held that the buyers failed to prove by a preponderance of the evidence that either sellers knew or believed that the statements were false, or that the sellers were recklessly indifferent to the statements' truthfulness, court also held that sellers were not negligent in making the false statements regarding the sewage system, in that they believed the statements they made were true. But the court found that the sellers were negligent in their reporting of the window conditions, as they should have known, and thus disclosed, that they were inoperable and that the screens and storm windows were missing from many windows.

Lemon v. Lake, 1998 Del. C.P. LEXIS 14 (Del. Ct. Common Pleas 1998) . It was uncontroverted that the seller provided the buyer with a "Seller's Report" and that this report implied on its face that there was a water problem only in the basement front wall after heavy rain. The buyer was given an opportunity to inspect the property before she signed the sales agreement and before settlement. The buyer denied knowledge of this water seepage although she did not deny that she was given the opportunity to inspect the property prior to settlement. The evidence showed that the seller was probably not personally aware of any water problem at the rear wall of the basement prior to being given notice of this by the buyer after settlement. Experts of both parties agreed that there was a water problem at both the front and rear basement wall, but their testimony was inconclusive as to why the problem existed and how long it had existed. A fair reading of the Seller's Disclosure of Real Property Condition Report did not put one on notice that this condition was disclosed. The court concluded, however, that there had not been a showing that the seller misrepresented the facts as to the condition of the water problem in the rear wall of the basement.

District of Columbia

Borzillo v. Thompson, 57 A.2d 195 (Mun. Ct. App. D.C. 1948) The broker had duty to disclose material facts to purchaser which were not disclosed by vendor.

Florida

M/I Schottenstein Homes, Inc. v. Azam, 813 So. 2d 91 (Fla. 2002) . Knowledge of clearly revealed information from recorded documents contained in the records constituting a parcel's chain of title is properly imputed to a purchasing party, based upon the fact that an examination of these documents prior to a transfer of the real property is entirely expected. For this reason, it may often be the case that where fraud regarding information contained in and clearly revealed through a parcel's chain of title is alleged, reliance is not justified and a cause of action will not exist.

Johnson v. Davis, 480 So. 2d 625 (Fla. 1985) . If a seller knows of defects materially affecting property's value which are not readily observable and are not known to buyer, the seller is under duty to disclose them to buyer.

Meyer v. Thompson, 861 So. 2d 1256 (Fla. Dist. Ct. App. 2003) . When the seller of a home knows of facts materially affecting the property's value which are not readily observable and are not known to the buyer, the seller is under a duty to disclose them to the buyer.

Syvrud v. Today Real Estate, Inc., 858 So. 2d 1125 (Fla. Dist. Ct. App. 2003) . An "as is" clause in a contract for the sale of Florida residential real property does not waive the duty to disclose hidden defects in the property.

Atria v. Hodor, 790 So. 2d 1229 (Fla. Dist. Ct. App. 2001) . If brokers or salespersons made fraudulent misrepresentations in their capacity as real estate professionals, they would be liable for such misrepresentations apart from any conduct of sellers. The brokers' or salespersons' liability would not be foreclosed by a dismissal of the case against the sellers.

Newbern v. Mansbach, 777 So. 2d 1044 (Fla. Dist. Ct. App. 2001) . The fact that sale property was located in designated flood plane, which was matter of public record and therefore could have been ascertained by purchaser, did not operate as matter of law to bar negligent and fraudulent misrepresentation claim against seller's broker who allegedly had misrepresented property's flood plane status.

Georgia

Akins v. Couch, 271 Ga. 276, 518 S.E.2d 674 (Ga. 1999) , reconsideration denied. The seller and seller's agent knew of septic problems due to inspection and communication from the health department. Despite this knowledge, the seller's property disclosure statement indicated no knowledge of septic problems. The question of whether the buyers exercised reasonable diligence in inspecting problem was a jury question. A jury could find that a buyer exercised due diligence even though they did not hire an inspector. Additionally, the location of information in public records did not necessarily defeat a claim of passive concealment. Summary judgment for the agent was improper.

Resnick v. Meybohm Realty, Inc., 269 Ga. App. 486, 604 S.E.2d 536 (Ga. Ct. App. 2004) , cert. denied, 2005 Ga. LEXIS 76 (Ga. Jan. 10, 2005) . The merger clause barred the buyer's "breach of professional duty" claim stemming from alleged misrepresentations made by the buyer's agent and the seller's agent. To succeed on this claim, the buyer had to prove that the purported misstatements proximately caused her injury. The buyer cannot do so without showing that she relied on the misrepresentations. The merger clause in the sales contract prevented such a showing. A buyer's broker has a duty to disclose to the buyer adverse material facts of which the broker has actual knowledge concerning the transaction. But a broker owes no fiduciary duty to a client. Instead, the broker is responsible for exercising reasonable

care in the discharge of the broker's specified duties.

Gibson v. Rezvanpour, 268 Ga. App. 377, 601 S.E.2d 848, (Ga. Ct. App. 2004) , cert denied, 2004 Ga. LEXIS 904 (Ga. Oct. 12, 2004) . Potential buyer was bitten by the seller's dog when viewing the home. The potential buyer sued the sellers and the agents. With respect to the agents, the court stated that there is no evidence that the agents and brokers knew or should have known that the dogs were vicious or dangerous.

Browning v. Stocks, 265 Ga. App. 803, 595 S.E.2d 642 (Ga. Ct. App. 2004) . A damage award to the buyers was affirmed. The buyers claimed that seller fraudulently induced them to buy a house by making false representations about the house's condition and by actively and passively concealing termite damage. The trial court did not err in denying a motion in limine to exclude the seller's property disclosure statement as it was relevant to the claim that seller fraudulently induced the sale by actively concealing the damage. The trial court did not err by excluding evidence of settlements the buyers obtained against the home inspector and the pest control company, as the buyers' suit was not based on a claim that they relied on the seller's representations.

Ikola v. Schoene, 264 Ga. App. 338, 590 S.E.2d 750 (Ga. Ct. App. 2003) . An agent intentionally withheld the seller disclosure statement from a homebuyer and tried to force the homebuyer to proceed with an "as is" sale. A jury could find from this evidence that agent acted adversely to the homebuyer's interests and thereby breached the duty to promote the homebuyer's interests. Summary judgment for the agent on the breach of contract claim was reversed. Summary judgment for the agent on fraudulent concealment claim was affirmed as the evidence showed that agent disclosed what she knew about a leakage problem.

Savage v. KGE Assocs., L.P., 260 Ga. App. 770, 580 S.E.2d 591 (Ga. Ct. App. 2003) , reconsideration denied, cert. applied for. The buyer characterized the seller's affidavit as representing that the property contained no garbage. After the sale, the buyer discovered a dump and sued. The trial court erred in applying the doctrine of passive concealment as the doctrine did not apply to commercial transactions. The summary judgment evidence did not show any actionable misrepresentations. The affidavit was not part of sales agreement. The affidavit was not intended to directly benefit the buyer. The affidavit did not survive closing under the sales agreement's survival clause. The seller was not a third party beneficiary of the affidavit, and the buyer's reliance was unreasonable since the buyer knew, before the sale, that the property contained garbage.

Smiley v. S & J Investments, Inc., 260 Ga. App. 493, 580 S.E.2d 283 (Ga. Ct. App. 2003) , cert. denied, 2003 Ga. LEXIS 644 (Ga., July 14, 2003) . When negligent misrepresentations are made by a third party which induced buyers to purchase home, buyers can sue the seller for the resulting damages under the contract where such misrepresentations become part of the contract. Jury issue arises where there is evidence that the contract incorporated the disclosure statement containing false statements as to the property's condition and gives rise to contract remedies either for breach or rescission, since representations were made within the four corners of the contract. The merger clause did not prevent buyers from claiming reliance to their detriment.

Ainsworth v. Perreault, 254 Ga. App. 470, 563 S.E.2d 135 (Ga. Ct. App. 2002) , cert. denied, 2002 Ga. LEXIS 783 (Ga. Sept. 6, 2002) . The contract did not provide that the disclosure statement or other statements outside of the contract had been made part of agreement. Reliance upon the sellers' oral statements and the disclosure statement was barred by merger clause. The law also did not require that sellers disclose every past repair made to their homes. The sellers were obligated to inform potential buyers of current defects of which they were aware.

Salinas v. Skelton, 249 Ga. App. 217, 547 S.E.2d 289 (Ga. Ct. App. 2001) , cert. denied, 2001 Ga. LEXIS 697 (Ga. Sept. 7, 2001) and 2001 Ga. LEXIS 698 (Ga. Sept. 7, 2001) . The buyer's failure to read disclosure statement until after she learned of asbestos around an enclosed boiler was without consequence even though the statement provided the buyer with constructive notice that the boiler was behind a basement wall on her property. The court could not say as a matter of law that further inquiry by the buyer would have informed her that the boiler was insulated with asbestos. The

court also found the summary judgment in favor of the seller's agent was proper since the representations on the disclosure statement were made by the seller.

Keller v. Henderson, 248 Ga. App. 526, 545 S.E.2d 705 (Ga. Ct. App. 2001) . A representation on the seller disclosure statement regarding the source of a basement leak was contradicted by testimony of neighbors. Summary judgment for the seller was improper.

ReMax North Atlanta v. Clark, 244 Ga. App. 890, 537 S.E.2d 138 (Ga. Ct. App. 2000) . An agent and broker were not liable for written misrepresentations in the disclosure statement. This form stated that the representations it contained were those of the seller. The agent's verbal statements were not actionable because they were general statements of opinion. Furthermore the contract's merger clause and disclaimer stated that the buyer had not relied upon the agent's representations. The buyer was estopped from asserting reliance on the agent's alleged misrepresentations not contained in the contract.

Hoffman v. Fletcher, 244 Ga. App. 506, 535 S.E.2d 849 (Ga. Ct. App. 2000) . The buyer received notice of a prior drainage problem and prior repairs. It was not necessary for the sellers to detail in their disclosure statement all the prior problems where it appeared that the problems had been repaired. Summary judgment in favor of sellers on the fraud claim was proper.

Paden v. Murray, 240 Ga. App. 487, 523 S.E.2d 75 (Ga. Ct. App. 1999) , cert. denied, 2000 Ga. LEXIS 186 (Ga. Feb. 25, 2000) , overruled in part by *Browning v. Stocking*, 265 Ga. App. 803, 595 S.E.2d 642 (*Paden v. Murray* overruled to the extent that it held that a fraud claim was precluded where the buyers affirmed the sales contract). The sellers' disclosure with regard to the past and present condition of the home's roof was inaccurate. A jury must determine whether the leaks about which the buyer now complains were the same ones of which the sellers were aware when they lived in the home. The buyers' breach of contract claim in this regard was not subject to summary judgment.

Hawaii

Create 21 Chuo, Inc. v. Southwest Slopes, Inc., 81 Haw. 512, 918 P.2d 1168 (Haw. Ct. App. 1996) . Recorded easements and archaeological sites on the land were material breaches of the seller's promise to convey marketable title pursuant to the contract. The seller did not disclose the archaeological sites on its seller's real property disclosure statement.

Idaho

White v. Mock, 140 Idaho 882, 104 P.3d 356 (Idaho 2004) . Stigma damages are not available under *Idaho Code* §§ 55-2801 and 55-2802 for non-toxic mold found in a property.

Lindberg v. Roseth, 137 Idaho 222, 46 P.3d 518 (Idaho 2002) . The buyers alleged that the statements in the property disclosure forms misrepresented the house's condition. Assuming the buyers were correct, i.e. had truthful representations been made in the disclosure forms, the buyers would have had the statutory right to rescind the real estate contract. Therefore, the district judge erred in holding there could be no reliance because the alleged misrepresentations were made in the property disclosure forms delivered after the execution of the real estate contract.

Enright v. Jonassen, 129 Idaho 694, 931 P.2d 1212 (Idaho 1997) . A broker and agent acting as the listing and selling agent, breached their fiduciary duty to the buyers to discover and disclose the existence of a floodplain district on the property.

Illinois

Skarin Custom Homes, Inc. v. Ross, 388 Ill. App. 3d 739, 329 Ill. Dec. 156, 906 N.E.2d 1 (2009) . The Illinois Residential Real Property Disclosure Act lists nine exceptions to its applicability. A buyer's intent to tear down a residential structure and rebuild on the property is not listed as an exemption.

Grady v. Sikorski, 349 Ill. App. 3d 774, 285 Ill. Dec. 637, 812 N.E.2d 457 (Ill. App. Ct. 2004) . The Residential Real Property Disclosure Act (765 ILCS 77/1 *et seq.*) does not require that a residential real estate disclosure form be completed for the sale of property that includes an uninhabitable structure.

CNA Ins. Co. v. DiPaulo, 342 Ill. App. 3d 440, 276 Ill. Dec. 715, 794 N.E.2d 965 (Ill. App. Ct. 2003) . Sellers have a duty to disclose defects which could not be discovered on a reasonable and diligent inspection. While seller's silence in not disclosing defects, by itself, is insufficient for a fraud action, there is enough when silence is combined with active concealment. A fraud claim may be based solely on a seller's false representation made in a disclosure report pursuant to the Residential Real Property Disclosure Act (765 ILCS 77/20). Homeowners' insurer, as subrogee, was the plaintiff.

Griffin v. Bruner, 341 Ill. App. 3d 321, 276 Ill. Dec. 215, 793 N.E.2d 974 (Ill. App. Ct. 2003) . The duty under the Residential Lead-Based Paint Hazard Reduction Act of 1992 (42 U.S.C. § 4852d(a)(4)) to disclose lead paint hazards applied to seller's agent and did not apply to buyer's agent.

Capiccioni v. Brennan Naperville, Inc., 339 Ill. App. 3d 927, 274 Ill. Dec. 461, 791 N.E.2d 553 (Ill. App. Ct. 2003) (Ill. App. Ct. April 15, 2003), rehearing denied 2003 Ill. App. LEXIS 941 (Ill. App. Ct. July 16, 2003) . The broker stated that the home was in a certain school district. The court held that the buyers did not plead common-law fraud by showing the broker and agent knew this was false. The real estate licensee exception to the Consumer Fraud and Deceptive Business Practices Act at 815 ILCS 505/10b(4) only related to information from a seller. The buyers adequately pled consumer fraud. The buyers also adequately pled negligent misrepresentation. Buyers also pled a violation of 225 ILCS 454/15-25(a) of the Real Estate License Act of 2000, as a licensee's duty to refrain from false information was not limited to information about the property's physical condition.

Penn v. Gerig, 334 Ill. App. 3d 345, 268 Ill. Dec. 339, 778 N.E.2d 325 (Ill. App. Ct. 2002) . The sellers' real property disclosure report disclosed foundation problems. Over a year after taking possession, the buyers sued the sellers alleging foundation defects. The buyers argued that the discovery rule tolled the running of the one-year limitations period until they knew or reasonably should have known of their injury. In an issue of first impression, the court held that the discovery rule did not apply to the Act. As to the award of attorney fees, the trial court never lost jurisdiction over the sellers' motion for sanctions, even though it was filed after the buyers filed their notice of appeal. The trial court did not abuse its discretion in imposing sanctions under Ill. Sup. Ct. R. 137.

Hogan v. Adams, 333 Ill. App. 3d 141, 266 Ill. Dec. 655, 775 N.E.2d 217 (Ill. App. Ct. 2002) , appeal denied, 202 Ill. 2d 602, 272 Ill. Dec. 341, 787 N.E.2d 156 (2002) . The sellers' disclosure report revealed that part of the house had flooded once. In fact, the lower level had been flooded twice, and the extent of the flooding was not fully disclosed. The sellers claimed that, based in part on advice from a real estate agent, they had met their disclosure obligations. The court held that under the Act, a plaintiff did not need to prove that the defendant actively concealed the material defect. The Act required the sellers to disclose known defects and imposed liability for failure to do so. The Act did not require that a purchaser further investigate a disclosure. The court also found that the trial court erred in considering the buyers' failure to further investigate the disclosure in determining liability under the Act.

Coughlin v. Gustafson, 332 Ill. App. 3d 406, 265 Ill. Dec. 493, 772 N.E.2d 864 (Ill. App. Ct. 2002) . The merger doctrine is not a bar to actions under the Disclosure Act.

Rolando v. Pence, 331 Ill. App. 3d 40, 264 Ill. Dec. 271, 769 N.E.2d 1108 (Ill. App. Ct. 2002) . The Residential Real Property Disclosure Act Section 45 allows buyers to seek recovery for fraudulent misrepresentation based solely on a disclosure made pursuant to the Act.

Curtis Inv. Firm, Ltd. v. Schuch, 321 Ill. App. 3d 197, 254 Ill. Dec. 185, 746 N.E.2d 1233 (Ill. App. Ct. 2001) . A buyer cannot waive the seller's responsibility to disclose certain defects by signing a contract without receipt of a written disclosure statement.

Denault v. Cote, 319 Ill. App. 3d 886, 254 Ill. Dec. 8, 746 N.E.2d 765 (Ill. App. Ct. 2001) , appeal denied, 196 Ill. 2d 539, 261 Ill. Dec. 347, 763 N.E.2d 317 (2001) . Buyers sued sellers claiming they violated the Illinois Residential Real Property Disclosure Act. The trial court dismissed the action as untimely and when the buyers filed a second action based on fraud in the same real estate transaction as the first case, the court dismissed the second action on the basis of res judicata. The appellate court affirmed.

Provenzale v. Forister, 318 Ill. App. 3d 869, 252 Ill. Dec. 808, 743 N.E.2d 676 (Ill. App. Ct. 2001) . An allegation of an actual transfer of real property is not required to state a cause of action for violation of the Residential Real Property Disclosure Act. This Act provides both prospective and actual buyers with remedies for violation of its provisions.

King v. Ashbrook, 313 Ill. App. 3d 1040, 247 Ill. Dec. 566, 732 N.E.2d 621 (Ill. App. Ct. 2000) , rehearing denied. The seller's residential real property disclosure report disclosed defects, but a sales contract addendum indicated that some defects had been repaired by the seller. The buyers subsequently sued the seller based on the seller's failure to repair. The buyers did not allege that the seller failed to disclose material defects as required by the Residential Real Property Disclosure Act. The fact the disclosure report became part of the contract did not eliminate the buyers' right to sue for a breach of contract or change the statute of limitations for breach of contract since the Act did not limit or change a purchaser's common-law remedies. The Act contains a one-year statute of limitations versus a ten-year period for breach of contract actions. The buyers' action was brought within the appropriate statute of limitations.

Miller v. Bizzell, 311 Ill. App. 3d 971, 244 Ill. Dec. 579, 726 N.E.2d 175 (Ill. App. Ct. 2000) . Section 55 of the Disclosure Act states, "the court may award reasonable attorney fees." The award of such fees is not mandatory, it lies within the discretion of the trial court, and that court's decision will not be overturned absent an abuse of discretion. A trial court, exercising its discretion on whether to award attorney fees under the Disclosure Act, should consider factors consistent with Rule 137.

Carrera v. Smith, 305 Ill. App. 3d 1079, 239 Ill. Dec. 432, 713 N.E.2d 1282 (Ill. App. Ct. 1999) . An individual selling his or her home is not liable to a purchaser under Consumer Fraud Act.

Hirsch v. Feuer, 299 Ill. App. 3d 1076, 234 Ill. Dec. 99, 702 N.E.2d 265 (Ill. App. Ct. 1998) . In the context of § 2-615 of the Code of Civil Procedure, the court discussed the pleading requirements of an allegation that sellers had violated the Residential Real Property Disclosure Act (765 ILCS 77/1 et seq.).

Indiana

Reum v. Mercer, 817 N.E.2d 1267 (Ind. Ct. App. 2004) . A seller is only required to disclose existing defects of which the seller has actual knowledge at the time of the disclosure.

Coffman v. Rohrman, 811 N.E.2d 868 (Ind. Ct. App. 2004) . With respect to land offered for sale, the agent knew about a mutual easement agreement with neighbors to share the cost of building a road to their properties, but the agent did not tell the buyer, who bought the land. The court found that the agent had a duty, under Ind. Code § 25-34.1-10-11(3)(C), to tell the buyer actually known adverse material facts, and, as the buyer said he would have reduced his purchase price by his share of the road costs, those costs were material.

Kashman v. Haas, 766 N.E.2d 417 (Ind. Ct. App. 2002) . In the statutory disclosure form, the sellers stated the home had no existing termite damage. Before the sale, the buyers had the home professionally inspected, and the inspector

found no termite damage. After closing the buyers discovered termite damage and sued the sellers. Summary judgment was properly entered for the sellers, as there was no evidence that the sellers had actual knowledge of any existing termite damage to the home when they completed the disclosure form and sold the home.

In re Flint, 720 N.E.2d 1230 (Ind. Ct. App. 1999) . The buyer sued the seller for fraudulent misrepresentation based on the Seller's Residential Real Estate Disclosure Statement. The court upheld a small claims court judgment obtained by the buyer against the seller.

Iowa

Jensen v. Sattler, 696 N.W.2d 582 (Iowa 2005) , rehearing overruled, 2005 Iowa Sup. LEXIS 79 (Iowa, June 1, 2005) . Under the Iowa Real Estate Disclosure Act the buyer had to show only that the seller had actual knowledge of an undisclosed defect or failed to use ordinary care in obtaining the information. It overruled *Sedgwick v. Bowers*, 681 N.W.2d 607 (Iowa 2004) , to the extent it held to the contrary. The seller who did not sign the disclosure form was liable under the Act if she had actual knowledge of the undisclosed defects or failed to exercise ordinary care in obtaining the information.

Sedgwick v. Bowers, 681 N.W.2d 607 (Iowa 2004) , overruled in part by, *Jensen v. Sattler*, 2005 Iowa Sup. LEXIS 55, at *14 (Iowa Apr. 29, 2005) (on other grounds). Under the Real Estate Disclosure Act, the transferor, or a broker or salesperson, shall not be liable for the error, inaccuracy, or omission in information required in a disclosure statement, unless that person has actual knowledge of the inaccuracy, or fails to exercise ordinary care in obtaining the information. No evidence was introduced to establish that the broker (a relocation facilitator) had any actual knowledge of the inaccuracies in the disclosure statements and there was no evidence that the broker failed to exercise ordinary care in obtaining the information. The court rejected the buyers' argument that the broker, in effect, adopted the false statements as part of their agreement with sellers.

Bramwell v. Tisue, 2002 Iowa App. LEXIS 352 (Iowa Ct. App. March 27, 2002) . The disclosure statement indicated no problems with the home's three fireplaces. When the buyers had problems with the fireplaces, the professional who cleaned them noted that the house was "too tight" for the fireplaces to work properly and that outside air might be needed. When the buyers communicated with the sellers, the sellers suggested cracking a window for air intake. The buyers were discontent, installed gas inserts, and sued the sellers for failing to disclose a "material defect" in the house prior to the sale, namely that the fireplaces did not work properly. The court affirmed the trial court's award of compensatory damages of \$8,250 and attorneys fees of \$3,018 finding that there was a material defect which the sellers failed to disclose on the form required by Chapter 558A.

Ashenberg v. O'Rourke, 2000 Iowa App. LEXIS 43 (Iowa Ct. App. Nov. 8, 2000) . This dispute involved the location of a property line. The buyers alleged they were misled by the seller's placement of sod on an adjoining lot. The sellers' disclosure statement did not indicate any features shared in common with adjoining landowners. The court found that the sellers had no duty to disclose since there was no inequality of knowledge. The buyers received a plat map containing an accurate depiction of the line in dispute. The buyers were not inexperienced people. There was no evidence to support a conclusion that the sellers had superior knowledge.

Kansas

Alires v. McGehee, 277 Kan. 398, 85 P.3d 1191 (Kan. 2004) . The buyers sued the sellers claiming fraudulent misrepresentation after the home's basement leaked. The sellers' property disclosure statement had disclosed only a leak due to a broken pipe which had been repaired. Though the record revealed substantial competent evidence to support the trial court's findings that one seller knowingly made untrue factual statements, pursuant to the sales contract, the buyers not only contractually assumed a duty to inspect the property and failed to have the property inspected, the buyers also agreed that if they failed to have inspections performed, they waived "any claim, right or cause of action relating to or

arising from any condition of the property that would have been apparent had inspections been performed." To prove their case, it was incumbent upon buyers to provide evidence that, even if an inspection had been performed, the basement water leaks would not have been apparent. Buyers provided no such evidence. Under cross-examination, one buyer admitted that if an inspection had been done, a determination about the basement's condition could have been made before closing. The court also found that the buyers' reliance upon the sellers' representations was not reasonable when the truth or falsity of the representation would have been revealed by a property inspection. The misrepresentations were made prior to or as part of the contract in which the buyers contracted for the inspection right, agreed that the sellers' statements were not warranties and should not replace the inspection right, declined inspection, and waived any claims arising from defects that would have been revealed by an inspection. There was no showing in the record that a subsequent contract addendum which contained the waiver of the inspection right was induced by any additional seller misrepresentations.

Stechschulte v. Jennings, 222 P.3d 507, 2010 Kan. App. LEXIS 6 (2010) The seller's disclosure statement contained a representation by the seller that he was disclosing "all material defects, conditions and facts of which seller is aware which may materially affect the value of the Property." If the seller knew of information regarding material defects, conditions, or facts which might materially affect the value of the home and he failed to disclose any or all of that information, the disclosure statement contained affirmative misrepresentations.

Osterhaus v. Toth, 39 Kan. App. 2d 999, 187 P.3d 126 (2008) , review granted, 2008 Kan. LEXIS 603 (Nov. 4, 2008) . Releasing the seller from any liability because the buyer signed the buyer's acknowledgment and agreement is too simplistic. The trial court must consider the disclosure statement, whether there was an inspection, and all of the facts surrounding the sale before concluding there was a waiver of the seller's untruths. A seller has an affirmative duty to be honest on the disclosure statement. When a seller is untruthful about material facts in the disclosure statement, the material fact is not discoverable in a reasonable inspection, and the seller does not correct the untruth before closing, the buyer's signature on the disclosure statement does not constitute a waiver of the seller's untruths.

McLellan v. Raines, 36 Kan. App. 2d 1, 140 P.3d 1034 (2006) . The buyer could not reasonably rely upon the seller's representations when the truth or falsity of the representation would have been revealed by an inspection of the subject property and the misrepresentations were made prior to or as part of the contract in which the buyer contracted for the right to inspect, agreed that the statements of the seller were not warranties and should not replace the right of inspection, declined inspection, and waived any claims arising from defects which would have been revealed by an inspection.

Katzenmeier v. Oppenlander, 39 Kan. App. 2d 259, 178 P.3d 66 (2008) , review denied, 2008 Kan. LEXIS 377 (Kan. July 3, 2008) Kansas courts have adopted a "buyer beware" standard regarding sellers' disclosures. A buyer cannot reasonably rely on seller's representations when the truth or falsity of the representations would have been discovered by a property inspection and the misrepresentations were made before or as part of the contract in which the buyer contracted for the right to inspect, agreed that the statements of the seller were not warranties, and acknowledged that the seller's disclosure statement was not a substitute for any inspection that the buyer may have wished to obtain.

Phillips v. Tyler, 35 Kan. App. 2d 256, 129 P.3d 656 (2006) , review denied, 281 Kan. 1378 (2006) . The buyers sued the sellers alleging negligent misrepresentation because of the defects caused by water infiltration that the buyers discovered in the house. The court found that the trial court should have granted summary judgment to the sellers because three provisions from the parties' agreement, when read together, shielded the sellers from a negligent misrepresentation claim. First, the buyers agreed that they were relying only on their own judgment and on their own inspections of the house. Second, the buyers accepted the property without any express or implied warranties by the sellers. Third, the buyers stated they were relying on no representations made by the sellers in order to make the purchase. The contractual provisions were not against public policy and were enforceable.

White v. J.D. Reece Co., 29 Kan. App. 2d 226, 26 P.3d 701 (Kan. Ct. App. 2001) . When an agent purposely injects

himself or herself into the independent investigation of the property to the buyer's detriment, the broker and its agent cannot rely on the seller's disclosure statement to shield themselves from liability.

Hamtil v. J.C. Nichols Real Estate, 22 Kan. App. 2d 809, 923 P.2d 513 (Kan. Ct. App. 1996) . The court concluded that brokers may protect themselves from negligent misrepresentation actions by disclaiming knowledge of property's defects and having the buyer or seller acknowledge such disclaimer.

Lynn v. Taylor, 7 Kan. App. 2d 369, 642 P.2d 131 (Kan. Ct. App. 1982) . The court upheld award of punitive damages against a broker who concealed an unfavorable termite inspection report from the buyer.

Kentucky

McLellan v. Yeager, 2003 Ky. App. LEXIS 38 (Ky. Ct. App. Feb. 14, 2003) , aff'd, 177 S.W.3d 807 (Ky. 2005) . The Seller's Disclosure of Property Condition form disclosed that their basement had leaked, and that it had not been repaired, but the sellers' answer suggested that it had only leaked twice in 20 years. After taking possession, the buyer discovered that it leaked constantly. Even though 201 Ky. Admin. Reg. 11:350 , § 2 specified that the mandatory disclosures were not warranties, there was nothing illegal in the parties' incorporating the disclosures into the contract of sale, at which point the disclosures became warranties. Summary judgment in favor of the sellers was therefore improper, but this did not mean that summary judgment should have been granted in favor of the buyer, since there remained a triable issue as to whether the sellers had lied in their disclosures.

Louisiana

Chumley v. Magee, 33 So. 3d, 345, 349 (La. App. 2 Cir. 2010) The buyers signed a Realtors(R) disclosure which provided that agents "are not the guarantors of performance, condition of property, or representations made by others" and that agents have "no responsibility or expertise to determine or advise whether the property is within the flood plain or as to physical condition of the property." The agent accurately disclosed the information she had received from the sellers, that sometime after 1998 their lender advised them the property no longer required flood insurance. By contract, the agent was not required to research the flood zones and, in general, was not required to speculate on potential zoning changes.

Laborde v. Dastugue, 868 So. 2d 228 (La. Ct. App. 2004) , rehearing denied, La. App. 2003-1491, 2004 La. App. LEXIS 617 (La. App. 4 Cir. Mar. 16, 2004) , writ denied, 876 So. 2d 84 (La. 2004) . The buyers of an option to purchase property received inspection results indicating that the lot and the house were smaller than the dimensions stated in a sales brochure and that the roof was in poor condition. The sales brochure contained express disclaimers as to representations. The buyers could have ascertained the size and condition of the property before paying the option price, buyers could not prove fraud or unjust enrichment.

Hughes v. Goodreau, 836 So. 2d 649 (La. Ct. App. 2002) , writ denied, 841 So. 2d 793 (La. 2003) . The sellers' agent was liable to sellers for failing to attach documents to the disclosure addendum form, this was a breach of the agent's and the broker's fiduciary duty to their client.

Billups v. Lyons, 821 So. 2d 499 (La. Ct. App. 2002) , writ denied, 827 So. 2d 424 (La. 2002) . The property disclosure form stated that the townhouse did not have any wood destroying insects. Shortly after closing the buyer discovered termites. The court stated that the sellers were in bad faith in reporting that there were no termites on the disclosure prepared by their broker; however, at the act of sale, the buyer relied on the inspection company's report.

Frey v. Walker, 807 So. 2d 887 (La. Ct. App. 2001) , writ of error denied, 813 So. 2d 1082 (2002) . The disclosure was inadequate to describe defects with foundation. The sellers concealment of defects was sufficient to vitiate the waiver of redhibition made by the buyers.

Agee v. Speers, 803 So. 2d 406 (La. Ct. App. 2001) . The sellers did not disclose flooding problems, water damage and termite damage on the property disclosure form and they attempted to hide the problems with paneling. The sellers personally built the roof with substandard lumber and knew of the flooding problems and signed a statement that deliberately downplayed the condition. The court's finding of bad faith was not manifest error.

Merlin v. Fuselier Construction, Inc., 789 So. 2d 710 (La. Ct. App. 2001) . The buyer can recover attorney fees by proving that the seller knew of the defect prior to the sale. The buyer need not prove willful misrepresentation; it is sufficient if the buyer shows actual or constructive knowledge by the seller.

McMorris v. Marcotte Builders, L.L.C., 756 So. 2d 424 (La. Ct. App. 1999) , writ of error denied, 760 So. 2d 1158 (La. 2000) . A seller's failure to disclose the existence of a drainage servitude entitled buyers to rescind the sale of a residential lot.

Watkins v. Evans, 716 So. 2d 399 (La. Ct. App. 1998) , review denied, 723 So. 2d 423 (La. 1998) . The date of discovery triggered the prescriptive period regarding an agent's liability in connection with a redhibitory action.

Moses v. Walker, 715 So. 2d 596 (La. Ct. App. 1998) . A disclosure which stated, "Property has a man made ditch across the backyard. Property was purchased from H.U.D. in that condition. Seller does not know or warrant of flood condition. Buyer so acknowledges this drainage ditch.", did not notify buyer that she was waiving her rights to allege that she was not informed that the house was flood-prone.

Ditcharo v. Stepanek, 538 So. 2d 309 (La. Ct. App. 1989) , cert. denied, 541 So. 2d 858 (1989) . The brokers were liable to buyers for failing to disclose termite infestation where brokers knew of the infestation and had a legal duty to disclose such to the buyers.

Reeves v. Weber, 509 So. 2d 158 (La. Ct. App. 1987) . A broker owes duty to disclose to buyer any material defects of which he is aware.

Josephs v. Austin, 420 So. 2d 1181 (La. Ct. App. 1982) , cert. denied, 427 So. 2d 870 (La. 1983) . A broker's failure to disclose house's cracked foundation constituted breach of broker's duty to disclose accurate information to purchasers. The broker could be held liable for negligent misrepresentation.

De Soto v. Ellis, 393 So. 2d 847 (La. Ct. App. 1981) . A broker has duty to disclose to prospective purchaser existence of material defect, salesperson not negligent in failing to disclose unstable house foundation where salesperson reasonably believed the defect had been repaired.

Maine

Kezer v. Mark Stimson Assocs., 1999 Me. 184, 742 A.2d 898, 902 (Me. 1999) . A disclosure statute does not require disclosure of environmental hazards in the neighborhood. The court declined to find a common law duty to disclose environmental hazards in the neighborhood.

Binette v. Dyer Library Association, 688 A.2d 898 (Me. 1996) . Pursuant to *Me. Rev. Stat. Ann. tit. 38, § 563(6)*, the owner of real estate on which an underground oil tank is located must file written notice of the existence of the tank prior to the sale or transfer of that real estate. This provision does not limit disclosure to sellers who know of an underground storage tank on their property. The statute's disclosure requirement, rather, is absolute. This section mandates that when an underground oil tank exists on property for sale the seller of that property may not remain silent. The seller's failure to disclose the tank was evidence of a breach by the seller of a duty, of reasonable care owed to the buyers, and can be considered by a factfinder along with other evidence relevant to the "reasonable care" element of the

tort of misrepresentation. With respect to the broker involved in the sale, the court held that the real estate regulations created a duty to disclose defects of which the broker knew or should have known. A jury should decide whether the broker exercised reasonable care in light of the regulatory requirement.

Maryland

Auction & Estate Representatives Inc. v. Ashton, 354 Md. 333, 731 A.2d 441 (Md. 1999) . An auctioneer was required by the auction contract to provide the standardized disclosure or disclaimer form to the purchaser at an auction of residential real estate. This obligation arose not because an auctioneer of real property was required by statute to do so, but because the auctioneer contracted specifically with the seller and assumed her obligation as seller to provide all forms necessary to effectuate a sale of the property.

Romm v. Flax, 340 Md. 690, 668 A.2d 1 (Md. 1995) . Md. Code Ann., Real Prop. § 10-702(g)(1) states: "If the disclosure statement is delivered by the Seller later than three (3) days after the Seller enters into a contract of sale with the Purchaser, the contract is void." The word "void" in this provision means voidable at the purchaser's option.

Merritt v. Craig, 130 Md. App. 350, 746 A.2d 923 (Md. Ct. Spec. App. 2002) , cert. denied, 359 Md. 29, 753 A.2d 2 (Md. 2000) . A seller's conduct in willfully misrepresenting the condition of the water system in the Disclosure Statement, coupled with her actions and those of her husband in interfering and diverting the water flow subsequent to the inspection and sale of the property, constituted egregious conduct sufficient to support the jury award of \$150,000 in punitive damages.

Lopata v. Miller, 122 Md. App. 76, 712 A.2d. 24, 32-33 (Md. Ct. Spec. App. 1998) cert. denied, 351 Md. 286, 718 A.2d 234 (Md. 1998) . A lot was represented as being 3 acres when it was only 1.87 acres. The broker and agent owed no duty to purchasers to verify the seller's representation as to lot size.

Massachusetts

Urman v. South Boston Savings Bank, 424 Mass. 165, 674 N.E.2d 1078 (Mass. 1997) . As a matter of law, a seller--a bank that had acquired the property at foreclosure--was not liable under Mass. G. L. c. 93A for the failure to disclose to the buyers the contamination-related closing of a nearby school. The seller owed the buyers no common law duty to disclose the minimum amount of information it knew about toxic waste contamination that existed on a nearby property. As a matter of law, the seller was not liable for fraud or misrepresentation.

Mongeau v. Boutelle, 10 Mass. App. Ct. 246, 407 N.E.2d 352 (1980) . The broker failed to inform the buyers that the property was encumbered by a right of way. The court found that under the Consumer Protection Act, the failure to disclose any material fact which may influence the buyer is actionable.

Michigan

Bergen v. Baker, 264 Mich. App. 376, 691 N.W.2d 770 (2004) . A party's reliance on a misrepresentation in fraud actions must be reasonable. There was a genuine issue of material fact with respect to whether the seller disclosure statement contained a misrepresentation, error, inaccuracy, or omission, and whether the sellers had or should have had personal knowledge of that. The statement on the form that the roof leaked was not in and of itself a misrepresentation. It was for the jury to resolve the issue of how to interpret the disclosure statement. A reasonable fact finder could have inferred that the sellers knew about the leak yet proceeded in bad faith by failing to fully disclose the condition.

M&D, Inc. v. McConkey, 231 Mich. App. 22, 585 N.W.2d 33 (Mich. Ct. App. 1998) , appeal denied, 459 Mich. 962, 590 N.W.2d 576 (Mich. 1999) . In a sale of commercial property the buyers did not establish elements of silent fraud. There was no evidence of a legal or equitable duty on the seller's behalf to disclose the property's flooding history. The sales

documents contained an "as is" clause and other statements specifically disclaimed the seller representations and warranties about the condition of the property. Furthermore, the seller refused to prepare a seller's disclosure statement and made this refusal a part of the purchase agreement.

McMullen v. Joldersma, 174 Mich. App. 207, 435 N.W.2d 428 (Mich. Ct. App. 1988) . The seller's agents had no duty to disclose to purchasers pending plan of State to construct highway bypass which would divert traffic away from the store where agents were not party to the underlying business transaction.

Minnesota

Rose Revocable Trust v. Eppich, 640 N.W.2d 601 (Minn. 2002) . The parties' agreement subject disputes to arbitration and provided that an arbitration request had to be filed within 18 months of the closing date. Two years after closing, the buyers sued alleging that the seller was aware of the home's defects at the time of the sale and failed to properly disclose them. The court held that the 18-month limitations period contained in the arbitration agreement, measured from the date of closing, was unreasonable as applied to a claim of fraud where undisclosed water problems resulted in structural damage that was not readily apparent to the buyers.

JEM Acres, LLC v. Bruno, 764 N.W.2d 77 (Minn. Ct. App. 2009) . A seller, who represents to a buyer that a septic system complies with applicable laws and rules governing sewage-treatment systems, but who has reason to know that these representations are false, is not shielded from liability under *Minn. Stat. § 115.55, subd. 6* based on the existence of a septic-system certificate of compliance.

Berryman v. Riegert, 286 Minn. 270, 175 N.W.2d 438 (1970) . The broker had duty to investigate whether there was a problem with water seepage.

Hommerding v. Peterson, 376 N.W.2d 456 (Minn. Ct. App. 1985) . The agent not liable to purchaser for failure to inform purchaser that the water pressure was insufficient for normal family use where such information was open to discovery upon reasonable inquiry by purchaser particularly where agent had no knowledge of low water pressure.

Mississippi

Lane v. Oustalet, 850 So. 2d 1143 (Miss. Ct. App. 2002) , aff'd in part, rev'd in part, 873 So. 2d 92 (Miss. 2004) . A dual agent who called the seller with the results of a termite inspection, but failed to call the buyers breached her fiduciary duties to the buyers. Disclosure to one party, but not the other was improper. The agent owed the same treatment to both principals.

Mississippi Real Estate Comm'n v. Hennessee, 672 So. 2d 1209, 1218 (Miss. 1996) . The broker not exempt from discipline when selling broker's own property.

Powell v. Cohen Realty, Inc., 803 So. 2d 1186 (Miss. Ct. App. 1999) . There was no evidence that the buyer had any contact with the listing agent until the day of closing. The listing agent provided the buyer with the statutorily required disclosure statement. This statement had been completed by the sellers who disclosed several defects. Buyer had in her possession a copy of the disclosure statement, and she had inspected the house with her own agent. The buyer failed to sustain her burden of proof of the element of fraud and fraudulent misrepresentation. Summary judgment for listing agent, selling broker, and seller was proper.

Crane v. Hahn, 754 So. 2d 471 (Miss. Ct. App. 1999) . The buyer signed a contract with an "as is" provision, as well as, an "acceptance" provision and was bound by the mutually agreed upon contract terms and thus waived the right to maintain an action on the contract. The seller's disclosure form did not warrant the house's actual age, but rather approximated the age and the form mentioned that the house had been moved. While this statement was not included on

the disclosure form when the buyer signed it, this fact was brought to her attention at closing, and she was given an opportunity to back out of the deal which she declined. The buyer was bound by the terms of those instruments.

Missouri

McClain v. Papka, 108 S.W.3d 48 (Mo. Ct. App. 2003) . The facts did not support the buyers' reliance on sellers' representations as the buyers knew of the termite presence in a different area of the house, sellers did not engage in active concealment of a non-observable condition, sellers performed their obligation to disclose and offered to let the buyers open the wall to conduct their own investigation; trial court did not err when it found that buyers failed to establish a breach of contract action with regard to seller's failure to disclose the termite damage, nor did trial court err in finding that the sellers disclosed the water leaks where buyers knew of basement dampness and observed foundation crack.

Lowdermilk v. Vescovo Building and Realty Co., Inc., 91 S.W.3d 617 (Mo. Ct. App. 2002) . Mo. Rev. Stat. § 339.730 does not allow a private cause of action against a broker or agent for negligence per se.

Artilla Cove Resort v. Hartley, 72 S.W.3d 291 (Mo. Ct. App. 2002) . The sellers told the buyers that the resort was in excellent condition. Buyers could not examine basement, as it was full of stuff. Sellers knew the basement wall was cracked and bowed, as they constructed a cosmetic plywood wall that concealed the defects. The sales contract provided that all representations that were not set forth therein had not been made. The court found that sellers had a duty to disclose the condition, as they had superior information not reasonably available to the buyers. The sales contract did not relieve the sellers of the duty to disclose. The buyers right to rely on the representations made was not an erroneous declaration of law, nor was it an erroneous application of law.

Keefhaver v. Kimbrell, 58 S.W.3d 54 (Mo. Ct. App. 2001) . The buyer did not stand on equal footing with sellers. The buyer had a right to rely on sellers' representations. The truth regarding the condition of the roof, basement, and deck was peculiarly within the seller's knowledge.

Wasson v. Schubert, 964 S.W.2d 520 (Mo. Ct. App. 1998) . The sellers' disclosure was part of the sales contract as it was an addendum to the contract. Paragraph eight of the contract stated that the contract would not be effective "until seller completes and buyer signs the attached Statement of Condition Addendum for the property." The fact that the buyers signed the sellers' disclosure one day after the parties signed the contract meant that the contract was not effective until the date the buyers signed the sellers' disclosure. Nowhere on the sellers' disclosure did the sellers mention the crack in the basement foundation wall behind the stairs, which they admit caused leaks in the past. The sellers claimed that they did not disclose the existence of that crack because they did not believe it was material. The sellers' disclosure required the sellers to disclose all cracks that, to their knowledge, had ever existed in the foundation walls, regardless of whether the sellers believed such cracks were material. The buyers made a submissible case that answers on the disclosure statement were misleading.

Groothand v. Schlueter, 949 S.W.2d 923 (Mo. Ct. App. 1997) . The court applied the following exceptions to the general rule that a party who conducts an independent investigation cannot say he or she relied on another's representations: (1) If the party making the independent investigation makes a partial rather than a full investigation, and relies on the misrepresentations as well as the investigation, the party may maintain an action for fraud. (2) If the facts are peculiarly within the knowledge of the party making the representations, the buyer may rely on such representations if he or she does not stand on "equal footing" with the seller and the truth is difficult for the buyer to ascertain. (3) If the seller makes a distinct and specific representation, then the buyer has the right to rely on that representation, even if the parties do stand on equal footing or have equal knowledge or means of information.

Seidel v. Gordon A. Gundaker Real Estate Co. Inc., 904 S.W.2d 357 (Mo. Ct. App. 1995) . The broker and listing agent were held responsible for prospective purchaser's costs incurred in purchase attempt and costs incurred to settle lawsuit

with the sellers when the prospective purchaser refused to complete the sale. The broker and agent failed to inform the prospective purchaser of the fact that the subdivision's sewer system had not been accepted by the public sewer district. The plaintiff in this case was also a broker.

Andrews v. Missouri Real Estate Comm'n, 849 S.W.2d 241 (Mo. Ct. App. 1993) . The salesperson prepared two sales contracts--one that showed that the seller was financing the down payment and another that omitted this fact. The second contract was submitted to the lender. This conduct occurred in two different transactions. It was held that such conduct constituted substantial misrepresentations and concealment or omission of material facts.

Pilgram v. Missouri Real Estate Comm'n, 835 S.W.2d 545 (Mo. Ct. App. 1992) . The omission of material facts may be a ground for disciplining a real estate licensee, but a broker's failure to inform sellers that she signed their name on form used to build up credit in her sales record regarding membership in a sales club did not constitute a "material fact" omission which could be a ground for discipline.

Montana

Bond v. City of Philipsburg, 315 Mont. 7, 2003 MT 74, 67 P.3d 255 (Mont. 2003) . The buyers were licensed real estate agents. After the purchase, the buyers learned that water had leaked into the building's basement in the early 1980s. The buyers filed an unsuccessful complaint alleging in part that the sellers intentionally and negligently misrepresented and failed to disclose the leaks. The fact that the buyers did their own inspection and found the basement to be dry and dusty tended to show that water was not an important consideration when they purchased the property. The court held that as the buyers thought an earlier water flow was a minor event that they did not need to disclose to their bank in 1998 when refinancing the property, the buyers could not later assert that the sellers were required to disclose the leakage that occurred in the 1980s, some 10 years before they sold the property.

Strom v. Logan, 304 Mont. 176, 2001 MT 30, 18 P.3d 1024 (Mont. 2001) . When the facts constituting a claim are by their nature concealed, or where the defendant has taken action which prevents the injured party from discovering the injury or its cause, the three-year statute of limitations does not begin to run until the facts constituting the claim either were discovered or should have been discovered with due diligence. Due diligence did not require buyers to cut holes in the walls and ceilings to find fire damage concealed behind new sheetrock, and the independent investigation clause did not preclude justifiable reliance by the buyers upon the sellers' misrepresentations.

Evans v. Teakettle Realty, 226 Mont. 363, 736 P.2d 472 (Mont. 1987) . A realty company's failure to disclose to buyers the dangers and illegal location of septic tank door under trap door on floor of utility room was negligence on part of realty company as well as violation of Consumer Protection Act.

Nebraska

R.J. Miller, Inc. v. Harrington, 260 Neb. 471, 618 N.W.2d 460 (Neb. 2000) . Nebraska disclosure law which applies to residential real property applied to a mixed-use building containing a tavern on the first floor and a residential apartment on the second floor. There is no strict liability for failure to provide a disclosure statement.

Cao v. Huan Nguyen, 258 Neb. 1027, 607 N.W.2d 528 (Neb. 2000) . A buyers' reliance on the seller's statement was reasonable because the buyers were not put on notice that the home did not meet the zoning requirements as it had been rented to two families in the past, it was divided into two units, and the advertisement described the property as a duplex, as did the contract. The buyers also claimed that the sellers failed to provide them with a property disclosure statement as required by Neb. Rev. Stat. § 76-2, 120. This is a separate cause of action. This provision presupposes that the contract is to be enforced, such relief is inconsistent with seeking to rescind the contract. A party may not plead inconsistent theories of recovery, and a party pleading inconsistent theories of recovery may be required to elect between them.

Gillespie v. State Real Estate Comm'n, 172 Neb. 308, 109 N.W.2d 305 (Neb. 1961) . A broker who failed to disclose every material fact to principal is guilty of fraud and bad faith.

Kramer v. Eagle Eye Home Inspections, Inc., 14 Neb. App. 691, 2006 Neb. App. LEXIS 68 (Apr. 26, 2006) , *overruled in part by*, *Tracy Broad. Corp. v. Telemetrix, Inc.*, 17 Neb. Ct. App. 112, 756 N.W.2d 742 (2008) . The sellers indicated on the property condition disclosure statement that there had not been damage due to wood-destroying insects, but that there had been treatment for wood-destroying insects. The buyer could not show that he reasonably relied on the disclosure statement and that he suffered damage as a result, because the buyer had a termite inspection and treatment done on the home prior to closing and received a credit on the sale price for such treatment. The buyer could not show reasonable reliance on the sellers' representation because the buyer's actions negated any claim of reasonable reliance on the seller's representations.

Burgess v. Miller, 9 Neb. Ct. App. 854, 621 N.W.2d 828 (2001) . The buyer failed to show that an addendum to the disclosure by the sellers was a knowingly false statement or that the sellers had actual knowledge of any other water damage not addressed in the addendum. Since the addendum disclosed the condition of the basement to the best of the sellers' belief and knowledge, the motion for directed verdict was properly granted.

Bohm v. DMA P'ship., 8 Neb. App. 1069, 607 N.W.2d 212 (2000) . Violations of Neb. Rev. Stat. § 76-2, 120 must be done knowingly. The residential property disclosure law substantively changed the law since it places a duty on sellers to provide a written disclosure statement to a buyer whereas no specific duty to provide the written disclosure statement existed at common law. In order to hold an agent liable a buyer would need to prove that the broker had knowledge, not of the defect, but of the seller's knowledge of the defect at the time the seller made the disclosure. If there is no disclosure statement there can be no agent liability.

New Hampshire

Snierston v. Scruton, 145 N.H. 73, 761 A.2d 1046 (2000) . The court rejected the buyers' argument that *N.H. Rev. Stat. Ann. § 477:4-c* and *4-d* created private causes of action. The disclosure statutes require a seller to disclose information that would not necessarily have to be disclosed under the common law.

New Jersey

Nobrega v. Edison Glen Assocs., 167 N.J. 520, 772 A.2d 368 (2001) . The New Jersey Residential Real Estate Off-Site Conditions Disclosure Act (enacted 1995) may apply retroactively if homeowners have no remedy under The Planned Real Estate Development Full Disclosure Act.

Strawn v. Canuso, 140 N.J. 43, 657 A.2d 420 (1995) , superseded by statute as stated in *Aden v. Fortsh*, 169 N.J. 64, 776 A.2d 792 (2001) . The legislature intended the New Residential Real Estate Off-Site Conditions Disclosure Act to reverse *Strawn v. Canuso*. The builder-developer and broker were liable for nondisclosure of off-site physical conditions known to them and unknown and not readily observable by purchaser if those conditions were of sufficient materiality to affect the habitability, use, or enjoyment of the property and, therefore rendered the property substantially less desirable or valuable to objectively reasonable purchaser.

Cohen v. W.B. Associates, Inc., 380 N.J. Super. 436, 882 A.2d 456 (Law Div. 2005) . Buyers of a new residential home claimed that they were misled by the developer's representations. When they learned that the home was near a minimum security prison, they attempted to cancel the contract. The developer refused to return the buyers' deposit and asserted that its compliance with the New Residential Construction Off-Site Conditions Disclosure Act (Act), *N.J. Stat. Ann. § 46:3C-1 et seq.* , insulated it from liability. The court held that any elaboration beyond the Act's strict language rendered the Act inapplicable and the immunity unavailable to the seller. In the contract at issue, the developer added

supplemental language relating to what was later determined by the buyers to have been the prison. Therefore, the Act was inapplicable.

N.J. Ass'n of Realtors(R) v. N.J. Dep't of Env'tl. Prot., 367 N.J. Super. 154, 842 A.2d 262 (App. Div. 2004) . The Realtors(R) association challenged the adoption by the New Jersey Department of Environmental Protection, of N.J. Admin. Code tit. 7, § 26E-8.2(g)(5). This regulation made the association a required recipient of what were called deed notices, reports of conditions, or restrictions on real property due to site contamination, and appeared to make the association and its members responsible for actually contributing to municipal lists under the Act. The association argued that the regulation was void because it conflicted with the New Jersey New Residential Construction Off-Site Conditions Disclosure Act, *N.J. Stat. Ann.* §§ 46:3C-1 to-12 (Disclosure Act). The court found the challenged regulation to be void ab initio and declared that the association and its members had no obligations thereunder.

Levine v. Kramer Group, 354 N.J. Super. 397, 807 A.2d 264 (App. Div. 2002) . While the home buyers' house was being built, the developers received abusive communications from an adjoining landowner, claiming that the new house was ruining his property. As a result the developers altered the plans somewhat. After the home buyers moved in, the adjoining landowner's conduct was so abusive that he was convicted of harassment. The court held that under common law tort principles, under the New Jersey Consumer Fraud Act, and under part of the New Jersey Planned Real Estate Development Full Disclosure Act, the developers had violated no duty of disclosure owed to the home buyers.

New Mexico

Moser v. Bertram, 115 N.M. 766, 858 P.2d 854 (N.M. 1993) . An agent must reveal to principal all facts known to agent that might affect principal's decisions, rights, and interests.

Gouveia v. Citicorp Person-to-Person Fin. Ctr., Inc., 101 N.M. 572, 686 P.2d 262 (N.M. Ct. App. 1984) . A broker may be liable for negligent failure to discover and disclose defects based on its status as a fiduciary if a broker exercising reasonable care could have gained knowledge of defects. Even if the brokers had no knowledge of defects in townhouse, they were required to make a prima facie showing that they did not breach standard of care of brokers in the community.

New York

Jablonski v. Rapalje, 14 A.D.3d 484, 788 N.Y.S.2d 158, 2005 N.Y. App. Div. LEXIS 166 (2005) . New York adheres to the doctrine of caveat emptor and imposes no duty on the seller or the seller's agent to disclose any information concerning the premises when the parties deal at arms length, unless there is some conduct on the part of the seller or the seller's agent which constitutes active concealment. If however, some conduct (i.e., more than mere silence) on the part of the seller rises to the level of 'active concealment,' a seller may have a duty to disclose information concerning the property. To maintain a cause of action to recover damages for active concealment, the plaintiff must show, in effect, that the seller or the seller's agents thwarted the plaintiff's efforts to fulfill his responsibilities fixed by the doctrine of caveat emptor.

Glazer v. Lopreste, 278 A.D.2d 198, 717 N.Y.S.2d 256, 2000 N.Y. App. Div. LEXIS 12529 (2000) . A broker was not required to voluntarily disclose that neighbor across the street was a convicted sex offender. The court noted that the neighbor's status was "well chronicled" in local newspapers.

Bando v. Achenbaum, 234 A.D.2d 242, 651 N.Y.S.2d 74 (1996) , appeal dismissed in part and denied in part, 90 N.Y.2d 920, 664 N.Y.S.2d 256, 686 N.E.2d 1350 (1997) (broker had no duty to volunteer fact that the termite infestation of the house might have been greater than the purchasers anticipated, particularly where purchasers were on notice of condition prior to closing and failed to discover the severity of the problem).

North Carolina

Johnson v. Beverly-Hanks & Assoc., 328 N.C. 202, 400 S.E.2d 38 (1991) . A broker who makes fraudulent misrepresentations or who conceals a material fact when there is a duty to speak is personally liable to the purchaser even though the broker was the seller's agent.

Little v. Stogner, 162 N.C. App. 25, 592 S.E.2d 5 (2004) . The seller represented that the soil was suitable to support a septic tank system and that the existing septic tanks had been grandfathered into compliance. Buyers did not independently investigate those claims. The parties completed a standard purchase form, but provisions related to property disclosure and inspections were crossed out, and the form stated that the buyers were waiving their right to receive a disclosure statement. The buyers soon located records that called into question the seller's representations and indicated to the buyers that they could not use the property to build a home in compliance with the property's restrictive covenants. The buyers sued. The seller's motion for directed verdict on fraud was granted, while the buyers' breach of implied warranty and claims under the Residential Property Disclosure Act, N.C. Gen. Stat. § 47E-1 et seq. (Act), were dismissed. On appeal, the appellate court found that neither the fraud nor breach of warranty claims should have been dismissed, but that the trial court properly dismissed the claim for damages under the Act.

Swain v. Preston Falls East, L.L.C., 156 N.C. App. 357, 576 S.E.2d 699 (2003) , review denied, 357 N.C. 255, 583 S.E.2d 290 (2003) . The buyers purchased a townhouse finished with a synthetic stucco product. Later the buyers learned about litigation regarding homes finished with synthetic stucco due to moisture intrusion through the product and resulting structural damage. Buyers claimed they were unaware of these problems, and had they known, they would not have purchased the townhouse. But the buyers had signed a synthetic stucco disclosure and prior to closing, the buyers had received an inspection report disclosing moisture intrusion problems with the townhouse. The court found that the buyers' conduct constituted contributory negligence as a matter of law and that the trial court had properly granted summary judgment to defendants.

Everts v. Parkinson, 147 N.C. App. 315, 555 S.E.2d 667 (2001) . The buyers purchased a home finished with a synthetic stucco. Sellers failed to disclose water intrusion problems. The court stated that North Carolina has long recognized that where a material defect is known to the seller, and the seller knows that the buyer is unaware of the defect and that it is not discoverable in the exercise of the buyer's diligent attention or observation, the seller has a duty to disclose the existence of the defect to the buyer. In such cases, suppressio veri (a failure to disclose the truth) is as much fraud as suggestio falsi (an affirmative false representation). The sellers were under an affirmative duty to disclose to the buyers the existence of any known material defects in the home which were not known to plaintiffs and which were not discoverable by them in the exercise of their diligent attention or observation.

Brown v. Roth, 133 N.C. App. 52, 514 S.E.2d 294 (1999) . A dual agent relied upon an appraiser's square footage figure which overstated the square footage. The court agreed that agent's reliance on a reliable appraiser for the square footnote when that agent represents the buyer, is some evidence of that agent's compliance with the applicable standard of care, but it was not conclusive as a matter of law. North Carolina Real Estate Commission suggested that agents were expected to personally measure all properties they list and accurately calculate square footage and not rely on the representations of others. Genuine issues of material fact exist as to whether the agent exercised reasonable care in obtaining and communicating to buyer the square footage, summary judgment was not proper on the breach of fiduciary duty and negligent misrepresentation claims.

Helms v. Holland, 124 N.C. App. 629, 478 S.E.2d 513 (1996) . The purchasers did not state a claim of negligent misrepresentation against broker for failing to disclose that health department disapproved house for use as family care facility in absence of evidence of broker's knowledge of the disapproval.

Clouse v. Gordon, 115 N.C. App. 500, 445 S.E.2d 428 (1994) . A broker's duty to disclose applies to material facts known to broker.

North Dakota

Asleson v. West Branch Land Co., 311 N.W.2d 533 (N.D. 1981) . A listing agent had duty to disclose to anyone interested in the property an error in its zoning status and to correct the listing.

Ohio

Miles v. McSwegin, 58 Ohio St. 2d 97, 12 Ohio Op. 3d 108, 388 N.E.2d 1367 (1979) . A broker had a duty to disclose to buyers that property was infested with termites.

Decaestecker v. Belluardo, 2008 Ohio 2077, 2008 Ohio App. LEXIS 1776 (May 2, 2008) . Fraudulent nondisclosure involves an omission to act when the seller has a duty to act. When the buyer accepts the property in an "as is" condition, the seller is relieved of any duty to disclose. In order to relieve the seller of the common law duty to disclose the existence of latent defects of which the seller knows, the "as is" provision must be unconditional. The parties' "as is" provision was conditional and limited to patent defects. The trial court erred when it granted summary judgment on a finding that the "as is" clause relieved the sellers of a duty to disclose the existence of any latent defects known to the sellers. The duty of disclosure imposed by *Ohio Rev. Code* § 5302.30 is limited to matters within the seller's actual knowledge, and a purchaser's proof of that actual knowledge, by a preponderance of the evidence, is necessary for the purchaser to prevail on a claim of fraud arising from the seller's alleged breach of this duty.

Lewis v. Basinger, 2004 Ohio 6377, 2004 Ohio App. LEXIS 5864 (2004) . The doctrine of caveat emptor and the "as is" nature of a contract preclude recovery against both a seller and the seller's agent absent fraud. When a buyer contractually agrees to accept property "as is," the seller is relieved of any duty to disclose the property's latent conditions and only has the duty not to commit an affirmative fraud. Ohio courts hold that a seller's agent is as protected by the doctrine of caveat emptor and the "as is" language in a sales contract as the seller.

Moreland v. Ksiazek, 2004 Ohio 2974, 2004 Ohio App. LEXIS 2618 (2004) . A cause of action cannot be maintained against the seller or its agent for fraudulent nondisclosure when the property is being sold "as is." However, even if real property is being sold "as is," a cause of action can still be maintained for fraudulent misrepresentation.

Chamar v. Schivitz, 2004 Ohio 1957, 2004 Ohio App. LEXIS 1704 (2004) . When a buyer receives a residential property disclosure form prior to executing a title transfer agreement, rescission is not an available remedy.

Findlay Ford Lincoln-Mercury v. Huffman, 2004 Ohio 541, 2004 Ohio App. LEXIS 486 (2004) . In a sale of commercial property, buyers claimed that seller intentionally misrepresented his knowledge of oil wells on the property and that the wells were a latent defect. The court disagreed. Although not visually discoverable, the well was discoverable if one searched the public records maintained by the Ohio Department of Natural Resources. The court found that the seller did not commit any fraud, as the elements of justifiable reliance and an actual or implied representation or concealment of a matter of fact were lacking.

McClintock v. Fluellen, 2004 Ohio 58, 2004 Ohio App. LEXIS 42 (2004) . Buyer alleged that seller intentionally failed to disclose in the Residential Property Disclosure Form, mechanical problems with the heating, ventilation and air conditioning unit. The court found that the caveat emptor doctrine could not be used to protect a vendor if the buyer proved fraud.

Witfoth v. Kiefer, 2003 Ohio 6766, 2003 Ohio App. LEXIS 6092 (2003) . Buyers alleged that well had a low yield that affected their water use and asserted that the sellers should have disclosed this fact to them. The well was disclosed on the residential property disclosure form in keeping with *Ohio Rev. Code Ann.* § 5302.30, but sellers made no other indication orally or on the form about the well. Buyers had to dig new wells. The court found that since no reasonable

person could consider the well a material defect or could consider the low yield to be a material water supply problem, the sellers were not required to disclose the low yield on the disclosure form. It was also undisputed that the buyers had a full opportunity to inspect the property, that a test existed to measure the yield, that they did not order such a test, and that the yield was public record. Therefore, no reasonable person could find that the yield of the well was not open and obvious. Thus, nondisclosure did not amount to fraudulent concealment.

Clemente v. Gardner, 2003 Ohio 6017, 2003 Ohio App. LEXIS 5352 (2003) , corrected by, 2004 Ohio 2254, 2004 Ohio App. LEXIS 2009 (2004) . Generally, an "as is" clause places the risk upon the purchaser as to the existence of defects and relieves the seller of any duty to disclose. But an "as is" clause does not bar a claim for positive fraud, a fraud of commission rather than omission. An "as is" clause bars claims for passive non-disclosure.

Funk v. Durant, 155 Ohio App. 3d 99, 2003 Ohio 5591, 799 N.E.2d 221 (2003) . The sales contract contained an "as is" clause. The real estate disclosure form did not accurately list all occasions of water leakage, but the buyers knew this disclosure was inaccurate. The buyers' claims was predicated upon fraudulent misrepresentations or failure to disclose. The court found there was open and obvious evidence of basement water problems, putting the buyers on notice. The buyers had an opportunity to have an inspection made, which was encouraged by *Ohio Rev. Code Ann. § 5302.30* and the buyers did this by using the services of their home inspector friend, who also observed such evidence. The buyers were aware of prior problems and knew the non-disclosure statements were inaccurate, and therefore, could not meet the requirements of affirmative false statements in a contract containing an "as is" clause, nor the burden of reliance.

Nunez v. J.L. Sims Co., 2003 Ohio 3386, 2003 Ohio App. LEXIS 3075, (2003) , appeal denied 100 Ohio St. 3d 1471, 2003 Ohio 5772, 2003 Ohio LEXIS 2865 (2003) , reconsideration denied, 100 Ohio St. 3d 1550, 2003 Ohio 6879, 800 N.E.2d 754, 2003 Ohio LEXIS 3564 (2003) . The buyers who ignored advice that they have the house, which they were purchasing "as is," inspected for lead-based paint hazards could not sue sellers and real estate agents in tort, contract, or for violating federal regulations.

Broida v. McGlumphy, 2002 Ohio 4738, 2002 Ohio App. LEXIS 4819 (2002) , appeal denied, 98 Ohio St. 3d 1423, 2003 Ohio 259, 782 N.E.2d 78 (2003) . When a buyer claiming fraud in the sale of property had the opportunity to inspect the property, the buyer will be charged with the knowledge of conditions that a reasonable inspection would have disclosed. Although the buyers asked an inspector to inspect the residential property, the court could not state that a twenty-minute inspection was reasonable in light of the fact that the inspector discovered mold on the hurricane door and failed to follow up this discovery with more questions or a more extensive inspection. The buyers cannot prove that their reliance on the sellers' residential property disclosure form was justified. The buyers' claim for fraudulent misrepresentation failed.

Hannah v. Sibcy Cline Realtors, 147 Ohio App. 3d 198, 2001 Ohio 3912, 769 N.E.2d 876 (2001) , appeal denied, 95 Ohio St. 3d 1436, 766 N.E.2d 1002 (2002) , reconsideration denied, 95 Ohio St. 3d 1488, 2002 Ohio 2625, 769 N.E.2d 403 (2002) . While an agent or broker may choose to provide information regarding the ethnic diversity of a neighborhood to a client or to direct a client to resources about the ethnic diversity of a particular neighborhood or community, the agent or broker does so at his or her risk. As a matter of law there is no fiduciary duty to do so.

Peach v. Love, 2001 Ohio App. LEXIS 3113 (2001) . The contract contained as is clause and the Residential Property Disclosure Form attached to the contract disclosed water seepage into basement. The doctrine of caveat emptor governed this case.

Shear v. Fleck, 2001 Ohio App. LEXIS 4063 (2001) . Judgment for the buyers on a fraud claim was affirmed where sellers of the residence actively concealed latent defect of water problems in basement.

Masten v. Brenick, 2001 Ohio App. LEXIS 3159 (2001) , appeal denied, 92 Ohio St. 3d 1433, 749 N.E.2d 759 (2001) . Recovery was precluded by the doctrine of caveat emptor as any non-disclosure failed to rise to the level of fraud. The

residential property defect could not be considered latent as it could have been detected by proper inspection by the buyer.

Allison v. Cook, 139 Ohio App. 3d 473, 744 N.E.2d 254 (2000) . Unless confidential information is at issue, the agent has an affirmative obligation to inform his or her client of all information material to the transaction, and the agent must also advise his or her client in furtherance of the client's interest. If a real estate agent fails to adhere to these fiduciary duties owed to his or her client, the agent may not thereafter assert caveat emptor as a defense to a claim that the real estate agent defrauded the client.

Hearty v. First Merit Bank, N.A., 1999 Ohio App. LEXIS 5544 (Nov. 24, 1999) , discretionary appeal denied, 88 Ohio St. 3d 1448, 725 N.E.2d 287 (2000) . Notwithstanding the enactment of the Residential Disclosure Statute, the principle of caveat emptor still governs real estate transactions in Ohio. The seller was under no duty to update the form. The form itself advises potential buyers that there is no duty of the seller to update the form. *Ohio Rev. Code* § 5302.30 only requires that the disclosure statement be an accurate statement of the seller's knowledge of the condition of the house, as of the date the form was signed. The buyers should have been alerted to the possibility that the disclosure statement might not still be accurate six months after it was signed. Given evidence of past or current problems, the buyers were on notice that they should make further inquiry of the seller, who was under an obligation not to make fraudulent statements, or undertake a professional inspection. Even assuming that the seller's licensee fraudulently represented that the basement problems had been fixed, the buyers were not justified in relying on an oral representation by the licensee, when the problem was open and obvious to both.

Wilson v. Safarek, 131 Ohio App. 3d 622, 723 N.E.2d 181 (1999) . The buyers received and reviewed a residential property disclosure form. One buyer acknowledged receipt of the disclosure by signing and dating it and then returned the form to the seller. Neither buyer retained a copy of the disclosure form at that time because, since they had declined to go to the real estate office. There was no copy machine at the meeting place. The buyers were considered to have received this form at this time, thus the buyers' attempted rescission was untimely.

Rosa v. Zaring Homes, Inc., 122 Ohio App. 3d 739, 702 N.E.2d 952 (1997) , appeal denied, 81 Ohio St. 3d 1421, 688 N.E.2d 1046 (1998) . A purchaser's failure to inspect can defeat claim of misrepresentation when facts were available to all.

Eiland v. Coldwell Banker Hunter Realty, 122 Ohio App. 3d 446, 459-460, 702 N.E.2d 116, 124-125 (1997) , question certified, 1997 Ohio App. LEXIS 3695 (1997) . When a buyer claiming fraud in the sale of property has repeated opportunities to inspect the property, the buyer will be charged with the knowledge of conditions that a reasonable inspection would have disclosed. This purchaser bought the property "as is." There was no evidence that the broker or its agent fraudulently induced the purchase or misrepresented the property's condition.

Montgomery v. Proper, 1997 Ohio App. LEXIS 470 (1997) . The disclosure form provides the buyer with notice of any conditions or information concerning the property which are actually known by the transferor. Although the disclosure statement is not a warranty or a substitute for careful inspection by the potential buyer, *Ohio Rev. Code* § 5302.30(F) relieves the seller of liability for damages to the person or property arising from errors, inaccuracies, or omissions in the property disclosure form, but only "if the error, inaccuracy, or omission was not within the transferor's actual knowledge."

Black v. Cosentino, 117 Ohio App. 3d 40, 689 N.E.2d 1001 (1996) . The sales contract contained a clause warranting that the sellers had no knowledge of any hidden or latent defects and recommending that the purchasers retain a professional contractor to inspect the home. The buyers did not obtain a professional inspection, and they later experienced water leakage in the basement. The buyers sued alleging misrepresentation and concealment. The court affirmed the summary judgment in favor of the sellers holding that (1) the sellers' disclosure provided the buyers with notice of the possibility of a basement water problem, after which the purchasers had the opportunity to arrange for an

inspection; (2) the defects were not latent because many of the conditions evidencing dampness were open, observable, and readily apparent upon inspection; and (3) the purchasers failed to establish the elements of fraud because the sellers did not have knowledge of an existing water problem that was not open and observable, or of misrepresentation because the sellers did not represent that the home complied with the requirements of the Federal Housing Authority.

Foust v. Valleybrook Realty Co., 4 Ohio App. 3d 164, 446 N.E.2d 1122, 4 Ohio B. 264 (1981) . An agent and seller have duty to disclose material facts which are not visible. Nondisclosure is willful misrepresentation.

Crum v. McCoy, 41 Ohio Misc. 34, 70 Ohio Op. 2d 76, 322 N.E.2d 161 (Ohio Mun. Ct. 1974) . A seller's broker who knows of serious latent defect in property listed with him has a duty to inform a buyer of that defect even though the buyer is a customer of another broker.

Oklahoma

Rogers v. Meiser, 2003 OK 6, 68 P.3d 967 (2003) . The sellers experienced repeated and heavy flooding of the house. The seller's repairs did not stop the flooding and the sellers knew their repairs were inadequate. The sellers deliberately concealed the nature and scope of the flooding problems by stating on a disclosure statement that the flooding problem had been repaired. The trial judge dismissed any theory of liability, including a fraud claim, and any remedy raised by the buyers' petition not arising under or permitted by the Residential Property Condition Disclosure Act (RPCDA) on the basis that the RPCDA abrogated or supplanted any such theory or remedy. In that the RPCDA neither expressly nor by necessary implication could be found to have legislatively intended to supplant or abrogate a common law actual fraud claim anchored on alleged misrepresentations concerning material defects in the house made in connection with its sale, or the remedies associated with such a claim, the trial judge erred in dismissing the buyers' fraud claim.

Keeler v. GMAC Global Relocation Services, 2009 OK CIV APP 88, 223 P.3d 1024, 2009 Okla. Civ. App. LEXIS 62 (Okla. Ct. App. 2009) The buyers purchased a home from a relocation services firm. The home had termite and other damage. The seller was not responsible for the defects under the Residential Property Condition Disclosure Act (RPCDA). While the relocation services firm was the statutorily-defined seller, it was not an owner-occupant and was not privy to any actual knowledge about the home's condition. The seller complied with the RPCDA by giving the buyers the disclosure form provided by the prior owner/occupants rather than delivering its form which would have answered each query with "unknown." RPCDA § 835 limits a seller's liability for erroneous, inaccurate or omitted information supplied to the purchaser as a required disclosure if the error, inaccuracy or omission was not within the seller's actual knowledge. There was no evidence that the seller had any actual knowledge of these defects.

Moore v. Williams, 2008 OK CIV APP 76, 192 P.3d 1275 (2008) . The real estate licensees had a duty to provide the sellers with the statutorily required disclosure form. Buyers may pursue a remedy when a real estate licensee has actual knowledge of a defect prior to the acceptance of an offer, and the defect was not included in the seller's disclosure statement and the real estate licensee does not reveal the defect to the buyer. Buyers cannot recover damages from a licensee on a mere showing that the licensee used an outdated version of the disclosure form.

Green v. Jacobson, 1998 OK CIV APP 121, 963 P.2d 26 (1998) . The court summarily rejected prospective buyers' contention the trial court erred in denying their claim under the Residential Property Condition Disclosure Act. The Act's sole and exclusive remedy for its violation is "an action for actual damages, including the cost of repairing the defect, suffered by the purchaser as a result of a defect existing in the property as of the date of acceptance by seller of an offer to purchase." Since the buyers did not purchase the subject property, they may obtain no relief under the Act.

Oregon

Archambault v. Ogier, 194 Ore. App. 361, 95 P.3d 257 (2004) . An earnest money agreement specified that the property to be sold is in a certain condition. The buyers sued the sellers alleging breach of contract. Under the doctrine

of merger, the deed supersedes the contract as to all provisions made pursuant to the agreement's terms. Contractual provisions that are not included in the deed and do not affect the title, possession, quantity, or emblements of the land are deemed collateral to the promise to convey. The alleged breaches involved collateral terms because they did not affect the title, possession, quantity, or emblements of the property. The collateral terms are merged into the deed only if the parties intended the deed to be the final memorial of their agreement. Since the deed did not mention merger, and there was no other evidence that the parties intended to extinguish their contractual rights or obligations not expressly embodied in the deed, the record on summary judgment does not support affirming the trial court on the alternative ground that the parties' contractual rights have merged into the deed.

Rathgeber v. James Hemenway, Inc., 176 Or. App. 135, 30 P.3d 1200 (2001), aff'd and remanded, 335 Or. 404, 69 P.3d 710 (2003). Because Or. Rev. Stat. § 696.820 required the agent to provide the Disclosure Regarding Agency Relationships form to buyers, the contents of this form do not constitute an actionable representation under Or. Rev. Stat. § 646.608(1)(e).

Cameron v. Harshbarger, 165 Ore. App. 353, 998 P.2d 221 (1999). The court did not agree with the statement that the voluntary disclosure statement made pursuant to Or. Rev. Stat. § 105.465(2) can create a special relationship between the parties that otherwise would not exist.

Seth v. Wilson, 62 Or. App. 814, 662 P.2d 745 (1983). A broker was not negligent for failing to inform purchaser that property was a solitary legal unit when broker knew or had reason to know that property appeared to purchaser to consist of four separate parcels.

Pennsylvania

Bortz v. Noon, 556 Pa. 489, 729 A.2d 555 (Pa. 1999). A broker cannot be liable for the misrepresentation of its agent, innocently made, under circumstances where the agent had no reason to know that her statement was false, and the agent had no duty to verify the accuracy of the third party report.

Youndt v. First National Bank of Port Allegany, 868 A.2d 539, 2005 PA Super 42 (2005). Whether a duty exists to disclose is a question of law. The first requirement of this duty is that the undisclosed fact be one that is basic to the transaction.

Blumenstock v. Gibson, 811 A.2d 1029, 2002 PA Super 339 (2002), appeal denied, 573 Pa. 714, 828 A.2d 349 (2003). The sellers' disclosure statement provided that the averments in the statement were "not a warranty of any kind" by the sellers or by their agent. A disclosure statement is limited in scope to disclosing material defects which are defined as a problem with the property or any portion of it that would have a significant adverse impact on the value of the residential real property or that involves an unreasonable risk to people on the land. A seller's agent may enforce the integration clause and any other exculpatory provision in the written agreement between a seller and a buyer.

Skurnowicz v. Lucci, 798 A.2d 788, 2002 PA Super 140 (2002). The court agreed with the trial court's conclusion that the sellers made a material misrepresentation. When asked on the sellers' property disclosure statement whether they knew of "any past or present drainage problems affecting the property," the sellers answered no. The extensive testimony citing past and present flooding on the premises demonstrates that this response was an affirmative misrepresentation. This misrepresentation violated the Unfair Trade Practices Act.

Anderson v. Harper, 424 Pa. Super. 161, 622 A.2d 319 (1993), alloc. den., 535 Pa. 659, 634 A.2d 222 (1993). The sellers' attempts to correct the septic system problems without obtaining the required permits and inspections placed on sellers a duty to disclose the existence of the problems, the nature of their repairs, and the fact that they were done without permits or inspections. The buyers should have been advised that there was an absorption problem and that the seller had attempted to correct this themselves. Armed with this knowledge, the buyers would then have been

responsible to detect the nature of the problem and the need for any further repairs. The buyers were entitled to recover damages from sellers.

Sevin v. Kelshaw, 417 Pa. Super. 1, 611 A.2d 1232 (1992) . Absent a request for information, the seller and broker had no duty to disclose the existence or location of a waterline easement.

Smith v. Renaut, 387 Pa. Super. 299, 564 A.2d 188 (1989) . The broker may be found liable to a purchaser where the broker misrepresents or conceals a material fact.

In re Humphrey's Pest Control Co., Inc., 80 B.R. 687 (Bankr. E.D. Pa. 1987) . The failure of the seller and the broker to disclose to the purchasers the existence of an exterminating service report detailing termite damage constituted fraudulent conduct.

Rhode Island

Stebbins v. Wells, 818 A.2d 711 (R.I. 2003) . The buyer had alleged numerous causes of action against the seller and the agents, including negligent omission, negligence, breach of fiduciary duty, and a private cause of action for damages under the Real-Estate Sales Disclosure Act (R.I. Gen. Laws tit. 5, ch. 20.8) for failing to disclose the presence of severe erosion. No right existed to file a private suit for civil damages under this Act so summary judgment on that count was proper. If disclosable defects were within the agents' personal knowledge, and the agents knew or should have known that the buyer was acting under a misapprehension concerning facts which would be important to the buyer and could probably affect the buyers's decision, an alleged breach of that duty could be the basis for a negligence claim or a negligent omission claim, and, in the case of a buyer's own agent, a breach-of-fiduciary-duty claim.

Stebbins v. Wells, 766 A.2d 369 (R.I. 2001) . Because erosion occurs naturally on waterfront properties, its mere existence cannot be considered a defect for purposes of the disclosure statute. However, if the specific erosion was far more severe than ordinary erosion it would rise to the level of being a defect for purposes of the disclosure statute, a genuine issue of material fact regarding whether the severity of the erosion amounts to a disclosable defect. Summary judgment for the seller and buyer's broker was reversed.

Hotel Assocs., LLC v. HMS Assocs. Ltd. Partnership, 2004 R.I. Super. LEXIS 44 (2004) . The exception to the rule of caveat emptor for passive concealment of a material defect which applies to residential real estate transactions in Rhode Island, does not apply to Rhode Island commercial real estate transactions.

South Carolina

Darby v. Furman Co., 334 S.C. 343, 513 S.E.2d 848 (S.C. 1999) . The broker failed to disclose that he was the purchaser. The broker admitted that he did not make any disclosure or obtain a written waiver. The seller was entitled to recover the commission she had paid the broker.

Chastain v. Hiltabidle, 381 S.C. 508, 673 S.E.2d 826 (S.C. Ct. App. 2009) *reh'g denied*, 2009 S.C. App. LEXIS 462 (Mar. 24, 2009) . A real estate licensee does not have a duty to inspect or investigate the physical condition of property for the purpose of confirming or denying statements made by a seller in a disclosure statement. The Legislature placed the duty of performing such an inspection or investigation squarely on the shoulders of the buyer.

McLaughlin v. Williams, 379 S.C. 451, 665 S.E.2d 667 (S.C. Ct. App. 2008) . While the property owner has a duty to make disclosures, a real estate licensee may still be liable to the buyer when the licensee knows that the Residential Property Disclosure Statement is incomplete or misleading. However, this possible liability to the buyer was not adverse to judgment in the licensee's favor because the buyer could not rely upon the incomplete disclosure statement because he was in possession of a home inspection report and a termite and moisture inspection report which disclosed the

moisture and termite problems.

Harrington v. Mikell, 321 S.C. 518, 469 S.E.2d 627 (S.C. Ct. App. 1996) . The son of the owner listed his mother's property believing that he held a power of attorney from his mother. The son did not have a power of attorney and was later appointed conservator. In this position the son repudiated a sales contract which had been entered into. The prospective buyers sued the agent and broker alleging negligent misrepresentation. The court held that the defendants had a duty not to defraud the buyer, however, it refused to hold that the defendants had a general duty to verify the information concerning the power of attorney.

South Dakota

Fuller v. Croston, 725 N.W.2d 600, 2006 SD 110 (2006) . Reliance on the seller's disclosure statement is not necessary for a real estate licensee to be held liable for the seller's false statement. A licensee can be held liable for a client's misrepresentations if the licensee knew of the misrepresentation.

Saiz v. Horn, 668 N.W.2d 332, 2003 SD 94 (2003) . After the home purchase, the buyers found substantial defects and learned that the seller had previously given other potential buyers a disclosure statement revealing these defects. The court ruled that the agent had a duty to inform buyers that seller was legally required to provide a disclosure statement.

Fisher v. Kahler, 641 N.W.2d 122, 2002 S.D. 30 (2002) . "It has been well accepted, not only in South Dakota but throughout the United States, that a seller's agent has no duty to ensure that a buyer's interests are well served."

Parmely v. Hildebrand, 630 N.W.2d 509, 2001 S.D. 83 (2001) . While the sellers are required to disclose the property's condition, there is no statutory authority to further require them to disclose possible remedies to those defects.

Parmely v. Hildebrand, 603 N.W.2d 713, 1999 S.D. 157 (1999) . Merely putting a buyer on notice of defects is not sufficient. Known defects must be revealed truthfully and in good faith.

Lucero v. Van Wie, 598 N.W.2d 893, 1999 S.D. 109 (1999) . The buyer initiated the sale and was familiar with the property she desired to purchase. The buyer entered into an enforceable contract and purchased the property "as is," the result of which was to waive disclosure requirements of S.D. Codified Laws § 43-4-38 through § 43-4-44.

Engelhart v. Kramer, 570 N.W.2d 550, 1997 S.D. 124 (1997) . A disclosure statement does not create a warranty by the seller to the buyer as to the property's condition, sellers are not strictly liable under the disclosure statute, a negligent or intentional failure to disclose known defects is required before liability attaches, the doctrine of caveat emptor has been abandoned in favor of full and complete disclosure of defects of which the seller is aware.

Tennessee

Odom v. Oliver, 2009 Tenn. App. LEXIS 103 (Tenn. Ct. App. Mar. 17, 2009) *appeal denied*, 2009 Tenn. LEXIS 814 (Nov. 23, 2009) . The seller's failed to disclose that the home's exterior was constructed of logs. The logs had been covered with vinyl siding on the outside and sheetrock on the inside. The buyers argued that the house's nature as a log home was a material fact that the sellers had a duty to disclose. This is an issue of material fact that is best determined by the trier of fact.

Orndorff v. Calahan, 2008 Tenn. App. LEXIS 603 (Oct. 9, 2008) . The sellers were liable to the buyers for the cost of repairing a faulty renovation that the sellers had improperly performed. The sellers failed to disclose the lack of permits and improper work which failed to comply with the applicable building code on the statutorily required disclosure form required under Tenn. Code Ann. § 66-5-201 *et seq.* The buyers were also awarded attorney's fees and costs.

McRae v. Hagaman, 2006 Tenn. App. LEXIS 550 (Aug. 22, 2006) . Both a buyer and a seller's broker can be liable for a portion of fault in a negligent misrepresentation case. One of the buyers was found to have been 25 percent at fault and the seller's broker was found to be 75 percent at fault for not discovering that a portion of the property they thought was part of the sale was not included.

Weaver v. v. McCarter, 2006 Tenn. App. LEXIS 369 (June 6, 2006) . Real estate agents owe a duty of loyalty to their clients. This duty of loyalty includes an obligation by the agent to make full and complete disclosure of facts that will benefit the agent's client.

McRae v. Hagaman, 2004 Tenn. App. LEXIS 693 (2004) . A seller's real estate agent has a duty to use reasonable care in determining that all representations made are true.

Chadwick v. Spence, 2004 Tenn. App. LEXIS 92 (2004) . A violation of *Tenn. Code Ann. § 66-5-208(b)* of the Tennessee Residential Property Disclosure Act creates no independent cause of action on behalf of the purchaser. An owner who fails to provide a disclosure statement is subject to any other cause of action available in law or equity against an owner for misrepresentation or failure to disclose material facts regarding the subject property.

Gurley v. Hickory Withe Partners, L.P., 2003 Tenn. App. LEXIS 674 (2003) . The buyers and seller entered into a sales contract for a lot. The buyers knew that lot lines were subject to change. The buyers were presented with a deed that incorporated the metes and bounds description which they accepted. The seller did not have a duty to disclose any change to the buyers.

Anderson v. Warren, 2001 Tenn. App. LEXIS 958 (2001) . Although the seller testified that he had no part in the preparation of the "Home Features" brochure, the seller was responsible for its contents. This brochure misrepresented many features of the home. The court affirmed finding that the sellers had fraudulently misrepresented the property's condition.

Strange v. Peterson, 2001 Tenn. App. LEXIS 23 (2001) . The one-time occurrence of a water-filled hole in the crawlspace was not enough to amount to "water leakage" or "accumulation." This occurrence did not amount to "previous flooding" or "improper drainage" which would require disclosure.

Harjes v. Russell, 1999 Tenn. App. LEXIS 316 (1999) , appeal denied, 1999 Tenn. LEXIS 646 (1999) . The buyer's action was not barred by one-year statute of limitations of the Residential Property Disclosures Act. Although the disclosure statement was relied upon as evidence of the seller's misrepresentations, the applicable portion of their complaint was based upon common law fraud and misrepresentation. If the gravamen of the complaint is a claim for damages to real property the three-year limitations period set forth in *Tenn. Code Ann. § 28-3-105(1)* controls.

Buford v. Cunningham, 1999 Tenn. App. LEXIS 335 (1999) . The buyers knew of a crawl space water problem. Given the sequence of events and the parties' contract, as a matter of law, the buyers cannot now establish reliance on the assertion by the seller in the Tennessee Residential Property Condition Disclosure document that she was not aware of any "... flooding, drainage, or grading problems." The buyers knew of the problems and attempted to provide for their remedy.

Fuller v. Feingold, 1999 Tenn. App. LEXIS 275 (1999) . The sellers executed a Tennessee Residential Property Condition Disclosure statement prepared by either the sellers' agent or buyers' agent which contained a checked box indicating the property had a current termite contract. No termite contract existed on the residence at closing. The buyers took no action to have any termite contract assigned to them, or to pay for the renewal of a termite contract. Evidence established that a termite contract is not a guarantee that no termites exist in the residence, therefore the notation on the disclosure statement indicating the existence of a current termite contract has no bearing on the issue of fraud or misrepresentation as to the existence of termites.

Gage v. Seaman, 1999 Tenn. App. LEXIS 114 (1999) . The buyers presented no proof that the agent had actual knowledge of the septic system problems. The buyers signed the Disclosure Statement, asserting that there were no defects in the property which would materially affect the value or desirability of the property. The proof was undisputed that the agent had no actual knowledge of the problem. The court refused to find that the agent had constructive knowledge of the problems due to the site's physical characteristics.

Gray v. Boyle Inv. Co., 803 S.W.2d 678 (Tenn. Ct. App. 1990) , rehearing denied, 1990 Tenn. App. LEXIS 687 (1990) . The broker and agent breached duty to purchaser by failing to disclose foreclosure proceedings in progress against the subject property.

Texas

Sims v. Century 21 Capital Team, Inc., 2006 Tex. App. LEXIS 7990 (Sept. 7, 2006) . A real estate licensee is bound to use Texas Real Estate Commission form contracts in most transactions pursuant to 22 Tex. Admin. Code § 537.11(b). The licensee is prohibited from giving advice or opinions as to the legal effect of any of the form contract's provisions.

Garza v. Wells Fargo Home Mortg., Inc., 2004 Tex. App. LEXIS 7590 (2004) , review denied, 2005 Tex. LEXIS 80 (2005) . The disclosure notice required by Tex. Prop. Code Ann. § 5.008 is a disclosure by the seller only, and not by the seller and broker regardless of whether the broker has also signed the disclosure notice. The listing broker and realty company could not be held liable for any alleged misrepresentations or nondisclosures in the seller's disclosure notice.

Bynum v. Prudential Residential Services., L.P., 129 S.W.3d 781 (Tex. Ct. App. 2004) , review denied, 2004 Tex. LEXIS 856 (2004) . The buyers, individually and as next friends of their minor children, sued inspection service, engineering company, remodeler, and sellers claiming breach of contract, breach of express and implied warranties, violation of deed restrictions, violations of the Deceptive Trade Practices-Consumer Protection Act, Tex. Bus. & Com. Code Ann. § 17.41, et seq., fraud, violations of Tex. Bus. & Com. Code Ann. § 27.01, negligence, negligence per se, negligent misrepresentation, failure to provide disclosures required by Tex. Prop. Code Ann. § 5.008, and strict products liability. The court held that an "as is" clause was valid. There was no evidence that sellers knew that they had remodeled without necessary permits, causing the mold. There was no authority for the suggestion that buyers' children would not be bound by the contract terms such that the "as is" clause would not apply to them. There was no action for a breach of an implied warranty of habitability because the sellers and entities were not the builders.

Sherman v. Elkowitz, 130 S.W.3d 316 (Tex. Ct. App. 2004) . The buyers sued, contending sellers, the listing agent and sellers' realty company failed to disclose that the sellers once sued the previous owner for failing to disclose defects in the home. These defects were the same defects the buyers say they discovered after the sale. No evidence showed that defendants misrepresented the property or concealed defects. The three-page notice the agent provided was printed by the Texas Association of Realtors(R) and appeared to be substantially similar to the form of the notice in Tex. Prop. Code Ann. § 5.008. The notice made clear that it was the sellers' disclosure. The statement that the agent had no reason to believe that the sellers' disclosures were false or inaccurate was not an affirmative representation by the agent of the property's condition. There was no evidence that the agent had any reason to believe the information provided by the sellers was false or inaccurate regarding defects in the property. The court held that, as a matter of law, defendants were not required to disclose the earlier lawsuit, as it was dismissed several years before the sellers put the property on the market. If the legislature had intended for prior lawsuits to be listed, it could have included a phrase indicating that. The notice required disclosure only of pending lawsuits, because the notice was seeking current information.

Robbins v. Capozzi, 100 S.W.3d 18 (Tex. Ct. App. 2002) . A real estate seller has no duty to disclose material facts which would be discoverable by the buyer in the exercise of ordinary care and due diligence.

Marshall v. Kusch, 84 S.W.3d 781 (Tex. Ct. App. 2002) , review denied, 2003 Tex. LEXIS 380 (2003) , motion for

rehearing on petition for review denied, 2003 Tex. LEXIS 662 (2003) . The original owner sold the property after animals were killed by an anthrax outbreak. The original owner represented that there was no anthrax on the property in the presence of a real estate broker. The ranch was sold to a real estate investment company, which then sold it to the buyer. After anthrax broke out, the buyer sued the original owner. Since the misrepresentation was not communicated to the buyer, there was no evidence the property's original owner made an affirmative misrepresentation that could have influenced the buyer in purchasing the property. Without evidence that the property's original owner was connected with the sale to the buyer, the Deceptive Trade Practices Act claim failed as a matter of law.

Larsen v. Carlene Langford & Associates, Inc., 41 S.W.3d 245 (Tex. App. 2001) , petition for review denied (Jul. 26, 2001). The validity of an "as is" agreement is determined in light of the parties' sophistication, the terms of the "as is" agreement, whether the "as is" clause is freely negotiated, whether it was an arm's length transaction, and whether there was a knowing misrepresentation or concealment of a known fact. The record supported the conclusion that the contract was negotiated by parties of equal bargaining strength in an arm's length transaction. The statement made by the seller's licensee referencing the seller's disclosure form that the house needed some leveling was not a misrepresentation of material fact because even if the buyers attached significance to this statement, there is no evidence whatsoever in the record that the licensee knew or had any reason to suspect that the seller's disclosure form was not correct, or that the seller knew the reason for the cracks.

Fernandez v. Schultz, 15 S.W.3d 648 (Tex. App. 2000) . An independent inspection does not always supersede a seller's misrepresentations as a producing cause of damages to the buyer. Instead the seller's misrepresentations may be one of several producing causes of the damages suffered.

Kessler v. Fanning, 953 S.W.2d 515 (Tex. App. 1997) , no writ. The Property Condition Disclosure Statement indicated that the sellers were unaware of any improper drainage or previous structure repair on the property. The terms "improper drainage" or "previous structural repair" are not vague. The terms clearly pertain to a past or current condition of the property at the time of the sale. The court affirmed judgment for the buyers under the Texas Deceptive Trade Practices-Consumer Protection Act.

Sanchez v. Guerrero, 885 S.W.2d 487 (Tex. App. 1994) . The agent failed to disclose that house's prior occupant had molested children in the house. The buyers sued alleging that the broker had violated the Deceptive Trade Practices Act for failing to disclose this information. The jury's finding that the Act had been violated was supported by evidence that the buyers had asked the agent who the previous owner had been and had told agent that the identity of the previous occupant was important to them.

Utah

Salt Lake County v. Western Dairymen Cooperative, Inc., 2002 UT 39, 48 P. 3d 910 (Utah 2002) An agency disclosure statement can be a valid contract which would support a contract action subject to a statute of limitations longer than that applied to tort actions. The parties can create a contractual duty that parallels a common law obligation.

Hermansen v. Tasulis, 2002 UT 52, 48 P.3d 235 (Utah 2002) . Though not occupying a fiduciary relationship with prospective purchasers, a real estate agent hired by the seller is expected to be honest, ethical, and competent and is answerable at law for his or her statutory duty to the public. Real estate agents and sellers are often unaware of latent defects in the home at the time of sale. The fact that the agent has a duty to disclose known defects to potential purchasers does not mean that the seller's agent is liable for all subsequent problems. The purchasers must also demonstrate that the agent misrepresented, or had prior knowledge of, defects in the home. Only when the purchaser can establish that the agent had both the duty to disclose and knowledge of the defects is recovery appropriate.

Mitchell v. Christensen, 2001 UT 80, 31 P.3d 572 (Utah 2001) . Summary judgment for the sellers was reversed. The sellers had a legal duty to disclose swimming pool leaks prior to the sale of their property. Assuming it is determined on

remand that the sellers knew of the existence of the leaks, swimming pool leaks could not have been discovered through reasonable care.

Dugan v. Jones, 615 P.2d 1239 (Utah 1980) . The rule of caveat emptor does not apply to those dealing with licensed real estate agent.

Vermont

Vastano v. Killington Valley Real Estate, 182 Vt. 550, 929 A.2d 720, 2007 VT 33 (2007) A real estate agent's failure to inform purchasers about the ongoing environmental monitoring of a well for gasoline contamination constituted a material omission as a matter of law and a violation of the Consumer Fraud Act (Vt. Stat. tit. 9, §§ 2451 to 2480n).

Carter v. Gugliuzzi, 168 Vt. 48, 716 A.2d 17 (1998) . The knowledge of broker's agent's supervisor regarding high wind risks on property being sold was properly imputable to the broker. The broker had a statutory duty to disclose all material facts regardless of the source of the knowledge. This rule reflects the reality that a broker's business consists of acquiring and conveying information about the community, neighborhood conditions, comparable properties, and other local factors that may affect the value, marketing and sale of property.

Virginia

Norris v. Mitchell, 255 Va. 235, 495 S.E.2d 809 (1998) . Under the circumstances of this case, the sellers of residential property were not required to disclose to the purchasers the contents of a public document describing a restriction on the use of the property being sold.

Washington

Svendsen v. Stock, 143 Wash. 2d 546, 23 P.3d 455 (2001) . The seller disclosure statute precludes an action under the Consumer Protection Act (CPA) against an agent or broker when the claim for fraudulent concealment arises directly from the completion of the disclosure statement. However, if the broker or agent's fraudulent concealment was separate and apart from the seller's completion of the disclosure statement, a plaintiff can establish the elements of an independent cause of action against a broker or agent under the CPA.

Bloor v. Fritz, 2008 Wash. App. LEXIS 743 (April 1, 2008) . The agent knew methamphetamine had been manufactured on the property. The agent violated his duty to disclose known material facts about the property under Wash. Rev. Code § 18.86.030. The trial court did not err in concluding that the agent negligently misrepresented a material fact in failing to disclose this illegal drug manufacturing. Listing and showing the property without disclosing its illegal drug manufacturing history could deceive members of the public, thus the agent violated the Washington Consumer Protection Act. The court ordered a rescission of the real estate purchase and sale agreement. To restore the buyers to their pre-contract position, the sellers had to pay the \$ 149,000 debt together with the unpaid interest that actually accrued, penalties, and foreclosure costs that the lender assessed against the buyers.

Brown v. Johnson, 109 Wn. App. 56, 34 P.3d 1233 (2001) . A prudent home buyer should hire a reputable inspector prior to purchasing. But the failure of a buyer to obtain an adequate professional inspection should not relieve a seller of liability for failing to disclose material defects, which she had both a common law and statutory duty to disclose. The trial court erred in limiting the buyer's attorney fee award. The buyer was entitled to fees because the purchase and sale agreement provided for attorney fees to the prevailing party in the event of a dispute.

Pacific Northwest Life Ins. Co. v. Turnbull, 51 Wash. App. 692, 754 P.2d 1262 (1988) , review denied, 111 Wash. 2d 1014 (1988) . The broker had duty to employ reasonable degree of effort and expertise to confirm or refute seller's information which broker knew was pivotal to the transaction from the buyer's perspective.

West Virginia

Terra Firma Co. v. Morgan, 674 S.E.2d 190, 2008 W. Va. LEXIS 119 (W. Va. 2008) . The West Virginia Real Estate License Law requires that a licensee disclose who they are representing in every transaction using a form prescribed by the West Virginia Real Estate Commission. The agent has a duty to disclose all facts known to the agent, which materially affect the value or desirability of the property. The buyer's agent disclosed that he was acting on behalf of the buyer. He violated no duty when he failed to disclose the identity of his client or his client's intended use of the land. The sellers never notified the agent that these facts were material to their decision to sell.

Kidd v. Mull, 215 W. Va. 151, 595 S.E.2d 308 (2004) . An agent represented that certain commercial property had water access. A title search would have revealed the inaccuracy of the agents' statements. The court held that this did not defeat the lessee's fraud claim and a grant of summary judgment in favor of the lessor's agent and lessor was wrong. The doctrine of constructive notice will not defeat a cause of action for fraud or negligent misrepresentation where the entity asserting the cause of action did not undertake independent investigation to ascertain the truth of the allegedly fraudulent representation.

Logue v. Flanagan, 213 W. Va. 552, 584 S.E.2d 186 (2003) . The buyers argued that there was evidence showing that the sellers knew about the defective septic system and conveyed the property without disclosing this knowledge. In a per curiam opinion, the court held that the trial court erred in relying on the caveat emptor doctrine, and summary judgment was improper. The fact that the property was purchased "as is" and without any warranties did not bar the cause of action. Sellers arguably knew of the true conditions of the septic system and failed to disclose this information to the buyers.

Darrisaw v. Old Colony Realty Co., 202 W. Va. 23, 501 S.E.2d 187 (1997) (summary judgement in favor of seller and broker reversed in part, a prior foundation repair had not been disclosed to the buyers, while no actual misrepresentations were made and no evidence of defect existed at the time of the sale, there still existed a genuine issue of material fact regarding whether a condition affecting the value of the home existed, precluding the grant of summary judgement).

Thomson v. McGinnis, 195 W. Va. 465, 465 S.E.2d 922 (1995) . Summary judgment for the seller's agent was improper where evidence showed that the agent retained control over the actions of an individual who inspected a furnace. The buyer also had alleged a cause of action for negligent hiring. Fraud in the procurement of an agreement vitiates benefits under contract.

Teter v. Old Colony Co., 190 W. Va. 711, 441 S.E.2d 728 (1994) . The broker had no independent duty to inspect and uncover latent defects on residential premises.

Wisconsin

Wangard Partners, Inc. v. Graf, 294 Wis. 2d 507, 719 N.W.2d 523, 2006 WI App 115 (2006) . Wis. Stat. § 452.135 requires disclosures regarding the brokerage relationship. The disclosures can be made in a separate form; it is not necessary for the disclosures to be in the parties' agency or listing agreement.

Eddy v. B.S.T.V., Inc., 280 Wis. 2d 508, 696 N.W.2d 265, 2005 WI App 78 (2005) , review denied, 2005 WI 134, 282 Wis. 2d 722, 700 N.W.2d 274 (2005) . Wis. Stat. § 452.133 establishes the duties of real estate brokers to not only their clients but to all parties to a transaction.

Huxhold, v. Campbell, 273 Wis. 2d 785, 680 N.W.2d 833, 2004 WI App 109 (2004) , review denied, 2004 WI 138, 276 Wis. 2d 28, 689 N.W.2d 56 (2004) . A broker was denied recovery of a commission because the broker failed to provide

the statutorily required written agency disclosure form. The court stated that to allow the broker to commit this violation, and then seek compensation for his prohibited services, was contrary to the legislative intent under any reasonable view.

Stathus v. Horst, 260 Wis. 2d 166, 659 N.W.2d 165, 2003 WI App 28 (2003) . The home's basement had a seepage problem and an outside spring water problem. For two years during the listing agreement sellers noted these problems on the real estate condition report. During this period, agent informed sellers that the number one reason why the home was not selling was the "leaky basement." Sellers hired a new agent, but, when the residence was re-listed, the sellers failed to disclose both the seepage in the basement and the existence of the spring under the front lawn, which was causing water to run over the sidewalk. Trial court concluded that this willful concealment was of such a nature to warrant trebling the damages. Regarding award of attorney fees, trial court award was based on an hourly rate multiplied by the hours spent. However, attorney agreed to be compensated on a contingent basis, not total hours. The appellate court concluded that the award of attorney fees was in error, as it was not based on the fees that the sellers actually incurred, and the fees should have been reasonable.

Johnson v. Neuville, 226 Wis. 2d 365, 595 N.W.2d 100 (Wis. Ct. App. 1999) . A purchaser's claim that the broker was negligent in failing to verify the existence of an access easement, and structuring the transactions in a way that limited the purchaser's ability to verify the easement stated the basis for liability separate from the broker's duty to make disclosures.

Grube v. Daun, 173 Wis. 2d 30, 496 N.W.2d 106 (Wis. Ct. App. 1992) , review denied. A broker has duty to conduct reasonably competent and diligent investigation to determine existence of material facts adverse to transaction, and must disclose such facts to buyer in writing in timely manner.

Wyoming

Roney v. B.B.C. Corp., 2004 WY 113, 98 P.3d 196 (2004) . A real estate agent substantially complied with the brokerage relationship disclosure law.

Hulse v. BHJ, Inc., 2003 WY 75, 71 P.3d 262 (2003) . The buyers purchased property for commercial use. Buyers alleged that seller's broker failed to disclose that the easement providing the only access to the property prohibited commercial use of the easement. Buyers alleged that broker failed to exercise care, skill, and diligence that those in the profession would ordinarily exercise under similar circumstances. On remand, broker filed a second motion for summary judgment on the statute of limitations, which was granted. The court affirmed, holding that a professional negligence claim against a real estate broker under *Wyo. Stat. Ann. § 33-28-303* was not controlled by the four-year statute of limitations imposed by *Wyo. Stat. Ann. § 1-3-105(a)(iv)(c)* but was instead governed by the two-year statute of limitations in *Wyo. Stat. Ann. § 1-3-107*.

Alexander v. Meduna, 2002 WY 83, 47 P.3d 206 (2002) . The sellers misrepresented the condition of their home. The sellers acknowledged the duty to complete the property condition statement honestly and fully, yet they made an affirmative false statement. The trial court unquestionably determined there was clear and convincing evidence of fraud because the sellers knew of the defects and purposely made misrepresentations regarding the property condition to induce the buyers, to their significant detriment, to make a purchase offer and enter into a purchase contract.

Sundown, Inc. v. Pearson Real Estate Co., Inc., 8 P.3d 324 (Wyo. 2000) . Brochure statements are opinions that are not actionable under the law. The failure to disclose the existence and the effect of mining agreements in the brochure and the map are not fraudulent unless the statements violate the accepted standards in the real estate field as provided by Wyoming statute. Wyoming does not recognize a claim for negligent nondisclosure.

Snyder v. Lovercheck, 992 P.2d 1079 (Wyo. 1999) . The buyer is not precluded from asserting a claim for fraudulent

misrepresentation against the seller and agents by either the merger or disclaimer clauses in the sales contract. However, the buyer cannot assert a claim for negligent misrepresentation where the contract contains a disclaimer provision stating that the buyer is not relying upon any representation of the seller or seller's agents.



84 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice 4.syn

§ 4.syn Synopsis to Chapter 4: The Broker's Obligation and Right to Compensation*

§ 4.01 Introduction

§ 4.02 Requirement that Title Close--Majority Rule

[1] Closing Not Required

[2] Effect of Contractual Provisions

[3] Financial Ability of the Purchaser

§ 4.03 Requirement that Title Close--Minority Rule

[1] Closing Required: *Dobbs v. Johnson*

[a] Introduction

[b] The Facts

[c] The Law

[d] Effect on Contractual Provisions

[e] Critique

[2] *Dobbs* in Other Jurisdictions

[a] Kansas: *Winkelman v. Allen*

[b] Massachusetts: *Tristram's Landing, Inc. v. Wait*

[c] Nebraska: Cornett v. Nathan

[d] Oregon: Brown v. Grimm

[e] Idaho: Margaret H. Wayne Trust v. Lipsky

§ 4.04 Excusing the Condition of Title Closing

[1] In General: Vendor's Default

[2] Effect of Vendor's Unmarketable Title

[3] Effect of Failure or Refusal of Contracting Party's Spouse to Sign Sales Contract or Deed

§ 4.05 Effect of Licensing Laws on Broker's Right to Compensation

[1] Introduction

[2] Isolated Transactions

[3] Finders or Middlemen

[4] Time of Procurement of License

[5] Where Broker Is Licensed But Associates or Employees Are Unlicensed

[6] Corporations

[7] Partnerships

[8] Conflict of Laws Issues

[9] Business Brokers--Where Real Property Is Included in Sale of Business

[10] Disciplinary Actions Resulting from Commission Disputes

[11] Can Fees Paid to an Unlicensed Broker Be Recovered?

[12] Employees of Developers May Need to Be Licensed to Recover Commission

[13] Assignment of a Commission

[14] Substantial Compliance Doctrine

[15] Out-of-State Cooperating Brokers

[16] Location Where the Brokerage Services Are Performed

[17] Consulting Fees Versus Commissions

§ 4.06 Effect of the Brokerage Agreement

- [1] General Considerations
- [2] Open Listings
- [3] Exclusive Listings
- [4] Exchanges Subject to Commission
- [5] Measure of Broker's Recovery
 - [a] Generally
 - [b] Possible Limitations on the Broker's Right to Compensation--The Interactive Properties Decision
 - [c] Customary Commission Rate
 - [d] Brokers Are Not Entitled to a Double Recovery
- [6] Who May Sue to Collect a Commission
- [7] Seller's Duties
- [8] Agreements Which Violate Public Policy
- [9] Liquidated Damages

§ 4.07 Requirement That the Broker Be the Procuring Cause of the Transaction

- [1] In General
- [2] Rule Illustrated: Competing Brokers
- [3] Tracing Connection Between Broker's Efforts and Ultimate Sale
- [4] Evidence of Procuring Cause
- [5] Essential Terms

§ 4.08 Effect of Breach of Fiduciary Duty

§ 4.09 Effect of Eminent Domain

§ 4.10 Broker's Rights Against the Purchaser

- [1] The Traditional Rule: Purchaser Not Liable
- [2] Exceptional Situations
- [3] The Holding of Ellsworth Dobbs

[4] The Dobbs Holding Qualified: Rothman Realty Corp. v. Bereck

§ 4.11 A Broker's Voluntary Reduction or Modification of Commission

§ 4.11A Other Theories of Recovery

[1] Quantum Meruit

[2] Fraud

[3] Tortious Interference

[4] Civil Conspiracy

[5] Implied-in-Fact Contract

[6] Equitable Estoppel

[7] Promissory Estoppel

§ 4.11B Broker's Liens

§ 4.11C Punitive Damages

§ 4.11D Broker Rebates

§ 4.12 Arbitration

[1] Realtor(R) Code of Ethics

[2] Duty to Arbitrate

[3] Arbitration Procedures

[4] The Arbitration Award

[5] Judicial Enforcement

§ 4.12A Broker Disputes Over Commissions

§ 4.13 Illustrative Forms

[1] Introduction

[2] Complaint in Action for Inducing Breach of Contract

[a] Complaint in Action for Tortious Interference With Broker's Contract--Another Form

[b] Answer and Third-Party Complaint in Action For Tortious Interference With Broker's Contract

[3] Complaint in Action Where Principal Repudiates Before Written Agreement of Sale Executed

[4] Illustrative Opening Statement to Jury in Action for Broker's Commission (Globerman v. Lederer)

[a] Plaintiff's Opening Statement

[b] Defendant's Opening Statement

[5] Illustrative Requests by Plaintiff to Charge--Action for Broker's Commission



85 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

A perusal of case law involving real estate brokers will quickly highlight that many cases involve brokers suing customers who have decided not to pay brokers for their services. As discussed in Chapter 4, numerous factors affect a broker's right to compensation (§ 4.01). There are instances when a broker is entitled to a commission even though the transaction never closes. For example, a majority of courts will allow a broker to recover a commission when the sale fails to close due to the seller's actions (§ 4.02). However, a substantial minority of courts holds that a successful closing is required as a condition to a broker's right to a commission. The jurisdictions holding this minority position are discussed (§ 4.03). However, even these jurisdictions will under some circumstances excuse the condition of title closing and title closing can be excused under some circumstances even though the listing agreement specifically requires that closing occur before the broker is due a commission (§ 4.04).

Real estate brokers who have legitimately earned commissions may find that they are legally unable to collect if the brokers were unlicensed. Section 4.05 discusses situations in which an unlicensed broker attempts to collect a commission. Chapter 4 also considers the effect of the brokerage agreement upon a broker's right to compensation (§ 4.06).

It is generally held that the broker must be the procuring and efficient cause of the transaction, particularly if the listing agreement is not an exclusive right-to-sell or exclusive agency listing. This general rule and a broker's proof of this causal connection are discussed (§ 4.07). A broker's fiduciary duties and a breach of those duties will affect the broker's right to compensation (§ 4.08) as will an eminent domain taking (§ 4.09).

Normally, the purchaser has no obligation to pay the broker's commission. However, in limited circumstances the broker may have a cause of action against the purchaser (§ 4.10).

Chapter 4 also discusses a broker's voluntary reduction of his or her commission in order to facilitate a sale (§ 4.11) and theories of recovery that generally involve equitable doctrines or tort claims (§ 4.11A). A few states offer brokers the protection of a statutory lien. This protection is also discussed (§ 4.11B).

Although litigation is frequently resorted to by the parties when a commission dispute is involved, the National Association of Realtors(R) and its member boards provide an arbitration system for resolving disputes. This means of

alternative dispute resolution is discussed in this chapter (§ 4.12). (Readers are also directed to Chapter 17, *Alternative Resolution of Disputes Involving Brokers*.)

Chapter 4 concludes with illustrative pleadings and other trial material (§ 4.13) including complaints and opening statements.



86 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.01

§ 4.01 Introduction

Few areas of real estate brokerage law generate as much dispute and litigation as the broker's right to a commission. Principals never see the efforts put in by the broker in the transactions that do not close. If a transaction is consummated quickly and smoothly, the principals may view the broker's efforts as minimal and resent the necessity of paying a commission; they may try to renegotiate or renege on payment. Brokers, on the other hand, frustrated in attempting to bring a deal to fruition, are sometimes tempted to collect a commission from a principal who received no proceeds from which to pay it. Courts of every jurisdiction have had to litigate cases in which a broker seeks to collect a commission where none is owed, or a principal refuses to pay a commission that has been earned. Several states have adopted real estate brokers lien acts to protect brokers from such twelfth-hour renegotiating tactics. These acts grant a lien on property to enable the collection of unpaid commissions without necessitating the time and expense of litigation. n1

There are many factors that come into play in determining a broker's right to a commission. n1.1 These include:

- (1) whether the broker was the procuring cause of the transaction; n2
- (2) whether the broker procured agreement on all essential terms of a bargain; n3
- (3) whether the broker was properly licensed and authorized; n4
- (4) whether or not the broker performed the duties required by the law of agency; n5
- (5) whether the broker met the conditions of the brokerage agreement; n6
- (6) whether the transaction was completed, that is, title closed; n7 and
- (7) if title did not close, whether the broker procured a financially able buyer n8 or, alternatively, whether the seller either "accepted" the prospect or the seller and purchaser entered into a binding contract of sale. n9
- (8) if the licensee meets all the requirements of the real estate licensing act of that licensee's individual

state. n10

Generally, the basis for the payment of the brokerage commission is found in the agreement of sale together with the listing agreement. n10.1

Absent unusual circumstances, it is an accepted legal principle that one is bound by one's own contract. n11
Consequently, it is generally no defense to a broker's claim for compensation that the seller did not understand the terms of the listing agreement. n12

Once a broker has earned his or her commission, the broker typically has no duty to mitigate his or her damages. n13
One court in addressing the property owner's mitigation argument stated that there is no way for the broker to minimize a commission to which the broker was entitled for services already rendered and that was already owed pursuant to the parties' brokerage agreement. n14

FOOTNOTES:

(n1)Footnote 1.

Connecticut: Conn. Gen. Stat. § 20-325a(c).

Georgia: Ga. Code Ann. §§ 44-14-600-44-14-605.

Illinois: 770 Ill. Comp. Stat. 15/10.

Maryland: Md. Code Ann. Real Prop. §§ 14-301-14-313.

Virginia: Va. Code Ann. §§ 55-526-55-527.

New York: N.Y. Lien Law §§ 2, 3, 10.

For a more in-depth discussion of broker's liens, see Streiker, *Getting Paid Commissions: A New Power Balance Between Real Estate Brokers, Appraisers and their Clients under the Missouri Commercial Real Estate Brokers' and State Certified Real Estate Appraisers' Lien Act*, 63 U.M.K.C. L. Rev. 727 (Summer 1995) .

(n2)Footnote 1.1. See, e.g., *Bodine v. Barecky*, 761 S.W.2d 525 (Tex. Civ. App. 1988) (the Texas Court of Appeals held that a written document, advising purchasers of their right to examine the abstract or the policy of title insurance which was signed by all parties to the purchase of the real estate, was sufficient to meet the requirements of the Texas Real Estate Licensing Act and broker was therefore entitled to bring an action for collection of commission). *But see Jones v. Del Anderson & Assocs.*, 539 S.W.2d 348, 19 Tex. Sup. Ct. J. 402 (Tex. 1976) .

(n3)Footnote 2. See § 4.07 below.

(n4)Footnote 3. See § 4.07 below.

(n5)Footnote 4. See § 4.05 and ch. 6 below.

Atlantic Commercial Group, Inc. v. George W. Dunham, 303 N.J. Super 122, 696 A.2d 85 (N.J. 1997) . ("While a broker may not have earned his commission until such time, there is no sound or just reason why a broker who was duly licensed when the brokerage services were performed and completed should not be entitled to a commission for such services simply because the broker was not licensed at the time of closing. To deny the broker the commission in such

circumstances is both unfair and inequitable and would lead to a windfall to the seller because the seller would not have to pay a commission which was justly due and owing").

(n6)Footnote 5. See § 4.08 below and ch. 3 above . See also *Hoff & Leight, Inc. v. Byler*, 62 P.3d 1077, 1078-1079 (Colo. Ct. App. 2002) (transaction-broker held entitled to recover commission even though the broker allegedly did not perform certain statutory duties).

(n7)Footnote 6. See § 4.06 below.

(n8)Footnote 7. See § 4.03 below.

(n9)Footnote 8. See § 4.02 and ch. 5 below.

(n10)Footnote 9. See ch. 5 below.

(n11)Footnote 10. See, e.g., *Tex. Occ. Code § 1101.351*.

(n12)Footnote 10.1. See *Smith v. Coldwell Banker Commercial N.E.R.A., LLC*, 91 Conn. App. 360, 364, 880 A.2d 1012, 1015 (2005) .

(n13)Footnote 11. See, e.g., *Allied Van Lines, Inc. v. Bratton*, 351 So. 2d 344, 347-348 (Fla. 1977) . Exceptions to this rule include situations where a party was prevented from reading the contract or where a party is induced by statements of the other party to refrain from reading the contract.

(n14)Footnote 12. See *First Florida Realty & Auction Co., Inc. v. Peacock*, 703 So. 2d 1199, 1200 (Fla. App. 1997) . *Mathews Partners, LLC v. Lemme*, 2009 Tenn. App. LEXIS 667, at *20 (Tenn. Ct. App. Oct. 2, 2009) .

(n15)Footnote 13. See *Rudy v. Carter*, 2009 Ohio 2729, 2009 Ohio App. LEXIS 2255, at *13 (June 11, 2009) ; *Kunkle v. Jaffe*, 71 N.E.2d 298, 47 Ohio Law Abs. 77, 1946 Ohio App. LEXIS 731, at *8 (1946) .

(n16)Footnote 14. See *Rudy v. Carter*, 2009 Ohio 2729, 2009 Ohio App. LEXIS 2255, at *13 (June 11, 2009) .

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87 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.02

§ 4.02 Requirement that Title Close--Majority Rule

[1] Closing Not Required

There are two types of circumstances that may entitle a broker to collect a commission if no closing occurs. In the first situation, sometimes referred to as the "no-written-sales-contract" pattern, the broker produces a prospect who is agreeable to the terms of the seller. At this point, the seller changes his mind, repudiates the transaction and refuses to enter into a written contract. If the jurisdiction requires title to close in order to collect a commission, then there is no recourse. The majority of jurisdictions hold that if a broker has in fact produced a buyer who is ready, able and willing to accept the principal's terms, the broker has earned the commission even though no written sales contract has been executed. n1 The rationale for the rule is that the principal cannot take advantage of his or her own obstruction of the contract process. n2 Some states, however, support the ability of the owner and broker to agree to the contrary. n3

When the parties actually meet to sign a contract, the deal may fall apart because of an inability to resolve open points on which the parties have good faith differences. In that circumstance, the broker has not earned a commission--despite the broker's best efforts, no deal has been made, and the failure to go forward was not a result of the seller's reneging on the agreed-upon terms of the sale. n4

The justice of requiring the seller to pay the broker's commission when the buyer reneges has, however, been questioned in the following manner:

[i]s it just to permit a broker to recover commission from an owner simply because he entered into a contract on mutually agreeable terms with a buyer produced by the broker, when it later develops that the buyer cannot or will not complete the transaction by closing the title? n5

The question posed in this extract from a New Jersey Supreme Court opinion constitutes another frequently litigated issue in contemporary brokerage law. Although the court that posed the question answered: "[w]e do not think so," n6 the great majority of courts over the years have answered, in effect, "we do think so." While the parties are always free to expressly condition the broker's right to a commission on some particular event, such as actual transfer of the deed and payment of the price (closing of title), where the brokerage contract contains no such stated conditions most courts hold that the broker's right to a commission accrues when he or she produces a purchaser who is ready, willing and able to buy the property on the terms set forth in the brokerage contract, or on other terms acceptable to the vendor. n7

As stated by the Utah Supreme Court, in characterizing its holding as the majority rule:

[a]bsent a contractual provision, which conditions the right to a commission on the performance of the buyer, the general rule accepted in Utah is that a broker has earned his commission upon the procuring of a buyer who is ready, willing and able and who is accepted by the seller. The broker is not an insurer of the subsequent performance of the contract and is not deprived of his right to a commission by the failure or refusal of the buyer to perform. n8

In 1934, the Arizona Supreme Court could say that "it is the almost universally accepted rule of law" that:

in the absence of a specific contract to the contrary, when a real estate broker has brought together the parties to a sale or exchange of real estate, and they have agreed fully on the terms and entered into a binding contract for such sale or exchange, his duties are at an end and his commission is fully earned, and it is immaterial that the parties to the contract rescind mutually or that one or the other thereof defaults and the sale or exchange is not fully effected. n9

This case established that even if litigation is required to complete the sale the lawsuit is not the procuring cause of the ultimate sale; rather, the agent is and as such is entitled to his commission.

Bringing the parties to a meeting of the minds is an expensive and sometimes problematic venture. The broker advertises the property, shows the property, and participates in negotiations. When the vendor and purchaser reach an agreement, theoretically the broker's job is done. Steering the deal to closing of title should then become the task of the parties and their attorneys. As the New York Court of Appeals stated in 1893:

If from a defect in the title of the vendor, or from a refusal to consummate the contract on the part of the purchaser for any reason in no way attributable to the broker, the sale falls through, nevertheless the broker is entitled to his commissions, for the simple reason that he has performed his contract. n10

The justice of this rule is seldom challenged when the sale collapses through the fault of the one who employed the broker--usually the vendor. Case law provides that a broker's right to compensation is not defeated by the seller's refusal or inability to honor the sales agreement. Yet the traditional majority view is not confined to cases where the vendor is at fault. It applies to cases where the purchaser is at fault, n11 and even to cases where no one is at fault. n11.1 In some instances, when the broker is a buyer's agent, the buyer may be liable for the broker's commission when the buyer fails to complete the transaction. n11.2

For example, under the Uniform Vendor and Purchaser Risk Act, unless the contract of sale provides otherwise, the risk of loss due to material destruction of the property continues to rest with the vendor until the purchaser takes either possession or title. In the New York case of *Hecht v. Meller*, n12 the property was substantially destroyed by fire after the contract was signed but before title closed and while the vendor still remained in possession. The purchaser exercised his statutory right to rescind the contract and recover his deposit. Since the contract between the vendor and the broker was silent on the vital question of when the commission was earned, the general rule was applied in favor of the broker. The court reasoned that the broker had "fully performed his part of the agreement with the vendor and his right to commission [became] enforceable." n13 The court found additional support for its adherence to the traditional rule in the "contractual flexibility" available to the vendor in dealing with the broker. Since the vendor could insist on conditioning the broker's right to a commission on closing of title, the court reasoned that his failure to do so refuted any suggested inequity in the traditional rule. However, if the seller (or purchaser) is not aware that a broker's commission must be paid even though the transaction is not completed through no fault of his own, it is of no consolation to be informed after the fact that including a condition precedent in the brokerage agreement would have protected the parties from owing the commission. n14

Nevertheless, a clear majority of states adhere to the view that the vendor owes the broker a commission under the "ready, willing and able" rule even though title never closes because of the purchaser's default. n15 A growing number of states, however, have denied the broker a commission when the buyer defaults. n16

[2] Effect of Contractual Provisions

A significant number of states require real estate brokers to obtain written brokerage contracts as a prerequisite to collecting a commission. n16.1 The rights, obligations, and duties of all parties should be in language that is clear and unambiguous. The courts generally will construe any ambiguity against the drafter of the document. If the broker's commission will be contingent upon the actual closing of title and payment of the purchase price, it should be so stated. n17 Such a provision, often called an "if, be and when" clause, is generally agreeable to both parties. As long ago as 1919, the New York Court of Appeals observed that "[n]o collections, no commissions has a fair business appeal to both seller and broker." n18 When there are specific requirements other than closing, however, and the broker meets the terms of the listing contract, the broker's commission will be enforceable. In *Edward S. Gordon v. TPD Corp.*, n19 the broker submitted documentary evidence establishing that the conditions for the commission had been met.

The term of the listing agreement must be carefully drafted. In *Callaway v. Overholt*, n20 the court held that a stipulation to a brokerage agreement requiring payment of a brokerage commission to a broker upon the consummation of a sale only affected the time at which a broker's commission was payable, and did not modify the seller's obligation to pay the commission when a broker procured a ready, willing and able buyer. n21

An important qualification of the effect of such a clause is that it will not shield the vendor from liability to pay a commission where the failure to close is the vendor's fault. n22 To overcome this qualification some brokerage agreements specifically state that no commission is due if title fails to close for "any reason whatsoever," n23 or "fault of the seller." n24 Such provisions shield the vendor from all liability for conduct short of fraud. n25

A New York case furnishes an interesting interpretation of a clause, widely used in the state, that stated: "The aforesaid commission is due and payable to the above named licensed broker as, if and when title passes [rider omitted], except for willful default on the part of the seller, in which case the commission shall be payable upon demand after said default." n26 A more disturbing result occurred in *R.L. Friedland Realty v. Modern Cabinets Corp.*, n27 wherein the New York court upheld the vendors' right not to pay a commission when the brokerage agreement required the commission to be paid "upon passing of title." In this case, the title did not pass because the vendors refused to provide a certificate of occupancy prior to the closing, and the court held that the broker failed to prove that the vendors willfully breached an enforceable contract.

The broker produced a ready, willing and able buyer on the vendor's previously stated terms, but the vendor refused to sign a contract because he had a better offer. A majority of the court found the clause ambiguous and since it was drafted by the broker, construed the term most strongly against the broker and held that "willful default" only applied to a vendor who breached a binding contract, finding that refusal to enter into a contract was not a default. n28

This theory is not without its limits, however. If a brokerage agreement provides that a broker's commission is to be paid upon sale, it most likely contemplates an actual sale and not a transfer of title due to foreclosure, where one court has held that no commission was due. n29

One should also note that in an option agreement, the almost universal rule is that if the buyer has a mere option to perform and does not perform, no commission will be payable because the broker has not produced a ready, willing and able buyer. n30 The drafting of the agreement must leave no room for doubt that both parties intended the agreement to be an option and not a binding contract. n30.1

Leases, however, fall under the traditional rule. Under most state statutes, a lease is considered a "sale" within the contemplation of the state's licensing statute. n31 The difficulty of leasing commissions is that they are often paid over a long period of time. Leasing commissions represent personal obligations that are not covenants running with the land, so that if the existing landlord sells the property, the new purchaser is not liable for the commission payments. n32 Brokers have sometimes attempted to record information pertaining to their commission and, in effect, to block the sale. The broker should be very cautious about this, however, because it could give rise to a slander of title suit, as a brokerage commission is normally a personal property right, not a real property right. n33 This also includes the broker's right to file lis pendens or place equitable liens on the property in order to enforce the right to a commission. n34

Long-term contracts for sale, frequently referred to as installment land contracts, create additional problems for brokerage commissions. In *Chicago Title Agency of Las Vegas, Inc. v. Schwartz*, n35 the Nevada Supreme Court held that "closing" occurred at the disbursement of escrow proceeds and not after all the terms of the contract for sale had been completed. The Connecticut courts have held "[i]n the case of an ordinary, unconditional brokerage arrangement, a commission is due when the broker produces a buyer who is ready, willing and able." Where the broker's right to a commission is "expressly made dependent upon the occurrence of a specific condition" then this reasoning would not control. n36 Some jurisdictions will enforce the payment of commission even if the written contract is entered into after the services have been rendered by the broker. n37

[3] Financial Ability of the Purchaser

In those jurisdictions following the majority rule, that is, where a broker may earn the right to a commission without a successful closing, or where the brokerage contract obviates the need for closing, a broker suing a vendor for payment of a commission must generally show that the prospective buyer had the financial ability to make the purchase.

Where, however, the vendor enters into a binding written contract with the purchaser produced in good faith by the broker, the majority view holds that no further proof of the purchaser's financial ability is traditionally required. As the Oregon Supreme Court stated:

If the employer [enters into a binding contract with the customer/buyer], he in effect says to the broker:

"I accept the customer as a person ready, able, and willing to purchase or exchange lands, as the case may be; you have done what you agreed to do; I have accepted the services rendered by you; and you have earned your commission."

The employer has a reasonable opportunity to investigate the ability of the customer to perform and when, *without fraud or misrepresentation on the part of the broker*, the employer accepts the customer by effecting a valid and binding contract with him, it is equivalent to a determination that the customer is a person ready, able and willing to purchase or exchange, and the employer is estopped thereafter to deny the ability or willingness of the customer to complete the contract. n38

When a broker must prove the financial ability of the purchaser and how a broker proves such ability are issues that constitute a major source of litigation in this field. n39 The subject is treated extensively in Chapter 5.

FOOTNOTES:

(n1)Footnote 1.

California: Freeman v. Creelman, 60 Cal. App. 14, 212 P. 56 (1922) .

Georgia: Ben Farmer Realty, Inc. v. Owens, 286 Ga. App. 678, 681, 649 S.E.2d 771, 774 (2007) , cert.

denied, 2008 Ga. LEXIS 81 (Jan. 7, 2008) .

Massachusetts: Hillis v. Lake, 421 Mass. 537, 658 N.E.2d 687 (Mass. 1995) (under Massachusetts law, where the broker produces a ready, willing, and able buyer whom the seller, for whatever reason, refuses to accept, the broker is entitled to a commission only if it appears that the closing was prevented by wrongful conduct on the seller's part or if the brokerage contract included a specific provision that the broker is entitled to the commission notwithstanding the seller's refusal to accept the buyer).

New York: Lane-- The Real Estate Dept. Store v. Lawlet Corp., 28 N.Y.2d 36, 319 N.Y.S.2d 836, 268 N.E.2d 635 (1971) ; Tanenbaum v. Boehm, 202 N.Y. 293, 95 N.E. 708 (1911) .

See also Mecox Realty Corp. v. Rose, 202 A.D.2d 404, 608 N.Y.S.2d 526, 1994 N.Y. App. Div. LEXIS 1950 (2d Dept. 1994) (holding that a broker's right to a commission is not dependent upon the closing of title, unless there is an agreement to the contrary).

(n2)Footnote 2. 3A Corbin, Contracts (1960); Annot. 45 A.L.R.3d 1936 (1972) .

See:

Federal: Duckworth v. Field, 516 F.2d 952 (5th Cir. 1975) .

New York: Ostroff v. Doctor, 238 N.Y. 264, 144 N.E. 577 (1924) .

See also §§ 4.04[1], 4.06[1] below .

(n3)Footnote 3. *Mecox Realty Corp. v. Rose, 202 A.D.2d 404, 608 N.Y.S.2d 526, 1994 N.Y. App. Div. LEXIS 1950 (2d Dept. 1994) .*

(n4)Footnote 4. *Verity v. Ottinger, 223 A.D. 344, 1928 N.Y. App. Div. LEXIS 6210, 227 N.Y.S. 650 (1st Dept. 1928) ; House v. Hornburg, 267 App. Div. 557, 1944 N.Y. App. Div. LEXIS 4776 (4th Dept. 1944) .* On the question of open points in the transaction, *see* the discussion on "Essential Terms" at § 4.07[5] below .

(n5)Footnote 5. *Ellsworth Dobbs, Inc. v. Johnson, 50 N.J. 528, 236 A.2d 843, 852 (1967) .*

(n6)Footnote 6. *Ellsworth Dobbs, Inc. v. Johnson, 50 N.J. 528, 236 A.2d 843, 852 (1967) .*

(n7)Footnote 7. An early and much-cited authority is *McGavock v. Woodlief, 61 U.S. (20 How.) 221, 15 L. Ed. 884 (1858) .*

See also:

New Hampshire: Blais v. Remillard, 643 A.2d 967 (N.H. 1994) .

Ohio: Driscoll v. Norprop, Inc., 129 Ohio App. 3d 757, 719 N.E.2d 48, 52-53 (1998) (agent or broker who makes a contract with a property owner to find a buyer for the real estate at a specified commission and then produces a buyer is, absent fraud, entitled to compensation for his services; a purchase agreement that contained an option allowing the buyer to cancel the agreement upon written notice was supported by valid consideration in the form of the buyer's earnest money deposit and was an enforceable contract for purposes of a claim for a commission).

Texas: Bayer v. McDade, 610 S.W.2d 171 (Tex. Civ. App.--Houston 1980) writ of error refused no reversible error (July 8, 1981); *Ramesh v. Johnson*, 681 S.W.2d 256 (Tex. Ct. App. 1984) writ of error refused no reversible error (Mar. 20, 1985), rehearing of writ of error overruled (May. 1, 1985) (where the requirements of procurement and a writing were satisfied, courts will regularly treat the broker's rights under the contract as continuing in existence for a reasonable time after the contract's termination by mutual rescission of the purchaser and owner so as not to deprive the broker of the commission he has earned).

For discussion of the "ready, willing, and able" requirements, see ch. 5 below.

(n8)Footnote 8. *Bushnell Real Estate, Inc. v. Nielson*, 672 P.2d 746, 751 (Utah 1983) ; *Robert Langston, Ltd. v. Mcquarrie*, 741 P.2d 554, 64 Utah Adv. Rep. 42 (Utah 1987) cert. denied, 765 P.2d 1277 (Utah 1987) (once the broker meets the obligation under the exclusive listing agreement, it is irrelevant that the buyer later failed to complete his payment obligation or that the sale agreement was rescinded years later). See also *Fairbourn Commercial, Inc. v. American Housing Partners, Inc.*, 2004 UT 54, at P13, 94 P.3d 292, 295 (Utah 2004) (the phrase "at closing," by itself, is not a condition precedent to a broker's receipt of commission).

(n9)Footnote 9. *Lockett v. Drake*, 43 Ariz. 357, 31 P.2d 499, 500 (1934) . Interestingly, the court remarked: "It is unfortunate that [the owner] is compelled to pay a commission, when the services of the broker did not produce the result which she anticipated ... "; *Manning v. Blackwelder*, 146 Ariz. 411, 706 P.2d 737 (Ariz. 1985) ; *Campbell v. Mahany* 620 P.2d 711 (Ariz. App. 1980) .

(n10)Footnote 10. *Gilder v. Davis*, 137 N.Y. 504, 506, 33 N.E. 599, 600 (1893) ; *Bass Inv. Co. v. Banner Realty, Inc.*, 103 Ariz. 75, 436 P.2d 894 (Ariz. 1968) ; *Nationwide Resources Corp. v. Ngai*, 129 Ariz. 226, 630 P.2d 49 (Ariz. App. 1981) .

(n11)Footnote 11. For cases discussing damages upon breach by the purchaser, see:

Minnesota: Real Estate Dynamics v. Genzler, 369 N.W.2d 22 (Minn. Ct. App. 1985) (the Court of Appeals of Minnesota found that where the seller had a choice between liquidated damages and specific performance after a prospective buyer defaulted, and the seller chose the liquidated damages, the broker could not collect his commission).

New York: Schaechter v. Regency Properties, Inc., 115 A.D.2d 981, 497 N.Y.S.2d 793, 1985 N.Y. App. Div. LEXIS 55371 (4th Dept. 1985) (holding that a purchaser who employed a broker, but breached the contract procured by that broker, is liable to the broker for the commission he would have received if the contract had been executed).

Tennessee: Wayne Boykin & Associates v. Tinsley, 2008 Tenn. App. LEXIS 178 (Mar. 26, 2008) (Defaulting buyer was liable to both the listing agent and the buyer's agent for their commissions. The court had found that the buyer was financially able to complete the sale but chose not to because of a conflict with his agent).

Texas: Davidson v. Suber, 553 S.W.2d 430 (Tex. Civ. App. - Austin 1977) (holding that if a purchaser backs out of the agreement, and the seller chooses not to enforce specific performance, the broker may still maintain an action for a commission).

(n12)Footnote 11.1. See *Bychowski v. ERA Tempo Realty*, 274 Ill. App. 3d 1093, 211 Ill. Dec. 389, 655 N.E.2d 292

(Ill. App. 1 Dist. 1995) (the broker remained entitled to the commission, notwithstanding the fact that the buyer and the seller agreed to rescind the sale shortly after the closing). *Byrd v. Wilson Trust*, 182 S.W.3d 701, 708 (Mo. Ct. App. 2006) (In the absence of an express stipulation in the contract to the contrary, a broker is entitled to a commission upon producing a buyer ready, willing, and able to purchase the real estate on terms agreeable to the seller. This rule, which was applied to an auctioneer, allowed the auctioneer to recover a commission even though the house burned prior to settlement and the buyer refused to complete the sale.).

(n13)Footnote 11.2. *See*:

New Mexico: Bogle v. Summit Investment Co., LLC, 107 P.3d 520, 527, 2005 NMCA 24 (N.M. Ct. App. 2005) (This case involved a buyer's broker. The court stated that the law implies certain promises between a buyer and a broker even if the commission is to be paid by the seller, as in this case. Generally, a purchaser is liable to a broker for breach of an implied promise when the purchaser fails to complete the transaction.).

New York: Duross Co. v. Evans, 22 A.D.2d 573, 574-575, 257 N.Y.S.2d 674, 677, 1965 N.Y. App. Div. LEXIS 4596 (N.Y. App. Div. 1965) (The purchasers' breach of their contract with the broker entitled the broker to damages because the purchasers' action prevented the broker from earning his commission. Although a proposed purchaser does not undertake to pay the commission, the purchaser may be liable for consequential damages by reason of the breach of his contract with the broker, which damages include compensation for the deprivation of the commission the broker would have been paid by the owner of the property.).

Cf. Blache v. Goodier, 22 So. 2d 82, 85-86 (La. Ct. App. 1945) (A broker is entitled to his commission as soon as he has obtained a purchaser ready, willing and able to buy at the price agreed upon by the owner, and that the commission is due by the prospective purchaser if, after binding himself, the prospective purchaser refuses to comply with his agreement.).

(n14)Footnote 12. 23 N.Y.2d 301, 296 N.Y.S.2d 561, 244 N.E.2d 77 (1968) .

(n15)Footnote 13. 23 N.Y.2d at 305 .

(n16)Footnote 14. *See Manzin v. United Bank & Trust Co.*, 6 Conn. App. 513, 506 A.2d 169 (1986) (a broker was denied a commission where the real estate brokerage commission agreement was modified to provide that the broker would accept as payment of his commission ten percent of the payments made by the purchaser and the purchaser failed to perform).

See also Bersani v. Basset, 184 A.D.2d 996, 585 N.Y.S.2d 245, 1992 N.Y. App. Div. LEXIS 8213 (4th Dept. 1992) (holding that the parties may agree to payment of commissions only on passage of title).

(n17)Footnote 15.

Federal: Otero v. Buslee, 695 F.2d 1244 (10th Cir. 1982) (in suit by seller for buyer's breach of contract, award for commission was upheld as seller incurred an obligation to pay broker for producing a ready, willing and able buyer).

Arkansas: Bailey v. Montgomery, 31 Ark. App. 1, 786 S.W.2d 594 (Ark. 1990) (broker's right to recover commission may not be predicated on a completed sale but there must be a contractual relationship and the broker must have been employed by the person from whom the commission is claimed. Here, the broker attempted to recover his lost commission from the buyers when the contract in question was

between the broker and the sellers); *Gautrau v. Long*, 271 Ark. 394, 609 S.W.2d 107 (Ark. Ct. App. 1980) (broker's commission was earned when buyer and seller executed binding contract, even though bank refused buyer's assumption of the mortgage and buyer thereby defaulted, as contract was not conditional on bank's granting assumption).

California: In re Estate of Lopez, 8 Cal. App. 4th 317, 10 Cal. Rptr. 2d 67 (Cal. Ct. App. 1992) (holding that California does not generally require consummation of a sale before a commission becomes due and owing and noting, however, that the California Probate Code does not permit the payment of a broker's commission until the sale is consummated).

Connecticut: Walsh v. Turlick, 164 Conn. 75, 316 A.2d 759 (1972) (broker earned commission by producing a buyer who signed a binding contract, irrespective of whether he was a ready, willing and able buyer who thereafter defaulted; clause in contract of sale that broker's commission is earned upon transfer of title was of no consequence, as broker was not a party to that contract, and no such provision was contained in brokerage agreement).

Delaware: Heldmyer v. Cleaver, 30 Del. 135, 104 A. 635 (1918) (if contract is signed, buyer's refusal to complete transaction, without broker's fault, does not prevent broker from recovering his commission).

Florida: Acheson v. Smiths, 110 Fla. 240, 148 So. 576 (1933) (liquidated damage clause does not cause valid contract for sale to be treated as an option which, if not exercised, prevents broker from earning commission).

Georgia: Davis v. Holbrook, 75 Ga. App. 417, 43 S.E.2d 791 (1947) (broker's right to commission depends not upon completion of sale, but is earned when a broker produces a ready, willing and able buyer who actually offers to buy on the owner's terms). *But see Bentley Group, Ltd. v. Paces Ferry Anesthesiology Assocs.*, 180 Ga. App. 818, 350 S.E.2d 826 (1986) (where the Court of Appeals of Georgia held that a broker could not recover his commission where there were inconsistencies between the seller's offered sales terms and the contract prepared by the broker).

Illinois: Real Estate Buyer's Agents, Inc. v. Foster, 600 N.E.2d 83 (Ill. App. Ct. 1992) (where the broker obtained a signed offer for the property on the defendant's terms but the defendant refused to sign, the court, relying on Illinois law, held that brokerage contracts may be oral or governed by ordinary contract law and that the statute of frauds is inapplicable); *Wilfong v. W.A. Schickedanz Agency, Inc.*, 85 Ill. App. 3d 333, 40 Ill. Dec. 625, 406 N.E.2d 828 (1980) (contract made pursuant to auction sale entitled broker to full commission even though sale was not consummated; brokerage agreement provided for full commission if property sold at auction, but only \$400 if property was not sold).

Iowa: Nickelsen v. Morehead, 238 Iowa 970, 29 N.W.2d 195 (1947) (where buyer unable to proffer purchase price in accordance with contract, and seller released him from contract for consideration, broker was still entitled to commission).

Kentucky: Shanklin v. Townsend, 431 S.W.2d 874 (Ky. Ct. App.), *modified on other grounds*, 434 S.W.2d 655 (Ky. 1968) (word "sale" is not interpreted as requiring consummation of transaction for purposes of broker's commission).

Maryland: DeFranceaux Realty Group, Inc. v. Leeth, 283 Md. 611, 391 A.2d 1209 (1978) (Maryland's common-law minority rule was changed by statute. Requirement that statute applies only without special agreement is strictly construed).

10-4 Real Estate Brokerage Law and Practice § 4.02

Michigan: Smith-Burns Inv. Co. v. Jones, 240 Mich. 89, 214 N.W. 946 (1927) (broker entitled to commission for bringing about sale even though buyer defaulted on payments and seller thereafter declared contract void).

Minnesota: Nelson v. Rosenblum Co., 289 Minn. 32, 182 N.W.2d 666 (1970) (broker supplied purchaser in performance of written net listing agreement and was entitled to commission paid out of buyer's forfeited earnest money when buyer breached legally enforceable purchase agreement).

Mississippi: Varner Real Estate, Inc. v. Bobb, 491 So. 2d 528 (Miss. 1986) (a real estate broker was entitled to his commission when he produced a ready, willing and able buyer on terms acceptable to the seller, notwithstanding the seller's inability to deliver possession and the buyer's disregard of a non-enforceable extension provision); *New South Corp. v. Godley*, 301 So. 2d 307 (Miss. 1974) (when down payments on property were made, brokers earned commissions, notwithstanding later defaults; if the default had occurred in the down payment (e.g., bad check) commission would not have been earned).

Missouri: Kelly v. Craigmiles, 460 S.W.2d 577 (Mo. 1970) (broker may recover commission without further proof that buyers were ready, willing and able to purchase, where sellers signed purchase agreement with buyers).

Montana: Johnson v. N.Y. Hart, 889 P.2d 1170 (Mont. 1995) (it is well established in Montana that a broker's right to recover a commission is conditioned on the broker's ability to accomplish that which he or she undertook to do in the contract of employment); *Sayegusa v. Rogers*, 846 P.2d 1005 (Mont. 1993) (supporting the broker's right to obtain his commission, the court strictly construed the terms of the listing agreement, wherein the seller had agreed to pay a commission upon execution of an agreement for the sale or exchange of the property).

New York: Hecht v. Meller, 23 N.Y.2d 301, 296 N.Y.S.2d 561, 244 N.E.2d 77 (1968) (broker was entitled to a commission when he procured a buyer who entered into a contract with the seller, even though before closing, the house was destroyed by fire and the buyer rescinded, as allowed by N.Y. G.O.L. § 5-1311); *Sauerhoff-Kessler Realty Corp. v. Roma Shopping Plaza, Inc.*, 201 A.D.2d 477, 607 N.Y.S.2d 404, 1994 N.Y. App. Div. LEXIS 1012 (2d Dept. 1994) (holding that a default by a tenant on its obligations under the lease shortly after the tenant assumed occupancy did not affect the broker's ability to recover a commission pursuant to the brokerage agreement); *Cornelia and Broad Streets, Inc. v. Chase*, 186 A.D.2d 341, 587 N.Y.S.2d 809, 1992 N.Y. App. Div. LEXIS 10810 (3d Dept. 1992) (holding that, where uncontroverted evidence charged that the plaintiff-broker procured a buyer, conclusionary assertions without evidentiary support that commissions would be earned only when title passed, are insufficient to defeat the broker's motion for summary judgment); *Bersani v. Basset*, 184 A.D.2d 996, 585 N.Y.S.2d 245, 1992 N.Y. App. Div. LEXIS 8213 (4th Dept. 1992) (holding that any preparatory work that a broker does to procure a ready, willing and able buyer is irrelevant once he agrees to forego his commission until title passes, and he bears the risks of the deal until the condition precedent is satisfied).

North Carolina: Harrison v. Brown, 222 N.C. 610, 24 S.E.2d 470 (1943) (court-appointed receiver employed broker to sell property, and broker found buyer at price fixed, but buyer, with court's permission, withdrew offer and recovered down payment: court held broker was entitled to commission); *but see Jones v. Palace Realty Co.*, 226 N.C. 303, 37 S.E.2d 906 (1946) (North Carolina Supreme Court held that an agreement to pay commission "when the deal is closed up" is enforceable only upon consummation of the sale).

Ohio: Ballard v. Thompson, 5 Ohio App. 2d 92, 34 Ohio Op. 2d 197, 214 N.E.2d 102 (1965) (this case

presents a brokerage commission dispute where a purchase agreement incorporated an earlier commission letter which placed the burden of the broker's commission on the buyer; the buyer refused to pay the full commission depending upon verbal agreements made between the buyer and the broker at the time of the signing of the commission letter; the court held the broker acted in accordance with his obligations pursuant to the contract; in the absence of fraud, broker's commission is earned upon the signing of a valid contract for sale, whether or not the sale is ever consummated).

Oklahoma: Waggoner v. Johnston, 1965 OK 192, 408 P.2d 761 (Okla. 1965) (buyer defaulted, claiming fraud, and sued for return of earnest money lost under liquidated damages provision; no fraud was established and court held that the broker, who, without misconduct, effected the sale agreement, was entitled to commission); *Eastern Oklahoma Land & Cattle Co. v. Dorris*, 549 P.2d 78 (Okla 1976) (if a broker enters into a contract with knowledge of a defect in title, or is aware of facts sufficient to put a reasonably prudent person on inquiry, and the transaction fails because of that defect, the broker is not entitled to a commission).

Pennsylvania: Shumaker v. Lear, 235 Pa. Super. 509, 345 A.2d 249 (1975) (while a broker earns commission as soon as a binding contract is signed, when the contract is conditional, and the condition does not arise to make the contract binding, the broker is not entitled to a commission unless seller has prevented the condition); *Coldwell Banker Phyllis Rubin Real Estate v. Romano*, 422 Pa. Super. 319, 619 A.2d 376 (1993), appeal denied, 534 Pa. 635, 626 A.2d 1154 (1993) (seller and broker entered into an Exclusive Right-to-Sell agreement, which contained a right of refusal by another entity; that entity purchased the property; because the broker drafted the agreements, any ambiguities would be construed against the broker, who was held to the language of the contract).

South Carolina: Thomas-McCain, Inc. v. Siter, 268 S.C. 193, 232 S.E.2d 728 (S.C. 1977) (provision providing for payment of commission "on or before settlement" related only to time of payment; thus, deletion in brokerage agreement of word "before," coupled with buyer's default on valid contract, did not serve to deprive the broker of his right to a commission); *Bishop Realty & Rentals, Inc. v. Perk, Inc.*, 292 S.C. 182, 355 S.E.2d 298 (S.C. Ct. App. 1987) (the court recognized the general rule that, unless the parties agree otherwise, a broker earns his commission when the seller accepts a buyer procured by the broker and a contract of sale is entered) cert. denied, 293 S.C. 538, 362 S.E.2d 26 (S.C. 1987).

South Dakota: Heinrich v. R.L. Oil & Gas Co. Inc., 442 N.W.2d 467 (S.D. 1989) (seller refused to furnish buyer with financial records needed to acquire financing and the transaction failed; the broker produced a buyer ready, willing, and able to purchase seller's property under a real estate listing agreement and was entitled to a commission).

Tennessee: Dobson & Johnson, Inc. v. Von Weiland, 644 S.W.2d 394 (Tenn. 1982) (the fact that the buyer stopped payment of a check in relation to a land purchase does not deprive the broker of his right to a commission which accrued when he effected a valid, written contract of sale) *Branson v. Fitzgerald*, 2009 Tenn. App. LEXIS 810, at *23 (Tenn. Ct. App. Dec. 4, 2009).

Texas: Cotten v. Deasey, 766 S.W.2d 874 (Tex. App. - Dallas 1989) writ denied (Sep. 6, 1989); *Stiles v. De Angelo*, 706 S.W.2d 175 (Tex. Ct. App. 1986) (a real estate broker who procures a buyer who is ready, willing, and able to buy on the seller's terms is entitled to a commission if completion of the sale is prevented by the seller, even if, after having been granted specific performance, the buyer later defaults).

Virginia: Edmonds v. Coldwell Banker Residential Real Estate Servs., Inc., 237 Va. 428, 377 S.E.2d 443 (1989) (a real estate broker is the procuring cause of a sale when it has originated or caused a series of events which, without a break in their continuity, resulted in the accomplishment of the prime object of

employment, *i.e.*, to procure a purchaser ready, willing and able to buy on the owner's terms); *Kuga v. Chang*, 241 Va. 179, 399 S.E.2d 816 (1991) (under a general contract of employment, as distinguished from a special contract, the broker is entitled to its commission from the owner when the broker produces a purchaser ready, willing, and able to buy the property on the owner's terms regardless of whether the sale is ultimately consummated).

Washington: Dryden v. Vincent D. Miller, Inc., 56 Wash. 2d 657, 354 P.2d 900 (1960) .

Wisconsin: Menard v. Sass, 127 Wis. 2d 397, 379 N.W.2d 344 (Wis. Ct. App. 1985) (where it was held that a broker was entitled to a full commission even though the buyer he secured defaulted and despite the fact that the standard printed listing agreement form used contained a standard clause providing for the broker to be paid one half of the amount paid by the buyer when the seller elected to take such amount as liquidated damages).

For discussion of the "ready, willing, and able" requirements, *see* ch. 5 *below*.

(n18)Footnote 16. The following states place no liability on seller to pay commission when the buyer defaults after a contract of sale (ordinary brokerage agreements):

Alabama: Brown v. Robinson, 354 So. 2d 272 (Ala. 1977) (due to defects in title, the purchasers were justified in delaying the tendering of the purchase price and the sellers were in default for refusing to convey the land, the broker was entitled to his commission); *Taylor Real Estate & Ins. Co. v. Greene*, 274 Ala. 694, 151 So. 2d 397 (1963) (court upheld rule in *Walmore Inv. Co. of Delaware v. Farrior-Jackson Realty Co.*, 218 Ala. 447, 118 So. 665 (1928) ; buyer didn't go through with the deal).

Colorado: Dunton v. Stemme, 117 Colo. 327, 187 P.2d 593 (1947) where purchaser's payments were late, violating "time of the essence" clause in a sales contract, the broker was not entitled to a commission as per Colo. Rev. Stat. § 12-61-201); *Green v. Grant*, 635 P.2d 236 (Colo. Ct. App. 1981) (the contract provided for commission payments by installments; buyer defaulted as to subsequent annual payment; obligations under the commission agreement were extinguished as to all payments but the first).

Florida: Arvida Realty Sales v. William Tinnerman, 13 Fla. L. Weekly 1563, 536 So. 2d 1041 (1988) (the broker produced three clients who made deposits under contracts but then defaulted prior to closing; the court found the language of the contract to be clear and unambiguous, and held that no commission was earned where no closing took place).

Idaho: Margaret H. Wayne Trust v. Lipsky, 123 Idaho 253, 846 P.2d 904 (1993) (wherein the Idaho Supreme court clearly adopted the *Ellsworth Dobbs* rule, discussed in § 4.03 *below*).

Kansas: Harrin v. Brown Realty Co., 226 Kan. 453, 602 P.2d 79 (1979) (where a purchaser was financially unable to perform, the court upheld the rule in *Winkelman v. Allen*, 214 Kan. 22, 519 P.2d 1377 (1974)) .

Louisiana: Adams v. Adams, 283 So. 2d 503 (La. Ct. App. 1973) (commission was denied to a broker where a buyer failed to have sale contract notarized, thus killing the deal). *See also Puckett v. Broussard*, 356 So. 2d 1021 (La. Ct. App. 1977) .

Massachusetts: Tristram's Landing, Inc. v. Wait, 367 Mass. 622, 327 N.E.2d 727 (1975) , (the court

followed *Ellsworth Dobbs v. Johnson*, saying that a commission is earned when: (1) a ready, willing and able buyer is produced; (2) a binding sales contract is made; and (3) a purchaser completes the transaction).

New Jersey: Rothman Realty Corp. v. Bereck, 73 N.J. 590, 376 A.2d 902 (1977) ; *Ellsworth Dobbs, Inc. v. Johnson*, 50 N.J. 528, 236 A.2d 843 (1967) .

North Dakota: Goetz v. Anderson, 274 N.W.2d 175 (N.D. 1978) (where neither the broker nor the purchaser would assure the seller of the financial ability of the buyer, the broker had not earned a commission based on the signing of an earnest money agreement). Note: This is an assumption of the minority rule through implication. The court never really verbalizes the rule.

Oregon: Engelking v. Boyce, 278 Or. 237, 563 P.2d 703 (1977) (the court recognized the rule that "the broker's right to a commission against the seller comes into existence only when his buyer performs in accordance with the contract of sale... ." 563 P.2d at 705).

The following jurisdictions adhere to the rule that if a buyer is unable to financially perform, the seller does not have to pay the broker's commission:

District of Columbia: Sweet v. H.R. Howenstein, 73 F.2d 660, 64 App. D.C. 20 (1934) (broker's commission was denied on grounds of a special conditional contract).

Nebraska: Cornett v. Nathan, 196 Neb. 277, 242 N.W.2d 855 (1976) .

New Hampshire: Dunn v. Staples, 109 N.H. 251, 248 A.2d 635 (1968) .

North Dakota: Goetz v. Anderson, 274 N.W.2d 175 (N.D. 1978) .

Rhode Island: Gartner v. Higgins, 214 A.2d 849 (R.I. 1965) .

Texas: Nugent v. Scharff, 476 S.W.2d 414 (Tex. Civ. App. 1971) .

(n19)Footnote 16.1. See Comment, *International Interference with Prospective Economic Advantage: A Tort that Eviscerates the Real Estate Brokers' Statute of Frauds*, 36 Santa Clara L. Rev. 150 (1996).

(n20)Footnote 17. As the court stated in *Wagner v. Derecktor*, 306 N.Y. 386, 390, 118 N.E.2d 570, 575 (1954) :

[a]lthough in the conventional brokerage transaction the broker does not assume the risk of performance, and has earned his commission when he procures purchaser ready, able and willing to buy, the parties may agree that payment is to be conditioned upon complete performance of the contract which the broker procures.

Accord:

Federal: Enerdyne Corp. v. William Lyon Dev. Co., 488 F.2d 1237 (10th Cir. 1973) (applying Colorado law); *Helmsley-Spear, Inc. v. Westdeutsche Landesbank Girozentrale*, 692 F. Supp. 194 (S.D.N.Y. 1988) (no commission was due because the consummation requirement of the brokerage agreement was unfulfilled).

Maine: Chamberlain v. Porter, 562 A.2d 673 (Me. 1989) (finding that a broker was not entitled to a commission despite his procurement of a ready, willing and able buyer, where the brokerage agreement required the commission to be paid out of the proceeds of the closing, and the sale fell through due to defects in seller's title).

New Jersey: Leadership Real Estate, Inc. v. Harper, 271 N.J. Super. 152, 638 A.2d 173 (Law Div. 1993) (holding that the common understanding of the term "the property shall be sold" requires, at a minimum, that the buyer and the seller enter into a binding contract of sale, pursuant to which the buyer would have an equitable remedy of specific performance and the seller a remedy of damages upon the breach by the buyer).

New York: Cimarron Realty 100 Ltd. v. Horner, 114 A.D.2d 924, 495 N.Y.S.2d 196, 1985 N.Y. App. Div. LEXIS 53970 (2d Dept. 1985) (a broker was not entitled to a commission where the contract specifically provided for payment of the commission when the property was "sold or exchanged" and not merely when the broker obtained a prospective buyer, and the seller refused to enter into a contract of sale with the buyer produced by the broker); *The Corcoran Group, Inc. v. Morris*, 107 A.D.2d 622, 484 N.Y.S.2d 7, 1985 N.Y. App. Div. LEXIS 42481 (1st Dept. 1985) (where the terms of an agreement between a seller and real estate broker clearly condition the broker's entitlement to a commission upon the actual closing of title, no commission is earned absent such a closing); *Ralph J. Taibi v. American Banknote*, 135 A.D.2d 810, 1987 N.Y. App. Div. LEXIS 52740 (2d Dept. 1987) (mere agreement as to price on a proposed sale of real property does not constitute a meeting of the minds of buyer and seller so as to entitle the real estate broker to a commission). Sometimes a seller will agree to pay a commission on the occurrence of some specified future event; see, e.g., *Cross & Brown Co. v. Laboratory Furniture, Inc.*, 79 A.D.2d 535, 433 N.Y.S.2d 467, 1980 N.Y. App. Div. LEXIS 13837 (1st Dept. 1980) (payment of commission upon renewal or execution of a new lease). Even when such a "contingency commission" is agreed to by the parties, problems as to whether the action by the broker fall within the realm of commissionable activities may arise. See, e.g., *Kenneth D. Laub and Co., Inc. v. 101 Park Ave. Assoc.*, 101 A.D.2d 744, 475 N.Y.S.2d 64, 1984 N.Y. App. Div. LEXIS 18378 (1st Dept. 1984) (summary judgment denied factual issues as to scope of broker's activities).

Oklahoma: Zuhdi v. Cohen Realty, Inc., 836 P.2d 686 (Okla. Ct. App. 1992) (in a case of first impression, where a brokerage agreement provided that the broker's commission was to come in installments when "cash" due on installments on the purchaser's note came in to the seller, and the purchaser defaulted and the seller received the property back at a foreclosure sale, the return of the home to the seller did not constitute "cash" for purposes of payment of the broker's commission).

Pennsylvania: Sork v. Rand, 422 Pa. 512, 222 A.2d 890 (1966) .

(n21)Footnote 18. *Colvin v. Post Mortgage & Land Co.*, 225 N.Y. 510, 517, 122 N.E. 454, 456 (1919) . The parties may agree, however, for a payment of commission only upon passage of title. This also applies to the execution of leases when the listing agreement conditions any commissions on a completed transaction. *R.B. Schlesinger & Co., Inc. v. Delson & Gordon*, 184 A.D.2d 393, 585 N.Y.S.2d 373, 1992 N.Y. App. Div. LEXIS 8506 (1st Dept. 1992) .

See also *Bersani v. Basset*, 184 A.D.2d 996, 585 N.Y.S.2d 245, 1992 N.Y. App. Div. LEXIS 8213 (4th Dept. 1992) .

(n22)Footnote 19. 182 A.D.2d 516, 582 N.Y.S.2d 699, 1992 N.Y. App. Div. LEXIS 6081 (1st Dept. 1992) .

(n23)Footnote 20. 796 S.W.2d 828 (Tex. App. 1990) .

(n24)Footnote 21. 796 S.W.2d 828, 833 (Tex. App. 1990) .

See also *Iowa Realty of Pella v. Boomsma's, Inc.*, 533 N.W.2d 549 (Iowa 1995) (under Iowa law, a letter agreement extending the protective clause for the broker's commission beyond the expiration date set forth in the original listing agreement was unenforceable, where there was no provision in the original listing agreement establishing a definite protection period).

(n25)Footnote 22. *Koupal & Anton, Inc. v. Wieczorek*, 375 N.W.2d 639 (S.D. 1985) (a jury could properly conclude that a principal has wrongfully revoked a listing agreement where, after presentation to the principal by the broker of a signed purchase offer, the principal stated that the land was priceless and that he would not sell the farm for even \$2,000 per acre); *White v. Nemastil*, 29 Ohio App. 3d 1, 503 N.E.2d 189 (Ohio 1985) . See generally § 4.04 below.

(n26)Footnote 23. *Roberts v. Food Fair Stores, Inc.*, 54 A.D.2d 635, 387 N.Y.S.2d 623 (1st Dept. 1976) , *aff'd*, 42 N.Y.2d 917, 397 N.Y.S.2d 1005, 366 N.E.2d 1359 (1977) .

(n27)Footnote 24. *Langfan v. Walzer*, 13 N.Y.2d 171, 244 N.Y.S.2d 305, 194 N.E.2d 124 (1963) .

(n28)Footnote 25. *Langfan v. Walzer*, 13 N.Y.2d 171, 244 N.Y.S.2d 305, 194 N.E.2d 124 (1963) .

See also:

Federal: Dixon v. Bernstein, 182 F.2d 104 (D.C. Cir. 1950) .

New York: Grenell Realty Agency, Inc. v. Gruner, 63 N.Y.S.2d 443, 1946 N.Y. Misc. LEXIS 2421 (1st Dept. 1946) .

(n29)Footnote 26. *Graff v. Billet*, 64 N.Y.2d 899, 902, 487 N.Y.S.2d 733, 735, 477 N.E.2d 212, 214 (1985) .

(n30)Footnote 27. 194 A.D.2d 657, 598 N.Y.S.2d 817, 1993 N.Y. App. Div. LEXIS 6134 (2d Dept. 1993) ; *Gulf Oil Corp. v. American Louisiana Pipe Line Co.*, 282 F.2d 401 (6th Cir. 1960) (the court held that where a contract depends upon a condition precedent one cannot avoid his liability by making the performance of the condition precedent impossible, or by preventing it).

(n31)Footnote 28. *Graff v. Billet*, 64 N.Y.2d 899, 902, 487 N.Y.S.2d 733, 735, 477 N.E.2d 212, 214 (1985) .

(n32)Footnote 29. *Zuhdi v. Cohen Realty, Inc.*, 836 P.2d 686 (Okla. Ct. App. 1992) . Cf. *Premier Van Schaack Realty, Inc. v. Sieg*, 51 P.3d 24, 30, 2002 UT App. 173, at P16 (Utah Ct. App. 2002) (no commission due when the seller transferred property to a separate legal entity in which he was an investor; the owner retained essentially the same ownership interest he had in the property prior to the conveyance). But see *Sutton v. East River Sav. Bank*, 55 N.Y.2d 550, 435 N.E.2d 1075 (1982) (broker was awarded a commission when his client's nominee bid on property subject to a commission agreement at the foreclosure sale and subsequently closed title).

(n33)Footnote 30. *John Dull & Co. v. Life of Nebraska Ins. Co.*, 642 S.W.2d 1 (Tex. App. - Houston 1982) .

(n34)Footnote 30.1. *Rubinstein v. Rubinstein*, 23 N.Y.2d 293, 296 N.Y.S.2d 354, 244 N.E.2d 49 (1968) .

(n35)Footnote 31. See:

Alabama: Glover v. Irving Winter Co., Inc., 595 So. 2d 881 (Ala. 1992) (holding that a broker's efforts in arranging the original lease of the property sparked the tenant's interest in purchasing the property and, therefore, the broker was entitled to his commission, even though the original lease had expired and the tenant purchased the property indirectly, where the tenant remained in continuous possession of the

property, whether under the original lease or a continuation thereof, and had become the equitable owner of the property).

California: John B. Kilroy Co. v. Douglas Furniture of Cal., Inc., 21 Cal. App. 4th 26, 25 Cal. Rptr. 2d 752 (Cal. Ct. App. 1993) (where the landlord pleaded that the leases had terminated and that no commission was due under the original terms of the lease, the California Court of Appeals held that the new leases involved the same tenants, landlord and premises, together with continuous occupancy, and that there were no material changes between the original lease and the existing lease).

Idaho: Strout Realty v. Milhous, 107 Idaho 330, 689 P.2d 222 (Idaho Ct. App. 1984) .

Texas: Moser Co. v. Awalt Indus. Properties, Inc., 584 S.W.2d 902 (Tex. Civ. App.--Amarillo 1979) .

(n36)Footnote 32. *Dauley v. First Nat'l Bank of Fort Worth*, 565 S.W.2d 346 (Tex. Civ. App.--Ft. Worth 1978) .

(n37)Footnote 33. *Walker v. Ruggles*, 540 S.W.2d 470 (Tex. App.--Houston, 1976) .

(n38)Footnote 34. *VRG Corp. v. GKN Realty Corp.*, 641 A.2d 519 (N.J. 1994) .

(n39)Footnote 35. 851 P.2d 419 (Nev. 1993) .

(n40)Footnote 36. *Nugent v. Del Vecchio*, 36 Conn. Supp. 532, 415 A.2d 1339 (1980) .

(n41)Footnote 37. *Isaguirre v. Echevarria*, 96 Idaho 641, 534 P.2d 471 (1975) .

(n42)Footnote 38. *Oregon Home Builders v. Montgomery Inv. Co.*, 94 Or. 349, 184 P. 487 (1919) .

Accord:

Florida: Sticht v. Shull, 543 So. 2d 395 (Fla. 4th DCA 1989) .

Illinois: Western Pride Builders Inc. v. Zicha, 23 Ill. App. 3d 770, 320 N.E.2d 181 (1974) .

New York: Flicker v. Ragan, 126 Misc. 185, 1925 N.Y. Misc. LEXIS 1151, 212 N.Y.S. 703 (1925) .

Wisconsin: Mansfield v. Smith, 88 Wis. 2d 575, 277 N.W.2d 740, 745 (1979) .

While entering into a binding contract shows "acceptance" of the purchaser, conduct amounting to less than an actual contract signing can produce the same conclusion, where it unequivocally shows satisfaction with the purchaser. *See Rosenblatt v. Bergen*, 237 N.Y. 88 (1923) .

Contra:

Kansas: Winkelman v. Allen, 214 Kan. 22, 519 P.2d 1377 (1974) .

Rhode Island: Mangano v. Rooney, 77 R.I. 324, 74 A.2d 867 (1950) ; *Butler v. Baker*, 17 R.I. 582, 23 A. 1019 (1892) .

Vermont: Staab & Messier, 128 Vt. 380, 264 A.2d 790 (1970) .

(n43)Footnote 39. *Carroll v. Harry Norman, Inc.*, 198 Ga. App. 614, 402 S.E.2d 357 (Ga. 1991) (at issue was whether purchaser qualified for a fixed-rate loan and made a reasonable effort to obtain one; agent-plaintiff did not carry burden of demonstrating purchaser failed to make a reasonable attempt to obtain the loan she was obligated to seek under the contract, or that she qualified for such, or that she agreed to close with the optional loan).

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88 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.03

§ 4.03 Requirement that Title Close--Minority Rule

[1] Closing Required: *Dobbs v. Johnson*

[a] Introduction

In 1967, the case of *Ellsworth Dobbs, Inc. v. Johnson*ⁿ¹ caused the New Jersey Supreme Court to reevaluate the traditional rule long followed by the state with respect to the accrual of a broker's right to a commission. ⁿ² The court established the general rule that a successful closing is required as a condition to a broker's right to a commission, thereby firmly establishing a minority holding on this issue. Basing its decision on public policy grounds and the inequality in bargaining power between the average homeowner-seller and the average broker, the court, in dictum, also declared that a contract provision purporting to eliminate closing of title as a prerequisite to the right of the broker to a commission might be declared unenforceable as against public policy.

[b] The Facts

The Johnsons wished to sell a one-hundred forty-four acre tract of farm land and listed it with several brokers on a non-exclusive basis. A party named Iarussi was interested in acquiring land for residential development and consulted the Ellsworth Dobbs Agency, with whom the Johnson property had been listed. ⁿ³ Thomas Fleming, a Vice President of Dobbs, showed Iarussi the Johnson tract and sometime in 1960 an oral agreement was reached between the Johnsons and Iarussi. This deal collapsed because of Iarussi's lack of financial support. Subsequently, in early 1961 Iarussi renewed his interest in the Johnson tract, and on May 1, 1961 signed a contract with the Johnsons to purchase it for \$250,000 payable as follows:

On execution of the contract etc.	\$1,500
Further, on June 15, 1961 additional	1,000
On passing of title.....	10,000
On purchase money mortgage, etc.	237,500

Closing was set for September 1, 1961. As to brokerage commissions, the contract provided:

The commission hereinafter mentioned shall be payable as follows: \$5,000.00 when sellers shall have received a total of \$25,000.00 on account of the above purchase price (\$10,000.00 herewith and \$15,000.00 on account of the principal sum of the above-mentioned purchase money note and mortgage); an additional \$5,000.00 when an additional \$25,000.00 shall have been paid on account of the principal sum of purchase money note and mortgage; and the remaining \$5,000.00 when an additional \$25,000.00 shall have been paid on account of the principal sum of said purchase money note and mortgage. The entire commission of \$15,000.00 shall become immediately due and payable upon any sale or assignment by sellers of said purchase money note and mortgage.

And the Seller hereby agrees to pay to Ellsworth Dobbs, Inc., a commission of Six (6) percent on the purchase price aforesaid, said commission to be paid in consideration of services rendered in consummating this sale; said commission to become due and payable as above mentioned. n4

Iarussi made the first two payments, totalling \$2,500 but never made any further payments because of inability to secure financing. The vendor, the purchaser and the broker gave conflicting evidence as to knowledge of the purchaser's financial problems and whether the broker had agreed to assist in the raising of money. In any event, after prolonged negotiations, including litigation between the vendor and the purchaser, the purchaser finally confessed his inability to make the remaining payments and the vendor released him on May 15, 1962, after the property had been tied up for about a year. Dobbs then commenced an action against the Johnsons and Iarussi, claiming a \$15,000 commission. The trial court directed a verdict against the Johnsons and the jury found for Dobbs against Iarussi on an implied agreement to complete the contract. The Appellate Division reversed both judgments and the Supreme Court granted Dobbs' application to appeal. On the merits the Supreme Court held: (1) as a matter of law the Johnsons owed no commission to Dobbs; and (2) as to Iarussi:

Under all the circumstances we hold that the Appellate Division erred in finding that Dobbs had no cause of action against Iarussi as a matter of law and in directing entry of judgment in favor of Iarussi. In our judgment, there is a jury question as to the nature of the relationship between Dobbs and Iarussi. A jury should also decide whether Dobbs (through Fleming) knew and agreed, expressly or impliedly, that performance was subject to the financing contingency and that commission would be earned only on satisfaction of that contingency. If the jury finds in favor of Iarussi on this issue, Dobbs is not entitled to recover. n5

[c] The Law

Although the court cited numerous New Jersey authorities in support of the traditional rule it found that rule deficient in point of justice and out of harmony with the reasonable expectations of the parties. In reaching this conclusion the court quoted extensively from the distinguished English jurist, Lord Denning, as follows:

When a house owner puts his house into the hands of an estate agent, the ordinary understanding is that the agent is only to receive a commission if he succeeds in effecting a sale; but if not, he is entitled to nothing. That has been well understood for the last 100 years or more. ... The agent in practice takes what is a business risk: he takes on himself the expense of preparing particulars and advertising the property in return for the substantial remuneration--reckoned by a percentage of the price--which he will receive if he succeeds in finding a purchaser.

No particular words are needed to create the relationship. All the familiar expressions "please find a purchaser," "find someone to buy my house," "sell my house for me", and so on, mean the same thing: they mean that the agent is employed on the usual terms; but none of them gives any precise guide as to what is the event on which the agent is to be paid. The common understanding of men is, however, that the agent's commission is payable out of the purchase price. The services rendered by the agent may be merely an introduction. He is entitled to commission if his introduction is the efficient cause in bringing

about the sale. ... But that does not mean that commission is payable at the moment of the introduction: it is only payable on completion of the sale. The house-owner wants to find a man who will actually buy his house and pay for it. He does not want a man who will only make an offer or sign a contract. He wants a purchaser "able to purchase and able to complete as well" [citing cases].

Some confusion has arisen because of the undoubted fact that, once there is a binding contract for sale, the vendor cannot withdraw from it except at the risk of having to pay the agent his commission. This has led some people to suppose that commission is payable as soon as a contract is signed: and I said so myself in *McCallum v. Hicks* [(1950) 2 K.B. 277, 1 All Eng. Rep. (1950) 864].

But this is not correct. The reason why the vendor is liable in such a case is because, once he repudiates the contract, the purchaser is no longer bound to do any more towards completion: and the vendor cannot rely on the non-completion in order to avoid payment of commission, for it is due to his own fault. ... [citing cases]. But if the vendor could show that the purchaser would not in any event have been able or willing to complete, he would not be liable for commission. ... When it is not the vendor, but the purchaser, who withdraws, the case is entirely different; for, even though a binding contract has been made, nevertheless, if the purchaser is unable or unwilling to complete, the agent is not entitled to his commission. n6

The extract was taken from *Dennis Reed, Ltd. v. Goody* [1950] 2 K.B. 277, at pp. 284-85 .

The New Jersey Supreme Court summarized its holding as follows:

Study of the problems involved in this case in light of the above considerations leads us to the following conclusions as to what the *controlling rule should* be in New Jersey: When a broker is engaged by an owner of property to find a purchaser for it, the broker earns his commission when (a) he produces a purchaser ready, willing and able to buy on the terms fixed by the owner, (b) the purchaser enters into a binding contract with the owner to do so, and (c) the purchaser completes the transaction by closing the title in accordance with the provisions of the contract. *If the contract is not consummated* because of lack of financial ability of the buyer to perform or because of any other default of his, [citation omitted] there is no right to commission against the seller. On the other hand, if the failure of completion of the contract results from the wrongful act or interference of the seller, the broker's claim is valid and must be paid. In short, in the absence of default by the seller, the broker's right to commission against the seller comes into existence only when his buyer performs in accordance with the contract of sale. n7

Interestingly, the court at one point in its discussion emphasized the "wrongful act or interference of the seller." This leaves in some uncertainty the common situation where the purchaser justifiably rejects the vendor's title because it is unmarketable. This is a breach by the vendor but does not necessarily represent a wilful act on his part. n8 Other jurisdictions have divided on this point, as discussed elsewhere in this text. n9

[d] Effect on Contractual Provisions

The New Jersey court did not stop with holding that a brokerage contract will ordinarily be interpreted to require a successful closing as a condition to the broker's right to a commission. Such a holding clearly solves the problem insofar as it is based on the reasonable expectations of laypersons. But what about a case where the brokerage agreement expressly negates such a condition and states in no uncertain terms that the broker's commission shall be earned when the vendor signs a contract with a purchaser produced by the broker? The court anticipated such a case and, in a bold dictum, declared that such an agreement violates public policy. The court stated:

The rules which we have set down above to govern dealings, rights, and duties between brokers and owners are necessary for the protection of property owners, and constitute the public policy of our

[s]tate. Whenever there is substantial inequality of bargaining power, position or advantage between the broker and the other party involved, any form of agreement designed to create liability on the part of the owner for commission upon the signing of a contract to sell to a prospective buyer, brought forward by the broker, even though consummation of the sale is frustrated by the inability or the unwillingness of the buyer to pay the purchase money and close the title, we regard as so contrary to the common understanding of men, and also so contrary to common fairness, as to require a court to condemn it as unconscionable. [Citation omitted].

In view of our holding here that a broker is not entitled to commission from the seller if title does not pass because of the inability or fault of the customer, and the further rule to be expounded hereafter respecting the liability of the buyer to the broker where the buyer is the defaulting party, in our judgment public policy requires the courts to read into every brokerage agreement or contract of sale a requirement that barring default by the seller, commissions shall not be deemed earned against him unless the contract of sale is performed. By the same token, whenever the substantial inequality of bargaining power, position or advantage to which we have adverted appears, a provision to the contrary in an agreement prepared or presented or negotiated or procured by the broker shall be deemed inconsistent with public policy and unenforceable. n10

By its emphasis on inequality of bargaining power the court seems to focus on the ordinary layperson selling his house through the agency of a professional broker. One might imply that the rule may not apply to more sophisticated parties in an environment where brokers are highly competitive.

The aspect of the case dealing with the broker's rights against a defaulting purchaser is discussed elsewhere in the text. n11

[e] Critique

It cannot be denied that the classic objective theory of contracts could operate harshly in particular cases. If a listing owner were distracted or inattentive and failed to read the "fine print" of a listing agreement, he was nevertheless bound by the terms set forth. n12 Even if the owner read the agreement he might not appreciate the meaning of terms that had the effect of vesting the broker's right to a commission on the signing of the contract of sale, though deferring its payment until the closing.

If a court is convinced that the usual understanding of laypersons is that, absent fault, a commission is payable only out of proceeds at closing, then not only may such court imply this term when the brokerage agreement is silent; it may go further--without going as far as the *Dobbs* court in holding continuing provisions substantively unconscionable *per se*. There is authority for a middle ground that modifies the severity of the traditional objective theory of contracts. The middle view is this: a term fixing the right to a commission at some time prior to closing is harsh and unusual--it crosses "the common understanding of mankind." n13 It is within the parties' competence to bind themselves to such a term but only by informed consent, not just the manifestation of assent traditionally associated with signing a writing, whether one has read and understood it or not. Accordingly, the owner may become bound by a harsh and unc customary term, but only if his attention is specifically called to it and its significance explained to him. n14

[2] *Dobbs* in Other Jurisdictions

The New Jersey Supreme Court's legal reasoning in the *Dobbs* case n14.1 has been adopted in several jurisdictions.

[a] Kansas: *Winkelman v. Allen*

Wishing to sell a ranch of some 9000 acres for \$356,800, the owner gave a non-exclusive listing to plaintiff broker. The broker produced a twenty-two year-old farmer with a net worth of \$6,000. Based on conflicting testimony, the trial

court found that an oral agreement was reached between the vendor and purchaser at a price of \$320,000. The purchaser was to pay \$20,000 in cash, assume an existing mortgage, and pay the balance in installments. The vendor later received an offer of \$356,920 from another source and declined to enter into a written contract with the purchaser procured by the plaintiff broker. The Kansas Supreme Court reversed a lower court judgment for the broker. n15

As with other cases that have approved of the *Dobbs* rationale, the facts of the Kansas case could justify a holding in the vendor's favor even under the traditional majority rule. The Court found no evidence that the intending purchaser had sufficient resources to complete the purchase without depending on third persons who were not bound to finance him. As stated elsewhere, n16 the broker has failed, under these circumstances, to demonstrate that he procured a ready, willing and able purchaser.

The court nevertheless took this case as the occasion to adopt the main features of the *Dobbs* holding. In particular the court approved of the *Dobbs* view that "acceptance" of a purchaser by entering into a contract with him should neither estop the vendor from disputing the purchaser's financial ability, nor relieve the broker of the burden of proving it. The Kansas court concluded:

Some jurisdictions have always had the rule announced in *Ellsworth Dobbs, Inc. v. Johnson*, above [Citation omitted]. Other jurisdictions are following New Jersey's lead. Decisions which have either adopted or expressly approved *Ellsworth Dobbs, Inc. v. Johnson*, above are: *Setser v. Commonwealth, Inc.*, 256 Or. 11, 470 P.2d 142 (1970) ; *Staab v. Messier*, 128 Vt. 380, 264 A.2d 790 (1970) ; *Potter v. Ridge Realty Corporation*, above; *Rogers v. Hendrix*, 92 Idaho 141, 438 P.2d 653 (1968) ; and *Mullenger v. Clause*, 178 N.W.2d 420 (Iowa 1970) . For a comprehensive discussion of the New Jersey case see Note, 23 Rutgers L. Rev. 83 (1968); Note, 9 Ariz. L. Rev. 519 (1968); Note 17 Cath. U.L. Rev. 487 (1968); and Note, 10 Wm. & Mary L. Rev. 240 (1968).

We are persuaded by the cogent reasoning in *Ellsworth Dobbs, Inc. v. Johnson*, above, and adopt the rules stated in the above quoted portion thereof as the law in Kansas.

On the facts in the instant case the appellant did not sign the contract tendered by the appellee. Factually, therefore, the case presently before us does not involve an executed contract wherein the purchaser subsequently defaults because he is financially unable to perform. But in either situation the broker is obligated to produce a qualified purchaser before he is entitled to a commission. The argument that the appellant "accepted" [the purchaser] during the course of negotiations, and in particular on the 26th day of September, 1970, when the appellee claims the appellant accepted him as a purchaser, is not availing to the broker, Mr. Winkelman. The "acceptance" of [the purchaser] by the appellant did not constitute a waiver on the appellant's part of the financial ability of [the purchaser] to purchase the property. The burden is upon the appellee, the broker, to show that he has produced an able buyer in the financial sense. Accordingly, the appellant is not estopped to assert in defense of this action that [the purchaser] was not a qualified purchaser. n17

[b] Massachusetts: *Tristram's Landing, Inc. v. Wait*

Plaintiff broker learned that defendant owner had property for sale on Nantucket Island. Plaintiff received oral permission to show the property (non-exclusively), and was told that the price was \$110,000. The broker procured a customer who made a written offer of \$100,000. The defendant then authorized the broker to make a counter-offer of \$105,000. The purchaser orally accepted this offer and signed a written contract prepared by the broker. The broker presented this writing, together with a check for a down payment of \$10,500, to the defendant, who also signed it. The purchaser, for undisclosed reasons, refused to go through with the purchase and forfeited the down payment. Upon defendant's refusal to pay a commission, the broker sued for five percent of the agreed sales price--the amount that was customary in the area.

The Supreme Judicial Court overruled a line of prior precedents and held that, since there was no closing because of the buyer's default, the broker was not entitled to a commission. n18 The court stated: "We believe, however, that it is both appropriate and necessary at this time to clarify the law, and we now join the growing minority of [s]tates who have adopted the rule of *Ellsworth Dobbs, Inc. v. Johnson*" n19

The court reviewed the reasons of policy supporting the *Dobbs* rule, emphasizing the layperson's normal expectations that the money paid at the closing will be the source for payment of the broker's commission. The rule was formulated as follows, quoting from the *Dobbs* case:

Thus, we adopt the following rules: When a broker is engaged by an owner of property to find a purchaser for it, the broker earns his commission when (a) he produces a purchaser ready, willing and able to buy on the terms fixed by the owner, (b) the purchaser enters into a binding contract with the owner to do so, and (c) the purchaser completes the transaction by closing the title in accordance with the provisions of the contract. If the contract is not consummated because of lack of financial ability of the buyer to perform or because of any other default of his ... there is no right to commission against the seller. On the other hand, if the failure of completion of the contract results from the wrongful act or interference of the seller, the broker's claim is valid and must be paid. *Id* at 551, 236 A.2d at 855 . n20

The parties may contractually vary the prerequisite of an actual closing by including a provision that is clear and specific as to the seller's potential liability for a commission if the buyer does not purchase the realty. n20.1 The burden is on the broker to ensure that the provision is adequate to alert the seller that the listing agreement varies from the *Tristram's Landing* rule. n20.2 Provisions that are not sufficiently clear are against public policy. n20.3

[c] Nebraska: *Cornett v. Nathan*

In this case, n21 defendant owners listed their property with plaintiff broker for sale at a price of \$349,700. The broker was to receive a seven percent commission. The broker produced a prospective purchaser who offered \$251,680. The owner accepted this offer, signed a written contract of sale, and received a deposit of \$5,000, expressly stated to be forfeited should the buyer fail to complete the sale. The buyer eventually defaulted because of financial inability and the broker sued for a \$17,617.60 commission. One need only read the court's summary of the claim to make a good guess as to the holding to come:

The defendant's property was not sold, but the plaintiff still demanded his \$17,617.60 commission. This placed the defendants in the position where they were entitled to only \$5,000 in damages from the buyer, but owed the plaintiff over \$17,000 in commission. Thus, the defendants would lose over \$12,000 and still be in the same position as they were before the plaintiff presented the buyer. n22

The court dealt with the issue in less sweeping terms than the New Jersey Court in *Dobbs*. It analyzed the issue in the traditional formula of the production of a "ready, willing and able" purchaser. After discussing the normal expectations of those who employ brokers (to pay the commission out of the proceeds at closing) and the superior ability of professional brokers to ascertain the financial ability of intending purchasers, the court held that financial ability to close is the test of a ready, willing and able purchaser.

[d] Oregon: *Brown v. Grimm*

In *Brown v. Grimm* n23 an owner listed his property with the broker for \$20,000 "net" with the terms of payment to be cash. The broker found a purchaser willing to accept these terms and a written earnest money contract was entered into. The vendor received no cash down payment, merely a promissory note for \$1,000. The purchaser's performance was conditioned on "obtaining zone change, adequate financing and building permits and sewer permits on proposed new construction." n24 The purchaser eventually defaulted and the broker sued for her commission.

Although failure to satisfy the conditions precedent to the buyer's duty to perform would probably have justified a judgment for the defendant vendor even under the majority rule, n25 the court nevertheless relied on *Dobbs* for its conclusion that, notwithstanding the signing of a contract of sale, the law required actual closing and payment by a financially responsible purchaser. n26

[e] Idaho: *Margaret H. Wayne Trust v. Lipsky*

In *Margaret H. Wayne Trust v. Lipsky*, n27 the Idaho Supreme Court addressed a situation in which a purchaser changed his mind and the vendor sued for damages and specific performance. The court acknowledged that Idaho had, in the past, adopted the traditional rule that a broker earned his commission when he procured a buyer ready, willing and able to purchase on terms acceptable to the owner. n28 The court, however, adopted the *Ellsworth Dobbs* Rule, holding that the broker earns his commission when: (1) he produces a purchaser ready, willing and able to buy on the terms fixed by the owner; (2) the purchaser enters into a binding contract with the owner to do so; and (3) the purchaser completes the transaction by closing the title in accordance with the provisions of the contract. n29

The court qualified its opinion, however, in that the adoption of the rule did not alter the obligation to pay the commission if the sale was not completed due to the fault of the seller. In reaching its decision, the court relied on a prior case involving an installment land contract. n30

FOOTNOTES:

(n1)Footnote 1. 50 N.J. 528, 236 A.2d 843 (1967) .

(n2)Footnote 2. *Hatch v. Dayton*, 130 N.J.L. 425, 33 A.2d 350 (Sup. Ct. 1943) ; *Hinds v. Henry*, 36 N.J.L. 328 (Sup. Ct. 1873) . See generally Note, *Ellsworth Dobbs, Inc. v. Johnson: A Reexamination of the Broker-Buyer-Seller Relationship in New Jersey*, 23 Rutgers L. Rev. 83 (1968).

(n3)Footnote 3. Iarussi purchased four other parcels through the Dobbs Agency. In each case the transaction was completed and Dobbs earned a commission from the sellers. 50 N.J. 528, 236 A.2d 843, 847 (1967) .

(n4)Footnote 4. 50 N.J. 528, 236 A.2d 843, 848 (1967) . It was contended by the Johnsons that the language of the commission agreement made the broker's rights expressly conditional on the stated stages in the process of his completion, and that parol evidence should be admitted to support this interpretation. Because of the court's sweeping holding it was not necessary to resolve these contentions. The court stated:

On the basis of all we have said above, and although we agree with the Appellate Division that the provision in the contract of sale between Dobbs and the Johnsons respecting the time when the commission could be considered earned is at the very least ambiguous (compare *Alnor Constr. Co. v. Herchet*, *above*), we hold as a matter of law that title not having closed solely because of the financial incapacity of Iarussi, the claim against the Johnsons for commission must fail.

50 N.J. 528, 236 A.2d 843, 858 (1967) .

(n5)Footnote 5. 50 N.J. 528, 236 A.2d 843, 861 (1967) .

(n6)Footnote 6. 50 N.J. 528, 236 A.2d 843, 853-54 (1967) ; but see *Jacob Gold Realty, Inc. v. Stefan Skocyzylas*, 178 Misc. 2d 409, 679 N.Y.S. 2d 499, 1998 N.Y. Misc. LEXIS 462 (1998) , citing *Graff v. Billet*, 101 A.D.2d 355, 475 N.Y.S. 2d 122, 1984 N.Y. App. Div. LEXIS 17825 (2d Dept. 1984) . The vendor rejected the purchaser because the purchaser altered or deleted certain mortgage contingency clauses in the proposed contract. The broker sued to recover his commission based on the theory that the agreement failed because the vendor had willfully defaulted. The court found it was well-settled law that before a broker may properly rely upon "willful default" language in a brokerage

agreement, the broker must demonstrate that a sales contract or agreement existed and was entered into by both parties. *See also Corcoran Group, Inc. v. Morris*, 107 A.D.2d 622, 484 N.Y.S. 2d 7, 1985 N.Y. App. Div. LEXIS 42481 (1st Dept. 1985), *aff'd*, 64 N.Y.2d 1034, 489 N.Y.S.2d 66, 478 N.E.2d 207 (1985).

(n7)Footnote 7. 50 N.J. 528, 236 A.2d 843, 855 (1967). *See also Drake v. Hosley*, 713 P.2d 1203 (Alaska 1986) (citing Ellsworth Dobbs, Inc. v. Johnson with approval, but noting that the adoption of the *Dobbs* rule would not help the plaintiff in the instant case).

(n8)Footnote 8. In an earlier New Jersey case, where the brokerage contract conditioned the right to a commission on an actual closing, the court denied a commission where the closing failed because of a defect in the vendor's titles. All parties acted in good faith. *Blau v. Friedman*, 26 N.J. 397, 140 A.2d 193 (1958). Failure to offer marketable title was not viewed as a willful act which prevented closing. This case furnishes a useful precedent in applying the rule of the *Dobbs* case.

The court's use of the term "default" of the seller in the case of *Apfelbaum v. Topf*, 104 N.J.L. 343, 140 A. 295 (Ct. of Errors and Appeals 1928) is also helpful. A seller who was unable to convey a marketable title because of:

a restrictive covenant with respect to the use of the land of which the owner was unaware, was not held liable to pay the brokerage commission. The commission agreement called for payment unless title did not close for a reason not due to the seller's default. The court reasoned that the word "default" reasonably read referred only to some wilful act of the seller which defeated the passing of title.

(n9)Footnote 9. *See § 4.03[3] below*

(n10)Footnote 10. 236 A.2d at 857-58. *See Van Winkle & Liggett v. G.B.R. Fabrics, Inc.*, 103 N.J. 335, 511 A.2d 124 (1986).

(n11)Footnote 11. *See § 4.10 below*

(n12)Footnote 12. *Pilkington v. Flack*, 152 E.G. 366 (1948).

(n13)Footnote 13. *Jaques v. Lloyd D. George & Partners, Ltd.*, 2 A.E.R. 187, 190 (1968).

(n14)Footnote 14. *See id.*, the Opinion of Denning, M.R. In discussing manifestations of assent to standardized contracts, Restatement (Second) of Contracts § 211(3) states:

Where the other party has reason to believe that the party manifesting such assent would not do so if he knew that the writing contained a particular term, the term is not part of the agreement. Several recent cases have recognized the necessity of actual assent, not merely objective assent, to harsh or unusual terms buried in a written contract.

See:

Federal: Silvestri v. Italia Societa Per Azioni Di Navigazione, 388 F.2d 11 (2d Cir. 1968) (steamship ticket limiting time to sue for personal injury); *Mattes v. National Fidelity Life Ins. Co.*, 506 F. Supp. 955 (M.D. Pa. 1980) (applying Pennsylvania law to a term in an insurance policy).

Connecticut: Griffin v. Nationwide Moving & Storage Co., 187 Conn. 405, 446 A.2d 799 (1982) (limitation of moving company's liability).

Pennsylvania: Standard Venetian Blind Co. v. American Empire Ins. Co., 469 A.2d 563 (Pa. 1983) .

(n15)Footnote 14.1. *Ellsworth Dobbs, Inc. v. Johnson*, 50 N.J. 528, 236 A.2d 843 (1967) , discussed in § 4.03[1][a], [b] above.

(n16)Footnote 15. *Winkelman v. Allen*, 214 Kan. 22, 519 P.2d 1377 (1974) .

(n17)Footnote 16. See § 4.02[2][b] above

(n18)Footnote 17. 519 P.2d at 1390 . The holding in *Winkelman* was reaffirmed in *Harrin v. Brown Realty Co.*, 226 Kan. 453, 602 P.2d 79 (1979) .

(n19)Footnote 18. *Tristram's Landing, Inc. v. Wait*, 367 Mass. 622, 327 N.E. 2d 727 (1975) .

(n20)Footnote 19. *Tristram's Landing, Inc. v. Wait*, 367 Mass. 622, 327 N.E. 2d 727, 730 (1975) .

(n21)Footnote 20. *Tristram's Landing, Inc. v. Wait*, 367 Mass. 622, 327 N.E. 2d 727, 731 (1975) .

(n22)Footnote 20.1. See *Richard Corapi, Inc. v. C & C Realty Dev., LLC*, 2009 Mass. App. Div. 231, 2009 Mass. App. Div. LEXIS 62, at *5 (2009) .

(n23)Footnote 20.2. *Id.*

(n24)Footnote 20.3. *Id.*

(n25)Footnote 21. *Cornett v. Nathan*, 196 Neb. 277, 242 N.W.2d 855 (1976) .

(n26)Footnote 22. *Cornett v. Nathan*, 196 Neb. 277, 242 N.W.2d 855, 856 (1976) .

(n27)Footnote 23. 258 Or. 55, 481 P.2d 63 (1971) .

(n28)Footnote 24. *Id.*, 258 Or. at 65 .

(n29)Footnote 25. See § 4.02 above. The court also noted a prior undisclosed relationship between the purchaser and the broker which supported a finding of lack of good faith performance of fiduciary duty. See § 4.08 below.

(n30)Footnote 26. See *Clark v. Wright*, 699 S.W.2d 174 (Tenn. Ct. App. 1985) (prospective purchaser held liable to the broker for damages based upon the amount of commission the broker would have earned if the transaction had closed).

(n31)Footnote 27. 846 P.2d 904 (Idaho 1993) .

(n32)Footnote 28. See *Rogers v. Hendrix*, 438 P.2d 653 (Idaho 1968) .

(n33)Footnote 29. *Margaret H. Wayne Trust v. Lipsky*, 846 P.2d 904, 911 (Idaho 1993) . See *Commercial Ventures, Inc. v. The Rex M. & Lynn Lea Family Trust*, 177 P.3d 955, 960 (Idaho 2008) (This Court expressly adopted the rule from *Ellsworth Dobbs, Inc. v. Johnson.*), *reh'g denied*, 2008 Ida. LEXIS 36 (Feb. 15, 2008) .

(n34)Footnote 30. *Strout Realty v. Milhous*, 107 Idaho 330, 689 P.2d 222 (Idaho Ct. App. 1984) . In that case, the seller, under an installment land contract claimed that he was not liable for a commission because the buyer defaulted before he had fully performed, and he was therefore not ready, willing and able. The court saw no difficulty in applying this to a more traditional real estate transaction.

* This chapter was revised by Charles J. Jacobus, Esq., a partner in the firm of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas. In 1999, Sections 4.01 through 4.03 were revised by Mary Fallon, Esq. Additional updates were contributed by Sandra Bullington, Esq.



89 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.04

§ 4.04 Excusing the Condition of Title Closing

[1] In General: Vendor's Default

The subject matter of this section becomes relevant only when closing of title is a condition precedent to the vendor's duty to pay a commission. This condition exists in states following the minority view ⁿ¹ or, in states following the majority view, when the parties have by contract made closing a condition precedent. ⁿ² Consequently, the following discussion presupposes that closing is a condition precedent.

It is a standard and familiar rule that one under a duty subject to a condition precedent cannot hide behind the condition if his own unjustified act caused the condition to fail. In such case, the condition is excused and the duty becomes absolute. ⁿ³ Thus, if the vendor refuses to close with a purchaser procured by the broker, he owes a commission even though the condition was not satisfied. ⁿ⁴ Moreover, where a broker is required to retain counsel to enforce the rights that the broker had under a brokerage agreement, the seller will be required to pay reasonable attorney's fees, particularly when the seller cancels the sales agreement in bad faith.

It is usually held that some definite, affirmative act is necessary to excuse the condition; a passive refusal by the vendor to seek specific performance against a defaulting purchaser will not nullify the condition of closing. ⁿ⁵ Two common situations involve the existence of title defects and the refusal of a co-owner, usually the vendor's spouse, to sign a deed. These will be separately discussed in the following two subsections.

[2] Effect of Vendor's Unmarketable Title

Clearly, in those jurisdictions that follow the traditional rule that the broker's commission is earned when the sales agreement is reached, irrespective of successful consummation, no issue will arise concerning the effect of the vendor's unmarketable title on the right to a commission. Indeed, since in these jurisdictions the commission is payable even where the purchaser defaults and the vendor is wholly free from fault, it follows *a fortiori* that the commission is payable where the purchaser justifiably rescinds because of a defect that renders the vendor's title unmarketable. ⁿ⁶

One exception to this position, even in jurisdictions that otherwise follow the traditional rule is where the broker knows or ought to know of the title problem when the broker accepts the listing. For example, in *Eastern Oklahoma Land & Cattle Co. v. Dorris*, ⁿ⁷ the broker who accepted employment from a widow knew that she owned only a one-third

undivided interest in the property. She told him that she thought she could get the other co-owners to agree to the sale but the broker was thereby put on notice that consummation of the sale was uncertain. When the other owners refused to assent and the purchaser procured by the broker justifiably refused to close, it was held that the broker was not entitled to a commission. n8

Where, because of an express condition in the brokerage agreement, or because of the prevailing local rule of law, the broker's right to a commission is contingent on closing of title, the cases are divided on the effect of a failure to close because of a defect in the vendor's title. n9 The issue is whether an unmarketable title is a "fault" within the doctrine that non-fulfillment of a condition precedent (closing of title) is excused when its non-fulfillment is due to the fault of the promisor. In terms of equity and policy the issue is a close one, and predictably the courts have focused on particular nuances, such as the broker's knowledge of the title defect n10 and whether the vendor could have cured it by reasonable actions. n11 If the vendor warrants to the broker that there are no encumbrances, the broker will be entitled to a commission. n12

The rule could apparently be different, however, when the brokerage commission contains a provision regarding the issue of a marketable title as a condition precedent to the payment of the commission. In *Brotsky v. Gozzola*, n13 the builder, through no fault of his own, rendered title unmarketable because he did not receive final approval of the subdivision plat. The court held that the broker was not entitled to his commission because the brokerage agreement required the subdivision approval as a condition precedent to the payment of the commission.

Due to the closeness of the issue, cases within a given jurisdiction have vacillated. In New York, for example, a closely-divided Court of Appeals ruled that even though the commission was contingent on title closing, it would nevertheless be payable if closing failed because of the vendor's failure to take affirmative action to remove liens for taxes and assessments that made the title unmarketable. n14 The implication of this case was that if reasonable efforts by the vendor were unavailing to remove the defect the condition would not be excused and no duty to pay a commission would arise. However, some courts soon whittled away this protection to the vendor by finding an implied warranty by the vendor to the broker that his title was marketable. n15

In 1968, the New York Court of Appeals, without referring to the implied warranty theory, reversed a judgment for a broker whose right to a commission was conditional, when title was rejected because it was unmarketable. After interpreting the brokerage agreement as making the commission contingent on closing, the court stated:

As was pointed out above, however, such an agreement will not absolve the seller of the obligation of paying a commission where the sale fails of completion through the seller's own fault and, therefore, if, upon the new trial that must be had here, plaintiff can show that it was through defendants' fault that the contract of sale was never consummated, he must prevail. With respect to the proceedings to be had following remand, though, it must be noted that our decisions discussing when a condition in a brokerage agreement that title actually close will be deemed waived speak of "fault" [citation omitted], "defendant's own wrong" [citation omitted], "waiver" or "active conduct of the conditional promisor, preventing or hindering the fulfillment of the condition" [citation omitted], and the vendor's "refus[ing] to perform his obligations under the contract of sale" [citation omitted]. The prospective seller will be held to have waived the condition that title actually close where closing of title was prevented solely by his refusal to remove curable defects or clouds on his title [citation omitted], but in a case such as this, where the defendants were presented by the prospective purchaser, Frazer, with a seemingly impossible ultimatum under which he expressed the desire to cancel the agreement if the title defects could not be cured within 30 days, a much closer question, going to the reasonableness of defendants' conduct in not undertaking themselves to cure the title defects, but, rather, of giving Frazer the option of bringing the necessary proceedings himself or of canceling, is presented. n16

[3] Effect of Failure or Refusal of Contracting Party's Spouse to Sign Sales Contract or Deed

Generally, where a sale does not occur due to the owner's inability to convey full title, and the broker is not at fault, he can recover full commission for his efforts. n17 This situation may arise when one spouse lists property with a broker, but when the closing date arrives, the other spouse will not sign the deed.

Cases in at least thirty states express the principle that it is no defense to a broker's action for compensation that the principal's spouse refuses to join the sale. n18 This rule holds equally when the wife, and not the husband, lists the property. n19

While some dicta to the contrary exists, generally the broker can recover his commission, if one spouse refuses to go through with the sale even where a clause in the brokerage contract calls for the commission to be paid "upon completion of a sale." n20 Further, refusal of a spouse to sign the deed is not a "title defect" that may excuse the payment of commissions. n21

When a broker knows that the cooperation of the lister's spouse will be necessary to consummate the deal, there is a split in authority concerning the broker's right to commission. The majority rule is that the broker's knowledge will not hinder his claim for commissions, n22 based on the theory that it is the listing spouse who obligates himself, and thus is liable. n23 A minority of states have held the broker's knowledge of the necessity of the wife's acquiescence to be a defense to an action for commissions. n24 In addition, some cases have included dicta indicating that commissions might have been denied if the broker had known that another signature would be required. n25

However, when the broker knows that the other spouse has no intention of cooperating with any sale of the property, the majority holds that the broker cannot recover commissions. n26

FOOTNOTES:

(n1)Footnote 1. Discussed in § 4.03[1], above

(n2)Footnote 2. See *LaRosa Realty, Inc. v. Kim*, 123 A.D.2d 839, 507 N.Y.S.2d 454, 1986 N.Y. App. Div. LEXIS 60960 (2d Dept. 1986) (held that a broker was not entitled to a commission, under an agreement which conditioned payment of the commission on the passing of title or the seller's breach, when the sale fell through during the contract closing because there was no wilful breach).

(n3)Footnote 3. 3 Corbin, Contracts § 768 (West 1960); 10 Williston, Contracts § 1287 (LCP 3d ed. 1967); Restatement (Second) Agency § 445, comment d (1958).

See:

Louisiana: Succession of Saulny, 637 So. 2d 1248 (La. App. 4th Cir. 1994) (the broker may sue the owner of a partial interest in the property, where the partial owner signed the listing agreement authorizing the broker to sell the property which the partial owner stated she owned in full).

Maryland: W.C. Pinkard & Co. v. Castlewood Realty Co., 271 Md. 598, 319 A.2d 123 (1974) .

New Jersey: A.S. Goldstein Co. v. Bloomfield Plaza Assocs., 272 N.J. Super. 59, 639 A.2d 347 (App. Div. 1994) (the broker was entitled to a commission where the transaction is defeated by the seller's willful conduct, notwithstanding the fact that a contingency clause in the commission agreement was not satisfied); *Leadership Real Estate, Inc. v. Harper*, 271 N.J. Super. 152, 638 A.2d 173 (Law Div. 1993) (bad faith on the part of the seller may be found where the seller refuses, without legal justification, to close title; fraudulently conceals existence of a title defect; materially misrepresents to the broker and the buyer the gross earnings of the business; misrepresents that a unit will be vacant on the date set for the

closing; or fails to refer a prospective buyer to the broker during the term of the exclusive agency and instructs the prospective buyer to delay making an offer for the property until the listing agreement with the broker expires).

New York: Ely-Cruikshank Co., Inc. v. Bank of Montreal, 81 N.Y.2d 399, 599 N.Y.S.2d 501, 615 N.E.2d 985 (1993) (in an action brought by a real estate broker against the vendor for breach of a contract that granted the broker the exclusive right to sell and thereby earn a commission, the court held that the cause of action accrued when the vendor failed to reveal its preliminary discussions with the purchaser prior to termination of the agreement, and not when the vendor actually sold the building after the agreement was terminated); *Wilsen Assocs. Real Estate Corp., Inc. v. Pizilly*, 204 A.D.2d 777, 611 N.Y.S.2d 694, 1994 N.Y. App. Div. LEXIS 4722 (3d Dept. 1994) (the vendor's attorney was not liable to the broker for a commission, where the broker admitted she was aware of the vendor's serious financial difficulties and acknowledged that the attorney never promised to pay a commission out of his own resources; therefore, the broker was not entitled to rely on the attorney's intimations that the broker might be paid); *Schuckman v. Sayville Plaza Dev. Co.*, 201 A.D.2d 638, 608 N.Y.S.2d 248, 1994 N.Y. App. Div. LEXIS 1479 (2d Dept. 1994) (a partnership was not bound by the brokerage agreement executed by a deceased general partner, where the "personal" agreement was written in the first person singular on the partner's personal stationery, included an express assertion that the partnership did not authorize brokers to act in a brokerage capacity, and concluded that the agreement would be binding on the partner; the fact that the partnership benefited as a result of the agreement did not make the agreement binding on the partnership); *Aiello v. B.E.P.R.A., Inc.*, 39 A.D.2d 541, 331 N.Y.S.2d 924, 1972 N.Y. App. Div. LEXIS 5030 (2d Dept. 1972) .

Ohio: White v. Nemastil, 29 Ohio App. 3d 1, 503 N.E.2d 189 (1985) (transaction terminated due to seller's insistence that buyers sign an addendum to the mortgage deed subsequent to the execution of the purchase agreement).

(n4)Footnote 4. *Premier Realty, LLC v. I.T.J. Investments, Inc.*, 42 Kan. App. 2d 148, 160, 209 P.3d 741, 750 (2009) ; *Coldwell Banker v. CitiBank & Trust of Shreveport*, 602 So. 2d 1051 (La. 1992) . A broker is entitled to a commission if a sale to a third party is a straw transaction designed to avoid paying the commission. *Farm Credit Bank of St. Louis v. Miller*, 316 Ark. 388, 872 S.W.2d 376 (Ark. 1994) . *Grommet v. Newman*, 2009 WY 150, 220 P.3d 795, 804 (Wyo. 2009) Cf. *R.L. Friedland Realty v. Modern Cabinets*, 194 A.D.2d 657, 598 N.Y.S.2d 817, 1993 N.Y. App. Div. LEXIS 6134 (2d Dept. 1993) (where the brokerage agreement required payment of a commission only upon the passing of title, title failed to close because the seller failed to obtain a certificate of occupancy; the court held that no commission was due, even though the contract of sale did not require a certificate of occupancy to be produced at closing).

(n5)Footnote 5. *Amies v. Wesnofske*, 255 N.Y. 156, 174 N.E. 436 (1931) . See also *Beattie-Firth v. Colebank*, 143 W. Va. 740, 105 S.E.2d 5 (1958) .

But see *Davidson v. Suber*, 553 S.W.2d 430 (Tex. Civ. App. - Austin 1977) .

(n6)Footnote 6.

Arkansas: Sorma v. Fairweather, 248 Ark. 742, 453 S.W.2d 715 (1970) .

Louisiana: Russell v. Smith, 671 So. 2d 356 (La. App. 1 Cir. 1995) (brokers were not entitled to a commission on grounds that the sellers failed to provide marketable title at the time of the buy-sell contract, where two lender-approved attorneys stated that title was marketable and another attorney

offered title insurance and notwithstanding that the purchaser's attorney contended that the title was unmarketable).

California: Williams v. Gaither, 202 Cal. App. 2d 308, 20 Cal. Rptr. 779 (1962) .

New York: Van Vliet & Place, Inc. v. Gaines, 249 N.Y. 106, 162 N.E. 600 (1928) . The court stated:

Both owner and broker acted in good faith; neither was aware of the [restrictive] covenant nearly a century in age. The established rule in this state does not impose any obligation upon the broker to become acquainted with the title. This broker performed its part of the agreement when it procured a purchaser ready to buy according to the terms offered in the owner's letter [to the broker].

249 N.Y. at 110, 162 N.E. at 601 . See also *Willard v. Mercer*, 83 A.D.2d 656, 442 N.Y.S.2d 200, 1981 N.Y. App. Div. LEXIS 14956 (3d. Dept.) , *aff'd*, 58 N.Y.2d 840 . 460 N.Y.S.2d 18, 446 N.E.2d 774 (1981) .

Tennessee: Smithwick v. Young, 623 S.W.2d 284 (Tenn. 1981) .

(n7)Footnote 7. 549 P.2d 78 (1976) .

(n8)Footnote 8. For cases in accord with *Eastern Oklahoma*, n.7 above, see:

Federal: Gatzemeyer v. Vogel, 544 F.2d 988 (8th Cir. 1976) (applying Iowa law).

Alabama: Rabren v. Norton, 381 So. 2d 645 (Ala. 1980) .

Kentucky: Ford v. Hurt, 265 S.W.2d 475 (Ky. 1954) .

Maine: Perry v. MacArthur, 358 A.2d 385 (Me. 1976) .

New York: Burkard v. Midvale Estates, Inc., 45 Misc. 2d 403, 257 N.Y.S.2d 62 , *aff'd*, 45 Misc. 2d 870, 257 N.Y.S.2d 615, 1965 N.Y. Misc. LEXIS 2243 (1964) .

The decision would be otherwise if the broker reasonably assumed that the defect was curable and that the vendor would correct it. *Mayberry v. Davis*, 288 Minn. 73, 178 N.W.2d 911 (1970) .

(n9)Footnote 9. Cases from various jurisdictions are analyzed in Annot., 28 A.L.R.4th 1007 (1984) .

(n10)Footnote 10.

Alabama: Rabren v. Norton, 381 So. 2d 645 (Ala. Ct. App. 1980) (broker aware of defect; commission denied).

New Jersey: Blau v. Friedman, 26 N.J. 397, 140 A.2d 193 (1958) (vendor's good faith is a critical fact where closing fails because of an unmarketable title).

(n11)Footnote 11. *Levy v. Lacey*, 22 N.Y.2d 271, 239 N.E.2d 378 (1968) (where a commission was contingent on closing vendor would be liable because of unreasonable refusal to remove a curable defect in title).

But see R.L. Friedland Realty v. Modern Cabinets Corp., 194 A.D.2d 657, 598 N.Y.S.2d 817, 1993 N.Y. App. Div. LEXIS 6134 (2d Dept. 1993) , where the seller's failure to obtain a certificate of occupancy excused the owner's obligation to pay a commission.

(n12)Footnote 12.

Federal: Gatzemeyer v. Vogel, 544 F.2d 988 (8th Cir. 1976) (applying Iowa law).

Arizona: Bradley v. Westerfield, 1 Ariz. App. 319, 402 P.2d 577 (1965) .

Missouri: Duggins v. Simons, 517 S.W.2d 82 (Mo. 1974) .

New York: O'Hara v. Bronx Consumers' Ice Co., 254 N.Y. 210, 172 N.E.472 (1930) .

(n13)Footnote 13. 183 A.D.2d 1051, 583 N.Y.S.2d 641, 1992 N.Y. App. Div. LEXIS 6885 (3d Dept. 1992) .

(n14)Footnote 14. *Stern v. Gepo Realty Corp.*, 289 N.Y. 274, 45 N.E.2d 440 (1942) .

(n15)Footnote 15. *Magrill v. Langan*, 43 N.Y.S.2d 210, 1943 N.Y. Misc. LEXIS 2156 (1943) ; *Coward v. McLaughlin*, 100 N.Y.S.2d 444, 1950 N.Y. Misc. LEXIS 2136 (1950) . *But see Leder v. Dry Dock Sav. Inst.*, 8 N.Y.S.2d 68, 1938 N.Y. Misc. LEXIS 2156 (1938) .

(n16)Footnote 16. *Levy v. Lacey*, 22 N.Y.2d 271, 276, 239 N.E.2d 378, 381 (1968) .

(n17)Footnote 17. The clearest examples of this are where the seller is not the owner of the property, or the seller's interest in the property is less than 100 percent. *See, e.g.:*

Arizona: Nationwide Resources Corp. v. Ngai, 129 Ariz. 226, 630 P.2d 49 (Ariz. Ct. App. 1981) .

Connecticut: Investors Mortgage Co. v. Jessco, 6 Conn. Cir. 445, 275 A.2d 287 (1970) .

Illinois: Reavy Grady & Crouch Realtors v. Hall, 110 Ill. App. 3rd 325, 66 Ill. Dec. 35, 442 N.E.2d 307 (1982) .

Mississippi: C. Buck Bush Realty Co. v. Whetstone, 266 So. 2d 135 (Miss. 1972) .

New York: U-Buy Realty, Inc. v. Aliota, 151 Misc. 2d 485, 487-488, 573 N.Y.S.2d 824, 826, 1991 N.Y. Misc. LEXIS 417 (N.Y. Civ. Ct. 1991) , citing this Treatise.

(n18)Footnote 18. *See, e.g.:*

Alabama: Guillotte v. Pope & Quint, Inc., 349 So. 2d 62 (Ala. Civ. App. 1977) .

California: McAlinden v. Nelson, 121 Cal. App. 2d 136, 262 P.2d 627 (1953) .

Delaware: Tebo v. Mitchell, 21 Del. (5 Penn) 356, 63 A. 327 (1905) .

Florida: Chastain v. Carroll, 307 So. 2d 491 (Fla. DCA 1975) .

Maine: Roy v. Huard, 157 Me. 477, 174 A.2d 41 (1961) .

New York: U-Buy Realty, Inc. v. Aliota, 151 Misc. 2d 485, 487-88, 573 N.Y.S.2d 824, 826 (N.Y. Civ. Ct. 1991) , citing this Treatise.

Oregon: Woodworth v. Vranizan, 273 Ore. 111, 539 P.2d 1055 (Or. 1975) .

Pennsylvania: Rick v. Moyer, 296 Pa. 176, 145 A. 793 (1929) .

Tennessee: Award Realty, Inc. v. Copeland, 698 S.W.2d 337 (Tenn. 1985) ; *Campbell v. Arthur H. Campbell & Co.*, 155 Tenn. 515, 296 S.W. 9 (1927) .

Wyoming: Guggenmos v. Tom Searl-Frank McCue, Inc., 481 P.2d 48 (Wyo. 1971) .

See also *Hale & Hale, Ltd. v. Arnold & Jeanie Pettit Declaration of Trust*, 298 S.W.3d 104, 110 (Mo. Ct. App. 2009) (The wife's interactions with one of the brokers and her testimony supported the finding that her husband was acting as her agent when he contracted with the broker to sell the property.), *transfer denied*, 2009 Mo. LEXIS 580 (Dec. 22, 2009) .

(n19)Footnote 19. See, e.g.:

Alaska: Pasley v. Barber, 368 P.2d 549 (Alaska 1962) .

District of Columbia: Pepper v. Chatel, 185 A.2d 508 (D.C. 1962) .

Louisiana: Cox v. Green, 70 So. 2d 724 (La. Ct. App. 1954) .

(n20)Footnote 20. See, e.g.:

Kansas: Staley v. Hufford, 73 Kan. 686, 85 P. 763 (1906) (letter showing that plaintiffs expected to pay nothing if the deal was not closed did not alter the general rule).

Pennsylvania: Smith v. Graham, 101 Pa. Super. 604 (1930) .

Texas: Caneer v. Martin, 238 S.W.2d 828 (Tex. Civ. App. 1951) (despite condition in brokerage contract that transaction be closed before commission became due, the court held that the defendant's arbitrary refusal to sign superceded the agreement).

(n21)Footnote 21. *Clark v. Ray*, 25 S.W.2d 656 (Tex. Civ. App. 1930) (brokerage contract called for commissions to be paid unless the deal fell through due to "title defects" and decision not to sign was held not to constitute a defect in title as contemplated at the time of signing).

(n22)Footnote 22. See, e.g.:

Arkansas: Portis v. Thrash, 216 Ark. 946, 229 S.W.2d 127 (1950) .

Maine: Roy v. Huard, 157 Me. 477, 174 A.2d 41 (1961) .

Texas: Cotten v. Willingham, 232 S.W. 572 (Tex. Civ. App. 1921) .

(n23)Footnote 23. *Max Broock, Inc. v. Walker*, 349 Mich. 63, 84 N.W.2d 336 (1957) .

(n24)Footnote 24. *See, e.g.:*

Florida: Hensley Ins. Co. v. Echols, 159 Fla. 324, 31 So. 2d 625 (1947) .

Louisiana: Guy L. Deano, Inc. v. Michel, 191 La. 233, 185 So. 9 (1938) .

(n25)Footnote 25. *See, e.g.:*

California: Russell v. Ramm, 200 Cal. 348, 254 P. 532 (1927) .

District of Columbia: Pepper v. Chatel, 185 A.2d 508 (D.C. 1962) .

Michigan: Koffman v. Pack, 224 Mich. 102, 194 N.W. 586 (1923) .

(n26)Footnote 26. *See, e.g.:*

Alaska: Pasley v. Barber, 368 P.2d 549 (Alaska 1962) .

California: McAlinden v. Nelson, 121 Cal. App. 2d 136, 262 P.2d 627 (1953) .

Kentucky: Hurt v. Sands Co., 236 Ky. 729, 33 S.W.2d 653 (1930) .

Contra:

Texas: Peters v. Coleman, 263 S.W.2d 639 (Tex. Civ. App. 1953) writ of error refused no reversible error.

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90 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.05

§ 4.05 Effect of Licensing Laws on Broker's Right to Compensation

[1] Introduction

Depending on how each state's real estate licensing law defines real estate, no state allows a real estate broker to recover a commission unless the broker has a real estate license recognized by that state. n1 Real estate broker licensing laws are regulatory n2 in nature, are designed to protect the public from dishonest and incompetent brokers and include penalties for violation of their provisions. n3 Contracts made in violation of licensing laws are generally held to be illegal and courts will not enforce them, n4 even though the unlicensed broker has performed his or her task conscientiously and to the satisfaction of his or her principal. n5 It is irrelevant whether the unlicensed person stated that he or she did or did not have a license. The issue is whether that person did the things that a licensed broker would have done. n6

Courts have acknowledged that application of statutes requiring that individuals be licensed before they can recover a commission seems harsh and unjust in that it may deprive plaintiffs from receiving money duly earned. n7 One court has stated that it is possible that, "Injustice is the hallmark of the brokers' licensing acts." n8

Licensing laws often require that sellers and lessors pay their commissions to a broker agency rather than to the individual agent who works under the auspices of the broker agency. n9 Often a lawsuit to recover a commission must be filed by the agent's broker rather than the individual agent involved in the transaction. n9.1

A statute that prevents an unlicensed individual from recovering a commission can have a broad reach. For example, *New York Real Property Law § 442-d*, which prevents an unlicensed individual from pursuing an action to recover broker's fees, has been held to bar suits in federal courts as well as state courts. n10 This statute has also been held to apply to property located outside New York. n11 However, § 442-d applies only in transactions where real estate is the dominant feature; it will not apply where the real estate involved is only incidental to the transaction. n12 In considering such a statute, counsel must consider the particular statute and how it has been applied by courts that have interpreted it.

Some jurisdictions define the term real estate broker to include more than the traditional providing of services in connection with the sale or purchase of real estate. For example, the District of Columbia defines this term to include anyone who negotiates a loan secured by a mortgage, deed of trust, or other encumbrance on real property. n13 Persons

providing such services who are not licensed as real estate brokers may find themselves unable to sue to collect the compensation allegedly due for such services. However, some courts have allowed severability of contracts involving a broad range of services to be provided by an unlicensed person. While the unlicensed person cannot recover compensation for services which required a license, the unlicensed person can recover compensation for those services performed under the contract which did not require a license. n14 The issue of compensation for the provision of services requiring a broker's license and services not requiring a broker's license, in the context of a business broker, is discussed in § 12.02, below.

The requirement that a real estate broker be licensed to legally enforce his or her right to a commission seems very straightforward. Problems arise, however, in situations where a broker acquires the license after the listing contract is made but before his or her cause of action arises, or when a broker performs services under a lapsed license, having negligently failed to renew it, or if a party licensed in one state does business in or affecting land in another. A broker may forfeit his or her right to a commission if the broker employs unlicensed salespersons or arranges to split fees with an unlicensed broker. Problems can also arise if the broker was licensed when the brokerage services were rendered, but was not licensed when the closing occurred. This was the situation in *Atlantic Commercial Group, Inc. v. Dunham* n15 which involved the sale of commercial real estate pursuant to an option contract. The problem stemmed from *New Jersey Statutes Annotated 45:15-3* which precluded a broker from suing to collect a commission without alleging and proving that he or she was a licensed broker when the cause of action arose. The seller in this case, who failed to pay the broker's commission, argued that the cause of action arose at closing. This argument was rejected. The court found that the governing statutory provision required that the broker be licensed when the brokerage services were performed and completed. The court stated that even though the broker may not have earned the commission until closing, there was no sound reason why a broker who was duly licensed when the brokerage services were rendered should not be entitled to the commission simply because the broker was not licensed at the time of closing. n16 Real estate broker licensing statutes may even affect business brokers if the sale of a business involves incidental real estate.

California statutorily imposes a duty on an escrow holder to obtain evidence that a real estate broker was regularly licensed before delivering compensation to the broker. n17

Though it appears to be a well settled rule in most jurisdictions that an agreement to compensate an unlicensed real estate broker is illegal and unenforceable, an illegal agreement for real estate brokerage services, by itself, does not invalidate or require rescission of the underlying real estate contract procured through the efforts of the unlicensed broker. n18

One court has held that a substantial violation of a broker licensing law could constitute a defense to a brokerage commission claim even though the applicable state licensing law did not require forfeiture of a commission for a substantial violation. n18.1

[2] Isolated Transactions

An unlicensed broker, suing for a commission, may claim that he or she has engaged in a single, isolated transaction. While many early cases held that a person need not get a license for an isolated transaction, n19 a single transaction will today be held to bring a party within the licensing requirements. For example, in *Owens v. Capri*, n20 the Supreme Court of Wyoming denied recovery of a commission to a cattle rancher whose only act as a broker was the subject of the suit. The statute cited by the court read, in pertinent part: "One act for a compensation or valuable consideration of buying or selling real estate ... shall constitute the person ... performing, offering, or attempting to perform any of the acts enumerated herein, a real estate broker or a real estate salesman within the meaning of this Act." n21 In fact, only the Virgin Islands, which requires licensing only for those "engaging in any such business" n22 of real estate brokering, will allow recovery for one who engaged in one isolated transaction and did not hold himself or herself out as a broker. n23 Approximately one-half of the states have enacted "single act" provisions to require licensure for any single transaction involving real estate. n24

[3] Finders or Middlemen

Commonly, a party suing for a commission will claim that he or she is a finder or a middleman and, therefore, outside the purview of a broker licensing statute. n25 The difference between a broker and a finder is that a broker has authority to engage in negotiations while a finder's role is limited to bringing two parties together--a "door opener." n26 In *Tyrone v. Kelly*, n27 the plaintiff sued to recover a commission for finding a lender for a construction project. The California Supreme Court held that the policies underlying licensing statutes do not apply to mere finders. The court stated:

One who merely introduces two parties to a real estate transaction, whether or not he solicits those persons, does not need to be as knowledgeable about real estate transactions as a licensed broker, unless, of course he participates in the negotiations. n28

On the other hand, the Superior Court of Pennsylvania held in *Harrison v. Soffer*, n29 "that the mere introduction of two willing parties comes within the purview of the [Pennsylvania] statute." n30 It continued:

We cannot give to the word "negotiate", in the sense intended by the Legislature, the strict construction contended for by appellee. If we should do so, it would exclude from the regulatory purpose of the Act a great percentage of brokers and salesmen who normally do no more than acquaint prospective buyers and sellers with the location and price of available property, and who annually comply with the licensing feature of the Act in the belief that they are covered by it. n31

It should be borne in mind, as noted previously (*see* § 3.02 above) that it is not the descriptive word that counts, but whether the activity of the finder or middleman is embraced within the licensing statute. Most states draft their license laws with a very broad application in order to achieve a maximum regulatory effect on the brokerage business. Under most state statutes, a "finder" would fall under the definition of "broker" if he or she ultimately has the goal of achieving a sale, rent, purchase or lease of real estate. n32

Finders must show that the transaction flowed directly from the finder's introduction of the parties in order to be entitled to collect his or fee. Brokerage commissions ordinarily become due when the broker produces to his or her principal a party ready, willing and able to purchase on the terms of sale authorized or accepted by such principal. While a finder may be entitled to a finder's fee in a special business situation for merely introducing and bringing the parties together to conduct their own negotiations, a licensed real estate broker generally cannot recover unless the broker brings the parties to an agreement. n32.1

While non-licensed individuals frequently assert that they are finders, there are instances when a licensed broker may be found to have been a finder. In such a case, the broker may be found to have no fiduciary duties or disclosure obligations to the seller. However, the seller may owe the broker a commission for acting as a finder. n33

[4] Time of Procurement of License

Sometimes a real estate broker will be unlicensed at the time a listing contract is executed but will have acquired a license at some time thereafter. n34 Where the state statute requires that a broker be licensed before engaging in the business of a real estate broker, courts have held that a license acquired after services are rendered will not apply retroactively and will deny a broker's recovery. n35 *Geneva Invest. Ltd. v. Trafalgar Developers, Ltd.*, n36 construed a Florida licensing statute, which reads:

475.41 Contracts of unregistered person for commissions invalid

No contract for a commission or compensation for any act or service ... shall be valid unless the broker or salesman shall have complied with this chapter in regard to registration and renewal of the certificate *at the time the act or service was performed* [Emphasis supplied by court.] n37

The *Geneva* court interpreted this to mean that a license is not required at the time of contracting, but a broker must be licensed "at the time he renders the services for which he is entitled to compensation." n38 Courts in Arkansas and Louisiana, which have statutes requiring only that a broker be duly licensed in order to recover a commission, hold that contracts entered into by unlicensed brokers are illegal and void as against public policy. n39

Many states require a broker to be licensed when the cause of action arose. A few states have construed such a provision to allow a broker to recover a commission as long as the broker is licensed before his or her services are completed or the contract is breached. n40 For example, in *Schreibman v. L.I. Combs & Sons, Inc.*, n41 the plaintiff broker signed a listing contract to sell land in Indiana. At the time of contracting, plaintiff, a licensed broker in New York, was unlicensed in Indiana, but subsequently, and before defendant breached the agreement, acquired an Indiana broker's license. The Seventh Circuit held that, under Indiana law, the fact that a broker is unlicensed at the time a contract is entered into does not of itself make the contract void, where a license is subsequently obtained before the broker's cause of action arose. n42

In several jurisdictions, the requirement that a broker be licensed at the time the cause of action arose has been construed to mean that a broker must be licensed when his or her services are performed, and having a license when the sale is consummated or the commission is due, is insufficient. n43 *Bendell v. DeDominicis*, n44 a New York case, involved a broker whose license had expired. Before he renewed it he procured a buyer who made an offer for a parcel of land which was not accepted. The buyer, however, entered into a contract after the broker had renewed his license but without further intervention on his part. Holding that the broker was not entitled to a commission for services illegally rendered without a license, the court wrote:

Otherwise an unlicensed broker might negotiate sales with impunity up to the point of a complete agreement and then obtain his license for the purpose of recovering his commissions on the execution of a formal contract. The law is not so toothless. n45

The *Bendell* court also reasoned that, since a broker's commission usually becomes due when he produces a ready, willing and able buyer, obtaining a license after such point but before the consummation of the transaction is ineffective.

If a broker's license expires subsequent to the making of a listing contract but before performance, he will not be able to recover a commission. n46 Conversely, if a broker's license expires after performance, but before the closing, or before he brings an action for the commission, the broker will be granted a recovery. n47

[5] Where Broker Is Licensed But Associates or Employees Are Unlicensed

Even though a broker is duly licensed, he may have trouble recovering his commission if he worked on a sale with unlicensed partners or salespersons. n48 A real estate salesperson, who must be employed by a broker, is also required to be licensed. Where a licensed broker employs an unlicensed salesperson who works on a transaction the broker may be denied recovery of the commission. n49 In *Meltzer v. Crescent Leaseholds, Ltd.*, n50 a federal district court, construing New York's broker licensing statute n51 stated that "the participation of the unlicensed broker or salesman as a substantial factor in effectuating the transaction renders it unlawful." n52

A broker will be precluded from recovering a commission if his licensed salesperson performs acts reserved under the applicable state statute to licensed brokers. n53 Of course, if the unlicensed salesperson was not a party to the particular transaction sued upon, the broker will not be precluded from recovery. n54 The rule is different when both are licensed. In *Braden v. Isabell K. Horsely Real Estate*, n55 a licensed salesperson obtained a listing but ended his affiliation with the sponsoring broker prior to closing. The court held that the salesperson would not be deprived of the right to sue for his part of the commission, particularly since the sale was consummated and the broker received a substantial

commission.

When a licensed broker and an unlicensed broker enter into a listing contract, neither one may be able to recover. n56 The court, in *Wasson v. Hart*, n57 for example, denied a licensed broker's action for commission, on the grounds that his fee-splitting arrangement with an unlicensed broker made the entire commission agreement void and illegal under Texas law. The court in *Kemmerer v. Rascher* n58 reached the same result, when the parties were an individual licensed as a real estate broker and a corporation that was not so licensed at the time the cause of action arose. However, if the licensed broker justifiably but mistakenly believed that a broker with whom he was working had a license, he would probably be allowed to recover. n59 In an interpleader action to establish rights to a commission between a licensed broker and an unlicensed broker, the licensed broker may be unable to plead the other's lack of license, as he is not within the class intended to be protected by licensing statutes. n60

Under Maryland law it is held that a holder of a Maryland broker's license may not recover a commission where the broker's agents, in procuring the sale of real estate, do not have a Maryland license. The fact that the agent is licensed in another jurisdiction will not save the commission. One factor considered by the court in coming to this holding was the relative ease by which individuals who are licensed in other states can obtain a Maryland license. n61

[6] Corporations

Licensing of corporations depends entirely upon each state's statutes. n62 In most cases, it involves the issuance of two licenses--one for the corporation and one for a designated broker of that corporation--making the ability to engage in a brokerage practice interdependent on both licenses remaining active. n63 Conversely, if there is a defalcation or a breach of fiduciary duty on the part of the corporation, both licenses are in danger of suspension by the licensing authority.

Where a licensed broker, working for an unlicensed corporation, or an unlicensed broker working for a licensed corporation makes a sale, the corporation may have trouble recovering a commission. In *Magoba Management v. Central Zone Property Corp.*, n64 the New York Supreme Court denied a commission to a licensed corporation where the negotiations were entered into by an unlicensed officer (rather than the duly designated officer) of the brokerage corporation. On the other hand, *Matthews-Pelton, Inc. v. LeBlanc* n65 held that a licensed corporation could recover its commission, even though the employee acting for the corporation did not become licensed until after the sale was consummated.

Conversely, in *Star Realty Corp. v. Sellers*, n66 the president of a corporation was a licensed real estate broker, but the corporation was not duly licensed. The Supreme Court of New Mexico, in denying the claim for commission, wrote:

Even though there is evidence that the corporation may have been entitled to a broker's license, there is no evidence that one was ever applied for or issued to it It is not enough that Mr. Williams [corporation president] held such a license. He is not the plaintiff. n67

Not all jurisdictions strictly impose such double licensing requirements. For example, Connecticut requires that if a corporation is licensed as a real estate broker, every officer who actively participates in its brokerage business must be licensed as a broker. In a case where the corporation's president was licensed as a salesperson rather than a broker, the court found that this failure to be duly licensed as a broker was not a bar to the corporation's recovery of a commission because the licensing law also provided that it should not prevent any licensee from recovering any commission, compensation or other payment in respect to any acts done or services rendered, if it would be inequitable to deny such recovery. The court found that a corporate broker licensee, whose president was not licensed as a broker, may not be denied its right to recover a commission otherwise earned solely because of that licensing failure. Instead, the corporation's right to recover was to be gauged under all of the facts and circumstances of the case and whether it would be inequitable, in light of those facts and circumstances, to deny the broker the right to recover its commission. n68

[7] Partnerships

A licensed brokerage partnership may not be able to recover commissions if an unlicensed partner performed the services under a listing contract, n69 as the individual partner would be acting in violation of the statute. But if, in an unlicensed partnership, all the partners are licensed, a partner may recover individually if acting in his own right and not on behalf of the partnership. n70

In *Heinfelt v. Arth*, n71 the California District Court of Appeal upheld the right of licensed brokers to act in partnership, even though the partnership is not separately licensed and the statute calls for partnerships to be licensed. The court wrote:

The essential requirement of the act is that every person, natural or artificial, operating as a real estate broker, must obtain a license so to do ... [I]t is in accord with both the letter and the spirit of the act to hold that fully licensed individuals may work in partnership with each other without obtaining another license in the firm name, the only possible effect of which would be to license the same individuals who are already licensed. n72

[8] Conflict of Laws Issues

Complex questions of conflict of laws arise when brokers are employed to sell land in states in which they are not licensed. n73 The relevant factors to consider when faced with such a situation include:

- (1) where the contract was formed;
- (2) where performance is to take place;
- (3) where the land is located; and
- (4) in what jurisdiction(s) the broker is licensed. n74

Landmark Commercial Realty, Inc. v. Developers Diversified, Ltd. n75 illustrates the problem with pursuing a commission that can arise when a broker acts in a foreign jurisdiction. The broker in this case was licensed in Florida, but the land that was sold was located in Ohio. The court found that the broker was precluded under Ohio law from claiming a commission on the sale of Ohio real estate since the broker was not registered in Ohio. n76

Often laws of the affected states are the same with respect to real estate licensees: to collect a commission, the broker must be a duly licensed real estate broker. When the law is the same and the resolution of a dispute would be the same in all potentially affected states, it has been held that no state has an interest in having its own law applied with the result being that there is no conflict of laws. n77

[9] Business Brokers--Where Real Property Is Included in Sale of Business

While Wisconsin requires business brokers to be licensed under the same rules as real estate brokers, n78 most states do not require business brokers to be licensed. n79 This may create problems for a business broker in obtaining commissions, as sales of businesses generally include, to some extent, transactions involving real property. There are two general theories under which commissions can be determined on the sale of businesses involving real estate:

- (1) the "bright-line" theory or,
- (2) the "mere incidental" theory.

The "bright-line" theory holds that if a sale of the ongoing business includes any real estate component, no matter how small that component may be, the broker will be denied any commission unless he has a real estate license. n80

In a number of other jurisdictions, however, the test is whether the real estate involved was "merely incidental" to the sale of the business.

In *Weingast v. Rialto Pastry Shop, Inc.*, n81 a business broker sued for a commission for his part in effecting the sale of a restaurant. In finding for the broker, the New York Court of Appeals wrote:

One who makes a specialty of procuring purchasers for restaurants, drug stores, grocery stores, and the like as going concerns, where a lease simply goes with the place as a part of the good will, does not become, within this law, a real estate broker. As failure to procure a license is made a crime, the statute must not be extended by implication. [citation omitted] n82

Other jurisdictions hold similarly. The courts supporting the "mere incidental" theory stress that real estate broker statutes are intended to protect unsophisticated home buyers, and not knowledgeable individuals buying and selling entire businesses, which seems to assume that all people who deal in businesses are sophisticated and all people who deal in residential real estate are not.

Either the "bright-line" or the "mere incidental" theory begs the question as to whether or not the conveyances involve real estate. In many areas of the law, fixtures constitute real estate, as do certain mineral interests, even though they may be excluded under individual states' statutes involving real estate licensees. Therefore, in either case, state law determines whether or not the items being conveyed constitute "real estate." n83

There is always an exception to the general rule. At least one jurisdiction (New Jersey) requires that the personal property component outweigh the real estate component in order for the business broker to recover a commission on the personal property. In *Kazmer-Standish Consultants v. Schoeffel Instruments Corp.*, n84 the court supported the severability view (i.e., that the business broker may only recover a commission based on the personalty element of the commission, not the value of the entire transaction), arguing that the real estate licensing statute should not apply to parties buying and selling businesses.

A South Carolina court has followed the lead of the New Jersey court. In *Roberts v. Gaskins* n85 the court stated:

[A] business broker unlicensed as a real estate broker may enforce a commission contractually earned on the sale of the personal property of a business, irrespective of the form of sale, even though the sale may include real estate; provided, of course, no commission can be based either directly or indirectly on the value of the real property involved. n86

Issues involving business brokers are discussed in greater detail in Chapter 12 *below* .

[10] Disciplinary Actions Resulting from Commission Disputes

It is a relatively simple matter for a disgruntled purchaser or seller to file a complaint with the state real estate commission. It should be no surprise that disputes over commissions have triggered such complaints. *Ohio Department of Commerce, Division of Real Estate v. DePugh* n87 illustrates the importance of relying upon an attorney's advice before pursuing the collection of a disputed commission. After consulting with his attorney and receiving the attorney's advice to sue the sellers, the broker sued for his commission. He lost at trial. The sellers (the defendants in the commission dispute case) subsequently filed a grievance against the broker. The commission's formal hearing notice stated that the broker had "demanded, without reasonable cause, by way of a lawsuit ... a real estate commission

Your conduct in this regard is a violation of *Ohio Revised Code Section 4735.18(A)(10)* and is misconduct, incompetency, and/or gross negligence" n88 The hearing commissioner concluded that the broker had reasonably relied upon the advice of his attorney when filing suit against the sellers and that there had been no statutory violations. The commission disagreed and found that the broker had committed the violations alleged in its hearing notice. The broker appealed this decision and the first court hearing this appeal reversed the commission's order. The commission then appealed. The reversal of the commission's order was sustained. This court discussed the hearing examiner's conclusion regarding the broker's reliance upon his attorney. This court stated:

The hearing examiner recognized the difference between two types of reliance when he wrote that a real estate licensee's significant reliance on an attorney's advice "is not unfettered," but rather is a basic consideration which may weigh strongly in a case. The hearing examiner further concluded that [the broker's] reliance on his attorney's advice weighed strongly in the case *sub judice* because "the attorney did the primary evaluation of the case [against the sellers] and decided legal action was warranted." ... We readily acknowledge that under different circumstances, a real estate licensee facing an *R.C. 4735.18* misconduct action may not be able to use a legal professional's advice as a shield. Whether a real estate licensee's reliance upon legal advice was reasonable, proper, and in accordance with real estate licensee professional standards must be evaluated under each case's unique facts and circumstances. n89

Brokers who choose to sue for their commissions should ensure that they have a reasonable legal basis for asserting their right to payment. If they lose their case, there is the possibility that a complaint may be filed against them by the disgruntled, but successful seller. A spurious suit may ultimately subject a broker to disciplinary sanctions.

The *DePugh* case also illustrates an attitude of some state real estate commissions which appear to function with an anti-broker attitude. Brokers and their counsel should realize that this appears to be the climate with some commissions and pursue appropriate appeals when state real estate commissions, such as the one in the *DePugh* case, behave arbitrarily and capriciously.

[11] Can Fees Paid to an Unlicensed Broker Be Recovered?

Most jurisdictions bar actions to recover commissions earned by unlicensed brokers. The issue may arise, however, as to whether fees paid to an unlicensed broker may be recovered. n90 Frequently statutes that bar unlicensed brokers from suing to collect commissions are silent as to whether individuals are entitled to recover compensation already paid. Generally, more is required to impel a court to action than to convince the court to leave matters where they are. Justice Cardozo wrote while on the New York Court of Appeals:

The law may at times refuse to aid a wrongdoer in getting that which good conscience permits him to receive; it will not for that reason aid another in taking away from him that which good conscience entitles him to retain. n91

Under this reasoning, many jurisdictions reject any automatic recovery rule. n92 One court has stated that the case for recovery for amounts paid is a function "of the strength of the public policy involved together with the degree of violation of that policy under the facts of the case." n93 However, some states statutorily permit the recovery of a commission paid to an unlicensed broker. n94

The Supreme Court of New Hampshire has held that a condominium association that acted as an unlicensed real estate broker by collecting commissions on the sale and rental of condominiums could be ordered to return commissions on a theory of unjust enrichment. This decision was based in part on the fact that if an unlicensed broker was allowed to retain any commissions it had collected, such unlicensed persons would be encouraged to seek advance payments which would undermine the purpose of the licensing statute. n95

When the disgorgement of compensation paid to an unlicensed broker is not automatic, the circumstances of the particular case must be considered to determine whether disgorgement is required to vindicate public policy underlying the statute. n96 Circumstances that favor disgorgement include:

- Significant injury to the user as a result of acts of the type the statute was intended to protect against.
- Bad faith or knowing violation of the law by the unlicensed broker.
- The vulnerability or relative lack of sophistication of the user of the services.
- Whether the applicable statute expressly or by clear implication favors, but does not require, disgorgement.

Circumstances weighing against disgorgement are the converse of the above and include the following:

- Whether disgorgement would unjustly enrich the user of the services.
- Whether the sanction of disgorgement would be disproportionate to the violation.
- Whether the unlicensed broker acted in good faith and can retain the payments in equity and good conscience.
- Whether the user violated the law, especially if the user was in pari delicto.
- Whether the violation was merely technical or was not a knowing violation.
- Whether the user of services was knowledgeable and sophisticated.

The balancing of the equities in light of relevant public policy is usually left to the discretion of the trial court. n97

[12] Employees of Developers May Need to Be Licensed to Recover Commission

A developer may employ salespersons to sell the houses or condominiums the developer builds. If the employment agreement with these salespersons provides compensation in the form of a commission, the employee is advised to carefully read any applicable licensing statutes. Some statutory licensing laws provide a separate category of licensure for employees of builders and developers. n98 The failure to be licensed may result in the employee receiving no compensation should the developer refuse to pay the agreed upon commission. n99

[13] Assignment of a Commission

As a general rule, one real estate licensee can assign a commission to another real estate licensee as long as the underlying brokerage agreement does not contain a valid anti-assignment clause and there is no statutory prohibition regarding such an assignment. n99.1

The assignment of a commission to an unlicensed party by a licensee may raise the issue of whether the non-licensed assignee can step into the shoes of the licensee. An Ohio court considered this issue when a licensed broker assigned its right to receive a commission to one of its former real estate salespersons. Since the salesperson was not a licensed broker, he had no independent right to sue for the commission. This issue was governed by a statutory provision which stated in part, "No right of action shall accrue to any person, partnership, association, or corporation for the collection of compensation for the performance of the acts mentioned in section 4735.01 of the Revised Code, without alleging and

proving that such person, partnership, association, or corporation was licensed as a real estate broker or foreign real estate dealer." n100 The court found that the crucial phrase was "no right of action shall accrue." There was no question but that the broker, the entity claiming the initial entitlement to the commission, was a licensed real estate broker at the time the cause of action accrued. The court held that when a right of action accrues for the payment of compensation, a broker who is licensed at the time the right of action accrues may validly assign that right of action, and the assignee of that right of action is not required to prove that the assignee is a licensed broker in order to maintain that right of action. n101

Other courts have held that an agent should be able to assign a commission due pursuant to his or her independent contractor agreement with his or her broker. Under such an assignment, the assignee should be able sue to collect the commission should the broker refuse to pay the commission. n102

There are lenders who make loans to real estate licensees where the licensee assigns a commission from a pending real estate transaction to secure the loan. Such lenders consider this practice to be factoring, but as discussed below, one court has found such a transaction to be a consumer loan. At least two courts have held that the assignment of a pending real estate commission in exchange for a cash advance does not involve commission splitting because the licensee's and the assignee's claims to the commission are supported by separate and distinct consideration. Since both the earning of the commission and its assignment are supported by discrete and valuable consideration, such specialized lenders are not engaging in commission splitting. n103

In *Decision Point, Inc. v. Nichols & Reece Realtors, Inc.*, n104 the Supreme Court of Kansas held that a lender who advanced cash to a real estate agent for personal, family, or household purposes in return for the assignment of an anticipated commission had made a consumer loan subject to the Uniform Consumer Credit Code (UCCC). n105 The plaintiff provided cash advances to real estate agents with commissions pending from real estate transactions. In return, the plaintiff took a percentage of the real estate commission. The plaintiff required that agents sign a Master Repurchase and Security Agreement (agreement), which irrevocably assigned the real estate agent's rights to receive the pending commission to the plaintiff and authorized the settlement agent or real estate company to pay the plaintiff directly. The agent was required to acknowledge that the transaction was "not a loan or a consumer transaction, but the sale of a business account receivable at a discount for commercial purposes." If the assigned commission was insufficient to satisfy the obligation, the agent was required to immediately pay the deficiency and any penalties assessed by the agreement. If the commission was not paid because the real estate transaction failed to close, the agent was required to repurchase the accounts receivable for the full amount of the assigned commission. The agreement also granted the plaintiff a security interest in all of the real estate agent's current and future commissions, accounts, general intangibles, contract rights, leases, chattel paper, other rights to receive money, and all cash and noncash proceeds from the foregoing items.

Litigation arose when cash advances the plaintiff had made were not repaid at settlement; instead the broker paid the commissions directly to the agents involved rather than the plaintiff even though the plaintiff had filed the necessary documents to perfect its security interest. When the agents involved defaulted on their agreements, the plaintiff sued the agents' broker. The plaintiff argued that the transactions were secured transactions governed by Article 9 of the Uniform Commercial Code. The plaintiff asserted that it had purchased the agents' accounts for a discount rather than issuing credit. The plaintiff claimed that UCCC did not apply because the transactions at issue were not consumer transactions. The broker argued that the transactions were subject to the UCCC because the cash advances received by the agents were consumer loans used for personal, family, or household purposes. The court agreed with the broker and found that commissions paid to agents who worked as independent contractors were earnings under the UCCC. The UCCC precluded the assignment of earnings. Since the agents had assigned their earnings in violation of the UCCC, the plaintiff could not enforce the assignment against the broker. n106

When an agent changes brokers, issues can arise regarding the departing agent's commissions. The handling of such commissions must accord with the applicable laws regulating brokers and agents. For example, in *Richard Bowers &*

Co. v. Creel, n107 the agent's agreement with his former broker provided for an equal split of commissions between the broker and agent for existing lease accounts when the agent departed, but changed this split to 45% for the former agent and 55% for the prior broker if existing lease accounts were renewed or expanded through the agent after his departure from the broker. When the agent's former broker sued to enforce this agreement, the court held that a contract term requiring an agent to pay his former broker commissions earned with a new broker, absent a written agreement between the former and new broker, was unlawful. n108 The court relied upon *Georgia Code § 43-40-19 (c)* which provides that an agent transferring to a new broker may continue to act for the former broker with regard to transactions begun prior to the transfer, provided that both brokers have a written agreement listing the transactions involved, the former broker assumes responsibilities for the agent's activities in these listed transactions and the agreement states how the former broker will compensate the agent.

[14] Substantial Compliance Doctrine

Washington courts apply a substantial compliance doctrine with respect to statutory provisions that require licensure before a person can sue with respect to an activity requiring licensure. n109 If the party has substantially complied with the licensing law and the failure is a technical defect that does not defeat the purpose of the underlying law, Washington courts will allow the unlicensed party to proceed with its suit. In a case involving an unlicensed corporate salesperson that was suing for its commission, the court noted that a corporation cannot sit for an examination. All that was required for a license was the submission of the articles of incorporation and a list of officers to ensure the legitimacy of the corporate entity. In this case there was no question but that the corporate entity was legal and its officers and employees were themselves duly licensed. Had the officers filed a corporate application and submitted the articles and the list of officers, the corporation would have been licensed because there was no other requirement. The court held that the doctrine of substantial compliance applied to the brokers' act, and that under the facts of the case before it there had been substantial compliance. The court stated: "To hold otherwise under these circumstances would stress form over substance and could transform a socially desirable licensing scheme 'into an unwarranted shield for the avoidance of a just obligation.' " n110

Other courts have rejected any application of a substantial compliance doctrine to real estate licensees. n111

[15] Out-of-State Cooperating Brokers

Some courts have held that an out-of-state broker need not comply with local real estate licensure requirements as long as the out-of-state broker works through a cooperating local broker. n112 This has been referred to as a "cooperating broker exception" to the licensing statutes. n113 Some legislatures have chosen to address this "exception" statutorily. n114 Some courts have found statutes that attempt to prohibit an in-state licensee from sharing a commission with a broker licensed in another state to be unconstitutional and in violation of the *Commerce Clause* by acting as a protectionist economic restraint on commerce by favoring in-state over out-of-state brokers. n115

Conversely some jurisdictions do not allow a broker to share a commission with an unlicensed broker. n116 Even when the unlicensed broker is a cobroker licensed in another state, the ban on sharing a commission with an unlicensed broker will apply. The existence of such a cobrokerage agreement may be found to bar recovery of a commission by the properly licensed broker involved in the transaction when the other participant is not licensed in the applicable jurisdiction. n117

[16] Location Where the Brokerage Services Are Performed

In some instances a duly licensed broker is involved with the sale of property located in another state where the broker is unlicensed. Normally this situation will result in the broker being unable to collect a commission. However, in some cases the broker has argued that even though the subject property is located in a state where the broker is unlicensed, the brokerage services were rendered in the state where the broker was licensed.

In the typical transaction involving a broker, some brokerage services are performed in the state where the subject property is located. In this scenario, many jurisdictions bar recovery of any commission by the broker who is not licensed in the state where the property is located. There are cases, however, where brokers have either successfully made this argument or where courts have appeared willing to accept this argument.

In *Wayne A. Vandenburg Enterprises, Inc. v. Park Drive Manor, Inc.*,ⁿ¹¹⁸ a case involving a plaintiff "finder," the real estate was located in Pennsylvania, but material elements of the plaintiff's performance occurred in Illinois. The matter before the court was a motion for summary judgment. The court stated that the purpose of the statute prohibiting recovery of compensation by unlicensed brokers was to prevent recovery for activities conducted within Pennsylvania.ⁿ¹¹⁹ The court found that the plaintiff's introduction of the parties in Illinois appeared to be the contractual performance on which the plaintiff's claim was founded and that the meetings which occurred in Pennsylvania "amounted to no more than collateral and incidental services." In denying summary judgment, the court stated that unless it could be shown that brokerage services occurred in Pennsylvania, the Pennsylvania brokerage law did not apply.ⁿ¹²⁰

In *Sun Sales Corp. v. Block Land, Inc.*,ⁿ¹²¹ the court held that the Pennsylvania Licensing Act did not apply to transactions occurring outside of Pennsylvania even though the subject property was located in Pennsylvania. This case involved New York corporations that had contracted to sell Pennsylvania land throughout the United States. The court stated that the New York corporations were suing over rights contained in a New York contract, written in New York and governed by New York law, to be performed in New York and elsewhere, but presumably not in Pennsylvania.ⁿ¹²²

Other courts, however, find that the location of the property is a paramount factor in considering the application of a licensing law. In a case involving a broker licensed in New York and the sale of New Jersey property, the broker argued that New York law should be applied to the case because the broker was licensed as a real estate broker in New York, the defendants resided and were headquartered in New York, all information concerning the subject property came through defendants' New York offices, the final sale of the property was closed in New York, and New York has a paramount interest in seeing that its licensed brokers are compensated.ⁿ¹²³ The court stated that among the traditional factors in a choice-of-law analysis involving a property transaction, "the heaviest weight is given to the location of the property being transferred."ⁿ¹²⁴ Since the property was located in New Jersey and the plaintiff admitted that over 100 meetings were held at the property site, this was more than the "single act" required to trigger the application of the New Jersey licensing statute. The court found that the plaintiff's claim was barred since the broker was not licensed as a real estate broker in New Jersey when the cause of action arose.ⁿ¹²⁵

[17] Consulting Fees Versus Commissions

When a party lacking the appropriate licensure claims that the party is due compensation, sometimes an argument is made that the party was acting as a consultant rather than as a broker. Typically, licensure statutes prevent such arguments from succeeding.ⁿ¹²⁶

There are cases where a real estate licensee asserts that compensation was a consultant's fee rather than a commission earned in the capacity as a real estate licensee. One example where this may occur with a licensee is where a licensee seeks compensation for work performed in a state where the individual is not licensed.ⁿ¹²⁷ In some situations the individual claims to have been acting in a capacity other than as a real estate licensee.ⁿ¹²⁸

As a general rule, courts will not allow an individual to call compensation a consultant fee in order to avoid the effects of a statute that required that an individual be licensed in order to seek recovery of the compensation.ⁿ¹²⁹ Changing the title of the compensation or the services provided will not allow recovery of income by an unlicensed individual.

Missouri law contains a provision providing that notwithstanding the requirement that those acting in the capacity of a

real estate broker or salesperson must be licensed, a broker who refuses to pay a person who assisted in a real estate transaction, knowing that person was not licensed, is liable to that person for the reasonable value of his or her work. n130 This provision could assist an unlicensed person asserting a quantum meruit claim provided that the person they are suing is duly licensed. n131

FOOTNOTES:

(n1)Footnote 1. *See* ch. 6 below. *See also Kirkpatrick v. Lawrence*, 908 S.W.2d 125 (Ky. App. 1995) (the court restated the "rigid rule" under Kentucky law precluding the enforcement of commission contracts procured by unlicensed brokers. The court specifically rejected the plaintiff's argument that the rule did not apply to a mere "finder," as distinguished from a broker). *But see Hunt v. Dark Hill Enters.*, 867 S.W.2d 497 (Ky. App. 1993) (unlicensed brokers who arranged coal leases, and who were to be compensated ten cents per ton of coal mined and sold under the leases, fell within the exception to the statutory definition of a broker in Ky. Rev. Stat. Ann. § 324.010(1)(a); thus, they were permitted to recover on their finder's fee agreement for coal that came from properties they found and that was sold under the leases).

(n2)Footnote 2. *See Blackthorne Group, Inc. v. Pines of Newmarket, Inc.*, 150 N.H. 804, 806, 848 A.2d 725, 728 (N.H. 2004) , rehearing denied, 2004 N.H. LEXIS 99 (N.H. May 28, 2004) .

Previous statutes under which the licensing requirement was found to be merely a revenue measure and not primarily an exercise of the state's policy power had been held not to preclude an unlicensed broker from recovering a commission. *See Garvin v. Gordon*, 36 N.M. 304, 14 P.2d 264 (1932) .

(n3)Footnote 3. *See*:

Federal: Huffman v. Cohen, 2009 U.S. Dist. LEXIS 51912, at *5 (N.D. Okla. June 19, 2009) , applying Oklahoma law.

New Jersey: Sammarone v. Bovino, 395 N.J. Super. 132, 141-42, 928 A.2d 140, 146 (App. Div. 2007) , cert. denied, 193 N.J. 275, 937 A.2d 977 (2007) .

New York: Handy v. Cohen, 195 Misc. 2d 548, 551-552, 759 N.Y.S.2d 627, 630 (N.Y. City Ct. 2003) *aff'd in part, modified in part*, 2005 N.Y. Misc. LEXIS 709, 2005 NY Slip Op 25143 (N.Y. App. Term Apr. 13, 2005) (statutory quadruple damage award affirmed where broker was not licensed and failed to disclose conflict of interest).

Tennessee: Business Brokerage Centre v. Dixon, 874 S.W.2d 1, 3 (Tenn. 1994) .

Texas: Henry S. Miller v. Treo Enters., 585 S.W.2d 674 (Tex. 1979) .

(n4)Footnote 4.

Alabama: Ex Parte Ledford, 761 So. 2d 990, 994-995 (Ala. 2000) (if a person violates the licensing statute, any agreement to compensate that person is void and unenforceable).

Arizona: Farragut Baggage & Tr. Co. v. Shadron Realty, Inc., 18 Ariz. App. 197, 200, 501 P.2d 38, 41 (1972) ("A plaintiff cannot recover where his cause of action cannot be established without showing that he has broken the law. ... Whenever a statute is made for the protection of the public, a contract in violation of its provisions is void... [citations omitted].").

Colorado: Amedeus Corp. v. McAllister, 2009 Colo. App. LEXIS 221, at *4 (Colo. Ct. App. Feb. 19, 2009) *Shotkoski v. Denver Investment Group Inc.*, 134 P.3d 513, 515 (Colo. Ct. App. 2006) .

District of Columbia: Ashton Gen. Partnership, Inc. v. Federal Data Corp., 682 A.2d 629 (D.C. App. 1996) (under District of Columbia law, an action to collect a commission is barred unless the broker alleges that he or she was duly licensed on the date the cause of action accrued. Upon failure to satisfy the mandatory pleading statute, a defendant may assert that no claim has been stated upon which relief can be granted); *RDP Dev. Corp. v. Schwartz*, 657 A.2d 301 (D.C. App. 1995) (statute barring recovery of a commission by an unlicensed broker was to be construed generously to encompass commercial real estate transactions involving knowledgeable and sophisticated parties who are capable of protecting themselves).

Florida: Meteor Motors, Inc. v. Thompson Halbach & Associates, 914 So. 2d 479, 483 (Fla. Dist. Ct. App. 2005) .

Indiana: Hoffman v. Dunn, 496 N.E.2d 818 (Ind. Ct. App. 1986) (statute that required a real estate broker or a partnership operating as a real estate broker to procure a license was proper exercise of the state's authority).

New Hampshire: Blackthorne Group, Inc. v. Pines of Newmarket, Inc., 150 N.H. 804, 807, 848 A.2d 725, 729 (N.H. 2004) , *rehearing denied*, 2004 N.H. LEXIS 99 (N.H. May 28, 2004) (general rule is that contracts with unlicensed brokers are void).

New York: Chappo & Co., Inc. v. Allan Riley Co., Inc., 225 A.D.2d 468, 639 N.Y.S.2d 383, 1996 N.Y. App. Div. LEXIS 3173 (1st Dept. 1996) (unlicensed real estate broker cannot bring an action for a commission, notwithstanding the broker's effort to recharacterize the mortgage negotiated by the broker as a leasebacked note transaction); *NFS Serv., Inc. v. West 73rd St. Assocs.*, 102 A.D.2d 388, 477 N.Y.S.2d 135, 1984 N.Y. App. Div. LEXIS 18796 (1st Dept. 1984) (real estate broker licensed in New Jersey but not in New York could not recover for breach of contract for services rendered in New York).

Utah: Consolidated Realty Group v. Sizzling Platter, Inc., 930 P.2d 268 (Utah App. 1996) *cert. denied*, 936 P.2d 407 (Utah 1997) (any terms set forth in agreement between broker and seller with respect to prospective purchasers are indications of those purchasers ultimately desired by the seller, but do not constitute conditions to receiving a commission unless the agreement specifically so requires).

Wisconsin: Greenlee v. Rainbow Auction/Realty Co., 202 Wis. 2d 653, 553 N.W.2d 257 (Wis. App. 1996) *review denied*, 205 Wis. 2d 134, 555 N.W.2d 815 (Wis. 1996) (the requirement under Wisconsin law that a broker may not collect a commission unless the broker is duly licensed cannot be waived by contracting parties who know that the broker was not licensed).

But cf. Penmont, LLC v. Blue Ridge Piedmont, LLC, 607 F. Supp. 2d 1266, 1270 (M.D. Ala. 2009) , applying Alabama law (The law does not void every contract entered into by an unlicensed real estate broker, but rather only those providing for compensation of the unlicensed broker.).

(n5)Footnote 5. *See Terry v. Allied Bancshares*, 760 S.W.2d 45 (Tex. App.--Ft. Worth 1988) ; *Shehab v. Xanadu, Inc.*, 698 S.W.2d 491 (Tex. Civ. App. 1985) (unlicensed real estate agent acting as on-site manager of condominium project was precluded from recovering commission on sale of units for failure to comply with Real Estate License Act). *See generally* Comment, *Recovery of Commissions by Unlicensed Real Estate Brokers*, 80 Dick. L. Rev. 500 (1976).

See also Winthrop & Co., Inc. v. Milgrom, 447 Pa. Super. 140, 668 A.2d 557 (Pa. Super. 1995) (an unlicensed broker is not barred from receiving a commission in connection with the sale of business assets, even if the same purchaser

also bought related real estate, where the sale of the assets occurred in a transaction separate from the sale of the real estate and where the broker sought compensation only for the sale of the assets. The Pennsylvania courts have not yet determined whether the broker could recover compensation based solely on the sale of the business assets where the sale of the assets took place in the same transaction involving the sale of the real estate).

(n6)Footnote 6. See *Ex Parte Ledford*, 761 So. 2d 990, 995 (Ala. 2000) .

(n7)Footnote 7. See *Klein v. Antebi*, 15 Misc. 3d 901, 911, 832 N.Y.S.2d 904, 912, 2007 N.Y. Misc. LEXIS 1476 (2007) *aff'd in part*, 53 A.D.3d 529, 861 N.Y.S.2d 143 (App. Div. 2008) .

(n8)Footnote 8. *Burke v. Israel*, 264 Pa. Super. 286, 294, 399 A.2d 779, 783 (1979) , citing Comment, *Recovery of Commissions by Unlicensed Real Estate Brokers*, 80 Dick. L. Rev. 500, 524 (1976). But see *Sammamone v. Bovino*, 395 N.J. Super. 132, 928 A.2d 140 (App. Div. 2007) , cert. denied, 193 N.J. 275, 937 A.2d 977 (2007) , where an unlicensed plaintiff sought promised compensation for introducing the defendant to Leona Helmsley. This contact allowed the defendant to acquire land. The defendant was an experienced real estate developer who was familiar with litigation. It did not escape the court's notice that the defendant had been involved in a prior case where he successfully invoked N.J. Stat. § 45:15-3 to defeat a claim for a commission. The trial court had dismissed the claim because of the plaintiff's unlicensed status. In reversing and remanding for further proceedings, the court stated that if this statute's purpose was to protect the public against unscrupulous and dishonest persons, the court was uncertain as to how that purpose would be furthered by dismissing plaintiff's claim if it developed that the defendant intended to rely upon the statute from the outset.

(n9)Footnote 9. See *Venturi & Co. LLC v. Pacific Malibu Development Corp.*, 172 Cal. App. 4th 1417, 1423-1424, 92 Cal. Rptr. 3d 123, 129 (2009) *Axtmann v. Chillemi*, 2007 ND 179, 740 N.W.2d 838, 846 (N.D. 2007) ; *Rockport Realty Investments, Inc. v. Riedel*, 2008 Ohio 820, 2008 Ohio App. LEXIS 711, at *9 (Feb. 29, 2008) *Dowlen v. Weathers*, 2005 Tenn. App. LEXIS 289, at *4 (May 17, 2005) , citing *Tenn. Code Ann. § 62-13-312(b)(11)*.

(n10)Footnote 9.1. See, e.g., *Matusik v. Ward*, 68 A.D.3d 1213, 1214, 892 N.Y.S.2d 561, 563 (2009) .

(n11)Footnote 10. See *Tukas Co. v. The Continuum Co., LLC*, 2003 U.S. Dist. LEXIS 5040, at *3 (S.D. N.Y. Mar. 31, 2003) ; *American Property Consultants, Ltd. v. Walden Lisle Assocs. Ltd. P'ship*, 1997 U.S. Dist. LEXIS 9984, at *22 (S.D. N.Y. July 14, 1997) .

(n12)Footnote 11. See *Tukas Co. v. The Continuum Co., LLC*, 2003 U.S. Dist. LEXIS 5040, at *3 (S.D. N.Y. Mar. 31, 2003) ; *American Property Consultants, Ltd. v. Walden Lisle Assocs. Ltd. P'ship*, 1997 U.S. Dist. LEXIS 9984, at *23 (S.D. N.Y. July 14, 1997) ; *J.I. Kislak, Inc. v. Carol Mgmt. Corp.*, 7 A.D.2d 428, 184 N.Y.S.2d 315, 317, 1959 N.Y. App. Div. LEXIS 9348 (1st Dept. 1959) , appeal denied, 8 A.D.2d 698, 185 N.Y.S.2d 745, 1959 N.Y. App. Div. LEXIS 8704 (1st Dept. 1959) .

(n13)Footnote 12. See *Berg v. Wilpon*, 271 A.D.2d 629, 707 N.Y.S.2d 861, 862, 2000 N.Y. App. Div. LEXIS 4525 (2d Dept. 2000) ; *Sorice v. DuBois*, 25 A.D.2d 521, 267 N.Y.S.2d 227, 228, 1966 N.Y. App. Div. LEXIS 4870 (1st Dept. 1966) .

(n14)Footnote 13. See *Stephen A. Goldberg Co. v. Remsen Partners, Ltd.*, 170 F.3d 191, 195 (D.C. Cir. 1999) (consultant who assisted client with securitized financing acted as a real estate broker under the District of Columbia Real Estate Licensure Law, D.C. Code § 45-1926).

(n15)Footnote 14. See *Mousa v. Saba*, 222 Ariz. 581, 586-88, 218 P.3d 1038, 1043-45 (Ariz. Ct. App. 2009) ; *Venturi & Co. LLC v. Pacific Malibu Development Corp.*, 172 Cal. App. 4th 1417, 1421-1422, 92 Cal. Rptr. 3d 123, 127-128 (2009) ; *Lindenstadt v. Staff Builders, Inc.*, 55 Cal. App. 4th 882, 894, 64 Cal. Rptr. 2d 484, 491 (1997) . Cf. *Marathon Entertainment, Inc. v. Blasi*, 42 Cal. 4th 974, 990-93, 70 Cal. Rptr. 3d 727, 737-40, 174 P.3d 741, 750-52 (2008) (allowing partial severability for enforcement of a personal manager employment contract when a license was

required for some, but not of the services rendered under the contract).

(n16)Footnote 15. 303 N.J. Super. 122, 696 A.2d 85 (1997) .

(n17)Footnote 16. 303 N.J. Super. 122, 130, 696 A.2d 85, 89 (1997) .

(n18)Footnote 17. See *Kangarlou v. Progressive Title Co., Inc.*, 128 Cal. App. 4th 1174, 1179, 27 Cal. Rptr. 3d 754, 756 (2005) , citing Cal. Business and Professions Code § 10138.

(n19)Footnote 18. See *Shotkoski v. Denver Investment Group Inc.*, 134 P.3d 513, 515 (Colo. Ct. App. 2006) ; *United National Bank v. Airport Plaza Ltd. Partnership*, 537 So. 2d 608, 610 (Fla. Dist. Ct. App. 1988) , review denied, 547 So. 2d 1209 (Fla. 1989) .

(n20)Footnote 18.1. See *Skiff re Business, Inc. v. Buckingham Ridgeview, LP*, 2010 PA Super 43, 2010 Pa. Super. LEXIS 71, at *32-*35 (Pa. Super. Ct. 2010) (the violations were material breaches of the broker's contract which forfeited the broker's entitlement to a commission).

(n21)Footnote 19.

Kentucky: *Miller & Damron v. Batten*, 247 Ky. 339, 57 S.W.2d 33 (1933) .

Louisiana: *Sheppard v. Hulseberg*, 171 La. 659, 131 So. 840 (1931) .

Exceptions were often made for isolated transactions when the statute required those "engaging in the business" of real estate broker to be licensed as in *Sheppard above*, or when the statute was designed to raise revenue, as in *Miller & Damron above*.

(n22)Footnote 20. 65 Wyo. 325, 202 P.2d 174 (1949) .

(n23)Footnote 21. 65 Wyo. at 325, 202 P.2d at 176 . See Wyo. Stat. § 37-2101 *et seq* .

See also *Loomis v. Lange Fin. Corp.*, 109 Nev. 1121, 865 P.2d 1161 (Nev. 1993) .

(n24)Footnote 22. V.I. Code Ann. tit. 27, § 301.

(n25)Footnote 23. Comment, *Recovery of Commissions by Unlicensed Real Estate Brokers*, 80 Dick. L. Rev. 500, 505 (1976).

(n26)Footnote 24. See § 6.02[1][b] below.

(n27)Footnote 25. But cf. *PKG Assocs. v. Dubb*, 306 A.D.2d 333, 760 N.Y.S.2d 681, 682 (2d Dept. 2003) (a licensed real estate broker is not barred from maintaining a lawsuit to recover a finder's fee where the broker has entered into a special contract to act solely as a finder).

(n28)Footnote 26. See, e.g., *Futersak v. Perl*, 897 N.Y.S.2d 886, 2010 N.Y. Misc. LEXIS 612, at *11-*12 (N.Y. Sup. Ct. 2010) *Brochu v. Santis*, 939 A.2d 449, 453 (R.I. 2008) . But see *Amedeus Corp. v. McAllister*, 2009 Colo. App. LEXIS 221, at *7 (Colo. Ct. App. Feb. 19, 2009) (Colorado's statutory definition of real estate broker does not recognize any distinction between a broker and a finder.).

(n29)Footnote 27. 9 Cal. 3d 1, 106 Cal. Rptr. 761, 507 P.2d 65 (1973) .

(n30)Footnote 28. 507 P.2d at 72 . Cf *Katayama v. Heller White Hotels Co., Inc.*, 692 F. Supp. 1239 (D. Haw.

1988) (dismissal of motion for summary judgment in action for finder's fee) *aff'd*, 956 F.2d 1167 (9th Cir. 1992) .

(n31)Footnote 29. 221 Pa. Super. 275, 289 A.2d 752 (1972) .

(n32)Footnote 30. *Harrison v. Soffer*, 221 Pa. Super. 275, 289 A.2d 752, 756 (1972) .

(n33)Footnote 31. *Harrison v. Soffer*, 221 Pa. Super. 275, 289 A.2d 752, 756 (1972) *allocatur denied* (quoting *Alfred v. Raschiatore*, 163 Pa. Super. 635, 63 A.2d 366, 368 (1949)) .

(n34)Footnote 32. *Andalex Resources, Inc. v. Myers*, 871 P.2d 1041 (Utah App. 1994) .

See also:

Massachusetts: Turnpike Motors, Inc. v. Newbury Group, Inc., 413 Mass. 119, 596 N.E.2d 989 (Mass. 1992) (where plaintiff-property sellers sought a declaratory judgment denying the defendant-broker's commissions on the sale of assets of two automobile dealerships, because the broker was unlicensed, the Supreme Judicial Court of Massachusetts, finding for the broker, held that (1) there was adequate evidence presented by the broker at trial to establish that the sellers knew he was unlicensed, (2) the defendant told the plaintiff-broker that a license would be unnecessary since the deal would be structured, not as a sale of real estate, but as a sale of stock, (3) the jury reasonably could have inferred from the seller's testimony that he did not intend to pay the agreed-upon commissions when he signed the agreements with the broker and (4) the broker sought out and procured buyers for the seller's businesses and the sellers refused to compensate the broker in accordance with their agreement).

Pennsylvania: Golibart v. Reamer, 610 A.2d 56 (Pa. App. 1992) *appeal denied*, 532 Pa. 664, 616 A.2d 985 (1992) , wherein the defendants contracted to purchase a 170-acre land parcel at a meeting between the defendant-seller and plaintiff-broker. The broker indicated that he did not want to be involved in the sale of the property, but rather, would help to find investors in exchange for a commission. The broker found an investor and put the investor in touch with the defendants, with whom a partnership was ultimately formed. The defendants refused to pay the commission. Reversing the trial court, the Superior Court held that the trial court should have directed the jury to find for the defendants since the broker was unlicensed, irrespective of the fact that the broker was engaged, not in the sale of real estate, but rather in the finding of investors for a condominium development.

Texas: Swor v. Tapp Furniture Co., 146 S.W.3d 778, 782 (Tex. App. 2004) (The fee for handling a property sale which included real estate is considered a real estate commission. The definition of real estate broker covers compensation labeled as a finder's fee. The plaintiff expected to be compensated for assisting in a transaction contemplating a sale of real estate. Therefore, the Texas Real Estate License Act applied to the plaintiff as a broker.).

(n35)Footnote 32.1. See *Futersak v. Perl*, 897 N.Y.S.2d 886, 2010 N.Y. Misc. LEXIS 612, at *14-*15 (N.Y. Sup. Ct. 2010) .

(n36)Footnote 33. See *Wardley Corp. v. Welsh*, 962 P.2d 86, 90-91 (Utah App. 1998) .

(n37)Footnote 34. For an extensive collection of cases on this topic, see 80 A.L.R.3d 318 .

In California, a broker's action for a commission arises when the commission becomes due and payable, although it is unnecessary for the sale to be completed in order for the broker to be entitled to a commission, unless the brokerage agreement specifies otherwise. When the realty is estate property, however, the broker's commission is not triggered as

due until consummation of the sale. Where a broker was unlicensed when the agreement to purchase estate property was made, his subsequent licensing at the time of actual sale, however, entitled him to maintain an action for recovery of a commission. *In re Estate of Lopez*, 8 Cal. App. 4th 317, 10 Cal. Rptr. 2d 67 (Cal. Ct. App. 1992) .

(n38)Footnote 35. See:

Federal: Rheinberger v. Security Life Ins. Co., 47 F. Supp. 196 (N.D. Ill. 1942) .

Illinois: Cooper v. Schoeberlein, 247 Ill. App. 147 (1928) .

Tennessee: Johnson v. Stuart, 7 Tenn. App. 1 (1928) .

See also *Smith v. Cannell*, 1999 Me. 19, 723 A.2d 876, 880-881 (Me. 1999) . The agent was not licensed when the alleged services were rendered, but was relicensed when the transaction closed. The court found that the agent had no reasonable expectation of compensation for services she provided while unlicensed as required for a *quantum meruit* recovery.

(n39)Footnote 36. 274 So. 2d 581 , appeal dismissed, 285 So. 2d 593 (Fla. DCA 1973) .

(n40)Footnote 37. Fla. Stat. Ann. § 475.41, quoted at 274 So. 2d at 583 .

(n41)Footnote 38. 274 So. 2d at 583 . Pennsylvania Courts have construed a similarly worded statute in the same way. See, e.g., *Burns v. Gartzman*, 139 Pa. Super. 453, 11 A.2d 708 (1940) . See also *Hale & Hale, Ltd. v. Arnold & Jeanie Pettit Declaration of Trust*, 298 S.W.3d 104, 108 (Mo. Ct. App. 2009) (The licensee must plead and prove that he or she was licensed at the time the licensee performed the services for which compensation is sought.), *transfer denied*, 2009 Mo. LEXIS 580 (Dec. 22, 2009) .

(n42)Footnote 39.

Arkansas: Nelson v. Stolz, 197 Ark. 1053, 127 S.W.2d 138 (1939) ; *Birnbach v. Kirspel*, 188 Ark. 792, 67 S.W.2d 730 (1934) .

Louisiana: Trentman Co. v. Brown 176 LA. 854, 147 So. 14 (1932) . *Bergeron v. Mumphrey*, 38 So. 2d 411 (La. Ct. App. 1949) .

(n43)Footnote 40.

Federal: Schreiber v. L.I. Combs & Sons, 337 F.2d 410 (7th Cir. 1964) (applying Indiana law), *cert. denied*, 380 U.S. 911 (1965) .

California: Bernasconi Commercial Real Estate v. Omni Health Plan, Inc., 42 Cal. Rptr. 2d 96 (Cal. App. 3d Dist. 1995) (under California law, a real estate broker may bring an action for breach of contract prior to the broker's performance of the contract, where the broker was licensed at the time the alleged breach occurred, notwithstanding that the broker was not licensed when the contract was executed).

Connecticut: CMG Realty of Conn., Inc. v. Colonnade One at Old Greenwich Ltd. Partnership, 36 Conn. App. 653, 653 A.2d 207 (1995) (under Connecticut law, to bring an action for a broker's commission, the plaintiff must be licensed and must have been licensed at the time the services were rendered; the statute does not require that the plaintiff be licensed as of the date the brokerage contract

was made or authorized).

Iowa: Pound v. Brown, 258 Iowa 994, 140 N.W.2d 183 (1966) .

New Mexico: Lakeview Invest., Inc. v. Alamogordo Lake Village, Inc., 86 N.M. 151, 520 P.2d 1096 (1974) .

Ohio: Pierce v. Isabel, 70 Ohio App. 385, 25 Ohio Op. 115, 40 N.E.2d 481 (1941) .

(n44)Footnote 41. 337 F.2d 410 (7th Cir. 1964) , cert. denied, 380 U.S. 911 (1965) .

(n45)Footnote 42. 337 F.2d 410, 413 (7th Cir. 1964) , cert. denied, 380 U.S. 911 (1965) (construing Ind. Code Ann. §§ 63-2407, 63-2408 (1961)).

(n46)Footnote 43.

California: Davis v. Chipman, 210 Cal. 609, 293 P. 40 (1930) .

New Jersey: Rosenthal v. Art Metal, Inc., 101 N.J. Super. 156, 243 A.2d 828 (1968) (where nothing was done to accomplish sale after broker obtained license, all services performed were illegal, and broker was not entitled to commission).

New York: Bendell v. De Dominicis, 251 N.Y. 305, 167 N.E. 452 (1929) ; *Hudson Michael Realty, Inc. v. Oliner*, 184 A.D.2d 929, 585 N.Y.S.2d 127 (3d Dept. 1992) .

Oregon: Hunter v. Cuning, 176 Or. 250, 154 P.2d 562, 574 (1944) ("at the time the alleged cause of action arose" is to be interpreted as meaning at the time, or throughout the period, when the broker performed the services which culminated in the accrual of his cause of action); *Jolma v. Steinbock*, 40 Or. App. 657, 596 P.2d 980 (1979) .

Texas: Justice v. Willard 538 S.W.2d 651 (Tex. Civ. App. 1976) (fact that broker was licensed when he brought suit did not satisfy the licensing requirement).

Washington: Irons Inv. Co. v. Richardson, 184 Wash. 118, 50 P.2d 42 (1935) (broker was not entitled to a commission where he negotiated a lease without a license but obtained a license before the commission was due).

Wisconsin: Kemmerer v. Roscher, 9 Wis. 2d 60, 100 N.W.2d 314 (1960) (unlicensed corporation given exclusive listing contract could not recover a commission when another broker sold the property, notwithstanding that the corporation was licensed at the time of sale).

(n47)Footnote 44. 251 N.Y. 305, 167 N.E. 452 (1929) .

(n48)Footnote 45. 251 N.Y. at 306, 167 N.E. at 454 .

(n49)Footnote 46.

Ohio: Stanson, Inc. v. McDonald, 147 Ohio St. 191, 34 Ohio Op. 77, 70 N.E.2d 359 (1946) .

Texas: Furman v. Keith, 226 S.W.2d 218 (Tex. Civ. App. 1949) .

See also *Douglas v. Schuette*, 607 N.W.2d 142, 147-148 (Minn. App. 2000) , review denied (agent whose license expired before the sale settled lacked standing to sue for a commission because he was not a licensed agent when the sale was consummated).

(n50)Footnote 47. See:

Maryland: Ohlandorf v. Shall, 260 Md. 665, 668, 273 A.2d 181, 183 (1991) .

New York: Bersani v. Basset, 184 A.D.2d 996, 585 N.Y.S.2d 245 (4th Dept. 1992) ; *Philip Mehler Realty, Inc. v. Kayser*, 176 A.D.2d 104, 574 N.Y.S.2d 1, 1991 N.Y. App. Div. LEXIS 11478 (1st Dept. 1991) (ruling that a corporate real estate brokerage firm that was not licensed as such when the services were performed could not recover its commission on the theory that the president of the corporation was, in fact, properly licensed).

(n51)Footnote 48. A broad collection of cases dealing with this topic may be found at 8 A.L.R. 3d 523.

(n52)Footnote 49. See:

California: Firpo v. Murphy, 72 Cal. App. 249, 236 P. 968 (1925) .

Florida: Willner v. Wilder, 280 So. 2d 1 (Fla. DCA 1973) .

Ohio: Frieman v. Greaves, 80 Ohio App. 341, 36 Ohio Op. 39, 74 N.E.2d 860 (1947) .

But see

Louisiana: Matthews-Pelton v. LeBlanc, 13 La. App. 596, 126 So. 449 (1939) , in which the court held that the fact that a duly licensed broker employed an unlicensed salesperson to assist in finding a buyer did not preclude the broker from recovering his commission.

(n53)Footnote 50. 315 F. Supp. 142 (S.D.N.Y. 1970) , *aff'd*, 442 F.2d 293 (2d Cir. 1971) .

(n54)Footnote 51. N.Y. Real Prop. L. §§ 140, 440-a, 442-d.

(n55)Footnote 52. 315 F. Supp. at 146 .

(n56)Footnote 53. See:

California: Tatterson v. Standard Realty Co., 81 Cal. App. 23, 253 P. 770 (1927) .

Oregon: Miller v. Ziedrich, 199 Or. 505, 263 P.2d 611 (1953) .

(n57)Footnote 54. *Hahn v. Hauptman*, 107 Cal. App. 739, 291 P. 418 (1930) .

(n58)Footnote 55. 425 S.E.2d 481 (Va. 1993) . But in New York an unlicensed insurance company is not entitled

to a commission, even where its owner was an attorney who could recover a commission without a license. S. *Kornreich & Sons, Inc. v. Goldsmith Murphy, Inc.*, 592 N.Y.S.2d 228, 1992 N.Y. Misc. LEXIS 568 (Sup. Ct. N.Y. County 1992) .

(n59)Footnote 56. See:

New York: *Brandenburger & Marx, Inc. v. Heimberg*, 34 N.Y.S.2d 935, 1942 N.Y. Misc. LEXIS 1585 (Mun. Ct. 1942) .

Wisconsin: *Payne v. Volkman*, 183 Wis. 412, 198 N.W. 438 (1924) .

(n60)Footnote 57. 244 S.W.2d 258 (Tex. Civ. App. 1951) . But see *Volkman v. Wortham*, 189 S.W.2d 776 (Tex. Civ. App. 1945) (licensed broker, who might be subject to penalties under the statute for sharing a commission with an unlicensed broker, was nevertheless able to recover a commission from seller).

(n61)Footnote 58. 9 Wis. 2d 60, 100 N.W.2d 314 (1960) .

(n62)Footnote 59. "Where the illegality is due to facts of which one party is justifiably ignorant and the other party is not, the illegality does not bar recovery by the innocent party of compensation for performance rendered while he remains justifiably ignorant of the facts establishing illegality." *Holland v. Morgan & Peacock Properties Co.*, 168 Cal. App. 2d. 206, 335 P.2d 769, 772 (1959) .

(n63)Footnote 60. See *Marx v. Lining*, 231 Ala. 445, 165 So. 207 (1935) .

(n64)Footnote 61. See *In re Merry-Go-Round Enters., Inc.*, 231 B.R. 241, 248 (Bkrtcy. D. Md. 1999) , applying Maryland law.

(n65)Footnote 62. See § 6.03[7] below.

(n66)Footnote 63. Cf. *Meteor Motors, Inc. v. Thompson Halbach & Associates*, 914 So. 2d 479, 483 (Fla. Dist. Ct. App. 2005) (Fla. Stat. § 475.15 requires a corporation "which acts as a broker" to "register with the commission" and "renew the licenses or registrations of its ... officers and directors for each license period.").

(N67)Footnote 64. 3 Misc. 2d 824, 156 N.Y.S.2d 313, 1956 N.Y. Misc. LEXIS 1554 , rev'd, 4 A.D.2d 145, 163 N.Y.S.2d 462, 1957 N.Y. App. Div. LEXIS 5165 (1st Dept. 1956) . See *Willner v. Wilder*, 280 So. 2d 1 (Fla. DCA 1975) cert. denied, 287 So. 2d 97 (Fla. 1973) .

See also *Venturi & Co. LLC v. Pacific Malibu Development Corp.*, 172 Cal. App. 4th 1417, 1423-24, 92 Cal. Rptr. 3d 123, 129 (2009) (Only a licensed broker may provide broker services. The employment of a licensed salesperson by an unlicensed broker will not allow recovery of compensation for broker services provided by the unlicensed broker.).

But see *Galbreath-Ruffin Corp. v. 40th & 3rd Corp.*, 19 N.Y.2d 354, 280 N.Y.S.2d 126, 227 N.E.2d 30 (1967) (licensed brokerage corporation could recover a commission though negotiations were conducted by an officer licensed as a broker for a second brokerage corporation but unlicensed as to the one at bar). A similar result was achieved in *Loomis v. Lange Fin. Corp.*, 109 Nev. 1121, 865 P.2d 1161 (Nev. 1993) .

(n68)Footnote 65. 13 La. App. 596, 126 So. 449 (1930) . See also *E.M. Glynn, Inc. v. Duplantis*, 250 La. 381, 196 So. 2d 47 (1967) (licensed realty corporation is not precluded from recovering a commission where its president was not personally licensed but was the sole owner and controller of the corporation).

(n69)Footnote 66. 73 N.M. 207, 387 P.2d 319 (1963) .

(n70)Footnote 67. 387 P.2d at 320 .

See also:

New York: Philip Mehler Realty, Inc. v. Kayser, 176 A.D.2d 104, 574 N.Y.S.2d 1 (1st Dept. 1991) appeal dismissed without opinion, 79 N.Y.2d 977, 583 N.Y.S.2d 195, 592 N.E.2d 803 (1992) , rehearing denied, 79 N.Y.2d 1041, 584 N.Y.S.2d 450, 594 N.E.2d 944 (1992) .

Texas: Henry S. Miller v. Treo Enters., 585 S.W.2d 674 (Tex. 1979) .

Wisconsin: Kemmerer v. Roscher, 9 Wis. 2d 60, 100 N.W.2d 314 (1960) (discussed at text accompanying n.42 above).

(n71)Footnote 68. See *Location Realty, Inc. v. General Financial Services, Inc.*, 273 Conn. 766, 781, 873 A.2d 163, 172 (2005) . See also *Location Realty, Inc. v. Colaccino*, 287 Conn. 706, 720, 949 A.2d 1189, 1197-98 (2008) (discussing *Location Realty, Inc. v. General Financial Services, Inc.*).

(n72)Footnote 69. See *Lee v. Moseley*, 40 Ga. App. 371, 149 S.E. 808 (1929) .

(n73)Footnote 70. *Fort Orange Co. v. O'Neal*, 138 Fla. 325, 189 So. 685 (1939) .

(n74)Footnote 71. 135 Cal. App. 445, 27 P.2d 420 (1933) .

(n75)Footnote 72. 27 P.2d at 422 . Cf. *Hoffman v. Dunn*, 496 N.E.2d 818 (Ind. Ct. App. 1986) (where several partners of brokerage firm unlicensed, partnership did not qualify for license under statute).

(n76)Footnote 73. See, e.g.:

Federal: Illustrative of the fact that there is to be no quick resolution of the conflicts problem by a mechanical reference to the location of the land is *Lucas v. Gulf & Western*, 666 F.2d 800 (3d Cir. 1981) (applying Florida law, recovery was allowed to a New Jersey broker on a transaction involving Florida land where the activities were conducted outside of Florida).

Arizona: Adams Realty Corp. v. Realty Ctr. Inv., Inc., 149 Ariz. 405, 719 P.2d 291 (Ariz. Ct. App. 1986) (real estate broker licensed in California, but not in Arizona, was legally entitled to share in the commissions with a real estate broker licensed in Arizona, for commissions earned in Arizona).

New York: Equis Corp. v. Mack-Cali Realty Corp., 6 A.D.3d 264, 265-267, 775 N.Y.S.2d 35, 37-39, 2004 N.Y. App. Div. LEXIS 4631 (1st Dept. 2004) (New Jersey has an interest in seeing that brokerage services in connection with property located in New Jersey are rendered in conformance with its laws, New York broker denied commission); *Andover Realty Corp. v. Western Elec. Co., Inc.*, 100 A.D.2d 157, 473 N.Y.S.2d 393 (1st Dept. 1984) , *aff'd* , (memo) 64 N.Y.2d 1006, 478 N.E.2d 193 (1985) (New Jersey Law requiring brokerage agreement to be in writing applied to deny recovery).

But see Rosenberg & Rosenberg, P.C. v. Hoffman, 195 A.D.2d 343, 600 N.Y.S.2d 228, 1993 N.Y. App. Div. LEXIS 7186 (1st Dept. 1993) (holding that New York had an interest in seeing that its licensed brokers were compensated on contracts arising from initial contacts in New York and contracts made in New York, even though the real estate was located in New Jersey).

See generally Ehrenzweig, *The Real Estate Broker and the Conflict of Laws*, 59 Colum. L. Rev. 303

(1959); Annot., 159 A.L.R. 266 (1945) .

(n77)Footnote 74. *Gold v. Wolpert*, 876 F.2d 1327 (7th Cir. 1989) (law of state in which subject matter is located or the law of the state in which the purchaser's reside will be applied and not the law of the state of the broker's residence). For a discussion of conflict of laws problems as they apply to real estate broker's right to commissions, see Comment, *Recovery of Commissions by Unlicensed Real Estate Brokers*, 80 Dick. L. Rev. 500, 511-16 (1976). See also Ehrenzweig, *The Real Estate Broker and the Conflict of Laws*, 59 Colum. L. Rev. 303 (1959).

(n78)Footnote 75. 163 F.3d 389 (6th Cir. 1998) .

(n79)Footnote 76. 163 F.3d 389, 391 (6th Cir. 1998) . See also *Klein v. Antebi*, 53 A.D.3d 529, 531-32, 861 N.Y.S.2d 143 (2008) (brokers were licensed in New York, the land sold was in Pennsylvania, brokers were barred by Pennsylvania law from receiving a commission).

(n80)Footnote 77. See *Erwin v. Cotter Health Centers, Inc.*, 161 Wash.2d 676, 692-93, 167 P.3d 1112, 1120 (2007) (finding that there was a conflict of laws).

(n81)Footnote 78. Wis. Stat. §§ 452.01, 452.03.

(n82)Footnote 79. See Comment, *Recovery of Commissions by Unlicensed Real Estate Brokers*, 80 Dick. L. Rev. 500 (1976). For a definition of a business broker, see ch. 12 above. In *Turnpike Motors, Inc. v. Newbury Group, Inc.*, 413 Mass. 119, 127, 596 N.E.2d 989 (Mass. 1992) (Mass. 1992), the property sellers brought a declaratory judgment against the broker, claiming that he was not entitled to a commission on the sale of assets of two automobile dealerships because the broker was unlicensed. The Supreme Judicial Court of Massachusetts held that the way in which the deal was structured constituted a sale of stock; therefore, a license was unnecessary.

(n83)Footnote 80. See:

Federal: Doran v. Imeson Aviation, Inc., 419 F. Supp. 586 (D. Wyo. 1976) .

Arizona: Bonasera v. Roffe, 8 Ariz. App. 1, 442 P.2d 165 (Ariz. Ct. App. 1968) .

Colorado: Broughall v. Black Forest Dev. Co., 196 Colo. 503, 593 P.2d 314 (1978) .

Kansas: Thomas v. Jarvis, 518 P.2d 532 (Kan. 1974) .

Kentucky: Lockridge v. Hale, 764 S.W.2d 84 (Ky. Ct. App. 1989) .

Missouri: Knight v. Johnson, 741 S.W.2d 842 (Mo. Ct. App. 1987) .

Nebraska: Chapin v. Neuhoff Broadcasting-Grand Island, Inc., 268 Neb. 520, 526, 684 N.W.2d 588, 593 (Neb. 2004) ; *Ford v. American Medical Intern, Inc.*, 228 Neb. 226, 422 N.W.2d 67 (Neb. 1988) .

(n84)Footnote 81. 243 N.Y. 113, 152 N.E. 693 (1926) .

See also:

California: Nittler v. Continental Casualty Co., 94 Cal. App. 498, 271 P. 555 (1928) .

Mississippi: Quick Shops of Mississippi v. Bruce, 232 So. 2d 351 (Miss. 1970) .

Washington: Grammer v. Scaggit Valley Lumber Co., 299 P. 376 (Wash. 1931) .

(n85)Footnote 82. 152 N.E. at 694 .

See:

Federal: Schultz v. Palmer Wellcot Tool Corp., 107 F.2d 652 (3d Cir. 1953) (applying Pennsylvania law (majority rule) to deny recovery but citing with approval the New York rule); *Scott Hubbard Co. v. Sika Chem. Corp.*, 708 F. Supp. 945 (N.D. Ill. 1989) (applying Illinois law).

Arkansas: Frier v. Terry, 323 S.W.2d 415 (Ark. 1959) .

Maryland: Glaser v. Shostack, 213 Md. 383, 131 A.2d 724 (1957) .

Mississippi: Quick Shops of Miss., Inc. v. Bruce, 232 So. 2d 351 (Miss. 1970) .

New York: Myer v. Jova Brick Works, Inc., 38 A.D.2d 615, 326 N.Y.S.2d 321, 1971 N.Y. App. Div. LEXIS 2890 (3d Dept. 1971) .

Tennessee: Business Brokerage Centre v. Dixon, 874 S.W.2d 1 (Tenn. 1994) .

(n86)Footnote 83. *Kerr v. Australia Pacific Resources, Ltd.*, 841 P.2d 401 (Colo. App. 1992) .

(n87)Footnote 84. 89 N.J. 286, 445 A.2d 1149 (1982) . See also *Cooney v. Ritter*, 939 F.2d 81, 90 (3d Cir. 1991) , applying New Jersey law (following Kazmer-Standish Consultants and allowing recovery of commission on the personal property).

(n88)Footnote 85. 327 S.C. 478, 486 S.E.2d 771 (S.C. App. 1997) .

(n89)Footnote 86. 327 S.C. 478, 490, 486 S.E.2d 771, 777 (S.C. App. 1997) .

(n90)Footnote 87. 129 Ohio. App. 3d 255, 717 N.E.2d 763 (Ohio App. 1998) .

(n91)Footnote 88. 129 Ohio. App. 3d 255, 717 N.E.2d 763, 765 (Ohio App. 1998) .

(n92)Footnote 89. 129 Ohio. App. 3d 255, 717 N.E.2d 763, 769 (Ohio App. 1998) .

(n93)Footnote 90. See *The Stephen A. Goldberg Co. v. Remsen Partners, Ltd.*, 170 F.3d 191, 196 (D.C. Cir. 1999) .

(n94)Footnote 91. *Schank v. Schuchman*, 212 N.Y. 352, 359, 106 N.E. 127, 129 (1914) .

(n95)Footnote 92. See *The Stephen A. Goldberg Co. v. Remsen Partners, Ltd.*, 170 F.3d 191, 197 (D.C. Cir. 1999) . See generally Brunner, Annot., *Recovery Back of Money Paid to Unlicensed Person Required by Law to Have Occupational License or Permit to Make Contract*, 74 A.L.R.3d 637 (1976) .

(n96)Footnote 93. See *The Stephen A. Goldberg Co. v. Remsen Partners, Ltd.*, 170 F.3d 191, 196 (D.C. Cir. 1999) , quoting from *CitaraManis v. Hallowell*, 328 Md. 142, 613 A.2d 964, 971-972 (1992) .

(n97)Footnote 94. *Tex. Rev. Civ. Stat. Ann. art. 6573a, § 19; Wyo. Stat. Ann. § 33-28-114. See Holloman v. Denson, 640 S.W.2d 417, 420 (Tex. App. 1982) , rehearing denied.*

(n98)Footnote 95. *See Kowalski v. Cedars of Portsmouth Condominium Association, 146 N.H. 130, 132-134, 769 A.2d 344, 347-48 (N.H. 2000) .*

(n99)Footnote 96. *See Remsen Partners, Ltd. v. The Stephen A. Goldberg Co., 2000 U.S. App. LEXIS 26677 (D.C. May 25, 2000) .*

(n100)Footnote 97. *See Remsen Partners, Ltd. v. The Stephen A. Goldberg Co., 2000 U.S. App. LEXIS 26677 (D.C. May 25, 2000) .*

(n101)Footnote 98. *See 63 Pa. Stat. § 455.201.*

(n102)Footnote 99. *See Meyer v. Gwynedd Development Group, Inc., 756 A.2d 67, 71-72, 2000 Pa. Super. 193 (Pa. Super. 2000) .*

(n103)Footnote 99.1. *See Easton Business Opportunities, Inc. v. Town Executive Suites, 2010 Nev. LEXIS 14, at *9-*10 (2010) .*

(n104)Footnote 100. *Ohio Rev. Code § 4735.21.*

(n105)Footnote 101. *See Ritchie v. Weston, Inc., 143 Ohio App. 3d 176, 180, 757 N.E.2d 835, 838 (2001) . See also Schaffter v. Creative Capital Leasing Group, LLC, 166 Cal. App. 4th 745, 759, 83 Cal. Rptr. 3d 19, 29 (Cal. Ct. App. 2008) (broker's assignment of its right to earn commissions did not violate public policy reasons behind a statutory provision prohibiting an unlicensed person from receiving a commission on the sale of real estate.). Kavian v. Vernah Homes Company, 19 A.D.3d 649, 651, 799 N.Y.S.2d 75, 76, 2005 N.Y. App. Div. LEXIS 7326 (2005) (The assignment of the commission agreement did not constitute a forbidden splitting of the real estate commission. The assignee did not provide any service in the real estate transaction. The right to receive the sums due under the commission agreement was assigned, for value, after the real estate services were rendered by the broker. The fact that the closing occurred after the assignment was irrelevant.).*

(n106)Footnote 102. *See Long & Foster Real Estate, Inc. v. NRT Mid-Atlantic, Inc., 357 F. Supp. 2d 911, 918-919 (E.D. Va. 2005) , applying Virginia law. Cf. Delacy Investments, Inc. v. Thurman, 693 N.W.2d 479, 484 (Minn. Ct. App. 2005) review denied, 2005 Minn. LEXIS 350 (Minn. June 14, 2005) (The plaintiff was in the business of factoring receivables from real estate agents. Since the agent-assignor was in arrears on his fees due his broker, the plaintiff was unable to collect because the commissions earned by the firm as a result of the fact that the agent's commissions did not exceed the agent's past-due obligations to the firm.).*

(n107)Footnote 103. *See Kentucky Real Estate Commission v. Hilliard Financial, LLC, 246 S.W.3d 910, 2008 Ky. App. LEXIS 38, at *4 (Feb. 15, 2008) ; Kavian v. Vernah Homes Co., 19 A.D.3d 649, 651, 799 N.Y.S.2d 75, 2005 N.Y. App. Div. LEXIS 7326 (N.Y. 2005) .*

(n108)Footnote 104. *282 Kan. 381, 144 P.3d 706 (2006) .*

(n109)Footnote 105. The Uniform Consumer Credit Code has been adopted in the following states: Colorado, Idaho, Indiana, Iowa, Kansas, Maine, Oklahoma, South Carolina, Utah, Wisconsin and Wyoming. *See generally* J. Barry Harper, *The Uniform Consumer Credit Code: A Critical Analysis*, 44 N.Y.U. L. Rev. 52 (1969); Robert L. Jordan & William D. Warren, *The Uniform Consumer Credit Code*, 68 Colum. L. Rev. 387 (1968); Chris Peterson, *Failed Markets, Failing Government, or Both? Learning from the Unintended Consequences of Utah Consumer Credit Law on Vulnerable Debtors*, 2001 Utah L. Rev. 543 (2001).

(n110)Footnote 106. 282 Kan. 381, 390, 144 P.3d 706, 713 (2006) .

(n111)Footnote 107. 280 Ga. App. 199, 633 S.E.2d 555 (2006) , cert. denied, 2006 Ga. LEXIS 722 (Sept. 18, 2006)

(n112)Footnote 108. 280 Ga. App. 199, 201, 633 S.E.2d 555, 557 (2006) , cert. denied, 2006 Ga. LEXIS 722 (Sept. 18, 2006) . See also *Morgan v. Richard Bowers & Co.*, 280 Ga. App. 533, 536-37, 634 S.E.2d 415, 418 (2006) , cert. denied, 2006 Ga. LEXIS 796 (Ga., Oct. 2, 2006) (Ga. Code § 43-40-19(c) permits an agent to pay his former broker commissions only when the former broker and the new broker enter into a written agreement to that effect.).

(n113)Footnote 109. See *Murphy v. Campbell Investment Co.*, 79 Wash. 2d 417, 486 P.2d 1080 (1971) (contractor registration act); *Williamson, Inc. v. Calibre Homes, Inc.*, 106 Wash. App. 558, 570, 23 P.3d 1118, 1125 (2001) , aff'd, 147 Wash. 2d 394, 54 P.3d 1186 (2002) (real estate brokers' and salespersons' act).

(n114)Footnote 110. See *Williamson, Inc. v. Calibre Homes, Inc.*, 106 Wash. App. 558, 570, 23 P.3d 1118, 1125 (2001) , aff'd, 147 Wash. 2d 394, 54 P.3d 1186 (2002) .

(n115)Footnote 111. See:

Georgia: Northside Realty Associates, Inc. v. MPI Corp., 245 Ga. 321, 265 S.E.2d 11, 12 (1980) .

New York: Philip Mehler Realty, Inc. v. Kayser, 176 A.D.2d 104, 574 N.Y.S.2d 1, 2 (1st Dept. 1991) appeal dismissed without opinion, 79 N.Y.2d 977, 583 N.Y.S.2d 195, 592 N.E.2d 803 (1992) , rehearing denied, 79 N.Y.2d 1041, 584 N.Y.S.2d 450, 594 N.E.2d 944 (1992) ; *NFS Services, Inc. v. West 73rd Street Associates*, 102 A.D.2d 388, 477 N.Y.S.2d 135, 138, 1984 N.Y. App. Div. LEXIS 18796 (1st Dept. 1984) , aff'd, 64 N.Y.2d 919, 488 N.Y.S.2d 648, 477 N.E.2d 1102 (1985) .

Rhode Island: New England Retail Properties, Inc. v. Commerce Park Associates 11, LLC., 824 A.2d 504, 506-508 (R.I. 2003) .

Texas: Conrad v. Artha Garza Co., 615 S.W.2d 238, 240-241 (Tex. Civ. App. 1981) .

(n116)Footnote 112. See *Marcus & Millichap Real Estate Investment Brokerage Co. v. Skeeters*, 395 F. Supp. 2d 541, 549 (W.D. Ky. 2005) , applying Kentucky law; *Williams Real Estate Co., Inc. v. CC&F Lincoln Street LLC*, 59 Mass. App. Ct. 714, 718, 797 N.E.2d 496, 499 (2003) , citing: *Howell v. Steffey*, 204 A.2d 695 (D.C. App. 1964) ; *Klein v. Antebi*, 15 Misc. 3d 901, 911, 832 N.Y.S.2d 904, 912, 2007 N.Y. Misc. LEXIS 1476 (2007) ; *Furr v. Fonville Morisey Realty, Inc.*, 130 N.C. App. 541, 503 S.E.2d 401 (1998) review dismissed, 351 N.C. 41, 519 S.E.2d 314 (1999) ; *Bell v. United Farm Agency, Inc.*, 1956 OK 73, 296 P.2d 149 (Okla. 1956) *Gold & Co., Inc. v. Northeast Theater Corp.*, 281 Pa. Super. 69, 74, A.2d 1151, 1153-54 (1980).

(n117)Footnote 113. See *Williams Real Estate Co., Inc. v. CC&F Lincoln Street LLC*, 59 Mass. App. Ct. 714, 717-718, 797 N.E.2d 496, 499 (2003) .

(n118)Footnote 114. See:

Arizona: Ariz. Rev. Stat. § 32-2163(A) ("licensed broker in this state may pay compensation to and receive compensation from a broker lawfully operating in another state").

Oklahoma: Okla. Stat. tit. 59, § 858-306(C) ("A broker who is duly licensed in another state ... may enter a cooperative brokerage agreement with a licensed real estate broker in this state").

Tennessee: Tenn. Code Ann. § 62-13-302 ("A licensed broker may pay a commission to a licensed broker of another state if such nonresident broker does not conduct in this state any of the negotiations for which a commission is paid").

(n119)Footnote 115. See *Marcus & Millichap Real Estate Investment Brokerage Co. v. Skeeters*, 395 F. Supp. 2d 541, 549 (W.D. Ky. 2005) , applying Kentucky law.

(n120)Footnote 116. See *Conn. Agencies Regs. § 20-328-8a(e)*.

(n121)Footnote 117. See:

Federal: Meltzer v. Crescent Leaseholds, Ltd., 315 F. Supp. 142, 146 (S.D.N.Y. 1970) , *aff'd*, 442 F.2d 293 (2d Cir. 1971) (under New York law, licensed broker cannot recover commission if broker agreed to split commission with unlicensed cobroker).

Arizona: Farragut Baggage & Transfer Co. v. Shadron Realty, Inc., 18 Ariz. App. 197, 201, 501 P.2d 38, 42 (1972) (licensed broker cannot recover commission from defendant seller for services provided by unlicensed agent).

California: Firpo v. Murphy, 72 Cal. App. 249, 254-255, 236 P. 968, 970 (1925) (licensed broker cannot recover commission from defendant landlord for services provided by unlicensed employee of broker).

Connecticut: Dow and Condon, Inc. v. Brookfield Developjent Corp., 266 Conn. 572, 595, 833 A.2d 908, 922 (2003) (a violation of *Conn. Agencies Regs. § 20-328-8a(e)* bars recovery of a commission by a licensed real estate broker who has violated the regulation by agreeing to share its commission with an unlicensed party).

Illinois: White v. Chicago Title & Trust Co., 99 Ill. App. 3d 323, 332, 54 Ill. Dec. 800, 425 N.E.2d 1017, 1023 (1981) (licensed broker cannot recover commission for services provided by unlicensed agent).

Maryland: Thorpe v. Carte, 252 Md. 523, 527, 250 A.2d 618, 620 (1969) (a broker, licensed in another state but not in Maryland could not recover a commission on an agreement made in Maryland for the sale of property in Maryland).

Ohio: Frieman v. Greaves, 80 Ohio App. 341, 350, 36 Ohio Op. 39, 74 N.E.2d 860, 864, 48 Ohio Law Abs. 493 (1947) (stating in *dicta* that licensed broker cannot recover commission if commission to be shared with unlicensed broker).

Texas: Wasson v. Hartt, 244 S.W.2d 258, 261 (Tex. Civ. App. 1951) , *writ of error refused no reversible error* (agreement between licensed broker and unlicensed person to divide commission was void and barred recovery of commission by licensed broker from defendant seller).

Wisconsin: Kemmerer v. Roscher, 9 Wis. 2d 60, 63, 100 N.W.2d 314, 316 (1960) (joint contract by brokers, one of whom is unlicensed, invalid as to all).

See generally Annot., *Licensed Real-Estate Broker's Right to Compensation as Affected by Lack of License on the Part of Partners, Coadventurers, Employees, or Other Associates*, 8 A.L.R.3d 523 (1966)

(n122)Footnote 118. 678 F. Supp. 515 (E.D. Pa. 1987) .

(n123)Footnote 119. 678 F. Supp. 515, 517 (E.D. Pa. 1987) .

(n124)Footnote 120. 678 F. Supp. 515, 517 (E.D. Pa. 1987) .

(n125)Footnote 121. 456 F.2d 857 (3d Cir. 1972) , *disapproved as stated in Cohen v. Wolgin*, 1995 U.S. Dist. LEXIS 972, at *22 (E.D. Pa. Jan. 24, 1995) (on other grounds).

(n126)Footnote 122. 456 F.2d 857, 861 (3rd Cir. 1972) .

(n127)Footnote 123. *See TDH-Berkshire Inc. v. Korff*, 33 A.D.3d 437, 823 N.Y.S.2d 20, 21, 2006 N.Y. App. Div. LEXIS 12388 (2006) .

(n128)Footnote 124. *Id.* *See also Klein v. Antebi*, 15 Misc. 3d 901, 911, 832 N.Y.S.2d 904, 912, 2007 N.Y. Misc. LEXIS 1476 (2007) (New York precedent gives deference to the law of the foreign jurisdiction in determining claims for commissions by New York brokers unlicensed in the states where the property is located. Applying choice of law analysis, New York courts have held that the law of the state where the land is situated is to be applied.)

(n129)Footnote 125. *See TDH-Berkshire Inc. v. Korff*, 33 A.D.3d 437, 438, 823 N.Y.S.2d 20, 21, 2006 N.Y. App. Div. LEXIS 12388 (2006) .

(n130)Footnote 126. *See In re Capitol Hill Group*, 344 B.R. 709, 712 (D.D.C. 2006) , applying D.C. law.

(n131)Footnote 127. *See Erwin v. Cotter Health Centers, Inc.*, 161 Wash.2d 676, 167 P.3d 1112 (2007) , for a case involving this scenario.

(n132)Footnote 128. *See Fieger v. Pitney Bowes Credit Corp.*, 251 F.3d 386 (2d Cir. 2001) (an unlicensed individual claimed to be acting as a financial advisor).

(n133)Footnote 129. *See, e.g., Schexnayder v. Gish*, 948 So. 2d 1259, 1266 (La. Ct. App. 2007) .

(n134)Footnote 130. *Mo. Rev. Stat. § 339.150.3.*

(n135)Footnote 131. *See Brennan v. Dorsett Village, L.L.C.*, 203 S.W.3d 770, 772 (Mo. Ct. App. 2006) .

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91 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.06

§ 4.06 Effect of the Brokerage Agreement

[1] General Considerations

Although some states do not require it, n1 most states do require that brokerage agreements be in writing in order to be enforceable. n2 In general terms, the listing agreement may be subject to the statute of frauds under a particular state statute. n3 Courts will generally require that brokers comply with the contract terms before they have a right to earn a commission. n4 The rule for interpreting brokerage agreements follows the law of contracts regardless of whether or not the agreement is required to be in writing. n4.1 In general, the agreement must include provisions for the licensee's employment. An agreement is normally considered to be adequate when:

- (1) it is in writing and signed by the person to be charged with a commission;
- (2) it promises that a definite commission will be paid, or refers to a written commission schedule;
- (3) it specifies the name of the broker to whom the commission will be paid; and
- (4) it must either, by itself or by reference to some other existing writing, identify with a reasonable certainty the land to be conveyed. n5

When the seller is a natural person, it is clear that this individual should sign the brokerage agreement. However, the question of who should sign if a general partnership or other entity is involved is not as clear. In such a situation, the applicable statutes should be consulted in order to determine who can sign on behalf of an entity and what formalities must be observed.

While the statute of frauds requires the signature of the person to be charged with paying the commission, the Supreme Court of Idaho has held that a brokerage contract requires the signature of both the owner and the broker since the contract is not a unilateral contract that a broker can accept by full performance. This court held that an agreement lacking the broker's signature could not act as a brokerage agreement. n5.1

The broker's name stated in a listing agreement should agree with the broker's name as shown on the broker's license.

However, a misnomer should not affect the validity of the listing when all parties know the identity of the real party.
n5.2

Different rules apply to buyer's broker's agreements. Since the property to be purchased cannot be identified in a buyer's broker's agreement, the property description element of the writing requirement is inapplicable to such a contract. n6 Procuring cause also becomes an issue. n7 The purchaser's refusal to contract with the seller, who is willing to contract on the purchaser's terms, makes the purchaser liable to the broker for the commission that the broker would have received from the seller. n8

State statutes require that the real estate salesperson be paid through the sponsoring broker. The salesperson has no control over the listing, as the agreement is between the owner and the sponsoring broker. The same strict rules of construction apply as in listing agreements generally. n9 Although this limits the salesperson's rights, it is consistent throughout the various states. Salespersons are not beneficiaries of broker's liens or rights to commissions, unless otherwise provided in their employment contract. n10

The broker's agreement determines when the commission is earned. n10.1 A broker's listing agreement may make the broker's compensation dependent on any lawful condition. n10.2 A broker employed "to sell" or "effect a sale" of the property is not entitled to compensation until the broker effects a sale or procures from the buyer a binding contract of purchase within the terms of his or her authority. n10.3 This type of agreement is distinguished from an agreement to find a purchaser. This latter type of agreement only requires that the broker find a purchaser ready, willing, and able to buy the property. n10.4

The general requirement that an agreement to pay a commission must be in writing applies to the agreement between the seller and the broker. There is generally no requirement that there be a written subagency agreement between brokers to share in a commission. Generally this authority is expressly contained in the listing agreement and in the real estate sales contract executed by the buyers. n10.5

A broker may also be unable to collect a commission if the listing agreement fails to contain terms that are required by statute or regulation. For example, a Texas court found that a regulatory requirement that a listing agreement contain a termination date is a condition precedent, which if absent, renders the listing agreement unenforceable. n10.6 However, other courts have held that a licensee's failure to strictly adhere to requirements regarding listing and brokerage agreements do not make the agreement void or deprive the licensee of the right to receive compensation even though the failure may subject the licensee to disciplinary proceedings. n10.7

If a broker's right to a commission is dependent upon the satisfaction of any condition other than the production of a ready, willing and able purchaser, the listing agreement should clearly state the additional condition or conditions. n10.8 Furthermore, the seller is expected to cooperate with the broker and act in good faith toward the broker. n10.9

A contract for a brokerage commission may be strictly construed. n10.10 Furthermore, the broker typically has the burden of proof to prove that he or she is entitled to a commission under a brokerage contract. n10.11 Furthermore, since most brokerage agreements are drafted by the broker, courts will often construe such an agreement against the broker. n10.12

[2] Open Listings

A non-exclusive listing, which specifies no particular duration of employment, is a mere offer of a unilateral contract inviting the broker's acceptance by performance, *i.e.*, producing a ready, willing and able buyer. n11 Like any other offer, this may be revoked at any time, n12 provided that the owner acts in good faith. Specifically, if the owner sees that the broker's efforts are nearing success and revokes his authorization for the purpose of denying him the reward of his efforts and reaping the benefits thereof without paying, then all courts will deny the right to revoke and award the

broker his commission. n13 Where a broker and a seller enter into a sales contract, however, its terms supersede the listing agreement. n14

A non-exclusive listing can be for a stated duration. But merely listing a property with one broker pursuant to a non-exclusive listing does not preclude a sale of the property through the efforts of the owner or another broker. Pursuant to a non-exclusive listing, the broker is generally entitled to a commission only if he or she was the procuring cause of the transaction. n15

[3] Exclusive Listings

A listing agreement which gives the broker an exclusive right to sell is interpreted to deny the owner the right to sell to a purchaser procured by himself. n15.1 An abbreviated form of an exclusive right to sell is often termed an exclusive agency, which allows the owner to sell the property himself and not pay a commission to the listing broker. n16 Where the transfer is deemed not to be a sale, the broker is not entitled to a commission. n17

A broker who has an exclusive listing agreement and substantially performs is entitled to a commission. n17.1 In this context, substantial performance means the expenditure of time, effort, or money. n17.2

Poorly drafted listing agreements may raise an issue as to whether an exclusive listing is an exclusive right-to-sell listing or an exclusive agency listing. This becomes an issue if the owner sells the property to a buyer that the owner has procured. Under an exclusive right-to-sell listing, the broker would be entitled to a commission while there would be no commission due under the exclusive agency agreement. As a general rule, any ambiguity in the agreement will result in it being found to be an exclusive agency agreement. n17.3

In *Foltz v. Begnoche* n17.4 several rules were applied in interpreting an exclusive listing. First, the title of the listing, while important, is not controlling. Second, the use of the phrase "exclusive right," standing alone, should not be determinative in creating an exclusive right-to-sell listing. Third, if the listing contains a phrase allowing a commission upon a sale made by the broker, it contemplates a sale by the owner without liability for a commission. Finally, ambiguity is further raised if the agreement provides that the right to sell was given in consideration of the broker's agreement to list the property. Listing agreements are usually prepared by the broker. Therefore, as a general rule, if the listing agreement is ambiguous it will be found to be an exclusive agency listing which allows the owner to sell the property without incurring liability for a commission. Exclusive right-to-sell listings must be created by clear and unambiguous language. n17.5

In *J.C. Nichols Company v. Osborn* n17.6 the court found that a listing agreement was an exclusive right-to-sell listing because:

- (1) the listing was titled, "Exclusive Right to Sell Agreement,"
 - (2) the agreement granted the broker the "exclusive and irrevocable right to sell" the parcels involved,
 - (3) the agreement provided that the broker would receive a commission if a buyer was "found"; it did not require that the buyer be found by the broker, and
 - (4) the contract required that the owner refer all offers and inquiries concerning the parcels to the broker.
- n17.7

Those drafting exclusive right-to-sell listing agreements should include a referral provision as this appears to be a defining hallmark of this type of listing. n17.8 This provision may also save a broker's commission. In *J.C. Nichols Company*, the agreement provided that the broker was entitled to a commission if within 120 days after the termination

date the property was sold to anyone to whom it was shown by the broker or if a purchaser was found during the time the agreement was in effect. The broker had not shown the property to the purchaser so the broker was not entitled to a commission based upon showing the property. Nor had the broker found a willing purchaser while the agreement was in effect. Despite the broker not satisfying either contractual basis for payment of a commission, the court found that the owner was not entitled to summary judgment in the broker's action to recover a commission because of the breach of the contract's referral provision. n17.9

The referral provision stated that the owner would refer all offers and inquiries concerning the parcels to the broker. The court said that by breaching the referral provision, the owner deprived the broker of the opportunity to show the property to the purchaser. The court concluded that the Kansas Supreme Court, if faced with the issue, would hold that a broker was entitled to recover its commission under an exclusive right-to-sell agreement if the seller breached a referral provision during the agreement's term, and then sold the property on the seller's own after the agreement expired. n17.10 This court also stated that it appeared that every court that had considered this issue under similar circumstances, where the seller breached the referral provision and then sold the property without the broker, found that the seller's breach entitled the broker to the commission. n17.11

The meaning of what it means to "show" a property may also arise in the context of a referral or extension provision. One court has applied the common meaning of the word "shown" as meaning "to cause or allow to be seen; display." It found that providing documents which were eventually reviewed by the ultimate purchaser did not qualify as a showing of the property which would entitle the broker to a commission. n17.12

One question that arises is whether the owner is bound by his promise to give the broker the exclusive sale or whether he may revoke it. This, in turn, depends on whether the broker gave consideration to the owner so as to bind the promise. The listing agreement may contain an express promise by the broker to use his best efforts to effect a sale n18 and, if it does not, the promise may reasonably be implied. n19 Some courts take this as creating a bilateral contract binding the owner from the moment of its execution. n20 More frequently, courts will consider the obligation to use best efforts as too ephemeral to constitute consideration when wholly executory, n21 and will bind the owner to his promise of exclusivity only after the broker partly performs his promise by investing time and expense, such as by advertising, showing the property, etc. n22 Differing rationales have been given for this result. Section 45 of the Restatement of Contracts, for example, states:

(1) Where an offer invites an offeree to accept by rendering a performance and does not invite a promissory acceptance, an option contract is created when the offeree tenders or begins the invited performance or tenders a beginning of it.

(2) The offeror's duty of performance under any option contract so created is conditional on completion or tender of the invited performance in accordance with the terms of the offer. n23

Other courts have reasoned as follows:

The type of contract involved here is basically a unilateral contract until it is converted into a bilateral contract by substantial performance. This is the view that we are adopting for the disposition of the issues in the instant case, even though there is authority to the contrary. n24

In either analysis, substantial efforts by the broker bind the owner to the terms of the listing (exclusive sale or exclusive agency) for the life of the contract. n25 There have been some defenses alleged by sellers against the enforcement of the exclusivity provisions. In *Lyle v. Moore*, n26 where the seller defended the cause of action by alleging that he was induced to sign the listing contract and that the exclusivity provisions were not properly explained to him, the Montana Supreme Court struck down the enforceability of the listing agreement. By contrast, however, the Indiana Supreme Court in *Campbell v. Vencel* n27 upheld the enforceability of the provision against the fraudulent inducement defense.

[4] Exchanges Subject to Commission

Exclusive brokerage agreements may contain language to the effect that if the subject property is sold *or exchanged* during the term of the listing, the property owner is liable to the broker for the commission. Consequently, owners may find themselves liable for a commission even though a sale has not occurred. *Hagan v. Adams Property Associates, Inc.*, n27.1 is illustrative of this situation. This case involved an exclusive right-to-sell listing of an apartment complex that triggered the payment of the commission if the property was sold or exchanged. The owner and two other persons organized a limited liability company (LLC). The apartment complex was transferred to this LLC by a deed dated during the listing term. The broker sought payment of its commission as a result of this transfer.

The owner argued that the transfer of legal title represented his contribution to the capital of the LLC and that capitalization of a new venture should not be classified as the sale of property. The owner also asserted that since he had not received any present valuable consideration, the transfer did not constitute a sale. The court disagreed. It stated that the owner received more than an interest in the LLC. Under the terms of the LLC's operating agreement, the LLC assumed all liabilities on the property, which included a first deed of trust. It was not clear whether the lender relieved the owner of personal liability under this assumption. The court had no problem with this uncertainty. It stated, "Even assuming such substitution did not occur, [the owner] nonetheless received substantial relief from his debt obligation because, upon assuming all liabilities on the property, [the LLC] became liable to [the owner] for any amount [the owner] would have had to pay the holder of the first deed of trust note." n27.2 The owner also received a second deed of trust from the LLC.

The usual brokerage transaction involves a licensed broker entering into a written brokerage agreement with a principal for compensation. Consequently, a broker's commission is predicated on an agency or employment relationship with a third party. When a broker agrees to purchase property on his or her own behalf, there is no agency or employment relationship with a third party and therefore no entitlement to a commission. In this situation, some brokers attempt to receive a "commission." It has been held that when a broker purchases property on his or her behalf, any agreement to pay a purported commission is, in essence, an agreement to a reduction in the purchase price. n27.3 If the sale fails to occur due to a default by the seller, the broker would not be entitled to a commission, but would instead be subject to damages for the breach. These damages would be computed using the reduced purchase price. n27.4

The court also rejected the proposition that contributions of property to an LLC was not a sale, but the capitalization of a new company. The court distinguished contributions made to a partnership or other entity governed by partnership law since a partnership was not an entity separate and distinct from the partners themselves. n27.5 The court stated that in the case of a contribution to a partnership there is no transfer of property from one person to another, but only a change in the form of ownership. In this case, the new venture was an LLC, not a partnership. Pursuant to Virginia law, LLCs were entities separate from their members. The court stated, "[T]he transfer of property from a member to the limited liability company is more than a change in the form of ownership; it is a transfer from one entity or person to another." n27.6 Thus, the owner was liable to the broker for a commission on this transfer.

[5] Measure of Broker's Recovery

[a] Generally

Where the brokerage contract gives the broker an exclusive right of sale and expressly provides that a commission is payable if the property is sold by anyone, including the owner himself, or withdrawn from the market, most cases hold the broker entitled to the broker's commission if any of the stated eventualities happen. n28 The duty to pay the commission is not viewed as a remedial penalty for breach of an executory contract but as a debt owed for a fully performed contract. n29 In such a case, it is unnecessary for the broker to prove that he would have been able to produce a ready, willing and able purchaser or that he was the procuring cause of the sale. n30 The duty to pay the commission may also exist after the expiration of the listing, provided that there is a provision in the listing agreement

for the payment of commissions for prospects introduced to the property during the listing period. The courts have reached differing results in this regard. n31

Where the broker has an exclusive agency contract and the owner breaches by selling through another agent, the action is necessarily one for damages. Nevertheless, most courts appear to measure the damages based upon the agreed commission, n32 though some cases require some proof that the plaintiff-broker could have found a suitable purchaser. n33

The statute of limitations for recovery of brokers' commissions begins to run at the time of the sale. n34 The statute of limitations, at least in New York, for recovery of commissions begins to run when a cause of action accrues, which is at the time of the breach. In *Ely-Cruikshank Co. v. Bank of Montreal*, n35 the listing agreement provided that either party could terminate the entire agreement for any reason at any time after January 31, 1991, with thirty days' notice. The broker alleged that the owner had undertaken negotiations for the sale to a potential purchaser prior to the termination of the agreement, and therefore earned his commission pursuant to the exclusive rights under the listing agreement. The broker alleged that the statute of limitations began to run on February 1, 1994, when the building was sold, and therefore, was not time-barred. The court disagreed, however, noting that the cause of action accrues at the time of the breach of contract and that the alleged breach, if any, occurred when the bank reportedly failed to reveal its preliminary discussions with the purchaser prior to the termination of the brokerage agreement.

If a broker is successful in a suit seeking recovery of a commission, the broker may also be entitled to prejudgment interest. n35.1 This is particularly true if the payment due under a listing agreement is a fixed and certain sum and the vendor breaches the agreement by failing to pay the commission. The fact that the disputed funds are held in escrow should not prevent an award of prejudgment interest n35.2

[b] Possible Limitations on the Broker's Right to Compensation--The *Interactive Properties* Decision

In the case of *Interactive Properties, Inc. v. Doyle Dane*, n36 the New York Court of Appeals denied a motion for leave to appeal from a ruling of the Appellate Division, First Department, which ruling as some commentators have noted, may serve to severely weaken a broker's right to recover commissions pursuant to an exclusive brokerage arrangement. n37 In the instant case, the plaintiff, Interactive Properties, was a licensed real estate broker who undertook to negotiate, on an exclusive basis, the leasing of office space for the defendant, the advertising agency of Doyle Dane. n38 Plaintiff was acting pursuant to a nine-month exclusive written brokerage contract. n39 Accordingly, plaintiff brought an action seeking to recover its commissions when defendant secretly utilized another broker to negotiate and procure office space located at 437 Madison Avenue ("Madison Avenue"). n40

After noting that damages in connection with a breach of contract "must, as nearly as possible, restore to the injured party all that he has lost by the breach and all that he, in reasonable probability, would have gained had there been no breach," n41 the Appellate Division expressly stated that the "precise issue of the proper measure of damages for breach of an exclusive agency to negotiate for the leasing of property" had never been addressed by the New York Courts. n42 In this regard, the court recognized that under current New York law n43 damages in the case of the breach of an exclusive agency agreement are based upon two distinct items. n44 These items include:

- (1) expenses actually incurred by the broker; and
- (2) any profits or commissions "lost on a sale the exclusive broker would have made." n45

Thus, the court's reasoning in effect required that in order for the plaintiff to recover the full commission in connection with the lease, the plaintiff would be required to show that "it would have earned the entire commission by independently procuring the Madison Avenue lease... ." n46

In light of the principles governing damages in the case of the breach of an exclusive agency agreement, the court concluded that plaintiff was unable to establish either of the above noted elements of damage. n47 In addition, the court held that plaintiff had not proved any avarice or willful breach on the part of the defendant which would have entitled it to damages against the defendant. n48 The court did hold, however, that the breach by the defendant prevented the plaintiff from conducting negotiations for certain office space and, consequently, plaintiff would be entitled to half of the commission. n49 In so holding, the court rejected the claim by plaintiff that a claim for the entire commission could be sustained on the theory that plaintiff's contract was similar to an "exclusive right to sell." n50 In rejecting plaintiff's theory, the court stated that:

It is well-accepted that a principal who makes a direct sale of property in violation of an exclusive right to sell certain property is liable to the broker for the agreed-upon commission, regardless of whether he would have effected the sale. [citations omitted]. Those cases, however, are not here dispositive, since each involved a specified commission and none involved the principal's use of another broker. In contrast, there was no specified commission here, and plaintiff had an exclusive agency, which prevented defendant from employing another broker, but did not preclude defendant from itself making a deal without becoming liable to plaintiff for a commission. [citations omitted]. *Bagley v. Butler* [301 N.Y.S.2d 148, 1969 N.Y. Misc. LEXIS 1745] ... is distinguishable because it involved an agreement which expressly provided for payment of the commission if another person effected the sale. We believe that plaintiff was required to prove that it would have independently procured the lease signed by defendant in order to receive the entire commission as the measure of damages. A careful reading of *Hammond v. C.I.T. Financial Corp.* ... [citation omitted] indicates the infirmity of plaintiff's claim to the entire commission. The court there held that the principal who, in breach of an exclusive right to sell, dealt directly with a buyer rather than referring the buyer to the broker was liable for the full commission because the broker demonstrated that he would have been as successful as the principal in negotiating with the purchaser. ... Here, as discussed ... the evidence demonstrated that plaintiff, acting independently, would not have been as successful as the other broker in procuring the Madison Avenue lease, but would have successfully conducted the negotiations and earned half of the commission. n51

Accordingly, the court awarded the plaintiff damages in the amount of \$325,000 discounted to present value as of July 7, 1975, plus interest, cost and disbursement, inasmuch as such amount represented one half of the commission. n52

[c] Customary Commission Rate

In some instances, an agreement is entered into by a seller and a broker with no commission rate being set. One court has stated that persons seeking commissions in connection with real estate transactions are required to prove by a preponderance of the evidence, that

- (1) there was an agreement;
- (2) they were the procuring cause of the sale;
- (3) there was a customary and usual brokerage commission; and
- (4) the customary commission was certain, uniform, and notorious. n53

In this particular case, the seller kept ducking the broker's efforts to agree to a specific commission rate. When the commercial property later sold for \$1,131,000 due to the broker's efforts, the seller tried to offer her a finder's fee of \$15,000, which she rejected. n54 The trial court in this case determined that the customary commission rate was 10%. This holding was affirmed on appeal. n55

In *Mitchell Realty Group, LLC v. Holt*, n56 the broker claimed that he was due a commission based upon a provision in a sales contract which stated that the broker was due a commission, but which failed to specify the amount of the commission. n57 The court found that under the Georgia Brokerage Relationships in Real Estate Transactions Act, agreements between a broker and its clients regarding the amount of brokerage compensation were required to be in writing. Since there was no written agreement covering the amount of the commission, the broker was not entitled to a recover a commission. n58

[d] Brokers Are Not Entitled to a Double Recovery

As a general rule, a broker cannot receive a double recovery. This principle is illustrated by *Holzman v. Blum* n59 where a broker sued the sellers to recover his commission which was allegedly owed under an exclusive listing agreement. The sellers had canceled the first sales contract which they had entered into in order to enter into a second sales contract with another buyer. n60 The commission dispute stemmed from the fact that the broker was entitled to the full commission under the first contract since there was no cooperating broker whereas under the second contract the commission had to be split with the buyer's real estate agent. The sellers preferred the second contract because the sales price was higher than the first. n61 The broker sued the sellers alleging that they had breached the listing contract by failing to pay the commission on the first sales contract.

The court found that the listing agreement was unambiguous and expressly provided that the broker's commission was not contingent upon settlement. Specifically, the court stated that the agreement did not state that the commission was to be paid from the sales proceeds, but rather that payment of the commission was due if the sellers executed a written agreement to sell the property. The trial court, however, had reduced the commission due on this first sale by the amount of commission the broker received on the second sale. In affirming the trial court on this issue, the court stated that the commission clause contemplated one fee from the sellers with respect to the property's sale. n62 It stated that based on the facts of the case, the commission clause did not contemplate double recovery by the broker. n63

[6] Who May Sue to Collect a Commission

Some states limit who is entitled to sue to collect a commission. For example, Pennsylvania holds that only the broker has the capacity to sue for an unpaid commission. Therefore, an agent or salesperson cannot sue a third party for a commission. n64 Pursuant to this rule, it has been held that a salesperson cannot sue another salesperson to collect his share of a commission. However, this principle does not prevent a salesperson from suing the licensed broker with whom he or she is affiliated to recover an unpaid commission. n65

[7] Seller's Duties

A seller's failure to fulfill his or her duties under a listing agreement can affect a broker's right to a commission. Some listing agreements require that the seller

- refer to the seller's broker or agent all prospective purchasers or brokers who contact the seller for any reason and
- provide the seller's broker or agent with the names and addresses of these third parties.

If the listing agreement contains such a provision and the seller fails to abide by this provision, a subsequent sale to a prospective purchaser not properly referred to seller's broker or agent can result in the broker or agent recovering a commission. n66

[8] Agreements Which Violate Public Policy

In *Rotemi Realty, Inc. v. Act Realty Co., Inc.*, n67 the Florida high court validated a brokerage agreement where the

broker, in negotiating a sale to a governmental agency (a school district) within a specified time period, would receive a commission "equal to the amount of the sales proceeds due the owner at closing that is over \$1,000,000." n68 A Florida intermediate appellate court had found that the broker was not entitled to a commission because this arrangement violated public policy. n69 In considering this issue, the Supreme Court of Florida framed the question as follows: "We consider whether the common practice of paying real estate commissions contingent on consummation of the sale violates the public policy of this state when applied to a purchase or sale by the government." n70 In holding that this common practice does not violate Florida public policy, the Florida high court stated that the general rule continues to be that an employment in which compensation is contingent on success in securing contracts from public officials is not illegal on its face, but rather is illegal only if shown to involve "favors or corrupt means." n71 This court found that there was no reason why this general rule should not apply specifically to the real estate brokerage industry. n72

[9] Liquidated Damages

A listing agreement can contain a liquidated damages clause. Various courts have upheld the validity of such provisions in real estate sales contracts. n73 In a case of first impression, an Illinois court has upheld the validity of a liquidated damages clause in a broker's listing agreement. n74 This clause allowed the broker to recover liquidated damages from a seller who prematurely terminated an exclusive listing agreement. The Illinois court stated that there was no reason to treat a liquidated damages clause in a real estate brokerage contract any differently than one found in any other contract. n75 This court also found that liquidated damage provisions in listing agreements that based the amount of liquidated damages upon the broker's bargained-for commission, as opposed to an estimate of damages "made from whole cloth," would be upheld as a reasonable estimate of damages. n76

In order for a liquidated damages provision in a listing agreement to be valid, the provision must meet the three tests imposed on these types of provisions: (1) the parties intended to agree in advance to the settlement of damages that might arise from the breach; (2) the amount of liquidated damages was reasonable at the time of contracting, bearing some relation to the damages which might be sustained; and (3) actual damages would be uncertain in amount and difficult to prove. n77 Liquidated damage provisions in listing agreements that fail the tests generally applied to liquidated damage provisions in other types of contracts will not be enforced. n78 Conversely, liquidated damages provisions in listing agreements that pass these tests will typically be found to be valid and enforceable. n79 However, provisions that allow the broker to recover a full commission in addition to costs, expenses, and attorney's fees based upon the seller's breach of a listing agreement have been found to be void as penalty clauses. n80

FOOTNOTES:

(n1)Footnote 1. *Hill v. Capps*, 248 Miss. 601, 612, 160 So.2d 186, 190 (1964) ; *Leary v. Stockman*, 937 So. 2d 964, 971 (Miss. Ct. App. 2006) ; *Moody Realty Co. v. Huestis*, 237 S.W.3d 666, 677 (Tenn. Ct. App. 2007) , *appeal denied*, 2007 Tenn. LEXIS 702 (Aug. 13, 2007) *Wyoming Realty Co. v. Cook*, 872 P.2d 551 (Wyo. 1994) .

See also N.J. Stat. Ann. § 25:1-16(d) which permits a broker to collect a commission if, within five days after making an oral agreement, the broker provides a writing to the principal who enlisted the broker's services, stating the terms of the oral agreement and the rate or amount of commission to be paid.

(n2)Footnote 2. *See, e.g., Coldwell Banker Commercial v. Resource Realty of Central Jersey*, 368 N.J. Super. 382, 392, 846 A.2d 633, 639 (2004) *Andersen v. Schenk*, 353 Mont. 424, 428-29, 2009 MT 399, 220 P.3d 675, 679 (2009) .

(n3)Footnote 3. *See:*

District of Columbia: D.C. Code § 42-1705; In re Capitol Hill Group, 344 B.R. 709, 713 (D.D.C. 2006) , applying D.C. law.

Rhode Island: Brochu v. Santis, 939 A.2d 449, 453 (R.I. 2008) , citing *R.I. Gen. Laws § 9-1-4 (6)*.

Texas: Givens v. Dougherty, 671 S.W.2d 877 (Tex. 1984) rehearing of cause overruled (Jul. 18, 1984).

(n4)Footnote 4. See *Insignia/Frain Camins & Swartchild v. Querrey & Harrow*, 36 F. Supp. 2d 1051, 1054-1055 (N.D. Ill. 1999), applying Illinois law; *Limehouse v. Resolution Trust Corp.*, 862 F. Supp. 97 (D.S.C. 1994). See also *Coldwell Banker v. Pauson*, 647 A.2d 146 (N.H. 1994) (holding that a broker was not entitled to a commission on a sale which occurred after the listing agreement protection period provided therein had expired, since a broker is entitled to a commission only if he achieves the result within the specified time); *Property Plus, Inc. v. Management & Rentals, Inc.*, 703 So. 2d 1363, 1364 (La. App. 1997) (the broker's failure to complete and have the property owner sign a property disclosure addendum in accordance with the marketing agreement resulted in the owner having no obligation to pay a commission on the property's sale) writ denied, 709 So. 2d 777, 1998 La. LEXIS 631 (La. Feb. 20, 1998). *Leary v. Stockman*, 937 So. 2d 964, 970 (Miss. Ct. App. 2006); (The broker has the burden of proving the terms of the brokerage contract.); *Reece & Nichols Realtors v. Zoll*, 201 S.W.3d 516, 519 (Mo. Ct. App. 2006) (If the broker substantially complied with the contract, the broker is entitled to a commission); *Trezevant Realty Corp. v. Threlkeld*, 2008 Tenn. App. LEXIS 618, at *23 (Oct. 14, 2008) (whether a broker is entitled to a commission is a contractual matter.) *Sonday v. Dave Kohel Agency, Inc.*, 2006 WI 92, 293 Wis. 2d 458, 474, 718 N.W.2d 631, 639 (2006) (Without a valid listing contract, a broker would not be entitled to any commission).

(n5)Footnote 4.1. See, e.g., *Tom Heal Commercial Real Estate, Inc. v. York*, 167 P.3d 523, 526, 2007 UT App 265 (2007). See also *Georgia Real Estate Properties, Inc. v. Lindwall*, 2010 Ga. App. LEXIS 272, at *5 (Mar. 22, 2010) (listing agreement must be construed according to its express terms).

(n6)Footnote 5. *Knight v. Hicks*, 505 S.W.2d 638 (Tex. Civ. App.--Amarillo, 1974) writ of error refused no reversible error (Apr. 10, 1974), rehearing of writ of error overruled (May. 8, 1974).

(n7)Footnote 5.1. See *Commercial Ventures, Inc. v. The Rex M. & Lynn Lea Family Trust*, 177 P.3d 955, 963 (Idaho 2008), reh'g denied, 2008 Ida. LEXIS 36 (Idaho, Feb. 15, 2008).

(n8)Footnote 5.2. See *Realty Center New Homes Div., LLC v. Dowlen Constr., LLC*, 2008 Tenn. App. LEXIS 782, at *21-*24 (Tenn. Ct. App. Dec. 30, 2008).

(n9)Footnote 6. *LA&N Interests, Inc. v. Fish*, 864 S.W.2d 745, 750 (Tex. App.--Houston [14th Dist.] 1993) overruled by *Trammel Crow Co. No. 60 v. Harkinson*, 944 S.W.2d 631, 634 (Tex. 1997) (on other grounds).

(n10)Footnote 7. *Lanstar Int'l Realty, Inc. v. New York News, Inc.*, 206 A.D.2d 411, 614 N.Y.S.2d 438, 1994 N.Y. App. Div. LEXIS 7316 (2d Dept. 1994).

(n11)Footnote 8. *Park-Haden, Inc. v. Loews Theater Management Corp.*, 789 F. Supp. 1257, 1262 (S.D.N.Y. 1992) (citing the application of New York law).

(n12)Footnote 9. *Braden v. Isabell K. Horsley Real Estate, Ltd.*, 245 Va. 11, 425 S.E.2d 481 (Va. 1993).

(n13)Footnote 10. *Batt v. Scully*, 168 B.R. 541 (D.N.J. 1994).

(n14)Footnote 10.1. Statutory law may address how a commission is earned if the listing agreement is silent on this issue. See *Md. Code Ann., Real Prop. § 14-105*. *Premier Realty, LLC v. I.T.J. Investments, Inc.*, 42 Kan. App. 2d 148, 157, 209 P.3d 741, 748 (2009).

See also *Grubb & Ellis/Centennial, Inc. v. Gaedeke Holdings, Ltd.*, 401 F.3d 770, 774-776 (6th Cir. 2005), applying Tennessee law (listing contract did not require that the broker establish that it was the procuring cause of a signed lease in order to receive a commission); *Helms Realty v. Gibson-Wall Co.*, 363 S.C. 334, 338, 611 S.E.2d 485, 487 (S.C.

2005) (In executing a listing agreement, a seller and a real-estate broker may agree to any condition precedent to the seller's obligation to pay a commission. If the listing agreement is silent as to what triggers the broker's right to a commission, then the common law fills the gap.); *The Boerke Company, Inc. v. Protein Genetics, Inc.*, 273 Wis. 2d 786, 680 N.W.2d 833, 2004 WI App 109, 2004 Wisc. App. LEXIS 336, at *6 (Wis. Ct. App. Apr. 22, 2004) (Ordinarily, a broker earns a commission when the broker procures a ready, willing, and able buyer. However, when the parties negotiate a non-form listing agreement, the parties' intent controls.).

(n15)Footnote 10.2. See *Premier Realty, LLC v. I.T.J. Investments, Inc.*, 42 Kan. App. 2d 148, 152, 209 P.3d 741, 746 (2009) .

(n16)Footnote 10.3. See *Granger v. Schachenmayr*, 49 A.D.3d 1079, 1081, 857 N.Y.S.2d 239, 240-41 (2008) (non-binding letter of intent was insufficient to entitle broker to a commission).

(n17)Footnote 10.4. See *Ben-Shmuel v. Wimbish-Riteway, Inc.*, 722 So. 2d 955, 957 (Fla. App. 1998) .

(n18)Footnote 10.5. See *Jones v. Lee*, 126 N.M. 467, 971 P.2d 858, 867, 1999 NMCA 8 (N.M. App. 1998) .

See also *Hubbell Commercial Brokers, L.C. v. Fountain Three*, 652 N.W.2d 151, 157 (Iowa 2002) (Real Estate Commission Rule requiring that listing agreements be written and contain certain information did not apply to fee agreements between two brokers since the reason behind this rule is to protect the public by regulating brokers, not to protect brokers from other brokers).

(n19)Footnote 10.6. See *Perl v. Patrizi*, 20 S.W.3d 76, 80 (Tex. App. 2000) , review denied.

(n20)Footnote 10.7. See *Exit A Plus Realty v. Zuniga*, 395 N.J. Super. 655, 663-64, 930 A.2d 491, 496 (App. Div. 2007) (agent failed to leave a fully executed copy of the listing agreement with the sellers); *Moody Realty Co. v. Huestis*, 237 S.W.3d 666, 677 (Tenn. Ct. App. 2007) , appeal denied, 2007 Tenn. LEXIS 702 (Tenn. Aug. 13, 2007) (agent failed to leave a copy of the agency contract executed by both parties).

(n21)Footnote 10.8. See *Resort Realty of the Outer Banks v. Brandt*, 163 N.C. App. 114, 117-118, 593 S.E.2d 404, 408 (2004) , review denied, 358 N.C. 236, 595 S.E.2d 154 (2004) (seller unsuccessfully argued that the listing agreement placed the duty on the broker to locate and secure replacement property).

(n22)Footnote 10.9. See *Resort Realty of the Outer Banks v. Brandt*, 163 N.C. App. 114, 117-119, 593 S.E.2d 404, 408-409 (2004) , review denied, 358 N.C. 236, 595 S.E.2d 154 (2004) .

(n23)Footnote 10.10. See *Avatar Business Connections, Inc. v. Uni-Marts, Inc.*, 2005 U.S. Dist. LEXIS 37506, *25 (D. N.J. Dec. 29, 2005) , applying New Jersey law; *Steve Schmidt & Co. v. Berry*, 183 Cal. App. 3d 1299, 1305, 228 Cal. Rptr. 689, 692 (1986) , review denied. But cf. *Dow & Condon, Inc. v. Muros N. Ltd. P'ship*, 69 Conn. App. 220, 226, 794 A.2d 554, 558 (2002) (While a written agreement is still strictly required, a broker may recover a commission if the broker has substantially complied with the statute and it would be inequitable to deny recovery).

(n24)Footnote 10.11. See *Avatar Business Connections, Inc. v. Uni-Marts, Inc.*, 2005 U.S. Dist. LEXIS 37506, *25 (D. N.J. Dec. 29, 2005) , applying New Jersey law; *Clammer v. Eddy*, 41 Colo. 235, 239, 92 P. 722, 723 (Colo. 1907) ; *White v. Miller*, 259 Iowa 609, 615, 145 N.W.2d 28, 32 (Iowa 1966) ; *Hand Realty Co. v. Meyers*, 234 Kan. 304, 307, 672 P.2d 583, 585 (Kan. 1983) ; *Porter v. Hunter*, 60 Utah 222, 226, 207 P. 153, 155 (Utah 1922) .

(n25)Footnote 10.12. See *Premier Realty, LLC v. I.T.J. Invs., Inc.*, 42 Kan. App. 2d 148, 153, 209 P.3d 741, 746 (2009) .

(n26)Footnote 11. *Garrett v. Richardson*, 149 Colo. 449, 369 P.2d 566 (1962) . But see *Callaway v. Overholt*, 796 S.W.2d 828 (Tex. Ct. App. 1990) writ denied, (Feb. 13, 1991), rehearing of writ of error overruled (Mar. 20, 1991)

(holding that a stipulation in a brokerage agreement requiring payment of a commission to the broker upon the consummation of the sale only affected the time at which the broker's commission was payable, and did not modify seller's obligation to pay the commission when the broker procured a ready, willing and able buyer).

(n27)Footnote 12.

Colorado: Garrett v. Richardson, 149 Colo. 449, 369 P.2d 566 (1962) .

District of Columbia: W. W. Chambers, Inc. v. Audette, 385 A.2d 10 (D.C. App. 1978) .

Massachusetts: Cadigan v. Crabtree, 179 Mass. 474, 61 N.E. 37 (1901) .

New Jersey: Ettinger v. Loux, 96 N.J.L. 522, 115 A. 384 (1921) .

New York: Sibbald v. Bethlehem Iron Co., 83 N.Y. 378 (1881) .

Ohio: Walker v. David Davies, Inc. 34 Ohio App. 2d 139, 63 Ohio Op. 2d 244, 296 N.E.2d 691 (1973) .

(n28)Footnote 13.

Arkansas: Branch v. Moore, 84 Ark. 462, 105 S.W. 1178 (1907) .

Maryland: Anderson-Stokes, Inc. v. Muslimani, 83 Md. App. 267, 574 A.2d 320 (Md. 1990) (holding that an owner could not deprive a broker of his right to a commission by selling to broker's client at a price lower than the broker was authorized to pursue, particularly where the owner had not revoked authority).

Michigan: Davis-Fisher Co. v. Hall, 182 Mich. 574, 148 N.W. 713 (1914) .

New York: Goodman v. Marcol, 261 N.Y. 188, 184 N.E. 755 (1932) .

North Carolina: Jaudon v. Swink, 276 S.E.2d 511 (N.C. Ct. App. 1981) .

Oregon: Snyder v. Schram, 274 Or. 539, 547 P.2d 102 (1976) .

See generally Note, *The New York Real Estate Broker: Earning a Commission*, 30 Ford. L. Rev. 137 (1961).

(n29)Footnote 14. See, e.g.,

Tennessee: Needham v. Winter, No. 426 (Tenn. App. June 9, 1989) (LEXIS, State Library, Omni file) (when two agreements are in conflict as to when a broker is entitled to a sales commission, the last executed agreement applies).

Cf.:

Colorado: Fallenius v. Walker, 787 P.2d 203 (Colo. Ct. App. 1989) (holding that the broker was not entitled to a commission where a third party preempted the sale by exercising its right to match offer, as provided in the brokerage agreement).

North Carolina: Thomco Realty, Inc. v. Helms, 107 N.C. App. 224, 418 S.E.2d 834 (1992) .

Ohio: Nate Doss v. Mosen & Sloan, No. 845 (Ohio Ct. App. Mar. 17, 1989) (LEXIS, State Library, Omni file) (a real estate broker was not entitled to a commission where a condition precedent imposed upon the listing agreement by contract remained unfulfilled).

(n30)Footnote 15. See *Cartel Realty, Inc. v. Southern Bearing & Parts Co., Inc.*, 243 Ga. App. 653, 534 S.E.2d 119, 121 (2000) ; *Gilmer v. Fauteux*, 723 A.2d 1150, 1151 (Vt. 1998) (one-year non-exclusive listing agreement).

(n31)Footnote 15.1. 12 Am. Jur. 2d, *Brokers* § 5231. Courts still conflict on this issue. In *Crowell v. Investment Realty Ctr., Inc.*, 597 So. 2d 907 (Fla. DCA 1992) , a court upheld the enforceability of the exclusive listing agreement in spite of the seller's protests that he had not agreed to the same. But see *Lyle v. Moore*, 599 P.2d 336 (Mont. 1979) , wherein the Montana Supreme Court maintained a contrary position.

(n32)Footnote 16. *Flynn v. LaSalle Nat'l Bank*, 9 Ill. 2d 129, 137 N.E.2d 71 (1956) .

(n33)Footnote 17.

Colorado: Cooley Inv. Co. v. Jones, No. 87 CA 1764 (Colo. App. May 4, 1989) (LEXIS, State Library, Omni file) (seller's transfer of real property to a partnership in which she held an interest did not constitute a "sale or exchange" for the purposes of the listing agreement, and, therefore the broker was not entitled to a commission).

Maine: Chamberlain v. Porter, 562 A.2d 675 (Me. 1989) (where the brokerage agreement required the commission to be paid out of the proceeds of the closing, and the sale fell through due to defects in seller's title, the court found that a broker was not entitled to a commission, despite his procurement of a ready, willing and able buyer).

Oklahoma: Zuhdi v. Cohen Realty, Inc., 836 P.2d 686 (Okla. Ct. App. 1992) , where a transfer of title pursuant to a foreclosure was held not to be a sale entitling a broker to a commission.

(n34)Footnote 17.1. See *Argabright v. Rodgers*, 2003 ND 59, 659 N.W.2d 369, 371 (N.D. 2003) .

(n35)Footnote 17.2. See *Argabright v. Rodgers*, 2003 ND 59, 659 N.W.2d 369, 371 (N.D. 2003) .

(n36)Footnote 17.3. See *J.C. Nichols Co. v. Osborn*, 12 F. Supp. 2d 1196, 1199 (D. Kan. 1998) (applying Kansas law); *Foltz v. Begnoche*, 222 Kan. 383, 385-386, 565 P.2d 592 (1977) .

(n37)Footnote 17.4. 222 Kan. 383, 565 P.2d 592 (1977) .

(n38)Footnote 17.5. 222 Kan. 383 . 387-389, 565 P.2d 592 (1977) .

(n39)Footnote 17.6. 12 F. Supp. 2d 1196 (D. Kan. 1998) (applying Kansas law).

(n40)Footnote 17.7. 12 F. Supp. 2d 1196, 1200 (D. Kan. 1998) (applying Kansas law).

(n41)Footnote 17.8. See *Hammond v. C.I.T. Fin. Corp.*, 203 F.2d 705, 707 (2d Cir. 1953) (construction of broker age contract as an exclusive right-to-sell agreement was reasonable in view of a referral provision contained therein); *J.C. Nichols Co. v. Osborn*, 12 F. Supp. 2d 1196, 1200 (D. Kan. 1998) (applying Kansas law) (referral provision

indicates that owners could not sell property on their own without incurring liability for broker's commission); *Doll v. Thornhill*, 6 So. 2d 793, 795 (La. Ct. App. 1942) (effect of a referral provision was that the owner could not trade directly with prospective purchasers); *Kislak Co. v. Geldzahler*, 210 N.J. Super. 255, 509 A.2d 320, 326 (1985) ("[T]he presence of a referral term has been recognized as an essential component of an exclusive agreement so much so that it has been found, of itself, to confer upon a broker the exclusive right to sell."); *Gaillard Realty Co. v. Rogers Wire Works*, 215 A.D. 326, 1926 N.Y. App. Div. LEXIS 10961, 213 N.Y.S. 616, 621 (1926) (referral clause made the contract an exclusive right-to-sell agreement); *E & E Mining, Inc. v. Flying "D" Group, Inc.*, 718 P.2d 58, 61 (Wyo. 1986) (agreement with referral clause unambiguously granted an exclusive right to sell).

See generally Marvel, Annot., "Exclusive Right to Sell" and Other Terms in Real-Estate Broker's Contract as Excluding Owner's Right to Sell, 88 A.L.R.2d 936, 961 (1963) .

(n42)Footnote 17.9. 12 F. Supp. 2d 1196, 1201 (D. Kan. 1998) .

(n43)Footnote 17.10. 12 F. Supp. 2d 1196, 1203 (D. Kan. 1998) .

(n44)Footnote 17.11. 12 F. Supp. 2d 1105, 1112 (D. Kan. 1998) .

(n45)Footnote 17.12. See *Prudential Kahler Realtors v. Schmitendorf*, 673 N.W.2d 663, 666, 2003 SD 148 (S.D. 2003) .

(n46)Footnote 18.

California: *Baumgartner v. Meek*, 126 Cal. App. 2d 505, 272 P.2d 552 (1954) .

Florida: *Mark Realty, Inc. v. Rogness*, 418 So. 2d 373 (Fla. DCA 1982) .

(n47)Footnote 19. *Wood v. Lucy, Lady Duff Gordon*, 222 N.Y. 88, 118 N.E. 214 (1917) .

(n48)Footnote 20.

Florida: *Flynn v. McGinty*, 61 So. 2d 318 (Fla. 1952) .

South Dakota: *Berven Co. v. Newman*, 281 N.W.2d 268 (S.D. 1979) .

(n49)Footnote 21. *Kruger v. Soreide*, 246 N.W.2d 764 (N.D. 1976) .

Restatement (Second) of Agency § 449, comment a states:

In the ordinary listing of property with a real estate broker, the broker's promises to use his best efforts or other similarly indefinite promises are not, without other facts, sufficient to indicate that consideration has been given.

(n50)Footnote 22.

Connecticut: *Harris v. McPherson*, 97 Conn. 164, 115 A. 723 (1922) .

Kansas: *Braniff v. Baier*, 101 Kan. 117, 165 P. 816 (1927) .

Michigan: Ladd v. Teichman, 359 Mich. 587, 103 N.W.2d 338 (1960) .

Ohio: Bell v. Dimmerling, 149 Ohio St. 165, 36 Ohio Op. 505, 78 N.E.2d 49 (1948) .

Tennessee: Jenkins v. Vaughan, 197 Tenn. 578, 276 S.W.2d 732 (1954) (exclusive agency for 90 days held revocable where broker expended no substantial effort in attempting to sell property).

Texas: James v. Baron Indus., Inc. 605 S.W.2d 330 (Tex. Civ. App. 1980) (substantiality of broker's efforts prior to vendor's revocation held a question of fact for the jury; summary judgment for vendor reversed and remanded).

Contra:

Massachusetts: Bartlett v. Keith, 325 Mass. 265, 90 N.E.2d 308 (1950) (exclusive sale held unilateral offer and revocable despite expenditure of effort by broker).

New York: R.B. Schlesinger & Co., Inc. v. Delson and Gordon, 184 A.D.2d 393, 585 N.Y.S.2d 373, 1992 N.Y. App. Div. LEXIS 8506 (1st Dept. 1992) (where the defendant-seller executed an exclusive brokerage agreement, permitting the defendant to consider competing offers, since the agreement conditioned any commissions on a completed transaction, a mere tender of an offer to sublease the available premises was made, but never executed or accepted by the defendant, for which no right to commission was created).

(n51)Footnote 23. Comment G to § 45 states:

Agency contracts. This Section frequently applies to agency arrangements, particularly offers made to real estate brokers. Sometimes there is a return promise by the agent, particularly if there is an agreement for exclusive dealing, since such an agreement normally imposes an obligation on the agent to use best efforts. See *Uniform Commercial Code* § 2-306(2); compare Restatement, Second, Agency § 378. In other cases the agent does not promise to act, but the principal must compensate him if he does act

Although the courts are not always explicit in stating the rationale, the following cases may fairly be viewed as supporting § 45 of the Restatement:

California: Baumgartner v. Meek, 126 Cal. App. 2d 505, 272 P.2d 552 (1954) .

Connecticut: Harris v. McPherson, 97 Conn. 164, 115 A. 723 (1922) .

Minnesota: Confer Bros. v. Colbrath, 149 Minn. 259, 183 N.W. 524 (1927) ; *Lapham v. Flint*, 86 Minn. 376, 90 N.W. 780 (1902) .

Ohio: Bell v. Dimmerling, 149 Ohio St. 165, 36 Ohio Op. 505, 78 N.E.2d 49 (1948) .

(n52)Footnote 24. *Kruger v. Soreide*, 246 N.W.2d 764, 773 (N.D. 1976) . See *Huff v. Rammell*, 108 Idaho 113, 697 P.2d 453 (Idaho Ct. App. 1985) (unilateral termination of exclusive brokerage agreement prior to expiration date is ineffective).

(n53)Footnote 25. There is no implied extension of a listing agreement. *See Lynn Beechler Realty Co. v. Warnygora*, 396 N.W.2d 717 (Minn. Ct. App. 1986) .

(n54)Footnote 26. *Lyle v. Moore*, 183 Mont. 274, 599 P.2d 336 (Mont. 1979) .

(n55)Footnote 27. 604 N.E.2d 601 (Ind. 1992) .

(n56)Footnote 27.1. 253 Va. 217, 482 S.E.2d 805 (Va. 1997) . *But cf. Premier Realty, LLC v. I.T.J. Investments, Inc.*, 42 Kan. App. 2d 148, 157, 209 P.3d 741, 748 (2009) (no express agreement to pay a commission if the property was gifted during the listing period).

(n57)Footnote 27.2. 253 Va. 217, 219, 482 S.E.2d 805, 807 (Va. 1997) .

(n58)Footnote 27.3. *See Horning v. Shilberg*, 130 Cal. App. 4th 197, 204, 29 Cal. Rptr. 3d 717, 723 (2005) ; *Stout v. Edmonds*, 180 Cal. App. 3d 66, 70, 225 Cal. Rptr. 345 (1986) , review denied.

(n59)Footnote 27.4. *See Horning v. Shilberg*, 130 Cal. App. 4th 197, 206, 29 Cal. Rptr. 3d 717, 725 (2005) .

(n60)Footnote 27.5. For cases involving partnerships that were held not to be subject to the payment of a commission since there was held to be only a change in the form of ownership, *see Southpace Properties, Inc. v. Acquisition Group*, 5 F.3d 500, 504 (11th Cir. 1993) ; *Cooley Inv. Co. v. Jones*, 780 P.2d 29, 31 (Colo. App. 1989) ; *Miller, Cowherd & Kerver, Inc. v. De Montejo*, 406 So. 2d 1196, 1198 (Fla. App. 1981) ; *McElhinney v. Belsky*, 165 Pa. Super. 546, 69 A.2d 178, 181 (1949) .

(n61)Footnote 27.6. 253 Va. 217, 220, 482 S.E.2d 805, 807 (Va. 1997) .

(n62)Footnote 28.

California: Blank v. Borden, 11 Cal. 3d 963, 524 P.2d 127 (1974) .

Maine: E.A. Strout Farm Agency v. McTeer, 111 Me. 169, 88 A. 411 (1913) .

Michigan: Ladd v. Teichman, 359 Mich. 587, 103 N.W.2d 338 (1960) .

Minnesota: Confer Bros., Inc. v. Colbrath, 149 Minn. 259, 183 N.W. 524 (1921) .

Texas: Holmes v. Holik, 238 S.W.2d 260 (Tex. Civ. App. 1951) .

Contra:

New York: Ackerman v. Dobbs, 181 A.D.2d 704, 580 N.Y.S.2d 793, 1992 N.Y. App. Div. LEXIS 3284 (2d Dept. 1992) (holding that no commission was due where (1) the ultimate buyer had already offered to purchase the property before the listing agreement had been executed, (2) the buyer was not introduced to the seller by the broker, and (3) the broker never showed the buyer the premises or discussed any terms and conditions of the deal; under these circumstances, it could not be said that the broker brought the parties together or that the broker was the procuring cause of the sale).

(n63)Footnote 29. In *Confer Bros., Inc. v. Colbrath*, 149 Minn. 259, 183 N.W. 524, 525 (1921) , the court stated:

The cases cited by defendant in respect to the measure of damages where a party who has undertaken to perform an executory contract is prevented from doing so by the other party are not in

point. Defendant agreed to pay a specified commission in the event of a sale. The sale was made, plaintiff brought suit on the contract for the stipulated amount, and, if entitled to recover at all, was entitled to recover that amount.

See *Easton Business Opportunities, Inc. v. Town Executive Suites*, 2010 Nev. LEXIS 14, at *25-*26 (2010), quoting this Treatise.

Accord:

California: Blank v. Borden, 11 Cal. 3d 963, 524 P.2d 127 (1974).

(n64)Footnote 30. *Kimmell v. Skelly*, 130 Cal. 555, 62 P.1067 (1900); *Carlsen v. Zane*, 261 Cal. App. 2d 399, 67 Cal. Rptr. 747 (1968). *Easton Business Opportunities, Inc. v. Town Executive Suites*, 2010 Nev. LEXIS 14, at *25-*26 (2010), quoting this Treatise. Cf. *Van C. Argiris & Co. v. FMC Corp.*, 144 Ill. App. 3d 750, 98 Ill. Dec. 601, 494 N.E.2d 723 (1986) (broker cannot recover in *quantum meruit* for services rendered unless such services can be proven to be the procuring cause of the sale).

(n65)Footnote 31. In *Pacifico v. Plate*, 183 A.D.2d 986, 583 N.Y.S.2d 600, 1992 N.Y. App. Div. LEXIS 6721 (3d Dept. 1992), where a broker brought the parties together and actively participated in negotiations, and the parties executed agreements while the exclusive listing was in effect, the court deemed that it was irrelevant that the transfer of title occurred after the listing had expired, since the broker proved that it had been the procuring cause of the sale. *But see Dale Denton Real Estate, Inc. v. Fitzgerald*, 635 A.2d 925 (D.C. 1993), where the court held that a summary judgment was unavailable to the broker when the exclusive listing had expired prior to the broker's procuring a ready, willing and able buyer.

(n66)Footnote 32.

Federal: Parke-Hayden v. Loews Theatre Management Corp., 789 F. Supp. 1257 (S.D.N.Y. 1992) (holding that punitive damages are not available for a breach of a brokerage agreement unless the allegations support the conclusion that a fraud upon the public was involved).

Alabama: F.W. Woolworth Co. v. Grimmer, 601 So. 2d 1043 (Ala. 1992) (emphasizing the need for specific commission amounts, the court held that the commission to the broker could only be paid on the lower amount because the listing agreement was not clear as to how commissions would be handled when the rentals increased).

Connecticut: Harris v. McPherson, 97 Conn. 164, 115 A. 723 (1922).

District of Columbia: Sandler v. Denston, 183 A.2d 392 (D.C. 1962).

Louisiana: Sam Fullilove & Assocs., Inc. v. Day, 639 So. 2d 801 (La. App. 2d Cir. 1994) (holding that, under the proration rule, the broker was entitled to a pro rata commission upon the owner's sale of the listed property for an amount less than the agreed upon listing price).

Maryland: Garfinkel v. Schwartzman, 253 Md. 710, 254 A.2d 667 (1969).

Missouri: Gordon A. Gundaker Real Estate Co., Inc. v. Missouri Real Estate Comm'n, 878 S.W.2d 466 (Mo. App. E.D. 1994) (upholding a real estate sales incentive program under which one successful agent at random was awarded \$10,000 accrued as a result of listing owners paying additional commissions;

since only selling agents, and not purchasers, benefited from the program, it did not violate state law prohibiting the use of lotteries, prizes or money to induce or influence customers).

Nevada: Flamingo Realty, Inc. v. Midwest Dev., Inc., 879 P.2d 69 (Nev. 1994) (holding that "established customs" are to be considered in determining the reasonable value of a real estate agent's services).

Oklahoma: Shorten v. Mueller, 206 Okla. 62, 241 P.2d 187 (1952) .

(n67)Footnote 33.

Federal: Parke-Hayden, Inc. v. Loews Theatre Management Corp., 789 F. Supp. 1257 (S.D.N.Y. 1992) (punitive damages are not available for breach of a brokerage agreement, unless the allegations support the conclusion that a "fraud upon the public" was involved).

Michigan: Crawford v. Cicotte, 186 Mich. 269, 152 N.W. 1065 (1915) .

Minnesota: Fairchild v. Rogers, 32 Minn. 269, 20 N.W. 191 (1884) .

Oregon: Brady v. E. Portland Sheet Metal Works, 222 Or. 584, 352 P.2d 144 (1960) .

See Restatement (Second) of Agency § 449, Comment a.

(n68)Footnote 34. See:

District of Columbia: Dale Denton Real Estate, Inc. v. Fitzgerald, 635 A.2d 925 (D.C. 1993) .

Pennsylvania: Coldwell Banker Phyllis Rubin v. Romano, 619 A.2d 376 (Pa. Super. Ct. 1993) .

(n69)Footnote 35. 81 N.Y.2d 399, 599 N.Y.S.2d 501, 615 N.E.2d 985 (1993) . But see *Panetta v. Tonetti*, 182 A.D.2d 977, 582 N.Y.S.2d 303, 1992 N.Y. App. Div. LEXIS 5739 (3d Dept. 1992) .

(n70)Footnote 35.1. See *Furr v. Fonville Morisey Realty, Inc.*, 503 S.E.2d 401, 408 (N.C. App. 1998) .

(n71)Footnote 35.2. See *J.R. Waymire Co. v. Antares Corp.*, 975 S.W.2d 243, 248-249 (Mo. App. 1998) .

(n72)Footnote 36. 125 A.D.2d 265, 509 N.Y.S.2d 806, 1986 N.Y. App. Div. LEXIS 62538 (1st Dept. 1986) (motion for leave to appeal denied by the New York Court of Appeals on Dec. 17, 1987).

(n73)Footnote 37. See *Exclusive Brokerage Pacts Weakened for Realty Dealers*, N.Y.L.J., at 1, col. 2 (Dec. 21, 1987). See § 13A.07 below for an illustrative brokerage agreement for an office lease.

(n74)Footnote 38. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 266, 509 N.Y.S.2d at 807.

(n75)Footnote 39. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 266, 509 N.Y.S.2d at 807.

(n76)Footnote 40. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 266-67, 509 N.Y.S.2d at 808 . The court noted that:

[c]onsonant with its implied obligation not to impede or frustrate performance by plaintiff, defendant

cannot rely upon its wrongful conduct, which prevented plaintiff from negotiating the Madison Avenue lease, to prove that plaintiff sustained no injury.

Interactive Properties, Inc. v. Doyle Dane, 125 A.D.2d at 269, 509 N.Y.S.2d at 810 .

See also § 4.07 below discussing the requirement that the broker be the "procuring cause of the transaction" to recover his commissions.

(n77)Footnote 41. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 267, 509 N.Y.S.2d at 809 .

(n78)Footnote 42. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 268, 509 N.Y.S.2d at 809 .

(n79)Footnote 43. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 268, 509 N.Y.S.2d at 809. The court also noted that the New York position on the damages issue was a minority position.

(n80)Footnote 44. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 268, 509 N.Y.S. 2d at 809.

(n81)Footnote 45. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 268, 509 N.Y.S. 2d at 809.

(n82)Footnote 46. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 268, 509 N.Y.S. 2d at 809 .

(n83)Footnote 47. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 268, 509 N.Y.S. 2d at 809 .

(n84)Footnote 48. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 268, 509 N.Y.S. 2d at 809 . Indeed, the court reasoned in this regard that the breach was the direct result of the defendant's "secret pact" with City Center.

(n85)Footnote 49. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 268, 509 N.Y.S. 2d at 809 .

(n86)Footnote 50. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 272-273, 509 N.Y.S.2d at 812.

(n87)Footnote 51. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 272-73, 509 N.Y.S.2d at 812 .

(n88)Footnote 52. *Interactive Properties, Inc. v. Doyle Dane*, 125 A.D.2d at 265, 509 N.Y.S.2d at 807 .

(n89)Footnote 53. *See Loyola Federal Sav. Bank v. Hill*, 114 Md. App. 289, 689 A.2d 1268, 1273 (1997) .

(n90)Footnote 54. *Loyola Federal Sav. Bank v. Hill*, 114 Md. App. 289, 689 A.2d 1268, 1270 (1997) .

(n91)Footnote 55. *Loyola Federal Sav. Bank v. Hill*, 114 Md. App. 289, 689 A.2d 1268, 1276 (1997) . See also *T.G. Slater & Son, Inc. v. The Donald P. And Patricia A. Brennan, LLC*, 385 F.3d 836, 842 (4th Cir. 2004) , applying Virginia law (where a contract is silent or ambiguous as to the commission to be paid for services, certain custom or usage of the business and of the locality, known to the parties, or so generally and notoriously known that it is presumed to be known, is admissible to establish the rate the parties agreed to under the contract.).

(n92)Footnote 56. 266 Ga. App. 217, 596 S.E.2d 625 (Ga. Ct. App. 2004) , reconsideration denied (March 12, 2004).

(n93)Footnote 57. There was no listing agreement between the seller and the broker. 266 Ga. App. 217, 219, 596 S.E.2d 625, 626 (Ga. Ct. App. 2004) , reconsideration denied (March 12, 2004).

(n94)Footnote 58. 266 Ga. App. 217, 220, 596 S.E.2d 625, 627 (Ga. Ct. App. 2004) , reconsideration denied (March 12, 2004). This court also stated that since the broker did not make a quantum meruit claim it was not considering this issue. See also *Pargar, LLC v. Jackson*, 294 Ga. App. 882, 670 S.E.2d 547, 551 (2008) (following

Mitchell Realty Group, LLC, the compensation provision in the buyer brokerage agreement had been stricken).

(n95)Footnote 59. *125 Md. App. 602, 726 A.2d 818 (1999)* .

(n96)Footnote 60. *125 Md. App. 602, 726 A.2d 818, 822-823 (1999)* . The first contract contained a provision which provided that in the event of the seller's default, the buyers' sole remedy was limited to a return of their deposit.

(n97)Footnote 61. When the sellers entered into the first contract they were aware of the higher offer from the second buyers. The court stated that the record did not reveal why the sellers entered into the first contract after they learned of the higher offer from the second buyers.

(n98)Footnote 62. *125 Md. App. 602, 726 A.2d 818, 833 (1999)* . The court stated that the broker was attempting to "double dip" and asked rhetorically whether the broker would have complained if the sellers' second sale had not involved a cooperating broker since it then would have received a higher commission on the second sale.

(n99)Footnote 63. *125 Md. App. 602, 726 A.2d 818, 834 (1999)* .

(n100)Footnote 64. *See Kreider v. Kleinfelter, 314 Pa. Super. 571, 461 A.2d 304, 306-307 (Pa. Super. 1983)* . *See also Matusik v. Ward, 68 A.D.3d 1213, 1214, 892 N.Y.S.2d 561, 563 (2009)* (an action to recover a commission may only be initiated, on the salesperson's behalf, by the broker associated with the salesperson); *Coldwell Banker-Hoffman Burke v. KRA Holdings, 42 S.W.3d 868, 874 (Tenn. Ct. App. 2000)* (under *Tenn. Code Ann. § 62-13-105* an affiliate broker lacks standing to sue a property owner for a real estate commission; an affiliate broker lacks the legal capacity to bring an action directly against the broker's client); *Ohio Rev. Code § 4735.21* ("No real estate salesman shall collect any money in connection with any real estate brokerage transaction, whether as a commission, deposit, payment, rental, or otherwise, except in the name of and with the consent of the licensed real estate broker under whom he is licensed").

(n101)Footnote 65. *See Eill v. Tegler, 722 A.2d 200, 202 (Pa. Super. 1998)* . This case involved a dispute between a licensed broker and two salespersons concerning the apportionment of a commission that was already paid by the third-party vendor.

(n102)Footnote 66. *See Wood/Fay Realty Group, Inc. v. New Aquarius Corp., 842 So. 2d 914, 917 (Fla. Dist. Ct. App. 2003)* ; *Gretencord v. Cryder, 336 Ill. App. 3d 930, 934, 271 Ill. Dec. 166, 784 N.E.2d 384, 387 (2003)* .

(n103)Footnote 67. *911 So. 2d 1181 (Fla. 2005)* , *rehearing denied, 2005 Fla. LEXIS 1838* (Fla. Sept. 13, 2005) .

(n104)Footnote 68. *911 So. 2d 1181, 1183 (Fla. 2005)* , *rehearing denied, 2005 Fla. LEXIS 1838* (Fla. Sept. 13, 2005) .

(n105)Footnote 69. *See Act Realty Co. v. Rotemi Realty, Inc., 863 So. 2d 334, 336 (Fla. Dist. Ct. App. 2003)* , *reversed, 911 So. 2d 1181 (Fla. 2005)* .

(n106)Footnote 70. *911 So. 2d 1181, 1183 (Fla. 2005)* , *rehearing denied, 2005 Fla. LEXIS 1838* (Fla. Sept. 13, 2005) .

(n107)Footnote 71. *911 So. 2d 1181, 1188 (Fla. 2005)* , *rehearing denied, 2005 Fla. LEXIS 1838* (Fla. Sept. 13, 2005) . *citing and quoting from Robert & Co. v. Mortland, 160 Fla. 125, 33 So. 2d 732 734 (Fla. 1948)* .

(n108)Footnote 72. *911 So. 2d 1181, 1188 (Fla. 2005)* , *rehearing denied, 2005 Fla. LEXIS 1838* (Fla. Sept. 13, 2005) . The court observed that contingency fees had long been the norm in real estate brokerage and that flat-fee real estate brokerage agreements are virtually unheard of.

(n109)Footnote 73. *See Jameson Realty Group v. Kostner, 351 Ill. App. 3d 416, 426, 286 Ill. Dec. 431, 813 N.E.2d 1124, 1132 (Ill. App. Ct. 2004)* .

But cf. Wright v. Schutt Construction Co., Inc., 262 Or. 619, 631, 500 P.2d 1045, 1051 (Or. 1972) (contract provision requiring payment of a commission based on the full listed price was a penalty).

(n110)Footnote 74. *See Jameson Realty Group v. Kostner*, 351 Ill. App. 3d 416, 426, 286 Ill. Dec. 431, 813 N.E.2d 1124, 1132 (Ill. App. Ct. 2004) .

(n111)Footnote 75. *See Jameson Realty Group v. Kostner*, 351 Ill. App. 3d 416, 425-426, 286 Ill. Dec. 431, 813 N.E.2d 1124, 1132 (Ill. App. Ct. 2004) .

(n112)Footnote 76. *See Jameson Realty Group v. Kostner*, 351 Ill. App. 3d 416, 425-426, 286 Ill. Dec. 431, 813 N.E.2d 1124, 1132 (Ill. App. Ct. 2004) .

(n113)Footnote 77. *See Jameson Realty Group v. Kostner*, 351 Ill. App. 3d 416, 423, 286 Ill. Dec. 431, 813 N.E.2d 1124, 1130 (Ill. App. Ct. 2004) .

(n114)Footnote 78. *Cf. CMG Realty of Connecticut, Inc. v. Colonnade One at Old Greenwich Ltd. Partnership*, 36 Conn. App. 653, 667, 653 A.2d 207, 215 (Conn. App. Ct. 1995) (a provision requiring the seller to pay the broker \$50,000 if termination occurred before 84 units had been sold and \$100,000 if termination occurred after 84 had been sold was an unenforceable penalty because \$50,000 was not related to any amount of damage that the broker would actually suffer in the event of a breach and because the doubling of the fee, dependent upon the amount of units that had been sold, could only serve to threaten the seller not to terminate the listing agreement).

Dean Vincent, Inc. v. McDonough, 281 Ore. 239, 246-247, 574 P.2d 1096, 1099 (Or. 1978) (A broker was not entitled to set aside the jury's verdict awarding him nominal damages based on the owners' failure to plead the invalidity of the liquidated damages provision because: (1) at the time of trial the burden of proof was on the broker to plead and prove that the liquidated damages provision was valid; and (2) even if the burden had been placed upon the owners, there was ample evidence to sustain a finding that the liquidated damages provision was invalid because the amount fixed was not a reasonable forecast of just compensation for the harm that would be caused by a breach of the agreement, and the harm that would be caused by a breach was not one that was incapable of accurate estimation.).

(n115)Footnote 79. *Cf. Larson-Hegstrom & Associates, Inc. v. Jeffries*, 145 Ariz. 329, 333-34, 701 P.2d 587, 591-92 (Ariz. Ct. App. 1985) (applying the Restatement (Second) of Contracts § 356 and finding enforceable a clause which provided the broker its 6% commission if the seller terminated the exclusive listing agreement before the end of the listing period); *Coldwell Banker-First Realty, Inc. v. Meide & Son, Inc.*, 422 N.W.2d 375, 380 (N.D. 1988) ; *DiTommaso Realty, Inc. v. Moak Motorcycles, Inc.*, 96 Or. App. 431, 434-35, 773 P.2d 391, 392-93 (Or. Ct. App. 1989) , *aff'd*, 309 Ore. 190, 785 P.2d 343 (Or. 1990) (finding valid a provision that provided the broker with its 10% commission if the seller prematurely terminated the exclusive listing agreement).

(n116)Footnote 80. *See Southpace Properties, Inc. v. Acquisition Group*, 5 F.3d 500, 505-506 (11th Cir. 1993) , applying Alabama law.

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92 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.07

§ 4.07 Requirement That the Broker Be the Procuring Cause of the Transaction

[1] In General

Aside from showing that he or she has produced a ready, willing and able buyer, in order to prevail in a suit for compensation, a broker may have to show that he or she was the "procuring and efficient cause" of the transaction. n1 This is particularly true when a broker has not obtained an exclusive right-to-sell or an exclusive agency listing. There cannot be multiple procuring causes. n1.1 Conflicts may arise when the broker introduces the buyer and seller, but the transaction does not close for an extended period of time. For example, intervening events may arise to deprive the broker of the right to a commission, or two competing brokers may seek to introduce the buyer and seller, with the ultimate goal of the sale, exchange or lease of real estate. n2 A broker is not entitled to a commission upon a sale merely because the purchaser is one whom the broker introduced to the property. n2.1 A broker is the procuring cause of a sale when it has originated or caused a series of events that, without break in their continuity, result in the accomplishment of the prime objective of procuring a purchaser ready, willing, and able to buy on the seller's terms. n2.2

The common law procuring cause doctrine does not apply when an express contract establishes the conditions under which a commission is to be paid. n2.2.1

The procuring cause doctrine does not apply to an exclusive right-to-sell contract. Such a contract entitles the broker to a commission upon a sale of the property during the contract period even if the owner makes the sale. Consequently, the procuring cause doctrine only applies to sales consummated outside the confines of an exclusive right-of-sale contract. n2.3

Without an exclusive right to sell or an exclusive agency agreement, cases are decided primarily on the basis of the facts involved. Merely introducing the buyer to the property does not make the broker the procuring cause of the sale. n3 Thus, where the services of two or more brokers have jointly contributed to the successful negotiations resulting in a transfer of real estate for an owner, the resolution of the question of which broker is entitled to the commission from the owner for effecting such transfer "depends upon whose efforts were the proximate and procuring cause" of the transfer negotiated. n4 A broker makes out a prima facie case that he or she was the procuring cause when the broker shows that negotiations for the sale were initiated through the broker's efforts and that the broker performed every possible service required by the broker's employment. n5 A North Carolina court has stated that:

The term *procuring cause* refers to "a cause originating or setting in motion a series of events which, without break in their continuity, results in the accomplishment of the prime object of the employment of the broker, which may variously be a sale or exchange of the principal's property, an ultimate agreement between the principal and a prospective contracting party, or the procurement of a purchaser, who is ready, willing and able to buy on the principal's terms." n6

It is not sufficient that a broker is the first to bring the parties together; if negotiations are unproductive and the parties withdraw from negotiations or abandon the sale, a subsequent sale by another broker does not entitle the first to a commission. n7 Furthermore, a broker is not entitled to a commission if the broker brings the parties together during the term of the listing agreement, and a sale is subsequently made by the owner to that other party produced by the broker, but on terms that are substantially different from those offered through the broker's efforts. n7.1

However, where the vendor who has listed his or her property at one price manifests a willingness to sell at a lower price to a purchaser procured by the broker, the right to a commission accrues and is not defeated even though the vendor subsequently rejects the first purchaser and sells at his or her original price to another purchaser not procured by the broker. Nor does it matter that the first agreement was oral n8 and unenforceable under the statute of frauds. For example, in *Arjay Properties, Inc. v. Hicks*, n9 the broker had an open listing from the owner for sale at \$79,500 "or any other price or terms acceptable" to the owner. The owner orally accepted an offer of \$75,000 from a purchaser procured by the broker. The owner never signed the written contract, however, and she subsequently signed a contract to sell for \$79,500 to a purchaser obtained by another broker (to whom the vendor presumably became obligated to pay a commission). The Vermont Supreme Court, approving of the modern view which requires a closing to perfect the broker's right to a commission, held that the first broker had earned his commission, notwithstanding the failure of the deal between the vendor and the purchaser procured by him. The court stated:

Here, defendant orally accepted the terms offered by plaintiff's purchasers, purported to be awaiting their signed purchase and sale agreement, and then silently signed a subsequent agreement offering a higher purchase price. Thus, defendant not only failed to notify plaintiff that she had found another purchaser, but she never rescinded her oral acceptance of July 9. Therefore, it is apparent from these facts that plaintiff's broker produced the first purchaser who satisfied the other elements of the test cited above [*Osler v. Landis*, 138 Vt. at 356, 415 A.2d at 1318] and that "[t]he bargain fell through by defendant's fault or inability to complete it and not because of any fault or failure of the plaintiff." [*Pond v. Carter*, 126 Vt. at 305, 229 A.2d at 252]. The fact that the purchaser was ready, able and willing to buy, and would have done so had defendant not accepted a subsequent offer, must be regarded as controlling, and as dispensing with, and as a waiver of, the necessity of a binding sales contract, which might otherwise exist. n10

[2] Rule Illustrated: Competing Brokers

The rule is sometimes expressed that a broker is compensated only for producing success and not for "planting seeds." n11 It is for the broker to establish that he or she was the procuring cause of the deal which was eventually made. This may become a very perplexing problem where there are claims by competing brokers.

Consider, for example, that Broker A submits the offer of a prospective purchaser which is rejected. Broker A does not pursue the matter any further. Some time later, Broker B, acting completely independently, contacts the same purchaser and at that time procures an offer which meets the price of the principal. The principal pays Broker B a commission, whereupon Broker A, presses a claim, asserting that she was the procuring cause of the deal. Assuming no aspect of fraud in such a case, it has been held Broker A cannot recover. n12 This example illustrates a type of difficulty with which a principal may be faced--a difficulty for which the principal will derive no aid from an agreement, conditioning commission on closing of title because, in our example, title has closed.

One should also note the difficult position that a selling broker maintains, particularly in those states that require a written employment agreement to maintain a cause of action to recover a commission. The selling broker may have a cause of action against the listing broker for failure to split the commission, but loses his or her right to pursue the seller regardless of whether or not he or she was the procuring cause of the transaction. n13 Whether the broker was a procuring cause is a question of fact for the jury. n14

[3] Tracing Connection Between Broker's Efforts and Ultimate Sale

Tracing the connection between the broker's employment and the eventual concluded transaction is a question of fact and, though the negotiations may have extended over a considerable period of time, the triers of fact may still find that the connection exists. n15 Moreover, even though the broker does not participate in every aspect of the negotiations between the principal and the purchaser, he may still collect a commission. The principal may accept the services of a broker in procuring the customer and thereafter undertake to do the negotiating himself. n16 This does not defeat the broker's right to recover or make him any less the procuring cause of the deal. Such a pattern often occurs in leasing transactions, where the landlord, tenant and their lawyers take over negotiations after the preliminary groundwork has been laid by the broker. However, absent a special agreement, the broker still must be the procuring cause of the lease in order to be entitled to a commission. n16.1 Nor is it of consequence that the principal is unaware that the person with whom he makes a deal was procured by the broker he employed; the procurement is still the broker's. n17 A broker may also be willing to show that he is the procuring cause of the sale even though the seller sells the property to an intervening third party (without the broker's assistance) if such third party then sells the property to a purchaser procured by the broker. n18 However, a change in the property's ownership frequently works against the broker's claim to a commission. n18.1

[4] Evidence of Procuring Cause

Too often lawyers, while acquainted with the substantive rule, find themselves in a quandary when they must apply the rule as advocates. Consider this in the matter of proof of procuring cause. Here the witness who most dramatically can relate the events of his dealings with the customer is, of course, the broker. At first blush, the broker's testimony as to his conversations with the prospect being hearsay would seem excludable on that ground. The New York Court of Appeals, however, ruled many years ago that such conversations are admissible to show procuring cause on the part of the broker notwithstanding their hearsay quality. n19

From the point of view of planning and drafting, the most effective way to satisfy the requirement that the broker is the procuring cause is to insert a clause in the contract between the vendor and the purchaser that the broker [stating name] brought about the sale. n20

Whether a broker is considered the procuring cause of a sale depends on the facts and circumstances of the case and is ordinarily a question of fact. n20.05 The broker's efforts need not be the sole cause of the sale, but must be the predominant cause. n20.1

Antrim, Piper, Wenger, Inc. v. Lowe n20.2 presents an interesting case in the context of proving procuring cause. The sellers in this case sought to deny the broker his commission because the sellers had handled the showing of their property and had prepared their own sales contract. The broker prevailed in the subsequent action to recover his commission because it was undisputed that the buyer became aware of the property's availability through the broker's website.

[5] Essential Terms

Where the broker relies upon an oral bargain, it is generally said, in jurisdictions where there is no requirement for closing of title, that to perform his engagement, the broker must bring the parties together on all the "essential terms" of

a bargain. n21

In the normal sales transaction, for example, the object of the prospective purchaser and seller is to come to an understanding upon all terms of the bargain and then have this reduced to writing as an enforceable contract. While this is the achievement for which the broker strives, it would be most unusual, to say the least, if particulars were submitted to a broker in the detail found in a printed form of sales contract. Businessmen do not conduct themselves in that way. More often than not, the broker is given incomplete terms. What liability does the principal incur if the broker produces a customer willing to meet the incomplete terms and the broker is discharged before a total bargain is made?

By the way of illustration, let us consider an all cash deal for a vacant parcel of land, and the only term given to the broker is price. The principal repudiates after the price is met but before any discussion is had on closing date or down payment. Does this defeat the broker's recovery? The answer is no. n22 In these circumstances the omitted items are merely "lawyer terms"--details to be worked out at the time of preparation of the contract--and the broker, in those jurisdictions which do not require a title closing, may recover the agreed commission if the proof shows that the purchaser would have been willing and able to meet any reasonable terms as to down payment and closing date. We have here an application of the rule concerning impeding the performance of conditions, the principal being powerless to take advantage of his own repudiation.

Suppose, however, the deal contemplates a purchase money mortgage, the terms of which were never given to the broker. The parties are brought together on all other aspects of the deal, but before there is any discussion on the terms of the mortgage, the principal discharges the broker and repudiates the deal. In such case, the principal incurs no liability to the broker. n23 It is obvious that it would be impossible to produce a standard of reasonable conduct as in the all cash deal, since mortgage terms vary so widely.

As indicated above, the parties negotiating a deal view the transaction in a business light and they expect all business terms to be agreed upon and the transaction ultimately reduced to writing. It is no easy matter to generalize this expectation into a guiding rule. If a generalization can be accepted on the basis of an aid to understanding the cases, and not as an inflexible pattern to mold conduct, perhaps it can be said that if what the parties have agreed upon would, if reduced to writing, make an enforceable agreement, with no terms left open for discussion and none discussed on which there was failure to agree, the parties are in agreement on "essential terms". It should be noted that what normally is needed to make an enforceable contract is not the datum on which liability is grounded; it is the terms given to the broker--whatever they may be--that the broker must bring agreement on. The seller can insist that the contract be drawn on green paper; if that is an element of the seller's offering then that requirement must be satisfied, bizarre as it may be.

Mere familiarity with the applicable cases dealing with essential terms leaves unfinished the task of adapting these to the tools of the courtroom. This is the advocates' problem. And from the viewpoint of that problem, it should be borne in mind that it is for the court to instruct the jury as to what the essential terms are in a particular transaction; it is not for the jury to make this determination. n24 With the difficulties inherent in the concept of essential terms, proper trial preparation would demand that requests to charge be carefully worked out in advance and not be prepared "off the cuff" so to speak. n25 When a broker has substantially performed under the brokerage agreement, the broker is entitled to his or her commission even if there have been changes in performance under the contract, provided these changes were immaterial and resulted in minimal or no harm to the broker's client. n26

FOOTNOTES:

(n1)Footnote 1. See, e.g.:

Federal: Christo v. Ramada Inns, Inc., 609 F.2d 1058 (3d Cir. 1979) .

New Hampshire: Belleau v. Hopewell, 120 N.H. 46, 411 A.2d 456 (1980) .

New Jersey: Schettino v. Roizman Dev., Inc., 310 N.J. Super. 159, 708 A.2d 446, 449 (1998) *aff'd*, 158 N.J. 476, 730 A.2d 797 (1999) .

New York: Zere Real Estate Servs. v. Adamag Realty Corp., 60 A.D.3d 758, 759, 875 N.Y.S.2d 162, 164 (2009) .

Ohio: Torbeck v. Iannelli, 2007 Ohio 4539, 2007 Ohio App. LEXIS 4102, at *11 (Sept. 4, 2007) .

(n2)Footnote 1.1. *See Grommet v. Newman*, 2009 WY 150, 220 P.3d 795, 808 (Wyo. 2009) .

(n3)Footnote 2. For cases holding brokers entitled to a commission, *see*:

Florida: South Pac. Enters., Ltd. Partnership v. Cornerstone Realty, Inc., 672 So. 2d 568 (Fla. App. 4 Dist. 1996) (the broker was entitled to a commission as the procuring cause of the sale, notwithstanding that the broker did not introduce the parties to each other and did not participate in the sales negotiations, where the broker played a pivotal role in generating the buyer's interest in the property and where the parties specifically and purposefully excluded the broker from the negotiations) *review denied*, 682 So. 2d 1100 (Fla. 1996) .

New Hampshire: Finlay v. Frederick, 135 N.H. 482, 606 A.2d 1375 (N.H. 1992) (holding that a plaintiff-broker was entitled to a commission on the lease and sale of defendant's property as procuring broker where: (1) the broker informed the buyer of the availability of the subject property, which led the buyer to contact the seller; and (2) the seller, although rejecting the buyer's initial offer through the broker, thereafter accepted the buyer's same offer without the services of the broker).

For cases holding against the broker's right to a commission, *see*:

Florida: Lee Giusti Realty, Inc. v. L.D. Corp., 603 So. 2d 39 (Fla. 4th DCA 1992) (holding that a real estate broker was not a procuring cause of a real estate transaction, and, thus, was not entitled to a commission on the transaction, even though the broker had an oral open listing on the property and showed it to one partner of a joint venture of which another partner subsequently purchased the property).

Louisiana: Century 21 Flavin Realty, Inc. v. Erwin Heirs, Inc., 657 So. 2d 108 (La. App. 3d Cir. 1995) (a broker who negotiated with a governmental entity that expropriated the seller's property one year after the extension clause in the listing agreement expired was not entitled to a commission as the procuring cause of the sale of the property).

New Jersey: Leadership Real Estate, Inc. v. Harper, 271 N.J. Super. 152, 638 A.2d 173 (Law. Div. 1993) (a real estate broker was not the efficient producing cause of the sale, where there was a substantial break in negotiations between the seller and the buyer, the seller did not act in bad faith and there was no evidence of collusion between the seller and the buyer to delay execution of the sales contract and thereby defeat the broker's claim for a commission).

New York: Ryan v. Bettiol, 620 N.Y.S.2d 625, 1995 N.Y. App. Div. LEXIS 52 (3d Dept. 1995) (the broker was not entitled to a commission on a theory of *quantum meruit*, where the broker introduced the parties to each other and attended an initial meeting, but there was no evidence that the broker's action prompted lease negotiations that did not begin until almost a year after that meeting); *Helmsley-Spear, Inc. v. Melville Corp.*, 203 A.D.2d 517, 611 N.Y.S.2d 240, 1994 N.Y. App. Div. LEXIS 4303 (2d Dept. 1994) (the

broker was not entitled to a commission on the basis of an alleged oral agreement to "cover" and "protect" the broker, where the broker failed to undertake extensive efforts with respect to the property in reliance on the agreement); *Brown & Son Realty, Inc. v. Greenberg*, 195 A.D.2d 583, 601 N.Y.S.2d 7, 1993 N.Y. App. Div. LEXIS 7569 (2d Dept. 1993) (holding that a broker was not entitled to a commission when he merely provided the buyers with information about a building after one of the buyers spotted the building from the roof of another building he was being shown by the broker, and the buyers subsequently concealed their interest in the property from the broker and purchased the property directly from the owner); *ERA Joseph Green Real Estate, Inc. v. Daubert*, 186 A.D.2d 885, 588 N.Y.S.2d 922, 1992 N.Y. App. Div. LEXIS 12140 (3d Dept. 1992) (holding that a broker, who introduced the parties who subsequently entered into a contract for the construction of an office building, was not entitled to a commission, since at the time the broker brought the parties together, no architectural plans or drawings were available and no discussion was had concerning the scope or cost of the project).

But see R.B. Miller Org. v. VASAP Constr. Corp., 184 A.D.2d 763, 585 N.Y.S.2d 473, 1992 N.Y. App. Div. LEXIS 8668 (2d Dept. 1992) (where a landlord alleged that the broker was not entitled to a commission because the commission was contingent upon the tenant paying rent, and the tenant had vacated the premises, the court upheld the broker's right to a commission under the general rule that the broker who produces a person ready, willing and able to enter into a contract has earned his commission).

Pennsylvania: Coldwell Banker Phyllis Rubin Real Estate v. Romano, 422 Pa. Super. 319, 328-329, 619 A.2d 376, 381 (1993), appeal denied, 534 Pa. 635, 626 A.2d 1154 (1993) (holding that a third party, which exercised its right of first refusal after the broker had produced a purchaser, was not a broker's prospect as required for the broker to be entitled to a commission under the parties' exclusive agency listing, since the third party had a long-standing option to purchase the property, which arose through no effort of the broker).

Washington: Roger Crane & Assocs., Inc. v. Felice, 74 Wash. App. 769, 875 P.2d 705 (1994) (holding that a cooperating broker was not entitled to a commission as the procuring cause of the sale, where the broker merely spoke to purchasers about the home, drove one purchaser past the home and arranged a viewing of the property).

(n4)Footnote 2.1. See *Schaller v. Weier*, 319 Ill. App. 3d 172, 179, 253 Ill. Dec. 94, 744 N.E.2d 376, 381 (2001); *Business Consulting Services, Inc., v. Wicks*, 703 N.W.2d 427, 431 (Iowa 2005); *Upper Valley Realty, Inc. v. Hanson*, 2006 Ohio 314, 2006 Ohio App. LEXIS 269, at *14 (Jan. 20, 2006); *Whitten v. Smith*, 2002 Tenn. App. LEXIS 165, at *11 (Tenn. Ct. App. February 27, 2002); *Shalimar Development, Inc. v. F.D.I.C.*, 257 Va. 565, 515 S.E.2d 120, 124 (Va. 1999). See also *Earnest & Stewart, Inc. v. Codina*, 732 So. 2d 364, 365-366 (Fla. App. 1999), rehearing denied (simple act of telling eventual purchasers that the piece of property was for sale did not entitle broker to recover commission). But cf. *Snipes v. Marcene P. Powell & Associates, Inc.*, 273 Ga. App. 814, 818, 616 S.E.2d 152, 156-157 (2005), cert. denied, 2005 Ga. LEXIS 742 (Oct. 24, 2005) (The extension clause in the listing agreement stated that if the seller sold the property to any buyer "introduced" to the property by broker within 90 days after the expiration of the listing period, the seller was obligated to pay the broker's commission. The broker successfully sued for his commission when during the listing period, the buyer contacted the broker and made appointments to see the sellers' property but always cancelled. After the listing period expired but before the extension period expired, the buyer purchased the sellers' property. The court found that a broker introduces a purchaser to a principal if, through any means the broker uses to attract attention, the purchaser is led to the principal.); *Perimeter Realty v. GAPI, Inc.*, 243 Ga. App. 584, 533 S.E.2d 136, 148 (2000), cert. denied, 2000 Ga. LEXIS 762 (Ga. Oct. 2, 2000) (broker may be the procuring cause of the sale even though the buyer and seller decide to negotiate the sale without the presence of the broker after the broker brings the principals together).

(n5)Footnote 2.2. See *Strategic Alliance Partners, LLC v. Dress Barn, Inc.*, 386 F. Supp. 2d 312, 317 (S.D. N.Y. 2005), applying New York law; *Rotemi Realty, Inc. v. Act Realty Co., Inc.*, 911 So. 2d 1181, 1188 (Fla. 2005), rehearing denied, 2005 Fla. LEXIS 1838 (Fla. Sept. 13, 2005); *Leary v. Stockman*, 937 So. 2d 964, 971 (Miss. Ct. App. 2006); *Shalimar Development, Inc. v. F.D.I.C.*, 257 Va. 565, 515 S.E.2d 120, 123 (1999).

(n6)Footnote 2.2.1. See *Gadsby v. Norwalk Furniture Corp.*, 71 F.3d 1324, 1327 (7th Cir. 1995), reh'g en banc denied, 1996 U.S. App. LEXIS 1330 (7th Cir. Jan. 29, 1996), applying Ohio law; *Georgia Real Estate Properties, Inc. v. Lindwall*, 2010 Ga. App. LEXIS 272, at *7-*8 (Mar. 22, 2010); *Hill v. Boozer*, 289 Ga. App. 750, 751, 658 S.E.2d 268, 269 (2008); *B&R Realty v. Carroll*, 245 Ga. App. 44, 45, 537 S.E.2d 183, 186 (2000).

(n7)Footnote 2.3. See *Atkins v. L.L. Cole & Sons, Inc.*, 79 Ark. App. 124, 127-128, 84 S.W.3d 899, 901-902 (2002); *First Florida Realty & Auction Co., Inc. v. Peacock*, 703 So. 2d 1199, 1200 (Fla. App. 1997).

(n8)Footnote 3. *Mollyann, Inc. v. Demetriades*, 206 A.D.2d 415, 614 N.Y.S.2d 437, 1994 N.Y. App. Div. LEXIS 7319 (2d Dept. 1994).

(n9)Footnote 4. See, e.g.:

Georgia: Doyal & Assocs., Inc. v. Wilma Southeast Inc., 174 Ga. App. 851, 332 S.E.2d 24 (1985) (broker not the procuring cause); *Nestle' Co. v. J.H. Ewing & Sons*, 153 Ga. App. 328, 265 S.E.2d 61, 64 (1980), citing *Gresham v. Lee*, 152 Ga. 829, 830, 111 S.E. 404, 405 (1922).

Nebraska: Marathon Realty Corp. v. Gavin, 224 Neb. 458, 398 N.W.2d 689 (Neb. 1987) (broker was the efficient procuring cause of a sale when the broker had secured a prospective buyer who was ready, willing and able to buy the property on terms acceptable to the seller).

New York: Levy Wolf Real Estate Brokerage, Inc. v. Lizza Indus., Inc., 118 A.D.2d 688, 500 N.Y.S.2d 37, 1986 N.Y. App. Div. LEXIS 54553 (2d Dept. 1986) (the court rejected an attempt by a brokerage firm to collect a commission because their best efforts were negligible in comparison with the firm which received the commission for leasing the property); *Aegis Property Servs. v. Hotel Empire Corp.*, 106 A.D.2d 66, 484 N.Y.S.2d 555, 1985 N.Y. App. Div. LEXIS 42535 (1st Dept. 1985) (broker was not the procuring cause of a lease when the broker: (1) "at no point had procured for the [landlord] a tenant 'ready, willing and able to lease the space in question' and (2) had not brought 'the minds of the buyer and seller to an agreement' or brought 'the parties together in an amicable frame of mind, with an attitude toward each other and toward the transaction in hand which permits their working out the terms of their agreement.'"); *Philip Winogad, Inc. v. Prudential Ins. Co.*, 102 A.D.2d 715, 476 N.Y.S.2d 854, 1984 N.Y. App. Div. LEXIS 18875 (1st Dept. 1984) (broker did not earn a commission where the extent of his effort was to provide the selling broker with a listing of information concerning the property).

North Carolina: Hecht Realty, Inc. v. Whisnant, 41 N.C. App. 702, 255 S.E.2d 647, reh'g denied, 259 S.E.2d 912 (1979) (a corporate realty firm was not the procuring cause of a sale and could not recover a commission for the value of services rendered where the firm showed the vendor's house to purchasers, presented the purchaser's offer and was met by an unaccepted counteroffer by the vendors).

(n10)Footnote 5. See:

Georgia: Kraft Servs., Inc., 165 Ga. App. 358, 300 S.E.2d 186 (1983); *Nestle' Co. v. J.H. Ewing & Sons*, 153 Ga. App. 328, 265 S.E.2d 61, 64 (1980).

New Jersey: Flood v. Caro Corp., 272 N.J. Super. 398, 640 A.2d 306 (App. Div. 1994) (the broker was

entitled to a commission, notwithstanding that all twenty-five condominium units were sold in bulk rather than one at a time).

See also: Provost v. St. Francis Commandery Hall Ass'n, 118 A.D.2d 922, 499 N.Y.S.2d 489 (3d Dept. 1986) (broker cannot recover commission merely by calling the property to the attention of the ultimate purchaser).

(n11)Footnote 6. *Hecht Realty, Inc. v. Whisnant*, 255 S.E.2d at 649 . It should be noted that for a real estate broker to earn a commission it may not be necessary that he participate in final negotiations leading to a sale of property. *See Belleau v. Hopewell*, 120 N.H. 46, 411 A.2d 456 (1980) . Moreover, a broker may collect a commission where his services were accepted in bringing the parties together with the understanding that negotiations would be left to the parties. *See, e.g., Eugene J. Busker Co., Inc. v. Galbreath Ruffin Realty Co. Inc.*, 22 A.D.2d 879, 254 N.Y.S.2d 673 (1st Dept. 1964) , *aff'd*, 15 N.Y.2d 992, 260 N.Y.S.2d 12, 207 N.E.2d 608 (1965) .

For cases holding that the broker did not perform sufficient services to recover a commission, *see*:

Federal: Follman Properties Co. v. Daly, 790 F.2d 57 (8th Cir. 1986) .

Missouri: Ham v. Morris, 711 S.W.2d 187 (Mo. 1986) .

(n12)Footnote 7. *See*:

Alabama: First Real Estate Corp. of Ala., Inc. v. Spiller, 603 So. 2d 954 (Ala. 1992) (summary judgment was properly granted to the seller, where the evidence showed that the plaintiff-broker was not the procuring cause of the sale of the subject property).

Missouri: Malone v. Johnson, 866 S.W.2d 935 (Mo. App. 1993) (when there were terms and conditions yet to be negotiated in the sale of a bank, and a number of unresolved issues (including drafting of a promissory note, drafting of security and escrow agreements, and the selection of an escrow agent), the selling broker was not yet entitled to a commission); *C. Meyers & Simpson Co. v. Feese Real Estate, Inc.*, 705 S.W.2d 600, 1986 Mo. App. LEXIS 3513 (Mo. Ct. App. 1986) ; *Mix v. Broyles*, 567 S.W.2d 696 (Mo. Ct. App. 1978) .

New York: Mautner-Glick Corp. v. Dime Sav. Bank of Williamsburgh, 647 N.Y.S.2d 782, 1996 N.Y. App. Div. LEXIS 10090 (A.D. 1st Dept. 1996) (individual buyers were not ready, willing, and able to purchase the property where they elected not to sign the purchase agreement, notwithstanding that the same individuals successfully bid for the property at a foreclosure sale the next day).

(n13)Footnote 7.1. *See Coldwell Banker Town & Country Realty of Hastings, Inc. v. Johnson*, 249 Neb. 523, 544 N.W.2d 360, 363 (1996) .

(n14)Footnote 8. Restatement (Second) Agency § 445 *comment d* states:

Irrespective of the completeness of the terms given the broker, if he is paid when he finds a customer "able, ready and willing", he is entitled to his commission if he finds such a customer who enters an oral agreement with the principal which he is willing to perform at the time fixed for the performance of the transaction, even though the agreement is not binding upon the principal; after the oral contract has been made the principal cannot avoid payment to the broker by refusing to perform it. If the broker produces a

customer who, without misrepresentation as to his assets or his intent to purchase, makes a binding contract with the principal, the broker's right to his commission is not defeated by a subsequent default on the customer's part, unless the principal's promise to the broker is expressed to be conditional upon actual performance by the customer, or unless the broker has failed to reveal to the principal facts known to him which would indicate the likelihood of such default, or unless he is guilty of some similar breach of duty to the principal.

See De Angelis v. Graham, 96 A.D.2d 570, 465 N.Y.S.2d 258 (2d Dept. 1983) (lack of sufficient writing does not determine right to recover commission).

(n15)Footnote 9. 143 Vt. 335, 465 A.2d 777 (1983) .

(n16)Footnote 10. *Id.*, 465 A.2d at 779 .

(n17)Footnote 11. *Donovan v. Weed*, 182 N.Y. 43, 74 N.E. 563 (1905) ; *Sibbald v. The Bethlehem Iron Co.*, 83 N.Y. 378, 383-384 (1881) . *See also Muldoon v. Silvestre*, 283 A.D. 886, 129 N.Y.S.2d 420, 1954 N.Y. App. Div. LEXIS 5648 (2d Dept. 1954) .

(n18)Footnote 12. *In re Fox's Will*, 126 N.Y.S.2d 158 (Sur. Ct. 1953) ; *Baker v. Thomas*, 12 Misc. 432, 1895 N.Y. Misc. LEXIS 431, 33 N.Y.S. 613 (1895) ; *Wylie v. Marine Nat'l Bank*, 61 N.Y. 415 (1875) . While it may be said that only one broker can be the effectuating cause of procuring a customer [*Sussdorff v. Schmidt*, 55 N.Y. 319 (1873) ; *Bickart v. Hoffmann*, 46 N.Y. St. Rep. 886 (1892)] , this does not aid one in making sure that he pays the right broker. As to the effect of a stipulation in a sales contract, that the named broker brought about the sale, *see Hevia v. Wheelock*, 155 A.D. 387, 140 N.Y.S. 351 (2d Dept. 1913) . Such stipulation is only an evidentiary factor and not the basis of liability. *See also*:

Federal: Coldwell Banker Residential Real Estate v. O'Brien & Assocs., 762 F. Supp. 131 (E.D. Va. 1991) (where one broker may have been the first to show the subject property to the ultimate buyer, the court found that he could not sustain his claim against the listing brokers as being the procuring cause of the sale, since he lacked an agency employment relationship with the seller).

Alabama: First Real Estate Corp. of Alabama, Inc. v. Spiller, 603 So. 2d 954 (Ala. 1992) (the Alabama Supreme Court held that evidence showed that the plaintiff-broker was not the procuring cause of the sale on the subject property and that it did not have an exclusive agency contract with the vendor).

Nebraska: Coldwell Banker Town & Country Realty of Hastings, Inc. v. Johnson, 249 Neb. 523, 544 N.W.2d 360 (Neb. 1996) (broker was not entitled to a commission, where the sale, made after the listing agreement terminated, to purchaser obtained by the broker was consummated as the result of the work done by the seller's attorney on terms substantially different from those in the purchase offer negotiated by the broker).

North Dakota: Schmidt v. First Nat'l Bank & Trust Co., 453 N.W.2d 602 (N.D. 1990) (finding that a broker who procured a prospective purchaser who only sought an option to purchase the seller's property was not entitled to a commission).

(n19)Footnote 13. *See Re/Max Homes and Estates, Inc. v. Leist*, 308 A.D.2d 439, 440, 764 N.Y.S.2d 107, 109, 2003 N.Y. App. Div. LEXIS 9258 (2d Dept. 2003) ; *Boyert v. Tauber*, 834 S.W.2d 60, 35 Tex. Sup. Ct. J. 1092 (Tex. 1992) .

(n20)Footnote 14. *Bersani v. Basset*, 184 A.D.2d 996, 585 N.Y.S.2d 245, 1992 N.Y. App. Div. LEXIS 8213 (4th

Dept. 1992).

(n21)Footnote 15. *Brown, Wheelock, Harris, Stevens, Inc. v. Coty, Inc.*, 291 N.Y. 601, 50 N.E.2d 1011, *aff'd*, (no op.) 265 A.D. 1048, 39 N.Y.S.2d 848, 1943 N.Y. App. Div. LEXIS 6833 (1st Dept. 1943); *Seckendorff v. Halsey, Stuart & Co. Inc.*, 259 N.Y. 353, 182 N.E. 14 (1932). In the *Seckendorff* case, not only did eighteen months elapse between employment of the broker and consummation of the deal, but in the interim there was a period of suspended animation, so to speak, and when the deal was revived, it took a modified form with new parties becoming interested in the syndicate employing the plaintiff.

See also:

Louisiana: Moody v. Thibodeaux, 495 So. 2d 1328 (La. Ct. App. 1986) (when the evidence supports a finding that a real estate broker actually was the procuring cause of an ultimate sale, even though the sale took place after the listing agreement expired, the broker was entitled to the sales commission).

New York: American Corporate Real Estate, Inc. v. Lifetime Hoan Corp., 233 A.D.2d 413, 650 N.Y.S.2d 271, 1996 N.Y. App. Div. LEXIS 11973 (2d Dept. 1996) (broker was not entitled to a commission, where the building ultimately purchased was not available for purchase at the time the broker brought the building to the buyer's attention nor during the time the broker claimed to have performed under an alleged oral exclusive broker's agreement with the buyer).

Pennsylvania: Strout Realty Inc. v. Haverstock, 555 A.2d 210 (Pa. Super. 1989) (realty corporation, through its agent, was the efficient procuring cause of sale of property; therefore, a commission was due).

(n22)Footnote 16. See:

Arkansas: McKay & Co. v. Garland, 701 S.W.2d 392 (Ark. Ct. App. 1986) (sham conveyance arranged to attempt to defeat recovery of commission and ultimate sale by owner).

New Hampshire: Finlay v. Frederick, 135 N.H. 482, 606 A.2d 1375 (N.H. 1992) (holding that it was irrelevant, for purposes of the payment of the broker's commission, that the owner carried on the negotiations that ultimately led to the agreement).

New York: Lloyd v. Matthews, 51 N.Y. 124 (1872); *Sholom & Zuckerbrot Realty Corp. v. 101 Fleet Place Assocs.*, 206 A.D.2d 965, 615 N.Y.S.2d 148, 1994 N.Y. App. Div. LEXIS 7670 (4th Dept. 1994); *Fanning v. Maggi*, 127 N.Y.S.2d 152, 1952 N.Y. Misc. LEXIS 2332 (Sup. Ct. Rockland County 1953); *Shapiro v. Greenwich Sav. Bank*, 266 A.D. 359, 42 N.Y.S.2d 316 (1st Dept. 1943), *aff'd*, (no op.) 293 N.Y. 724, 56 N.E.2d 734 (1944); *Karlin v. Heller*, 137 Misc. 261, 1930 N.Y. Misc. LEXIS 1283, 242 N.Y.S. 188 (City Ct. Bronx County 1930).

North Carolina: Koger Properties, Inc. v. Lowe, 106 N.C. App. 387, 416 S.E.2d 585 (1992) (merely furnishing the name to a prospective lessor under a letter of registration was enough to support an action for commission).

(n23)Footnote 16.1. See *Goldstein v. Ballirano*, 694 N.Y.S.2d 404, 405, 1999 N.Y. App. Div. LEXIS 7029 (1999) (absent special agreement, broker does not automatically earn a commission simply because he initially calls the property to the attention of the ultimate lessee).

(n24)Footnote 17. *Lloyd v. Matthews*, 51 N.Y. 124 (1872) . See also:

Federal: Risser v. Hirshhorn, 199 F.2d 917 (2d Cir. 1952) .

New York: Cohen v. City Bank Farmers Trust Co., 276 A.D. 195, 93 N.Y.S.2d 609, 1949 N.Y. App. Div. LEXIS 3142 (1st Dept. 1949) (on the question of lack of knowledge of the customer by the principal where there is a question of fraud).

(n25)Footnote 18. *Farm Credit Bank of St. Louis v. Miller*, 316 Ark. 388, 872 S.W.2d 376 (1994) .

(n26)Footnote 18.1. See *Shalimar v. F.D.I.C.*, 257 Va. 565, 515 S.E.2d 120, 124 (Va. 1999) (the owner who entered into a listing agreement subsequently went into receivership and the property was transferred to new financial institution, the listing agreement was terminated prior to the receivership).

(n27)Footnote 19. *Lockhart v. Hamlin*, 190 N.Y. 132, 82 N.E. 1094 (1907) . But see *Karlin v. Heller*, 137 Misc. 261, 1930 N.Y. Misc. LEXIS 1283, 242 N.Y.S. 188 (City Ct. Bronx County 1930) , as to conversations between the defendant seller and the prospective purchaser.

(n28)Footnote 20. 1 Williston, Contracts § 922 (3d ed. Forms). See also *Greene v. Hellman*, 51 N.Y.2d 197, 433 N.Y.S.2d 75, 412 N.E.2d 1301 (1980) .

A caution should be noted as to the suggested broker's clause in the text on the matter of planning and drafting. While the clause suggested may appear acceptable to both a vendor and purchaser as a rational design to reduce risks of brokerage claims, the clause is not entirely free of such risks. It might be seized upon by a competing claimant to a commission as evidence of tortious conspiratorial conduct on the part of the purchaser and vendor. The claim would be that the design was to give the appearance of legitimacy to a scheme that in reality was conduct inducing a breach of the competing claimant's contract for a commission. See *Hornstein v. Podwitz*, 254 N.Y. 443, 173 N.E. 674 (1930) . The presence of such a clause could thus be the basis of joining the purchaser as a party defendant in a brokerage action on the allegation (stated on "information and belief") that the purchaser conspired with the seller to deprive the suing broker of a commission--a tort claim. (cf. *Julien J. Studley, Inc. v. Gulf Oil Corp.*, 386 F.2d 161, 167-68 (2d Cir. 1967)) ; see also *Collins Tuttle & Co. v. Ausnit*, 95 A.D.2d 668, 463 N.Y.S.2d 219, 1983 N.Y. App. Div. LEXIS 18561 (1st Dept. 1983) . Such a claim contains a suggestion of unfair dealing--something more than a controversy based on mere business differences, with the consequent need to defend against that unsavory intimation. Thus, caution by the purchaser, in the light of the facts which may prevail, may compel an insistence by the purchaser that any contract provision be limited to a statement of the names of the parties that the purchaser dealt with (as distinguished from the "broker who brought about the sale"). Added to the clause can be a statement that the purchaser makes no warranty as to the party entitled to a commission, with the seller agreeing to pay whatever brokerage commission that derives from the transaction, other than from a hiring of a broker by the purchaser. The question that still remains, nevertheless, even with amendments to the clause, is whether, with *Studley* as a warning sign, the clause in its final version in a particular fact situation may create more problems than it was intended to resolve, with the preferable course being to omit the clause completely--recalling the wisdom that the wicked flee when no man pursueth, but the righteous are bold as a lion.

Finally, we note that while a brokerage clause may give the impression that it is a matter of secondary importance, the clause may, in fact, not have that status at all. Rather, it may be a matter of first-line importance to the seller--i.e., an "essential term" of the overall bargain on which the broker must come to an understanding with the seller if the broker is to be entitled to a commission. (See § 4.07[5] below). (cf. *Albert Bialek Assocs., Inc. v. Arden-Esquire Realty Co.*, 110 A.D.2d 578, 487 N.Y.S.2d 794 (1st Dept.) , *aff'd*, 65 N.Y.2d 1020, 484 N.E.2d 667 (1985)) .

(n29)Footnote 20.05. See, e.g., *Premier Realty, LLC v. I.T.J. Investments, Inc.*, 42 Kan. App. 2d 148, 154-55, 209

P.3d 741, 747 (2009); Sudeen v. Castleberry, 794 So. 2d 237, 246 (Miss. Ct. App. 2001).

(n30)Footnote 20.1. *See Sudeen v. Castleberry, 794 So. 2d 237, 245 (Miss. Ct. App. 2001).*

(n31)Footnote 20.2. *37 Kan. App. 2d 932, 936, 159 P.3d 215, 219-20 (2007).*

(n32)Footnote 21. *Thoens v. J.A. Kennedy Realty Corp., 279 A.D. 216, 108 N.Y.S.2d 882, aff'd, 304 N.Y. 753, 108 N.E.2d 616 (1st Dept. 1951).*

See also:

Illinois: Real Estate Buyer's Agents, Inc. v. Foster, 234 Ill. App. 3d 257, 600 N.E.2d 83 (1992) (where the plaintiff-broker was offered a 3% commission if it was able to find a buyer on the defendant's terms, and the broker obtained a signed offer for the property on the defendant's terms, but the defendant refused to sign, the plaintiff's small claims action for recovery of the commission was dismissed as being within the statute of frauds, since the contract for the sale of the property was unsigned).

Missouri: Malone v. Johnson, 866 S.W.2d 935 (Mo. App. 1993) (holding that the selling broker was not entitled to a commission where the parties had not agreed to the terms and conditions).

New York: Posson v. Hayes, 37 A.D.3d 936, 937, 829 N.Y.S.2d 286, 288, 2007 N.Y. App. Div. LEXIS 1430 (2007) (The broker must bring the parties in agreement not only with respect to the price but "to all terms customarily encountered in such a transaction" before the commission is earned.); *Kling Real Estate, Ltd. v. DePalma, 306 A.D.2d 445, 445-446, 762 N.Y.S.2d 256, 257, 2003 N.Y. App. Div. LEXIS 7397 (2d Dept. 2003), appeal denied, 100 N.Y.2d 516, 769 N.Y.S. 2d 203, 801 N.E.2d 424 (2003)* (prospective purchasers' unilateral modification of the proposed sales contracts constituted a counter offer which the seller rejected; since there was no meeting of the minds as to an essential term of the agreement, the prospective purchasers were not ready, willing, and able to purchase on the sellers' terms).

Texas: Collins v. Beste, 840 S.W.2d 788 (Tex. App. 1992) writ denied (Apr. 14, 1993) (where an employer accepted and received the benefit from the real estate sales generated by a broker, the court upheld the enforceability of the parties commission agreement, even though the agreement did not precisely describe the property).

(n33)Footnote 22. *Mengel v. Lawrence, 276 A.D. 180, 93 N.Y.S.2d 443 (1st Dept. 1949).*

(n34)Footnote 23. *See Kaelin v. Warner, 27 N.Y.2d 352, 267 N.E.2d 86 (1971).*

(n35)Footnote 24. *Thoens v. J.A. Kennedy Realty Corp., 279 A.D. 216, 108 N.Y.S.2d 882, 1951 N.Y. App. Div. LEXIS 2902 (1st Dept.), aff'd, 304 N.Y. 753, 108 N.E.2d 616 (1951).*

(n36)Footnote 25. *See § 4.11[5] below.*

(n37)Footnote 26. *Scanlon v. Jensen, 867 P.2d 560 (Or. App. 1994)* (the broker earned his \$70,000 commission related to the exchange of the client's apartment building and ultimate sale of the exchanged property, in spite of the fact that properties other than those originally contemplated at the time of the agreement were traded for the apartments). *But see Barry Mogul and Assocs., Inc. v. Terrestris Dev. Co., 643 N.E.2d 245 (Ill. App. 2d Dist 1994)* (an agent whose compensation is subject to a clearly expressed condition is not entitled to compensation if, as a result of the agent's efforts, a transaction is effected on different or modified terms).

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93 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.08

§ 4.08 Effect of Breach of Fiduciary Duty

As an agent of the party who employs him, the broker is viewed as a fiduciary and comes under the duty of good faith and subordination of his own interests to those of his principal. n1 Not only must the broker refrain from misrepresentation or other affirmative wrong to his principal; full and fair disclosure of all facts pertaining to their mutual dealing is required. n2 As a general rule, if the broker violates his fiduciary duty, he is not entitled to a commission and must make restitution on a commission previously collected. In the changing law of agency, as more states revise their licensing laws to change the scope of agency of real estate licensees, this becomes a much more complex issue. n3 In such a case Judge Cardozo stated "Commissions were not earned unless duty has been done." n4

In addition, a broker or other agent employed by an intending purchaser to assist in acquiring a property, who instead acquires it for himself, will be held as a constructive trustee of the property and will be required to transfer title to his principal upon reimbursement for his outlay. n5 This must be distinguished from the situation where two parties orally agree to become co-tenants of a property to be initially acquired by one of them with his own funds. When he subsequently refuses to convey an interest therein to the other, his promise is usually held unenforceable under the statute of frauds. n6

Although a broker employed by a vendor is not ordinarily in a fiduciary relationship with the prospective purchaser he may become liable to the purchaser for secret profits he acquires through misrepresentation. n7

A particular circumstance that raises issues regarding a broker's right to a commission occurs when the broker breaches his or her fiduciary duty by engaging in an undisclosed dual agency. Though courts are split, it appears that the majority rule is that a broker is entitled to no commission if the broker fails to timely disclose to the seller that the broker is also representing the buyer. n8 However, there are jurisdictions that have allowed a broker to receive a commission in this circumstance. n9 In addition, some courts have held that if an agent has assumed to act in a double capacity, a principal with no knowledge of the dual representation may avoid the transaction. n10

FOOTNOTES:

(n1)Footnote 1.

New Jersey: Young v. Hughes, 32 N.J. Eq. 372 (E.P.A. 1880) .

New York: Haydock v. Stow, 40 N.Y. 363 (1869) .

Oklahoma: Wilcox v. Reynolds, 169 Okla. 153, 36 P.2d 488 (1934) .

For discussion of the nature of the broker's duties and liabilities, *see* ch. 3 *above*

(n2)Footnote 2.

Alabama: Eastburn v. Espalla, 215 Ala. 650, 112 So. 232 (1927) .

Arkansas: Bennett v. Thompson, 126 Ark. 61, 189 S.W. 363 (1916) .

California: Rattray v. Scudder, 28 Cal. 2d 214, 169 P.2d 371 (1946) .

Massachusetts: Veasey v. Garson, 177 Mass. 117, 58 N.E. 177 (1900) .

(n3)Footnote 3. *See id*

The problems of divided loyalty are ably discussed in Currier, *Finding the Broker's Place in the Typical Residential Real Estate Transactions*, 33 U. Fla. L. Rev. 655 (1981). The author comments:

Obtaining the seller's consent to a dual agency arrangement is another problem. Optimally, a seller would consent to his broker acting as dual agent with respect to all buyers working with the broker so that separate consent would not need to be obtained for each client. If the agency relationship with the buyer commences at or near the outset of the broker's contact with each prospect, the seller's consent to the dual agency should be contained in the listing agreement. A seller who understands the implications of buyer-broker agency might be deterred from fully explaining his hopes and expectations about the sale to the broker. This would interfere with the broker's satisfactory servicing of seller's needs. Sellers might, therefore, resist dual agency.

Id. at 675 (footnotes omitted).

See:

California: Huijers v. DeMarrais, 11 Cal. App. 4th 676, 14 Cal. Rptr. 2d 232 (Cal. Ct. App. 1992) (where a dual agent failed to provide the seller with his dual representation form, thereby failing to disclose his dual representation of the buyer and seller, the court awarded damages to the seller and denied the recovery of the commission, even though the seller suffered no injury).

Idaho: Enright v. Jonassen, 931 P.2d 1212 (Idaho 1997) (purchasers in action alleging broker's breach of fiduciary duty lacked standing to pursue disgorgement of broker's commission paid out of funds that the seller received for sale of the property).

Illinois: Bear Kaufman Realty, Inc. v. Spec Dev., Inc., 645 N.E.2d 244 (Ill. App. 1 Dist. 1994) (a broker's failure to inform the seller of the identity of a prospective purchaser procured by the broker is a breach of fiduciary duty and may preclude recovery by the broker of a commission).

New York: Donati v. Shaffer, 83 N.Y.2d 828, 611 N.Y.S.2d 495 (1994) (holding that the New York Secretary of State has the authority to require interest payments to be added to restitution for a wrongfully obtained commission).

(n4)Footnote 4. *Wendt v. Fischer*, 243 N.Y. 439, 154 N.E. 303 (1926) .

(n5)Footnote 5.

Florida: Quinn v. Phipps, 93 Fla. 805 . 113 So. 419 (1927) .

Massachusetts: Berenson v. Nirenstein, 326 Mass. 285, 93 N.E.2d 610 (1950) .

New Jersey: Harrop v. Cole, 85 N.J. Eq. 32, 95 A. 378, 379 (1915) , *aff'd*, 86 N.J. Eq. 250, 98 A. 1085 (1916) . *Stevenson, V.C.* stated:

When one man assumes to act as agent for another, as the representative of another, he necessarily establishes a fiduciary relation between himself and the other person who stands as his principal. This is in the very nature of the transaction because the agent undertakes to act, not for his own benefit, but for the benefit of his principal, and his principal stays out of his own business, and confides in the agent to attend to this business for him. It is the assumption by the agent of his representative status and the confidence necessarily reposed in him by the principal which create the agent's peculiar liabilities and cast special limitations and obligations upon him. The agency may be established by a written contract, or a verbal contract, or no contract whatever, the assumption and confidence involving a purely gratuitous service, for which the agent is to receive no compensation in any form.

New York: Kaplan v. Meyer, 271 A.D. 837, 65 N.Y.S.2d 765, 1946 N.Y. App. Div. LEXIS 3358 (2d Dept. 1946) .

Pennsylvania: Hamberg v. Barsky, 355 Pa. 462, 50 A.2d 345 (1947) .

Wisconsin: Krzysko v. Gaudynski, 207 Wis. 608, 242 N.W. 186 (1932) .

(n6)Footnote 6.

Missouri: Cohn v. Jefferson Sav. & Loan Ass'n, 349 S.W.2d 854 (Mo. 1961) .

New Hampshire: Clark v. Lovelace, 102 N.H. 97, 151 A.2d 224 (1959) .

New York: Bauman v. Holzhausen, 26 Hun. 505 (N.Y. Gen Term 1882) ; *Eidelberg v. Zellermyer*, 5 A.D.2d 658, 174 N.Y.S.2d 300 , *aff'd*, 6 N.Y.2d 815, 188 N.Y.S.2d 204, 159 N.E.2d 691 (1958) (distinguishing partnership agreements).

Vermont: Pinnock v. Clough, 16 Vt. 500, 42 Am. Dec. 521 (1844) .

(n7)Footnote 7.

California: Ward v. Taggart, 51 Cal. 2d 736, 336 P.2d 534 (1959) .

Maryland: Homa v. Friendly Mobile Manor, 93 Md. App. 337, 359, 612 A.2d 322, 329 (1992) , *appeal dismissed without opinion*, 330 Md. 318, 624 A.2d 490 (1993) (holding that a broker lost his right to a commission when he failed to inform the seller of an impending financial interest in an assignee of the purchase agreement).

New York: All Industrial Real Estate Corp. v. Northgate Plaza, 186 A.D.2d 103, 587 N.Y.S.2d 708, 1992 N.Y. App. Div. LEXIS 10558 (2d Dept. 1992) (holding that a real estate broker was entitled to summary judgment against a landlord to recover its entire brokerage commission, where it was uncontroverted that it procured a tenant ready and willing to enter into a lease, and the tenant paid the first four month's rent, which according to the brokerage agreement, rendered the commission enforceable).

Vermont: Quechee Lakes Rental Corp. v. Boggess, 158 Vt. 258, 608 A.2d 39 (Vt. 1992) (holding that a real estate agent owed a fiduciary duty to disclose to its principal any material information relevant to the sale, and that the agent's failure to communicate promptly to buyers that the seller had rescinded his counteroffer and was willing to accept buyers' last offer constituted a material breach of the agent's duty to the seller).

(n8)Footnote 8. Courts so holding include:

California: McConnell v. Cowan, 44 Cal. 2d 805, 809, 285 P.2d 261, 264 (1955) (neither principal is liable for the commission unless both knew of the dual representation); *Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 685-686, 14 Cal. Rptr. 2d 232, 238 (1992) , *review denied* (Mar. 11, 1993).

Georgia: Richardson v. Dupree, 32 Ga. App. 3, 4, 122 S.E. 707 (1924) , *cert. denied* (where a broker's dual agency is relied on to defeat a claim for commissions, the defendant must prove, not only the fact of such dual agency, but also that it was not known to both parties).

Illinois: Duffy v. Setchell, 38 Ill. App. 3d 146, 150, 347 N.E.2d 218, 222 (1976) (a broker who has acted for both buyer and seller without the full knowledge of both is not allowed to recover compensation from either).

Kansas: Crawford v. The Surety Investment Co., 91 Kan. 748, 752, 139 P. 481, 482-483 (Kan. 1914) (a dual agent may not recover a commission from either principal without a showing that each of the principals had full knowledge of all the circumstances and assented to the double employment).

Minnesota: PMH Properties v. Nichols, 263 N.W.2d 799, 802 (Minn. 1978) .

Ohio: Reef v. Nagle, 85 Ohio App. 323, 326, 40 Ohio Op. 213, 88 N.E.2d 424, 425 (1949) .

Texas: Clark v. Price, 112 S.W.2d 256, 257 (Tex. Civ. App. 1937) , *writ of error dismissed for want of jurisdiction*.

Washington: Investment Exchange Realty, Inc. v. Hillcrest Bowl, Inc., 82 Wash. 2d 714, 718, 513 P.2d 282, 284 (Wash. 1973) (commercial lease transaction).

(n9)Footnote 9. See *Highlands Business Park, LLC v. Grubb & Ellis Co.*, 2005 Ohio 3139, 2005 Ohio App. LEXIS

2938, at *18 (June 23, 2005) (commission was earned on a commercial lease).

(n10)Footnote 10. See:

California: McConnell v. Cowan, 44 Cal. 2d 805, 809, 285 P.2d 261, 264 (1955) ; *Huijers v. DeMarrais*, 11 Cal. App. 4th 676, 685-686, 14 Cal. Rptr. 2d 232, 238 (1992) , review denied (Mar. 11, 1993).

Florida: Quest v. Barge, 41 So. 2d 158, 162-163 (Fla. 1949) .

Illinois: Duffy v. Setchell, 38 Ill. App. 3d 146, 149-150, 347 N.E.2d 218, 221 (1976) .

Minnesota: PMH Properties v. Nichols, 263 N.W.2d 799, 802 (Minn. 1978) .

Cf. Governor's Ranch Professional Center, Ltd. v. Mercy of Colorado, Inc., 793 P.2d 648, 651 (Colo. Ct. App. 1990) (when founded on the dual agency defense, a summary judgment granting rescission of a contract may be upheld only if it is undisputed that the alleged agent represented two principals with respect to the transaction, the principals had no knowledge of the common agency, and the party seeking to void the transaction has not waived the remedy of rescission by representing that it intended to perform after learning of the dual agency.); *Mohnk v. Seyfarth*, 339 Ill. 371, 380, 171 N.E. 510, 514 (Ill. 1930) (if the agent is in the secret employment of the purchaser, a contract between the principal and purchaser through the agent's efforts is not binding upon the principal and that fact is a good defense to a bill for specific performance).

* This chapter was revised by Charles J. Jacobus, Esq., a partner in the firm of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas. In 1999, Sections 4.01 through 4.03 were revised by Mary Fallon, Esq. Additional updates were contributed by Sandra Bullington, Esq.



94 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.09

§ 4.09 Effect of Eminent Domain

There may be incidences where the property listed by a broker is involved in condemnation proceedings. It is unsettled whether the broker becomes entitled to a commission where the property is taken by a governmental entity n1 through its power of eminent domain, or where the property is sold to the government after condemnation proceedings. In *Dalvis v. Coz*, n2 the court held that the broker was not entitled to a commission where:

- (1) the defendant-seller owned a recreational property for which the municipality had a right of first refusal on any sale;
- (2) a broker entered into a brokerage agreement with the seller with full knowledge of the municipality's right; and
- (3) the municipality exercised its right by matching a \$1.3 million offer to the seller.

The determinative question is whether such transfer constitutes a "sale." n3 Some courts have suggested that the following three-prong test be used in order to determine whether there was a sale:

- (1) whether the owner has been deprived of the power to negotiate what property should be sold;
- (2) whether the owner has been deprived of the power to negotiate the time when possession should be given; and
- (3) whether the owner has been deprived of the power to negotiate the price. n4

It is clear under condemnation proceedings that the property owner does not sell his property under the aforementioned test. n5 Furthermore, the broker offers his services to produce a ready, willing and able buyer, and does not offer to produce a condemnation of the listed property by a public authority. n6 Therefore, the fact that the seller receives a higher price than originally listed does not alter the general rule of no commission. n7

The rule of no commission has been adopted in those cases where the seller agrees to sell to the governmental entity in

light of pending or threatening condemnation proceedings. n8 Even where the broker is the procuring catalyst, a commission will not normally be awarded. n9 This is based upon the conclusion that the agreement is the "practical equivalent of a condemnation." n10 However, in most cases of condemnation, the broker is not the efficient cause of the sale. n11

A broker may be awarded a commission where the seller contracts with the broker to sell the property to the governmental entity. Where an agreement to sell to the governmental entity fails to transpire and the government obtains the property by eminent domain, the broker may be able to obtain a commission. n12 However, there must be a defect in the title, and a refusal by the seller to cure, so that the sale to the governmental entity failed due to the defect in the seller's title. n13 Similarly, where the broker's agreement could be construed to allow a commission for finding a purchaser, instead of limited to commission on a sale, and the broker procures the government as purchaser, but the seller frustrates the purchase and the government then condemns the property, a commission may be due. n14 The exceptions to the general rule of no commission have generally involved a seller who contacts the broker to sell the property to the government and problems arose that led to a condemnation instead of a voluntary sale. n15

In order to protect themselves from losing the potential commission, brokers could include a clause in the brokerage agreement that provides that a commission will be due if the property is condemned by the government during the period of the agreement. n16 Furthermore, a broker could seek recovery under the theory of quantum meruit. n17

Where the broker has procured a third party to purchase the property, but the property is condemned before the transfer is complete, a commission is not due under the brokerage agreement. n18 Courts have indicated that since the sale is not consummated, no commission is necessary. It would seem in such a situation that there is a basis to seek relief under quantum meruit. n19

The Supreme Court of Florida has considered whether a commission was due where the seller and broker specifically contemplated condemnation as an alternative to a sale. n20 The court found that in this situation, ordinary contract principles should apply to determine the existence and parameters of a commission agreement. n21 In coming to this holding, the Florida high court considered *Wilson v. Frederick R. Ross Investment Co.*, n22 which it described as the first case to consider whether a real estate broker was entitled to a commission for condemnation of the property. n23 *Wilson* denied the broker a commission, reasoning that in a condemnation proceeding, the owner cannot designate or negotiate the property to be sold, cannot determine when the grantee may take possession, and cannot refuse to transfer the property if the offered price is inadequate, but must either reach an accord or litigate the question of just compensation. But the Florida high court stated that the court in *Wilson* did not intimate that its holding would apply where the owner sought condemnation. n24

The Florida court stated that since *Wilson*, other courts had held that condemnation can never constitute a sale for purposes of a brokerage commission. n25 The Florida court also observed, however, that the rule was not always strictly applied and that some courts had considered the facts of a particular case. n26 The Florida court stated that a recurring theme of these cases was that when property was condemned, the owner was not a willing seller.

The case before the Florida court presented a different situation as the seller had not only consented to the condemnation, but had specifically sought condemnation when a traditional sale appeared unlikely. The court stated that while *Wilson* may apply where the condemnation was involuntary, the court did not believe the holding in *Wilson* was intended to apply where the property owner authorized the broker to seek condemnation. The court found that in the circumstances of voluntary condemnations, whether a broker is entitled to a commission for condemnation of property should be analyzed according to ordinary contract principles, including those applicable to oral contracts and contract modification, with the focus being on the agreed scope of the broker's employment. n27

FOOTNOTES:

(n1)Footnote 1. The governmental entity may include the federal government. *See, e.g., Mealey v. Orlich, 120 Ariz.*

321, 585 P.2d 1233 (1978) (Uniform Real Acquisite Policy Act of 1970, 42 U.S.C. § 4651).

(n2)Footnote 2. 594 N.E.2d 890 (Mass. App. Ct. 1992) .

(n3)Footnote 3. *Lundstrom, Inc. v. Nikkei Concerns, Inc.*, 52 Wash. App. 250, 758 P.2d 561 (1988) . See also *Sonday v. Dave Kohel Agency, Inc.*, 2006 WI 92, 293 Wis. 2d 458, 482, 718 N.W.2d 631, 642-43 (2006) . This court stated "The jurisdictions that have concluded that a transfer of property by condemnation does not constitute a sale for purposes of a broker's commission have relied on the fact that the brokerage contract under review did not contain any explicit reference to a condemnation action."

(n4)Footnote 4.

Colorado: Wilson v. Frederick R. Ross, Inc., 116 Colo. 249, 180 P.2d 226 (1947) .

New York: Shaw v. Avenue D Stores, Inc., 115 N.Y.S.2d 194, 1952 N.Y. Misc. LEXIS 1648 (Sup. Ct. 1952) .

But cf. McIver v. St. Joe Corp., 828 So. 2d 394, 397-399 (Fla. Dist. Ct. App. 2002) (The three factors are not a bright-line rule that once the state has initiated a condemnation action, any conveyance that occurs while that action is pending does not constitute a sale for purposes of a broker's commission, unless the brokerage agreement provides for such a contingency. Instead, the three-factor test should be examined in light of the facts in each case.).

(n5)Footnote 5. See, e.g., *Dauer v. Pichowski*, 413 So. 2d 62, 63-4 (Fla. Dist. Ct. App. 1982) , review denied, 419 So. 2d 1199 (Fla. 1982) , overruled in part, *St. Joe Corp. v. McIver*, 875 So. 2d 375, 377 (Fla. 2004) .

(n6)Footnote 6. *Schwenn v. S. Goldberg & Co., Inc.*, 88 N.J. Super. 113, 210 A.2d 808 (Law. Div. 1965) , *aff'd on opinion below*, 91 N.J. Super. 346, 220 A.2d 421 (App. Div.) , cert. denied, 48 N.J. 111, 223 A.2d 490 (1966) . The court noted that in "strict terms, the condemnation did not represent performance by [the] broker."

(n7)Footnote 7. *Id.*

(n8)Footnote 8. See, e.g., *Preston v. Carnation Co.*, 196 Cal. App. 2d 43, 16 Cal. Rptr. 240 (1961) .

(n9)Footnote 9. See, e.g., *Dauer v. Pichowski*, 413 So. 2d 62, 63-4 (Fla. Dist. Ct. App. 1982) , review denied, 419 So. 2d 1199 (Fla. 1982) , overruled in part, *St. Joe Corp. v. McIver*, 875 So. 2d 375, 377 (Fla. 2004) .

But see Sonday v. Dave Kohel Agency, Inc., 2006 WI 92, 293 Wis. 2d 458, 718 N.W.2d 631 (2006) (A transfer of property by a condemnation action constituted a sale under the contract terms. The broker was entitled to a commission based on the jurisdictional award. Public policy did not preclude recovery of this commission.).

(n10)Footnote 10. *Mealey v. Orlich*, 120 Ariz. 321, 585 P.2d 1233 (1978) .

(n11)Footnote 11. See, e.g., *Morgan v. Ezzard*, 121 Ga. App. 208, 173 S.E.2d 423 (1970) .

(n12)Footnote 12.

California: But see Preston v. Carnation Co., 196 Cal. App. 2d 43, 16 Cal. Rptr. 240 (1961) .

New York: Tyler v. Seiler, 76 Misc. 185, 1912 N.Y. Misc. LEXIS 772, 136 N.Y.S. 394 (App. Term. 1912) .

(n13)Footnote 13. *Lundstrom, Inc. v. Nikkei Concerns, Inc.*, 52 Wash. App. 250, 758 P.2d 561 (1988) (distinguishing *Tyler v. Seller*). In other words, in *Tyler* the broker procured the city as a ready, willing and able buyer so that the commission was earned at that time (See ch. 5 below). Therefore, the fact that the seller defaulted on the sale forcing the city to condemn the property did not undermine the broker's right to commission.

(N14)Footnote 14. See, e.g., *Keyes Co. v. Florida Nursing Corp.*, 340 So. 2d 1254 (Fla. DCA 1976).

(n15)Footnote 15. See, e.g., *Lundstrom, Inc. v. Nikkei Concerns, Inc.*, 52 Wash. App. 250, 758 P.2d 561 (1988).

(n16)Footnote 16. See, e.g.:

New York: *Shaw v. Avenue D Stores, Inc.*, 115 N.Y.S.2d 194, 1952 N.Y. Misc. LEXIS 1648 (1952).

Washington: *Lundstrom, Inc. v. Nikkei Concerns, Inc.*, 52 Wash. App. 250, 758 P.2d 561 (1988).

(n17)Footnote 17. Cf.:

Colorado: *Wilson v. Frederick R. Ross Inv. Co.*, 116 Colo. 249, 180 P.2d 226 (1947).

New York: *Polley v. Plainshun Corp.*, 8 A.D.2d 638, 186 N.Y.S.2d 295, 1959 N.Y. App. Div. LEXIS 8950 (2d Dept. 1959).

(n18)Footnote 18. See, e.g., *City of Turlock v. Paul M. Zagaris, Inc.*, 209 Cal. App. 3d 189, 256 Cal. Rptr. 902 (1989); *Snell v. Wickersham*, 140 Cal. App. 2d 812, 295 P.2d 918 (1956).

(n19)Footnote 19. See, e.g., *Carey v. Cusack*, 245 Cal. App. 2d 57, 54 Cal. Rptr. 244 (1966).

(n20)Footnote 20. See *St. Joe Corp. v. McIver*, 875 So. 2d 375 (Fla. 2004), rehearing denied, 2004 Fla. LEXIS 960 (Fla. June 2, 2004).

(n21)Footnote 21. See *St. Joe Corp. v. McIver*, 875 So. 2d 375, 379 (Fla. 2004), rehearing denied, 2004 Fla. LEXIS 960 (Fla. June 2, 2004).

(n22)Footnote 22. 116 Colo. 249, 180 P.2d 226 (1947).

(n23)Footnote 23. See *St. Joe Corp. v. McIver*, 875 So. 2d 375, 379 (Fla. 2004), rehearing denied, 2004 Fla. LEXIS 960 (Fla. June 2, 2004).

(n24)Footnote 24. See *St. Joe Corp. v. McIver*, 875 So. 2d 375, 380 (Fla. 2004), rehearing denied, 2004 Fla. LEXIS 960 (Fla. June 2, 2004).

(n25)Footnote 25. See *St. Joe Corp. v. McIver*, 875 So. 2d 375, 380 (Fla. 2004), rehearing denied, 2004 Fla. LEXIS 960 (Fla. June 2, 2004), citing *Preston v. Carnation Co.*, 196 Cal. App. 2d 43, 16 Cal. Rptr. 240 (1961); *Haigler v. Ingle*, 119 Colo. 145, 200 P.2d 913 (1948); *Shaw v. Ave. D Stores, Inc.*, 115 N.Y.S.2d 194, 1952 N.Y. Misc. LEXIS 1648 (N.Y. Sup. Ct. 1952).

(n26)Footnote 26. See *St. Joe Corp. v. McIver*, 875 So. 2d 375, 380 (Fla. 2004), rehearing denied, 2004 Fla. LEXIS 960 (Fla. June 2, 2004), citing *Tyler v. Seiler*, 76 Misc. 185, 1912 N.Y. Misc. LEXIS 772, 136 N.Y.S. 394 (N.Y. App. Term 1912) (allowing a commission where the city condemned the property in order to clear a defect in the seller's title that had prevented a voluntary sale); *Keyes Co. v. Florida Nursing Corp.*, 340 So. 2d 1254 (Fla. Dist. Ct. App.

1976) (acknowledging the rule that condemnation does not equate to a sale, but concluding that, despite condemnation, a factual issue remained about whether the owner frustrated the sale to avoid a commission).

(n27)Footnote 27. *See St. Joe Corp. v. McIver*, 875 So. 2d 375, 380-381 (Fla. 2004) , rehearing denied, 2004 Fla. LEXIS 960 (Fla. June 2, 2004) . The court disapproved *Dauer v. Pichowski*, 413 So. 2d 62, 63-64 (Fla. Dist. Ct. App. 1982) , to the extent that it held that a condemnation can never constitute a sale for purposes of a brokerage commission.

* This chapter was revised by Charles J. Jacobus, Esq., a partner in the firm of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas. In 1999, Sections 4.01 through 4.03 were revised by Mary Fallon, Esq. Additional updates were contributed by Sandra Bullington, Esq.



95 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.10

§ 4.10 Broker's Rights Against the Purchaser

[1] The Traditional Rule: Purchaser Not Liable

Since the broker's right to a commission is based on a contract of employment, it has traditionally been held that the broker has no right against one who did not employ him. n1

Consequently, a broker employed by a vendor cannot look to a defaulting purchaser for his commission. n2 This rule can be modified, however, by an agreement between the purchaser and the seller. n3 And in some instances the buyer may agree to pay the broker's commission. n4

The purchaser cannot recover the commission paid to the broker when the vendor is alleged to have engaged in fraud or negligent misrepresentation. The purchaser has no legal interest in the commission paid to the broker by the vendor. n5

New York courts have also held that a defaulting purchaser may not be compelled to indemnify the seller for payment of a real estate licensee's commission in the absence of an express agreement. n6 These courts hold that this is a contractual matter; when there is no contractual indemnification clause in the contract of sale, a claim against the purchaser for a commission is without merit. n7

[2] Exceptional Situations

The advent of buyer's brokers has brought new issues concerning the broker's ability to sue the purchaser for the commission. A buyer's brokerage agreement may provide that the buyer will pay the broker his or her commission. If this is the situation, the brokerage agreement will be interpreted similarly to the traditional agreement usually found between sellers and brokers. The broker's right to a commission will be governed by the agreement, applicable agency law and contract law. n7.1 The parties to a buyer's brokerage agreement can make the broker's compensation dependent upon any lawful condition that they agree to place in their agreement. n7.2

Where a prospective purchaser engages a broker to find a suitable property it is sometimes expressly agreed between them that the broker will look only to the seller for a commission notwithstanding his original employment by the purchaser. While such an agreement will be given effect, it does give rise to a duty on the part of the purchaser that would not otherwise exist. It has been held that willful default by the purchaser that has the effect of absolving the

vendor of the duty to pay a commission violates an implied duty of cooperation running from the purchaser to the broker. n8

Somewhat similar to the above-stated case is the familiar situation where a vendor engages the broker with payment conditioned on closing and the purchaser agrees in the sales contract with the vendor to be responsible for the broker's commission. If the sale is consummated, the broker has standing to enforce the purchaser's promise: The vendor is the promisee, the purchaser is the promisor, and the broker is the third party creditor beneficiary, since performance of the purchaser's promise will discharge an obligation to pay a commission owed by the promisee (the vendor) to the third party (the broker). n9

Note that in this situation there are no dealings between the broker and the purchaser and no direct privity between them. The broker's rights derive wholly from the contract between the vendor and the purchaser. Yet, in an interesting case, the United States Court of Appeals for the First Circuit held the purchaser liable for commissions to the broker under circumstances in which the vendor, who had employed the broker, would not have been liable. In *Massengale v. Transitron Electronic Corp.*, n10 a corporation, Thermo King, engaged a broker to assist in the sale of its business assets. The broker's commission was subject to consummation of the sale. The broker found a prospective purchaser, Transitron, which signed a contract of purchase with Thermo King to acquire all of its assets in exchange for shares of Transitron stock. In the contract with Thermo King, Transitron agreed to pay the commission in the following language:

Transitron and Thermo King each represents that neither of them has retained any broker or paid or agreed to pay any brokerage fee or commission to any agent or broker for or on account of the transaction herein contemplated, except that Thermo King has agreed to pay a fee of \$300,000 to Messrs. McClellan & Burck, Inc. of New York, New York, in the event that the said transactions are consummated, but not otherwise. Such fee shall be paid by Transitron if and when such transactions are effected. n11

Transitron, it was alleged, subsequently breached its contract with Thermo King by raising unjustified objections to Thermo King's financial condition. When the broker's assignee sued Transitron for its unpaid commission the District Court granted summary judgment to the defendant. It reasoned that Transitron only agreed to pay such commission as the promisee, Thermo King, was responsible for; and since Thermo King's duty was conditioned on consummation, which failed through no fault of its own, Thermo King owed no commission; hence, Transitron owed none.

The Court of Appeals reversed and remanded for a trial. The court conceded that, because of the failure to complete, the condition precedent to Thermo King's duty failed, and Thermo King owed no commission. But the court reasoned that it did not follow that Transitron owed nothing. The purchaser was more than a mere guarantor of the seller's contractual duty to the broker. The purchaser, said the court, "has come directly into legal relationship with" the broker, n12 and this relationship made the buyer's duty to the broker "co-extensive" with the seller's. n13 The seller clearly had a duty to the broker not to renege on the contract, thereby causing the condition (consummation of the sale) to fail--had it done so the condition would have been excused. Since the buyer's duty was held to be co-extensive with the seller's, the buyer likewise incurred a similar implied duty, which it violated when it unjustifiably reneged on its contract with the seller.

In evaluating this case it might be noted that the court was quite sweeping in its conclusion that the purchaser's duty to the broker became "co-extensive" with the seller's, by virtue of the quoted clause in the contract of sale. What interest of the promisee (the seller) is served by interpreting the buyer's promise to cover a situation in which the seller was under no obligation to the broker? Since the rights of the third party derive primarily from the manifested intent of the promisee, n14 and since the promisee theoretically must pay for every additional obligation he bargains to have the promisor undertake, it is hard to understand why the buyer's promise was anything more than one to hold the seller harmless for any broker's commission. n15

[3] The Holding of *Ellsworth Dobbs*

It will be recalled that in a previous discussion of the leading modern case of *Ellsworth Dobbs, Inc. v. Johnson*,ⁿ¹⁶ the court in limiting the broker's rights against the vendor who employed him, enlarged his rights against the purchaser whose default occasioned the collapse of the sale. Emphasizing that the prospective purchaser had approached the broker to assist him in obtaining a suitable property, the New Jersey Court stated:

This Court has held that when a prospective buyer solicits a broker to find or to show him property which he might be interested in buying, and the broker finds property satisfactory to him which the owner agrees to sell at the price offered, and the buyer knows the broker will earn commission for the sale from the owner, the law will imply a promise on the part of the buyer to complete the transaction with the owner. If he fails or refuses to do so without valid reason, and thus prevents the broker from earning the commission from the owner, he becomes liable to the broker for breach of the implied promise. The damages chargeable to him will be measured by the amount of commission the broker would have earned from the owner. If no amount or percentage had been agreed upon, recovery will be based on *quantum meruit* and measured by the amount accepted as reasonable according to the usual custom in such brokerage business.ⁿ¹⁷

It will be noted that this rationale does not assume that the broker is a third party beneficiary of the contract between the vendor and the purchaser. It rests on a direct contract, implied in fact, between the purchaser and the broker.ⁿ¹⁸ As in every other brokerage agreement the key concept is that of employment. Where a broker employed by the owner approached the purchaser, the New York Court of Appeals refused as a matter of law to find a double employment.ⁿ¹⁹

[4] The Dobbs Holding Qualified: *Rothman Realty Corp. v. Bereck*

In *Rothman Realty Corp. v. Bereck*,ⁿ²⁰ the New Jersey Supreme Court was confronted with a fact pattern that caused it to qualify some of the sweeping language of the *Dobbs* decision concerning a defaulting purchaser's liability to the broker. In December of 1971 Mr. and Mrs. Bereck consulted the broker, Rothman Realty, with a view to buying a home. Rothman found a suitable home under construction and the Berecks contracted to purchase it, the commission being payable by the vendor on closing. The price of the house was \$135,000. The Berecks made a \$14,000 deposit; the broker was to procure a \$6,000 mortgage commitment and the Berecks were to pay \$61,000 at the closing.

The primary asset owned by the Berecks was 5600 shares of an over-the-counter stock, then worth \$135,000. It was planned to sell some of this stock to raise the money needed at the closing. Before closing, however, adverse information was published concerning the company and in a three-day period its value dropped from \$25.00 to \$9.00 per share, reducing the value of the Berecks' holding from \$135,000 to \$50,000--an amount substantially less than the \$61,000 needed to close. Because of this financial adversity the Berecks failed to close and forfeited their \$14,000 deposit. The suit by Rothman followed.

The trial court found that the purchasers' good faith attempt to close, frustrated by financial inability, took them out of the *Dobbs* ruling. The Appellate Division reversed, holding that only a legally sufficient justification for failure to close could bar the broker's claim. The Supreme Court reversed, holding the buyers in this case not liable for the commission. The Court stated:

The nature of the relationship between the broker and the buyer should be considered in light of all the circumstances. In most cases where individuals are seeking to purchase homes, the members of the public are engaging realtors who, licensed by the State, *N.J.S.A. 45:15-1*, have superior expertise and knowledge with respect to financing acquisitions. They, practically speaking, dominate the market, so that would-be home owners must seek their services. [citation omitted]. To imply an obligation on the part of a buyer that he will pay the broker a commission, even though the buyer has acted in good faith with every intentment of acquiring the premises, but is unavoidably through no fault of his own

prevented from consummating the purchase, is unquestionably contrary to the buyer's expectable understanding when he engages the broker

It must be remembered that the buyer has not entered into any written or formal agreement with the broker, but that the promise between the broker and the buyer has been implied by law. In these circumstances the "risk of such inability at that crucial time [the closing] must be treated as a normal incident of the brokerage business." [citation omitted]. n21

The considerations of relative bargaining power and public policy that made *Bereck* distinguishable from *Dobbs* appear in the following passage:

We held in *Ellsworth Dobbs* that the buyer's inability to obtain the necessary financing was not a defense to the broker's action unless the financial ability contingency was a term, express or implied, in the agreement between the buyer and the broker. However, our holding there is distinguishable. The buyer was not seeking a home, but was a residential developer who agreed to purchase a 144 acre tract of farm land for \$250,000. The buyer was engaged in a commercial enterprise and his position vis-a-vis the broker was quite different than that of the individual who is purchasing a residence. In *Tanner Associates, Inc. v. Ciraldo*, 33 N.J. 51, 161 A.2d 725 (1960) , upon which *Ellsworth Dobbs* relied, the buyer also was a land developer which contracted for the acquisition of a large tract of land for \$220,000. The bargaining power and expertise of such buyers are far superior to those of the average home purchaser. The added protection which we afford to consumer purchasers today is not warranted or required for the type of buyer exemplified in *Ellsworth Dobbs* and *Tanner Associates*. n22

FOOTNOTES:

(n1)Footnote 1.

Ohio: Young v. Equitec Real Estate Investors Fund, 100 Ohio. App. 3d 136, 652 N.E.2d 234 (Ohio App. 8th Dist. 1995) (the lessor remained responsible for paying commissions to the broker arising from lease agreement, notwithstanding subsequent appointment of a receiver for the property in a foreclosure action; the receiver did not become the lessor responsible for the commissions once the receivership opened).

(n2)Footnote 2. Restatement of Agency § 372 (2). See also Annot. 30 A.L.R.3d 1395.

Alabama: Messer-Johnson Realty Co. v. Newman, 210 Ala. 340, 98 So. 20 (1923) .

District of Columbia: Giovannoni v. Waple & James, 105 F.2d 108, 70 App. D.C. 229 (D.C. Cir. 1939) .

Florida: Moss v. Sperry, 140 Fla. 301, 191 So. 531 (1939) .

Georgia: Reynolds Props. v. Bickelmann, 300 Ga. App. 484, 486-87, 685 S.E.2d 450, 452 (2009) (Parties entered into a termination and release agreement when the buyer decided not to complete the transaction.).

Missouri: McIntosh v. Frisinger, 507 S.W.2d 419 (Mo. App. 1974) .

New York: Hoka Prod. Corp. v. Griscom & Co., 40 N.Y.S.2d 54, 1943 N.Y. Misc. LEXIS 1618 (1945) .

Contra:

New Jersey: Ellsworth Dobbs, Inc. v. Johnson, 50 N.J. 528, 236 A.2d 843 (1967) .

Louisiana: Treigle v. Patrick, 138 So. 2d 652 (La. Ct. App. 1962) .

(n3)Footnote 3. *See, e.g.:*

Federal: Park-Haden, Inc. v. Loews Theater Management Corp., 789 F. Supp. 1257 (S.D.N.Y 1992) .

Texas: LA&N Interests, Inc. v. Fish, 864 S.W.2d 745 (Tex. App.--Houston [14th Dist.] 1993) .

But cf.:

Florida: In egregious situations, the buyer and seller who intentionally exclude the broker may risk more than the amount of the broker's commission. In one case, in which the commission would have been over \$150,000, a broker stated a cause of action against the buyer for tortious interference with the broker's contract with the seller. The appellate court reversed the trial court's dismissal of the broker's complaint, which, among other things, alleged that before executing the standard form contract, the seller crossed out the commission percentage and amount, and that after signing the contract, the buyer and seller dealt directly with each other and concealed the closing details from the broker. *Riteway Real Estate v. Bentley Ocean View*, 659 So. 2d 1194 (Fla. 3d DCA 1995) *review denied*, 666 So. 2d 142 (Fla. 1995) [excerpt from discussion written by William Ryan, Esq. in Boyer, Florida Real Estate Transactions, ch. 2 (Matthew Bender)].

(n4)Footnote 4. *See Sudeen v. Castleberry*, 794 So. 2d 237, 243 (Miss. Ct. App. 2001) .

(n5)Footnote 5. *See Snierston v. Scruton*, 145 N.H. 73, 79, 761 A.2d 1046, 1050 (2000) .

(n6)Footnote 6. *See Monahan v. Lewis*, 51 A.D.3d 1308, 1310-11, 858 N.Y.S.2d 812, 814 (2008) ; *Blackman DeStefano Real Estate, Inc. v. Smith*, 157 A.D.2d 932, 934, 550 N.Y.S.2d 443, 445 (1990) .

(n7)Footnote 7. *Blackman DeStefano Real Estate, Inc. v. Smith*, 157 A.D.2d 932, 934, 550 N.Y.S.2d 443, 445 (1990) .

(n8)Footnote 7.1. *See RC Royal Development and Realty Corp. v. Standard Pacific Corp.*, 177 Cal. App. 4th 1410, 1418, 100 Cal. Rptr. 3d 115, 121 (2009) , *review denied*, 2010 Cal. LEXIS 252 (Jan. 13, 2010) .

(n9)Footnote 7.2. *See RC Royal Development and Realty Corp. v. Standard Pacific Corp.*, 177 Cal. App. 4th 1410, 1413, 100 Cal. Rptr. 3d 115, 117 (2009) (Under the parties' agreement, the broker earned its commission when the buyer entered into a buy-sell agreement. The close of escrow was not a condition precedent to the right to a commission.), *review denied*, 2010 Cal. LEXIS 252 (Jan. 13, 2010) .

(n10)Footnote 8. *Gronich & Co., Inc. v. 649 Broadway Equities Co.*, 169 A.D.2d 600, 565 N.Y.S.2d 18, 1991 N.Y. App. Div. LEXIS 588 (1st Dept. 1991) ; *Long Island Business Exch., Inc. v. DeLuca*, 58 A.D.2d 594, 395 N.Y.S.2d 244, 1977 N.Y. App. Div. LEXIS 12637 (2d Dept. 1977) . But the right of a buyer's broker to maintain an action for commission against the purchaser is not always clear cut. For instance, if the purchaser and the buyer's broker enter into a contract, which turns out to be faulty, no commission is payable.

See also:

Federal: New Spectrum Realty Servs., Inc. v. The Nature Co., 42 F.3d 773 (2d Cir. 1994) (holding that a broker may recover in quasi-contract against a lessee, where the record demonstrates unjust enrichment or similar advantage accruing to the lessee sufficient to move the court to act for the broker's benefit or protection); *Park-Haden, Inc. v. Loews Theater Management Corp.*, 789 F. Supp. 1257 (S.D.N.Y. 1992) .

Alabama: Betts v. McDonald's Corp., 567 So. 2d 1252 (Ala. 1990) .

(n11)Footnote 9.

New York: Ficor v. National Kinney Corp., 67 A.D.2d 659, 412 N.Y.S.2d 621, 1979 N.Y. App. Div. LEXIS 10229 (1st Dept. 1979) . Note should be made of the regulation promulgated by the New York Secretary of State prohibiting a seller from employing a broker on a "net listing" basis. (See 19 N.Y.C.R.R. § 175.19).

North Carolina: Chipley v. Morrell, 228 N.C. 240, 45 S.E.2d 129 (1947) .

(n12)Footnote 10. 385 F.2d 83 (1st Cir. 1967) .

(n13)Footnote 11. *Id.* at 86 .

(n14)Footnote 12. *Id.* at 89 .

(n15)Footnote 13. *Id.* But see *VRG Corp. v. GKN Realty Corp.*, 135 N.J. 539, 641 A.2d 519 (N.J. 1994) (the broker was not permitted to recover commissions due from the developer by means of an equitable lien imposed on commercial rental income derived from long-term tenants; the new owner of the shopping center was aware of the broker's claim, but had not agreed to be responsible for the commissions).

(n16)Footnote 14. Restatement (Second) of Contracts § 302 (1980); Farnsworth, Contracts § 10.3 (Little Brown 1982).

(n17)Footnote 15. *Wales v. Ripperger*, 262 A.D. 1062, 30 N.Y.S.2d 233 (1941) is in accord with the *Massingale Case*; *Cox v. Dolvin Realty Co.*, 56 Ga. App. 649, 193 S.E. 467 (1937) is *contra*.

See also *Mortgage Bankers Ass'n of N.J. v. New Jersey Real Estate Comm'n*, 283 N.J. Super. 233, 661 A.2d 832 (N.J. Super A.D. 1995) (statute prohibiting a broker from "[c]ollecting a commission as a real estate broker in a transaction, when at the same time representing either party in a transaction in a different capacity for a consideration" [N.J.S.A. 45:15-17(i)] does not bar the broker from receiving a commission from the seller when the broker also receives consideration from the buyer for aiding the buyer in the mortgage transaction; "transaction" refers only to the real estate sale, and aiding the buyer does not constitute "representing" the buyer).

(n18)Footnote 16. 50 N.J. 528, 236 A.2d 843 (1967) , discussed in § 4.03 above.

(n19)Footnote 17. 236 A.2d at 859 .

(n20)Footnote 18. See *Bogle v. Summit Investment Co., LLC*, 107 P.3d 520, 527, 2005 NMCA 24 (N.M. Ct. App. 2005) .

(n21)Footnote 19. *Grossman v. Herman*, 266 N.Y. 249, 194 N.E.2d (1935). The New York Court stated:

The mere fact that brokers have been employed by an owner to procure a sale or lease of real estate need not in itself necessarily prevent such brokers, under proper circumstances, from accepting employment also from a purchaser or a lessee. The question always is whether the facts in a given case may be held as matter of law to justify an inference of a double employment. In *Pease & Elliman, Inc., v. Gladwin Realty Co.*, 216 A.D. 421, 1926 N.Y. App. Div. LEXIS 9241, 215 N.Y.S. 346, the Appellate Division, in weighing the evidence, inferred an employment by defendant as well as the owner. When, as in the case before us, the complaint alleges an employment of plaintiffs by defendants as prospective purchasers, the right to recovery must depend upon proof of such allegations. There must be an existing contract between the plaintiffs and defendants which the latter had broken with resulting liability for damages. *Parker v. Simon*, 231 N.Y. 503, 508 132 N.E. 404 (N.Y. 1921).

See generally Epstein, *Indoor Air Pollution and the "Duty to Warn,"* 5 A.B.A. Prob. & Prop. 23 (Nov./Dec. 1991).

(n22)Footnote 20. 73 N.J. 590, 376 A.2d 902 (1977) .

(n23)Footnote 21. 376 A.2d at 907-8 .

(n24)Footnote 22. 376 A.2d at 908 .

* This chapter was revised by Charles J. Jacobus, Esq., a partner in the firm of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas. In 1999, Sections 4.01 through 4.03 were revised by Mary Fallon, Esq. Additional updates were contributed by Sandra Bullington, Esq.



96 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.11

§ 4.11 A Broker's Voluntary Reduction or Modification of Commission

In certain situations brokers will voluntarily agree to reduce their commissions in order to make a sale go through. For example, in one case the sellers refused to pay an extra \$540 to decrease a home's radon level, so the buyer's broker offered to reduce its commission by one half of the \$540 if the seller's agent would do the same. n1 While this is a common technique to facilitate a sale when the parties have reached an impasse, it can lead to disputes regarding a broker's commission. While such disputes can raise issues regarding promissory estoppel and waiver, the primary issue to consider first is whether there has been a modification of the underlying contract.

Jones v. Best n2 illustrates some of the difficulties that can arise. John Paul Jones, a licensed real estate agent, entered into a one-year exclusive listing agreement with Peter Best to sell a 96-acre apple orchard. The orchard was listed for \$800,000 and Jones had the right to sell the orchard at that price or any other price to which Best agreed. Jones was to receive 5% of the sales price as his commission, whether he or someone else sold the property. Two or three months after the agreement was made, Jones learned that Pacific Fruit Growers & Packers, Inc. was a potential purchaser. Earl Nordberg, a real estate agent with whom Jones had worked in the past, represented Pacific Fruit. Best informed Jones that he was considering Pacific Fruit's offer of \$735,000 or \$740,000. At their next meeting, Best told Jones that he had made a deal on the orchard. Figuring that five percent of the purchase price of \$740,000 was \$37,000, Jones told Best, "Pete, I'll take \$18,000 and you take care of Nordberg." While Jones knew he was entitled to the full \$37,000, he intended to take slightly less than half the commission and have the remainder paid to Nordberg, who had procured the buyer. In similar transactions involving Nordberg, Jones testified that each took half of the commission and that he expected that this would occur in this sale. Jones testified that Best shook hands and "was evidently well pleased." n3

The sale closed and Jones called Best to ask for his \$18,000 commission. Best was hostile and stated that Jones had no commission coming as he had not procured the buyer. Best subsequently asked Jones to show the listing agreement to Best's attorney, which Jones did. About that time, Jones learned that Nordberg had never received a commission.

Best's attorney later spoke to Jones and asked if he had agreed to take \$18,000 for his commission. Jones replied that he had as long as Best took care of Nordberg. The attorney later sent a letter stating that he would send Jones a check for \$18,000 upon receipt of a release signed by both Nordberg and Jones showing that the \$18,000 was a complete settlement. Jones responded in writing, stating that as the exclusive listing agent, he was entitled to the full five percent, or \$37,000. He also stated that he would accept \$18,500 plus interest and costs as a full release of his claims under the

agreement, but would need the full \$37,000 to get a release from Mr. Nordberg. Jones later received a final letter from Best's attorney along with a check for \$18,000. The letter stated that the check was forwarded as a means of settlement and compromise. Jones sued for the full \$37,000. n4

The trial court found that Jones had not waived a commission greater than \$18,000, but had agreed to reduce his commission by \$500. The trial judge awarded Jones \$36,500, prejudgment interest and attorney fees. The intermediate appellate court, in an unpublished opinion, held that Jones was estopped from claiming more than \$18,000 commission and that he was not entitled to attorney's fees. However, it allowed the prejudgment interest.

In an en banc decision, the Supreme Court of Washington stated that the trial court and the Court of Appeals had confused several theories in their attempts to resolve the issues. Since there was a valid written contract between the parties, the parties' subsequent conversation did not constitute an agreement to reduce the commission. The intermediate court's application of promissory estoppel was found to be inapplicable to this case. n5 The trial court heard the evidence, judged the witnesses' credibility, and found that Jones made no promise to accept \$18,000 as the entire commission. The court stated, "The sine qua non of promissory estoppel is the existence of a promise; there was no promise here." n6 Furthermore, there was no justifiable change in position by Best that would implicate promissory estoppel.

This court stated that neither the litigants nor the courts had addressed the case as one of attempted, but unsuccessful modification of a valid contract. This the court concluded was the appropriate analysis. The court found that there had been an attempted modification of the written listing agreement, but that Best's silence did not constitute acceptance. Mutual assent was required for a modification; one party could not unilaterally modify the agreement. n7 Since there was no modification of the agreement, Jones was entitled to his five percent commission under the original contract terms.

This court also addressed the issue of waiver. It found that at most, the circumstances did not evidence an intent to waive over half the commission. Instead, the evidence pointed to a desire to have a portion of the commission paid to someone else.

If a commission is to be modified in some manner or reduced, the parties should comply with the statute of frauds and reduce the modification or reduction to a writing signed by both parties. n8 This can avoid a costly dispute.

One area where reduced commissions are expected involves lender sales of property where the debt encumbering the property exceeds the property's value. In this situation, the lender agrees to accept less than the indebtedness in order to sell the property. These sales have been referred to as "short sales." n9

FOOTNOTES:

(n1)Footnote 1. See *In re Appeal of Sheaffer*, 116 Ohio App. 3d 98, 100-101, 686 N.E.2d 1382, 1384 (1996) .

(n2)Footnote 2. 134 Wash. 2d 232, 950 P.2d 1 (1998) (en banc).

(n3)Footnote 3. 134 Wash. 2d 232, 235, 950 P.2d 1, 3 (1998) .

(n4)Footnote 4. 134 Wash. 2d 232, 235, 950 P.2d 1, 3 (1998) .

(n5)Footnote 5. 134 Wash. 2d 232, 237-239, 950 P.2d 1, 4-5 (1998) . The Court of Appeals had discussed whether equitable or promissory estoppel applied and concluded that promissory estoppel was the proper doctrine.

(n6)Footnote 6. 134 Wash. 2d 232, 239-240, 950 P.2d 1, 5 (1998) .

(n7)Footnote 7. 134 Wash. 2d 232, 239-240, 950 P.2d 1, 5 (1998) .

(n8)Footnote 8. *Cf. American Garment Properties, Inc. v. CB Richard Ellis-El Paso, L.L.C.*, 155 S.W.3d 431, 437 (Tex. App. 2004) (Oral agreements to modify a real estate commission agreement raised defensively by owners are not treated any differently from oral agreements asserted by brokers seeking to recover their commissions. The court refused to enforce an allegedly oral agreement to reduce the broker's commission.).

(n9)Footnote 9. *See In re Marcoux*, 301 B.R. 381, 383 (Bankr. D. Conn. 2003) ; *Gale v. Commissioner*, 2006 Tax Ct. Summary LEXIS 54, *3 n. 2 , *T.C. Summary Opinion 2006-152* (2006).

* This chapter was revised by Charles J. Jacobus, Esq., a partner in the firm of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas. In 1999, Sections 4.01 through 4.03 were revised by Mary Fallon, Esq. Additional updates were contributed by Sandra Bullington, Esq.



97 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.11A

§ 4.11A Other Theories of Recovery

Although actions to recover a brokerage commission are usually based upon the terms of a broker's listing agreement or other promise involving a commission, n1 other causes of action include *quantum meruit*, fraud, constructive fraud and civil conspiracy. An additional cause of action is intentional interference with the broker's efforts, commonly referred to as tortious interference, which almost always involves the interference of a party with the broker's efforts to find a ready, willing and able purchaser for the property.

[1] Quantum Meruit

The theory of *quantum meruit* applies almost exclusively in states which do not require real estate listing agreements to be in writing. n2 Where a broker is unable to fully perform its obligation under the agreement because of a wrongful act on the part of the vendor, and is therefore not entitled to recover under the agreement for full performance, it will have a cause of action in *quantum meruit* to recover the reasonable value of its services. n3 In awarding damages under *quantum meruit*, courts may use the customary method and rate of compensation prevailing in the real estate industry, n4 usually a percentage of the sale price. n5

To recover on a *quantum meruit* claim, the broker must allege that:

- (1) the broker performed service to benefit the defendant,
- (2) the broker performed the service nongratuitiously,
- (3) the defendant accepted the service, and
- (4) no contract existed to prescribe payment for the service. n6

The basis for *quantum meruit* recovery is equitable and results from the receipt by a defendant from a plaintiff of a benefit that is unjust for the defendant to retain without paying for it. n7 A failure to plead that the broker expected payment from the defendant can prove fatal to a broker's *quantum meruit* claim. n8

In Georgia, in order for a broker to recover on a *quantum meruit* claim, the broker must also prove that he or she was the procuring cause of the completed transaction. n9

If a seller withdraws listed property from the market before the broker's efforts have produced a purchaser, the seller is responsible to the broker only for such damages as may be established for breach of contract or on a quantum meruit basis for special services rendered in connection with reasonable efforts to sell the property, undertaken before the property was withdrawn from the market. However, ordinary services of a general nature rendered by the broker are not recoverable even on a quantum meruit basis since they are a cost of doing business. This result is considered in accordance with the principle that in the absence of bad faith or special circumstances, the seller is not liable for the full commission unless a sale occurs. n10

Quantum meruit was applied in a case where the listing broker believed that the selling broker was a member of the multiple listing service (MLS). n11 Pursuant to that organization's rules, a finder was entitled to a 1.6% commission. After the sale was consummated, the listing broker learned that the selling broker was not a member of MLS. The listing broker then took the position that the selling broker was entitled to none of the commission. It was held that the trial court was well within its equitable discretion to allow the selling broker *quantum meruit* for his services. n12

Quantum meruit is generally unavailable as a remedy if a valid legally enforceable contract between the parties exists. n13 This remedy is a form of restitution where the plaintiff seeks to recover the fair value of services performed for the defendant. It is not consensual, nor is it a contract. This remedy seeks to accomplish justice and avoid unjust enrichment. Consequently, if there is a valid listing agreement, *quantum meruit* should be unavailable for pursuit of a commission. n14 Instead, the broker's remedy is for breach of contract.

Quantum meruit may also be unavailable as a remedy if the broker or agent is unlicensed since one of the elements of this remedy is that the services be rendered under circumstances that make it reasonable for the plaintiff to expect payment. If the state prohibits the payment of commissions to unlicensed persons, it would not be reasonable for an unlicensed person to expect to receive a commission. n15

Courts that require a written listing agreement may reject *quantum meruit* as a basis of recovery because of the belief that this theory would in effect render the statute requiring a written commission agreement a nullity. These courts hold that to allow performance to take a claim for a commission out of the statute of frauds would leave nothing on which the statute would operate. n16 Such courts may be willing, however, to allow compensation for other services even though there is no written listing agreement for the transaction consummated if another written document provides for compensation. n17 If a court rejects quantum meruit as a basis of recovery because there is no written listing agreement, the court may allow the broker to pursue compensation on an hourly based compensation if the parties' express oral agreement supports this remedy. n18

If a broker is allowed to pursue compensation based on a theory of *quantum meruit* and the compensation is for services rendered over a period of time, it has been held that the statute of limitations begins to run when the final services have been performed. n19

[2] Fraud

Absent a special statute requiring real estate brokerage commission agreements to be in writing, such contracts would not fall within the traditional statute of frauds. n20 Most states now have statutes requiring that an agreement to pay a commission for or upon the sale of an interest in real estate be in writing.

[3] Tortious Interference

Tortious interference is an emerging cause of action based on tort theories as they relate to contractual obligations. This

theory can be divided into two basic components:

- (1) tortious interference with a prospective economic advantage; n21 and
- (2) tortious interference with a contract, also known as civil conspiracy, discussed below.

The elements of tortious interference with a contract include:

- (1) a contract subject to interference;
- (2) with which the defendant willfully and intentionally interferes;
- (3) without justification or excuse; and
- (4) proximately causes injury to the plaintiff. n22

While this cause of action supports a broker's right to pursue the buyer, it also has been upheld as a right to be pursued against competing buyers' brokers, as when a second buyer's broker interferes with the first buyer's broker. n23 Merely being the first broker to introduce a buyer to a property may be insufficient to support this tort claim if another broker also shows the same property to the same buyer and negotiates a sale with that buyer. n24

Most states, by regulation or statute, prohibit and will sanction a broker or agent who induces any party to a contract, sale, or lease to break the contract for the purpose of substituting in lieu thereof a new contract where the substitution is motivated by the licensee's personal gain. n25

In some jurisdictions and under certain circumstances, a violation of well-defined, established rules or standards of a trade, association or profession (such as a Realtors(R) association) may constitute the type of wrongful conduct that will support a cause of action for intentional interference with prospective economic advantage. n26

[4] Civil Conspiracy

Civil conspiracy requires two or more persons seeking to accomplish an unlawful purpose or to accomplish a lawful purpose by unlawful means. n27 Civil conspiracy has also been termed "conspiring to interfere with contractual relations." n28 To establish a cause of action for tortiously interfering with a prospective economic advantage, the plaintiff is required to prove: (1) unlawful, intentional interference with the prospect of, or reasonable expectation of, economic advantage; and (2) a reasonable probability that plaintiff would have received the anticipated economic benefits had there been no interference. n29 This cause of action seems to be most successfully pursued by buyer brokers who have been induced into transactions by buyers promising them that "they will be taken care of," but then later cutting the brokers out of the transactions. n30

The broker must be entitled to receive a commission before there can be a conspiracy to deprive the broker of his or her commission. n30.1

[5] Implied-in-Fact Contract

In *Moshovitis v. The Bank Companies*, n31 the court held that the absence of a written contract, by itself, did not bar a real estate broker from receiving a commission based on an unwritten implied-in-fact contract. The seller in this case had rescinded a contract in bad faith to avoid paying two separate commissions. This bad faith determination was supported by evidence that showed that the day after rescinding the contract, the seller contacted the buyer and resumed negotiations without the broker's involvement. There was no substantial difference between the rescinded contract and

the subsequently executed contract except that the later contract excluded the broker's commission.

Moshovitis was decided based on D.C. Code § 45-1945, which was repealed in 1997. This prior statute had been construed as not altering D.C. common law which allowed brokers to collect commissions on oral listing agreements. D.C. Code § 42-1705, which was enacted in 1997, provides that a written listing contract is required in the District for the sale of all real property. Thus, pursuant to D.C. Code § 42-1705, a licensee cannot receive a commission in the absence of a written listing agreement. n31.1

[6] Equitable Estoppel

A Connecticut court relied upon the doctrine of equitable estoppel to allow a broker a commission where the seller had not signed the listing agreement. The seller had signed the original listing agreement, but when it expired her husband signed her name to an extension of this listing. This extension also reduced the property's listing price. When the husband signed, he had the seller's oral authorization to act on her behalf. The broker, however, believed that the defendant had signed the extension. Subsequently, the property was sold at an even lower price which was insufficient to pay the broker's commission. n32 Rather than attempt to work out an agreement with the broker regarding the commission, the seller tried to avoid paying the commission altogether. The broker sued to collect his commission.

The court found that the statutory requirement that the seller sign the listing agreement was mandatory. Therefore, the statutory requirements were not met. n33 However, the court found that the defective listing agreement extension was valid due to the equitable estoppel doctrine. The court stated that it had previously rejected application of this doctrine against homeowners seeking to avoid paying a broker's commission, but that this case was factually distinguishable from its prior decisions. The court specifically noted that the broker's need for relief did not result from his ignorance of the laws governing his profession. The broker had what he believed to be a valid extension of the listing agreement signed by the owner. The broker was unaware that the owner's husband had signed the extension on the owner's behalf and with her consent. The broker had relied upon this document to his detriment. Furthermore, applying the doctrine in this case did not emasculate the statutory licensing system since the broker believed he was operating within the law's requirements and the owner and her husband allowed the broker to believe that. n34 A concurring judge agreed with the result, but would have applied a bad faith exception doctrine rather than the doctrine of equitable estoppel. n35

[7] Promissory Estoppel

Promissory estoppel is another theory brokers have used to recover a commission. Section 90 of the Restatement (Second) of Contracts states that promissory estoppel arises from a promise that the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and that does induce such action or forbearance is binding if injustice can be avoided only by enforcement of the promise. Promissory estoppel applies to promises that are otherwise unenforceable. A seller's repeated promises to a broker who does not have a written listing to continue trying to sell a property because the seller would make sure that the broker's commission would be protected was found to support recovery of the commission under a theory of promissory estoppel. n36

Not all jurisdictions accept promissory estoppel as a theory under which a broker can recover a commission. The Supreme Court of Texas has rejected promissory estoppel as a recovery theory stating that a licensed real estate broker cannot act or forbear from acting in reliance on anything less than a signed written commission agreement. It stated that when a broker relies on an oral promise to sign a written agreement that would satisfy statutory requirements, the broker does so at his or her peril. n37

FOOTNOTES:

(n1)Footnote 1. *See* § 4.01 above.

(n2)Footnote 2. *Cf. Uhar & Co. v. Jacob, 2010 U.S. Dist. LEXIS 43025*, at *19 (D.D.C. May 3, 2010) (D.C. law

does not allow recovery for brokerage services under quasi-contract theories in the absence of a true contract); *PKG Associates, Inc. v. Dubb*, 306 A.D.2d 333, 760 N.Y.S.2d 681, 682 (2d Dept. 2003) (plaintiffs were licensed real estate brokers and therefore recovery in quantum meruit for the reasonable value of their services was not precluded by the absence of a signed writing evidencing the parties' alleged agreement).

(n3)Footnote 3. *Joseph Sternberg, Inc. v. Walber 36th St. Assoc.*, 187 A.D.2d 225, 594 N.Y.S.2d 144, 1993 N.Y. App. Div. LEXIS 1706 (1st Dept. 1993) .

See also *Christopher Inv. Properties, Inc. v. Cox*, 219 Ga. App. 440, 465 S.E.2d 680 (1995) (a broker may prevail on a quantum meruit claim notwithstanding that the broker was not the procuring cause of the sale).

(n4)Footnote 4. *Flamingo Realty, Inc. v. Midwest Dev., Inc.*, 110 Nev. 984, 879 P.2d 69 (Nev. 1994) .

See also *Mills Realty, Inc. v. Wolff*, 910 S.W.2d 320 (Mo. App. E.D. 1995) (in a suit to recover a commission based on quantum meruit, the broker cannot establish the reasonable value of the broker's services merely by citing the terms of the contract, unless the contract has been fully performed except for the payment of the commission).

(n5)Footnote 5. 879 P.2d at 72 .

(n6)Footnote 6. See *Owen Wagener & Co. v. U.S. Bank*, 297 Ill. App. 3d 1045, 232 Ill. Dec. 160, 697 N.E.2d 902, 908 (1998) .

(n7)Footnote 7. See *Owen Wagener & Co. v. U.S. Bank*, 297 Ill. App. 3d 1045, 232 Ill. Dec. 160, 697 N.E.2d 902, 908 (1998) ; *Coldwell Banker Commercial v. Resource Realty of Central Jersey*, 368 N.J. Super. 382, 392, 846 A.2d 633, 639 (2004) .

(n8)Footnote 8. See *Owen Wagener & Co. v. U.S. Bank*, 297 Ill. App. 3d 1045, 232 Ill. Dec. 160, 697 N.E.2d 902, 909 (1998) .

(n9)Footnote 9. See *Amend v. 485 Properties*, 280 Ga. 327, 330, 627 S.E.2d 565, 2006 Ga. LEXIS 167, at *7 (Mar. 13, 2006) .

(n10)Footnote 10. See *Island Realty v. Bibbo*, 329 N.J. Super. 528, 748 A.2d 620, 624 (2000) , cert. denied, 165 N.J. 487, 758 A.2d 646 (2000) .

(n11)Footnote 11. See *Bozzelli v. Hollenbaugh*, 594 N.E.2d 782 (Ind. 1992) .

(n12)Footnote 12. See 594 N.E.2d 782, 783 (Ind. 1992) .

(n13)Footnote 13. But see *Scheerer v. Fisher*, ___ N.C. App. ___, 688 S.E.2d 472, 476-77 (2010) (Despite the existence of a valid oral brokerage contract, the court found that the broker should have been able to state a claim for quantum meruit as the broker was entitled to seek alternative forms for relief. The court also found that the broker had sufficiently stated a claim for quantum meruit.); *Carolantic Realty, Inc. v. Matco Group, Inc.*, 151 N.C. App. 464, 470-471, 566 S.E.2d 134, 138-139 (2002) . Quantum meruit may apply even though there is a valid written listing agreement if the broker renders services after the listing period has terminated.

(n14)Footnote 14. See *Prestige Homes Real Estate Co. v. Hanson*, 151 Or. App. 756, 761-762, 951 P.2d 193, 195-196 (1997) .

(n15)Footnote 15. See *Everett v. Goodloe*, 268 Ga. App. 536, 541, 602 S.E.2d 284, 289-290 (Ga. Ct. App. 2004) (unlicensed individual cannot pursue a quantum meruit claim); *Smith v. Cannell*, 1999 Me. 19, 723 A.2d 876, 881 (Me. 1999) . The agent in this case was unlicensed at the time the services were rendered, but was licensed at the time the

transaction closed. Despite a *quantum meruit* argument, the agent was not allowed any compensation.

(n16)Footnote 16. See *Patterson-Woods & Associates., LLC v. Realty Enterprises, LLC*, 2008 Del. Super. LEXIS 196, at *45-*46 (May 21, 2008) *reargument denied*, 2008 Del. Super. LEXIS 286 (July 29, 2008) . *Trammel Crow Co. No. 60 v. Harkinson*, 944 S.W.2d 631, 636, 40 Tex. Sup. Ct. J. 425 (Tex. 1997) , *rehearing overruled*. See also *Amato & Stella Associates, Inc. v. Florida North Investments, Ltd.*, 678 F. Supp. 445, 449 (D. Del. 1988) , applying Delaware law (a broker who neglects a statutory demand for a written listing contract cannot alternatively recover in quantum meruit; allowing a broker to recover based on an oral listing contract even though services were rendered would undercut the purpose and intent of the regulation requiring a written listing agreement). See generally Annot., *Real Estate Broker's Right To Recover in Quantum Meruit For Services Although Contract Is Not in Writing as Required by Statute*, 41 A.L.R. 2d 906. But see *Coldwell Banker Commercial/Feist & Feist Realty Corp. v. Blancke P.W. L.L.C.*, 368 N.J. Super. 382, 392-402, 846 A.2d 633, 639-645 (2004) (Though strict compliance with the statute of frauds is essential for a broker to recover a commission for the sale of real estate, the doctrine of substantial compliance avoids the rejection of a legitimate legal claim solely on a technical basis. The technical violation of the governing condition to enforce an agreement, in this case the statute of frauds, precluded the broker's recovery under the agreement. However, a factfinder may conclude that because plaintiffs conferred a benefit on defendant, the circumstances are such that to deny plaintiffs recovery would be unjust. The broker in such a situation may be able to recover under a theory of quantum meruit.).

(n17)Footnote 17. See *Chabbott Petrosky Commercial Realtors, Ltd v. Peterson*, 859 A.2d 77, 80 (Del. 2004) .

(n18)Footnote 18. See *In re Capitol Hill Group*, 320 B.R. 460, 471-472 (Bankr. D. D.C. 2005) .

(n19)Footnote 19. See *Tesser v. Allboro Equipment Co.*, 2007 N.Y. Misc. LEXIS 8952, at *14-*15 (Sup. Ct. Dec. 31, 2007) .

(n20)Footnote 20. See Restatement (2d) of Contracts § 126, comment b (1981).

(n21)Footnote 21. *Harper-Lawrence, Inc. v. United Merchants*, 261 N.J. Super. 554, 619 A.2d 623 (App. Div. 1993) .

(n22)Footnote 22. *Snyder Realty, Inc. v. BMW of N. Am., Inc.*, 233 N.J. Super. 65, 558 A.2d 28 (App. Div.) , *cert. denied*, 117 N.J. 165, 564 A.2d 883 (1989) .

(n23)Footnote 23. *Harris v. Perl*, 197 A.2d 359 (N.J. 1964) ; *Sustick v. Slatina*, 137 A.2d 54 (N.J. App. Div. 1957) .

(n24)Footnote 24. *Team Resources, Inc. v. Exodus Communications, Inc.*, 60 Fed. Appx. 899, 2003 U.S. App. LEXIS 4476, *9-*11 (3d Cir. Mar. 12, 2003) , applying New Jersey law.

(n25)Footnote 25. Cf. *Mississippi Real Estate Comm'n v. Anding*, 732 So. 2d 192, 197 (Miss. 1999) (there was no evidence in the record that the salesperson acted to induce any clients of her former broker to breach a contract with the broker; the salesperson's letter to clients informing them of her new employment did not amount to inducing clients to break contracts).

(n26)Footnote 26. See *Stevenson Real Estate Services, Inc. v. CB Richard Ellis Real Estate Services, Inc.*, 138 Cal. App. 4th 1215, 1223, 42 Cal. Rptr. 3d 235, 242 (2006) .

(n27)Footnote 27. See *Prism Marketing Co. v. Casino Factory Shoppes, LLC*, 2009 U.S. Dist. LEXIS 110759, at *15 (N.D. Miss. Nov. 30, 2009) ; *Massey v. Armco Steel Co.*, 652 S.W.2d 932, 934 (Tex. 1983) *rehearing of cause overruled* (Jul. 20, 1983).

(n28)Footnote 28. *BIEC International, Inc. v. Global Steel Services, Ltd.*, 791 F. Supp. 489, 492 (E.D. Pa. 1992) .

(n29)Footnote 29. See generally *Zamore*, Business Torts, Chapter 12 (LexisNexis 2010).

(n30)Footnote 30. *L A & N Interests, Inc. v. Fish*, 864 S.W.2d 745 (Tex. App.--Houston [14th Dist.] 1993) .

(n31)Footnote 30.1. *See Georgia Real Estate Properties, Inc. v. Lindwall*, 2010 Ga. App. LEXIS 272, at *9 (Mar. 22, 2010) .

(n32)Footnote 31. 694 A.2d 64 (D.C. App. 1997) .

(n33)Footnote 31.1. *See Uhar & Co. v. Jacob*, 2010 U.S. Dist. LEXIS 43025, at *12 (D.D.C. May 3, 2010) .

(n34)Footnote 32. This situation resulted from the debts encumbering the property.

(n35)Footnote 33. *Conn. Gen. Stat. § 20-325a (b)* required in part that the listing agreement be signed by the owner or an agent authorized to act on behalf of the owner only by a written document executed in the manner statutorily provided for real property conveyances. The husband only had oral authorization to sign the extension on his wife's behalf.

(n36)Footnote 34. *See Rapin v. Nettleton*, 50 Conn. App. 640, 718 A.2d 509, 514-515 (1998) .

Conn. Gen. Stat. § 20-325a (d) provides that a licensee cannot be prevented from recovering a commission if it would be inequitable to deny such recovery and the licensee has substantially complied with certain subdivisions depending upon the type of real estate transaction involved. *See Location Realty, Inc. v. Colaccino*, 287 Conn. 706, 723-30, 949 A.2d 1189, 1199-1203 (2008) for a discussion of this provision and unjust enrichment.

(n37)Footnote 35. *Rapin v. Nettleton*, 50 Conn. App. 640, 718 A.2d 509, 515-516 (1998) .

(n38)Footnote 36. *See Daigle Commercial Group, Inc. v. St. Laurent*, 1999 Me. 107, 734 A.2d 667, 673 (Me. 1999) . The seller in this case also promised to make up a prior commission where the broker believed he had been short changed.

(n39)Footnote 37. *See Trammell Crow Co. No. 60 v. Harkinson*, 944 S.W.2d 631, 636, 40 Tex. Sup. Ct. J. 425 (Tex. 1997) , rehearing overruled.

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98 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.11B

§ 4.11B Broker's Liens

Some states statutorily provide for a commercial broker's lien. For example, Georgia provides for a commercial broker's lien that arises from the management, sale, or lease of, or conveyance of an interest in commercial real estate. n1 Maryland on the other hand limits its broker's lien to the leasing of commercial property. n2 If a state recognizes or statutorily provides for a broker's lien, the broker must first be owed a commission before there can be a basis for a lien. n3

The Court of Appeals of Georgia considered the scope of its broker's lien in *Padgett v. City of Moultrie*. n4 The broker's services in this case went beyond traditional brokerage services, and included services for which no broker's license was required. The court held that the statutory lien was not limited strictly to licensed services. The court also addressed the priority of the broker's lien. The applicable code provision stated, "Prior recorded liens and liens for ad valorem taxes shall have priority over a broker's lien." n5 The court held that the broker's lien was entitled to priority over not only the subsequently recorded deed to secure a debt, but also over a prior encumbrance where the encumbrancer had agreed to subordinate to this subsequently recorded deed. The court reasoned that when the subordination agreement was recorded, the prior encumbrancer knew of the broker's intervening lien both through its earlier recordation and by the encumbrancer's receipt of a copy of the lien. n6

Wisconsin allows brokers to file a lien with respect to commercial real estate. n7

The Missouri Commercial Real Estate Brokers and State Certified Real Estate Appraisers Lien Act n8 has been interpreted as applying to broker's commissions arising from leases as well as sales. n9 Under this act, valid prior recorded liens or mortgages have priority over a real estate broker's lien. n10

New York's mechanic's lien law allows brokers in some instances to file a lien for services rendered. A 1982 amendment to this law expanded the definition of "improvement" to include the performance of certain real estate brokerage services. n11 The amended law states that improvement includes:

the performance of real estate brokerage services in obtaining a lessee for a term of more than three years of all or any part of real property to be used for other than residential purposes pursuant to a written contract of brokerage employment or compensation n12

This definition has been held to mean that in order for a broker to have a lien, there must be a brokerage contract between the broker and the property owner (*i.e.*, the lessor). n13

Pennsylvania's Commercial Real Estate Broker's Lien Act n14 has been interpreted as imposing two requirements in order for a broker to place a lien on a commercial property. First, the broker and the commercial real property owner must have signed a listing agreement for the sale of commercial property. Second, during the term of the listing agreement, the broker must have provided services which resulted in a buyer for the commercial real property. This Act embodies a public policy of creating a broker's lien only where the commission was earned by the broker. n15 Because of this second requirement, a broker could be contractually entitled to a commission pursuant to an exclusive agency agreement, but the broker would not be entitled to a broker's lien under the Act if the sale did not result from the broker's services.

It should be noted that a statutory broker's lien differs from a broker placing a mortgage on the public land records for the purpose of collecting a commission. The later act may be statutorily prohibited. n16

FOOTNOTES:

(n1)Footnote 1. *Ga. Code Ann. §§ 44-14-600 et seq.*

(n2)Footnote 2. *Md. Code Ann., Real Prop. §§ 14-301 et seq.* Maryland's broker's lien statute is modeled to a large extent upon the Maryland mechanic's lien statute. The broker's lien statute is remedial and should be so construed to give effect to its purpose. *See Howard Chertkof & Co., Inc. v. Gimbel*, 157 Md. App. 118, 132, 849 A.2d 1036, 1044-1045 (Md. Ct. Spec. App. 2004) .

(n3)Footnote 3. *See Sherlock Homes, Inc. v. Wilcox*, 2001 Ohio App. LEXIS 792 (Ohio App. Mar. 6, 2001) , *appeal denied*, 92 Ohio St. 3d 1430, 749 N.E.2d 757, 2001 Ohio LEXIS 1768 (2001) ; *Re/Max Select Realty v. DeAugustino*, 73 Pa. D. & C.4th 371, 376 (2005) .

(n4)Footnote 4. 229 Ga. App. 500, 494 S.E.2d 299 (Ga. Ct. App. 1997) , *cert. denied*, 1998 Ga. LEXIS 393 (Ga. Mar. 6, 1998) and 1998 Ga. LEXIS 413 (Ga. Mar. 6, 1998) .

(n5)Footnote 5. *Ga. Code Ann. § 44-14-603.*

(n6)Footnote 6. 229 Ga. App. 500, 505, 494 S.E.2d 299, 303 (1997) .

(n7)Footnote 7. *See Wis. Stat. § 779.32; Sondag v. Dave Kohel Agency, Inc.*, 2006 WI 92, 293 Wis. 2d 458, 466, 718 N.W.2d 631, 635 (2006) .

(n8)Footnote 8. *Mo. Rev. Stat. §§ 429.600 through 429.630. See generally Streiker, Getting Paid Commissions: A New Power Balance Between Real Estate Brokers, Appraisers and Their Clients Under the Missouri Commercial Real Estate Brokers' and State Certified Real Estate Appraisers' Lien Act*, 63 U.M.K.C. L. Rev. 727 (1995) .

(n9)Footnote 9. *See Incentive Realty, Inc. v. Hawatmeh*, 983 S.W.2d 156, 160 (Mo. App. 1998) *reh'g denied* (1999).

(n10)Footnote 10. *See Dalton Invs., Inc. v. Nooney Co.*, 10 S.W.3d 590, 592-593 (Mo. App. 2000) .

(n11)Footnote 11. *See generally Powell on Real Property § 38.13* (Michael Allan Wolf ed., Matthew Bender) for a discussion of the types of services for which a mechanic's lien may be filed.

(n12)Footnote 12. *N.Y. Lien Law § 2(4).*

(n13)Footnote 13. See *Robert Plan Corp. v. Greiner-Maltz Co.*, 229 A.D.2d 122, 655 N.Y.S.2d 648, 649-650, 1997 N.Y. App. Div. LEXIS 3074 (1997) , appeal denied, 90 N.Y.2d 808, 664 N.Y.S.2d 270, 686 N.E.2d 1365 (1997) .

Pursuant to *N.Y. Real Prop. Law § 294-b*, a real estate broker who meets the requirements of this section can act to require that his or her commission in connection with residential property be escrowed before there has been a judgment that the commission has been earned. The broker must file an affidavit of entitlement to commission with the county clerk. The required contents of this affidavit are stated in *N.Y. Real Prop. Law § 294-b (2)*. Subsection (5)(k) defines the affected residential real property which may be subjected to this escrow requirement. Included are properties improved by a one to four family dwelling, individual condominium units and individual cooperative apartments. The property must be used or occupied, or intended to be used or occupied, wholly or partly, as the home or residence of one or more persons. In order for a broker to file this affidavit, there must be a written brokerage contract containing the following statement in clear and conspicuous bold face type:

At the time of closing, you [seller] may be required to deposit the broker's commission with the county clerk in the event that you do not pay the broker his and her commission as set forth herein. Your obligation to deposit the broker's commission with the county clerk may be waived by the broker.

While an affidavit can be filed with respect to other real property (i.e., non-residential), the affidavit does not invalidate the transfer of property or create a lien. Since the affidavit outside of the residential context does not require the escrowing of the broker's commission, this provision is less effective in protecting the broker's commission with these types of property.

(n14)Footnote 14. 68 P.S. § 1051 et seq.

(n15)Footnote 15. See *Re/Max Select Realty v. DeAugustino*, 73 Pa. D. & C.4th 371, 377 (2005) .

(n16)Footnote 16. *Fla. Stat. Ann. § 475.42(l)(j)*. See *Michel v. Beau Rivage Beach Resort, Inc.*, 774 So. 2d 900, 902 (*Fla. App.* 2001) .

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99 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.11C

§ 4.11C Punitive Damages

As a general rule, punitive damages are not awarded in breach of contract actions. n1 However, some jurisdictions allow the recovery of punitive damages in breach of contract actions when the breach is attended by intentional wrong, insult, abuse, or such gross negligence as to amount to an independent tort. n2 While punitive damages are often awarded in tort actions, punitive damages are awarded in contract actions only in extreme cases. It has been stated that such an award must be done with caution and within narrow limits. n3 It is possible for a broker to be awarded punitive damages in an action to recover a commission when the party responsible for paying the commission engages in willful or wanton conduct in refusing to pay a commission. n4 Counsel representing a broker seeking to recover a commission should also not overlook the possibility of an award of prejudgment interest since such an award is usually within the court's discretion n5 and may be awarded in a breach of contract action. n6

It is also possible for an unlicensed individual to be assessed damages which are penal in nature for unlawfully accepting a commission on the sale of real estate. For example, New York Real Property Law Article 12-A states that no person may receive a commission arising out of the sale of real estate unless that person has a real estate license. Section 442-e(3) of New York Real Property Law provides that unlicensed brokers who have received funds in violation of the provisions of Article 12-A may be liable for not less than the amount received by them and not more than quadruple the amount. Quadruple damages under this provision are penal in nature and discretionary with the court. n7

FOOTNOTES:

(n1)Footnote 1. *See generally* Dodge, *The Case for Punitive Damages in Contracts*, 48 *Duke L. J.* 629 (1999).

(n2)Footnote 2. *See Polk v. Sexton*, 613 So. 2d 841, 845 (Miss. 1993) .

(n3)Footnote 3. *See Bryant v. Alpha Entertainment Corp.*, 508 So. 2d 1094, 1098 (Miss. 1987) .

(n4)Footnote 4. *See Sudeen v. Castleberry*, 794 So. 2d 237, 252 (Miss. Ct. App. 2001) (punitive damages of \$100,000 awarded on a commission of \$48,000).

See generally Black, *Client Liability to Real Estate Brokers: From Contract to Punitive Damages*, 25 *Real Est. L. J.* 78 (Summer 1996). This article examines theories of agency, contract, and tort that form the basis of client liability to

brokers.

(n5)Footnote 5. *See Sunburst Bank v. Keith*, 648 So. 2d 1147, 1152 (Miss. 1995) .

(n6)Footnote 6. *See Warwick v. Matheney*, 603 So. 2d 330, 340 (Miss. 1992) .

(n7)Footnote 7. *See Handy v. Cohen*, 195 Misc. 2d 548, 549-550, 759 N.Y.S.2d 627, 629, 2003 N.Y. Misc. LEXIS 69 (N.Y. City Ct. 2003) .

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100 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.11D

§ 4.11D Broker Rebates

One marketing scheme used by some real estate brokers is to offer a rebate of the broker's commission. Since the majority of sellers are not licensed as brokers, agents or salespersons, the issue this conduct raises is whether this scheme constitutes an illegal sharing a commission with an unlicensed person. It appears that some states bar this type of activity due to specific statutory language which prohibits brokers from paying rebates. For example, *Oregon Revised Statutes § 696.290* states in part:

No real estate licensee shall offer, promise, allow, pay or rebate, directly or indirectly, any part or share of the licensee's commission or compensation arising or accruing from any real estate transaction or pay a finder's fee to any person who is not a real estate licensee...

Thus, Oregon outright bars a rebate marketing plan. Similarly, Minnesota and Mississippi have similar statutory restrictions. n1

By regulation, in Kentucky it is illegal for any licensee to offer a prize, money, free gift, rebate or any other thing of value for the purpose of influencing a purchaser or prospective purchaser of real estate. n2 However, a licensee may offer refreshments or snacks to the general public and may give a gift that has a value of less than \$100.00 as a closing gift so long as it was not offered before closing.

Not all states bar rebate programs, however. Nevada's Attorney General has opined that in the absence of any judicial or legislative prohibition, buyer's broker rebates, gifts, or discounts are probably lawful in Nevada real estate transactions. However, the Nevada Attorney General noted that the Nevada Real Estate Division has the authority to adopt regulations defining the perimeters of a buyer's brokerage agreement. n3

The Florida Attorney General has opined that Florida allows a broker to offer and promote a program in which purchasers of property listed by a broker receive a discount at a specific retail outlet. Florida's Attorney General found that such a program was in the nature of a gift and that neither Chapter 475 nor the Florida Real Estate Commission rules prohibited such conduct if the recipient purchased property listed with the broker. n4

FOOTNOTES:

(n1)Footnote 1. *See* Minn. Stat. Ann. § 696.290; *Miss. Code Ann.* § 73-35-21(1)(j).

(n2)Footnote 2. 201 KAR 11:121, Section 2.

(n3)Footnote 3. *See* Nevada Attorney General's Opinion No. 97-28 (Dec. 31, 1997).

(n4)Footnote 4. *See* Florida Attorney General Opinion No. 83-48.

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101 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.12

§ 4.12 Arbitration

Commission disputes between brokers in some cases never reach the courthouse. The National Association of Realtors(R) and member boards provide an arbitration system for resolving disputes on agency, subagency and commission issues between members, and in some cases, members and non-members of a particular board.

[1] Realtor(R) Code of Ethics

Article 17 of the Realtor(R) Code of Ethics provides that "[i]n the event of a contractual dispute between Realtor(R) associated with different firms, arising out of their relationship as Realtors(R), the Realtors(R) shall submit the dispute to arbitration in accordance with the regulations of their Board or Boards, rather than litigate the matter. The term "dispute" means "a controversy arising out of a real estate transaction and all of the related agency and subagency questions between Realtors(R) and their clients and the contractual matters arising out of their relationship with customers." n1 Article 17 further provides that "[i]n the event clients of Realtors(R) wish to arbitrate contractual disputes arising out of real estate transactions, Realtors(R) shall arbitrate those disputes in accordance with the regulations of their Board, provided the clients agree to be bound by the decision." The structure of the arbitration procedure is set out in the Code of Ethics and Arbitration Manual published by the National Association of Realtors(R). n2

[2] Duty to Arbitrate

Having signed the agreement to abide by the bylaws of the Board, every member, where consistent with applicable law, agrees to submit to arbitration by the Board's facilities all disputes with any other member under the following conditions:

1. Every Realtor(R) and non-resident member of the Board who as a principal broker of a real estate firm involving any disputes arising out of the real estate business with a Realtor(R) who is a principal broker in another real estate firm to a Realtor(R) or a non-resident member other than a principal of a Realtor(R) Associate shall have the right to invoke the arbitration facilities of the board in a business dispute with a Realtor(R), Realtor(R) Associate or non-resident member in another firm within the same or a different board. Arbitration in such cases shall be between the principle brokers. This type of dispute can include Realtors(R) (non-principals) and Realtors(R) Associates who are affiliated with one of the

participants and have a vested financial interest in the outcome.

2. A client of a Realtor(R) or a non-resident member (principal) shall have the right to invoke the arbitration facilities of the board in a business dispute with a Realtor(R) (principal) arising out of an agency relationship, provided the client agrees to be bound by the arbitration.

The arbitration may be available, but is not required to be available for other disputes involving Realtors(R) in the same firm with non-member brokers, and in some cases, including customers, provided that all parties to the dispute agree in writing to arbitrate the dispute.

[3] Arbitration Procedures

Arbitration procedures are set out in the Arbitration Manual. n3 Not sooner than fifteen days, and no later than twenty-one days after the mailing of a notice to the respondent of the request for arbitration, the Secretary of the Board must mail to the claimant a copy of the response and respondent's affirmative claim, if any. The Professional Standards Committee Chairperson of the Board shall appoint from a list of potential panel members, three or more arbitrators to hear the dispute. The chairperson of the Professional Standards Committee shall also select one of the panel members to serve as chairperson for the Hearing Panel. Any Hearing Panel must have an odd number of members, of which at least two shall be Realtors(R). In the event a Realtor(R) Associate is involved in the dispute, one of the arbitrators must also be a Realtor(R) Associate or a Realtor(R) other than a principal. In the case of an arbitration involving issues related to areas of the commercial or industrial real estate business, the Board can be requested to provide a representative peer panel.

[4] The Arbitration Award

An award by the arbitration panel is required to be in writing and signed by the arbitrators (or a majority of them) and must state only the amount of the award. An arbitration award is binding and is not subject to review or appeal unless there are alleged irregularities occurring in the conduct of the proceeding. In that situation, the aggrieved party can appeal to the Board of Directors of the Board. n4

[5] Judicial Enforcement

The Arbitration Manual provides that, after the award is entered, judgment may be rendered upon the award by any competent court of record in the country. If the member fails to comply with the award, the recipient is advised by the Board to seek judicial enforcement to request reimbursement of legal fees incurred in seeking enforcement, which is provided under most state statutes.

The scope of judicial review is very limited. An award will be upheld, absent clear error, manifest disregard of a contractual provision or a completely irrational result, or unless it can be shown that the trial judge overlooked material evidence. n5

FOOTNOTES:

(n1)Footnote 1. Code of Ethics and Arbitration Manual, Part 10, Section 43.

(n2)Footnote 2. Note Volume 110a-1995.

(n3)Footnote 3. Part 10, Section 51.

(n4)Footnote 4. Part 10, Section 53.

(n5)Footnote 5. *Berthod Realtors, Inc. v. J.W. Riker-Northern Rhode Island, Inc.*, 636 A.2d 1328 (R.I. 1994) .

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102 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
CHAPTER 4 The Broker's Obligation and Right to Compensation*

10-4 Real Estate Brokerage Law and Practice § 4.12A

§ 4.12A Broker Disputes Over Commissions

While many disputes between brokers as to the sharing of a commission are handled by arbitration under the Realtor(R) Code of Ethics, some of these disputes are decided by the courts. The few decisions addressing disputes between brokers over a commission do not mention the concept of procuring cause, but rather apply general contract principles. n1 Generally, the procuring cause rule does not apply to disputes between brokers arising out of an agreement to divide a commission. n2 Instead, the issue is what was the agreement between the brokers regarding the distribution of the commission. The client typically does not have to know of the broker's intent to split or share the commission with another broker. n2.1

When brokers agree to share a commission it is the majority rule that the principal must pay the commission before one broker becomes liable to share the commission with another broker. n3 This is also the general rule when the commission is shared by the selling broker and an agent supervised by that broker; the agent is due his or her share of the commission when the funds are paid to the broker. n4

When a transaction involves a listing broker and a selling broker, the seller's brokerage agreement is with the listing broker. Should the selling broker not receive his or her commission, the broker's cause of action lies against the listing broker since the seller has no contract with the selling broker. Consequently, courts have rejected arguments based on subagency assertions in these cases where the selling broker has sought to hold the seller responsible for the commission. n4.1

Commission disputes can also arise between the broker and the agent. Agents are typically independent contractors. n5 Under some arrangements, a percentage of the agent's commission is retained by the broker. Under other arrangements, the agent is entitled to 100% of the commissions the agent earns, but the agent must pay a monthly amount to the broker in exchange for management, shared office expenses, miscellaneous shared expenses and institutional advertising. Under this latter arrangement, the broker functions in part as a conduit for payment of the commissions. A broker who wrongfully releases a client from its obligation to pay a commission to an agent may be liable to the agent for damages. n6

Disputes can also arise between an agent and his or her broker concerning commissions earned while the agent was associated with the broker, but which are collected or paid after the agent and broker have terminated their relationship.

When the parties' agreement provides guidance, it should determine whether the agent is due a commission on sales which close after the agent departs from the broker's business. n7 When there is either no agreement or the agreement is silent on this issue, the court may apply a general rule used with respect to employees when the agent is an employee. n8

The underlying sale may determine whether the former agent is due a commission. In one case, the former agent was not entitled to commissions where the sales closed after the agent had been terminated and each listing had expired by its terms before a sales contract had been executed and before the property had been sold. In each instance, a new and separate listing agreement had been obtained by another agent affiliated with the broker and the sale was made under the new listing. None of the new listing agreements referred to any renewal of an earlier agreement. n9

FOOTNOTES:

(n1)Footnote 1. See, e.g., *Deer Run Properties, L.L.C. v. Keys to the Lake Lodgings, Co., L.L.C.*, 2010 Mo. App. LEXIS 519, at *9 (Apr. 26, 2010) *Maxwell v. Michael P. Doyle, Inc.*, 164 N.C. App. 319, 324, 595 S.E.2d 759, 762 (N.C. Ct. App. 2004) .

(n2)Footnote 2. See, e.g., *Howell v. Steffey*, 204 A.2d 695, 696 (D.C. 1964) ; *Blake v. Gunkey*, 88 Kan. 272, 274, 128 P. 181, 182 (Kan. 1912) ; *Drew v. Maxim*, 150 Me. 322, 324-25, 110 A.2d 602, 604 (Me. 1954) ; *De Benedictis v. Gerechoff*, 134 N.J. Super. 238, 242-43, 339 A.2d 225, 228 (N.J. Super. Ct. App. Div. 1975) ; *Maxwell v. Michael P. Doyle, Inc.*, 164 N.C. App. 319, 324-325, 595 S.E.2d 759, 762-763 (N.C. Ct. App. 2004) . See generally Perovich, Annot., *Construction of Agreement Between Real-Estate Agents to Share Commissions*, 71 A.L.R.3d 586 (1976).

(n3)Footnote 2.1. See *Puckett v. Burris*, 2009 Tex. App. LEXIS 9056, at *36 (Tex. App. Nov. 24, 2009) , *pet. for review filed* (Jan. 12, 2010).

(n4)Footnote 3. See *Overseas Dev. Disc Corp. v. Sangamo Constr. Co.*, 840 F.2d 1319, 1332 (7th Cir. 1988) , applying Illinois law; *Sven Salen AB v. Jacq. Pierot, Jr., & Sons, Inc.*, 559 F. Supp. 503, 506 (S.D. N.Y. 1983) , *aff'd without opinion*, 738 F.2d 419 (2d Cir. 1984) , applying New York law (dicta); *Valdina v. Martin*, 47 A.D.3d 1159, 1160, 849 N.Y.S.2d 364, 365, 2008 N.Y. App. Div. LEXIS 371 (2008) *William T. Bell & Assocs., LLP v. Pyramid Brokerage Co.*, 281 A.D.2d 943, 721 N.Y.S.2d 893, 894, 2001 N.Y. App. Div. LEXIS 2759 (N.Y. App. Div. 2001) ; *White v. Robinson*, 153 App. Div. 776, 777, 1912 N.Y. App. Div. LEXIS 9361, 1912 N.Y. App. Div. LEXIS 11266, 138 N.Y.S. 992, 993 (N.Y. App. Div. 1912) ; *Chears v. Robert A. Young & Associates, Inc.*, 49 N.C. App. 674, 677, 272 S.E.2d 402, 404 (N.C. Ct. App. 1980) . Perovich, Annot., *Construction of Agreement Between Real-Estate Agents to Share Commissions*, 71 A.L.R.3d 586, 606-10 (1976).

(n5)Footnote 4. See *Young v. Wardley Corporation*, 182 P.3d 412, 415-416, 2008 UT App 104 .

(n6)Footnote 4.1. See *Deer Run Props., L.L.C. v. Keys to the Lake Lodgings, Co., L.L.C.*, 2010 Mo. App. LEXIS 519, at *5-*9 (Apr. 26, 2010) ; *Valdina v. Martin*, 47 A.D.3d 1159, 1160, 849 N.Y.S.2d 364, 365 (2008) ; *Geoffrey S. Matherson & Associates, Ltd. v. Calderone*, 190 Misc. 2d 775, 739 N.Y.S.2d 876, 877 (2001) . See also *McCombs v. Moss*, 121 Ark. 533, 536, 181 S.W. 907, 908 (Ark. 1916) (Where a sale of real estate is made by an agent with the assistance of a sub-agent under an agreement to divide the commissions with him, such sub-agent is not entitled to recover the commission from the seller since there is no privity of contract between them.).

(n7)Footnote 5. Cf. *Goodale v. Langenberg*, 243 S.W.3d 575, 582-83 (Tenn. Ct. App. 2007) (agent properly found to be an independent contractor), *appeal denied*, 2007 Tenn. LEXIS 1063 (Tenn. Nov. 19, 2007) .

(n8)Footnote 6. See *Dowlen v. Weathers*, 2005 Tenn. App. LEXIS 289, at *4 (May 17, 2005) (agent awarded treble damages for the broker's inducement of breach of contract when the broker released the client from liability for the agent's commission).

(n9)Footnote 7. *See Smith v. Johnston*, 73 Ill. App. 3d 601, 603, 29 Ill. Dec. 409, 391 N.E.2d 1092, 1094 (1979) .

(n10)Footnote 8. *See Citigroup Realty, Inc. v. Valdes*, 8 So. 3d 383, 385 (Fla. Dist. Ct. App. 2009) (general rule is that employee is entitled to commissions earned during employment, but collected after termination and noting three exceptions to this rule).

(n11)Footnote 9. *See Braden v. Isabell K. Horsley Real Estate, Ltd.*, 245 Va. 11, 14, 425 S.E.2d 481, 482 (1993) .

* This chapter was revised by Charles J. Jacobus, Esq., a partner in the firm of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas. In 1999, Sections 4.01 through 4.03 were revised by Mary Fallon, Esq. Additional updates were contributed by Sandra Bullington, Esq.



103 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation
 CHAPTER 4 The Broker's Obligation and Right to Compensation*

*10-4 Real Estate Brokerage Law and Practice § 4.13***§ 4.13 Illustrative Forms****[1] Introduction**

This section provides examples of pleadings and other trial materials. Set out below is an illustrative complaint in an action alleging that defendant induced the breach of a brokerage agreement. n1 Section 4.13[3] sets out an illustrative complaint in an action where the principal repudiated a brokerage agreement, pleading alternative causes of action in addition to that of the mere repudiation. Section 4.11[4] provides examples of opening statements by both the plaintiff's and defendants' counsel in an action for a broker's commission, and Section 4.11[5] sets out a plaintiff--broker's requested charge to the jury in an action for a brokerage commission.

[2] Complaint in Action for Inducing Breach of Contract Complaint in Action for Inducing Breach of Contract

COURT OF THE STATE OF
 COUNTY OF

_____	)
AUTREFOIS ASSOCIATES, INC.,	)
Plaintiff,	)
	)
-against-	)
INFINITIVE REALTY CO., INC. and	)
JISMO & JISMO, a Partnership,	)
Defendants.	)
_____	)

Plaintiff, for its complaint, by and, its attorneys, alleges as follows:

AS AND FOR A FIRST CAUSE OF ACTION

FIRST: At all times herein mentioned, plaintiff was, and now is, a domestic corporation.

SECOND: Upon information and belief, at all times herein mentioned the defendant Infinitive Realty Co., Inc. (hereinafter called Infinitive) was, and now is, a domestic corporation.

THIRD: At all times hereinafter mentioned, plaintiff was, and now is, regularly engaged in business as a real estate broker and was, and now is, duly licensed as such broker.

FOURTH: In and about the month of, 19.... the defendant Infinitive employed the plaintiff to procure a tenant for certain real property owned by Infinitive, then located at Street and Avenue, in the Borough of, City of

FIFTH: Infinitive promised and agreed to pay the plaintiff for its services [*here, state the agreed percentages relative to the rentals under the lease procured*].

SIXTH: The plaintiff procured a tenant for said property, to wit, Iago Realty Corp., a nominee of Othello Mfg. Co., and on or about, 19....., a lease for said property for a term of 5 years from, 19, was duly made between the said Infinitive, as landlord, and said Iago Realty Corp., as tenant, which lease reserved a rental of \$..... per annum.

SEVENTH: The commission earned by the plaintiff under plaintiff's engagement above alleged is \$..... which said sum is also the reasonable value of the work, labor and services performed by the plaintiff for the defendant.

EIGHTH: By reason of the premises, there is now due and owing from Infinitive to the plaintiff the sum of \$....., with interest thereon, no part of which has been paid, although duly demanded.

AS AND FOR A SECOND CAUSE OF ACTION

NINTH: Plaintiff repeats and re-alleges as part of this cause of action each and every allegation contained in paragraphs 'FIRST' to 'SEVENTH', inclusive, as if herein re-alleged in full.

TENTH: Upon information and belief, at all times herein mentioned the defendant Jismo & Jismo was a partnership having an office for the transaction of business at Avenue, Borough of, and was regularly engaged in business as a real estate broker and was, and now is, duly licensed as such broker.

ELEVENTH: Upon information and belief, the defendant Jismo & Jismo, with intent to deprive the plaintiff of its commissions and to induce the defendant Infinitive to breach its agreement of employment with the plaintiff hereinabove alleged, fraudulently caused Infinitive to conspire with the defendant Jismo & Jismo that any knowledge of the progress and course of the negotiations in the making and consummation of the aforesaid lease with said Iago Realty Corp. should be withheld from the plaintiff; that Infinitive should execute and deliver said lease without the knowledge of the plaintiff and that upon the making of the lease, Infinitive should without the knowledge of the plaintiff pay the commission to the defendant Jismo & Jismo each of the defendants well knowing that it was the plaintiff and not the defendant Jismo & Jismo who had been hired by Infinitive to procure a tenant for the property hereinabove alleged and that it was the plaintiff and not the defendant Jismo & Jismo who had procured the tenant hereinabove mentioned for said property.

TWELFTH: Upon information and belief, in pursuance of the fraudulent conspiracy hereinabove alleged, Infinitive paid said commissions to the defendant Jismo & Jismo without the knowledge or consent of the plaintiff.

THIRTEENTH: No commission has been paid to the plaintiff by the defendants or any of them, though due demand has been made by the plaintiff for the commission earned by plaintiff, as above alleged.

WHEREFORE, plaintiff demands judgment in the sum of \$, with interest from, 19.....

(a) against the defendant Infinitive hereinabove described on the first cause of action, and

(b) against the defendant Jismo & Jismo on the second cause of action,

together with costs and disbursements of this action

..... &

Attorneys for Plaintiff

Office & P.O. Address:

.....

.....

(Verification)

[a] Complaint in Action for Tortious Interference With Broker's Contract--Another Form Complaint in Action for Tortious Interference With Broker's Contract--Another Form

Attorney for Plaintiff

....., INC. REALTORS	)	
[Plaintiff-Broker]	)	SUPERIOR
Plaintiff	)	COURT OF
v.	)	NEW JERSEY
..... and, his Wife [sellers] and	)	LAW DIVISION
..... [Purchaser]	)	
Defendants	)	 COUNTY
	)	DOCKET NO.
	)	
	)	CIVIL ACTION
	)	COMPLAINT
	)	AND JURY DEMAND
	)	

Plaintiff, a corporation organized and existing under the laws of the state of New Jersey with its principal place of business located at Street, in the Borough of, County of, State of New Jersey says:

FIRST COUNT

1. During all the times hereinafter mentioned, Plaintiff was and is a duly licensed real estate broker, engaged in such business in County, New Jersey.
2. On 19, at, New Jersey, the Defendants, ... [sellers], entered into a written agreement with the Plaintiff for good and valuable consideration whereby the Defendants, ... [sellers], retained the services of the Plaintiff as exclusive sales agent for the purpose of selling the property of Defendants, ... [sellers], at Road in the Township of, County of, State of New Jersey, also known as lot No. on Block No. of the tax map of the aforesaid municipality. A true copy of the agreement is annexed hereto and made a part hereof, marked Exhibit "A."
3. The aforementioned agreement provides inter alia that Plaintiff is entitled to a commission in the amount of 6% of the selling price if the property of the Defendants, ... [Sellers], is sold between, 19....., and, 19.... or if the property is sold within six(6) months after, 19, to parties who have been shown the said property during the term of the agreement.
4. In accordance with the terms of the agreement and in reliance thereon, Plaintiff proceeded to extensively advertise the property of the Defendants, ... [Sellers], for sale to the general public and to other real estate brokers, and Plaintiff continually made every feasible effort to obtain a purchaser for said property.
5. During the term of the agreement between Plaintiff and Defendants, ... [Sellers], said property was shown to Defendant, ... [Purchaser], a prospective purchaser.
6. During the term of the agreement between Plaintiff and Defendants, ... [Sellers], Defendant, ... [Purchaser], made several offers to purchase the subject property, ultimately offering to purchase said property for \$ 00.
7. Plaintiff participated in the negotiating process between Defendants, ... [Sellers] and Defendant, ... [Purchaser]. All Defendants were at all times aware of Plaintiff's participation.
8. Defendants, ... [Sellers] rejected Defendant's, ... [Purchaser] offers to purchase their property.
9. Subsequently, during the six (6) month period referred to in Paragraph 3 above and, more specifically, on, 198....., Defendants, ... [Sellers], sold their property to Defendant, ... [Purchaser], entering into a binding and enforceable contract of sale for the price of \$ 00.
10. Plaintiff has become entitled to a commission for its services pursuant to the agreement between Plaintiff and Defendants, ... [Sellers], and has duly demanded the same from the Defendants,

_____[Sellers].

11. Defendants, _____[Sellers], have not paid such commission nor any part thereof.

WHEREFORE, Plaintiff demands judgment against the Defendants, _____[Sellers], in accordance with the terms of their agreement together with interest thereon and costs of suit.

SECOND COUNT

1. Plaintiff repeats the allegations of the First Count herein in their entirety.

2. The course of conduct of Defendants, _____[Sellers], as alleged above represents a tortious, intentional interference with the Plaintiff's business opportunity to earn a commission as a licensed real estate broker.

3. The course of conduct of Defendants, _____[Sellers], as alleged above, represents a knowing and willful attempt by Defendants, _____[Sellers], to defraud Plaintiff of monies due to Plaintiff.

WHEREFORE, Plaintiff demands judgment against Defendants, _____[Sellers], for damages and punitive damages, interest and costs of suit.

THIRD COUNT

1. Plaintiff repeats the allegations of the FIRST COUNT herein in their entirety.

2. The Defendants, _____[Sellers], and the Defendant, _____[Purchaser], for the purpose of interfering with Plaintiff's business opportunity to earn a commission and in an attempt to defraud Plaintiff of monies due Plaintiff, conspired and agreed between themselves to conduct negotiations in secret, as far as Plaintiff was concerned.

3. Defendants, _____[Sellers], and Defendant, _____[Purchaser], conspired and agreed to consummate the sale of the subject property in such a fashion as to avoid the payment of a commission to Plaintiff.

4. The sale of the property of Defendants, _____[Sellers], to Defendant, _____[Purchaser], has been consummated and no commission has been paid to Plaintiff.

WHEREFORE, Plaintiff demands judgment against Defendants, _____[Sellers] and Defendant, _____[Purchaser], jointly and severally, for damages and punitive damages, interest and costs of suit.

JURY DEMAND

Plaintiff demands trial by jury of twelve (12) persons.

.....

Attorney for Plaintiff

Date

Attorneys for Defendants--Third-Party Plaintiffs

	)	
	)	SUPERIOR
	)	COURT OF
	)	NEW JERSEY
	)	LAW DIVISION
Plaintiff, INC., REALTORS,	)	
[Plaintiff-Broker]	)	 COUNTY
vs.	)	
Defendants-Third-Party Plaintiffs, ... and	)	<i>Docket No.</i>
..... his wife [Sellers] and Defendant,	)	
....., [Purchaser]	)	
vs.	)	<i>CIVIL ACTION</i>
Third-Party Defendants, LMN REAL ESTATE and	)	ANSWER
XYZ REAL ESTATE	)	AND
	)	THIRD-PARTY
	)	COMPLAINT
	)	

FIRST COUNT

1. Defendants do not possess knowledge or information sufficient to form a belief as to the allegations of Paragraph 1 of the First Count and, therefore, leave plaintiff to their proofs.
2. Defendants admit the allegations of Paragraph 2 of the First Count.
3. Defendants deny the allegations of Paragraph 3 of the First Count.
4. Defendants deny the allegations of Paragraph 4 of the First Count.
5. Defendants deny the allegations of Paragraph 5 of the First Count.
6. Defendants deny the allegations of Paragraph 6 of the First Count.
7. Defendants deny the allegations of Paragraph 7 of the First Count.
8. Defendants deny the allegations of Paragraph 8 of the First Count.

9. Defendants deny the allegations of Paragraph 9 of the First Count.
10. Defendants deny the allegations of Paragraph 10 of the First Count.
11. Defendants admit the allegations of Paragraph 11 of the First Count.

WHEREFORE, defendants, _____[Sellers], demand judgment against plaintiff dismissing the Complaint, together with attorneys' fees and costs of suit.

SECOND COUNT

1. Defendants repeat their answers to the First Count.
2. Defendants deny the allegations of Paragraph 2 of the second Count.
3. Defendants deny the allegations of Paragraph 3 of the second Count.

WHEREFORE, defendants, _____[Sellers], demand judgment against plaintiff dismissing the Complaint, together with attorneys' fees and costs of suit.

THIRD COUNT

1. Defendants repeat their answers to the First and Second Counts.
2. Defendants deny the allegations of Paragraph 2 of the Third Count.
3. Defendants deny the allegations of Paragraph 3 of the Third Count.
4. Defendants admit the allegations of Paragraph 4 of the Third Count.

WHEREFORE, defendants, _____[Sellers], demand judgment against plaintiff dismissing the Complaint, together with attorneys' fees and cost of suit.

FIRST SEPARATE DEFENSE

The Complaint fails to state a claim upon which relief can be granted.

SECOND SEPARATE DEFENSE

Defendants _____[Sellers] have paid all real estate commissions due on the sale of their property to the proper real estate brokers.

THIRD SEPARATE DEFENSE

The "trailer clause" in the plaintiff's agreement expired prior to the sale of the property owned by defendants,

_____[Sellers].

FOURTH SEPARATE DEFENSE

Plaintiff did not introduce defendant, _____[Purchaser], to the property owned by defendants _____[Sellers].

FIFTH SEPARATE DEFENSE

Defendants _____[Sellers] acted at all times relevant to this action in a proper and reasonable manner.

SIXTH SEPARATE DEFENSE

The "trailer clause" in the plaintiff's agreement is unconscionable.

THIRD-PARTY COMPLAINT

Defendants and Third-Party Plaintiffs, _____[Sellers], by way of Third-Party Complaint against LMN REAL ESTATE and XYZ REAL ESTATE say:

FIRST COUNT

1. Third-Party plaintiffs, _____[Sellers], sold their property located _____, _____ Township, _____ County, New Jersey to defendant, _____[Purchaser], on _____, 19

2. Following this sale, Third-Party Plaintiffs, _____[Sellers], paid all real estate commissions due. Commissions in the amount of \$ 00 were paid to the defendant-purchaser's real estate broker and Third Party Defendant XYZ REAL ESTATE and commission in the amount of \$.....00 to Third-Party Defendant LMN REAL ESTATE, the Defendant-Third-Party Plaintiffs' real estate broker.

3. Therefore, if Defendants-Third-Party Plaintiffs _____[Sellers] are found to be liable to Plaintiff, then Third-Party Defendants LMN REAL ESTATE and XYZ REAL ESTATES are required to indemnify Defendant-Third-Party Plaintiffs.

WHEREFORE, Defendant-Third-Party Plaintiffs _____[Sellers] demand judgment against Third-Party Defendants LMN REAL ESTATE and XYZ REAL ESTATE for indemnification together with attorneys' fees and costs of suit.

Attorneys for Defendants

.....

Third-Party Plaintiffs

..... and

By:.....

For the Firm

Dated:.....

[3] Complaint in Action Where Principal Repudiates Before Written Agreement of Sale Executed n2
Complaint in Action Where Principal Repudiates Before Written Agreement of Sale Executed

..... COURT OF THE STATE OF
COUNTY OF

_____	)
.....	)
Plaintiff,	)
	)
-against-	)
.....	)
Defendants.	)
	)

* * *

PLAINTIFF'S ORIGINAL PETITION

* * *

TO THE HONORABLE JUDGE OF SAID COURT:

COMES NOW, ..., hereinafter called "Plaintiff," complaining of, (hereinafter called "....."), ..., (hereinafter called "....."), ..., (hereinafter called "....."), which are hereinafter collectively called "Defendants," unless they are specifically addressed by their name.

PARTIES, JURISDICTION AND VENUE

PARTIES

1. Plaintiff, ..., is an individual, who resides and conducts business in, County, ...
2. Defendant, ..., is an individual doing business at and may be served with process at that address.
3. Defendant, ..., is an individual doing business at and may be served with process at that address.

4. Defendant, ..., is an individual doing business at and may be served with process at that address.

JURISDICTION

All parties are domiciliaries of or each defendant is subject to the jurisdiction of due to sufficient contacts which are the basis of this action. All or part of the complained of transactions occurred in and the amount in controversy exceeds the Court's minimum jurisdiction and Plaintiffs are suing under the common laws and statutes of

VENUE

Venue. Venue is mandatory and proper in the above county pursuant to the Civil Practice and Remedies Code, Sections where: all or part of the causes of action accrued; in which all parties reside as a result of their minimum contacts, business activities, tortious conduct and torts occurred. The following Paragraphs regarding factual background, causes of action and damages are specifically incorporated herein by reference.

FACTUAL BACKGROUND

At all times mentioned herein Plaintiff was, and now is, regularly engaged in business as a real estate broker, and was, and is now duly licensed under the laws of the State of, as a real estate broker. On or about, Defendant, ..., by and through, as agent, officer and director of employed Plaintiff to act as a real estate broker and agreed to pay real estate broker's commission by executing an enforceable agreement, a true copy of which is attached and incorporated herein as Exhibit "A." According to the Commission Agreement, Plaintiff was to assist in the acquisition of certain nursing home facilities located within the state of, More particularly, these facilities are known as the (herein after referred to as the "properties"). All of the properties were owned by Defendants.

Defendants promised and agreed to pay the Plaintiff two percent (2%) of the final sales price for the above properties for his professional services. Plaintiff, presented the above properties to Defendant. After extensive negotiations, Defendant acting as agent, officer and director for Defendants executed a contract to purchase the properties from, the seller procured by Plaintiff, for \$

The two percent (2%) commission earned by the Plaintiff under Plaintiff's engagement above is \$ Said sum is also the reasonable value of the work, labor and services performed by the Plaintiff for the Defendants.

During the negotiation of the sale of the properties from June 1990 through late 1994 Plaintiff provided professional assistance and had numerous conversations with Defendant regarding the sale of the properties and utilized Plaintiff's facilities in County, ... During these negotiations Defendant represented to Plaintiff that the sale of the properties was forthcoming and that Defendant would keep Plaintiff informed as to all material developments relating to the sale of the properties. During these conversations the Defendants that the acquisition of the properties from the seller would take place and the commission would be paid to Plaintiff. Plaintiff relied at all times stated herein on these representations.

On or about August 9, 1994 Plaintiff had a further conversation with Defendant during which Defendant represented to Plaintiff that the seller had agreed to sell the properties and that Defendant would forward a copy of the contract to Plaintiff once the written agreement was signed. Defendant instructed Plaintiff that Plaintiff did not need to do anything

else to assist in the transaction. Plaintiff and Defendant had several additional conversations, during each of which Defendant made representations that the acquisition of the properties from the seller that Plaintiff produced would, in fact, take place.

Plaintiff made numerous offers to assist Defendant in the required formalities of the acquisition of the properties, but was assured by Defendant that everything was proceeding forward without delay. On or about November 16, 1994 Defendant had a telephone conversation with Plaintiff at Plaintiff's Houston office, Defendant informed Plaintiff that a \$50,000.00 earnest money contract had been signed with the seller for the acquisition of the properties. Subsequent to this conversation Plaintiff faxed a copy of the May 4, 1990 agreement to Defendant's office. During a subsequent phone conversation Defendant stated that he had received the fax and that he would discuss the matter with Plaintiff at a subsequent date. After this Defendant failed to respond to any additional requests from Plaintiff for information regarding the sale of the properties. (See the Agreement of Purchase and Sale of Assets which is attached hereto and incorporated herein as Exhibit "B"). Defendants used this material omission to intentionally deceive Plaintiff.

On or about December 1, 1994 [other broker] called Plaintiff and attempted to convince Plaintiff that Plaintiff did not have any right to the commission from the sale of the properties. During this conversation [other broker] revealed to Plaintiff that [other broker] had been working with Defendants in an attempt to obtain the commission for the sale of the properties. Plaintiff is informed and believes that Defendants collectively, knowingly and maliciously entered in to a conspiracy to attempt to deprive Plaintiff his right to a commission from the sale of the properties.

By reason of the premises, there is now due and owing from Defendants to the Plaintiff the sum of at least \$ with interest thereon, no part of which has been paid, although duly demanded.

CAUSES OF ACTION

The following causes of action are based upon and grow out of the factual background and complaints aforementioned which were and continue to be the proximate or producing causes of the damages aforementioned.

I.

BREACH OF CONTRACT

Contract. Defendants became obligated to perform the contractual duties set out herein. Plaintiff, having performed all of its prerequisites and contractual duties, is entitled to all benefits of the bargain from Defendant.

Defendant has failed to provide all entitled consideration pursuant to its contract with Plaintiff as set out herein.

Damages. Plaintiff is entitled to recover all damages and all benefits of the bargain as set forth at length herein, plus recovery of attorneys' fees, costs and expenses as requested in the subject contract and applicable law.

II.

TORTIOUS INTERFERENCE WITH CONTRACT

A. Interference. By the aforementioned intentional unlawful acts, omissions and conspiracy of [other broker], set forth

herein, Defendants thereby breached their legal duties to Plaintiff by tortiously interfering with contractual benefits belonging or potentially belonging to Plaintiff, thereby proximately damaging Plaintiff.

Plaintiff asserts that [other broker] tortiously interfered with:

1. Plaintiff's binding written contract;
2. That such interference was willful and intentional because said contract was known to [other broker] in whole or generally;
3. By actively inducing the breach by persuasion, defamation, fraud or other unlawful means;
4. Thereby proximately damaging Plaintiff without justification or privilege.

B. Damages. As a proximate result of [other broker]' interference and conversion, Plaintiff has been damaged and prays for recovery as set forth below.

III.

CONVERSION

A. Duty, Breach and Proximate Cause. Defendants had a duty to protect and preserve Plaintiff's property and property rights and/or had a duty to not unreasonably interfere with Plaintiff's property, property interests, use and benefits of Plaintiff's property and rights. As set out herein, Defendants' intentional acts amount to an unlawful exercise of dominion and control over property rights, uses and benefits adverse to Plaintiff's rights and interest. Defendants' acts are tantamount to one or more of the following wrongful acts: wrongful acquisition, wrongful transfer, wrongful detention, without right or permission substantially changing or withhold Plaintiff's property and keeping the consideration of sale or transfer and/or severely damaging or destroying and/or misusing Plaintiff's property and property rights. Said acts constitute serious interference with Plaintiff's property and property rights, use and benefits.

Defendants had a duty to protect Plaintiff's property and to account for all the money and property including mutations thereof, and interest, income and increases therefrom that Defendant received from or for the benefit of Plaintiff and to deliver the profits due and property of Plaintiff to Plaintiff, to allow Plaintiff to use unfettered, its property and goodwill; to allow Plaintiff the exclusive use and benefits of its property and goodwill. By Defendants' serious interference or the consequences thereof, Defendants converted the foregoing for Defendants' own use and benefit thereby proximately damaging Plaintiff.

B. Damages. As a proximate result of Defendants' conversion of the foregoing property, Plaintiff has been deprived of the use and benefit of such property by the assertion, dominion and control over them by Defendants for which Plaintiff should be compensated in the actual and equivalent value of said property at the time and place of conversion and an accounting of the benefits unlawfully received by Defendants. In addition to entitled monetary damages, Plaintiff requests replevin of all of Plaintiff's property, mutations thereof and interest, income and increases therefrom and other consequential property rights, uses and benefits or their equivalent value at the time Defendants acquired Plaintiff's property or the present value which ever is higher, and such other damages set forth below to which Plaintiff may show itself entitled.

IV.

CIVIL CONSPIRACY

Defendants combined to unlawfully deprive Plaintiff of his right to receive a commission for the sale of the properties. Defendants made numerous material misrepresentations to Plaintiff and withheld information in an effort to deprive Plaintiff of his commission. Further, Defendants, in an effort to illegally deprive Plaintiff of his commission refused to allow Plaintiff access to, or participation in, the closing of the properties so as to avoid their legal obligations to Plaintiff. As a direct and proximate result of the conduct of Defendants, Plaintiff has been damaged in that Defendants conspired to deceive Plaintiff so as to deprive him of commission for his professional services.

Defendants are jointly and severally liable for all claims and causes of action because Defendants acted in conspiracy to form an unlawful scheme or plan, and then Defendants intentionally acted in conspiracy with one or more of the other Defendants to further the conspiracy by performing the complained of unlawful acts against Plaintiff which proximately resulted in damage Plaintiff. The Defendants conspired with each other to acquire the business and property rights and advantages of Plaintiff and to circumvent their duties and debts to Plaintiff.

V.

NEGLIGENT MISREPRESENTATION

Defendant made specific representations to plaintiff regarding the acquisition of the properties. More particularly, Defendant assured Plaintiff, as late as November of 1994, that the sale of the properties would take place and that a commission would be paid to Plaintiff. These representations were false and were made to Plaintiff at his office in response to Plaintiff's request for material information regarding the acquisition of the properties; Defendant did not exercise reasonable care or competence in obtaining or communicating the information regarding the acquisition of the properties; and Plaintiff suffered damages as set forth below by justifiably relying on these representations.

VI.

FRAUD AND MISREPRESENTATION

Defendants made misrepresentations of past, present and/or future material facts or conditions as alleged herein, knowing their falsity or should have known they were false or made the statements with reckless disregard as to their truth or falsity intending, knowing or calculating that Plaintiff would act with reasonable reliance upon such misrepresentations. Defendant thereby induced Plaintiff to enter into the transactions and agreements described herein. Defendant knew or should have known at the time said statements were made that Plaintiff would not have entered into the transactions described herein had Plaintiff known that the statements were false or misleading.

Reliance and Causation. Plaintiff reasonably and actually relied upon said misrepresentations which played a substantial part in inducing Plaintiff to take the aforementioned action.

Damages. As a proximate result of said reliance, Plaintiff has been damaged and Defendant has unlawfully acquired Plaintiff's property by such false pretext and intentional malfeasance and is therefore entitled recover as set out herein, for which Plaintiff requests recovery.

VII.**CONSTRUCTIVE OR RESULTING TRUST**

A. Relationship. Defendants and their responsible employees, shareholders, officers and directors had a duty at law and in equity as a result of their contractual relationship with Plaintiff, confidential business relationship with Plaintiff, and/or as Plaintiff's trustee, fiduciary or property custodian, to act as reasonable and prudent people similarly situated and reposed with such trust, duty, authority and ability would have acted under the same or similar circumstances.

B. Trust Creation. By acting and failing to act when honest, fair, diligent and faithful duty required, Defendant took unreasonable and unlawful advantage of their superior, fiduciary or confidential relationship with Plaintiff. By committing the malfeasance and fraud complained of herein, said Defendants acquired Plaintiff's property, failed to give Plaintiff all benefits entitled and/or caused Plaintiff the losses, damages and injuries to Plaintiff's property under the asserted inequitable and unlawful circumstances and conditions described. Wherefore, by operation of law, an imputed constructive or resulting trust has been created and been impressed upon for the benefit of Plaintiff. The subject or res of the trust is Plaintiff's property, including mutations and increases thereof and income and interest therefrom.

VIII.**STATUTORY VIOLATIONS**

Defendants' conduct, as set forth above, violates the following sections of the Real Estate Fraud Statute _____[citation], and Plaintiff is entitled to damages as set out therein. Defendants' acts and omissions are per se violations of these statutes for which Plaintiff requests recovery in the maximum amount and benefit allowed and as set forth herein.

IX.**ATTORNEYS' FEES**

The undersigned attorney, by this pleading makes demand for performance and/or has or will have made demand on each Defendant by certified mail, return receipt requested, or as otherwise allowed by law, for all damages incurred by Plaintiff as alleged herein. Defendant has failed and refused to tender performance, cure or make the demanded payment and more than thirty (30) days will have elapsed since said demand and the time of judgment. Upon proof thereof, Plaintiff requests its costs of court and reasonable and necessary attorneys' fees, plus interest thereon, for which Plaintiff is entitled recovery for Defendant's breach of contract, or as punitive damages, or as otherwise may be shown to be entitled under contract rights, statute or common law at time of trial, including attorneys' fees, costs and expenses for contract defense, if any. The following will be shown: that this requesting party will be the prevailing party; that Plaintiff has been damaged by the opposing party's breach; that the undersigned has been hired to prosecute Plaintiff's rights growing out of that breach, and that Plaintiff is entitled to recover its attorneys' fees.

Without waiving the foregoing, to the extent that Plaintiff is entitled to recovery under contractual provisions mentioned in any contract referred to herein and/or as provided by any additional statute, Plaintiff requests recovery of all reasonable, necessary and allowed attorneys' fees.

X.

DAMAGES

Plaintiff seeks damages within the jurisdictional limits of the Court.

Actual Damages. In the amount of at least \$

General Damages. To the extent Plaintiff is entitled to general damages, as a proximate or producing cause and the result of the malfeasance of Defendant, Plaintiff has suffered general damages in excess of the jurisdictional limits of this Court.

Consequential Damages. As a proximate result of the malfeasance enumerated herein, Plaintiff has and will suffer consequential damages.

Punitive Damages. Plaintiff alleges that the aforementioned malfeasance and breaches were intentional, fraudulent, willful, malicious, grossly negligent or showed wanton or conscious disregard for the rights of and duties owed to Plaintiff, and as such, Plaintiff is entitled to recover exemplary or punitive damages to deter future commission of similar wrongs in an amount of at least twenty (20) times the actual damages or as allowed by law since Plaintiff will prove an intentional tort, malice or other justifiable grounds, and to have the Court order Defendant to pay Plaintiff's attorney fees and all other expenses of litigation, because said fees and expenses were a foreseeable required remedial consequence of Defendants unjustified conduct.

XI.

DEMAND FOR JURY

Plaintiff hereby formally makes this demand and application for a jury trial in this litigation. The required fee has been paid.

XII.

PIERCING THE CORPORATE VEIL

The corporate veil of each corporate Defendant should be disregarded and the shareholders, directors and officers should be held liable for the acts and omissions of said corporations based upon the following grounds:

A. Alter Ego. There exists one or more of the following conditions with respect to each corporate Defendant which entitles Plaintiff to pierce their corporate veil:

1. Unity between corporation and individual is such that the corporation ceases to be separate.
2. Disregard of the corporate entity is necessary to promote justice.

3. Failure of the shareholders to maintain the corporation as a distinct legal entity.
4. Owners failure (neglect) to maintain the formal existence of the corporation as required by law.
5. Failure of the corporation to obey state law by maintaining corporate formalities.
7. Inadequate capitalization.
8. It would be unfair to the Claimant to allow the corporate and/or limited partnership status.
9. Corporate formalities have not been kept.
10. Corporate and individual property have not been kept separately.
11. There is an excessive amount of financial interest which is guiding the decisions of the limited partnership.
12. The corporation has been used for personal purposes.

B. Sham to Perpetrate a Fraud. There exists one or more of the following conditions:

1. Recognizing the separate corporation entity would bring about an inequitable result.
2. The facts will show constructive fraud.
3. There is or would be excessive reliance of the financial backing of the owners should the corporation become insolvent.
6. Corporate form is used to evade an existing obligation.
7. Corporate form is used as a protection of a crime or to justify a wrong.
8. An injustice or unfairness was done to the claimant caused by the corporation and its owners.

C. Illegal Purpose. Based upon the relationship between and among the corporation, its owners, officers, directors and the laws of the State and/or their purposes, which are unlawful, the separate corporate status of said corporation should be ignored.

D. Factual Basis. One or more of the foregoing grounds for piercing the corporate veil is justified based upon the alleged facts stated in the preceding sections.

XIII.

PRAYER

All conditions precedent have been performed or have occurred to entitle Plaintiff to recover as pled, wherefore, Plaintiff prays that:

1. Defendant be cited to appear and answer herein;
2. Judgment against each Defendant jointly and severally as above requested and for all relief requested by Plaintiff and for Plaintiff's attorneys and that in the event that an election of remedies is required that Plaintiff recover the maximum allowable and/or cumulative and/or alternative recovery authorized by law;
3. That in event any statute, code, or other legislative enactment upon which Plaintiff seeks relief is amended, revised, superseded, or in any way modified that this Honorable Court grant relief to Plaintiff based upon the controlling amended, revised, or superseded enactment or common law ruling which will provide Plaintiff with the maximum allowable recovery and rights;
4. Plaintiff be granted judgment for the recovery requested herein at least in the amount of \$
..... ;
5. Plaintiff be granted judgment for prejudgment interest at the maximum allowable rate for the maximum allowable time through the date of judgment;
6. Plaintiff be granted judgment for attorneys' fees plus all allowed interest thereon;
7. Plaintiff be granted judgment for all costs of court and allowable expenses;
8. Plaintiff be granted attorneys fees for post-judgment discovery and collection services to recover the judgment in the amount of at least \$
..... ; attorneys' fees in the event of appeal to the Court of Civil Appeals in the amount of at least \$
..... ; attorneys' fees in the event of filing writ to the Supreme Court in the amount of at least \$
..... ; and attorneys' fees in the event the writ to the Supreme Court is granted at least in the amount of \$
..... ;
9. Plaintiff be granted judgment for the maximum allowable post-judgment interest on the total amount of the judgment including the attorneys fees from the date of judgment until paid;
10. Plaintiff be granted such other and further relief, special or general, legal or equitable as Plaintiff may show itself justly entitled to receive at time of trial.

Respectfully submitted,

.....

Attorneys for plaintiff

Office & P.O. Address:

.....

.....

(Verification)

[4] Illustrative Opening Statement to Jury in Action for Broker's Commission (*Globerman v. Lederer*) n3

[a] Plaintiff's Opening Statement

Mr. Green: May it please your Honor, ladies and gentlemen.

At this point our purpose is just in one direction, for each of us to tell you what we intend to prove. So, before we start putting witnesses on the stand to fill in the pattern, you will have a fair idea of what both sides contend.

In this case, as we mentioned before, Philip I. Globerman is suing these other people who are the Lederers. It is all one family. The Lederers, and Maass, their daughter.

He is suing them because he claims they owe him a brokerage, which is a payment made for getting a purchaser for property after he had been employed, after he had been told to find such a purchaser at a certain price.

He has not been paid. There is a controversy as to whether he should be paid, and the only way of resolving it is to be right here.

Now, what is the story? We go back to early July, 1951, last year. Mr Globerman is a real estate broker. He has been that for some 28 years. These brokers must all be licensed under the law.

Early in July he finds out that certain property, which is called Riverside Drive West, up at 158th Street is for sale. He finds out that the people who have it are the Lederers. The Lederers and Maass. I will call them by one name.

Mr. Globerman had some dealings on this property some eight or nine years before. About that.

So, he goes up to see Mr. Lederer, and he asks him, "Is it true that this is for sale?" Mr. Lederer tells him it is.

Now, at this point there is much which may be of little interest in the case. You see, the Lederers don't actually own these buildings. You have a situation like Rockefeller Center, or this new Lever Bros. building. The land is owned by a certain person. That person gives a lease, where you put up the building, so that the person who owns the lease owns the building, and he has a right to it for a certain number of years, and you pay the owner of the land a certain rent. So, if you, or I owned the property, and we lease it to somebody else, that other person pays the taxes, he pays the interest on

the mortgage, he takes care of all the expenses, and you and I, we get a certain amount of every year as rent. It is what they call a net lease.

So, here the Lederers had this lease for the property, a lease where they were paying somebody \$25,000 a year rent, and they themselves paid the taxes, the interest on the mortgage, mortgage expenses, and of course they took in all the rent.

This lease had until 1960 to run; about nine years. But, they also had a right to renew it later for another 21 years. So, you see, the one who bought it is not technically the owner of the property. He is the owner of the lease, which means that after paying all the expenses, he has the profit from this land, as if he were the owner.

So, when we talk here, we don't talk about selling property. We are going to talk about selling a lease. In effect, it is just what I tell you.

So, on July 10th, Mr. Globerman comes up to see Mr. Lederer; to Mr. Lederer's office. They do business under the name of Reredel Associates. Reredel is just the word Lederer spelled backwards. And, when Mr. Globerman asked Lederer if this leasehold, if this property is for sale, Lederer tells him it is. In fact, he has many brokers working on it. He himself will tell you about 150.

It was so much for sale that he had printed up mimeographed sheets giving you all the details, the price, the rentals, the expenses, and then he was giving it to brokers, whoever might be interested in getting a purchaser, and he gave those to this broker Globerman, and just the main thing which I will tell you, because you will see the sheets, it says, "We have a mortgage on the property now of \$811,000," and he will sell it if he gets \$300,000 in cash. That means you pay \$300,000 in cash, and then when you take over the property, there is still a mortgage on it of \$811,000. But the important term, which I will leave with you now, is Lederers wanted \$300,000 cash for that property. As you will find, they have been trying to sell it through, as he would tell you, 150 brokers. And when Globerman was there, it had not yet been sold, and he told Globerman, "Go ahead; it is yours; sell it."

It is one of these propositions, sometimes you can work on for years, and sometimes, if you are lucky enough, you will get a purchaser.

Negotiations were had, on and off. Globerman got one prospective purchaser, two, three. He made different offers to Lederer, which were under \$300,000. Lederer wouldn't budge. One of the people he was negotiating with was a Dr. Weinraub, a man of very extensive property interests.

We move along, and I will skip over all of Globerman's negotiations with his purchasers, and with Dr. Weinraub, and going back to Lederer, because not only did Lederer give him these details, but he had given him the floor plan, and we come to a Tuesday. These dates are important, and there are very few of them, so I will mention them.

We come to a Tuesday late in July. The date is July 24th; and Dr. Weinraub, who has been very much interested in this property, as he will tell you, has reached the point where he wanted it, if he could check on the further details, and he wanted the broker to give him more details on rentals, the rentals of each apartment, and Globerman, the broker, anxious to make a sale, comes back to Mr. Lederer, and he tells him that this man seems to be interested now in that price, and wants detailed statements of this, and on this Tuesday, July 24th, Mr. Lederer gets to work and copies all of these figures off himself. It took him a couple of hours.

I mention this to show you that on this day, whether he was anxious to sell at the price that he gave Globerman, the price he gave him in writing, because up to this point I don't want you to have to rely too much on anybody's word.

Mr. Lederer writes all this off, gave it to Globerman, Globerman rushes it back to his man. It is a case of where you see a person sometimes three or four times a day in order to make a sale, and by late that night his man authorizes him to go

ahead, he wants to buy it for the \$300,000. You see, they discussed that matter.

Mr. Lederer wanted ten per cent cash when you make the contract. "Be sure you have the purchase amount." It is a proper thing. So, this happened on Tuesday, July 24th.

The fact that Lederer gave him all this data, you will see all the writing. The fact that Globerman took it back to his man and got the acceptance after they examined it, and you will have all that here.

And the very next morning, on Wednesday, July 25th, Mr. Globerman is down to Mr. Lederer's office, and he is there to tell him, "We are ready to buy this; here is my purchaser; this is his name; this is his address; this is his attorney's name; ten per cent was to be paid on the contract."

Their closing was to be made in the usual time, thirty days afterward. Mr. Lederer writes it down. His attorney will get together with their attorney. This is Wednesday. It is agreed. Globerman reports to his purchaser.

Now, it is only fair to tell you at this stage I am giving you--at this point I am giving you our side, because they are going to dispute some of these things, and that will be for you to decide.

Globerman comes back Friday morning.

"Are you ready? I can have my doctor right down here."

It turns out Mr. Lederer never called the purchaser's lawyer and he says, "No, we won't sell. We don't want to give away our shirts. We changed our minds. We now want \$400,000."

And, with that, he gives Globerman a new printed sheet on which you will see is the same thing that he gave him weeks before, except, instead of \$300,000, it is \$400,000.

We will show you that where they couldn't sell that property for \$300,000, as they say, with 150 brokers, we gave them a purchaser for \$300,000. We are the only ones who did. And then, when they saw they could get that, and after this broker had made a deal, one of these things you are lucky to have one in five years, they then changed their minds, and instead of \$300,000 they said they wanted \$400,000.

That was no deal to us. We say we complied with everything. We complied with the arrangement to get a purchaser for \$300,000 which was their agreement with us, and on that basis we are entitled to the commission.

The commission is what? Where you agree to be bound by the rates, it is what the New York Real Estate Board puts out; whatever that is. We say it is about \$21,000.

Now, we will prove to you the fact that they engaged us. A lot of these things we will prove through the words of Mr. Lederer where we examined him. We will prove that we brought him this purchaser. We brought them the offer of purchase; that the man we offered to purchase was ready. We will prove that he was able to buy it, and as the best proof of that, we will show you that later they did make a deal, some months later they gave him a deed to this very property, to our man's corporation, for a much higher price, which shows you that our man was not only able to buy it on the \$300,000 basis, but able to buy it on a much higher basis, which he then paid for it.

Ladies and gentlemen, we will prove these facts to you.

On that basis we will ask you to give us a verdict for the payment we should have had, to which we were entitled, except for the fact that they, after seeing that we brought them a purchaser for their price, then at the last minute decided

instead of \$300,000, now that they had a buyer, "Maybe we won't sell. Maybe we can get more. Now we want \$400,000."

But, that is no excuse not to sell the property to us. We did everything to earn the money we are suing for, and we will ask you to give us a recovery.

[b] Defendant's Opening Statement

(Mr. Goldstein thereupon opened to the jury as follows:)

Mr. Goldstein: May it please the Court, ladies and gentlemen of the jury.

As I listened to my adversary, one would think that there is no reason for the defendant to be here.

Now, of course, we are here because there is a real controversy. Our version of the transaction differs from what Mr. Green has outlined to you. Because of that controversy, because of that difference, we are here, and our contention is of course that the plaintiff is entitled to no recovery; to nothing.

We feel that the evidence that we have is convincing on that point. And we hope that after you have listened to the evidence which the defendant will adduce, that you will likewise feel the same way and agree with us.

Our contention is that the plaintiff did not produce any customer on July 25th. In one of the legal papers that the plaintiff signed in this action he said he produced a customer on July 25, 1951.

We will adduce evidence to show that on that particular day that he came to the defendants and pleaded for more time; pleaded for time for his customer, because his customer couldn't make the deal. His customer had to rearrange his finances, and he asked the Lederers to take this property off the market, so that he could arrange with his customer to rearrange his financing.

As a matter of fact, on that day the plaintiff was told nothing like that would be done; that the defendants wouldn't keep this property off the market for anybody, and that the price was being changed to \$400,000; and he was given a mimeographed offering showing the change in the price.

Now, ladies and gentlemen of the jury, I wish you would bear in mind the dates here, because they are vitally important, particularly the date of July 25, 1951.

To support the defendants' contentions, you will hear from two of the defendants who dealt with the plaintiff. There will also be corroborating testimony by the defendants' bookkeeper, all of which we feel sustains our position, and we hope after you have listened to them, you will agree with us.

Before I conclude, I might just refer to an anecdote of an Eastern Potentate who was trying cases and who listened to the plaintiff, and turned around to the majordomo and said, "I decide for the plaintiff," and then the majordomo said to the Potentate, "Now you have to listen to the defendant."

He said, "Very well, bring the defendant up."

So, he listened to the defendant, and then decided for the defendant, and he turned around to the majordomo and said, "Now, hereafter, I only want to hear one side of the case. Two sides confuse me."

Now, all I ask you to do, ladies and gentlemen of the jury, is to keep an open mind in this lawsuit. You are going to hear

the plaintiff first. Reserve your judgment until you have had an opportunity to hear the defendant's version of the transaction.

[5] Illustrative Requests by Plaintiff to Charge--Action for Broker's Commission

1. The plaintiff contends that the defendant acting through its president, Mr. Jones, promised to buy the plaintiff a 6% commission calculated on the purchase price if the plaintiff would procure a purchaser for premises Avenue, ..., on certain terms given to the plaintiff by Mr. Jones. This the plaintiff contends occurred in March of 1982. If you find that the defendant's president, Mr. Jones, made such promise, then the defendant employed the plaintiff to sell that property.

2. Plaintiff contends that the terms given to him by the defendant's president, Mr. Jones, were the following: Purchase price, \$100,000 with \$35,000 cash and a mortgage of \$65,000 for three years at an interest rate of 13% per annum; amortization of 3% per annum, with the balance payable at maturity, the interest and amortization to be payable monthly. The plaintiff further contends that he procured one, Mr. Harold Caster to meet those terms and that he so notified the defendant, but that the defendant then refused to go forward with the deal. If you find, as the plaintiff contends, that he did what he was supposed to do and procured Mr. Caster to meet the terms just mentioned and so notified the defendant but the defendant refused to go forward, then the plaintiff procured a sale to be made on the defendant's terms. n4

3. It is not necessary for Mr. Caster to have made a written contract with the defendant in order for the plaintiff to recover. If the purchaser procured by the plaintiff, that is Mr. Caster, orally met the terms given by the defendant to the plaintiff and then the defendant refused to go through with the deal, the plaintiff is nevertheless entitled to recover. n5

4. It is not necessary that Mr. Jones in the terms given by him to the plaintiff should have specified the closing date or the down payment, that is to say, the amount to be paid on the contract. If you find that the defendant stopped the progress of the deal so that the parties were never able to work out these details, the plaintiff may nevertheless recover. n6

5. Mr. Caster, according to the plaintiff, was prepared to make a contract immediately, to pay 10% of the purchase price on the signing of the contract and to take title in thirty days and that he was prepared to make any reasonable changes in these terms that the defendant asked for, and that he told all this to Mr. Jones who offered no dissent. If you so find, then the defendant, by interrupting the progress of the deal, cannot now insist that the terms stated by Mr. Caster were not agreeable to it. n7

6. The purchaser must be a financially able party. n8 This means that it had the means to meet the down payment of 10% of the purchase price of \$100,000, namely, \$10,000, on or about April 12, 1982, and that as to the balance of cash, that is \$25,000, it had the means to meet this thirty days later. If you find that Mr. Caster had these means, then he was financially able to close the deal (*Globerman v. Lederer*, 281 App. Div. 39, 1952 N.Y. App. Div. LEXIS 3061 (1st Dept., 1952)) .

7. If you find for the plaintiff, he is entitled to recover the full agreed commission of \$6,000.

FOOTNOTES:

(n1)Footnote 1. See § 4.13[2] below.

(n2)Footnote 2. See § 4.02 above

(n3)Footnote 3. Taken from the record in *Globerman v. Lederer*, 281 A.D. 39, 117 N.Y.S. 549 (1st Dept. 1952).

(n4)Footnote 4. *Tanenbaum v. Boehm*, 202 N.Y. 293, 95 N.E. 708 (1911) . See § 4.02[1] above

(n5)Footnote 5. *Id*

(n6)Footnote 6. *Mengel v. Lawrence*, 276 A.D. 180, 1949 N.Y. App. Div. LEXIS 3139 (1st Dept. 1949) .

(n7)Footnote 7. *Id.*; *Ostroff v. Doctor*, 238 N.Y. 264 (1924) ; *Rees v. Gair*, 144 A.D. 294, 1911 N.Y. App. Div. LEXIS 1690 (2d Dept. 1911) .

(n8)Footnote 8. *See generally* ch. 5 below

* This chapter was revised by Charles J. Jacobus, Esq., a partner in the firm of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas. In 1999, Sections 4.01 through 4.03 were revised by Mary Fallon, Esq. Additional updates were contributed by Sandra Bullington, Esq.



104 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 5 The "Ready, Willing and Able" Requirements--Proof of Purchaser's Financial Ability to Consummate the Transaction *

10-5 Real Estate Brokerage Law and Practice 5.syn

§ 5.syn Synopsis to Chapter 5: The "Ready, Willing and Able" Requirements--Proof of Purchaser's Financial Ability to Consummate the Transaction *

§ 5.01 Broker Commission Hinges on Presenting Purchaser Who Is Ready, Willing and Able to Complete Transaction on Seller's Terms

§ 5.02 Purchaser Must Be Ready, Willing and Able to Complete Transaction

[1] "Able" Purchaser Commands Necessary Funds

[2] Modern View Weighs Several Factors to Determine Financial Ability

[3] Courts May Examine Personal Information to Determine Purchaser's Ability to Complete Transaction

[a] Determination May Be Highly Subjective

[b] Decisions Lack Uniformity

[4] Financial Ability May Depend on Commitment of Funds from Third Parties

[a] Financial Ability May Be Based on Complex Funding

[b] Third Parties Must Be Under Legal Obligation to Provide Funds

[c] Family Loans Generally Do Not Support Determination of Financial Ability

[d] "Straw" Purchasers Must Be Financially Able to Complete Transaction

[5] Subsequent Purchases by Buyer Generally Considered Irrelevant to Show Financial Ability

§ 5.03 Broker May Be Required to Prove Purchaser's Financial Ability to Consummate Transaction

[1] Determination Depends on Several Factors Including Rule of Jurisdiction, Status of Parties' Agreement, and Which Party Defaulted

[a] Traditionally Financial Ability Presumed When Unconditional Sales Contract Is Executed

[b] Traditional Rule Based on "Acceptance" Doctrine

[2] Contract Must Be Binding and Enforceable

[a] Commission Earned When Conditions of Sales Contract Are Met

[b] Conditions to Sale May Be Implied

[3] Broker Must Offer Proof if Negotiations Are Not Finalized

[4] Traditional Rule Increasingly Subject to Exceptions

[5] Minority Rule Requires Proof of Purchaser's Financial Ability Whenever Sale Is Not Consummated

[a] Minority View Neutralizes Harsh Effect of Acceptance Doctrine

[b] Broker Entitled to Commission Only if Transaction Fails Due to Seller's Wrongful Act

[6] Broker May Be Entitled to Commission Even in Absence of Sales Contract

§ 5.04 Seller May Waive Ready, Willing and Able Requirement

[1] Seller May Investigate Purchaser's Financial Ability

[2] Seller's Repudiation Prior to Contract Does Not Amount to Waiver

[a] Broker Must Prove Purchaser's Financial Ability

[b] Broker Must Prove That Performance Could Have Occurred but for Repudiation

[c] Determination Depends on Seller's Basis for Repudiation

§ 5.05 Broker Has Burden of Proving Financial Ability of Purchaser

[1] Determination Is Fact-Based

[2] Broker Must Show That Purchaser Is Ready, Willing and Able During Negotiations

[a] Seller May Reject Purchaser if Broker Fails to Provide Adequate Proof

[b] Seller May Accept Subsequent Purchaser Prior to Accepting First

[3] Testimony Regarding Purchaser's Ability May Be Presented at Trial

[a] Purchaser May Testify to Readiness, Willingness and Ability

[b] After Purchaser Testifies, Burden of Proof Shifts to Seller

[c] Financial Experts May Testify

§ 5.06 Courts May Consider the Seller's and Buyer's Negotiations Occurring After Expiration of Listing Agreement

§ 5.07 Practitioner Checklists

[1] Checklist for Representing Brokers

[2] Checklist for Representing the Owner



105 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 5 The "Ready, Willing and Able" Requirements--Proof of Purchaser's Financial Ability to Consummate the Transaction *

10-5 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 5 discusses the "ready, willing and able" element of the general rule which states that a broker earns a commission by bringing to a property seller, a purchaser who is ready, willing and able to buy the property upon the terms the seller has prescribed, or when a written contract upon any terms acceptable to the seller has been entered into by the seller and a purchaser procured by the broker. In particular, Chapter 5 focuses on the able aspect.

The purchaser's ability to consummate the purchase has evolved over the years and the meaning of "able" has varied due to the changing patterns of real estate financing. Factors that enter into what constitutes a purchaser's ability are discussed in detail (§ 5.02) as is the evidence that a broker may have to produce in order to be entitled to his or her commission (§ 5.03). In some circumstances, the seller may waive the requirement that the proffered buyer be ready, willing and able to purchase the property. These circumstances and the proof a broker must present in order to be entitled to a commission are discussed (§ 5.04). The burden to prove that the purchaser was financially able to complete the purchase is placed upon the broker. This burden and how it can be met are discussed (§ 5.05). Chapter 5 concludes with two practitioner checklists, one for attorneys representing brokers (§ 5.07[1]) and one for attorneys representing owners (§ 5.07[2]).



106 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 5 The "Ready, Willing and Able" Requirements--Proof of Purchaser's Financial Ability to Consummate the Transaction *

10-5 Real Estate Brokerage Law and Practice § 5.01

§ 5.01 Broker Commission Hinges on Presenting Purchaser Who Is Ready, Willing and Able to Complete Transaction on Seller's Terms

In general, a real estate broker earns a commission by bringing to the seller of the property a purchaser who is ready, willing and able to buy the property upon the terms that the seller has prescribed, *or* when a written contract upon any terms acceptable to the seller has been entered into by the seller and a purchaser procured by the broker. n1 Chapter 4 discusses variations and exceptions to this general rule and offers a comprehensive review of all factors that affect a broker's right to compensation. n2 This chapter focuses on the "ready, willing and able" element of the general rule--especially the "able" aspect.

The seller is obliged to pay a commission to the broker only if a buyer is found who is ready, willing, and able to purchase the property on the terms specified by the seller. Though this chapter focuses on the buyer's financial ability to consummate the transaction, brokers have been found to have no entitlement to a commission when the buyer is unwilling to purchase the property on terms specified by the seller. If the parties cannot agree on the material terms, there is no transaction to consummate. Without a binding contract, the broker will have no right to a commission. n2.1

Not all cases require proof of a ready, willing and able buyer. Generally, there are two classes of cases in which this issue is relevant:

- (1) **Seller's or buyer's failure to perform:** Although the seller and buyer may sign a binding, enforceable sales agreement, the sale may not be consummated due to one party's failure or inability to perform. In this situation, the states differ considerably on whether the broker must prove that the buyer was financially able to complete the sale in order to recover a commission. The traditional rule is that the broker need not prove the purchaser's financial ability in this situation, even if the transaction does not close due to the fault of the buyer.
- (2) **Seller refuses to proceed with sale:** Even if the broker presents an offer on behalf of a buyer that complies with the terms of the listing (or the seller agrees to a modification of those terms), the seller may change his or her mind and refuse to proceed with the sale. In this situation, the broker must prove that the buyer was ready, willing and able to complete the sale in order to recover a commission. n3

In the first class of cases, jurisdictions that strictly adhere to the traditional rule find the purchaser's financial ability irrelevant if there is an executed sales agreement. However, many jurisdictions have created exceptions and variations to the traditional rule and other jurisdictions have adopted one of several minority views on whether proof of the buyer's financial ability is required. n4 Proof of the purchaser's financial ability is still required in many situations in these jurisdictions. Another situation where the ready, willing and able rule will not apply is where the broker represents the buyer. In this case the broker will probably be bound by the terms of the agreement with the buyer since these agreements typically contain a special provision addressing the broker's compensation. n4.1

The question of whether a broker produced a "financially able" buyer is a frequently litigated issue. It is clearly a question of fact and is sometimes based on subjective criteria. n4.2 This chapter examines the many different factors that affect such a determination.

The timing and manner in which a broker must prove a purchaser's financial ability is reviewed in § 5.05 *below* . Finally, § 5.06 *below* presents practical checklists for attorneys representing brokers or sellers.

Excluded from the scope of this chapter are the following related issues:

- (1) whether the purchaser's offer conforms to the terms required by the owner (which is discussed in § 4.07[5] *above*);
- (2) the effect of the terms of the brokerage agreement on the broker's right to a commission (which is addressed in § 4.02[2] *above*); and
- (3) whether the broker was the procuring cause of the sale (which is outlined in § 4.07 *above*).

For purposes of this chapter, it is assumed that the broker's duty to produce a ready, willing and able buyer is not negated by these or other factors.

Another related but separate issue is whether the broker should be denied a commission due to a breach of fiduciary duty in failing to disclose financial information about the purchaser. (See §§ 3.05[4], 4.08 *above* for a discussion of the broker's fiduciary duty to disclose material information). A broker's breach of fiduciary duty to disclose material information to the seller can be a defense to a broker's claim for a commission, n5 but this is a separate defense and should be distinguished from the broker's duty to prove that he or she produced a ready, willing and able buyer as an affirmative element of his or her case. n6 These two issues can be intertwined when a broker has knowledge of a buyer's financial inability and fails to disclose this information to the seller. The court will often find both a breach of fiduciary duty and a failure by the broker to produce a financially able buyer. n7 This chapter will not deal directly with the broker's fiduciary duty to disclose material information, which is covered in §§ 3.05[4], 4.08 *above* .

It is clear from the volume of litigation in which the purchaser's financial ability is a central issue that the careful practitioner should treat the matter of proof of this requirement seriously and, ideally, far in advance of trial. The challenge for trial counsel representing the real estate broker is to demonstrate a strong financial profile of the purchaser, by tangible and admissible evidence, from which a fair and reasonable inference can be drawn that the purchaser could have consummated the transaction. Case law illustrates that considerable attention to this problem is necessary to produce the financial evidence to support a verdict for the broker.

FOOTNOTES:

(n1)Footnote 1. See *Mapes v. City Council of the City of Walsenburg*, 151 P.3d 574, 578 (Colo. Ct. App. 2006) , cert. denied, 2007 Colo. LEXIS 44 (Jan. 16, 2007) ; ch. 4, *The Broker's Right to Compensation*, *above*. It should be noted that, as employed in this chapter, the term "seller" includes a lessor and the term "purchaser" includes a prospective

tenant in a leasing brokerage transaction. *See also Posson v. Hayes*, 37 A.D.3d 936, 937, 829 N.Y.S.2d 286, 288, 2007 N.Y. App. Div. LEXIS 1430 (2007) (The broker must bring the parties in agreement not only with respect to the price but "to all terms customarily encountered in such a transaction" before the commission is earned.).

See generally, What Does A Real Estate Broker Have To Do To Earn A Commission?, 5 J. Suffolk Acad. L. 1 (1988).

(n2)Footnote 2. A sample brokerage clause is the following:

Seller gives Broker the sole and exclusive right to procure a purchaser for the property described below at the price and upon the terms set forth in this contract. If a purchaser is procured for the property by Broker, by Seller, or by any other person, at the price and upon the terms set forth in this contract, or at any other price or upon any other terms accepted by Seller during the term of this contract, ... Seller agrees to pay Broker a commission as set forth in this contract regardless when the transaction closes.

Another example is the following:

If during the said period of one year, the property is sold by the Agent, by Seller or anyone else; or if the Agent produces a purchaser ready, willing and able to purchase the property; or within sixty days after the expiration of said period a sale is made to any person to whom the property has been shown by Seller or referred by the Agent, Seller agrees to pay the Agent a commission of _____% of the selling price.

A basic listing provisions is the following:

Seller agrees to pay _____percent of the selling price in the event that during the period of this agreement Broker, or Broker's agent, or cooperating brokers, secure a purchaser on the above terms or other terms to which Seller may consent, or if property is sold or exchanged by Broker or any other person, including Seller.

(n3)Footnote 2.1. *See Coldwell Banker/Hunneman v. Shostack*, 62 Mass. App. Ct. 635, 639-640, 818 N.E.2d 1079, 1083-1084 (Mass. App. Ct. 2004) ; *Posson v. Hayes*, 37 A.D.3d 936, 937, 829 N.Y.S.2d 286, 288, 2007 N.Y. App. Div. LEXIS 1430 (2007) . *But see Dabbs v. Southern Real Estate, Inc.*, 2008 Ala. Civ. App. LEXIS 3, at *9 (Jan. 11, 2008) (where it was not necessary for the seller to have accepted the buyers' purchase offer in order for the broker to be entitled to a commission), *cert. denied*, 2008 Ala. LEXIS 78 (Ala. Apr. 25, 2008) .

(n4)Footnote 3. *See* § 4.02 above.

(n5)Footnote 4. This is discussed in §§ 4.02, 4.03 above and § 5.03[1] below .

(n6)Footnote 4.1. *See Hamilton v. Hopkins*, 834 So. 2d 695, 702 (Miss. 2003) (ready, willing and able rule was not dispositive).

(n7)Footnote 4.2. *See Dabbs v. Southern Real Estate, Inc.*, 2008 Ala. Civ. App. LEXIS 3, at *6 (Jan. 11, 2008) , *cert. denied*, 2008 Ala. LEXIS 78 (Ala. Apr. 25, 2008) .

(n8)Footnote 5.

Florida: Young v. Field, 548 So. 2d 784, 785 (Fla. Dist. Ct. App. 1989) (holding that to preserve fiduciary relationship between broker and seller, broker may neither purchase from nor sell to his or her

principal unless principal assents thereto or acquiesces in such course, with full knowledge of all facts and circumstances).

Illinois: United Investors, Inc. v. Tsotsos, 132 Ill. App. 3d 175, 179, 87 Ill. Dec. 439, 442, 477 N.E.2d 40, 43 (1985) (stating that brokers owe fiduciary duty of loyalty to sellers which requires that brokers keep sellers fully informed of all pertinent facts regarding the transaction and if duty is breached brokers are precluded from receiving commission); *Winternitz v. National Bank*, 289 Ill. App. 3d 753, 683 N.E. 2d 492 (1997) .

(n9)Footnote 6. *Gordon v. Bauer*, 177 Ill. App. 3d 1073, 127 Ill. Dec. 26, 532 N.E.2d 855 (Ill. App. 5 Dist. 1988) (discussing fiduciary duty and proof of financial ability).

(n10)Footnote 7. *See, e.g., McGarry v. McCrone*, 56 Ohio Op. 479, 118 N.E.2d 195 (Ohio 1954) .

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107 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 5 The "Ready, Willing and Able" Requirements--Proof of Purchaser's Financial Ability to Consummate the Transaction *

10-5 Real Estate Brokerage Law and Practice § 5.02

§ 5.02 Purchaser Must Be Ready, Willing and Able to Complete Transaction

[1] "Able" Purchaser Commands Necessary Funds

A real estate broker earns a commission only when the broker produces a purchaser who is ready, willing and able to buy. n1 Within the context of the "ready, willing and able" rule, the accepted definition of the term "able" has evolved over the years, largely due to the changing patterns of real estate financing. n2 Obviously, the simplest and most convincing method to establish the purchaser's financial ability is to show that the buyer had the means to pay for the property entirely with cash. However, most real estate transactions are more "financially challenged" than that, and it is not common today to find a purchaser who has "cash in hand" for the entire purchase price of the property at the time the offer is made. The courts have adapted to the changing face of real estate financing and have interpreted the ready, willing and able requirement accordingly.

The term "able" means "more than mere mental competence to make a contract or physical ability to sign it." n3 At core, prospective purchasers meet the legal standard of "ready, willing and able" to buy, although they may not have the cash in hand, if they are able to command the necessary funds to complete the purchase within the time fixed for performance. n4 The word "command" is important; it means "to have control of." n5 Thus, the purchaser must have sufficient assets, which may consist in part of the property to be purchased, and a credit rating that enables the purchaser with reasonable certainty to command the requisite funds at the closing. n6 The required funds include any initial payments as well as any deferred or installment payments provided for in the sales contract. n7 Establishing that the purchaser was "able" does *not* require proof that the purchaser had "all the money in his pocketbook or to his credit at the bank" at the time the offer to purchase was made or a contract was executed. n8 In fact, the precise source of the buyer's anticipated funds for purchase need not be identified. n9 Rather, the "able" requirement refers more to the power to effect the necessary funds at the time for payment. n10 In other words, the financially able condition of the buyer relates to the time of closing. n11 Consequently, a signed binder and good faith deposit is insufficient by itself to establish the purchaser's financial ability. n12 Moreover, a purchaser's default after the closing does not affect a broker's right to a commission. n13

While it is widely accepted that the meaning of "able" refers to the purchaser's financial ability, it should be noted that "able" has also been interpreted to include the purchaser's legal capacity as well. n14

[2] Modern View Weighs Several Factors to Determine Financial Ability

There are no absolute rules to test the purchaser's financial ability. Each case is fact-specific, and courts generally base their decisions on the totality of all factors. The modern view, which applies a concise summary of factors, has been widely accepted in brokerage commission cases. n15 Under the modern view, a purchaser is deemed financially ready and able to buy when the purchaser:

- has the "needed cash in hand"
- is "personally possessed of assets--which in part may consist of the property to be purchased--and a credit rating that enables him with reasonable certainty to command the requisite funds at the required time."
- has "definitely arranged to raise the necessary money--or as much thereof as he is unable to supply personally--by obtaining a *binding commitment* for a loan to him for that purpose *by a financially able third party*, irrespective of whether such loan be secured in part by the property to be purchased" n16

When a purchaser relies primarily upon the "proceeds of a contemplated loan or loans to be made to him by a third party, he is financially able to buy *only* if he has a *definite and binding commitment* from such third-party loaner." n17 The purchaser must show adequate consideration for the loan. "A purchaser who personally has little, if any, cash or other assets must establish that the financial crutches to be loaned him by others are both legally and financially dependable." n18 The flexible criteria are tailored to the purpose of establishing a "purchaser's financial ability to buy with reasonable certainty," n19 and prevent unreasonable hardship to either the purchaser or seller:

A purchaser may not have the necessary cash in hand, but that alone, it is recognized, does not disqualify him if he is otherwise so situated that he is reasonably able *to command the requisite cash at the required time*. On the other hand, the seller is not required to part with his property to a purchaser whose financial ability rests upon nothing more than shoestring speculation or upon attractive probabilities that fall short of reasonable certainty. In short, the rules are designed to protect the seller by binding him to a sale only when there is a reasonable certainty of the purchaser's financial ability to pay and, on the other hand, to protect the purchaser--and persons similarly situated--from a technical, insubstantial, or sharp-dealing disqualification. n20

Obviously, no one set of criteria can encompass the myriad fact patterns that are involved in establishing that a purchaser was ready, willing and able to buy. What constitutes financial ability depends upon such a variety of circumstances as to make it difficult to state a general rule. In all cases, "able" must be given a reasonable construction. n21 These guidelines offer a modern view of the common-law rules regarding the purchaser's financial ability in a concise, summary format. These guidelines are frequently cited and used by the courts in many states to analyze the factual evidence of the purchaser's financial ability.

Practice Note

The courts generally base their decisions on the totality of all factors involved, with the result that any one factor may support a finding of financial ability in one case and a lack of financial ability in another. In fact, this area of the law is filled with inconsistent decisions among the states with respect to the nature and quality of the evidence required to establish a purchaser's financial ability.

While the factors have been widely applied, they have produced inconsistent results. Any one factor may support a finding of financial ability in one case and a lack of financial ability in another. For example, see § 5.02[5] *below* (subsequent purchases by the purchaser), § 5.04 *below* (waiver by owner when issue of buyer's financial ability is not raised), and § 5.05[3] *below* (self-serving testimony of purchaser). It behooves the practitioner to be well versed in the

facts of the authoritative cases in the relevant jurisdiction when arguing the facts of the subject case. n22

[3] Courts May Examine Personal Information to Determine Purchaser's Ability to Complete Transaction

[a] Determination May Be Highly Subjective

Courts will consider a wide range of personal and financial factors in deciding whether a buyer has the requisite financial ability to purchase a particular property. Consideration should be given to the following information about the buyer:

- assets;
- credit;
- financial rating;
- enforceable agreements for loans; and
- other data indicating ability or inability to command requisite funds at the required time n23

The "other data" can include the buyer's personal information such as:

- age;
- business experience;
- employment history;
- length of residence in the area; and
- other general and somewhat subjective factors.

In short, one's purchasing ability may be demonstrated by showing that the purchaser is a "person of substance." n24 A person of substance conveys an idea of wealth, the ability to deal in business ventures, and the ability to make do in an above-average fashion. n25

Courts will also note characteristics of the buyer that illustrate the court's thinking that the buyer is not a person of substance. For example, it is not uncommon for a court to refer to the buyer's youth and relative lack of experience when concluding that the buyer is not deemed to be financially able to buy. n26

Practice Note

The fact that these ideas are quite subjective in nature--one might ask how much wealth is needed, what exactly constitutes the "ability to deal in business ventures" or the "ability to make do in an above-average fashion"--presents a challenge to practitioners. A common-sense approach, given the totality of the circumstances, is likely to prevail.

[b] Decisions Lack Uniformity

Although there are general patterns found in the cases, there is little uniformity among the states. As part of the basis for determining the purchaser's financial ability or inability to complete the transaction, courts commonly consider the following factors:

Net worth v. purchase price: Courts commonly consider the relationship between the buyer's net worth and the purchase price. n27 The buyer's net worth and assets can be significant without regard to the nature or liquidity of the buyer's assets. n28

Ability to raise money: Some courts hold that the mere fact that a purchaser may own property upon which the buyer could raise the money is insufficient by itself to establish the buyer's financial ability. n29

Employment: The courts look favorably on the buyer's employment in supporting his or her financial ability; n30 however if that employment is recent, it may be discounted by the court. n31

Business experience: Courts give weight to the purchaser's general business experience, especially if that experience is related to the type of property or business involved in the subject transaction. n32

[4] Financial Ability May Depend on Commitment of Funds from Third Parties

[a] Financial Ability May Be Based on Complex Funding

In considering the issue of third-party financing, the courts recognize that real estate financing today is not always a simple matter. n33 Courts apply "a reasonable and factual determination" to decide whether a purchaser is financially able to pay. n34 A reasonable construction should be applied in determining a purchaser's financial ability. Each case is evaluated based on its unique facts. n35

[b] Third Parties Must Be Under Legal Obligation to Provide Funds

Purchasers of property commonly obtain loans from institutional or individual lenders, or rely on family or friends, for some or all of the purchase price. The financial ability of the buyer who is relying on third-party funds is determined in part on the identity of the third-party lender and how speculative or definite that loan might be.

When purchasers rely primarily on borrowed funds, *i.e.*, their own contribution is small compared with the funds supplied by third parties, they cannot be considered financially able without a legally binding commitment from either an institutional or individual lender. n36 Thus, a lender's non-binding verbal promise made to a prospective buyer without assets of his or her own is insufficient to prove the buyer's financial ability. n37

In fact, buyers generally are not considered financially able if they rely, to any degree, on funds from third parties who are under no legal obligation to lend. n38 "A proposed purchaser cannot be said to be able to purchase when he is dependent upon third parties who are in no way bound to furnish the funds." n39

The courts give greater weight to lending agreements from a well-established institutional lender that is in the business of lending (and may have an incentive to lend) than the promises of a buyer's friend or relative. n40 Courts will not necessarily require a formal written commitment from the commercial lender to establish the buyer's financial ability. n41 This is in contrast to cases involving loans from family members.

[c] Family Loans Generally Do Not Support Determination of Financial Ability

Proposed loans from family members are viewed with skepticism by the courts. Unless the relatives were legally obligated to provide the funds, the courts tend to discount such evidence as being too speculative. n42 Courts recognize that proposed loans from family members are often wishful thinking on the part of the buyer. n43 Similarly, loans from brokers involved in the transaction are not generally considered favorably by the courts in determining a buyer's financial ability. n44 Thus, in these cases, the courts tend to require a legally binding commitment on the part of the lender. n45

[d] "Straw" Purchasers Must Be Financially Able to Complete Transaction

It is generally recognized that a seller cannot circumvent the listing broker by changing the terms of the contract or selling to a strawman who then acts as a conduit and ultimately conveys the property to the purchaser who originally was procured by the broker. n45.1 The use of a "straw" buyer, *i.e.*, a person acting on behalf of others, can present a challenge for brokers in proving that they produced a financially able buyer. Since the unnamed buyers are generally not obligated to proceed with the transaction, it is the so-called "straw" buyer who must be financially able to buy. n46

[5] Subsequent Purchases by Buyer Generally Considered Irrelevant to Show Financial Ability

Generally, evidence that a purchaser has subsequently acquired property is irrelevant and not admissible to prove financial ability. n47 However, if the property subsequently acquired is the same property for which the broker's suit seeks a commission, that transaction would support a conclusion that the broker produced a ready, willing, and able buyer. n47.1

FOOTNOTES:

(n1)Footnote 1. *See, e.g.*,

Colorado: City of Pueblo v. Leach Realty Co., 149 Colo. 92, 94-95, 368 P.2d 195, 196 (1962) ; *Mapes v. City Council of the City of Walsenburg*, 151 P.3d 574, 578 (Colo. Ct. App. 2006) , *cert. denied*, 2007 Colo. LEXIS 44 (Jan. 16, 2007) .

Connecticut: Howland v. Schweir, 7 Conn. App. 709, 713, 510 A.2d 215 (1986) ("To recover a commission, a broker must ordinarily show ... that he has produced a customer ready, willing and able to buy on terms acceptable to the seller."); *McCutcheon & Burr, Inc. v. Berman*, 218 Conn. 512 , 519, 590 A.2d 438 (1991); *Ditchkus Real Estate Co. v. Storm*, 25 Conn. App. 51, 54, 592 A.2d 959 , *cert. denied*, 220 Conn. 905, 593 A.2d 971 (1991) ; *New England Investment Properties, Inc. v. Spire Realty and Development Corp.*, 31 Conn. App. 682, 626 A.2d 1316 (1993) .

Illinois: United Investors, Inc. v. Tsotsos, 132 Ill. App. 3d 175, 178, 87 Ill. Dec. 439, 441, 477 N.E.2d 40, 42 (1985) .

Kansas: Premier Realty, LLC v. I.T.J. Investments, Inc., 42 Kan. App. 2d 148, 153, 209 P.3d 741, 746 (2009) .

(n2)Footnote 2. *See generally* Annotation, *What Constitutes Financial Ability to Perform Within Rule Entitling Broker to Commission for Producing Ready, Willing, and Able Purchaser of Real Property*, 87 A.L.R.4th 11 (1991).

(n3)Footnote 3. *Ellsworth Dobbs, Inc. v. Johnson*, 50 N.J. 528, 236 A.2d 843, 851 (1967) .

(n4)Footnote 4. *See, e.g.*:

Florida: Sticht v. Shull, 543 So. 2d 395, 397 (Dist. Ct. App. Fla. 1989) (broker failed to show that purchaser commanded sufficient funds); *Hollywood Mall, Inc. v. Capozzi*, 545 So. 2d 918, 921 (Dist. Ct. App. Fla. 1989) (stating that "[t]here was no proof that [purchaser] had cash in hand or that he was personally possessed of assets and a credit rating which would enable him with reasonable certainty to command the requisite funds to close.").

Illinois: Telander v. Posejpal, 94 Ill. App. 3d 616, 624-25, 49 Ill. Dec. 590, 598, 418 N.E.2d 444, 452 (1981) (holding that purchaser is deemed ready and able to buy if he or she "has sufficient funds on hand

or if he [or she] is able to command the necessary funds with which to complete the purchase within the time set by the offer.").

Kansas: Premier Realty, LLC v. I.T.J. Investments, Inc., 42 Kan. App. 2d 148, 154, 209 P.3d 741, 746-47 (2009) ; *Moody Invest., Inc. v. Baldwin*, 12 Kan. App. 2d 686, 754 P. 2d 810 (1988) review denied, 243 Kan. 779 (1988) ; *Winkelman v. Allen*, 214 Kan. 22, 519 P.2d 1377 (1974) .

Minnesota: Century 21-Birdsell Realty, Inc., v. Hiebel, 379 N.W.2d 201, 203 (Minn. App. 1986) .

Wisconsin: Peter M. Chalik & Assocs. v. Hermes, 56 Wis. 2d 151, 201 N.W.2d 514 (1972) (individual lender).

Cf.

Minnesota: Jones v. Amoco Oil Co., 483 N.W.2d 718 (Minn. App. 1992) (breach of contract).

(n5)Footnote 5.

Kansas: Winkelman v. Allen, 214 Kan. 22, 519 P.2d 1377 (1974) .

(n6)Footnote 6. *The Heritage Group v. Jonas*, 204 Wis. 2d 110, 552 N.W.2d 898 1996 Wisc. App. LEXIS 890 (Wis. Ct. App. 1996) (unpublished opinion) review denied, 205 Wis. 2d 135, 555 N.W.2d 815 (Wis. 1996) .

(n7)Footnote 7. See, e.g.:

Tennessee: Gatlinburg Real Estate Co., Inc. v. Booth, 651 S.W.2d 203 (Tenn. 1983) .

Washington: Record Realty, Inc. v. Hull, 15 Wn. App. 826, 552 P.2d 191 (1976) .

Minnesota: Shell Oil Co. v. Kapler, 235 Minn. 292, 50 N.W.2d 707 (1951) .

(n8)Footnote 8. *Peter M. Chalik & Assocs. v. Hermes*, 56 Wis. 2d 151, 201 N.W.2d 514, 519 (1972) (quoting *McCabe v. Jones*, 141 Wis. 540, 124 N.W. 486, 487 (1910)) ; *Century 21 Blowers & Assoc. v. PCA of Southeast Wis.*, 169 Wis. 2d 466, 487 N.W.2d 660, (Wis. App. 1992) (unpublished opinion).

(n9)Footnote 9. *McGill Corp. v. Werner*, 631 P.2d 1178 (Colo. App. 1981) .

(n10)Footnote 10. See, e.g.:

New Hampshire: Philbrick v. Chase, 95 N.H. 82, 58 A.2d 317 (1948) (holding that the fact that the bank had not actually approved the loan at the time the action was commenced did not defeat the financial ability of the buyer when there was evidence that the buyer could have qualified for the loan).

Colorado: McGill Corp. v. Werner, 631 P.2d 1178 (1981) (finding that the buyers obtained a tentative loan commitment and had sufficient funds to comply with contract, and therefore the precise source of anticipated funds needed for the transaction need not be identified at time of offer); *Daybreak Construction Specialties, Inc. v. Saghatoleslami*, 712 P.2d 1028, 1032 (Colo. Ct. App. 1985) ; *Colorado*

Inv. Servs., Inc. v. Hager, 685 P.2d 1371, 1375 (Colo. App. 1984) .

(n11)Footnote 11.

Minnesota: Birdsell Realty, Inc. v. Hiebel, 379 N.W.2d 201 (Minn. App. 1985) (finding that the buyer had not obtained loan approval at the time seller refused to proceed on contract, and therefore the broker had until the closing date to produce able buyer and that once contract was rescinded, broker's duty ended).

North Dakota: Allied Realty, Inc. v. Boyer, 302 N.W.2d 774 (N.D. 1981) (holding that financially able condition did not apply to developments subsequent to closing in case when buyer defaulted on payments due after closing). *Goetz v. Anderson*, 274 N.W.2D 175 (N.D. 1978) .

(n12)Footnote 12. *O'Connor Realty Services, Inc. v. Higgins*, 149 A.D.2d 492, 539 N.Y.S.2d 975, 1989 N.Y. App. Div. LEXIS 4583 (1989) .

(n13)Footnote 13. *Agency, Broad and Cornelia Street, Inc. v. Lavigne*, 470 N.Y.S.2d 729, 730, 1983 N.Y. App. Div. LEXIS 20724 (3d Dept. 1983) (purchasers' default shortly after closing did not raise question of fact as to their ability to meet vendors' terms when they entered into the contract and default did not affect broker's right to commission); *Kaplon-Belo Assocs. v. Farrelly*, 221 A.D.2d 321, 633 N.Y.2d (2d Dept. 1995).

(n14)Footnote 14. *See, e.g.:*

Texas: Campbell v. Hood, 35 S.W.2d 93 (Tex. Civ. App. 1931) (holding that the corporate purchaser was not an able buyer because it was expressly prohibited by Texas State Law to enter into the subject contract to buy the property).

(n15)Footnote 15. *Shell Oil Co. v. Kapler*, 235 Minn. 292, 50 N.W.2d 707 (1951) .

See, e.g.:

Kansas: Winkelman v. Allen, 214 Kan. 22, 519 P.2d 1377 (Kan. 1974) .

North Dakota: Goetz v. Anderson, 274 N.W.2d 175 (N.D. 1978) .

South Dakota: Heinrich v. R.L. Oil & Gas Co., Inc., 442 N.W.2d 467 (1989) .

Washington: Record Realty, Inc. v. Hull, 15 Wash. App. 826, 552 P.2d 191 (1976).

(n16)Footnote 16. 50 N.W.2d at 712-713, n.11 .

(n17)Footnote 17. 50 N.W.2d at 712-713, n.11 (emphasis in original).

(n18)Footnote 18. 50 N.W.2d at 712-713, n.11 .

(n19)Footnote 19. 50 N.W.2d at 712-713, n.11 .

(n20)Footnote 20. 50 N.W.2d at 712-713, n.11 .

(n21)Footnote 21. *Glascocock v. James*, 183 Va. 561, 32 S.E.2d 734 (1945) .

(n22)Footnote 22. See Annotation, 87 A.L.R.4th 11 (1991) for a comprehensive summary of cases on this subject.

(n23)Footnote 23. *Record Realty, Inc. v. Hull*, 15 Wash. App. 826, 552 P.2d 191 (1976) ; *Shell Oil Co. v. Kapler*, 235 Minn. 292, 50 N.W.2d 707 (1951) ; *Walton v. Hudson*, 38 Ohio Op. 28, 79 N.E.2d 921 (Ohio 1947) .

(n24)Footnote 24. *Mogul v. McClaskey Realty*, 309 So. 2d 254, 255 (4th Dist. Ct. App. Fla. 1975) (citing *Sharp v. Long*, 283 So. 2d 567 (4th Dist. Ct. App. Fla. 1973)) .

(n25)Footnote 25. *Mogul v. McClaskey Realty*, 309 So. 2d 254, 256 (4th Dist. Ct. App. Fla. 1975) . In the *Mogul* case, the court found the buyer to be a person of substance because, among other things, he agreed to a price increase, he signed the sales contract, he had a contracting business, he employed engineers to inspect the property, and the realtor testified that the buyer was a "select" client. 309 So. 2d 254 . Also noted was the lack of rebuttal testimony by the owner. See § 5.05[3] below for a discussion of this point.

(n26)Footnote 26. See, e.g.:

Connecticut: Potter v. Ridge Realty Corp., 28 Conn. Super. 304, 259 A.2d 758 (1969) (27-year-old prospective buyer with no business experience).

Kansas: Winkelman v. Allen, 214 Kan. 22, 519 P.2d 1377 (Kan. 1974) (finding that the buyer, a 22-year-old man who wanted to get financial help from his father, could not handle the purchase without his father's participation).

(n27)Footnote 27. See, e.g.:

Illinois: Gordon v. Bauer, 177 Ill. App. 3d 1073, 1097, 127 Ill. Dec. 26, 41, 532 N.E.2d 855, 869 (Ill. App. 5th Dist. 1988) (noting net worth of prospective purchasers as evidence of their ability to consummate transaction).

Kansas: Winkelman v. Allen, 214 Kan. 22, 519 P.2d 1377 (Kan. 1974) (finding that buyer with a net worth of \$6,000 was not financially able to purchase property for \$320,000).

Nebraska: Fleming Realty & Ins., Inc. v. Evans, 199 Neb. 440, 259 N.W.2d 604 (1977) (buyer was financially able to purchase land for \$155,840 when he had 800 acres of pasture land, a net worth of approximately \$239,000 and a reputation that he was a good farmer and could perform on the contract).

South Dakota: Heinrich v. R.L. Oil & Gas Co., Inc., 442 N.W.2d 467, 470 (S.D. 1989) .

(n28)Footnote 28. See, e.g.:

California: Mitidiere v. Saito, 246 Cal. App. 2d 535, 54 Cal. Rptr. 665 (Cal. 1966) (buyer was financially able to buy property for \$120,000 when he had a net worth of \$225,000 and also had authority to commit his partner whose net worth was approximately \$120,000; there was no discussion of the liquidity of assets).

Louisiana: Joiner v. Lockart, 350 So. 2d 199 (La. 1977) (court found that buyer's employment as a teacher and coach, and his ownership of 87 acres were sufficient to establish his ability to obtain a loan,

notwithstanding the fact that he did not have much in his savings account).

(n29)Footnote 29. *See, e.g.:*

South Dakota: Watters v. Dancey, 23 S.D. 481, 122 N.W. 430 (1909) (holding that evidence that buyer has an abundance of property, from which he could raise the cash, is not sufficient to show he was financially able when cash is required).

Iowa: Reynor v. Mackrill, 181 Iowa 210, 164 N.W. 335 (Iowa 1917) (the court found the buyer was financially able based on her testimony that "the money was ready for her, was at her command..."; merely having property from which she could raise the cash would not be sufficient).

(n30)Footnote 30. *See Joiner v. Lockart*, 350 So. 2d 199 (La. 1977) .

(n31)Footnote 31. *See Record Realty, Inc. v. Hull*, 15 Wash. App. 826, 552 P.2d 191 (Wash. 1976) (court found that the buyer who was employed as a used car salesperson, having recently moved to the area, with no showing of assets, income, etc. did not show financial ability).

(n32)Footnote 32. *See*

Florida: Hollywood Mall, Inc. v. Capozzi, 545 So. 2d 918, 921 (Dist. Ct. App. Fla. 1989) (evaluating purchaser's business experience, court found that although purchaser has business experience as sole shareholder of savings and loan association, it had been taken over by the Federal regulatory agency and the purchaser had been excluded from its operations; although purchaser had built several large real estate projects, nothing in the record indicated whether he owned those projects or whether they were financially successful; thus evidence did not show financial ability).

Minnesota: ERA Town and Country Realty v. Tevac, Inc. 376 N.W.2d 526 (Minn. App. 1985) (in purchase of mobile home park for \$125,000, it was significant that buyer was the successful owner of four other mobile home parks that generated a net income of approximately \$1500 per month and an apartment building with monthly income of \$998 per month).

But see R. Zemper & Assoc. v. Scozzafava, 28 Conn. App. 557, 611 A.2d 449 (1992) (in a purchase of a dry-cleaning business, the buyer's testimony that he owned two other dry cleaners and later purchased three more was insufficient evidence of the buyer's financial ability without any evidence of the earnings of his other businesses).

(n33)Footnote 33. *Heinrich v. R.L. Oil & Gas Co., Inc.*, 442 N.W.2d 467, 470 (S.D. 1989) (prospective purchaser was required to obtain a bank loan, backed by the Small Business Administration ("SBA"), but seller failed to provide sufficient information required by the SBA and the sale was not consummated; broker's award of the commission was affirmed by the Supreme Court of South Dakota, which noted that "[a]lthough Buyer's ability to finance [the purchase] had some hurdles to overcome, on this record we do not deem the trial court's finding of fact, that the Buyer was financially able, to be clearly erroneous. There are always some wrinkles to iron out in financing large sums of money.").

(n34)Footnote 34. 442 N.W.2d at 470.

(n35)Footnote 35. *Shell Oil Co. v. Kapler*, 235 Minn. 292, 50 N.W.2d 707 (1951) .

(n36)Footnote 36. *See, e.g.:*

Connecticut: Potter v. Ridge Realty Corp., 28 Conn. Super. 304, 259 A.2d 758 (1969) (27-year-old prospective buyer with no business experience and only \$3,000 in cash was not financially able to purchase property for \$275,000 when he offered no testimony from the bank or his in-laws that they had in fact agreed to loan the buyer the funds required for the purchase).

Louisiana: Morere v. Dixon Real Estate Co., 188 So. 2d 623 (La. App. 1966) (corporate purchaser was not financially "able" when it had only one asset (land), no credit rating and was entirely dependent on shareholder's financial ability).

(n37)Footnote 37. *See, e.g.:*

Kansas: Winkelman v. Allen, 214 Kan. 22, 519 P.2d 1377 (Kan. 1974) (the court found that the broker failed to prove the buyer's financial ability when the buyer was relying on his father to co-sign a note for the down payment funds, but his father had not committed to do so and there were only "tentative agreements" on the part of the bank to issue the loans).

California: Merzoian v. Kludjian, 191 P. 673 (1920) (buyer was not financially able when he had only \$1,000 of a \$5,000 down payment with the balance to come from the broker and a friend based on verbal promises with inadequate consideration and buyer's assets and financial standing were questionable).

(n38)Footnote 38. *Peter M. Chalik & Assocs. v. Hermes*, 56 Wis. 2d 151, 201 N.W.2d 514 (1972) .

(n39)Footnote 39. 201 N.W.2d at 520 (buyer's testimony that he could either obtain a mortgage or borrow from his mother, who was in no way bound to furnish the funds, was insufficient to establish financial ability).

(n40)Footnote 40. *See Heinrich v. R.L. Oil & Gas Co., Inc.*, 442 N.W.2d 467 (S.D. 1989) (court made a distinction between the subject case involving an SBA loan and *Peter M. Chalik & Assocs. v. Hermes*, 56 Wis. 2d 151, 201 N.W.2d 514 (1972) , in which the proposed lender was the buyer's mother).

(n41)Footnote 41. *See Epstein v. Bossard*, 206 Misc. 48, 131 N.Y.S.2d 709, 1954 N.Y. Misc. LEXIS 3356 (1954) , *aff'd*, 286 A.D. 920, 143 N.Y.S.2d 659, 1955 N.Y. App. Div. LEXIS 4505 (4th Dept. 1955) (court ruled that buyer's testimony that the bank made an oral commitment to lend was insufficient to establish financial ability. However, the court did not require a written loan commitment, but stated that, at a minimum, the bank officer should testify giving the owner an opportunity to cross examine the witness).

(n42)Footnote 42. *See, e.g.:*

Florida: Sticht v. Shull, 543 So. 2d 395 (Dist. Ct. App. Fla. 1989) (holding that broker failed to adequately prove financial ability of purchaser with net worth of only \$150,000 for \$650,000 purchase and claimed difference would be made up by assistance from his mother, who was under no contractual commitment to provide funds to either vendors or prospective purchaser).

Wisconsin: Peter M. Chalik & Assocs. v. Hermes, 56 Wis. 2d 151, 201 N.W.2d 514 (1972) .

(n43)Footnote 43. *McGarry v. McCrone*, 56 Ohio Op. 479, 118 N.E.2d 195, 198 (Ohio 1954) (buyer failed to obtain funds from a relative).

(n44)Footnote 44. See *Hare v. Bauer*, 223 Minn. 292, 26 N.W.2d 359 (1947) (finding that the buyer was not financially able when the contract called for down payment of \$1,000, and \$700 of that was in the form of a unsecured note from the buyer to the broker).

(n45)Footnote 45. See, e.g., *Peter M. Chalik & Assocs. v. Hermes*, 56 Wis. 2d 151, 201 N.W.2d 514 (1972) .

(n46)Footnote 45.1. See *Shands v. Wm. R. Winton, Ltd.*, 91 P.3d 416, 2003 Colo. App. LEXIS 1783, at *6 (Colo. Ct. App. Nov. 20, 2003) , rehearing denied, 2003 Colo. App. LEXIS 1964 (Colo. Ct. App., Dec. 18, 2003) .

(n47)Footnote 46. See *Epstein v. Howard*, 5 Ill. App. 2d 553, 126 N.E.2d 162 (1955) (there was no evidence that the owner was aware of the other parties involved and the trial court properly disregarded evidence of their financial status. There was also no evidence that the named buyer could command the funds to buy the property).

(n48)Footnote 47. See, e.g.:

Wisconsin: *Peter M. Chalik & Assocs. v. Hermes*, 56 Wis. 2d 151, 201 N.W.2d 514 (1972) (the court noted that the jury could not infer from the subsequent purchase that the buyer had a sufficient credit rating under the Shell Oil guidelines at the time the buyer was attempting to purchase the property in the instant case).

Washington: *Record Realty, Inc. v. Hull*, 15 Wn. App. 826, 552 P.2d 191 (1976) (exhibit showing that purchaser purchased another house after transaction in question fell through did not substantiate the buyer's financial ability when there was no evidence of the purchase price of the second home or evidence that the buyer could afford the home in the instant case).

But see:

Weinrib v. Krich, 17 Misc. 2d 868, 191 N.Y.S.2d 874, 1959 N.Y. Misc. LEXIS 3747 (2d Dept. 1959) (purchaser reneged on the offer and three months later used the cash he claimed was available to him to purchase another building. The court held that this undisputed fact was sufficient to submit the question of the buyer's financial ability to the jury).

(n49)Footnote 47.1. See *Resort Realty of the Outer Banks, Inc. v. Brandt*, 163 N.C. App. 114, 118, 593 S.E.2d 404, 409 (N.C. Ct. App. 2004) , appeal dismissed, 358 N.C. 236, 595 S.E.2d 154 (N.C. 2004) , motion dismissed, 597 S.E.2d 134 (N.C. 2004) .

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108 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 5 The "Ready, Willing and Able" Requirements--Proof of Purchaser's Financial Ability to Consummate the Transaction *

10-5 Real Estate Brokerage Law and Practice § 5.03

§ 5.03 Broker May Be Required to Prove Purchaser's Financial Ability to Consummate Transaction

[1] Determination Depends on Several Factors Including Rule of Jurisdiction, Status of Parties' Agreement, and Which Party Defaulted

[a] Traditionally Financial Ability Presumed When Unconditional Sales Contract Is Executed

A common factual situation involves a seller and a buyer who enter into a sales contract, but the transaction does not close because either the buyer or the seller is unwilling or unable to perform. In jurisdictions that adhere to the traditional rule, the broker earns his or her commission at the time the sales contract is executed, assuming it is not subject to any conditions, regardless of whether the transaction is ultimately closed. n1 Therefore, proof of the purchaser's financial ability is immaterial and irrelevant.

Under the traditional rule, the broker never has to prove the purchaser's financial ability in any case in which the sales contract is executed. n2

[b] Traditional Rule Based on "Acceptance" Doctrine

The traditional rule is based on the "acceptance" doctrine, that when the seller enters into a contract of sale with a purchaser procured by the broker, the seller is deemed to have "accepted" the purchaser and "cannot thereafter question the purchaser's capacity to complete the transaction except in cases involving fraud or bad faith" on the part of the broker. n3 Accordingly, the broker's right to a commission accrues at the time the sales contract is executed. n4

The rationale underlying the traditional rule of "acceptance," or estoppel by contract, is that a broker is hired to produce the customer; once a contract is signed, the owner is in effect telling the broker that he or she is satisfied with the broker's services. n5 "The seller will be presumed to have satisfied himself with respect to the purchaser's financial ability before entering into the contract ... and to have waived proof of the issue." n6 Thus, "[t]he existence of a written contract renders testimony with respect to the question of financial ability immaterial on the issue of the broker's right to a commission ... and not admissible at the trial." n7

An additional justification for the rule is that "[t]he broker is not an insurer of the subsequent performance of the

contract and is not deprived of his right to a commission by the failure or refusal of the buyer to perform." n8

[2] Contract Must Be Binding and Enforceable

[a] Commission Earned When Conditions of Sales Contract Are Met

Even in a jurisdiction that adheres to the traditional rule, *i.e.*, in an action for a commission the broker need prove no more than that the principal entered into a binding contract of sale with the purchaser, courts will give effect to conditions in the contract of sale that may prevent the contract from becoming binding and enforceable, thereby precluding application of the "acceptance" rule. For example, when a buyer and seller enter into a contract that is conditioned upon the buyer obtaining a loan or on the approval of another party, the broker will not earn his or her commission at the time of execution of the contract based on the theory that the contract does not become binding and enforceable until that condition is met. n9 In these cases, the broker must offer proof of the purchaser's financial ability in order to earn his or her commission.

Another theory supporting the denial of a broker's commission in a conditional sales contract--until the purchaser's financial ability is proven--is that the broker's knowledge of and acquiescence in a contingent sales contract transforms the owner's agreement to pay the commission into a conditional agreement, contingent on the event(s) forming the condition in the sales contract. n10 In effect, when the sales contract is conditional, there is no presumption of the purchaser's qualifications at the time the contract is executed n11 and the broker earns his or her commission only when the condition is fulfilled. n12 Therefore, if the buyer is unable to obtain a mortgage commitment within the time specified in a conditional sales contract, the seller may terminate the sales contract without being liable to the broker for a commission. n13

[b] Conditions to Sale May Be Implied

If there is no written condition, some courts imply a condition to alleviate the harshness of the "acceptance" doctrine in cases in which the purchaser defaults. They construe the purchase agreement as conditional on the performance of the buyer, thereby avoiding the seller's "acceptance" of the buyer at the time of contract execution. n14

[3] Broker Must Offer Proof if Negotiations Are Not Finalized

When a broker undertakes to sell property, there are often details that are not specified in the listing agreement or in the offer to purchase. If the listing agreement between the seller and the broker contemplates negotiation of terms of sale, the broker does not earn a commission until the seller and buyer reach an agreement. n15 If the agreement has not been finalized, there is no presumption that the seller has accepted the purchaser's offer and the broker will be required to prove that the buyer was ready, willing, and able to obtain a commission. n16 Generally, a seller cannot deny a broker's otherwise legitimate right to a commission based on terms that are not material to the seller's rejection of the offer. Once the offer to purchase satisfies all material terms in the listing agreement, the seller becomes obligated to pay the broker's commission. n17

[4] Traditional Rule Increasingly Subject to Exceptions

The trend by the courts is to create exceptions to or to overrule altogether the traditional rule of acceptance. This may very well be in response to the changing patterns of real estate transactions. For example, prior to the advent of mortgages and other forms of third-party financing, a buyer often would pay an earnest money deposit at the time the contract was signed and then the balance of the down payment, or the full purchase price, at closing. If the buyer was unable to pay the entire purchase price with cash, the seller often would finance the balance of the purchase price. Today, with third-party financing a common occurrence and with increasingly complex issues involving disclosures, environmental concerns, zoning, easements, and other complications of modern life, there is more potential for something to go wrong in a real estate transaction, resulting in a failure to close the sale. The courts have responded

accordingly to avoid requiring the seller to pay a commission when the failure to close was not due to the wrongdoing of the seller. This is part of a judicial trend to apply a standard of reasonableness when requiring a seller to pay a broker's commission when the transaction does not close.

Another factor supporting this trend is that most sellers and brokers today expect that the commission will be paid to the broker at closing out of the proceeds realized by the seller. In fact, this understanding is often incorporated into a brokerage agreement between the seller and the broker. *See* § 4.02[2] *above* for a more detailed discussion of this topic.

[5] Minority Rule Requires Proof of Purchaser's Financial Ability Whenever Sale Is Not Consummated

[a] Minority View Neutralizes Harsh Effect of Acceptance Doctrine

Some jurisdictions have abandoned the traditional rule altogether. These courts unequivocally reject the "acceptance" doctrine and, in effect, require the broker, in any case that does not result in a closed sale, to prove the purchaser's financial ability regardless of whether it is the buyer or the seller who fails to consummate the sale. n18 The minority rule attempts to make more equitable the harsh results of the traditional acceptance doctrine under which the seller remains liable for the broker's commission even if the buyer later fails to perform the contract. n19 The minority rule acknowledges the reality that a seller hires a broker to find a buyer who is able to complete the transaction, not merely able to sign a contract. n20 Because this is the broker's job, the risk that a purchaser will turn out to be financially incapable is placed with the broker. n21 A seller's obligation to pay the broker a commission arises only if and when the sale is consummated, unless the seller's own conduct prevents the transaction from closing. Thus, jurisdictions applying the minority rule hold that a broker earns his or her commission when

- the broker produces a purchaser ready, willing and able to buy on the seller's terms;
- the purchaser enters into a binding contract with the seller; and
- the transaction is completed by closing the title in accordance with the provisions of the contract. n22

[b] Broker Entitled to Commission Only if Transaction Fails Due to Seller's Wrongful Act

Under the minority rule, if the transaction is not consummated because the purchaser defaults, the broker is not entitled to commission. If the transaction fails because of the wrongful act or interference of the seller, the broker is entitled to commission. n23 If, for example, the buyer defaults because he or she is not able to secure the necessary financing or to convert his or her assets into the cash needed for the purchase, the broker will not be able to recover from the seller because the broker will not be able to prove an essential element of the broker's case, *i.e.*, that the buyer was "able" to complete the purchase. n24 In order for a broker to recover when the buyer's financial ability is in doubt, the broker must "establish that the seller's refusal to consummate the sale was arbitrary, capricious, unreasonable, or wrongful and was not for good cause." n25 With respect to whether the failure to close resulted from a wrongful act or interference of the seller, the courts apply a standard of reasonableness. n26

What if the seller is unable to deliver marketable title or the transaction fails to close due to some other "fault" of the seller that is not entirely within the seller's control? This has been a grey area in minority jurisdictions. n27

Finally, some states have always held the view that a signed sales contract does not obviate a broker's duty to prove that he or she produced a ready, willing and able buyer. n28

[6] Broker May Be Entitled to Commission Even in Absence of Sales Contract

In some jurisdictions, a binding sales contract between a seller and a purchaser need not be executed in order for a broker to recover a commission. n29 If a broker produces a buyer who is ready, willing and able to purchase the owner's

property on terms acceptable to the owner within the required time and the owner then refuses to sign a contract, the broker is entitled to a commission. n30 The fact that an owner changes his or her mind or that the owner's spouse chooses not to sell is insufficient to shield the owner from paying a commission under a listing agreement. n31

However, the broker must prove the purchaser's financial ability as an essential element of the broker's cause of action (see § 5.02 above), n32 unless such proof has been waived by the owner (see § 5.04 below), even if the seller refuses to sign the contract for no legally justifiable reason. For example, the seller may refuse a purchaser's offer even though it conforms to the terms of the listing or the seller may renege upon terms that are orally agreed to between the seller and the buyer.

This general rule applies in jurisdictions following both the traditional and the minority rules.

FOOTNOTES:

(n1)Footnote 1. *See, e.g.,*

Florida: Quantum Realty, Inc., v. Laudherill Apt. Investors, 391 So. 2d 228, 229 (Fla. Dist. Ct. App. 1980) , *petition denied*, 399 So. 2d 1143 (Fla. 1981) . ("Regardless of whether the employment contract requires the finding of a purchaser or a sale, the broker is entitled to a commission if the seller is responsible for the failure to consummate the sale.").

Hawaii: Property House, Inc. v. Kelley, 715 P.2d 805 (Haw. 1986) .

Illinois: Gordon v. Bauer, 177 Ill. App. 3d 1073, 1097, 127 Ill. Dec. 26, 42, 532 N.E.2d 855, 870 (1988) *cert. denied*, 125 Ill. 2d 564, 130 Ill. Dec. 480, 537 N.E.2d 809 (Ill. 1989) ("[W]hen the seller enters into an enforceable contract with a purchaser to sell real estate, the readiness, willingness and ability of the purchaser is no longer open to question and the broker's right to compensation accrues regardless of whether the sale is completed."); *United Investors*, 132 Ill. App. 3d 175, 179, 87 Ill. Dec. 439, 442, 477 N.E.2d 40, 43 (1985) ("By entering into [an unconditional, enforceable purchase agreement], the seller is precluded from asserting that the buyer was not ready, willing and able to purchase the property, and the broker is entitled to his commission even if the sale is never consummated.").

(n2)Footnote 2. *See, e.g.:*

Connecticut: Walsh v. Turlick, 164 Conn. 754, 316 A.2d 759 (1972) .

Kentucky: Neel v. Wagner-Shuck Realty Co., 576 S.W.2d 246 (Ky. App. 1978) .

Minnesota: Bailie v. Ridker, 249 Minn. 161, 81 N.W.2d 798 (1957) .

Montana: Wood v. Strodbeck, 142 Mont. 180, 382 P.2d 170 (1963) .

New Mexico: Ranch World of New Mexico, Inc. v. Berry Land & Cattle Co., Inc., 110 N.M. 402, 796 P.2d 1098 (1990) .

For an exhaustive list of jurisdictions applying the rule that an executed contract of sale entitles the broker to his or her commission, *see* Annotation, *Modern view as to right of real estate broker to recover commission from seller-principal where buyer defaults under valid contract of sale*, 12 A.L.R.4th 1083 (1982); *Real Property-Brokerage Commission-Threshold Standard for Imposing Seller Liability for A Brokerage Commission in A Failed Transaction Is*

A Determination That The Seller Breached The Sales Contract-Van Winkle and Liggett, 18 Seton Hall L. Rev. 183 (1988); Annotation, Real-estate broker's right to recover commission from seller where sale fails because of seller's failure to deliver good title-modern cases, 28 A.L.R.4th 1007 (1984).

(n3)Footnote 3. *Bailie v. Ridker, 249 Minn. 161, 81 N.W.2d 798, 806 (1957) .*

See also McLeod v. Wilson, 445 So. 2d 280, 282 (Ala. 1984) ("Acceptance by the seller is conclusive evidence of the fact that the purchaser was ready, able, and willing, thereby dispensing with the necessity of a factual determination on the issue.").

Accord Heinrich v. R.L. Oil & Gas Co., Inc., 442 N.W.2d 467 (S.D. 1989) .

*But see F. Richard Wolff & Son, Inc. v. Tutora, 2008 N.Y. App. Div. LEXIS 3519, *4, 2008 NY Slip Op 3583 (Apr. 22, 2008) (where the mere signing of a contract does not establish that the buyer is financially able to complete the transaction and meet the purchase price).*

(n4)Footnote 4. *United Investors, 132 Ill. App. 3d 175, 178, 87 Ill. Dec. 439, 441, 477 N.E.2d 40, 42 (1985) ("Where a seller of real estate, enters into an enforceable contract of sale with a purchaser procured by a broker, the readiness, willingness and ability of the purchaser is no longer open to question and the broker's right to compensation accrues whether or not the sale is completed."); Door Knob Realty, Inc. v. James Northrop, 86 Misc. 2d 675, 383 N.Y.S.2d 484, 1976 N.Y. Misc. LEXIS 2503 (Sup. Ct. 1976) . But see Dabbs v. Southern Real Estate, Inc., 2008 Ala. Civ. App. LEXIS 3, at *9 (Jan. 11, 2008) (where it was not necessary for the seller to have accepted the buyers' purchase offer in order for the broker to be entitled to a commission), cert. denied, 2008 Ala. LEXIS 78 (Ala. Apr. 25, 2008) .*

(n5)Footnote 5. *Oregon Home Builders v. Montgomery Inv. Co., 94 Or. 349, 363, 184 P. 487, 492 (1919) (citations omitted). But see Brown v. Grimm, 258 Or. 55, 481 P.2d 63 (1971) (rejecting "acceptance" doctrine).*

(n6)Footnote 6. *Door Knob Realty, Inc. v. Northrop, 86 Misc. 2d 675, 383 N.Y.S.2d 484, 486, 1976 N.Y. Misc. LEXIS 2503 (Sup. Ct. 1976) (citations omitted); Agency, Broad and Cornelia Street, Inc. v. Lavigne, 470 N.Y.S.2d 729, 730, 1983 N.Y. App. Div. LEXIS 20724 (3d Dept. 1983) .*

(n7)Footnote 7. *Door Knob Realty, Inc. v. Northrop, 86 Misc. 2d 675, 383 N.Y.S.2d 484, 486, 1976 N.Y. Misc. LEXIS 2503 (Sup. Ct. 1976) (citations omitted).*

(n8)Footnote 8. *Bushnell Real Estate, Inc. v. Nielson, 672 P.2d 746, 751 (Utah 1983) .*

(n9)Footnote 9. *See, e.g.:*

California: Kopf v. Milam, 60 Cal. 2d 600, 35 Cal. Rptr. 614, 387 P.2d 390 (1963) (sales contract was subject to buyer assuming existing loan).

Illinois: Telander v. Posejpal, 94 Ill. App. 3d 616, 625, 49 Ill. Dec. 590, 598, 418 N.E.2d 444, 452 (1981) (holding that because the contract was dependent on loan conditions, agreement to pay real estate commission was also dependent on loan condition unless seller waived ready, willing and able requirement).

Iowa: Mullenger v. Clause, 178 N.W.2d 420 (Iowa 1970) .

New York: Stiefvater Real Estate, Inc. v. Hinsdale, 812 F.2d 805, 808 (2d Cir. 1987) (no presumption of buyer's readiness, willingness or ability when contract of sale was conditioned on purchaser obtaining a mortgage).

Missouri: Dark v. MRO Mid-Atlantic Corp., 876 S.W.2d 714 (Mo. App. 1994) (holding that contract conditioned on senior management approval of corporate buyer was not binding and enforceable and the buyer never became ready, willing and able to purchase).

Pennsylvania: Shumaker v. Lear, 235 Pa. Super. 509, 345 A.2d 249 (1975) .

(n10)Footnote 10. *Cooper v. Liberty Nat'l Bank of Chicago*, 332 Ill. App. 459, 75 N.E.2d 769 (1947) .

Cf. The Huffines Co., LLC v. Lockhart, 365 S.C. 178, 194-195, 617 S.E.2d 125, 133 (S.C. Ct. App. 2005) , rehearing denied, 2005 S.C. App. LEXIS 190 (S.C. Ct. App., Aug. 26, 2005) (an option contract did not meet the requirement that a sale or transfer occur within six months of the expiration of the listing agreement in order to trigger payment of a commission).

(n11)Footnote 11. *Kopf v. Milam*, 60 Cal. 2d 600, 35 Cal. Rptr. 614, 387 P.2d 390 (1963) .

(n12)Footnote 12. *Schumaker v. Lear*, 235 Pa. Super. 509, 345 A.2d 249, 251, n.8 (1975) .

(n13)Footnote 13. *See* 345 A.2d 249, 251, n.8 (1975) (holding that seller is excused from paying the broker's commission where buyer allegedly obtained a mortgage nine days after the financing deadline).

(n14)Footnote 14. *See, e.g.*,

Cabry v. Ionidas, 122 Ill. App. 2d 167, 258 N.E. 2d 45 (1970) (involving purchasers who defaulted at closing, were unable to tender the down payment, and never executed a contract for a deed, court rejected broker's suit for a commission finding that the preliminary purchase agreement was conditioned upon the tender of the down payment at closing, and that when the seller signed the agreement he was not accepting the buyers as purchasers, irrespective of their financial ability to tender the down payment at closing).

(n15)Footnote 15. *Moore and Moore Real Estate v. Aloj*, 234 A.D.2d 683, 650 N.Y.S.2d 450, 451-51, 1996 N.Y. App. Div. LEXIS 12351 (3d Dept. 1996) (holding that broker failed to establish agreement on essential term and, in the absence of bad faith on seller's part, he was not entitled to brokerage commission).

See also Wilson v. W.E. Upchurch, 425 N.E.2d 236, 238 (Ind. App. 1981) .

(n16)Footnote 16. *Peter M. Chalik & Assocs. v. Hermes*, 56 Wis. 2d 151, 158, 201 N.W.2d 514, 518 (1972) .

See also Wilson v. W.E. Upchurch, 425 N.E.2d 236, 238 (Ind. App. 1981) (noting that broker does not have to bring the buyer and seller to a binding enforceable purchase agreement before the broker earns his commission, but "[b]efore a broker is entitled to his commission he must prove 1) an actual sale of the real estate or 2) that he had secured a buyer who was ready, willing and able to purchase the property upon terms listed by the seller and the seller refuses to complete the transaction or 3) that by and through the procurement of the broker, a third party had entered into a valid executory contract with the seller for the purchase of the land.").

(n17)Footnote 17. *Century 21 Blowers & Assocs., Inc. v. Product Credit Ass'n of Southeast Wisconsin*, 487 N.W.2d 660 (Wis. App. 1992) .

Here, plaintiff produced buyers who, after negotiating with defendants, entered into a contract for the sale of the real property. Failure of the contract attributable to a purchaser's default is not attributable to the broker.

(n18)Footnote 18. *Ellsworth Dobbs, Inc. v. Johnson*, 50 N.J. 528, 236 A.2d 843, 855 n.17 (1967) (involving

broker's claim for a commission when the purchaser defaulted on the contract of sale, court stated "Execution of a contract to sell to the tendered purchaser, without more, will not bar the owner from relying upon the financial or other inability or failure of the buyer to complete his undertaking as an absolute defense to the broker's suit.").

See also:

Idaho: Strout Realty, Inc. v. Milhous, 107 Idaho 330, 334, 689 P.2d 222, 226 (Idaho App. 1984) (noting that minority rule modifies traditional rule of estoppel, which estops sellers from defending against a broker's claims for a commission once he accepts the buyer by entering a contract of sale, to enforcing estoppel once the closing has occurred).

Illinois: Daybreak Constr. Specialties, Inc. v. Saghatoleslami, 712 P.2d 1028, 1032 (Ill. App. 1985) (stating that "[i]n the absence of a completed sale, a broker is entitled to a commission only if he has procured a purchaser who is ready, willing, and able to consummate the sale on the terms and conditions prescribed by the seller, and the broker must prove that he has presented such a purchaser to the seller.").

Massachusetts: Bennett v. McCabe, 808 F.2d 178, 180 (1st Cir. 1987) ; *Tristram's Landing, Inc. v. Wait*, 367 Mass. 622, 629-30, 327 N.E.2d 727, 731 (1975) (holding that a seller need not pay a broker's commission if the broker's customer defaults on a signed purchase and sale agreement).

Oregon: Setser v. Commonwealth, Inc., 256 Or. 11, 470 P.2d 142 (1970) .

See generally Sonja A. Soehnel, Annotation, *Modern View As To Right Of Real Estate Broker To Recover Commission From Seller-Principal Where Buyer Defaults Under Valid Contract of Sale*, 12 A.L.R.4th 1083 (1981); Note, Ellsworth Dobbs, Inc. v. Johnson: A Reexamination of the Broker-Buyer-Seller Relationship in New Jersey, 23 Rutgers L. Rev. 83 (1968).

The New Jersey Supreme Court in *Van Winkle & Liggett v. G.B.R. Fabrics, Inc.*, 511 A.2d 124 (N.J. 1986) , offered a succinct summary of the development of the minority rule:

Prior to Ellsworth Dobbs, the common-law rule was that in the absence of an express agreement to the contrary, a real estate broker earned its commission by producing a willing and able purchaser who entered into a contract of sale. Any perceived ambiguity in the language of a listing agreement, such as a provision that the commission would be "paid on closing" or "payable when title passes," was often construed as controlling the time of the payment of the commission and not as a condition precedent to the broker's right to receive the commission. Even if title did not close because the buyer was financially unable to perform, the broker would still be entitled to a commission.

In rejecting this rule, we were mindful of the fact that when an owner lists his property with a broker, the owner invariably expects that the money for a brokerage commission will be paid out of the proceeds of sale. We noted that the owner's expectation is reasonable and consistent with the broker's expectation as to the kind of purchaser his engagement requires him to tender to the owner. A seller seeks a buyer who is able to close, not merely one who is able to sign a contract, and the risk of a financially incapable purchaser should be borne by the broker. Accordingly, we held that a seller's liability for the commission will arise only if the sale is consummated, unless the title "does not pass because of the owner's improper or frustrating conduct."

Van Winkle & Liggett v. G.B.R. Fabrics, Inc., 511 A.2d 124, 128--129 (N.J. 1986) (citations and footnotes omitted).

(n19)Footnote 19. *Tristram's Landing, Inc. v. Wait*, 367 Mass. 622, 327 N.E.2d 727 (1975) (citing *Gaynor v. Laverdure*, 362 Mass. 828, 291 N.E.2d 617 (1973) (applied the acceptance rule to award broker a commission despite purchaser's default)).

(n20)Footnote 20. *Drake v. Hosley*, 713 P.2d 1203, 1206 (Alaska 1986) ("In a practical world the true test of a willing buyer is not met at the time a purchase agreement is signed, but at the time of closing of title.").

(n21)Footnote 21. *Drake v. Hosley*, 713 P.2d 1203, 1206 (Alaska 1986) .

(n22)Footnote 22. *Drake v. Hosley*, 713 P.2d 1203, 1206 (Alaska 1986) .

(n23)Footnote 23. *Drake v. Hosley*, 713 P.2d 1203, 1206 (Alaska 1986) (stating that "absent default by the owner, the contract of sale must be performed by the buyer before liability for commission is imposed upon the owner").

See also:

Massachusetts: Benn v. Halyard Realty Trust (In re Halyard Realty Trust), 37 B.R. 260, 263 (Bankr. D. Mass. 1983) ("When a broker finds a buyer who enters into a purchase and sale agreement which is not consummated because of the seller's inability to deliver good title as promised, the broker has earned his commission even though title has not passed.").

New Jersey: Schenck v. HJI Assocs., 295 N.J. Super. 445, 685 A.2d 481 (N.J. Super A.D. 1996) (relying on the language of the lease agreement and the interrelationship of its provisions, the court held that the broker was entitled to a commission only if financing was obtained, notwithstanding a provision that the commission was to be earned upon the signing of the agreement).

Oregon: Setser v. Commonwealth, Inc., 256 Or. 11, 470 P.2d 142, 147 (1970) (noting that minority rule does not require buyer to completely perform all terms of an installment contract of sale before the broker is entitled to his commission; "if the broker has done everything necessary under the contract to close the sale and there remains only the payment of future installments, the broker need not wait until the future installments are paid before he is entitled to his commission.").

(n24)Footnote 24. *Asset Realty, Inc. v. Guyuron*, No. 70431, 1996 Ohio App. LEXIS 5620 (Ohio App. 8th Dist. 1996) (unpublished opinion) (stating that "[t]he law is clear that the record must demonstrate that the broker procured a ready, willing and able buyer before the court can find that the broker performed its part of the broker's agreement.").

(n25)Footnote 25. 274 N.W.2d at 183 .

(n26)Footnote 26. *Goetz v. Anderson*, 274 N.W.2d 175 (N.D. 1978) (in action involving rescission due to the seller's concerns about the buyer's financial ability, the broker failed to produce any evidence at trial that the seller's doubts about the financial ability of the purchaser were unfounded which would justify commission).

(n27)Footnote 27. *Bennett v. McCabe*, 808 F.2d 178 (1st Cir. 1987) (applying Massachusetts law). The Bennett court appeared to interpret the meaning of a "wrongful act" of the seller to include a defect in title or some other "innocent" act of the seller. However, the Massachusetts Supreme Court criticized this ruling, without explicitly overruling it, in *Hillis v. Lake*, 421 Mass. 537, 658 N.E.2d 687 (1995) . The case involved a seller's representation that there were no hazardous materials. It was later discovered that there were hazardous materials and this resulted in a failure to close. The court ruled that the seller's misrepresentation was not a "wrongful act" within the *Ellsworth Dobbs* rule because it was only a representation, made in good faith, and not a promise. 421 Mass. 537, 658 N.E.2d 687 .

But see Hillis v. Lake, 421 Mass. 537, 658 N.E.2d 687 (Mass. 1995) .

(n28)Footnote 28. *See, e.g.:*

Connecticut: Nugent v. Del Vecchio, 415 A.2d 1339, 1341 (Conn. Super. 1980) .

Illinois: Telander v. Posejpal, 94 Ill. App. 2d 616, 418 N.E.2d 444 (1981) (holding that when the seller refuses to perform on the contract, the broker must still prove that the buyer was ready, willing and able to purchase the property on the proposed terms); *United Investors*, 132 Ill. App. 3d 175, 179, 87 Ill. Dec. 439, 442, 477 N.E.2d 40, 43 (1985) .

Minnesota: Century 21-Birdsell Realty, Inc. v. Hiebel, 379 N.W.2d 201 (Minn. App. 1985) (finding that where the seller's repudiation made it unnecessary for the buyer to proceed with the loan process, that the broker had until the closing date to establish the buyer's financial ability).

(n29)Footnote 29. *See, e.g.:*

New Jersey: Stanchak v. Cliffside Park Lodge No. 1527 L.O.M., Inc., 116 N.J. Super. 471, 282 A.2d 775 (1971) .

New Hampshire: Philbrick v. Chase, 95 N.H. 82, 58 A.2d 317 (1948) .

California: Woodbridge Realty v. Plymouth Development Corp., 130 Cal. App. 2d 270, 278 P.2d 713 (1955) .

(n30)Footnote 30. *Perper v. Edell*, 160 Fla. 477, 35 So. 2d 387 (1948)

Restatement (Second) of Agency, § 445(e).

(n31)Footnote 31. *See, e.g.:*

Minnesota: Century 21-Birdsell Realty, Inc. v. Hiebel, 379 N.W.2d 201 (Minn. App. 1985) (change of mind).

California: Russell v. Ramm, 254 P. 532 (1927) (spouse refused to sell).

(n32)Footnote 32. *See, e.g.:*

Connecticut: Potter v. Ridge Realty Corp., 28 Conn. Super. 304, 259 A.2d 758 (1969) (rejecting claim that it is seller's burden to prove affirmatively that prospect lacked financial ability to complete transaction).

Florida: Perper v. Edell, 160 Fla. 477, 35 So. 2d 387 (1948) .

Washington: Record Realty, Inc. v. Hull, 15 Wn. App. 826, 552 P.2d 191 (1976) .

New York: Globerman v. Lederer, 281 A.D. 39, 117 N.Y.S.2d 549 (1st Dept. 1952) .

New Jersey: Stanchak v. Cliffside Park Lodge No. 1527 L.O.M., Inc., 116 N.J. Super. 471, 282 A.2d 775 (1971) .

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109 of 163 DOCUMENTS

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 5 The "Ready, Willing and Able" Requirements--Proof of Purchaser's Financial Ability to Consummate the Transaction *

10-5 Real Estate Brokerage Law and Practice § 5.04

§ 5.04 Seller May Waive Ready, Willing and Able Requirement

[1] Seller May Investigate Purchaser's Financial Ability

A seller may waive the requirement that the proffered buyer be ready, willing and able to purchase the property, and agree to accept the purchaser regardless of his or her financial ability. n1 Waiver can occur in both classes of cases in which the purchaser's financial ability may be an issue, *i.e.*, in cases in which an owner refuses to sign a contract and in cases involving an executed sales contract and a subsequent failure to close.

The most compelling argument for waiver by the owner is "where there has been affirmative evidence that the seller investigated the financial ability of the prospective buyer and after due investigation satisfied himself of that ability, thereby waiving the conditions of readiness, willingness and ability to purchase." n2 When a seller makes an independent determination as to the purchaser's financial ability to complete the transaction, the seller may not use failure of the ready, willing and able requirement as a defense to payment of the broker's commission. n3

Once the seller approves and accepts the buyer, and executes a written contract of sale with the buyer, the broker becomes entitled to a commission. n4

[2] Seller's Repudiation Prior to Contract Does Not Amount to Waiver

[a] Broker Must Prove Purchaser's Financial Ability

When a seller reneges prior to contract signing, the courts generally hold that the broker is not excused from offering proof of a financially able buyer unless the seller rejected on grounds of the buyer's financial inability. Four issues must be considered:

(1) What if the seller gives no reason for rejecting the offer other than that he or she has had a change of heart about selling?

(2) Should the seller be estopped from later claiming that the buyer procured by the broker was not "able" when the broker sues for a commission?

(3) Should the seller be deemed to have waived the "able" purchaser requirement by failing to base his or her rejection on that ground, thereby relieving the broker of the broker's usual burden to prove financial ability when no binding sales contract has been executed?

(4) Should it make any difference whether the seller had initially agreed, either orally or in writing, to enter into a contract of sale with the prospective buyer, but later backed away from the deal on grounds other than the purchaser's lack of financial ability?

[b] Broker Must Prove That Performance Could Have Occurred but for Repudiation

To recover his or her commission, "the broker must show that he did perform or could have performed had the contract not been repudiated." n5 Based on general principles of contract law, the financial ability of the purchaser is considered a substantial condition. A broker must "prove performance of the conditions precedent to the duty of the seller to pay a commission, to wit, to prove production of a 'ready, able and willing' buyer." n6 Otherwise, brokers could recover for full performance when no performance whatsoever had been given. Thus, "the broker must show that the condition could have occurred had its performance not been prevented by the seller." n7

[c] Determination Depends on Seller's Basis for Repudiation

When sellers change their minds about parting with their property and give no additional reason for rejecting the offer to buy, many courts have held that the sellers have not waived the condition that the broker procure a buyer who is ready, willing and able to buy on the sellers' terms. Accordingly, the broker must still prove that the prospective purchaser was financially able to meet the terms of the listing in order to recover a commission on the brokerage agreement itself. n8

A seller cannot be said to have waived the financial inability of the buyer as a defense simply because the seller gives no reason for rejecting the offer. n9 On the other hand, if the seller does give a reason for rejecting an offer, but that reason does not relate to the buyer's financial ability and is not legally justifiable, many courts prevent the owner from raising the issue of the buyer's financial ability at time of trial. n10

A few courts have applied the "acceptance" by contract doctrine to a seller who has agreed, orally or in writing, to enter into a contract of sale and who has failed to specify that he or she was reneging on grounds of financial ability. n11 At least one court has stated the rationale for such a result as follows:

In a contested case of this nature the agent ordinarily must also prove the prospective buyer's financial ability to consummate the transaction The owner's right to require such proof, however, may be waived, and is waived when the owner changes his mind and unqualifiedly and absolutely refuses to complete the contract of purchase. In that case the agent is relieved of the necessity of going forward or proceeding further, since the law does not require the doing of a useless thing The owner may not defeat the agent's right to a commission under these circumstances by refusing to consummate the transaction on the ground that they changed their minds and decided not to sell. n12

A seller who revokes an earlier acceptance cannot defeat a broker's claim upon grounds not originally stated. n13 Some courts, however, have rejected the argument that by orally agreeing to contract with the buyer the seller has "accepted" the buyer as financially able. n14

In several of the cases that have concluded that the broker is relieved of the burden of proving financial ability when the seller reneges on an oral agreement to sell, the court concluded that there was in fact sufficient evidence of the prospective buyer's financial ability. n15

Furthermore, if the seller interferes with or prevents the buyer from establishing his or her financial ability, the seller will not be able to use the buyer's lack of financial ability as a defense. n16

When the seller comes to terms with the buyer and agrees, either orally or in writing, to enter into a contract of sale but later reneges on a ground other than the buyer's financial inability, should the result be different from that reached in cases in which the offer is rejected from the outset? Here, again, there is no binding contract from which to conclude that the seller has "accepted" the buyer; and again, principles of contract law would seem to require that the broker prove that, but for the wrongful prevention by the seller, the broker could have satisfied the condition that he or she procure an "able" buyer. n17

The lesson to be drawn from these cases is that there is no facile formula that permits relying on the owner's failure to object to the purchaser's financial ability at the time of rejection as a means to escape the burden of proving financial ability. The vast majority of states require the broker to prove the financial ability of the buyer as an affirmative element in the broker's case, even if the owner did not object to the buyer's financial ability at the time of rejection. Prudence dictates that the broker should be wary of seeking to avoid the burden of proving financial ability when an owner reneges on an oral agreement to sell by relying on a claim of waiver or "acceptance."

FOOTNOTES:

(n1)Footnote 1. *Welek Realty, Inc. v. Juneau*, 596 S.W.2d 495 (Mo. App. 1980) .

(n2)Footnote 2. *Telander v. Posejpal*, 94 Ill. App. 3d 616, 418 N.E.2d 444 (1981) (finding no evidence of waiver).

(n3)Footnote 3. *Wood v. Johnson*, 264 N.E.2d at 262-263 (court refused to vacate a default judgment against the seller in a brokerage commission action because the defendant-seller had exercised independent judgment as to the buyer's financial ability before signing the contract of sale, and therefore had no meritorious defense).

(n4)Footnote 4. *Wood v. Johnson*, 264 N.E.2d at 262-263

The *Wood* court stated:

The circumstance that the purchaser was held in default following the execution of the contract would be no defense to [a] suit for [a] broker's commission under the contract, since defendant accepted the purchaser after investigating his financial stability. Where a seller had obtained credit reports or makes an independent investigation, and thereafter executes an agreement to sell to such purchaser, the transaction amounts to a conclusive arrangement between the seller and the buyer, and the actions of the seller in concluding such contract, following receipt of credit reports, amounts to a waiver of a condition relating to the readiness, willingness and ability of the purchaser to complete the transaction, that might otherwise have obtained.

Id. at 262-263.

See, e.g.:

New Jersey: Stanchak v. Cliffside Park Lodge No. 1527 L.O.M., Inc., 116 N.J. Super. 471, 282 A.2d 775 (1971) (change of heart).

Washington: Record Realty, Inc. v. Hull, 15 Wn. App. 826, 552 P.2d 191 (1976) (change of heart).

Wisconsin: Peter M. Chalik & Assocs. v. Hermes, 56 Wis. 2d 151, 201 N.W.2d 514 (1972) (seller offered

no reasons for rejecting offer).

(n5)Footnote 5. *Record Realty, Inc. v. Hull*, 15 Wash. App. 826, 552 P.2d 191 (1976) (citations omitted) (in action involving seller who, when presented with an earnest money agreement signed by the proposed purchaser, stated that he had decided not to sell the property no matter what offer was presented, court rejected broker's contention that a seller who so repudiates is estopped from defending an action on the ground of failure of the condition that the broker present an "able" buyer).

(n6)Footnote 6. *Record Realty, Inc. v. Hull*, 15 Wash. App. 826, 552 P.2d 191, 195, n.52 (1976) .

(n7)Footnote 7. *Record Realty, Inc. v. Hull*, 15 Wash. App. 826, 552 P.2d 191, 194 (1976) .

Massachusetts: Real Advantage, Inc. v. Howard H. Hood, 2000 Mass. Super. Lexis 404 (Sup. Ct. Mass 2000) citing *Tristram's Landing*, 367 Mass. at 629 (broker earns a commission even though the transaction is not consummated so long as (1) the broker produces a ready, willing, and able buyer (2) the purchaser and seller enter into a binding contract, and (3) there is a wrongful conduct on the part of the seller which undermines completion of the sale.

(n8)Footnote 8. 56 Wis. 2d 151, 201 N.W.2d 514 .

(n9)Footnote 9. 552 P.2d at 195, citing *Peter M. Chalik & Assocs. v. Hermes*, 56 Wis. 2d 151, 201 N.W.2d 514 (1972) .

(n10)Footnote 10. See *Russell v. Ramm*, 254 P. 532 (Cal. 1927) (owner's stated reason for rejecting offer was his wife's refusal to sell; held: owner could not thereafter defend the broker's claim on buyer's lack of financial ability. It should be noted that court went on to find that there was evidence of the buyer's financial ability).

(n11)Footnote 11. See, e.g.:

Minnesota: Bailie v. Ridker, 249 Minn. 161, 81 N.W.2d 798 (1957) (holding that presumption of purchaser's financial ability arises on an oral agreement to sell after the seller's attorney reviewed the buyer's financial status).

Missouri: Welek Realty, Inc. v. Juneau, 596 S.W.2d 495 (Mo. App. 1980) (seller who changed mind about selling after orally agreeing to terms with broker's customer waived proof of financial ability).

New York: Door Knob Realty, Inc. v. Northrop, 86 Misc. 2d 675, 383 N.Y.S.2d 484, 1976 N.Y. Misc. LEXIS 2503 (Sup. Ct. 1976) (oral agreement to enter into contract constitutes acceptance unless seller's subsequent refusal to sign the contract is based upon the buyer's alleged financial incapacity).

(n12)Footnote 12. *Welek*, 596 S.W.2d at 497, n. 46 above.

(n13)Footnote 13. *Julian James Stores, Inc. v. Bennett*, 250 Ark. 279, 465 S.W.2d 94 (1971) (buyer was financially able based on the purchaser's testimony that he was in the retail furniture business, he owned a farm, he had interests in other businesses and that he was able to come up with the down payment money). In *Julian James*, the seller revoked because he wanted to sell the property in lots at a higher price. However, the buyer was financially acceptable to the seller. When the seller revoked the acceptance and increased the price, the seller stated that he hoped the buyer would be the purchaser at the new, higher price. The court acknowledged that other courts create an exception to the doctrine of waiver if the objection was one for which there was no cure, such as the buyer's financial inability.

250 Ark. 279, 465 S.W.2d 94 .

(n14)Footnote 14. *See, e.g.,*

Arkansas: Julian James Stores, Inc. v. Bennett, 250 Ark. 279, 465 S.W.2d 94 (1971) .

Kansas: Winkelman v. Allen, 214 Kan. 22, 519 P.2d 1377 (1974)

Vermont: Arjay Properties, Inc. v. Hicks, 143 Vt. 335, 465 A.2d 777 (1983) .

(n15)Footnote 15. *See Russell v. Ramm*, 254 P. 532 (Cal. 1927) ; *Julian James Stores, Inc. v. Bennett*, 250 Ark. 279, 465 S.W.2d 94 (1971) .

(n16)Footnote 16. *See, e.g.:*

South Dakota: Heinrich v. R.L. Oil & Gas Co., Inc. 442 N.W.2d 467 (1989) (seller failed to provide sufficient information required by the SBA, and the sale never was consummated).

New York: Roberts v. H. Gin Realty Corp., 185 A.D.2d 209, 586 N.Y.S.2d 264 (1992) (seller's withdrawal of property after an oral agreement was reached thwarted the buyer's efforts to syndicate the purchase).

(n17)Footnote 17. *See Peter M. Chalik & Assocs. v. Hermes*, 56 Wis. 2d 151, 201 N.W.2d 514 (1972) (seller offered no reasons for rejecting offer).

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110 of 163 DOCUMENTS

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 5 The "Ready, Willing and Able" Requirements--Proof of Purchaser's Financial Ability to Consummate the Transaction *

10-5 Real Estate Brokerage Law and Practice § 5.05

§ 5.05 Broker Has Burden of Proving Financial Ability of Purchaser

[1] Determination Is Fact-Based

When evidence is required of the purchaser's financial ability, the broker has the burden of proving that he or she has produced a ready, willing and able buyer n1 by a preponderance of the evidence. n2 The fact that the word "able" is omitted from the listing agreement does not relieve the broker of this burden of proof. n3 However, the broker must offer tangible evidence from which the trier of fact may reasonably infer the competency of the purchaser to complete the transaction. n4 The matter ought not to be left to innuendo or speculation; proof and not "irresistible inferences, ... [is] required, facts and not surmises." n5 The nature and quality of evidence that is sufficient to establish a purchaser's financial ability, or lack thereof, is discussed in § 5.05[2] below.

[2] Broker Must Show That Purchaser Is Ready, Willing and Able During Negotiations

[a] Seller May Reject Purchaser if Broker Fails to Provide Adequate Proof

A key issue is whether the broker must present evidence of the purchaser's financial ability to the owner at the time the offer is made or whether this can be established at a later time, usually at trial. The answer will depend on a number of factors. If the owner questions the purchaser's financial ability during the offer and negotiation phase, the broker must show that such financial ability was communicated to the seller in a sufficiently objective manner before any duty on the part of the owner arises. If the broker fails to do this, notwithstanding the fact that the purchaser may in fact be financially able to complete the transaction, the owner may have a legally justifiable reason to reject the offer. For example, if the owner requests financial information on the buyer but the broker fails to provide such information or offers only his own statements regarding buyers' ability, this will be insufficient. n6 Proving purchaser is ready, willing, and able to complete a transaction requires more than the broker's assurances about the purchaser's general characteristics. Seller must be reasonably satisfied that the purchaser can complete the transaction, including making mortgage payments.

[b] Seller May Accept Subsequent Purchaser Prior to Accepting First

The issue of timing is critical when a seller receives an offer from a buyer, and then subsequently receives and accepts

an offer from a second buyer. Is the seller obligated to pay a commission to the broker of the first buyer? The answer is no unless, at the time of acceptance of the second buyer, the first buyer was both

- legally obligated to purchase, by either tendering a deposit or signing a written offer; and
- financially able to purchase. n7

If the first buyer has not tendered a deposit or signed a written offer, the seller may accept a subsequent purchaser. Seller's acceptance of a subsequent purchaser may negate the seller's obligations to pay commission to the original purchaser's broker. Verbal discussions between the first buyer and the seller's attorney do not legally obligate either party. In such cases, the owner does not owe a commission to the broker of the first buyer. n8

As to the "able" requirement, the owner is free to reject the offer of the first buyer if the owner doubts the buyer's financial ability based on a reasonable evaluation of facts. n9 As one court explained, "The seller has it within his power to reject an offer of purchase if he doubts the prospective purchaser's ability ... such rejection must be based on a reasonable evaluation of the facts." n10 Would-be buyers cannot tie up property until they become financially able, nor can their brokers expect to get a commission if the sellers find another buyer in the meantime.

An issue of timing also can be critical in cases when the seller and buyer have executed a sales contract. If the contract is contingent on the buyer obtaining financing within a limited period of time, and he fails to do so, resulting in the owner terminating the contract, the broker may not later argue that the buyer could have obtained financing had the owner not terminated. n11

Practice Note

Practitioners representing purchasers should be sure to include a clause in the contract of sale conditioning the sale on purchaser's obtaining adequate financing. In such cases, practitioners representing sellers should recognize that purchaser's failure to obtain financing may negate seller's obligation to pay the broker's commission.

Whether an owner's failure to specifically raise the purchaser's lack of financial ability at the time the buyer is rejected constitutes a waiver of this requirement is discussed in § 5.04 above.

[3] Testimony Regarding Purchaser's Ability May Be Presented at Trial

[a] Purchaser May Testify to Readiness, Willingness and Ability

At trial, the purchaser's testimony, if strong and plausible, and especially if supported by evidence that the purchaser is a person of substance, can be sufficient to establish a *prima facie* case that the purchaser was financially able. At least one court has held that a buyer's self-serving testimony stating that he or she was able to go through with the transaction is not a mere expression of opinion but essentially a statement of fact—a thought that is expressed in the form of a conclusion that rests upon facts known to the speaker. n12

Thus, in some instances, a purchaser's testimony that is self-serving and general in nature can be sufficient to establish financial ability. n13

But this is not a reliable rule. It is usually not sufficient to have a witness merely assert that he or she has the necessary funds or that he or she is able to perform. n14 Similarly, statements by the broker that the buyer was able to perform generally will not be sufficient to establish the purchaser's financial ability without further evidence substantiating this claim. n15 As one court stated: "some facts must be adduced, beyond the mere conclusion of the prospective purchaser, that he could have performed his obligations in the transaction." n16 The determination in each case has less to do with

the specific testimony of the purchaser and more to do with whether the court views the purchaser as a "person of substance." This concept is analyzed in detail in § 5.02 above .

Practice Note

Purchasers may be reluctant to testify, but should be encouraged to do so. Although the prospective purchasers are not directly involved in the controversy between the broker and seller, they may be called upon to disclose their financial affairs--a disclosure that they may resent, resulting in a reluctance to speak freely when they take the stand as witnesses. However, by utilization of proper discovery devices, *i.e.*, deposition and subpoena *duces tecum*, procuring information about the prospective purchaser's financial affairs should be possible.

[b] After Purchaser Testifies, Burden of Proof Shifts to Seller

After the purchaser testifies, the burden shifts to the owner to overcome the broker's case either through cross-examination or affirmative evidence of the lack of the buyer's financial ability. n17 More than one court has commented on the owner's failure to cross examine the purchaser to support a finding that the purchaser's testimony was sufficient to establish financial ability. n18

Practice Note

The purchaser's own testimony is often the most essential evidence in establishing the purchaser's financial ability to buy. Courts also give weight to testimony of businesses related to credit or banking.

[c] Financial Experts May Testify

In addition to the purchaser's own testimony, testimony from others who are in a business related to credit, banking and similar businesses can be very effective. For example, testimony from a representative of Dunn & Bradstreet, a commercial rating agency, was properly admitted over a hearsay objection on the issue of the prospective purchaser's financial responsibility and general business standing. n19

Counsel must be conscious of the need to establish financial ability by competent, admissible and relevant evidence. The hearsay rule has stymied more than one broker suing for a commission. n20 However, if not objected to, such hearsay testimony may well be binding on an appellate court in a jurisdiction that limits the scope of appellate review. n21 Or an appellate court may rule that the admission of hearsay testimony is nonreversible error. n22

As discussed in § 5.02[5] above, evidence of a subsequent purchase by the buyer will generally not be deemed relevant and admissible in deciding the buyer's financial ability. However, there may be some creative ways around this rule. The testimony of a loan representative regarding a loan made to a buyer may be relevant and admissible. n23 Such a witness's familiarity with the buyer's financial situation and credit standing provide the foundation for the witness to answer a hypothetical question about whether the lender would have made a loan to the buyer. n24

FOOTNOTES:

(n1)Footnote 1.

California: Abbott v. Floyd, 136 Cal. App. 365, 28 P.2d 929 (1934) .

Connecticut: Potter v. Ridge Realty Corp., 28 Conn. Super. 304, 259 A.2d 758 (1969) .

Kansas: Winkelman v. Allen, 214 Kan. 22, 519 P.2d 1377 (1974) .

Washington: Record Realty, Inc. v. Hull, 15 Wn. App. 826, 552 P.2d 191 (Wash. 1976) .

Cf. Property House, Inc. v. Kelley, 715 P.2d 805 (Haw. 1986) (holding that once vendors accepted purchaser and its

offer by agreeing to terms of sale, subsequent bad faith of sellers preventing sale from being consummated caused burden to shift to vendors to show purchaser was not a ready, willing, and able buyer, in absence of which broker was entitled to a real estate commission without being required to show financial ability of purchaser).

(n2)Footnote 2. *R. Zemper & Assoc. v. Scozzafava*, 28 Conn. App. 557, 560, 611 A.2d 449, 450 (1992) ; *William T. Beazley Co. v. Streeto*, 20 Conn. App. 718, 721, 570 A.2d 233 (1990) (plaintiff must show by a preponderance of the evidence that the buyer it produced was ready, willing and financially able to make purchase).

(n3)Footnote 3. *Goetz v. Anderson*, 274 N.W.2d 175 (N.D. 1978) .

How the courts define a "financially able" purchaser is discussed at length in § 5.02 above . No hard and fast rules can be formulated; financial ability is, after all, a question of fact and must necessarily turn on the facts of each case as explained in § 5.02 above .

(n4)Footnote 4. *See Globerman v. Lederer*, 281 A.D. 39, 117 N.Y.S.2d 549, 1952 N.Y. App. Div. LEXIS 3061 (1st Dept. 1952) . *Accord Stiefvater Real Estate, Inc. v. Hinsdale*, 812 F.2d 805, 808 (2d Cir. 1987) .

(n5)Footnote 5. *Jaffe v. Lederer*, 1920 N.Y. Misc. LEXIS 1778, 184 N.Y.S. 585, 587 (N.Y. Sup. Ct. 1st Dept. 1920) .

(n6)Footnote 6. *Gatlinburg Real Estate Co., Inc. v. Booth*, 651 S.W.2d 203 (Tenn. App. 1983) (broker assurances that buyers were "strong" and "fine people" held to be insufficient to provide owner with reasonable assurance and satisfaction that the buyers were able to complete the purchase).

(n7)Footnote 7. *Wood v. Strodtbeck*, 142 Mont. 180, 382 P.2d 170 (1963) .

(n8)Footnote 8. *Wood v. Strodtbeck*, 142 Mont. 180, 382 P.2d 170, 173 (1963) (seller did not reject the buyer outright, but sold to another buyer while the first buyer was trying to raise the down payment money).

(n9)Footnote 9. *Wood v. Strodtbeck*, 142 Mont. 180, 382 P.2d 170 (1963) .

(n10)Footnote 10. *Wood v. Strodtbeck*, 142 Mont. 180, 382 P.2d 170, 173 (1963) . In this case, the court supported the owner's rejection of a buyer who was a young man who had not yet come up with down payment money. This buyer was employed, had a good reputation and owned some assets, including 90 head of cattle. The loan agent testified that the security for the loan was ample and the buyer would be able to repay the loan. The buyer planned to raise the down payment money (plus money to buy owner's cattle) by mortgaging his own cattle and the owner's cattle and obtaining a loan from future in-laws. The buyer did in fact raise the money to complete the transaction, but was a few days too late. The owner sold the property to another buyer one day before the first buyer was ready to consummate the purchase. Presumably, if the first buyer had signed a written offer and had obtained some written assurances of the mortgage commitment and the loan commitment from his in-laws, the broker could have prevailed. This case illustrates how important timing is in real estate transactions.

(n11)Footnote 11. *See Shumaker v. Lear*, 345 A.2d 249 (Pa. Super. 1975) (explaining this variation to its usual "acceptance" doctrine (upon signing of the contract) by concluding that there is no enforceable contract when a finance contingency is included); *see also* § 5.03[2] above for discussion of the effect of a conditional sales contract in a jurisdiction adhering to the traditional rule of acceptance.

(n12)Footnote 12. *Driscoll v. Bunar*, 328 Mass. 398, 103 N.E.2d 809, 812 (Mass. 1952) .

(n13)Footnote 13. *See, e.g.:*

Arkansas: Sarna v. Fairweather, 248 Ark. 742, 453 S.W.2d 715 (Ark. 1970) (buyer's testimony that she owned quite a bit of real estate and had the required \$35,000 cash payment, along with testimony from a

witness who had participated in making loans to the buyer in the past, was sufficient to establish the buyer's financial ability).

California: Russell v. Ramm, 254 P. 532 (Cal. 1927) (one buyer's testimony that the buyers were able to raise the down payment, and had considerable property and money in the bank, was sufficient. Court noted that since the buyer was familiar with the owner and lived in the area, the owner probably was equally familiar with the buyers' properties and financial standing).

(n14)Footnote 14. *Cherry v. Montgomery*, 242 Ark. 233, 412 S.W.2d 845 (1967) .

(n15)Footnote 15. *See, e.g.:*

Connecticut: R. Zemper & Assoc. v. Scozzafava, 28 Conn. App. 557, 611 A.2d 449 (1992) (broker's testimony that he always prequalified his buyers prior to showing them property was insufficient evidence of the purchaser's financial ability).

Florida: Sharp v. Long, 283 So. 2d 567 (1973) (the fact that the buyer made a deposit and the broker testified that the buyer intended to pay cash was insufficient by itself to show financial ability.)

(n16)Footnote 16. *Globerman v. Lederer*, 281 A.D. 39, 117 N.Y.S.2d 549, 552, 1952 N.Y. App. Div. LEXIS 3061 (1st Dept. 1952) ; *see also Ramsdell v. Krehmke*, 95 Cal. App. 195, 272 P. 333 (Cal. 1928) (buyer's testimony that she had the funds for most of the down payment with specifics of how she raised the money and when and where she deposited the funds, together with testimony from the bank manager confirming that the bank would loan the buyer the difference, was sufficient to establish buyer's financial ability).

(n17)Footnote 17. *Russell v. Ramm*, 254 P. 532 (Cal. 1927) ; *Lathrop v. Gauger*, 127 Cal. App. 2d 754, 274 P.2d 730 (Cal. 1954) .

(n18)Footnote 18. *See, e.g.:*

Florida: Mogul v. McClaskey Realty, Inc., 309 So. 2d 254 (Fla. 1975) (lack of rebuttal testimony by owner failed to challenge conclusion that buyer was "person of substance").

California: Pellaton v. Brunski, 69 Cal. App. 301, 231 P. 583 (1924) (finding that owner did not rebut presumption of the buyer's financial ability, that owner failed to cross examine buyer and that the buyer would not have gone to the trouble and expense of borrowing the needed funds if he had not had the balance himself).

(n19)Footnote 19. *Perper v. Edell*, 160 Fla. 477, 35 So. 2d 387 (Fla. 1948) .

(n20)Footnote 20.

Colorado: Horton-Cavey Realty Co. v. Reese, 34 Colo. App. 323, 527 P.2d 914 (1974) (there was no proof of financial ability when hearsay was stricken upon objection and purchaser was not called).

Illinois: Manxi v. Kimbley, 351 Ill. App. 377, 115 N.E.2d 343 (1953) (testimony by broker that prospective buyer was worth \$1.5 million and owned various pieces of valuable property was inadmissible hearsay).

(n21)Footnote 21. *See Gatlinburg Real Estate Co., Inc. v. Booth*, 651 S.W.2d 203 (Tenn. App. 1983) (appellate court bound by trial court's findings on financial ability that were based on hearsay).

(n22)Footnote 22. *See Drake v. Conkling*, 129 N.H. 660, 531 A.2d 333 (N.H. 1987) (court held that the admission of the buyer's agent's testimony that the buyer was ready, willing and able to buy was at most a harmless error and not reversible).

(n23)Footnote 23. *Scott v. Cravaack*, 53 Ohio App. 2d 248, 7 Ohio Op. 3d 302, 372 N.E.2d 1375 (Ohio 1977) .

(n24)Footnote 24. *Scott v. Cravaack*, 53 Ohio App. 2d 248, 7 Ohio Op. 3d 302, 372 N.E.2d 1375 (Ohio 1977) .

* This chapter was revised by Roslyn K. Myers, a writer and attorney working in New York City; B.A., University of California, Berkeley; J.D., Fordham University School of Law; a member of the New York, Washington D.C., Connecticut, Minnesota and Wisconsin bars. It was previously revised by Linda Breen Pierce, a member of the State Bar of California. Additional updates were contributed by Sandra Bullington, Esq. and Mary Fallon, Esq.



111 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 5 The "Ready, Willing and Able" Requirements--Proof of Purchaser's Financial Ability to Consummate the Transaction *

10-5 Real Estate Brokerage Law and Practice § 5.06

§ 5.06 Courts May Consider the Seller's and Buyer's Negotiations Occurring After Expiration of Listing Agreement

In determining whether a buyer was ready, willing, and able, under some circumstances a court may be entitled to consider the negotiations of the seller and buyer which extend beyond the expiration of a listing agreement. This was the holding in *East Kendall Investments, Inc. v. Bankers Real Estate Partners*.ⁿ²⁵ The exclusive listing agreement provided that the commission was to be paid if the broker, the seller, or any other party found a buyer ready, willing and able to purchase the property at the terms and for the price specified in the agreement. This agreement expired on August 10, 1996. The property was listed for sale at \$3,950,000.

On August 9, 1996, a letter of intent was presented that contained a purchase price of \$3,400,000. On August 13, 1996, the buyer increased his offer to \$3,950,000, the full asking price. On August 16, 1996, the seller presented a counteroffer of \$3,995,000--a figure above the original asking price. Negotiations continued until the buyer met the new asking price. On September 10, the seller orally accepted the buyer's letter of intent at the new price. On September 11, a second letter of intent was prepared on behalf of the buyer reflecting these terms. The seller failed to respond and the transaction did not proceed. The trial court found that the seller was responsible for the failure to consummate the sale.ⁿ²⁶

After the seller refused to pay the broker's commission, the broker sued alleging that it was entitled to a commission because it had produced a ready, willing, and able buyer during the term of the listing agreement. The seller argued that because the buyer's only offer before the expiration of the listing agreement was at a purchase price lower than the full listing price, the buyer could not have been ready, willing, and able. The seller also asserted that whatever happened after expiration of the listing agreement was legally irrelevant. The court disagreed. It stated that in determining whether the buyer was ready, willing, and able, the trial court was entitled to look at the parties' continuous negotiations, which extended beyond the expiration of the listing agreement, and culminated in an above-price offer on terms accepted by the seller.ⁿ²⁷

Another issue raised by the seller concerned the fact that the buyer had only presented a nonbinding letter of intent. The seller argued that since the buyer did not present his offer in a form which, if accepted, would be legally binding, it followed that the buyer could not be considered ready, willing, and able. Under the particular facts of this case the court

disagreed because the seller was responsible for the failure to consummate the sale. However, the court noted that the seller was correct in asserting that a broker is ordinarily not deemed to have located a ready, willing, and able buyer if the buyer has presented the offer in the form of a legally nonbinding letter of commitment. n28 The court agreed that under normal circumstances, the presentation of the letter of intent would be insufficient to demonstrate that the buyer was ready and willing. However, since the seller failed to consummate the transaction, the broker was entitled to its commission. n29

FOOTNOTES:

(n1)Footnote 25. *742 So. 2d 302, 304 (Fla. App. 1999) , rehearing denied.*

(n2)Footnote 26. *742 So. 2d 302, 304 (Fla. App. 1999) , rehearing denied.*

(n3)Footnote 27. *742 So. 2d 302, 304 (Fla. App. 1999) , rehearing denied.*

(n4)Footnote 28. *See Restatement (Second) of Agency, § 445, comment d. (1958).*

(n5)Footnote 29. *742 So. 2d 302, 305-306 (Fla. App. 1999) , rehearing denied.*

* This chapter was revised by Roslyn K. Myers, a writer and attorney working in New York City; B.A., University of California, Berkeley; J.D., Fordham University School of Law; a member of the New York, Washington D.C., Connecticut, Minnesota and Wisconsin bars. It was previously revised by Linda Breen Pierce, a member of the State Bar of California. Additional updates were contributed by Sandra Bullington, Esq. and Mary Fallon, Esq.



112 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART II The Broker's Obligation and Right to Compensation

CHAPTER 5 The "Ready, Willing and Able" Requirements--Proof of Purchaser's Financial Ability to Consummate the Transaction *

10-5 Real Estate Brokerage Law and Practice § 5.07

§ 5.07 Practitioner Checklists

[1] Checklist for Representing Brokers

Ideally, the broker will have clear evidence that the buyer had the cash needed for the down payment and, if not an actual written loan commitment, evidence of the ability to obtain any required financing.

(1) Obtain Early Third-Party Commitments: Unless the buyer has sufficient liquid cash to pay all cash for the property, the broker should encourage the buyer to obtain a firm, written commitment for any third-party financing as soon as possible in the offer and negotiation stage. If a contract is signed and the transaction is consummated, the work undertaken by the buyer to obtain early loan approval will simply make the transaction go more smoothly with less stress and uncertainty for both parties.

(2) Use Commitment as Negotiation Advantage: Written loan approval can facilitate the negotiations and offer a purchaser an advantage if there are other buyers bidding for the property who do not have loan approval.

(3) Establish Purchaser's Financial Ability: If, after the purchaser has obtained a loan commitment, the owner unreasonably refuses to accept an offer that conforms to the listing (or on such terms as agreed to by the parties), the evidence of the financial ability of the purchaser is in place.

(4) Communicate Financial Ability to Seller: The broker should communicate the buyer's financial ability to the owner at the time the offer is made. Otherwise there could be some question as to whether an owner may be justified in rejecting a purchaser based on lack of financial ability.

(5) Provide Additional Information When Requested: If the owner requests further information on the buyer's financial position, the broker should definitely arrange to provide any data that is the subject of a reasonable request.

(6) Obtain Evidence of Purchaser's Financial Ability: If the broker anticipates proving the

purchaser's financial ability at trial, start gathering such evidence as soon as possible.

(7) Secure Early Cooperation from Purchaser: If the buyer has not obtained loan approval at the time the seller unreasonably rejects the buyer's offer or the contract is canceled, the broker should still attempt to identify evidence of the purchaser's financial ability as soon as possible. The broker is more likely to have the purchaser's cooperation and the facts may be easier to ascertain at this time rather than waiting for the trial.

(8) Obtain Written Documentation: Obtain as much written evidence of the buyer's financial ability as possible, *e.g.*, copies of bank statements showing cash savings, employment records establishing income and tangible evidence of other assets such as stock certificates and deeds to property.

(9) Request a Letter from the Lender: If the buyer has a relationship with a lender, request that the lender write a letter stating, in effect, that if the buyer had applied for a loan, it would have been granted.

(10) Call Witnesses to Testify: At trial, counsel representing a broker should consider calling as witnesses people who can testify that the buyer is a "person of substance."

(11) Call Business Institutions to Testify: If the buyer is a business entity, testimony from banks, vendors, and other commercial institutions that do business with the buyer could be helpful.

(12) Obtain Written Documentation: Evidence in the form of credit reports, net worth statements, and tax returns can be effective.

[2] Checklist for Representing the Owner

(1) Advise Sellers Regarding Bases of Rejection: Proactive counseling when representing an owner is also advisable. Counsel should advise owners that they cannot arbitrarily reject an offer that conforms to the listing without incurring potential liability for the broker's commission.

(2) Advise Sellers that Change of Heart Does Not Change Commission Obligation: The fact that an owner has changed his or her mind or that an owner's spouse does not really want to sell is not sufficient justification to unilaterally terminate the brokerage agreement.

(3) Caution Seller to Carefully Evaluate Buyer's Financial Ability: An owner should be cautious about rejecting a purchaser based on lack of financial ability. It is important for the owner to evaluate the buyer's financial position before rejecting a buyer.

(4) Request Specific Financial Information: Evaluating a buyer's financial position may involve requesting specific information on how the buyer is going to pay for the property. If the owner does not do this, his or her rejection of the purchaser may be viewed as arbitrary and unreasonable.

(5) Condition Commission on Closing: One of the most effective tools in representing the owner on this issue is to provide in the brokerage agreement, unequivocally, that the broker earns his or her commission if, and only if, the transaction actually closes. If done properly, this will eliminate the issue of the purchaser's financial ability altogether.

(6) Cross-Examine Purchaser: At trial, counsel representing the owner should always cross-examine the purchaser. Failure to cross-examine the purchaser can result in a finding for the purchaser, even if the purchaser's testimony was general and conclusive in nature.

* This chapter was revised by Roslyn K. Myers, a writer and attorney working in New York City; B.A., University of California, Berkeley; J.D., Fordham University School of Law; a member of the New York, Washington D.C., Connecticut, Minnesota and Wisconsin bars. It was previously revised by Linda Breen Pierce, a member of the State Bar of California. Additional updates were contributed by Sandra Bullington, Esq. and Mary Fallon, Esq.



113 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation
CHAPTER 6 Licensing of Brokers and Salespersons *

10A-6 Real Estate Brokerage Law and Practice 6.syn

§ 6.syn Synopsis to Chapter 6: Licensing of Brokers and Salespersons *

§ 6.01 Introduction

§ 6.02 Regulation

[1] Scope of Regulation

[a] Who Must Comply

[b] Activities Subject to Regulation

[c] Single Act Laws

[2] Licensing Agency Has Broad Authority

[3] Regulation of Advertising

[a] Disciplinary Proceedings Arising from Advertising Activities

[b] Regulation of Internet Advertising

[c] National Association of Realtors(R) Internet Data Exchange Policy

[4] Unlicensed Assistants and Office Staff

[5] Record Retention and Electronic Media

§ 6.03 Licensing Procedure

[1] In General

[2] Age

[3] Education

[4] Experience Requirements

[5] Residence and Reciprocity

[a] Residency

[b] Reciprocity

[6] Examination Requirements

[7] Entity Licensing

[8] Grounds for Denial of License

§ 6.04 License Terms and Renewal

[1] Terms of Licenses

[2] Continuing Education Requirements

§ 6.05 Suspension or Termination of License

[1] Grounds

[2] Administrative Procedures and Judicial Review

[3] Legislative Remedies

[a] In General

[b] Recovery Funds

§ 6.06 State Statutes

[1] Alabama

[2] Alaska

[3] Arizona

[4] Arkansas

[5] California

[6] Colorado

- [7] Connecticut
- [8] Delaware
- [9] District of Columbia
- [10] Florida
- [11] Georgia
- [12] Hawaii
- [13] Idaho
- [14] Illinois
- [15] Indiana
- [16] Iowa
- [17] Kansas
- [18] Kentucky
- [19] Louisiana
- [20] Maine
- [21] Maryland
- [22] Massachusetts
- [23] Michigan
- [24] Minnesota
- [25] Mississippi
- [26] Missouri
- [27] Montana
- [28] Nebraska
- [29] Nevada
- [30] New Hampshire
- [31] New Jersey

[32] New Mexico

[33] New York

[34] North Carolina

[35] North Dakota

[36] Ohio

[37] Oklahoma

[38] Oregon

[39] Pennsylvania

[40] Rhode Island

[41] South Carolina

[42] South Dakota

[43] Tennessee

[44] Texas

[45] Utah

[46] Vermont

[47] Virginia

[48] Washington

[49] West Virginia

[50] Wisconsin

[51] Wyoming

§ 6.07 Mortgage Foreclosure Consultants

[1] Regulation of Mortgage Foreclosure Consultants

[2] California Mortgage Foreclosure Consultants Act

§ 6.08 Film Location Representatives

§ 6.09 Apartment Information Vendors and Apartment Sharing Agents



114 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 6 Licensing of Brokers and Salespersons *

10A-6 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 6 discusses the licensing of real estate brokers, agents, and salespersons. Every state and the District of Columbia imposes licensure requirements on these real estate professionals. The justification for licensure and regulation of the real estate brokerage industry is the protection of the public from unlicensed, incompetent, and untrustworthy individuals.

Generally, states restrict who can be licensed. For example, most applicants must pass a written examination to show their competency before they can be licensed. Licensure is not automatic. Statutes frequently address grounds that would justify a real estate commission's decision to deny a license to an individual. Furthermore, each state regulates these professionals. Once individuals are licensed, they must comply with rules and regulations that address their conduct. Frequently, licensees must participate in continuing education in order to renew their licenses. Certain egregious conduct can result in licensees having their licenses suspended or revoked, or the imposition of disciplinary sanctions.

Chapter 6 discusses who must be licensed and the authority of the licensing authority (§ 6.02). About half of the states have provisions that make a single act of acting as an unlicensed broker or agent subject to penalties and fines. The licensing procedure is discussed, including some of the requirements common to most states such as minimum age, education, experience requirements, residency requirements, reciprocity with other jurisdictions, and examinations (§ 6.03). License terms and renewal requirements are discussed (§ 6.04) as are grounds for suspension or termination of a license (§ 6.05). The chapter also contains citations to each state's licensing requirements (§ 6.06). Additional topics include mortgage foreclosure consultants (§ 6.07), film location representatives (§ 6.08), apartment information vendors and apartment sharing agents (§ 6.09).



115 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 6 Licensing of Brokers and Salespersons *

10A-6 Real Estate Brokerage Law and Practice § 6.01

§ 6.01 Introduction

Most individuals employed in the private sector can pursue their occupations without official authorization, with little or no governmental oversight and without fear of sanctions such as the revocation or suspension of the right to pursue their careers. Certain private sector occupations, however, are so fraught with overriding public policy considerations that governmental intrusion is warranted. The medical and legal professions are examples of regulated professions. The real estate industry is yet another.

The real estate industry is regulated in all fifty states and the District of Columbia. n1 State government determines who can become a licensed real estate broker or salesperson. n1.1 The states establish minimum age, education and standards of acceptable conduct; provide criteria for license renewal and suspension; and can impose sanctions against licensed and unlicensed individuals and entities. n2 Real estate licensees are generally regulated for public policy reasons (*i.e.*, to protect the public from incompetent and untrustworthy licensees). n2.1 Licensees owe duties of care not only to the real estate commissions that regulate them, but also to the public in general. n3 The public has a right to rely on a real estate licensee to be honest, trustworthy and have integrity. n4

While all states and the District of Columbia have statutes governing brokers and salespersons, the various state laws are not uniform. Minimum work experience, education and examination criteria vary from state to state. In an effort to find constancy and relationship among the various state laws, an organization was formed in 1930 called the National Association of Real Estate License Law Officials (NARELLO). It was established as a federation of real estate license law officials to assist each other in the administration and enforcement of license laws in the United States and Canada. In 1993, this organization's membership voted to change its name to Association of Real Estate License Law Officials (ARELLO) to better reflect the organization's international scope. ARELLO monitors licensing law provisions and has developed a Model License Law. n5 ARELLO has also addressed issues concerning real estate schemes and scams involving land sales, time-sharing, consumer fraud and misrepresentation. ARELLO's mission statement is as follows:

The primary purpose of this Association of Real Estate License Law Officials shall be better administration and enforcement of real estate license and regulatory laws in the member jurisdictions. This distinctive task of the Association is to help equip its members to fulfill their roles as regulators. That role is to protect the public interest in real estate brokerage transactions. Protecting the public interest does not mean advocating an industry or consumer position. Instead, it means assuring each

individual's right to justice and equal opportunity under the law. Therefore, the public interest demands the regulator's best effort to achieve impartial administration of the law.

While it is beyond the scope of this chapter to examine every license law, the following discussion will emphasize the general rules and the NARELLO Model Law, along with significant exceptions as noted from state to state. ARELLO publishes an annual Digest of Real Estate License Laws. The cost of the 2010 Digest was \$47.50. The current Digest can be obtained by writing or telephoning, or it can be ordered from ARELLO's web site:

ARELLO Address:

8361 S. Sangre De Cristo Road, Suite 250, Littleton, Colorado 80127; Phone: 303-979-6190;

Website: <http://www.arello.org>.

FOOTNOTES:

(n1)Footnote 1. *See Stroman Realty, Inc. v. Antt*, 2005 U.S. Dist. LEXIS 16048, at *26 (S.D. Tex. July 28, 2005) .

(n2)Footnote 1.1. *See § 6.02 infra* for definitions of "broker" and "salesperson." *See also Crandall v. Grbic*, 36 Kan. App. 2d 179, 198, 138 P.3d 365, 379 (2006) (Kansas Real Estate Brokers' and Salespersons' License Act deals with the process of getting and keeping a real estate license.).

(n3)Footnote 2. *See, e.g., Smith v. Real Estate Agency*, 148 Or. App. 62, 67-68, 939 P.2d 77, 79-80 (1997) . The court affirmed the Oregon Real Estate Commissioner's imposition of a penalty of \$112,547.50 against an individual for engaging in professional real estate activities without a license.

Licensing laws affect a broker's right to compensation. The general rule is that a broker must be licensed to collect the broker's commission. However, issues may arise as to when the broker must possess the license in order to collect his commission. For a discussion of the effect of the licensing laws on these issues, *see § 4.05 supra*. *See also* Annot., *Licensed Real-Estate Broker's Right to Compensation as Affected by Lack of License on the Part of Partners, Coadventurers, Employees, or Other Associates*, 8 A.L.R.3d 523 (1966).

(n4)Footnote 2.1. *See Huffman v. Cohen*, 2009 U.S. Dist. LEXIS 51912, at *5 (N.D. Okla. June 19, 2009) , applying Oklahoma law; *Robinson v. New Hampshire Real Estate Comm'n*, 157 N.H. 729, 731, 958 A.2d 958, 960 (2008) . *Fitzgerald v. Hutchins*, 2009 ME 115, 983 A.2d 382, 390 (2009) ; *Re/Max v. Wausau Ins. Cos.*, 162 N.J. 282, 744 A.2d 154, 158 (2000) . *Sammarone v. Bovino*, 395 N.J. Super. 132, 141-42, 928 A.2d 140, 146 (App. Div. 2007) , *cert. denied*, 193 N.J. 275, 937 A.2d 977 (2007) .

See also Chabott Petrosky Commer. Realtors v. Peterson, 859 A.2d 77, 79 (Del. 2004) (The Delaware Real Estate Commission regulates the licensing and conduct of real estate brokers. The Commission's primary purpose is to protect the general public, especially those persons who are direct recipients of services regulated by this chapter from unsafe practices, and from occupational practices which tend to reduce competition or fix the price of services rendered.).

(n5)Footnote 3. *Henry S. Miller v. Treo Enters.*, 585 S.W.2d 674 (Tex. 1979) .

(n6)Footnote 4. *Ellis v. Flink*, 301 So. 2d 493 (Fla. 2d DCA 1974) .

(n7)Footnote 5. Note that the organization's model law continues to be called the NARELLO Model License Law.

* Revised by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues, including licensing issues, has practiced in the areas of tax, business and probate law, and is licensed as a C.P.A. in the State of Maryland.



116 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 6 Licensing of Brokers and Salespersons *

10A-6 Real Estate Brokerage Law and Practice § 6.02

§ 6.02 Regulation

[1] Scope of Regulation

[a] Who Must Comply

The transactions subject to licensing vary from state to state. As a general rule, once the state regulates persons or licensees, it extends its coverage to a broad scope of regulated activities and businesses.

The NARELLO Model License Law is typical. Section 3(4) of that model law broadly defines a "Broker" as:

an individual or professional association while acting for another for commissions or other compensation or the promise thereof, or a licensee under this chapter, while acting in his own behalf who:

- (a) Sells, exchanges, purchases, rents, or leases real estate.
- (b) Offers to sell, exchange, purchase, rent or lease real estate.
- (c) Negotiates, offers, attempts or agrees to negotiate the sale, exchange, purchase, rental or leasing of real estate.
- (d) Lists, offers, attempts or agrees to list real estate for sale, lease or exchange.
- (e) Auctions, offers, attempts or agrees to auction real estate.
- (f) Buys, sells, offers to buy or sell or otherwise deals in options on real estate or improvements thereon.
- (g) Collects, offers, attempts or agrees to collect rent for the use of real estate.
- (h) Advertises or holds himself out as being engaged in the business of buying, selling,

10A-6 Real Estate Brokerage Law and Practice § 6.02

exchanging, renting or leasing real estate.

(i) Assists or directs in the procuring of prospects, calculated to result in the sale, exchange, lease or rental of real estate.

(j) Assists or directs in the negotiation of any transaction calculated or intended to result in the sale, exchange, leasing or rental of real estate.

(k) Engages in the business of charging an advance fee in connection with any contract whereby he undertakes to promote the sale or lease of real estate either through its listing in a publication issued for such purpose or for referral of information concerning such real estate to brokers or both.

(l) Performs any of the foregoing acts as an employee of, or on behalf of, the owner of, or any person who has a real or equitable interest in, real estate for compensation.

A "salesperson" is defined under the NARELLO Model Act as "an individual or professional association other than the associate broker who is licensed under a broker."

The Model Act exempts the following persons from regulation:

- (1) a person who purchases property for his or her own account;
- (2) an attorney in fact under a duly executed and recorded power of attorney or for services rendered by an attorney at law in the performance of his or her duty as an attorney at law;
- (3) any person acting as a receiver, trustee in bankruptcy, administrator, executor or guardian while acting under a court order or under the authority of a will or a trust instrument;
- (4) any person acting as a resident manager when such resident manager resides in the dwelling and is engaged in the leasing of property in connection with his or her employment;
- (5) any officer employed with a federal agency in the performance or conduct of his or her official duties;
- (6) any officer or employee of the state government or any political subdivision thereof in performing his or her official duties.

Most of these exemptions are for people acting in the scope of their official capacity. They are narrowly construed to limit the exempted conduct. One noteworthy exception is attorneys. Most statutes recognize that attorneys engage in the negotiation of real estate transactions on a regular basis in their capacity as attorneys. Not to exempt attorneys would require state brokerage licensure for performing legal functions if those functions fell under that state's definition of a brokerage function.

This statutory exemption varies from state to state. Some states provide wholesale exemptions for lawyers, apparently feeling that lawyers have the ability to engage in brokerage functions without any regulation. In some states lawyers are given broker's licenses merely upon application to the department regulating real estate licensees. Other statutes, including the Model Act, exempt lawyers only when they act in their capacity as lawyers. Under this form of statute, a lawyer could not sue for a real estate commission or otherwise engage in brokerage activities unless licensed to do so.

n1 Other states simply prohibit splitting commissions with non-licensees. n2 Virtually all state statutes require that real estate salespersons receive their compensation through a sponsoring broker. n2.01 Therefore, if an attorney is not a licensed broker, he cannot employ a salesperson to engage in the real estate business.

It may be illogical to think that a license to practice law should exempt a person from real estate licensure. Such loose regulation does not support the general theory of real estate licensure (*i.e.*, to protect the public from incompetent licensees engaging in the business). A second problem involves disciplinary matters. If the attorney is performing a brokerage function, the state bar does not have jurisdiction; if the attorney is not licensed as a broker, the real estate licensing agency has no jurisdiction. This lack of regulation over two otherwise heavily state-regulated activities is a potentially serious problem.

In some jurisdictions it is a crime to impersonate a licensed professional. n2.02

Some states statutorily allow an individual harmed by the conduct of a party while acting as an unlicensed broker to recover damages. n2.03

[b] Activities Subject to Regulation

The key elements of most real estate license acts involve: (1) performing brokerage service for another person (performing a brokerage function for yourself is exempt); and (2) performing the brokerage service for consideration. It is common for licensing acts to list activities that constitute the activities of a real estate agent and broker. n2.1

Many states, because of their unique real estate laws, have enacted real estate licensure requirements for other activities such as: (1) the sale of cemetery lots; n3 (2) the sale of oil and gas interests; n4 (3) auctioneers of real estate; n5 (4) the sale of campgrounds; n6 (5) the management of rental property; n7 (6) the management of condominiums; n8 (7) mortgage brokers; n9 (8) business brokerage; n10 and (9) time share sales. n11

[c] Single Act Laws

Approximately half the states have so-called "single act" provisions that subject a person to fines and penalties, regardless of whether that person is licensed or not, based upon a "single act" or "single transaction" carried out without a license. n12 Other state licensure statutes do not apply to those who are not regularly engaged in the real estate industry.

[2] Licensing Agency Has Broad Authority

Each state administers its real estate license act through some government agency, referred to under different names from state to state (*e.g.*, Real Estate Commission, Department of Licensing and Regulation, Department of State). This regulatory commission regulates and enforces the broker licensing provisions, passes rules and regulations to enforce and perform the provisions of that state's licensing act. As discussed in § 6.05[2], the agencies' decisions are given great deference by the courts.

The commission's makeup varies from state to state. The number of commissioners ranges from as few as three (West Virginia) to as many as twelve (Connecticut and Indiana). Most require that a majority of the members be from the real estate industry, but some consumer input is provided by appointees who are not actively engaged in the real estate business. However, there are states that require no appointees from the public.

The agency enforcing the broker licensing laws generally has the authority to promulgate regulations. n12.1 For example, in *Campo v. State Real Estate Commission*, n13 the court upheld the Pennsylvania Real Estate Commission's regulation requiring that salespersons and associate brokers list the business name and telephone number of their

employing broker in advertisements. The court also affirmed the imposition of fines against salespersons and associate brokers who failed to list their employing broker's directory assistance telephone number. n14

Penalties for acting as an unlicensed broker can be substantial. n14.1 In some jurisdictions, any penalty imposed for unlicensed activity may be awarded to the person aggrieved by the unlicensed activity. n14.2

Certain statements made to a regulatory agency may be subject to judicial immunity. *Skoglund v. Durham* n15 involved an individual's application for a real estate broker's license. The applicant brought a defamation action alleging that the defendants falsely stated that a jury had found the applicant guilty of defrauding the defendants. This statement was made in a "Request for Investigation" filed with the Georgia Real Estate Commission. The court found that these statements were absolutely privileged. The court stated that these statements were judicial in nature and that public policy supported application of an absolute privilege. n16

[3] Regulation of Advertising

[a] Disciplinary Proceedings Arising from Advertising Activities

Most real estate commissions regulate advertising by real estate brokers and can hold disciplinary proceedings if a broker engages in false or misleading advertising. n17 However, such commissions should not seek disciplinary action because a broker makes statements that may be unpopular with his or her fellow brokers. Such commissions should rely upon substantial evidence in determining whether broker advertisements are misleading. n18

In *Snider v. State of Oklahoma Real Estate Commission* n19 the real estate commission sanctioned a real estate broker because of statements made in a booklet used in his advertising. He asserted that buyers' agents saved buyers thousands of dollars and that buyers should beware of any agent who mentioned words such as "dual agent," "assigned agent," or "contract broker." The booklet stated that these were all methods of conducting real estate transactions which gave the buyer less than full representation. n20 This booklet stated that the traditional real estate firm represented the seller, and that when such a firm tries to represent the seller and the buyer, it cannot meaningfully represent both. The booklet continuously referred to the law of agency. After administrative proceedings, the commission ordered that the broker be formally reprimanded and fined \$200. The Supreme Court of Oklahoma held that the advertising booklet was not false and misleading in stating that dual agents provide less than full representation. The court stated that agency law was not an area in which the Oklahoma Real Estate Commission could claim expertise superior to the courts of Oklahoma. n21 The court found that the order of the Commission was clearly erroneous, contrary to its own rule, and without evidentiary support and had to be set aside. n22

One issue that may arise is whether or not a licensee can use a nickname rather than the licensee's legal name. In response, some states allow a licensee to use a nickname. For example, *Maryland Code Annotated, Business Occupations & Professions § 17-527.2* allows licensees to register a nickname with Real Estate Commission and thereby hold themselves out to the public by that nickname.

[b] Regulation of Internet Advertising

Many brokers maintain extensive websites where prospective purchasers or sellers can view the broker's listings and obtain other information about the firm and its agents or salespersons. While some websites are relatively simple, others are quite complex. It should be anticipated that the importance and incidence of Internet advertising in the real estate brokerage industry will only increase over time (*see Ch. 10, The Effect of E-Commerce on the Real Estate Brokerage Business below*). The significance of the Internet to this industry is highlighted by the fact that the National Association of Realtors(R) offers a professional designation for real estate professionals who work in the online real estate industry (*see § 2.06, above, for a discussion of professional designations*). The advent of Internet advertising by real estate brokers has led to various states either regulating such advertising or offering policy guidelines. For example, in

California all licensees who advertise on the Internet must disclose their license status. n23

It should be anticipated that courts and regulatory agencies will be confronted with issues arising from Internet advertising. Examples of conduct that may lead to disciplinary actions would include maintaining on a website a listing for a property when in fact the listing had expired. Another example would be the continued advertising of a property even though it had been sold and the transaction had settled. Ohio has addressed these issues in part by requiring that information on an Internet website maintained by a licensee that becomes outdated or expired must be updated within 14 days of the information becoming outdated or expired. In addition, Ohio requires that each website maintained by a licensee must disclose when the information contained therein was most recently updated. n24

California has broadly defined a broker as anyone charging an advance fee in connection with the sale, listing, or advertisement of real property. n24.1 The phrase advance fee was defined as including any fee charged for listing, advertising, or offering to sell or lease real property, except that a "newspaper of general circulation" is expressly exempted from that definition. n24.2 An Internet website that advertised properties for sale, including properties for sale in California, challenged the real estate licensing requirements, as codified in *California Business and Professions Code § 10000 et seq.*, on constitutional grounds. This website which catered to owners selling their property without the services of a broker, charged a flat fee to property owners to advertise their homes. The Forsalebyowner.com website contended that any distinction between the treatment accorded its website and the exemption for newspapers was nonsensical. It was undisputed that many newspapers maintained websites operating in much the manner as the Forsalebyowner.com website. n24.3 The court agreed with the Forsalebyowner.com website. The court stated that the California Department of Real Estate had not shown any compelling state interest in requiring a real estate broker's license for the Forsalebyowner.com website but not for virtually identical newspaper websites. The court found that the presumption of unconstitutionality triggered by this disparity of treatment has not been overcome and that *California Business & Professional Code § 10026* failed constitutional muster on that basis. n24.4

[c] National Association of Realtors(R) Internet Data Exchange Policy

The National Association of Realtors(R) (NAR) has adopted a policy authorizing Multiple Listing Service (MLS) participants to display the listings of other participants on their websites, subject to certain limitations. The NAR refers to this policy as Internet Data Exchange (IDX). n25 This policy mandates that as of January 1, 2002, all local MLSs must afford brokers the opportunity to place the entire MLS database of active listings on their own web sites. A broker can either choose to participate in the Internet Data Exchange program or a broker can choose to prohibit the display of his or her company's listings on another broker's site. If a broker opts not to participate, that broker's listings will be made unavailable by the MLS to other brokers and the non-participating broker will not have access to the listings of the IDX participating brokers. One effect of this policy is that a small broker with relatively few listings can display many listings thereby appearing to have a large "inventory" of available property.

[4] Unlicensed Assistants and Office Staff

Brokers often employ clerical and secretarial employees. Issues can arise as to the tasks that such unlicensed persons can perform. Clearly, unlicensed personnel should not be performing acts that require licensure as a broker, agent, or salesperson. The Idaho Real Estate Commission has issued Guideline No. 17 n26 to assist Idaho licensees in the proper use of unlicensed assistants and office staff. In its Guideline, the Idaho Real Estate Commission stated that inquiries it receives generally fit into two categories:

- (1) whether the activity performed is one which requires a license, and
- (2) what are the supervisory responsibilities of an employing broker?

Though this Guideline is specific to Idaho, its basic concepts should apply to other states.

In addressing the use of unlicensed personnel, the Idaho Real Estate Commission noted that personal assistants who hold active real estate licenses and the brokers in whose offices they work must realize that brokers are responsible for all licensees, regardless of their job title and that licensed assistants are fully subject to Idaho License Law and Rules. Idaho license law prohibits unlicensed persons from negotiating, listing, or selling real property. The commission advises that personal assistants must be restricted so that their activities avoid illegal brokerage practice. This Guideline states that while personal assistants may complete forms prepared and as directed by licensees, they should never independently draft legal documents such as listing and sales contracts, nor should they offer opinions, advice, or interpretations. Unlicensed assistants also cannot distribute information on listed properties other than information that has been prepared by the employing broker or broker associate. This Guideline states that unlicensed assistants can perform the following duties:

1. Perform clerical duties for an employing broker or broker associate which may include the gathering of information for a listing;
2. Provide access to a property other than showings to potential buyers and hand out preprinted, objective information, so long as no negotiating, offering, selling or contracting is involved;
3. Distribute preprinted, objective information at an open house, so long as no negotiating, offering, selling or contracting is involved;
4. Distribute information on listed properties when such information is prepared by the broker or broker associate;
5. Deliver paperwork to other brokers;
6. Deliver paperwork to sellers or purchasers, if such paperwork has already been reviewed by a broker;
7. Deliver paperwork requiring signatures in regard to financing documents that are prepared by lending institutions; and
8. Prepare market analyses for sellers or buyers on behalf of a broker, but disclosure of the name of the preparer must be given, and it must be submitted by the broker.

Brokers are advised to have a written office policy explaining the duties, responsibilities, and limitations on the use of personal assistants. This policy should be understood by all employees.

The Texas Real Estate Commission has offered similar advice to the brokers it regulates. In its "Information for Brokers and Salespersons Regarding Use of Unlicensed Assistants in Real Estate Transactions,"²⁷ the Texas Real Estate Commission advises that an unlicensed assistant cannot make telephone calls to determine whether a person is interested in buying or selling property, or has property they wish to sell. However, under appropriate circumstances an unlicensed assistant can:

- (1) Sit in on an open house so long as the unlicensed assistant does not "show" the house to prospective purchasers. The unlicensed assistant can serve as a hostess, attendant, or custodian at homes offered for sale by the broker, but the unlicensed assistant's duties should be limited to welcoming the visitors, registering guests, and referring inquiries to a licensee. The unlicensed assistant should not point out features of the home or neighborhood to visitors. However, the unlicensed assistant may distribute a flyer or brochure that describes the property.

- (2) Set appointments to show a listing. An unlicensed assistant can telephone a homeowner and schedule an appointment for the broker to bring a potential buyer to see the home. If the broker becomes unavailable for the appointment, the unlicensed assistant can also drive the purchaser to the listing and let them in the home, but this individual cannot "show" the property. The individual should identify himself or herself as an unlicensed assistant and explain the assistant's limited role. Questions regarding the property or the purchase of the property must be referred to a licensee.
- (3) Place "for sale" signs as directed by the broker.
- (4) Open a property or accompany inspectors as directed by the broker.
- (5) Place newspaper advertisements as directed by the broker.
- (6) Serve as a bookkeeper and handle personnel matters. Such an employee may also serve as a trainer. However, an unlicensed assistant may not direct or supervise agents in their work as licensees.
- (7) Assist in arranging financing. At the direction of a licensee, an unlicensed assistant may gather information, contact lenders, and set appointments.

In considering the conduct of an unlicensed employee, the Texas Real Estate Commission advises that the broker should analyze any new factual situation to determine the extent to which the unlicensed assistant is being allowed to act with discretion, and how close the unlicensed assistant is to "directly" assisting others in buying, selling, or leasing property. Brokers can consult with their own attorney or write the Commission (or call in an emergency) for an informal opinion based on a particular fact situation.

Alaska Administrative Code title 12, § 64.140 directly addresses the employment of unlicensed personnel. This rule specifically states that a licensee may not authorize an unlicensed assistant to perform any duties for which a license is required, including:

- (1) discussing a listing or property management agreement with an owner or with licensees;
- (2) showing any property available for sale or rental;
- (3) negotiating or discussing the terms of a sale or rental;
- (4) having a prospective buyer or lessee sign an offer to purchase or lease;
- (5) presenting an offer to a seller;
- (6) making prospecting calls or visits; and
- (7) reading prepared information in response to inquiries about properties.

Many state real estate commissions have similar policies, guidelines, and rules. Brokers must exercise caution in using unlicensed personnel and should adopt policies to prevent the violation of applicable licensing laws. The effect of the use of unlicensed employees on a broker's right to a commission is discussed in § 4.05(5) *above*.

[5] Record Retention and Electronic Media

Real estate licensees typically are obligated by statute or regulation to retain records for a designated period of time. For

example, *Cal. Bus. & Prof. Code § 10148* requires that a licensed real estate broker retain for three years "copies of all listings, deposit receipts, canceled checks, trust records, and other documents executed by him or her or obtained by him or her in connection with any transactions for which a real estate broker license is required." The retention period commences from the date of the closing of the transaction or from the date of the listing if the transaction is not consummated. These documents are to be available for examination, inspection, and copying by the commissioner during regular business.

This record retention requirement can be costly since it can require a lot of space to retain such records. California, by regulation, permits licensees to meet the requirements of *Cal. Bus. & Prof. Code § 10148* by storing these documents on electronic media. *California Code of Regulations, Title 10, § 2729* permits a licensee to use electronic image storage media to retain and store copies of these documents provided certain requirements are met. Among the requirements is that the electronic image storage must be nonerasable "write once, read many" ("WORM") that does not allow changes to the stored document or record. The electronic image storage system must contain a reliable indexing system that provides ready access to a desired document or record, appropriate quality control of the storage process to ensure the quality of imaged documents or records, and date ordered arrangement of stored documents or records to assure a consistent and logical flow of paperwork to preclude unnecessary search time.

It should be anticipated that more states, by statute or regulation, will specifically address record retention through electronic media.

FOOTNOTES:

(n1)Footnote 1. In *Matter of Roth*, 120 N.J. 665, 577 A.2d 490 (N.J. 1990) , the Supreme Court of New Jersey examined this issue at length as an attorney disciplinary matter to determine the appropriate ethics standards governing an attorney who undertakes to represent a client as both an attorney and real estate broker in the same transaction. A complaint was filed against the attorney-broker alleging a conflict of interest, stating that it was not unlawful or unethical *per se* for an attorney to engage in the business of a real estate broker so long as the two functions were separated, citing a New Jersey disciplinary rule. The attorney-broker alleged that he sought not to profit from the transaction but to reduce the purchase price for the client. The court concluded that the statutory exemption for attorneys, however, was not meant to provide the equivalent of a broker's license to one exempt from the requirement of the license law, but rather to authorize attorneys to perform only those services "incidental to the normal practice of the profession or business," and that it was "surely not the Legislature's intent to allow attorneys to freely engage in all aspects of the real estate brokerage business." 577 A.2d at 494 . The court also held that a licensed attorney who seeks to act as both a broker and lawyer for the same client in the same transaction must confine any broker's services to those that are obviously minor, incidental, ancillary, and subordinate to the legal services entailed in the client's representation. A similar holding was made by the Kentucky Supreme Court in *Kentucky Bar Ass'n v. Burbank*, 539 S.W.2d 312 (Ky. 1976) .

See also *Wiseman v. Ruwe (In re Estate of Ronan)*, 277 Neb. 516, 763 N.W.2d 704 (2009) (An attorney was barred from recovering compensation when he acted as a broker without obtaining a broker's license. This conduct fell outside the attorney exemption.).

See generally Zitter, Annot., *Right of Attorney as Such, to Act or Become Licensed to Act as Real-Estate Broker*, 23 A.L.R.4th 230 (1983).

(n2)Footnote 2. See *Tex. Occ. Code § 1101.652 (b)(11)*.

(n3)Footnote 2.01. See *Axtmann v. Chillemi*, 2007 ND 179, 740 N.W.2d 838, 846 (N.D. 2007) ; *Rockport Realty Investments, Inc. v. Riedel*, 2008 Ohio 820, 2008 Ohio App. LEXIS 711, at *9 (Feb. 29, 2008) .

(n4)Footnote 2.02. See *State v. Camacho* 2007 Tenn. Crim. App. LEXIS 831, at *20 (Oct. 29, 2007) , citing *Tenn.*

Code § 39-16-302.

(n5)Footnote 2.03. See Miss. Code § 73-35-31(2) (civil penalty of not less than the sum of money received and not more than four times the sum of money received by the unlicensed broker from the aggrieved person).

(n6)Footnote 2.1. See *G.C. Timmis & Co. v. Guardian Alarm Co.*, 468 Mich. 416, 433, 662 N.W.2d 710, 720 (2003).

(n7)Footnote 3. See, e.g., *Ariz. Rev. Stat. § 32-2122*.

(n8)Footnote 4. See, e.g., *Cal Bus & Prof Code § 10500*.

(n9)Footnote 5. An auctioneer's license is separate from a real estate broker's license. See, e.g., *Tex. Occ. Code § 1802.051*. Often an auctioneer who sells real estate must also be licensed as a real estate broker.

(n10)Footnote 6. See, e.g., *63 Pa. Stat. § 455.301*.

(n11)Footnote 7. See, e.g., *Ohio Rev. Code § 4735.01(A)(5)*.

(n12)Footnote 8. See, e.g., *Fla. Stat. §§ 468.431 to 468.438*.

(n13)Footnote 9. See, e.g., *Ala. Code § 5-25-1, et seq.* (Alabama Mortgage Brokers Licensing Act); *205 ILCS 635/1-1, et seq.* (Illinois Residential Mortgage License Act of 1987). See generally Lloyd T. Wilson, *A Taxonomic Analysis of Mortgage Broker Licensing Statutes: Developing a Programmatic Response to Predatory Lending*, 36 *N.M.L. Rev.* 297 (2006).

In 2008, Congress enacted the Secure and Fair Enforcement for Mortgage Licensing Act of 2008 (Pub. L. No. 110-289, 122 Stat. 2810 (July 30, 2008)). This Act is also referred to as the S.A.F.E. Mortgage Licensing Act of 2008. The Act is codified at 12 U.S.C. § 5101, *et seq.* The Act provides that the States, through the Conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators, are encouraged to establish a Nationwide Mortgage Licensing System and Registry for the residential mortgage industry. A majority of states have agreed to participate in this Nationwide Mortgage Licensing System. This System is used by state residential mortgage regulators to accept and process national, uniform license applications and renewal forms that have been created by state regulators. Licensees will be able to electronically manage a single record in the System to apply for, amend, renew, and surrender licenses in one or more regulators. This System began operations in 2008. See generally Lloyd T. Wilson, Jr., *All Things Considered: The Contribution of the National Mortgage Licensing System to the Battle Against Predatory Lending*, 24 *Ga. St. U.L. Rev.* 415 (2007).

(n14)Footnote 10. See, e.g., *Mass. Gen. Laws ch. 259, § 7*; *Mich. Comp. Laws § 339.2501*.

(n15)Footnote 11. See generally Rohan, *Condominium Law & Practice*, § 55.05[5] (licensing of time share salespersons).

(n16)Footnote 12. For example, in *Correll v. Boulware*, 74 N.C. App. 631, 329 S.E.2d 695, 701 (N.C. Ct. App. 1985), in a discussion affirming the six-month suspension of a broker's license, the court found that the state licensing statute allowed the Real Estate Licensing Board to revoke or suspend a salesperson's or broker's license for any one of several listed misdeeds. The court stated that "[o]nly one violation of one section is needed to revoke or suspend one's license."

The following states have "single act" statutes:

Arkansas: Ark. Stat. Ann. § 17-42-301(b).

California: Cal. Bus. & Prof. Code § 10131.

Colorado: Colo. Rev. Stat. Ann. § 12-61-101(2).

Florida: Fla. Stat. Ann. § 475.01(3).

Georgia: Ga. Code Ann. § 43-40-30(a).

Illinois: 225 Ill. Comp. Stat. 454/20-15.

Iowa: Iowa Code Ann. § 543B.6.

Kentucky: Ky. Rev. Stat. Ann. § 324.010(2).

Maine: Me. Rev. Stat. Ann. tit. 32, § 13001(2).

Mississippi: Miss. Code Ann. § 73-35-3(1).

Montana: Mont. Code Ann. § 37-51-103.

Nebraska: Neb. Rev. Stat. § 81-885.03.

Nevada: Nev. Rev. Stat. § 645.260.

New Jersey: N.J. Stat. Ann. § 45:15-2.

New Mexico: N.M. Stat. Ann. § 61-29-2(C).

New York: N.Y. Real Prop. Law § 442(e)(1).

North Dakota: N.D. Cent. Code § 43-23-06.1(8).

Oregon: Or. Rev. Stat. § 696.040.

Tennessee: Tenn. Code Ann. § 62-13-103.

Texas: Tex. Occ. Code § 1101.004.

Utah: Utah Code Ann. § 61-2-4.

Virginia: Va. Code § 54.1-2107.

West Virginia: W. Va. Code § 47-12-2(e).

Wyoming: Wyo. Stat. § 33-28-104.

*See also Arnold v. Bowman, 2005 Tenn. App. LEXIS 363, at *27 (June 23, 2005), appeal denied, 2005 Tenn. LEXIS 1054 (Dec. 5, 2005) (any person who attempts to perform or performs a single statutorily enumerated act enumerated is deemed a broker).*

(n17)Footnote 12.1. *See Walker v. Johnson*, 278 Ga. App. 806, 812-13, 630 S.E.2d 70, 76 (2006) *overruled in part*, *Kleber v. City of Atlanta*, 2008 Ga. App. LEXIS 396, at *15 (Mar. 28, 2008) (on other grounds).

(n18)Footnote 13. 723 A.2d 260 (Pa. Cmwlth. 1998) , *reargument denied* (1999).

(n19)Footnote 14. 723 A.2d 260, 262-263 (Pa. Cmwlth. 1998) , *reargument denied* (1999). Fines of \$500 were imposed against first-time offenders and \$750 fines were imposed against second-time offenders. These offenders had used a telephone number in their advertisements that was owned by the employing broker, but which provided a direct connection to the advertising salesperson or associate broker, rather than the employing broker's number as maintained by directory assistance.

(n20)Footnote 14.1. *See Tenn. Code Ann. § 62-13-110(b)* (imposing a penalty of not less than the amount of the money received by the unlicensed individual and not more than three times the amount received, as determined by the court). *See also Arnold v. Bowman*, 2005 Tenn. App. LEXIS 363, at *32 (June 23, 2005) , *appeal denied*, 2005 Tenn. LEXIS 1054 (Dec. 5, 2005) (affirming a penalty of twice the amount of commission collected by the unlicensed broker).

(n21)Footnote 14.2. *See Tenn. Code Ann. § 62-13-110(b)*; *See also Arnold v. Bowman*, 2005 Tenn. App. LEXIS 363, at *32 (June 23, 2005) , *appeal denied*, 2005 Tenn. LEXIS 1054 (Dec. 5, 2005) (The purchaser was aggrieved in that he probably paid more than the sellers would have been willing to take, had the unlicensed broker not extracted his fee. The court found no error in awarding the penalty to the buyer.).

(n22)Footnote 15. 233 Ga. App. 158, 502 S.E.2d 814 (Ga. App. 1998) .

(n23)Footnote 16. 233 Ga. App. 158, 502 S.E.2d 814, 816 (Ga. App. 1998) .

(n24)Footnote 17. *See, e.g., Okla. Stat. tit. 59, § 858-312(2)*.

(n25)Footnote 18. *See Snider v. State of Oklahoma Real Estate Comm'n*, 1999 Okla. 55, 987 P.2d 1204, 1208-1209 (1999) , *rehearing denied* (statements made by broker regarding dual agency, for which the broker was sanctioned, were neither false nor misleading).

(n26)Footnote 19. 1999 Okla. 55, 987 P.2d 1204 (1999) , *rehearing denied*.

(n27)Footnote 20. 1999 OK 55, 987 P.2d 1204, 1206 (1999) , *rehearing denied*.

(n28)Footnote 21. 1999 Okla. 55, 987 P.2d 1204, 1208 (1999) , *rehearing denied*.

(n29)Footnote 22. 1999 Okla. 55, 987 P.2d 1204, 1210 (1999) , *rehearing denied*.

(n30)Footnote 23. *See Cal. Bus. & Prof. Code §§ 10235.5 and 10140.6*.

(n31)Footnote 24. *See Ohio Administrative Code § 1301:5-1-02 Advertising*.

(n32)Footnote 24.1. *See Forsalebyowner.com Corp. v. Zinnemann*, 347 F. Supp. 2d 868, 871 (E.D. Ca. 2004) , citing *Cal. Bus. & Prof. Code § 10131.2*.

(n33)Footnote 24.2. *See Forsalebyowner.com Corp. v. Zinnemann*, 347 F. Supp. 2d 868, 871 (E.D. Ca. 2004) , citing *Cal. Bus. & Prof. Code § 10026*.

(n34)Footnote 24.3. *See Forsalebyowner.com Corp. v. Zinnemann*, 347 F. Supp. 2d 868, 872 (E.D. Ca. 2004) .

(n35)Footnote 24.4. *See Forsalebyowner.com Corp. v. Zinnemann*, 347 F. Supp. 2d 868, 879 (E.D. Ca. 2004) .

(n36)Footnote 25. The NAR's Statement of Multiple Listing Policy became effective on May 19, 2001. For additional information about this policy, *see* the library of the National Association of Realtors(R) at <http://www.realtor.org> (search term "Internet Data Exchange").

(n37)Footnote 26. This Guideline and others can be found online at:
<http://www.idahorealestatecommission.com/rules.html#guidelines>.

(n38)Footnote 27. Found online at:
<http://www.trec.state.tx.us/formsrulespubs/publications/unlicensed-assistants.asp>.

* Revised by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues, including licensing issues, has practiced in the areas of tax, business and probate law, and is licensed as a C.P.A. in the State of Maryland.



117 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation
CHAPTER 6 Licensing of Brokers and Salespersons *

10A-6 Real Estate Brokerage Law and Practice § 6.03

§ 6.03 Licensing Procedure

[1] In General

All states require that minimum standards be met before a person or entity is eligible for licensing as a broker or salesperson. Most states address requirements relating to minimum age, education, prior experience and residence. *See § 6.07* for specific state statutory requirements.

As a general rule, the requirements for brokerage licensure are higher than those of salesperson licensure.

Many states, by statute or regulation, require that applicants be subjected to a criminal background check. For example, *Ark. Code § 17-42-306 (a)(4)(B)* states that upon successful completion of the license exam, a license cannot be issued until the commission receives and approves the state and federal criminal background check. Such an applicant, prior to sitting for the license exam must submit a request to the Identification Bureau of the Department of Arkansas State Police for a state and federal criminal background check. n0.1 If the federal criminal background check has not been received by the commission within ninety (90) days of the date of the examination, the date may be extended by the commission until receipt of the federal criminal background check. n0.2 The Arkansas Code is unambiguous; a real estate license cannot be issued until receipt and approval by the commission of the state and federal criminal background check. n0.3 More states are implementing requirements that real estate licensees must undergo criminal background checks before they can be licensed. n0.4 Typically, the applicant is responsible for the cost of obtaining the criminal background check.

[2] Age

In most states, one must be at least eighteen years of age to obtain a broker's license. In some jurisdictions, there is a minimum experience requirement for salespersons before they can apply for a broker's license (usually two years). Although not statutorily mandated, it makes the minimum brokerage age in those states twenty years old.

[3] Education

As in other areas of licensing regulation, educational requirements vary widely. Most states separate educational requirements into pre-licensing and post-licensing requirements and, in recent years, have enacted continuing education

requirements to require that licensees be updated on changes in the law and industry issues. The Real Estate Educators Association, dedicated solely to the real estate education issue, can be contacted at:

Real Estate Educators Association
19 Mantua Road
Mt. Royal, NJ 08061
Telephone: 856-423-3215
Fax: 856-423-3420
Website: <http://www.reea.org/contact>.

The requirements for salesperson pre-licensure range from no classroom hours (New Hampshire) to 180 classroom hours (Texas). Texas, which has the highest educational requirements, defines core courses of required real estate class study. *See* § 6.07[44]. Educational requirements for brokerage licensure similarly range from no classroom hours (Arkansas) to 630 classroom hours (Texas).

Defining the quality of the educational requirement is difficult. In most states the regulatory commission establishes course outlines and criteria that must be taught in a given course. The course materials, instructors and subject matter must be approved by the regulatory commission. If not, the regulatory commission may disapprove licensure for the school teaching the subjects or, alternatively, revoke the approval of the instructor. Absent classroom monitoring of each individual class, this is as close as regulations can come to assuring quality and competence.

Most state regulatory agencies have blanket approval for courses taught in colleges and universities under any state's boards of higher education. The theory is that any real estate course that qualifies for approval at the college or university level automatically qualifies for real estate commission approval. University-approved courses also have the benefit of being transferable from university to university, and therefore possibly from state to state. This has prompted a new hybrid of educational program in which a proprietary school obtains university approval for their curriculum which, oddly enough, can be transferred to another four-year institution in the home state.

[4] Experience Requirements

Experience requirements for brokers always involve licensure as a salesperson for a minimum time. Some experience requirements are only licensure, while other experience requirements include a certain number of years experience of being actively engaged in the brokerage business. n0.5

[5] Residence and Reciprocity

Residency and reciprocity of real estate licensees has been a sensitive and political issue. Each state has its own culture, history, and laws pertaining to real estate. These facts, coupled with the intangible pride that people have in their own states, have formed the basis for the affirmative regulation of real estate licensure as well as the prohibition of other state's licensees from engaging in business in the home state without meeting the home state's requirement for education and competence.

This understandably conflicts with theories of encouraging uniform laws among the states, which many believe promotes interstate commerce. It would also presumably make licensee regulation easier for national real estate companies and license law officials. The differences, however, remain substantial, although one case has recently held that the Privileges and Immunities Clause as well as the *Commerce Clause of the Constitution* need to be addressed to assure nondiscriminatory practices among the states. n1 These differences tend to involve residency of the broker and the transferability of licenses between states and the criteria for that transferability.

[a] Residency

The requirement that a broker maintain a residence in a state in order to be licensed is not a new requirement, and has been upheld in other areas of the law involving trade associations. In the case of state licensure, however, the application of the *Fourteenth Amendment of the United States Constitution* to state-regulated activities invokes two other areas of constitutional law: the Privileges and Immunities Clauseⁿ² and the *Commerce Clause*.ⁿ³

The United States Supreme Court established the criteria for interpretation of whether or not a statute violates a Privileges and Immunities Clause in *Supreme Court of New Hampshire v. Piper*.ⁿ⁴ The test is whether (1) there is a substantial reason for the difference in treatment; and (2) whether the discrimination practiced against nonresidents bears a substantial relationship to the State's objective.ⁿ⁵ Therefore, it is imperative that in state license laws all applicants for licensure, whether resident or nonresident, be subject to the same duties and restrictions or they will violate the Privileges and Immunities test. For instance, requiring the same hours of educational requirements and the same educational criteria for a course would presumably not violate the Privileges and Immunities Clause, provided that these requirements are applied equally to residents and nonresidents.

The *Commerce Clause*, as interpreted by the courts over the years, has different criteria. In interpreting the *Commerce Clause*, the courts presume that where a statute regulates even-handedly to effectuate a legitimate local public interest, and its effects on interstate commerce are only incidental, it will be upheld unless the burden imposed on such commerce is clearly excessive in relation to the local benefits.ⁿ⁶ The *Commerce Clause* test addresses burdens affecting interstate commerce and whether or not that burden represents legitimate state interests, and assures that the burdens imposed by the state legislation or regulations are not unreasonable discriminators in affecting interstate commerce.

In *Georgia Ass'n of Realtors, Inc. v. Alabama Real Estate Comm'n*,ⁿ⁷ the court found that the requirement to maintain an in-state office for an out-of-state business imposes a considerable burden on interstate commerce because of the expense of maintaining that office when it achieves no benefit for the owner of the office. The court refused to follow the holding of *Georgia Ass'n of Realtors v. Alabama Real Estate Com.*,ⁿ⁸ that upheld the Alabama Real Estate Commission's in-state office requirement. *Georgia Association*, found that the Alabama Real Estate Commission's requirement that the broker operate a "place of business" in the state that could be performed more efficiently elsewhere, was *per se* illegal.ⁿ⁹ Alabama's licensing statute also required that the licensee attend course requirements taught within the State of Alabama, along with proof that the licensee had an active real estate broker's or salesperson's license in any state for a required time period. The statute effectively barred access to Alabama licensing on the basis of experience except to those who obtained such experience in Alabama. The *Georgia Association* court held that the fifteen-semester hour requirement, *in conjunction with the requirement that experience and education be obtained in Alabama*, unduly burdened interstate commerce and violated the *Commerce Clause of the U.S. Constitution*.

Presumably, educational requirements, by themselves, would not affect interstate commerce unless coupled with an in-state education requirement or an in-state place of business requirement, although this area of legal interpretation remains fact oriented.

[b] Reciprocity

The issue of reciprocity usually surfaces in two areas: (1) whether or not a state will grant a license to a nonresident; and (2) the requirements of a nonresident to apply for licensure in the home state. Virtually all states grant licenses to nonresidents,ⁿ¹⁰ provided that they meet minimum educational and competency requirements.

A more complicated issue involves qualifying for state licensure. In states with uniform examination procedures (administered by professional testing companies such as Assessment Systems, Inc. ("ASI") or American College Testing ("ACT")), the examinations have sections that apply to all states, in addition to state-specific sections. If a state uses one of these uniform examination procedures, it frequently waives the requirement that the uniform section of the

examination be retaken, recognizing that the same section of the examination was passed in another jurisdiction.

Some states allow a full waiver of licensing exams, effectively allowing any licensee who has passed the examination in another state to obtain a license in the home state. ⁿ¹¹ A more proprietary attitude is represented in those states which only recognize a full waiver of examination requirements if the reciprocal state recognizes the home state's license and waives requirements of examination. An additional concern develops when a nonresident licensee moves to the home state. Some states require that the nonresident take an exam to convert their nonresident license to a resident license.

Virtually all states treat their nonresident licensee as having the same privileges as resident licensees. This may create a conflict in those states that require additional exams when moving into the home jurisdiction, and may be additional grounds for litigation under the *Commerce Clause of the United States Constitution*.

[6] Examination Requirements

All states require passing a licensing exam before an individual or entity can be licensed. ⁿ¹² It is considered the sole test of competence by most states. Examinations must be written to test competence and must be administered to provide the proper security so that exams do not get lost, stolen or otherwise diverted to unintended parties. For purposes of convenience, most states have the exams administered by professional examination services such as ASI or ACT. A minority of states use their own agency and staff for both administration and security.

[7] Entity Licensing

There are provisions in most states to allow business entities to be licensed as salespersons or brokers, the most common of these being licensure for corporations or partnerships. If there is a breach of a duty by that licensee, who will be responsible for the liability or damage? Can a negligent licensee be protected by the corporate shield?

In many states there is dual licensure, wherein the corporation is licensed and the designated broker must also be licensed. ⁿ¹³ One entity (*e.g.*, Jane Jones Corporation, a licensed broker, and Jane Jones, designated broker for that corporation) pays two license fees. Contrary to appearances, this is not charging twice for one service. If only the broker is licensed, the regulatory commission has no jurisdiction over the company. For instance, if Jane Jones Corporation is found guilty of fraud, the broker's license can be revoked, but the company can stay in business. Since in this situation there is no jurisdiction of the licensing authority over a corporation engaged in the brokerage business, licensure of the company may need to be separately maintained for jurisdictional and enforcement purposes.

In licensing a partnership, a majority of states require that one of the partners be licensed, while other states maintain a separate licensure for the partnership as a separate entity.

A more genuine concern is the personal liability of the designated broker. For instance, it is often thought that if an individual (Jane Jones) incorporates herself as Jane Jones Inc., it may shield her from personal liability for torts and contracts of the brokerage corporation. The more logical theory seems to be that if the corporation condones the conduct, the licensing agency will attempt to pursue both licensees rather than let a broker hide behind a corporate veil for a breach of fiduciary duty.

[8] Grounds for Denial of License

Real estate has been held to be one of those "common occupations of the community" invoking due process protection. In light of most applicants' substantial interest in their real estate license based upon their investment of time and money, substantial risk of erroneous deprivation due to lack of opportunity to explain criminal misconduct must be balanced against the real estate licensing authority's substantial interest in licensing honest and trustworthy agents. ⁿ¹⁴ All jurisdictions include in their licensing statutes specific provisions relating to the denial of licenses. All statutory

provisions are subject to due process scrutiny, and all statutes provide for appeal in the event of denial. The grounds for denial coordinate with the rules for suspension and revocation, discussed below.

Since there is always a factual basis for denial of due process, virtually all of the denials are handled on a case-by-case basis. Denial can be upheld so long as it is not arbitrary or capricious and there is a reasonable basis for denial of the licensure. If it exceeds the bounds of reasonableness, the suspension will not be upheld. n15 It is not necessary that the denial be based on a real estate activity so long as it involves untrustworthy business dealings. n16 The right to deny includes crimes involving moral turpitude n17 which have been held to include passing bad checks, n18 federal tax evasion, n19 perjury, n20 incest, n21 interference with commerce by threats of violence, n22 felony stealing of moneys, n23 bookmaking, n24 solicitation to commit a "crime against nature," n25 and the possession of marijuana for sale. n26

Denial can also be based on matters other than crimes. In *Tuerk v. State of Washington, Dept. of Licensing* n27 a real estate broker refused to provide her home address to the Department. Consequently, the Department refused to renew her license. The broker argued that the statutory provisions did not authorize this requirement, i.e., that brokers must provide their home address on a change of business address form. The court disagreed, stating that requiring the broker's home address was within the Department's statutory authority. The court stated that a broker's home address allowed the Department to efficiently locate brokers who did not yet have a business location, who were in the process of moving their businesses, or who no longer used their business address. It should be noted that many states statutorily require that brokers keep the licensing authority advised of their current address and that failure to do so can result in suspension or revocation of a license. n28

The NARELLO Model Act is silent on grounds for denial of licensure. Perhaps it is too difficult to define denial of one's rights in general terms, without dealing with specific state issues. n29

FOOTNOTES:

(n1)Footnote 0.1. Ark. Code § 17-42-306 (a)(4)(A).

(n2)Footnote 0.2. Ark. Code § 17-42-306 (b)(1)(B)(1).

(n3)Footnote 0.3. Ark. Code § 17-42-306 (b)(1)(B)(1)(ii).

(n4)Footnote 0.4. Cf., e.g., Ky. Rev. Stat. § 324.045 (4).

(n5)Footnote 0.5. Cf. *Paolucci v. Ohio Div. of Real Estate*, 2009 Ohio 5551, 2009 Ohio App. LEXIS 4666 (Oct. 20, 2009) (The applicant was not allowed to sit for the broker examination, because he failed to submit evidence that he had completed at least 20 real estate transactions), citing *Ohio Rev. Code § 4735.07(B)(5)*.

(n6)Footnote 1. *Georgia Ass'n of Realtors, Inc. v. Alabama Real Estate Comm'n*, 748 F. Supp. 1487 (M.D. Ala. 1990).

(n7)Footnote 2. U.S. Const. art. IV, § 2, cl. 1.

(n8)Footnote 3. U.S. Const. art. I, § 8, cl. 3.

(n9)Footnote 4. 470 U.S. 274, 105 S. Ct. 1272, 84 L. Ed. 2d 205 (1985).

(n10)Footnote 5. 470 U.S. at 284.

(n11)Footnote 6. See *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S. Ct. 844, 847, 25 L. Ed. 2d 174 (1970).

(n12)Footnote 7. *Georgia Ass'n of Realtors, Inc. v. Alabama Real Estate Comm'n*, 748 F. Supp. 1487 (M.D. Ala. 1990), relying on *Underhill Assocs. v. Coleman*, 504 F. Supp. 1147 (E.D. Va. 1981).

(n13)Footnote 8. *748 F. Supp. 1487 (M.D. Ala. 1990)* .

(n14)Footnote 9. *394 Mass. 608, 476 N.E.2d 955* , *appeal dismissed, 474 U.S. 991, 106 S. Ct. 401, 88 L. Ed. 2d 353 (1985)* (dismissing appeal for lack of a substantial federal question).

(n15)Footnote 10. *748 F. Supp. at 1494 (M.D. Ala. 1990)* .

(n16)Footnote 11. According to the website of the Real Estate Branch of the Hawaii Professional and Vocational Licensing Division, Hawaii is not reciprocal with any other state, however, a salesperson may qualify for an equivalency to the prelicense education requirement and/or the equivalency to the Uniform Examination.

(n17)Footnote 12. *But see Williamson, Inc. v. Calibre Homes, Inc.*, *106 Wash. App. 558, 562, 566, 23 P.3d 1118, 1121, 1123 (2001)* , *aff'd*, *147 Wash. 2d 394, 54 P.3d 1186 (Wash. 2002)* (Washington broker act allows a corporation to become a licensed real estate salesperson, as to the application requirement for corporate salespersons, obviously a corporation cannot sit for an examination).

(n18)Footnote 13. *Cf. Still v. Arakelyan (In re Still)* *393 B.R. 896, 912 (Bankr. C.D. Cal. 2008)* (real estate license of a corporation is dependent upon the valid real estate broker's license of its designated officer and not vice versa.).

(n19)Footnote 14. The following states do not require any additional educational or examination requirements for applicants who have passed an examination in another state: Georgia, Illinois, Mississippi, Missouri, Nebraska, Oklahoma, and Virginia. *See ARELLO 1996 Digest of 1996 Real Estate License Laws in the United States and Canada*, § I, p. 37.

(n20)Footnote 15. *Becker v. Illinois Real Estate Administrative and Disciplinary Bd.*, *884 F.2d 955 (7th Cir. 1989)* *cert. denied*, *493 U.S. 1088, 110 S. Ct. 1154, 107 L. Ed. 2d 1058 (1990)* .

(n21)Footnote 16. *Rogers v. Division of Real Estate of Dep't of Business Regulations*, *790 P.2d 102 (Utah Ct. App. 1990)* .

(n22)Footnote 17. In 2007, *Cal Bus & Prof Code § 10177 (b)* removed the phrase "moral turpitude" from the list describing activity that could result in an applicant being denied a license. This subsection now states in part that the commissioner may revoke, suspend or deny a license to an individual who has "[e]ntered a plea of guilty or nolo contendere to, or been found guilty of, or been convicted of, a felony, or a crime substantially related to the qualifications, functions, or duties of a real estate licensee ..."

(n23)Footnote 18. *Missouri Real Estate Com. v. McCormick*, *778 S.W.2d 303 (Mo. Ct. App. 1989)* . *See generally* Blum, Annot., *Grounds for Revocation or Suspension of License of Real--Estate Broker or Salesperson*, *7 A.L.R.5th 474 (1992)*; Zitter, Annot., *Revocation or Suspension of Real--Estate Broker's License for Conduct Not Connected with Business as Broker*, *22 A.L.R.4th 136 (1983)*.

(n24)Footnote 19. *Harrington v. Department of Real Estate of California*, *214 Cal. App. 3d 394 (1989)* .

(n25)Footnote 20. *Bear v. Nicholls*, *142 Ariz. 560, 691 P.2d 326 (Ariz. Ct. App. 1984)* (broker pled *nolo contendere* to federal tax evasion).

(n26)Footnote 21. *Application of O'Neill*, *24 A.D. 2d 940, 265 N.Y.S.2d 95 (1965)* .

(n27)Footnote 22. *Jennings v. Karpe*, *36 Cal. App. 3d 709, 111 Cal. Rptr. 776 (1974)* .

(n28)Footnote 23. *Coles v. Department of Registration and Educ.*, *59 Ill. App. 3d 1046, 17 Ill.Dec. 270, 376 N.E.2d 269 (1978)* ; *Kerley v. Real Estate Agency*, *337 Ore. 309, 317-318, 96 P.3d 1211, 1215 (Or. 2004)* (embezzlement of partnership funds before the individual became a licensee).

(n29)Footnote 24. *Missouri Real Estate Com. v. McCormick*, 778 S.W.2d 303 (Mo. App. 1989) .

(n30)Footnote 25. *Hodgkins v. North Carolina Real Estate Comm'n*, 504 S.E.2d 789 (N.C. App. 1998) .

(n31)Footnote 26. *Carp v. Florida Real Estate Comm'n*, 211 So. 2d 240 , cert. dismissed, 219 So. 2d 427 (Fla. App. DCA 3d 1968) .

(n32)Footnote 27. *Golde v. Fox*, 98 Cal. App. 3d 167, 159 Cal. Rptr. 864 (1979) .

(n33)Footnote 28. 123 Wash. 2d 120, 864 P.2d 1382 (1994) (en banc).

(n34)Footnote 29. See statutory provisions cited at § 6.05, n.1 *infra* .

* Revised by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues, including licensing issues, has practiced in the areas of tax, business and probate law, and is licensed as a C.P.A. in the State of Maryland.



118 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 6 Licensing of Brokers and Salespersons *

10A-6 Real Estate Brokerage Law and Practice § 6.04

§ 6.04 License Terms and Renewal

[1] Terms of Licenses

The term of a broker's or salesperson's license varies from one year to four years, depending on the state. States generally have the same term for broker's and salesperson's licenses. n1

[2] Continuing Education Requirements

With the exception of New Jersey, every state and the District of Columbia have adopted continuing professional education requirements as a condition of license renewal. This is the fastest growing industry in real estate education. Most states not only have extensive continuing education requirements, but also have criteria for both course content and instructor evaluation to ensure that courses include current and useful information. Courses on "How to List Real Estate" or "Farming Real Estate Effectively" are generally not considered to be updating law, finance, agency or licensing information which the real estate licensee needs, nor are such "fluff" subjects substantive enough that they need updating on a regular basis.

Many states have a significant amount of continuing education. Iowa, for instance, requires thirty-six hours of continuing education each year and New Mexico requires thirty hours of continuing education per year. Many states require mandatory continuing education over a two-year period that coincides with the term of a salesperson's or broker's license.

Some states designate the real estate topics that must be taught in continuing education courses. Frequently there are requirements that a minimum number of continuing education hours must be in specific real estate topics. States use different terms such as classroom hours, actual hours, or clock hours. In some states, the continuing education is defined according to its duration. For example, *Florida Statutes Annotated § 475.182* states, "The renewal application for an active license as broker, broker-salesperson, or salesperson shall include proof satisfactory to the commission that the licensee has, since the issuance or renewal of his current license, satisfactorily completed at least 14 classroom hours of 50 minutes each of continuing education courses during each biennium, as prescribed by the commission." n2 Most states have approved instructor materials, require some sort of monitor, and require student evaluations of the materials in course study. n3

FOOTNOTES:

(n1)Footnote 1. *See* ARELLO 1996 Digest of Real Estate License Laws of United States and Canada, § I, p. 8.

(n2)Footnote 2. *See* § 6.07[10] *infra* for a full discussion of Florida statutory requirements.

(n3)Footnote 3. *See* ARELLO 1996 Digest of Real Estate License Laws of United States and Canada, § II, p. 8.

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119 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation
CHAPTER 6 Licensing of Brokers and Salespersons *

10A-6 Real Estate Brokerage Law and Practice § 6.05

§ 6.05 Suspension or Termination of License

[1] Grounds

Each licensing statute includes provisions for license suspension or revocation, n1 although the statutes differ in the degree of particularity in which the grounds for discipline are set out. Typically, disciplinary measures include suspension or revocation of a license. n2 The following have been held to be a proper basis for license revocation:

- murder of a business associate; n3
- inflating appraisals to help a buyer obtaining financing; n4
- passing bad checks, which applicant "forgot" to mention in his license application; n5
- not acting "promptly" in fulfilling duties of selecting an arbitrator; n6
- withdrawing funds from an escrow account without obtaining consenting signatures; n7
- incompetence and untrustworthiness; n8 and
- failing to deposit a purchaser's funds into an escrow account in accordance with a contract. n9
- suspension of the licensee's law license. n10

The NARELLO Model Act has adopted strong provisions for license suspension and revocation. Licensees who engage in prohibited acts are subject to the following disciplinary action:

The state regulatory agency may investigate the actions of any person engaged in the business or acting in the capacity of a real estate broker, associate broker, or real estate salesperson, regardless of whether the transaction was for his or her own account or in his or her capacity as broker, associate broker, or salesperson and if found guilty of violating this chapter may impose any one or more of the following sanctions: suspend, revoke or deny a license or the renewal thereof, levy a fine not to exceed

..... dollars for each offense, require the completion of a course in a selected area of real estate practice relevant to the section of this chapter violated, or order a refund of compensation collected from consumers injured by the violation of this chapter. n11

Some states require that the conduct be related to the licensee's real estate activities. n11.1 This has lead to speculation as to what type of conduct is so related to the licensee's real estate activities that it would subject a licensee to disciplinary conduct. n11.2 However, some state statutes also provide for revoking a broker's license for conduct not directly related to the individual's brokerage. n12 Some courts have also revoked a broker's license in the absence of an express statutory mandate. n13 Courts that have so held reason in part that an individual who is incompetent or dishonest with respect to non-brokerage activities will probably behave in a similar manner in connection with such individual's brokerage activities. n14 Other courts have come to varying conclusions on whether a broker's license could be suspended or revoked for conduct not directly related to one's brokerage activities, depending upon the acts involved and the statutory section violated. n15 Therefore, in addition to reviewing the applicable state statutory scheme providing for license suspension or revocation, the broker would be well advised to be aware of relevant case law construing such statute. n16 Absent exigent circumstances, the court will not overturn the decision of a real estate commission unless the administrator's decision exceeds the bounds of reasonableness or is otherwise arbitrary and capricious. n17

A real estate licensee should not indicate that he or she is a member of the National Association of Realtors(R) or a state or local Realtors(R) association unless the licensee is indeed a member. Falsely indicating this membership is a violation of licensing laws in some jurisdictions and can subject a licensee to discipline. n18

The Supreme Court of New Hampshire considered a case involving a misrepresentation concerning a seller's status as a broker and a Realtor(R). n19 Dale Robinson (Robinson) had been a licensed broker and salesperson for over twenty years. His licenses were revoked in 1989. In 2005, Roberson placed for sale signs on property he owned. These signs and his business card which he distributed to the buyers indicated that he was a Realtor(R). The business cards also indicated that Roberson was a broker. When the buyers filed a complaint with the New Hampshire Real Estate Commission, the Commission, despite Robinson's argument that the Commission lacked jurisdiction, held that Robinson had violated statutory provisions by acting as a real estate broker without a license, by disregarding the Commission's prior order revoking his licenses, and by misrepresenting his membership in a state or national realty organization. n20 This decision was upheld on by the superior court, but was subsequently reversed by the New Hampshire high court which agreed with Robinson's jurisdictional argument. *N.H. Rev. Stat. § 331-A:4, I*, provides that the provisions of the New Hampshire Real Estate Practices Act do not apply to an owner selling his property. The court agreed with Robinson's assertion that since he was exempt under the Act, the Commission lacked jurisdiction to conduct a hearing on the buyers' complaint. This court emphasized that the owner exemption contained no qualifying language.

A North Carolina court has held that the owner exemption found in the North Carolina broker licensing law did not apply to a licensed broker involved in the sale of real estate by a corporation in which she held an ownership interest. The broker owned 8% of the corporation's outstanding stock. This court rejected the broker's argument that the North Carolina Real Estate Licensing Board lacked the jurisdiction to revoke her real estate broker's license. The court found that the broker acted as a real estate broker, not as an owner, in negotiating the sale of the subject house and lot. n21

A real estate licensee has been found to have violated a Montana statute addressing unprofessional conduct when the licensee used a buy-sell agreement form copyrighted by the National Association of Realtors(R) (NAR) which was intended for use by a member of the NAR or the Montana Association of Realtors(R). When the licensee used the form, he was not a member of either group. The disciplinary action of imposing a monetary fine against this licensee was found to be correct. n22

Brokers must also adequately supervise agents and salespersons who work for them. n23 A broker's failure to adequately supervise those working for the broker may find that their broker's license is revoked or suspended. n24 In

some jurisdictions, it is not necessary that the broker have actual knowledge of the misconduct since a failure to adequately supervise such persons can leave a broker without knowledge of the misconduct of such individuals. n25

Practitioners should also review statutes that proscribe activities in which brokers may engage in an effort to sell real estate. A Missouri statute that prohibited brokers from using prizes or other valuable consideration as an inducement to secure customers to purchase real property was upheld against a challenge that it unduly restricted commercial speech. n26

Brokers who act in several different capacities should realize that claiming to act in a capacity other than as a broker may not protect them from having their licenses suspended or revoked. n27 The zealous approach of some state real estate commissions may lead to unnecessary disciplinary actions. Even if the brokers ultimately prevail, they will have incurred expenses and emotional turmoil in defending themselves against charges. n28 Perhaps the best advice for brokers who act in different capacities is that they should always comply with the high standards of conduct imposed on brokers. Anything short of that may invite trouble.

Regulatory agencies are not limited to the severe remedy of revoking or suspending a broker's license, but are generally able to impose sanctions for violating rules. n29 Regulatory agencies generally are granted the authority to review a broker's records and accounts. In *Waxler v. Maine Real Estate Commission* n30 this authority was upheld against a broker's challenge that such authority violated the broker's right to be free of unreasonable searches. This case also illustrates that a broker's carelessness can result in sanctions. The broker paid his license renewal with a check from his real estate trust account, rather than his regular account. The broker notified the Maine Real Estate Commission of his error. The Commission had already caught this error and informed the broker that it would seek to inspect, examine and audit his trust account records. The broker refused to allow the Commission to examine these records. Sanctions were imposed and the broker challenged the statute allowing examination of a broker's books and records. n31 This challenge failed and the statute was found to be constitutionally valid. n32

The revocation or suspension of a real estate broker's license generally does not constitute punishment for the purposes of double jeopardy analysis. n33

[2] Administrative Procedures and Judicial Review

Before a license is revoked or suspended, there is usually some form of administrative review. n34 Additionally, most state statutes allow judicial review of various facets of administrative proceedings. n35 The primary concern is that due process must be addressed before any license revocation. n36 In practice, however, because of the Administrative Procedures Act of most states, few revocation decisions are overturned unless they can be proven to be arbitrary and capricious conduct on the part of the State Regulatory Commission. Decisions to sanction will be reversed, however, if the commission fails to follow statutory guidelines or its own procedures. In one case the commission's omission of certain procedural documents from the record submitted to the court on the agent's appeal and the commission's failure to adhere to statutory time limits for holding a hearing on a complaint resulted in a reversal of its decision to sanction an agent. n37 Regulatory commissions also cannot sanction any conduct at will; before a commission may prohibit conduct that is not *malum per se*, it must notify a licensee that his or her conduct is forbidden. n38

Brokers and agents usually are not entitled to jury trials or Miranda warnings since violations of brokerage statutes generally are not subject to criminal punishment or custodial interrogations. n39 However, one court has stated that when a broker is threatened with the suspension or loss of his or her license, the testimony must clearly establish guilt. n40

The NARELLO Model Act requires the following notice and hearings before the administrative agency may issue a cease and desist order:

(1) The [Department/agency/Commission] may issue a cease and desist order to a person after notice and hearing and upon a determination that the person has violated a provision of this chapter or a lawful order or rule of the [Department/agency/Commission].

(2) If the [Department/agency/Commission] makes a written finding of fact that the public interest will be irreparably harmed by delay in issuing an order, a temporary cease and desist order may be issued. Before issuing the temporary cease and desist order, whenever possible the [Department/agency/Commission] shall give notice by telephone or otherwise of the proposal to issue a temporary cease and desist order to the person. Every temporary cease and desist order shall include a provision that a hearing will be held upon request to determine whether or not the order will become permanent.

At the time the temporary cease and desist order is served, the person or the licensee shall be notified that he is entitled to request a hearing for the sole purpose of determining whether or not the public interest imperatively requires that the temporary cease and desist order be continued or modified pending the outcome of the hearing to determine whether or not the order will become permanent. The hearing shall be held within thirty days after the [Department/agency/Commission] receives the request for hearing, unless the licensee requests a later hearing. The person may secure review of any decision rendered at a temporary cease and desist order review hearing as provided in [state statute], the Administrative Procedures Act. n41

A real estate commission is usually statutorily restricted as to the punishment it can mete out to a licensee. For example, it has been held that a statute which authorized a commission to order that a licensee perform or refrain from performing any acts (including community service without compensation) that the commission considered appropriate to the public interest or to the rehabilitation or treatment of the licensee did not grant the commission the authority to order that the licensee refund the commission she had received as a sanction for her actions in connection with her principal's purchase of a home. n42

[3] Legislative Remedies

[a] In General

There is a remarkably small number of complaints against real estate brokers in relation to the number of licensees. n43 To protect the public, however, all states provide some sort of recovery for aggrieved parties. This takes the form of a bond required for all agents upon licensure, errors and omissions insurance, or a recovery fund. Most states provide a fund to provide recovery for aggrieved parties in the event there is a breach of duty on the part of a licensee to the general public. n44 Refunds are paid out of the license fees of the licensee or assessed, as a general rule, either annually or biannually depending upon licensing procedures. Ten states require that licensees carry errors and omission insurance. n45

[b] Recovery Funds

Most recovery funds are established to reimburse persons who have been damaged by certain acts of a real estate licensee when they cannot collect their damages from that licensee. n46 There are two basic theories for recovery from such a fund. The first is that the person submitting the claim must be an aggrieved party who can maintain a claim as defined by the statute. The second involves the basis of the claim itself.

The "aggrieved party," in general terms, means a member of the general public who stood as a principal in a real estate transaction. It has been held that another licensee can stand as an aggrieved person. n47

The basis for a claim against the fund usually involves an aggrieved person who has a valid but uncollectible judgment

against the licensee in the state claiming jurisdiction over the transaction, or a cause of action based upon a specific violation of the state's real estate license act. Recovery against such a fund has been allowed where the agent was alleged to have engaged in fraudulent conduct, but the parties stipulated to a judgment wherein the agent expressly denied her liability on the claims alleged in the complaint. n48

Generally, a recovery fund statute provides that the aggrieved party can be reimbursed for his uncollected losses against the licensee, subject to statutory limitations. n49 Usually, the statute provides that the aggrieved party can only recover actual damages, and does not include punitive damages, n50 although the claim could allow reimbursement for attorney's fees. n51 Statutes typically provide that an aggrieved claimant can recover an amount up to a statutory limit for that person's damage, although the transaction may support a cause of action for more than one claimant with a higher limit in the aggregate.

Some states limit an injured party's recovery to situations in which the licensee was acting as a broker or agent. For example, under such a rule, the injured party cannot recover from the fund if the broker was sued as the purchaser. n52

To date, virtually all states provide for the fund out of licensee's fees either upon licensure, upon renewal of the licensure or perhaps through an annual or biennial contribution to the fund. n53

Recovery funds are generally intended to be a remedy of last resort. Therefore, they are to be accessed only when other potential sources of recovery are unavailable. For this reason, it is possible that an injured party may be denied recovery from a fund for failing to diligently pursue damages from other potentially liable persons. n54 Through this theory the industry basically polices itself and pays for damages to the public out of the industry's contributions to the fund.

Claims against these funds usually must be filed within a certain time period. n55 A late filing will result in no recovery. n56

FOOTNOTES:

(n1)Footnote 1. The relevant citations are:

Alabama: Ala. Code §§ 34-27-31(e)(6), 34-27-32(h), 34-27-36.

Alaska: Alaska Stat. §§ 08.88.037, 08.88.071(a)(3), 08.88.291.

Arizona: Ariz. Rev. Stat. Ann. §§ 32-2125(D), 32-2126(A), 32-2130(E), 32-2153, 32-2157(B), 32-2161(A), 32-2188(H), 32-2126(A).

Arkansas: Ark. Stat. Ann. §§ 17-42-311 and 17-42-312.

California: Cal. Bus. & Prof. Code § 10165.

Colorado: Colo. Rev. Stat. §§ 12-61-109(1), 12-61-110(5), 12-61-113, 12-61-118.

Connecticut: Conn. Gen. Stat. Ann. §§ 20-320, 20-320a, 20-323, 20-324e(f), 20-329f(a), 20-329i.

Delaware: Del. Code Ann. tit. 24, §§ 2912, 2915, 2919, 2920, 2921(h), 2947.

District of Columbia: D.C. Code § 47-2853.197.

Florida: Fla. Stat. Ann. § 475.25.

Georgia: Ga. Code Ann. §§ 43-40-14, 43-40-15, 43-10- 17.

Hawaii: Hawaii Rev. Stat. §§ 467-14, 467-17(b), 467- 18(e).

Idaho: Idaho Code §§ 54-2035E, 54-2040, 54-2050.

Illinois: 225 ILCS 455/9, 225 ILCS 455/15.1, 225 ILCS 455/18, 225 ILCS 455/22.

Indiana: Ind. Code Ann. §§ 25-34.1-6-1.1.

Iowa: Iowa Code Ann. § 543B.29.

Kansas: Kan. Stat. Ann. §§ 58-3050, 58-3062, 58-3072.

Kentucky: Ky. Rev. Stat. Ann. §§ 324.160, 324.170, 324.230, 324.420(3).

Louisiana: La. Rev. Stat. Ann. §§ 37:1442, 37:1447, 37:1448, 37:1450(B), 37:1455, 37:1463(G).

Maine: Me. Rev. Stat. Ann. tit. 32, §§ 13066, 13067, 13068, 13069, 13182, 13194.

Maryland: Md. Code Ann. Bus. Occ. & Prof. §§ 17-322, 17-327, 17-328.

Massachusetts: Mass. Gen. Laws Ann. ch. 112, §§ 87 VV, 87 YY, 87 AAA.

Michigan: Mich. Stat. Ann. §§ 339.2512, 339.2513.

Minnesota: Minn. Stat. Ann. §§ 82.20(4)(d), (9), (10); 82.27; 82.34(13).

Mississippi: Miss. Code Ann. §§ 73-35-17(4), 73-35- 21.

Missouri: Mo. Ann. Stat. § 339.100.

Montana: Mont. Code Ann. § 37-51-321.

Nebraska: Neb. Rev. Stat. §§ 81-885.14(1), 81-885.24, 81-885.29.

Nevada: Nev. Rev. Stat. Ann. §§ 645.321, 645.324(2), 645.420(6), 645.570(3), 645.577, 645.630, 645.633, 645.635, 645.645, 645.660, 645.847.

New Hampshire: N.H. Rev. Stat. Ann. §§ 331-A:26, 331- A:28.

New Jersey: N.J. Rev. Stat. Ann. §§ 45:15-15, 45:15-17; 45:15-12.1, 45:15-19.1, 45:15-19.2, 45:15-13, 45:15-19, 45:15-41.

New Mexico: N.M. Stat. Ann. §§ 61-29-12; 61-29-11(C), 61-29-27.

New York: N.Y. Real Prop. L. § 441-c.

North Carolina: N.C. Gen. Stat. §§ 93A-6, 93A-7, 93A- 22.

10A-6 Real Estate Brokerage Law and Practice § 6.05

North Dakota: N.D. Cent. Code §§ 43-23-11.1(1), 43-23-12(2), 43-23-13.1, 43-23.2-09.

Ohio: Ohio Rev. Code Ann. §§ 4735.141(c), 4735.18, 4735.12(E), 4735.13(C), (D).

Oklahoma: Okla. Stat. Ann. tit. 59, § 858-312.

Oregon: Or. Rev. Stat. §§ 696.174(2), 696.200(2), 696.232(1), 696.301, 696.310(3), 696.320(1).

Pennsylvania: Pa. Cons. Stat. Ann. tit. 63, §§ 455.604(a), 455.702, 455.803(f).

Rhode Island: R.I. Gen. Laws §§ 5-20.5-5(c)(5), 5-20.5-6, 5-20.5-14, 5-20.5-15.

South Carolina: S.C. Code Ann. § 40-57-170.

South Dakota: S.D. Comp. Laws Ann. §§ 36-21A-45, 36-21A-68, 36-21A-69, 36-21A-70.

Tennessee: Tenn. Code Ann. §§ 62-13-208(g), 62-13-311, 62-13-312.

Texas: Tex. Occ. Code § 1101.652.

Utah: Utah Code Ann. §§ 61-2-11, 61-2-13.

Vermont: Vt. Stat. Ann. tit. 26, § 2296.

Virginia: Va. Code § 54.1-2119.

Washington: Wash. Rev. Code Ann. § 18.85.230.

West Virginia: W. Va. Code § 42-12-8, 42-12-11, 42-12-17(b).

Wisconsin: Wis. Stat. Ann § 452.14.

Wyoming: Wyo. Stat § 33-28-111.

(n2)Footnote 2. As an alternative to license suspension, one state provides that the real estate commissioner is permitted to accept, on petition of the licensee, a monetary penalty in lieu of a license suspension. *Cal. Bus. & Prof. Code § 10175.2* provides in pertinent part:

(a) If the Real Estate Commissioner determines that the public interest and public welfare will be adequately served by permitting a real estate licensee to pay a monetary penalty to the department in lieu of an actual license suspension, the commissioner may, on the petition of the licensee, stay the execution of all or some part of the suspension on the condition that the licensee pay a monetary penalty and the further condition that the licensee incur no other cause for disciplinary action within a period of time specified by the commissioner.

* * *

(d) The amount of the monetary penalty payable under this section shall not exceed two hundred dollars and fifty ... for each day of suspension stayed nor a total of ten thousand ... dollars per decision

regardless of the number of days of suspension stayed under the decision.

(e) Any monetary penalty received by the department pursuant to this section shall be credited to the Recovery Account of the Real Estate Fund.

(n3)Footnote 3. *Cannizzaro v. Commonwealth, Dep't of State, Bureau of Professional & Occupational Affairs*, 129 Pa. Commw. 39, 564 A.2d 564 (Pa. Commw. 1989) .

(n4)Footnote 4. *Grygiel v. Shaffer*, 154 A.D.2d 763, 546 N.Y.S.2d 211 (1989) .

(n5)Footnote 5. *Harrington v. Department of Real Estate, State of California*, 214 Cal. App. 3d 394 (1989) .

(n6)Footnote 6. *Wallen v. Florida Dep't of Professional Regulation, Div. of Real Estate*, 568 So. 2d 975 (Fla. 3d DCA 1990) .

(n7)Footnote 7. *Muller v. California State Dept. of Real Estate*, 204 Cal. App. 3d 295 (1988) .

(n8)Footnote 8. *Eckley v. Colorado Real Estate Comm'n*, 752 P.2d 68 (Colo. 1988) (finding that the terms "incompetence" and "untrustworthiness" are not unconstitutionally vague, because they are sufficiently descriptive as standards of acceptable practice as developed by custom and tradition over the years in the real estate brokerage profession); *License of Nick Topik*, 761 P.2d 32 (Utah 1988) (similar holding).

See also *Mississippi Real Estate Comm'n v. Hennessee*, 672 So. 2d 1209 (Miss. 1996) (in a case of first impression, the Supreme Court of Mississippi held that a real estate broker may be subject to licensing disciplinary actions while selling property wholly owned by the broker).

(n9)Footnote 9. *White v. Department of Business and Professional Regulation*, 715 So. 2d 1130, 1131 (Fla. App. 1998) .

(n10)Footnote 10. *Herrera v. Department of Real Estate*, 88 Cal. App. 4th 776, 779-80, 106 Cal. Rptr. 2d 232, 234-35 (2001) , review denied, 2001 Cal. LEXIS 4848 (July 18, 2001) .

(n11)Footnote 11. NARELLO Model Act, § 20, ARELLO 1996 Digest of Real Estate License Laws in United States and Canada, § XIII, p. 14.

(n12)Footnote 11.1. See Cal. Bus. & Prof. Code § 490; *Robbins v. Davi*, 175 Cal. App. 4th 118, 122-23, 95 Cal. Rptr. 3d 792, 795-96 (2009) , review denied, 2009 Cal. LEXIS 9831 (Sept. 17, 2009) .

(n13)Footnote 11.2. Cf. *Robbins v. Davi*, 175 Cal. App. 4th 118, 122-23, 95 Cal. Rptr. 3d 792, 795-96 (2009) (violation of municipal fire protection and prevention provision which were strict liability offenses supported revoking a broker's license), review denied, 2009 Cal. LEXIS 9831 (Sept. 17, 2009) .

(n14)Footnote 12. See, e.g., *Wetzel v. Arizona State Real Estate Dep't*, 151 Ariz. 330, 727 P.2d 825 (Ariz. Ct. App. 1986) cert. denied, 482 U.S. 914, 107 S. Ct. 3186, 96 L. Ed. 2d 674 (1987) (applying Ariz. Rev. Stat. Ann § 32.215B4, which authorized the revocation of a broker's license "when it appear[ed] that the holder ... [was] ... [n]ot ... a person of honesty, truthfulness and good reputation," to revoke a broker's license based on findings made at his disbarment proceeding); *Harris v. Hunt*, 122 S.W.3d 683, 687-688 (Mo. Ct. App. 2003) (conduct leading to license suspension occurred in broker's personal real estate investment activity, broker was not representing a principal). See also *Moran v. Ohio Dept. of Commerce, Div. of Real Estate*, 109 Ohio App. 3d 494, 672 N.E.2d 699 (Ohio App. 9 Dist. 1996) (the court upheld the revocation of the agent's license for misconduct, where the agent failed to inform the Commission of her being convicted of theft and forgery after she completed the real estate license application and before she received

her license); *Richard T. Kiko Agency, Inc. v. Ohio Dept. of Commerce, Division of Real Estate*, 48 Ohio St. 3d 74, 549 N.E.2d 509 (1990) rehearing granted in part, 49 Ohio St. 3d 709, 551 N.E.2d 1305, 2 Ohio Pending Op. Rep. 17 (1990); and *Missouri Real Estate Comm'n v. McCormick*, 778 S.W.2d 303 (Mo. Ct. App. 1989) .

(n15)Footnote 13. See e.g.:

Arkansas: Black v. Arkansas Real Estate Comm'n, 275 Ark. 55, 626 S.W.2d 954 (Ark. 1982) .

Nevada: Laman v. Nevada Real Estate Advisory Comm'n, 95 Nev. 50, 589 P.2d 166 (Nev. 1979) .

Oregon: Klein v. Real Estate Comm'r, 19 Or. App. 646, 528 P.2d 1355 (1974) . See also *South Carolina Real Estate Comm'n v. Boineau*, 267 S.C. 574, 230 S.E.2d 440 (S.C. 1976) , cert. denied, 431 U.S. 954, 97 S. Ct. 2673, 53 L. Ed. 2d 270 (1977) ("realtors may have their licenses revoked for conduct not strictly related to a transaction in which they are acting as broker [sic]").

But cf. *Pacella v. Ohio Department of Commerce, Division of Real Estate*, 2003 Ohio 3432, 2003 Ohio App. LEXIS 3106, at *7-*11 (Ohio Ct. App. June 30, 2003) (Division found the licensee's conduct violated Ohio Rev. Code Ann. § 4735.58(A) because the disclosure did not contain either the seller's signature or a notation of rejection, dated prior to the marketing and showing of the real estate. Though the court found that the statute clearly stated a seller's agent was to provide the seller the disclosure prior to marketing or showing the seller's property, § 4735.58 did not require that the agent obtain proof of the seller's approval or secure the seller's signature when providing the disclosure. By enforcing, and effectively creating a duty to secure the seller's signature, the division exceeded its administrative power and encroached upon the legislative policy-making power of the general assembly.).

(n16)Footnote 14. See, e.g.:

Nebraska: Wright v. State, 208 Neb. 467, 304 N.W.2d 39 (Neb. 1981) .

Pennsylvania: State Real Estate Comm'n v. Tice, 200 Pa. Super. 553, 190 A.2d 188 (1963) (stating that "[a] broker who is dishonest or incompetent in the real estate activities in which he is involved as an owner, is not likely to be honest or competent in his activities which are purely brokerage in nature" [Citations omitted]) allocatur denied.

(n17)Footnote 15. Compare *Ring v. Smith*, 5 Cal. App. 3d 197, 85 Cal. Rptr. 227 (1970) , *Tushner v. Savage*, 219 Cal. App. 2d 71, 33 Cal. Rptr. 247 (1963) and *Phillips v. Mann*, 147 So. 2d 559 (Fla. 2d DCA 1962) , with *Schlinder v. Florida Real Estate Comm'n*, 144 So. 2d 862 (Fla. 3d DCA 1962) and *Cannizzaro v. Commonwealth, Dep't of State, Bureau of Professional & Occupational Affairs*, 129 Pa. Commw. 39, 564 A.2d 564 (Pa. Commw. 1989) appeal denied, 525 Pa. 605, 575 A.2d 570 (1990) . See also *Petropoulos v. Dept. of Real Estate*, 142 Cal. App. 4th 554, 567, 47 Cal. Rptr. 3d 812, 823 (2006) (A broker had pled guilty to misdemeanor battery against his girlfriend and he had pled nolo contendere to misdemeanor battery against his former wife. Both convictions were later expunged. The court held that Cal. Bus. & Prof. Code § 490 does not provide independent statutory authorization for the suspension or revocation of the license of a person based on his or her conviction of a crime.), rehearing denied, 2006 Cal. App. LEXIS 1448 (Sept. 21, 2006) .

(n18)Footnote 16. See *South Carolina Real Estate Comm'n v. Boineau*, 267 S.C. 574, 230 S.E.2d 440 (S.C. 1976) , cert. denied, 431 U.S. 954, 97 S. Ct. 2673, 53 L. Ed. 2d 270 (1977) (broker's license could be revoked on both statutory and common law grounds).

(n19)Footnote 17. *Rogers v. Division of Real Estate of Dep't of Business Regulations*, 790 P.2d 102 (Utah Ct. App. 1990) .

(n20)Footnote 18. *Cf. Tenn. Code Ann. § 62-13-312(b)(4)* (prohibiting "Misleading or untruthful advertising, including use of the term 'Realtor' by a person not authorized to do so, or using any other trade name or insignia or membership in any real estate association or organization, of which the licensee is not a member.").

(n21)Footnote 19. *See Robinson v. New Hampshire Real Estate Comm'n*, 157 N.H. 729, 958 A.2d 958 (2008) .

(n22)Footnote 20. *See Robinson v. New Hampshire Real Estate Comm'n*, 157 N.H. 729, 730-31, 958 A.2d 958, 959 (2008) . The statutory provisions were N.H. Rev. Stat. §§ 331-A:3, 331-A:34, 331-A:26, II, and 331-A:26, XVI.

(n23)Footnote 21. *See Cox v. North Carolina Real Estate Licensing Board*, 47 N.C. App. 135, 266 S.E.2d 851, 1980 N.C. App. LEXIS 2992 (1980) , petition denied, 301 N.C. 87, 273 S.E.2d 296 (1980) . *See also Gresco Real Estate Inv. Trust v. Nathaniel Greene Development Corp.*, 218 Va. 228, 237 S.E.2d 107, 1977 Va. LEXIS 183 (1977) (the owner's exemption in Va. Code Ann. § 54-734 did not apply because a shareholder was not an owner of a corporation's land).

(n24)Footnote 22. *See White v. Dept. of Labor and Industry*, 2007 MT 252N, 2007 Mont. LEXIS 441 (Mont. Oct. 2, 2007) (unpublished opinion). The statutes violated were *Mont. Code §§ 37-1-316(5), 37-1-316(18)* and *37-51-321(1)(d)*. The latter statute allows revocation or suspension of a license if the licensee is found "guilty" of using the term "realtor" when he or she is not authorized to do so or using another trade name or insignia of membership in a real estate organization of which the licensee is not a member.

(n25)Footnote 23. *See Farris v. Miss. Real Estate Comm'n*, 994 So. 2d 229, 233-34 (Miss. Ct. App. 2008) , cert. denied, 998 So. 2d 1010 (Miss. 2008) *Gibbons v. Bureau of Professional and Occupational Affairs, State Real Estate Commission*, 921 A.2d 551, 553-54 (Pa. Commw. Ct. 2007) .

(n26)Footnote 24. *Id.*

(n27)Footnote 25. *See Gibbons v. Bureau of Professional and Occupational Affairs, State Real Estate Commission*, 921 A.2d 551, 554 (Pa. Commw. Ct. 2007) ; *Dougherty v. Commonwealth, State Real Estate Commission*, 99 Pa. Commw. 397, 400, 513 A.2d 555, 557 (1986) , appeal denied, 515 Pa. 587, 527 A.2d 547 (1987) .

(n28)Footnote 26. *Coldwell Banker Residential Real Estate Servs. v. Missouri Real Estate Comm'n*, 712 S.W.2d 666 (Mo. 1986) (en banc) (upholding *Mo. Rev. Stat. § 339.100.2(12)*); *contra: Coldwell Banker Residential Real Estate v. Clayton*, 105 Ill. 2d 389, 86 Ill. Dec. 322, 475 N.E.2d 536, (1985) (holding, on substantially similar facts, that an Illinois statute was an unconstitutional regulation of commercial speech).

(n29)Footnote 27. *Harris v. Hunt*, 122 S.W.3d 683, 687-688 (Mo. Ct. App. 2003) ; *White v. Department of Business and Professional Regulation*, 715 So.2d 1130, 1131 (Fla. Dist. Ct. App. 1998) .

(n30)Footnote 28. *See Ohio Div. of Real Estate v. Vantell*, 128 Ohio App. 3d 410, 715 N.E.2d 217, 221-222 (Ohio App. 1998) . This case involved a broker who entered into a joint venture with an investor to acquire, improve, and resell the property. The commission found that the broker committed misconduct by having authorized the investor to act in a representative real estate capacity on behalf of another when the investor was not licensed. An exemption to the licensure statute provided an exception for owners and individuals who had an interest in property on their own account. The court reversed the commission's decision stating that the commission misinterpreted this exemption and that the commission had no jurisdiction to suspend the broker's license.

See also Franich v. The Real Estate Commission of the State of Iowa, 681 N.W.2d 620, 623-624 (Iowa 2004) . As a sanction, the commission permanently prohibited a broker from using a marketing plan that had been found to be a

prohibited practice. The court found that the commission did not err in imposing this sanction.

(n31)Footnote 29. *Cf., e.g., Staff of the Idaho Real Estate Comm'n v. Nordling*, 135 Idaho 630, 135 Idaho 630, 22 P.3d 105 and 112 (Idaho Mar. 29, 2001)(in addition to suspending an agent's license for fourteen days, the commission fined her \$3,000 and ordered her to pay up to \$55,000 of costs and attorneys fees incurred by the commission in prosecuting the action).

(n32)Footnote 30. 1998 Me. 65, 708 A.2d 663 (1998) .

(n33)Footnote 31. The statute challenged was *Me. Rev. Stat. Ann. tit. 32, § 13178*.

(n34)Footnote 32. 1998 Me. 65, 708 A.2d 663, 666 (1998) .

(n35)Footnote 33. *See Clark v. Tyrrell*, 16 Neb. Ct. App. 692, 700, 750 N.W.2d 364, 373 (2008) . *See also Wendte v. State*, 70 P.3d 1089, 1094 (Alaska 2003) (suspension of an appraiser's license) (revoking or suspending a professional license is not punishment for double jeopardy purposes when it furthers a regulatory goal). *See generally* Robyn Scheina Brown, *Double Jeopardy: Can Non-Monetary Civil Sanctions Constitute Punishment under the Fifth Amendment* , 26 U. Balt. L.F. 14, 15-17 (1996) (stating that virtually every jurisdiction that has been confronted with whether suspensions and revocations of driver's licenses and professional licenses implicate the prohibitions of the *Double Jeopardy Clause* has held that the suspension of these licenses does not violate the protections afforded by the *Fifth Amendment*).

(n36)Footnote 34. *See Krantz v. Utah Dep't of Commerce*, 856 P.2d 369 (Utah. App. 1993) (finding that the Utah Real Estate Commission's failure to notify a real estate broker of his statutory right to apply for reconsideration was presumed to be substantially prejudicial since the commission could not know whether the reconsideration would be granted, and remanding the matter to the Executive Director of Commerce to direct the Real Estate Commission to issue an order advising the broker of his right to apply for reconsideration of the decision to revoke his license).

(n37)Footnote 35. *See, e.g.:*

Alabama: Lambert v. Alabama Real Estate Comm'n, 479 So. 2d 68 (Ala. Ct. App. 1985) (real estate broker whose license was revoked by the Commission was entitled to an oral hearing by the State Circuit Court before that court could dismiss the broker's appeal of the revocation).

Montana: Matter of Sorini, 717 P.2d 7 (Mont. 1986) (the fact that the hearing examiner and the attorney for the Board of Realty Regulation were both state deputy attorneys did not deny broker's right to an administrative hearing).

North Carolina: Correll v. Boulware, 329 S.E.2d 695 (N.C. Ct. App. 1985) (noting that in reviewing the sufficiency of the Real Estate Licensing Board's findings of fact in a license suspension hearing, a reviewing court must examine the "whole record" to determine if there is substantial evidence in the record to support the board's findings).

Pennsylvania: Fumo v. State Real Estate Comm'n, 515 A.2d 1349 (Pa. 1986) (defense of laches must normally be raised at the administrative level to be considered on appeal; however, that defense had to be considered in the instant case in the light of an earlier court ruling that the defense of laches was available against the Commonwealth in an administrative disciplinary proceeding by a licensing board). For a case reviewing an administrative suspension of a broker's license and reversing such administrative determination on the basis of a narrow construction of the license suspension statute, *see Gobao v. Commonwealth, State Real Estate Com.*, 96 Pa. Commw. 341, 507 A.2d 917 (Pa. Commw. Ct. 1986) , in which the court narrowly construed a statute that listed numerous criminal offenses, conviction of which

required suspension of a real estate broker's license.

(n38)Footnote 36. *Cf. Morris v. Real Estate Comm'n, 2008 Del. Super. LEXIS 140* (Del. Super. Ct. Apr. 11, 2008) (Since there was no evidence that the licensee had received proper notice of the hearing, the Delaware Real Estate Commission's decision was reversed.).

(n39)Footnote 37. *See Royer v. Ohio Real Estate Comm'n, 131 Ohio App. 3d 265, 722 N.E.2d 172, 175-176 (1999)* .

(n40)Footnote 38. *See Ohio Dept. of Commerce v. Flenniken, 2000 Ohio App. LEXIS 5633* (Ohio App. Nov. 30, 2000) (an agent did not commit misconduct by using four business names on three separate agency disclosure statements with no form listing the same combination of businesses for three offers made on the same property).

(n41)Footnote 39. *See McDerment v. Mississippi Real Estate Comm'n, 748 So. 2d 114, 119-120 (Miss. 1999)* .

(n42)Footnote 40. *See Mississippi Real Estate Comm'n v. Anding, 732 So. 2d 192, 196 (Miss. 1999)* .

(n43)Footnote 41. NARELLO Model Act, § 22, ARELLO 1996 Digest of Real Estate License Laws United States and Canada, § VIII, p. 20.

(n44)Footnote 42. *See Indiana Real Estate Commission v. C.M.B. III Enterprises, Inc., 734 N.E.2d 653, 662 (Ind. App. 2000)* . The statute involved was *Ind. Code § 25-1-11-12(a)(5)(D)*.

(n45)Footnote 43. *See ARELLO Digest of Real Estate License Law United States and Canada, § I, p. 19* for a table of complaint statistics. For example, this Digest shows that as of June 30, 1995, Florida had 71,392 licensed brokers and 218,810 licensed salespersons. For the period of July 1994 through June 1995, 5,499 complaints were received which resulted in 3,067 investigations.

(n46)Footnote 44. The exceptions are Iowa, Maine, Massachusetts, Michigan, Mississippi, Missouri, Nebraska, New Hampshire, New York, Oregon, South Carolina, Vermont, Washington, West Virginia, and Wisconsin.

(n47)Footnote 45. These states have mandatory errors and omissions insurance requirements: Alabama, Idaho, Iowa, Kentucky, Louisiana, Mississippi, Nebraska, Rhode Island, South Dakota, and Tennessee. New Mexico statutorily provides for optional errors and omissions insurance coverage.

(n48)Footnote 46. *See Texas Real Estate Comm'n v. Nagle, 767 S.W.2d 691, 693 (Tex. 1989)* .

(n49)Footnote 47. *Texas Real Estate Comm'n v. Century 21 Security Realty, Inc., 598 S.W.2d 920, 922 (Tex. Civ. App. 1980)* .

(n50)Footnote 48. *See Smith v. I.W. Levin and Co., Inc., 800 A.2d 374, 379 (Pa. Commw. Ct. 2002)* .

(n51)Footnote 49. *See Paris v. Feder, 179 Ill.2d 173, 688 N.E.2d 137, 139 (1997)* (recoveries from Real Estate Recovery Fund are limited to \$10,000 per transaction and are not intended to be fully compensatory).

(n52)Footnote 50. *See Cairone, Inc. v. Frey Realty, Inc., 703 A.2d 585, 588 (Pa. Cmwlth. 1997)* (punitive damages are not recoverable from the Real Estate Recovery Fund).

(n53)Footnote 51. *Texas Real Estate Comm'n v. Hood, 617 S.W.2d 838, 840 (Tex. Ct. App. 1981)* .

(n54)Footnote 52. *See Fla. Stat. § 475.482(1)(b)* (no recovery if the licensee was the seller, buyer, landlord or tenant in the transaction); *Dorcely v. State Dep't of Bus. & Prof'l Regulation, 22 So. 3d 834, 836-37 (Fla. Dist. Ct. App.*

2009) ; *Wasser v. Dep't of Bus. & Prof'l Regulation*, 717 So.2d 633, 634 (Fla. Dist. Ct. App. 1998) .

(n55)Footnote 53. See ARELLO 1996 Digest of Real Estate License Laws United States and Canada, § I, p. 42.

(n56)Footnote 54. See *Bedow v. Watkins*, 552 N.W.2d 543, 544, 547-548 (Minn. 1996) .

(n57)Footnote 55. See, e.g.,0 Fla. Stat. § 475.483(1)(c) (two-year period, but a four-year period under some circumstances).

(n58)Footnote 56. See *Dorcely v. State Dep't of Bus. & Prof'l Regulation*, 22 So. 3d 834, 836 (Fla. Dist. Ct. App. 2009) .

* Revised by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues, including licensing issues, has practiced in the areas of tax, business and probate law, and is licensed as a C.P.A. in the State of Maryland.



120 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 6 Licensing of Brokers and Salespersons *

10A-6 Real Estate Brokerage Law and Practice § 6.06

§ 6.06 State Statutes

Every state and the District of Columbia requires that real estate brokers and salespersons must be licensed. The following subsections provide citations to each state's licensing laws. Note that the requirements to receive a broker's license are more exacting than those for a salesperson's license.

[1] Alabama

Statutory provisions governing the licensing of Alabama brokers and salespersons are found at *Alabama Code §§ 34-27-1 to 37-27-88, 40-12-149, and 40-12-150*.

The Alabama Real Estate Commission may be reached at 1201 Carmichael Way, Montgomery, Alabama 36106-4350, Phone: 334-242-5544, Fax: 334-270-9118. The Alabama Real Estate Commission may be found on the Internet at <http://www.arec.alabama.gov/>.

[2] Alaska

Statutory provisions regarding the licensing of Alaska real estate brokers and salespersons are found at *Alaska Statutes §§ 08.88.011 through 08.88.990*.

The Alaska Real Estate Commission may be reached at 550 West 7th Avenue, Suite 1500, Anchorage, Alaska 99501-3567; Telephone: 907-269-8162, Fax: 907-269-1066. The Alaska Real Estate Commission may be found on the Internet at <http://www.dced.state.ak.us/occ/prec.htm>.

[3] Arizona

Statutory provisions regarding the licensing of Arizona real estate brokers and salespersons are found at *Arizona Revised Statutes Annotated §§ 32-2101 through 32-2164*.

The Arizona Department of Real Estate may be reached at 2910 North 44th Street, Suite 100, Phoenix, Arizona 85018, Phone: 602-468-1414, Customer Service Fax: 602-955-6284, Administration Division Fax: 602-468-0562. The Arizona Department of Real Estate may be found on the Internet at <http://www.re.state.az.us/>.

[4] Arkansas

Statutory provisions regarding the licensing of Arkansas real estate brokers and salespersons are found at *Arkansas Code Annotated §§ 17-42-101 through 17-42-314*.

The Arkansas Real Estate Commission may be reached at 612 South Summit Street, Little Rock, Arkansas 72201-4740, Phone: 501-683-8010, Fax: 501-683-8020. The Arkansas Real Estate Commission may be found on the Internet at <http://www.state.ar.us/arec/frmain.htm>.

[5] California

Statutory provisions regarding the licensing of California real estate brokers and salespersons are found at *California Business and Professions Code §§ 10150 through 10165*.

The California Department of Real Estate may be reached at 2201 Broadway, P.O. Box 187000, Sacramento, California 95818-7000, 916-227-0931. The California Department of Real Estate may be reached on the Internet at <http://www.dre.ca.gov/>.

[6] Colorado

Statutory provisions regarding the licensing of Colorado brokers and salespersons are found at *Colorado Revised Statutes §§ 12-61-101 through 12-61-309*.

The Department of Regulatory Agencies, Division of Real Estate may be reached at 1560 Broadway, Suite 925, Denver, Colorado 80202, Phone: 303-894-2166, Fax: 303-894-2683. The Colorado Division of Real Estate may be found on the Internet at <http://www.dora.state.co.us/real-estate/>.

[7] Connecticut

Statutory provisions governing the licensing of Connecticut real estate brokers and salespersons are found at *Connecticut General Statutes §§ 20-311 through 20-329ff*.

The Connecticut Department of Consumer Protection, Real Estate and Professional Trades Division may be reached at 165 Capitol Avenue, Room 110, Hartford, Connecticut 06106, Phone: 860-566-3290, Fax: 860-566-7630. It may be found on the Internet at <http://www.state.ct.us/dcp/>.

[8] Delaware

Statutory provisions regarding the licensing of Delaware real estate brokers and salespersons are found at Delaware Code Annotated §§ 2901 through 2929A.

The Delaware Department of Administrative Services, Division of Professional Regulation, Real Estate Commission may be reached at 861 Silver Lake Boulevard, Suite 203, P.O. Box 1401, Dover, Delaware 19903, Phone: 302-739-4522, ext. 219, Fax: 302-739-2711. It may be found on the Internet at <http://dpr.delaware.gov/boards/realestate/index.shtml>.

[9] District of Columbia

Statutory provisions regarding the licensing of District of Columbia real estate brokers and salespersons are found at *District of Columbia Code Annotated §§ 47-2853.161 through 47-2853.198*. Provisions addressing a real estate broker's duties are found at *D.C. Code Annotated §§ 42-1701 through 42-1709*.

Information on real estate licenses in the District of Columbia may be obtained from the Department of Consumer and Regulatory Affairs, Government of the District of Columbia, 941 North Capitol Street NE, Washington, DC 20002, Phone: (202) 442-4400, Fax: (202) 442-9445. It may be found on the Internet at <http://dcra.dc.gov>.

[10] Florida

Statutory provisions regarding the licensing of Florida real estate brokers and salespersons are found at *Florida Statutes Annotated §§ 475.001 through 475.5017*.

The Florida Department of Business and Professional Regulation (DBPR), Division of Real Estate, can be reached at 400 West Robinson Street, N309 (Post Office Box 1900, Zip Code 32802-1900), Orlando, Florida 32801-1772, Phone: 850-487-1395, Fax: 850-921-0038. The Florida Division of Real Estate may be found on the Internet at <http://www.state.fl.us/dbpr/re/index.shtml>.

[11] Georgia

Statutory provisions regarding the licensing of Georgia real estate brokers and salespersons are found at *Georgia Code Annotated §§ 43-40-1 to 43-40-31*.

The Georgia Real Estate Commission may be reached at Suite 1000, International Tower, 229 Peachtree Street, N.E., Atlanta, Georgia 30303-1605, Phone: 404-656-3916, Fax: 404-656-6650. The Georgia Real Estate Commission may be found on the Internet at <http://www.greab.state.ga.us/>.

[12] Hawaii

Statutory provisions regarding the licensing of Hawaii real estate brokers and salespersons are found at Hawaii Revised Statutes §§ 467.1 through 467.30.

The Hawaii Real Estate Commission may be reached at 335 Merchant Street, Room 333, Honolulu, HI 96813. Phone (808) 586-2643. It may be found on the Internet at <http://www.hawaii.gov/hirec/>.

[13] Idaho

Statutory provisions regarding the licensing of Idaho real estate brokers and salespersons are found at *Idaho Code §§ 54-2021 through 54-2097*.

The Idaho Real Estate Commission may be reached at 633 North Fourth Street, P.O. Box 83720, Boise, Idaho 83720, Phone: 208-334-3285, Fax: 208-334-2050. The Idaho Real Estate Commission may be found on the Internet at <http://www2.state.id.us/irec/>.

[14] Illinois

Statutory provisions regarding the licensing of Illinois real estate brokers and salespersons are found at Smith-Hurd Illinois Compiled Annotated §§ 455/1 through 455/34.

The Illinois Office of Banks and Real Estate may be reached at 500 East Monroe Street, Suite 200, Springfield, Illinois 62701, Phone: 217-785-3000, Fax: 217-524-5941. The Illinois Office of Banks and Real Estate may be found on the Internet at <http://www.state.il.us/obr>.

[15] Indiana

Statutory provisions regarding the licensing of Indiana real estate brokers and salespersons are found at *Indiana Code* §§ 25-34.1-1-1 through 25-34.1-7-13.

The licensing of Indiana brokers is handled by the Indiana Professional Licensing Agency, 402 West Washington Street, Room W072, Indianapolis, Indiana 46204, Phone: 317-234-3009, Fax: 317-232-2312. Web site: <http://www.in.gov/pla/bandc/estate/>.

[16] Iowa

Statutory provisions regarding Iowa real estate brokers and salespersons are found at *Iowa Code Annotated* §§ 543B.1 through 543B.55.

The Iowa Professional Licensing & Regulation Division, Real Estate Commission, 1920 SE Hulsizer Avenue, Ankeny, Iowa 50021-3941, Phone: 515-281-7393, Fax: 515-281-5910. The Iowa Real Estate Commission may be found on the Internet at <http://www.state.ia.us/government/com/prof/sales/home.html>.

[17] Kansas

Statutory provisions regarding the licensing of Kansas real estate brokers and salespersons are found beginning at *Kansas Statutes Annotated* § 58-3034.

The Kansas Real Estate Commission may be reached at Three Townsite Plaza, Suite 200, 120 SE 6th Avenue, Topeka, Kansas 66603-3511; Phone: 785-296-3411; Fax: 785-296-1771. The Kansas Real Estate Commission may be found on the Internet at <http://www.accesskansas.org/krec>.

[18] Kentucky

Statutory provisions regarding the licensing of Kentucky real estate brokers and salespersons are found at *Kentucky Revised Statutes* §§ 324.010 through 324.990.

The Kentucky Real Estate Commission may be reached at 10200 Linn Station Road, Suite 201, Louisville, Kentucky 40223, 502-425- 4273. Its toll free number is 1-888-373-3300 and its fax number is 502-426-2717. The Kentucky Real Estate Commission may be found on the Internet at <http://krec.ky.gov/index.html>.

[19] Louisiana

Statutory provisions regarding the licensing of Louisiana real estate brokers and salespersons are found at *Louisiana Revised Statutes Annotated* §§ 37:1430 through 37:1468.

The Louisiana Real Estate Commission may be reached at P.O. Box 14785, Baton Rouge, Louisiana 70898-4785 Street Address: 9071 Interline Avenue, Baton Rouge, LA 70809; Telephone: 225-925-1923, Fax: 225-925-4501, Phone: 504-925-4771, Fax: 504-925-4431. It can be reached on the Internet at <http://www.lrec.state.la.us/>.

[20] Maine

Statutory provisions regarding the licensing of Maine real estate brokers and sales agents are found at *Maine Revised Statutes Annotated* §§ 13001 through 13201.

The Maine Real Estate Commission may be reached at 35 State House Station, Augusta, Maine 04333-0035, Phone: 207-624-8603, Fax: 207-624-8637. It can be reached on the Internet at

<http://www.state.me.us/pfr/olr/categories/cat38.htm>.

[21] Maryland

Statutory provisions regarding the licensing of Maryland brokers and salespersons are found at Annotated Code of *Maryland Business Occupations and Profession §§ 17-101 through 17-614*.

The Maryland Real Estate Commission may be reached at 500 N. Calvert Street, Baltimore, Maryland 21202-2272, Phone: 410-230-6230, Toll-free 1-888-218-5925, Fax: 410-333-0851. The Maryland Real Estate Commission may be found on the Internet at <http://www.dllr.state.md.us/license/occprof/recomm.html>.

[22] Massachusetts

Statutory provisions regarding the licensing of Massachusetts real estate brokers and salespersons are found at Massachusetts General Laws chapter 112, §§ 87P through 87DDD.

The Massachusetts Division of Professional Licensure, Real Estate Board may be reached at 239 Causeway Street, Suite 500, Boston, Massachusetts 02114; Phone: 617-727-2373; Fax: 617-727-2669. The Real Estate Board may be found on the Internet at <http://www.state.ma.us/reg>.

[23] Michigan

Statutory provisions regarding the licensing of Michigan real estate brokers and salespersons are found at *Michigan Compiled Laws §§ 339.2501 through 339.2515*.

The regulatory agency is the Department of Energy, Labor & Economic Growth, Michigan State Board of Real Estate Brokers & Salespersons, 2501 Woodlake Circle, Okemos, Michigan 48865; Telephone: 517-373-7353; Fax: 517-373-1044; Website: www.michigan.gov/realestate.

[24] Minnesota

Statutory provisions regarding the licensing of Minnesota real estate brokers and salespersons are found at *Minnesota Statutes Annotated §§ 82.17 through 82.34*.

The Minnesota Department of Commerce may be reached at 85 7th Place East, St. Paul MN 55101, Phone: 651-296-6319. The Minnesota Department of Commerce may be found online at <http://www.state.mn.us/> (click on "more" under licensing and forms and then click on "Department of Commerce License Lookup").

[25] Mississippi

Statutory provisions regarding the licensing of Mississippi real estate brokers and salespersons are found at *Mississippi Code Annotated §§ 73-35-1 through 73-35-35*.

The Mississippi Real Estate Commission may be reached at Post Office Box 12685, Jackson, Mississippi 39236 (Street address: 2506 Lakeland Drive, Suite 300, Jackson, MS 39232); Phone: 601-932-9191; Fax: 601-932-2990. It may be found on the Internet at <http://www.mrec.state.ms.us/>.

[26] Missouri

Statutory provisions regarding the licensing of Missouri real estate brokers and agents are found at Annotated Missouri Statutes §§ 339.010 through 339.617.

The Missouri Real Estate Commission may be reached at 3605 Missouri Boulevard, P.O. Box 1339, Jefferson City, Missouri 65102-1339, Phone: 573-751-2628, Fax: 573-751-2777. It may be found on the Internet at <http://pr.mo.gov/realestate.asp>.

[27] Montana

Statutory provisions regarding the licensing of Montana real estate brokers and salespersons are found at *Montana Code Annotated §§ 37-51-102 through 37-51-608*.

The Montana Board of Realty Regulation may be reached at Post Office Box 200513, 301 South Park Avenue, Helena, Montana 59620-0513, Phone: 406-444-2961; Fax: 406-841-2323. The Montana Board of Realty Regulation may be found on the Internet at Website: <http://mt.gov/>.

[28] Nebraska

Statutory provisions regarding the licensing of Nebraska real estate brokers and salespersons are found at Nebraska Rev. Stat. §§ 81-855.01 through 81-887.03.

The Nebraska Real Estate Commission may be reached at 1200 N. Street, Suite 402, P.O. Box 94667, Lincoln, Nebraska 68509-4667, Phone: 402-471-4492, Fax: 402-471-4492. It may be found on the Internet at <http://www.nrec.state.ne.us/>.

[29] Nevada

Statutory provisions regarding the licensing of Nevada real estate brokers and salespersons are found at *Nevada Revised Statutes §§ 645.0005 through 645.440*.

The Nevada Department of Business & Industry, Real Estate Division may be reached at 2501 E. Sahara Ave., Suite 102, Las Vegas, Nevada 89104-4137; Phone: 702-486-4033; Fax: 702-486-4275. The Real Estate Division may be found on the Internet at <http://www.red.state.nv.us/>.

[30] New Hampshire

Statutory provisions regarding the licensing of New Hampshire real estate brokers and salespersons are found at *New Hampshire Revised Statutes Annotated §§ 331-A:1 through 331-A:35*.

The New Hampshire Real Estate Commission may be reached at State House Annex, Room 434, 25 Capitol Street, Concord, New Hampshire 03301, 603-271-2701. It may be found on the Internet at <http://www.state.nh.us/nhrec/>.

[31] New Jersey

Statutory provisions regarding the licensing of New Jersey real estate brokers and salespersons are found at *New Jersey Revised Statutes §§ 45:15-1 through 45:15-29.2*.

The New Jersey Real Estate Commission may be reached at 20 West State Street, CN-328, Trenton, New Jersey 08625, 609-292-8280, Fax: 609-292-0944. It may be found on the Internet at <http://www.nj.gov/dobi/remnu.shtml>.

[32] New Mexico

Statutory provisions regarding the licensing of New Mexico real estate brokers and salespersons are found at *New*

Mexico Statutes Annotated §§ 61-29-1 to 61-29-29.

The New Mexico Real Estate Commission may be reached at 5200 Oakland Ave. NE Albuquerque, NM 87113; Phone: 505-222-9820; Fax: 505-222-9886. The New Mexico Real Estate Commission may be found on the Internet at <http://www.rld.state.nm.us/RealEstateCommission/>.

[33] New York

Statutory provisions regarding the licensing of New York real estate brokers and salespersons are found at *New York Real Property Law § 440 et seq.*

The New York Division of Licensing may be reached at Street Address: Alfred E. Smith Office Building, 80 S. Swan Street, 10th Floor, Albany, NY 12210; Mailing Address: P.O. Box 22001, Albany, NY 12201-2001; Phone: 518-474-4429; Fax: 518-473-6648. It may be found on the Internet at <http://www.dos.state.ny.us/lcns/licensing.html>.

[34] North Carolina

Statutory provisions regarding the licensing of North Carolina real estate brokers and salespersons are found at *North Carolina General Statutes §§ 93A-1 through 93A-59.*

The North Carolina Real Estate Commission may be reached at P.O. Box 17100, Raleigh, North Carolina 27619-7100, 919-733-9580. It may be found on the Internet at <http://www.ncrec.state.nc.us/default.asp>.

[35] North Dakota

The statutory provisions regarding the licensing of North Dakota real estate brokers and salespersons are found at *North Dakota Century Code §§ 43-23-02 through 43-23-18.*

The North Dakota Real Estate Commission may be reached at Mailing address: P.O. Box 727, Bismarck ND 58502-0727; 200 East Main Avenue, Suite 204, 727, Bismarck, ND 58502-0727, 701-328-9749, Fax: 701-328-9751. It may be found on the Internet at <http://www.realestatend.org/>.

[36] Ohio

The statutory provisions regarding the licensing of Ohio real estate brokers and salespersons are found at *Ohio Revised Code Annotated §§ 4735.01 through 4735.99.*

The Ohio Division of Real Estate may be reached at 77 South High Street, 20th Floor, Columbus, Ohio 43266-0547, 614-466-4100, Fax: 614-644-0584. It may be found on the Internet at <http://www.com.ohio.gov/real/>.

[37] Oklahoma

Statutory provisions regarding the licensing of Oklahoma real estate brokers and real estate sales associates are found at Oklahoma Statutes §§ 858-101 through 858-604.

The Oklahoma Real Estate Commission may be reached at *Shepherd Mall, 2401 N.W. 23rd*, Suite 18, Oklahoma City, Oklahoma 73107, Phone: 405-521-3387; Fax: 405-521-2189. It may be found on the Internet at <http://www.orec.state.ok.us/>.

[38] Oregon

Statutory provisions regarding the licensing of Oregon real estate brokers and salespersons are found at *Oregon Revised Statutes § 696.007 et seq.*

The Oregon Real Estate Agency may be reached at 1177 Center Street, N.E., Salem, Oregon 97310-2503, 503-378-3256, Fax: 503-378-2491. It may be found on the Internet at <http://www.rea.state.or.us/>.

[39] Pennsylvania

Statutory provisions regarding the licensing of Pennsylvania real estate brokers and salespersons are found at Pennsylvania Consolidated Statutes §§ 455.101 through 455.902.

The Pennsylvania Real Estate Commission may be reached at P.O. Box 2649, Harrisburg, Pennsylvania 17105-2649, Phone: 717-783-3658, Fax: 717-787-0250. It may be found on the Internet at www.dos.state.pa.us/estate.

[40] Rhode Island

Statutory provisions regarding the licensing of Rhode Island real estate brokers and salespersons are found at *Rhode Island General Laws §§ 5-20.5-1 through 5-20.5-25.*

The Rhode Island Department of Business Regulation, Division of Commercial Licensing and Regulation, Real Estate may be reached at 1511 Pontiac Avenue, Cranston, RI 02920, Telephone: 401-462-9500; Fax: 401-462-9532. It may be found on the Internet at <http://www.dbr.state.ri.us/>.

[41] South Carolina

Statutory provisions regarding the licensing of South Carolina real estate brokers and salespersons are found at *South Carolina Code Annotated §§ 40-57-10 through 40-57-240.*

The South Carolina Real Estate Commission may be reached at Kroger Office Park, Kingtree Building, 110 Centerview Drive, Suite 201, Columbia, South Carolina 29210. Its mailing address is P.O. Box 11847, Columbia, South Carolina 29211-1847. Its telephone numbers are: Voice: 803-896-4400, Fax: 803-896-4404. It may be found on the Internet at <http://www.llronline.com/POL/REC/>.

[42] South Dakota

Statutory provisions regarding the licensing of South Dakota real estate brokers and salespersons are found at *South Dakota Codified Laws §§ 36-21A-1 through 36-21A-123.*

The South Dakota Real Estate Commission may be reached at 221 W. Capitol Suite 101, Pierre, South Dakota 57501; Phone: 605-773-3600; Fax: 605-773-4356. The South Dakota Real Estate Commission may be found on the Internet at <http://www.state.sd.us/sdrec/>.

[43] Tennessee

Statutory provisions regarding the licensing of Tennessee real estate brokers and *Tennessee Code Annotated §§ 63-13-101 through 63-13-408.*

The Tennessee Real Estate Commission may be reached at 500 James Robertson Parkway, Suite 180, Volunteer Plaza, Nashville, Tennessee 37243-1151, 615-741-2273, Fax: 615-741-0313. It may be found on the Internet at <http://www.state.tn.us/commerce/boards/trec/index.html>.

[44] Texas

Statutory provisions regarding the licensing of Texas real estate brokers and salespersons are found at *Texas Occupations Code § 1101.001, et seq.*

The Texas Real Commission may be reached at P.O. Box 12188, Austin, Texas 78711-2188, 512-459-6544, Toll-free: 800-250-TREC (8732), Fax: 512-465-3910. Its street address is 1101 Camino La Costa, Austin, Texas 78752. The Texas Real Estate Commission may be found on the Internet at <http://www.trec.state.tx.us>.

[45] Utah

Statutory provisions regarding the licensing of Utah real estate brokers and sales agents are found at *Utah Code Annotated §§ 61-2-1 through 61-2-22.*

The Utah Division of Real Estate may be reached at Post Office Box 146711, Salt Lake City, Utah 84114-6711 (Street address: *Heber M. Wells Building, 160 East 300 South, 2nd Floor*, Salt Lake City, UT 84111), Phone: 801-530-6747, Fax: 801-530-6749. The Utah Division of Real Estate may be found on the Internet at <http://www.commerce.utah.gov/dre/>.

[46] Vermont

Statutory provisions regarding the licensing of Vermont real estate brokers and salespersons are found at *Vermont Statutes Annotated tit. 26, §§ 2211 through 2299.*

The Vermont Real Estate Commission may be reached at Vermont Real Estate Commission, Office of Professional Regulation, National Life Building, North FL2, Montpelier, VT 05620-3402; 802-828-3228, Fax: 802-828-2368. The Vermont Real Estate Commission may be found on the Internet at http://www.vtprofessionals.org/opr1/real_estate/.

[47] Virginia

Statutory provisions regarding the licensing of Virginia real estate brokers and sales persons are found at *Virginia Code Annotated §§ 54.1-2100 through 54.1-2141.*

The Virginia Department of Professional and Occupational Regulation may be reached at 9960 Mayland Drive, Suite 400, Richmond, Virginia 23233, Phone: 804-367-8500 or 804-367-8552, Fax: 804-527-4298. It may be found on the Internet at <http://www.state.va.us/dpor/>.

[48] Washington

Statutory provisions regarding the licensing of Washington real estate brokers and salespersons are found at *Washington Revised Code §§ 18.85.010 through 18.85.920.*

The Washington Real Estate Program of the Department of Licensing--Business and Professions Division may be reached at P.O. Box 9015, Olympia, Washington 98507, 360-586-6101, Fax: 360-586-0998. It may be found on the Internet at <http://www.dol.wa.gov/business/realestate/index.html>.

[49] West Virginia

Statutory provisions regarding the licensing of West Virginia real estate brokers and salespersons are found at *West Virginia Code §§ 47-12-1 through 47-12-23.*

The West Virginia Real Estate Commission may be reached at 300 Capitol Street, Suite 400, Charleston, West Virginia 25301; Phone: 304-558-3555, Fax: 304-558-6442. It may be found on the Internet at <http://www.wvrec.org/>.

[50] Wisconsin

Statutory provisions regarding the licensing of Wisconsin real estate brokers and salespersons are found at *Wisconsin Statutes §§ 452.01 through 452.23*.

The Wisconsin Department of Regulation and Licensing may be reached at P.O. Box 8935, Madison, WI 53708-8935 (Street address: 1400 E. Washington Avenue, Madison Wisconsin 53703); Telephone: 608-266-2112; Fax: 608-261-7083. It may be found on the Internet at <http://drl.wi.gov>.

[51] Wyoming

Statutory provisions regarding the licensing of real estate brokers and salespersons are found at *Wyoming Statutes §§ 33-28-101 through 33-28-206*. Wyoming's real estate brokerage laws were amended effective July 1, 2009. n57

The Wyoming Real Estate Commission may be reached at 2020 Carey Avenue, Suite 720, Cheyenne, Wyoming 82002-0180, 307-777-7141, Fax: 307-777-3796. The Wyoming Real Estate Commission may be reached on the Internet at <http://realestate.state.wy.us/>.

FOOTNOTES:

(n1)Footnote 57. 2009 Wy. ALS 20; 2009 Wyo. Sess. Laws 20; 2009 Wy. Ch. 20; 2009 Wy. SF 110; 2009 Wy. EA 12.

* Revised by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues, including licensing issues, has practiced in the areas of tax, business and probate law, and is licensed as a C.P.A. in the State of Maryland.



121 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 6 Licensing of Brokers and Salespersons *

10A-6 Real Estate Brokerage Law and Practice § 6.07

§ 6.07 Mortgage Foreclosure Consultants

[1] Regulation of Mortgage Foreclosure Consultants

The term "mortgage fraud" encompasses a wide variety of fraudulent behaviors intended to victimize lenders and/or borrowers. One particular type of mortgage fraud involves unscrupulous individuals who seek out homeowners facing foreclosure and offer to "help" such a homeowner out of his or her financial predicament. Often homeowners who agree to accept such "help" are unsophisticated and lower income. Instead of helping the homeowner, the individual often dupes the homeowner into conveying his or her home to the individual. The perpetrator then strips the home of its equity through a loan, or charges the homeowner rent with the promise that the perpetrator will pay the underlying mortgage. Instead, the perpetrator walks away with the cash and leaves the homeowner facing foreclosure and eviction.

The increase of mortgage fraud by mortgage foreclosure consultants has resulted in a minority of states enacting laws regulating this activity. n1 Mortgage foreclosure consultant laws vary, but states that regulate these individuals legislatively are seeking to lessen the chance that a financially strapped homeowner will enter into an imprudent loan or be taken advantage of by an unscrupulous individual.

Mortgage foreclosure consultant laws typically provide the homeowner with statutory rights to cancel or rescind a contract entered into with a consultant. These laws require that specific statutory notices be provided to the homeowner. Typically, consultants cannot take a security interests or wage assignments from the homeowner or receive compensation from a third party.

Readers wanting to learn more about mortgage fraud and the regulation of mortgage foreclosure consultants are directed to Chapter 5A of Real Estate Financing (LexisNexis 2009).

[2] California Mortgage Foreclosure Consultants Act

"Mortgage foreclosure consultants" are defined by California law as:

any person who makes any solicitation, representation, or offer to any owner to perform for compensation, or who, for compensation, performs any service which the person in any manner represents will in any manner do any of the following:

- (1) Stop or postpone the foreclosure sale.
- (2) Obtain any forbearance from any beneficiary or mortgagee.
- (3) Assist the owner to exercise the right of reinstatement provided in Section 2924c.
- (4) Obtain any extension of the period within which the owner may reinstate his or her obligation.
- (5) Obtain any waiver of an acceleration clause contained in any promissory note or contract secured by a deed of trust or mortgage on a residence in foreclosure or contained that deed of trust or mortgage.
- (6) Assist the owner to obtain a loan or advance of funds.
- (7) Avoid or ameliorate the impairment of the owner's credit resulting from the recording of a notice of default or the conduct of a foreclosure sale.
- (8) Save the owner's residence from foreclosure. n2
- (9) Assist the owner in obtaining from the beneficiary, mortgagee, trustee under a power of sale, or counsel for the beneficiary, mortgagee, or trustee, the remaining proceeds from the foreclosure sale of the owner's residence.

The conduct of such consultants is limited in California by the Mortgage Consultant Foreclosure Act. n3 *California Civ. Code* § 2945(a) states the purpose of this act as follows:

The Legislature finds and declares that homeowners whose residences are in foreclosure are subject to fraud, deception, harassment, and unfair dealing by foreclosure consultants from the time a Notice of Default is recorded ... until the time of the foreclosure sale. Foreclosure consultants represent that they can assist homeowners who have defaulted on obligations secured by their residences. These foreclosure consultants, however, often charge high fees, the payment of which is often secured by a deed of trust on the residence to be saved, and perform no services or essentially a worthless service. Homeowners, relying on the foreclosure consultants' promises of help, take no other action, are diverted from lawful businesses which could render beneficial services, and often lose their homes, sometimes to the foreclosure consultants who purchase homes at a fraction of their value before the sale.

Real estate brokers are exempt from this act, when with their own funds, they make direct loans to homeowners secured by a deed of trust on the property. n4 However, brokers who make a direct loan must in good faith attempt to assign the loan to a lender rather than foreclose upon the property. The lending broker may not acquire any interest in the property directly from the owner other than as a beneficiary under a deed of trust. n5

Penalties for violating this act are severe, as illustrated by *Onofrio v. Rice*. n6 In that case, Onofrio, a homeowner, was in serious financial difficulty. Her home was in foreclosure and she was in bankruptcy. She was not only delinquent on the first and second mortgages, but was also delinquent in her community association dues. Onofrio was working with an individual to obtain new financing. A broker named Marshall Rice (Marshall) approached Onofrio and told her that he knew the individual with whom she was working and he believed that this other party did not know what she was doing. Marshall persuaded Onofrio to work with him instead.

Marshall subsequently prepared a promissory note and a deed of trust indicating that his spouse, Myra Rice (Myra), would lend Onofrio \$14,000. The accompanying disclosure statement indicated a 35% per year interest rate. The \$14,000 was insufficient, so Marshall prepared an identical note and trust deed, except that the amount was now \$21,000. The escrow statement acknowledged: "Marshall D. Rice is a licensed Real Estate Broker in the State of California and is acting as the BROKER and the escrow company in this transaction. No escrow fee is charged." n7

Marshall was required to produce a settlement statement within 24 hours, however he did not do so until 6 days later.

Onofrio's financial affairs did not improve and the Rices recorded a notice of default and election to sell under Myra's deed of trust. The Rices had purchased the second deed of trust. They subsequently recorded an assignment of deed of trust from the second lienholder, and bought the property at the foreclosure sale conducted pursuant to Myra's notice of default. The Rices later recorded a trustee's deed upon sale acknowledging that they owned the property. Onofrio sued, alleging federal truth in lending violations, and violations of Marshall's duties as a real estate broker and foreclosure consultant. The trial court dismissed the federal truth in lending actions, but the Rices did not fare so well with Onofrio's other claims. Onofrio claimed violations of the statutory provisions regarding real estate brokers and foreclosure consultants. The court entered judgment against the Rices awarding \$230,097 in damages and \$52,788 in attorneys fees and costs. The trial court also rescinded the foreclosure and voided the Rices' note and purchase of the second deed of trust. This judgment was affirmed.

Marshall contended that he could not be in violation of both the statutory provisions regarding foreclosure consultants and those provisions regarding real estate brokers. The court disagreed. Pursuant to *California Business and Professions Code § 10131(d)*, a real estate broker was defined as including one who negotiated loans or performed services for borrowers in connection with loans secured directly or collaterally by liens on real property. Marshall had secured a loan for which he was entitled to compensation. Marshall acquired an interest in a residence directly from the foreclosure when it was his spouse, not he, who loaned the home owner the money. Even if the funds had come from Marshall, he was in violation of the real estate broker laws as he had not attempted to place the loan. The court quoted from the Senate Judiciary Committee in its original analysis of the senate bill which warned of just the conduct in which Marshall had engaged. The court stated:

Many homeowners who have found themselves in default on their home mortgage payments have actually lost their homes through deceptive loans made to them by unscrupulous business [people.] [P] These "loans" usually require the homeowner in default to convey, via a Trust Deed, the homeowner's interest in his [or her] home (i.e. [] equity) in exchange for the payment of the full amount of the regular mortgage arrearage. The loans are usually written with high finance charges, and the payments become difficult for the homeowner to make. [P] As soon as the homeowner defaults on the second loan, the money lender, or a third party to whom the Trust Deed had been conveyed in the meantime, attempts to evict the homeowner out of his [or her] home. n8

The court also stated that the purpose of this statutory scheme was to prevent exactly the type of conduct in which Marshall and his spouse engaged.

Marshall objected to the computation of damages. At trial, the court determined that the home owner's actual damages were \$65,174, the difference between what Marshall and his spouse paid for the property at foreclosure and the property's market value at that time. In essence, the Rices' unbegotten gain was considered to be the home owner's lost equity. Marshall argued that this computation made no sense, as it disregarded their three years of payments on the property liens, as well as the money they loaned. Moreover, the property was returned to the home owners and the second and third notes and deeds of trust were canceled. The appellate court found that the damage award made "perfect sense" in the context of the statutory provisions. n9 It stated that the violations were cumulative and that the Legislature intended that the remedies were to be construed liberally. The Legislature also intended that any real property lien received by a foreclosure consultant was to be voidable and unenforceable. This court discussed the damages in the context of constructive fraud and found that the appropriate measure of damages was the benefit of the bargain. Since Marshall breached his fiduciary obligation to the home owner, she was to be compensated accordingly.

FOOTNOTES:

(n1)Footnote 1. See:

California: Cal. Civ. Code § 2945, et seq .

Colorado: Colo. Rev. Stat. § 6-1-1101, et seq .

Illinois: 765 Ill. Comp. Stat. 940/1, et seq .

Maryland: Md. Code Ann., Real Prop. § 7-301, et seq .

Minnesota: Minn. Stat. § 325N.01, et seq.

Missouri: Mo. Rev. Stat. § 407.935, et seq.

Rhode Island: R.I. Gen. Laws § 5-79-1, et seq .

Tennessee: Tenn. Code Ann. § 45-20-110, et seq .

Washington: Wash. Rev. Code § 61.34.010, et seq.

(n2)Footnote 2. *Cal. Civ. Code § 2945.1.*

(n3)Footnote 3. *Cal. Civ. Code § 2945 et seq.*

(n4)Footnote 4. *Cal. Civ. Code § 2945.1(b)(3). See Still v. Arakelyan (In re Still) 393 B.R. 896, 911-12 (Bankr. C.D. Cal. 2008) .*

(n5)Footnote 5. *Cal. Civ. Code § 2945.1(b)(3).*

(n6)Footnote 6. *55 Cal. App. 4th 413, 64 Cal. Rptr. 2d 74 (1997) , review denied, 1997 Cal. LEXIS 5129 (Aug. 13, 1997) .*

(n7)Footnote 7. *64 Cal. Rptr. 2d at 76 .*

(n8)Footnote 8. *64 Cal. Rptr. 2d at 78 .*

(n9)Footnote 9. *64 Cal. Rptr. 2d at 79 .*

* Revised by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues, including licensing issues, has practiced in the areas of tax, business and probate law, and is licensed as a C.P.A. in the State of Maryland.



122 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 6 Licensing of Brokers and Salespersons *

10A-6 Real Estate Brokerage Law and Practice § 6.08

§ 6.08 Film Location Representatives

California Civil Code § 10133.4 provides that persons acting in the capacity of a film location representative need not be licensed as a real estate broker. This provision defines a film location representative as "an employee of a principal arranging for the use of real property for photographic purposes." n1 A principal is the person who will use the real property for photographic purposes. n2 In every transaction arranged by a film location representative, the principal must maintain liability insurance in an amount not less than five hundred thousand dollars per person or one million dollars per occurrence for personal injury, and five hundred thousand dollars for property damage. n3

FOOTNOTES:

(n1)Footnote 1. *Cal. Bus. & Prof. Code § 10133.4(b)(1)*.

(n2)Footnote 2. *Cal. Bus. & Prof. Code § 10133.4(b)(2)*.

(n3)Footnote 3. *Cal. Bus. & Prof. Code § 10133.4(c)*.

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123 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 6 Licensing of Brokers and Salespersons *

10A-6 Real Estate Brokerage Law and Practice § 6.09

§ 6.09 Apartment Information Vendors and Apartment Sharing Agents

New York requires the licensure of apartment information vendors and apartment sharing agents. n1 An apartment information vendor is defined as a person who engages "in the business of claiming, demanding, charging, receiving, collecting, or contracting for the collection of, a fee from a customer for furnishing information concerning the location and availability of real property, including apartment housing, which may be leased, rented, shared or sublet as a private dwelling, abode, or place of residence." n2 The definition of an apartment information vendor also includes an "apartment sharing agent" which is defined as a person who, for a fee, arranges, conducts, coordinates, handles or causes meetings between a customer and the current owner or occupant of legally occupied real property, including apartment housing, who wishes to share that housing with one or more individuals as a private dwelling, abode or place of residence" n3 The licensing of apartment information vendors is intended to prevent fraudulent advertising practices and breach of contract resulting from sales of rental listings that contain non-existent or unavailable apartments. n4 This law has withstood a constitutional challenge. n5

Among the requirements imposed upon apartment information vendors, a licensed apartment information vendor licensed must furnish customers with a contract prepared on a form approved by the New York Secretary of State. The contract must include in plain language form a statement showing the sources of information concerning the location and availability of real property. n6 A failure to include this information in plain language form constitutes grounds for license suspension. n7

Being licensed as a real estate broker does not entitle an individual to function as an apartment information vendor. One licensed broker who continued to function as an apartment information vendor without obtaining this specific license despite repeated warnings from the New York Department of State had her broker's license suspended on the ground that her defiance and refusal to obtain the proper license showed an untrustworthiness within the meaning of *New York Real Property Law § 441-c(1)*. n8

FOOTNOTES:

(n1)Footnote 1. *N.Y. Real Prop. Law § 446-b*.

(n2)Footnote 2. *N.Y. Real Prop. Law § 446-a(2)*.

(n3)Footnote 3. *N.Y. Real Prop. Law § 446-a(2)*. The term apartment sharing agent does not apply to any person

who for another and for a fee, commission or other valuable consideration, supervises, organizes, arranges, coordinates, handles or is otherwise in charge of or responsible for the relocation of commercial or residential tenants from buildings or structures that are to be demolished, rehabilitated, remodeled or otherwise structurally altered.

(n4)Footnote 4. *See Wang v. Pataki*, 396 F. Supp. 2d 446, 451 (S.D.N.Y. 2005) . The court observed that prior to amendment of this law, apartment information vendors had been referred to as "apartment referral agents."

(n5)Footnote 5. *See Wang v. Pataki*, 396 F. Supp. 2d 446, 455-459 (S.D.N.Y. 2005) .

(n6)Footnote 6. *See New York Real Prop. § 446-c(1)*.

(n7)Footnote 7. *See New York Real Prop. § 446-c(1-a)*.

(n8)Footnote 8. *See Lan Lan Wang v. Daniels*, 305 A.D.2d 186, 187, 757 N.Y.S.2d 857 (N.Y. App. Div. 2003) , *appeal denied*, 100 N.Y.2d 511, 766 N.Y.S.2d 165, 798 N.E.2d 349 (N.Y. 2003) , *cert. denied*, 124 S. Ct. 1417, 158 L. Ed. 2d 83, 2004 U.S. LEXIS 1086, 72 U.S.L.W. 3535 (U.S. 2004) .

* Revised by Sandra R. Bullington. Ms. Bullington, a member of the Maryland Bar, has written on a variety of real estate issues, including licensing issues, has practiced in the areas of tax, business and probate law, and is licensed as a C.P.A. in the State of Maryland.



124 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 7 The Real Estate Broker and the Unauthorized Practice of Law *

10A-7 Real Estate Brokerage Law and Practice 7.syn

§ 7.syn Synopsis to Chapter 7: The Real Estate Broker and the Unauthorized Practice of Law *

§ 7.01 Introduction

§ 7.02 Broker Authority in Relation to Real Estate Documents

§ 7.03 Policy Decisions

§ 7.04 The Regulation of Real Estate Brokers: Selected Approaches

§ 7.05 Realtor(R) Code of Ethics and the Model Definition of the Practice of Law

§ 7.06 The Role of Paralegals and Legal Technicians

§ 7.07 Conclusion



125 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 7 The Real Estate Broker and the Unauthorized Practice of Law *

10A-7 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 7 discusses the unauthorized practice of law by real estate brokers and examines the issues that arise because of a broker's involvement with sales contracts and other legal documents.

Section 7.02 discusses significant case law and statutory law concerning brokers and the unauthorized practice of law. The policy arguments given by those in the legal and brokerage industries to support their respective positions on the authority that should be granted to brokers are discussed in § 7.03, and the various approaches adopted by different states are discussed in § 7.04. The issue of the unauthorized practice of law by brokers has resulted in some conflict between the legal profession and brokers. This conflict resulted in the issuance of a joint statement by the American Bar Association and the National Association of Realtors(R), discussed in § 7.05. Section 7.06 addresses the expanding role of paralegals and other legal technicians in the real estate brokerage industry.



126 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 7 The Real Estate Broker and the Unauthorized Practice of Law *

10A-7 Real Estate Brokerage Law and Practice § 7.01

§ 7.01 Introduction

A myriad of non-lawyer professionals have come under fire from members of the legal profession who have accused these professionals of the "unauthorized practice of law." Among those targeted have been accountants, architects, bankers, collection agents, insurance brokers, title insurance companies, and, the subject of this treatise, real estate brokers. A precise definition of what constitutes the practice of law is elusive and varies from state to state.

Real estate brokers may run the risk of unauthorized practice not only through involvement in court proceedings, but also through the advising of clients, or through the preparation of contracts or deeds or any other instrument by which legal rights are secured. n1 In some instances, courts have considered the preparation of documents by a realtor to be the "practice of law," but have not prohibited such activity. n2 The Supreme Court of Washington, for example, has held that the completion by a licensed real estate broker or salesperson of a standard form earnest money agreement was not prohibited in spite of the fact that such activities constituted the "practice of law." n3 The court found "sound and practical reasons why some activities that fall within the broad definition of 'the practice of law' should not be unauthorized simply because they are done by lay persons." n4 Absolute attorney hegemony over the practice of law is not necessary to protect the public, stated the court. "It is in the public interest to permit licensed real estate brokers or salespersons to complete lawyer-prepared standard form agreements, provided that in doing so they comply with the standard of care demanded of an attorney." n5

Judicial decisions on the unauthorized practice of law have been consistent in at least one respect: agreement that the purpose of the prohibition against unauthorized practice is not for the benefit of attorneys but for the protection and benefit of the public. n6 Control of the practice of law has generally been attempted through statutory enactments, decisional law and various combinations of the two. A real estate broker in one state may be permitted to prepare virtually all kinds of documents relating to a sale, while in another state may be permitted to prepare almost no documents at all. The broker may be given the right in one state to draft a document from scratch, while in another state may be permitted only to fill in the blanks of a previously prepared document. n7 Accordingly, a broker must be aware of the restriction on: (1) the *kind* of document he may deal in: *i.e.*, preliminary or post-contract; and (2) the *extent* to which he may prepare the instrument: *i.e.*, drafting or merely filling in the blanks.

It should be noted that brokers and agents who engage in the unauthorized practice of law run the risk of statutory treble damages in some jurisdictions. This risk is greater if the broker or agent charges a separate fee for the legal services. n8

This chapter explores the current law on unauthorized practice applicable to real estate brokersⁿ⁹ as well as the rationale behind such law. ⁿ¹⁰ Also examined are the approaches adopted by various jurisdictions for controlling the unauthorized practice of law by real estate brokersⁿ¹¹ and the use of lawyer-broker accords designed to reach agreement between attorneys and brokers on the proper role of these parties in a real estate transaction. ⁿ¹² The impact of the growing use of "paralegals" and "legal technicians" on what tasks non-lawyers may legally perform is also explored. ⁿ¹³

FOOTNOTES:

(n1)Footnote 1. *See, e.g.:*

Kentucky: Howton v. Morrow, 269 Ky. 1, 106 S.W.2d 81 (1937) .

Missouri: Bray v. Brooks, 41 S.W.3d 7, 13-14 (2001) .

Utah: Malia v. Giles, 100 Utah 562, 114 P.2d 208 (1941) .

(n2)Footnote 2. *See, e.g.:*

Colorado: Conway-Bogue Realty Inv. Co. v. Denver Bar Ass'n, 135 Colo. 398, 312 P.2d 998 (1957) .

Wisconsin: State ex rel. Reynolds v. Dinger, 14 Wis. 2d 193, 109 N.W.2d 685 (1961) .

(n3)Footnote 3. *Cultum v. Heritage House Realtors, Inc.*, 103 Wash. 2d 623, 694 P.2d 630 (1985) .

(n4)Footnote 4. 694 P.2d at 633 .

(n5)Footnote 5. *Id.*

(n6)Footnote 6. *See Dacey v. New York County Lawyers Ass'n*, 290 F. Supp. 835 (S.D.N.Y. 1968) , *aff'd*, 423 F.2d 188 (2d Cir. 1969) , *cert. denied*, 398 U.S. 929, 90 S. Ct. 1819, 26 L. Ed. 2d 92 (1970) .

(n7)Footnote 7. *Cf. Sims v. Century 21 Capital Team, Inc.*, 2006 Tex. App. LEXIS 7990, at *6 (Sept. 7, 2006) (A licensee must use Texas Real Estate Commission form contracts in most transactions pursuant to 22 Tex. Admin. Code § 537.11(b). The licensee is prohibited from giving advice or opinions as to the legal effect of any of the form contract's provisions.).

(n8)Footnote 8. *Cf. Bray v. Brooks*, 2001 Mo. App. LEXIS 14 (Mo. App. Jan. 9, 2001) (the court reversed the trial court's award of treble damages \$22,800 against a broker found to have engaged in the unauthorized practice of law).

(n9)Footnote 9. *See* § 7.02 *infra*.

(n10)Footnote 10. *See* § 7.03 *infra*.

(n11)Footnote 11. *See* § 7.04 *infra*.

(n12)Footnote 12. *See* § 7.05 *infra*.

(n13)Footnote 13. *See* § 7.06 *infra*.

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127 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 7 The Real Estate Broker and the Unauthorized Practice of Law *

10A-7 Real Estate Brokerage Law and Practice § 7.02

§ 7.02 Broker Authority in Relation to Real Estate Documents

A non-attorney is clearly engaged in the unauthorized practice of law where he holds himself out as an attorney without having first been duly and regularly licensed and admitted to practice law. n1 Moreover, unauthorized practice will be found where a non-attorney counsels or advises a client as to matters which require the use of legal skills and which will secure the client's legal rights. n2 In a number of jurisdictions, statutory provisions award exclusive authority to attorneys to prepare "legal documents," n3 although it should be noted that most courts have not interpreted these statutes to forbid preparation by non-attorneys of such documents as earnest money contracts. In every state except North Carolina the bar association may enforce unauthorized practice prohibitions, n4 and the majority of the states have unauthorized practice committees. Informal enforcement activities undertaken by bar associations and unauthorized practice committees include issuance of cease and desist letters, negotiation of informal compliance agreements, and issuance of advisory opinions. n5 Formal penalties for violation of unauthorized practice prohibitions vary widely. Thirty-seven states make a violation a misdemeanor, n6 while some states treat it as contempt. n7 Probably the most frequently provided judicial remedy is injunctive relief. n8

Article 17 of the National Association of Realtors Code of Ethics provides that a realtor "shall not engage in activities that constitute the unauthorized practice of law and shall recommend that legal counsel be obtained when the interest of any party to the transaction requires it." n9 Courts have held that state licensing agencies may discipline brokers who have engaged in the unauthorized practice of law where adequate evidence of such practice is presented. n10

Although the bulk of authority dealing with the unauthorized practice of law by real estate brokers consists of case law, there are a number of statutes that explicitly refer to real estate brokers and outline their rights. Minnesota's statute, for example, allows a broker to draw papers incident to a sale, trade, lease or loan of property. n11 In Utah, it is provided by statute that brokers may "fill out any documents associated with the closing of a real estate transaction," while sales agents may fill out forms (1) prepared by buyer's or seller's legal counsel, or (2) approved by specified state agencies or, (3) where a necessary form has not been so approved, by any legal counsel. n12 Important to keep in mind, is that even where a broker derives explicit rights by statute, the statute may be struck down by a court as invading the province of the judiciary. n13

The amount of freedom allowed to brokers in the various phases of a real estate transaction to draft documents or to fill in blanks varies greatly from jurisdiction to jurisdiction. Even the most restrictive jurisdictions allow brokers to draft or

prepare their own listing agreements. A party to a contract always has the right to draft or complete the instrument that embodies the underlying agreement. n14 The mere filling in of blanks on an offer and acceptance form also seems to be lawful, or at least to be tolerated, virtually everywhere. Litigated claims against brokers based solely upon such conduct have rarely been reported. n15

A broker's act of providing a copy of recorded restrictive covenants affecting a parcel of land does not constitute the unauthorized practice of law. n15.1

The various jurisdictions also generally permit the agent to fill in the blanks of a real estate sales contract, preferably consisting of a form approved by the local bar association, or at least an attorney. n16 That such conduct is approved is not surprising since the sales contract is the consummation of the broker's function: the bringing together of a buyer and seller. Note, however, that a broker must exercise caution when complex legal questions arise prior to the preparation of the offer form or sales contract. Courts have ruled a number of times that the judicial authority generally extended to brokers to fill in contract blanks does not protect brokers where the filling in of blanks requires the application of complex legal knowledge. n17 One court has ruled that a broker's insertion of detailed terms into an offer form constitutes the practice of law where the insertion requires "the exercise of legal expertise." n18 A broker handling a transaction involving complicated legal issues should refer contract-related matters to an attorney. n18.1

A few jurisdictions allow the broker to actually draft the contract of sale. n19 Most do not, however. A broker, n20 or other lay person, n21 who drafts the full text of a real estate contract is generally held to be practicing law. Some courts have ruled that the drafting of contracts in combination with other wrongful conduct constitutes the practice of law. n22 It should be noted that an executed offer form frequently constitutes a binding contract of sale. The offer form may constitute a contract even where the form provides that the parties will, in the future, negotiate and execute a more detailed agreement. n23 For this reason, brokers who are prohibited by local law from drafting contracts, and are not specifically authorized by law to draft offers of purchase, should avoid drafting the latter.

Buyers and sellers frequently rely on their real estate brokers to explain contract provisions and may believe that their brokers will advise them regarding the advantages and disadvantages of certain provisions. This point is illustrated by *Snyder v. Lovercheck* n23.1 where the Supreme Court of Wyoming addressed the duty of a buyer's broker to advise the buyer of the presence of and failure to strike a disclaimer clause in a sales contract. The buyer had asserted that his broker's failure to so advise and strike the disclaimer clause constituted an actionable breach of duty. The court relied upon a Wyoming statute which provides that "[f]ailing to advise the buyer and seller of all terms of the proposed sale at the time an offer is presented including estimated discounts and closing costs" is a breach of the broker's duty to his client. n23.2 The court found that a broker's statutory duty to advise his client of the terms of a proposed contract is fulfilled when an explanation commensurate with the client's sophistication has been made. Clearly, some would consider the rendering of this type of advice to be the unauthorized practice of law. n23.3

In regard to the post-contract stage of a real estate sales transaction, which encompasses deed preparation and contemplation of the actual passage of title, the courts are divided as to permissible action by the broker. A number of courts that have authorized document preparation or completion of the sales contract stage n24 have refused to extend the privilege to post-contract forms such as deeds. An Illinois court has stated in this regard that when the broker has secured the signatures on the usual form of preliminary contract or offer to purchase, completed by the insertion of necessary factual data, he has fully performed his obligation as broker. The drawing or filling in of blanks on deeds, mortgages and other legal instruments subsequently executed requires the peculiar skill of a lawyer and constitutes the practice of law. Such instruments are often muniments of title and become matters of permanent record. They are not ordinarily executed and delivered until after title has been examined and approved by the attorney for the purchaser. Their preparation is not incidental to the performance of brokerage services but falls outside the scope of the broker's function. n25

Other courts, however, have allowed the filling in by brokers of printed post-contract documents, including simple

deeds, provided that such documents are completed by the broker without compensation by the customer and that the completion was incidental to the broker's handling and consummation of the real estate transaction. n26 Moreover, a number of courts have even allowed realtors to draft deeds and other related documents in the regular course of their business, where such preparation has been without charge and has been at the request of the broker's customer in connection with the transaction handled by the broker. n27

The authority to draft all documents relating to a real estate transaction appears to be expressly stated only in statutory form. n28

A broker or other lay person is clearly prohibited by both statute and common law from rendering an opinion concerning title based upon an examination of title documents. n29

FOOTNOTES:

(n1)Footnote 1. *See, e.g.:*

Alaska: Alaska Stat. § 08.08.230.

California: Cal. Bus. & Prof. Code § 6126.

Colorado: Colo. Rev. Stat. Ann. § 12-5-112.

Minnesota: Minn. Stat. Ann. § 481.02.

New York: N.Y. Judic. Law § 478.

Ohio: Ohio Rev. Code Ann. § 4705.01.

(n2)Footnote 2. This is evidenced by both case law and statute.

See, e.g.:

Georgia: Ga. Code Ann. § 9-402 [15-19-51].

Maryland: Md. Code Ann., [Bus. Occ. & Prof.] § 10-601.

Michigan: Ingham County Bar Ass'n v. Walter Neller Co., 342 Mich. 214, 69 N.W.2d 713 (1955) .

Minnesota: Minn. Stat. Ann. § 481.02(1).

See also Cardinal v. Merrill Lynch Realty/Burnet, Inc., 433 N.W.2d 864 (Minn. 1988) (discussed at length in § 7.02, n.26 infra).

New York: People v. Alfani, 227 N.Y. 334, 125 N.E. 671 (1919) .

North Carolina: N.C. Gen. Stat. § 84-2.1.

Rhode Island: R.I. Gen. Laws § 11-27-2(2).

(n3)Footnote 3. *See, e.g.:*

Alabama: Ala. Code § 34-3.6.

Georgia: Ga. Code Ann. § 9-401.

Kansas: Kan. Stat. Ann. § 58-2802.

Louisiana: La. Rev. Stat. tit. 37, § 212(2)(b).

Missouri: Mo. Ann. Stat. § 484.020.

New Jersey: N.J. Stat. Ann. § 2A:170-80.

New York: N.Y. Judic. Law § 484.

(n4)Footnote 4.

Ohio: Lender's Service, Inc. v. Dayton Bar Ass'n, 758 F. Supp. 429 (S.D. Ohio 1991) (bar association's pursuit of unauthorized practice claim against business that provided title reports did not violate antitrust provisions of Sherman Act).

(n5)Footnote 5. Rhode, *Policing the Professional Monopoly: A Constitutional and Empirical Analysis of Unauthorized Practice Prohibitions*, 34 Stan. L. Rev. 1, 15 (1981).

(n6)Footnote 6. *See, e.g.:*

Alabama: Ala. Code §§ 34-3-1, -7.

Arizona: Ariz. Rev. Stat. Ann. § 32-261.

Indiana: Ind. Code § 33-1-5-1.

Louisiana: La. Rev. Stat. Ann. § 37:213.

Missouri: Mo. Stat. Ann. § 484.020.

Nebraska: Neb. Rev. Stat. § 7-101.

New Mexico: N.M. Stat. Ann. § 36-2-28.

New York: N.Y. Jud. Law § 485.

North Carolina: N.C. Gen. Stat. § 84-8.

North Dakota: N.D. Cent. Code § 27-11-01.

South Carolina: S.C. Code Ann. § 40-5-320.

(n7)Footnote 7.

Colorado: Colo. Rev. Stat. § 12-5-112.

Illinois: 705 ILCS 205/1.

Iowa: Iowa Code Ann. § 665.3(2).

Michigan: Mich. Comp. Laws § 600.916; Mich. Stat. Ann. § 27A.916.

Montana: Mont. Rev. Code Ann. § 37-61-210.

Utah: Utah Code Ann. § 78-51-25.

Wyoming: Wyo. Stat. § 33-5-117.

(n8)Footnote 8. *See, e.g.:*

Georgia: Ga. Code Ann. § 9-407.

Maine: Me. Rev. Stat. Ann. tit. 4, § 808.

Minnesota: Minn. Stat. Ann. § 481.02.

New Hampshire: N.H. Rev. Stat. §§ 311:7a-311:7f.

Utah: Utah Code Ann. § 78-51-25.

Wyoming: Wyo. Stat. § 33-5-117.

(n9)Footnote 9. The Code is set out in full in National Association of Realtors, Professionalism in Real Estate Practice (1985), at 3-31.

(n10)Footnote 10. *See, e.g.:*

Mississippi: Pope v. Mississippi Real Estate Comm'n, 872 F.2d 127 (5th Cir. 1989) (broker who drew legal descriptions of real property was not engaged in constitutionally protected free speech and may be disciplined).

New York: Janes v. Department of State Div. of Licensing Servs., 167 A.D.2d 960, 561 N.Y.S.2d 1021 (4th Dept. 1990) (evidence adequate to support discipline); *Mulford v. Shaffer*, 124 A.D.2d 876, 508 N.Y.S.2d 302 (1986) (evidence adequate); *Tucci v. Dept. of State*, 63 A.D.2d 835, 405 N.Y.S.2d 846 (1978) (evidence adequate).

(n11)Footnote 11. *Minn. Stat. Ann. § 481.02(3-8). See also R.I. Gen. Laws Ann. § 11-27-16.*

(n12)Footnote 12. Utah Code Ann. § 61-2-20.

(n13)Footnote 13.

Washington: Bennion, Van Camp, Hagen & Ruhl v. Kassler Escrow, Inc., 96 Wn.2d 443, 635 P.2d 730 (1981) (statute authorizing escrow agents to prepare and complete contracts and deeds invalid).

See generally Comment, *Unauthorized Practice of Law-Limited Practice of Law for Real Estate Closing Officers?*, 57 Wash. L. Rev. 781 (1982).

See also:

West Virginia: West Va. State Bar v. Earley, 144 W.Va. 504, 109 S.E.2d 420 (1959) (no statutory authorization of laymen).

Cf.:

Wisconsin: State ex rel. Fiedler v. Wisconsin Senate, 155 Wis.2d 94, 454 N.W.2d 770 (1990) (legislation mandating continuing legal education requirements for lawyers was unconstitutional in that it trespassed upon the exclusive province of the courts).

But see:

New Jersey: State v. Bander, 56 N.J. 196, 265 A.2d 671 (1970) (statute authorizing the drafting of documents by a broker held constitutional; case disapproves the reasoning of *Jeffcott v. Erles*, 84 N.J. Super. 70, 200 A.2d 820 (1964)).

(n14)Footnote 14. *State Bar v. Arizona Land Title & Trust Co.*, 91 Ariz. 293, 371 P.2d 1020 (1962) .

(n15)Footnote 15.

Ohio: Gustafson v. V.C. Taylor & Sons, Inc., 138 Ohio St. 392, 35 N.E.2d 435 (1941) (filling-in of blanks on offer form selected by broker's attorney does not constitute unauthorized practice of law).

(n16)Footnote 15.1. *See NCCF Support, Inc. v. Harris McHaney Real Estate Co.*, 2010 Ark. App. 384, 2010 Ark. App. LEXIS 393, at *12-*13 (2010) .

(n17)Footnote 16. *See N.J. State Bar Ass'n v. N.J. Ass'n of Realtor Bds.*, 93 N.J. 470, 93 N.J. 470, 461 A.2d 1112, 1114 (1983) , *modified on other grounds*, 94 N.J. 449, 467 A.2d 577 (1983) .

Illinois: Chicago Bar Ass'n v. Quinlan & Tyson, Inc., 34 Ill. 2d 116, 214 N.E.2d 771 (1966) .

Indiana: State ex rel. Indiana State Bar Ass'n v. Indiana Real Estate Ass'n, 244 Ind. 214, 191 N.E.2d 711 (1963) .

Ohio: Martineau v. Gresser, 19 Ohio Op. 2d 374, 182 N.E.2d 48 (Ohio Ct. Com. Pl. 1962) .

Washington: Cultum v. Heritage House Realtors, Inc., 103 Wash. 2d 623, 694 P.2d 630 (1985) .

Cf. Duncan & Hill Realty, Inc. v. Department of State, 62 A.D.2d 690, 405 N.Y.S.2d 339 (4th Dept. 1978) , *appeal dismissed*, 45 N.Y. 2d 821, 409 N.Y.S.2d 210, 381 N.E.2d 608 (1978) , noting that real estate brokers and agents may prepare "simple" contracts between their clients as part of their professional work, in expediting the progress of their business and the affairs of their clients. Brokers, however, may not hold themselves out to be attorneys-at-law, but must confine their actions to serving their clients in relation to the special transaction (such as drawing a contract of sale) in which the broker has a financial interest for payment of his services, and must not charge for these incidental services. In the instant case, the broker went beyond these limits into the zone of unauthorized practice by adding detailed terms of a purchase money mortgage to a purchase order form. *See* text accompanying ns.4-9 in § 7.04, *infra* , for a detailed discussion of the *Duncan* case.

In *Dayton Bar Ass'n v. Lender's Service, Inc.*, 40 Ohio St. 3d 96, 532 N.E.2d 120 (1988) , the court ruled that an abstract company could use legal categories or terms of art as headings on their title reports. Such usage, without more, would not constitute the unlawful practice of law. The same was held to be true for use of such terminology in appraisals.

(n18)Footnote 17.

Indiana: State ex rel. Indiana State Bar Ass'n v. Indiana Real Estate Ass'n, 244 Ind. 214, 191 N.E.2d 711 (1963) (when filling in of blanks involves significant legal knowledge, it may be restricted).

New Mexico: The State Bar v. Guardian Abstract & Title Co., 91 N.M. 434, 575 P.2d 943 (1978) ("[W]hen the filling in of the blanks affects substantial legal rights, and if the reasonable protection of such rights requires legal skill and knowledge greater than that possessed by the average citizen, then such practice is restricted to members of the legal profession. ... Exercising a legal judgment as to which competing form to use or giving advice about the legal effect of executing a joint-tenancy deed ... constitutes the unauthorized practice of law.").

Ohio: Martineau v. Gresser, 19 Ohio Op. 2d 374, 182 N.E.2d 48 (Ohio Ct. Com. Pl. 1962) (broker provided provisions went beyond allowable items of factual information).

West Virginia: Cf. Sedlock v. Moyle, 222 W. Va. 547, 551, 668 S.E.2d 176, 180 (W. Va. 2008) . W. Va. Code 30-40-26(f) states that a licensee's duties include making "certain that all the terms and conditions of a real estate transaction are contained in any contract prepared by the licensee." This provision cannot be read in a vacuum so as to impose a blanket duty on a licensee to include any and all possible terms and conditions in a real estate sales contract. Activities normally performed by a lawyer are not included in the capacity of a real estate salesperson.

(n19)Footnote 18. *Duncan & Hill Realty, Inc. v. Department of State*, 62 A.D.2d 690, 405 N.Y.S.2d 339 (4th Dept.) , *appeal dismissed*, 45 N.Y.2d 821, 409 N.Y.S.2d 210, 381 N.E.2d 608 (1978) (terms at issue concerned purchase money loan to be provided by seller and mortgage to be provided by buyer).

(n20)Footnote 18.1. *Cf. Bray v. Brooks*, 2001 Mo. App. LEXIS 14 (Mo. App. Jan. 9, 2001) . The real estate broker prepared an offer, a counteroffer, an addendum, a corporate resolution authorizing the sale of corporate assets, a promissory note, a security agreement, a real estate lease, and a covenant not to compete. The court stated that these documents were far from fill in the blank standardized forms; these forms called for complex and sophisticated consideration of legal issues. The court also stated that the need for such consideration was demonstrated by the fact that the promissory note drafted by the broker was payable to the individuals involved even though the seller was a corporation.

(n21)Footnote 19. *See, e.g.:*

Florida: Keyes Co. v. Dade County Bar Ass'n, 46 So.2d 605 (Fla. 1950) .

New Jersey: N.J. State Bar Ass'n v. N.J. Ass'n of Realtor Bds., 93 N.J. 470, 93 N.J. 470, 461 A.2d 1112 (1983) , modified, 94 N.J. 449, 467 A.2d 577 (1983) (settlement; specified types of realty); *see text* accompanying ns.9-10 in § 7.05, *infra* , for a discussion of this case.

Virginia: Commonwealth v. Jones & Robins, Inc., 186 Va. 30, 41 S.E.2d 720 (1947) .

Washington: Washington State Bar Ass'n v. Washington Ass'n of Realtors, 41 Wash. 2d 697, 251 P.2d 619 (1952) .

But see:

New Jersey: In re Roth, 120 N.J. 665, 577 A.2d 490 (1990) (attorney who sought real estate brokerage commission and legal fee from purchaser client found to have a conflict of interest); *Slimm v. Yates*, 236 N.J. Super. 558, 566 A.2d 561 (1989) (broker lost right to a commission when he also handled application for subdivision before a planning board).

South Dakota: Quatier v. Century 21, 422 N.W.2d 412 (S.D. 1988) (broker advised seller to take purchaser's promissory note as part of the consideration, but failed to advise seller that the note could not be enforced without foreclosure proceeding).

(n22)Footnote 20.

Illinois: Chicago Bar Ass'n v. Quinlan & Tyson, Inc., 34 Ill. 2d 116, 214 N.E.2d 771 (1966) .

Kentucky: Kentucky State Bar Ass'n v. Kelly, 421 S.W.2d 829 (1967) .

New Jersey: Wheatly v. Myung Sook Suh, 207 N.J. Super. 539, 504 A.2d 792 (1985) , *rev'd in part on other grounds*, 217 N.J. Super. 233, 525 A.2d 340 (1987) .

(n23)Footnote 21.

Oregon: Oregon State Bar v. Security Escrows, Inc., 233 Or. 80, 377 P.2d 334 (1962) .

(n24)Footnote 22.

Idaho: In re Matthews, 57 Idaho 75, 62 P.2d 578 (1936) .

Michigan: Grand Rapids Bar Ass'n v. Denkema, 290 Mich. 56, 287 N.W. 377 (1939) .

Tennessee: Union City & Obion County Bar Ass'n v. Waddell, 30 Tenn. App. 263, 205 S.W.2d 573 (1947) .

(n25)Footnote 23.

Massachusetts: Coan v. Holbrook, 327 Mass. 221, 97 N.E.2d 649 (1951) ..

(n26)Footnote 23.1. 992 P.2d 1079 (Wyo. 1999) .

(n27)Footnote 23.2. 992 P.2d 1079, 1090 (Wyo. 1999) . The statute relied upon was Wyo. Stat. Ann. § 33-28-111.

(n28)Footnote 23.3. Cf. *Gjonaj v. Sines*, 69 A.D.3d 1188, 1189-90, 896 N.Y.S.2d 176, 178-79 (2010) (Brokers can provide limited assistance to their clients with contract forms. There was no evidence that the broker exceeded this customary role and engaged in the unauthorized practice of law. The contract contained appropriate warning of its legal effect.)

(n29)Footnote 24. See ns.16 & 19 *supra*.

(n30)Footnote 25. *Chicago Bar Ass'n v. Quinlan & Tyson, Inc.*, 34 Ill. 2d 116, 214 N.E.2d 771, 774 (1966) .

(n31)Footnote 26.

Arkansas: Pope County Bar Ass'n v. Suggs, 274 Ark. 250, 252, 624 S.W.2d 828, 829 (1981) , holding that brokers could fill in the blanks of standard warranty deeds, release deeds, quitclaim deeds, bills of sale, lease agreements and mortgages with a power of sale provided that:

(1) the person for whom the broker is acting has declined to employ a lawyer to prepare the necessary instruments and has authorized the broker to do so;

(2) the forms are approved by a lawyer either before or after the blanks are filled in but prior to delivery to the person for whom the broker is acting;

(3) the forms shall not be used for other than simple real estate transactions which arise in the usual course of the broker's business;

(4) the forms shall be used only in connection with real estate transactions actually handled by such brokers as a broker;

(5) the broker shall make no charge for filling in the blanks; and

(6) the broker shall not give advice or opinions as to the legal rights of the parties, as to the legal effects of instruments to accomplish specific purposes or as to the validity of title to real estate.

Michigan: Ingham County Bar Ass'n v. Walter Neller Co., 342 Mich. 214, 69 N.W.2d 713 (1955) (licensed brokers may engage in conveyancing by having, without compensation, completed and filled out printed forms, including quitclaim deeds, that are incidental to their handling and consummation of realty transactions in which they act as brokers).

Minnesota: In Cardinal v. Merrill Lynch Realty/Burnet, Inc., 433 N.W.2d 864 (Minn. 1988) , the court held that the broker's practice of performing closing services and charging a separate flat fee was not, without any other evidence, the unauthorized practice of law. In this case, Merrill Lynch, a licensed real estate broker, maintained a closing department that provided "closing services" to clients who retained

Merrill Lynch to sell real property. The supervisor of the closing department, although a licensed real estate agent, was not licensed to practice law. Merrill Lynch charged a separate flat fee of \$250 in every transaction in which it performed closing services. This fee was charged whether or not Merrill Lynch performed all of the closing services and irrespective of whether it prepared any of the closing documents.

The sellers in this case entered into an exclusive listing agreement with Merrill Lynch. At the closing of the sale of their property, the closer prepared certain pre-printed closing documents. One of the sellers, a lawyer, drafted the deed and requested that Merrill Lynch waive the \$250 fee in return for his preparing all the closing documents. Upon Merrill Lynch's refusal, the seller paid the \$250 at the time of closing and Merrill Lynch paid an \$8.00 closing fee. The sellers brought suit, claiming that Merrill Lynch's practice of charging and collecting a fee for closing services in connection with the sale of real property was the unauthorized practice of law in violation of *Minn. Stat. § 481.02(3)*.

The district court awarded the seller the \$250 closing, less the cost of recording. The Supreme Court of Minnesota, however, held that Merrill Lynch's practice of charging a fee for the services it provided at the closing did not "convert a practice not otherwise unlawful into the unauthorized practice of law." In so holding, the court noted that charging a fee was, nevertheless, "relevant to and a factor in ... the decision whether the service constituted the unlawful practice of law."

Wisconsin: State ex rel. Reynolds v. Dinger, 14 Wis. 2d 193, 109 N.W.2d 685 (1961) .
Cf. Hulse v. Criger, 363 Mo. 26, 247 S.W.2d 855 (1952) .

(n32)Footnote 27. *See Conway-Bogue Realty Inv. Co. v. Denver Bar Ass'n, 135 Colo. 398, 312 P.2d 998 (1957) .*

See also:

Pennsylvania: Childs v. Smeltzer, 315 Pa. 9, 171 A. 883 (1934) (realty brokers not precluded by statute from drafting deeds, mortgages or other contracts growing out of their business transactions).

Texas: Caneer v. Martin, 238 S.W.2d 828 (Tex. Civ. App. 1951) (act of broker in preparing deeds of conveyance did not constitute practice of law; case is superseded by *Tex. Rev. Civ. Stat. Ann. art. 6573a, § 16*, which provides that brokers may not draft deeds, notes, deeds of trust, or wills but may complete contract forms promulgated by Texas Real Estate Commission or prepared by an attorney or property owner).

But see Oregon State Bar v. Fowler, 278 Or. 169, 563 P.2d 674 (1977) (state bar not entitled to enjoin broker from drafting or filling in forms of deeds or real estate contracts where the bar did not sustain its burden of proving that in the preparation of the documents involved the broker did anything other than fill in blanks under the direction of a customer on a form or forms selected by the customer).

(n33)Footnote 28. *See:*

Rhode Island: R.I. Gen. Laws Ann. § 11-27-16 (drafting deeds, mortgages, leases and agreements).

(n34)Footnote 29. *See, e.g.:*

Michigan: Ingham Co. Bar Ass'n v. Walter Neller Co., 342 Mich. 214, 69 N.W.2d 713 (1955) .

Mississippi: Miss. Code Ann. § 73-35-21.

South Carolina: State v. Buyers Serv. Co., 292 S.C. 426, 357 S.E.2d 15 (1987) .

* This chapter was revised by Professor Paul Teich, New England School of Law, Boston, Massachusetts. Additional updates were contributed by Sandra R. Bullington, Esq.



128 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 7 The Real Estate Broker and the Unauthorized Practice of Law *

10A-7 Real Estate Brokerage Law and Practice § 7.03

§ 7.03 Policy Decisions

Courts have, in varying degrees, employed several rationales as justification for the chosen restraints, or lack thereof, imposed upon real estate brokers in regard to their completion and preparation of real estate documents.

Both the attorney and the broker claim to be proponents of what is best for the public. Perhaps the most popular theory in support of allowing brokers to engage in instrument preparation as part of their real estate business is the "public-convenience" argument, n1 under which are urged the advantages of having one person, the broker, complete and control all aspects of the sale. Such advantages, it is contended, include: the convenience of having one agent in one location, avoidance of duplicative procedures and paperwork, reduced cost, and familiarity of the agent with the needs of both buyer and seller. n2

The legal profession has contended, on the other hand, that for the public's protection, only those licensed to practice law should attempt to control a real estate conveyance. n3 Attorneys have warned that there is the possibility that a conveyance will be mishandled by a self-serving, far from disinterested agent, who is not versed in legal technicalities, obligations and consequences. Mistake and oversight, it is argued, are likely from one untrained and unqualified to deal in legal complexities. n4 In sum, expediency should not be promoted at the expense of effective and fully competent representation.

Other arguments on behalf of the attorneys' viewpoint are that it is "customary" for lawyers to fill in legal forms, n5 the broker's function must not include consideration of complex legal questions, n6 and brokers should be permitted to deal in only "simple" documents. n7

Some courts have supported the right of brokers to prepare documents on the basis of an "incidental to" exception, *i.e.*, that brokers' services are so intertwined with the sales contract that to deny them the privilege of preparing forms that are incidental to the brokers' function of bringing together the buyer and seller will deny brokers their livelihood and subject the public to needless expense and bother. n8 At least one court has suggested that the bar and judiciary waive their right to object to the selection and completion of standard forms by brokers where there has been acquiescence to the custom over a lengthy period. n9

FOOTNOTES:

(n1)Footnote 1. *See generally*:

Colorado: Conway-Bogue Realty Inv. Co. v. Denver Bar Ass'n, 135 Colo. 398, 312 P.2d 998 (1957) .

Michigan: Ingham County Bar Ass'n 342 Mich. 214, 69 N.W.2d 713 (1955) .

(n2)Footnote 2. *See*:

Arkansas: Creekmore v. Izard, 236 Ark. 558, 367 S.W.2d 419 (1963) .

Colorado: Conway-Bogue Realty Inv. Co. v. Denver Bar Ass'n, 135 Colo. 398, 312 P.2d 998 (1957) .

Minnesota: Cowern v. Nelson, 207 Minn. 642, 290 N.W. 795, 797 (1940) .

(n3)Footnote 3. *See*:

Federal: Dacey v. New York County Lawyers Ass'n, 290 F. Supp. 835 (S.D.N.Y. 1968) , *aff'd*, 423 F.2d 188 (2d Cir.) , *cert. denied*, 398 U.S. 929 (1969) .

California: Gerhard v. Stephens, 68 Cal. 2d 864, 69 Cal. Rptr. 612, 442 P.2d 692 (1968) .

Illinois: People ex rel. Illinois State Bar Ass'n v. Schafer, 404 Ill. 45, 87 N.E.2d 773 (1949) .

Minnesota: Gardner v. Conway, 234 Minn. 468, 48 N.W.2d 788 (1951) .

Oklahoma: Latson v. Eaton, 341 P. 2d 247 (Okla. 1959) .

(n4)Footnote 4. *See Pope County Bar Ass'n v. Suggs*, 274 Ark. 250, 624 S.W.2d 828 (1981) , where it was held that while real estate brokers could fill in the blanks of certain standardized, printed forms (prepared by attorneys) in connection with "simple" real estate transactions (*i.e.*, a standard warranty deed, a release deed, a quitclaim deed, a bill of sale, a lease agreement and a mortgage with a power of sale), brokers could not complete forms involving "complex" transactions, *e.g.*, conveyances involving the creation of life estates, limited or conditional estates, contingent or vested remainders, fee tails, easements or rights-of-way grants "or any other conveyance of future, contingent or limited interest." The court observed that: "The line must be drawn somewhere and this seems the appropriate place. Easements, rights-of-way, future or contingent interests, remainders and the like are *not* routine in comparison with the other transactions and the likelihood of error when prepared by laymen is appreciably greater." 624 S.W.2d at 831 .

(n5)Footnote 5. *See*:

Arkansas: Creekmore v. Izard, 236 Ark. 558, 367 S.W.2d 419 (1963) .

Illinois: Chicago Bar Ass'n v. Quinlan & Tyson, Inc., 34 Ill. 2d 116, 214 N.E.2d 771 (1966) .

(n6)Footnote 6.

Missouri: Hulse v. Criger, 363 Mo. 26, 247 S.W.2d 855 (1952) .

(n7)Footnote 7. See ns.4-5 *supra*, and § 7.02.

(n8)Footnote 8. See, e.g.:

Colorado: Conway-Bogue Realty Inv. Co. v. Denver Bar Ass'n, 135 Colo. 398, 312 P.2d 998 (1957) .

Michigan: State Bar of Michigan v. Kupris, 366 Mich. 688, 116 N.W.2d 341 (1962) .

Minnesota: Cardinal v. Merrill Lynch Realty/Burnet, Inc., 433 N.W.2d 864 (Minn. 1988) .

New Mexico: State Bar v. Guardian Abstract & Title Co., 91 N.M. 434, 575 P.2d 943 (1978) .

Washington: Cultum v. Heritage House Realtors, Inc., 103 Wash. 2d 623, 694 P.2d 630 (1985) .

(n9)Footnote 9.

Wisconsin: State ex rel. Reynolds v. Dinger, 14 Wis. 2d 193, 109 N.W.2d 685 (1961) .

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129 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 7 The Real Estate Broker and the Unauthorized Practice of Law *

10A-7 Real Estate Brokerage Law and Practice § 7.04

§ 7.04 The Regulation of Real Estate Brokers: Selected Approaches

The extent of real estate broker participation in the preparation and completion of real estate transaction documents has generally been controlled by statute or case law or a combination thereof. n1 A few states, however, have attempted to regulate brokers through more novel means, including a constitutional amendment n2 and through authorization (in Washington State) for "closing officers," lay practitioners who are authorized to complete specified legal documents incident to the closing of real estate transactions. n3

New York is an example of a jurisdiction that has sought to regulate the unauthorized practice of law through case law and statute. *New York Judiciary Law Section 484* provides that no one but an attorney, duly admitted to practice, may receive compensation for preparing deeds, mortgages or any other instruments affecting real estate. n4 In addition, a broker is guided by court decisions. A 1978 appellate decision summarizes the New York position as allowing brokers "to prepare simple purchase and sales contracts," *i.e.*, to fill in the blanks. In *Duncan & Hill Realty, Inc. v. Department of State*, n5 the broker modified a standard purchase offer form by inserting detailed terms for a purchase money mortgage to be given to the seller to secure a substantial part of the purchase price. After the deal fell through, a complaint was brought against the broker and his license was suspended. On review of that determination, the court found that the broker had engaged in the unauthorized practice of law. The court recognized

that from time immemorial, real estate brokers and agents have drafted "simple" contracts between [buyer and seller] as a part of their professional work, in expediting the progress of their business and the affairs of their clients. As long as real estate brokers and agents have not held themselves out to be attorneys-at-law, have confined their actions to serving their clients in relation to the specific transaction (such as drawing a contract of sale) in which the broker has a financial interest for payment of his services, and have made no charge for these incidental services, such acts have been held by our courts to be proper and not to constitute the unlawful practice of law. n6

The court noted that while New York holds to the rule, followed in many states, that grants to real estate brokers the privilege of preparing purchase offer contracts in real estate transactions, "[t]he line between such permitted acts by real estate brokers and the unauthorized practice of law has been recognized as thin and difficult to define and, at times, to discern." n7 Although the practical considerations that justify completion of simple purchase and sale documents are not to be ignored, "[t]he insertion into such documents of provisions respecting the legal rights of the parties without a

lawyer's advice may produce ill-conceived, ambiguous and unintended terms out of which may arise dissension and litigation," n8 as was the case here. Therefore, the court concluded

real estate brokers and agents must refrain from inserting in a real estate purchase offer or counter offer any provisions which require the exercise of legal expertise. Thus it is not proper for such a broker to undertake to devise the detailed terms of a purchase money mortgage or other legal terms beyond the general description of the subject property, the price and the mortgage to be assumed or given. A real estate broker may readily protect himself from a charge of unlawful practice of law by inserting in the document that it is subject to the approval of the respective attorneys for the parties. Moreover, a real estate broker or agent who uses one of the recommended purchase offer forms referred to above, or one recommended by a joint committee of the bar association and realtors association of his local county, who refrains from inserting provisions requiring legal expertise and who adheres to the guidelines agreed upon by the American Bar Association and the National Association of Real Estate Brokers ... has no need to worry about the propriety of his conduct in such transactions. n9

Arizona has embraced a somewhat different approach to the unauthorized practice of law question: a constitutional amendment. Real estate brokers in that state were able to bring the issue to the electorate, in reaction to a court decision which prohibited a broker from even filling in the blanks of real estate forms. n10 The constitutional amendment entitles brokers to draft instruments pertaining to real estate transactions provided no extra fee is charged. n11 This display of public dissatisfaction with such broad restrictions on brokers gives credence to the "public convenience" argument, n12 especially since the referendum passed by a four-to-one margin.

A still different approach to the problem of unauthorized practice by real estate brokers has been taken by the Supreme Court of Washington, which, in 1983, promulgated "Rule 12." n13 The Rule provides for a new group of lay-practitioners, known as closing officers, who are allowed to select, prepare, and complete certain legal documents incident to the closing of real estate transactions. Specified documents include deeds, promissory notes, guaranties, deeds of trust, mortgages, and Uniform Commercial Code documents.

Closing officers are supervised by a "Limited Practice Board" made up of bar and business representatives appointed by the State Supreme Court, which supervises all aspects of admission to "closing officer" status and performance of "closing officer" duties. Conceptually, closing officers are members of a profession practicing law in a limited area, and thus do more than is normally permitted a real estate broker with respect to document preparation. However, the closing officers' activities are closely circumscribed by the Rule. First, all parties must agree in writing to the basic terms and conditions of the transaction prior to the performance of the services. Thereafter, all parties must be advised by the closing officer of the limited nature of the services rendered, and then be advised in writing that: (1) the closing officer is not acting as the advocate or representative of any party; (2) the documents prepared will affect the legal rights of the parties; (3) the parties' interests in the documents may be different; (4) the parties have the right to be represented by attorneys of their own choice; and (5) the closing officer is not permitted to give legal advice as to the manner in which the documents affect the parties. Finally, the Rule specifies that existing law is not affected with regard to: (1) the fiduciary relationship between a closing officer and a client; (2) conflicts of interest that may arise between a closing officer and a client; (3) the right of a party to act pro se, including the right of a lender to prepare documents of title to property in which it takes a security interest; (4) the lack of authority of a closing officer to give legal advice without being licensed to practice law; and (5) the standard of care which a closing officer must observe in carrying out the duties prescribed by the Rule.

It remains to be seen whether Rule 12 will be an effective means of solving the unauthorized practice dilemma, and whether Washington's lead will be followed elsewhere. The Washington approach, however, provides a means to accommodate both the concern of the judiciary with the maintenance of high ethical standards and acceptable competence by those who practice law, and the desire of the public for efficient and low cost conveyancing. n14

A number of Western states other than Washington have allowed virtually all legal aspects of real estate transactions to be handled by non-lawyer escrow agents, or title company or lender representatives for decades. n15 These lay persons have not generally been closely supervised by government officials.

FOOTNOTES:

(n1)Footnote 1. See text accompanying ns.4-9 *infra*.

(n2)Footnote 2. See Ariz. Const. art. XXVI, § 1, discussed in text accompanying ns.10-12 *infra*.

(n3)Footnote 3. See text accompanying n.13 *infra*.

(n4)Footnote 4. N.Y. Jud. Law § 484.

(n5)Footnote 5. 62 A.D.2d 690, 405 N.Y.S.2d 339 (4th Dept. 1978) , appeal dismissed, 45 N.Y.2d 821, 381 N.E.2d 608 (1978) .

(n6)Footnote 6. 62 A.D.2d at 696, 405 N.Y.S.2d at 342 (citations omitted).

(n7)Footnote 7. *Id.* at 697, 405 N.Y.S.2d at 343 (footnote omitted).

(n8)Footnote 8. *Id.* at 701, 405 N.Y.S.2d at 345 .

(n9)Footnote 9. *Id.*

(n10)Footnote 10. *State Bar v. Arizona Land Title & Trust Co.*, 90 Ariz. 76, 366 P.2d 1 (1961) , modified, 91 Ariz. 293, 371 P.2d 1020 (1962) .

(n11)Footnote 11. Ariz. Const. art. XXVI, § 1. A real estate broker may "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."

(n12)Footnote 12. See § 7.03, ns.1-2 *supra*.

See *Cardinal v. Merrill Lynch Realty/Burnet, Inc.*, 433 N.W.2d 864 (Minn. 1988) , where the Minnesota Supreme Court relied on the "public convenience" doctrine in allowing brokers to complete real estate deeds and other instruments for their brokerage transactions for a flat fee of \$250.00

(n13)Footnote 13. See generally ABA/BNA Lawyers' Manual on Professional Conduct 21:8029 (1984).

(n14)Footnote 14.

Nebraska: In *Ford v. American Medical Int'l, Inc.*, 228 Neb. 226, 422 N.W.2d 67 (1988) , a business broker sought a fee for acting as a "finder" for a corporation that employed him to assist in the acquisition of a hospital. The court denied the requested relief, holding that any sale or acquisition of a business that involved real property required the person seeking a commission (even as a business broker) to have a real estate broker's license.

New Jersey: Cf. *Wharton v. Howard S. Straub, Inc.*, 235 N.J. Super. 179, 561 A.2d 1169 (1989) , wherein a defrauded party who gave money to a real estate broker to invest in mortgages was denied recovery from the States fund (which was designed to cover defaulting real estate brokers), on the theory that the activity of the broker in this case amounted to mortgage brokerage and not real estate brokerage (the former being regulated by the state's Banking Commission and the latter being regulated by the

state's Real Estate Commission).

Washington: See also Styrk v. Cornerstone Invs., Inc., 61 Wash. App. 463, 810 P.2d 1366 (1991) , review denied, 117 Wn.2d 1020 (1991) and 818 P.2d 1098 (Wash. 1991) where the court ruled that closing real estate transactions and acting as an escrow agent for a fee are commercial activities. Even if they are performed by an attorney, they are not exempt from the applicable Consumer Protection Act.

(n15)Footnote 15. Jacobs, *More Home Buyers, Sellers are Skipping the Lawyer*, Wall St. J., Apr. 6, 1995, at B1 col.5.

* This chapter was revised by Professor Paul Teich, New England School of Law, Boston, Massachusetts. Additional updates were contributed by Sandra R. Bullington, Esq.



130 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 7 The Real Estate Broker and the Unauthorized Practice of Law *

10A-7 Real Estate Brokerage Law and Practice § 7.05

§ 7.05 Realtor(R) Code of Ethics and the Model Definition of the Practice of Law

The National Association of Realtors(R) has addressed the issue of the unauthorized practice of law by its members in Article 13 of its Code of Ethics and Standards of Practice of the National Association of Realtors(R) (Jan. 1, 2010) which states:

REALTORS(R) shall not engage in activities that constitute the unauthorized practice of law and shall recommend that legal counsel be obtained when the interest of any party to the transaction requires it.

The American Bar Association Task Force on the Model Definition of the Practice of Law has drafted a definition of the practice of law which describes actions that constitute the practice of law. This definition includes exceptions and exclusions. This definition has received much criticism. Both the U.S. Department of Justice and the Federal Trade Commission have voiced their concern about efforts to prevent nonlawyers from competing with attorneys in the provision of certain legal services. n1 This attempt to define the practice of law has been considered unsuccessful. n2

One resource for readers concerned about the unauthorized practice of law is the survey performed by the American Bar Association Standing Committee on Client Protection. The 2009 Unauthorized Practice of Law Survey contains charts showing state-by-state listings addressing enforcement against the unauthorized practice of law. This survey is online at: <http://www.abanet.org/cpr/clientpro/09-upl-survey.pdf> (site visited May 13, 2010).

FOOTNOTES:

(n1)Footnote 1. See Joint letter from the Department of Justice and the Federal Trade Commission, Comments on the American Bar Association's Proposed Model Definition of the Practice of Law (Dec. 20, 2002). This letter concludes, "By including overly broad presumptions of conduct considered to be the practice of law, the proposed Model Definition likely will reduce competition from nonlawyers. Consumers, in turn, will likely pay higher prices and face a smaller range of service options. The Task Force makes no showing of harm to consumers from lay service providers that would justify these reductions in competition." This letter is found online at <http://www.justice.gov/atr/public/comments/200604.htm> (site visited May 13, 2010).

(n2)Footnote 2. See, e.g., Anthony J. Luppino, *Multidisciplinary Business Planning Firms: Expanding the Regulatory Tent Without Creating a Circus*, 35 *Seton Hall L. Rev.* 109, 133 (2004).

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131 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 7 The Real Estate Broker and the Unauthorized Practice of Law *

10A-7 Real Estate Brokerage Law and Practice § 7.06

§ 7.06 The Role of Paralegals and Legal Technicians

In the nineteen eighties, a new category of law office personnel arrived on the scene, namely the "paralegal." The underlying concept was that simple documents (or complex documents that were routinely executed as part of a transaction) could be explained to the non-lawyer, who, in turn, would then carry out a legal transaction (such as a mortgage loan or closing) under the supervision of the lawyer. The latter would be available for consultation, to answer any questions that arose, to handle any new or different problems that might arise, and to review the finished documents prior to the conclusion of the deal. Within a decade, the use of paralegals grew geometrically, particularly in such areas as conveyancing and mortgage lending. There is now a movement underway to expand the role of paralegals to enable them to handle simple or routine matters on their own and without direct supervision by an attorney. California is in the forefront of this movement that is predicated upon the need to make such services cheaper and more accessible to the average citizen.

The Public Protection Committee of the California State Bar Association conducted hearings on proposed legislation to facilitate this type of practice by paralegals. The pros and cons developed at the hearings were summarized by one commentator as follows:

The committee acknowledged the potential for consumer fraud by legal technicians, but it found that "the overwhelming need to provide better access to legal services justifies some risk of individual harm."

The committee noted that lawyers cannot provide or don't want to provide better legal access for low- and middle-income persons, especially in landlord-tenant, immigration, family and bankruptcy law.

There is no doubt that certain legal services, such as uncontested divorces, name changes, uncontested adoptions, simple wills, the preparation of income tax returns, certain real estate matters, simple personal bankruptcies, collections, and the incorporation of a small business are often standardized and routine and can be competently performed by financial advisors, escrow agents, paralegals and--in some instances--even typing services.

On the other hand, critics of the recommendations raise some valid concerns about the proposed legislation. It does not require minimum educational requirements for, or impose ethical restrictions on, legal technicians. A client's confidences would not be protected by the attorney-client privilege. n1

The position that stringent legal controls on the practice of law by non-lawyers should continue to be maintained has been championed by one of the authors of this publication, Bernard H. Goldstein, Esq. He recently argued that brokers should not be authorized to advise sellers or purchasers of the legal implications of any legal document pertaining to conveyancing. Goldstein was opposed to the proposed regulations of the New York Secretary of State that, by inference, would enlarge the scope of the real estate broker's powers and liabilities. He argued that only a legislative enactment, not mere regulations, could expand the powers of the broker to such an extent. Reviewing and explaining contract documents, he stated, is a skill that is particularly acquired by the lawyer as a result of the lawyer's professional education and training, and that skill should not be diluted by allowing it to be exercised by those having a tangential relationship with the discipline of the law. Further, to issue such regulations would give the public the impression that a broker or salesperson has expertise in a field different from that of the broker's discipline. Rather than mandating the conduct called for by the proposed regulations, Goldstein proposed that the legislature require the broker to deliver to the party using the broker's services a written memorandum informing the party that the broker gives no legal advice, and that the party should consult a lawyer for such advice. Moreover, to recover any compensation in such a transaction, the broker must allege and prove the timely delivery of the memorandum to the party. n2

In 1992, the ABA created the Commission on Non-Lawyer Practice to study the prevalence of unauthorized practice and its impact on the public and the legal profession. The Commission's final report is expected in 1995. State legislatures are increasingly interested in non-lawyer practice. Since 1990, the number of legislative bodies considering laws which would modify or clarify common law or administratively imposed limitations on unauthorized practice has grown from 7 to 21. n3

FOOTNOTES:

(n1)Footnote 1. Despite the interest shown by some consumers and legislative committees in the creation of a type of lay, legal practitioner, the California state legislature has rejected (or has failed to act on) a number of proposals advanced since the early 1990's which would have allowed licensed "legal technicians" to provide direct services to the public in limited areas of practice or, alternatively, would have created licensing for paralegals. See Samborn, *So What Is a Lawyer, Anyway?*, N.J.L., June 21, 1993, at 1. A number of paralegal organizations continue to view paralegals as fully capable of representing the public and continue to press for a law which would allow them to do so.

(n2)Footnote 2. Goldstein, *Proposed Broker Rules, Regulations or Legislation*, N.Y.L.J., March 14, 1990, at 1, col. 4.

For a case illustrating the malpractice pitfalls that a real estate broker faces in giving incorrect legal advice, or in discouraging the client from seeking legal counsel, see *Crutchley v. First Trust & Sav. Bank*, 450 N.W.2d 877 (Iowa 1990). The opinion in the *Crutchley* case also contains a valuable discussion of the appropriate charge to a jury passing upon real estate broker malpractice issues. See also *Kunz v. Warren*, 725 P.2d 794 (Colo. Ct. App. 1986).

Preparation of real estate contracts by real estate brokers was held to constitute the unlawful practice of law, even in situations in which the agreements contained an escape clause based upon the parties' right not to be bound if an attorney acting on their behalf rejected the agreement. *Wheatly v. Myung Sook Suh*, 207 N.J. Super. 539, 504 A.2d 792 (1985), rev'd in part on other grounds, 217 N.J. Super. 233, 525 A.2d 340 (1987). The broker in that case was denied the right to recover a commission on this basis, as well as on the ground that the real estate contracts drafted by the broker violated the state's "plain language law," N.J. Stat. Ann. § 56:12.

The Connecticut State Department of Banking has published rules authorizing real estate brokers (who act as mortgage brokers) to participate in "Computer Loan Origination Systems" (called "CLOs"), provided they undertake to obtain the best possible mortgage for the vendee. It is authoritatively reported that HUD is in the process of issuing similar regulations under R.E.S.P.A., authorizing mortgage brokers to collect a modest fee for this service. The broker is also required to offer the potential borrower a choice of multiple lenders, i.e., they cannot restrict their offering to

mortgages supplied by a single lending source. See Valvo, *Dual Fiduciary Brokers-- Realtors to Work for Both Buyers and Sellers*, 7 Mortgage Journal 1 (Nov. 7, 1990).

(n3)Footnote 3. *ABA Still Mum on Non-Lawyer Issue*, N.L.J., May 30, 1994, at A8.

* This chapter was revised by Professor Paul Teich, New England School of Law, Boston, Massachusetts. Additional updates were contributed by Sandra R. Bullington, Esq.



132 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 7 The Real Estate Broker and the Unauthorized Practice of Law *

10A-7 Real Estate Brokerage Law and Practice § 7.07

§ 7.07 Conclusion

The current state of the law regarding "unauthorized practice" by real estate brokers is not always readily discernible. Clearly, however, a real estate broker will best serve his principal (and protect himself) if he abstains from dispensing legal advice to the parties, and declines additional compensation for document preparation or assistance. Beyond these simple admonitions, the broker must be aware of the particular rules in his jurisdiction regarding the drafting of legal documents and the filling in of pre-prepared forms. The ideal for both attorneys and brokers would be uniform guidelines that are clear and easily applied. Considering the historical animosity between brokers and attorneys, however, as well as the conflicting theories employed by the courts in the various jurisdictions, the development of uniform rules seems difficult to achieve. Yet broker-lawyer cooperation is necessary. The public interest requires it. n1

FOOTNOTES:

(n1)Footnote 1. *See generally* Fisher & Lachman, *Unauthorized Practice Handbook* (1990); Shedd, *Real Estate Agents and the Unauthorized Practice of Law*, 10 *Real Estate L.J.* 135 (1981); A.B.A., *Unauthorized Practice of Law* (1958); Fischer, *Unauthorized Practice Handbook* (1972).

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133 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 8 Real Estate Brokers and Antitrust Laws *

10A-8 Real Estate Brokerage Law and Practice 8.syn

§ 8.syn Synopsis to Chapter 8: Real Estate Brokers and Antitrust Laws *

§ 8.01 Historical Background

§ 8.02 Potential Liability Under Antitrust Laws

§ 8.03 Basic Antitrust Law

[1] Interstate Commerce: A Threshold Requirement

[2] Monopolization: Section 2 of the Sherman Act

[a] Relevant Market Definition

[i] Product Market: Cross-Elasticity of Demand.

[ii] Geographic Market.

[b] Offense of Monopolization

[i] First Prong: Definition of Market Power.

[ii] Second Prong: Exclusionary Conduct.

[c] Statute Rarely Applied to Real Estate Brokerage Cases

[3] Combinations in Restraint of Trade: Section 1 of The Sherman Act

[a] Proof of Conspiracy

[b] Rule of Reason

[i] Common Law Roots.

[ii] Supreme Court's Formulation Emphasizes Pro-Competition.

[iii] Analysis of Rule of Reason Inquiry.

[c] The Per Se Rule

[4] Group Boycotts: Applying Per Se Analysis and Rule of Reason

[a] Market Power of Parties Not Relevant in Per Se Cases

[b] Rule of Reason Analysis Applies to "Pro-Competitive" Boycotts

[5] Tying Agreements Are Per Se Illegal: Three Elements of Claim

[a] "Two Product Requirement": Functional Test

[b] Market Power Need Not Rise to "Monopoly Power"

[c] \$200,000 Threshold for "Not Insubstantial" Requirement

§ 8.04 Application of the Antitrust Laws to the Real Estate Brokerage Profession

[1] Defining Relevant Market in Real Estate Brokerage Cases

[a] Product Market Includes Property Owners and Other Brokers

[b] Geographic Market Definition Depends on Focus of Business

[2] Price-Fixing of Commission Rates Is Per Se Illegal

[a] Agreement Found in Conduct, Writing or Speech

[b] Argument that Uniform Prices Are Result of Competitive Market

[i] Agricultural Market Is Prototypical Perfectly Competitive Market.

[ii] Real Estate Market: Attributes of Perfectly Competitive Market.

[iii] Cooperation in Real Estate Brokerage Is No Indicia of Monopoly.

[iv] Fixing Multiple Listing Service Participation Fees Is Per Se Illegal.

[3] Group Boycotts and Issues of Proof

[a] Presumption of Unilateral Conduct Applies to Individual Defendants

[b] Presumption of Concerted Action Applies to Trade Associations

[i] Anti-Competitive Effects of Multiple Listing Services.

[ii] Anti-Competitive Effects of Ethical Standards.

[4] "List Back Agreement" May Constitute Tying Violation

[a] No Tying Issue If Seller Has No Economic Interest

[b] Conflicting Decisions on Membership Requirements

[5] Miscellaneous Claims: Unreasonable Restraints of Trade

[6] Antitrust Implications of E-Commerce and Access to Multiple Listing Service Databases

[a] Availability of Electronic Data from Real Estate Multiple Listing Services

[b] MLS Exclusive Data License Agreements with National Internet Listing Data Aggregators

[c] Related Discussion in Chapter 10, The Impact of Electronic Commerce in the Real Estate Brokerage Business

§ 8.05 Program for Compliance

[1] Comments to Be Avoided

[2] Document Objections to, or Explanations for Anti-Competitive Conduct

[3] Avoid Sharing Correspondence with Competitors



134 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 8 Real Estate Brokers and Antitrust Laws *

10A-8 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 8 discusses the application of antitrust law to the real estate brokerage industry and explains why real estate brokers and their counsel must make antitrust compliance a high priority. Beginning with an introduction addressing the historical background of antitrust law and the real estate brokerage industry (§ 8.01), this chapter discusses the severe penalties that have been applied to real estate brokers who are found to violate antitrust law (§ 8.02). The basics of antitrust law and its application to real estate brokerage are discussed (§ 8.03). The concepts of monopoly (§ 8.03[2]), restraint of trade (§ 8.03[3]), boycotts (§ 8.03[4]), and tying agreements (§ 8.03[5]) are discussed. Application of antitrust law to specific industry practices is discussed in § 8.04. Industry practices discussed include:

- fixing of commissions (§ 8.04[2]),
- group boycotts that are alleged to have arisen in response to "discount" brokers (§ 8.04[3][a]),
- multiple listing services and their potentially anti-competitive effect on the relevant market (§ 8.04[3][b][i]),
- real estate trade association's ethical standards and their potentially anti-competitive effect on the relevant market (§ 8.04[3][b][ii]), and
- list-back agreements as possible tying violations (§ 8.04[4]).

Chapter 8 concludes with practical suggestions on implementing a compliance program to avoid running afoul of antitrust laws (§ 8.05).



135 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 8 Real Estate Brokers and Antitrust Laws *

10A-8 Real Estate Brokerage Law and Practice § 8.01

§ 8.01 Historical Background

Prior to the 1970s the conventional wisdom was that the antitrust laws did not apply to the real estate brokerage profession, or most of the service sector of the economy. Judges and lawyers presumed either that the sale of real estate was not "interstate" commerce, or the profession was exclusively regulated by state licensing laws. Based upon these assumptions, and the relative dearth of any antitrust cases dealing with the real estate brokerage business, n1 real estate brokers and their trade associations (1) routinely promulgated recommended fee schedules, (2) severely restricted who could participate in multiple listing services, and (3) agreed upon "codes of ethics" that strictly regulated a broker's business solicitations, office hours, and salesperson hiring policies. All of these practices have now been abandoned by reason of the widespread application of federal and state antitrust laws to the real estate brokerage industry.

FOOTNOTES:

(n1)Footnote 1. Prior to 1970, the only reported antitrust case against real estate brokers or their trade associations was *United States v. National Ass'n of Real Estate Boards*, 339 U.S. 485 (1950) in which the Supreme Court held that *enforceable* commission rate schedules promulgated by local real estate boards violated Section 1 of the Sherman Act. On December 18, 1969 the United States Department of Justice Antitrust Division filed the second case ever initiated against a real estate board in *United States v. Prince George's County Board of REALTORS(R), Inc., 1971 Trade Cas. (CCH) P 73, 393 (D. Md. 1970)*. In the *Prince George's* case, the government challenged a fee schedule promulgated by the defendant association that was merely recommended, and not mandatory.

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136 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation
CHAPTER 8 Real Estate Brokers and Antitrust Laws *

10A-8 Real Estate Brokerage Law and Practice § 8.02

§ 8.02 Potential Liability Under Antitrust Laws

No other body of commercial law has a broader reach, harsher penalties, or more variety of potential enforcers than the antitrust laws. The number of government enforcement agencies, and "bonuses" (treble damages and attorneys fees) available to private plaintiffs, make it very unlikely that an antitrust violation will remain undetected or unchallenged during the four-year statute of limitations under the federal antitrust laws. ⁿ² This is especially true in an industry that is as visible and publicly scrutinized as the real estate brokerage business. These factors all make antitrust compliance a high priority for real estate brokers and their counsel.

The Sherman Act of 1890, ⁿ³ which is the primary federal antitrust law, contains some of the most severe sanctions of any law regulating commercial conduct. The United States Justice Department can seek criminal indictments for Sherman Act violations, and a court can sentence a guilty defendant to a jail sentence of up to three years, as well as fines not to exceed \$350,000.00 for an individual and \$10,000,000 for a corporation. ⁿ⁴ The Justice Department can also bring civil actions to secure injunctions against Sherman Act violations. ⁿ⁵

Private plaintiffs who have been injured in their business or property by anything forbidden in the antitrust laws may also sue. A prevailing plaintiff may receive three times their actual damages and recover their reasonable attorneys fees from the defendant. ⁿ⁶

Section 5 of the Federal Trade Commission Act (FTC Act), ⁿ⁷ which prohibits "unfair methods of competition," provides a basis for injunctive relief. The FTC Act is enforced by the Federal Trade Commission (FTC). Private plaintiffs do not have any cause of action under the FTC Act. Any violation of the Sherman Act is also a violation of the FTC Act; therefore, the FTC may challenge Sherman Act violations as well as a broad range of other anti-competitive conduct that could be found to be an "unfair" method of competition. The FTC is, however, empowered only to issue cease and desist orders. Damages and criminal sanctions are not available under the FTC Act.

Recently, Section 5 has been applied to prohibit restrictions on price-related advertising promulgated by professional associations. ⁿ⁸

Finally, state attorneys general may bring "parens patriae" suits to enforce the Sherman Act on behalf of the citizens of their state. ⁿ⁹ Most states also have state antitrust laws or "little FTC Acts." ⁿ¹⁰ These statutes can be enforced

criminally and civilly. n11 They also typically allow prevailing plaintiffs to recover double or triple damages and reasonable attorneys fees from defendants. n12 Some state statutes have been interpreted by state supreme courts to require less proof to support a violation than is required under the federal antitrust laws, or to permit a broader class of plaintiffs to have standing to sue. n13

FOOTNOTES:

(n1)Footnote 2. 15 U.S.C. § 15B.

(n2)Footnote 3. 15 U.S.C. § 1 et seq.

(n3)Footnote 4. 15 U.S.C. § 1 et seq.

(n4)Footnote 5. 15 U.S.C. § 4.

(n5)Footnote 6. 15 U.S.C. § 15(a).

(n6)Footnote 7. 15 U.S.C. § 45(a)(1).

(n7)Footnote 8. Restrictions on price-related advertising have been found illegal under several analyses. See *American Medical Ass'n v. FTC*, 94 F.T.C. 701 (1979), *aff'd*, 638 F.2d 443 (2d. Cir. 1980), *aff'd by an equally divided Court* 455 U.S. 676, 102 S. Ct. 1744, 71 L. Ed. 2d 546, 1981-1 Trade Cas. (CCH) P73378 (1982) (Rule of Reason); Massachusetts Board of Registration in Optometry, 110 F.T.C. 549 (1988) (creating a middle-level inquiry between the *per se* rule and the Rule of Reason); *In re California Dental Ass'n*, No. 9259, 1996 F.T.C. LEXIS 81 (March 25, 1996) (*per se* rule). California Dental Ass'n is currently on appeal in the Ninth Circuit. See also Stoll & Goldfein, *Price-Related Advertising and Professional Associations*, N.Y. Law J., May 21, 1996, at 3 ("Restrictions that limit advertising ... can remove a member's incentive to lower prices, provide special services or give discounts, because the information cannot be conveyed to the public. Thus, price and service may be adversely affected.")

(n8)Footnote 9. 15 U.S.C. § 15C(a)(1).

(n9)Footnote 10. See, e.g., the Cartwright Act, *Cal. Bus. & Prof. Code*, § 16700 et seq.; Illinois Antitrust Act, 740 Ill. Ann. Stat. § 10/1 et seq. and Illinois Consumer Fraud and Deceptive Business Practices Act, 815 Ill. Ann. Stat. § 505/1 et seq.

(n10)Footnote 11. See, e.g., *Cal. Bus. & Prof. Code* § 16754.

(n11)Footnote 12. See, e.g., *Cal. Bus. & Prof. Code* § 16750(a); Illinois Antitrust Act, 740 Ill. Ann. Stat. § 10/7.

(n12)Footnote 13. See *Cal. Bus. & Prof. Code* § 16750(a) (persons indirectly injured by defendant's antitrust violation have standing to sue).

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137 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation
CHAPTER 8 Real Estate Brokers and Antitrust Laws *

10A-8 Real Estate Brokerage Law and Practice § 8.03

§ 8.03 Basic Antitrust Law

An understanding of how the antitrust laws apply to real estate brokerage requires a basic understanding of the structure and operation of these laws as interpreted by the United States Supreme Court during the Twentieth Century. When Congress passed the Sherman Act in 1890 it was targeting the massive trusts and cartels that had come to dominate many major industries at the end of the nineteenth century. The Sherman Act reflects the twin goals of Congress in 1890.

Section 1 of the Sherman Act prohibits "[e]very contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several States or with foreign nations." n14 Section 2 of the Sherman Act punishes "[e]very person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person to monopolize any part of the trade or commerce among the several states, or with foreign nations." n15 In short, Section 1 is directed against monopolies in their "incipiency," while Section 2 is directed at monopolies that have already formed, or are about to be formed.

[1] Interstate Commerce: A Threshold Requirement

A threshold requirement to any suit or prosecution under the Sherman Act is a showing that the conduct of which the plaintiff or the government is complaining is "in" or "affecting" the "commerce among the several States or with foreign nations." This is commonly known as the "interstate commerce" requirement or "interstate commerce nexus." Until the 1970's it was generally assumed that real estate brokerage did not have any interstate commerce nexus because real estate, by definition, did not move across state lines. The Supreme Court has held since 1945, however, that the scope of the Sherman Act is coextensive with Congress's authority to regulate under the *Commerce Clause*, and Congress is empowered to regulate not only conduct that is "in" interstate commerce, but also conduct that "affects" such commerce. n16

In 1980 in *McLain v. Real Estate Board of New Orleans, Inc.*, n17 the Supreme Court laid to rest any suggestion that the business of real estate brokerage was beyond the interstate commerce jurisdiction of the federal antitrust laws. *McLain* was a class action price-fixing case brought under Section 1 of the Sherman Act against the New Orleans Real Estate Board and several of its individual broker members. The Fifth Circuit had held that the plaintiffs' claims should be dismissed for lack of interstate commerce jurisdiction. The Supreme Court granted certiorari and reversed.

The Court held that an antitrust plaintiff must allege facts sufficient to show that the conduct of which the plaintiff is complaining is in a stream of interstate commerce, or has an effect on some other business that is in interstate commerce. n18 As far as the alleged fixing or stabilizing of real estate commissions in the New Orleans real estate marketplace is concerned, the Supreme Court noted that a real estate commission is a cost of consummating a real estate transaction. A real estate transaction, in turn, often involves mortgage loans and title and mortgage insurance that are secured from out-of-state lenders and insurers. These streams of interstate commerce are affected by the costs of consummating real estate transactions. As transaction costs rise, fewer transactions will occur and fewer loans or insurance policies will be written. n19

It is important to note, however, that *McLean* simply held that the plaintiff in that case alleged a sufficient nexus between the real estate brokerage business and interstate commerce to survive a motion to dismiss under Rule 12 of the Federal Rules of Civil Procedure. Antitrust plaintiffs suing real estate brokers must prove at trial that the brokers' conduct was in or affecting interstate commerce. A failure to do so will result in a directed verdict. n20

[2] Monopolization: Section 2 of the Sherman Act

Section 2 prohibits the offense of "monopolization," "attempts to monopolize," or "conspiracies to monopolize." By definition, monopolization means to acquire and maintain nearly all of the output in a particular relevant market. Section 2 is intended to eliminate monopolies that have been formed by attacking conduct by a monopolist that has the effect of perpetuating the monopoly. n21

[a] Relevant Market Definition

Any seller of a product or service has a monopoly over the specific product or service he or she produces and sells. The offense of monopolization does not extend this far. n22 A violation of Section 2 of the Sherman Act requires proof that the defendant monopolized a particular "relevant market." While the concept of a "relevant market" is fundamental to an analysis of whether a defendant has acquired a "monopoly," so-called "market definition" is a necessary and, often, outcome-determinative inquiry in nearly all antitrust cases.

"Relevant markets" for the purpose of the antitrust laws have been defined by the Supreme Court as the alternatives available to a customer seeking a supply of a particular product or service. n23 Relevant markets, therefore, have two dimensions: a product market and a geographic market.

[i] Product Market: Cross-Elasticity of Demand. A "product market" is defined by the sources of supply for a particular product or service, or interchangeable substitutes for the product or service. Substitutability is sometimes referred to as "cross-elasticity of demand." Cross-elasticity is high when an increase in price of one product causes consumers to shift their purchases to another product. The Supreme Court used this test in *United States v. E.I. du Pont de Nemours & Co.*, n24 to determine whether du Pont had monopolized the market for cellophane plastic wrap. The Court examined the cross-elasticity of demand between cellophane and other flexible wrappers, such as waxed paper and aluminum foil. Noting that consumers of flexible wrapping material readily switched from one product to another in response to price changes, the Court concluded that all such products should be included in the "relevant product market." By defining the product market so broadly, the Court rejected the monopoly claims against du Pont, even though du Pont had a monopoly in the domestic production of cellophane.

[ii] Geographic Market. A "relevant market" also has a geographic dimension. A relevant geographic market has been defined by the Supreme Court as the territory to which consumers can effectively turn for supplies of a particular product or service. n25 Geographic markets can be national or even world-wide in scope, or can be confined to a single city or part of a city. n26

[b] Offense of Monopolization

Section 2 of the Sherman Act condemns "monopolization": it does not condemn a "monopoly." In *United States v. Grinnell Corp.*,ⁿ²⁷ the Supreme Court held that "monopolizing" conduct is the "willful acquisition or maintenance of [monopoly] power as distinguished from growth or development as a consequence of superior product, business acumen, or historic accident." n28 Therefore, it is not illegal to have a monopoly on a product or service so long as that monopoly was not acquired or maintained by "exclusionary" conduct toward competitive rivals.

[i] First Prong: Definition of Market Power. Only defendants that have sufficient "market power" within the relevant market are deemed monopolists under Section 2 of the Sherman Act. "Market power" is the ability of a seller to control the price that will prevail in the relevant market. n29 A monopolist has complete control over prices and can therefore raise its price and not suffer a corresponding reduction in sales volume to suppliers of other competing products or services.

Courts have typically required a defendant to possess a relevant market share in excess of seventy percent (70%) before being considered a monopolist. n30 Somewhat lesser market shares have supported allegations that the defendant has "attempted" to acquire a monopoly, or has "conspired" to monopolize. n31

[ii] Second Prong: Exclusionary Conduct. The second issue in a monopolization case is whether the defendant acquired or maintained its monopoly by "exclusionary" conduct. Exclusionary conduct that can support a monopolization claim includes predatory pricing, n32 exclusive dealing contracts, n33 and refusals to deal with a competitor. n34

[c] Statute Rarely Applied to Real Estate Brokerage Cases

Monopolization cases will rarely be filed against a real estate broker because the real estate brokerage markets in most metropolitan areas are highly de-concentrated. With numerous competitors in most markets, it is highly unlikely that any individual real estate brokerage company will possess market power anywhere near monopoly proportions.

Real estate trade associations, however, could possess market power, and, therefore, could be susceptible to monopolization claims, especially if they operate multiple listing services. Most real estate brokerage markets support only one, or at most two, multiple listing services. If the real estate trade association that owns and operates the only multiple listing services in the market engages in exclusionary conduct designed to prevent the formation of a competing multiple listing service, the dominant multiple listing service could be liable for monopolization in violation of Section 2 of the Sherman Act. n35

[3] Combinations in Restraint of Trade: Section 1 of The Sherman Act

While Section 2 of the Sherman Act condemns monopolization, Section 1 of the Sherman Act prohibits "contracts, combinations, or conspiracies in restraint of trade." Defendants in suits brought under Section 1 need not be monopolists; however, plaintiffs in Section 1 cases must prove that the defendants engaged in "concerted action" that restrained trade.

[a] Proof of Conspiracy

A "contract, combination or conspiracy" under Section 1 of the Sherman Act requires concerted action by two or more separate business entities. In *American Tobacco Co. v. United States*,ⁿ³⁶ the Supreme Court defined a conspiracy for antitrust purposes as "a unity of purpose or a common design and understanding or a meeting of minds in an unlawful arrangement." n37 In *Monsanto v. Spray-Rite Service Corp.*,ⁿ³⁸ the Supreme Court defined the standard of proof necessary to prove a conspiracy under Section 1 of the Sherman Act as "evidence that tends to exclude the possibility of independent action." n39

Cases brought under Section 1 of the Sherman Act often turn on whether the plaintiff has succeeded in proving that the challenged conduct was the result of a joint undertaking by two or more entities. The *Monsanto* case, however, makes clear that a Section 1 conspiracy is not proven simply by evidence that two or more firms engaged in the same conduct when faced with the same set of circumstances.

Forty-five years prior to *Monsanto*, the Supreme Court held in *Interstate Circuit, Inc. v. United States*,ⁿ⁴⁰ that a conspiracy under Section 1 could be proven by evidence that the defendants engaged in "consciously parallel" conduct that would not be rational unless the parties were acting pursuant to common plan or understanding.ⁿ⁴¹ *Monsanto* made clear that mere "conscious parallelism" alone is not sufficient to establish that the challenged conduct was undertaken pursuant to a "conspiracy." To survive a motion for summary judgment, or for a directed verdict, after *Monsanto*, a plaintiff must introduce evidence that "tends to exclude the possibility" that the challenged conduct was the result of unilateral independent decision making by the respective firms.ⁿ⁴² More recently in *Bell Atlantic Corp. v. Twombly*^{n42.1} the United States Supreme Court held that an antitrust plaintiff must plead enough facts to show that an agreement was made to support a claim under Section 1 of the Sherman Act. According to the Court, allegations that the defendants engaged in parallel conduct and a conclusory assertion that the defendants acted pursuant to a conspiracy is not sufficient to withstand a motion to dismiss. The Supreme Court's *Twombly* decision was cited by the federal district court in *Hackman v. Dickerson, Realtors(R), Inc.*^{n42.2} when that court granted the motions to dismiss of the Illinois Association of Realtors(R), the Rockford Area Association of Realtors(R), and numerous individual brokerage companies in a case in which the plaintiff alleged that the defendants conspired to eliminate the plaintiff as a competitor in the Rockford, Illinois real estate brokerage market because the plaintiff was offering discounted brokerage commissions.

The plaintiff alleged that the Illinois and Rockford Associations participated in the alleged conspiracy by adjudicating ethics complaints brought against the plaintiff by other defendant brokers. Relying on *Twombly*, the court dismissed the claims against the Illinois and Rockford Associations because the plaintiff failed to allege any facts showing that the two Associations participated in any conspiracy to refuse to deal with the plaintiff or boycott his services. The court further relied on *Twombly* to dismiss the plaintiff's antitrust claims against a number of the broker defendants because the plaintiff failed to allege more than parallel conduct and a conclusory assertion of a conspiracy. In *Home Quarters Real Estate Group v. Michigan Data Exchange d/b/a MIRealSource, et al*^{n42.3} magistrate judge issued a Report and Recommendation that held that plaintiff did sufficiently state an antitrust claim under the *Twombly* standard against two Detroit area multiple listing services that terminated the plaintiff's access to the services' databases allegedly because the plaintiff was operating an online brokerage business and offering discounted commissions to sellers and commission rebates to buyers. The court found that the plaintiff's specific allegations that the two services acted within twenty-four hours of each other in terminating the plaintiff's access privileges, and each cited similar, but allegedly baseless violations of the services' rules as grounds for the terminations, constituted sufficient specificity to satisfy the *Twombly* pleading standard.

The Supreme Court's *Twombly* decision nevertheless, imposes a much greater burden upon antitrust plaintiffs seeking to sustain claims under Section 1 of the Sherman Act. Plaintiffs must not only adduce evidence to prove the existence of a conspiracy beyond mere parallel conduct by the defendants to avoid summary judgment, but they now must plead such facts to avoid a motion to dismiss.

The Supreme Court has also held that shareholders in a corporation may engage in a "conspiracy" subject to Section 1 of the Sherman Act if the shareholders are otherwise competing enterprises and operations of the corporation reduce competition among the shareholders. This is the holding of *American Needle, Inc. v. National Football League, et al.*^{n42.4} In *American Needle*, the Court considered whether National Football League Properties, Inc. (NFLP) constituted a "conspiracy" for the purposes of Section 1 of the Sherman Act, or a "single firm" that is not engaged in "concerted action" for antitrust purposes pursuant to the Supreme Court's previous holding in *Copperweld Corp. v. Independence Tube Corp.*^{n42.5} In *Copperweld* the Court held that a corporation and its wholly owned subsidiaries are considered to be a "single entity" that are not engaged in "concerted action" for antitrust purposes when they are carrying out the

mission of the corporate enterprise as a whole.

NFLP was organized by the thirty-two (32) teams that compose the National Football League (NFL). NFLP's purpose is to grant licenses to third parties to manufacture and distribute products bearing the trademarks and logos of the NFL teams. NFLP enters into license agreements and collects royalties for the use of the team's intellectual property and distributes the profits to the teams or for other purposes authorized by the teams. The plaintiff, American Needle, Inc., (American Needle) manufactured and distributed apparel bearing the NFL team trademarks under a license agreement with NFLP. NFLP later entered into an exclusive license agreement with Reebok International, Inc. (Reebok) for the manufacture and distribution of NFL team branded apparel. American Needle then sued NFLP contending that the exclusive license with Reebok constituted a conspiracy in violation of Section 1 of the Sherman Act. The trial court granted the NFLP's motion for summary judgment finding that the NFLP was a "single entity" under the *Copperweld* doctrine, and the Seventh Circuit Court of Appeals affirmed. The Supreme Court granted American Needle's petition for certiorari and reversed and remanded the case to the Seventh Circuit.

The Court noted that the NFL teams were each independent business that separately owned the intellectual property rights in their trademarks and logos. In the market in which American Needle competed, each NFL team was a competing source of trademark and logo rights for use on shirts, hats, or other apparel. The Court acknowledged that the NFL was an enterprise that could not exist but for cooperation and coordination among the independent NFL teams on team composition, competitive balance, and the scheduling and playing of games. But such necessary cooperation and coordination for the purpose of operating the NFL as a viable sports league did not automatically extend to the teams' separate exploitation of their respective independently owned trademarks and logos. According to the Court, the collective licensing of intellectual property rights in team trademarks and logos was not a function essential to operation of the NFL. Rather, the NFLP was akin to a "cartel" through which the independently owned and operated NFL teams eliminated the competition that previously existed among the teams in the relevant market for the licensing of the intellectual property rights to their team trademarks and logos.

The Court made clear, however, that it was only holding that the NFLP was a joint venture that constituted "concerted action" for the purposes of Section 1 of the Sherman Act. It remained to be determined on remand whether the NFLP's exclusive license with Reebok constituted an unreasonable restraint of trade that violated the Sherman Act. *American Needle* and *Copperweld* make clear that whether a joint venture among competitors will be treated as a "single entity" or a "conspiracy" for antitrust purposes must be determined by analyzing the substance of the venture, and not the form of business entity through which the venture operates. *American Needle* holds that competitors may not insulate their cartel from the antitrust laws by carrying out their purposes through a corporation owned by the cartel members. On the other hand, *Copperweld* holds that a corporation and its legally separate subsidiaries that act as a single economic enterprise are do not engage in a "conspiracy" for the purposes of the antitrust laws when the corporation and its subsidiaries coordinate their activities to achieve a common corporate objective.

[b] Rule of Reason

Not only must a plaintiff in a Section 1 case prove that the challenged conduct was the product of concerted action, but the plaintiff must also prove that the concerted action "restrained trade" that is in or affecting interstate commerce. At the turn of the century, the Supreme Court recognized that the Sherman Act, read literally, would prohibit all commercial contracts. Every contract between two businesses is joint action that "restrains" the trade of the contracting parties. The Court, therefore, concluded that Congress' intent when it passed the Sherman Act in 1890 was to prohibit only those trade restraints that had been judged to be "unreasonable," and thus illegal, at common law. n43

[i] Common Law Roots. The common law of many states in 1890 prohibited business conduct that constituted a "direct" restraint of trade, such as price-fixing. n44 On the other hand, so-called "ancillary" restraints that may "restrain" participants in a market, but also result in a more competitive marketplace as a whole were considered legal and enforceable. n45 The consequence, however, of a state court determination that a restraint was "direct," and therefore

illegal, was simply to declare the restraint unenforceable much the same as a contract term that is found to be "contrary to public policy." n46 There was not any cause of action for treble damages or the possibility of a criminal conviction as there is under the Sherman Act.

[ii] Supreme Court's Formulation Emphasizes Pro-Competition. The Supreme Court's declaration that the Sherman Act only prohibits conduct that restrains trade "unreasonably" has come to be known as the "Rule of Reason." In 1918 in *Chicago Board of Trade v. United States*, n47 Justice Brandeis enunciated the following oft-quoted formulation of the Rule of Reason:

The true test of illegality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts before and after the restraint, the evil believed to exist, the reason for adopting the particular remedy, the purpose or end sought to be attained, are all relevant facts. This is not because a good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and to predict consequences. n48

In *Chicago Board of Trade*, the Court upheld the legality of a Board of Trade rule that any commodity trades made after the exchange closed must be made at the last prevailing price on the exchange. Construed literally, the Board's rule was price-fixing; yet the Court upheld the rule because the rule, when examined in its total context, ensured that farmers and others who consummated transactions after the exchange closed were able to do so at competitively determined market prices. Since the Board rule enhanced and protected a competitive market for grain, the rule was "reasonable" and therefore legal under the Sherman Act.

[iii] Analysis of Rule of Reason Inquiry. The *Chicago Board of Trade* case demonstrates how broad and far-reaching a Rule of Reason inquiry can be. First, the relevant market must be defined. Then the purpose and effect of the challenged restraint must be examined to determine if its effect, on balance, is pro-competitive, and therefore, reasonable and lawful, or anti-competitive, and therefore, unreasonable and illegal. A full scale Rule of Reason inquiry is highly fact-intensive, and generally includes expert economic testimony or evidence.

[c] The *Per Se* Rule

Not long after *Chicago Board of Trade*, the Supreme Court declared that, in appropriate circumstances, a trade restraint will be so complete in its elimination of competition and so devoid of any pro-competitive justification that it will be judged to be unreasonable "*per se*." The first type of restraint that the Court declared to be subject to this truncated "*per se*" analysis is price-fixing.

In 1927 in *United States v. Trenton Potteries*, n49 the Supreme Court forcefully condemned a price-fixing agreement at issue in the following words:

The aim and result of every price-fixing agreement, if effective, is the elimination of one form of competition. The power to fix prices, whether reasonably exercised or not, involves the power to control the market and to fix arbitrary and unreasonable prices. The reasonable fixed price today may through economic and business changes become the unreasonable price of tomorrow. Once established, it may be maintained unchanged because of the absence of competition. ... Agreements which create such potential power may well be held in themselves unreasonable or unlawful restraints, without the necessity of minute inquiry, whether a particular price is reasonable or unreasonable. n50

However, the Supreme Court did not establish that price-fixing is *per se* unreasonable until 1940 in its decision in *United States v. Socony-Vacuum Oil Co.*: n51

Thus for over forty-years this Court has consistently and without deviation adhered to the principle that price-fixing agreements are unlawful *per se* under the Sherman Act and that no showing of so-called competitive abuse or evils which those agreements were designed to eliminate or alleviate may be interposed as a defense. n52

The *Socony Vacuum* Court stated that the consequence of the determination that a restraint is unreasonable "*per se*" is that the defendant is barred from introducing any evidence to show that the restraint is, on balance, reasonable.

In articulating the operation of the *per se* rule, the Court made plain that its application is to be reserved to those types of restraints with which the courts have had considerable experience, and have concluded that the likelihood that the patently anti-competitive effects of the restraint could ever be offset by any pro-competitive effects is so remote as to render any inquiry into such pro-competitive effects a waste of judicial resources. n53 In addition to price-fixing, the Supreme Court has held since *Socony-Vacuum* that the *per se* rule should be applied to the following types of restraints; (1) horizontal territorial allocations; n54 (2) tying agreements n55 and (3) certain types of group boycotts. n56

[4] Group Boycotts: Applying *Per Se* Analysis and Rule of Reason

Group boycotts, or "concerted refusals to deal" have been condemned under both the *per se* rule and the Rule of Reason, depending upon whether an anti-competitive intent is established. The *per se* rule against group boycotts is limited to those "naked boycotts" that have no purpose or effect other than the elimination of a competitor. On the other hand, "concerted refusals to deal" that are ancillary to broader pro-competitive objectives are tested against the more rigorous analysis of the Rule of Reason.

In *Associated Press v. United States*, n57 the Supreme Court struck down a set of rules adopted by the Associated Press that limited access to Associated Press news only to newspapers who were members of the Associated Press news gathering and dissemination cooperative, and also barred Associated Press membership to any newspaper that was in competition with an existing Associated Press member. The combined effect of the two rules deprived access to Associated Press news to any newspaper that competed with another Associated Press member.

While the two Associated Press rules in combination were held to be illegal, the Supreme Court affirmed that a single rule that limited access to Associated Press news only to Associated Press members was necessary to maintain the value of the Associated Press network. n58 So long as any newspaper could join Associated Press on reasonable terms, a rule forbidding Associated Press members from conveying Associated Press news to non-members was a reasonable "group boycott" that was essential to the preservation of the Associated Press, which itself served a pro-competitive purpose in the market for news of current events.

[a] Market Power of Parties Not Relevant in *Per Se* Cases

Group boycotts among competitors carried out through professional associations that are clearly intended to achieve a result through the elimination of competition are *per se* illegal. For example, In *FTC v. Superior Court Trial Lawyers Ass'n*, n59 the attorney members of the Superior Court Trial Lawyers Association of the District of Columbia attempted to gain an increase in the hourly rates paid by the D.C. City Council to defend indigent criminal defendants. The Association members passed a resolution agreeing not to accept any further appointments to represent criminal defendants unless the City Council raised the authorized hourly rate of compensation. Rejecting arguments that the Association's conduct was antitrust exempt as a collective effort to influence governmental policy-making, n60 the Supreme Court declared the Association's action to be a *per se* illegal group boycott designed to affect price. Significantly, the Supreme Court held that the Association's boycott was *per se* illegal without regard to whether the Association possessed market power because the Association's action was a "naked restraint" on price and output. n61

Other examples of *per se* illegal group boycotts are a trade association persuading manufacturers not to sell products to

non-member distributors in *Montague v. Lowry*,ⁿ⁶² and a trade association's circulating a "black list" of lumber wholesalers who sold their products at retail in *Eastern States Retail Lumber Dealers' Ass'n v. United States*.ⁿ⁶³

In *Klor's, Inc. v. Broadway-Hale Stores, Inc.*,ⁿ⁶⁴ the Supreme Court held that the competitive impact of the elimination of the plaintiff on the relevant market was not to be considered where the defendant's conduct was so obviously intended to destroy competition that it would be declared illegal *per se*. In *Klor's*, a large appliance retailer persuaded leading appliance manufacturers not to sell appliances to a small appliance retailer that competed with the defendant. The record showed that the relevant market was highly deconcentrated and that the elimination of the plaintiff would not have any perceptible impact on competition in the relevant market.

The *Klor's* case made clear that the *per se* rule applies to concerted action that has the purpose and effect of denying the "target" of the concerted action access to goods or facilities that the target needs in order to compete. It also dispelled any suggestion a prior decision, *Fashion Originators' Guild of America v. FTC.*,ⁿ⁶⁵ may have created that group boycotts by organizations without market power would not be illegal. The Fashion Originators' Guild was an association of women's dress designers. The Guild members became concerned about "style pirates" who created inexpensive imitations of the Guild members' "original" designs. The Guild adopted an ethical rule that prohibited Guild members from selling dresses to any retail store that also carried the dresses of "style pirates." The Supreme Court determined the Guild's ethical rule to be an illegal group boycott in violation of Section 1 of the Sherman Act. In doing so, however, the Court relied upon the fact that the Guild's members constituted nearly all of the leading women's dress designers, and, therefore, the Guild's refusal to deal with retailers had a highly coercive effect upon these retailers.

[b] Rule of Reason Analysis Applies to "Pro-Competitive" Boycotts

The Supreme Court has expressly recognized that concerted action that restricts the freedom of certain competitors in a relevant market can also have a pro-competitive impact on competitive conditions as a whole. These types of "group boycotts" are to be judged by the Rule of Reason, and not the *per se* rule announced in *Klor's*. For example, in *Broadcast Music, Inc. (BMI) v. Columbia Broadcasting System, Inc.*,ⁿ⁶⁶ the Supreme Court confirmed the application of the Rule of Reason to Broadcast Music, Inc.'s pricing policies on blanket copyright licenses to musical compositions. In *National Collegiate Athletic Ass'n v. Board of Regents*,ⁿ⁶⁷ the Supreme Court held that the Rule of Reason applied to the NCAA's rules restricting the rights of member universities to license television rights to inter-collegiate football games. Finally, the Court in *Northwest Wholesaler Stations, Inc. v. Pacific Stationary & Printing Co.*,ⁿ⁶⁸ affirmed the right of a retail stationers' cooperative to expel a member without notice when membership did not constitute a competitive advantage.

In *Chicago Board of Trade*ⁿ⁶⁹ Court upheld a rule adopted by the Board that required Board members to "refuse to deal" except at prices that last prevailed on the floor of the Board's exchange. The Court stated that the rule was as necessary to preserve the pro-competitive impact of the Board's open bidding process for establishing grain prices, and to prevent fraud on traders not privy to the latest prevailing prices.

[5] Tying Agreements Are *Per Se* Illegal: Three Elements of Claim

In *Northern Pacific Railway Co. v. United States*,ⁿ⁷⁰ the Supreme Court held that tying arrangements are *per se* illegal when their purpose is to extend a seller's market power in tying product market to a second relevant market for the tied product. A tying arrangement occurs when a seller who has market power in one product or service refuses to sell that product or service to a buyer unless the buyer also agrees to purchase a different and less desired product or service from the same seller. The seller has therefore "tied" the sale of one product or service to the purchase of a second product or service. When the seller has market power in one of the products or services ("the tying product") he is able to use that power to coerce purchases of the second product or service ("the tied product"), which the consumer may not want at all, or may prefer to purchase from a different source.

In *Northern Pacific*, the railroad sold land adjacent to its tracks to manufacturers on the condition that goods produced at the site be shipped using the railroad's facilities. The Court in *Northern Pacific* articulated the following three elements of a *per se* illegal tying arrangement:

- two separate and distinct products or services must be tied together by an express contract or course of dealing between two parties
- the seller of tying product must have sufficient market power in the tying product market to restrain competition in the tied product market
- the amount of commerce restrained in the tied product markets must be not insubstantial n71

[a] "Two Product Requirement": Functional Test

The first issue in any tying case is whether the seller has in fact tied together two separate products or services. The "two product" requirement is not interpreted literally. Otherwise, the sale of three piece suits, salt and pepper shakers, or automobiles with tires would be considered to be tying arrangements. In determining whether two products and services are "separable" for the purpose of tying analysis, the Supreme Court has announced a test based upon the separate functions served by the allegedly separate products, and not whether the products are invariably sold as a combination.

In *Jefferson Parish Hospital v. Hyde*, n72 the Supreme Court considered whether a hospital's exclusive contract with one anesthesiology practice group illegally tied the use of the anesthesiology group to the use of the hospital's general surgery facilities. The Court held that general surgical services and anesthesiology services were two separate products even though surgery was not performed without anesthesia, and anesthesia was not administered to a patient except as incident to a surgical procedure. The Court noted that surgeons often selected specific anesthesiologists for specific procedures and that hospitals billed for anesthesia services separately from other surgical services. These factors supported a conclusion that anesthesia was a "product" separate from general surgical services.

[b] Market Power Need Not Rise to "Monopoly Power"

The second issue in a tying case is whether the seller has market power in the tying product market. Market power in a tying case is measured in much the same fashion as monopoly power is measured in a case under Section 2 of the Sherman Act. See § 8.03[2] *supra*. Market power, however, in a tying case need not rise to the same level as "monopoly power." To have market power a seller must have the power to impose a price increase of indefinite duration and not lose market share.

A leading case on whether a tying product seller has "market power" in the tying product market is *United States Steel Corp. v. Fortner Enterprises, Inc.* n73 In *Fortner*, U.S. Steel offered below-market financing to purchasers of U.S. Steel's prefabricated houses. A buyer of prefabricated houses challenged U.S. Steel's requirement that its inexpensive financing was only available for purchases of U.S. Steel's prefabricated houses. The attractive financing was alleged to be the "tying product" and U.S. Steel's prefabricated houses were alleged to be the "tied product." The Supreme Court rejected the plaintiff's claims because U.S. Steel was not shown to have any market power in the market for credit. Many other lenders were willing to finance sales of prefabricated homes, but not at U.S. Steel's low rates. As the Court concluded, U.S. Steel was simply offering cheap credit as an inducement to buy expensive houses.

A seller that does not have market power, but who attempts to impose a tying arrangement, is in the same position as a farmer who refuses to sell his wheat unless the buyer also buys the farmer's corn. Those buyers who do not want to buy corn along with wheat will simply buy their wheat from the other farmers who do not require buyers to buy corn.

[c] \$200,000 Threshold for "Not Insubstantial" Requirement

The third element of a tying violation is that the tying arrangement restrain a "not insubstantial" volume of commerce in the tied product market. This element is of no practical significance since the Supreme Court has held that an arrangement that affects less than \$200,000.00 in tied product sales is a "not insubstantial" amount of commerce in the tied product market. n74

FOOTNOTES:

(n1)Footnote 14. 15 U.S.C. § 1.

(n2)Footnote 15. 15 U.S.C. § 2.

(n3)Footnote 16. See *United States v. Frankfort Distilleries, Inc.*, 324 U.S. 293 (1945) (noting that Congress left no area of its constitutional power unoccupied when it passed the Sherman Act); *Hospital Building Co. v. Trustees of Rex Hospital*, 425 U.S. 738 (1976) (conspiracy to block expansion of local hospital affected interstate movement of hospital supplies).

(n4)Footnote 17. 444 U.S. 232 (1980) .

(n5)Footnote 18. 444 U.S. at 242 .

(n6)Footnote 19. 444 U.S. at 246 .

(n7)Footnote 20. See *Pope v. Mississippi Real Estate Comm'n*, 695 F. Supp. 253, 273-74 (N.D. Miss. 1988) , *aff'd*, 872 F.2d 127 (5th Cir. 1989) (granting defendants' summary judgment motion, in part, because plaintiff failed to introduce evidence of effect of defendants' conduct on interstate commerce).

(n8)Footnote 21. See *United States v. Grinnell Corp.*, 384 U.S. 563, 570-71 (1966) (Section 2 prohibits "willful acquisition or maintenance" of monopoly power); *Lorain Journal Co. v. United States*, 342 U.S. 143 (1951) (monopoly newspaper's refusal to accept advertising from advertisers who also chose to advertise on small local radio station held to be monopolistic conduct in violation of Section 2).

(n9)Footnote 22. For example, the owner of a patent or copyright is accorded a legally enforceable monopoly on the right to commercialize the patented or copyrighted product, process, or service. Patent and copyright protections are intended to encourage creativity and invention, and have their basis in *Article I, Section 8, Clause 8 of the Constitution*.

(n10)Footnote 23. Definition of a "relevant market" is an essential element of a variety of antitrust violations including monopolization cases under Section 2 of the Sherman Act, tying violations under Section 1 of the Sherman Act and Section 3 of the Clayton Act, and mergers or acquisitions that tend to create a monopoly in violation of *Section 7 of the Clayton Act*. In *United States v. Philadelphia National Bank*, 374 U.S. 321 (1963) the Supreme Court stated that the "area of effective competition in the known line of commerce must be charted by careful selection of the market area in which the seller operates, and to which the purchaser can practically turn for supplies."

(n11)Footnote 24. 351 U.S. 377 (1956) .

(n12)Footnote 25. See *Tampa Electric Co. v. Nashville Coal Co.*, 365 U.S. 320 (1961) (relevant geographic market for assessing competitive impact of electric utility's exclusive dealing contract for coal was the area where coal producers were located who were willing to compete for the utility's business).

(n13)Footnote 26. See *Grumman Corp. v. LTV Corp.*, 665 F.2d 10 (2d Cir. 1981) (worldwide market for airframe subassemblies); *RSR Corp. v. FTC*, 602 F.2d 1317, 1979-2 Trade Cas. (CCH) P62774 (9th Cir. 1979) (nationwide market for secondary lead); *United States v. Philadelphia Nat'l Bank*, 374 U.S. 321 (1963) (metropolitan market for consumer banking services).

(n14)Footnote 27. 384 U.S. 563 (1966) .

(n15)Footnote 28. 384 U.S. at 570-71 .

(n16)Footnote 29. See *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377 (1956) (monopoly power is the power to control prices or exclude competition); *U.S. Steel Corp. v. Fortner Enterprises, Inc.*, 429 U.S. 610 (1977) (finding that manufacturer of prefabricated houses who extended credit to purchasers of houses did not have market power over market for credit because other lenders could easily have matched the manufacturer's credit terms if they so desired).

(n17)Footnote 30. In his seminal decision on monopolization in *United States v. Aluminum Co. of Am.*, 148 F.2d 416 (2d Cir. 1945) , Judge Learned Hand found that Alcoa produced 90% of the "virgin" aluminum produced in the United States, 64% of the aluminum fabricated and sold in the United States including imported "virgin" aluminum and "secondary" aluminum made from scrap aluminum, and 33% of the non-fabricated aluminum sold as ingot, including "virgin" and "secondary" aluminum. Concerning the question of whether Alcoa possessed a monopoly in any of these markets, Judge Hand held that a 90% market share is clearly a monopoly, a 64% market share is "doubtful," and a 33% market share "certainly is not" a monopoly. 148 F.2d at 424 .

For a recent case construing "market share," see *RE/MAX Int'l, Inc. v. Realty One Inc.*, 1996-1 Trade Cas. (CCH) P71434 .

(n18)Footnote 31. Unlike the offence of "monopolization" in which the defendant need only have willfully acquired or maintained a monopoly, the offense of "attempted monopolization" requires the plaintiff to prove that the defendant had a "specific intent" to monopolize a relevant market and possessed a "dangerous probability of success" in achieving its intended goal. See *American Tobacco Co. v. United States*, 328 U.S. 781, 785 (1946) .

(n19)Footnote 32. In *United States v. Aluminum Co. of Am.*, 148 F.2d 416 (2d Cir. 1945) , Judge Hand found that Alcoa's acts of monopolization included maintaining aluminum ingot prices at artificially high levels, and rolled aluminum sheet price at artificially low levels to prevent competitors from entering the market for rolled sheet. 148 F.2d at 436-38 .

(n20)Footnote 33. See *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 112 S. Ct. 2072, 119 L. Ed. 2d 265, 1992-1 Trade Cas. (CCH) P69839 (1992) (Kodak could have monopolized market for parts and service for Kodak copiers by entering into exclusive dealing contracts for parts and service with purchasers of Kodak copying equipment.)

(n21)Footnote 34. See *Aspen Skiing Co. v. Aspen Highlands Skiing Corp.*, 472 U.S. 585 (1985) (finding that owner of three out of four ski resorts in Aspen has monopoly of local skiing market, and violated antitrust laws by refusing to participate with owner of fourth resort in a combined lift ticket program).

(n22)Footnote 35. See *Hartrampf v. First Multiple Listing Serv., Inc.*, 2 Trade Cases (CCH) P 65, 518 (N.D. Ga. 1983) . In *Hartrampf*, the defendant multiple listing service was found to have violated the Sherman Act by imposing a rule on participants that prohibited them from joining any other multiple listing service. While *Hartrampf* was decided under Section 1 of the Sherman Act, the facts could also support a claim under Section 2.

(n23)Footnote 36. 328 U.S. 781 (1946) .

(n24)Footnote 37. 328 U.S. at 810 .

(n25)Footnote 38. 465 U.S. 752 (1984) .

(n26)Footnote 39. 465 U.S. at 764 .

(n27)Footnote 40. 306 U.S. 208 (1939) .

(n28)Footnote 41. 306 U.S. at 233 .

(n29)Footnote 42. See *Matsustria Electric Indus. Corp. v. Zenith Radio Corp.*, 475 U.S. 574 (1986) . In *Matsustria*, the Supreme Court affirmed summary judgment for Matsustria Electric Industrial Corporation when Zenith could not identify any evidence that Matsustria had participated in a conspiracy to price its television sets below cost.

(n30)Footnote 42.1. 127 S.Ct. 1955 (2007) .

(n31)Footnote 42.2. Case No. 06 C 50240 (N.D. Ill. August 31, 2007).

(n32)Footnote 42.3. Case No. 07-12090 (E.D. Mich., filed June 18, 2008).

(n33)Footnote 42.4. 560 U.S. ____ (2010) .

(n34)Footnote 42.5. 467 U.S. 752 (1984) .

(n35)Footnote 43. See *United States v. Joint-Traffic Ass'n*, 171 U.S. 505 (1898) (holding that the Sherman Act only applies to contracts whose direct and immediate effect is a restraint on commerce rather than agreements entered into for the purpose of promoting the legitimate business of an individual or competitor).

(n36)Footnote 44. See *Craft v. McConoughy*, 79 Ill. 346 (1875) .

(n37)Footnote 45. See *Leslie v. Lorillard*, 110 N.Y. 519, 18 N.E. 363 (1888) .

(n38)Footnote 46. See; *Nester v. Brewing Co.*, 161 Pa. 473, 29 A.102 (1894) ; *Andersen v. Jett*, 89 Ky. 375, 12 S.W. 670 (1889) ; *Salt Co. v. Guthrie*, 35 Ohio St. 666 (1880) .

(n39)Footnote 47. 246 U.S. 231 .

(n40)Footnote 48. 246 U.S. at 238 .

(n41)Footnote 49. 273 U.S. 392 (1927) .

(n42)Footnote 50. 273 U.S. at 397 .

(n43)Footnote 51. 310 U.S. 150 (1940) .

(n44)Footnote 52. 310 U.S. at 218 .

(n45)Footnote 53. In his dissent in *United States v. Container Corp. of Am.*, 393 U.S. 333, 341 (1969) , Justice Marshall explained the logic of the *per se* rule as follows:

[T]he potential competitive harm plus the administrative costs of determining in which particular situation the practice may be harmful must outweigh the benefit that may result. If the potential benefits in the aggregate are outweighed to this degree, then they are simply not worth identifying in individual cases.

(n46)Footnote 54. See *United States v. Topco Assocs.*, 405 U.S. 596 (1972) .

(n47)Footnote 55. See *Northern Pacific Railway Co. v. United States*, 356 U.S. 1 (1958) .

(n48)Footnote 56. See *Klor's, Inc. v. Broadway-Hale Stores, Inc.* 359 U.S. 207, 79 S. Ct. 705, 3 L. Ed. 2d 741, 1959 Trade Cas. (CCH) P69316 (1959) .

(n49)Footnote 57. 326 U.S. 1 (1945) .

(n50)Footnote 58. See *Associated Press v. United States*, 52 F. Supp. 362, 374 (S.D.N.Y. 1943) , *aff'd*, 326 U.S. 1 (1945) ("it is essential to the protection of the main purpose that the member who furnished 'spontaneous' news, or AP itself, shall not destroy the value of what is transferred by making it available to others, before it can be published.")

(n51)Footnote 59. 493 U.S. 411 (1990) .

(n52)Footnote 60. In *Eastman Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961) , the Supreme Court held in 1961 that the antitrust laws do not apply to collective efforts to secure governmental action, even if the governmental action desired by the petitioners would injure or destroy competition. The *Noerr* decision, which applied to efforts to influence legislation, was later extended to efforts to influence administrative agencies. *United Mine Workers v. Pennington*, 381 U.S. 657 (1965) .

(n53)Footnote 61. 493 U.S. at 423 .

(n54)Footnote 62. 193 U.S. 38 (1904) .

(n55)Footnote 63. 234 U.S. 600 (1914) .

(n56)Footnote 64. 359 U.S. 207 (1959) .

(n57)Footnote 65. 312 U.S. 457 (1941) .

(n58)Footnote 66. 441 U.S. 1 (1979) .

(n59)Footnote 67. 468 U.S. 85 (1984) .

(n60)Footnote 68. 472 U.S. 284 (1985) .

(n61)Footnote 69. 246 U.S. 231 (1918) .

(n62)Footnote 70. 356 U.S. 1 (1958) .

(n63)Footnote 71. 356 U.S. at.

(n64)Footnote 72. 466 U.S. 2 (1984) .

(n65)Footnote 73. 429 U.S. 610 (1977) .

(n66)Footnote 74. See *Fortner Enters., Inc. v. United States Steel Corp. (Fortner I)*, 394 U.S. 495, 501-502 (1969) .

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138 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 8 Real Estate Brokers and Antitrust Laws *

10A-8 Real Estate Brokerage Law and Practice § 8.04

§ 8.04 Application of the Antitrust Laws to the Real Estate Brokerage Profession

[1] Defining Relevant Market in Real Estate Brokerage Cases

Relevant market definition is often the critical inquiry in an antitrust case. If the market is defined too broadly, the defendant's market power will be understated, and the anti-competitive effects of the defendant's conduct will be minimized. Correspondingly, if the relevant market is defined too narrowly, a defendant's market power will be overstated, and the anti-competitive effects of the defendant's conduct will be magnified.

In defining the relevant market in real estate brokerage cases, it is necessary to examine carefully the product or service impacted by the allegedly illegal restraint of trade or monopoly. That product or service could be real estate brokerage, memberships in real estate trade associations or participation in a multiple listing service, sales of products or services to real estate brokers and their trade associations, or sales of new home construction, existing homes, or commercial, industrial or investment real estate. Furthermore, the market could be national or local in geographic scope, or could involve a few or many competitors.

[a] Product Market Includes Property Owners and Other Brokers

Relevant market definition in a real estate brokerage context is particularly elusive. From a "product market" definition standpoint, *see § 8.03[2][a][i]*, real estate brokers are always in competition with property owners themselves ("for sale by owners" or "FSBOs") who are free to sell their own property without the aid of a real estate broker. "Full service" brokers compete with "limited service" brokers, or even non-licensed companies, who, for a lesser fee, offer property owners only certain services, such as yard signs, classified advertising, contract forms, or phone-answering services.

The product market in real estate brokerage is characterized by a large number of competitors, and closely analogous to a perfectly competitive market. This feature is the cornerstone of the argument that one broker alone could not possess "market share" for a particular relevant market, and therefore no violation of antitrust laws occurred.

[b] Geographic Market Definition Depends on Focus of Business

Practitioners must also define the geographic market. *See § 8.03[2][a][ii]*. In practice, few real estate brokers market

property statewide, although they are licensed to engage in real estate brokerage within an entire state. An individual real estate agent's "market" is usually defined by the properties reachable in a twenty-minute drive from the agent's office or home.

Real estate brokerage companies, on the other hand, may compete in a much broader marketplace. Brokerage firm expansion usually occurs through the opening of a "branch" or "satellite" office in an adjoining market area. The territorial jurisdictions of local real estate trade associations also are indicators of "natural market areas" for real estate brokers.

Brokers may also confine their "markets" to specific types of real estate or neighborhoods within a larger metropolitan area. In *Thompson v. DeKalb Board of REALTORS(R)*,ⁿ⁷⁵ the Eleventh Circuit stated that different parts of Atlanta could each be "relevant markets" for real estate brokerage because the high-priced properties in one part of Atlanta did not compete with the lower priced properties in another part of Atlanta, even though Atlanta-based real estate brokers were licensed to market property throughout the state of Georgia.

Re/Max International, Inc. v. Realty One, Inc.^{n75.1} illustrates the difficulties in defining geographic markets in the real estate brokerage business with sufficient precision to meet market definition standards under the antitrust laws. In the *Realty One* case, several Re/Max franchises doing business in Northern Ohio sued Realty One, Inc. and another major independent brokerage firm, Smythe-Cramer, Inc., under the federal and Ohio antitrust laws alleging, among other things, that the defendants had monopolized various local real estate brokerage markets.

To meet their burden of defining appropriate relevant markets, the plaintiffs relied upon testimony of an expert economist who analyzed market shares of the defendants within the 161 different suburbs that were identified in the regional multiple listing service that served Northern Ohio. The plaintiffs' expert simply presumed that each one of the suburbs constituted a distinct geographic market since real estate brokerage markets are "very local."

The district court rejected the expert's presumption as without factual support. The court noted that the 161 different communities included municipalities that ranged in population from less than 1,000 to 71,000. The court also noted that there was not any evidence adduced to show that the residents of these communities only sought real estate brokerage services from real estate brokerage firms with offices in the specific community. The court further observed that there was not any evidence that real estate brokerage firms in the communities did not compete for listings in areas outside the community.

In conclusion, the court determined that there is not any reason to conclude that political boundaries necessarily conform, as a matter of law, to commercial real estate brokerage markets.

[2] Price-Fixing of Commission Rates Is *Per Se* Illegal

Agreements among real estate brokers to fix commission rates are "per se" violations of Section 1 of the Sherman Act, as well as a felony. Prior to the 1970's real estate trade associations promulgated "recommended" commission schedules as a matter of course. The conventional wisdom prior to 1970 was that professional association fee schedules that were merely "recommended" and not enforced as a matter of professional ethics were not Sherman Act violations.ⁿ⁷⁶ The Supreme Court in 1975 flatly rejected this conventional wisdom in *Goldfarb v. Virginia State Bar Association*.ⁿ⁷⁷ In *Goldfarb*, the Supreme Court declared that the recommended fee schedule promulgated by the Virginia State Bar Association was *per se* illegal price-fixing. The Court rejected the notion that fee schedules that were merely "recommended" were permissible under the Sherman Act. The Court in *Goldfarb* also rejected the proposition that professional fees were not "in" or "affecting" interstate commerce, foreshadowing the Court's holding six years later in *McLain v. New Orleans Real Estate Board*.ⁿ⁷⁸

Even before the Supreme Court's decision in *Goldfarb*, the National Association of REALTORS(R) (NAR) prohibited

its member associations of Realtors from maintaining any fee schedules, whether mandatory or merely recommended. As a result of NAR's efforts, fee schedules promulgated by real estate trade associations have been eliminated, and any vestiges of their effects have long since been dissipated.

[a] Agreement Found in Conduct, Writing or Speech

An "agreement" for antitrust purposes can be established by conduct, as well as by oral or written agreements. In *United States v. Foley*,⁷⁹ the Fourth Circuit upheld the criminal conviction of a real estate broker who announced his intention at a trade association meeting to increase his firm's commission rates due to financial losses he was suffering. Within a few weeks, all other brokers who attended the meeting had also increased their commission rates to match the rate announced by the defendant. The court concluded that the defendant's statement at the meeting was an invitation to agree on price, which the other competitors accepted by raising their commission rates shortly thereafter. The court presumed that none of the real estate brokers could have successfully raised his or her rates had not the rest of the competitors followed suit. If the defendant's competitors had not gone along with the price increases, the defendant who raised his rates would simply have lost even more business to his competitors.

[b] Argument that Uniform Prices Are Result of Competitive Market

In analyzing potential price fixing claims against real estate brokers, it is important to keep in mind the teaching of the Supreme Court's decision in *Monsanto v. Spray-Rite Service Corp.*,⁸⁰ that "parallel" conduct by competitors is not sufficient to prove that competitors "agreed" to engage in the parallel conduct. An antitrust plaintiff must prove facts that tend to eliminate the possibility that the competitors' uniform conduct is the result of individual unilateral decision-making.

Real estate brokerage markets frequently contain a large number of competitors all charging the same commission rate. Of course, an equilibrium price, or commission rate, in a real estate brokerage market could be the result of a common agreement as reflected in a recommended fee schedule. Uniform prices, however, are also a characteristic of a perfectly competitive marketplace.

[i] Agricultural Market Is Prototypical Perfectly Competitive Market. The hallmarks of perfectly competitive markets are large numbers of sellers, a fungible or "commodity" product or service, and widespread knowledge of prevailing market prices. A market that approximates perfect competition is the market for most agricultural products, such as wheat, corn or soy beans. These markets are characterized by a large number of farmers who produce products that are essentially interchangeable (bushels of corn). Farmers taking their products to market will "charge" the same price for their bushels of corn as every other farmer selling corn on that day. If a farmer tried to charge more than the market price, no buyers would pay the higher price if they could buy the same bushel of corn from another farmer at the lower market price. Likewise, farmers would have no reason to sell their corn at a lower price than the prevailing market price as long as they can sell all of their production at the higher market price, which will maximize the revenues from their crops.

[ii] Real Estate Market: Attributes of Perfectly Competitive Market. The typical real estate brokerage market also has a large number of broker competitors. No single broker generally has the power to raise his or her commission rates above the prevailing market rate and not lose business. Similarly, most real estate brokers will not profit by lowering their commission rates to gain more listings because they will not gain revenue from an increase in listing volume unless those listings are sold before they expire. In their efforts to sell listed property, most brokers face fairly uniform and fixed costs, including the cost of advertising, office overhead, and compensation paid to their sales agents, or to cooperating real estate brokerage firms who may find the buyer for the listed property. If the broker cannot reduce these fixed costs, a lower commission rate will simply reduce his or her net profit. Thus, a strong argument can be made that the uniform commission rates that predominate in most markets are the result of competition and not collusion. As a result of these economic forces confronting real estate brokers in most markets, a uniformity of commission rates within those markets is almost certain to occur. Applying antitrust price-fixing principles to these markets, such

uniformity will not be sufficient to support a price-fixing claim unless the plaintiff has clear evidence of collusion among brokers to maintain a uniform commission rate. Given the antitrust awareness of most real estate brokers, such evidence of collusion will rarely be present.

[iii] Cooperation in Real Estate Brokerage Is No Indicia of Monopoly. A unique feature of real estate brokerage markets is that brokers both compete and cooperate with each other simultaneously in their efforts to sell property quickly at the highest possible price. Real estate brokers not only charge prices to sellers who list property with them for sale, but the brokers also charge prices to each other for their cooperative efforts to sell each other's listings. Brokers compete to secure a seller's listing, but once the contest for the listing is over, the "winning" listing broker invites the other brokers in the market to assist in finding a buyer for the property. If a cooperating broker is successful in this regard, he or she is paid a portion of the commission received by the listing broker, or a "commission split."

For all of the same reasons that listing commission rates reach an equilibrium point, so also do the rates of cooperative compensation that listing brokers offer to cooperating brokers. These offers of cooperative compensation are typically extended through multiple listing services operated by local real estate trade associations. Listing brokers generally offer the same compensation to cooperating brokers as all other listing brokers are offering. If the listing broker offers a lesser cooperative "split" he runs the risk of discouraging cooperation on his listings as cooperating brokers focus their efforts on listings offering a higher split. On the other hand, a broker has little incentive to offer a greater split if a split at the market rate will generate sufficient efforts by the other cooperating brokers. n81

Uniform commission splits that are common in most markets are therefore most likely the result of competitive forces, rather than inter-broker collusion. Clearly, if real estate brokers collude on the amount of cooperative compensation they will offer or accept, that collusion would be subject to attack as *per se* illegal price-fixing. The NAR long ago established policies governing the operation of affiliated associations of Realtors that forbid these associations from having any policy or procedure that fixes, suggests, or recommends rates of cooperative compensation between or among real estate brokers. n82

[iv] Fixing Multiple Listing Service Participation Fees Is Per Se Illegal. In the early 1990s, advances in computerized database technology enabled multiple listing services to manage larger quantities of real estate information at ever decreasing costs. At the same time, as suburban housing markets grew around central cities, real estate brokers expanded their operations by opening branch offices in outlying communities. To secure the marketing exposure necessary to service customers and clients in these newer markets, brokers were often required to join and pay fees to several multiple listing services, each of which utilized individual computer software programs, which the brokers' agents were required to learn to operate. These changing market forces caused a dramatic increase in the "regionalization" of multiple listing services during the last decade of the twentieth century.

A typical regional multiple listing service is a corporation owned by several local associations of Realtors(R) that previously operated their own separate multiple listing service. The regional multiple listing service corporation operates a computerized database compilation that consists of the aggregation of the separate multiple listing service databases that the local associations of Realtors(R) operated individually prior to the formation of the regional multiple listing service. Hence, after the regional multiple listing service is formed, a real estate broker may belong to any one of the various associations of Realtors(R), or multiple listing services, that own the regional database corporation, and, by virtue of that single membership and participation fee, gain access to the aggregated database compilation containing properties listed for sale throughout the entire metropolitan market area served by all of the associations of Realtors(R) that own the regional multiple listing service database compilation.

In the late 1990s, at the same time that regional multiple listing services were forming or expanding at a rapid rate throughout the United States, the National Association of Realtors(R) amended its membership policies to abandon the rule that a real estate broker who wished to join an association of Realtors(R) or participate in a Realtor(R) association-owned multiple listing service had to join the association of Realtors(R) that had been assigned by the

National Association of Realtors(R) the territorial jurisdiction over the location of the broker's office. As a result of this membership policy change, a real estate broker is free to "shop around" for association of Realtor(R) membership services, including multiple listing service participation, among all of the association of Realtors(R) in the metropolitan area, and not simply the one association that has jurisdiction over the location of the broker's office. This freedom of a real estate broker to select the Realtor(R) association and multiple listing service he or she wishes to join is referred to by the National Association of Realtors(R) as its "Board of Choice" policy.

The Board of Choice policy creates an environment in which associations of Realtors(R) in a metropolitan area are in competition with each other for Realtor(R) members and multiple listing service participants. Each association independently determines the "bundle" of membership benefits it offers to real estate brokers in the marketplace, and likewise independently sets its association dues and multiple listing service participation fees at levels necessary to provide this bundle of membership benefits to those brokers who choose to join. As competitors for real estate broker members and multiple listing service participants, associations of Realtors(R) are subject to the antitrust laws to the same extent as any other group of competing businesses in a relevant market.

The status of associations of Realtors(R) as competitors creates antitrust risks when these competing associations decide to form a regional multiple listing service. Typically, the existing associations of Realtors(R) in a market area are of various sizes, and have very different dues and fee structures. On the other hand, if a regionalized multiple listing service database compilation is formed, the multiple listing service participants of each of the shareholder associations of Realtors(R) will be utilizing the exact same database compilation as the participants of every other shareholder association. Consequently, as a result of the Board of Choice policy, the shareholder association of Realtors(R) of a regional multiple listing service are competing among themselves on the terms and conditions upon which they make access to the same database available to real estate brokers in the relevant market.

This price competition for access to the regional multiple database compilation, as well as the other non-multiple listing services benefits that associations of Realtors(R) offer to attract members, can threaten the survival of smaller associations of Realtors(R) who might otherwise be inclined to become a shareholder in a regional multiple listing service database corporation. These smaller associations typically charge higher per capita association dues because they have fewer members over which to spread the cost of association operations. If a broker member of the small association can acquire access to the exact same multiple listing database compilation from a larger neighboring association of Realtors(R) at a lower price, the smaller association may suffer significant membership losses to the point of dissolution.

This competitive threat to smaller or medium-sized associations of Realtors(R) posed by the potential formation of a regional multiple listing service database corporation has led to the adoption of regional multiple listing service corporate structures designed to achieve pricing uniformity among all of the association shareholders for access to the regional multiple listing service corporation database. To the extent these corporate structures have the purpose and effect of creating a single price charged by each shareholder association for access to the regional multiple listing database compilation, these structures are, in all likelihood, per se illegal price fixing in violation of Section 1 of the Sherman Act.

This is the holding of *Freeman v. Sandicor, Inc.* n82.1 In *Freeman*, the eleven associations of Realtors(R) in San Diego County, California decided in 1991 to create a single regional multiple listing service database for the entire county. The associations formed a corporation named Sandicor, Inc. in which each association was a shareholder. Prior to the formation of Sandicor, each association operated its own independent multiple listing service database. By forming Sandicor, the members of each of the associations of Realtors(R) in San Diego County could gain access to an aggregated multiple listing service database for the entire County at a per capita cost that was significantly less than the cost of participating in each of the associations' individual multiple listing services.

The associations of Realtors(R) in San Diego county varied dramatically in size from the large San Diego Association

of Realtors(R) to the very small Valley Center Association of Realtors(R). To protect the smaller associations from the risk of membership losses as a result of the formation of the regional multiple listing service corporation, the Sandicor shareholders agreed among themselves on a corporate structure that insured that all multiple listing service participants that accessed the Sandicor database compilation paid a uniform price for such access without regard to the Sandicor shareholder through which the participant gained such access.

First, the associations of Realtors(R) formed the Sandicor corporation for the purpose of operating the single county-wide centralized multiple listing service database compilation. Sandicor's cost of the database hardware and software, executive and administrative staff, rent, telephone, and other overhead expenses required to operate the centralized database would be spread on a per capita basis among all of the multiple listing service participants of all of the Sandicor shareholders.

Second, the Sandicor shareholders entered into a shareholders' agreement that required each Sandicor shareholder to enter into a "Service Center Agreement" with Sandicor. Pursuant to the Service Center Agreement, each shareholder agreed to perform certain "local" services for the multiple listing service participants who accessed the Sandicor database through that particular shareholder. The Sandicor shareholders' agreement and the Service Center Agreements set a uniform fee to be paid by Sandicor to each of the shareholders for the performance of the "service center" functions. The Sandicor governing documents also prohibited each of the shareholders from rebating any of the service center fee it received to its multiple listing service participants.

Each month the Sandicor shareholders billed the brokers who received access to the Sandicor database compilation through that shareholder an amount equal to the per capita cost of providing the "core" Sandicor services, plus the amount to be paid to the shareholder for performing the "service center" functions. Again, each shareholder charged its multiple listing service participants the same monthly fee for access to the Sandicor database as every other shareholder. Every month, each Sandicor shareholder remitted to Sandicor the total amount it collected from its multiple listing service participants, and Sandicor then returned to the shareholder the amount represented by the "service center" component of the fees paid by that shareholder's participants.

This pricing structure resulted in the multiple listing participants of the larger San Diego Association of Realtors(R) paying fees for access to the combined Sandicor database that were significantly more than they had been paying for access to the San Diego Association of Realtors(R) multiple listing service prior to the formation of Sandicor. On the other hand, the multiple listing service participants of the smaller Valley Center Association of Realtors(R) paid significantly less for access to the centralized Sandicor database than they had paid for access to the Valley Center Association of Realtors(R) multiple listing service prior to the formation of Sandicor. The Sandicor governing documents, however, prohibited the San Diego Association of Realtors(R) from agreeing with Sandicor to perform "service center" functions for the San Diego Association multiple listing service participants at a lesser price than the uniform price set for all of the Sandicor shareholders. Likewise, the San Diego Association of Realtors(R) was prohibited from rebating to its multiple listing service participants any portion of the "service center" fee it received from Sandicor. Either of these actions would have enabled the San Diego Association of Realtors(R) to offer its multiple listing service participants access to the Sandicor database at a lesser price, and thereby attract to it multiple listing service participants from other Sandicor shareholders.

In 1998, two brokers who accessed the Sandicor database through the San Diego Association of Realtors(R) sued Sandicor and each of its shareholders alleging that the Sandicor pricing structure was per se illegal price fixing in violation of Section 1 of the Sherman Act. The federal district court granted the defendants' motions for summary judgment holding that the Sandicor pricing policy was "intra-corporate" conduct that did not satisfy the "concerted action" requirement of Section 1 of the Sherman Act.

On appeal, the Ninth Circuit Court of Appeals reversed the district court's summary judgment in favor of the defendants and entered summary judgment in favor of the plaintiffs. The Ninth Circuit held that the Sandicor shareholders did not

engage in protected "intra-corporate" conduct by agreeing upon the Sandicor pricing structure because the Sandicor shareholders maintained their separate corporate existence and continued to compete among themselves for Realtor(R) members in San Diego County. Through the Sandicor structure, however, they successfully eliminated price competition among themselves for access to the centralized Sandicor database. According to the Ninth Circuit, the Sandicor shareholders' agreement and the Service Center Agreements that prohibited individual negotiation between Sandicor and a shareholder for the price of performing the service center functions, or any rebates by a shareholder to its multiple listing service participants of the service center fees received from Sandicor, was per se illegal price fixing as a matter of law. The case was remanded to the district court for a determination of the amount of the plaintiffs' damages and whether the plaintiffs could represent a class of similarly situated brokers who accessed Sandicor as multiple listing service participants of the Sandicor shareholders.

After remand, the claims of the two original Sandicor plaintiffs were settled. Several additional plaintiffs filed similar complaints against the original Sandicor defendants. These plaintiffs also sought to certify a class of similarly situated brokers. The claims of these plaintiffs were resolved by a class wide settlement approved by the district court in a final judgment in early 2005. Certain objectors to the class wide settlement have appealed this judgment to the Ninth Circuit.

The lesson of the *Freeman* case is that associations of Realtors(R) as well as real estate brokers can engage in illegal price fixing in violation of Section 1 of the Sherman Act. Prior to Board of Choice, associations of Realtors(R) did not compete for members. A broker who wished to become a Realtor(R) or participate in a Realtor(R)-owned multiple listing service had to join the association of Realtors(R) or participate in the multiple listing service that had been assigned the territorial jurisdiction by the National Association of Realtors(R) that included the location of the broker's office. After Board of Choice, each association of Realtors(R) in a metropolitan region is a competitor of every other association of Realtors(R) in that market. The *Freeman* holding makes clear that agreements among competing associations of Realtors(R) to eliminate price competition among themselves are just as illegal as agreements among real estate brokers to fix the amount of real estate commissions. The *Freeman* case further establishes that the corporate structure of a regional multiple listing service cannot immunize what is otherwise an agreement among competing associations of Realtors(R) to fix the fees they charge to their members or multiple listing service participants.

As a result of *Freeman*, associations of Realtors(R) that are shareholders of regional multiple listing service corporations must insure that they preserve the shareholders' ability individually to set the price for access through each shareholder to the corporation's centralized database, or, alternatively, remove the shareholders completely from the delivery of multiple listing services to the individual real estate brokers in the market place. If the regional multiple listing service corporation were the sole entity delivering database services to the real estate brokers who participate in the multiple listing service, then the corporation is free to set a uniform price to all brokers who utilize its services. On the other hand, if the association of Realtor(R) shareholders of the regional multiple listing service corporation wish to "mark up" the cost of the service to their members, the associations are prohibited by the *Freeman* holding from agreeing among themselves on a uniform "mark up" to be charged by each shareholder association.

[3] Group Boycotts and Issues of Proof

Both the *per se* and Rule of Reason theories of group boycott analysis apply to the real estate brokerage industry. If real estate brokers collude to foreclose competitive opportunities to a rival real estate broker, such collusion will almost certainly be tested under the *per se* rule.

Group boycott claims under Section 1 of the Sherman Act require proof of concerted action to the same extent as price-fixing cases. Therefore, plaintiffs in a group boycott case cannot rely solely on parallel, or consciously parallel, conduct to prove a conspiracy. Similar to a price-fixing plaintiff, a group boycott plaintiff must introduce evidence that excludes the possibility that the defendants' conduct was the result of unilateral business decision-making.

[a] Presumption of Unilateral Conduct Applies to Individual Defendants

In the real estate brokerage industry, competitors tend to base their actions on what other competitors do. Thus, the real estate brokerage industry is characterized by a high degree of consciously parallel conduct. But this conduct, standing alone, is not sufficient to establish a "conspiracy" for purposes of Section 1 of the Sherman Act. A plaintiff must introduce evidence that overcomes a presumption that the defendants' conduct is not collusive if the defendants have a rational non-collusive explanation for their actions.

Thus, the outcome often turns on the quality of proof that the brokers in fact colluded to inflict competitive injury. In *Park v. El Paso Board of REALTORS(R)*, n83 the Fifth Circuit affirmed a jury verdict against several real estate brokers who were found to have conspired to frustrate the marketing efforts of a so-called "discount" broker who entered the El Paso market. The defendant real estate brokers were found to have:

- (1) disparaged the discounter to buyers and sellers,
- (2) attempted to coerce the discounter to pay higher commission splits to the defendants, and
- (3) refused to pay commission splits to the discounter if he sold one of the defendants' listings.

By contrast, in *Market Force, Inc. v. Wauwatosa Realty, Inc.*, n84 the Seventh Circuit dismissed the case against the defendants where plaintiffs did not offer evidence that rebutted a presumption that the defendants' conduct could be explained by unilateral conduct. n85 In *Market Force*, the defendants were accused of conspiring to offer a so-called "buyers' broker" less cooperative compensation than the defendants were offering to so-called "traditional" brokerage firms. The evidence showed that the defendants each elected to pay the plaintiff substantially less cooperative compensation than the defendants paid to other cooperating brokers. Certain defendants elected to offer the plaintiff less cooperative compensation only when they became aware that other defendants had already done so. The defendants justified their conduct on the grounds that "buyers' brokers" disclaim any fiduciary duties owed to the defendants or their seller clients. Therefore, the defendants contended that they should not pay "buyers' brokers" cooperative compensation equal to the amount paid to other brokers who act as subagents of the listing broker. Other than the defendants' consciously parallel conduct, the plaintiff did not have any other evidence of collusion among the defendants.

In *Re/Max International, Inc. v. Realty One, Inc.* n85.1 the federal district court granted summary judgment for two defendant real estate brokerage firms who were sued for allegedly conspiring to impose so-called "adverse commission splits" upon certain real estate franchisee competitors. The *Realty One* court noted that consciously parallel conduct alone is insufficient to prove a conspiracy; rather, the plaintiffs were required to produce evidence of "plus factors" that tended to negate an inference that the defendants acted independently.

The court observed that these "plus factors" could be evidence of

- (1) common motive;
- (2) exchange of price information; and
- (3) opportunity to meet to collude.

According to the court a "common motive" meant evidence that the defendants' parallel conduct would not be economically rational unless each defendant knew the other defendant would take the same action. The court noted, however, that the plaintiffs' own expert confirmed that each defendant would achieve their objectives in imposing the adverse commission splits on the plaintiffs whether or not the other defendant did the same thing. Since the defendants introduced evidence that their adverse commission split policy was "a sensible business response" to the competitive

practices of the plaintiffs, the court found that the plaintiffs had failed as a matter of law to prove an antitrust conspiracy.

[b] Presumption of Concerted Action Applies to Trade Associations

Because the "conspiracy" element of Section 1 of the Sherman Act will be presumptively satisfied in a case involving the policies of a real estate trade association, the association's conduct will be construed to be a "concerted refusal to deal" to the extent the association requires its members to conform to certain behavioral standards under penalty of membership expulsion. Furthermore, real estate brokers may be individually liable when they act collusively through their trade associations. As a result, the policies and practices of real estate trade associations or multiple listing services will, by definition, be construed to be concerted action by the association members. n86

Whether these association policies will be considered illegal *per se*, or tested under the Rule of Reason, will depend upon whether the policies at issue are shown to have a purpose of inflicting competitive injury, or whether the policies are "ancillary restraints" that support broader pro-competitive objectives.

[i] Anti-Competitive Effects of Multiple Listing Services. Real estate trade associations that operate multiple listing services must be particularly sensitive to the competitive effects of their membership criteria and ethical standards. In most real estate brokerage markets, access to the association and its multiple listing service will be found to be competitively significant, if not essential, to effective participation in the residential brokerage market. n87 The more important association membership is to effective participation in a relevant market, the more scrutiny will be accorded to the competitive effects of the association's policies on that relevant market.

Since real estate trade association policies are almost always based upon a stated purpose of improving market efficiencies through the operation of a multiple listing service, or raising the industry's professional standards through a Code of Ethics, the policies of the association will typically be judged under the Rule of Reason. In *United States v. Realty Multi-List*, n88 the Fifth Circuit held that the membership criteria established by a local multiple listing service should be judged under the Rule of Reason rather than the *per se* rule. Under the Rule of Reason, the Fifth Circuit first concluded that access to the service was essential for effective competition in the local brokerage market. The Fifth Circuit next examined the membership criteria of the service to determine whether the criteria advanced a legitimate pro-competitive objective, and did so without unnecessarily excluding otherwise qualified industry participants. The court ultimately held that the service's membership criteria requiring a "favorable" credit rating and business reputation could be interpreted to permit the exclusion of a broker who was unpopular, or viewed as "slow to pay," but who had never violated the law or defaulted on a debt. The court applied a similar analysis and struck down the service's initiation fees that did not bear any relation to the costs of operating the service, and a requirement that a member have an office open during normal business hours.

The *Realty Multi-List* case addressed whether a multiple listing service's membership criteria were overly restrictive when access to the service was essential to effective competition in the relevant market. Most multiple listing services in the country are owned and operated by local real estate trade associations. In many cases, the associations require real estate brokers to join the association before they are eligible to participate in the association's multiple listing service. This association membership requirement raises the additional issue of whether an association can impose a membership requirement as a condition of access to association services, even when membership is available to any real estate broker who chooses to join.

Real estate trade associations that require association membership as a condition of access to the association's multiple listing service justify the requirement as necessary to ensure that service participants are bound by the association's Code of Ethics that includes an inter-broker arbitration requirement and a requirement that participants refrain from soliciting other participants' clients.

In *Pope v. Mississippi Real Estate Comm'n*, n89 the Fifth Circuit affirmed a trial court's award of summary judgment to the defendant association on the antitrust legality of the association's requirement of membership in the association as a condition of participation in the association's multiple listing service. In *Thompson v. DeKalb Board of REALTORS(R), Inc.*, n90 however, the Eleventh Circuit took the opposite view. The Eleventh Circuit held that the association could have incorporated its ethical standards into its multiple listing service rules and regulations and achieved the same purpose as requiring service participants to subscribe to the association's Code of Ethics by joining the association. Therefore, the association's membership requirement was overly restrictive and a Sherman Act violation if evidence could be introduced at trial that the association's multiple listing service was competitively significant. n91 The *Thompson* case was subsequently settled after the Eleventh Circuit issued its order.

Challenges have also been made to the ability of associations of REALTORS(R) to limit other services used by real estate brokers in the course of their business to members of the association. One recent case has challenged an association of REALTORS(R)' rules that limit access to the association's lock box system and to "comparable" information about properties that have been sold to brokers who are members of the association. n91.1

The Antitrust Division of the United States Department of Justice is also scrutinizing the operations of multiple listing services. In May of 2008 the Division filed suit against the Consolidated Multiple Listing Service located in Columbia, South Carolina. The Division challenged under Section 1 of the Sherman Act various provisions of the Service's membership requirements and rules of operations. Among the Service's practices challenged by the Division were a rules (1) prohibiting Service members from using any listing forms other than the form prescribed by the Service, (2) requiring the members to be "actively involved" in the marketing, sale, and closing of all listed property, (3) prohibiting members from operating from "home offices", (4) requiring members to have a place of business in the Columbia metropolitan area, and (5) assessing potential members a non-refundable application fee of \$5,000, which far exceeded the Service's actual costs of adding a new member to the Service. On May 4, 2009 the Service and the Division agreed to a Stipulation and proposed Final Judgment in which the Service agreed to eliminate the rules and policies challenged by the Division. n91.2

[iii] Anti-Competitive Effects of Ethical Standards. The principles of *Realty Multi-List* and *Thompson* also apply to challenges to a real estate trade association's ethical standards. If access to the association is competitively significant, the association's ethical standards must be shown to advance competition in the marketplace as a whole. The association cannot defend its ethical standards by arguing that competition must be suppressed in order to advance some other public purpose. This is clear from the Supreme Court's holding in *National Society of Professional Engineers v. United States*. n92 In *Professional Engineers*, the Society had an ethical rule that prohibited members from engaging in price competition to secure an engineering assignment. The Society justified its rule on the ground that engineers who competed on price might be induced to take less care in performing their work resulting in unsafe buildings. The Supreme Court rejected this defense, and held that the only justification that can be advanced to support an ethical rule that suppresses competition is a showing that the rule has a countervailing pro-competitive effect. Reliance upon some other public policy such as health and safety was foreclosed by Congress when it passed the Sherman Act in 1890 and declared free competition as the country's method of allocating economic resources.

The Supreme Court more recently imposed Sherman Act liability upon an association member who manipulated the association's standard setting process in a manner that benefitted the member's product and correspondingly disadvantaged a competitor's product. In *Allied Tube & Conduit Corp. v. Indian Head, Inc.*, n93 the Court condemned the efforts of a manufacturer of steel conduit to pack a meeting of the National Fire Prevention Association (NFPA) with new Association members whose sole purpose was to vote against a proposal to amend the NFPA National Electric Code to allow the use of plastic conduit in building construction.

Six years earlier in *American Society of Mechanical Engineers v. Hydrolevel Corp.*, n94 the Supreme Court imposed antitrust liability upon the professional association itself when the association allowed a member to deny the association's certification to a competitor's product in violation of the association's policies and procedures. The *Indian*

Head and *Hydrolevel* cases illustrate that antitrust liability can be imposed upon both association members, and the association itself if the association's self regulatory power over members or their products or services are manipulated for anti-competitive purposes.

[4] "List Back Agreement" May Constitute Tying Violation

While tying arrangements are not common in the real estate brokerage business, an example of a possible tying violation is a so-called "list back" agreement. A "list back" agreement occurs when a real estate developer also owns or controls a real estate brokerage company. The developer then conditions the sale of homesites in a development on the home builder's agreement to "list back" the finished house for sale with the developer's real estate brokerage subsidiary. When challenged, "list back" agreements have been declared illegal. n95

A "list back" agreement should not be confused, however, with a builder's including in the sale price of a new home an amount equal to a real estate broker's commission. So long as the real estate broker's services were rendered to the homebuilder, there is not any requirement that the home buyer purchase a second product (real estate brokerage services) that he or she does not want. The builder is simply passing along as part of the price of the house the fee the builder owes to the real estate broker who marketed the property. n96

This principle was affirmed in by Ninth Circuit Court of Appeals in *Blough et al, v. Holland Realty, Inc., et al.* n96.1 In this case, various buyers of newly constructed homes in Boise, Idaho sued several real estate brokers contending that the brokers tied the sale of undeveloped lots to the brokers' services for the home builders who constructed homes on the lots for the plaintiffs. The homebuyers contracted with home builders to construct homes on vacant lots in subdivisions controlled by a developer. The developers had entered into marketing agreements with certain real estate brokers in which the developers paid the brokers a flat fee for the sale of the lot to the builders. The builders in turn agreed to pay the brokers a "referral fee" of three percent (3%) of the price paid by the homebuyers for the improved lot. The builders passed on the three percent "referral fee" to the homebuyers as part of the purchase price of the improved lot.

The homebuyers filed a complaint alleging that the "referral fee" was an illegal tying violation because the homebuyers were required to pay for brokerage services rendered to the home builders as a condition of purchasing a newly constructed home from the home builders. The trial court granted the brokers' motion of summary judgment, which was affirmed by the Ninth Circuit.

The Court held that the homebuyers had failed to prove that the brokers' conduct resulted in any reduction in competition in the market for the "tied" product, which was the brokers' service to the home builders on the sales of the developed lots to the homebuyers. The Court observed that the anticompetitive effects that the prohibition on tying agreements was meant to prevent a foreclosure of competition for the tied product caused by a seller's conditioning of purchase of the tying product on the buyer purchasing the tied product from the tying-product seller rather than from a competing seller. Such "market foreclosure" does not occur, however, when the buyer would not have purchased the tied product under any circumstances from any seller. If the buyer would not have purchased the tied product from any seller, there has not been any foreclosure of another seller's opportunity to make a sale of the tied product, and there has not been any "foreclosure" of competition that is required to establish a tying violation.

Here, the homebuyers did not offer any evidence that they would have engaged the services of another real estate broker had they not been required to pay for the defendants' services to the homebuilder. According to the Court, the fee paid by the home builders to the brokers simply increased the price that the homebuyers had to pay for the houses and the lots that they purchased. The brokers' fee was simply a cost to the home builders that they passed onto the buyers. So long as the buyers would not have purchased the brokerage services from another supplier there was not any foreclosure of competition in the brokerage services market, and therefore not any violation of the antitrust laws.

[a] No Tying Issue If Seller Has No Economic Interest

Tying issues can also arise when the sale of a condominium is conditioned on the unit owner's agreement to accept a lease to other facilities such as a swimming pool or parking lot. n97 A tying arrangement does not occur, however, unless the seller of the tying product also has an economic interest in the sale of the tied product. In *Carl Sandburg Village Condominium Association No. 1 v. First Condominium Development Co.*, n98 the Seventh Circuit Court of Appeals rejected a plaintiff's tying challenge to a condominium developer's requirement that the unit owners retain a particular management company. The court held that an illegal tie-in could not exist because the condominium developer did not have any economic interest in the management company the unit owners were required to utilize.

[b] Conflicting Decisions on Membership Requirements

Courts have reached conflicting conclusions on whether tying claims may be successfully asserted against real estate trade associations' requirement that brokers become association members before they can participate in the association's multiple listing service. The association's multiple listing service is alleged to be the tying product and association membership is alleged to be the tied product. In *Thompson v. DeKalb Board of REALTORS(R)*, n99 the Eleventh Circuit held that a tying claim could be asserted against the association's membership requirement because the association's multiple listing service and association membership were two separate products, and the association could have market power in the market for multiple listing service access.

The First Circuit, however, rejected a tying challenge to a similar rule requiring association membership as a condition for multiple listing service access in *Wells Real Estate Company v. Greater Lowell Board of REALTORS(R)* n100 The court in *Wells* held that association membership and multiple listing service participation were not two separate products because the association was not a "seller" of association memberships in the traditional sense that has been applied in tying cases. Association memberships is not a "product" that is sold separately from the benefits and services that are available to association members.

Three cases decided in 2006 suggest that courts are likely to construe the *Thompson* case narrowly. In *Reifert v. South Central Wisconsin MLS Corporation*, the plaintiff, a participant in the defendant multiple listing service, claimed that the defendant's rule requiring membership in the association of REALTORS(R) as a condition of participating in the association's multiple listing service is an illegal tying arrangement. The district court recently denied the plaintiff's motion to certify him as a representative of a class of similarly situated brokers. n100.1 The district court then granted summary judgment to the defendants, and the Seventh Circuit affirmed. n100.2 The Seventh Circuit held that Reinfert's tying claim failed because he could not show any loss of competition in the market for the tied product (Realtor Association memberships) by reason of the MLS's requirement that its participants belong to an Association of Realtors(R) as a condition of MLS participation. Reifert could not show any loss of competition in the tied product market because the Realtor Association of South Central Wisconsin was the only real estate brokerage professional association operating in the relevant market; therefore, competition in the tied product market was not affected in any way by the MLS's participation requirements. The Seventh Circuit also affirmed the district court's dismissal of Reinfert's group boycott claim on the ground that Reifert could not identify any real estate broker who was prevented from joining the Association of Realtors(R).

Federal district courts in Washington and Kentucky had earlier reached similar conclusions. In *Prencipe v. Spokane Board of Realtors* n100.3 the plaintiffs were Realtor members of the Spokane Board of Realtors, but alleged that the only reason they joined the Board was to gain access to the Board's MLS, which required Board membership as a condition of MLS participation. The plaintiffs claimed that the Board's MLS participation requirements were illegal under the antitrust laws as a tying agreement and a group boycott. The trial court entered summary judgment for the defendants on all of the plaintiffs' claims. On the tying claim, the court found that the plaintiffs failed to show any harm to competition in a market for the "tied product" (Board memberships) because the plaintiffs did not adduce any evidence of any competition in the tied product market that was foreclosed by the Board's MLS participation requirement. The court also dismissed the plaintiffs' group boycott claim because the plaintiffs did not introduce any

evidence to show that any broker was unable to join or participate in the Board's MLS by reason of the Board's MLS participation rule. Indeed, the plaintiffs themselves were Board members who were participating in the Board's MLS.

The Kentucky federal district court reached the same result in *Buyer's Corner Realty, Inc. v. Northern Kentucky Association of Realtors*.ⁿ¹⁰⁰ In this case, the managing broker of the plaintiff brokerage firm was a member of the Northern Kentucky Association of Realtors and a participant in the Association's MLS. The plaintiff's broker alleged that the only reason she joined the Association was because the Association required such membership as a condition of MLS participation. The plaintiff alleged that the Association's requirement that MLS participants must be Realtor members of the Association constituted an illegal tying agreement and a group boycott in violation of the Sherman Act. The Association moved for summary judgment on both claims, which the court granted. On the plaintiff's tying claim, the court found that the plaintiff had failed to show that it had suffered any antitrust injury by reason of the Association's MLS participation requirements. The plaintiff contended that the Association's MLS participation rule foreclosed brokers from joining other real estate professional associations that competed with the Association for broker members. The plaintiff, however, failed to adduce any evidence of any other professional association that lost, or could not recruit, members because of the Association's MLS participation rule. The court found the plaintiff's failure to demonstrate how the Association's MLS participation rule harmed competition in any relevant market was also fatal to the plaintiff's group boycott claim.

The *Reinfert*, *Precipe* and *Buyer's Corner* cases all suggest that the courts are becoming much stricter in analyzing antitrust challenges to participation requirements of MLSs owned by Associations of Realtors that require MLS participants to first become Realtor members of an Association of Realtors. Courts reviewing these cases are increasingly limiting the Eleventh Circuit's *Thompson* decision to its precise facts. In *Thompson*, the plaintiffs included the Empire Real Estate Board who alleged that the MLS's participation rule caused it to lose a substantial number of members who were compelled as a matter of practical economics to join the Realtor Association rather than the Empire Board in order to be able to participate in the Association's MLS, which was essential to their business. In *Reinfert*, *Precipe* and *Buyers Corner* there was not any competing association as a plaintiff, and the failure of the plaintiffs to show how the Association's MLS participation rule harmed the ability of any other real estate association to compete for members resulted in the dismissal of the plaintiffs' tying and group boycott claims.

[5] Miscellaneous Claims: Unreasonable Restraints of Trade

Agreements among competitors that are not classifiable as price-fixing, group boycotts, or tying agreements are also potential Sherman Act violations if the effect of the agreement is to restrain trade unreasonably. For example, agreements among real estate brokers to restrict certain types of advertising have been held to violate the Sherman Act.ⁿ¹⁰¹ Real estate trade associations have been held to violate the antitrust laws by discouraging members from accepting "exclusive agency" listings that allow sellers to sell their property themselves without owing a commission to the listing broker.ⁿ¹⁰² Other trade associations have been subjected to antitrust attack when they have attempted to regulate their members' employment practices.ⁿ¹⁰³

While not a basis for an antitrust claim against any individual broker or Realtor Association, many State Associations of Realtors throughout the country beginning in 2004 have urged their legislatures or real estate regulatory agencies to adopt rules that establish "minimum service" levels that all licensed real estate brokers must provide to consumers with whom they enter into exclusive listing agreements.ⁿ¹⁰⁴ These state regulations are targeted at so-called "limited service" brokerage companies who offer to list property and place the listing in the MLS for a minimal flat non-refundable fee. In return for the flat fee, the "limited service" broker typically provides the seller with a yard sign, contract forms, advertising flyers, and an answering service that responds to inquiries from potential buyers. Sellers who list with "limited service" brokers are typically required to conduct their own showings and negotiations with potential buyers, and attend to the details required to close a sales contract. Supporters of these "minimum service" regulations contend that they are necessary to protect consumers from unwittingly retaining a broker believing that the broker will be performing certain functions for the seller, when in fact such services will not be performed. Supporters

also argue that these laws are necessary to protect cooperating brokers who may find buyers for these "limited service" listings who find that they must perform functions to consummate a sale on behalf of their buyer client that ordinarily would have been performed by a "full service" listing broker; yet the cooperating broker is only earning a portion of the commission they would ordinarily earn had they both listed and sold the property without cooperation from another broker.

When these statutes have been considered by state legislatures or real estate regulatory agencies, the Federal Trade Commission or the Antitrust Division of the United States Justice Department, or both, have submitted written comments to the state officials urging that these statutes or regulations not be adopted because they will result in competitive harm to the market for real estate brokerage services in the particular state. ⁿ¹⁰⁵ The federal antitrust agencies argue that there is not any evidence of any consumers who have been harmed by being unaware that the "limited service" broker they engaged will not be performing certain functions customarily performed by a real estate broker in an exclusive listing relationship. Any such harm, should it come to pass, could be addressed by full and complete disclosures to consumers at the time they enter into a "limited service" listings. On the issue of cooperative brokers representing buyers compelled to do more work when the seller engages a "limited service" broker, the federal agencies contend that consumers should be free to purchase "unbundled" real estate brokerage services, and brokers should be free to offer such services on an "a la carte" basis. The market place will then determine the extent consumers opt for one service package and pricing system over another.

To date, the federal agencies have been distinctly unsuccessful in persuading state legislatures and regulatory agencies not to adopt "minimum services" requirements for real estate licensees. The trend is towards the adoption of these statutes or regulations, largely because of the enormous political power wielded by State Associations of Realtors who are urging the adoption of these types of regulations.

[6] Antitrust Implications of E-Commerce and Access to Multiple Listing Service Databases

[a] Availability of Electronic Data from Real Estate Multiple Listing Services

In the 1980s and 1990s, real estate multiple listing services converted from printed publications to electronic databases maintained on computers. Multiple listing participants directly input into computerized databases information about new listings taken by their offices, and also update listing information as listing prices or other terms change, and properties are placed under contract and ultimately sold and closed. Likewise, brokers working with prospective buyers access the multiple listing service database via computers and search the database for properties on the market that meet the buyer's needs and wants. These computerized multiple listing service databases also typically include computerized access to public real estate transfer data, and property tax information. Brokers can also secure current mortgage rate information, down payment and monthly payment calculators, and other productivity-enhancing applications through their multiple listing services.

During the late 1990s, computerized multiple listing services began another evolution from databases maintained on computer servers accessible only through dial-up connections over separate telephone lines to computer servers accessible via the Internet. Users of an Internet-based multiple listing services connect to the multiple listing service database using whatever Internet connection and browser serves their real estate office computer network.

While most real estate multiple listing services now operate accessible computer databases, the basic "core" function of the multiple listing service has not changed. The service is still intended, fundamentally, to provide a means for real estate brokers to exchange data for the purposes of cooperatively marketing the listed property. Multiple listing services continue to treat the listing data as proprietary data accessible only to legitimate participants in the service. Most multiple listing services also have registered copyright claims in their computerized real estate data compilations.

At the same time that multiple listing services were developing Internet-accessible computer databases to maintain

information on listed and sold property, other companies were developing Web sites on the World Wide Web for the purpose of displaying information to consumers about property for sale throughout the country, and about other services necessary to consummate a real estate transaction, such as mortgage financing, insurance, and escrow services. The largest of these "national aggregators" of real estate listing information on the Internet are "Realtor.com" operated by Move, Inc.

These companies depend on a continuing supply of comprehensive and current listing data about real estate available for sale. To secure this listing data, they enter into licensing agreements with real estate multiple listing services to post the listing data from the service on the company's Website. The Internet Website operators depend on the availability of this listing data to attract visitors to their Website. The volume of visitors to the Website in turn determines the amount of fees the Website can charge for banner advertising that appears on the Website.

[b] MLS Exclusive Data License Agreements with National Internet Listing Data Aggregators

Some Internet-based national listing aggregators have entered into exclusive agreements with many multiple listing services serving major metropolitan markets. These exclusive agreements preclude the multiple listing service licensor from entering into any data licensing agreement with any other national Internet listing data aggregator.

These exclusive licensing agreements raise the issue of whether the agreements restrain competition unreasonably among national Internet aggregators. Securing listing data from the largest, or perhaps only, multiple listing service in a major market area is plainly the most efficient means of acquiring listing data about property for sale in that market. The only alternative is to enter into separate licensing agreements with each and every individual real estate brokerage firm in the market served by the multiple listing service. Hence, an exclusive licensing agreement between a national Internet aggregator and a multiple listing service serving a major metropolitan market can effectively foreclose access to listing data from that market to other competing national Internet aggregators.

This potential anti-competitive effect on competition among national Internet aggregators has caused the Antitrust Division of the United States Department of Justice in 2000 to open an investigation into the lawfulness of the exclusive licensing agreements entered into by Homestore.com, Inc., the predecessor of Move, Inc., and the operator of "Realtor.com," the largest national Internet aggregator, with the multiple listing services serving most major metropolitan areas. The Division's investigation was closed after Realtor.com made the decision to abandon its exclusive licensing program. More recently, in *Klickads, Inc. d/b/a Brokers NYC v. Real Estate Board of New York, et al* n106 the plaintiff alleged that the Real Estate Board of New York (REBNY) conspired with several of the larger brokerage firms doing business in Manhattan and certain third party technology vendors in violation of the Sherman Act by adopting rules that effectively required REBNY members to use the systems of the defendant vendors to comply with REBNY's newly adopted policy mandating that members share listings with each other. The Manhattan real estate brokerage market has never been served by a traditional multiple listing service. Prior to 2002, Manhattan brokers did not cooperate with each other in the sale or rental of residential property.

In 2002, REBNY adopted rules mandating that its members share listings with each other on a cooperative basis. In 2005, REBNY adopted another rule mandating that members use the defendant vendors' automated listing dissemination software. The plaintiff was another technology vendor who provided a software product that performed the same automated listing dissemination function as the defendant vendors' products. Plaintiff alleged that the defendants' conduct constituted an illegal conspiracy to boycott the plaintiff's product. The defendants filed a motion for summary judgment claiming that plaintiff had not adduced evidence sufficient to permit a finding of a Sherman Act violation. The court denied the defendant's motion finding that questions of fact existed concerning whether the efficiencies cited by the defendants that resulted from a single interface for the dissemination of REBNY members' listings required that only two technology vendors be allowed to access the single interface. The *Klickads* case teaches that real estate broker trade associations can violate the antitrust laws whenever they exercise market power in a manner that excludes competitors from a relevant market, and the excluded competitors with standing to sue can include

technology vendors or other service providers.

[c] Related Discussion in Chapter 10, *The Impact of Electronic Commerce in the Real Estate Brokerage Business*

See Chapter 10 *below* for discussion of e-commerce issues affecting real estate brokers, including Section 10.05, *Use of Multiple Listing Data by "Virtual" Real Estate Brokerage Companies*, which discusses antitrust implications of the National Association of Realtors(R) Policy on virtual office websites (§ 10.05[5]).

FOOTNOTES:

(n1)Footnote 75. 934 F.2d 1566 (11th Cir. 1991) , *cert. denied*, 113 S. Ct. 295 (1992) .

(n2)Footnote 75.1. 924 F. Supp. 1474 (N.D. Ohio 1996) .

(n3)Footnote 76. In *United States v. National Ass'n of Real Estate Bds.*, 339 U.S. 485 (1950) , the Supreme Court's holding was confined to *mandatory* commission rate schedules.

(n4)Footnote 77. 421 U.S. 773 (1975) .

(n5)Footnote 78. 444 U.S. 232 (1980) .

(n6)Footnote 79. 598 F.2d 1323 (4th Cir. 1979) , *cert. denied*, 444 U.S. 1043 (1980) .

(n7)Footnote 80. 465 U.S. 752 (1984) .

(n8)Footnote 81. There are occasions, however, when brokers will choose to offer a higher than normal cooperative commission rate, or "bonuses" to successful cooperating brokers. This occurs when the property at issue is particularly hard to sell, or the listing broker's listing is nearing its expiration, after which the broker's marketing expenses may be lost if the listing is not renewed or extended with the listing broker.

(n9)Footnote 82. National Ass'n of REALTORS(R) Handbook on Multiple Listing Policy (Residential)(1995) at p. 6-1.

(n10)Footnote 82.1. 322 F.3d 1133 (9th Cir. 2003) .

(n11)Footnote 83. 764 F.2d 1053 (5th Cir. 1985) , *cert. denied*, 474 U.S. 1102 (1986) .

(n12)Footnote 84. 906 F.2d 1167 (7th Cir. 1990) .

(n13)Footnote 85. *See also Orval Sheppard Real Estate Co., Inc. v. Valinda Freed & Assocs., Inc.*, 608 F. Supp. 354 (M.D. Ala. 1985) .

(n14)Footnote 85.1. 924 F. Supp. 1474 (N.D. Ohio 1996) .

(n15)Footnote 86. *See United States v. Realty Multi-List, Inc.*, 629 F.2d 1351 (5th Cir. 1980) ("a concerted denial of access to [the multiple listing service] when [service members] have agreed to pool and share their listings, amounts to a group boycott of the non-members").

(n16)Footnote 87. 629 F.2d 1351 . *See also Thompson v. DeKalb Bd. of REALTORS(R)*, 934 F.2d 1566 (11th Cir. 1991) , *cert. denied*, 113 S. Ct. 295 (1992) .

(n17)Footnote 88. 629 F.2d 1351 (5th Cir. 1980) .

(n18)Footnote 89. 872 F.2d 127 (5th Cir. 1989) ; see also O'Riordan v. Long Island Board of REALTORS(R), 707 F. Supp. 111 (E.D. N.Y. 1989) .

(n19)Footnote 90. 934 F.2d 1566 (11th Cir. 1991) , cert. denied, 113 S. Ct. 295 (1992) .

(n20)Footnote 91. The *Thompson* case reversed the trial court's summary judgment for the defendants. The Eleventh Circuit's holding in *Thompson* that sections of Atlanta could be relevant real estate brokerage markets virtually insured that the defendants' multiple listing service would be found to be competitively significant on remand. The *Thompson* defendant settled before trial.

(n21)Footnote 91.1. Hekker v. Sarasota Association of REALTORS, Civ. No 8:04-cv-2589-T-30EAJ (M.D. Fla., filed Nov. 30, 2004). The case was dismissed without prejudice in July 2005 based upon the named plaintiff's serious illness. Since the case was dismissed without prejudice, it can be refiled at any time, and the dismissal does not have any preclusive effect on the merits of the claims made in the complaint.

(n22)Footnote 91.2. United States v. Consolidated Multiple Listing Service, Inc., Case No. 3:08-CV-01786-SB (Stipulation and Proposed Final Judgment, filed May 4, 2009).

(n23)Footnote 92. 435 U.S. 679 (1978) .

(n24)Footnote 93. 486 U.S. 492 (1988) .

(n25)Footnote 94. 456 U.S. 556 (1982) .

(n26)Footnote 95. See *State v. Hossan Maxwell, Inc.* 2 Trade Cases (CCH) P 63, 471 (Conn. Sup. Ct. 1980) ; *State v. Mililani Town, Inc.*, 1980- 2 Trade Cases (CCH) P 63, 504 (Haw. Cir. Ct. 1980) ; *State v. Candlewood Shores Estates, Inc.*, 1981- 1 Trade Cases P 63, 881 (Conn. Super. Ct. 1981) .

(n27)Footnote 96. See *Ballo v. James S. Black Company, Inc.*, 39 Wash. App. 21, 692 P.2d 182 (1984) ; *Ridgeview Properties v. Starbuck*, 96 Wash. 2d 716, 638 P.2d 1231 (1982) .

(n28)Footnote 96.1. 574 F.3d 1084 (9th Cir. 2009) .

(n29)Footnote 97. See *Levinson v. Maison Grande, Inc.*, 517 F. Supp. 963 (S.D. Fla. 1981) .

(n30)Footnote 98. 758 F.2d 203 (7th Cir. 1985) .

(n31)Footnote 99. 934 F.2d 1566 (11th Cir. 1991) , cert. denied, 113 S. Ct. 295 (1992) .

(n32)Footnote 100. 850 F.2d 803 (1st Cir.) , cert. denied, 488 U.S. 955 (1988) .

(n33)Footnote 100.1. *Reifert v. South Central Wis. MLS Corp.*, No.04-C-969-S, 2005 U.S. Dist. LEXIS 9741 (W.D. Wis. May 20, 2005) .

(n34)Footnote 100.2. *Reifert v. South Central Wis. MLS*, No. 05-3601, 2006 U.S. App. LEXIS 14327 (7th Cir. 2006) .

(n35)Footnote 100.3. *Prencipe v. Spokane Board of Realtors*, No. CV-04-319-Prencipe, 2006 U.S. Dist. LEXIS 29828, 2006-1 Trade Cas. (CCH) P75301 (E.D. Wash. May 12, 2006) .

(n36)Footnote 100.4. *Buyers Corner Realty, Inc. v. Northern Kentucky Association of Realtors*, 410 F. Supp. 2d 574 (E.D. Ky. 2006) .

(n37)Footnote 101. See *Cantor v. Multiple Listing Service, Inc.*, 568 F. Supp. 424, 1983-2 Trade Cas. (CCH)

P65514 (S.D.N.Y. 1983) .

(n38)Footnote 102. See *In re* MLS of Greater Michigan City Area, Inc., FTC File No. 8210129 (consent decree filed May 5, 1984).

(n39)Footnote 103. See *In re* Council of Fashion Designers of America, FTC Dkt. No. C-3621 (1995).

(n40)Footnote 104. See, e.g., 225 ILCS 445/15-75 (Illinois); *Texas Occupation Code, Section 1101.557; RSMo* 339.780.7 (Missouri).

(n41)Footnote 105. See, e.g., October 18, 2005 Joint Letter from FTC Chairman and Assistant Attorney General for Antitrust to Chairman of Michigan Senate Committee on Economic Development and Director of Michigan Department of Labor and Economic Growth and May 12, 2005 Joint Letter from FTC Chairman and Assistant Attorney General for Antitrust to Members of the Alabama State Senate.

(n42)Footnote 106. Case No. 04 Civ. 8042 (S.D.N.Y. August 6, 2007).

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139 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 8 Real Estate Brokers and Antitrust Laws *

10A-8 Real Estate Brokerage Law and Practice § 8.05

§ 8.05 Program for Compliance

The economic consequences of an antitrust judgment against a real estate brokerage company, or real estate trade association, can be the business equivalent of capital punishment. Treble damages, attorneys fees, and possible jail terms and criminal fines are more that most businesses can withstand. Antitrust compliance for real estate brokers must begin with education of the brokers, and perhaps more importantly, education of the broker's sales agents. Brokers must make clear to their sales agents that antitrust compliance is high priority and failure to adhere to the firm's antitrust compliance policies can, and will, lead to discipline and potential dismissal.

Brokers and agents must clearly understand that any collusion with competitors on matters relating to the commission rates or other economic terms of a listing agreement are strictly forbidden. The same is true of any collusion or agreements relating to otherwise lawful and ethical business practices, such as non-deceptive advertising, office hours, or hiring of sales agents. Once basic antitrust principles are understood, compliance should not be overly difficult. Antitrust awareness and compliance by real estate brokers should also ensure that the real estate markets in the United States remain among the most liquid and efficient in the world.

[1] Comments to Be Avoided

Antitrust plaintiffs typically rely on circumstantial evidence of the defendants' allegedly collusive conduct. Rarely does an antitrust plaintiff have a letter or tape recording of a conversation in which the defendants' memorialize their agreement to restrain trade. Circumstantial evidence consists of statements by the defendants orally or in writing that are consistent with the existence of an agreement to restrain trade. Since actual agreements to restrain trade rarely occur in the real estate industry, brokers and agents must take care to express themselves to competitors, clients, and other participants in a real estate transaction, in terms that reflect the absence of any collusion among competitors. For example, the following phrases, or others like them, should never be used:

- "Everyone else charges the same rates as we do."
- "Why did you agree to lower your commission? If you do that again, the rest of us will have to do something about it."

- "Did you hear about that new discount firm that just opened? They won't last long if no other firm cooperates with them."

Each of these comments permits the inference that competitors have colluded to achieve a common objective. While each statement is capable of being explained in non-collusive terms, these statements may be sufficient to allow and antitrust plaintiff to overcome a summary judgment motion and have his or her case decided by a jury.

Real estate brokers should also be vigilant in their dealings with the trade associations. Antitrust enforcers view trade association meetings as fertile ground for evidence of collusion among competitors. This is true because competitors come together at trade association meetings to discuss issues of general concern to the industry as a whole. Conversations at these meetings can easily turn to concerted action to increase industry profits by fixing prices or eliminating other types of competition that industry participants may view as "destructive" or "ruinous."

[2] Document Objections to, or Explanations for Anti-Competitive Conduct

Real estate brokers who are present at meetings of competitors where these forbidden topics are raised or discussed must take immediate and unambiguous steps to disassociate themselves from any participation in a possible conspiracy to restrain trade. If official minutes are kept, a broker or agent should be sure that the broker's or agent's objections to any anti-competitive conduct be noted in the record. If a formal record of the meeting is not kept, the broker or agent should immediately communicate in writing his renunciation of any collusive behavior to the other participants in the meeting. Finally, the broker or agent should ensure, to the extent possible, that his or her own conduct is not consistent with any agreement among competitors to restrain trade.

Not only should real estate brokers and agents avoid any participation, or the appearance of participation, in collusive behavior with competitors on matters relating to price or other terms, conditions, or methods of doing business, but brokers and agents should also take positive steps to ensure that they can document that their decisions relating to their firm's commission structure or other business practices were made unilaterally. For example, when brokers decide to change their firm's commission rate structures, or their offers of cooperative compensation to other brokers, they should document their reasons for doing so through memoranda to the file, or to their sales agents. The memorandum should indicate that the decisions were based upon the firm's costs and expenses, and prevailing competitive conditions in the marketplace. Distribution of the memorandum should be confined solely to members of the broker's own firm.

[3] Avoid Sharing Correspondence with Competitors

Brokers should also avoid sharing their business correspondence to one broker with other brokers in the marketplace. It is not uncommon for a broker to write to another broker to advise that broker that the cooperative compensation offered to that other broker will be lower than the amount appearing in the local multiple listing service compilation. Sometimes a broker will copy other brokers in the marketplace on such a letter. The other brokers may then be motivated to send the same type of letter to the recipient of the original letter. The other brokers may even duplicate the words nearly verbatim from the original letter. Proof that the original letter was also sent to other brokers, and that, within a short time, the recipient of the first letter also received virtually the same letter from the other brokers, raises a strong inference that the recipient of the original letter is the target of a group boycott. Simply put, sharing business correspondence with competitors who do not have a direct interest in the subject matter of the correspondence is extremely dangerous.

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140 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation
CHAPTER 9 The Broker And Discrimination *

10A-9 Real Estate Brokerage Law and Practice 9.syn

§ 9.syn Synopsis to Chapter 9: The Broker And Discrimination *

§ 9.01 Prohibiting Discrimination--Major Legislative and Judicial Developments

[1] Civil Rights Act of 1866

[a] Continued Discrimination Under the Civil Rights Act of 1866

[b] Major Anti-Discrimination Developments Through 1968

[2] Fair Housing Act of 1968

[3] Major Anti-Discrimination Developments Through 1988

[4] Fair Housing Amendments Act of 1988

[5] HUD Regulations Implementing the Fair Housing Amendments Act of 1988

[6] All Legislative and Regulatory Sources--Federal, State, and Local--Should Be Examined to Ensure Compliance

§ 9.02 Prohibited Acts of Discrimination Under Federal Legislation

[1] Discriminatory Housing Practices

[a] Discrimination in the Sale or Rental of Housing

[b] Discrimination in Advertising for Sale or Rental

[c] False Representations of Unavailability

[d] Blockbusting and Steering

- [i] Blockbusting

- [ii] Steering

- [2] Other Prohibited Acts of Discrimination Under the FHA

- [a] Discrimination in Brokerage Services

- [b] Interference, Coercion, or Intimidation

- [3] Discrimination Based Upon Certain Protected Classifications

- [a] Discrimination Based Upon Familial Status

- [b] Discrimination Based Upon Handicap or Disability Status

- [c] Discrimination Based Upon Sex

§ 9.03 Exemptions from the Fair Housing Act

- [1] Single-Family Houses

- [2] The "Mrs. Murphy" Exception

- [3] Religious Organizations and Private Clubs

- [4] Limitations on Occupancy

- [5] Housing for Older Persons

§ 9.04 Enforcement and Penalties Under the Fair Housing Act

- [1] Standing to Sue

- [2] Broker's Right to Intervene

- [3] Persons and Entities Exposed to Liability

- [4] Damages and Related Relief Under the Fair Housing Act

- [a] Compensatory and Nominal Damages

- [b] Punitive Damages

- [c] Injunctive Relief

- [d] Attorneys' Fees and Costs

- [e] Civil Fine

§ 9.05 Housing Discrimination--Proof and Defenses

[1] Proof of Claims of Discrimination

[a] Pattern or Practice of Discrimination

[b] Disparate Treatment

[2] Defenses to Claims of Discrimination

[a] Business Necessity Defense

[b] Mixed Motive Defense

[3] Opinion Evidence in Fair Housing Act Cases

§ 9.06 Practices and Procedures Before HUD

[1] HUD Complaints

[2] HUD Investigation Procedures

[3] Conciliation of the HUD Complaint

[4] Reasonable Cause Determination by HUD

[a] Determination of No Reasonable Cause

[b] Determination of Reasonable Cause

[c] Zoning Exception to Reasonable Cause Determination

[5] Issuance of Charge by HUD

[6] Judicial Determinations Unfavorable to HUD

§ 9.07 State Legislation Prohibiting Discriminatory Housing Practices

§ 9.08 Fair Housing Partnership Agreement

§ 9.09 Americans with Disabilities Act (ADA)

[1] Title III of the ADA

[2] New Construction

[3] Alterations

[4] Other Modifications

[5] Defenses

[a] Threat to Health and Safety

[b] Private Clubs

[c] Religious Organizations

[d] Not Readily Achievable

[e] Structural Impracticability

[f] Technical Infeasibility

[g] Residential Structures

[h] Asbestos Removal

[i] Historic Structures

[6] Responsibility for Compliance

[7] Foreclosure

[8] Enforcement

[9] Department of Justice Enforcement

[10] Private Cause of Action

§ 9.10 Discrimination Against Real Estate Licensees



141 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation
CHAPTER 9 The Broker And Discrimination *

10A-9 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 9 addresses discriminatory housing practices and laws designed to prohibit such practices. Major legislation is first examined to familiarize the reader with the statutes being discussed throughout the chapter (§ 9.01). Prohibited acts of discrimination are then addressed and include:

- Discrimination in the sale or rental of housing (§ 9.02[1][a]).
- Discrimination in advertising for sale or rental (§ 9.02[1][b]).
- False representations of unavailability (§ 9.02[1][c]).
- Blockbusting and steering (§ 9.02[1][d]).
- Discrimination in brokerage services (§ 9.02[2][a]).
- Interference, coercion, or intimidation (§ 9.02[2][b]).
- Discrimination based upon familial status (§ 9.02[3][a]).
- Discrimination based upon handicap or disability status (§ 9.02[3][b]).
- Discrimination based upon gender (§ 9.02[3][c]).

Those properties, persons, and activities exempted under the Fair Housing Act are then discussed (§ 9.03). Enforcement and penalties under the Fair Housing Act are then examined (§ 9.04), with an examination of the parties to a civil housing discrimination lawsuit (§ 9.04[1], [2]), a broker's right to intervene (§ 9.04[3]), and the types of damages and related relief allowed under the Fair Housing Act (§ 9.04[4]).

Major means of proving a housing discrimination case are examined (§ 9.05[1]), as are major bases of defense (§

9.05[2]). A separate subsection is devoted to the impact of *Daubert* and its progeny on the admissibility of opinion testimony in housing discrimination cases (§ 9.05[3]).

As almost all federal housing discrimination complaints are processed through the United States Department of Housing and Urban Development (HUD), the practices and procedures one will encounter in dealing with HUD, whether one is the complainant or the respondent, are examined (§ 9.06). For ease of reference, state laws specifically intended to prohibit discriminatory housing practices are listed (§ 9.07).

The National Association of Realtors(R) and HUD have entered into a Fair Housing Partnership Agreement to foster a cooperative approach in promoting fair housing in all communities throughout the United States. This landmark agreement is discussed in § 9.08. Because of its potential impact upon brokers regarding certain properties accessible to the public, the requirements of the Americans with Disabilities Act are briefly examined (§ 9.09).

Discrimination against real estate licensees is briefly discussed in § 9.10.



142 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation
CHAPTER 9 The Broker And Discrimination *

10A-9 Real Estate Brokerage Law and Practice § 9.01

§ 9.01 Prohibiting Discrimination--Major Legislative and Judicial Developments

[1] Civil Rights Act of 1866

The Civil Rights Act of 1866, as passed by Congress, guaranteed to all United States citizens the same right as white citizens to inherit, purchase, lease, sell, hold and convey real property. n1

[a] Continued Discrimination Under the Civil Rights Act of 1866

The Civil Rights Act of 1866 provided little relief from racial discrimination, as evidenced by decisions of the U.S. Supreme Court:

- In 1883 the U.S. Supreme Court held that the *Fourteenth Amendment to the United States Constitution* (the *equal protection clause*) did not prohibit private acts of discrimination but only prohibited acts of discrimination that were the result of government action. n2
- In 1896 the U.S. Supreme Court held that enforcement of racial segregation for private or public facilities did not violate the United States Constitution if the separate facilities were "equal." n3

[b] Major Anti-Discrimination Developments Through 1968

The U.S. Supreme Court withdrew from its support of discriminatory practices in two landmark decisions:

- In 1948 the U.S. Supreme Court held that state enforcement of a private racially restrictive covenant constituted sufficient government involvement to violate the *equal protection clause of the Fourteenth Amendment*. n4
- In 1954 the U.S. Supreme Court reversed the "separate but equal" position espoused in 1896, prohibited segregation in schools and rejected legalized segregation. n5

The executive branch of the government followed the trend and in November 1962 President Kennedy signed an executive order prohibiting discrimination in housing zoned, operated, or assisted by the federal government. Two years

later Congress enacted Title VI to the Civil Rights Act of 1964, which prohibited discrimination in programs receiving federal financial assistance.

In June 1968 the U.S. Supreme Court held that the Civil Rights Act of 1866 prohibited private racial discrimination in housing in addition to racial discrimination by the government. n6 Specifically, the Supreme Court found that the plaintiff, who had been denied the right to purchase a home because of his race, could seek judicial relief under 42 U.S.C. § 1982, which provides that "all citizens in the United States shall have the same right as is enjoyed by white citizens to ... purchase, lease, sell, hold and convey real and personal property." This decision, rendered during the same year as the Civil Rights Act of 1968, was the first by the U.S. Supreme Court to prohibit discrimination in the private housing market. Though § 1982 only offers protection on racial grounds, in the appropriate case it remains a viable alternative or supplement to the Fair Housing Act.

[2] Fair Housing Act of 1968

The Fair Housing Act was enacted by Congress as Title VIII of the Civil Rights Act of 1968. n7 The Fair Housing Act (also commonly referred to as "FHA" and as "Title VIII") prohibited discrimination on the basis of race, color, religion, and national origin. It provided remedies for public housing discrimination and for private housing discrimination.

The Fair Housing Act was amended in 1974 to prohibit discrimination on the basis of gender.

[3] Major Anti-Discrimination Developments Through 1988

Discrimination based on gender in housing zoned, operated, or assisted by the federal government was prohibited by an executive order entered by President Carter during 1980 that expanded President Kennedy's executive order of November 1962. The 1980 executive order also granted additional authority to the Department of Housing and Urban Development (HUD) to issue regulations to encourage fair housing.

The U.S. Supreme Court rendered two major decisions regarding those who had standing to sue for violations of the Fair Housing Act:

- In 1972 the U.S. Supreme Court upheld the right of fair housing organizations and other residents to sue persons or municipalities that violated the Fair Housing Act. n8
- In 1982 the U.S. Supreme Court determined that fair housing organizations and "testers" had standing to sue in racial steering cases. n9

[4] Fair Housing Amendments Act of 1988

The Fair Housing Amendments Act of 1988 (commonly referred to as "FHAA") expanded the classes of persons protected from housing discrimination to include families with children and handicapped persons. n10 Simultaneously, it created exemptions from the Act for maximum occupancy limitations and housing for older persons. The Fair Housing Amendments Act also increased the amount of civil damages available under Title VIII and expanded the types of discriminatory practices regulated by Title VIII to include:

- real estate loans for repairs and improvements,
- certain secondary market activities, and
- real estate appraisals. n11

The Fair Housing Amendments Act was signed into law by President Reagan during 1988 and became effective on March 12, 1989.

[5] HUD Regulations Implementing the Fair Housing Amendments Act of 1988

Pursuant to the mandate of the Fair Housing Amendments Act of 1988, the U.S. Department of Housing and Urban Development (HUD) issued sweeping regulations to implement the provisions of the FHAA. Many of those regulations affect the daily activity of real estate brokers.

Under the 1988 amendments, HUD received new enforcement authority. The Fair Housing Act, as amended, provides that:

(1) HUD must prepare a final investigative report and determine whether reasonable cause exists to believe that a discriminatory housing practice has occurred. n12

(2) If HUD makes a sufficient reasonable cause determination it must issue a charge against the respondent on behalf of the aggrieved person, and the charge initiates legal proceedings before an administrative law judge; or, n13

(3) After such a charge, either party may elect to have the claims adjudicated in a federal civil action, n14 and if such an election is made, HUD must authorize the Attorney General to commence and maintain a civil action on behalf of the aggrieved person. n15

The right of the government to file a cause of action on behalf of the aggrieved party was a new development under the 1988 amendments. No longer was the government limited to filing a traditional "pattern or practice" lawsuit. To prove a practice or pattern of discrimination the government was formerly required to show that the defendant engaged in discriminatory activity as a matter of standard operating procedure. n16 Isolated or sporadic acts of discrimination were insufficient to prove a pattern or practice under the FHA. n17 The government could now step into the shoes of the aggrieved party and file suit for any individual act of discrimination, while the aggrieved party retained the absolute right to intervene. n18

Regulations were enacted in addition to those establishing procedures for the investigation of complaints of discriminatory housing practices and for administrative proceedings involving discriminatory housing practices. Other HUD regulations describe the nature of conduct made unlawful with respect to the sale, rental and financing of dwellings or in the provision of services and facilities in connection with such dwellings.

The FHAA also made it unlawful to design or construct certain multi-family dwellings for first occupancy after March 13, 1991 in a manner that makes them inaccessible to persons with disabilities. Section 100.205 of HUD's regulations implements the FHA's design and construction requirements (also referred to as "accessibility requirements"). n19 HUD published final Fair Housing Accessibility Guidelines to provide builders and developers with technical guidance on how to comply with the accessibility requirements. n20

The regulations issued under Title VIII have been revised to reflect the expanded coverage of the Fair Housing Act. Finally, HUD amended regulations providing for the recognition of substantially equivalent state and local fair housing laws to provide for the certification procedure established by the FHAA. n21

[6] All Legislative and Regulatory Sources--Federal, State, and Local--Should Be Examined to Ensure Compliance

In addition to the Fair Housing Act, other civil rights authorities may apply regarding a discriminatory housing practice. Certain discriminatory housing practices are prohibited by many federal laws, including the following:

- Title VI of the Civil Rights Act of 1964; n22
- section 109 of the Housing and Community Development Act of 1974; n23
- section 504 of the Rehabilitation Act; n24 and
- the Age Discrimination Act. n25

There are also myriad national, state, and local regulations intended to define and eliminate discrimination in housing. The same activity may be regulated at all three levels and all legislative and regulatory sources should be examined to ensure compliance. For example, in New York City one will find that blockbusting is prohibited by federal law, n26 is prohibited by state law, n27 and is prohibited by local law. n28 Further, conduct that is exempt under federal law may still be prohibited by state statute. For example, federal law regarding discriminatory housing practices contains an exemption for sale by an "owner" of a single-family dwelling. n29 Maryland state law regarding discriminatory real estate practices in Baltimore City does not follow the federal exemption. The Maryland law applies to any building intended to be occupied as a residence. n30

Real estate brokers are subject to regulation at all three levels and are protected at all three levels. If there is a question of whether an activity is lawful, all legislative sources should be considered before one engages in the activity. Similarly, if a broker has suffered a loss due to an unlawful discriminatory housing practice, he or she should examine all levels of legislation and regulation for possible relief.

FOOTNOTES:

(n1)Footnote 1. 42 U.S.C. §§ 1981, 1982.

(n2)Footnote 2. *Civil Rights Cases*, 109 U.S. 3 (1883) .

(n3)Footnote 3. *Plessy v. Ferguson*, 163 U.S. 537 (1896) .

(n4)Footnote 4. *Shelley v. Kraemer*, 334 U.S. 1 (1948) .

(n5)Footnote 5. *Brown v. The Board of Education*, 347 U.S. 483, 53 Ohio Op. 326 (1954) .

(n6)Footnote 6. *Jones v. Alfred H. Mayer Co.*, 392 U.S. 409, 47 Ohio Op. 2d 43 (1968) .

(n7)Footnote 7. 42 U.S.C. § 3601 *et seq.*

(n8)Footnote 8. *Trafficante v. Metropolitan Life Insurance Co.*, 409 U.S. 205 (1972) .

(n9)Footnote 9. *Havens Realty Corp. v. Coleman*, 455 U.S. 363 (1982) .

(n10)Footnote 10. 42 U.S.C. § 3604(d), (e).

(n11)Footnote 11. See generally Fair Housing Instructor Development Workshop, published by the Association of Real Estate Licensed Law Officials; Caruso, *Fair Housing in the 1990's: An Overview of Recent Developments and Prognosis of Their Impact*, 23 J. Marshall L. Rev. 421 (1989); Maywalt, *The Fair Housing Amendments of 1988*, 18 Colo. Law. 1109 (1989).

(n12)Footnote 12. 42 U.S.C. §§ 3610(b)(5), 3610(g).

(n13)Footnote 13. 42 U.S.C. § 3610(g)(2)(A).

(n14)Footnote 14. 42 U.S.C. § 3612(a).

(n15)Footnote 15. 42 U.S.C. § 3612(o).

(n16)Footnote 16. See *International Bhd. of Teamsters v. United States*, 431 U.S. 324, 336 (1977) .

(n17)Footnote 17. See *United States v. Balistrieri*, 981 F.2d 916, 929 (7th Cir. 1992) , cert. denied, 510 U.S. 812 (1993) .

(n18)Footnote 18. 42 U.S.C. § 3602(o)(2).

(n19)Footnote 19. 24 C.F.R. § 100.205.

(n20)Footnote 20. 24 C.F.R. Ch. I, Subch. A., App. II.

(n21)Footnote 21. 54 Fed. Reg. 3232 (1989) .

(n22)Footnote 22. 42 U.S.C. §§ 200d, 2000d-5.

(n23)Footnote 23. 42 U.S.C. § 5309.

(n24)Footnote 24. 29 U.S.C. § 794.

(n25)Footnote 25. 42 U.S.C. § 6101.

(n26)Footnote 26. 42 U.S.C. § 3604(e).

(n27)Footnote 27. N.Y. Exec. Law § 296(3-b).

(n28)Footnote 28. N.Y.C. Admin. Code tit. B § B1-7.0.

(n29)Footnote 29. 42 U.S.C. § 3603.

(n30)Footnote 30. Md. Code Ann. art. 56, § 230 D.

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143 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation
CHAPTER 9 The Broker And Discrimination *

10A-9 Real Estate Brokerage Law and Practice § 9.02

§ 9.02 Prohibited Acts of Discrimination Under Federal Legislation

[1] Discriminatory Housing Practices

It is the purpose of the Fair Housing Act (Title VIII or FHA) to provide for fair housing throughout the United States. n1 The Fair Housing Act of 1968 prohibited discrimination in the sale or rental of housing on the basis of race, color, religion, sex, or national origin. The scope of protection was enlarged by the Fair Housing Amendments Act of 1988 (FHAA) n2 and by regulations promulgated by the Department of Housing and Urban Development (HUD).

It is now unlawful under the Fair Housing Act, as amended and supplemented, to discriminate in any aspect relating to the sale, rental, advertising, or financing of dwellings based on seven protective classifications, specifically: race, color, religion, national origin, sex, handicap, or familial status. n3 "Dwellings" are defined to include any building, structure, or portion of any building or structure that is occupied as, or designed or intended for occupancy as, a residence by one or more families, and any vacant land offered for sale or lease for the construction or location of any such building or structure. n4 A "family" may consist of a single individual. n5

The following are unlawful discriminatory housing practices under the Fair Housing Act: n6

[a] Discrimination in the Sale or Rental of Housing

One may not refuse to sell or rent after a bona fide offer has been made, nor may one refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny a dwelling to any person because of race, color, religion, national origin, sex, handicap, or familial status. n7 This prohibition is commonly violated when one refuses to rent or sell a dwelling to an individual who falls within one of the seven protective classifications. Such an individual is referred to as a member of a protected class.

To make out a *prima facie* discriminatory housing refusal case, a plaintiff must show that he or she is a member of a statutorily protected class who applied for and was qualified to rent or purchase housing and was rejected although the housing remained available. n8 A plaintiff stating a claim under the FHA need allege "only discriminatory effect, and need not show that the decision complained of was made with discriminatory intent." n9

Similarly, one may not discriminate against any person in the terms, conditions or privileges of sale or rental of a

dwelling because of race, color, religion, national origin, sex, handicap, or familial status. One may not discriminate in the types of services or facilities provided incident to the sale or rental of a dwelling because of race, color, religion, national origin, sex, handicap, or familial status. n10 This is known as discrimination in terms or conditions. A common example of a violation of this prohibition is when one charges additional monies to a member of a protected class to dissuade or prevent that individual from purchasing or renting a property.

Regulations promulgated by HUD list four activities that are prohibited if they are based on any of the seven protected classifications:

- Using different provisions of the sales or lease contract for different individuals;
- Failing or delaying in the maintenance or repairs to sale or rental dwellings;
- Failing to process or accurately communicate an offer for the sale or rental of a dwelling; or
- Limiting the use of privileges, services, or facilities associated with the building because of the protected classification of the owner, tenant, or person associated with the owner or tenant. n11

Similarly, it is unlawful to discriminate in the sale or rental of a dwelling because of the buyer's or lessee's refusal to provide sexual favors. n12

[b] Discrimination in Advertising for Sale or Rental

An advertisement in any form that indicates any preference, limitation, or discrimination based on race, color, religion, national origin, sex, handicap, or familial status, or that indicates an intention to make such a preference, is prohibited. n13 Congress concluded that the regulation of advertising practices was warranted because of the key role housing advertisements play in potential real estate transactions. n14

The Fair Housing Act's prohibition against discriminatory advertising applies to the publisher of the advertisement as well as to the party who places the advertisement. n15 The prohibition extends to all advertisements regardless of the medium used, including all written statements and oral statements. n16

In determining whether an advertisement or statement "indicates" impermissible discrimination, the court determines whether the advertisement for housing suggests to an ordinary reader, viewer, or listener that a person of a particular race or other characteristic is preferred or that a member of a protected class is not preferred for the housing in question. n17 Claimants may establish violations of section 3604(c) by proving an actual intent to discriminate. n18 A claimant, however, is not required to establish discriminatory intent or establish discriminatory effect to recover on a claim of discriminatory advertising. n19 A claimant may establish a *prima facie* case by showing by oral testimony that she or he was exposed to the advertising that indicated impermissible discrimination and was substantially insulted or distressed by one or more advertisements, with the nature and extent of the claimant's injury to be reflected in the amount of damages awarded. n20

Following are a few examples of what courts have found to constitute discriminatory advertising prohibited by the Fair Housing Act:

- A rental ad specifying that an apartment was in a "white home"; n21
- A landlord's statement to a white tenant that she should send her friends over to see a vacant apartment but to "make sure her friends are whites"; n22 and

- The exclusive use of Caucasian models in advertisements appearing in newspapers and on the sides of buses. n23

In contrast, the single publication of an advertisement that uses a small number of all-white models does not, without more, state a cognizable claim for discriminatory advertising under the Fair Housing Act. n24

Further, an affirmative marketing program with advertising efforts directed toward a predominantly white audience with the intention of promoting racial balance in an area of predominant interest to black home buyers has been upheld under the FHA. n25 The decision was based on the goal of the Fair Housing Act to eliminate segregated housing coupled with the facts that limited race-conscious marketing was utilized, the intent was to promote racial balance, there were no racial quotas or other provisions that made race a factor in deciding who would be allowed to see or purchase a home, and members of the protected classes (referred to as minorities) were not excluded. n26

HUD has enacted regulations specifically prohibiting the following discriminatory advertising practices:

- The use of any catch words or phrases implying that dwellings are or are not available to a member of a protected class. n27
- The selection of particular media for advertising locations that effectively discriminates against a protected class by denying them housing market information. n28
- The refusal to publish sale or rental advertising because of a protected classification, or charging different rates for such advertising based upon the classification. n29

[c] False Representations of Unavailability

One may not falsely represent to any person because of race, color, religion, national origin, sex, handicap, or familial status that a dwelling is not available for inspection, sale, or rental when that dwelling is available for inspection, sale, or rental. n30 This prohibition creates an enforceable right to truthful information for every person. n31 A misrepresentation made about the availability of properties for sale or rental is the most common means used to ensure segregation by "steering" a member of a protected class away from a segregated building, area, or community. n32 Section 3604(d) is commonly violated when one refuses to rent or sell a dwelling to an individual who falls within one of the seven protective classifications. Such an individual is referred to as a member of a protected class.

The following are examples of facts upon which courts have upheld plaintiffs' rights to pursue claims under 3406(d) for false representations of unavailability:

- A black prospective tenant was informed that no apartments were available. Upon investigation, a black tester was informed that apartments were not available, and a white tester was informed that apartments were available. n33
- An apartment manager refused an application from a family receiving income from the Federal Aid to Families with Dependent Children program. During an investigation a tester who claimed to receive welfare payments was told no apartments were available for inspection until the following week. Later that day another tester who did not claim to receive federal assistance and did not report children was shown an apartment. n34
- The manager of an apartment complex told a black prospective tenant that no apartments were available and her requests to see floor plans or to view a model unit were refused. The next day a white prospective tenant, after being told that apartments were available immediately, was allowed to inspect a

model and several available units. n35

[d] Blockbusting and Steering

Blockbusting and steering are two primary techniques that were utilized by real estate professionals to perpetuate integration and wrongfully profit from the threat of integration. Though the overwhelming number of cases addressing these practices arise out of racial discrimination, there are many cases involving national origin and the discriminatory practices and the considerations discussed within this subsection apply to all protected classifications. Extensive legislation exists at federal, state, and local levels, prohibiting blockbusting and steering.

[i] Blockbusting

Blockbusting is specifically prohibited under section 3604(e) which makes it unlawful for one to induce or try to induce any person to sell or rent any dwelling by making a representation regarding the entry or prospective entry into the neighborhood of one or more persons of a particular race, color, religion, sex, handicap, familial status, or national origin. n36

Blockbusting has long been identified as a process through which individuals (typically real estate brokers) stimulate and prey on racial bigotry and fear by initiating and encouraging rumors that blacks are about to move into a given area, that whites will leave, and that the market values of properties will descend to panic prices with residence in the area becoming undesirable and unsafe for individuals who are not black. n37 Real estate agents artificially stimulate sales of residential property by making representations to homeowners regarding the migration of a particular racial, ethnic, religious, or social group into the neighborhood. The brokers then use frenzied solicitation practices, known as "churning," as a means of increasing the number of real estate transactions. As a result, brokers gain the benefit of commissions generated by increased sales while "homeowners and communities suffer the detriment of declining property values and neighborhood instability brought on by panic selling, the fanning of racial tensions and promoting of ethnic stereotypes." n38 The practice of blockbusting has been recognized as a fundamental element in the perpetuation of segregated neighborhoods and racial ghettos. n39

Blockbusting techniques used by brokers have included the following:

- Door-to-door solicitation;
- Dissemination of literature stating that a member of a minority group has purchased a home nearby;
- Racial steering;
- Telephone solicitations;
- Obtaining numerous listings in an area and placing "For Sale" signs on the properties to frighten local residents into selling;
- "Wrong number" telephone calls in which the callers claim to have believed they were calling the black family that just moved in;
- Purchasing a home in the area and selling it on contract to a minority buyer;
- Telling owners that the FHA has inspected certain property, implying that it would be sold to a black or to a Hispanic;

- Implying that the police can no longer patrol the area effectively; and
- Telling homeowners that the influx of minorities will adversely affect the schools. n40

The concern, as stated by one court, is that if the real estate industry were "allowed to operate unchecked, the pace of racial transition will be manipulated in a way that will irreparably distort any chance for normal and stable racial change." n41 In that case the plaintiffs were a multiracial group of homeowners and the defendants were a group of incorporated and unincorporated real estate agencies and a number of individual real estate salespersons. Testimony was presented that some of the real estate agents had approached the residents at their homes, although none of them had expressed an interest in selling. The homeowners were warned of impending racial changes in the neighborhood and advised to sell as soon as possible so as to get a good price. The brokers conducted a massive solicitation campaign "involving flyers, telephone calls and door-to-door canvassing." The court stated that the issue was not whether the process by which white families are replaced by black families is either irrational or inevitable, but was whether the real estate industry should be allowed to enter into the process and, for commercial advantage, artificially hasten or at least accelerate the rate of population turnover and the pace of racial change. n42

The transitional nature of the involved area is a key factor in establishing illegal blockbusting. The prohibitions of Section 3204(e) have, therefore, been found applicable to overt blockbusting and other uninvited solicitations in racially transitional neighborhoods. Plaintiffs are required to establish that:

- the solicitations are made for profit;
- the solicitations are intended to induce the sale of a dwelling, and
- the solicitations would convey to a reasonable man, under the circumstances, the idea that members of a particular race are, or may be, entering the neighborhood. n43

Not every uninvited solicitation into a transitional area constitutes illegal blockbusting or unlawful solicitation. A racially neutral solicitation directed to an area experiencing racial transition does not necessarily violate Section 3604(e). n44

[iii] Steering

Steering is a practice used by real estate brokers and agents to preserve and encourage patterns of racial segregation by "steering" or directing members of racial or ethnic groups to buildings or areas occupied primarily by members of their own racial or ethnic group and away from buildings and neighborhoods inhabited by members of other races or groups. n45 Steering is the practice of directing prospective home buyers interested in equivalent properties to different areas according to their race. n46

Though not specifically prohibited under the Fair Housing Act, the means through which steering is most commonly accomplished are prohibited. Those means include:

- unlawful refusals to sell or rent under Section 3604(a),
- discrimination in terms or conditions under Section 3604(b),
- discriminatory publications and advertisements under Section 3604(c),
- false statements of unavailability under Section 3604(d), and

- blockbusting activities prohibited by Section 3604(e).

For example, illegal steering was established when a real estate agency responded differently to testers of different races, with similar rental profiles. The agency directed the white testers to look at apartments in primarily white neighborhoods but directed the African-American and Latino testers to look at apartments in primarily minority neighborhoods or informed the minority tester that no apartments were available. n47

To recover on a claim of steering one must establish that a challenged statement or conduct would have a discriminatory effect on a reasonable person under the circumstances who is seeking housing. Additionally the plaintiff must establish that the challenged statement or conduct was made with the intent to steer. n48

[2] Other Prohibited Acts of Discrimination Under the FHA

[a] Discrimination in Brokerage Services

Section 3606 of the Fair Housing Act makes it unlawful to deny any person access to, or membership or participation in, any multiple listing service, real estate brokerage organization, or facility relating to the business of selling dwellings. n49

[b] Interference, Coercion, or Intimidation

Section 3617 of the Fair Housing Act makes it unlawful to coerce, intimidate, threaten, or interfere with any person who on his or her own behalf or to aid another has exercised rights granted or protected by Sections 3603 through 3606. n50 The language "interfere with" has been applied to reach all practices that have the effect of interfering with the exercise of rights under the Fair Housing Act. n51

Types of conduct found to constitute unlawful interference under Section 3617 include the following:

- racially motivated firebombing; n52
- exclusionary zoning; n53 and
- insurance redlining. n54

Economic competition, however, does not constitute actionable interference, as when one group of purchasers outbid a prospective purchaser who intended to use a property to provide a residential group home for mentally disabled students. n55 Yet, economic consequences may constitute actionable interference, as when a city reduced the amount of rent a mobile park owner could charge after the owner terminated an "adults only" policy to provide housing for families with children. The court, finding that it could not attach value to unlawful discrimination, rejected the city's argument that the rent reduction simply reflected the reduced value of housing services and found that the rent reduction constituted interference under Section 3617.

To state a *prima facie* claim for retaliation under the Fair Housing Act it must be shown that one was engaging in a protected activity under the Act, that subsequent action was taken against the individual that was causally linked with one's exercise of protected activities, and that some resulting damage was suffered. n56

For example, when hotel owners planned to sell their hotel for development of housing primarily for the mentally disabled, the defendant city and an individual council member interfered with their plans by failing to recommend for approval a loan required by the purchasers to complete the housing project. When the hotel owners threatened to sue the city to obtain approval that had been wrongfully withheld, the city retaliated by citing them for numerous building code

violations. The hotel owners spent \$40,000 to make repairs and, when the loan was still not approved, filed suit against the city and an individual councilman. In retaliation, the city found that there had not been substantial progress in response to the previous citations and charged the owners with criminal slum offenses. Though the loan was ultimately approved and the housing project proceeded, the hotel owners pursued their Section 3617 claims for retaliation under the FHA. The Ninth Circuit reversed the dismissal of the hotel owners' claims, holding that they had standing to sue under the FHA and that they had stated a *prima facie* case of retaliation under the Act. The court also held that the councilman was not protected by immunity from the owners' retaliation claim. n57

[3] Discrimination Based Upon Certain Protected Classifications

[a] Discrimination Based Upon Familial Status

The Fair Housing Act has, since its amendment in 1988, prohibited discriminatory housing practices based upon familial status. n58 "Familial status" is defined to mean one or more minors domiciled with a parent or legal custodian, or the designee of a parent or custodian. n59

The fact that adults stay in a dwelling with minors is not sufficient to establish that the minors are domiciled with those adults. For that reason, familial status protection was not extended to a single-family dwelling acquired to house ten troubled adolescents who would be supervised by adult professionals who would stay with them at various times. n60 The court reasoned that a domicile is one's fixed and permanent home and, traditionally, an individual has only one domicile at a time. Adults establish a domicile by their physical presence in a place and by their intent to remain there. The fact that one stays there or spends the night is not sufficient. To establish a dwelling as one's domicile the adults must make it their "home."

Discrimination on the basis of familial status was found, recovery of compensatory damages was affirmed, and punitive damages should have been submitted to a jury in a case where a family with eight children was discriminated against in the following ways:

- it was told the property was rented and unavailable;
- it was told there were no properties available that were "suitable for the family's size"; and
- it was told there were no properties large enough to accommodate the family.

The rent for the property was \$1,000 per month. After offering to pay a full year's rent in advance, the real estate broker agreed to lease the property if the family would pay a \$3000 security deposit--though the property was offered to the public for monthly rent of \$1,000 and a security deposit of \$600. n61

The prohibition against discrimination on the basis of familial status often comes into conflict with legitimate limitations on occupancy. For that reason the Fair Housing Act includes an exemption permitting reasonable local, state, or federal restrictions regarding the maximum number of occupants permitted to occupy a dwelling. n62 Therefore, even though limitations on occupancy may have an adverse impact upon families with children, that adverse impact is not sufficient to establish discrimination if the limits are reasonable and apply equally to all occupants. n63 For more information concerning occupancy limits, see § 9.03[4], *Limitations on Occupancy*.

[b] Discrimination Based Upon Handicap or Disability Status

The Fair Housing Act makes it unlawful to discriminate against any person in the terms, conditions, or privileges of sale or rental of a dwelling, or in the provision of services or facilities in connection with such dwelling to:

10A-9 Real Estate Brokerage Law and Practice § 9.02

- (1) any buyer or renter based on the handicap of the renter or buyer;
- (2) a person who lives with or intends to live with the handicapped renter or buyer; or
- (3) any person associated with the handicapped renter or buyer. n64

A person with a handicap is defined as a person who:

- (1) has a physical or mental impairment which substantially limits one or more of that person's major life activities;
- (2) has a record of having such an impairment; or
- (3) is regarded as having such an impairment. n65

The Department of Housing and Urban Development has clarified the foregoing definition. "Has a record of such an impairment" means that the individual has a history of, or has been misclassified as having, a mental or physical impairment that substantially limits one or more major life activities. "Is regarded as having an impairment" means that the individual:

- (1) has a physical or mental impairment that does not substantially limit one or more major life activities, but that is treated by another person as constituting such a limitation;
- (2) has a physical or mental impairment that substantially limits one or more major life activities only as the result of the attitudes of others toward such impairment; or
- (3) has none of the impairments previously defined but is treated by another person as having such an impairment. n66

There are three exclusions to the prohibition on discrimination based on handicap status:

- (1) current, illegal use of or addiction to a controlled substance; n67
- (2) direct threat to the health or safety of other individuals, or individuals whose tenancy would result in substantial damage to the property of others; n68 and
- (3) conviction by any court of competent jurisdiction of the illegal manufacture or distribution of a controlled substance. n69

Discrimination prohibited by the Fair Housing Act includes the refusal to make reasonable accommodations in rules, policies, practices, or services when such accommodations may be necessary to allow handicapped individuals an equal opportunity to use and enjoy a dwelling. n70 Landlords have an affirmative duty reasonably to accommodate the needs of handicapped persons. n71 Accommodations required under the Fair Housing Act must be both reasonable and necessary. An accommodation is reasonable when it imposes no "fundamental alteration in the nature of a program" or "undue financial and administrative burdens." n72

The duty to provide accommodation is not absolute. Providing reasonable accommodation does not mean doing "everything humanly possible to accommodate a disabled person." n73 The duty to provide accommodation does not require a local governmental entity to waive a neutral zoning regulation to allow expansion of facilities housing handicapped individuals. n74

It is the burden of the plaintiff to establish that an accommodation was reasonable and necessary. Finding that it was not reasonable to expect a landlord to evict other tenants to accommodate the screaming and slamming of a tenant suffering from schizophrenia and depression, it was held that the plaintiff had failed to meet his burden and that the landlord's decision to evict the handicapped individual did not violate the Fair Housing Act. n75

Upon cost benefit balancing that takes both parties' needs into account, it is a reasonable and necessary accommodation to allow a person who is deaf to keep a "hearing dog" (a dog that is trained to assist those who are hearing-impaired). Consideration must be given to the degree to which a hearing dog aids individuals in coping with their disabilities and though "professional credentials" from a recognized training facility may be considered, they are not required. n76

Defining "handicapped" when a person does not have an obvious physical handicap has presented some difficulties for the courts. Despite that fact, it has been found that people in the following situations were entitled to handicap status protection:

- People with AIDS are considered handicapped under the Fair Housing Act, and refusal to issue a special permit for AIDS patients has been held to violate the Act. n77
- People in the re-entry phase of a drug rehabilitation program are considered handicapped under the Fair Housing Act--the court reasoning that the inability to obtain an apartment was on par with the inability to obtain a job and, therefore, created an impairment substantially limiting a major life activity. n78 Regarding the "current, illegal use of or addiction to a controlled substance" exclusion set forth at 42 U.S.C. § 3602(h), the court held that the Fair Housing Act does not *per se* exclude from its coverage every person who would be considered a drug addict. The court found, instead, that Congress intended to recognize that addiction is a disease; through rehabilitation efforts a person may recover from addiction; and an individual who makes an effort to recover should not be subject to housing discrimination based on society's accumulated fears and prejudices associated with drug addiction. While drug addicts are exempted from FHA protections, recovering drug addicts are not.
- People considered mentally retarded or who are the subject of a psychological disorder or disease are considered handicapped under the Fair Housing Act. n79

For guidance in defining handicapped individuals under the Fair Housing Act, and guidance in determining the types and extent of accommodations required under the Act, one can refer to Section 504 of the Rehabilitation Act of 1973, n80 and cases decided under that Act. For example, in holding that a landlord was not allowed to evict a tenant from an apartment in a federally subsidized housing complex without first reasonably accommodating the individual to minimize the risk the tenant posed to others, the court relied upon a Supreme Court case n81 decided under Section 504 of the Rehabilitation Act. The accommodation requirement was held to apply even though the tenant exhibited erratic behavior and threatened other tenants in the complex. n82 In the aftermath of the Supreme Court's decision, the Fair Housing Act was amended to exclude from its protections those individuals who "would constitute a direct threat to the health or safety of other individuals or whose tenancy would result in substantial physical damage to the property of others." n83

Housing for handicapped individuals is often opposed based upon the fear of nearby property owners that it will cause depreciation in housing values. Such fear is what the Fair Housing Act is intended to redress and it will not excuse unlawful discrimination on the basis of handicap. n84 A neighboring property owner can be sued for violation of the Fair Housing Act based on an attempt to enforce restrictive covenants to prevent mentally handicapped individuals from residing in the neighborhood. n85

Yet, neighbors opposed to a particular property use are still allowed to avail themselves of their *First Amendment* rights

to protest and to petition the government. For example, it was found the HUD officials wrongly chilled the *First Amendment* rights of neighbors opposed to the conversion of a motel into a multi-family housing unit for homeless persons by attempting to prevent their activities protesting the conversion. This was true despite the fact that the neighbors' concern stemmed from their belief that the building's conversion would result in an influx of people who would be considered handicapped under the Fair Housing Act, people who were mentally disabled or who were disabled due to substance abuse. The neighbors' protest activities in the form of writing newspaper articles, writing letters, and passing out leaflets were protected activities not prohibited by the Fair Housing Act. n86

[c] Discrimination Based Upon Sex

Discrimination on the basis of sex, as a gender qualification, is prohibited under the Fair Housing Act. n87 The duty of a property owner to not discriminate on the basis of sex is non-delegable. n88

Discrimination on the basis of sex often arises in the context of sexual harassment during one's tenancy. For example, a plaintiff was allowed to pursue an action for discrimination on the basis of sex against the manager and part-owner of the apartment building in which she had resided. The defendant subjected her to numerous unwanted sexual advances and ultimately engaged in conduct that led to his conviction for assault. The defendant retaliated by threatening the plaintiff with eviction, interfering with the equipment and services provided to her unit, and attempting to have her arrested on a false report of theft. n89

Similarly, a landlord who leased a property and then persistently sought sexual relations in lieu of rent from the tenant, a woman with two children, was found to have violated the Act's prohibition against discrimination based on sex. The landlord was required to pay a civil fine and damages for alternative housing costs and for emotional distress and inconvenience. n90 However, in accordance with the guidelines utilized in Title VII employment discrimination cases, an isolated incident may not support an action under the Act. n91

FOOTNOTES:

(n1)Footnote 1. 42 U.S.C. § 3601.

(n2)Footnote 2. 42 U.S.C. § 3604(d), (e).

(n3)Footnote 3. 42 U.S.C. § 3604.

See Aalberts, *Strict Liability Under the Fair Housing Act*, 24 Real Estate L.J. iv (Spr. 1996).

(n4)Footnote 4. 42 U.S.C. § 3602(b).

(n5)Footnote 5. 42 U.S.C. § 3602(c).

(n6)Footnote 6. 42 U.S.C. § 3602(f).

(n7)Footnote 7. 42 U.S.C. § 3604.

See Aalberts, *Strict Liability Under the Fair Housing Act*, 24 Real Estate L.J. iv (Spr. 1996).

(n8)Footnote 8. *Robinson v. 12 Lofts Realty*, 610 F.2d 1032, 1038 (2d Cir. 1979) .

(n9)Footnote 9. *United States v. Yonkers Bd. of Education*, 837 F.2d 1181, 1217 (2d Cir. 1987) , cert. denied, 486 U.S. 1055, 108 S.Ct. 2821, 100 L. Ed. 2d 922 (1988) .

(n10)Footnote 10. 42 U.S.C. § 3604(b).

(n11)Footnote 11. F.H.A. Reg. 100.65(b)(1)-(4).

(n12)Footnote 12. F.H.A. Reg. 100.65(b)(5).

(n13)Footnote 13. 42 U.S.C. § 3604(c).

(n14)Footnote 14. *Housing Opportunities Made Equal, Inc. v. Cincinnati Enquirer, Inc.*, 943 F.2d 644, 652 (6th Cir. 1991) .

(n15)Footnote 15. *United States v. Hunter*, 459 F.2d 205 (4th Cir.) , cert. denied, 409 U.S. 934 , reh'g denied, 413 U.S. 923 (1972) .

(n16)Footnote 16. F.H.A. Reg. 100.75(b); *Soules v. United States Dept. of Hous. & Urban Dev.*, 967 F.2d 817, 822 (2d Cir. 1992) .

(n17)Footnote 17. *Ragin v. New York Times Co.*, 923 F.2d 995, 999 (2d Cir.) , cert. denied, 502 U.S. 821, 112 S. Ct. 81, 116 L. Ed. 2d 54 (1991) .

(n18)Footnote 18. See *Housing Opportunities Made Equal v. Cincinnati Enquirer*, 943 F.2d 644, 646 (6th Cir. 1991) .

(n19)Footnote 19. See *Ragin v. Harry Maclowe Real Estate Co.*, 6 F.3d 898 (2d Cir. 1993) .

(n20)Footnote 20. *Ragin v. New York Times Co.*, 923 F.2d 995 (2d Cir.) , cert. denied, 502 U.S. 821, 112 S. Ct. 81, 116 L. Ed. 2d 54 (1991) .

(n21)Footnote 21. *United States v. Hunter* 459 F.2d 205, 215 (4th Cir.) , cert. denied, 409 U.S. 934, 93 S. Ct. 235, 34 L. Ed. 2d 189 (1972) .

(n22)Footnote 22. *United States v. Gilman*, 341 F. Supp. 891, 896-97 (S.D.N.Y. 1972) .

(n23)Footnote 23. *Ragin v. Harry Maclowe Real Estate Co.*, 6 F.3d 898 (2d Cir. 1993) .

(n24)Footnote 24. *Housing Opportunities Made Equal, Inc. v. Cincinnati Enquirer, Inc.*, 943 F.2d 644 (6th Cir. 1991) .

(n25)Footnote 25. *South-Suburban Housing Center v. Greater South Suburban Board of Realtors*, 935 F.2d 868 (7th Cir. 1991) .

(n26)Footnote 26. *South-Suburban Housing Center v. Greater South Suburban Board of Realtors*, 935 F.2d 868, 884-885 (7th Cir. 1991) .

(n27)Footnote 27. F.H.A. Reg. 100.75(c)(1).

(n28)Footnote 28. F.H.A. Reg. 100.75(c)(3).

(n29)Footnote 29. F.H.A. Reg. 100.75(c)(4).

(n30)Footnote 30. 42 U.S.C. § 3604(d).

(n31)Footnote 31. *Havens Realty Corp. v. Coleman*, 455 U.S. 363, 373-374, 102 S. Ct. 1114, 1121, 71 L. Ed. 2d 214 (1982) .

(n32)Footnote 32. See *Village of Bellwood v. Dwivedi*, 895 F.2d 1521 (7th Cir. 1990) .

- (n33)Footnote 33. *Havens Realty Corp. v. Coleman*, 455 U.S. 363, 102 S. Ct. 1114, 71 L. Ed. 2d 214 (1982) .
- (n34)Footnote 34. *Gilligan v. Jamco Development Corp.*, 108 F.3d 2465 (9th Cir. 1997) .
- (n35)Footnote 35. *Asbury v. Brougham*, 866 F.2d 1276 (10th Cir. 1989) .
- (n36)Footnote 36. 42 U.S.C. § 3604(e).
- (n37)Footnote 37. *United States v. Bob Lawrence Realty, Inc.*, 474 F.2d 115 (5th Cir. 1973) .
- (n38)Footnote 38. *New York State Ass'n of Realtors, Inc. v. Shaffer*, 27 F.3d 834, 836 (2d Cir. 1994) .
- (n39)Footnote 39. *Brown v. State Realty Co.*, 304 F. Supp. 1236, 1240 (N.D. Ga 1969) .
- (n40)Footnote 40. *City of Chicago v. Prus*, 117 Ill. App. 455, 453 N.E.2d 776, 779 (1983) .
- (n41)Footnote 41. *Zuch v. Hussey*, 394 F. Supp. 1028, 1034 (E.D. Mich. 1975) .
- (n42)Footnote 42. *Zuch v. Hussey*, 394 F. Supp. 1028, 1033 (E.D. Mich. 1975) .
- (n43)Footnote 43. *Zuch v. Hussey*, 394 F. Supp. 1028, 1049 (E.D. Mich. 1975) .
- (n44)Footnote 44. *Heights Community Congress v. Hilltop Realty*, 774 F.2d 135 (6th Cir. 1985) .
- (n45)Footnote 45. *Coles v. Havens Realty Corp.*, 633 F.2d 384 (4th Cir. 1980) .
- (n46)Footnote 46. *Gladstone Realtors v. Village of Bellwood*, 441 U.S. 91 (1979) ; *Smith v. City of Cleveland Heights*, 760 F.2d 720 (6th Cir. 1985) , cert. denied, 474 U.S. 1056 (1986) .
- (n47)Footnote 47. *Cabrera v. Jakobovitz*, 24 F.3d 372 (2d Cir. 1994) .
- (n48)Footnote 48. *Central Alabama Fair Housing v. Lowder Realty*, 236 F.3d 629 (11th Cir. 2000) .
- (n49)Footnote 49. 42 U.S.C. § 3606.
- (n50)Footnote 50. 42 U.S.C. § 3617.
- (n51)Footnote 51. *Michigan Protection & Advocacy Serv. v. Babin*, 18 F.3d 337, 347 (6th Cir. 1994) .
- (n52)Footnote 52. *See Stirgus v. Benoit*, 720 F. Supp. 119, 123 (N.D. Ill. 1989) .
- (n53)Footnote 53. *See United States v. City of Birmingham*, 727 F.2d 563 (6th Cir.) , cert. denied, 469 U.S. 821, 105 S. Ct. 95, 83 L. Ed. 2d 41 (1984) .
- (n54)Footnote 54. *See Laufman v. Oakley Bldg. & Loan Co.*, 408 F. Supp. 489, 497-98 (S.D. Ohio 1976) .
- (n55)Footnote 55. *Michigan Protection & Advocacy Serv. v. Babin*, 18 F.3d 337, 347 (6th Cir. 1994) .
- (n56)Footnote 56. *San Pedro Hotel Co., Inc. v. City of Los Angeles*, 159 F.3d 470 (9th Cir. 1998) .
- (n57)Footnote 57. *San Pedro Hotel Co., Inc. v. City of Los Angeles*, 159 F.3d 470 (9th Cir. 1998) .
- (n58)Footnote 58. *See* 42 U.S.C. § 3604(a)-(e).
- (n59)Footnote 59. 42 U.S.C. § 3602(k).

- (n60)Footnote 60. *Keys Youth Services v. City of Olathe*, 248 F.3d 1267 (10th Cir. 2001) .
- (n61)Footnote 61. *Badami v. Flood*, 214 F.3d 994 (8th Cir. 2000) .
- (n62)Footnote 62. 42 U.S.C. § 3607(b)(1).
- (n63)Footnote 63. *Fair Housing Adv. v. City, Richmond Heights*, 209 F.3d 626 (6th Cir. 2000) .
- (n64)Footnote 64. 42 U.S.C. § 3604(f)(1)-(2).
- (n65)Footnote 65. 42 U.S.C. § 3602(h).
- (n66)Footnote 66. 24 C.F.R. § 100.201(c), (d).
- (n67)Footnote 67. 42 U.S.C. § 3602(h).
- (n68)Footnote 68. 42 U.S.C. § 3604(f)(9).
- (n69)Footnote 69. 42 U.S.C. § 3607(b)(4).
- (n70)Footnote 70. 42 U.S.C. § 3604(f)(3)(B).
- (n71)Footnote 71. *United States v. California Mobile Home Park Mgmt. Co.*, 29 F.3d 1413, 1416 (9th Cir. 1994) .
- (n72)Footnote 72. *Smith & Lee Assocs., Inc. v. City of Taylor*, 102 F.3d 781, 795-796 (6th Cir. 1996) .
- (n73)Footnote 73. *Bronk v. Ineichen*, 54 F.3d 425, 429 (7th Cir. 1995) .
- (n74)Footnote 74. *Bryant Woods, Inc. v. Howard County, Maryland*, 124 F.3d 597 (4th Cir. 1997) .
- (n75)Footnote 75. *Groner v. Garden Gate Gardens*, 250 F.3d 1039 (6th Cir. 2001) .
- (n76)Footnote 76. *Bronk v. Ineichen*, 54 F.3d 425 (7th Cir. 1995) .
- (n77)Footnote 77. *Association of Relatives & Friends of Aids Patients v. Regulations and Permits Admin.*, 740 F. Supp. 95 (D.P.R. 1990) ; *Baxter v. Belleville*, 720 F. Supp. 720 (S.D. Ill. 1989) .
- (n78)Footnote 78. *United States v. Southern Management Corp.*, 955 F.2d 914 (4th Cir. 1992) .
- (n79)Footnote 79. *See, e.g., Groner v. Garden Gate Gardens*, 250 F.3d 1039 (6th Cir. 2001) .
- (n80)Footnote 80. 29 U.S.C. § 794.
- (n81)Footnote 81. *School Bd. of Nassau County v. Arline*, 480 U.S. 273 (1987) .
- (n82)Footnote 82. *Roe v. Sugar River Mills Assocs.*, 820 F. Supp. 636 (D.N.H. 1993) .
- (n83)Footnote 83. 42 U.S.C. § 3604(f)(9).
- (n84)Footnote 84. *See United States v. Scott*, 788 F. Supp. 1555 (D. Kan. 1992) .
- (n85)Footnote 85. *Deep East Texas Regional Mental Health & Mental Rehabilitation Services v. Kinnear*, 877 S.W.2d 550 (Tex. Ct. App. 1994) ; *see also Martin v. Constance*, 843 F. Supp. 1321 (E.D. Mo. 1994) .
- (n86)Footnote 86. *White v. Lee*, 227 F.3d 1214 (9th Cir. 2000) .

(n87)Footnote 87. *42 U.S.C. § 3601 et seq.*

(n88)Footnote 88. *Walker v. Crigler*, 976 F.2d 900 (4th Cir. 1992) .

(n89)Footnote 89. *United States v. Presidio Investments, Ltd.*, 4 F.3d 805 (9th Cir. 1993) .

(n90)Footnote 90. *Krueger v. Cuomo*, 115 F.3d 487 (7th Cir. 1997) .

(n91)Footnote 91. *Dicenso v. Cisneros*, 96 F.3d 1004 (7th Cir. 1996) .

* This chapter was revised by Georgia Lewis Leonhart, Esq., of Ocean View, Delaware. Ms. Leonhart is a member of the Maryland Bar.



144 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation
CHAPTER 9 The Broker And Discrimination *

10A-9 Real Estate Brokerage Law and Practice § 9.03

§ 9.03 Exemptions from the Fair Housing Act

The Fair Housing Act generally exempts from its coverage:

- Rentals and sales of certain single-family houses; n1
- Rentals and sales of certain dwellings of four or less units; n2
- Rentals and sales of dwellings or lodgings owned, operated, supervised, or controlled by religious organizations or private clubs; n3
- Reasonable governmental limitations on occupancy; n4 and
- Certain housing for older persons. n5

When properly invoked, the statutory exceptions provide absolute exemption from FHA's governance. The exceptions to the Fair Housing Act are, therefore, construed narrowly in order to preserve the primary purpose of the Act to provide within constitutional limitations for fair housing throughout the United States. n6 Further, the party claiming the exemption has the burden of proving its eligibility for the exemption. n7

[1] Single-Family Houses

The sale or rental by an owner of a single-family house (sometimes referred to as an "SFH") is exempted from coverage under the Fair Housing Act if the private individual owner does not own more than three single-family houses at any one time. Also, if the sale is of a single-family house that the owner did not reside in or that the owner was not the most recent resident of, the exemption applies only regarding one such sale within any 24-month period. Finally, the sale or rental of such a property will be excepted only if the facilities or services of a real estate broker or other person in the business of selling or renting dwellings was not involved in the sale or rental of the dwelling and if the owner did not use any discriminatory advertisement, notice, or other publication in violation of Section 3604(c) of the FHA. n8

In determining whether the exemption applies, the current or primary residence of the private individual owner is

included in calculating the number of single-family houses owned. n9 Seasonal residences are also included. n10 If a real estate broker is involved in the rental or sale, the exemption will not apply. If any other person in the business of selling or renting houses was involved in the sale or rental of the single-family house, the exemption will not apply. A person "in the business of selling or renting dwellings" is defined as:

- (1) a person who has participated in three or more sale or rental transactions in the past 12 months; or
- (2) a person who has participated as an agent in two or more sale or rental transactions in the preceding 12 months excluding the sale of the seller's personal residence; or
- (3) a person who owns any dwelling designed or intended for occupancy by five or more families. n11

[2] The "Mrs. Murphy" Exception

Though the prohibitions against discriminatory advertising apply, the sale or rental of a room, unit, or dwelling is otherwise exempt from the Fair Housing Act if the dwelling is occupied by no more than four families and the owner maintains and actually occupies one of the units as the owner's residence. n12 This exemption is commonly referred to as the "Mrs. Murphy" exception and is available only to individual owners of private dwellings.

[3] Religious Organizations and Private Clubs

Religious organizations, associations, or societies and nonprofit institutions or organizations that are operated, supervised, or controlled by such religious organizations, associations, or societies are allowed to limit the sale, rental, or occupancy of dwellings to members of the same religion and are allowed to give preference to persons of the same religion unless membership in the religion is restricted on account of race, color, or national origin. n13 The exemption only applies to dwellings not owned or operated for commercial purposes.

The defendant bears the burden of showing that it fits within the "religious organizations" exemption. To do so, it "must prove that it is either: (1) a religious organization, or (2) a non-profit organization 'operated, supervise or controlled by or in conjunction with' a religious organization." n14 A mere association with a religious organization is not sufficient for purposes of the exemption. There must be a mutual, formal, or legal relationship between the religious organization and the non-profit organization that it operates, supervises, or controls. n15

Similarly, private clubs that are not open to the public are allowed to limit the rental or occupancy of lodgings to their members and are allowed to give preference to their members. n16 This exemption does not apply to dwellings, such as those occupied by their owners seasonally, and does not apply to sales.

A defendant must meet five conditions to qualify for the "private club" exemption. The defendant must:

- (1) be a private club not open to the public;
- (2) provide lodgings; and
- (3) only limit the rental or occupancy of such lodgings.

The lodgings provided by the defendant must be:

- (4) provided incident to a primary purpose of the defendant; and
- (5) must be owned or operated for other than a commercial purpose. n17

This exemption does not apply to dwellings, such as those occupied by their owners seasonally, and does not apply to sales.

[4] Limitations on Occupancy

Nothing in the Fair Housing Act limits the applicability of any reasonable local, state, or federal restrictions regarding the maximum number of occupants permitted to occupy a dwelling. n18

Section 3607(b)(1) removes from the FHA's scope only total occupancy limits--numerical ceilings intended to prevent overcrowding in living quarters. n19 Maximum occupancy limitations cap the number of occupants per dwelling, typically in relation to available floor space or the number and type of rooms. The purpose of maximum occupancy restrictions is to protect health and safety by preventing dwelling overcrowding.

The burden is on the governmental entity to establish that its occupancy limit is reasonable. If the governmental entity meets its burden by showing that the occupancy limits apply to all residents of all dwelling units, the exemption applies. n20

Limitations on occupancy frequently conflict with the prohibition against discriminating on the basis of familial status. Congress, prompted by fears that landlords would be forced to allow large families to crowd into small housing units, enacted the exemption for maximum occupancy restrictions at the same time that it expanded the FHA to ban discrimination on the basis of familial status. Such cases are scrutinized to ensure that limitations of occupancy are not, in fact, intended to unlawfully discriminate on the basis of familial status. n21

[5] Housing for Older Persons

To prevent the Fair Housing Act prohibition against discrimination based on familial status from eliminating the "adults only" and "no children" housing policies in force in many retirement housing communities, Congress created three exemptions. In addition to an exemption for HUD-approved housing programs designed and operated to assist elderly persons, Section 3607(b)(1) and (2) allows a housing community to discriminate on the basis of familial status if (1) 80% of the dwellings are occupied by at least one person 55 years old or older, or (2) the housing community is reserved exclusively (100%) for persons age 62 or older. n22

As enacted in 1988, the exemption applicable if 80% of the dwellings were occupied by at least one person 55 years old or older required that "significant facilities and services" be provided to meet the needs of older persons. Due to numerous lawsuits and complaints regarding the meaning of "significant facilities and services," Congress enacted the Housing for Older Persons Act of 1995 n23 (HOPA) and eliminated the requirement during 1995. n24 HOPA's modifications, however, are not applied retroactively. n25

The burden remains on the party asserting the exemption to establish that the housing qualifies as "housing for older persons." Real estate brokers should exercise caution to confirm that the dwelling qualifies for the exemption under the Fair Housing Act and the Department of Housing and Urban Development Guidelines. If they do not ensure application of the exemption, brokers may expose themselves to liability by engaging in conduct that would otherwise be illegal, such as by refusing offers from families with children.

FOOTNOTES:

(n1)Footnote 1. 42 U.S.C. § 3603(b)(1).

(n2)Footnote 2. 42 U.S.C. § 3602(b)(2).

(n3)Footnote 3. 42 U.S.C. § 3607(a).

(n4)Footnote 4. 42 U.S.C. § 3607(b)(1).

(n5)Footnote 5. 42 U.S.C. § 3607(b)(1), (2).

(n6)Footnote 6. *City of Edmonds v. Oxford House, Inc.*, 514 U.S. 725, 731-732 (1995) .

(n7)Footnote 7. *Massaro v. Mainlands Section 1 & 2 Civic Ass'n, Inc.*, 3 F.3d 1472, 1475 (11th Cir. 1993) , cert. denied, 513 U.S. 808 (1994) .

(n8)Footnote 8. 42 U.S.C. § 3602(b)(1).

(n9)Footnote 9. *Hogar Agua y Vida en el Desierto v. Suarez-Medina*, 36 F.3d 177 (1st Cir. 1994) .

(n10)Footnote 10. *United States v. Columbus Country Club*, 915 F.2d 877 (3d Cir. 1990) .

(n11)Footnote 11. 42 U.S.C. § 3603(c).

(n12)Footnote 12. 42 U.S.C. § 3603(b)(2).

(n13)Footnote 13. 42 U.S.C. § 3607(a).

(n14)Footnote 14. *United States v. Columbus Country Club*, 915 F.2d 877, 882 (3d Cir. 1990) , cert. denied, 501 U.S. 1205 (1991) .

(n15)Footnote 15. *United States v. Columbus Country Club*, 915 F.2d 877, 883 (3d Cir. 1990) , cert. denied, 501 U.S. 1205 (1991) .

(n16)Footnote 16. 42 U.S.C. § 3607(a).

(n17)Footnote 17. *United States v. Columbus Country Club*, 915 F.2d 877, 884 (3d Cir. 1990) , cert. denied, 501 U.S. 1205 (1991) .

(n18)Footnote 18. 42 U.S.C. § 3607(b)(1).

(n19)Footnote 19. *City of Edmonds v. Oxford House, Inc.*, 514 U.S. 725 (1995) .

(n20)Footnote 20. *Fair Housing Adv. v. City, Richmond Heights*, 209 F.3d 626 (6th Cir. 2000) .

(n21)Footnote 21. *City of Edmonds v. Oxford House, Inc.*, 514 U.S. 725, 728 (1995) .

(n22)Footnote 22. 42 U.S.C. § 3607(b)(1), (2).

(n23)Footnote 23. 46 U.S.C. § 3601 et seq.

(n24)Footnote 24. *See Taylor v. Rancho Santa Barbara*, 206 F.3d 932 (9th Cir. 2000) .

(n25)Footnote 25. *Covey v. Hollydale Mobilehome Estates*, 116 F.3d 890 (9th Cir. 1997) .

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145 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation
CHAPTER 9 The Broker And Discrimination *

10A-9 Real Estate Brokerage Law and Practice § 9.04

§ 9.04 Enforcement and Penalties Under the Fair Housing Act

Prohibitions against illegal discrimination in housing may be enforced in federal court actions, may be enforced in state court actions, and may be enforced through administrative actions under the jurisdiction of federal authorities, state authorities, and local authorities. This section addresses civil lawsuits. Federal court actions alleging housing discrimination almost always begin with a complaint filed with the Department of Housing and Urban Development (HUD). For further information concerning practices and procedures before HUD, see § 9.06.

There are many penalties that may be imposed against a broker who engages in a discriminatory act or practice, including exposure to an award of damages, fines, imprisonment, and suspension or revocation of a broker's license. Conversely, a broker who sustains damage because he or she engages in anti-discriminatory practices as required by law may recover for that loss. n1

[1] Standing to Sue

Claims brought under the Fair Housing Act are judged under a very liberal standing requirement. The plaintiff need not allege that he or she was a victim of discrimination. For standing under the Fair Housing Act, the plaintiff need only allege that as a result of the defendant's discriminatory conduct the plaintiff has suffered a distinct and palpable injury. n2 Under the Fair Housing Act, any person harmed by discrimination, whether or not the target of the discrimination, can sue to recover for his or her own injury. n3 This is true even where no housing has actually been denied to members of a protected class. n4

The following cases provide examples of standing upheld under the Fair Housing Act:

- An African-American resident and a Caucasian resident of a large apartment complex in San Francisco had standing to challenge their landlord's exclusion of nonwhites from the complex. They complained that the landlord's discriminatory housing practices stigmatized them as residents of a "white ghetto" and deprived them of the social and professional advantages of living in an integrated community. n5
- Caucasian homeowners in a suburban neighborhood had standing to challenge the intentional

segregation of their community attributable to the steering practices of two real estate brokerage firms and some of their employees. They complained that the target area was losing its integrated character due to the defendants' illegal conduct, thereby depriving them of the benefits of living in an integrated society. n6

- A corporation that provided community living arrangements for the mentally ill had standing to bring suit under the Fair Housing Act for a county's alleged discriminatory refusal to assume its leases. n7

- Hotel owners had standing to seek recovery against the City of Los Angeles for its alleged retaliatory interference with a loan required by purchasers who wanted to convert the property into housing for mentally ill individuals. n8

- A minority resident of an apartment building had standing to seek recovery against her landlords on the basis of a statement made by the landlords' agent that "The owners don't want to rent to Blacks." Standing was also allowed as a result of the owners' unsuccessful attempt to evict the plaintiff after the plaintiff made a complaint to the local Fair Housing Council. n9

- A non-profit corporation whose mission is eliminating discrimination in housing had standing to challenge racial steering by brokers on the basis that the brokers' discriminatory practices caused it to divert its resources to counteract and combat the effects of the defendants' illegal racial steering programs. n10

- Freshmen and sophomores at Yale College had standing to challenge Yale's requirement that all unmarried freshmen and sophomores under the age of 21 pay to reside in the college's co-educational dormitories. Plaintiffs were Orthodox Jews who claimed that the co-educational living requirement conflicted with their religious convictions and duties. n11

Non-profit corporations created to eliminate discrimination in housing (often referred to as "fair housing organizations") have been adjudged injured and standing has been granted based upon the diversion of their resources to counteract discriminatory housing practices and investigate discriminatory housing practices. The resources were typically found to have been diverted away from the organization's counseling and educational programs designed to inform, protect, and ensure that people benefit from equal housing opportunities. Yet, the expense of litigation without more is not sufficient to establish damage or injury, a prerequisite to standing to sue. n12

A fair housing organization has standing to recover certain types of damages on its own to the extent that it suffers injury proximately caused by defendant's unlawful conduct. n13 A fair housing organization is still entitled to seek its damages proximately caused by the defendants' unlawful discrimination towards its testers, even if none of the individual plaintiffs prevail on their claims. n14

[2] Broker's Right to Intervene

Commissions lost by real estate brokers attributable to the unlawful discriminatory conduct of others are properly recoverable as damages under the Fair Housing Act. n15 Additionally, brokers have standing to sue under the Fair Housing Act and have the right to intervene as plaintiffs in a Title VIII action. n16

The opportunity to intervene arises under Rule 24 of the Federal Rules of Civil Procedure. Upon timely application anyone may intervene in a federal lawsuit when an applicant's claim or defense and the main action have a question of law or fact in common. In deciding whether to permit intervention, the court must consider whether the intervention will unduly delay or prejudice the adjudication of the rights of the original parties. n17 A "timely application" is one that

does not cause undue delay in the lawsuit, and it is axiomatic that multiple parties attempting to recover from the same wrongdoers for the same discriminatory act under the same federal law (in this case the Fair Housing Act) have questions of law and fact in common.

In addressing a case where white sellers refused to consummate a sale to black purchasers, the Seventh Circuit considered the following factors in permitting brokers to intervene in an action under the Fair Housing Act:

(1) The brokers' claim was based upon the seller's refusal to pay the real estate commission, as required in the real estate sales contract, because the brokers aided the plaintiff-buyers in the exercise of their right to buy real estate.

(2) The Fair Housing Act makes it unlawful for anyone to coerce, intimidate, threaten, or interfere with any person who encourages any other person in the exercise or enjoyment of their right to obtain a dwelling. n18

(3) The Fair Housing Act provides for enforcement by "appropriate civil action." n19

The court concluded that the Fair Housing Act provided the brokers with a cause of action if they were intimidated or interfered with when aiding a buyer in the buyer's right to buy or sell a house. The court also found that the claims of the brokers and the plaintiffs-buyers shared common questions of law and fact as both actions related to the sellers' refusal to sell their house in violation of the Fair Housing Act. Both the brokers and the buyers, therefore, could trace the cause of their injury to the sellers' illegal conduct.

The court found that the general purpose of Title VIII, to encourage the transfer of real estate regardless of race, "is well served by allowing brokers who follow the law to join aggrieved buyers in enforcing their rights." n20

[3] Persons and Entities Exposed to Liability

Property owners are generally liable for all unlawful acts of discrimination regarding the properties owned by them because the duty to not engage in unlawful discrimination is a non-delegable duty. It has, therefore, been held that the discriminatory conduct of an apartment manager or rental agent is, as a general rule, attributable to the owner and apartment manager of the complex both under the doctrine of *respondeat superior* and because the duty to obey the law is non-delegable. n21

Similarly, real estate brokers should exercise caution regarding the actions of their subordinates because under the Fair Housing Act a corporation and its officers are responsible for the acts of a subordinate employee, even if the acts were neither directed nor authorized. The statutory duty to not discriminate is non-delegable and the rule imposing liability is followed, therefore, even where it seems harsh to punish innocent and well-intentioned employers. n22

[4] Damages and Related Relief Under the Fair Housing Act

In a civil action to enforce the Fair Housing Act, if the court finds that a discriminatory housing practice has occurred or is about to occur it may award to the plaintiff compensatory damages ("actual" damages) and punitive damages. The court may grant other relief, including an injunction or temporary restraining order, and may allow to the prevailing party, other than the United States, a reasonable attorney's fee and costs. n23

[a] Compensatory and Nominal Damages

It has generally been found that the compensatory damages provision of the Fair Housing Act is mandatory. n24 If plaintiffs prove unlawful discrimination and actual damages, they are entitled to judgment for that amount. n25

Compensatory damages include lost profits, the commissions payable to real estate brokers, and syndication fees. For example, at the conclusion of a case seeking damages for a city's unlawful discriminatory conduct, a jury awarded plaintiffs damages in the amount of \$3,040,439. Plaintiffs had organized to purchase and develop low-income housing at a mobile home park in the City of Desert Hot Springs. The plaintiffs' efforts to obtain financing with bonds to be issued by the county failed because the city withheld its consent for the issuance of the bonds. The plaintiffs' efforts to obtain financing from the state failed because the city counsel denied approval. The plaintiffs were then unable to pursue the project and sued the city under the Fair Housing Act. The trial court ordered a remittitur to \$348,146.20. In ordering reinstatement of the original verdict awarding damages of \$3,040,439, the Seventh Circuit found that lost profits were not too speculative to form the basis of a compensatory award and found that the brokers who would have been paid commissions and the individual who would have been paid a syndication fee were not "marginally affected individuals" and that their losses were compensable under the Act. n26

Further, regarding mitigation, the court found that to the extent that one who is harmed by another's unlawful discriminatory conduct has a duty to mitigate damages, that duty requires the plaintiff to do no more than is reasonable to avoid damages. Because of the city's refusals to consent or approve financing from the county or state, the partnership no longer had access to a favorable mortgage and there was no evidence that they had any other source of financing to purchase the project. n27

Compensatory damages may be awarded for emotional harm and distress, including that resulting from one's lack of stability and security in having a dwelling, and including that resulting from hostile, coercive, intrusive, and intimidating tactics used by local officials to close boarding houses catering to the disabled. Such damages are not restricted to members of a protected classification. n28 For example, the seller of a home intended to be used as a group home for physically and mentally handicapped adults was permitted standing to sue as an "aggrieved person" under the Fair Housing Act and was allowed to recover actual compensatory damages for emotional distress based upon specific instances of "cool treatment and social shunning" by the defendants. n29

Even absent proof of actual injury, nominal damages are to be awarded to recognize violation of a constitutional right. n30 Though this applies to cases brought under the Fair Housing Act, it is the responsibility of the plaintiffs to bring their entitlement to mandatory nominal damages to the attention of the trial judge. n31

[b] Punitive Damages

The Fair Housing Act provides for the recovery of punitive damages by victims of discriminatory housing practices. n32 Federal law governs the assessment of punitive damages under Title VIII. n33 Punitive damages are appropriate in a federal civil rights action "when the defendant's conduct is shown to be motivated by evil motive or intent, or when it involves reckless or callous indifference to the federally protected rights of others." n34

The standard applied regarding punitive damages in a Title VII case is the same that is applied in a case brought under the Fair Housing Act. n35 In the context of a Title VII case, the Supreme Court has stated that malice or reckless indifference relate to a defendant's knowledge that the defendant may be acting in violation of federal law. Malice or reckless indifference does not require that the defendant be aware that it is engaging in discrimination. n36 Further, though conduct justifying a punitive damage award is often referred to as "egregious" or "outrageous," defendants need not engage in conduct with an independent egregious quality before being subject to a punitive award. To be liable for punitive damages it is sufficient that a defendant discriminate in the face of a risk that its actions will violate federal law. n37

Recklessness and malice may be inferred when an individual responsible for showing and renting apartments repeatedly refuses to deal with members of a protected class and misrepresents the availability of the apartments. n38

The Fair Housing Amendments Act of 1988 removed the prior cap of \$1,000 on punitive damages. Federal courts are

seriously divided, however, regarding whether punitive damages can be awarded absent an award of nominal or compensatory damages. n39

[c] Injunctive Relief

When plaintiffs have established the defendants' liability under the Fair Housing Act, they are not required to establish a reasonable likelihood of future violations of the Act in order to be entitled to injunctive relief. Since the plaintiffs established that the defendants violated the Act, future violations should be presumed. Further, the plaintiffs are not required to show irreparable injury. n40

An injunction may be issued that polices the defendant to ensure that he or she does not persist in or initiate further unlawful discriminatory practices. For example, the following provisions in an injunction issued against a real estate agent who discriminated on the basis of gender were upheld:

- (1) That he would engage in no further discriminatory conduct to plaintiff and would not retaliate against plaintiff;
- (2) That he would quarterly submit copies of written rental applications to HUD for two years;
- (3) That he would keep records of the gender of oral applicants and of persons who inquired orally about rentals, the dates of the communications, whether the applicant was accepted as a tenant and, if rejected, the reason for rejection;
- (4) That he would keep a list of occupants and vacancies with the gender of the departed tenants noted, the dates of departure, when the units were again rented and the gender of the new tenants; and
- (5) That he would, during the two-year period, provide HUD with copies of advertisements, copies of written rental applications, and sample leases made and used during that period. n41

[d] Attorneys' Fees and Costs

The Fair Housing Act allows the court, in its discretion, to award to the prevailing party its reasonable attorneys' fees and costs. n42 Though attorneys' fees are awarded in the majority of cases, such fees are subject to limitations.

That plaintiffs obtain a judgment that defendants engaged in some act of illegal discrimination is not always sufficient to have them viewed as prevailing parties for the purpose of obtaining an award of attorneys' fees. This is in accord with the general federal position that the prevailing party, when allowed to do so by statute, should recover attorneys' fees unless special circumstances would render such an award unjust. n43 An insignificant, technical victory may be insufficient to support "prevailing party" status for fee-shifting purposes. n44

An award of attorneys' fees is committed to the trial court's discretion and will rarely be disturbed unless the trial court abused its discretion. Attorneys' fees are subject to judicial review as to "reasonableness." A court's determination of reasonable attorneys' fees in a case incorporates subjective and objective factors, including:

- the court's appraisal of the difficulty of the case;
- the time the court considered necessary for the case;
- the number of motions;
- the number of witnesses;

- the length of the trial;
- the number of attorneys involved; and
- the number of plaintiffs represented in the action. n45

Additionally, Rule 68 of the Federal Rules of Civil Procedure applies to awards of attorneys' fees made under the Fair Housing Act. n46 Rule 68 states that if a timely pretrial settlement offer is not accepted and if the judgment finally obtained by the party that rejected the offer is not more favorable than the offer, the person who rejected the offer must pay all costs incurred after the making of the offer. The purpose of Rule 68 is to encourage settlement and to avoid litigation. The "costs" contemplated by Rule 68 include attorneys' fees. n47

[e] Civil Fine

In a civil action brought by the Attorney General, courts are empowered to impose a civil penalty in addition to compensatory damages, punitive damages and costs for violations of the Fair Housing Act. The maximum fine permitted for a first-time offense is \$50,000, and may not exceed \$100,000 for any subsequent violation. n48

FOOTNOTES:

(n1)Footnote 1. *Smith v. Stechel*, 510 F.2d 1162, 1164 (9th Cir. 1975) .

(n2)Footnote 2. *Havens Realty Corp. v. Coleman*, 455 U.S. 363, 372 (1982) .

(n3)Footnote 3. *See Trafficante v. Metropolitan Life Ins. Co.*, 409 U.S. 205, 212 (1972) .

(n4)Footnote 4. *San Pedro Hotel Co., Inc. v. City of Los Angeles*, 159 F.3d 470 (9th Cir. 1998) .

(n5)Footnote 5. *Trafficante v. Metropolitan Life Ins. Co.*, 409 U.S. 205 (1972) .

(n6)Footnote 6. *Gladstone Realtors v. Village of Bellwood*, 441 U.S. 91, 115 (1979) .

(n7)Footnote 7. *Growth Horizons, Inc. v. Delaware County, Pa.*, 983 F.2d 1277, 1282 n.7 (3d Cir. 1993) .

(n8)Footnote 8. *San Pedro Hotel Co., Inc. v. City of Los Angeles*, 159 F.3d 470 (9th Cir. 1998) .

(n9)Footnote 9. *Harris v. Itzhaki*, 183 F.3d 1043 (9th Cir. 1999) .

(n10)Footnote 10. *Central Alabama Fair Hous. Ctr. v. Lowder Realty*, 236 F.3d 629 (11th Cir. 2000) .

(n11)Footnote 11. *Hack v. President and Fellows of Yale Coll.*, 237 F.3d 81 (2d Cir. 2000) .

(n12)Footnote 12. *Fair Housing Auth. v. Montgomery Newspapers*, 141 F.3d 71 (3d Cir. 1998) .

(n13)Footnote 13. *See, e.g., Arkansas Acorn Fair Housing, Inc. v. Greystone Development, Ltd., Co.*, 160 F.3d 433, 434 (8th Cir. 1998) ; *Ragin v. Harry Marlowe Real Estate Co.*, 6 F.3d 898, 904-5 (2d Cir. 1993) .

(n14)Footnote 14. *Central Alabama Fair Hous. Ctr., Inc. v. Lowder Realty Co., Inc.*, 236 F.3d 629 (11th Cir. 2000) .

(n15)Footnote 15. *Silver Sage Partnership, Ltd. v. City of Desert Hot Springs*, 251 F.3d 814 (9th Cir. 2001) .

(n16)Footnote 16. *Crumble v. Blumthal*, 549 F.2d 462 (7th Cir. 1977) .

- (n17)Footnote 17. Fed. R. Civ. P. 24.
- (n18)Footnote 18. 42 U.S.C. § 3617.
- (n19)Footnote 19. 42 U.S.C. § 3617.
- (n20)Footnote 20. *Crumble v. Blumthal*, 549 F.2d 462 (7th Cir. 1977) .
- (n21)Footnote 21. *Marr v. Rife*, 503 F.2d 735, 741 (6th Cir. 1974) .
- (n22)Footnote 22. *See Saunders v. General Services*, 659 F. Supp. 1042, 1059 (E.D. Va. 1987) .
- (n23)Footnote 23. 42 U.S.C. § 3613(c).
- (n24)Footnote 24. *See United States v. Hayward*, 36 F.3d 832, 839-40 (9th Cir. 1994) .
- (n25)Footnote 25. *See Curtis v. Loether*, 415 U.S. 189, 197 (1974) .
- (n26)Footnote 26. *Silver Sage Partnership, Ltd. v. City of Desert Hot Springs*, 251 F.3d 814 (9th Cir. 2001) .
- (n27)Footnote 27. *Silver Sage Partnership, Ltd. v. City of Desert Hot Springs*, 251 F.3d 814 (9th Cir. 2001) .
- (n28)Footnote 28. *See New Jersey Rooming & Boarding House Owners v. Asbury Park*, 152 F.3d 217 (3d Cir. 1998) .
- (n29)Footnote 29. *United States v. Scott*, 809 F. Supp. 1404, 1406-07 (D. Kan. 1992) .
- (n30)Footnote 30. *Carey v. Phipus*, 435 U.S. 247, 266-67 (1978) .
- (n31)Footnote 31. *Alexander v. Riga*, 208 F.3d 419 (3d Cir. 2000) .
- (n32)Footnote 32. 42 U.S.C. § 3613(c)(1).
- (n33)Footnote 33. *United States v. Big D Enterprises, Inc.*, 184 F.3d 924, 932 (8th Cir. 1999) , cert. denied, 120 S. Ct. 1419 (2000) .
- (n34)Footnote 34. *Smith v. Wade*, 461 U.S. 30, 56 (1983) .
- (n35)Footnote 35. *Badami v. Flood*, 214 F.3d 994 (8th Cir. 2000) .
- (n36)Footnote 36. *Kolstad v. American Dental Ass'n*, 527 U.S. 526, 119 S. Ct. 2118, 2124 (1999) .
- (n37)Footnote 37. *Kolstad v. American Dental Ass'n*, 527 U.S. 526, 119 S. Ct. 2118, 2125-2126 (1999) .
- (n38)Footnote 38. *See Miller v. Apartments & Homes*, 646 F.2d 101 (3d Cir. 1981) .
- (n39)Footnote 39. *Louisiana Acorn Fair Housing v. LeBlanc*, 211 F.3d 298 (5th Cir. 2000) .
- (n40)Footnote 40. *Silver Sage Partnership, Ltd. v. City of Desert Hot Springs*, 251 F.3d 814 (9th Cir. 2001) .
- (n41)Footnote 41. *Baumgardner v. Sec., HUD on behalf of Holley*, 960 F.2d 572 (6th Cir. 1992) .
- (n42)Footnote 42. 46 U.S.C. § 3613(c)(2).
- (n43)Footnote 43. *People Helpers Found., Inc. v. Richmond, Va.*, 12 F.3d 1321 (4th Cir. 1993) .

(n44)Footnote 44. *See Hewitt v. Helms*, 482 U.S. 755, 107 S. Ct. 2672, 96 L. Ed. 2d 654 (1987) .

(n45)Footnote 45. *Cole v. Wodziak*, 169 F.3d 486 (7th Cir 1999) .

(n46)Footnote 46. *See People Helpers Found., Inc. v. Richmond, Va.*, 12 F.3d 1321 (4th Cir. 1993) ; *Cole v. Wodziak*, 169 F.3d 486 (7th Cir. 1999) .

(n47)Footnote 47. *Marek v. Chesny*, 473 U.S. 1 (1985) .

(n48)Footnote 48. 42 U.S.C. § 3614(d)(1)(C).

* This chapter was revised by Georgia Lewis Leonhart, Esq., of Ocean View, Delaware. Ms. Leonhart is a member of the Maryland Bar.



146 of 163 DOCUMENTS

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PART III Public Regulation
CHAPTER 9 The Broker And Discrimination *

10A-9 Real Estate Brokerage Law and Practice § 9.05

§ 9.05 Housing Discrimination--Proof and Defenses

[1] Proof of Claims of Discrimination

[a] Pattern or Practice of Discrimination

The Fair Housing Act empowers the Attorney General to bypass administrative procedures and to file a civil action against any person engaged in a "pattern or practice of resistance to the full enjoyment of any of the rights granted" under the Act. n1 Private parties may intervene in a "pattern or practice" case initiated by the Attorney General.

Any plaintiff under the Fair Housing Act may succeed upon proof of a pattern or practice of discrimination. Proof that defendants discriminated against several people, without more, is insufficient to prove a pattern or practice of discrimination. Proof of isolated or sporadic acts of discrimination does not suffice to prove a pattern or practice. Evidence must be presented that establishes that discrimination was the defendants' standard operating procedure. Plaintiffs must present evidence from which the fact-finder can reasonably conclude " 'that ... discrimination was the [defendants'] standard operating procedure--the regular rather than the unusual practice.' " n2

[b] Disparate Treatment

Plaintiffs in Fair Housing Act cases can prove their cases by establishing disparate intent or disparate impact. Disparate intent requires that the defendants were denied a housing opportunity or were allowed housing under discriminatory terms and conditions for reasons that were discriminatory. Disparate impact intends to provide a remedy for "practices that are fair in form, but discriminatory in operation." n3 To establish disparate impact, plaintiffs must show that the defendants' conduct had a discriminatory impact upon housing for members of a protected class, or upon the terms and conditions on which the housing was offered. n4

A *prima facie* case of disparate impact is established by showing that the defendants' facially neutral practice actually or predictably results in discrimination against members of a protected class. n5 To state a *prima facie* claim, plaintiffs must allege a causal connection between a facially neutral policy and the resultant proportion of members of a protected class in the population at issue. n6

FHA disparate impact cases are evaluated in accordance with the standards established in Title VII employment

discrimination cases. In most jurisdictions the following factors will be considered in determining whether conduct that produces a discriminatory impact will violate section 3604(a) of the Fair Housing Act:

- (1) the strength of plaintiff's showing of discriminatory effect,
- (2) the defendant's interest in taking the challenged action, and
- (3) whether the plaintiff seeks to compel the defendant to affirmatively provide housing for members of a protected class or merely to restrain the defendant from interfering with individual property owners who wish to provide such housing. n7

In some jurisdictions proof of discriminatory effect alone will satisfy the *prima facie* burden for disparate impact claims under the Fair Housing Act. n8

When plaintiffs establish a *prima facie* case of disparate impact, the burden passes to the defendants to avoid liability by establishing a legitimate justification for the challenged practice. If defendants can show that the practice was reasonably necessary to achieve an important social objective (such as to provide for the public health, safety, or welfare) or business objective, plaintiffs then must show that the defendants unreasonably refused to adopt an alternative housing practice that would serve the defendants' legitimate objective with less discriminatory impact. n9

[2] Defenses to Claims of Discrimination

[a] Business Necessity Defense

A genuine business need for a challenged practice can overcome a *prima facie* case of disparate impact. The business necessity standard to be applied in Title VIII cases is that utilized in employment discrimination cases under Title VII. n10

When the plaintiff has established a *prima facie* case of disparate impact, the burden shifts to the defendant to produce evidence of a genuine business need for the challenged practice. n11 Yet the burden to prove that discrimination against a protected group has been caused by a specific practice always remains with the plaintiff. For that reason, when the defendant has produced evidence that its practices are based on legitimate business reasons the burden shifts to the plaintiff to show that other policies without a similarly undesirable effect would also serve the plaintiff's legitimate interest. n12

To successfully assert the defense of business necessity the defendant must demonstrate that the discriminatory practice has a manifest relationship to the housing in question. An insubstantial justification will not suffice because such a low standard would permit discrimination through the use of deceptive, outwardly neutral practices. Yet the plaintiff is not required to establish a "compelling need or necessity," a burden almost impossible to meet. n13 For example, a trailer park occupancy limit of three persons per trailer attributable to sewer capacity limitations and concern over quality of park life was upheld as a business necessity despite its discriminatory impact upon families with children. n14

[b] Mixed Motive Defense

When a decision that appears unlawful and discriminatory was motivated by a legitimate reason, a defendant may present a mixed motive defense. The defendant is required to present sufficient evidence for a jury to conclude that the defendant's adverse actions against the plaintiff were motivated by a legitimate reason. n15 When evidence has been introduced of both permissible and impermissible motives, a defendant will be held liable unless the defendant can show that he or she would have taken the same action against the plaintiff regardless of the improper motive. n16

Though applicable in a case brought under the Fair Housing Act, the defendants are not entitled to a mixed motive jury instruction unless they have provided sufficient evidence of a legitimate motive for the adverse decision. Defendants' verbal assertions, without other corroborating evidence or testimony, are not sufficient evidence of a legitimate motive.
n17

[3] Opinion Evidence in Fair Housing Act Cases

The testimony of "testers" utilized by HUD and fair housing organizations, and the opinion testimony of others premised upon information gathered, compiled, or generated by "testers," have been the mainstay of many cases successfully pursued under the Fair Housing Act. An extensive review of Fair Housing Act cases establishes that, historically, challenges to the admissibility of such opinion testimony were rarely pursued. Plaintiffs' key litigation tool may now be in jeopardy.

Rule 702 of the Federal Rules of Evidence governs the admissibility of opinion evidence in a federal action:

If scientific, technical or other specialized knowledge will assist the trier of fact to understand the evidence or to determine a fact in issue, a witness qualified as an expert by knowledge, skill, experience, training or education, may testify thereto in the form of an opinion or otherwise.

Rule 702 fails to set forth guidelines to assess the reliability of expert opinions. The United States Supreme Court set forth four factors to be considered in determining the reliability of a scientific theory or technique and imposed a "gatekeeping" obligation upon trial judges to determine whether expert testimony is admissible under Rule 702 in the case of *Daubert v. Merrill Dow Pharmaceuticals, Inc. (Daubert)*. n18 Six years later the Supreme Court expanded the scope of its holding in *Daubert* to encompass opinion testimony based on technical and other specialized knowledge. n19 Factors enunciated in *Daubert* are, therefore, relevant to a determination of reliability regarding all types of expert testimony.

The four factors set forth in *Daubert* are:

- (1) whether the expert's testimony has been tested;
- (2) whether the technique has been subjected to peer review and publication;
- (3) whether the technique has a known or knowable rate of error; and
- (4) whether the technique has been generally accepted in the proper scientific community.

In response to a *Daubert* motion challenging the admissibility of opinion testimony from plaintiffs' experts in a racial steering case, the U.S. District Court for the Eastern District of Missouri rejected plaintiffs' contention that "tester evidence" had always been accepted by the courts and "should simply be accepted at face value" once again. n20 The court found, by a preponderance of the evidence, that the testing protocol utilized by the testers was seriously flawed and unreliable, and therefore inadmissible. The court further concluded that plaintiffs' experts were not qualified to render opinions regarding defendants' alleged steering practices and that their expert opinions were, therefore, inadmissible.

In determining the reliability of the data and information gathered by the testers employed by the fair housing organization, the court examined the testers' depositions, the agents' depositions, the test forms completed by the testers, the debriefing forms and excerpts from the depositions of plaintiffs' proffered expert witnesses. In determining that "the testing protocol of both the 1996 and 1997 tests was seriously flawed and lacked any reasonable indicia of reliability" the court adjudged the methodology utilized in the creation and execution of the tests--not the credibility of the testers or agents. Though recognizing "the fact that tester evidence is probably the best means by which to demonstrate fair

housing violations," the court rejected the proffered evidence because its production was not done under standards "which assure a reasonable level of validity and reliability." n21 The court was influenced by the following factors:

- Neither test coordinator had an extensive background in fair housing matters, particularly not regarding fair housing testing.
- Neither test coordinator was familiar with the protocol established in the HUD audit studies or with the manner in which that protocol was judicially modified, and neither used the HUD protocol.
- There were ambiguities and inconsistencies in the test instructions used, in the test forms used, and in the debriefing forms and procedures (one tester was never debriefed).
- There were significant inconsistencies in the execution of the tests. Several testers failed to follow the fabricated script, some failed to complete all or part of the test forms, and some exercised their own discretion regarding follow-up telephone calls and visits to additional homes.
- The tests were not part of an effort to gather evidence of housing discrimination based upon an individual's complaint, but were, instead, tests commissioned to investigate and study possible fair housing discrimination taking place in a city.
- Plaintiffs failed to articulate a set of standards that govern the validity and reliability of an enforcement test, and plaintiffs' experts opined that there are no standards that govern the validity and reliability of fair housing tests.

In rejecting nearly all of the expert opinion testimony offered by the plaintiffs, the court concluded as follows:

- An executive director of a fair housing organization was not permitted to testify that race could be conclusively identified over the telephone because she was not a linguist, and was not trained in voice analysis, there are no written reports linking voice analysis with fair housing testing, she published no work regarding her voice identification theory, she conducted no standardized testing for racial voice identification, she had not spoken to the testers to ascertain if any of their voices were strongly indicative of race, and she was vague as to what constitutes the characteristics of a black voice and of a white voice.
- An executive director of a fair housing organization was not permitted to testify that the defendants' experts applied the wrong standards in reviewing plaintiffs' test data because she "did not review a single test report form, tester deposition, agent deposition or tester debriefing report" in the matter and "could offer no standard by which to adjudge the validity and reliability" of the tests.
- An executive director of a fair housing organization for more than 25 years was not permitted to testify that the defendants' experts approach to the plaintiffs' test data was "mistaken" because he had no formal degree in sociology and is not a statistician or a lawyer, there is no recognized written authority for the standards he espoused for an enforcement test, and he admitted that he was not an expert.
- A man with a doctorate degree in urban geography who had been involved in several fair housing issues involving discriminatory lending practices was not allowed to testify that the defendants had engaged in racial steering because he had no experience regarding fair housing tests on real estate agents, he relied solely on plaintiffs' conclusions and did not review any of the underlying data (such as the tester depositions, the agent depositions, the test report forms or the debriefing forms), he assumed that the testing protocol had isolated race as the variable factor, he conceded that he applied his first statistical test inaccurately, his second test was never tested or subjected to peer review or publication, and he

admitted that his third test could not be used to determine the existence of racial steering.

Conversely, defendants' expert witnesses were allowed to testify regarding the design, execution, and data derived from the plaintiffs' tests because they demonstrated by a preponderance of the evidence that their methods for evaluating the tests were scientifically valid and reliable. Defendants' experts possessed genuine expertise and the trial court had ensured that it was "dealing with an expert, not just a hired gun."

FOOTNOTES:

(n1)Footnote 1. 42 U.S.C. § 3614(a).

(n2)Footnote 2. *United States v. Balistieri*, 981 F.2d 916 (7th Cir. 1992) , citing *King v. General Electric Co.*, 960 F.2d 617, 623 (7th Cir. 1992) ; *United States v. DiMucci*, 879 F.2d 1488, 1497 n. 11 (7th Cir. 1989) .

(n3)Footnote 3. See *Griggs v. Duke Power Co.*, 401 U.S. 424, 432 (1971) .

(n4)Footnote 4. *Hack v. President and Fellows of Yale College*, 237 F.3d 81, 88 (2d Cir. 2000) .

(n5)Footnote 5. See *Huntington Branch, N.A.A.C.P. v. Town of Huntington*, 844 F.2d 926, 934 (2d Cir) , *aff'd*, 488 U.S. 15 (1988) .

(n6)Footnote 6. *Brown v. Coach Stores, Inc.*, 163 F.3d 706, 712 (2d Cir. 1998) .

(n7)Footnote 7. See, e.g., *Metropolitan Housing Development Corp. v. Arlington Heights*, 558 F.2d 1283, 1290 (7th Cir. 1977) .

(n8)Footnote 8. See, e.g., *Resident Advisory Bd. v. Rizzo*, 564 F.2d 126, 148 (3d Cir. 1977) .

(n9)Footnote 9. *Albemarle Paper Co. v. Moody*, 422 U.S. 405, 425 (1975) .

(n10)Footnote 10. *Mountain Side Mobile Estates v. Sec. of HUD*, 56 F.3d 1243 (10th Cir. 1995) .

(n11)Footnote 11. *Griggs v. Duke Power Co.*, 401 U.S. 424, 432, 91 S. Ct. 849, 854, 28 L. Ed. 2d 158 (1971) .

(n12)Footnote 12. *Watson v. Fort Worth Bank & Trust*, 487 U.S. 977, 997-998, 108 S. Ct. 2777, 2790, 101 L. Ed. 2d 827 (1988) .

(n13)Footnote 13. *Mountain Side Mobile Estates v. Sec. of HUD*, 56 F.3d 1243 (10th Cir. 1995) , relying upon *Griggs v. Duke Power Co.*, 401 U.S. 424, 91 S. Ct. 849, 28 L. Ed. 2d 158 (1971) .

(n14)Footnote 14. *Mountain Side Mobile Estates v. Sec. of HUD*, 56 F.3d 1243 (10th Cir. 1995) .

(n15)Footnote 15. See *Price Waterhouse v. Hopkins*, 490 U.S. 228, 252 (1989) (plurality). *aff'd* 920 F.2d 967 (1990).

(n16)Footnote 16. See *Kriss v. Sprint Communications Co.*, 58 F.3d 1276, 1280 (8th Cir. 1995) .

(n17)Footnote 17. *United States v. Big D Enterprises, Inc.*, 184 F.3d 924 (8th Cir. 1999) .

(n18)Footnote 18. *Daubert v. Merrill Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 113 S. Ct. 2786, 125 L. Ed. 2d 469 (1993) .

(n19)Footnote 19. *Kumho Tire Co., Ltd. v. Carmichael*, 526 U.S. 137, 119 S. Ct. 1167, 143 L. Ed. 2d 238 (1999) .

(n20)Footnote 20. *Metropolitan St. Louis Equal Housing Opportunity Council v. Gordon A. Gundaker Real Estate*

Co., Inc, 130 F. Supp. 2d 1074, n. 12 (E.D. Mo. 2001) .

(n21)Footnote 21. *Metropolitan St. Louis Equal Housing Opportunity Council v. Gordon A. Gundaker Real Estate Co., Inc*, 130 F. Supp. 2d 1074, 1084 (E.D. Mo. 2001) .

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147 of 163 DOCUMENTS

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PART III Public Regulation
CHAPTER 9 The Broker And Discrimination *

10A-9 Real Estate Brokerage Law and Practice § 9.06

§ 9.06 Practices and Procedures Before HUD

The Secretary of the Department of Housing and Urban Development (HUD) has the authority to administer and enforce the Fair Housing Act. n1 HUD has established procedures for the investigation and conciliation of complaints under the Administrative Enforcement Provisions of the Fair Housing Act. n2 Those real estate brokers charged with violations of the Fair Housing Act, and those real estate brokers seeking recovery under the Fair Housing Act attributable to the unlawful and discriminatory conduct of others, usually will be required to deal with HUD.

[1] HUD Complaints

An "aggrieved person" with standing to file a housing discrimination complaint with HUD includes any person who claims to have been injured by a discriminatory housing practice or any person who believes that he or she will be injured by a discriminatory housing practice that is about to occur. n3 Any aggrieved person or the Assistant Secretary for Fair Housing and Equal Opportunity in HUD ("Assistant Secretary") may file a complaint no later than one year after an alleged discriminatory housing practice has occurred or terminated. n4

If a complaint alleges a discriminatory housing practice that is within the jurisdiction of a substantially equivalent certified state or local agency, the Assistant Secretary will notify that agency of the complaint and refer the complaint to that agency for processing before HUD takes further action with respect to the complaint. n5 The complainant will be notified of the referral and will be advised of his or her right to proceed with a civil action in an appropriate U.S. District Court not later than two years after the occurrence or termination of the discriminatory housing practice. n6 The complaint may be reactivated for processing by HUD under the Fair Housing Act, however, if the state or local agency fails to begin proceedings within 30 days or otherwise fails to proceed with reasonable promptness. n7

[2] HUD Investigation Procedures

After a complaint is filed, an investigation is initiated. The purposes of the HUD investigation are:

- (1) To obtain information regarding the alleged discriminatory housing practice identified in the complaint;
- (2) To document the policies and practices of the respondent involved in the alleged discriminatory

housing practice raised in the complaint; and

(3) To develop factual data necessary to determine whether reasonable cause exists, or does not exist, to believe that a discriminatory housing practice has occurred or is about to occur. n8

Within ten days of the filing of a complaint or amended complaint, a notice will be served on each respondent by personal service or certified mail. If a person is not named in the complaint but is, in the course of HUD's investigation, identified as someone engaging in illegal activity relating to the discriminatory housing practice alleged in the complaint, that person will be notified within ten days of his or her identification. n9 "The Assistant Secretary will also serve notice on any person who directs or controls, or who has the right to direct or control, the conduct of another person who is involved in a fair housing complaint." n10 The respondent may file an answer, affirmed under the penalties of perjury, within ten days after receipt of the notice from HUD. The respondent may assert within the answer any defense that might be available to a defendant in a court of law. n11

HUD's investigative powers are expansive. While conducting an investigation, HUD is allowed access to premises, access to records, access to documents and access to individuals. It may examine, record, and copy documents. HUD may take and record testimony or statements of persons it believes reasonably necessary for the furtherance of the investigation. n12 If a person does not comply with HUD's request for "voluntary cooperation," the Assistant Secretary has the authority to issue subpoenas that require compliance. n13 Additionally, HUD can utilize the services of other federal, state, or local agencies. n14

The investigation will remain open until a determination is made as to whether reasonable cause exists to believe that a discriminatory housing practice has occurred or is about to occur ("reasonable cause determination") or a conciliation agreement has been reached and approved. "Unless it is impracticable to do so," the investigation will be completed within 100 days of the filing or reactivation of the complaint. If the investigation is not completed within 100 days, HUD will notify the aggrieved person and the respondent of the reasons for the delay. n15

A final investigative report will be prepared at the end of each investigation. n16 The investigative report will contain:

(1) The names and dates of contacts with witnesses. Though the report will not disclose the names of witnesses that request anonymity, HUD may be required to disclose their identities in the course of an administrative hearing or a civil action under the Fair Housing Act.

(2) A summary and the dates of correspondence and other contacts with the aggrieved person and the respondent.

(3) A summary description of other pertinent records.

(4) A summary of witness statements.

(5) Answers to interrogatories (written questions that are required to be answered in writing and under oath).

The aggrieved person and the respondent will be notified when the final investigative report is complete. The aggrieved person and the respondent are entitled to receive a copy of the final investigation report and are entitled to other information derived from the investigation. n17

[3] Conciliation of the HUD Complaint

During the period from the filing of the complaint to the filing of a charge or the dismissal of the complaint, the Assistant Secretary will, if possible, attempt to conciliate the complaint. n18 In conciliating a complaint, HUD will

attempt to resolve the complaint and receive assurances that the respondent will satisfactorily remedy the violations of the rights of the aggrieved person. HUD will take action to assure that discriminatory housing practices are eliminated and that their occurrence is prevented in the future. n19

Incident to the conciliation process, the aggrieved person may seek monetary relief in the form of damages, including damages attributable to humiliation or embarrassment, and attorneys' fees. The aggrieved person may also seek equitable relief, such as access to the dwelling at issue or to a comparable dwelling, the provision of services or facilities, or other specific relief. The aggrieved person may also seek injunctive relief to eliminate the discriminatory housing practices complained of. n20

If the matter can be settled, the terms of the settlement of the complaint will be reduced to a written conciliation agreement. The agreement must be executed by the respondent and the complainant and is subject to the approval of the Assistant Secretary. The Assistant Secretary will approve or execute a conciliation agreement only if:

- (1) The complainant and respondent agree to the relief accorded to the aggrieved person;
- (2) The provisions of the agreement adequately vindicate the public interest; and
- (3) If the Assistant Secretary is the complainant, all aggrieved persons named in the complaint are satisfied with the relief provided to protect their interests. n21

Provisions that may vindicate the public interest include those that would eliminate discriminatory housing practices and those that would prevent future discriminatory housing practices. Other provisions could require remedial affirmative activities to overcome discriminatory housing practices, could impose reporting requirements, or could subject a person to other monitoring and enforcement activities. n22

As occurs in the context of most civil settlement negotiations, nothing done or said as part of the conciliation process can be used in a subsequent administrative hearing or civil lawsuit without the written consent of the persons involved. n23 Conciliation agreements shall be made public unless the aggrieved person and respondent request nondisclosure and the Assistant Secretary determines that disclosure is not required to further the purposes of the Fair Housing Act, though a description of the results of the conciliation may be published. n24 The conciliation agreement may provide for binding arbitration of the dispute arising from the complaint. n25

HUD may review conciliation agreements. If there is reasonable cause to believe that a respondent has breached a conciliation agreement a civil action to enforce the terms of the agreement may be filed under the Fair Housing Act. n26

[4] Reasonable Cause Determination by HUD

When HUD's investigation has been completed, and if a conciliation agreement has not been reached and approved, the Assistant Secretary must determine whether reasonable cause exists to believe that a prohibited discriminatory housing practice has occurred. This decision is to be based upon the totality of factual circumstances known at the time of the review. n27 In making the determination the Assistant Secretary must consider whether the facts concerning the alleged discriminatory housing project are sufficient to warrant the filing of a civil action in federal court n28

A determination of reasonable cause or no reasonable cause must be made within 100 days of the filing or reactivation of the complaint. If the reasonable cause determination is not made within that period, the Assistant Secretary will notify the complainant and the respondent of the reasons for the delay. n29

[a] Determination of No Reasonable Cause

If the Assistant Secretary determines that no reasonable cause exists to believe that a discriminatory housing practice

has occurred or is about to occur, the Assistant Secretary must:

- issue a statement of facts upon which the no reasonable cause determination was based;
- dismiss the complaint; and
- notify the aggrieved person and the respondent of the dismissal.

The fact of the dismissal and the names of the parties are public information. n30

[b] Determination of Reasonable Cause

If the Assistant Secretary determines that reasonable cause exists to believe that a discriminatory housing practice has occurred or is about to occur, the Assistant Secretary shall, with the agreement of the General Counsel:

- issue that determination;
- direct that charges be issued on behalf of the aggrieved person; and
- notify the complainant and respondent of the determination. n31

If the aggrieved person has initiated a civil action and trial has begun, the Assistant Secretary may not issue a charge.

[c] Zoning Exception to Reasonable Cause Determination

If the Assistant Secretary determines that the matter involves the legality of local zoning or land use laws or ordinances, instead of making a determination as to reasonable cause he or she shall refer the investigative materials to the Attorney General for appropriate action. The complainant and respondent will be notified of that decision. n32

[5] Issuance of Charge by HUD

The charge is based upon the final investigative report and should contain a short and plain statement of facts upon which the Assistant Secretary found reasonable cause to believe that a discriminatory housing practice had occurred or was about to occur. The charge can include allegations that were not set forth in the underlying complaint if the respondent was given notice of the allegations and was given a chance to respond during the investigative process. n33

Within three business days after the charge is issued, the charge must be filed, the charge must be served, and a hearing date must be scheduled before an administrative law judge. n34 The affected parties (complainant, respondent, or aggrieved person), however, are not required to proceed before an administrative law judge. Any of the affected parties may, within 20 days of service of the charge, elect to have the claims asserted in the charge decided in a civil action. n35 If a civil action is not elected, the administrative action will proceed.

[6] Judicial Determinations Unfavorable to HUD

The following are examples of recent cases in which HUD met with judicial displeasure:

- In refusing to grant qualified immunity to HUD officials and holding that they were subject to personal liability for their violations of plaintiffs' *first amendment* rights to free speech, the Ninth Circuit stated, "When government officials violate citizens' clearly established *first amendment* rights we will not apply a doctrine of qualified immunity to defeat a remedy of damages to which the citizens are entitled." n36

■ When called upon to enforce the terms and conditions of a conciliation agreement against a real estate agent who violated the agreement, the Seventh Circuit--though construing the agreement as an enforceable contract--refused to enforce its terms and conditions, specifically refusing to require the agent to relinquish her real estate license. n37

■ In reversing a decision that a neutral numerical occupancy restriction utilized by private landlords violated the FHA as illegally discriminating against families with children, the Ninth Circuit went on to state, "Furthermore, we admonish HUD for its heavy-handed conduct in his case." n38

■ The previously unchallenged use by fair housing organizations of data collected by testers was dealt a severe blow when a federal district court excluded all test data and all proffered expert opinions associated with that data because it failed to meet the guidelines of reliability set forth by *Daubert* n39 and its progeny. n40

FOOTNOTES:

(n1)Footnote 1. 24 C.F.R. § 100.1.

(n2)Footnote 2. 42 U.S.C. § 3610.

(n3)Footnote 3. 24 C.F.R. § 103.9.

(n4)Footnote 4. 24 C.F.R. § 103.15.

(n5)Footnote 5. 24 C.F.R. § 103.100(a).

(n6)Footnote 6. 24 C.F.R. § 103.100(b).

(n7)Footnote 7. 24 C.F.R. § 103.110.

(n8)Footnote 8. 24 C.F.R. § 103.200.

(n9)Footnote 9. 24 C.F.R. § 103.202(a).

(n10)Footnote 10. 24 C.F.R. § 103.202(b).

(n11)Footnote 11. 24 C.F.R. § 103.203.

(n12)Footnote 12. 24 C.F.R. § 103.215(a).

(n13)Footnote 13. 24 C.F.R. § 103.215(b).

(n14)Footnote 14. 24 C.F.R. § 103.220.

(n15)Footnote 15. 24 C.F.R. § 103.225.

(n16)Footnote 16. 24 C.F.R. § 103.230.

(n17)Footnote 17. 24 C.F.R. § 103.230

(n18)Footnote 18. 24 C.F.R. § 103.300(a).

(n19)Footnote 19. 24 C.F.R. § 103.300(b).

- (n20)Footnote 20. 24 C.F.R. § 103.315(a).
- (n21)Footnote 21. 24 C.F.R. § 103.310.
- (n22)Footnote 22. 24 C.F.R. § 103.320.
- (n23)Footnote 23. 24 C.F.R. § 103.330(a).
- (n24)Footnote 24. 24 C.F.R. § 103.330(b).
- (n25)Footnote 25. 24 C.F.R. § 103.315(b).
- (n26)Footnote 26. 24 C.F.R. § 103.335.
- (n27)Footnote 27. 24 C.F.R. § 103.400(a).
- (n28)Footnote 28. 24 C.F.R. § 103.400(a)(1).
- (n29)Footnote 29. 24 C.F.R. § 103.400(c).
- (n30)Footnote 30. 24 C.F.R. § 103.400(a)(1).
- (n31)Footnote 31. 24 C.F.R. § 103.400(a)(2).
- (n32)Footnote 32. 24 C.F.R. § 103.400(a)(3).
- (n33)Footnote 33. 24 C.F.R. § 103.405(a).
- (n34)Footnote 34. 24 C.F.R. § 103.405(b).
- (n35)Footnote 35. 24 C.F.R. § 103.410(a)-(b).
- (n36)Footnote 36. *White v. Lee*, 227 F.3d 1214 (9th Cir. 2000) .
- (n37)Footnote 37. *South Suburban Housing Center v. Berry*, 186 F.3d 851 (7th Cir. 1999) .
- (n38)Footnote 38. *Pfaff v. United States Dept. of Housing*, 88 F.3d 739 (9th Cir. 1996) .
- (n39)Footnote 39. *Daubert v. Merrill Dow Pharmaceuticals, Inc.*, 509 U.S. 579, 113 S. Ct. 2786, 125 L. Ed. 2d 469 (1993) .
- (n40)Footnote 40. *Metropolitan St. Louis Equal Housing Opportunity Council v. Gordon A. Gundaker Real Estate Co., Inc*, 130 F. Supp. 2d 1074, n. 12 (E.D. Mo. 2001) .

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148 of 163 DOCUMENTS

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PART III Public Regulation
CHAPTER 9 The Broker And Discrimination *

10A-9 Real Estate Brokerage Law and Practice § 9.07

§ 9.07 State Legislation Prohibiting Discriminatory Housing Practices

Most states have enacted legislation designed to eliminate discrimination in housing. These laws may impose requirements upon real estate brokers that exceed those set forth in the federal laws or that differ from the requirements set forth in federal law. Further, state laws may expose real estate brokers to potential liability that differs from their exposure under federal law. Specifically, many states allow for or require surrender of a broker's license upon a judicial determination that the broker has engaged in unlawful discriminatory housing practices. n1 The statutes of each state must be carefully scrutinized.

The following is a list of state laws specifically intended to prohibit discriminatory housing practices:

- Alabama Code § 24-8-1, *et seq.*, Alabama Fair Housing Law.
- Alaska Statutes § 18.80.240. Unlawful practices in the sale or rental of real property.
- Ariz. Rev. Stat. § 41-1491, *et seq.*, Fair Housing.
- Arkansas Code § 16-123-204. Conduct prohibited in real estate transactions--Exception.
- Cal. Gov. Code. § 12921, Employment and housing without discrimination as civil right, and § 12955, *et seq.*, Housing Discrimination.
- Colorado Revised Statutes § 24-34-502. Unfair housing practices prohibited.
- Connecticut Statutes § 46a-64c. Discriminatory housing practices prohibited.
- Delaware Code, 6 Del. C. § 4603. Discrimination in sale or rental of housing and other prohibited practices.
- District of Columbia Code § 2-1402.21. Unlawful discriminatory practices in real estate transactions.

10A-9 Real Estate Brokerage Law and Practice § 9.07

- *Florida Statutes § 760.23*. Discrimination in the sale or rental of housing and other prohibited practices.
- *Georgia Code § 8-3-202*. Unlawful practices in selling or renting dwellings; exceptions.
- *Hawaii Statutes § 515-3*. Discriminatory practices.
- *Idaho Code § 67-5909(8) to (11)*. Acts prohibited --Commission on Human Rights.
- *Illinois Statutes, 775 I.L.C.S. 5, § 3-102*. Civil rights violations; real estate transactions.
- *Ind. Code Ann. § 22-9-1-3(l)(4)*, Civil Rights Act and *Ind. Code Ann. § 22-9.5-1-1, et seq.*, Indiana Fair Housing.
- *Iowa Statutes § 216.8*. Unfair or discriminatory practices--housing.
- *Kansas Statutes § 44-1016*. Unlawful acts in connection with sale or rental of real property.
- *Kentucky Statutes § 344.360*. Unlawful housing practices--Design and construction requirements.
- *Louisiana Revised Statutes § 51:2601, et seq.* , "Louisiana Equal Housing Opportunity Act."
- *Maine Revised Statutes, 5 M.R.S.A. § 4582*. Unlawful housing discrimination.
- *Md. Code Ann., State Gov't §§ 20-701 et seq., 20-1020 et seq., 20-1102, and 20-1103*.
- *Massachusetts, General Laws of Massachusetts G.L.C. 151B, § 4 (6), et seq.* Unlawful practices.
- *Michigan Compiled Laws § 37.2502*. Persons engaging in real estate transactions, real estate brokers, or real estate salesmen; prohibited practices; section subject to § 37.2503.
- *Minn. Stat. § 363A.09* (Unfair Discriminatory Practices Relating to Real Estate) and *§ 363A.10* (Real Property; Disability Discrimination).
- *Missouri Statutes § 213.040*. Unlawful housing practices § discrimination in housing
- *Montana Statutes § 49-2-305*. Discrimination in housing--exemptions.
- *Nebraska Revised Statutes § 20-318*. Unlawful acts enumerated.
- *Nevada Revised Statutes § 118.100*. Prohibited acts and practices.
- *New Hampshire Statutes § 354-A:10*. Unlawful discriminatory practices.
- *New Mexico Statutes Annotated § 28-1-7(G)*, Unlawful discriminatory practice.
- *New York Consolidated Laws, Exec. § 296*, Unlawful discriminatory practices, at paragraphs 2-a, *et seq.*
- *North Carolina General Statutes § 41A-4*. Unlawful discriminatory housing practices.

- North Dakota Century Code, § 14-02.5-01, *et seq.*, Housing Discrimination.
- *Ohio Revised Code § 4112.02* re: Unlawful discriminatory housing practices.
- *Oklahoma Statutes, tit. 25, § 1452.* Discriminatory housing practices--Categories or classes of persons protected--Jurisdiction of Human Rights Commission.
- *Oregon Revised Statutes § 659A.421.* Discrimination in selling, renting or leasing real property prohibited.
- Pennsylvania Statutes, 43 P.S. § 955. Unlawful discriminatory practices, at paragraph (h), *et seq.*
- Rhode Island General Laws § 34-37-1, *et seq.* Rhode Island Fair Housing Practices Act.
- South Carolina Code § 31-21-10, *et seq.* South Carolina Fair Housing Law.
- South Dakota Statutes § 20-13-20. (Regarding unfair or discriminatory housing practices.)
- *Tennessee Code Annotated § 4-21-601.* Discriminatory housing practices generally.
- *Texas Property Code § 301.001, et seq.* Texas Fair Housing Act.
- Utah Statutes § 57-21-1, *et seq.* Utah Fair Housing Act.
- *Vermont Statutes, tit. 9, § 4503.* Unfair housing practices.
- *Virginia Code § 36-96.3.* Unlawful discriminatory housing practices.
- Washington, R.C.W. 49.60.222. Unfair practices with respect to real estate transactions, facilities, or services.
- *West Virginia Code § 5-11A-1, et seq.* West Virginia Fair Housing Act.
- *Wisconsin Statutes § 106.50.* Open housing.
- Wyoming Stat. § 6-9-102 (a). "No person shall be denied the right to life, liberty, pursuit of happiness or the necessities of life because of race, color, sex, creed or national origin."

FOOTNOTES:

(n1)Footnote 1. *See e.g., South Suburban Hous. Ctr. v. Berry, 186 F.3d 851 (7th Cir. 1999).*

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149 of 163 DOCUMENTS

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PART III Public Regulation
CHAPTER 9 The Broker And Discrimination *

10A-9 Real Estate Brokerage Law and Practice § 9.08

§ 9.08 Fair Housing Partnership Agreement

The National Association of Realtors(R) (NAR) and the U.S. Department of Housing and Urban Development (HUD) entered into a Fair Housing Partnership on December 5, 1996. The Fair Housing Partnership replaces the Voluntary Affirmative Marketing Agreement (VAMA), which terminated. By its terms, the partnership is slated to last five years. In contrast with the VAMA's focus on monitoring compliance with fair housing laws, the partnership emphasizes a cooperative approach between Realtors(R) and HUD.

The purpose of the Fair Housing Partnership between NAR and HUD is to jointly identify, address and promote fair housing in all communities throughout the United States. The Fair Housing Partnership recognizes the role of Realtors(R) in promoting fair housing. The Fair Housing Partnership establishes a national model for discussion, planning, and action that can be utilized in individual communities. The Fair Housing Partnership Agreement emphasizes the development of collaborative strategies and measurable actions to address fair housing issues.

The Partnership relaxed requirements that Realtors(R) abide by a prescribed set of association-wide or company-wide fair housing plans and procedures. Instead, Realtors(R) are encouraged to develop their own consistent fair housing procedures.

The Fair Housing Partnership should alleviate the stress and worry of real estate brokers who, despite their best efforts and commitment to fully comply with fair housing laws, have been continually scrutinized through testing by local fair housing organizations. Brokers, especially those associated with large firms, had cause to be fearful of an employee mistake. The approach of the Fair Housing Partnership casts Realtors(R) and fair housing organizations in the roles of allies instead of adversaries, encouraging Realtors(R) to turn to their partners for authoritative answers when they are faced with complicated fair housing questions. It is the expectation of HUD and NAR that a large number of complicated or difficult fair housing questions will be resolved through discussion rather than through litigation.

The partners, HUD and NAR, developed a fair housing declaration for use by Realtors(R). The declaration outlines a series of affirmative fair housing principles that Realtors(R) are encouraged to incorporate into their daily business practices. The declaration provides as follows:

Realtor(R) Fair Housing Declaration

I agree to:

Provide equal professional service without regard to the race, color, religion, sex, handicap, familial status, or national origin of any prospective client, customer, or of the residents of any community.

Keep informed about fair housing law and practices, improving my clients' and customers' opportunities and my business.

Develop advertising that indicates that everyone is welcome and no one is excluded, expanding my client's and customer's opportunities to see, buy, or lease property.

Inform my clients and customers about their rights and responsibilities under the fair housing laws by providing brochures and other information.

Document my efforts to provide professional service, which will assist me in becoming a more responsive and successful Realtor(R).

Refuse to tolerate non-compliance.

Learn about those who are different from me and celebrate those differences.

Take a positive approach to fair housing practices and aspire to follow the spirit as well as the letter of the law.

Develop and implement fair housing practices for my firm to carry out the spirit of this declaration.

n1

Recognizing that the goals of the partnership will be best achieved at the local level, and to ensure the success of the partnership and replicate their efforts at the local level, both HUD and NAR encourage state and local associations and HUD field offices to voluntarily enter into local partnerships and to jointly address the fair housing concerns of a community through collaborative strategies and joint action.

FOOTNOTES:

(n1)Footnote 1. Fair Housing Partnership Appendix 2.

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150 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation
CHAPTER 9 The Broker And Discrimination *

10A-9 Real Estate Brokerage Law and Practice § 9.09

§ 9.09 Americans with Disabilities Act (ADA)

The Americans with Disabilities Act (ADA) is a broad civil rights law guaranteeing equal opportunity for individuals with disabilities. The Department of Justice is the lead federal agency for implementation of the ADA.

The ADA was enacted July 26, 1990, n1 and went into effect July 26, 1992. n2 The ADA generally provides access requirements for and prohibits discrimination against people with disabilities in public accommodations, state, and local government, transportation, telecommunications, and employment. The Americans with Disabilities Act covers anyone who has a physical or mental impairment that interferes with a major life activity, or who is perceived as having such impairment.

The ADA affects the commercial real estate brokerage industry in a manner similar to how the Fair Housing Act affects the residential real estate business. One must approach the ADA with caution as the Act is very detailed and several areas lack clear interpretation.

A commercial real estate broker must determine whether the building, shopping center, or other commercial structure that the broker is selling, managing, or leasing is in compliance with the ADA. If the building is not in compliance with the federal law, the broker may subject himself or herself to a claim of negligent misrepresentation by holding it out to the public as suitable and fit for commercial purposes.

[1] Title III of the ADA

Title III n3 of the ADA addresses accessibility requirements for public accommodations. Strictly residential facilities are not considered places of public accommodation and are not subject to Title III of the ADA, nor are amenities provided for the exclusive use of residents and their guests. However, common areas that function as places of public accommodation within residential facilities are considered places of public accommodation if they are open to persons other than residents and their guests. Rental offices and sales offices are, therefore, places of public accommodation and must comply with the ADA requirements in addition to all requirements of the Fair Housing Act.

Title III applies to both the owner and the operator of public accommodations and commercial facilities. Title III of the ADA has the greatest potential impact upon real estate brokers as it broadly expands the concept of "disability" and

imposes regulations on existing buildings.

The anti-discrimination and the removal of barrier requirements of the ADA apply to "places of public accommodations." The accessibility requirements of the ADA regarding new construction and alterations apply to public accommodations and "commercial facilities."

"Places of accommodation" encompass twelve categories of retail and service businesses, including places of lodging, food and drink establishments, places of exhibitional entertainment, places of public gathering, sales and rental establishments, services establishments such as law firms, accounting firms and banks, public transportation stations, places of public display or collection, places of recreation, educational facilities, social service center establishments, and exercise clubs. It is presumed that this definition includes services establishments such as brokerage offices, even if they are located in private homes.

"Commercial facility" is defined as a facility whose operations affect commerce, that is intended for non-residential use, and that is not a facility expressly exempted from coverage under the Fair Housing Act.

The ADA contains a broad provision prohibiting discrimination against those with disabilities in the full and equal enjoyment of goods, services, facilities, privileges, advantages, and accommodations of any place of public accommodation. Facilities need to be usable by persons with disabilities.

[2] New Construction

All new construction coming available for occupancy after January 26, 1993 must meet structural requirements for disability access. The ADA requirements apply only to construction that becomes available for first occupancy. Department of Justice regulations therefore specifically exclude from the ADA's coverage those projects for which a completed building permit application was certified and received by the appropriate government agency before January 26, 1992. If a building permit was issued after January 26, 1992, but has a certificate of occupancy on or before January 26, 1993, it is exempted from the requirements of the ADA. Otherwise, the construction requirements apply to all commercial facilities.

Special barrier removal requirements became effective January 26, 1992, and apply only to facilities that are "places of public accommodations" as defined under the Act. The ADA requires removal of architectural and communications barriers that are structural in nature, where such removal is readily achievable (easily accomplishable and able to be carried out without much difficulty or expense). Barrier removal includes ramp installations, curb cuts in sidewalks and entrances, repositioning shelving, rearranging tables and chairs, repositioning telephones, adding raised markings on elevator control buttons, installing flashing alarm lights, widening doors, eliminating turnstiles, and providing for alternate paths of travel.

[3] Alterations

All commercial facilities must be made accessible to the maximum extent feasible whenever alterations are being performed on a facility. Alteration is defined as any change that affects the feasibility of a facility. If alterations are made to a lobby or work area of a public accommodation, an accessible path of travel to the altered area and to the bathrooms, telephones, and drinking fountains serving that area must be made to the extent that the added accessibility costs are not disproportionate to the overall cost of the original alteration.

Disproportionate cost is defined for the purpose of the ADA as a cost that exceeds 20% of the original alteration. The cost of alteration includes all costs of renovation to the facility incurred in a three-year period.

[4] Other Modifications

The ADA requires modifications to procedures so that disabled individuals are not excluded from regular programs. Places of public accommodations must make reasonable modifications to their policies and procedures to accommodate individuals with disabilities and not create restrictions that tend to screen out individuals with disabilities, such as not allowing more than one person in a clothes-changing area when a disabled person required the assistance of another person.

The ADA also requires auxiliary aids and services to ensure effective communication for individuals with hearing, vision, or speech impairment. Such aids and services include interpreters, listening headsets, television closed caption decoders, telecommunication devices for the deaf, video tech displays, Braille materials and large-print materials.

[5] Defenses

There are several defenses and exclusions available under the ADA, but most are extremely narrow in scope. They include:

[a] Threat to Health and Safety

Refusal to serve a disabled person or to offer equipment, goods or services if such an individual poses a direct threat to the health and safety of others (e.g., amusement park rides, rafting exhibitions, or difficult swimming maneuvers).

[b] Private Clubs

Private clubs are excluded under Section 307 of the ADA. n4 The ADA defines a private club as being in accordance with Title II of the 1964 Civil Rights Act.

[c] Religious Organizations

Religious organizations are also exempt. The exemption applies even if it involves a church that operates a day care center, nursing home, or private school.

[d] Not Readily Achievable

Barrier removal is not required of the public accommodation if it is not readily achievable. Readily achievable means easily accomplishable and able to be carried out without much difficulty or expense.

[e] Structural Impracticability

Structural impracticability is a defense if the circumstances are such that incorporating excessive disability features in to the structure would destroy the structural integrity of the facility.

[f] Technical Infeasibility

Technical infeasibility applies to something that has little likelihood of being accomplished because of existing structural conditions that would require removing or altering a load-bearing member, such as a structural frame.

[g] Residential Structures

Residential structures are generally not subject to the requirements of the ADA unless they accommodate the public. In that case they would fall within the ambit of the public accommodations portion of the statute. Similarly, owner-occupied boarding houses and "bed-and-breakfast" establishments are not subject to the ADA if they have five

rooms or less.

[h] Asbestos Removal

Asbestos removal projects do not trigger the "alterations" requirements under the ADA.

[i] Historic Structures

Qualified historic structures need not comply with the requirements of the ADA if compliance would threaten or destroy the historic significance of the building or facility.

[6] Responsibility for Compliance

The ADA generally imposes the obligation of compliance upon the building owner instead of the tenant or the property manager. A real estate agent, however, is exposed to liability under the ADA. An agent may be found negligent if the agent, as a professional, knew or should have known of the owner's noncompliance with the ADA or if an agent fails to inform a potential future owner of the building's noncompliance. Many leases make tenants responsible for all of the compliance expenses incurred due to federal, state, or local law. In such cases, the realtor's duty of disclosure is enhanced.

The Department of Justice has suggested different formulas or standards for allocating compliance costs between landlords and tenants. The suggestions have been criticized on the grounds that they are arbitrary.

[7] Foreclosure

In the event of foreclosure on a building not exempted by the ADA, such as an office building, one may find that though it may not be required to comply with the ADA prior to foreclosure, it may be required to comply with the ADA after foreclosure. This could cause the cost of barrier removal to fall upon the lender who initiated the foreclosure because of the change in use or ownership of the building. It has been suggested that lenders do an ADA audit of a building prior to foreclosure, similar to that done regarding toxic waste or an environmental assessment.

[8] Enforcement

The Department of Justice and private individuals may maintain a cause of action to enforce Title III against commercial building owners. The Department may seek monetary damages or injunctive relief, but private individuals are only entitled to seek injunctive relief under the ADA. It is possible, however, that a tort claim could create a cause of action for monetary damages.

[9] Department of Justice Enforcement

The Department of Justice enforces the provisions of Title III of the ADA by establishing a pattern or practice of discrimination, or by establishing a failure to comply, or by establishing that any person or group of persons has been denied any of the rights granted by Title III and that such denial raises an issue of general public importance.

Civil penalties may be imposed in the amounts of \$50,000 for the first violation and \$100,000 for each subsequent violation. The Attorney General may also seek monetary damages on behalf of aggrieved individuals. Any individual who believes that he or she has been the object of discrimination prohibited by the ADA may request that the Department of Justice investigate the claim.

[10] Private Cause of Action

An individual has a right to bring suit for injunctive relief if that individual has reasonable grounds to believe that he or she has been subjected to discrimination or is about to be subjected to discrimination. The private suit may be brought in court without first pursuing administrative remedies, and the individual may be entitled to a court-appointed attorney if, under the circumstances, the court deems such an appointment to be just.

FOOTNOTES:

(n1)Footnote 1. Pub. L. No. 101-336, *104 Stat. 327 (1990)*, codified at *42 U.S.C. § 12101 et seq.*

(n2)Footnote 2. Pub. L. No. 101-336 § 108.

(n3)Footnote 3. *42 U.S.C. §§ 12181-12189.*

(n4)Footnote 4. *42 U.S.C. § 12187.*

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151 of 163 DOCUMENTS

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PART III Public Regulation
CHAPTER 9 The Broker And Discrimination *

10A-9 Real Estate Brokerage Law and Practice § 9.10

§ 9.10 Discrimination Against Real Estate Licensees

Most real estates agents and other licensees are employed by brokers as independent contractors. Consequently, discrimination statutes aimed at protecting employees will not protect a licensee who is an independent contractor.

Licensees have sued alleging that they were employees even though the contract with their supervising broker defined the relationship as being that of an independent contractor. In resolving the status of a licensee, courts usually look to the common law test of the master-servant relationship. Factors considered are the employer's right to control the details of the employee's work, the method of payment, the skill required in the particular occupation, whether the employer supplies the tools, instrumentalities and place of work, as well as the parties' own belief as to whether they are creating a master-servant relationship. n1

It appears that as a general rule, Title VII of the Equal Employment Opportunities Act n2 and similar state laws do not cover real estate licensees acting as independent contractors. n3 It also appears that as a general rule, that licensees acting as independent contractors will not be covered by the Americans with Disabilities Act (42 U.S.C. § 12101 *et seq.*), the Age Discrimination in Employment Act (29 U.S.C. § 621 *et seq.*), or any similar state law. n4

FOOTNOTES:

(n1)Footnote 1. *See, e.g., Kakides v. King Davis Agency, Inc.*, 283 F. Supp. 2d 411, 416 (D. Mass. 2003) ; *Verdecchia v. Douglas A. Prozan, Inc.*, 274 F. Supp. 2d 712, 721 (W.D. Pa. 2003) .

(n2)Footnote 2. *See* 42 U.S.C. §§ 2000e *et seq.*

(n3)Footnote 3. *See, e.g., Kakides v. King Davis Agency, Inc.*, 283 F. Supp. 2d 411, 418 (D. Mass. 2003) ; *Stetka v. Hunt Real Estate Corp.*, 859 F. Supp. 661, 667 (W.D.N.Y. 1994) ; *Krijn v. Pogue Simone Real Estate Co.*, 752 F. Supp. 102, 104 (S.D.N.Y. 1990) , *aff'd without opinion*, 930 F.2d 910 (2d Cir 1991) . *See also* *Alberty-Velez v. Corporacion de P.R. Para la Diffusion Publica*, 242 F.3d 418, 421 (1st Cir. 2001) (it is settled law that Title VII does not apply to independent contractors).

(n4)Footnote 4. *See Verdecchia v. Douglas A. Prozan, Inc.*, 274 F. Supp. 2d 712, 723 (W.D. Pa. 2003) .

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152 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 10 The Impact of Electronic Commerce on the Real Estate Brokerage Business *

10A-10 Real Estate Brokerage Law and Practice 10.syn

§ 10.syn Synopsis to Chapter 10: The Impact of Electronic Commerce on the Real Estate Brokerage Business *

§ 10.01 Real Estate Brokers Cannot Ignore E-Commerce Issues

§ 10.02 Personal Jurisdiction or "Where Can Website Operators Be Sued?"

[1] Long-Arm Statutes

[2] Long-Arm Statutes Can Be Used to Sue Foreign Operators of Interactive Web Sites If Sites Are Accessible to Web Users Located in the State

[a] If Web Site Is "Passive," Personal Jurisdiction Over the Web Site Operator Probably Will Not Attach

[b] Advertising "Plus" May Well Confer Jurisdiction

[c] Sales of Products or Services via Internet to State Residents Will Most Likely Confer Jurisdiction in Purchaser's Home State

[d] How Much "Plus" Is Enough to Confer Jurisdiction?

§ 10.03 Advertising Real Estate on the World Wide Web

[1] Statutory Shield to Internet Service Providers for Third Party Postings

[2] Advertising May Not Be False or Misleading

[3] Brokers or Agents May Not Advertise Property for Sale or Lease Without Permission of Owner or Owner's Agent

[4] Laws of Defamation and Invasion of Privacy Apply to Internet Communications

[5] Intellectual Property Rights Can Be Infringed on the Internet

[6] Operators of Web Sites Are Not Vicariously Liable for Defamation or Copyright Infringement Unless Operators Actively Control Content on Site

§ 10.04 Who Owns Real Estate Data Gathered by Real Estate Agents and Posted on the Internet?

[1] Raw Facts Are Not "Owned" by Anyone

[2] Ownership of "Data" Is Separate from Ownership of Real Estate or Ownership of a Listing Agreement

[3] Database Compilation of Facts Can Be Copyrighted If "Creativity" Is Shown in Selection and Categorization of Data

[4] Extent of Copyright Protection

§ 10.05 Use of Multiple Listing Data by "Virtual" Real Estate Brokerage Companies

[1] "Virtual" Real Estate Brokerage Companies As Participants in Regional Multiple Listing Services

[2] Brokers Displaying Each Other's Listings on Websites

[3] Use of Multiple Listing Service Listing Data for Internet Advertising

[4] Delivery of Multiple Listing Service Data to Brokers' Customers or Clients through the Internet.

[5] Antitrust Implications of the National Association of Realtors(R) Policy on Virtual Office Websites.

[a] Antitrust Litigation

[b] US v. NAR Settlement

[c] Other Challenges in Attempt to Expand Real Estate Listing Information

[d] Report on Competition in the Real Estate Industry Issued by FTC and DOJ

§ 10.06 "Linking" or "Framing" Other Websites Can Create Liability Risks

§ 10.07 Consumer "Privacy" Breaches Can Lead to Liability

§ 10.08 Extraterritorial Reach of State Real Estate License Laws

§ 10.09 E-Mail Liability

§ 10.10 Conclusion: Implications for the Future



153 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 10 The Impact of Electronic Commerce on the Real Estate Brokerage Business *

10A-10 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Selling real estate without using the Internet today is the equivalent of doing business without a fax machine, cell phone, or photocopier a decade ago. This chapter examines the following legal issues raised by the impact of the electronic commerce on the real estate brokerage business:

- Where can website operators be sued? (§ 10.02)
- Advertising real estate on the World Wide Web (§ 10.03)
- Who owns real estate data gathered by real estate agents and posted on the Internet? (§ 10.04)
- Use of multiple listing data by "virtual" real estate brokerage companies (§ 10.05)
- Liability risks of "linking" or "framing" other websites (§ 10.06)
- Consumer "privacy" breaches (§ 10.07)
- Extraterritorial reach of state real estate license laws (§ 10.08)
- E-mail liability (§ 10.09)

For related discussion, see:

- *Regulation of Internet Advertising* (§ 6.02[3][b] above)
- *National Association of Realtors(R) Internet Data Exchange Policy* (§ 6.02[3][c] above)
- *Antitrust Implications of E-Commerce and Access to Multiple Listing Service Database* (§ 8.04[6] above)

- Stephen Y. Chow, E-Commerce and Communications: Transactions in Digital Information (Matthew Bender).



154 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 10 The Impact of Electronic Commerce on the Real Estate Brokerage Business *

10A-10 Real Estate Brokerage Law and Practice § 10.01

§ 10.01 Real Estate Brokers Cannot Ignore E-Commerce Issues

Incorporation of the Internet into the marketing of real estate is not optional for real estate brokers and salespersons. In 2000, the number of unique visitors to real estate web sites increased seventy-five percent (75%) from the previous year, while overall Web traffic only increased twenty-two percent (22%). In addition, almost thirty percent (30%) of consumers who access the Internet are in the market to buy a new property, or have been in the market in the last six months. n1 Surveys conducted by the National Association of Realtors(R) show that more and more buyers are searching the Internet for available listings before they ever contact a real estate agent. n2 Sellers are insisting that their agents advertise their properties on the Web, often at multiple national and local web sites. Buyers and sellers can research the sales price of comparable properties on the Web. Mortgage loan, homeowner's insurance, and title insurance applications can be submitted by consumers over the Web. Recorders of deeds and local tax assessors are making real estate public records accessible online in electronic formats. Lenders, insurance companies, Fannie Mae, and Freddie Mac can use automated valuation model software, linked to electronic real estate databases, to secure estimates of value of real estate parcels totally online in a matter of seconds.

Competition is intense for the patronage of the electronically sophisticated consumer. Sellers of products and services on the Internet are rapidly developing "data mining" techniques that enable them to "target" consumers who are most likely to buy their products and services based on the consumer's prior web surfing habits and purchasing history.

Real estate brokers cannot ignore these developments. The use of the Internet and e-commerce must be included in every broker's strategic business plan. To sell real estate without using the Internet today is the equivalent of doing business without a fax machine, cell phone, or photocopier ten years ago.

Not surprisingly, the law has not kept pace with advances in computer technology. Applying legal concepts developed before the invention of the touchtone telephone to electronic commerce creates confusing and numerous traps for the unwary. Examples of legal issues raised by the impact of the Internet on the real estate brokerage business are set forth below.

FOOTNOTES:

(n1)Footnote 1. See Pastore, *Real Estate Sites Getting Popular with Consumers*, CyberAtlas, Sept. 20, 2000.

(n2)Footnote 2. See National Association of Realtors(R), Profile of Home Buyers and Sellers (2002) (forty-one percent (41%) of home buyers used the Internet in the course of their home search).

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155 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 10 The Impact of Electronic Commerce on the Real Estate Brokerage Business *

10A-10 Real Estate Brokerage Law and Practice § 10.02

§ 10.02 Personal Jurisdiction or "Where Can Website Operators Be Sued?"

[1] Long-Arm Statutes

Every state has a "long arm statute." n1 These statutes provide that a company "doing business" in a state can be required to defend itself in the courts of that state. Long-arm statutes are constitutional so long as the defendant has "minimal contacts" in the forum state. n2 These decisions are premised upon business transactions being consummated between parties from fixed locations within state territorial borders. When a vendor interacts with a consumer from a "virtual" location at an address on the World Wide Web, the issue arises whether the vendor is "present" in every state (or nation) from which the vendor's web site can be accessed.

[2] Long-Arm Statutes Can Be Used to Sue Foreign Operators of Interactive Web Sites If Sites Are Accessible to Web Users Located in the State

[a] If Web Site Is "Passive," Personal Jurisdiction Over the Web Site Operator Probably Will Not Attach

If the web site simply displays information to an Internet user, much like a billboard on a highway, the site probably will not be viewed as being "present" in a forum state. n3 Courts analogize to advertisements in magazines, which generally do not, standing alone, confer jurisdiction upon the advertiser in every state in which the magazine is sold or distributed.

Courts also decline to assert personal jurisdiction over non-resident web site operators who express purely non-commercial messages on their sites. In *Jerry L. Falwell v. Gary Cohn and God.Info*, n4 the plaintiff, a well-known evangelical minister based in Virginia, sued the defendant, an Illinois resident, in a Virginia federal court alleging that the defendant's web site on which the defendant published various statements critical of the plaintiff contained defamatory material and violated the Anti-Cybersquatting Consumer Protection Act. The court granted the defendant's motion to dismiss for lack of personal jurisdiction in Virginia. The court concluded that the defendant's messages on his website were not targeted at residents of Virginia because the plaintiff, while a Virginia resident, was a national figure.

A different result was reached in *Tamburo d/b/a Man's Best Friend Software v. Dworkin, et al.* n4.1 There, the plaintiff was an Illinois resident who designed and marketed a software program that provided users with access to information about dog pedigrees. Tamburo's software program scanned the Internet and indexed data accessible on public websites

about dog pedigrees. In his complaint, Tamburo alleged that the defendants falsely accused him of "stealing" their proprietary data, and engaging in an aggressively Internet based campaign to encourage other dog enthusiasts to boycott Tamburo's products and to send him emails and other messages complaining about his conduct. In the course of promoting their boycott of Tamburo the defendants published Tamburo's Illinois address in their various communications.

The defendants were four operators of public websites from which Tamburo acquired data for his software program. The individual defendants were residents of Colorado, Michigan, Ohio, and Ottawa, Canada. An additional defendant was WildSystems Pty, Ltd., an Australian software company that operated a private only Yahoo email listserve for customers of its software that also information about dog pedigrees. Wildsystems is alleged to have posted messages from the other defendants on its Yahoo email listserve. Tamburo alleged that all of the defendants violated federal and state antitrust laws, and committed common law defamation by organizing a boycott campaign against his business. All of the defendants moved to dismiss Tamburo's complaint for lack of personal jurisdiction. The trial court granted the defendants' motion, which the Seventh Circuit reversed in part and affirmed in part.

The Seventh Circuit held at the outset that Tamburo had failed to allege facts to state a claim under the federal or state antitrust laws against any of the defendants. The Court then found that Tamburo alleged sufficient facts to establish personal jurisdiction over the individual defendants for the purposes of this common law claims. The Court found initially that the trial court could not assert general personal jurisdiction over any of the defendants because none of them had any continuous and systematic contacts with Illinois. On the other hand, the Court found that the trial court had specific personal jurisdiction over the individual defendants because, based on the facts alleged in Tamburo's complaint, they engaged in specific conduct targeted at Tamburo and with the intent to inflict injury upon him in Illinois. The Court then held that Tamburo had not alleged sufficient facts to establish specific personal jurisdiction over the Australian software company because the company merely posted messages from the other defendants on its listserve. Tamburo did not allege that the company knew Tamburo was a resident of Illinois or participated in any conduct intended to inflict injury upon Tamburo in Illinois.

The teaching of the *Tamburo* case is that persons who use internet communication media to intentionally inflict injury on another person may be subject to personal jurisdiction in the plaintiff's state of residence whether or not the defendants had any other contacts with the forum state.

[b] Advertising "Plus" May Well Confer Jurisdiction

In *Minnesota v. Granite Gate Resorts* n5 Minnesota courts asserted jurisdiction over a Nevada corporation that solicited sports bets over the Internet when 248 Minnesota residents placed such bets. Illinois courts asserted jurisdiction over a power boat manufacturer who operated a web site on which consumers could communicate with the defendant about their intentions to attend upcoming boat shows. n6

More recently, in *Metro-Goldwyn-Mayer Studios v. Grokster, Ltd*, n7 the court held that an Australian company that distributed from its website the Kazaa peer-to-peer software that allows users to share files of recorded music was subject to the jurisdiction of California courts even though it did not have any connections to the state other than operating a site on the World Wide Web from which California residents could download the software for subsequent use in the state. In a suit brought against the company for contributory copyright infringement, the court found that the defendant purposely availed itself of the privilege of doing business in California by permitting California residents to download its software. The court rejected the defendant's argument that it did not purposely avail itself of the privilege of doing business in California because it did not know the domicile of the persons who downloaded its software. The court concluded, alternatively, that since the company did not dispute that as many as two million California residents downloaded the company's software, and that the company offered the free downloads to drive visitors to its website on which it sold advertising, that the company was engaging "commercial contacts" with California residents at its website.

[c] Sales of Products or Services via Internet to State Residents Will Most Likely Confer Jurisdiction in Purchaser's Home State

In *CompuServe, Inc. v. Patterson*,ⁿ⁸ a Texas defendant entered into an agreement with CompuServe to distribute defendant's software through CompuServe's Internet distribution system. Using CompuServe's system, the Texas defendant sold \$650.00 of software to Ohio residents, which the court found sufficient to confer personal jurisdiction over the defendant in Ohio. In *Euromarket Designs, Inc. v. Crate & Barrel, Ltd.*,ⁿ⁹ an Irish company created a web site that featured the trademark of Crate & Barrel, a well-known Illinois-based retailer. The Irish firm's web site accepted orders and solicited consumers to place their names on a mailing list. One sale was made to an Illinois resident. This sale, together with the court's finding that the Irish firm's use of the Crate & Barrel trademark was "targeted" at the Illinois company, was sufficient to permit the Illinois court to assert personal jurisdiction over the Irish defendant.

Courts are willing, however, to enforce forum selection provisions of online Terms of Use Agreements pursuant to which goods and services are provided to online customers and clients. In *Robert Novak, d/b/a Pets Warehouse and Petswarehouse.com v. Overture Services, Inc.*,ⁿ¹⁰ the plaintiff sued Google, Inc. when Google sold preferred search engine placements that appeared in response to searches that included the terms "pets" and "warehouse," which constituted the plaintiff's trade name and web site domain. The court granted Google's motion to dismiss the case based upon the "forum selection" paragraph in Google's Terms of Service agreement, which the defendant had accepted by clicking the "I Accept" button on the Google site. The Google Terms of Service specified that all suits arising from Google's services had to be brought in California, rather than New York. The court declined, however, to dismiss the claims against another defendant based on lack of personal jurisdiction. The court concluded that the New York Long-Arm Statute conferred jurisdiction upon New York courts over this defendant because it sold approximately \$6000 a year in products to residents of New York from its web site that appeared in response to users' Google searches using the plaintiff's trade name as a search term.

[d] How Much "Plus" Is Enough to Confer Jurisdiction?

Set forth below are examples of other types of "interactivity" on a web site that have been deemed sufficient to confer personal jurisdiction in the plaintiff's home state.

(a) Advertisement of toll free telephone number on the Internet.ⁿ¹¹

(b) Compiling a mailing list of interested users.ⁿ¹²

In addition to the question of where a web site operator can be sued by reason of products and services available from the operators' web site, there is the related question of whether the web site operator is subject to any regulatory or licensing requirements of other jurisdictions if the activity occurring on the operator's site is of the type regulated by state agencies. This is particularly true of real estate brokers. In *Stroman Realty, Inc. v. Antt*,ⁿ¹³ a real estate brokerage company filed a declaratory judgment action against the California and Florida real estate commissions challenging their right to require the broker to possess a California or Florida real estate brokerage license to engage in the sale of time share interests using a web site. The plaintiff was a real estate broker licensed in the state of Texas. The plaintiff specialized in the sale of "interval ownership" interests or "time shares." The two states with the largest percentages of time share properties in the United States are Florida and California. The plaintiff operated from a single office outside of Houston, Texas. From that office, plaintiff advertised its services through the mail and in print media. It also operated a website that displayed properties from around the world, and maintained toll free telephone numbers that interested persons may call to inquire about time share interests for sale, or to list an interest for sale with the plaintiff.

The plaintiff's sellers and buyers could be located throughout the world, and more often than not the buyers and sellers would be located in a state or country other than where the time share property is located. California and Florida regulators sent the plaintiff letters demanding that the plaintiff secure California and Florida real estate licenses as a

precondition of participating in any transactions involving residents of either state as buyers or sellers of time share interests. Rather than acquiesce in the demands of the state regulators, the plaintiff filed suit seeking a declaratory judgment that the state regulators' demand for a license under these circumstances constituted a burden on interstate commerce in violation of the *Commerce Clause of the United States Constitution*. The district court agreed with the broker and entered the declaratory judgment. The court found that the market for time share interests was a "national" market. The time share interests were almost exclusively used by their owners for vacation purposes, and therefore properties located in one state competed with properties located in other states at potential vacation destinations for buyers of time share interests. The court determined that the states' demands that the plaintiff submit to regulation in their states, in addition to the state of Texas, unduly burdened this "national market" without a sufficiently countervailing interest on the part of the states. The California and Florida regulators stated their intention to file an appeal of this decision with the Fifth Circuit Court of Appeals.

Practice Note:

More and more real estate brokers, and agents as well, are creating web sites that permit potential buyers and sellers to search electronic databases of listings available for sale, and maintain electronic portfolios of these listings in personal "files." It is highly likely that these web sites will be found to have sufficient "interactivity" to confer personal jurisdiction over the broker in the consumer's home state.

FOOTNOTES:

(n1)Footnote 1. See, e.g., 735 Ill. Comp. Stat. § 5/2-209.

(n2)Footnote 2. See, e.g., *Hanson v. Denckla*, 357 U.S. 235 (1958); *International Shoe Co. v. Washington*, 326 U.S. 310 (1945).

(n3)Footnote 3. See *Zippo Mfrg. Co. v. Zippo Dot Com, Inc.*, 952 F. Supp. 1119, 1124 (W.D. Pa. 1997).

(n4)Footnote 4. Civ. Act. No. 6:02CV0040 (W.D. Va., March 4, 2003).

(n5)Footnote 4.1. Case No. 08-2406 (7th Cir., April 8, 2010).

(n6)Footnote 5. *Minnesota v. Granite Gate Resorts*, 568 N.W.2d 715 (Minn. App. 1997).

(n7)Footnote 6. *Vitullo v. Velocity Powerboats*, No. 97 C 8745, 1998 U.S. Dist. LEXIS 7120 (N.D. Ill. Apr. 24, 1998).

(n8)Footnote 7. 243 F. Supp. 2d 1073 (C.D. Cal. 2003) .

(n9)Footnote 8. *CompuServe, Inc. v. Patterson*, 89 F.3d 1257 (6th Cir. 1996).

(n10)Footnote 9. *Euromarket Designs, Inc. v. Crate & Barrel, Ltd*, 96 F. Supp. 824 (E.D. Ill. 2000).

(n11)Footnote 10. 309 F. Supp. 2d 446 (E.D.N.Y. 2004) .

(n12)Footnote 11. *Inset Systems v. Instruction Set*, 937 F. Supp. 161 (D. Conn. 1996).

(n13)Footnote 12. *Maritz v. Cybergold, Inc*, 947 F. Supp. 1328 (E.D. Mo. 1996).

(n14)Footnote 13. *Stroman Realty, Inc. v. Antt*, 2005 U.S. Dist. LEXIS 16048 (S.D. Tex. 2005) .

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156 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 10 The Impact of Electronic Commerce on the Real Estate Brokerage Business *

10A-10 Real Estate Brokerage Law and Practice § 10.03

§ 10.03 Advertising Real Estate on the World Wide Web

With certain exceptions (*see Regulation of Internet Advertising in § 6.02[3][b] above*), using the Internet to advertise real estate for sale is not treated under the law any differently than advertising in any other format. All of the basic rules still apply.

[1] Statutory Shield to Internet Service Providers for Third Party Postings

While advertisers themselves are liable for the content of the advertising they disseminate, Congress enacted in 1996 Section 230 of the Communications Decency Act n1 for the purpose of immunizing Internet Service Providers (ISPs) from liability for content posted by third parties through their services. Section 230(c) of the Act provides in part that "[n]o provider ... of an interactive computer service shall be treated as the publisher or speaker of any information provided by another information provider." The federal Seventh Circuit Court of Appeals construed Section 230 of the Act as applied to real estate advertising in *Chicago Lawyers Committee for Civil Rights Under The Law v. Craigslist, Inc.* n2 Craigslist is a widely used site at which individual members of the "community" post advertisements for various products or services, including apartments for rent. Some of the advertisements posted on the site contained expressions of preferences for housing occupants based on race, gender, sexual preference or religion. Such expressions of a preference violate Section 804 (c) of the Federal Fair Housing Act., n3 and newspapers that publish such advertising are liable under the Fair Housing Act. n4

The Seventh Circuit affirmed the trial court's dismissal of the plaintiff's complaint against Craigslist based on Section 230 of the Communications Decency Act. The Seventh Circuit concluded that Section 230 immunizes an "interactive computer service," such as Craigslist, from any action premised on Craigslist being deemed a "publisher" of the content appearing on the site. The court then construed Section 804(c) of the Fair Housing Act as imposing liability upon the "publishers" of discriminatory housing advertisements. For that reason, the court held that Section 230 of the Communications Decency Act immunized Craigslist from the Fair Housing Act claims asserted by the plaintiff. A different result was reached, however, by the Ninth Circuit Court of Appeals in *Fair Housing Council of San Fernando Valley, et al. v. Roommates.com, LLC.* n5

In this case, Roommates.com required its members to complete questionnaires that solicited information about the members' housing preferences, including information about, among other things, a potential roommates familial status

or preferred sexual preference. The questionnaires were used to create profiles of the members, and the members' profiles were used to determine what postings for roommates they were shown. For example, a member with children would not be shown a posting indicating a preference for a roommate without children. The Ninth Circuit held that Roommates.com was not entitled to any immunity under Section 230 of the Communications Decency Act because, by soliciting information from its members, using the information to prepare member profiles, and using the profiles to screen the postings provided to the members, Roommates.com assumed responsibility for the information provided by the members, and the uses to which the information was put. As an "information content provider" itself, Roommates.com was not entitled to Section 230 immunity.

The court did hold, however, that Roommates.com was entitled to immunity under Section 230 for dissemination of "additional comments" submitted by members. In the "additional comments" portion of the profile form, members were invited to compose a narrative about the particular characteristics they were seeking in a future roommate. Because these comments were composed entirely by the member and disseminated in an unedited form, Roommates.com was entitled to immunity under Section 230 for the content of the comments, many of which contained explicitly discriminatory remarks. A further case that defines the scope of the immunity afforded to "interactive computer services" by Section 230 of the Communications Decency Act is *Doev. Friendfinder Network, Inc., et al.* n6

In the *Friendfinder* case, the defendants operated a number of affiliated "web communities," one of which promoted itself as the largest "sex and swinger personal community." At the defendants' site a profile of a female member was posted that included birth date, height, build, hair and eye color that matched the plaintiff, together with a photo, under the user name "petra03755." Upon learning about the profile on the defendants' site, the plaintiff demanded that it be removed, which the defendants did. The plaintiff then filed a multi-count complaint against the defendants that included claims for invasion of her "intellectual property rights", defamation, intentional infliction of emotional distress, and false designation of origin under the federal Lanham Act. The plaintiff's Lanham Act claim contended that the defendants falsely advertised that the plaintiff was available for the type of encounters promoted on the defendants' websites. The defendants filed a motion to dismiss all of the plaintiff's claims based on Section 230 of the Communications Decency Act. The court agreed that Section 230 immunity was available to the defendants for all of the plaintiff's tort based claims that were not grounded in an infringement of the plaintiff's "intellectual property rights."

Section 230(e)(2) of the Communications Decency Act n7 provides that "[n]othing in this section shall be construed to limit or expand any law pertaining to intellectual property." The court held that this limitation on Section 230 immunity included state law claims based on infringement of intellectual property rights. The court construed plaintiff's complaint as making a claim of invasion of the plaintiff's right of "publicity." The court held that the right to "publicize" one's likeness was an "intellectual property right" that was excluded from Section 230 immunity by Section 230(e)(2). The court reached the opposite conclusion concerning the plaintiff's claim for invasion of privacy. The court treated an invasion of privacy claim as a violation of a "personal right" and not a "property right." The court further held that the plaintiff successfully plead a claim for "false designation of origin" and "false advertising" in violation of Section 43(a) of the Lanham Act. n8 The court found that the plaintiff had adequately plead her claims under the Lanham Act by alleging that the defendants had falsely represented that she was a member of the defendants' sites, that she was available for the types of encounters promoted on the sites, and that consumers were deceived into believing that they could engage in such encounters with the plaintiff by availing themselves of the defendants' services.

The *Craigslist*, *Roommates.com* and *Friendfinder* cases demonstrate the scope of the immunity, and the limits thereon, available under Section 230 of the Communications Decency Act. Section 230 immunity is available to "interactive computer services" only to the extent they do not create the content posted on the site. While the *Friendfinder* case does not involve real estate advertising, it does illustrate that Section 230 immunity is not available to an "interactive computer service" for claims alleging an infringement of rights in "intellectual property," which can include common law claims of infringement of a right to publicity. More and more real estate brokers, and real estate listing aggregators, are expanding the functionality on their websites to permit consumers to post information or commentary about themselves, their neighborhood, their dealings with other real estate agents or brokers, or about particular property

listings. As the use of this functionality expands, website operators must be sure that they operate these features of their sites in manner that permits them to rely on Section 230 immunity, and create procedures to minimize the risk that this functionality can be used to invade a third party's "intellectual property rights" under state or federal law.

[2] Advertising May Not Be False or Misleading

Real estate brokers have always been held liable for false or misleading advertising of real estate available for sale. This liability will continue to attach to any such conduct that occurs on a broker's web site. Such conduct is prohibited by:

- the Federal Trade Commission Act,
- state consumer fraud acts,
- real estate license laws, and
- the common law of misrepresentation. n9

[3] Brokers or Agents May Not Advertise Property for Sale or Lease Without Permission of Owner or Owner's Agent

Real estate brokers and agents routinely display their own listed properties on their publicly accessible web sites. Real estate brokers are prohibited, however, under most real estate license laws and the Realtors(R) Code of Ethics from advertising property listed with another broker without the express permission of the other broker, or of the seller.

Because of this general rule, the National Association of Realtors(R) added a new provision to its Multiple Listing Policy in May of 2000 designed to enable brokers to advertise listings of other brokers on publicly accessible web sites. This policy states that, unless a broker has expressly withheld such consent, a broker's submission of a listing to a Multiple Listing Service that is owned and operated by an association of Realtors(R) constitutes the broker's implied consent to allow other participants in the Service to display the broker's listing on the other brokers' publicly accessible web sites.

The listing broker may, however, "opt out" of the Internet display of the broker's listings, either on a company-wide or listing-by-listing basis. If the listing broker elects to "opt out" on a company-wide basis, then that broker may not display the listings of other brokers on the broker's web site. The National Association of Realtors'(R) policy on Internet display of listing information is clearly intended to enable Realtors(R) to serve the increasing number of home buyers who use the Internet to research available properties for sale before they actually contact a brokerage company. The National Association of Realtors(R) Internet display policy supplies the consent of the listing broker, which is required by law to enable a broker to advertise another broker's listing. The value to home buyers of a broker's web site that displays all of the listings in the local Multiple Listing Service is greatly enhanced over a site that only displays the broker's own listings.

[4] Laws of Defamation and Invasion of Privacy Apply to Internet Communications

The use of the Internet to disseminate information that is defamatory or invades an individual's personal privacy is just as actionable as if the offending material were disseminated in any other medium.

[5] Intellectual Property Rights Can Be Infringed on the Internet

In *Religious Technology Center v. Lerma* n10 the court granted summary judgment in favor of the Church of Scientology whose copyrighted texts were posted by an infringer on the Internet. Courts have also held that the manner in which real estate data is displayed in Multiple Listing Service compilations, as well as certain narrative material in

the compilation, is protected under the Federal Copyright Act, and persons who copy a Multiple Listing Service's compilation infringe upon the Service's copyright rights. n11

An increasing number of Multiple Listing Services are utilizing Internet-accessible database management software to deliver multiple listing services to their real estate broker participants. Brokers contact the Service's address on the Internet and enter a user ID and password to gain access to the Service database. Accessing the Multiple Listing Service database via a browser and an Internet Service Provider (ISP) is significantly less expensive than utilizing direct "dial up" telephone connections to a mainframe computer. The accessibility of the Multiple Listing Service database on the Internet, however, requires Multiple Listing Services to take additional measures to protect their copyright and other intellectual property rights in their real estate databases. Many Multiple Listing Services require their participants to sign separate participation agreements that include terms that specifically acknowledge the Service's intellectual property rights in the Service database compilation. An increasing number of Multiple Listing Services also require computer vendors and consultants who construct and manage brokers' and agents' web sites and internal data management systems to sign license agreements that establish limitations on the consultants' access to the Service database.

The Internet can also be a vehicle through which a real estate broker's trademark rights can be infringed. This is illustrated by the case of *Edina Realty, Inc. v. The MLSOnline.com*. n12 The plaintiff, Edina Realty, Inc., is a large real estate brokerage firm headquartered in Minneapolis, Minnesota. The defendant operated a website at themlsonline.com at which it generated potential purchasers of Minneapolis residential real estate who were serviced by the defendants' licensed agents. Edina Realty received a federal trademark registration for its name, "Edina Realty" in mid 2002. Edina invested considerable resources in promoting its trade name and operated its own website at edinarealty.com. The defendant purchased Edina's trademark "Edina Realty" as a keyword from Google and Yahoo. The defendant also inserted "Edina Realty" into the meta tags on its own website. As a result of these two actions, if users of these search engines search for the term "Edina Realty" they will receive search results that include a "sponsored link" to the defendant's site at the top of the search results page. Edina's site is listed below the sponsored links. The defendant's site is also shown further down the search results list. According to the Google and Yahoo statistics, users clicked on the defendant's link nearly forty percent of the time a search for "Edina Realty" was conducted. Edina sent the defendant a letter demanding that it cease and desist from using Edina's trademark as a purchased keyword or as a meta tag. When the defendant refused, Edina sued the defendant for trademark infringement and various unfair competition violations. After discovery the parties filed cross motions for summary judgment. The court denied Edina's motion for summary judgment on its trademark infringement claims holding that there were disputed issues of material fact on the likelihood that consumers are, or will be, confused by the appearance of a link to the defendant's website in the search results returned to a consumer who searches for the term "Edina Realty."

The court also denied the defendant's motion for summary judgment. The defendant contended that it was entitled to the defense of "nominative fair use." Nominative fair use is available as a defense to a trademark infringement action when the defendant can show that it used the plaintiff's mark as a means of describing its own goods or services. In this case, the defendant contended that it was making a "fair use" of the plaintiff's mark because it displayed Edina Realty listings on its website by reason of its participation in the local multiple listing service's IDX program. The court declined to find that the defendant's use of the Edina mark was nominative fair use as a matter of law. The court noted that the defendant was not required to use the Edina trade mark to describe the services available at its website. It could just as easily have stated that it displays "real estate listings from all firms in the Twin Cities." The court also found that the defendant could have purchased search terms that referred to "Twin Cities real estate" generally, as opposed to Edina Realty specifically. As a result the court rejected the defendant's nominative fair use defense to plaintiff's trademark infringement claim. The court did, however, grant the defendant's summary judgment motion on Edina's trademark dilution claim. The court noted that a trademark dilution claim requires proof that the plaintiff's mark was "famous" and that the defendant used the mark in a manner that diluted the distinctive quality of the plaintiff's mark by causing consumers to associate plaintiff's mark with the goods or services of other suppliers. The court found that Edina's mark was "famous" but that Edina had not produced any evidence that the defendant had used Edina's mark in a manner that

reduced its effectiveness as an indicator of real estate brokerage services provided by Edina. The *Edina* case shows that a real estate broker's Internet marketing practices can be the basis for trademark infringement claims, especially when one broker attempts to use another broker's trade name as a means to attract Internet traffic. The *Edina* case serves as a warning that the use of another broker's mark will not be excused simply because the broker operates an IDX site on which listings of the other broker appear.

After the *Edina* case was decided, the Second Circuit court of appeals in *Rescuecom Corp. v. Google, Inc.* n13 considered whether Google committed trademark infringement by offering the to sell other companies' trademarks as part of its "AdWords" and "Keyword Suggestion Tool." As part of its paid search advertising program, Google offered "keywords" for sale to potential advertisers. Under the Google "AdWord" program, if a company purchased a "keyword" from Google, then whenever a consumer typed that word into the Google search engine, the name of the purchaser's company and a hypertext link to the purchaser's website would appear at the top of the search results presented to the consumer. Through its "Keyword Suggestion Tool," Google counseled potential advertisers on the keywords that would be most appropriate for them to purchase based on the nature of their business. Often Google would suggest that a company purchase as keywords the trademarks of the company's competitors. Rescuecom was in the business of franchising computer servicing and sales companies. Rescuecom had federally registered its name as a trademark. Google in turn sold the Rescuecom trademark to a Rescuecom competitor, and, as a result, the competitor's name and website link appeared at the top of the search results when a person typed "Rescuecom" into the Google search engine. Rescuecom sued Google for trademark infringement in violation of the federal Lanham Act.

The district court dismissed Rescuecom's complaint for failure to state a cause of action under Rule 12(b)(6) of the Federal Rules of Civil Procedure. The district court interpreted the Second Circuit's previous decision in *1-800 Contacts v. WhatU.com, Inc.* n14 as holding that the use of trademark as a hidden website "metatag" was not a use of the trademark "in commerce", which is required element of a Lanham Act trademark infringement claim. The Second Circuit, however, distinguished its *1-800* decision and reversed and remanded the case to the district court. In *1-800*, the defendant provided software that computer users could download. The software, in turn, generated "pop up ads" for "contextually relevant" advertisers when ever a computer user typed a particular search term into a browser or visited a particular website. The "pop up ads" appeared in a completely separate browser window and were clearly branded in the name of the advertiser so as not to cause any confusion to the consumer concerning the source of the services or products being advertised in the pop up ad. Furthermore, the triggering event that caused the ad to "pop up" was not a company's trademark, but its website address. On these facts the Second Circuit held in *1-800* that the defendant did not use the plaintiff's trademarks "in commerce."

In *Rescuecom*, however, the Second Circuit noted that Google sold use of the plaintiff's trademark as a "keyword" component of its AdWord program, and through its Keyword Suggestion Tool, it affirmatively counseled potential keyword purchasers to purchase as keywords the trademarks of their competitors. The court concluded that this use of company trademarks was materially different that the lack of use in *1-800*. Accordingly, the court held that *Rescuecom* sufficiently alleged that Google had used the plaintiff's trademarks "in commerce" to satisfy the threshold requirement of the Lanham Act. The court further held that the plaintiff sufficiently alleged that the manner in which Google displayed the names and websites of competitors who purchased *Rescuecom*'s trademark as a keyword created consumer confusion concerning whether the competitor's site was in fact operated by, or affiliated with, *Rescuecom*.

The lesson of the Second Circuit's *Rescuecom* decision, as well as the *Edina*, is that use of registered trademarks as website "metatags" for the purpose of redirecting internet users searching for the trademark owner's site to another site can lead to infringement liability under the Lanham Act.

[6] Operators of Web Sites Are Not Vicariously Liable for Defamation or Copyright Infringement Unless Operators Actively Control Content on Site

In *Religious Technology Center v. Netcom On-Line Communications Services, Inc.* n15 the court rejected a copyright

infringement claim against a computer bulletin board operator whose bulletin board was used to post material that infringed upon the plaintiff's copyright. The court reached its conclusion because:

- there was not any evidence that the operator controlled the conduct of the infringer, and
- the operator did not receive any economic benefit from the infringement.

To clarify a web site operator's vicarious liability for copyright infringement that might occur on the operator's web site, the United States Congress passed in 1999 the Digital Millennium Copyright Act (DMCA). n16 Section 512(c) of the DCMA contains a "safe harbor" for web site operators from damage liability for copyright infringement, provided that the web site operator did not have any actual knowledge of the infringing nature of the material posted to the site by a web site user. To take advantage of the "safe harbor," web site operators must identify a designated agent that aggrieved copyright owners may contact if they believe infringement is occurring on the site. The operator may remove the allegedly infringing material pending an investigation of the merits of the copyright owner's claims. If the terms of the "safe harbor" are met, the web site operator is not vicariously liable for any monetary damages arising from copyright infringement that occurs on the site.

A court defined the limits on the "safe harbor" provision of the Digital Millennium Copyright Act (DCMA) in *Perfect 10, Inc. v Cybernet Ventures, Inc.* n17 In this case, the defendant operated an age verification "adult check" system that was intended to ensure that visitors to adult web sites were in fact over the legal age for permissible access to such sites. Websites using the defendant's services inserted script into the code for their sites that directed first-time visitors to the defendant's site from which the defendant sold the visitors an access code that granted the visitors free access for a limited period of time to the adult websites that participated in the defendant's service.

As a condition of participation in the defendant's service, the defendant required website operators to submit the content of their sites to defendant for review to determine that the content is appropriate and not illegal. The defendant also published "reviews" of the participating websites to the defendant's subscribers. The defendant, however, does not procure any of the images or other content that appears on its participants' websites. Each site is operated by an independent third party who is responsible for procuring content and advertising its site.

The plaintiff published a magazine and operated a website containing photographs of nude women in which it owned the copyrights. The plaintiff sued the defendant for contributory and vicarious copyright infringement liability when it discovered that the websites that participated in the defendant's service contained over 10,000 images in which the plaintiff held the copyright. The court held that the plaintiff was likely to prevail on its claim, and the defendant was not likely to be entitled to the "safe harbor" of the DMCA because

- (1) the defendant failed to adopt any policy to permit copyright holders to pursue allegations of copyright infringement occurring on the participants' sites, or to deter repeat infringers;
- (2) the defendant received a financial benefit derived from the infringing conduct of the sites that participated in the defendant's service; and
- (3) the defendant exercised a degree of control over the content of sites that participated in defendant's service through its evaluation and review process.

In a later decision in *Corbis Corporation v. Amazon.com, Inc.*, n18 Amazon.com, Inc. was found to be entitled to protection from the "safe harbor" provision of the DMCA when copies of infringing photographs were sold on Amazon's website. At its web site, Amazon permits unaffiliated third parties to sell products through its "zShops" program. Amazon charges a fee to sellers to create "listings" at the "zShop" page. Amazon's agreement with vendors using its "zShops" program includes a provision in which the vendors agree not to sell any material that infringes upon

another party's intellectual property rights. According to its procedures, if Amazon receives notice that a product on its site is infringing another's intellectual property rights, Amazon cancels the listing of the alleged infringer. When the plaintiff discovered photographs for sale on the Amazon site for which the plaintiff claimed a copyright, it commenced suit against Amazon without first informing Amazon of the existence of the allegedly infringing material on the Amazon site. Upon receipt of the plaintiff's lawsuit, Amazon cancelled the listings of the vendors who were promoting the allegedly infringing material. On Amazon's motion for summary judgment, the court dismissed Amazon from the lawsuit on the grounds that it was entitled to the protection of the DMCA "safe harbor."

Courts have also held that the DCMA does not preempt other defenses that may be available to an Internet Service Provider (ISP) alleged to have engaged in copyright infringement. In *CoStar Group, Inc., et al, v. LoopNet, Inc.* n19 the court held that the defendant was not liable for copyright infringement when third parties posted on its site infringing photographs of commercial real estate properties. The court found that the defendant, which operated a listing service for commercial real estate, was not liable for copyright infringement based upon the acts of third parties, even though the defendant was entirely "passive" in its handling of the infringing material. The defendant did screen material posted on its site for obvious infringements or material that did not relate to the properties listed for sale or lease. When alerted by the plaintiff of the existence on the site of the infringing photographs, the defendant deleted the material from its site. The court held there was not sufficient "volitional" conduct by the defendant to hold the defendant liable for direct copyright infringement. The decision does not, however, address the defendant's liability for contributory or vicarious copyright infringement based upon knowledge of the infringing material and the defendant's financial interest in the illegal copying.

FOOTNOTES:

(n1)Footnote 1. 47 U.S.C. §230

(n2)Footnote 2. 519 F.3d 666 (7th Cir. 2008) .

(n3)Footnote 3. 42 U.S.C. § 3604(c).

(n4)Footnote 4. See *Ragin v. New York Times Co.*, 923 F.2d 995 (2d Cir. 1991) ; *Mayers v. Ridley*, 465 F.2d 630 (D.C.Cir. 1972) .

(n5)Footnote 5. 489 F.3d 921 (9th Cir. 2008) .

(n6)Footnote 6. Case No. 07-cv-286 (D.N.H., March 27, 2008).

(n7)Footnote 7. 47 U.S.C. § 230(e)(2).

(n8)Footnote 8. 15 U.S.C. § 1125(a).

(n9)Footnote 9. As discussed above, "false advertising" can also be a basis for liability under Section 43(a) of the Lanham Act. See 15 U.S.C. §1125(a). Additionally, the Communications Decency Act limits any immunity for such claims available to "interactive computer services" under Section 230 of that Act. See 47 U.S.C. § 230(e)(2).

(n10)Footnote 10. *Religious Technology Center v. Lerma*, No. 97-16160; 98-16146, 1999 U.S. App. LEXIS 11828 (E.D. Va. 1996).

(n11)Footnote 11. See *Montgomery County Ass'n of Realtors(R) v. Realty Photo Master Corp.*, 878 F. Supp. 804 (D. Md. 1995).

(n12)Footnote 12. *Edina Realty, Inc. v. The MLSOnline.com*, Civ. No. 04-4371 (JRT/FLN) (D. Minn., filed March 20, 2006).

(n13)Footnote 13. *562 F.3d 123(2d Cir. 2009)* .

(n14)Footnote 14. *414 F.3d 400 (2d Cir. 2005)* .

(n15)Footnote 15. *Religious Technology Center v. Netcom On-Line Communications Services, Inc.*, 907 F. Supp. 1361 (N.D. Cal. 1995).

(n16)Footnote 16. *17 U.S.C. § 512*.

(n17)Footnote 17. *213 F. Supp. 2d 1146 (C.D. Cal. 2002)* .

(n18)Footnote 18. *351 F. Supp. 2d 1090 (W.D. Wash. 2004)* .

(n19)Footnote 19. No. 03-1911 (4th Circuit, June 21, 2004).

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157 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 10 The Impact of Electronic Commerce on the Real Estate Brokerage Business *

10A-10 Real Estate Brokerage Law and Practice § 10.04

§ 10.04 Who Owns Real Estate Data Gathered by Real Estate Agents and Posted on the Internet?

[1] Raw Facts Are Not "Owned" by Anyone

Confusion continues among real estate brokers and Multiple Listing Service operators over the "ownership" of the data about real property listed for sale, or that has been sold, that is contained in the Service's database compilation. This debate has its origin in the United States Supreme Court's decision in *Feist Publications v. Rural Telephone Service Co.* n1 In *Feist*, the Supreme Court held that a telephone book "white pages" that contained an alphabetical list of names, addresses, and telephone numbers is not entitled to copyright protection. According to the Court, the Copyright Clause of the Constitution mandates that only works that demonstrate "creativity" in the expression of an idea or concept are entitled to copyright protection. The alphabetical arrangement of names, together with addresses and telephone numbers, was too obvious and devoid of creativity to rise to the level of an "original" work entitled to copyright protection.

As a result of *Feist*, a person who compiles data cannot claim copyright rights in the database compilation simply by reason of having expended the effort to create the compilation in the first instance. The Supreme Court in *Feist* expressly rejected the "sweat of the brow" as a basis for copyright acquisition. Hence, the mere act of compiling facts into a database compilation does not confer any copyright right in the compiler in the raw facts that are contained in the database compilation. Nor does the compiler enjoy any copyright protection in the database compilation if the manner in which the data is arranged and displayed is devoid of a minimal degree of creativity or originality.

The *Feist* decision makes clear that the data about properties for sale, or that have been sold, contained in a Multiple Listing Service database compilation is not subject to copyright protection under any circumstances. Accordingly, real estate data, per se, is not "owned" in a proprietary sense by anyone, including the listing broker, or the property owner. This is not to say, however, that listing brokers or Multiple Listing Services do not have any control over access to the data contained in the Service's database, or over the uses to which the database compilation shall be put by those persons who are granted access to it.

For example, certain components of the content contained in a multiple listing service database are, in and of themselves, "works" of creativity, and therefore separately copyrightable. One of these "works" is any image or photograph of the listed property. Photographs or videos that depict a property are defined as a copyrightable work in

the federal Copyright Act. n2 The copyright in the photograph or image is owned initially by the photographer who took the photograph or video. Most multiple listing service rules and regulations provide that rights to the photographs or images submitted by a multiple listing service participant are conveyed to the multiple listing service.

The case of *Dawes-Ordonez v. Realtors Association of Greater Fort Lauderdale*, n2.1 addresses a multiple listing services rights to redisplay property photos submitted on listed property in the event the property is subsequently relisted with another broker. In *Dawes-Ordonez*, a listing agent hired the plaintiff photographer to photograph the agent's listed property. The engagement agreement between the agent and the photographer stated that the photographs could be used for a variety of marketing purposes, including submission to the multiple listing service to which the agent subscribed. The agent entered the photographs into the multiple listing service database, with the full knowledge and consent of the photographer, although the photographs did not include a copyright notice from the photographer. The listing agent then sold the property.

Some time later the property was relisted for sale by another agent who subscribed to the same multiple listing service. The new listing agent had access through the multiple listing service's historical database to the photographs taken by the plaintiff. The new listing agent included the photographs taken by the plaintiff when she entered data about the property as part of the new listing. When the plaintiff discovered that the photographs have been included as part of the subsequent listing of the property she notified the new listing agent that she owned the copyrights to the photographs and that the agent did not have permission to display the photographs as part of the new listing filed with the multiple listing service. The new listing agent promptly removed the photographs from the listing data about the property in the multiple listing service's active database. The plaintiff did not at that time notify the multiple listing service of her copyright claims to the photographs.

Notwithstanding the new listing agent's removal of the photographs from the property listing data, the plaintiff photographer filed a copyright infringement claim against the new listing agent, her brokerage firm, and the multiple listing service. In response to the plaintiff's complaint, the multiple listing service filed a motion for summary judgment contending that it did not infringe upon the plaintiff's copyrights, and, alternatively, that the plaintiff granted the multiple listing service an implied license to use the plaintiff's photographs and make them available to its participants, including the new listing agent for their use on marketing listed property.

The court granted the multiple listing service's motion holding that the plaintiff had granted an implied license to the multiple listing service to include the photographs in the multiple listing service's database. The court found that a copyright holder grants a implied license to use a copyrighted work when a party (1) creates work at another's request, (2) delivers the work to the other party, and (3) intends that the other party copy and distribute the work. The court then noted that the original listing agent contracted with the plaintiff to take photographs of the property. The plaintiff took the photographs and delivered them to the original listing agent. The plaintiff also knew that the original listing agent would disseminate the photographs in the course of marketing the property, including submitting the photographs to the multiple listing service database. The court held that the plaintiff's delivery of the photographs to the original listing agent constituted constructive delivery to the multiple listing service. The court concluded that the multiple listing service's use of the plaintiff's photographs were within the scope of the implied license that the plaintiff granted to the multiple listing service.

The court also granted summary judgment to the multiple listing service on the plaintiff's claim the multiple listing service had engaged in "contributory infringement." The court noted that a party is liable for contributory infringement if it intentionally induces, or contributes to, the infringing conduct of another person. The court found that the plaintiff had not introduced any evidence to show that the multiple listing service had intentionally induced anyone to infringe upon the plaintiff's copyright rights.

While this court found that on the record before it that the plaintiff photographer had granted the multiple listing service an implied license to disseminate the photographer's works, the case still underscores the importance of establishing a

clear "chain of title" to all copyrightable works that are submitted to an multiple listing service database, and that either an assignment or a license has been granted by the original copyright owner to use the works for the purposes intended by the multiple listing service.

Another creative work that is a typical component of the property records in a multiple listing service database compilation is the "remarks" written by the listing agent describing the positive features of the property. These "remarks" are the creative work of the agent who composed them, and the agent is the "author" who owns the copyright right in the "remarks" unless and until those rights have been assigned or conveyed through operation of the multiple listing service's rules and regulations or other participation agreement.

There is also the possibility that the "list price" at which a property is offered for sale is a creative work. This argument is based on cases that have found that "blue book" prices of automobiles are "works" that are copyrightable. n3 The "blue book" case found that the automobile values published in the "blue book" were the result of the author's research and were offered as opinions of fair market value based upon the condition and age of the vehicle. An analogy is to a real estate appraisal report. There is little doubt that an appraiser's report and opinion of value is a "work" in which the appraiser who created the report has a copyright right. n4 A list price, however, is not an appraisal. It is simply the price that the seller is willing to accept in return for a deed to the property. While some "analysis" may have been undertaken to arrive at the listing price, the list price is no different than the price on the windshield of a car on a used car lot. In this respect, it is likely that a "list price" will be considered to be a "fact" not any different from the number of bedrooms and bathrooms in a house, which is not entitled to copyright protection under the *Feist* decision. Once the property is sold, the actual sales price is a "fact" that is not copyrightable.

[2] Ownership of "Data" Is Separate from Ownership of Real Estate or Ownership of a Listing Agreement

While the listing broker "owns" the listing, and the owner "owns" the house, neither "own" factual data about the house, even if both have gathered some or all of the data. A person who compiles, or even discovers, a "fact" does not acquire ownership of the "fact" simply by being the first to do so. The Supreme Court in *Feist* made clear that "creativity," not effort, is the touchstone of copyright entitlement. Nevertheless both the listing broker and the owner have the right to control how information about the owner's property will be used for the purpose of marketing the property. These rights derive from the contractual relationship between the broker and the owner.

A listing broker who secures an exclusive listing agreement from a property owner owns the contractual right to earn compensation from the owner if the broker's efforts to market the property to a ready, willing, and able buyer n5 are successful. The exclusive listing agreement also confers upon the listing broker the exclusive right to determine the manner and methods through which the property will be marketed on the owner's behalf, subject only to the owner's power to limit the scope of that right. To this extent the listing broker controls how the data about the listing that is contained in the Multiple Listing Service's database compilation will be used by the Service, or by other brokers who utilize the Service, for the purpose of marketing the property to potential buyers.

The listing broker's right to control the use of information about the property for marketing purposes is, nevertheless, subordinate to the instructions of the owner. As the broker's principal, the owner always has the power to set limitations on the marketing methods that the broker may employ on the owner's behalf. This power to control the broker's marketing methods includes the power to control how the broker uses information about the owner's property in the course of the broker's marketing efforts.

But the power to control the manner in which information about the property will be used for marketing purposes does not include the power to control the use of information about the property for all purposes. To the extent the Multiple Listing Service makes the non-copyrightable data components available for purposes other than marketing of the listed property, the Service alone has the right to control access to the real estate data contained in the Service's compilation. Among these "non-marketing" purposes for which the Service's database can be put include:

- property valuations,
- real estate research and consulting, and
- lender portfolio risk assessments.

A Multiple Listing Service that chooses to license access to the non-copyrighable components of its database compilation to third parties for such non-marketing purposes need not secure the consent of listing brokers, or property owners, before entering into such licensing agreements. This is true because no one owns the factual data, and the broker's and owner's right to control the use of the property data is limited solely to efforts to sell the listed property. As the owner of the database compilation, however, the Multiple Listing Service has the power to control access to the compilation, even if the Service does not "own" the individual data in the compilation.

A useful analogy is to water distribution companies. Water exists naturally in the environment. No one "owns" the chemical combination of hydrogen and oxygen atoms commonly known as water. On the other hand, companies exist that bottle and distribute water. These companies extract the water from naturally occurring aquifers or other sources, treat it, bottle it, and distribute it to consumers. These companies have the right to be paid for their efforts to bottle and distribute an otherwise naturally occurring chemical compound. Real estate data is the functional equivalent of water. The data are facts that occur naturally and are not owned by anyone. But companies, such as Multiple Listing Services, may compile the facts into a common database and control and sell access to the data that is maintained in their database. But these Multiple Listing Services do not own the data to the extent that they can prevent others from compiling the same facts into a different database compilation.

It should be noted that state law may affect the resolution of some disputes involving property subject to a copyright. In *re Valdez* n5.1 involved a real estate salesman who alleged that he held the copyright to certain photographs of real estate which he had listed with the broker prior to termination of his association with that broker. While considering federal copyright law, the court also considered N.Y. Comp. Codes R. & Regs. tit. 19, § 175.14 which provided that:

A real estate salesman shall, upon termination of his association with a real estate broker, forthwith turn over to such broker any and all listing information obtained during his association whether such information was originally given to him by the broker or copied from the records of such broker or acquired by the salesman during his association.

The court found that the photographs were listing information and that the salesman was required to relinquish ownership of the photographs when he was required to turn them over to the broker upon his termination. This court also found that this regulation was not preempted by the Copyright Act since there was no inconsistency between the Copyright Act and state law. n5.2

[3] Database Compilation of Facts Can Be Copyrighted If "Creativity" Is Shown in Selection and Categorization of Data

Although the Supreme Court in *Feist* held that a database arranged alphabetically cannot be protected under the Federal Copyright Act, the Court did state that the degree of creativity that must be shown to confer a copyright on the creator of a work is quite minimal. Federal courts of appeals since *Feist* have sustained the copyright claims of database compilers when the compiler has shown a degree of creativity in the manner in which the data in the database is arranged and displayed to database users. n6

The copyright protection afforded to a compilation, however, is limited to the "original" components of the compilation, and not to the purely factual data in the compilation or to methods of arranging the data in the compilation that are

devoid of the requisite creativity for copyright protection. These distinctions between the factual data and "originality" are illustrated in the decision of the Eleventh Circuit Court of Appeals in *BellSouth Advertising & Publishing Corp. v. Donnelley Information Publishing, Inc.* n7

In *BellSouth*, Donnelley decided to compete with BellSouth in the marketing of Yellow Pages telephone directories in the Greater Miami area. To create its competing Yellow Pages directory, Donnelley employees extracted from BellSouth's copyrighted directory the names, addresses, telephone numbers, and business types of the companies listed in the directory. From this data that was admittedly "copied" from the BellSouth copyrighted directory, Donnelley created "contact lists" for its sales staff. Donnelley also classified the businesses identified in the BellSouth directory according to a system of headings that Donnelley independently created. There were, however, numerous overlapping business headings in the Donnelley and BellSouth directories.

In an *en banc* decision, the Eleventh Circuit reversed the district court's finding that Donnelley had infringed upon BellSouth's copyright in its Yellow Pages directory. The Eleventh Circuit held that the data extracted by Donnelley from the BellSouth directory was purely factual data, which was not entitled to any copyright protection. The Eleventh Circuit further held that any similarity between the business headings in the Donnelley and BellSouth directories was not the result of Donnelley's copying of the protected elements of the BellSouth directory. Rather, the overlapping headings were the result of both companies' use of certain headings that were patently obvious. BellSouth's use of patently obvious business headings was not a component of the copyright protection afforded to BellSouth's directory. Therefore, BellSouth's copyright in its own directory did not permit BellSouth to prohibit Donnelley from duplicating such obvious headings from BellSouth's directory, together with the other factual information Donnelley extracted about the names, addresses, and telephone numbers of the businesses listed in the BellSouth directory. So long as Donnelley did not copy any components of the BellSouth directory that reflected BellSouth's original works, Donnelley was free to use the BellSouth directory to construct its own competing directory. The *BellSouth* decision illustrates that the degree of protection afforded by the Federal Copyright Act to database compilations is in fact quite minimal.

[4] Extent of Copyright Protection

To claim intellectual property rights in its real estate database compilation, the Multiple Listing Service must "add value" to the data by arranging and categorizing the data in a "creative" manner. While copyright protection is available for Multiple Listing Service database compilations that demonstrate originality in the arrangement and presentation of the data in the compilation, this protection does not protect the Service from others who may extract the raw data from the Service and recompile the data into another compilation with a distinctly different method of data presentation.

This limitation on the scope of a multiple listing service's copyright protection in its database compilation is illustrated by the case of *American Massage Therapy Association v. Maxwell Petersen Associates, Inc.* n8 In this case, the American Massage Therapy Association maintained and distributed a directory of its members. The directory arranged the members' names and addresses by geographic area. The information included in the directory about a particular therapist included the therapist's name, address, telephone number, membership category, and the type of therapy performed. The directory also had a "membership category" section that listed each member by name and category of membership, and a cross reference to the page of the geographical section at which the member's address and telephone was listed.

Maxwell Petersen Associates, Inc. published a magazine targeted at massage therapists, and marketed other goods and services to the massage therapy profession. The Maxwell Petersen employee responsible for maintaining its mailing list procured a copy of the American Massage Therapy Association's directory. Using the directory, the employee extracted over 17,000 names and addresses of massage therapists and added them to the Maxwell Petersen mailing list. Maxwell Petersen used its mailing list for its own purposes, and also sold and rented its list to other companies.

When the Association learned about the use to which Maxwell Petersen put its directory, the Association filed a suit

against Maxwell Petersen alleging, among other things, that Maxwell Petersen violated the Association's copyright in its directory. On the parties' cross motions for summary judgment, the court granted summary judgment to Maxwell Petersen. Relying on the Supreme Court's decision in *Feist Publications v. Rural Telephone Service Company*,ⁿ⁹ the court held that copying names and addresses from the Association directory was not copyright infringement because the Association could not claim copyright protection for the names and addresses of its members, which were "raw facts" not capable of being copyrighted. The court concluded that the raw facts did not become "original" for the purposes of copyright protection simply because the facts may have been arranged in an original manner. The original arrangement may be protected by copyright, but the facts themselves are not.

The *American Massage Therapy Association* case underscores the limited protection that the copyright laws afford to databases containing raw facts, such as real estate multiple listing services. So long as a third party does not copy the manner in which the raw facts are arranged by the database compiler, the compiler cannot rely on the copyright laws to deter others from copying the raw facts contained in the database.

Extending the principle of the *American Massage Therapy Association* is *Nautical Solutions Marketing, Inc. v. Boats.com*ⁿ¹⁰ decided in 2004 by the federal district court for the Middle District of Florida. In *Nautical Solutions*, Boats.com operated a yacht listing service at a website known as Yachtworld.com. Yacht brokers could post their listed yachts on the Yachtworld website. Nautical Solutions created a website known as Yachtbroker.com that competed with the Boats.com site. Both sites included factual information about the yachts for sale, including list price, manufacturer, and features of each yacht.

Nautical Solutions employed Internet "spider" software that searched the World Wide Web for websites containing information about yachts for sale. The "spider" would copy the webpage, extract facts about the yachts on the page, and discard the copied page, all in a matter of seconds. The facts about the yacht were then inserted into the Nautical Solutions Yachtbroker.com website. Nautical Solutions also offered on its site a "valet service" through which it would move yacht listing information from one site to another at the direction of the yacht owner.

Nautical Solutions sued Boats.com for defamation and for a declaration that its use of its "spider" did not violate any copyright rights of Boats.com. After finding Boats.com liable for defaming Nautical Solutions business, the court granted Nautical Solutions petition for a declaratory judgment that its business did not infringe on any of Boats.com's copyright rights. The court found, based on *Feist*, that "facts" as such were not entitled to any copyright protection. The court concluded that the "momentary" copying of the Boats.com webpage, which might be copyrightable, was a "fair use" and not an actionable infringement. The court applied the same rationale to conclude that the "valet service" was not an act of infringement to the extent it extracted factual information from the Boats.com site.

The court also rejected Boats.com's argument that it had a copyrightable interest in the headings under which it organized the facts about a yacht. The court concluded that the Boats.com headings were too obvious to qualify for copyright protection under the *Feist* case. The court also rejected Boats.com's contention that Nautical Solutions had copied the "look and feel" of the Boats.com site. The court noted that the Boats.com and the Nautical Solutions sites had very different appearances. Because the differences in the sites predominated over any similarities, the court concluded that Boats.com's "look and feel" argument did not have any merit.

The court also rejected Boats.com's final argument that Nautical Solutions had infringed Boats.com's copyright in its "compilation" of yacht data. The court characterized the copyright right in a "compilation" as a "weak" copyright right. For an owner of copyright in a compilation to establish infringement, it would have to prove that the infringer's compilation was an identical copy of the original compiler's work. Since Nautical Solutions did not present the data on its site in the same manner as the Boats.com site, there was not any infringement of the Boats.com "compilation" copyright.

The Eleventh Circuit substantially limited the holding of *Nautical Solutions* in *BUC International Corp. v. International*

Yacht Council Limited.ⁿ¹¹ In *BUC*, the plaintiff published a used boat price guide listing used boats and yachts for sale along with relevant market values. In the mid-1980s the plaintiff automated the guide and promoted it as a centralized directory of yacht listings for use by yacht brokers. The plaintiff's directory, in effect, acted as a multiple listing service for yachts. Participating brokers signed a license agreement with the plaintiff pursuant to which they were provided with a password that enabled them to access, search, view, print and copy the listings contained in the plaintiff's database. The plaintiff also developed a standardized listing format for the information about a particular yacht. Participating brokers were to use the plaintiff's standardized format unless some other arrangement would better portray the yacht being offered for sale. Over ninety percent of the listings in the plaintiff's database were presented in the standardized format. In 1997 the plaintiff registered his copyright claims in the "compilation, selection and organization" of his yacht listing database, as well as accompanying text. The plaintiff also placed a copyright notice on each yacht listing appearing in the database.

In June of 2000, the defendant Florida Yacht Brokers Association formed the defendant International Yacht Council Limited for the purpose of creating an online multiple listing service for yachts listings. In early 2001 the defendant engaged the co-defendant software developer, MLS Solutions, Inc., to assist in the creation of its MLS. Unlike the plaintiff's MLS, the Yacht Council's MLS had a private section limited to yacht brokers, and a public section accessible to potential yacht purchasers. When the Yacht Council launched its MLS, it solicited brokers to send their yacht listings to MLS Solutions by fax or email. Most yacht brokers were also subscribers to the plaintiff's system, and they simply copied their yacht listings as they appeared in plaintiff's database and sent them to MLS Solutions. By early 2002, the Yacht Council database contained 4,100 listings of which 2,700 were derived from the plaintiff's database. Others were also acquired from plaintiff's database by MLS Solutions' employees who acquired passwords to the plaintiff's MLS from plaintiff's participating brokers. Upon discovery of this practice, the plaintiff placed "markers" on the listings in its database to identify those listings if they appeared in the Yacht Council's database. The plaintiff eventually identified 4,400 listings in the Yacht Council database that had originated from the plaintiff's database. The plaintiff sued the Yacht Council and MLS Solutions for copyright infringement in June of 2002, and secured a preliminary injunction prohibiting the defendants from "copying descriptive expressions" from the plaintiff's database, and ordering the removal of such copied listings from the Yacht Council database. The case was tried to a jury in March of 2004, after which the jury returned a verdict for the plaintiff and awarded the plaintiff \$1,598,278 in actual damages.

On appeal, the defendants contended that (1) the plaintiff's listings were not entitled to copyright protection on the ground that the plaintiff needed to register each individual listing to assert a copyright claim in such listing, (2) the plaintiff's listing database did not qualify as a "compilation" under the Copyright Act, and (3) the plaintiff's compilation could not be copyrighted because it lacked originality. Finding that the defendants had failed to preserve the first two arguments for appeal, the Eleventh Circuit then rejected the defendants' third argument.

The Eleventh Circuit cited the Supreme Court's *Feist* decision, and its own *Bell South* decision for the proposition that a compiler's "selection, arrangement and coordination" of data, if original, is protectable under the federal Copyright Act. On the issue of "originality" of the plaintiff's selection, arrangement and coordination of the data in its database, the court considered and rejected the defendants' argument that it was the brokers and not the plaintiff who were the "authors" of the compilation since they had the freedom to disregard the plaintiff's standardized format of data presentation. The Eleventh Circuit noted that only two percent of the listings in the plaintiff's database varied from the plaintiff's standardized format. The Eleventh Circuit then rejected the defendants' argument that the plaintiff's database compilation was not "original" because of the "merger doctrine" in which protectable creative expression is "merged" with non-protectable "ideas" if there is only one or two ways an idea can be expressed. The defendants argued that there are so few ways a yacht can be described that the plaintiff should not be accorded protection for its standardized format. The Eleventh Circuit determined that the "idea" that was excluded from copyright protection was the idea of creating a method of delivering relevant yacht information to brokers and not, as defendants argued, the idea of how to divide a yacht into features of interest to brokers and potential buyers. According to the Eleventh Circuit, to find for the defendants, it would have to conclude that there was only one meaningful way of presenting useful information about a yacht for sale. Rejecting the argument, the Eleventh Circuit cited the evidence in the record that before the plaintiff

created its MLS, the yacht listing data then available in print and elsewhere varied dramatically in the information presented and how it was arranged and coordinated.

The Eleventh Circuit then disposed of the defendants' third argument that the plaintiff's compilation lacked the minimal degree of creativity required for copyright protection. On this point the Eleventh Circuit again relied on the evidence that prior to plaintiff's offering of its MLS, the available data on yachts for sale was presented in a "hodge podge" fashion and that plaintiff's standardized format was a creative method of presenting the relevant information in a uniform and meaningful manner. The Eleventh Circuit then addressed and rejected the defendants' final argument that they should be awarded a new trial because the trial court instructed the jury that it could return a verdict for the plaintiff if the jury found "substantial similarities" between the listing formats of the plaintiff and the defendants, rather than "virtual identity" between the listing formats as held in the *Nautical Solutions* case. Notwithstanding its conclusion that the defendants had failed to preserve their objections to the trial court's jury instructions, the Eleventh Circuit found that "substantial similarity" is the proper standard for determining whether an infringing copy of the plaintiff's work had been made, citing as authority its *Bell South* decision and its later holding in *Warren Publishing, Inc. v. Microdos Data Corp.* n12 The *BUC* case is directly applicable to copyright protections available to real estate multiple listing services. While the *BUC* case should make it easier for multiple listing services to prevail on such claims, the *BUC* and *Nautical Solutions* cases underscore the limited nature of the copyright protection available to a multiple listing service for its real estate database compilation. For example, the *BUC* case does not extend protection to the "raw facts" in a multiple listing database. Therefore, the use of "spiders" to extract non-copyrightable data from these databases is a potential risk to the integrity of the databases for which the copyright laws do not provide meaningful protection.

A more recent case illustrating the extent of copyright protection for database compilations is *Tennessee Walking Horse Breeders' and Exhibitors' Association v. National Walking Horse Association*. n13 In this case, the Tennessee Walking Horse Breeders' and Exhibitors' Association (TWHBEA) created and maintained a registry through which owners of Tennessee walking horses could register the pedigrees of their horses. The TWHBEA published the registry in the form of a book, and also designed a "registration certificate" that was provided to each horse owner. TWHBEA filed copyright registration applications and received registration certificates for both the registry database and its registration certificate form. In 1998 the National Walking Horse Association (NHWHA) was organized and in 2004 the NHWA launched its own registry on its website. When it launched its registry, the NHWA invited horse owners to register their horses with the NHWA by tendering to the NHWA the owners' registration certificates issued by the TWHBEA. The NHWA issued registration certificates to horse owners who used its registry that were nearly identical in form and content to the certificates issued by the TWHBEA. The TWHBEA sued the NHWA for copyright and trademark infringement. The court granted summary judgment to the TWHBEA on its copyright infringement claim and held a bench trial on its trademark infringement claims. At the conclusion of the trial it awarded damages to the TWHBEA on its copyright infringement claim, but dismissed the TWHBEA's trademark infringement claims. The court acknowledged that under the Supreme Court's *Feist* decision, the TWHBEA could not claim any copyright rights in the factual information about a horse's parentage. The court concluded, however, that TWHBEA was entitled to copyright protection for the originality it exercised in deciding what horses to include in its registry and the choices about the types of horses that will be considered "pure bred" walking horses, and the markings and colorings associated with such horses. When NHWA copied into its registry the copyright-able components of the TWHBEA's registry and registration certificates, it infringed upon TWHBEA's copyright rights. The court enjoined NHWA from any further infringement of TWHBEA's copyrights and awarded TWHBEA statutory damages for NHWA's "willful" infringement.

The copyright protection that extends to the a database compiler's creativity in the selection, arrangement and coordination of the factual information contained in the database does not necessary extend to the format used to present the information. This is the holding of *Utopia Provider Systems, Inc. v. Pro-Med Clinical Systems, LLC*. n13.1 There, the plaintiff created a software program for the creation of electronic health records for treatments administered in hospital emergency rooms. The plaintiff's software consisted, in part, of charts and forms into which the emergency room physicians or staff would enter information about a patient's condition, diagnosis and treatment. The plaintiff licensed the rights to the defendant to market the plaintiff's software as part of the defendant's suite of products in return

for the payment of royalties. The defendant later developed an alternative software product that incorporated the same template forms used in the plaintiff's product. The plaintiff sued the defendant for copyright infringement. The district court granted the defendant's motion for summary judgment on the plaintiff's copyright infringement claim and the Eleventh Circuit affirmed. The Eleventh Circuit cited prior precedent under the Copyright Act holding that copyright protection does not extend to "blank forms which do not convey information or contain original pictorial expression." Examples of such unprotected forms are time cards, graph paper, account books, diaries, bank checks, scorecards, address books, report forms, or order forms. The Court determined that the templates incorporated in plaintiff's software that provided the format into which information about the patient would be entered by the emergency room physicians or staff were forms that in and of themselves did not contain any information or original expressions, and therefore were not entitled to copyright protection.

Other cases have discussed the extent to which the "fair use" doctrine protects the ability of web sites operators to use web indexing software or "robots" to make copies of material from web pages for other uses, including the operation of general and specialized "search engines." Two of these cases involve Google, Inc., which operates one of the most widely known and used Internet search engines at Google.com. In *Field v. Google Inc.*,ⁿ¹⁴ Field, an author who is also an attorney, created a website on which he posted various works of authorship. Using its "spider" software, Google indexed Field's site and displayed it in response to search inquiries using key words that matched words on Field's site. Google also "cached" the web pages from Field's site that it indexed. When Google, or any other search engine, "caches" a web page, it makes a literal copy of the page and stores the page on its server for archival purposes. When a Google user receives the results of an Internet search, the user can be linked to the indexed web page, or the user can open the cached page on Google's server, and view the page as it was indexed by the search engine spider. The cached page also highlights the user's search terms as they were found on the web page.

Field sued Google contending that Google's indexing and caching of his web page containing his copyrighted work infringed upon his copyright rights. Field sought statutory damages. Shortly after filing his initial complaint, Field posted fifty additional copyrighted works at his web site. He then amended his complaint to add the additional fifty claims of copyright infringement and sought statutory damages of \$2,500,000 or the maximum of \$50,000 in statutory damages for each of his copyrighted works.

The parties filed cross motions for summary judgment. The court granted Google's motion and denied Field's. The court noted that Google observed a standard protocol in use by all Internet search engines through which web page operators can block search engine spiders by entering certain codes into the web site meta tags. Web site operators can also enter meta tag codes that will allow the web pages to be indexed by Google, but not cached. Field testified that he was well aware of these techniques for blocking Google's search robots altogether, or only preventing Google from caching his web pages. Based on this testimony, the court found that Field had granted Google an "implied license" to index and cache the pages of his web page. The court held that if an owner of a copyrighted work knows of the copying of his work and has the power to stop the copying if he so chooses, the copyright owner has granted an implied license to copier.

The court also held that Google's indexing and caching of Field's web pages constituted a "fair use" of Field's copyright. The Copyright Act provides that persons can make "fair use" of others' copyrights without liability for copyright infringement.ⁿ¹⁵ In determining whether a use of a copyrighted work is a "fair use," courts are to consider (1) the purpose and character of the use; (2) the nature of the copyrighted work; (3) the amount and substantiality of the copied portion of the work in relation to the work as a whole; and (4) the effect of the copying on the potential market for the owner's copyrighted work. Applying these criteria, the court found that Google provided an enormously valuable service to Internet users in cataloguing and making accessible the huge array of information accessible on the Internet. Google's caching function is integral to Google's ability to perform this function in that it enables users to see a copy of the page of a web site as indexed by Google to determine the extent of any changes that may have been made to the page since Google last indexed it. The court also found that Google's cached pages did not significantly interfere with Field's ability to commercialize his works. Google takes several steps to ensure that its cached pages cannot substitute

for a visit to the actual web page it indexed. The court concluded that Google's copying and caching of Field's web page was a fair use of Field's copyright in his works contrasting the use to which Google was putting the cached pages with whatever commercial use Field was attempting to make of his works. The court further concluded that the fact that Google itself was a commercial, rather than a not-for-profit or charitable, enterprise did not undermine its holding that Google's use of Field's copyrighted works was a "fair use."

Another case in which Google was a party reached an opposite result on the issue of "fair use." In *Perfect 10 v. Google, Inc.*,ⁿ¹⁶ Perfect 10 published an adult-oriented magazine in which it displayed numerous copyrighted photographs. Infringing copies of these copyrighted photographs routinely appeared on other websites. Google introduced a function as part of its general search engine that enabled users to search the Internet for particular images, as opposed to text. Users of Google's "image search" function would receive search results in the form of "thumbnails" of images responsive to the searcher's request. A thumbnail was a low resolution granular version of the image that was not a meaningful substitute for the full scale image as it appeared on a web site indexed by the Google search engine. When a Google user received image search results the user could be linked to the web site on which the full scale image of the site could be viewed.

Perfect 10 sued Google for direct copyright infringement based upon its display of "thumbnails" of its copyrighted images, and for contributory infringement for linking users to infringing copies of its images appearing on unauthorized websites. Google asserted a "fair use" affirmative defense in response to Perfect 10's suit. When considering Google's fair use defense, the court noted that Perfect 10 offered a service of its own through which, for a fee, it would transmit "thumbnails" of its copyrighted images to a subscriber's cell phone. The court found that Google's image search directly competed with this commercialization by Perfect 10 of its copyrighted images. In this sense, Google's use was duplicative use of Perfect 10's images rather than a "transformative" use that would have qualified for the fair use defense. This factor was sufficient in the court's view to tip the balance of the fair use analysis to Perfect 10.

The court went on to find that Google was not liable for contributory infringement. The court held that Perfect 10 did not show that Google had specific knowledge that the images it returned to its users from non-Perfect 10 sites were in fact infringing upon Perfect 10's copyrights. Google may have had general knowledge that some of the images were infringing, but it did not have knowledge of the infringing nature of any given image.

The Ninth Circuit later affirmed in part and reversed in part the district court's holding.ⁿ¹⁷ The Ninth Circuit agreed with the district court that Google did not directly infringe upon Perfect 10's copyrights in the full-size version of its copyrighted photographs by "in line framing" of those images as they appeared on third-party web sites, but that Google did make a "copy" for copyright infringement purposes of the thumbnail versions of the Perfect 10 images that were stored on Google servers. The Ninth Circuit, however, reversed the district court, and held that Google was likely to prevail on its fair use defense with respect to the thumbnails of the Perfect 10 images. The Ninth Circuit concluded that Google's use of the thumbnails was sufficiently "transformative" in nature to outweigh any contention by Perfect 10 that the thumbnails reduced the economic value of Perfect 10's cell phone distribution of thumbnail images of its copyrighted photographs. The Ninth Circuit, however, reversed and remanded the district court's holding that Perfect 10 could not show that Google was liable for contributory infringement. The Ninth Circuit applied the Supreme Court's test for contributory infringement announced in *Metro-Goldwyn-Mayer Studios, Inc. v. Gronkster, Ltd.*ⁿ¹⁸ The Ninth Circuit held that Google could be liable for contributory infringement under the Supreme Court's *Gronkster* test if it had knowledge that its search engine was being used to enable infringement of Perfect 10's copyrights in its photographs and failed to take relatively simple steps to prevent the infringement. The Ninth Circuit concluded that the district court failed to resolve the factual disputes over the adequacy of Perfect 10's notices to Google of the use of its search engine to link users to infringing copies of Perfect 10's copyrighted photographs, and Google's response to those notices. The Ninth Circuit also held that the resolution of this factual dispute would determine the outcome of Google's argument on appeal that it was entitled to the protection of the safe harbor in the Digital Millennium Copyright Act.ⁿ¹⁹

The *Field* and *Perfect 10* cases have implications for a new group of companies that have entered the online real estate

industry, known as "vertical" search engines. Examples of these companies are Trulia, Inc. and PropSmart, Inc. These companies operate search engines that focus only on searching for real estate listing information found on publicly accessible websites, as opposed to "general" or "generic" search engines, such as those operated by Google, Yahoo, or AOL. These real estate vertical search engines use the same "robot" technology as Google or Yahoo. Using this technology, they index listing information that appears on the publicly accessible web sites of the listing broker. When a consumer uses a real estate vertical search engine, the search engine returns to the user indexed "snippets" of information about the listed property as it appears on the listing broker's website. These "snippets" of information also include a "thumbnail" of the listing image as it appears on the listing broker's site. Using the same search engine protocols that apply to Google or Yahoo search engines, a real estate broker can block the vertical search engine robots from searching the broker's site if the broker does not want its listings being made accessible to consumers who use the vertical search engines to locate properties of interest to them. The *Field* case in particular stands for the proposition that a broker will not likely succeed in a case of copyright infringement against a vertical search engine, since the broker has the ability on its own to prevent its site from being indexed. The broker's failure to block the search engine robots will likely be construed, as in *Field*, to constitute an implied license to the search engine operator to index and return information about the listing broker's listings to the search engine's users. The Ninth Circuit's holding in the *Perfect 10* case also confirms that courts will apply the fair use doctrine to any minimal copying of the listing broker's content that might occur to facilitate the operation of the search engine.

Website operators must still be cautious when accessing the sites of other operators using automated devices. In *Ticketmaster, L.L.C. v. RMG Technologies, Inc.*, n20 the court considered Ticketmaster's claims that RMG used automated devices to purchase event tickets using Ticketmaster's online ticket sales system in a manner that violated Ticketmaster's "terms of use" agreement, and therefore RMG is liable for breach of contract and infringement of Ticketmaster's copyright rights in its website. Ticketmaster sells tickets to sporting and entertainment events on its website. Ticketmaster adopted a policy that limits the number of tickets any individual user may purchase to any event. RMG created software that it markets to ticket brokers that is able to overcome Ticketmaster's security systems designed to distinguish between purchases made by actual individuals and those made by automated devices. By using the RMG software, ticket brokers can acquire large quantities of tickets to events promoted by Ticketmaster, all in violation of Ticketmaster's "terms of use agreement" that all users of its site must accept as a condition of making ticket purchases on the site. Upon filing its complaint, Ticketmaster sought a preliminary injunction to prevent RMG from permitting its software to be used to purchase tickets at the Ticketmaster site. The court granted Ticketmaster's preliminary injunction petition. On Ticketmaster's copyright infringement claim, the court noted that when a user views a webpage the user's computer makes a copy of the page on the random access memory (RAM) of the user's computer. According to the court, this "cache" of the webpage is a "copy" of the page for the purposes of the Copyright Act. The court further found that RMG had to have viewed, and therefore "copied" pages of the Ticketmaster site in order to create its automated tool that enables RMG users to circumvent the limits on purchases of Ticketmaster tickets. Ticketmaster argued, and the court agreed, that RMG's copying of the Ticketmaster webpages in violation of the authorization contained in the terms of use agreement constituted direct infringement of Ticketmaster's copyright rights.

The court then rejected RMG's contention that it was not aware of Ticketmaster's terms of use agreement, and that in any event, the agreement is too ambiguous to be enforced. The court cited sufficient evidence that RMG was well aware of Ticketmaster's terms of use agreement and found the terms of the agreement to be sufficiently clear to put users on notice that the site can only be used for non-commercial uses and that the use of automated devices to purchase tickets at the site is prohibited. The court further found that Ticketmaster was highly likely to succeed on its claim that RMG engaged in contributory copyright infringement by providing its clients with technology that was specifically designed to violate Ticketmaster's terms of use agreement and thereby infringe upon Ticketmaster's copyright rights.

The *Ticketmaster* case makes plain that courts will enforce terms of use agreements that website operators require users to accept as a condition of accessing and using the functionality available at the operators' sites. Use of a website in breach of the operator's terms of use agreement can also constitute copyright infringement based upon the "copying" of webpages that occurs when a user visits a website.

FOOTNOTES:

(n1)Footnote 1. *Feist Publications v. Rural Telephone Service Co.*, 499 U.S. 340 (1991).

(n2)Footnote 2. 17 U.S.C. § 101 et seq.

(n3)Footnote 2.1. Case No. 09-60335-CIV-COHN/SELTZER (S.D. Fla., May 5, 2010).

(n4)Footnote 3. *See CCC Information Services, Inc. v. Maclean Hunter Market Reports, Inc.*, 44 F.3d 61, 33 U.S.P.Q.2d (BNA) 1183, cert. denied, 516 U.S. 817, 116 S. Ct. 72, 133 L. Ed. 2d 32 (1997).

(n5)Footnote 4. *See Marshall & Swift v. BS&A Software*, 871 F. Supp. 952 (W.D. Mich. 1994).

(n6)Footnote 5. For discussion of the "ready, willing, and able" requirements, see Ch. 5, *The "Ready, Willing and Able" Requirements--Proof of the Purchaser's Financial Ability to Consummate the Transaction*, above.

(n7)Footnote 5.1. 2010 U.S. Dist. LEXIS 30160 (E.D.N.Y. Mar. 26, 2010).

(n8)Footnote 5.2. 2010 U.S. Dist. LEXIS 30160, at *15-*21 (E.D.N.Y. Mar. 26, 2010).

(n9)Footnote 6. *See Key Publications v. Chinatown Today Publishing Enters., Inc.*, 945 F.2d 509 (2d Cir. 1991) (Directory of Chinese-American businesses is copyrightable because editor exercised creativity in deciding what businesses to include); *Montgomery County Ass'n of Realtors v. Realty Photo Master Corp.*, 878 F. Supp. 804, 810 (D. Md. 1995) (Multiple Listing Service database containing unique and elaborate system of abbreviations and codes entitled to copyright protection).

(n10)Footnote 7. *BellSouth Advertising & Publishing Corp. v. Donnelley Information Publishing, Inc.*, 999 F.2d 1436 (11th Cir. 1993).

(n11)Footnote 8. 209 F. Supp. 2d 941 (N.D. Ill. 2002).

(n12)Footnote 9. 499 U.S. 340 (1991).

(n13)Footnote 10. No.8:02-CV-760-T-23TGW, 2004 U.S. Dist. LEXIS 6304, 17 Fla. L. Weekly Fed. D 635 (M.D. Fla. April 1, 2004).

(n14)Footnote 11. *BUC International Corp. v. International Yacht Council Limited*, Doc. No. 04-13653 (11th Cir., filed June 27, 2007).

(n15)Footnote 12. *Warren Publishing, Inc. v. Microdos Data Corp.*, 115 F.3d 1509, 1519, 43 U.S.P.Q.2d 1065 n.19 (11th Cir. 1997 (en banc)).

(n16)Footnote 13. Case No. 1:05-0088 (M.D. Tenn. December 12, 2007).

(n17)Footnote 13.1. 596 F.3d 1313 (11th Cir. 2010).

(n18)Footnote 14. *Field v. Google, Inc.*, 412 F. Supp. 2d 1106 (D. Nev. 2006).

(n19)Footnote 15. 17 U.S.C. § 107.

(n20)Footnote 16. *Perfect 10 v. Google, Inc.*, 416 F. Supp. 2d 828 (C.D. Cal. 2006).

(n21)Footnote 17. *Perfect 10 v. Google, Inc.* Doc. No. 06-55405 (9th Cir., filed May 16, 2007).

(n22)Footnote 18. *Metro-Goldwyn-Mayer Studios, Inc. v. Gronkster, Ltd.*, 545 U.S. 913 (2003).

(n23)Footnote 19. *17 U.S.C. § 512.*

(n24)Footnote 20. Cast No. CVC07-2534 (C.D. Cal. October 16, 2007).

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158 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 10 The Impact of Electronic Commerce on the Real Estate Brokerage Business *

10A-10 Real Estate Brokerage Law and Practice § 10.05

§ 10.05 Use of Multiple Listing Data by "Virtual" Real Estate Brokerage Companies

[1] "Virtual" Real Estate Brokerage Companies As Participants in Regional Multiple Listing Services

With the rapid expansion of Internet access by consumers, and the equally rapid expansion of Internet access to real estate listing information stored on computer servers, more and more real estate brokerage companies, and individual agents, have incorporated the World Wide Web into their company business strategies.

These strategies include the creation of Websites that promote individual brokerage companies. These brokerage company Websites also incorporate the display of current listing information. The real estate license laws of most states, however, forbid a real estate broker from advertising property listed with another broker unless the advertising broker has the permission of the listing broker. Consequently, most real estate company Websites are limited to displaying only properties listed with that individual company.

As Internet access has become more widespread, some real estate brokerage companies have introduced the concept of a "virtual" real estate office. The "virtual" office consists of a company Website on which visitors to the Website are invited to "register" as a client of the company. The "client relationship" is arguably formed when visitors indicate their acceptance of an online agreement in which the visitors appoint the company as the visitors' agent for the purpose of searching for property in a particular marketplace.

These "virtual" real estate companies also join local real estate associations and become participants in regional multiple listing services. As bona fide multiple listing service participants, the brokers and agents of "virtual" real estate companies are granted the right to access and use the real estate data in the multiple listing service's computerized database. These virtual offices, however, typically place the entire multiple listing service database of current listing information on the company's Website and make access to the listing data available to their "clients" who have registered with them by clicking "I agree" on a representation agreement displayed on the Website.

[2] Brokers Displaying Each Other's Listings on Websites

At least one real estate association contended that this display of an entire database of multiple listing service listing data on a "virtual" brokerage company Website violated the service's rules and regulations and, specifically, infringed upon the association's copyright in its multiple listing service database compilation. The association contended that the

real estate company was disclosing the multiple listing service database to the general public. This type of widespread disclosure of data about property listed with all companies participating in the service exceeded the limited authority the service grants to participants to display the data to "bona fide" home purchasers, and, as such, infringed on the association's copyright right to control the manner, and terms and conditions on which its copyrighted multiple listing service database compilation is displayed.

The association ultimately threatened to expel the "virtual" real estate company from its multiple listing service unless the company removed the multiple listing service database from the company's Website. When the company refused, the association filed suit in federal court against the company, alleging copyright infringement. n1 The company, in turn, filed an antitrust counterclaim against the association, and sought a preliminary injunction against the association to prevent its expulsion from the multiple listing service. The court granted the company's request for the preliminary injunction.

The company contended that the association's attempt to expel it from the multiple listing service constituted a boycott against it because it has chosen to operate a "virtual" real estate office, and also because the company's commission rate structure was significantly lower than the rates charged by other "traditional" companies in the market. The company contended that its "clients" who enter into online brokerage agreements are legally and functionally indistinguishable from clients of "bricks and mortar" real estate firms who meet and communicate with their clients through more traditional means of face-to-face meetings, telephone, facsimile machine, or by mail. A traditional brokerage firm regularly and routinely displays listing data from the multiple listing service database to its clients about properties listed with other multiple listing service participants.

The district court agreed with the real estate company that it had a substantial likelihood of success in showing that the association violated the federal antitrust laws by prohibiting the company from displaying the full multiple listing service database to its "clients" on its Website.

Shortly after the court entered its preliminary injunction against the association, the National Association of Realtors(R) adopted a policy requiring that all multiple listing services owned or operated by local associations of Realtors(R) must adopt rules that allow individual participants to grant each other blanket consent to display their listing data on other multiple listing participants' Websites. Listing brokers retain the right to "opt out" of the program on a general basis, or on a listing-by-listing bases. On the other hand, if most, or all, participants in a multiple listing service agree to participate in the blanket consent program, then participants will be allowed to display each other's listings on their individual company Websites.

After this policy was adopted by the local association of Realtors(R), the district court granted the association's motion to dissolve the preliminary injunction because the "virtual" company was now able to display other brokerage companies' listings on its Website without regard to whether visitors to the Website were "bona fide" clients of the company. n2 The parties eventually reached a negotiated settlement of their dispute.

[3] Use of Multiple Listing Service Listing Data for Internet Advertising

As part of the settlement, however, the National Association of Realtors(R) General Counsel issued a written opinion that the brokerage company's "virtual office" was not subject to the association's rules that governed a participant's advertising of another participant's listings on the participant's publicly accessible web site. n3 Rather, because visitors to the company's site created a "brokerage relationship" with the company by accepting the company's Terms of Use agreement before the visitor could view any multiple listing service information, the company was not "advertising" the listings of other brokers. Instead, the company was simply using the Internet and browser-based technology to deliver listing data to its bona fide customers and clients in the same manner as "traditional" brokers used other offline media (facsimile, hand delivery, or mail) to perform the same function.

Therefore, since the company was using the listing data for cooperative marketing purposes rather than general advertising, the National Association of Realtors(R) General Counsel opined that the company's use of the multiple listing service's listing data was governed by the association's multiple listing service rules that apply to participants' delivery of listing information to bona fide customers and clients. These rules permit participants to deliver non-confidential information about a "reasonable number" of properties contained in the multiple listing service database. n4 When using the multiple listing database for cooperative marketing, rather than "advertising," purposes, a participant may deliver information about any property in the multiple listing service database compilation. The National Association of Realtors(R) Multiple Listing Policy

- requires participants to make "blanket" offers of cooperation to other participants on all of the listings that the participant submits to the multiple listing service, n5 and
- does not permit participants to withhold (or "opt out") their listings from use by other participants for cooperative marketing purposes (in contrast to "opt out" provisions relating to virtual offices and to advertising, described in § 10.05[5] below).

While participants may vary the amount of compensation that they offer to other participants who succeed in finding a ready, willing and able buyer for the listed property, participants may not prevent another participant from receiving information about a participant's listing that is contained in the multiple listing service database compilation, or delivering that information to the participant's customers or clients.

[4] Delivery of Multiple Listing Service Data to Brokers' Customers or Clients through the Internet.

In early 2002, certain real estate brokerage companies that operated so-called "virtual office websites" or "VOWS" formed marketing alliances with Yahoo!, Inc., a major Internet search engine, or "portal." Under these alliances, Yahoo would link a visitor to its Real Estate Page to the VOW of a real estate brokerage company in the market in which the visitor indicated an interest in acquiring property. The development of these strategic alliances between Internet portals, such as Yahoo, and real estate brokers with VOWS caused the National Association of Realtors(R) to reexamine its Multiple Listing Policy as applied to the use of the Internet and browser-based technology to deliver multiple listing service listing information to a participant's customers and clients.

After over a year of deliberations, the National Association of Realtors(R) in May 2003 substantially amended its Multiple Listing Policy to add new regulations designed specifically to regulate participants' delivery of multiple listing service listing information to customers or clients through a VOW. n6 These new Multiple Listing Service Rules and Regulations are known as the National Association of Realtors(R) Virtual Office Website Policy, or VOW Policy. The National Association of Realtors(R) VOW Policy requires all multiple listing services owned or operated by associations of Realtors(R) to adopt local multiple listing service rules and regulations that conform to the Policy by January 1, 2004. This deadline has since been extended to January 1, 2006.

The National Association of Realtors(R) VOW Policy requires all Realtor(R) association multiple listing services to permit participants to use multiple listing service information on a VOW. On the other hand, the VOW Policy requires local multiple listing services to impose specific restrictions on the operation of a VOW on which multiple listing service information is delivered to the VOW operator's customers or clients. First, VOW operators must require visitors to register online by providing a verifiable email address, and execute a Terms of Use agreement by mouse clicking on an "I accept" button, before they may view any multiple listing service information. n7 Second, the Terms of Use Agreement must require registrants, among other things, to represent and warrant that they are bona fide potential buyers of property of the type they view at the participant's VOW, and that they will use the multiple listing service information provided to them solely for non-commercial purposes. n8

The VOW Policy also prohibits VOW operators from providing any information about a registrant to any other entity

for compensation. n9 The debate leading to the National Association of Realtors(R)' adoption of its VOW Policy made clear that the purpose of this provision is to prevent a participant from operating a VOW on which multiple listing service listing information is displayed for the primary purpose of capturing information about persons who may be interested in purchasing a home (a "lead"), and then referring the leads to other brokers in return for a referral fee.

The VOW Policy further requires Realtor(R) association multiple listing services to allow individual listing broker participants to prohibit other participants from using a VOW to deliver information about the listing broker's listings to the VOW operator's customers or clients. n10 This provision of the VOW Policy is known as the listing broker's "opt out" right. While the VOW Policy "opt out" provision is analogous to the "opt out" provision of the National Association of Realtors(R) Information Data Exchange ("IDX") Policy, n11 which deals with the use of multiple listing service information for advertising to the general public on the publicly accessible portion of a participant's website, the VOW Policy "opt out" right is quite different.

Under the National Association of Realtors(R) IDX Policy, a listing broker may elect to "opt out" of the local multiple listing service's IDX Program, either on a company-wide basis, or on a listing-by-listing basis. If the participant elects to "opt out" on a company-wide basis, none of the company's listings are available to other participants for advertising purposes on the other participants' publicly accessible websites. Likewise, the company that opts out of the IDX Program on a company-wide basis may not display the listings of any other participants on the company's publicly accessible website. A participant may also elect to withhold, or opt out, individual listings from the IDX Program. If a listing participant elects to withhold an individual listing from a multiple listing service's IDX Program, then that listing is not available for advertising display on the publicly accessible websites of any other participants in the IDX Program.

The National Association of Realtors(R)' VOW Policy, however, allows a listing broker to withhold listings from use by other participants on their VOWs on a "selective" basis. For this reason, the "opt out" right that is included in the VOW Policy is called a "selective opt out." A listing broker exercising the VOW Policy "selective opt out" privilege may elect to withhold one or more of its listings from the VOW operated by one participant, but allow its listings to be used on the VOWs of any other of the participants in the multiple listing service. n12 Hence, unlike the IDX Policy "opt out" provision, the VOW "opt out" provision permits a listing broker to "pick and choose" the participants who can use the broker's listings for delivery to customers or clients via a VOW. The National Association of Realtors(R) added this "selective opt out" provision to its VOW Policy at the urging of large brokerage companies and real estate franchisors who insisted on the right to preclude individual competitors from using the companies' listings for purposes that the listing companies deemed disadvantageous to their competitive interests. n13

[5] Antitrust Implications of the National Association of Realtors(R) Policy on Virtual Office Websites.

[a] Antitrust Litigation

The National Association of Realtors(R) VOW Policy for the first time grants participants in multiple listing services the unfettered right to prevent other participants from using browser-based technology for the delivery of information about the participants' listings to the customers and clients of the other participants. Such a right to dictate how other participants may deliver listing information to customers and clients is not afforded to the listing broker when other participants use "offline" communication methods, such as facsimile, hand delivery, or the postal system, for similar purposes.

The National Association of Realtors(R)' Multiple Listing Policy has long permitted listing participants separately to advise another participant that the listing participant would pay to the other participant a cooperative compensation that was less than the compensation offer shown in the multiple listing service compilation, or that the listing participant would not pay any compensation at all to the other participant, if that participant found a buyer for the listing participant's listing. n14 So long as listing participants do not collude among themselves in their decisions when, and if, to make a "discriminatory" compensation offer to another participant, such variations in compensation offers do not

raise antitrust concerns.

The National Association of Realtors(R) Multiple Listing Policy governing the "offline" use of listing information, however, does not permit a listing broker to preclude another participant from delivering information about the listing participant's listing to the other broker's customers or clients. The "offline" Policy simply provides that the listing participant is free to offer compensation to the other participant that is less than the amount offered in the multiple listing service compilation, or no cooperative compensation at all, if the other participant should find a buyer for the listed property. The other participant, on the other hand, is still permitted to offer the listing participant's listing to customers or clients. If the compensation offered by the listing participant is deemed to be inadequate, the other participant must seek any additional compensation from other sources (such as the buyer).

The National Association of Realtors(R) VOW Policy does not alter the listing participant's right to vary the terms of its cooperative compensation offer to other participants who operate VOWS. The VOW Policy, however, also permits a listing participant to instruct another participant that it may not deliver to its customers or clients information about the listing participant's listings via its VOW. This added power granted to listing participants to dictate the communication media chosen by other participants to deliver multiple listing information to customers and clients is an erosion of the fundamental purpose of a multiple listing service, which is to provide a mechanism through which brokers make "blanket" offers of cooperation and compensation to all other participants in the multiple listing service.

The National Association of Realtors(R) VOW Policy is susceptible to antitrust attack because it creates a "two tier" regulatory system for the delivery of multiple listing service listing information to potential property purchasers. One tier regulates the delivery of such information through "offline" media, and does not permit listing participants to "pick and choose" which other participants may share information about the listing participant's listings with customers and clients. The second tier regulates the "online" delivery of listing information, and under this regulatory framework, a listing broker is allowed, not only to offer a VOW operator a lesser amount of cooperative compensation, but also to prevent the VOW operator from using its VOW to deliver to its customers or clients any information about the listing participant's listings. A listing participant is permitted to exclude its listings from one participant's VOW, while allowing its listings to be available on other VOWS, including the listing participant's own VOW.

For the purposes of antitrust analysis, it is significant that VOWS increase the efficiency of the real estate marketing process for the benefit of brokers and agents, and the buying and selling public. A VOW enables registered customers or clients of a broker to retrieve "real time" information about properties on the market in seconds on an around-the-clock basis. A customer or client does not have to telephone or email a real estate agent requesting listing information and wait for it to be delivered by facsimile or by hand. A customer or client who uses a broker's VOW is likely to physically inspect far fewer properties before making a purchasing decision because that customer or client has used the broker's VOW to eliminate properties that are not appropriate. A broker or agent who offers a VOW to customers and clients is also able to spend time on functions for which a real estate professional's expertise and judgment is truly required by a potential purchaser. All of these features of a VOW result in a more efficient real estate transaction. Such efficiencies in turn result in lower costs per transaction. For this reason, many brokers who operate VOWS also pass on the resulting efficiencies in the form of lower brokerage fees.

The National Association of Realtors(R) VOW Policy, on the other hand, is clearly designed to enable listing participants to exercise leverage over their control of the listings in the multiple listing database compilation to minimize the competitive threat posed by other participants who have been quicker to adopt the web-based technology upon which VOWS are based. This power granted by the VOW Policy to thwart VOW operations does not have any apparent justification in the administrative requirements of the multiple listing service. Such a justification is required if the VOW Policy is to be sustained under the antitrust laws as a regulation that advances the legitimate requirements of the multiple listing service in the least restrictive manner.

Significantly, multiple listing services themselves use browser-based technology to deliver the multiple listing service

data to the brokers who participate in the services. Hence, it is difficult to contend that the Internet or browser-based technology is itself antithetical or threatening to the legitimate operations of a multiple listing service. Furthermore, real estate information supplied by multiple listing services is widely available on the Internet from, among other sources, Realtor.com, the national website operated on behalf of the National Association of Realtors(R) by Move, Inc. (see ch. 8, § 8.04[3][b][i]).

For all of these reasons, it would seem that there are numerous "less restrictive alternatives" through which any legitimate concern could be addressed about the safety and security of multiple listing service listing information made available over the Internet to the customers and clients of a multiple listing service participant. The availability of these less restrictive alternatives, in turn, suggests that the only justification for the "selective opt out" provision of the National Association of Realtors(R) VOW Policy is to enable large listing companies to use their market leverage to retard the growth of efficiency-enhancing business models that threaten to exert downward pressure on brokerage fees. Courts have not previously found this type of justification sufficient to offset the anticompetitive impact of a multiple listing service rule or regulation.

Shortly after the National Association of Realtors(R) adopted its VOW Policy, the Antitrust Division of the United States Department of Justice commenced an investigation of whether the Policy violated the federal antitrust laws by unreasonably restricting the application of web-based technology to the real estate brokerage industry. During the pendency of the Department's antitrust investigation, the National Association of Realtors(R) continuously extended the deadline by which local multiple listing services must adopt rules implementing the National Association of Realtors(R) VOW Policy. In May 2005, the National Association of Realtors(R) amended its Internet Data Exchange Policy to incorporate into that Policy various features of its VOW Policy. The stated purpose of these amendments is to create a single "unified" Policy that would govern all methods of delivering multiple listing service information using browser-based technology, using the Internet Data Exchange Policy as the basis for this "unified" policy. The National Association of Realtors(R) has also indicated that it intends that such a "unified" policy be a framework for a negotiated settlement with the Department of Justice over the Department's concerns that the National Association of Realtors(R) VOW Policy violates the federal antitrust laws.

In September 2005, negotiations between the National Association of Realtors(R) and the Department of Justice broke down. Negotiations between the parties had continued throughout the summer of 2005. In early September, however, NAR unilaterally announced the repeal of its VOW policy and the substitution of a new "Internet Listing Display" or ILD policy. According to NAR, the ILD policy replaces both its VOW policy and its IDX policy, and is intended to be a single "unified" policy governing the use and display on individual broker websites of listing information originating from MLS database compilations. The ILD policy eliminated the "selective opt out" provision of the VOW policy, but retained the "blanket opt out" provision. The ILD policy also eliminated the provision of the VOW policy that prohibited listing brokers who operated VOWs from referring persons who registered as customers at their VOW to other service providers for a fee. This provision that is not found in the ILD policy is known as the "anti-referral" provision of the VOW policy. The net result of the NAR ILD policy is to require brokers who operate IDX or VOW sites to conform to a set of regulations that contain a "blanket opt out" provision that implicitly presumes that any display of listing information on a broker's web site is "advertising" that requires the consent of the listing broker, even if the VOW registrant has signed an engagement agreement with the VOW operator to the same extent as any other client of the broker who engages the broker using offline communication methods.

At the same time that it announced the replacement of its VOW and IDX policies with its new ILD policy, NAR also announced that it was redefining the definition of "participant" in an MLS found at Section 7.9 of NAR's Handbook on Multiple Listing Policy. The former Section 7.9 provided that any licensed real estate broker who was "capable" of listing property, or working with a buyer of real estate, was eligible to participate in an MLS operated by an Association of Realtors(R). The practical meaning of NAR's former definition of MLS participant was that any persons or firms that possessed a real estate broker's license could participate in an MLS because such licensure rendered the persons or firms "capable" of listing or selling real estate whether or not their business model actually included such activity.

NAR amended Section 7.9 to require that persons or firms eligible to participate in MLSs must "actually" list, sell or appraise real property. It is no longer sufficient merely to be "capable" of engaging in such activity. In explaining the rationale behind the amendment to Section 7.9 to require MLS participants to "actually" list and sell, NAR stated that certain companies were acquiring real estate brokerage licenses or affiliating with otherwise inactive brokers solely for the purpose of being eligible to join a local Association of Realtors and participate in the Association's MLS. Once these companies became MLS participants, they were entitled to access and use the MLS's database compilation, potentially for purposes other than the cooperative sale of the listed property that appears in the MLS database compilation. At the time NAR announced its amendment to Section 7.9 of this MLS Policy, LendingTree, Inc., which operates a web site at realestate.com, announced its intention to acquire brokerage licenses in several jurisdictions and then join the local Association of Realtors(R) and participate in its MLS. Since NAR amended Section 7.9, Zillow, Inc. launched its web site at Zillow.com in early 2006. Zillow has acquired a database of information available from public assessors and recorders offices about the valuations of nearly all of the homes in the United States. At Zillow.com, persons can enter a property address and receive an automated estimate of the value of the property. Zillow has since acquired real estate brokerage licenses in many states and announced its intention to join local Associations of Realtors(R) and their wholly owned MLSs for the purpose of acquiring access to the MLS data that Zillow intends to use to enhance the quality of the automated valuations that it offers to users of this web site. In more recent commentary, NAR has stated that Zillow is not an appropriate participant in an MLS operated by an Association of Realtors(R) because Zillow, by its own admission, is not in the business of listing, selling, or formally appraising real property. Therefore, the amendment to Section 7.9 of NAR's MLS Policy is essential to exclude companies such as Zillow from acquiring access to MLS listing information.

On the same day that NAR announced its ILD policy and its amendment to Section 7.9 of its MLS Policy, the Department of Justice filed an antitrust lawsuit against NAR challenging NAR's VOW Policy. n15 Shortly thereafter, the Department amended its complaint to include an attack on both the NAR VOW policy and its new ILD policy and amended Section 7.9. NAR has since filed a motion to dismiss the United States's complaint under Rule 12 of the Federal Rules of Civil Procedure contending that the court does not have subject matter jurisdiction over the challenge to the NAR VOW policy on the ground that the VOW policy has since been repealed. NAR is also contending that the United States's complaint does not state a cause of action because any "opting out" that may occur as a result of either the VOW or ILD policy is the unilateral action of individual real estate brokers, and as such, cannot support a claim for a violation of Section 1 of the Sherman Act.

The court denied NAR's motion in late 2006. n16 The court began by rejecting NAR's contention that it lacked subject matter jurisdiction to consider the Department's claims directed at NAR's initial VOW Policy, the repeal of which NAR announced on the day the Department filed its complaint. The court found that the Department had sufficiently alleged continuing anti-competitive effects derived from NAR's initial VOW Policy that required an injunction to remedy. The court noted that the Department alleged that NAR's initial VOW Policy and its subsequent ILD Policy are part of a single ongoing contract, combination or conspiracy in restraint of trade. The court further cited the Department's allegations that over two hundred NAR-affiliated multiple listing services had adopted the initial VOW Policy and that various individual brokers had exercised their opt out rights under the Policy. The court also observed that the Department had alleged that by reason of NAR's initial VOW Policy the real estate brokerage industry was less competitive than it otherwise would have been and that the subsequently adopted ILD Policy fails to remedy those anti-competitive effects. The court additionally determined that it had subject matter jurisdiction to consider, and if necessary, enter injunctive relief addressing NAR's initial VOW Policy because of the reasonable threat that NAR would resume its prior alleged misconduct. The court observed that one of the criteria a court is to consider in determining the likelihood that a defendant will resume its illegal conduct is the extent to which the defendant has acknowledged that its past conduct was in fact improper. In this case, the court noted that NAR did not abandon its initial VOW Policy until after the Department notified it of its intention to file suit, and that NAR continues to maintain that its initial VOW Policy is entirely lawful under federal antitrust laws. The court went on to find that NAR's initial VOW Policy could still be the basis of injunctive relief based upon the Department's complaint given the scope of the

court's power to remedy the effects of NAR's current ILD Policy. The court stated that if the Department proves that NAR's VOW and ILD Policies violate the Sherman Act, the court is empowered to enter an injunction that can go beyond a prohibition on those practices that were shown to constitute illegal conduct. The court cited cases holding that when the defendant has shown a clear purpose to restrain trade, the relief that can be entered is not limited to a restoration of the status quo ante, but the relief must be directed to curing the ongoing and future effects of the illegal conduct. The court next turned to NAR's argument that the Department failed to state a claim in its challenge to NAR's initial VOW Policy. The court found that the Department had alleged a conspiracy among NAR and its members to restrain competition from brokers who use the Internet to deliver MLS information to their customers and clients, and that NAR retained the power to sanction members and multiple listing services that did not comply with NAR's policies to that effect. The court also found that the Department had adequately alleged relevant markets in which NAR's conduct had adverse effects on competition and that NAR had market power in those relevant markets. The court further noted the Department's allegations that NAR's policies were developed with anti-competitive animus towards brokers who used the Internet as a substantial part of their brokerage business and such policies could harm American consumers. Citing *United States v. Realty Multi-List*,ⁿ¹⁷ the court observed that, while a multiple listing service can have significant pro-competitive effects upon a real estate brokerage market, it also has the potential to stifle competition. The court then cited favorably the holding in *Austin Board of Realtors v. e-Realty, Inc.*ⁿ¹⁸ which also relied upon Realty Multi-List to hold that multiple listing service restraints imposed on brokers using the Internet that were not likewise imposed on brokers using off-line brokerage methods were sufficiently likely to violate the Sherman Act to warrant the issuance of a preliminary injunction. The court concluded its opinion by rejecting NAR's contention that the Department had failed to allege any anti-competitive effects flowing from NAR's VOW or ILD Policies. NAR argued that all of the alleged anti-competitive effects in the Department's complaint were based on the now repealed initial VOW Policy. The court found, however, that the Department's complaint adequately alleged anti-competitive effects resulting from both the "selective" and "blanket" opt out provisions of the NAR initial VOW Policy and that the blanket opt out provision was still a feature of the more recent ILD Policy. In summary, the court made clear that if the Department can prove the allegations in its complaint attacking the NAR initial VOW Policy and the subsequent ILD Policy, the Department will have proven that NAR's policies violate the Sherman Act and the court is empowered to enter injunctive relief sufficient to eliminate the present and future effects of such policies.

[b] US v. NAR Settlement

On May 27, 2008, the Department and NAR filed with the court a proposed final judgment that sets forth terms upon which the Department and NAR have agreed to resolve the Department's amended complaint.ⁿ¹⁹ Pursuant to the proposed final judgment, NAR has agreed to repeal its ILD Policy and replace that Policy with a "Modified VOW Policy," and to require all multiple listing services affiliated with its member Associations of Realtors(R) to adopt the Modified VOW Policy within ninety (90) days after the final judgment is entered by the court. The Modified VOW Policy is, for all practical purposes, NAR's former VOW Policy challenged by the Department, but without any right of a listing broker to "opt out" its listings from display on other MLS participants' VOWs.

The Modified VOW Policy also requires MLSs to provide specific data feeds available to their participants to facilitate the operation of VOWs. This "VOW-specific" data feed must include all of the non-confidential data about a listed property that a participant could otherwise provide to a potential purchaser in an offline context. Furthermore, this data feed must also include "sold data" about the prices at which properties have sold if such sales price information is otherwise available on the public records in the market in which the MLS operates. The Modified Policy does include a provision permitting sellers to affirmatively direct their listing brokers to withhold their listing or property address from display on the Internet. The seller, however, must sign a acknowledgement form in which the seller acknowledges that by withholding their listing or address from display on the Internet their property will not be exposed to consumers who use the Internet to search for a home. The purpose of the acknowledgement form is to require the seller to affirmatively acknowledge that withholding the listing from Internet display will negatively affect the marketing of the property.

The proposed final judgment permits NAR to amend the definition of "MLS Participant" in NAR's Multiple Listing

Policy to provide that an MLS participant must not only have a real estate license, and therefore be "capable" of making and accepting offers of cooperation and compensation to and from other MLS participants, but also must "actively endeavor" to list property of the type listed in the MLS, or to accept offers of cooperation and compensation made by brokers who have listed property in the MLS. The purpose of the amendment to NAR's definition of MLS Participant is to limit MLS participation only to those licensees who are actually attempting to practice real estate brokerage, as opposed to companies who have acquired a real estate license for no purpose other than becoming an MLS participant to secure the MLS data for purposes other than listing and selling real estate. By operation of this amended definition of "MLS Participant", NAR and its constituent MLSs are able to exclude companies such as Zillow and LendingTree from securing access to MLS information unless those companies actually enter and engage in the real estate brokerage business.

The proposed final judgment also contains strict enforcement provisions. NAR is required take affirmative steps to insure that its constituent MLSs adopt and adhere to the Modified VOW Policy. NAR is obligated to report to the Department any MLS that fails meet its obligation to adopt the Modified VOW Policy, or after adoption to comply with the terms of the Policy. If NAR determines that a constituent MLS has not complied with the Modified VOW Policy, NAR is required to report the MLS to the Department. Further, NAR is required to file quarterly reports with containing any communications with any person alleging that a constituent MLS has not complied with its obligations under the Modified VOW Policy.

The Department is also permitted to conduct audits of NAR's business records pertaining to compliance with the final judgment. These compliance obligations are in force for ten (10) years following the entry of the final judgment.

On November 18, 2009, the court entered a Final Judgment that, for all practical purposes, is identical to the proposed final judgment filed by the Department and NAR on May 18, 2009. n20 During the intervening period between the filing of the proposed final judgment and the entry of the Final Judgment, the Department complied with the Antitrust Administrative Procedures Act by filing a Competitive Impact Statement concerning the proposed final judgment and publishing the proposed final judgment in the Federal Register for public comment. Based on the comments that were filed, the Department filed a Response to the comments on October 23, 2008 in which it made a number of clarifications to the proposed final judgment and stated how it was to be interpreted. First, the Department agreed to a minor modification to the judgment that made clear that registered users of VOW accounts could distribute copies of listings from the MLS database to family members, friends, or mortgage lenders of those properties in which they had a serious interest in acquiring without violating the prohibition on a registered VOW user's retransmission of the MLS Data to third parties.

Second, the Department clarified that if a seller directed that her property address be withheld from internet display that the address would nevertheless be included in the MLS data feed provided to the VOW operator to permit the operator to provide the seller's address to VOW registered users by email or other non-internet means when a registered user initiated a search that returned the seller's listing. The proposed judgment was not clear that a VOW operator could transmit seller addresses by email when the seller directed that her address be withheld from internet display to the same extent that a VOW operator could transmit a full listing record by email when the seller directed that the entire listing record be withheld from internet display.

Third, the Department made clear that MLSs had the obligation to include in any MLS data feed provided to VOW operators the full inventory of currently listed property, including the property records and addresses of listings that sellers had directed be excluded from internet display. The VOW operator was obligated to suppress the identified listings or addresses from display to registered users through a browser. But the MLS was required to include the suppressed data in the VOW data feed to enable the VOW operator to deliver the suppressed data to registered users through email or other non-internet means as permitted by the Final Judgment.

Fourth, the Department interpreted the provision of the Final Judgment that permitted sellers to require the disabling of

any VOW features that enable registered users to access automated valuation analyses of the seller's property, or post comments about the seller's property on a VOW, to apply to all VOW websites to which the seller's listing data may be sent. Hence, the Final Judgment does not permit a seller to target selectively only certain VOWs when exercising her right to prohibit the display of automated valuation analyses or third party commentary about the seller's property.

Fifth, the Department interpreted the provision of the Final Judgment prohibiting NAR from adopting or endorsing any policy that discriminates against VOWs as prohibiting an MLS from assessing fees to a web services provider (or Affiliated VOW Partner or "AVP" as referenced in the Final Judgment) that provides VOW hosting services for multiple brokers in a market served by a single MLS for an MLS data feed for each of the AVP's customers when a single feed is sufficient to support all the VOWs operated by the AVP in the MLS' service area. The Department later clarified that an MLS may spread its fixed costs of supplying MLS data feeds to VOW operators among all of its participants who operate VOWs, whether they use an AVP or host their VOW themselves. But the MLS cannot require a VOW operator or AVP to pay fees reflecting the MLS' variable costs of providing MLS data feeds to VOWs unless the service actually incurs the variable cost for a particular VOW. Therefore, when an AVP with multiple VOW customers can support all of its customers with a single MLS data feed, the MLS cannot impose a fee to recover its variable costs for feed more than once.

The Final Judgment also required NAR affiliated MLSs to adopt by February 15, 2009 local rules and regulations that implement the revised VOW Policy set forth in the Final Judgment. During period prior to the implementation deadline, the issue arose whether the VOW Policy provision requiring MLSs to provide "VOW-specific data feeds". to VOW operators and AVPs also required the MLSs to provide VOW operators with a data feed of the MLS data from other neighboring MLSs that the MLS made accessible to its participants through "data-sharing" agreements among two or more MLSs. A typical "data sharing" agreement permits the participants of the MLSs that are parties to the agreement to access the MLS databases of the other MLSs on a "read only" basis through a separate access point and log in function on the MLS' web page. One of the most expansive MLS "data sharing" system is operated by the Florida Association of Realtors, in which nearly all of the MLSs in Florida participate. Through this system a MLS participant in any subscribing MLS can access MLS data from the MLS databases of all of the other subscribing MLSs throughout the State. The data sharing system, however, only permits "read only" access to the other MLS databases. An MLS participant a subscribing MLS is not permitted to upload a listing to the other MLS databases. The participant can only upload a listing to the MLS(s) in which the participants has MLS participation rights.

Notwithstanding the limited functionality that is available through MLS "data sharing" agreements, both NAR and the Department interpreted the Final Judgment to require an MLS that subscribes to a data sharing consortium to make a MLS data feed available to VOW operators that includes not only MLS data from that MLS, but also from all of the other MLSs that are parties to the MLS data sharing consortium. According the Department and NAR, if the MLS data from the data sharing consortium is accessible to an MLS participant in its "bricks and mortar" office, the same data must be provided, on request, to an MLS participant that operates a VOW. It remains to be seen if the imposition of this duty on MLSs in data sharing consortiums will cause them to withdraw from such consortiums, or alternatively, encourage MLSs to consolidate their databases into a single unified data base that covers an even broader, or potentially state wide coverage area.

While NAR does not admit liability in the Final Judgment and the Judgment does not have precedential value in any subsequent litigation, the Department has clearly succeeded, through the Final Judgment, in enjoining NAR from imposing any heightened burdens on the use of MLS information in the operation of VOWs that are in excess of the burdens otherwise imposed on the use of MLS information in a broker's "bricks and mortar" business. This result should remove the disincentives to brokers' creation and operation of VOWs. If VOWs become more widespread by reason of the Department's settlement with NAR, there is the potential for VOWs to bring about efficiencies in the practice of real estate brokerage similar to the efficiencies that the Internet has brought about in other service industries. If these efficiencies are realized there is also the potential for a reduction in the real estate commission rates and a corresponding reduction in the number of persons and companies engaged in the real estate business. If these development in fact

occur, the more efficient competitors who remain in the industry will realize profits higher than presently realized even if the commissions collected in any individual transaction may be reduced.

[c] Other Challenges in Attempt to Expand Real Estate Listing Information

In addition to the United States Justice Department's challenge to NAR's initial VOW Policy and its ILD Policy, the Federal Trade Commission has also been active in challenging local multiple listing policies that have allegedly adversely impacted the use of the internet to disseminate real estate listing information. The issue of particular concern to the Commission is a policy recommended by NAR and adopted by many multiple listing services that excluded "exclusive agency" listings from IDX data feeds and from display on public websites operated by the multiple listing services themselves, or by third parties, such as Realtor.com. An exclusive agency listing is a listing in which the seller owes the listing broker a commission if the listing broker or any other real estate broker procures a buyer for the listed property, but the seller is not obligated to pay any commission to the listing broker if the seller procures a buyer for the property without the aid of any real estate broker. Exclusive agency listings are commonly used by brokers offering reduced brokerage services for reduced fees. These fees would often take the form of a non-refundable flat fee paid at the time the seller lists her property with the "limited service" broker. The limited service broker places the listing into the local multiple listing service, but the seller is expected to show the property and negotiate any offers that may be forthcoming. The FTC many years ago secured consent orders from several multiple listing services prohibiting them from excluding exclusive agency listings from the multiple listing service in the first instance.ⁿ²¹ Extending the principle derived from these consent orders, the Commission opened a series of investigations in 2006 of multiple listing services throughout the country to determine whether the multiple listing services' policies of excluding exclusive agency listings from IDX data feeds or from display on the services' public websites, or Realtor.com, violated Section 5 of the Federal Trade Commission Act. In mid 2006 the Commission threatened to sue several multiple listing services affiliated with NAR unless they agreed to consent orders in which the services abandoned their rules prohibiting the inclusion of exclusive agency listings in IDX feeds and display on other publicly accessible websites. Nearly all of the targeted multiple listing services accepted the consent orders rather than litigate with the Commission.ⁿ²²

In November 2006, NAR amended its Multiple Listing Policy to preclude, for all practical purposes, multiple listing services from excluding exclusive agency listings from IDX data feeds and publicly accessible websites. Specifically, NAR repealed the provision of its IDX Policy that allowed an MLS, at its option, to exclude exclusive agency listings from an IDX data feed. NAR further added a new Statement of Multiple Listing Policy, which provides that a multiple listing service need not operate a publicly accessible website or transmit Participants' listings to publicly accessible websites operated by third parties. But if they do offer those services, the multiple listing services must include exclusive agency listings in such feeds, unless the property address of the exclusive agency listed property will be included in the data feed and the seller displays a "For Sale By Owner" sign on the listed property. The rationale for NAR's Statement of Multiple Listing Policy is that a multiple listing service should not be forced to provide advertising support for an exclusive agency listing that the seller is also promoting as a "For Sale By Owner" property. To require otherwise would constitute a form of "free riding" that the antitrust laws permit individual competitors to discourage or prohibit.

Notwithstanding these consent orders, and NAR changes to its Multiple Listing Policy, RealComp II, the NAR-affiliated multiple listing service serving the greater Detroit metropolitan area, declined to agree to a Commission consent order, and chose instead to litigate with the Commission over the legality of its policy of excluding exclusive agency listings from its IDX data feed and from any publicly accessible websites to which it transmits its participants' listing data.ⁿ²³

In its Complaint against RealComp II, the Commission alleged that RealComp II responded to competition from non-traditional discount brokers by (1) excluding exclusive agency listings or other listings taken by discount brokers from RealComp II's IDX data feed, the data feeds RealComp II provides to third party Internet listing aggregators such

as NAR's official site at Realtor.com, and from the data RealComp II displays on its own publicly accessible website, "MoveInMichigan.com", and (2) configuring the search functionality used by RealComp II's participants to search the RealComp II private database to exclude exclusive agency listings or discount brokers' listings from the "default" search results. RealComp II did accept exclusive agency listings and listings from discount brokers, but as a result of the "default" search functionality, these listings would be displayed in response to a participant's search query only if the participant specifically requested that the search include these types of listings. Without the participant's affirmative request to include exclusive agency or other types of listings from discount brokers, the only listings returned by "default" would be exclusive right to sell listings of traditional full service participants. The Commission alleged that RealComp II's policies restrained trade in the market for residential real estate brokerage services in southeastern Michigan in violation of Section 5 of the FTC Act.

The Commission's complaint against RealComp II was tried before a Commission Administrative Law Judge (ALJ) who issued an Opinion on December 10, 2007. In his Opinion, the ALJ found that, while RealComp II had market power in the southeast Michigan markets for real estate brokerage services and multiple listing services, and that the Real Comp II's policies had an adverse effect on competition in those markets, RealComp II offered sufficiently compelling justifications for the policies that outweighed their anticompetitive effects. Therefore, the ALJ found that RealComp II's policies did not violate Section 5 of the FTC Act. The Commission's complaint counsel appealed the ALJ's decision to the full Commission, and in an Opinion rendered on October 30, 2009, the Commission reversed the ALJ. n23.1

The Commission found initially that consumers rely increasingly on the Internet as a source of information about homes for sale. In response to this development, certain brokers offered to "unbundle" the traditional package of brokerage services and allow consumers to select the types of services they desired in return for non-refundable flat fees that were substantially less than the fees payable under a typical six percent (6%) sales commission. These non-traditional discount brokers also offered to list properties under exclusive agency listings that allowed the homeowner to avoid any brokerage fee if the homeowner found the eventual buyer without the efforts of the listing broker or any cooperating broker. The Commission noted that the business models of these discount brokers put significant downward pressure on the fees charged by traditional brokers. The Commission further cited the ALJ's findings that RealComp II conceded that it possessed market power in the southeast Michigan market for the delivery of multiple listing services to real estate brokers, and that RealComp II's policy of excluding exclusive agency and discount broker listings from its data feeds to publicly accessible websites was "likely anticompetitive."

In analyzing the antitrust legality of RealComp II's policies, the Commission determined that the policies should be judged under an analytical framework recognized by the United States Supreme Court in *California Dental Ass'n v. FTC*. n23.2 According to the Commission, the Supreme Court has held that level of analysis necessary to determine whether a restraint is anticompetitive under the Rule of Reason is on a continuum. If the restraint at issue is "inherently suspect" then the defendant must offer a cognizable justification for the restraint even in the absence of a showing that the defendant possessed market power. A restraint is "inherently suspect" if by its very nature it withholds from consumers a particular service that they desire. The Commission stated that the United States Supreme Court had endorsed this "inherently suspect" Rule of Reason framework in *FTC v. Indiana Federation of Dentists*, n23.3 and the Commission itself had adopted this framework in its decision in *Polygram Holding, Inc.*, which was affirmed by the District of Columbia Circuit. n23.4

The Commission also interpreted the *California Dental* decision as endorsing an additional Rule of Reason framework that finds a restraint that is not "inherently suspect" to be illegal without a need for a market power analysis if there is direct evidence that the restraint caused actual, as opposed to potential, anticompetitive effects in the relevant market, and the defendant failed to offer a convincing justification for the restraint. The Commission found that, in addition to the two forms of Rule of Reason analysis endorsed by the Supreme Court in *Indiana Federation of Dentists* and *California Dental* that did not require an inquiry into whether the defendant possessed market power, the market power analysis, a restraint could also be analyzed under the full Rule of Reason analysis in which the court defines a relevant

market, determines the extent of the defendant's market power in that market, and the potential that the restraint will reduce competition in the market.

The Commission then analyzed the RealComp II policies and found them to be a violation of Section 5 of the FTC Act under both an "inherently suspect" analysis, in which it was necessary to determine if RealComp II possessed market power, and under the full Rule of Reason analysis. The Commission determined that the RealComp II policies of discount broker and exclusive agency listings from RealComp II's data feeds to publicly accessible websites and from the "default" search results were "inherently suspect" because the policies penalized discount competitors by restricting the accessibility to consumers of information about the properties listed with the discount competitors. The Commission noted that similar restraints on consumers' access to non-deceptive advertising had been condemned summarily by the Commission and other courts. n23.5

The Commission then considered and rejected RealComp II's proffered justifications for its policies. RealComp II urged that its policies were justified as a means to prevent "free riding" by sellers under exclusive agency listings from using RealComp II's facilities at no charge to promote their property for sale, but avoid paying a commission to a RealComp II participant if the seller found a buyer through the seller's own efforts. The Commission noted that prevention of "free riding" can legitimize a policy that otherwise restrains trade. The Commission, however, summarily rejected RealComp II's contention that home sellers using exclusive agency listings were "free riding" on RealComp II's services. The Commission noted that home sellers do not have any power to submit listings directly into RealComp II's database. Only RealComp participants who pay participation fees to RealComp II may submit listings. Therefore, RealComp II is paid fees for all listings submitted to its database, whether they are exclusive right to sell listings or exclusive agency listings. The Commission also rejected RealComp II's argument that cooperating brokers were being "free ridden upon" because under an exclusive agency listing a cooperating broker who found a buyer could be denied compensation if the seller sold the property to a buyer found by the seller. The Commission found this argument to be unavailing because the cooperating broker who finds a buyer for an exclusive right to sell listing is even more likely to be denied a commission when the eventual buyer is found by the listing broker, who is able to keep the entire commission if she finds the buyer for her own listing.

The Commission also rejected RealComp's argument that its policies were justified because they prevented sellers under exclusive agency listings from enjoying a "bidding advantage" when considering an offer from a buyer they procured as opposed to an offer procured from a real estate broker for which the seller would be obligated to pay a commission if the broker procured buyer bought the property. The Commission characterized this "bidding advantage" as simple competition and not "free riding." The Commission stated that RealComp II's efforts to insulate broker represented buyers from a price advantage enjoyed by an unrepresented buyer was an effort by RealComp II to protect a commission structure that raises the cost of selling a home, and therefore is not cognizable under the antitrust laws. According to the Commission, rather than saving RealComp II's policies from condemnation under the antitrust laws, RealComp II's justification reinforces the Commission's conclusion that the policies have an anticompetitive effect.

The Commission concluded by analyzing RealComp II's policies under a traditional Rule of Reason analysis and found that the policies failed under this analysis as well. The Commission emphasized that RealComp II conceded, and the ALJ found, that it had market power in the southeast Michigan market for multiple listing services. The Commission then found that as a result of RealComp II's market power, its policies were not only likely to have an anticompetitive effect on the competition for real estate brokerage services in the relevant market, but that the policies had an actual anticompetitive effect. The Commission cited a study performed by complaint counsel's economic expert that showed a significant reduction in exclusive agency listings in RealComp II's database after RealComp II adopted its policies disadvantaging exclusive agency listings and listings of non-traditional discount brokers.

The Commission's RealComp II Opinion signals that the FTC, and presumably courts and other antitrust enforcement agencies, will treat as "inherently suspect" any policies of multiple listing services that adversely affect the ability of Internet based business models to compete with the traditional full service commission based business model. These

types of policies are likely to be condemned using a truncated Rule of Reason analysis that dispenses with any need to inquire into the multiple listing services' market power in a relevant market. The Commission's RealComp II Opinion also makes clear that multiple listing services cannot justify their policies that adversely impact non-traditional brokers' Internet based business models on the ground that such policies are necessary to insulate the multiple listing services' full service participants from competition from Internet based non-traditional discount brokers.

RealComp II has filed a timely notice of appeal from the Commission's Opinion to the Sixth Circuit Court of Appeals. Given the Commission's use of the truncated Rule of Reason analysis to find that RealComp II's policies violated Section 5 of the FTC Act, the Sixth Circuit's opinion will be further indication of the willingness of federal courts to embrace the notion that a full market power analysis under the Rule of Reason need not be employed when the evidence shows that a restraint has a clear and direct adverse impact on competition.

[d] Report on Competition in the Real Estate Industry Issued by FTC and DOJ

In addition to their respective enforcement initiatives targeted at reducing restrictions on the use of the Internet to make the real estate brokerage industry more competitive and efficient, the Federal Trade Commission and the United States Department of Justice issued in April 2007 a jointly authored Report on Competition in the Real Estate Industry. ⁿ²⁴ The Report is based in substantial part on a Public Workshop sponsored by the agencies in October 2005, at which industry participants, critics, and scholars made presentations. ⁿ²⁵

The Report provides an overview of competitive relationships within the real estate brokerage industry and how the industry is characterized by simultaneous competition and close cooperation among competitors. The Report then discusses the impact of the Internet on the real estate brokers and home buyers and sellers who use their services, and the potential of the Internet to make the industry more efficient, which in turn should reduce the cost of brokerage services to consumers. The Report also includes analyses of economic literature discussing the extent of the flexibility of real estate commission rates and that the amount spent by consumers on real estate brokerage commissions tends to increase in direct proportion to the increase in housing prices. The economic analyses further observe that the high commission levels paid to brokers and agents has led to a rapid increase in the number of agents competing for listings. This competition, however, has not led to lower commission rates, but rather to increasing amounts spent by agents on marketing efforts designed to procure listings and buyer clients. These expenses, in turn, reduce broker and agent net profits to the extent that broker and agent income levels remain stagnant despite a dramatic increase in the aggregate amount spent by consumers on brokerage services.

The Report then discusses obstacles to more robust competition in the real estate brokerage industry. The Report devotes considerable attention to state laws and regulations mandating minimum levels of service that real estate brokers must accord to home buyers and sellers, as well as state laws prohibiting brokers from paying commission rebates to their customers and clients. Both agencies have lobbied vigorously in opposition to such state legislation, but have been generally unsuccessful in persuading state legislatures not to enact these proposals. The Report also details the enforcement actions by the Federal Trade Commission against multiple listing services' exclusion of exclusive agency listings from IDX and public website data feeds, and the Department of Justice's suit against NAR's VOW and ILD Policies. Finally, the Report lists a series of actions designed to improve competition in the real estate brokerage industry. First, the agencies should continue to pursue enforcement actions against collusive conduct that unreasonably lessens competition. Second, the agencies should continue to press state legislatures to decline to adopt, or repeal, legislation that restricts competition among real estate brokers and restricts consumer choice of brokerage services. Third, the agencies and state regulators should initiate programs to ensure that consumers are aware of commission rate negotiability and the range of service options available to them from participants in the real estate brokerage industry. Lastly, the agencies and state regulators should undertake a new empirical analysis of the real estate industry using better and more detailed data on the strength of the correlation between commission rates and housing prices. If nothing else, the Report reveals the analytical framework the Federal Trade Commission and the United States Department of Justice will employ when evaluating potential enforcement actions against the various businesses and organizations that

participate in the real estate brokerage industry.

FOOTNOTES:

(n1)Footnote 1. Austin Bd. of Realtors(R) v. e-Realty, Inc. No. A-00-CA 154 JN (W.D. Tex Sept. 2, 2000).

(n2)Footnote 2. Austin Bd. of Realtors(R) v. e-Realty, Inc., No. A-00-CA 154 JN (W.D. Tex Sept. 2, 2000).

(n3)Footnote 3. Letter dated January 29, 2001 from Laurene K. Janik, Esq., General Counsel, National Association of Realtors(R), to Russell Capper, President, eRealty, Inc.

(n4)Footnote 4. See National Association of Realtors(R), Handbook on Multiple Listing Policy (2003 Edition), Part 15, Section 12 at 15-11, 15-12.

(n5)Footnote 5. National Association of Realtors(R), Handbook on Multiple Listing Policy (2003 Edition), Part 1, Section 1.2 at 1-1.

(n6)Footnote 6. See National Association of Realtors(R), Virtual Office Website Policy, adopted May 17, 2003.

(n7)Footnote 7. See National Association of Realtors(R), Virtual Office Website Policy, Section II.2, adopted May 17, 2003.

(n8)Footnote 8. See National Association of Realtors(R), Virtual Office Website Policy, Section II.2.b, adopted May 17, 2003.

(n9)Footnote 9. See National Association of Realtors(R), Virtual Office Website Policy, Section II.4.h, adopted May 17, 2003.

(n10)Footnote 10. See National Association of Realtors(R), Virtual Office Website Policy, Section I.3, adopted May 17, 2003.

(n11)Footnote 11. See National Association of Realtors(R), Handbook on Multiple Listing Policy (2003 Edition), Part 15, Section 18.1 at 15-16.

(n12)Footnote 12. See National Association of Realtors(R), Virtual Office Website Policy, Section II.4.h, adopted May 17, 2003.

(n13)Footnote 13. See Cendant, Inc., *Emerging Issues Posed By the Misuse of Virtual Office Websites*, Feb. 28, 2003. See also Realty Times, *Cendant Will Pull Brand Listings If VOWS Remain Unregulated*, Mar. 5, 2003; Realty Times, *Realty Executives Also Prefers Broker Opt-Out Provision for VOWS*, Apr. 1, 2003; Realty Times, *Re/Max Issues VOW White Paper, Urges Selective Broker Opt-Out*, Apr. 10, 2003.

(n14)Footnote 14. See National Association of Realtors(R), Handbook on Multiple on Multiple Listing Policy (2003 Edition), Part 15, Section 5, Note 1, at 15-7.

(n15)Footnote 15. United States v. National Association of Realtors, No. 05-CIV-5140 (N.D. Ill., Sept. 7, 2005).

(n16)Footnote 16. United States v. National Association of Realtors, No. 05-CIV-5140 (N.D. Ill., filed Nov. 27, 2006).

(n17)Footnote 17. *United States v. Realty Multi-List*, 629 F.2d 1351, 1980-81 Trade Cas. (CCH) P63624 (5th Cir. 1980).

(n18)Footnote 18. Austin Board of Realtors v. eRealty, Inc., No. CIV A-00-CA-154IN (W.D. Tex., Mar. 30,

2000).

(n19)Footnote 19. *United States v. National Association of Realtors*, Case No. 05-5140 (N.D. Ill., Proposed Final Judgment, filed May 27, 2008). The proposed final judgment is subject to the requirements of the Antitrust Procedures and Penalties Act, 15 U.S.C. § 16(b)-(h). Pursuant to this Act, the Department must file a Competitive Impact Statement setting forth its rationale for the settlement. The proposed final order must be published in the Federal Register and interested parties have sixty (60) days to file comments on the proposed settlement. After the comment period closes, the Department shall file its response to any comments that are filed. Thereafter the Department likely will move for entry of the final order in the form proposed.

(n20)Footnote 20. *United States v. National Association of Realtors*, Case No. 05-C 5140 (Final Judgment, entered November 18, 2008).

(n21)Footnote 21. *See, e.g., In the Matter of Multiple Listing Service of the Greater Michigan City Area, Inc.*, Dkt. 3163, 106 F.T.C. 95 (1985) ; *In the Matter of Orange County Board of Realtors, Inc.*, Dkt. C-3162, 106 F.T.C. 88 (1985) ; *In the Matter of Poer Washington Real Estate Board*, Dkt. C-3227, 120 F.T.C. 882 (1995) .

(n22)Footnote 22. *See, e.g., In the Matter of Northern New England Real Estate Information Network, Inc.*, FTC Dkt. C-4175 (2006); *In the Matter of Williamsburg Area Association of Realtors, Inc.*, FTC Dkt. C-4177 (2006); *In the Matter of Realtors Association of Northeast Wisconsin, Inc.* FTC Dkt. C-4173 (2006).

(n23)Footnote 23. *See In the Matter of RealComp II*, Dkt. 9320 (2006).

(n24)Footnote 23.1. *RealComp II*, FTC Docket No. 9320, op. (October 30, 2009), available at <http://ftc.gov/us/adjpro/d9320/091102realcompopinon.pdf>

(n25)Footnote 23.2. 526 U.S. 756 (1999) .

(n26)Footnote 23.3. 476 U.S. 447, 458 (1986) .

(n27)Footnote 23.4. *In re Polygram Holding*, 136 F.T.C. 310, 136 F.T.C. 310 (2003) , *aff'd*, *Polygram Holdings, Inc. v. FTC*, 416 F.3d 29 (D.C.Cir. 2005) .

(n28)Footnote 23.5. *See Denny's Marine, Inc. v. Renfro Publications, Inc.*, 8 F.3d 1217, 1219-20 (7th Cir. 1993) ; *Detroit Auto Dealers Ass'n v. FTC*, 955 F.2d 457 (6th Cir. 1992) .

(n29)Footnote 24. United State Department of Justice and Federal Trade Commission, *Competition in the Real Estate Brokerage Industry* (April, 2007).

(n30)Footnote 25. The agenda, transcript and other information relating to the Workshop can be found at the agencies' websites at <http://www.usdoj.gov/atr/public/workshops/reworkshop.htm> and <http://www.ftc.gov/bc/realestate/workshop/index.htm>.

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159 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 10 The Impact of Electronic Commerce on the Real Estate Brokerage Business *

10A-10 Real Estate Brokerage Law and Practice § 10.06

§ 10.06 "Linking" or "Framing" Other Websites Can Create Liability Risks

The software used to maintain a web site permits an operator of one site to create a hypertext "link" to another web site. When an Internet user "clicks" on the highlighted terms, the user is transported to the "linked" site. As a general rule, "linking" to another website is not viewed as a copyright infringement or unfair competition because:

- websites themselves are "public" displays,
- the "link" alone does not involve any copying of material on the "linked" site, and
- most website operators welcome the referral of Internet users to their sites.

Issues can arise, however, when a web site operator employs so-called "deep linking" in which a web site operator links to an "inside" page of another web site, as opposed to the web site's "home page." Many web sites display banner advertising or other promotional material on their opening page or "home page." The value of this advertising is determined by the number of visitors that the web site operator can document have viewed the site. A "deep link" allows a visitor from another web site to bypass the "home page," and, likewise, the advertisements that appear on that page. This dilution of the value of the advertising on the linked site's home page has lead to challenges to "deep linking" on grounds of unfair competition. n1

"Framing" occurs when one website operator displays another website within a border or "frame" of the original website. "Framing" another entity's website can lead to claims of copyright and trademark infringement, or unfair competition, when the "framing" site permits an Internet user to avoid the "framed" site's home page, or blocks banner advertisements appearing on the "framed" site's pages.

Caution dictates that web site operators who wish to "link" to, or "frame" another operator's web site should do so only after securing the permission of the other web site operator. Many Multiple Listing Services, however, operate "public" web sites on which the Service's listing data is accessible. These Multiple Listing Services typically permit participants to link to, or frame, the Service's public site from the participant's company web site.

FOOTNOTES:

(n1)Footnote 1. *See* Ticketmaster Corp. v. Microsoft Corp., No. CV 97-3055 RAP (C.D. Cal. filed Apr. 28, 1997).

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160 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 10 The Impact of Electronic Commerce on the Real Estate Brokerage Business *

10A-10 Real Estate Brokerage Law and Practice § 10.07

§ 10.07 Consumer "Privacy" Breaches Can Lead to Liability

Display of real estate data on a web site rarely leads to claims of "privacy" breaches. This is true because consumers cannot assert credible claims of any expectation of privacy concerning the characteristics or value of the real property that they own. Real estate ownership, conveyancing, and taxation are dependent upon publicly recorded information about real estate ownership and values. Consumers cannot reasonably claim that such data is "private." On the other hand, consumers do have expectations of privacy about their individual Internet usage patterns. A web site operator's collection of personal data about people who visit a web site can lead to "privacy" issues depending upon whether consumers are informed about the collection of such data, and how such data is subsequently used.

Available technology permits web site operators to gather data on those who visit their sites, including visitors' e-mail addresses, frequency of visits to the site, and the pages visited within the site. Many web site operators use "cookies," which are computer files placed on the user's computer that record the user's visits to the site, and the pages viewed by the user while on the site. Other web sites require users to "register" with the web site operator by providing the users' name, a verifiable e-mail address, and telephone number.

This information allows web site operators to compile data about customers' web site usage, which can be used for targeted marketing, or can be sold to other entities. The Federal Trade Commission (FTC) is becoming increasingly aggressive in attacking perceived breaches of consumers' right to privacy on the World Wide Web. Major FTC concerns are:

- (1) gathering data from or about children; and
- (2) use of consumer personal data for purposes other than those approved by the consumer.

Web site operators should establish and publish a "privacy policy" on their site that clearly informs visitors to the site about the types of data, if any, that is collected about the visitors, and what uses may be made of that data. Web site visitors should be allowed to "opt out" of any use of their personal data for purposes for which they do not consent. For web site operators engaged in the "financial services" industry, Title V of the Gramm Leach Bliley Financial Services Modernization Act of 1999 includes specific limitations on the use by financial services providers of personal non-public information about consumers. n1 The Federal Trade Commission has promulgated regulations that further

refine the duties of financial service providers concerning the collection and use of personal non-public information about consumers. n2 Real estate brokerage is not defined as a "financial service" under the Gramm Leach Bliley Act; however, if a real estate broker engages in real estate appraising, or mortgage brokerage or lending, through an affiliated company, the Gramm-Leach-Bliley privacy regulations would apply to that activity.

FOOTNOTES:

(n1)Footnote 1. *See 12 U.S.C. § 6801.*

(n2)Footnote 2. *See 16 C.F.R. Part 313.*

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161 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 10 The Impact of Electronic Commerce on the Real Estate Brokerage Business *

10A-10 Real Estate Brokerage Law and Practice § 10.08

§ 10.08 Extraterritorial Reach of State Real Estate License Laws

The Internet and e-mail allow real estate brokers to solicit buyers and transmit offers to buy or sell real estate worldwide. This technology arguably allows a real estate broker or agent to engage "in the business of real estate brokerage" in all fifty (50) states. State real estate regulators could take the position that if a broker or agent disseminates electronic real estate advertising to consumers in the state, the broker becomes subject to the rules and regulations of that state's license law. The assertion of jurisdiction by state real estate commissions over the Internet activities of out-of-state brokerage companies is a corollary to the state's assertion of personal jurisdiction over out-of-state defendants pursuant to the state's "long arm" statute (discussed in § 10.02 above).

* This chapter was written by Robert D. Butters, Esq. of Arnstein & Lehr, Chicago, IL. Mr. Butters is admitted to practice before the Bars of Illinois, the District of Columbia, the United States District Court for the Northern District of Illinois, the United States Court of Appeals for the Seventh Circuit, and the United States Supreme Court. A former trial attorney for the Bureau of Competition of the Federal Trade Commission in Washington, D.C., Mr. Butters also served as the Deputy General Counsel of the National Association of Realtors(R) from 1987-1992.



162 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 10 The Impact of Electronic Commerce on the Real Estate Brokerage Business *

10A-10 Real Estate Brokerage Law and Practice § 10.09

§ 10.09 E-Mail Liability

E-mail can be used to commit fraud, infringe upon copyright rights, violate federal laws governing interstate commerce (anti-gambling and anti-obscenity laws), and engage in common-law defamation. E-mail can also be used to reveal trade secrets and to sabotage corporate records. To avoid company liability for misuse of e-mail by employees or agents, and to create a basis to sue a disgruntled employee or agent who uses e-mail to undermine the company, a company should adopt an employee e-mail policy. Before addressing the content of such policies, certain features of e-mail communications must be recognized.

First, e-mail is *permanent*. E-mail is more permanent than paper records. Paper can be shredded or burned. E-mail messages exist on a computer hard drive and are not removed when the "delete" key is tapped on a keyboard. Hence, one of the first pieces of "evidence" seized in a civil or criminal investigation is a company's computers to search for incriminating e-mail messages.

Second, e-mail is *public*. E-mail messages can be forwarded to hundreds of recipients with the tap of a key on a keyboard. E-mail is the electronic equivalent of a postcard.

Companies should make clear to employees and agents the rules that apply to use of the company e-mail system. Companies have very broad latitude in developing an e-mail policy. Examples of e-mail policy provisions are:

- (1) E-mail may be used only for business purposes.
- (2) E-mail messages may be shared only with other persons in the company.
- (3) Company reserves the right to monitor all employees' or agents' e-mail messages.
- (4) Unless necessary for business purposes, attachments of photographs are not permitted on the company system.
- (5) All e-mail messages are the property of the company.

(6) The e-mail system may not be used to transmit obscenity or profanity, threats, abusive language, or messages containing racist, sexist, or bigoted references.

* This chapter was written by Robert D. Butters, Esq. of Arnstein & Lehr, Chicago, IL. Mr. Butters is admitted to practice before the Bars of Illinois, the District of Columbia, the United States District Court for the Northern District of Illinois, the United States Court of Appeals for the Seventh Circuit, and the United States Supreme Court. A former trial attorney for the Bureau of Competition of the Federal Trade Commission in Washington, D.C., Mr. Butters also served as the Deputy General Counsel of the National Association of Realtors(R) from 1987-1992.



163 of 163 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART III Public Regulation

CHAPTER 10 The Impact of Electronic Commerce on the Real Estate Brokerage Business *

10A-10 Real Estate Brokerage Law and Practice § 10.10

§ 10.10 Conclusion: Implications for the Future

The Internet is here to stay, but courts and state regulators have yet to address the breadth, speed, and interactivity of the Internet. Consequently there is little definitive case law upon which to rely when counseling your real estate industry clients. One can assume, however, that traditional rules prohibiting fraud, defamation, and protecting intellectual property rights, will apply with equal force to web site operations and Internet communications.

The Internet will almost certainly lead to a more efficient and less time-consuming real estate transaction, with the likely advent of a "paperless transaction" in the next decade. The challenge for real estate brokers is to harness the power of the Internet to allow them to better serve their clients, or risk being rendered obsolete.

* This chapter was written by Robert D. Butters, Esq. of Arnstein & Lehr, Chicago, IL. Mr. Butters is admitted to practice before the Bars of Illinois, the District of Columbia, the United States District Court for the Northern District of Illinois, the United States Court of Appeals for the Seventh Circuit, and the United States Supreme Court. A former trial attorney for the Bureau of Competition of the Federal Trade Commission in Washington, D.C., Mr. Butters also served as the Deputy General Counsel of the National Association of Realtors(R) from 1987-1992.



1 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice 11.syn

§ 11.syn Synopsis to Chapter 11: Mortgage Brokers *

§ 11.01 The Role of Mortgage Brokers in the Real Estate Market

§ 11.02 Licensing and Fee Regulation

[1] Licensing

[2] Fee Regulation

§ 11.03 Factors Affecting Whether Mortgage Broker's Commission Might Cause Loan to Be Considered Usurious

§ 11.04 Mortgage Broker's Right to Compensation

[1] Employing the Mortgage Broker

[2] Effect of Licensing Laws

[3] Statute of Frauds

[4] When Commission Is Earned

[a] Procuring Cause

[b] Exclusive Mortgage Brokerage Agreements

[5] Broker Recovery in Quantum Meruit

[6] Tortious Interference with Mortgage Broker's Contract by Third Parties

§ 11.05 Mortgage Broker's Duties

[1] Generally

[2] Duties to Borrower

[a] Common-Law Duties

[b] Common-Law Duties Supplemented by Statute

[c] Role of Consumer Protection Legislation

[3] Duties to Lenders and Others

§ 11.06 State Securities Regulation

§ 11.07 Mortgage Brokerage Forms

[1] Mortgage Lender/Mortgage Broker Agreement

[2] Mortgage Broker/Borrower Agreement

[3] Affiliated Business Arrangement Disclosure

§ 11.08 The Legality of Yield Spread Premiums

§ 11.09 RESPA Reform Effort

§ 11.10 The Legality of Mark-Ups/Overcharges

§ 11.11 Mortgage Brokers and the Subprime Mortgage Crisis



2 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 11 discusses the mortgage broker's role in real estate transactions. Mortgage brokers function as the retail outlet for many lenders and are able to offer borrowers a variety of mortgage products. In their role as an intermediary between mortgage lenders and borrowers, mortgage brokers facilitate the placement of mortgage loans. The increasing use of mortgage brokers, particularly by residential borrowers, has resulted in greater regulation of this industry.

Chapter 11 discusses the licensing and regulation of mortgage brokers (§ 11.02), whether payment of a mortgage broker's commission can cause a loan to be considered usurious (§ 11.03), a mortgage broker's right to compensation (§ 11.04), the duties owed by a mortgage broker to the borrower, the lender and others (§ 11.05), and whether the activities of mortgage brokers fall within the ambit of blue sky laws (§ 11.06). Chapter 11 also includes mortgage brokerage forms (§ 11.07).



3 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice § 11.01

§ 11.01 The Role of Mortgage Brokers in the Real Estate Market

The mortgage broker's role in real estate transactions, few of which are consummated without financing, has become more significant as the industry has grown. While commercial mortgage brokerage has changed little over the years, the function of the mortgage broker in residential real estate financing has evolved from one analogous to that of the real estate broker in the realm of real estate conveyancing and leasing to one more closely aligned with the role of a lender. n1 This is largely a result of the expansion of the residential mortgage delivery system in recent years to include the "wholesale" method of lending.

The traditional "retail" method of residential mortgage lending is illustrated by a savings and loan (S & L) branch office of the 1970s, where a customer in need of a home mortgage submitted a loan application to the branch manager or loan officer. The processing of the loan--that is, the process of obtaining the verifications of deposit and employment, credit report, appraisal and other information necessary to making a determination to lend--was performed in the branch office. Upon completion of the file, the home office underwriters made the loan decision. If the underwriters deemed both the borrower and the property to be worthy, the loan was consummated or "closed" at the branch office. The S & L then serviced the loan for the customer. Servicing generally consists of collecting monthly payments from the borrower; paying property taxes, insurance premiums and other escrowed items; working with borrowers who are in default; and, when necessary, foreclosing on the mortgage.

With the S & L debacle of the 1980s came massive changes to the mortgage delivery system, including the downsizing of S & L's, growth of mortgage banks and the secondary market, securitization of residential mortgages and an acknowledgment that the constant expansion and contraction of mortgage banks during the "boom and bust" cycles was costly and inefficient. Out of these changes was born the new residential mortgage broker. n2

Many out-of-work S & L employees opened their own small mortgage brokerage businesses, developed relationships with a number of mortgage lenders and used their business contacts and marketing experience to attract borrowers. Once the prospective borrowers were in the office, the mortgage broker learned their particular needs, took loan applications, provided requisite disclosures, processed the loans, and submitted completed loan packages to one of typically many lenders with which it had a relationship. The mortgage lender made the credit decision based on the lender's or the ultimate investor's underwriting guidelines. The loan package was returned to the mortgage broker to facilitate the loan closing.

One court explained the evolution of the residential mortgage delivery system in the following way:

Traditionally, residential mortgage lenders made loans to borrowers directly from offices maintained with employees of the lender that originated, processed, and underwrote such loans. In recent years, a number of wholesale mortgage lending programs have evolved whereby mortgage lenders purchase loans from other lenders or from mortgage brokers who have completed all of the origination work. Mortgage lenders regularly purchase wholesale closed loans made by other mortgage lenders.

In addition to buying closed loans at wholesale, mortgage lenders also acquire loans through mortgage brokers. Mortgage brokers originate and process loans that the mortgage lender then purchases from the mortgage broker. The arrangement between the mortgage lender and the mortgage broker varies, but generally the closing of the loan is arranged by the mortgage broker in the name of the mortgage lender. n3

The growth of wholesale lending brought with it another practice called "table funding." Known in some areas of the country as "concurrent funding," a table-funded transaction is one in which the mortgage broker makes the loan in the mortgage broker's name and concurrently sells the mortgage to a mortgage banker. The *Smith* court also described this practice as follows:

Under this arrangement, the mortgage broker or correspondent lender performs all of the originating functions and closes the loan in the name of the mortgage broker with funds supplied by the mortgage lender. The mortgage broker depends upon "table funding," the simultaneous advance of the loan funds from the mortgage lender to the mortgage broker. Once the loan is closed, the mortgage broker immediately assigns the mortgage to the mortgage lender. The essence of the table funding relationship is that the mortgage broker identifies itself as the creditor on the loan documents even though the mortgage broker is not the source of the funds. n4

Some state statutes specifically acknowledge the practice of table funding. Arizona's statute, for example, states that "[a] person who funds a mortgage loan which has been originated and processed by a licensee," is, under certain conditions, exempt from the mortgage broker act. n5 The next subsection clarifies that " 'originate' includes loans closed in a name other than that of the licensee." n6 New Jersey regulations define a table funding agreement as "an agreement between an investor and a licensee whereby the investor agrees to purchase specified mortgage loans from a licensee immediately after the closing of the mortgage loans, and which permits the licensee to close loans with funds of the investor."

Correspondent lending is another practice that developed with the wholesale lending market. A correspondent lender typically has a "warehouse line of credit" from which it funds the loans; closes the loans in its own name; immediately sells the closed loans to an investor, often another lender; and repays the warehouse lender. Correspondent lenders do not service the mortgages they sell. The New Jersey legislature defined the term "correspondent mortgage lender" as "A residential mortgage n7 lender who: (1) in the regular course of business, does not hold any mortgage loans in its portfolio, or service mortgage loans, for more than 90 days; and (2) has shown to the department's satisfaction an ability to fund mortgage loans through warehouse agreements, table funding agreements or otherwise." n8 n9

With the growth of wholesale lending came efforts to define the activities of a mortgage broker. The United States Department of Housing and Urban Development (HUD) first defined the term in 1992, when it issued final regulations, long-awaited by the mortgage finance and real estate industries, in the Real Estate Settlement Procedures Act (RESPA). n10

While most mortgage brokerages are small businesses, n11 mortgage bankers are generally large corporations which

make loans and sell them to an institutional investor or other secondary market entity. The secondary market, another phenomenon that developed rapidly, improved the flow of capital across the United States from capital-rich areas to capital-poor areas, but certain secondary market practices have been cited as a major factor contributing to the recent financial crisis. ⁿ¹²

The two largest and most well-known secondary market agencies are Freddie Mac (the Federal Home Loan Mortgage Corporation) and Fannie Mae (the Federal National Mortgage Association), also known as government-sponsored enterprises (GSEs). A smaller GSE, the Government National Mortgage Association, or Ginnie Mae, was created concurrently with Fannie Mae and securitizes government mortgages. Freddie Mac and Fannie Mae do not purchase loans directly from mortgage brokers; rather, they deal with mortgage bankers who have been approved as "Sellers" and "Servicers" by meeting specific requirements set out by the GSEs in the "Sellers/Servicers Guides" or in negotiated contracts. These Sellers and Servicers either buy completed loan packages from other lenders or mortgage brokers, or originate loans themselves and sell them to Freddie Mac and Fannie Mae.

Mortgage bankers are better capitalized than mortgage brokers and have higher net worth requirements under the Freddie Mac and Fannie Mae guidelines, and also under state laws and regulations. ⁿ¹³ Mortgage bankers, unlike mortgage brokers, are often retained by investors to service the loan. In some states a mortgage banker must obtain an additional license or endorsement to service mortgage loans, which can impose an even higher net worth requirement. ^{n13.1}

Mortgage brokers generally receive a fee or commission for services from the borrower, and may also receive fees from the lender. In this case, the state may require the mortgage broker to disclose the fee arrangement to both parties. ⁿ¹⁴ Regulation X, promulgated pursuant to RESPA, also requires the disclosure of all fees received by a mortgage broker in a federally related transaction, ⁿ¹⁵ whether paid by the borrower or the lender. ⁿ¹⁶

Clearly, mortgage brokers perform an important function in the real estate market. Like the GSEs, they help facilitate the redistribution of available investment capital among the various geographical regions of the United States. They are the retail outlet for many lenders, offering borrowers a variety of mortgage products; they facilitate the placement of mortgage loans; and they act as an intermediary between mortgage loan consumers and lenders.

As the field of mortgage brokerage has gained greater prominence, and more borrowers have sought mortgage brokerage services, the amount of regulation, both state and federal, has significantly increased. This chapter discusses the rights, duties and compensation of mortgage brokers, and the growing bodies of statutory, regulatory and case law, which are evolving with respect to this segment of the mortgage industry.

FOOTNOTES:

(n1)Footnote 1. This blurring of the lines is most clearly demonstrated by the Maryland Mortgage Lender Law, *Md. Code Ann., Fin. Inst. §§ 11-501-11-524*, which defines "mortgage lender" as, *inter alia*, a mortgage broker. *Md. Code Ann., Fin. Inst. § 11-501(i)*.

(n2)Footnote 2. See T. LaMalfa, D. Olson, *The Nation's Mortgage Brokers: Who Are They? Where Are They? What Do They Do?* 6-7 (National Ass'n of Mortgage Brokers 1992), in which the authors state:

Prior to the 1980s, mortgage brokerages were generally associated with niche lending, such as commercial loans, other types of income-producing property loans, second mortgages, and non-investment quality hard money and private money loans. The reason for this was that the traditional portfolio lenders, thrifts and savings banks, were so predominant that there was little room for brokers. As a result, they focused on filling the slots left behind by the traditional lenders.

(n3)Footnote 3. *Smith v. First Family Fin. Servs., Inc.*, 626 So. 2d 1266, 1268-69 (Ala. 1993) .

(n4)Footnote 4. *Smith v. First Family Fin. Servs., Inc.*, 626 So. 2d 1266, 1269 (Ala. 1993) .

(n5)Footnote 5. *Ariz. Rev. Stat. § 6-902 A.3.*

(n6)Footnote 6. *Ariz. Rev. Stat. § 6-902 B.1.*

(n7)Footnote 7. *N. J. Admin. Code § 3:15-1.2.*

(n8)Footnote 8. *N. J. S. A. 17: 11C-53.*

(n9)Footnote 9. [Reserved].

(n10)Footnote 10. Regulation X of RESPA, 24 C.F.R. § 3500, defines "mortgage broker" as follows:

Mortgage broker means a person (not an employee of a lender) or entity that renders origination services and serves as an intermediary between a borrower and a lender in a transaction involving a federally related mortgage loan, including such a person or entity that closes the loan in its own name in a table funded transaction. A loan correspondent approved under 24 C.F.R. 202.8 for Federal Housing Administration programs is a mortgage broker for purposes of this part. 24 C.F.R. § 3500.2 as amended by 73 Fed. Reg. 68204 (November 17, 2008) .

Following are the relevant provisions of the definition of "settlement service" as found in Section 3500.2:

Settlement service means any service provided in connection with a prospective or actual settlement, including, but not limited to, any one or more of the following:

- (1) Origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of such loans);
- (2) Rendering of services by a mortgage broker (including counseling, taking of applications, obtaining verifications and appraisals, and other loan processing and origination services, and communicating with the borrower and lender);
- (3) Provision of any services related to the origination, processing, or funding of a federally related mortgage loan;
- (15) Provision of any other services for which a settlement service provider requires a borrower or seller to pay. *Id.*

(n11)Footnote 11. T. LaMalfa, D. Olson, *The Nation's Mortgage Brokers: Who Are They? Where Are They? What Do They Do?* 8 (National Ass'n of Mortgage Brokers 1992).

(n12)Footnote 12. G. Nelson, D. Whitman, *Real Estate Finance Law* 765 (2d ed. 1985), in which the authors state:

Both of these agencies [Freddie Mac and Fannie Mae] are primarily engaged in purchasing on the secondary market residential mortgages originated by local lending institutions. ... Both FNMA and FHLMC are expected to improve the operation of the mortgage market in several ways: (1) They

facilitate the flow of capital from areas of the country where funds are plentiful to places in which mortgage money is in short supply. ...

GAO-09-216 Financial Regulation, p. 22 ("In particular, the securitization process created incentives throughout the chain of participants to emphasize loan volume over loan quality, which likely contributed to the problem as lenders sold loans on the secondary market, passing risks on to investors.").

(n13)Footnote 13. *See, e.g.:*

Florida: FL. Sess. Laws Ch. 2009-241 § 27 to be codified at *Fla. Stat. § 494.00321*, eff. October 1, 2010, which does not require a mortgage broker to demonstrate any net worth; and *Fla. Stat. § 494.00611*, which requires mortgage bankers to have a net worth of at least \$163,000 if not seeking a servicing endorsement.

Illinois: 205 Ill. Comp. Stat. 635/3-5, which requires mortgage brokers to have a net worth of at least \$50,000 and mortgage bankers to have a net worth of at least \$150,000.

(n14)Footnote 13.1. *Florida:* FL Sess. Laws Ch. 2009-241 § 51, to be codified at *Fla. Stat. § 494.0067(11)* eff. October 1, 2010. A mortgage lender may close loans in its own name but may not service the loan for more than 4 months unless the lender has a servicing endorsement. Only a mortgage lender who continuously maintains a net worth of at least \$250,000 may obtain a servicing endorsement.

(n15)Footnote 14. *See, e.g.:*

Arizona: *Ariz. Rev. Stat. § 6-906 D* (licensee must comply with the disclosure requirements of the Truth in Lending Act and the Real Estate Settlement Procedures Act) and *Ariz. Rev. Stat. § 6-907 A* (before an investor pays any money to a mortgage broker in connection with a mortgage loan, the licensee must provide certain documents and disclosures to the investor).

Florida: FL. Sess. Laws Ch. 2009-241 § 34, to be codified at *Fla. Stat. § 494.0038(1) (b)(2)* eff. October 1, 2010 ("If the mortgage broker is to receive any payment of any kind from the mortgage lender, the maximum total dollar amount of the payment must be disclosed to the borrower in the written mortgage broker agreement." ... If the agreement does not accurately state the exact amount of the payment, then "the exact amount of any payment of any kind by the lender to the mortgage broker must be disclosed in writing to the borrower within 3 business days after the mortgage broker is made aware of the exact amount of the payment from the lender but not less than 3 business days before the execution of the closing or settlement statement.")

New York: N.Y. Comp. Codes R. & Regs. tit. 38, § 38.3(a), regarding disclosures required of mortgage brokers:

(1)(iv) a statement to the effect that the rate, points, fees, and other terms quoted at commitment by or on behalf of the lender encompass the consideration to be received by the mortgage broker from a lender for its services. In addition, the statement shall disclose the specific maximum amount of such consideration to be received. ..."

South Carolina: *S.C. Code Ann. § 40-58-75(C)* ("[a]ll fees earned for services rendered as a mortgage

broker must be disclosed to the applicant by the mortgage broker as required by federal or state law").

But see Wash. Rev. Code § 19.146.030(1) ("[t]his subsection shall not be construed to require disclosure of the distribution or breakdown of loan fees, discount, or points between the mortgage broker and any lender or investor").

(n16)Footnote 15. Regulation X, at 24 C.F.R. § 3500.2 (the definition of "federally related mortgage loan" encompasses virtually any consumer-purpose loan on residential (1-4 family) real property, except for temporary financing and loans made by private investors whose investments in real estate loans equal \$1,000,000 per year or less).

(n17)Footnote 16. Regulation X now requires disclosure of lender payments to mortgage brokers on both the Good Faith Estimate and the HUD-1/1A in an entirely different way. *See § 11.09 infra*.

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The chapter was formerly revised by Mary J. Burt, Esq. Additional updates have been contributed by Sandra Bullington, Esq., of Louisa, Virginia.



4 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice § 11.02

§ 11.02 Licensing and Fee Regulation

[1] Licensing

While all states require that to act as a real estate broker one must obtain a real estate broker's license, n1 until recently there were few comprehensive regulatory schemes governing mortgage brokers. However, with the growth of wholesale lending and the mortgage brokerage industry has come increased legislation and regulation, particularly in the area of residential mortgage finance. n2 As of March 1, 2009, all fifty states and the District of Columbia regulated the conduct of mortgage brokers, or required their licensing or registration, or both. n3 Furthermore, all states were required to enact a law requiring appropriate licensing and/or registration for loan originators pursuant to the federal S.A.F.E. Mortgage Licensing Act of 2008 as of July 1, 2009. n4

In an effort to streamline and standardize the licensing process, the conference of State Bank Supervisors and the American Association of Residential Mortgage Regulators (AARMR) collaborated to launch the National Mortgage Licensing System (NMLS), an online system designed to manage multi-state applications, amendments, updates and renewals of state mortgage lender, broker, and loan originator licenses. The system, which went live on January 2, 2008, is intended to increase regulatory efficiency for regulators and industry alike by creating a single record for each licensee, which can be accessed by any state that regulates that licensee. The NMLS does not replace the decision-making authority of an individual state's regulator; rather, it is a processing center and secure content database that assists regulators in performing their duties more efficiently. As of December 31, 2010, all but three states (Florida, Minnesota and Nevada) will have transitioned their licensing procedures to the NMLS system. n5

Whereas in the past it was common to include mortgage brokerage activities within the scope of the statutory definition of real estate brokerage, many mortgage broker licensing laws now contain exemptions for real estate licensees only to the extent the real estate licensee is acting within the scope of that license and does not receive compensation for engaging in mortgage broker activities. Thus, in many states a licensed real estate broker may not receive a fee for acting as or for a mortgage broker without a separate mortgage broker's license. n6 However, now that the S.A.F.E. Mortgage Licensing Act of 2008 requires licensing for mortgage loan originators, several states have chosen to remove the real estate broker exemption from the mortgage broker licensing statute and instead exempt real estate brokers from licensing as mortgage loan originators. As a result, the exemption is generally applicable unless the real estate broker is compensated by a mortgage lender, mortgage broker or mortgage originator. n6.1

The state statutes vary greatly in scope. California, for example, requires the real estate mortgage broker to prepare and deliver to both the prospective lender and the prospective borrower a comprehensive disclosure statement. n7 Idaho, Iowa and Missouri, on the other hand, have minimal requirements. n8

As the mortgage industry continues to change and grow, state regulators will continue to seek ways to protect the consumers in their state. Generally, state legislatures are charged with setting policy, with enforcement power granted to state agencies. AARMR, a trade group with member-regulators from many states, was formed in 1989 to provide direction to a rapidly burgeoning number of state regulators. AARMR, working with an Advisory Council of industry representatives, created the AARMR Compendium of Mortgage Activity (Lending, Brokering and Servicing) Statutory Provisions (the AARMR Act) with the expectation of promoting some consistency to regulations affecting the mortgage industry. The AARMR Act covers such topics as:

- Licensing Procedures;
- Net Worth, Bonding, Escrow Funds, Record Keeping Requirements, and Prohibited Practices; Disclosure Requirements;
- Powers and Duties of the Regulator; and
- Investigation and Enforcement. n9

The AARMR Act begins with a statement that expresses the need for laws and regulations of the mortgage industry, a need echoed by many government officials and people within the industry:

Section 1-2 Policy and Purpose

The activities of mortgage lenders, mortgage brokers, and mortgage servicers and the offering of financing for residential real property have a direct, valuable and immediate impact upon this State's consumers, this State's economy, the neighborhoods and communities of this State, and the housing and real estate industry. The (Legislative body) finds that accessibility to mortgage credit is vital to the state's citizens. The (legislative body) also finds that it is essential for the protection of the citizens of this State and the stability of the State's economy that reasonable standards for licensing and regulation of the business practices of mortgage lenders, mortgage brokers, and mortgage servicers be imposed. The (legislative body) further finds that the obligations of mortgage lenders, mortgage brokers, and mortgage servicers to consumers in connection with the making, brokering, and servicing of mortgage loans are such as to warrant the regulation of the mortgage lending process, including the making, brokering, and servicing of mortgage loans. The purpose of this Act is to protect consumers seeking mortgage loans and to ensure that the mortgage lending industry is operating without unfair, deceptive, and fraudulent practices on the part of mortgage lenders, mortgage brokers, and mortgage servicers. n10

The AARMR Act is a conceivable basis for much of the statutory language governing mortgage broker licensing or registration.

[2] Fee Regulation

Many of the reported cases on mortgage brokers are in the commercial context, and are often the result of disputes over commissions. In both commercial and residential transactions, plaintiffs' allegations often include fraudulent activity or breach of fiduciary duty. n11

Residential mortgage transactions fall generally into three categories:

- government loans (loans insured by the Federal Housing Administration or guaranteed by the Veterans Administration, neither of which will be discussed here);
- conforming mortgage transactions (those that conform to the underwriting guidelines of Freddie Mac or Fannie Mae and benefit from an implicit government guarantee); and
- non-conforming mortgage transactions (mortgages that do not fit into either of the other two categories).

In conforming transactions, mortgage brokers typically charge the borrower a fee of from one to two percent of the face amount of the loan for services provided. n12 However, the market for non-conforming mortgages cannot be so easily classified. Varying market conditions, the perception that non-conforming mortgages are riskier, and the lack of a government guarantee may justify the higher fees charged in non-conforming transactions.

While a competitive marketplace ordinarily leads to self-regulating of fees, a 1994 lawsuit n13 was the first in a succession of class action suits directed at the practices of mortgage brokers. The 1994 suit indicated a growing concern about what some plaintiffs have alleged are fraudulent practices surrounding fees paid to residential mortgage brokers, particularly in the non-conforming or high-risk context. The parties to the lawsuit reached a settlement before the court could render a verdict on the numerous issues. n14 However, the disputes over mortgage broker fees rages on fueled in part by the passage of the Home Ownership and Equity Protection Act (HOEPA) in 1994, n15 amendments to RESPA that brought refinancings and subordinate liens under its auspices, n16 the controversy over "yield spread premiums" and how they are to be disclosed to consumers, n17 the subprime mortgage meltdown, and recent amendments to Regulation Z regarding "Higher Priced Mortgage Loans." n18 HOEPA was seen by consumer groups as an attempt to stem a tide of perceived abuses, n19 defining what in early drafts was referred to as a "high-cost" mortgage, n20 providing for additional disclosures to borrowers, n21 adding limitations for mortgages that fall under the "high-cost" definition, n22 and giving the Federal Reserve Board discretionary authority to exempt certain products or categories of mortgages. n23

Only a few states currently regulate the dollar amount of fees and commissions a mortgage brokerage may charge. Maryland limits "finders fees" to 8% of the amount of the loan or advance. n24 Minnesota limits the aggregate of "lender fees," which include fees paid to mortgage brokers by borrowers or lenders, to a maximum of 5% of the loan amount. n25 Florida, through its comprehensive Mortgage Brokerage and Mortgage Lending Act, puts a ceiling on the maximum fees or commissions which may be charged for any mortgage loan depending upon the net proceeds of the loan to the borrower, up to \$250 plus ten percent of the "entire mortgage loan." n26

California, in contrast, limits the total dollar amount of all fees charged in connection with real estate secured loans (including mortgage broker fees) but does not apply these limitations to first mortgage loans of thirty thousand dollars or more, and junior loans of twenty thousand dollars or more. n27 Thus, the broker's commission in the bulk of California mortgage transactions is, as in most jurisdictions, whatever the market will bear.

n28 n29 n30 However, in California, a broker licensed under the real estate law who charges more than the statute allows will have to refund the excessive charges, and will forfeit its entire commission unless it can show that the violation was "not intentional and resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error." n31 While many state statutes exempt licensed attorneys, while acting in that capacity, from the purview of the broker licensing laws, n32 this exemption typically applies only where the attorney/mortgage broker does not accept compensation for his mortgage broker activity or is not actively and principally engaged in the business of negotiating mortgage loans. For example, in Florida a mortgage broker who is also a licensed attorney may not receive compensation for title insurance he wrote for the same loan in which he acted

as mortgage broker because in such transactions he would be "actively and principally engaged" in business as a mortgage broker. n33

FOOTNOTES:

(n1)Footnote 1. For a discussion of state licensing schemes for real estate brokers, *see* ch. 6 *above*.

(n2)Footnote 2. Most reported cases that deal with mortgage brokers are in the commercial lending context. Federal and state laws and regulations of the mortgage industry were enacted for consumer-protection purposes and thus focus on single-family owner-occupied residential property.

(n3)Footnote 3. An Alaska law, A.S. 06.60.010 *et seq.* required mortgage brokers to become licensed by March 1, 2009.

(n4)Footnote 4. *See*: S.A.F.E. Mortgage Licensing Act, Title V of P.L. 110-289.

(n5)Footnote 5. [Reserved].

(n6)Footnote 6. *See, e.g.*:

Arkansas: Ark. Code Ann. § 23-39-502(9)(B)(ix)(a)-(b).

Georgia: Ga. Code Ann. § 7-1-1001(a)(6) exempts from licensing "a real estate broker or real estate salesperson not actively engaged in the business of negotiating mortgage loans"; and requires licensing for "a real estate broker or real estate salesperson who receives any fee, commission, kickback, rebate, or other payment for directly or indirectly negotiating, placing, or finding a mortgage for others."

Iowa: Iowa Code § 535B.2 (limits the exemption for real estate brokers licensed under chapter 543B to apply only while engaged in practice as a real estate broker).

Massachusetts: Mass. Gen. Laws ch. 255E, § 2.

New Jersey: N.J. Stat. Ann. § 17:11C-554(d) provides that mortgage broker licensing requirements do not apply to a person licensed as a real estate broker or salesperson and not engaged in the business of a mortgage banker or broker, which includes directly or indirectly negotiating, placing or selling first mortgage loans for others in the primary market, in exchange for compensation or gain.

New York: N.Y. Banking Law § 590(2)(b); *see also* N.Y. Real Prop. Law § 440:

1. Whenever used in this article "real estate broker" means any person, firm, limited liability company, or corporation, who, for another and for a fee, commission or other valuable consideration, ... negotiates or offers or attempts to negotiate, a loan secured or to be secured by a mortgage, other than a *residential* mortgage loan, as defined in section five hundred ninety of the banking law. ... (Emphasis added.)

North Carolina: N.C. Gen. Stat. § 53-243.01(8)(d) exempts any licensed real estate agent..

Oregon: Or. Rev. Stat. § 86A.100(7)(b)(D) provides that mortgage broker licensing is not required for a real estate licensee who performs services solely incidental to the practice of professional real estate activity as defined in ORS 696.010, unless the real estate licensee negotiates or offers to make or

negotiate a mortgage loan for compensation.

Virginia: Va. Code Ann. § 6.1-411(8) exempts from the requirements of the Mortgage Lender and Broker Act

Persons licensed by the Commonwealth as ... real estate brokers, or real estate salesmen, not actively and principally engaged in negotiating, placing or finding mortgage loans, when rendering services as ... real estate broker or real estate salesman; however, a real estate broker or real estate salesman who receives any fee, commission, kickback, rebate or other payment for directly or indirectly negotiating, placing or finding a mortgage loan for others shall not be exempt from the provisions of this chapter. ...

Washington: Wash. Rev. Code § 19.146.020(1)(e) provides an exemption from mortgage broker licensing for a real estate broker or salesperson who obtains financing for a real estate transaction in the course of his or her duties as a real estate broker, and who receives only the customary real estate broker's or salesperson's commission in connection with the transaction.

But see, e.g.:

California: The California real estate broker statute contains a well-developed mortgage broker component that distinguishes it from real estate licensing laws in most other states. *See Cal. Bus. & Prof. Code § 10131(d)* (real estate broker includes one who "[s]olicits borrowers or lenders for or negotiates loans or collects payments or performs services for borrowers or lenders or note owners in connection with loans secured directly or collaterally by liens on real property or on a business opportunity").

(n7)Footnote 6.1. *See, e.g., Illinois: 205 ILCS 635/1-4(jj)*. "Mortgage loan originator" does not include a person or entity that only performs real estate brokerage activities and is licensed in accordance with the Real Estate License Act of 2000, unless the person or entity is compensated by a lender, a mortgage broker, or other mortgage loan originator, or by any agent of that lender, mortgage broker, or other mortgage loan originator.

(n8)Footnote 7. *Cal. Bus. & Prof. Code §§ 10232.5, 10240* (disclosures to prospective lender, prospective borrower).

See also Barry v. Raskov, 283 Cal. Rptr. 463, 467 (Ct. App. 1991) (mortgage loan broker owes a fiduciary duty to both lender-investor and borrower, with duty of full disclosure of all material facts).

(n9)Footnote 8. *See, e.g.:*

Idaho: Idaho Code § 26-3114; *Idaho Admin. Code r. 12.01.10.050*.

Iowa: Iowa Code §§ 535B.1-535B.16.

(n10)Footnote 9. AARMR Compendium of Mortgage Activity (Lending, Brokering and Servicing) Statutory Provisions (American Ass'n of Residential Mortgage Regulators 2000). For more information, write to the American Association of Residential Mortgage Regulators, 1255 Twenty-Third Street, N.W., Suite 200, Washington, D.C. 20037; or call 202-521-3999; or visit its website at www.aarmr.org.

(n11)Footnote 10. AARMR Compendium of Mortgage Activity (Lending, Brokering and Servicing) Statutory Provisions § 1.2 (American Ass'n of Residential Mortgage Regulators 2000).

(n12)Footnote 11. *See, e.g.:*

California: Barry v. Raskov, 283 Cal. Rptr. 463, 465 (Ct. App. 1991) ; *UMET Trust v. Santa Monica Med. Inv. Co.*, 189 Cal. Rptr. 922, 924 (Ct. App. 1983) (mortgage broker retained to assist in securing loan originally designed as sale-leaseback owed fiduciary duty to borrower extending at least to time of loan funding).

(n13)Footnote 12. *See* Letter from Frank Keating, General Counsel of HUD, to Laurence E. Platt, Esq., and Robert Chamness, Esq., regarding the disclosure of mortgage broker fees and charges under RESPA (Dec. 2, 1992), *reprinted in* L. Platt, P. Schulman, A Practical Guide to the Real Estate Settlement Procedures Act (WGL 1995), Exhibit A18 at 3.

(n14)Footnote 13. *Hunter v. Fleet Fin., Inc.*, No. 94-CV-266 (E.D.Va., filed Apr. 20, 1994) (Introduction to Class Action Complaint:

"1. This action challenges a fraudulent practice in which defendant Fleet Finance, Inc., a mortgage company and various mortgage brokers ... bilked numerous homeowners of thousands of dollars and homeowners' equity through hidden brokers' fees in connection with mortgage loans.").

(n15)Footnote 14. *Hunter v. Fleet Fin., Inc.*, No. 94-CV-266 (E.D. Va., filed Apr. 20, 1994). The first six charges allege violation of a number of sections of 18 U.S.C. § 962(a) of the Racketeering Influenced and Corrupt Organizations Act (RICO); the seventh charge alleges violation of the Federal Truth in Lending Act, 15 U.S.C. § 1601 *et seq.* ; the eighth charge alleges common-law fraud; the ninth charge alleges a breach of contract claim against brokers; and the tenth charge alleges violation of Virginia Usury Laws.

(n16)Footnote 15. The Home Ownership and Equity Protection Act of 1994, Pub. L. No. 103-325, 108 Stat. 2190 (1994), codified at 15 U.S.C. §§ 1601-1666j.

(n17)Footnote 16. Real Estate Settlement Procedures Act of 1974, Pub. L. No. 93-533, 88 Stat. 1724 (1994), codified at 12 U.S.C. §§ 2601-2617.

(n18)Footnote 17. *See* discussion at § 11.08 below.

(n19)Footnote 18. *See* discussion at § 11.10 below.

(n20)Footnote 19. *See, e.g.*, M. Hudson, A. Feuerstein, *Reforming High Finance*, Southern Exposure, Fall 1993, at 33.

(n21)Footnote 20. 15 U.S.C. § 1602(aa)(1).

(n22)Footnote 21. 15 U.S.C. § 1639(a).

(n23)Footnote 22. 15 U.S.C. § 1639(c)-(i).

(n24)Footnote 23. 15 U.S.C. § 1639(1).

(n25)Footnote 24. Md. Comm. Law 12-804(a).

(n26)Footnote 25.

Minnesota: Minn. Stat. 58.137

(n27)Footnote 26. *Fla. Stat. § 494.0042(2)(d)* states that, "[f]or the purpose of determining the maximum fee, the amount of the mortgage loan is based on the amount of mortgage loan actually funded exclusive of the authorized maximum fees or commissions."

(n28)Footnote 27. *Cal. Bus. & Prof. Code § 10242, 10245*

(n29)Footnote 28. [Reserved].

(n30)Footnote 29. [Reserved].

(n31)Footnote 30. [Reserved].

(n32)Footnote 31. *Cal. Bus. & Prof. Code § 10248.2; see also Cal. Bus. & Prof. Code § 10248.1* ("[n]o real estate licensee shall charge, receive, or negotiate for the payment by the borrower of any service charge or fee other than charges and fees specified in Sections 10241, 10241.1, 10242, and 10242.5..."); *Cal. Bus. & Prof. Code § 10248.2(b)* (if an offending broker does not comply with a written demand for the return of commissions and fees charged within 20 days from the "date of written demand," which means "either the date upon which the written demand is personally delivered to the licensee or the date upon which the written demand is mailed to the licensee," the broker is liable for double the commission or actual damages, whichever is greater, plus costs and reasonable counsel fees).

(n33)Footnote 32. *See, e.g.:*

California: Cal. Bus. & Prof. Code § 10133.1(a)(5).

Arizona: Ariz. Rev. Stat. § 6-902A.5.

Florida: Fla. Stat. § 494.00115(1)(d).

Michigan: Mich. Comp. Laws § 445.1675(j).

New York: N.Y. Banking Law § 590(2)(b).

South Carolina: S.C. Code Ann. § 40-58-20(16)(h).

Washington: Wash. Rev. Code § 19.146.020(1)(c).

(n34)Footnote 33. *Waller v. State*, 592 So. 2d 319, 321 (*Fla. Dist. Ct. App.* 1992) (attorneys are only exempt from this rule where the mortgage brokerage activity occurs as part of legal representation of client).

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The chapter was formerly revised by Mary J. Burt, Esq. Additional updates have been contributed by Sandra Bullington, Esq., of Louisa, Virginia.



5 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice § 11.03

§ 11.03 Factors Affecting Whether Mortgage Broker's Commission Might Cause Loan to Be Considered Usurious

It is well established that a mortgage loan transaction is not made usurious by the mere fact that a mortgage broker commission is paid by the borrower. n1 As a Nevada court stated: "[W]here one negotiates a loan through a broker with a money lender, and the latter bona fide lends the money at a legal rate of interest, the transaction is not made usurious by the fact that the broker charges the borrower a commission for his services." n2

On the other hand, it is equally recognized that "the exaction of a broker's fee by the lender or his agent will be considered in computing interest to determine whether the transaction is usurious." n3 Thus, where the broker is also the lender, n4 or the lender requires as a condition of the loan that a commission be paid to the lender's agent, n5 the loan may be subject to a charge of usury if the effective rate of interest to the borrower (including payments to the lender or his agent in the form of brokerage fees) exceeds the rate allowed by law. n6

Violation of the Virginia usury statute n7 was alleged in a 1994 class-action lawsuit against Fleet Finance, Inc. (Fleet) and some mortgage brokers who originated loans for Fleet. n8 Plaintiffs claimed that fees paid to mortgage brokers by the lender were "unlawfully hidden brokers' fees on loans involving first mortgages within the meaning of *Va. Code Section 6.1-330.70*" and were "not 'reasonable and necessary' charges in connection with the making of first mortgage loans." n9

Counsel for defendant mortgage broker Crosstate Mortgage and Investments, Inc., responded as follows:

There is no prohibition in any Virginia statute governing first mortgage loans on the amount of payments by lenders to brokers in connection with such loans. The interest charged is by agreement of the lender and the borrower and, therefore, there is no requirement that the interest and points charged by Fleet to a borrower be "reasonable." Reasonableness is a function of the market. Moreover, the reasonableness limits on non-interest charges in *Va. Code § 6.1-330.70* apply only to certain types of charges "in addition to those permitted by § 6.1-330.69." n10

The parties reached a settlement before trial, leaving the legal issues, including the usury charge, unresolved. Yet the case remains instructive, as since that time at least 150 class action lawsuits have been filed challenging the legality of

such payments under RESPA § 8. n11

Other courts have had to confront thorny questions of agency in determining whether the mortgage broker's fee has, in fact, been exacted by the lender or the lender's agent. The mere fact that the mortgage broker and lender have executive officers or corporate directors in common is usually not itself sufficient to sustain the borrower's burden of proving that the broker and lender are either "one entity" or principal and agent. n12 For example, in *Swanson v. Gulf West International Corp.*, n13 the borrower contended that because the chief executive officer of the brokerage firm was also president of the corporate lender, the broker was an agent of the lender and the broker's commission should have been deemed interest for the purpose of determining whether the loan was usurious. Rejecting this claim, the court stated:

As to the question of the brokerage commission, there was sufficient evidence to support the trial court's determination that the brokerage commission was a legitimate brokerage charge, was not paid to the lender or an agent of the lender, and was, therefore, not interest. For example, except for Mr. Barrish who was president of both corporations, the two companies had no officers in common; they had no common stockholders, the [borrower's] loan application was taken by an employee of the brokerage corporation and was submitted to several other lenders before being accepted by [the lender]; and Mr. Barrish testified that lenders other than [Gulf West International Corporation] made about 95 percent of the loans brokered by Gulf West Financial Corporation. n14

However, where there is a close connection between the lender and broker, including stockholders in common, and there is proof that the lender intends that a brokerage commission be received by its agent, courts have held that the brokerage fee constitutes interest on the mortgage loan. n15

The issue of whether a brokerage fee constitutes a "finance charge" on a mortgage was addressed in two separate amendments to Regulation Z (Reg. Z) issued by the Federal Reserve Board. n16 Reg. Z, which implements the Truth in Lending Act (TILA), n17 has as its stated purpose "to promote the informed use of consumer credit by requiring disclosures about its terms and cost." n18 The first Reg. Z amendment stated that a broker's fee paid by a borrower is a finance charge only if the lender required the borrower to use the broker. n19 The second Reg. Z amendment, which is currently in effect, specifically provides that all mortgage broker fees paid by the borrower are to be considered to be finance charges under the Truth in Lending Act. n20

A 1993 Georgia case, *Johnson v. Fleet Finance, Inc.*, n21 demonstrated the confusion surrounding the cost-of-consumer-credit issue before adoption of this last Reg. Z amendment. In *Johnson*, the court framed the issue as "whether a loan broker's fee constitutes a finance charge under the federal Truth in Lending Act, 15 U.S.C. § 1605(a), when the lender neither receives part of the fee nor requires the borrower to use a loan broker." n22 The plaintiffs acknowledged that all fees and charges were disclosed on the disclosure documents, but alleged that the fee paid to a mortgage broker was shown "as part of the 'amount financed' rather than as a separate 'finance charge' " n23 giving the impression that "the cost of the loan was lower than it actually was." n24 The court, relying on the official staff commentary to Reg. Z, n25 opined that because the plaintiffs sought the services of the mortgage broker on their own, the lender did not require the use of the mortgage broker, n26 and the disclosure was correct.

In determining whether the broker is an agent of the lender for purposes of the usury statutes, courts weigh the various factors but do not always agree as to their significance. Some courts attach little significance to the fact that the broker services the loan for the lender after closing, n27 while others see this same factor as tending to establish an agency relationship. n28 Courts seem to agree, however, that the disclosure of brokerage commissions required under TILA and Reg. Z are not probative on the question of agency. n29

A number of courts have taken the view that the mortgage broker may perform various services for the lender without becoming the lender's agent. n30 The broker may obtain and transmit to the lender information relating to the financial condition of the borrower, the state of the borrower's title to the property, and may even prepare all the essential

mortgage loan documents without being deemed the lender's agent. Consequently, an Illinois court has stated:

Needless to say, a loan broker gets no fee unless the borrower successfully negotiates the loan. The broker may understandably perform any number of accommodations for the lender in an effort to induce him to make the loan. But those acts of accommodation are based on self-interest and not on any desire to further the interests of the lender. n31

This view, however, is not universally accepted. Sometimes a court will find an implied agency relationship between broker and lender despite their intentions to the contrary. For example, in *Busk v. Hoard*, n32 a sharply divided Supreme Court of Washington inferred an agency relationship and found the mortgage transaction in a foreclosure action to be usurious. In *Busk*, after the borrowers had approached the mortgage broker and entered into a written brokerage contract, the lender, a private individual with no prior real-estate experience, responded to the broker's newspaper advertisement and agreed to make the loan. He was told the broker would service the mortgage without charge and would secure title insurance. The lender neither saw the property nor met the borrowers and left everything to the broker, including the preparation of the mortgage documents and the recording of the lien, all of which was done after the lender had turned the loan funds over to the broker. Later, when the borrower defaulted, the broker sent foreclosure notices which characterized the lender as the broker's client. n33 These facts, concluded the court, created an agency relationship between the lender and broker as a matter of law; knowledge of the brokerage commission, which when added to the principal and interest due on the mortgage rendered the loan usurious, was imputed to the lender. n34

Another question that has confronted the courts is whether fee-splitting between the mortgage broker and lender renders the transaction usurious. The answer to this question depends, in many jurisdictions, upon whether the mortgage lender requires the borrower's mortgage broker to split its commission. n35 If fee splitting is required as a condition of the loan, and the lender thereby receives more than the legal rate of interest on the loan, the transaction is generally seen as usurious. n36 However, to the extent that the broker voluntarily offers part of its fee to the lender as an inducement to make the loan, and there is no sufficient proof that the broker is also the lender's agent, courts hold that the commission was not "exact" by the lender, and the fee-splitting does not subject the loan to a charge of usury. n37

There is dicta in some cases stating the even more permissive view that, as long as the parties act in good faith without intent to circumvent the usury laws, and the borrower is not further burdened by the sharing of the commission, the mere fact that the lender makes fee-sharing a condition of the loan does not make the transaction usurious. n38

FOOTNOTES:

(n1)Footnote 1. *See, e.g.:*

Federal: Kovian v. Fulton County Nat'l Bank and Trust Co., 647 F. Supp. 830 (N.D.N.Y. 1986) .

Arizona: Sulger v. Maslin, 365 P.2d 1113, 1116 (Ariz. 1961) .

Florida: Swanson v. Gulf West Int'l Corp., 429 So. 2d 817, 818 (Fla. Dist. Ct. App. 1983) (broker's commissions not deemed interest); *Fla. Stat. § 494.0042(1)* (a mortgage brokerage fee earned by a licensee, pursuant to §§ 494.003-494.0043, is not considered interest or a finance charge under chapter 687).

Illinois: Farrell v. Lincoln Nat'l Bank, 320 N.E.2d 208, 211-13 (Ill. App. Ct. 1974) .

Louisiana: Roy. A. Schnebelen & Assocs. v. American Bank & Trust Co., 349 So. 2d 1020, 1023-24 (La. Ct. App. 1977) .

Nevada: United Mortgage Co. v. Hildreth, 559 P.2d 1186, 1187 (Nev. 1977) .

New Mexico: Diane, Inc. v. Kapnison, 667 P.2d 450, 452 (N.M. 1983) .

New York: Feinberg v. Old Vestal Rd. Assocs., 550 N.Y.S.2d 482, 484 (App. Div. 1990) .

Texas: Great S. Life Ins. Co. v. Williams, 135 S.W.2d 241, 245 (Tex. Civ. App. 1939) .

See also *Stoneridge Parkway Partners, LLC v. MW Housing Partners III, L.P.*, 153 Cal. App. 4th 1373, 1379, 64 Cal. Rptr. 3d 61, 66 (2007) , review denied, 2007 Cal. LEXIS 13030 (Nov. 14, 2007) (California Constitution Art. XV, § 1 limits the interest rate lenders can charge on nonpersonal loans. However, this limit does not apply to loans, made or arranged by a California licensed real estate broker which is secured in whole or in part by liens on real property. This constitutional exemption for loans obtained through licensed real estate brokers is implemented in Cal. Civ. Code § 1916.1.).

(n2)Footnote 2. *United Mortgage Co. v. Hildreth*, 559 P.2d 1186, 1187 (Nev. 1977) .

(n3)Footnote 3. *United Mortgage Co. v. Hildreth*, 559 P.2d 1186, 1187 (Nev. 1977) (citations omitted).

(n4)Footnote 4. See, e.g., *Garcia v. Wetzel*, 159 Cal. App. 3d 1093, 206 Cal. Rptr. 251, 254 (Ct. App. 1984) (even though a licensed real estate broker charged interest in excess of 250% per annum, the broker did not need to act in his licensed capacity for the exemption from the constitutional prohibition against usury to apply; citing Cal. Const. art. XV, § 1; Cal. Civ. Code § 1916.1, which specifically exempts from usury loans "made or arranged by any person licensed as a real estate broker in California," including any loan made by a real estate licensee, either as principal or agent, regardless of whether such person is acting in the scope of such license).

See also *Winnett v. Roberts*, 225 Cal. Rptr. 82, 85 (Ct. App. 1986) (when "the only participant in the loan transaction who is licensed as a real estate broker is the borrower, the loan has not been 'made' by the broker within the meaning of the [statutory] exemption").

See also:

Federal: In re Lara, 731 F.2d 1455, 1459 (9th Cir. 1984) ("a licensed real estate broker need not be acting in his licensed capacity for the usury exemption to apply").

Michigan: Attorney General v. Diamond Mortgage Co., 327 N.W.2d 805 (Mich. 1982) (transactions specifically authorized by license cannot form the basis of a complaint under the Michigan Consumer Protection Act).

(n5)Footnote 5. See *Sulger v. Maslin*, 365 P.2d 1113, 1116 (Ariz. 1961) ("If [paying a portion of the commission to the lender] had been a condition of the loan we might have a case of usury before us.").

(n6)Footnote 6. It also should be noted that mortgage brokers and lenders who seek to evade statutory limits on mortgage interest by having the borrower incorporate, thereby taking advantage of the typical statutory exception to the usury laws for business corporations, may well find themselves accused of violating state consumer protection laws.

See, e.g., *Allan v. M & S Mortgage Co.*, 359 N.W.2d 238 (Mich. Ct. App. 1984) (complaint for declaratory relief under Michigan Consumer Protection Act, challenging ability of mortgage broker and second mortgage lender to insist that homeowners form a corporation in order to borrow at interest rates which would be usurious if charged to an

individual, stated a claim upon which relief would be granted).

(n7)Footnote 7. *Va. Code Ann. §§ 6.1-330.69, 6.1-330.70.*

(n8)Footnote 8. *Hunter v. Fleet Fin., Inc.*, No. 94-CV-266 (E.D. Va., filed Apr. 20, 1994).

(n9)Footnote 9. *Hunter v. Fleet Fin., Inc.*, No. 94-CV-266 (E.D. Va. filed Apr. 20, 1994) (Plaintiff's Amended Class Action Complaint at 92).

(n10)Footnote 10. *Hunter v. Fleet Fin., Inc.*, No. 94-CV-266 (E.D. Va. filed Apr. 20, 1994) (Memorandum in Support of Motion to Dismiss of Defendant Crosstate Mortgage and Investments, Inc. at 28).

(n11)Footnote 11. *See § 11.08 below* for further discussion.

(n12)Footnote 12. *See, e.g.:*

Florida: Swanson v. Gulf West Int'l Corp., 429 So. 2d 817, 818 (Fla. Dist. Ct. App. 1983) (president of mortgage brokerage firm was also president of ultimate lender; agency claim rejected).

Louisiana: Roy A. Schnebelen & Assocs. v. American Bank & Trust Co., 349 So. 2d 1020, 1023 (La. Ct. App. 1977) (mortgage brokerage corporation and bank had several overlapping directors; "one entity" claim rejected).

(n13)Footnote 13. 429 So. 2d 817 (Fla. Dist. Ct. App. 1983) .

(n14)Footnote 14. 429 So. 2d 817, 818 (Fla. Dist. Ct. App. 1983) .

(n15)Footnote 15. *See North Am. Mortgage Investors v. Cape San Blas Joint Venture*, 378 So. 2d 287, 290-91 (Fla. 1979) .

(n16)Footnote 16. Regulation Z, Truth in Lending (12 C.F.R. part 226).

(n17)Footnote 17. 15 U.S.C. §§ 1601 to 1700.

(n18)Footnote 18. 12 C.F.R. part 226.1(b).

(n19)Footnote 19. 46 FR 20848 .

(n20)Footnote 20. 12 C.F.R. § 226.4(a)(3).

(n21)Footnote 21. 4 F.3d 946 (11th Cir. 1993) (per curiam). *See also Smith v. First Family Fin. Servs., Inc.*, 626 So. 2d 1266, 1271 (Ala. 1993) (the yield spread premium is part of the origination loan fee paid to the mortgage broker, and is a "finance charge" under the Mini-Code, or Consumer Finance Act). *But see Goldome Credit Corp. v. Burke*, 923 So. 2d 282, 293 (Ala. 2005) (to the extent *Smith* held that the yield spread premium constitutes "points" for purposes of the Mini-Code, it is overruled.).

(n22)Footnote 22. *Johnson v. Fleet Finance, Inc.*, 4 F.3d 946, 947 (11th Cir. 1993) .

(n23)Footnote 23. *Johnson v. Fleet Finance, Inc.*, 4 F.3d 946, 948 (11th Cir. 1993) .

(n24)Footnote 24. *Johnson v. Fleet Finance, Inc.*, 4 F.3d 946, 948 (11th Cir. 1993) .

(n25)Footnote 25. Official Staff Commentary to Regulation Z, 12 C.F.R. Part 226, Supp I.

(n26)Footnote 26. *Johnson v. Fleet Finance, Inc.*, 4 F.3d 946, 949-50 (11th Cir. 1993) .

(n27)Footnote 27. See *United Mortgage Co. v. Hildreth*, 559 P.2d 1186, 1187 (Nev. 1977) (broker serviced construction loan for private lender).

(n28)Footnote 28. See *Busk v. Hoard*, 396 P.2d 171, 175 (Wash. 1965) (servicing of a loan was one of the factors which established implied agency between a broker and a lender).

(n29)Footnote 29. See *Farrell v. Lincoln Nat'l Bank*, 320 N.E.2d 208, 215 (Ill. App. Ct. 1974) . But cf. *United Mortgage Co. v. Hildreth*, 559 P.2d 1186, 1187 (Nev. 1977) (fact that broker signed a Regulation Z notice may be read to suggest that the broker was to be the lender).

(n30)Footnote 30. In *Jones v. Kallman*, 244 Cal. Rptr. 609, 611 (Cal. Ct. App. 1988) , the court held that determining interest rates, setting terms of forbearance and reviewing loan documents constituted sufficient involvement by a broker to make a loan "broker-arranged" and therefore exempt from the state usury statute. In the case at bar, Jones engaged a broker to obtain refinancing of a trust deed. The initial broker contacted another licensed broker, Johnston, who referred the matter to his partner, Kallman, a licensed real estate salesman. Kallman arranged for a loan and later arranged for a forbearance on the loan. After repaying the loan, Jones brought an action against the lender and Kallman, charging that the loans were usurious. The court held that the record supported the trial court's finding that the loans were not usurious, since they fell within the exception for loans "arranged" by licensed real estate brokers. The court found that Johnston arranged the loan, since Johnston determined the interest rate, set the terms of forbearance and reviewed the documents. The court also held that Johnston received compensation for his services, which was sufficient to trigger the exception clause, even though Kallman received all the commissions. The court reasoned that since courts traditionally give a liberal interpretation to the term "compensation," the fact that Kallman contributed some of his commission to the expenses of his partnership with Johnston amounted to compensation for Johnston.

(n31)Footnote 31. *Farrell v. Lincoln Nat'l Bank*, 320 N.E.2d 208, 213-14 (Ill. App. Ct. 1974) .

Accord:

Florida: Shaffran v. Holness, 102 So. 2d 35, 40-41 (Fla. Dist. Ct. App. 1958) (per curiam).

Georgia: Merck v. American Freehold Land Mortgage Co., 7 S.E. 265, 268 (Ga. 1887) .

Texas: Great S. Life Ins. Co. v. Williams, 135 S.W.2d 241, 247 (Tex. Civ. App. 1939) .

(n32)Footnote 32. 396 P.2d 171 (Wash. 1965) .

(n33)Footnote 33. 396 P.2d 171, 174 (Wash. 1965) .

(n34)Footnote 34. 396 P.2d 171, 175-76 (Wash. 1965) . This conclusion drew a sharp dissent from Chief Justice Ott, who would have held that the relationship between the broker and lender was that of seller and buyer and wrote: "[I]t is more consistent to hold that [the broker] performed these services gratuitously or was compensated therefor by the brokerage commission, than it is to hold that [the lender] was receiving a financial benefit from the services; hence, had knowingly and intentionally executed a usurious contract" 396 P.2d 171, 179 (Wash. 1965) (Ott, C.J., dissenting) (emphasis in original).

(n35)Footnote 35. See, e.g., *Sulger v. Maslin*, 365 P.2d 1113 (Ariz. 1961) (lender received 1.5% of mortgage broker's commission as incentive to make loan).

(n36)Footnote 36. *Sulger v. Maslin*, 365 P.2d 1113, 1116 (Ariz. 1961) ("[t]he purpose of this general proposition of

law is to prevent ingenious methods and arrangements wherein borrowers in dire need of immediate money may be filched of excessive sums under the pretense of incidental expenses.").

(n37)Footnote 37. *Sulger v. Maslin*, 365 P.2d 1113, 1116 (Ariz. 1961) .

(n38)Footnote 38. *See also* Annotation, *Usury: Expenses or Charges in Form of Commissions to Agents, Brokers, or Like Intermediaries Incident to Loan of Money*, 52 A.L.R.2d 703 (1957) .

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6 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice § 11.04

§ 11.04 Mortgage Broker's Right to Compensation

[1] Employing the Mortgage Broker

A fundamental prerequisite to the mortgage broker's right to compensation is the employment of the broker for the purpose of seeking financing for acquisition, refinancing or development of real estate. Most states require an employment contract, either express or implied, before a mortgage broker can claim compensation. n1 A number of states have codified this requirement for residential mortgage brokers. n2 The burden of proof is on the mortgage broker, who must establish by competent evidence that it was in fact retained by the borrower as a mortgage broker. n3 The fact that the party claiming to have been retained as a mortgage broker has had a previous business relationship with the borrower is not, standing alone, sufficient proof of employment. For example, in a commercial real estate case, n4 a lawyer who had represented a real estate developer for more than twenty years claimed mortgage brokerage commissions in connection with the financing of a shopping center built by his client. The proof at trial showed that the plaintiff-attorney, while seeking financing for a shopping center of his own, had shown the proposed site of his client's project to an officer of a bank that ultimately financed the client's project. Beyond this, there was no proof of further contact between the plaintiff and the bank in regard to the client's mortgage, and it was shown that the plaintiff took no part in the mortgage negotiations, the preparation of documents for the transaction or any other aspect of the financing of his client's project. Rather, the proof showed that the client had dealt directly with the bank and never made any mention of plaintiff as broker or that any commission had ever been paid to him.

On these facts, the Appellate Division reversed a judgment awarding the plaintiff-attorney the value of services rendered as a mortgage broker and dismissed the complaint, stating:

[W]e hold that plaintiff failed to meet the burden of proof that he was retained by the [defendant] to act in the capacity of mortgage broker. During their long professional relationship, plaintiff performed services and received compensation solely as [defendant's] attorney. Neither before nor after the instant mortgage application was any claim asserted by plaintiff against the [defendant] in any other capacity. There is no competent evidence that plaintiff was especially retained by the [defendant] as a mortgage broker. In fact he had never been so employed by anyone. In our opinion, it is highly unlikely that the parties intended plaintiff's proffered services to be other than incidental to their long-time and ongoing attorney-client relationship. n5

One who volunteers his or her services as a mortgage broker but who obtains no authorization to act in that capacity is not entitled to compensation for his or her efforts. n6 This is so, even when there has been a prior brokerage agreement between the parties but the agreement has terminated. n7 In Arizona, n8 a commercial mortgage broker had been retained to arrange for a "refinancing loan" for a hospital. The mortgage broker obtained a proposed loan offer from an institutional lender which the hospital declined to accept. Later, the broker saw a newspaper report announcing a large expansion program at the hospital and offered his brokerage services to the hospital administrator, who declined his offer. Despite this, the broker contacted the lender from whom he had obtained the earlier "refinancing" offer. When the hospital, through direct dealing, ultimately financed its building program with the same lender, the broker sued for a two percent commission, claiming breach of brokerage agreement. Rejecting the claim, the court found that the original agency relationship had been terminated by the refusal of the earlier "refinancing" proposal and that the broker had never been employed by the hospital to seek financing of the hospital expansion. The court found the broker's efforts in contacting the lender after his services were refused to be the acts of a volunteer and, therefore, not compensable. n9

[2] Effect of Licensing Laws

As stated in § 11.02 above, mortgage brokers must be licensed in order to be compensated as such. n10 Some states even make it a criminal offense for anyone to compensate an unlicensed broker for performing acts for which a license is required. n11 A claim of illegality is a defense to the unlicensed mortgage broker's suit for a commission. Despite the existence of statutes prohibiting an unlicensed broker from charging a commission, n12 some courts have deemed the defense an affirmative one which, if not properly pleaded by the defendant, is waived. n13 Thus, the practitioner should be aware that in some jurisdictions the public policy behind the statutes barring recovery of commissions by unlicensed mortgage brokers may not be deemed weighty enough to protect a borrower who fails to assert a timely defense of illegality in a broker's suit for commissions.

In *Waller v. State* n14 the court determined that a rule of the Florida Department of Banking and Finance disallowed compensation to Mr. Waller, who was both a licensed attorney and mortgage broker. Waller did closings for a bank, and in that capacity sometimes issued mortgage title insurance. He would also, while acting as a mortgage broker, sell some of the mortgages to a second bank. In these transactions, Mr. Waller expected to be paid a reasonable attorney's fee, a mortgage broker fee and a premium for issuing the title insurance policy. The relevant administrative rule stated that "[a] licensee or registrant may not receive or accept any monetary consideration or inducement in connection with the issuance of a title insurance policy in a transaction in which he was involved." n15

The Agency stated that Waller could not collect both the mortgage brokerage fee and the title insurance premium on the same transaction, but that he *could* be compensated for selling the title insurance in cases where he was not acting as a mortgage broker. However, Mr. Waller claimed that he was exempt under Fla. Stat. § 494.03(1)(c), n16 which says that "[a]ny person licensed to practice law in this state, not actively and principally engaged in the business of negotiating loans secured by real property, when such person renders services in the course of her or his practice as an attorney at law," is exempt from the mortgage broker law. Because he was "actively and principally engaged in the business of negotiating loans secured by real property," that is, acting as a mortgage broker, he was *not* rendering services primarily as an attorney, and was not entitled to the statutory exemption.

[3] Statute of Frauds

Absent a special statute requiring real estate brokerage commission agreements to be in writing, such contracts would not fall within the traditional statute of frauds. n17 This policy has also developed in the case of mortgage brokerage commission agreements. Most states now have statutes requiring that an agreement to pay a commission for or upon the sale of an interest in real estate be in writing. n18 Similarly, many states have codified the requirement that there be a written agreement between the parties in order for a mortgage broker to be compensated by a borrower. n19

The Michigan courts, for example, interpret their real estate brokerage commission statute of frauds to encompass

mortgage brokerage commission agreements on the theory that "[a]n agreement to obtain a mortgage upon real estate is an agreement concerning an interest in real estate." n20 Furthermore, under Michigan law, a mortgage broker who renders services pursuant to an oral brokerage agreement will also be barred from recovering compensation in *quantum meruit* for the value of the services rendered pursuant to the unenforceable agreement. n21 On the other hand, in the states that do not require real estate brokerage agreements to be in writing, n22 oral mortgage brokerage agreements have been found to be enforceable, barring contrary legislation or regulations. n23

Another aspect of the statute of frauds, of which the commercial mortgage broker in particular must be aware, is the typical provision that requires any agreement that cannot be performed within one year to be in writing. n24 Accordingly, when a mortgage brokerage agreement contemplates that the mortgage broker will help secure financing for several phases of development over a period of more than one year, the agreement should be in writing. n25

[4] When Commission Is Earned

For many years the general rule was that, unless the parties agreed otherwise, the mortgage broker was deemed to have fully performed its obligation to its principal and was entitled to its commission when it produced a lender who was ready, willing and able to make the loan on the borrower's terms. n26 This rule, derived by analogy from the majority view that a real estate broker earns a commission upon production of a ready, willing and able purchaser of its principal's real estate, n27 is, like all "general rules," subject to qualification. Ultimately, it is the brokerage agreement itself which will determine what the mortgage broker must do to earn its commission.

While the emerging trend is toward a policy of compensating the real estate broker only if the transaction is consummated, unless the client has willfully breached the agreement, n28 in mortgage brokerage the reviews are mixed. Some states do require that the transaction close before the mortgage broker can collect a fee. n29 Of course, the question of when the mortgage broker becomes entitled to a fee generally arises only when the borrower's mortgage loan is not consummated. In these circumstances, the borrower often resists paying the commission, arguing that the loan commitment offered does not meet the terms of the brokerage agreement; or, when it does meet the terms of the agreement, or the borrower agrees to the lender's counter-offer, the borrower argues that the broker was hired to provide a consummated loan, not merely a loan commitment.

A borrower is entitled to reject a proposed loan commitment which differs from the terms contemplated by the brokerage agreement without incurring liability for the mortgage broker's commission. n30 Thus, where the lender sought to add a term to the loan commitment which required the borrower to complete a street which was not necessary for access to a proposed development, the Supreme Court of Texas n31 found that the broker had not procured a lender ready, willing and able to lend on the borrower's terms, but rather, one who had made a counter-proposal that the borrower was entitled to refuse. This is also the result where the mortgage broker fails to inform the borrower of numerous modifications and conditions required by the lender and represents to the borrower that the brokerage fee has been earned. Here, the broker has not produced a ready, willing and able lender and cannot collect a commission. n32

Where the loan commitment procured by the broker does meet the terms initially proposed by the borrower, it is usually no defense to a suit for brokerage commissions that the borrower refused to accept the loan commitment. Absent a contractual provision giving the borrower the right to back out of the deal, the courts agree that the mortgage broker has earned his commission even though the loan is not consummated. n33 The courts will not find an implied condition in the brokerage agreement which would allow the borrower to defeat the broker's right to compensation by an arbitrary refusal to proceed with the loan. In brief, as stated by the Supreme Court of Nebraska, "[a] broker does not, in the absence of a contractual provision providing otherwise, lose his right to an earned commission because the loan is not consummated on account of the unjustified failure or refusal of the principal to complete the transaction." n34 Moreover, once the borrower accepts a loan commitment procured by the broker which meets the original terms, the borrower cannot, absent a contractual provision which justifies such an argument, n35 refuse to complete the transaction and then claim that acceptance of the commitment was conditional n36 or that payment of the commission was

contingent upon the mortgage transaction being completed. n37

If the mortgage broker procures a mortgage loan commitment which deviates from the terms contemplated by the brokerage agreement, the borrower is free to refuse the counter-offer. n38 On the other hand, the borrower is equally free to agree to the lender's counter-proposal, and if the borrower does so agree, he or she may be deemed to have accepted or ratified the performance tendered by the mortgage broker. In this instance, the mortgage broker will have earned a commission despite the fact that the loan is never consummated. n39 And, where the loan is consummated, the same result could be reached on a theory of waiver, *i.e.*, by accepting the benefit of the broker's performance, the borrower has waived any defects in that performance and cannot refuse to pay the brokerage commission on that basis. n40

The general rule with respect to when the mortgage broker earns his or her commission contemplates that the parties to the brokerage contract are entitled to decide by mutual agreement that the mortgage broker's obligation extends beyond merely procuring a loan commitment acceptable to the borrower. n41 Consequently, litigation arises over whether the contract between the broker and borrower calls for the broker to procure a loan commitment or to procure a loan.

When the brokerage agreement does not contain express language making the borrower's obligation to pay a commission conditional upon consummation of the loan, the courts will usually find that the broker's only obligation is to procure a loan commitment. n42 However, when the brokerage agreement is deemed ambiguous as to whether brokerage commissions are contingent upon closing the loan, courts will admit extrinsic evidence to establish the true intent of the parties. n43 For example, where the brokerage agreement provided: "This is your authority to arrange for me ... a mortgage loan ... upon the facility I operate Upon delivery to me and acceptance by me of this commitment, I agree to pay you a fee," a court concluded that the contract was ambiguous and that " 'this commitment' could reasonably refer to 'an arranged loan'." n44 Therefore, where the broker procured a loan commitment which was later withdrawn by the lender through no fault of the borrower, it was proper to admit extrinsic evidence which showed that the parties intended that the broker's commission be contingent upon securing an unequivocal commitment to make a loan. n45

Typically, questions of the exact nature of the broker's obligation under the agreement arise in the context of financing commercial real estate projects, where lenders often impose conditions precedent to actual consummation of the loan. A common condition is that the borrower secure certain leases with commercial tenants. n46 In this context, the question arises whether the broker is owed his fee if the borrower accepts the conditional commitment but is unable to fulfill the conditions despite good faith efforts to do so. Some courts take the view that, in the absence of express language in the brokerage agreement making payment to the broker contingent upon successful consummation of the loan, "the conditions imposed on the loan commitment have no bearing on the [borrower's] duty to pay the broker's fee." n47 On the other hand, a court may find that the brokerage agreement is ambiguous and admit extrinsic evidence which establishes that the parties intended the broker to earn its fee only when the loan, not merely the commitment, was obtained. For example, in *Don J. McMurray Co. v. Wiesman*, n48 a mortgage broker sued for its commission after the loan commitment expired without the borrower having secured a lease by a designated major corporation of one of the properties involved in the development, a precondition imposed by the lender. The court found that the brokerage agreement was ambiguous as to whether the broker's fee was earned upon securing the loan commitment or upon closing the loan, because the agreement stated, "you [the borrower] would be given full credit for [the good faith fee] at the time of the final loan closing at the 2% fee which is our charge for handling the loan." n49

By employing the words, "handling the loan" instead of "securing the commitment," the meaning of the contract was put in doubt. "It is apparent ... that no 'loan' is made unless the transaction is consummated." n50 Looking to the extrinsic evidence admitted below, and noting that the language of an ambiguous contract is generally to be construed against the party who prepared it, the court found that the trial court was justified in interpreting the brokerage agreement to require actual closing of the transaction as a condition of the mortgage broker's right to a fee. n51 Here, where the delay was caused only by the good faith efforts of the borrower to negotiate the terms of the lease with the

corporation designated by the lender, there could be no claim that the borrower acting in bad faith had prevented the occurrence of the condition precedent to the broker's performance of the agreement. n52

The borrower owes a duty to the mortgage broker not to prevent the broker's performance of the terms of the brokerage contract or the occurrence of any preconditions to the broker's right to compensation. This is merely an application of settled principles of contract law to the brokerage contract. n53 For example, the borrower may not usually avoid the obligation to compensate the broker by wrongfully revoking the broker's authority, n54 by failing to file a timely loan application, n55 by encumbering the property so as to preclude performance by the broker, n56 or by engaging in secret direct dealings with the lender procured by the broker and consummating the transaction upon different terms and without the participation of the broker. n57 This same principle applies where the parties agree that the broker's right to compensation is dependent upon actual consummation of the loan. Absent a contract provision containing language to the effect that the borrower will not have to pay a commission if the loan is not consummated for any reason whatsoever, courts generally agree that the borrower may not escape liability by an arbitrary or willful default. n58 It is worth noting, however, that there is at least one mortgage brokerage case n59 holding that where payment of the commission was expressly contingent upon "the actual loan consummation," the borrower was not liable for the commission even though he had prevented consummation of the loan by arbitrarily refusing to provide the proposed lender with information necessary to make the loan commitment firm. n60

Aside from making the broker's commission contingent upon consummation of the loan, another condition to the broker's entitlement to his fee may arise by operation of law in those situations in which the broker is hired to procure a "loan package," the whole of which is necessary to go forward with the project. Such a brokerage contract will be treated as entire and indivisible, and if the broker is unable to procure all segments of the loan contemplated by the parties, it has not earned a fee. Thus, in a Florida case, n61 the borrower employed the broker to obtain both a condominium conversion loan to be used to acquire the property and a permanent end loan with which to develop the property. When the broker could only obtain permanent financing, but not the loan needed to buy the property, the borrower cancelled the agreement and requested the return of its good faith deposit. The broker sued for its commission and lost. On appeal, the court found that the contract was indivisible and that to earn its fee the broker had to procure commitments for both the conversion loan and permanent financing. n62

[a] Procuring Cause

One aspect of any action brought by a mortgage broker seeking compensation from the borrower who employed her that cannot be overlooked is the requirement that, to earn a commission, the mortgage broker must show that she was the procuring cause of the loan commitment or, where required by the agreement, the consummated loan. In brief, the broker must show that it was through the broker's efforts that the transaction contemplated by the brokerage agreement took place. n63 The fact that the borrower obtained the loan which he or she sought does not, absent an agreement to the contrary, entitle the broker to a fee if the broker had nothing to do with inducing the lender to make the loan. n64 Thus, where the broker's efforts to obtain financing have failed, and the borrower employs a second broker who is successful in obtaining the loan, the first broker has not successfully performed its obligations under the brokerage agreement. n65

In *Vandever v. Goetee*, n66 a Texas court, interpreting loan brokerage contracts that gave the broker the exclusive right to submit loan applications n67 to lending institutions or investors during a specified time, concluded that the mortgage broker must prove it was the procuring cause of a loan commitment that met the borrower's terms in order to recover where the borrower obtained financing through a source other than the broker. This was the result despite dicta in real estate brokerage cases stating that a real estate broker with an exclusive right to sell listing need not be the procuring cause of the sale to be entitled to a commission. n68 Absent proof that he or she was the procuring cause, the mortgage broker has not shown full or substantial performance of the terms of the agreement. n69

[b] Exclusive Mortgage Brokerage Agreements

As stated above in § 11.04[4][a], it is not uncommon for the commercial mortgage broker to seek with the borrower an exclusive brokerage agreement granting the broker exclusive authority to obtain financing. Under such an agreement, the broker who obtains a loan commitment on the borrower's terms earns its commission even if the borrower refuses to deal with the lender procured by the broker and later obtains his or her own financing from another source. n70 Grants of exclusive authority are often limited to a specified time period. n71 Once the agreement terminates by its terms, the broker who has failed to procure the loan contemplated by the agreement cannot recover upon the contract. n72 Like any brokerage agreement, an exclusive contract that does not expire by its own terms may be terminated on notice after the broker has been given a reasonable time to perform but has been unsuccessful. If, after termination of an exclusive contract, the borrower re-engages the broker, the new agreement will not automatically be deemed an exclusive one; its nature will depend upon the manifested intent of the parties. n73

[5] Broker Recovery in *Quantum Meruit*

As discussed in § 11.04[4] above, the mortgage broker must procure a loan commitment on terms acceptable to the borrower or, where stipulated by the brokerage contract, a consummated loan, in order to earn its agreed-upon commission. However, where the mortgage broker is unable to fully perform its obligation under the agreement because of a wrongful act on the part of the borrower, n74 and is therefore not entitled to recover under the contract for full performance, it will have a cause of action in *quantum meruit* to recover the reasonable value of its services.

In a Florida case, the United States Bankruptcy Court held that a real estate broker who worked as an independent contractor for, rather than employee of, a Chapter 11 debtor, played no meaningful role in the ultimate success of debtor in pursuing a construction loan, and thus the broker was not entitled to compensation on a *quantum meruit* basis from the Chapter 11 estate. In this case, the broker entered into a contract with Corkscrew Golf Property Land Trust (Trust), in which the broker agreed to assist the Trust in obtaining necessary financing for the development of a golf course construction project. The broker made efforts to procure financing, none of which were successful in producing a loan. Finally, the Trust successfully negotiated a loan with a Miami lender in which the broker played no part whatsoever. However, the broker argued that his labor benefited the trust, thereby entitling the broker to compensation.

The court found that the agreement was a nonexclusive service contract entitling the broker to payment only if, in fact, he procured a loan. The court held that the broker was not entitled to any commission under the agreement but should be given opportunity to show if any of his work produced a benefit for the trust, particularly to the extent his labor assisted the trust to ultimately obtain the loan from the Miami Bank. However, since the broker was an independent contractor and not an employee of the trust, was one of several who attempted to obtain the financing, and played no meaningful role whatsoever in the ultimate success in obtaining the loan, the court concluded that the broker could not recover on a *quantum meruit* basis. n75

Recovery in *quantum meruit* may also be available when the brokerage contract has expired by its own terms or is otherwise validly terminated, and the borrower accepts the benefits of the mortgage broker's services. n76 In those jurisdictions that do not require the mortgage brokerage agreement to be in writing (see § 11.04[3] above) the broker will be able to recover the reasonable value of its services, even though the parties failed to enter into an express contract. n77

The attorney for a mortgage broker suing for compensation must be familiar with local pleading requirements because some jurisdictions, such as Florida, n78 hold that the failure to allege a *quantum meruit* cause of action in a suit on a brokerage agreement is fatal where the broker is unable to prove full performance under the express agreement. Other states, such as New York, n79 take a more liberal view and allow recovery on a *quantum meruit* basis in an action based upon an express contract even though no *quantum meruit* theory of recovery is pleaded. Another question upon which the states differ is the measure of recovery in *quantum meruit* where there is no enforceable underlying brokerage contract. For example, Florida allows an invalid or otherwise inadmissible express contract into evidence on the question of the value of the broker's services, n80 while New York holds an unenforceable contract irrelevant on the

issue of damages in a *quantum meruit* action. n81 Thus, in New York, the broker must be prepared to present independent evidence as to the value of the services he has rendered. Finally, the mortgage broker seeking the reasonable value of its services must be able to prove that the services actually conferred a benefit on the borrower. n82

[6] Tortious Interference with Mortgage Broker's Contract by Third Parties

Just as wrongful interference by third persons in the employment relationship between a real estate broker and its principal will give rise to a cause of action for tortious interference with contractual relations, so will interference with the contract between the mortgage broker and borrower similarly afford the broker the right to seek tort damages from the interfering third party. n83 Moreover, when the borrower breaches the brokerage agreement as a result of the third party's conduct, the broker will be able to pursue a claim for tortious interference with the contract against the third person concurrently with a claim for breach of contract against the borrower. n84

Tortious interference with the mortgage broker's contract may occur, for example, where the lender seeks to deprive the mortgage broker of its commission by secretly negotiating the deal on different terms without the participation of the procuring broker, n85 or where the lender makes it a condition of the loan that the broker receive a lesser commission than was stipulated in the brokerage contract. n86 Both of these fact patterns satisfy the elements of the tort of interference with contractual relations which, as stated by a Florida court, is established by proof that

(1) the acts were intentional and willful; (2) said acts were calculated to cause damage to the [broker] in his or her business; (3) that the acts were done with the unlawful purpose of causing damage and loss, without right or justifiable cause on the part of the defendant (constituting malice); and (4), that actual damages and loss resulted. n87

It is important to note that "[i]t is not necessary to prove that the [interfering party] acted with ill will, hostility or an intent to injure. It is only necessary to show that [such person] acted intentionally and without just cause." n88 In the context of mortgage brokerage, it has been held that "economic self-interest alone is not a defense to interference with contractual relations... ." n89 Something more than a benefit to the interfering party must be shown before inducement to breach of contract will be deemed justified. n90

FOOTNOTES:

(n1)Footnote 1. *See, e.g.:*

Arizona: Wilson v. Tucson Gen. Hosp., 499 P.2d 762 (Ariz. Ct. App. 1972) .

Louisiana: First Louisiana Mortgage Co. v. Nesser Gardens, Inc., 285 So. 2d 837 (La. Ct. App. 1973) .

New York: Andromidas v. Schefer, 406 N.Y.S.2d 556, 1978 N.Y. App. Div. LEXIS 12398 (App. Div. 1978) .

For a full discussion of the parallel requirement with respect to real estate brokers, *see* § 4.06 above.

(n2)Footnote 2. *See, e.g.:*

Connecticut: Conn. Gen. Stat. § 36a-498.

Delaware: Del. Code Ann. tit. 5, § 2113.

Florida: Fla. Stat. § 494.0038(1)(a).

Illinois: Ill. Admin. Code tit. 38, § 1050.1010.

Indiana: Ind. Code § 23-2-5-9(a).

Kansas: Kan. Stat. Ann. §§ 50-1006, 50-1007.

Louisiana: La. Rev. Stat. Ann. § 6-1098(C).

Maine: Me. Rev. Stat. Ann. tit. 9-A, § 10-302.

Massachusetts: Mass. Gen. Laws ch. 259, § 7.

New Jersey: N.J. Admin. Code § 3:1-16.10(b).

South Dakota: S.D. Admin. R. 20:69:08:09.

Tennessee: Tenn. Code Ann. § 45-13-206(c).

Utah: Utah Code 70D-2-305.

Virginia: Va. Code Ann. §6.1-422.B.4.

(n3)Footnote 3. *See:*

Arizona: Wilson v. Tucson Gen. Hosp., 499 P.2d 762 (Ariz. Ct. App. 1972) .

Louisiana: First Louisiana Mortgage Co. v. Nesser Gardens, Inc., 285 So. 2d 837 (La. Ct. App. 1973) .

New York: Andromidas v. Schefer, 406 N.Y.S.2d 556, 1978 N.Y. App. Div. LEXIS 12398 (App. Div. 1978) .

(n4)Footnote 4. *Andromidas v. Schefer, 406 N.Y.S.2d 556, 1978 N.Y. App. Div. LEXIS 12398 (App. Div. 1978) .*

(n5)Footnote 5. *Andromidas v. Schefer, 406 N.Y.S.2d 556, 557, 1978 N.Y. App. Div. LEXIS 12398 (App. Div. 1978)*

(n6)Footnote 6. *See Wilson v. Tucson Gen. Hosp., 499 P.2d 762 (Ariz. Ct. App. 1972) .*

(n7)Footnote 7. *Wilson v. Tucson Gen. Hosp., 499 P.2d 762, 764-65 (Ariz. Ct. App. 1972) .*

(n8)Footnote 8. *499 P.2d 762, at 763 .*

(n9)Footnote 9. *Wilson v. Tucson Gen. Hosp., 499 P.2d 762, 765 (Ariz. Ct. App. 1972) .*

(n10)Footnote 10. *See, e.g.:*

Arizona: Ariz. Rev. Stat. § 6-909.B.

See also Roberts v. State, 880 P.2d 1159, 1161 (Ariz. Ct. App. 1994) ("Arizona Superintendent of Banks has the

authority to order a person to repay loan fees earned on transactions which were unauthorized because the person was not a licensed mortgage broker").

California: Cal. Bus. & Prof. Code § 10136 (real estate mortgage broker must allege and prove she was duly licensed at time alleged right to commission arose).

Louisiana: La. Rev. Stat. Ann. § 6:1090(F).

See also Talbot v. Jones, 288 So. 2d 80, 82-83 (La. Ct. App. 1974) (unlicensed loan broker could not maintain action for commission even if transaction was isolated one and securities commission granted postdated exemption).

(n11)Footnote 11. *See, e.g.:*

Arkansas: Ark. Code Ann. § 23-39-516 (one who willfully violates the Fair Mortgage Lending Act or willfully makes false or misleading statements in any document filed with the Securities Commissioner knowing the statement is false or misleading, is guilty of a Class B Felony).

California: Cal. Bus. & Prof. Code § 10138 (compensating an unlicensed person for any act within the scope of the chapter is a misdemeanor punishable by a fine of up to \$100 for each offense).

Kansas: Kan. Stat. Ann. § 9-2203.

Michigan: Mich. Comp. Laws § 445.1679.

See also Lushington v. State, 585 So. 2d 1147 (Fla. Dist. Ct. App. 1991) (affirming conviction for acting as mortgage broker without a license).

(n12)Footnote 12. *See, e.g.:*

Arizona: Roberts v. State, 880 P.2d 1159, 1161 (Ariz. Ct. App. 1994) ("Arizona Superintendent of Banks has the authority to order a person to repay loan fees earned on transactions which were unauthorized because the person was not a licensed mortgage broker").

California: Cal. Bus. & Prof. Code § 10136.

(n13)Footnote 13. *See, e.g.:*

Florida: Sonnenblick-Goldman Corp. v. Feldman, 266 So. 2d 48, 50 (Fla. Dist. Ct. App. 1972) .

Louisiana: Webster v. Rushing, 316 So. 2d 111, 114 (La. 1975) .

(n14)Footnote 14. 592 So. 2d 319 (Fla. Dist. Ct. App. 1992) .

(n15)Footnote 15. *Waller v. State*, 592 So. 2d 319, 320 n.1 (Fla. Dist. Ct. App. 1992) (quoting former *Fla. Admin. Code Ann. r. 3D-40.008(3)(a)(5)*); *see Fla. Admin. Code r. 69V-40.008(3)(a)5*.

(n16)Footnote 16. This statute has since been amended, and now exempts "an attorney licensed in [Florida] who

negotiates the terms of a mortgage loan on behalf of a client as an ancillary matter to the attorney's representation of the client." *Fla. Stat. § 494.00115(1)(d)*.

(n17)Footnote 17. See Restatement (Second) of Contracts § 126 cmt. b (1981).

See also:

Idaho: Salazar v. Tilley, 716 P.2d 1356, 1359-60 (*Idaho Ct. App.* 1986) . The Idaho Court of Appeals, in deciding a dispute over the terms of an oral agreement concerning a mortgage broker's commission, upheld the agreement after it was breached by the defendant when its terms were unclear as to what constituted full performance. In *Salazar*, the broker delivered a letter of commitment which was similar to one which the borrower had indicated would be an acceptable promise. When the borrower learned from a third party that the letter would not be acceptable as proof of a commitment by a bank, the borrower stopped payment on the broker's commission check. The court upheld the broker's right to a commission in finding that he had lived up to his obligation to provide valid financial funding despite missing terms in the oral agreement.

Colorado: Fisher v. 1st Consumers Funding, Inc., 160 P. 3d 321, 323-324 (holding that a mortgage broker is not a creditor, so an action based upon an oral agreement to obtain a loan for a consumer could not be dismissed based upon the statute of frauds because the statute protects only creditors and debtors).

Nebraska: In a case of first impression, the Nebraska Court of Appeals held that the statute of frauds is inapplicable to a contract with a mortgage broker. Thus, an oral agreement between a property owner and a mortgage broker to obtain refinancing for a loan does not constitute a contract for the sale of land within the statute of frauds and is enforceable. Wright & Souza, Inc. v. DM Properties, 510 N.W.2d 413, 418 (*Neb. Ct. App.* 1993) .

(n18)Footnote 18. For a discussion of these special statutes of frauds governing real estate brokerage commission agreements, see § 2.03[3] above.

(n19)Footnote 19. See, e.g.:

Delaware: Del. Code Ann. tit. 5, § 2113.

Florida: Fla. Stat. § 494.0038(1)(a).

Illinois: Ill. Admin. Code tit. 38, § 1050.1010.

Indiana: Ind. Code § 23-2-5-9(a).

Kansas: Kan. Stat. Ann. § 50-1006, 50-1007.

Louisiana: La. Rev. Stat. Ann. § 6:1098.

Maine: Me. Rev. Stat. Ann. tit. 9-A, § 10-302.

New Jersey: N.J. Admin. Code § 3:1-16.10(b).

South Dakota: S.D. Admin. R. 20:69:08:09.

Utah: Utah Code -2-305..

Virginia: Va. Code Ann. § 6.1-422.B.4.

(n20)Footnote 20. See *Pine-Wood Ltd. v. Detroit Mortgage & Realty Co.*, 290 N.W.2d 86, 87 (Mich. Ct. App. 1980) (citation omitted). In an action by borrower to recover a mortgage loan application fee, a mortgage broker could avail itself of the full performance exception to the Michigan statute of frauds where it only claimed the right to retain a commission already in its possession and earned by its full performance of a brokerage contract.

(n21)Footnote 21. See *Mead v. Rehm*, 239 N.W. 858, 859 (Mich. 1932), a real estate brokerage case in which the court stated that "[a] verbal agreement to pay the commission is rendered absolutely void by the statute [of frauds], and there can be no recovery on *quantum meruit*, even though the service was rendered and accepted."

(n22)Footnote 22. See § 2.03[3] above.

(n23)Footnote 23. See, e.g.:

Alabama: *Key Mortgage Co. v. Copeland Glass Co.*, 365 So. 2d 1221, 1222 (Ala. Civ. App. 1978) (mortgage broker-client contract need not be in writing to be valid).

Texas: *Stuckey v. Union Mortgage & Inv. Co.*, 383 S.W.2d 429 (Tex. Civ. App. 1964).

(n24)Footnote 24. See, e.g., *N.Y. Gen. Oblig. Law* § 5-701.

See also *Ryan v. Kinderhill Corp.*, 558 N.Y.S.2d 652, 653, 1990 N.Y. App. Div. LEXIS 7944 (App. Div. 1990) (writings were insufficient to defeat the affirmative defense of the Statute of Frauds).

(n25)Footnote 25. See, e.g., *Robert v. Berlanti Dev. Co.*, 250 N.Y.S.2d 154, 155, 1964 N.Y. App. Div. LEXIS 3674 (App. Div. 1964) (a broker who had an oral contract for the two or three years it would take to complete a development sued in *quantum meruit*); *Landow-Luzier Co. v. Grey*, 232 N.Y.S.2d 247, 254, 1962 N.Y. Misc. LEXIS 3127 (Sup. Ct. 1962) (whether a mortgage brokerage agreement could be performed within one year was a question of fact to be decided at trial).

(n26)Footnote 26. See, e.g.:

Florida: *Padron v. Plantada*, 632 So. 2d 113, 113-14 (Fla. Dist. Ct. App. 1994) (a mortgage broker was not entitled to a commission when he offered the mortgagors a loan commitment that offered only a floating rate, because it did not reflect the terms of the brokerage agreement requiring a fixed rate).

Louisiana: *Mid-South Mortgage Co. v. Bartmess*, 419 So. 2d 89, 90 (La. Ct. App. 1982) ("[t]he issue in this appeal is whether the broker 'earned' its commission by producing a lender able, ready, and willing to lend on the borrower's terms.>").

Maryland: *Rhoderick v. Roy Hansen Mortgage Co.*, 271 A.2d 647, 649 (Md. 1970) ("[t]he loan broker is entitled to his commissions where he has procured a lender who is ready, willing and able to lend the money on the terms proposed.") (citations omitted).

Nebraska: *Don J. McMurray Co. v. Wiesman*, 260 N.W.2d 196, 200 (Neb. 1977).

New Jersey: Abeles v. Adams Eng'g. Co., 173 A.2d 246, 252 (N.J. 1961) .

New York: Real Estate Econ. Resources, Inc. v. Armendariz, 556 N.Y.S.2d 886, 887-888, 1990 N.Y. App. Div. LEXIS 7463 (App. Div. 1990) (brokerage commissions are not earned unless the person produced by the broker reaches agreement not only as to amount but also as to terms); *Midland Mortgagee Corp. v. 220 Highland Boulevard Realty Co.*, 548 N.Y.S.2d 304, 305, 1989 N.Y. App. Div. LEXIS 15399 (App. Div. 1989) (a mortgage broker was not entitled to a commission on a commitment that was not accepted by its clients); *Lester Morse Co., Inc. v. 3 Hanover Square Owners Corp.*, 548 N.Y.S.2d 492, 493, 1989 N.Y. App. Div. LEXIS 15524 (App. Div. 1989) .

Pennsylvania: Colonial Mortgage Serv. Co. v. Melrose Country Club, 206 A.2d 10, 11 (Pa. 1965) .

Texas: MacArthur Park Corp. v. Sunshine, 589 S.W.2d 538, 541 (Tex. Civ. App. 1979) .

But see:

California: Keystone Mortgage Co. v. MacDonald, 62 Cal. Rptr. 562, 565 (Ct. App. 1967) (ready, willing and able lender means one who makes an unconditional offer to loan).

(n27)Footnote 27. Courts often state that the law regarding mortgage brokers and their clients may be derived by analogy from cases dealing with real estate brokers. *See, e.g.:*

Alabama: Key Mortgage Co. v. Copeland Glass Co., 365 So. 2d 1221, 1222 (Ala. Civ. 1978) .

Maryland: Rhoderick v. Roy Hansen Mortgage Co., 271 A.2d 647, 649 (Md. 1970) .

Nebraska: Don J. McMurray Co. v. Wiesman, 260 N.W.2d 196, 200 (Neb. 1977) .

Oklahoma: Deming Inv. Co. v. Britton, 179 P. 468 (Okla. 1919) .

Texas: Sunshine v. Manos, 496 S.W.2d 195, 199 (Tex. Civ. App. 1973) .

For discussion of the conflicting views as to when the real estate broker earns his commission see ch. 4 above.

(n28)Footnote 28. G. Lefcoe, *Real Estate Transactions* (1993).

(n29)Footnote 29. *See, e.g.:*

Maryland: Md. Regs. Code tit. 9, subtit. 3, § 09.03.06.11(c).

New Jersey: N.J. Admin. Code § 3:1-16.3(e)3.

Oregon: Or. Rev. Stat, 86A.157(6).

Washington: Wash. Rev. Code § 19.146.070.

(n30)Footnote 30. *See, e.g.:*

Louisiana: Mid-South Mortgage Co. v. Bartmess, 419 So. 2d 89, 91 (La. Ct. App. 1982) .

New York: Prime Funding, Inc. v. Demetriades, 510 N.Y.S.2d 654, 655, 1987 N.Y. App. Div. LEXIS 41668 (App. Div. 1987) (holding that a mortgage broker was not entitled to a commission for obtaining a mortgage for its principal, where the mortgagor had engaged the broker to obtain a \$300,000 mortgage with a twenty-year duration, with interest for the first five years at fourteen and one-half percent and the balance of fifteen years at one and one-half percent above the lending bank's prime rate, while the broker instead obtained a mortgage with a fifteen-year term, with interest for the first five years at thirteen and one-half percent and one and one-half percent above prime for the last ten years).

Texas: Ashford Dev., Inc. v. USLife Real Estate Servs. Corp., 661 S.W.2d 933, 935 (Tex. 1983) .

(n31)Footnote 31. *Ashford Dev., Inc. v. USLife Real Estate Servs. Corp.*, 661 S.W.2d 933, 935 (Tex. 1983) .

(n32)Footnote 32. *Mid-South Mortgage Co. v. Bartmess*, 419 So. 2d 89, 91 (La. Ct. App. 1982) (holding, in a broker's suit on a promissory note for a commission, a note was unenforceable for failure of consideration because the broker did not produce a lender ready, willing and able to lend on the borrower's terms).

(n33)Footnote 33. *See, e.g.:*

Maryland: Rhoderick v. Roy Hansen Mortgage Co., 271 A.2d 647, 650 (Md. 1970) (rejecting a claim that lender imposed conditions that were not part of a brokerage agreement).

Nebraska: Don J. McMurray Co. v. Wiesman, 260 N.W.2d 196, 200 (Neb. 1977) (finding an agreement conditional upon actual consummation of a loan).

New York: Donald Zucker Co. v. Lieberman, 583 N.Y.S.2d 456, 457, 1992 N.Y. App. Div. LEXIS 7341 (App. Div. 1992) . Where a "loan procured" was not the "loan prescribed," a borrower is not required to accept it, nor may the mortgage broker recover a commission for services in procuring the loan. Where, however, the prospective mortgagor agreed to be bound by the mortgagee's "usual terms and conditions," and the objected to condition (repair/escrow provision) was among its "customary" closing requirements, the mortgagors could not complain that the term of the loan deviated from the loan the mortgage broker was hired to obtain. (But unresolved factual issues precluded summary judgment).

(n34)Footnote 34. *Don J. McMurray Co. v. Wiesman*, 260 N.W.2d 196, 200 (Neb. 1977) (citations omitted).

(n35)Footnote 35. *See Pearce, Urstadt, Mayer & Greer Realty Corp. v. Atrium Dev. Assocs.*, 571 N.E.2d 60, 62 (N.Y. 1991) , where the court found issues of fact to exist as to whether the language in the brokerage agreement clearly entitled the broker to his commission when he had satisfied his contractual obligation of obtaining a loan commitment which was accepted by the principal, despite the ultimate failure of the principal to close on the loan.

(n36)Footnote 36. *See Colonial Mortgage Serv. Co. v. Melrose Country Club*, 206 A.2d 10, 11 (Pa. 1965) (claim that written acceptance by a country club president of a loan commitment was subject to an oral condition that the membership vote to approve the loan was barred by the parol evidence rule).

(n37)Footnote 37. *See Freiwald v. Fidelity Interstate Cas. Co.*, 138 A.2d 146 (Pa. Super. Ct. 1958) . In *Freiwald*, the court stated:

[A] mortgage broker earns his commission, as a rule, when he secures a commitment for the mortgage even though the transaction is not completed, especially when the failure of completion is due solely to the fault of the proposed mortgagor as in this case. If the seller wants to relieve himself of liability for a commission to a broker, who had brought to him a purchaser acceptable to him, it must be so stipulated categorically in unmistakable terms. If the defendant's breach occasioned the cancellation, the defendant cannot take advantage of its wrong-doing to escape liability. 138 A.2d 146, 148 (citations omitted).

The above-quoted language illustrates the extent to which courts have relied in the past on real estate brokerage commission cases in deciding cases involving mortgage brokers.

(n38)Footnote 38. See:

Louisiana: Mid-South Mortgage Co. v. Bartmess, 419 So. 2d 89 (La. Ct. App. 1982) .

New York: Prime Funding, Inc. v. Demetriades, 510 N.Y.S.2d 654, 655, 1987 N.Y. App. Div. LEXIS 41668 (App. Div. 1987) .

Texas: Ashford Dev., Inc. v. USLife Real Estate Servs. Corp., 661 S.W.2d 933 (Tex. 1983) .

This does not mean, however, that the borrower is free to terminate his broker's agency merely because the broker presents a loan proposal which deviates from the brokerage agreement. Generally speaking, where there is no termination date in the agreement, the broker must be given a reasonable time to perform. See *Landow-Luzier Co. v. Grey*, 232 N.Y.S.2d 247, 252, 1962 N.Y. Misc. LEXIS 3127 (Sup. Ct. 1962) . And where the broker has expended time and effort pursuant to the agreement the borrower may not revoke the broker's authority with impunity. If he wrongfully revokes, the borrower will be liable to the broker in damages for breach of contract. See *Sunshine v. Manos*, 496 S.W.2d 195 (Tex. Civ. App. 1973) for an extensive discussion of the borrower's right to revoke a broker's authority and the measure of damages upon breach of the brokerage contract where the broker has not fully performed.

(n39)Footnote 39. See, e.g.:

New Jersey: Abeles v. Adams Eng'g Co., 35 N.J. 411, 173 A.2d 246 (N.J. 1961) (acceptance of a lender-imposed condition that the loan be secured by a five-year term \$500,000 life insurance policy on an officer of the corporate borrower).

Texas: Stuckey v. Union Mortgage & Inv. Co., 383 S.W.2d 429, 433-434 (Tex. Civ. App. 1964) (where borrower took delivery of a loan commitment which deviated from terms contemplated by an oral brokerage contract, told broker he had submitted it to a bank, waited two weeks to inform broker he would not accept the commitment, and successfully procured on his own a loan on similar terms from another lender in the interim, evidence supported a jury verdict that borrower accepted and ratified broker's performance).

The extent to which acceptance by the borrower of a loan commitment, which deviates from the brokerage agreement, obligates the borrower to pay the brokerage commission is graphically illustrated by a Florida case in which, after the borrower agreed to the lender's counter-proposal, the lender insisted on changing the terms of the loan on the eve of closing to provide for additional security for the loan in the form of a \$300,000 letter of credit. The borrower refused to close and obtained financing elsewhere without a brokerage fee. The broker sued for his commission and won. The court held that the brokerage agreement appointing the plaintiff-broker exclusive agent to procure "a

conversion/construction loan commitment" was "a binding contract, entitling the plaintiff broker to a commission as of the execution of the loan commitment, regardless of the conduct of the lender subsequent to executing the agreement." *S & D Enters. Inc., v. Sonnenblick-Goldman Southeast Corp.*, 310 So. 2d 343, 344 (Fla. Dist. Ct. App. 1975). The court went on to say that "if the lender has violated its commitment, then [the borrower] has recourse against the lender, by specific performance or damage or both," including the brokerage fee the borrower was obligated to pay on the broken contract. *Id.* at 344-45. But see *Ieracitano v. Shaw*, 815 So. 2d 787, 788 (Fla. Ct. App. 2002) (absence of express provision indicating that the broker will earn his commission upon the execution of a loan commitment is open to the interpretation that the broker will earn his fee upon the closing of the loan). See also *N.J.A.C. 3:1-16.2, -16.10* (residential mortgage broker can only collect discount points at closing).

(n40)Footnote 40. See *First Capitol Mortgage Corp. v. Talandis Constr. Corp.*, 365 N.E.2d 66 (Ill. App. Ct. 1977), where waiver and ratification theories were rejected because they were raised for the first time on appeal. In *Talandis*, the dissenting justice would have awarded the broker his commission on a waiver theory where, after expiration of a sixty-day exclusive brokerage agreement, the borrower accepted a mortgage loan which varied from the terms of the original agreement. *Id.* at 71-72 (Jiganti, J., dissenting).

(n41)Footnote 41. In fact, according to a Texas court, the parties are free, if they so choose, to reduce the broker's obligation to less than that required by the generally accepted rule. Thus, in *MacArthur Park Corp. v. Sunshine*, 589 S.W.2d 538 (Tex. Civ. App. 1979), the court interpreted a brokerage agreement which provided that the "sole obligation" of the broker was to "seek to find a lender ready, willing and able to consider making a loan commitment to [the borrower]" to mean that procurement of a written loan commitment was not a condition precedent to the payment of the brokerage fee. *Id.* at 541 (emphasis in original). The *MacArthur* court went on to say, however, that "[a]ssuming arguendo that a written loan commitment is a condition precedent to payment, then [the borrower's] failure to promptly file a formal application excused the alleged nonperformance by [the broker]." *Id.* This is, of course, a classic application of the "prevention" doctrine of contract law, which prohibits a party to a contract from using his own frustration of the other party's performance as a defense. See generally Restatement (Second) of Agency § 445, cmt. d (1957).

(n42)Footnote 42. In *Wilson v. John Frantz Co.*, 723 S.W.2d 189 (Tex. Ct. App. 1986), the court held that the language in an agreement which required that "loan approval" be "delivered" by the mortgage loan broker in "21 working days" on terms acceptable to the real estate developer should have been left to the jury to interpret in the light of the evidence presented. Frantz sought a loan to finance the construction of an industrial warehouse in Houston, and Wilson agreed to assist Frantz in procuring such a loan. Frantz signed an application for a loan, and the controversial language was inserted in a commission agreement executed at the same time. The dispute arose when Frantz denied that a condition of the loan commitment was that he contribute his own equity to the project. He also disagreed about the form of delivery used. The court reasoned that since the parties did not dispute the existence of a contract, the only disagreement resulted from whether Wilson's performance satisfied the terms of the contract. The court stated that whether a party has performed is a question of fact for the jury. Accordingly, since there was some evidence to support the jury's answer to the special issue before them, the trial court should have rendered judgment on behalf of the mortgage broker. *Id.* at 194.

See also *Freiwald v. Fidelity Interstate Cas. Co.*, 138 A.2d 146, 148 (Pa. Super. Ct. 1958).

(n43)Footnote 43. See, e.g.:

Nebraska: Don J. McMurray Co. v. Wiesman, 260 N.W.2d 196, 201 (Neb. 1977).

Texas: Howerton v. Tomlinson, 421 S.W.2d 494, 496 (Tex. Civ. App. 1967).

(n44)Footnote 44. *Howerton v. Tomlinson*, 421 S.W.2d 494, 495 (Tex. Civ. App. 1967), 496.

(n45)Footnote 45. *Howerton v. Tomlinson*, 421 S.W.2d 494, 495 (Tex. Civ. App. 1967) . *Howerton*, 425 S.W.2d at 495 .

(n46)Footnote 46. *See, e.g.:*

Alabama: Key Mortgage Co. v. Copeland Glass Co., 365 So. 2d 1221 (Ala. Civ. App. 1978) (lender conditioned a commitment on a seventeen-year lease guarantee by a specified third party).

California: Keystone Mortgage Co. v. MacDonald, 62 Cal. Rptr. 562, 564 (Ct. App. 1967) (commitment conditioned by lender on borrower obtaining non-cancelable fifteen-year lease with a specified third party at a guaranteed annual rental).

(n47)Footnote 47. *Key Mortgage Co. v. Copeland Glass Co.*, 365 So. 2d 1221, 1222 (Ala. Civ. App. 1978) .

See also:

Alabama: Johnson v. Boggan, 325 So. 2d 178 (Ala. Civ. App. 1975) (where conditions in a commitment were inserted at borrower's request, the court held that the broker earned his commission despite cancellation of the loan commitment, because the brokerage agreement was not expressly contingent upon the consummation of the loan).

Note, however, that in California, which defines a ready, willing and able lender as one who makes an unconditional commitment to lend the money, a condition in the loan commitment will operate as a condition precedent to the broker's entitlement to a fee because the lender is not ready, willing and able until the condition precedent occurs.

California: Keystone Mortgage Co. v. MacDonald, 62 Cal. Rptr. 562, 567 (Ct. App. 1967) (where the lender conditioned the loan commitment on the borrower obtaining a non-cancelable lease with a specified third party at a specified rent, the court held that the borrower, who failed to obtain leases which were preconditions to loan commitment despite good faith and diligent effort, was not liable to pay the broker's commission).

(n48)Footnote 48. 260 N.W.2d 196 (Neb. 1977) .

(n49)Footnote 49. 260 N.W.2d 196, 199 (Neb. 1977) .

(n50)Footnote 50. 260 N.W.2d 196, 201 (Neb. 1977) .

(n51)Footnote 51. 260 N.W.2d 196, 201-02 (Neb. 1977) .

(n52)Footnote 52. 260 N.W.2d 196, 202 (Neb. 1977) .

(n53)Footnote 53. For a discussion of the "prevention" doctrine in contract law, *see generally* Corbin on Contracts (1960).

(n54)Footnote 54. *See, e.g.:*

New York: Landow-Luzier Co. v. Grey, 232 N.Y.S.2d 247, 254, 1962 N.Y. Misc. LEXIS 3127 (Sup. Ct. 1962) .

Texas: Sunshine v. Manos, 496 S.W.2d 195, 198-99 (Tex. Civ. App. 1973) .

(n55)Footnote 55. See *MacArthur Park Corp. v. Sunshine*, 589 S.W.2d 538, 541-42 (Tex. Civ. App. 1979) (alternate holding).

(n56)Footnote 56. See *Coppedge v. Financial Servs. Group Corp.*, 258 S.E.2d 654, 655 (Ga. Ct. App. 1979) (borrower, by encumbering property with a second mortgage, prevented performance of the agreement that the broker's fee would not be due until the broker had obtained a second mortgage commitment for the borrower).

(n57)Footnote 57. See *Bermil Corp. v. Sawyer*, 353 So. 2d 579, 584-85 (Fla. Dist. Ct. App. 1977) (holding that "[i]t is no defense to the payment of a brokerage commission that the parties consummated the transaction upon different terms without the participation of the broker when (1) the broker initially brought the parties together and (2) the parties purposely excluded the broker from the negotiations by dealing with one another directly and in a clandestine manner").

(n58)Footnote 58. See, e.g.:

California: Keystone Mortgage Co. v. MacDonald, 62 Cal. Rptr. 562, 567 (Ct. App. 1967) (holding that "[i]f [the broker] has proved that [the borrower] prevented the happening of the conditions precedent in [the loan commitment, the broker] could recover its commission despite the failure of the conditions in the [loan commitment]").

Nebraska: Don J. McMurray Co. v. Wiesman, 260 N.W.2d 196, 202 (Neb. 1977) (if the borrower, acting in bad faith, had caused delay in executing the lease, which was a condition of the loan in order that lender's commitment would expire, the borrower would be liable to the broker).

(n59)Footnote 59. *Harbour Inn, Inc. v. Kagan*, 343 So. 2d 1353 (Fla. Dist. Ct. App. 1977) .

(n60)Footnote 60. In holding that the broker could not recover in *quantum meruit*, the *Harbour Inn* court intimated that the broker's cause of action for breach of contract, which was not in issue on the appeal, would also fail. *Harbour Inn, Inc. v. Kagan*, 343 So. 2d 1353, 1355-56 (Fla. Dist. Ct. App. 1977) . The Florida court's reading of the brokerage agreement to, in effect, allow the borrower to walk away from the deal without liability may find some support in a New York Court of Appeals decision involving real estate brokerage commissions. In *Graff v. Billet*, 477 N.E.2d 212 (1985) , the New York Court of Appeals held that when the brokerage agreement expressly provides that the commission is due when "title passes," the seller's arbitrary refusal to enter into a contract of sale with a prospective purchaser produced by the broker is not a willful default which makes the seller liable for the broker's commission. *Id.* at 213 . Only if the seller enters into a contract of sale with the purchaser and then refuses to complete the transaction will he be liable to the broker. On parallel reasoning, it could also be argued that when the mortgage broker's fee is contingent upon actual consummation of the loan, unless the broker protects himself by inserting an express provision that an arbitrary refusal to go forward with the proposed loan that meets the borrower's terms is a default which entitles the broker to his commission, the borrower is under no duty to accept a proposed loan procured by the broker. Absent such a provision, only if the borrower accepts the loan commitment and then refuses to go forward would he be liable, despite the fact that the fee is contingent upon closing the loan.

(n61)Footnote 61. *Florida Mortgage Fin., Inc. v. Flagler Plaza Corp.*, 308 So. 2d 571 (Fla. Dist. Ct. App. 1975) .

(n62)Footnote 62. Of course, the borrower may not prevent the broker from obtaining the entire "loan package" and then defend a suit for commissions on that basis. See *Coppedge v. Financial Servs. Group Corp.*, 258 S.E.2d 654 (Ga. Ct. App. 1979) .

(n63)Footnote 63. See *Wilson v. Tucson Gen. Hosp.*, 499 P.2d 762 (Ariz. Ct. App. 1972) .

See also *Rossini & Smith Cos., Inc. v. Locke*, 660 A.2d 1088, 1090 (N.H. 1995) (mortgage broker was entitled to commission as an effective cause of the procurement of the loan, where the broker was involved in devising the strategy used to approach the lender, developed the financing proposal used to secure the loan, and helped to arrange the financing).

(n64)Footnote 64. See, e.g.:

Louisiana: First Louisiana Mortgage Co. v. Nesser Gardens, Inc., 285 So. 2d 837, 839 (La. Ct. App. 1973) .

New York: Donald Zucker Co. v. Lieberman, 583 N.Y.S.2d 456, 457, 1992 N.Y. App. Div. LEXIS 7341 (App. Div. 1992) (where the prospective mortgagor agreed to be bound by the mortgagee's "usual terms and conditions," and the objected-to condition was a customary closing requirement, the mortgagor could not complain that the term of the loan deviated from the loan the mortgage broker was hired to obtain); *Grace v. Dry Dock Sav. Bank*, 162 N.Y.S.2d 381, 384-85, 1957 N.Y. App. Div. LEXIS 5489 (App. Div. 1957) .

Texas: Vandever v. Goettee, 678 S.W.2d 630, 633 (Tex. Civ. App. 1984) .

Utah: Mahmood v. Neilson, 142 B.R. 454, 456 (Bankr. D. Utah) (bankruptcy court properly disallowed a brokerage commission to loan broker, where record showed that his introduction of the parties resulted in nothing more than an informal acquaintance, and no loan was obtained through the broker's actions; one reference in a letter acknowledging the obligation to pay the broker a fee cannot defeat overwhelming evidence to the contrary).

(n65)Footnote 65. See *First Louisiana Mortgage Co. v. Nesser Gardens, Inc.*, 285 So. 2d 837, 838-39 (La. Ct. App. 1973) .

(n66)Footnote 66. *Vandever v. Goettee*, 678 S.W.2d 630 (Tex. Civ. App. 1984) .

(n67)Footnote 67. See § 4.06[2] above for discussion of the "exclusive right to sell" listing.

(n68)Footnote 68. *Vandever v. Goettee*, 678 S.W.2d 630, 633 (Tex. Civ. App. 1984) .

(n69)Footnote 69. *Vandever v. Goettee*, 678 S.W.2d 630, 633 (Tex. Civ. App. 1984) .

(n70)Footnote 70. See *S & D Enters., Inc. v. Sonnenblick-Goldman Southeast Corp.*, 310 So. 2d 343, 344-45 (Fla. Dist. Ct. App. 1975) .

See also *Vandever v. Goettee*, 678 S.W.2d 630, 633 (Tex. Civ. App. 1984) (broker was unable to prove that the borrower breached an exclusive brokerage agreement because the broker failed to show that the borrower, who obtained his own financing, had applied for such during the life of the agreement with the broker).

(n71)Footnote 71. See, e.g.:

Federal: Sonnenblick-Goldman Corp. v. Marbella Del Caribe, 412 F. Supp. 439, 441 (S.D.N.Y. 1975) (applying New York law; thirty days, plus fifteen additional days if necessary, and thereafter until authorization was cancelled by borrower).

Illinois: First Capitol Mortgage Co. v. Talandis Constr. Corp., 365 N.E.2d 66, 67 (Ill. App. Ct. 1977) (sixty days).

(n72)Footnote 72. See *First Capitol Mortgage Co. v. Talandis Constr. Corp.*, 365 N.E.2d 66, 70 (Ill. App. Ct. 1977) .

(n73)Footnote 73. *Sonnenblick-Goldman Corp. v. Marbella Del Caribe*, 412 F. Supp. 439, 446 (S.D.N.Y. 1975) .

(n74)Footnote 74. See :

Nebraska: Don J. McMurray Co. v. Wiesman, 260 N.W.2d 196, 202 (Neb. 1977) discussed in § 11.04[4].

(n75)Footnote 75. *In re Corkscrew Golf Property Land Trust*, 93 B.R. 277 (Bankr. M.D. Fla. 1988) .

See also *Coppedge v. Financial Servs. Group Corp.*, 258 S.E.2d 654, 655 (Ga. Ct. App. 1979) (where the borrower prevented broker from fully performing under the contract, broker was entitled to compensation for that part of the agreement he actually performed).

For a classic case of fraudulent interference with the business opportunity of a broker, see *Keviczky v. Lorber*, 49 N.E.2d 146 (N.Y. 1943) .

(n76)Footnote 76. See *First Capitol Mortgage Co. v. Talandis Constr. Corp.*, 365 N.E.2d 66, 71 n.1 (Ill. App. Ct. 1977) .

(n77)Footnote 77. See *Fred McGilvray, Inc. v. Delphian Group, Inc.* 424 So. 2d 891, 892 (Fla. Dist. Ct. App. 1982) .

(n78)Footnote 78. *Belen Sch., Inc. v. Higgins*, 462 So. 2d 1151, 1154 (Fla. Dist. Ct. App. 1984) .

(n79)Footnote 79. *Landow-Luzier Co. v. Grey*, 232 N.Y.S.2d 247, 256, 1962 N.Y. Misc. LEXIS 3127 (Sup. Ct. 1962) .

(n80)Footnote 80. *Fred McGilvray, Inc. v. Delphian Group, Inc.* 424 So. 2d 891, 892 (Fla. Dist. Ct. App. 1982) .

(n81)Footnote 81. *Robert v. Berlanti Dev. Co., Inc.*, 250 N.Y.S.2d 154, 155, 1964 N.Y. App. Div. LEXIS 3674 (App. Div. 1964) .

(n82)Footnote 82. See *Vandever v. Goettee*, 678 S.W.2d 630, 636 (Tex. Civ. App. 1984) (broker failed to prove his efforts conferred a benefit on the borrower).

(n83)Footnote 83. See, e.g.:

Florida: Bermil Corp. v. Sawyer, 353 So. 2d 579 (Fla. Dist. Ct. App. 1977) .

Illinois: Amalgamated Fin. Corp. v. Atlantis, Inc., 434 N.E.2d 417 (Ill. App. Ct. 1982) .

(n84)Footnote 84. *Bermil Corp. v. Sawyer*, 353 So. 2d 579, 585 (Fla. Dist. Ct. App. 1977) .

(n85)Footnote 85. *Bermil Corp. v. Sawyer*, 353 So. 2d 579, 582 (Fla. Dist. Ct. App. 1977) .

(n86)Footnote 86. *See Amalgamated Fin. Corp. v. Atlantis, Inc.*, 434 N.E.2d 417, 418-19 (Ill. App. Ct. 1982) (where the brokerage agreement provided for a commission of three to five percent, depending on the terms of the financing, the lender conditioned the loan on limiting the broker to a fee of one percent).

(n87)Footnote 87. *Bermil Corp. v. Sawyer*, 353 So. 2d 579, 585 (Fla. Dist. Ct. App. 1977) .

(n88)Footnote 88. *Amalgamated Fin. Corp. v. Atlantis, Inc.*, 434 N.E.2d 417, 419 (Ill. App. Ct. 1982) (citations omitted).

(n89)Footnote 89. *Amalgamated Fin. Corp. v. Atlantis, Inc.*, 434 N.E.2d 417, 420 (Ill. App. Ct. 1982) .

(n90)Footnote 90. *Amalgamated Fin. Corp. v. Atlantis, Inc.*, 434 N.E.2d 417, 420 (Ill. App. Ct. 1982) .

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7 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice § 11.05

§ 11.05 Mortgage Broker's Duties

[1] Generally

With established supervision of mortgage brokers has come codification of the mortgage brokers' duties. In some states, statutes stipulate that the mortgage broker functions specifically as an agent of one of the parties to the transaction, therefore owing to that party certain fiduciary duties. n1 In most of these jurisdictions, the common-law fiduciary duties of mortgage brokers have been embedded in the statutes. Among the common-law duties are the duties of loyalty, good faith, fair dealing, full disclosure of all material facts and avoidance of self-dealing in the subject matter of the agency relationship. n2 In those states where mortgage brokers must be licensed as real estate brokers, the mortgage broker's common-law duties are supplemented by the real estate broker licensing laws. n3 Additionally, one must be aware that in some situations, the mortgage broker may be deemed to be in a quasi-fiduciary relationship with the persons whom it solicits to lend monies to its customers, that is, private investors and wholesale mortgage lenders. n4 Florida has codified duties owed by the mortgage broker to both the borrower and the lender. n5

The question of whether a mortgage broker has a fiduciary duty to a borrower arose in a class action lawsuit brought in United States District Court in Virginia. n6 In an article explaining the settlement reached in that case, the attorneys representing one of the mortgage brokers wrote:

In Virginia, unlike many other states, there is no statute providing that a broker has a fiduciary duty to a borrower. No decision of Virginia's highest court has imposed such a duty by common law. If such a duty exists, how is it discharged? Does a broker have a duty to get the lowest cost loan? How many lenders does a broker have to contact? If a broker does not have a relationship with the lowest cost lender, must the broker refer a borrower to another broker with the lender relationship? Is a mortgage broker a "middleman"--one who brings together borrowers and lenders, but not a fiduciary owing a duty to any one side of the transaction? n7

These questions remain at the crux of many of the concerns held by consumers and their lawyers. At the present, the key to resolving issues of fiduciary duty appears to be in disclosure of fees paid to mortgage brokers. n8

[2] Duties to Borrower

[a] Common-Law Duties

The borrower who hires a broker to obtain financing for a commercial project must often rely on the common-law duties imposed on an agent for protection against improper broker conduct. The broker who fails to disclose material facts to the borrower has breached its common-law fiduciary duty and thereby forfeits its commission and becomes liable for damages, both actual and punitive. n9 A Georgia mortgage broker who failed to disclose that he knew nothing of the proposed lender's financial status or whether the lender had ever actually closed a loan for anyone breached his fiduciary duty to the borrower. n10 So too did a Washington broker who obtained the borrower's signature on a mortgage by trick and misrepresented and concealed the nature and extent of his fees. n11

Another of the mortgage broker's common-law duties that should not be overlooked is the duty to use diligence and due care in carrying out the obligations of the brokerage agreement. n12 A broker who negligently fails to place a client's mortgage loan and then affirmatively acts to secure an expensive interim loan, which would have been totally unnecessary had the broker acted diligently, is liable to the borrower in negligence. n13 Moreover, if the broker, by charging the borrower for a service (such as conducting a well pump test to determine whether the property to be purchased has an adequate domestic water supply) takes on an implied contractual obligation to ensure that the service is performed, the negligent failure to perform the contractual obligation may render the broker liable for damages. n14

When the mortgage broker has fully performed its obligation under a brokerage agreement that requires only the procurement of a loan commitment on terms acceptable to the borrower, the broker's agency relationship with the borrower is usually terminated. n15 Once the borrower accepts the commitment the broker, at most, owes his principal "a duty to assist it, when requested in meeting its contract obligation, and ... a duty not to prevent or hinder, by affirmative act, the execution of the [loan] contract." n16 However, if at the request of the borrower, the broker undertakes, with or without compensation, further negotiations with the lender, a special agency may be created giving rise to the same fiduciary duties to which a paid agent is subject. n17

A striking example of this principle is found in *Armstrong v. Republic Realty Mortgage Corp.*, n18 in which the United States Court of Appeals for the Eighth Circuit, applying Missouri law, sustained a jury verdict of compensatory and punitive damages against a mortgage broker. In *Armstrong*, the broker had successfully obtained, and the borrower had accepted, a permanent loan commitment for the borrower's commercial real estate development. The loan was to be closed in three stages: a floor loan of \$900,000 and two further stages as tenant leases reached specified annual dollar totals. The first stage of the loan was successfully closed, but because of construction problems the borrower sought, through the broker, an extension of time for the succeeding stages. The broker who, for a fee, was also going to service the permanent end loan for the institutional lender and who had insisted that all contacts with the lender take place through him, agreed to seek the extension, which was granted. Thereafter, the borrower continued its leasing efforts to qualify for full funding of the loan. However, the lender decided it would fund only the second stage of the loan, forcing the borrower to prepay the floor loan and be released from the lender's first mortgage so it could seek other first mortgage long-term financing. The borrower, faced with a very restrictive prepayment penalty clause in the first mortgage loan it would have to prepay, turned again to the broker. The broker agreed to contact the lender to request that either the loan be fully funded or, if the lender refused, that the lender permit prepayment of the existing mortgage without penalty. However, when the lender agreed to allow prepayment with a one percent penalty fee, the broker urged the lender to charge a prepayment penalty of four percent. The broker and lender then agreed to split whatever monies were obtained from the borrower. The broker then informed the borrower that the lender would require a prepayment penalty of four percent. The borrower, through direct negotiations with the lender, finally paid a two percent penalty, half of which was secretly paid by the lender to the broker. Subsequently, the borrower sued the broker for breach of fiduciary duty and won both compensatory and punitive damages (\$125,000) at trial.

In sustaining the jury verdict, the Eighth Circuit found that the evidence was sufficient to support the finding that the broker had become the special agent of the borrower concerning the loan prepayment negotiations and was, therefore, subject to all the fiduciary duties of loyalty and good faith that an agent, even a gratuitous one, owes his principal. n19

The court also noted that the broker, who stood to lose the loan servicing fee it would receive from the lender if the borrower prepaid, had an interest potentially adverse to the borrower, which ripened into an actual adverse interest when the borrower requested the broker to negotiate for prepayment. n20 Despite this conflict of interest, the court stated:

[The broker] ... agreed to do as [the borrower] requested, remaining silent about its own adverse interest in the subject of the agency. ... [The broker], when it accepted the special agency, had a strong motive to want [the lender] either to refuse prepayment, or to permit it only if conditioned on a high prepayment penalty. Under the circumstances, [the broker] should not have accepted the special agency at all but, having done so, its subsequent conduct must be measured against the fiduciary duty to [the borrower] implicit in the special agency [the broker] knowingly assumed.

Because of [the broker's] conflict of interest, and because of its secret competition with and disloyalty towards its principal, its claim of non-liability because of a mere "middleman" status cannot stand, nor will the evidence permit its claim of a lawful dual agent status. n21

[b] Common-Law Duties Supplemented by Statute

Perhaps the most extensive judicial discussion of the mortgage broker's fiduciary duties to the borrower is found in *Wyatt v. Union Mortgage Co.* n22 There, the Supreme Court of California applied the common law of agency and the state's real estate/mortgage broker licensing legislation to broadly define the broker's fiduciary obligations.

In *Wyatt*, the borrower responded to the broker's television advertising campaign promoting inexpensive second mortgage financing. When the borrower asked about the rate of interest, late payments and the size of balloon payments due at the end of the loan period, the broker responded with materially misleading and incomplete information which grossly understated the financial obligations the borrower would bear under the loan. Thereafter, the borrower was unable to pay as agreed and had to borrow additional sums through the broker to satisfy the substantial late charges and balloon payments required. Faced with foreclosure of his home, the borrower sued the broker for damages, alleging that the broker's advertising, misrepresentations about the terms of the loan, failure to tell the borrower about the very unfavorable provisions buried in the loan papers and exaction of unjustified late charges on the loans, breached the fiduciary duty owed by the broker to its clients. The broker answered, claiming that it had fully met its duty of disclosure when it gave the borrower written loan documents containing the information required by the California statutes n23 governing real property loans.

In sustaining a jury verdict awarding damages to the plaintiff-borrower, the court noted that:

A mortgage loan broker is customarily retained by a borrower to act as the *borrower's agent* in negotiating an acceptable loan. All persons engaged in this business in California are required to obtain real estate licenses. Thus, general principles of agency combine with statutory duties created by the Real Estate Law to impose upon mortgage loan brokers an obligation to make a full and accurate disclosure of the terms of a loan to borrowers and to act always in the utmost good faith toward their principals. "The law imposes on a real estate agent 'the same obligation of undivided service and loyalty that it imposes on a trustee in favor of his beneficiary.' This relationship not only imposes upon him the duty of acting in the highest good faith toward his principal but precludes the agent from obtaining any advantage over the principal in any transaction had by virtue of his agency." A real estate licensee is "charged with the duty of fullest disclosure of all material facts concerning the transaction that might affect the principal's decision." n24

By giving materially misleading and incomplete information to the borrower in response to his questions about the terms and conditions of the loan, the broker did not satisfy its fiduciary obligation of disclosure and good faith toward its principal, even though the loan documents themselves accurately disclosed all the terms. n25 As the court noted, "the existence of a confidential relationship may justify reliance upon oral misrepresentation of the terms of a contract." n26

The *Wyatt* court found an additional reason for holding that the broker had breached its fiduciary duty to the borrower by analogy to insurance law cases which "recognized that a fiduciary's duty may extend beyond written disclosure of the terms of a transaction to duties of oral disclosure and counseling." n27 The court noted that

The reasoning of these [insurance law] cases applies to transactions with mortgage loan brokers as well. Here, the record discloses that respondents were persons of modest means and limited experience in financial affairs, whose equity in their home was their principal asset. They retained a mortgage loan broker to negotiate for them highly complex loan terms and they may be assumed to have justifiably relied on the latter's expertise. Against such a backdrop, the broker's failure to disclose orally the true rate of interest, the penalty for late payments or the swollen size of the balloon payment clearly constituted breach of the broker's fiduciary obligations. It is noteworthy also that the provisions regarding interest rate, late charges and balloon payment were highly unfavorable to the borrower and yet the broker made no attempt to draw his clients' attention to these matters. n28

As *Wyatt* indicates, California is a leader in holding the mortgage broker accountable to the mortgage loan consumer. Other California cases have found that both the fiduciary duties of the broker created by general principals of agency and statutory duties peculiar to mortgage brokers extend at least to the time of the funding of the loan, n29 and that mortgage brokers must disclose to a borrower who indicates the need for a loan within the monetary limits below which the compensation of the broker is statutorily limited, that if the borrower accepts the broker's suggestion that he seek a loan exceeding these statutory limits, the statutory ceiling on brokerage commissions will no longer obtain. n30

[c] Role of Consumer Protection Legislation

Another way to hold the mortgage broker accountable to the borrowing public, even in jurisdictions which already regulate mortgage brokers through special licensing or by requiring that they hold a real estate broker's license, is the use of state consumer protection legislation as a vehicle for public or private redress. Thus, the Michigan courts sanctioned both public n31 and private n32 law suits against mortgage brokers under the Michigan Consumer Protection Act, holding that although mortgage brokers were at that time regulated by the real estate licensing laws, they were not exempt from claims under the consumer protection statutes. n33 The Supreme Court of South Dakota upheld a judgment which ordered a mortgage broker to refund advance fees obtained from mortgage loan consumers, imposed a stiff civil penalty payable to the state for engaging in deceptive trade practices and enjoined the broker from doing business within the state unless it was in full compliance with the state's Deceptive Trade Practices and Consumer Protection Law. n34 In that case, the broker had failed to comply with a statute requiring that consumer contracts contain cancellation provisions in bold face type and had misrepresented, among other things, the availability of long-term financing when it knew that the only type of financing it could secure was short-term, which would have been totally unacceptable to the small agricultural borrowers it solicited.

An Arizona court n35 determined that the state could sue under both the Arizona Consumer Fraud Act and Mortgage Brokers Act where a state-licensed mortgage broker was alleged to have engaged in fraudulent business practices. The broker had unilaterally increased the discount rate (a "discount point" system whereby cash payments, normally made by the sellers in Arizona real estate transactions, are required by lenders as a condition to making an FHA or VA guaranteed loan) despite having offered a commitment that specified the discount rate to be charged and stated that the loan was subject to "renegotiation" in the event of an interest rate change. The Arizona Attorney General claimed that the use of the term "renegotiation" in the loan commitment was misleading and deceptive because of the broker's conduct in raising the discount rate on a "take it or leave it" basis and that the broker concealed material information by failing to inform sellers that discount rates frequently were subject to change. The court observed that the Mortgage Brokers Act did not provide direct relief to consumers and concluded that "[b]ecause the Mortgage Brokers Act is not comprehensive and detailed legislation designed to provide omnibus consumer protection, the action against [the broker] based on the Consumer Fraud Act is not preempted by the Mortgage Brokers Act." n36

Prior to the enactment of the Alabama Mortgage Brokers Licensing Act, *Ala. Code* §§ 5-25-1 through -18, the state's Consumer Finance Act n37 was relied upon to regulate the conduct of mortgage brokers. In *Smith v. First Family Financial Services*, n38 the mortgage broker/correspondent lender had received a "yield spread premium" from the lender, a fee that was not disclosed to the borrowers. The plaintiffs maintained

(1) that the defendants committed legal fraud and conspired to commit legal fraud against them in regard to undisclosed mortgage broker fees and charges incurred by them in the loan transaction; (2) that [lender's] correspondent lender program was a scheme to avoid the letter and spirit of the 5% cap on mortgage origination fees under *Alabama Code 1975, § 5-19-4(g)*; that [lender] was required to disclose the material facts in that it violates the Alabama Deceptive Trade Practices Act and that, further, [lender] was under a duty to disclose because of the particular circumstances of this case; (3) that [lender's] correspondent lender program was a combination between [lender] and its broker to do the wrongs alleged, which combination constituted a civil conspiracy under Alabama Law; and (4) that the defendants breached their fiduciary duty by seeking a loan for the plaintiffs that contained terms and conditions that would benefit themselves to the detriment of the plaintiffs. n39

Claiming that the "yield spread premium" was in addition to the five percent origination fee that was disclosed, the plaintiffs alleged that the yield spread premium resulted in the mortgage broker receiving more than the five percent origination fee allowed under the Consumer Finance Act, or "Mini-Code." n40 "Indisputedly, [sic] the yield spread premium was a part of the cost of the loan borne by the borrowers." n41 In reaching a decision in favor of the borrowers, the court relied on the then-current version of RESPA:

RESPA admittedly does not apply to the transaction that is the basis of this litigation Nevertheless, RESPA and the regulations promulgated under RESPA are instructive with regard to material disclosures required of mortgage lenders and mortgage brokers or correspondent lenders under similar or identical facts. Regulation X ... expressly requires that loan correspondents and loan brokers disclose their fees to borrowers. Disclosure requirements, referred to by HUD as "mortgage broker disclosures," apply to any transaction in which the loan either is closed in the wholesale lender's name or is originated under a "table funding" arrangement in which the wholesale lender provides the funds for the loan closing. If the loan closes in the broker's name, the disclosure must be made, whether the broker's fees are in the form of a yield spread premium (sometimes referred to as a "market gain") or a servicing release premium or other fee. RESPA Regulation X requires disclosure of all broker's fees, by whatever name, just as the Mini-Code requires disclosure of all finance charges, by whatever name. n42

[3] Duties to Lenders and Others

In the absence of a statute which imposes on the mortgage broker duties of good faith and fair dealing toward persons other than his principal, n43 what duties, if any, does the broker owe to the mortgage lenders with whom he deals and other persons who are affected by the real estate loan transactions he seeks to promote?

The leading cases on the subject of the broker's duties toward the lenders whom he solicits on behalf of his principal are from the Supreme Court of Washington. In two cases n44 decided in the 1960s, that court held in favor of private persons who claimed they had been defrauded into making unsafe mortgage loans by mortgage brokers who falsely represented the safety and security of the loans and the status of title to the property which was to secure the loans. Furthermore, the brokers concealed documents from the lender which would have shown not only that the proposed borrowers were contract vendees rather than owners, but also that the property was already encumbered by mortgages or tax liens. Indeed, in one case, the broker failed to inform the lender, who was to make a \$5,500 mortgage loan, that if the borrower defaulted, an expenditure of over \$100,000 might be necessary to protect his investment. n45

In these cases the court found that the mortgage broker had

a duty to disclose the information [he] possessed and of which [the lender] was ignorant. Here, because of the superior business acumen and experience of [the broker] as compared with [the lender], because of the superior factual knowledge of the one as against the factual ignorance of the other, and because [the broker] knew [the lender] was relying on his superior knowledge, experience and judgment, there existed a *quasi-fiduciary relationship*, if not an actual one, that brings the case within the rule that "a party to a business transaction is under a duty to exercise reasonable care to disclose to the other before the transaction is consummated ... such matters as the other is entitled to know because of ... a relation of trust and confidence between them." n46

Nor could the broker defend on the ground that, had the lender searched the public record instead of relying on the broker, he would have discovered the true state of facts. " '[W]rongdoers cannot shield themselves from liability by asking the law to condemn the credulity of their victims.' " n47

The idea articulated by the Washington court that the mortgage broker may, under certain circumstances, owe a duty of disclosure to persons other than his principal has also found expression in an Alabama case n48 in which a property owner sued a mortgage broker for damages resulting from the loss of approximately nineteen acres of its land in foreclosure of development loans arranged by the broker for the holder of a ground lease. It turned out that an officer of the corporate mortgage broker had a secret partnership interest in the apartment projects to be constructed on the property, and that the broker and the others misapplied large amounts of the loan proceeds for their own benefit, thereby causing the project to founder and the loan to go into default.

While the Supreme Court of Alabama agreed with the trial court that there was no proof of a fiduciary relationship arising out of any employment relationship between the owner and mortgage broker, it determined that a trial on the merits was required on the owner's claim that the broker owed it a duty to disclose the material fact that an officer of the broker and others had hidden equity interests in the projects and had made secret profits from the construction loan proceeds at the owner's expense. The question, said the court, was whether the broker was under an obligation to disclose under the particular circumstances of the case. n49 The court found that

[t]he facts alleged ... properly state a claim of actionable fraud based upon a duty to disclose or communicate ... where the defendant has special knowledge or means of knowledge not open to the plaintiff and is aware that the plaintiff is acting under a misapprehension as to facts which would be of importance to him and would probably affect his decision. n50

As illustrated by these Washington and Alabama decisions, when confronted by mortgage broker misconduct toward those to whom no traditional fiduciary duties are owed, the courts have moved the law in the direction of providing a remedy for the injured party, whether couched in terms of quasi-fiduciary duties or fraud. The judicial trend in favor of mortgage broker accountability will, in all likelihood, continue. This premise also applies to civil rights suits, but the mortgage broker may not be liable when the origin of the discrimination lies with the lending institution and not with the broker. n51

FOOTNOTES:

(n1)Footnote 1. See, e.g.:

Delaware: Del. Code Ann. tit. 5, § 2101(5).

Kentucky: Ky. Rev. Stat. Ann. § 286.8-010(8) (mortgage broker "serves as agent for any borrower in an attempt to obtain a mortgage loan ... ").

Minnesota: Minn. Stat. Ann. § 58.161 (A mortgage broker shall be considered to have created an agency relationship with the borrower in all cases).

Nevada: Nev. Rev. Stat. § 645B.0127(a)-(b) (mortgage broker mean a person who, directly or indirectly, holds himself out for hire to serve as an agent for any person (1) in an attempt to obtain a loan which will be secured by a lien on real property or (2) who has money to lend, if the loan is or will be secured by a lien on real property).

Texas: Although not codified by statute or regulation, Texas case law indicates that the mortgage broker is the agent for the borrower. *See, e.g., First City Mortgage Co. v. Gillis*, 694 S.W.2d 144, 146 (Tex. Ct. App. 1985) (holding that the broker is a fiduciary required to exercise fidelity and good faith towards his principal and must disclose material information); *FDIC v. Golden Imports, Inc.*, 859 S.W.2d 635, 642-43 (Tex. App. 1993) (holding that "[a] broker is an agent employed to make bargains and contracts between other persons in matters of trade and commerce for a compensation commonly called brokerage") (citation omitted).

See also:

Minnesota: Minn. Stat. Ann. § 58.15 (if a mortgage broker is not acting as the borrower's agent, he or she must disclose that fact in writing to the borrower).

But see Strumpf v. State, 31 Ala. App. 409, 18 So. 2d 104, 107 (Ala. Ct. App. 1944) (holding that "[a] broker is distinguished from an agent, in that a broker holds himself out for employment by others, and acts as an intermediate negotiator between the parties to a transaction, and in a sense is the agent of both parties, whereas the element of exclusiveness of representation of the principal by which he is employed enters into the employment of an agent") (citations omitted).

(n2)Footnote 2. *See generally* Restatement (Second) of Agency § 13, cmt. a (1957).

Cf. Wright & Souza, Inc. v. DM Properties, 510 N.W.2d 413 (Neb. Ct. App. 1993) (no principal-agent relationship existed between a landowner seeking refinancing of its mortgage and a mortgage broker when: (1) the landowner exercised no control over the broker; (2) the broker was engaged in a distinct occupation usually done without supervision; (3) the payment was not based on an hourly rate, but rather on whether the broker could obtain the refinancing; and (4) the work performed by the broker was not a regular part of the landowner's business).

(n3)Footnote 3. *See, e.g.:*

California: Cal. Bus. & Prof. Code § 10131(d).

See also § 11.02[1] above for further discussion.

(n4)Footnote 4. *See, e.g.:*

Delaware: Del. Code Ann. tit. 5, § 2101(5).

Kentucky: Ky. Rev. Stat. Ann. § 286.8-010(8) (mortgage broker "serves as agent for any borrower in an attempt to obtain a mortgage loan ...").

Nevada: Nev. Rev. Stat. § 645B.0127 (a)-(b) (mortgage broker mean a person who, directly or indirectly, holds himself out for hire to serve as an agent for any person (1) in an attempt to obtain a loan which will be secured by a lien on real property or (2) who has money to lend, if the loan is or will be secured by a lien on real property).

North Carolina: N.C.G.S.A. 53-244.030(21)(c)(2). A person or entity that only performs real estate brokerage activities and is licensed or registered as such in accordance with State law, unless the person or entity is compensated by a mortgage lender, a mortgage broker, or other mortgage loan originator or by any agent of a mortgage lender, mortgage broker, or other mortgage loan originator.

Texas: Although not codified by statute or regulation, Texas case law indicates that the mortgage broker is the agent for the borrower. See, e.g., First City Mortgage Co. v. Gillis, 694 S.W.2d 144, 146 (Tex. Ct. App. 1985) (holding that the broker is a fiduciary required to exercise fidelity and good faith towards his principal and must disclose material information); FDIC v. Golden Imports, Inc., 859 S.W.2d 635, 642-43 (Tex. App. 1993) (holding that "[a] broker is an agent employed to make bargains and contracts between other persons in matters of trade and commerce for a compensation commonly called brokerage") (citation omitted).

But see Strumpf v. State, 31 Ala. App. 409, 18 So. 2d 104, 107 (Ala. Ct. App. 1944) (holding that " '[a] broker is distinguished from an agent, in that a broker holds himself out for employment by others, and acts as an intermediate negotiator between the parties to a transaction, and in a sense is the agent of both parties, whereas the element of exclusiveness of representation of the principal by which he is employed enters into the employment of an agent' ") (citations omitted).

(n5)Footnote 5.

Florida: Fla. Stat. §§ 494.001-494.0043.

(n6)Footnote 6. *Hunter v. Fleet Fin., Inc., No. 94-CV-266 (E.D. Va., filed Apr. 20, 1994).*

(n7)Footnote 7. *Perrow, Eicher, Lenders & Brokers Settle Virginia Class Action Suit, MBA Statelines (Mortgage Bankers Ass'n of Amer.) Feb. 1995.*

(n8)Footnote 8. *See, e.g.:*

Alabama: Smith v. First Family Fin. Servs. Inc., 626 So. 2d 1266, 1271 (Ala. 1993) (overruled in part by Goldome Credit Corp. v. Burke, 923 So. 2d 282 (Ala. 2005) and superseded by statute).

California: Wyatt v. Union Mortgage Co., 598 P.2d 45, 50 (Cal. 1979) .

*But see Stetler v. Greenpoint Mortg. Funding, Inc., 2008 U.S. Dist. LEXIS 4880 *16-17 (E.D. Cal. 2008) (as broker was not acting as borrower's agent pursuant to mortgage loan origination agreement, broker's duties arise from a prohibition against making affirmative misrepresentations rather than from a duty to explain the ins and outs of each loan product).*

(n9)Footnote 9. *See Restatement (Second) of Agency § 469 (stating that "[a]n agent is entitled to no compensation for conduct which is disobedient or which is a breach of his duty of loyalty; if such conduct constitutes a wilful and deliberate breach of his contract of service, he is not entitled to compensation even for properly performed services for*

which no compensation is apportioned").

See also *In re Thomson McKinnon Sec., Inc.*, 143 B.R. 612, 621 (Bankr. S.D.N.Y. 1992) (holding that although a mortgage broker has a duty to keep the principal fully informed of all material facts which come to the broker's attention, the duty to divulge information does not extend to all matters peripherally affecting the transaction).

(n10)Footnote 10. *Grainger v. Jackson*, 176 S.E.2d 279, 282 (Ga. Ct. App. 1970) (fraud conspiracy action by borrower against mortgage broker).

(n11)Footnote 11. *Rushing v. Stephanus*, 393 P.2d 281, 283-84 (Wash. 1964) (finding that the broker forfeited his commission and was liable for actual damages, since "[t]he broker must fully reveal the nature and extent of his fees to the client for whom he acts, and the failure to do so will render him liable") (citations omitted).

(n12)Footnote 12. See also *McAllister v. Charter First Mortgage, Inc.*, 567 P.2d 539 (Or. 1977) (en banc) (where a borrower sued seller for rescission and won, based on concealment of inadequate domestic water supply, but the seller was unable to return the purchase price, the mortgage broker who charged for, but failed to perform a well pump test, was held liable to the borrower for damages).

(n13)Footnote 13. *Rushing v. Stephanus*, 393 P.2d 281, 283-84 (Wash. 1964) .

(n14)Footnote 14. *McAllister v. Charter First Mortgage, Inc.*, 567 P.2d 539 (Or. 1977) .

(n15)Footnote 15. See *Armstrong v. Republic Realty Mortgage Corp.*, 631 F.2d 1344, 1348 (8th Cir. 1980) (applying Missouri law and assuming, without deciding, that the agency relationship terminated when the borrower accepted the loan commitment obtained by the broker).

(n16)Footnote 16. *Armstrong v. Republic Realty Mortgage Corp.*, 631 F.2d 1344, 1350 (8th Cir. 1980) (footnote omitted).

(n17)Footnote 17. *Armstrong v. Republic Realty Mortgage Corp.*, 631 F.2d 1344, 1348-49 (8th Cir. 1980) .

(n18)Footnote 18. 631 F.2d 1344 (8th Cir. 1980) .

(n19)Footnote 19. *Armstrong v. Republic Realty Mortgage Corp.*, 631 F.2d 1344, 1348-49 (8th Cir. 1980) .

(n20)Footnote 20. *Armstrong v. Republic Realty Mortgage Corp.*, 631 F.2d 1344, 1349 (8th Cir. 1980) .

(n21)Footnote 21. *Armstrong v. Republic Realty Mortgage Corp.*, 631 F.2d 1344, 1349-50 (8th Cir. 1980) (citations omitted).

(n22)Footnote 22. 598 P.2d 45 (Cal. 1979) . But see: *Stetler v. Greenpoint Mortg. Funding, Inc.*, 2008 U.S. Dist. LEXIS 4880 *16-17 (E.D. Cal. 2008) (as broker was not acting as borrower's agent pursuant to mortgage loan origination agreement, broker's duties arise from a prohibition against making affirmative misrepresentations rather than from a duty to explain the ins and outs of each product).

(n23)Footnote 23. Cal. Bus. & Prof. Code §§ 10240, 10241, 10241.4.

(n24)Footnote 24. *Wyatt v. Union Mortgage Co.*, 598 P.2d 45, 50 (Cal. 1979) .

(n25)Footnote 25. *Wyatt v. Union Mortgage Co.*, 598 P.2d 45, 50 (Cal. 1979) .

(n26)Footnote 26. *Wyatt v. Union Mortgage Co.*, 598 P.2d 45, 50 (Cal. 1979) (citations omitted).

(n27)Footnote 27. *Wyatt v. Union Mortgage Co.*, 598 P.2d 45, 51 (Cal. 1979) .

(n28)Footnote 28. *Wyatt v. Union Mortgage Co.*, 598 P.2d 45, 51 (Cal. 1979) . The court additionally found that the broker had breached its fiduciary duty by imposing fraudulent late charges on the second loan taken out by the borrower.

(n29)Footnote 29. *UMET Trust v. Santa Monica Med. Inv. Co.*, 189 Cal. Rptr. 922, 927 (Ct. App. 1983) . In *UMET Trust*, the broker was hired to secure mortgage financing by a medical group, and arranged a loan disguised as a sale-leaseback transaction. When the borrower breached the lease by failing to make certain rent payments, the lender sought possession of the realty. In a suit by the lender to quiet title, the borrower sought reformation of the transaction from a sale-leaseback to a conventional mortgage loan, and also sued the broker for breach of fiduciary duty. In affirming the trial court's finding that the broker had committed numerous breaches of the fiduciary duties outlined in *Wyatt*, the Court of Appeal noted that the trial court had found that the broker had

failed to advise its clients that their interest in the property, as lessee, could be terminated upon abbreviated notice; failed to advise its clients that the statutory right of redemption existing in loan agreements does not exist in sale-leaseback transactions; failed to disclose that the anti-deficiency provisions which statutorily exist in traditional loans secured by interests in real property do not exist in sale-leaseback transactions; and failed to advise [the borrower] that the final transaction documents contained provisions which could be interpreted as granting to [the lender] an immediate future interest in the building. [The broker] further affirmatively misrepresented that the sale-leaseback financing gave [the borrower] the same flexibility as a conventional loan, and would accomplish the same result.

UMET Trust v. Santa Monica Med. Inv. Co., 189 Cal. Rptr. 922, 927-28 (Ct. App. 1983) .

(n30)Footnote 30. *Realty Projects, Inc. v. Smith*, 108 Cal. Rptr. 71, 73-76 (Ct. App. 1973) (upholding revocation of mortgage broker's license on basis of breach of statutory duty of fair and honest dealing by real estate licensees).

See also Fla. Stat. § 494.0025 (Florida Mortgage Brokerage and Lending Act), which provides:

It is unlawful for any person:

...

(4) In any practice or transaction or course of business relating to the sale, purchase, negotiation, promotion, advertisement, or hypothecation of mortgage transactions, directly or indirectly:

- (a) To knowingly or willingly employ any device, scheme, or artifice to defraud;
- (b) To engage in any transaction, practice, or course of business which operates as a fraud upon any person in connection with the purchase or sale of any mortgage loan; or
- (c) To obtain property by fraud, willful misrepresentation of a future act, or false promise.

(5) In any matter within the jurisdiction of the department, to knowingly and willfully falsify, conceal, or cover up by a trick, scheme, or device a material fact, make any false or fraudulent statement or representation, or make or use any false writing or document, knowing the same to contain any false or fraudulent statement or entry.

(n31)Footnote 31. *See Attorney General v. Diamond Mortgage Co.*, 327 N.W.2d 805 (Mich. 1982) (Attorney General alleged that an insurance company engaging in non-insurance (mortgage broker) activity violated usury and consumer protection statutes when he lent his own money to borrowers, represented interest to be eleven percent per annum but exacted usurious rates by imposing brokerage fees at closing and used documents that were confusing and inconsistent as to whether the broker was acting as lender or broker, and as to the amount to be paid to borrower, the amount to be financed, and the amounts of the annual percentage rates and finance charge).

(n32)Footnote 32. *See Allan v. M & S Mortgage Co.*, 359 N.W.2d 238 (Mich. Ct. App. 1984) (in a suit by a homeowner, in which the Attorney General intervened under the Michigan Consumer Protection Act, claiming that the homeowner was forced to form a corporation as a condition of a loan in order to circumvent state usury statutes, the court held that allegations that defendants advertised and sold their services as mortgage brokers and insisted that borrowers incorporate in order to obtain a loan at interest rates which would be usurious if charged to an individual stated a claim under the Consumer Protection Act).

(n33)Footnote 33. *Attorney General v. Diamond Mortgage Co.*, 327 N.W.2d 805, 810-811 (Mich. 1982) (the Attorney General could bring a public action against a mortgage broker under the Consumer Protection Act, seeking revocation of broker's corporate privileges, relief for injured homeowners through reformation of mortgage loan transactions and imposition of penalties without first exhausting administrative remedies before the real estate licensing authority).

But see Liss v. Lewiston-Richards, Inc., 732 N.W. 2d. 514, 520 (Mich. 2007) (exemption from liability under Michigan Consumer Protection Act for activities authorized by license does not extend to activities not "specifically authorized" by law).

(n34)Footnote 34. *State v. Western Capital Corp.*, 290 N.W.2d 467 (S.D. 1980) .

(n35)Footnote 35. *Madsen v. Western Am. Mortgage Co.*, 694 P.2d 1228 (Ariz. Ct. App. 1985) .

(n36)Footnote 36. *Madsen v. Western Am. Mortgage Co.*, 694 P.2d 1228, 1235 (Ariz. Ct. App. 1985) .

(n37)Footnote 37. *Ala. Code §§ 5-19-1 et seq.*

(n38)Footnote 38. 626 So. 2d 1266 (Ala. 1993) , *overruled in part by Goldome Credit Corp. v. Burke*, 923 So. 2d 282 (Ala. 2005) and *superseded* by statute.

(n39)Footnote 39. *Smith v. First Family Financial Services*, 626 So. 2d 1266, 1270 (Ala. 1993) .

(n40)Footnote 40. *Smith v. First Family Financial Services*, 626 So. 2d 1266, 1269-70 (Ala. 1993) .

(n41)Footnote 41. *Smith v. First Family Financial Services*, 626 So. 2d 1266, 1270 (Ala. 1993) . The yield spread premium issue is a confusing one, with the lender admittedly paying the mortgage broker/correspondent lender from the funds the lender discloses as its "profit" on the settlement papers required by the Truth in Lending Act. *See § 11.08 below* for discussion of yield spread premiums.

(n42)Footnote 42. *Smith v. First Family Financial Services*, 626 So. 2d 1266, 1272 (Ala. 1993) (footnote omitted). *See § 11.08 below* for further discussion of yield spread premiums.

(n43)Footnote 43. *See, e.g.:*

Florida: Fla. Stat. § 494.0025(4)-(5) (prohibits a Florida mortgage broker from engaging in fraudulent

practices).

See also *Hughes v. State*, 406 So. 2d 73 (Fla. Dist. Ct. App. 1981) (disciplinary action against a mortgage broker for allegedly defrauding a lender in a mortgage transaction).

Maryland: Md. Code Ann., Fin. Inst. § 11-517(a)(3)(i) (a licensee is subject to suspension or revocation of license if he/she commits fraud in connection with any mortgage loan or loan transaction).

North Carolina: N.C. Gen. Stat. § 53-244.111.

Tennessee: Tenn. Code Ann. § 45-13-401(8).

(n44)Footnote 44. *Sigman v. Stevens-Norton, Inc.*, 425 P.2d 891 (Wash. 1967) ; *Boonstra v. Stevens-Norton, Inc.*, 393 P.2d 287 (Wash. 1964) .

(n45)Footnote 45. *Boonstra v. Stevens-Norton, Inc.*, 393 P.2d 287, 288 (Wash. 1964) .

(n46)Footnote 46. *Boonstra v. Stevens-Norton, Inc.*, 393 P.2d 287, 289-90 (Wash. 1964) (emphasis added) (citation omitted).

(n47)Footnote 47. *Boonstra v. Stevens-Norton, Inc.*, 393 P.2d 287, 290 (Wash. 1964) .

(n48)Footnote 48. *Shades Ridge Holding Co. v. Cobbs, Allen & Hall Mortgage Co., Inc.*, 390 So. 2d 601 (Ala. 1980) .

(n49)Footnote 49. *Shades Ridge Holding Co. v. Cobbs, Allen & Hall Mortgage Co., Inc.*, 390 So. 2d 601, 615 (Ala. 1980) .

(n50)Footnote 50. *Shades Ridge Holding Co. v. Cobbs, Allen & Hall Mortgage Co., Inc.*, 390 So. 2d 601, 616 (Ala. 1980) .

(n51)Footnote 51. See *Parent v. Credit Union One*, 792 F. Supp. 526, 527 (E.D. Mich. 1992) (where the plaintiff's claim against the broker lacked a factual basis, plaintiff should have sued the lending bank for its racially motivated rejection of plaintiff's mortgage).

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The chapter was formerly revised by Mary J. Burt, Esq. Additional updates have been contributed by Sandra Bullington, Esq., of Louisa, Virginia.



8 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice § 11.06

§ 11.06 State Securities Regulation

Lawyers interested in mortgage brokerage law ought to be aware of the assertion by several state securities commissions that some or all of the activities of the mortgage broker fall within the ambit of state "Blue Sky" laws. n1 While there are as yet few decided cases on the subject, the possibility of criminal prosecution for state securities law violations counsels caution on the part of mortgage brokers and those advising them as to the applicable law.

Some states have addressed the securities question in their mortgage broker licensing laws. n2 Michigan's Mortgage Brokers, Lenders and Servicers Licensing Act, for example, goes into great detail. A licensee can be found guilty of a misdemeanor and fined up to \$5,000, or receive a prison term of up to three years, or both, if the licensee:

(c) Transfers or assigns a mortgage loan or a security representing an interest in 1 or more mortgage loans to an individual investor unless 1 or more of the following apply:

(i) The transfer or assignment is made through a broker-dealer which is a member of the New York stock exchange.

(ii) The transfer or assignment is made through a broker-dealer who meets all of the following criteria:

(A) The broker dealer is registered under the uniform securities act, 1964 PA 265, MCL 451.501 to 451.818, or the *Uniform Securities Act (2002)*, 2008 PA 551, MCL 451.2102 to 451.2703.

(B) The broker-dealer is not an affiliate of the mortgage lender unless the person acquired the broker-dealer registration, directly or indirectly, prior to September 1, 1987, under Act. No. 265 of the Public Acts of 1964, was affiliated with a mortgage lender before September 1, 1987, and has continuously maintained that registration subsequent to September 1, 1987. ...

(C) The broker-dealer acquired the mortgage loan or security on a firm commitment.

(iii) The transfer or assignment is made to a person who the transferor or assignor believes, or has reasonable grounds to believe, is 1 of the following:

(A) A business entity having either net income from operations after taxes in excess of \$100,000.00 in its last fiscal year or its latest 12-month period, or a net worth in excess of \$1,000,000.00 at the time of purchase.

(B) An individual who, after the purchase, has an investment of more than \$50,000.00 in mortgage loans or securities representing an interest in 1 or more mortgage loans, including installment payments to be made within 1 year after purchase by the individual, has either personal income before taxes in excess of \$100,000.00 for his or her last fiscal year or latest 12-month period and is capable of bearing the economic risk, or net worth in excess of \$1,000,000.00, and has the knowledge and experience in financial and business matters that he or she is capable of evaluating the merits and risks of the prospective investment, or has obtained the advice of an attorney, certified public accountant, or investment advisor registered under the investment advisors act of 1940, or an investment advisor registered under the *Uniform Securities Act, 1964 PA 254, MCL 451.501 to 451.808*, or the *Uniform Securities Act (2002), 2008 PA 551, MCL 451.2101 to 451.2703* with respect to the merits and risks of the prospective investment. n3

One attempt to assert jurisdiction over mortgage brokers by a state securities department took place in Oklahoma. n4 In response to complaints from the public about a broker's business activities, the Administrator of the Oklahoma Department of Securities concluded that a mortgage broker who receives advance fees from homeowners for obtaining mortgage loan commitments is "selling unregistered securities in the form of advanced fees charged to prospective borrowers in consideration for the promise to loan money in the future, or to provide lenders of money at a future date." n5 These alleged advance fee loan contracts were asserted to be "evidence of indebtedness" as defined in the state securities act. n6 The Supreme Court of Oklahoma, however, remanded the matter for administrative determination of the issue, so no definitive judicial pronouncement on the subject has yet been made in Oklahoma.

On the other hand, a California appellate case n7 sustained an indictment against a mortgage broker for violations of the state corporate securities law. There, the mortgage broker funded loans to borrowers by issuing to many different individual lenders fractional interests in a promissory note and related mortgage secured by the borrower's real property, and agreed to (1) service the loans; (2) advance funds to investors when borrowers were in arrears; and (3) bid on the property in a foreclosure sale. In holding that the instruments used in the broker's loan transactions constituted non-exempt corporate securities, the unregistered sale of which is a felony offense, the court conceded that the instruments in question did not qualify as securities under the "risk-capital" approach usually used by the California courts. n8 However, the court found it appropriate to look to federal decisions interpreting the term "security" as defined in the Securities Act of 1933 because the California statute was modeled on the federal act. n9 Applying the test articulated by the Supreme Court of the United States in *SEC v. W.J. Howey Co.*, n10 and *United Housing Foundation, Inc. v. Forman*, n11 the California court found that the transactions in question involved an investment of money in a common enterprise with profits to come solely from the entrepreneurial or managerial skills of others. n12 These transactions, stated the court,

fit squarely within the federal test: specifically, that ordinary individual investors--many committing relatively modest sums--relied upon the skill, services and solvency of [the broker] to protect their investments. [The broker] selected the borrowers, provided collection services, agreed to advance funds to investors when borrowers were in arrears and bid on the property in a foreclosure sale. n13

The court went on to say that the "risk capital" test was only applicable to cases of institutional commerce, where sophisticated institutional lenders exercise greater control over the transaction. n14 Moreover, the court discerned a legislative intent that a secured transaction involving a series of promissory notes, as opposed to a single note, be governed under the state securities law. n15 Therefore, the defendant mortgage broker was subject to criminal prosecution for non-compliance with the securities statute. To date, there has been no final word on the subject from the California Supreme Court. In the meantime, California mortgage brokers, and perhaps their colleagues elsewhere, must

take care lest they run afoul of the blue sky laws. Where possible, counsel for a mortgage broker seeking to use innovative business methods which might conceivably subject the client to securities regulation should seek a "no-action" letter from the appropriate governmental authority.

FOOTNOTES:

(n1)Footnote 1. *See, e.g.:*

California: People v. Schock, 199 Cal. Rptr. 327 (Ct. App. 1984) (felony prosecution for selling unregistered securities).

Oklahoma: Marley v. Cannon, 618 P.2d 401 (Okla. 1980) (litigation arising out of a cease and desist order issued by the State Department of Securities against a mortgage broker).

But see: United States v. Namer, 680 F.2d 1088, 1096 (5th Cir. 1982) (transaction in which a mortgage broker's clients came to him with intention of structuring commercial deals, namely, to arrange financing of construction projects, not with expectation of profits but with hopes of obtaining fixed loan commitments, was not within federal securities law definition of "security").

(n2)Footnote 2. *See, e.g.:*

California: Cal. Bus. & Prof. Code § 10131.3, which provides:

A real estate broker within the meaning of this part is also a person who, for another or others, for compensation or in expectation of compensation, issues or sells, solicits prospective sellers or purchasers of, solicits or obtains listings of, or negotiates the purchase, sale, or exchange of securities as specified in Section 25206 of the Corporations Code.

The provisions of this section do not apply to a broker-dealer or agent of a broker-dealer licensed by the Commission of Corporations under the provisions of the Corporate Securities Law of 1968.

Oregon: Or. Rev. Stat. § 59.015(1)(h), which states that Oregon's mortgage brokers, who are licensed in the same chapter as Oregon securities broker-dealers, are specifically exempt from the Oregon Securities Law ("Broker-dealer does not include ... [a] person licensed as a mortgage banker or a mortgage broker under [citations omitted] when effecting sales of securities involving real estate paper registered for sale pursuant to ORS 59.065 ... ").

(n3)Footnote 3. *Mich. Comp. Laws § 445.1679*.

(n4)Footnote 4. *Marley v. Cannon, 618 P.2d 401 (Okla. 1980)* .

(n5)Footnote 5. *Marley v. Cannon, 618 P.2d 401, 403 (Okla. 1980)* .

(n6)Footnote 6. *Marley v. Cannon, 618 P.2d 401, 403 (Okla. 1980)* .

(n7)Footnote 7. *People v. Schock, 199 Cal. Rptr. 327 (Ct. App. 1984)* .

(n8)Footnote 8. *People v. Schock, 199 Cal. Rptr. 327, 331 (Ct. App. 1984)* .

(n9)Footnote 9. *People v. Schock*, 199 Cal. Rptr. 327, 331 (Ct. App. 1984) .

(n10)Footnote 10. 328 U.S. 293 (1946) ("investment contract" case).

(n11)Footnote 11. 421 U.S. 837 (1975) (cooperative housing stock not a security).

(n12)Footnote 12. *People v. Schock*, 199 Cal. Rptr. 327, 331 (Ct. App. 1984) .

(n13)Footnote 13. *People v. Schock*, 199 Cal. Rptr. 327, 332 (Ct. App. 1984) .

(n14)Footnote 14. *People v. Schock*, 199 Cal. Rptr. 327, 332 (Ct. App. 1984) .

(n15)Footnote 15. *People v. Schock*, 199 Cal. Rptr. 327, 333 (Ct. App. 1984) .

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9 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice § 11.07

§ 11.07 Mortgage Brokerage Forms

[1] Mortgage Lender/Mortgage Broker Agreement Mortgage Lender/Mortgage Broker Agreement

This Mortgage Lender/Mortgage Broker Agreement (Agreement) is entered into by and between ABC Corporation, a corporation (Lender), and XYZ Company, a Corporation (Broker) this day of(Month), ... (Year).

RECITALS

I. Lender and Broker want to establish a nonexclusive relationship in which Broker will submit loan packages (Loan Packages) to Lender on behalf of Broker's customers (Borrowers) for possible funding.

II. Lender and Broker want to set out the terms of their relationship in this Agreement.

NOW, THEREFORE, Lender and Broker agree as follows:

AGREEMENT

1. *Broker Responsibilities:* At Broker's expense, Broker will perform the following functions:

1(a) submit to Lender complete Loan Packages under the programs, procedures, and fee schedules established by Lender. A completed Loan Package shall consist of all credit, financial, and other Borrower information required by Lender, and, if Lender requests, information that will help Lender to market the Loans to secondary market investors.

1(b) perform other services required by Lender for closing of Loans.

1(c) provide a written explanation to Lender of why any approved Borrower failed to close a Loan.

All Loan Packages shall become the property of Lender upon funding.

2. *Loan Approval:* Loan approval shall be at Lender's sole discretion. Broker shall not represent that Lender has approved or will approve any Loan until Broker is so informed by Lender in writing. All loans shall close in Lender's name.

3. *Broker's Warranties:* Broker represents and warrants the following to Lender:

3(a) The statements and information in the Loan Package are true, accurate, and understandable, and no material facts have been withheld from Lender.

3(b) Except as previously disclosed by Broker to Lender in writing, there is no pending or threatened legal, administrative, or other investigation against Broker or its current or former owners, agents, or employees which could have an adverse effect on Lender.

3(c) No Borrower shall have had in its possession or control any verification document submitted to Lender in the Loan Package.

3(d) Broker possesses all necessary licenses and authority to engage in the mortgage brokerage activities required under this Agreement. If applicable, Broker's license number and its expiration date appear below the relevant signature line of this Agreement.

3(e) Except as otherwise disclosed by Broker to Lender in writing prior to funding of the Loan Package, Broker has no ownership interest in the property which is the security for the Loan Package.

3(f) Broker has complied and will comply with all applicable state and federal laws and regulations that apply to Broker, including but not limited to, the Real Estate Settlement Procedures Act, the Truth in Lending Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Home Mortgage Disclosure Act, and the Flood Disaster Protection Act, with respect to the Loan Package.

4. *Status of Broker:* Nothing in this Agreement shall be construed to make the Broker a joint venturer, partner, representative, employee, or agent of Lender. Broker shall not hold itself out as such, nor shall it use the Lender's name in any advertising. Broker is an independent contractor, and Broker shall determine the method, details, and means of performing Broker's services described in this Agreement.

5. *Broker's Indemnification:* Broker shall indemnify and hold Lender and its employees, officers, directors, shareholders, successors, and assigns harmless from and against all loss, damage, liability, and expenses, including reasonable attorney's fees, resulting from or in connection with (a) a breach of representation or warranty contained in paragraph 3 above; and (b) Broker's failure to perform any of its obligations under this Agreement; provided, however, that this indemnification shall not apply to any of the foregoing caused solely by Lender's failure to perform its duties and obligations under this Agreement, or by Lender's breach of any representation given under this Agreement. This indemnification shall survive the termination of this Agreement.

6. *Lender's Responsibilities:* At Lender's expense, Lender will perform the following functions:

6(a) subject to Lender's written programs, procedures, and fee schedules established periodically by Lender, pay Broker its fees, including fees owed by Borrower from the proceeds of the Loan Package, contemporaneously with the funding of each Loan Package without deduction or offset for any reason. Lender will deduct its fees and charges from the proceeds of the Loan Package.

6(b) make only reasonable requests for additional information and documentation, which shall be in writing.

6(c) promptly deliver approvals and material terms of Loan Packages to Broker in writing.

6(d) at Lender's expense, return to Broker any original documents submitted by Broker, if Broker's requests their return any time before to funding of a Loan Package.

6(e) if a Loan Package is not approved by Lender, provide reasons for the denial will in writing to Broker, including the name, address, and phone number of the source of the credit information on which Lender relied in making its decision.

7. *Lender's Warranties:* Lender represents and warrants the following to Broker:

7(a) Lender is duly organized, validly existing, and in good standing under the laws of the state of its incorporation and of the state of and has all required licenses to conduct business.

7(b) Lender is in compliance with all federal and state laws and regulations that are necessary to make loans in accordance with the terms of this Agreement and that apply to Lender, including but not limited to, the Real Estate Settlement Procedures Act, the Truth in Lending Act, the Equal Credit Opportunity Act, the Fair Credit Reporting Act, the Home Mortgage Disclosure Act, and the Flood Disaster Protection Act. If Broker requests, Lender shall deliver evidence of compliance to Broker immediately.

7(c) Lender has full power and authority to execute and deliver this Agreement and to perform Lender's obligations in accordance with this Agreement.

7(d) This Agreement contains no false statements or representations, nor have any material facts been omitted.

7(e) Lender's origination and closing practices are, and will be in all respects, legal, proper, and prudent.

7(f) There is no pending or threatened legal, administrative, or other investigation against Lender or its current or former owners, agents, or employees which could have an adverse effect on Broker, or which could impair the ability of Lender to carry out the terms of this Agreement.

8. *Lender's Indemnification:* Lender shall indemnify and hold Broker and its employees, officers, directors, shareholders, successors, and assigns harmless from and against all loss, damage, liability, and expenses, including reasonable attorney's fees, resulting from or in connection with (a) the failure of Lender to perform its duties and obligations under this Agreement; and (b) Lender's breach of any representation or warranty contained in paragraph 7 above; provided, however, that this indemnification shall not apply to any of the foregoing caused solely by Broker's failure to perform its duties and obligations under this Agreement, or by Broker's breach of any representation given under this Agreement. This indemnification shall survive the termination of this Agreement.

9. *Termination of Agreement.* Lender or Broker may terminate this Agreement at any time upon written notice to the other party; provided, however, that the obligations contained in paragraphs 3 through shall survive termination.

10. *Governing Law:* This Agreement shall be governed by law.

11. *Notices:* All notices required under this Agreement shall be in writing.

12. *Assignment:* This notice may not be assigned by either Lender or Broker.

ENTERED INTO AT (City), ... (State), on (Date), ...(Year).

LENDER_____

BY_____

ADDRESS_____

BROKER_____

LICENSE NO. _____

ADDRESS_____

[2] Mortgage Broker/Borrower Agreement n1 Mortgage Broker/Borrower Agreement

Agreement made (Date), by and between, City of, County of, State of (the Client) and of, County of, State of (the Broker).

Whereas, the Broker is engaged in negotiations for the benefit of the Client, and in consideration of the mutual covenants set forth below, the parties agree as follows:

SECTION ONE**RIGHT TO NEGOTIATE MORTGAGE LOAN**

The Client grants to the Broker the right to negotiate on behalf of the Client the mortgage loan described below (the Mortgage Loan), to be secured by the Client's premises located at

SECTION TWO**AMOUNT OF MORTGAGE LOAN**

The Mortgage Loan is to be in the amount of (\$.....) Dollars and is to bear interest at the rate of percent (.... %) per annum and amortized over a period not to exceed years (but payable in not less than years).

SECTION THREE**EARNED PLACEMENT FEE**

The Client agrees to accept a loan in the stated amount and with this agreement delivers to the Broker the Client's check in the amount of (\$.....) Dollars as evidence of good faith. This will be an earned placement fee to the Broker when a commitment is issued for the Mortgage Loan and will be applied against the Broker's fee as set forth below.

If the Broker is not successful in obtaining a mortgage loan according to these conditions, good faith deposit of (.....) is to be returned to the Client.

If the commitment is issued for an acceptable amount, but less than the requested amount, it is agreed that the Broker's fee will be (..... %) percent of the mortgage loan amount.

If the commitment is issued for the terms contained in Section Two, it is agreed that the Broker's fee will be (\$.....) Dollars. The fee shall be deemed earned upon the issuance of a commitment. The balance of the fee shall be payable upon the funding of the Mortgage Loan or upon default of Client. The Client shall be deemed in default when, for any reason whatsoever, the Client does not accept the funding of a whole or a part of the Mortgage Loan or if Client fails to meet any condition of the commitment as accepted by Client.

SECTION FOUR

PERIOD OF AGREEMENT

Broker is granted the exclusive right to negotiate the Mortgage Loan for a period of days from the date of this Agreement.

SECTION FIVE

FINDER'S FEE

By the execution of this Agreement, Client acknowledges that in connection with a loan commitment obtained in accordance with the terms set forth in this agreement, Broker may receive a finder's fee or other form of remuneration from the lender upon the issuance of a commitment loan from the lender as compensation for the servicing of the loan after closing or for any other reason, and Client expressly consents to any such contractual arrangement between the Broker and the lender.

SECTION SIX

RESTRICTIONS

The Client agrees that for a period of years from the date the Mortgage Loan is funded or should have been funded, Client will not, without the Broker, go directly or through another Broker to the mortgage lender issuing the commitment for any other loan whether or not for the same property as that referred to in this agreement. Client, for the purposes of this section, shall mean the Client or any affiliate of the Client, including any partnership, organization, corporation or other business with which Client is affiliated.

SECTION SEVEN

DEFINITIONS

(a) Affiliate: A person or entity that (1) directly or indirectly through one or more intermediaries, controls, or is controlled by, or in common control with, Client; or (2) any spouse of Client, or any corporation or other organization in which Client is the beneficial owner of ten percent or more of any class of equity interest; or (3) any trust or estate in which Client collectively owns ten percent or more of the total beneficial interests or of which Client shall serve as trustee, executor, or in any similar capacity.

(b) Mortgage Lender: Party issuing the commitment and funding a part of or all of the Mortgage Loan.

ENTERED INTO AT (City),..... (State), on (Date), ... (Year).

BORROWER_____

BY_____

ADDRESS_____

BROKER_____

LICENSE NO._____

ADDRESS_____

[3] Affiliated Business Arrangement Disclosure

The affiliated business arrangement disclosure statement format is set out as part of the RESPA discussion in chapter 14 of this treatise. *See 14.02[12] below.*

FOOTNOTES:

(n1)Footnote 1. Exclusive mortgage brokerage agreements are discussed in § 11.04[4][b] *above*.

Note that under this agreement, the broker's fee is deemed earned upon the issuance of a loan commitment on the terms sought by the borrower or acceptable to the borrower. For discussion of when the mortgage broker's commission is earned and the effect of contract language on the accrual of the right to a commission, *see* § 11.04[4] *above*.

Of special concern to the borrower (and his or her attorney) is the provision in Section Three of the agreement that requires the borrower to pay the commission if it is unable, despite good faith efforts, to meet any condition of the loan commitment it has accepted. For discussion of this problem, one that often arises in the context of commercial real estate financing because lenders often impose conditions precedent to actual consummation of the loan in such transactions (for example, that the borrower secure certain leases with commercial tenants), *see* § 11.04[4] *above*.

Note also that under Section Six of the agreement, the borrower binds himself for a period of years to the broker with respect to any future financing from the particular lender involved, whether or not for the same property covered by the agreement. As in all brokerage agreements, the inclusion of such provisions will be a function of the relative bargaining strengths of the parties.

Finally, it bears mention that a mortgage broker who is also acting as a real estate broker in the particular transaction, must comply with any applicable state regulations prohibiting him from taking both a real estate brokerage commission from the seller and a fee from the buyer for obtaining the necessary financing.

* The chapter was revised by Robert M. Jaworski, Esq., a partner at Reed Smith LLP, in Princeton, New Jersey, and a member of its Financial Services Regulatory Group, with the assistance of associate Lisa Stone Hardt, Esq.

Mr. Jaworski is also a former Deputy Commissioner of the New Jersey Department of Banking and a frequent speaker and author on compliance-related topics. His practice includes providing federal and state compliance advice and assistance to all kinds of financial institutions, performing compliance audits, preparing multi-state surveys, and, in conjunction with Reed Smith litigators, defending individual and class actions brought against lenders.

The chapter was formerly revised by Mary J. Burt, Esq. Additional updates have been contributed by Sandra Bullington, Esq., of Louisa, Virginia.



10 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice § 11.08

§ 11.08 The Legality of Yield Spread Premiums

A yield spread premium is a payment made by a lender to a mortgage broker in return for the broker placing a mortgage with a lender at an interest rate that is above "par." n1 Par is the lender's lowest interest rate at which it will make a loan without charging the borrower discount points.

One commentator has stated, "From a pure business perspective, there is nothing sinister or unique about the payment or receipt of overages." n2 Nonetheless, the payment of yield spread premiums has generated controversy. This is partially due to the fact that some members of the public believe that a mortgage broker's job is to obtain the best possible loan for the borrower. This is particularly true in those few states in which the laws give a mortgage broker a "fiduciary duty" to a borrower.

This industry practice came under attack beginning in April 1994, when public interest lawyers in Virginia filed a class action lawsuit against Fleet Finance, Inc. and two mortgage brokers, challenging the payment of yield spread premiums. n3 Since then, numerous class action lawsuits have been filed challenging the legality of such payments under RESPA § 8, and many federal District Courts and one Circuit Court of Appeals have considered the legality of these payments.

The Culpepper Saga

Culpepper I. In the absence of guidance from HUD, the task of providing the industry with the necessary guidance initially fell to the courts. The United States Court of Appeals for the Eleventh Circuit considered the payment of yield spread premiums in *Culpepper v. Inland Mortgage Corporation (Culpepper I)*, n4 a case of first impression that would come to haunt the lending industry. The court reversed a district court's grant of summary judgment in favor of the lender. The district court had determined that the lender's payment of a yield spread premium to the broker constituted reasonable compensation for "goods furnished," namely, the loan itself, and not for the mere referral of settlement service business. n5 The circuit court disagreed, finding that, on the facts presented, the payment could have been neither

(1) in return for a "good," since the lender, not the broker (who closed the loan in its own name with funds supplied by the lender), owned the loan from the outset, nor

(2) in return for "services actually performed," since the broker expends the same effort and provides the same quantity of services whether it originates a loan at an interest rate that will provide it with a yield spread premium at closing or at a lower interest rate that will not generate such a payment. n6

While some courts besides the Eleventh Circuit have intimated in *dicta* that yield spread premiums as a general matter may violate RESPA, no court has so held. n7 On the other hand, several courts have held that yield spread premiums do not violate RESPA. n8

The National Association of Mortgage Brokers, in its position paper on the subject, cites the following example of why mortgage brokers have become so popular with consumers:

Many consumers today want to conserve their cash when obtaining a mortgage by paying low or no closing costs. Many first time borrowers do not have enough cash to pay all their closing costs. They are currently able to choose to pay such costs over time with a slightly higher interest rate. The cash the borrower doesn't have to pay at closing is his or hers to use at their discretion. Mortgage brokers... have popularized these loans because they are able to get their compensation from the lender instead of the borrower. n9

The Federal Reserve's View. To give added weight to this perspective, the Federal Reserve Board has stated that the disclosure of a yield spread premium is duplicative. The 1995 Amendments to Regulation Z stated that, beginning September 30, 1996, mortgage broker fees paid directly by the borrower must be included in the finance charge. n10

Then, in the Final Official Staff Commentary, published March 6, 1997, and effective February 28, 1997, the Board stated:

Section 226.4--Finance Charge

4(a) Definition.

4(a)(1) Charges by third parties.

4(a)(3) Special rule; mortgage broker fees.

3. Compensation by lender. The rule requires all mortgage broker fees to be included in the finance charge. Creditors sometimes compensate mortgage brokers under a separate arrangement with those parties. Creditors may draw on amounts paid by the consumer, such as points or closing costs, to fund their payment to the broker. Compensation paid by a creditor to a mortgage broker under an agreement is not included as a separate component of a consumer's total finance charge (although this compensation may be reflected in the finance charge if it comes from amounts paid by the consumer to the creditor that are finance charges, such as points and interest). *****

Clearly, the Federal Reserve Board takes the position that yield spread premiums are legitimate. n11 But confusion reigns regarding RESPA, and the proliferation of lawsuits has been of great concern.

HUD Steps In/Policy Statement I. At the insistence of Congress, n12 HUD issued a formal Statement of Policy (*Policy Statement I*) on March 1, 1999 in an attempt to end the confusion. n13 HUD took the position in Policy Statement I that it considers yield spread premiums not to be illegal per se, and to be legal if it is shown (1) that goods or facilities were actually furnished or services were actually performed for the total compensation paid to the mortgage broker; and (2) the compensation was reasonably related to the value of those goods, facilities, or services. n14

HUD further stated that in determining whether goods or facilities were furnished or services were provided by the broker in return for the total compensation received by the broker, it "may be useful" to refer to its February 14, 1995 letter to the Independent Bankers Association of America (IBAA letter).ⁿ¹⁵ The IBAA letter, which is essentially replicated in Policy Statement I, provides that HUD will not pursue enforcement action under RESPA if it is satisfied that sufficient origination work was performed to justify compensation. In HUD's view, this requires the broker to take the loan application information and perform at least 5 other origination services (at least one of which is something other than a "counseling-type" activity) from a list of fourteen origination-type services identified by HUD.ⁿ¹⁶

HUD also indicated in Policy Statement I that, in determining whether the total compensation received by the broker was reasonably related to the value of the goods or facilities furnished or the services performed, the total compensation received by the broker must be commensurate with the amount normally charged for similar services, goods or facilities. This, in turn, requires consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets.ⁿ¹⁷ HUD further indicated that, in undertaking this analysis, any "volume-based" compensation paid by a lender (compensation based on the volume of loans the broker delivers to the lender over a fixed period and which is paid in the form of either cash rebates on the amount of loans delivered in excess of a "threshold" or "floor amount" or a lower "start rate") must be considered as part of the total compensation received by the broker.ⁿ¹⁸

Finally, Policy Statement I provided additional guidance to lenders and brokers as to how best to disclose yield spread premium payments to customers. HUD indicated that such a payment would be appropriately disclosed as "Mortgage Broker fee from lender to XYZ Corporation (P.O.C.)," and suggested that other fees or payments from the borrower to the broker should identify that they are mortgage broker fees from the borrower. HUD also recommended that brokers disclose, during their initial discussions with the customer, the nature of the broker's services and the various methods of compensation the broker can receive.ⁿ¹⁹ In a letter dated December 17, 1999 to Congressman Bruce F. Vento, HUD indicated that it did not intend for Policy Statement I to create a new legal standard, change existing law or weaken the prohibitions contained in Section 8 of RESPA.

Unfortunately for the industry, Policy Statement I did not prove to be the end of the story. Plaintiffs' counsel argued in many of the cases that the test formulated in Policy Statement I for determining whether or not the payment of a yield spread premium was legal under section 8 of RESPA was the same as the Eleventh Circuit's test in *Culpepper I* or, if different, was arbitrary and capricious and thus outside HUD's authority.

Plaintiffs' counsel raised this argument most often in the context of a motion for class certification, in an attempt to counter defendants' argument that the RESPA yield spread premium issue was inappropriate for class treatment because its resolution was dependent on the particular circumstances underlying each loan. Several courts, mostly in Alabama, accepted plaintiffs' argument and, as a consequence, granted class certification.ⁿ²⁰ Most courts, however, rejected the argument, deferring instead to HUD's interpretation of the statute.ⁿ²¹ As of year-end 2000, appeals from some of these class certification decisions were pending, most notably in the Eleventh Circuit, where four of these decisions were under review.ⁿ²²

Culpepper II. On June 15, 2001, the mortgage lending industry suffered a serious blow when the Eleventh Circuit Court of Appeals issued its long awaited decision in *Culpepper v. Irwin Mortgage Corporation (Culpepper II)*.ⁿ²³ This decision affirmed the Alabama district court's prior order granting class certification.ⁿ²⁴

The Eleventh Circuit's decision addressed the issue concerning how to interpret the first part of the HUD Test as stated in Policy Statement I, namely whether goods or facilities were actually furnished or services were actually performed for the compensation paid.ⁿ²⁵

The Eleventh Circuit interpreted the first part of the HUD Test to mean that a YSP is illegal if there is not a direct link

between the payment of the YSP and the performance of specific services by the broker; i.e., if it can be demonstrated that the YSP, considered apart from any other compensation the broker might receive in the transaction, was not paid in return for specific services performed by the broker. Plaintiff argued that such a result can follow from evidence, common to all class members, suggesting that whether a YSP is paid and how much of a YSP is paid depends entirely on whether the loan is above par and by how much. The court agreed with plaintiffs on this point, and concluded that class treatment was appropriate.

In reaching this conclusion however, the court failed to consider HUD's own explanation of the first part of the HUD Test.

In the determination of whether payments from lenders to mortgage brokers are permissible under Section 8 of RESPA, the threshold question is whether there were goods or facilities actually furnished or services actually performed for the total compensation paid the mortgage broker [*64 Fed. Reg. 10085*] .

Under this statement of the test, it would seem that a court would have to inquire what services the broker provided with respect to each loan made to a borrower in the class and whether those services exceeded the threshold level of services identified elsewhere in Policy Statement I as necessary to justify any compensation to the broker. The second part of the HUD Test would then require the court to additionally inquire as to whether the total compensation received by the broker was reasonable in relation to all the services provided by the broker on behalf of the borrower or the lender.

Policy Statement II. Four months after *Culpepper II* was decided, HUD issued a Clarification of Statement of Policy 1999-1 Regarding Lender Payments to Mortgage Brokers, and Guidance Concerning Unearned Fees Under Section 8(b) (Policy Statement II).ⁿ²⁶ In Policy Statement II, HUD took clear exception to the Eleventh Circuit's interpretation of Policy Statement I.

The Eleventh Circuit read Policy Statement I to mean that each component of broker compensation (including a YSP) must be tested separately to determine (1) whether it was paid in return for some specific service, and (2) whether it was reasonable in amount in relation to that specific service. In Policy Statement II, HUD confirmed that the Eleventh Circuit's approach was incorrect; rather, a YSP is not illegal under Section 8 of RESPA if it can be shown that (1) (at least a threshold level of) services were performed in return for the total compensation received by the broker (from all sources) and (2) the total compensation was reasonable in relation to those services:

HUD's position is that in order to discern whether a yield spread premium was for goods, facilities or services under the first part of the HUD test, it is necessary to look at each transaction individually, including examining all of the goods or facilities provided or services performed by the broker in the transaction, whether the goods, facilities or services are paid for by the borrower, the lender, or partly by both.

[N]either Section 8(a) of RESPA nor [Policy Statement I] supports the conclusion that a yield spread premium can be presumed to be a referral fee based solely upon the fact that the lender pays the broker a yield spread premium that is based upon a rate sheet, or because the lender does not have specific knowledge of what services the broker has performed.ⁿ²⁷

Recognizing, however, that in certain circumstances (particularly in uncompetitive markets) YSPs can be used in a way that is harmful rather than helpful to consumers' interests, HUD specifically recommended in Policy Statement II, as a "best practice," that meaningful disclosure concerning YSP payments be given to borrowers before they apply for a loan.ⁿ²⁸ HUD further indicated that it would consider such disclosure favorably when determining whether or not to pursue enforcement action in cases involving mortgage broker fees.ⁿ²⁹ In HUD's view, "meaningful disclosure" includes disclosure of the specific services the broker will perform, the amount of the broker's total compensation for

performing those services (including any YSP to be paid by the lender), whether or not the broker has an agency or fiduciary relationship with the borrower, and an explanation of the borrower's options (including monthly payment options) vis-a-vis paying less to the broker up front in exchange for a higher interest rate on the loan and vice-versa. n30

The Culpepper Saga Ends. Nine months after *Culpepper II* was decided, the Eighth Circuit Court of Appeals in *Glover v. Standard Federal Bank* n31 reversed a district court grant of certification that had been based on the *Culpepper II* rationale. According deference to Policy Statement II, the Eighth Circuit determined that class action treatment of a YSP complaint is inappropriate given the individualized inquiry that must be made under the HUD Test. The court stated:

[a] lender's reliance on a rate sheet to uniformly offer and calculate a YSP payable to a broker does not, without more, mean that class certification is appropriate. Nor does it mean that you can presume that each payment reflects payment of a prohibited referral fee simply because the lender does not have specific knowledge of the nature and amount of service the broker performs in conjunction with a particular loan or group of loans. n32

The court indicated, however, that the Glovers' individual action alleging that a YSP constitutes an illegal referral fee under RESPA § 8 can still succeed, so long as they can establish that some part of the total payment to the broker, including the YSP, is excessive:

If total compensation paid by the lender to the broker in a given transaction exceeds a reasonable amount for the goods, services and facilities provided, it is likely that a RESPA violation has been established. American courts have accurately and fairly determined reasonability in similar situations since their inception, and, they will do so in the Glovers' case, if necessary. n33

Other circuit courts that have considered this issue after HUD came out with Policy Statement II, including, most significantly, the Eleventh Circuit in *Heimmerman v. First Union Mortgage Cor.*, n34 have adopted the rationale expressed by the Eighth Circuit in *Glover*.

Following *Heimmerman*, the *Culpepper* district court granted the defendants' motion to de-certify the class and for summary judgment, n35 and plaintiffs appealed. The Eleventh Circuit affirmed the district court's decision, thereby finally putting an end to the *Culpepper* Saga and the class action challenge to the practice of lenders paying mortgage broker yield spread premiums. n36

FOOTNOTES:

(n1)Footnote 1. See *Dubose v. First Security Sav. Bank*, 974 F. Supp. 1426, 1427 (M.D. Ala. 1997) .

(n2)Footnote 2. Jaworski, *Overages: To Pay or Not to Pay, That Is the Question*, 113 *Banking L.J.* 909, 910 (1996).

(n3)Footnote 3. See *Hunter, et al. v. Fleet Fin., Inc., Crosstate Mortgage & Invs., Inc. & Westover Inv. Corp.*, No. 94-CV-266 (E.D. Va. filed Apr. 20, 1994), *reh'g denied*, 144 F.3d 717 (11th Cir. June 27, 1998) .

(n4)Footnote 4. 132 F.3d 692 (11th Cir. 1998) , *reh'g denied*, 144 F.3d 717 (11th Cir. June 27, 1998) .

(n5)Footnote 5. 953 F. Supp. 367 (N.D. Ala. 1997) .

(n6)Footnote 6. On rehearing, the Eleventh Circuit clarified that (1) its decision stood only for the proposition that the record presented below in support of the motion for summary judgment failed to establish as a matter of law "that *this* yield spread premium for *this* table-funded loan" was a payment for goods or services and therefore not a prohibited referral fee, and (2) the lender remained free to pursue all of its argument at trial. See 144 F.3d 717, 718 (11th Cir. June

27, 1998) . (Emphasis added).

(n7)Footnote 7. *See Hastings v. Fidelity Mortgage Decisions Corp.*, 984 F. Supp. 600, 611-612 (N.D. Ill. 1997) ; *Dubose v. First Sec. Sav. Bank*, 974 F. Supp. 1426, 1431 (N.D. Ala. 1997) ; *Martinez v. Weyerhaeuser Mortgage Co.*, 959 F. Supp. 1511 (S.D. Fla. 1996) .

(n8)Footnote 8. *See Lee v. N.F. Investments, Inc.*, No. 4:99CV426 ERW (E.D. Mo., Mar. 15, 2000); *Schmitz v. Aegis Mortgage Corp.*, 48 F. Supp. 2d 877, 883-884 (D. Minn. 1999) ; *Barbosa v. Target Mortgage Corp.*, 968 F. Supp. 1548 (S.D. Fla. 1997) ; *McWhorter v. Ford Consumer Fin.*, 33 F. Supp. 2d 1059 (N.D. Ga., Sept. 5, 1997) ; *see also Dubose v. First Sec. Sav. Bank*, 974 F. Supp. 1426 (N.D. Ala. 1997) a case which, following denial of plaintiffs' motion for class certification, was tried as an individual matter before a jury, with the result that the jury returned a verdict in favor of the lender on all counts including the count asserting violation of RESPA. Kara Gerloch Flynn, *Jury Sides with Lender in RESPA Case*, Real Estate Finance Today, Dec. 19, 1997.

(n9)Footnote 9. National Association of Mortgage Brokers, 8201 Greensboro Drive, Suite 300, McLean, VA 22102; telephone: (703) 610-9009; internet: <http://www.namb.com/>.

(n10)Footnote 10. Pub. L. 104-29, 109 Stat. 271.

(n11)Footnote 11. *But see* the discussion in § 11.09 concerning recent unsuccessful efforts by the Federal Reserve Board to impose upon mortgage brokers a requirement to disclose up-front the total amount of compensation that they will receive in the transaction, including any direct compensation to be paid by the borrower or out of the loan proceeds and any yield spread premium or other payments by the lender outside of closing.

(n12)Footnote 12. In H.R. Conf. Rep. No. 105-769, 105th Cong., 2nd Sess. 260 (1998) (FY 1999 HUD Appropriations Act), Congress indicated that "[it] never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [Sections 8](a) or (b) of [RESPA]" and directed HUD to clarify its position on such payments within 90 days after the enactment of FY 1999 HUD Appropriates Act on Oct. 21, 1998.

(n13)Footnote 13. 64 Fed. Reg. 10,080 (Mar. 1, 1999) .

(n14)Footnote 14. 64 Fed. Reg. 10,084-10,085 .

(n15)Footnote 15. 64 Fed. Reg. 10,085 .

(n16)Footnote 16. 64 Fed. Reg. 10,085 .

(n17)Footnote 17. 64 Fed. Reg. 10,085-10,086 .

(n18)Footnote 18. 64 Fed. Reg. 10,081, 10,086 .

(n19)Footnote 19. 64 Fed. Reg. 10,087 .

(n20)Footnote 20. *See, e.g., Perry v. Mid-South Mortgage, Inc.*, Civ. Action No. CV-98-3205-W (N.D. Ala. Aug. 30, 2000); *Glover v. Standard Federal Bank*, Civ. Action No. 97-2068 (DWF/AJB) (D. Minn. Mar. 22, 2000); *Culpepper v. Inland Mortgage Corp.*, 189 F.R.D. 668 (N.D. Ala. 1999) [hereinafter *Culpepper II*]; *Heimmerman v. First Union Mortgage Corp.*, 188 F.R.D. 403 (N.D. Ala. 1999) ; *Dujanovic v. Mortgage Am., Inc.*, 185 F.R.D. 660 (N.D. Ala. 1999) .

(n21)Footnote 21. *See, e.g., Levine v. North American Mortgage*, Civ. No. 98-556 (JRT/RLE) (D. Minn. May 17, 2000); *Lee v. NF Invs., Inc.*, Civ. Case No. 4: 99CV426 ERW (E.D. Mo. Mar. 15, 2000); *In re Old Kent Mortgage Co.*, 191 F.R.D. 155 (D. Minn. 2000) ; *Brancheau v. Residential Mortgage*, 187 F.R.D. 591 (D. Minn. 1999) ; *Schmitz v.*

Aegis Mortgage, 48 F. Supp. 2d 877 (D. Minn. 1999) ; *McBride v. ReliaStar Mortgage*, U.S. Dist. LEXIS 21654 (N.D. Ga., Apr. 29, 1999); *Hirsch v. BankAmerica Corp.*, Civ. Action No. 1:98-CV-1032-ODE (D. Ga. Apr. 20, 1999); *Medlock v. Chase Manhattan Mortgage Corp.*, 1999 U.S. Dist. LEXIS 19937 (N.D. Ga. Apr. 16, 1999) ; *Richter v. Bank One Mortgage Corp.*, U.S. Dist. LEXIS 16074 (D. Ariz. Mar. 17, 1999); *Yasgur v. Aegis Mortgage Corp.*, 1999 U.S. Dist. LEXIS 20989 (D. Minn. Mar. 9, 1999) .

(n22)Footnote 22. See *Culpepper v. Inland Mortgage Corp.*, 189 F.R.D. 668 (N.D. Ala. 1999) ; *McBride v. ReliaStar Mortgage*, U.S. Dist. LEXIS 21654 (N.D. Ga., Apr. 29, 1999); *Hirsch v. Bank America Corp.*, Civ. Action No. 1:98-CV-1032-ODE (D. Ga. Apr. 20, 1999); *Heimmerman v. First Union Mortg. Corp.*, 188 F.R.D. 403 (N.D. Ala. 1999) .

(n23)Footnote 23. 253 F. 3d 1324 (2001) .

(n24)Footnote 24. *Culpepper v. Inland Mortgage Corp.*, 189 F.R.D. 668 (N.D. Ala. 1999) .

(n25)Footnote 25. 64 Fed. Reg. 10,084-10,085 .

(n26)Footnote 26. 66 Fed. Reg. 53,052-53,059 (Oct. 18, 2001) .

(n27)Footnote 27. 64 Fed. Reg. 53,055 .

(n28)Footnote 28. 64 Fed. Reg. 53,056 .

(n29)Footnote 29. 64 Fed. Reg. 53,056 .

(n30)Footnote 30. 64 Fed. Reg. 53,056 .

(n31)Footnote 31. 283 F.3d 953 (8th Cir. Minn. 2002) .

(n32)Footnote 32. 283 F.3d 953, 964 (8th Cir. Minn. 2002) .

(n33)Footnote 33. 283 F.3d 953, 965 (8th Cir. Minn. 2002) .

(n34)Footnote 34. 305 F.3d 1257 (11th Cir. 2002) . See also *Scheutz v. BancOne Mortgage Corp.*, 222 F. 3d 1004 (9th Cir. 2002) .

(n35)Footnote 35. *Culpepper v. Inland Mortgage Corp.*, 243 F.R.D. 459, 2006 U.S. Dist. LEXIS 96491 (N.D. Ala. 2006) .

(n36)Footnote 36. 491 F. 3d 1260 (11th Cir. 2007) .

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The chapter was formerly revised by Mary J. Burt, Esq. Additional updates have been contributed by Sandra Bullington, Esq., of Louisa, Virginia.



11 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice § 11.09

§ 11.09 RESPA Reform Effort

While the class action challenge to the practice of lenders paying brokers yield spread premiums appears to be over, it has had a lasting impact. Specifically, it helped to convince HUD that RESPA and Regulation X needed an overhaul.

RESPA REFORM I

This conviction led HUD, on July 29, 2002, to propose significant measures to improve Regulation X for the benefit of consumers, including measures addressed to yield spread premiums ("Proposal I"). One such measure would require that all yield spread premiums be disclosed on the HUD-1 Uniform Settlement Statement (HUD-1) and the Good Faith Estimate (GFE) as payments from the lender to the borrower. (The HUD-1A version of the Uniform Settlement Statement would no longer be able to be used in connection with refinance or subordinate-lien loans in which a yield spread premium payment is made.) For a mortgage broker to receive a yield spread premium, the mortgage broker would have to disclose on its GFE a direct "origination fee" which includes any anticipated yield spread premium payment (and which therefore will represent the mortgage broker's entire compensation in connection with the loan). The result will be that the broker would no longer collect indirect fees from the lender, only direct fees from the borrower.

A second proposed measure would prohibit mortgage brokers from retaining any portion of any points paid by the borrower to obtain a lower interest rate (discount points) from the lender. Any such payment would have to be disclosed as a payment by the borrower to the lender.

A third proposed measure would change HUD's model form GFE to require disclosure of the following additional information:

- A description of the nature of the services that the lender and/or mortgage broker (defined in the proposal as "loan originators") will provide so as to "disabuse borrowers of the notion that brokers or other loan originators are acting as their agents."
- A statement indicating that borrowers have the option to pay settlement costs (1) using their own funds at settlement, (2) using additional borrowed funds, or (3) using a yield spread premium they

receive from the lender in exchange for agreeing to pay an above par interest rate. (The GFE would also have to disclose that the borrowers may lower the interest rate [and the monthly payment] by paying discount points to the lender.)

- The *total* origination charges of the mortgage broker and the lender, as a consolidated figure, and, on a new GFE attachment (A-1), a breakdown of the charges that are included in that figure, grouped according to whether they are charges of the broker or the lender.

These proposed changes were intended by HUD to insure that "brokers will have no incentive to seek out lenders paying the largest yield spread." However, they will not affect lenders who close loans with their own funds and thereafter sell those loans at a profit in the secondary market.

Proposal I attracted numerous comments from the settlement services industry and consumer groups alike, and generated Congressional opposition as well. In the end, HUD was forced to withdraw the proposal.

FEDERAL RESERVE BOARD PROPOSES YSP RESTRICTIONS

In January, 2008, the Federal Reserve Board proposed to revise Regulation Z primarily to deal with the aftermath of the subprime mortgage loan crisis and prevent further abuses. n1 One of the most significant and controversial changes contained in this proposal was a requirement that a mortgage broker make an upfront disclosure to any customer seeking a closed-end loan to be secured by his/her principal dwelling. This upfront disclosure would state the total amount of compensation the broker will receive in the transaction, both from the borrower and the lender. The proposal would also prohibit creditors from paying any compensation to the mortgage broker that would cause the mortgage broker's total compensation to exceed the amount so disclosed. n2 These provisions, however, were withdrawn by the Board when adopting the final rule, although the Board indicated that it would continue to examine options for addressing potential unfairness to consumers associated with broker compensation arrangements, such as yield spread premiums, and continue to consider possible disclosure or other remedies to such potential unfairness in connection with its ongoing comprehensive review of Regulation Z. n3

During the next year or so, the Board continued to work on this issue, culminating in the publication, on August 26, 2009, of a new proposal that would among other things prohibit payments to a mortgage broker or the creditor's loan officer based on the loan's interest rate or other terms and prohibit a mortgage broker or loan officer from "steering" consumers to a lender offering less favorable terms in order to increase the broker's or loan officer's compensation. n3.1 This proposal has not yet been adopted and remains under consideration by the Board.

RESPA REFORM II

After withdrawing Proposal I, HUD indicated its intent to publish a new reform proposal. It followed-up by holding a series of invitation-only RESPA Reform Roundtables to obtain input from a cross-section of representatives of industry, consumer organizations and other interested parties. n4 It then digested what it learned from those discussions, developed and tested new forms which it hoped would improve the process and, on March 13, 2008, published its second RESPA Reform proposal ("Proposal II"). n5

Proposal II is both a scaled-back version of Proposal I--it does not include a "packaging" element--and an aggressive foray into several new areas. Briefly, Proposal II would, among other things: (1) dramatically change the form of Good Faith Estimate ("GFE") that has been in use since 1992 and establish consequences for underdisclosures on that form (which exceed specified tolerances); (2) modify the HUD-1/1A Uniform Settlement Statement forms ("HUD-1") in several regards; (3) create a new "Closing Script" to be read aloud by the closing agent to the borrowers at settlement; (4) expand the definition of a prohibited "required use" in connection with a referral to an affiliated business arrangement (to make builder incentives to use affiliated settlement services providers more problematic under section

8); and (5) clarify that average-cost pricing and volume discounts that satisfy certain conditions will not be deemed to violate the Section 8 referral fee prohibition.

Proposal II also attempts to deal with the issue of how best to disclose yield spread premiums paid by lenders to brokers in return for above par loans. The new GFE will require lenders and mortgage brokers to disclose (i) their total compensation, labeled as "Our service charge," and (ii) any yield spread premium the mortgage broker expects to receive, labeled as "[t]he credit ... for the interest rate you have chosen [, which] is included in 'Our service charge'" or which will "reduce[s] your upfront charges." The amounts listed as "Our service charge" and the yield spread premium "credit" may not change once the borrower's interest rate has been locked. Borrowers who wish to obtain a below par loan, rather than receiving a yield spread premium credit, will have to pay discount points to the lender, which will be labeled on the new GFE as "[t]he ... charge for the specific interest rate chosen."

"Our service charge" is supposed to be the sum of all non-third party, loan origination-related charges imposed by the lender and the mortgage broker (if any), including application fees, processing fees, underwriting fees, origination fees, mortgage broker fees, points, etc. Proposal II would thus force lenders and brokers to lump all of their direct charges into a single all-encompassing originator fee.

RESPA REFORM BECOMES A REALITY

On November 17, 2008, HUD adopted a final rule amending Regulation X which it hoped would achieve meaningful RESPA reform (the "New Rule").⁶ The New Rule

- dramatically changes the form of Good Faith Estimate ("GFE") that has been in use since 1992 and establishes consequences for inaccurate disclosures on that form,
- modifies the HUD-1 and HUD-1A Uniform Settlement Statement forms in several regards so that they better coincide with the new GFE,
- clarifies that average cost pricing that satisfies certain conditions will not violate the Section 8 referral fee prohibition,
- creates a new "simplified" servicing disclosure statement to be provided at application, and
- revises the definition of a prohibited "required use" in connection with a referral to an affiliated business arrangement.

Details concerning these changes are discussed below.

The New Expanded GFE

Description. HUD has traded in its old, one-page model form GFE for a brand new three-page model (which is one page fewer than proposed).

First Page. The first page is the most critical one, with HUD envisioning consumers using it to comparison shop for a mortgage loan. While the GFE previously focused solely in settlement costs, and not loan terms, the revised form discloses on the first page what HUD believes are the essential loan terms and attendant costs that a lender is obligated to offer to a loan applicant unless "changed circumstances" dictate otherwise.

The first page of the new GFE must show the initial loan amount, term, initial interest rate, initial monthly payment amount, whether the interest rate can increase, and whether the loan allows for negative amortization or provides for a

prepayment penalty or a balloon payment. These are all new disclosures for a GFE form, and some observers feel these items duplicate or conflict with the information on the Truth-in-Lending Act early-disclosure statement. The new GFE must also tell the consumer what the total origination charges and the charges for other settlement services are likely to be. Lenders and mortgage brokers (dubbed "Loan Originators" in the New Rule) may not force the customer to pay a fee to obtain the GFE, other than the cost of the credit report.

HUD expects consumers to take the first page of the new GFE to other Loan Originators to attempt to negotiate better deals. Under the New Rule, the consumer is given at least 10 days to shop, during which the "offer" encapsulated on the GFE must remain open and "fixed," *i.e.*, within prescribed tolerances, unless there are "changed circumstances." If the consumer accepts the offer, the terms and costs are then fixed through the closing, again within the same prescribed tolerances and absent "changed circumstances."

Second Page. The second page of the new GFE gives a breakdown of the origination charges and the charges for the other settlement services. Rather than being itemized, as on the old GFE, these charges are grouped into categories, including "Our origination charge," "Required services that we select," "Title services and lender's title insurance," and "Required services that you can shop for." The origination charge on the second page is adjusted to reflect any credits or charges for the interest rate chosen. ("Credits" would include that the lender will pay to a mortgage broker (if one is involved) or any discount points that the borrower may choose to pay to lower the interest rate. The theory of the "adjusted origination charge" may be difficult for a borrower to grasp.

Third Page. The last page of the GFE gives general information to consumers as to how best to use the form. It also provides consumers with a "tradeoff table" on which the Loan Originator may set forth two loan options—one that describes a loan for which the consumer would pay a higher interest rate but less in settlement charges, and another that describes a loan for which the consumer would pay a lower interest rate but more in settlement charges. (The Loan Originator need not list any options, but for any option it chooses to list, it must be willing to provide the borrower with a GFE based on the same information it relied on to provide the current GFE.) Lastly, it provides a space where consumers may insert and compare relevant data concerning other loan offers that they receive.

GFE Timing. The New Rule says that a GFE must be provided within three business days following receipt of a consumer's "application." In this respect, the New Rule is the same as the old one. However, the New Rule redefines the term "application." Under the New Rule, Loan Originators receive an "application" when potential borrowers submit financial information to them in anticipation of a credit decision, including, at minimum, their name, monthly income, social security number, property address, estimate of the value of the property, and the amount they wish to borrow, plus whatever other information the Loan Originator deems necessary. Loan Originators may require additional information as a condition of providing a GFE, but may not require borrowers to submit verifying information or documentation as part of an "application."

Fee Tolerances. To prevent "bait or switch" scenarios, HUD has made the GFE less of an "estimate" and more of a "promise." As indicated above, the terms and costs disclosed on a GFE (except for the initial interest rate and the fees that are dependent on the interest rate), once given, must remain open and "fixed" for at least 10 business days. If "accepted" by the borrower, those same terms and costs must remain in place until closing, absent "changed circumstances." By "fixed," HUD means within the applicable tolerances described below. (The initial interest rate, unless locked, must remain "fixed" only for whatever period of time the Loan Originator chooses to keep it open, which must be disclosed on the first page of the GFE.)

The first tolerance is zero percent. This tolerance applies to all lender and mortgage broker origination fees, all transfer fees, and, if the interest rate has been locked, any discount points or YSPs. This means that none of these items may exceed by any amount the number disclosed on the GFE. (The initial interest rate listed on the GFE is also subject to a zero percent tolerance, but only during whatever time period the Loan Originator indicates on the GFE that it will remain fixed—which can be less than 10 days—unless the consumer locks in that rate.)

The second tolerance is 10 percent. This tolerance applies to the total of (1) all lender-required settlement services paid to providers selected by the lender, (2) all lender-required settlement services paid to providers selected by the borrower from lender-provided lists, (3) premiums for optional owners' title insurance selected by the borrower from lender-provided lists, and (4) government recording fees. This means that the sum of the actual charges for these items cannot exceed by more than 10 percent the sum of the charges disclosed on the GFE for these items.

Finally, any other charges disclosed on the GFE would be permitted to change at closing by any amount, so long as the estimate for the charge was offered in "good faith."

Changed Circumstances. The New Rule defines "changed circumstances" that can obviate a tolerance as: (1) Acts of God, war, disaster, or other emergencies; (2) application information that the lender relied on in providing the GFE but which subsequently changes or is found to be inaccurate; (3) information on the borrower's credit report obtained before providing the GFE that subsequently changes; (4) new information particular to the borrower or the transaction that was not relied on by the lender in providing the GFE (excluding any of the items of financial information that at minimum are deemed to constitute an "application"); and (5) other circumstances particular to the borrower or the transaction, such as boundary disputes, the need for flood insurance, and environmental problems. Within three business days after learning that "changed circumstances" exist, the Loan Originator may deny the loan or issue a new GFE showing different terms and/or costs.

Post Settlement Cure. A lender may cure a tolerance violation within 30 calendar days after settlement by reimbursing to the borrower the excess amount. Currently, there is no private right of action for a GFE violation, but HUD plans to ask Congress to change that.

Effective Date. Loan Originators must begin using the new GFE beginning January 1, 2010. Loan Originators may use the new GFE before January 1, 2010 but, if they do, they must also use the HUD-1/1A forms as modified by the New Rule and be subject to all of the other requirements in the New Rule that pertain to the new GFE.

The New HUD-1/1A Forms

The New Rule also revises the existing two-page HUD-1 by making certain changes to the second page and adding a third page. It similarly revises the existing one-page HUD-1A by making changes to the first page and adding a second page.

The changes consist primarily of the following: (1) Replacing the fee terminology that appears on the existing HUD-1/1A with the terminology that is used on the new GFE, specifically, "Our origination charge," "Your credit or charge for the specific interest rate chosen," "Your adjusted origination charge," "Title services and lender's title insurance," and "Required services that you can shop for"; (2) including after each such fee the line number on the GFE at which the same charge appears; and (3) providing a breakdown of the portion of the total title insurance premium that goes to the title underwriter and the title agent.

The page that the New Rule adds to the HUD-1/1A replaces the "Closing Script" that HUD, in its March proposal, would have required the closing agent to read aloud to the borrower at closing. This page compares the loan terms and attendant costs disclosed on the GFE that the borrower received at time of application (or subsequently, where there were changed circumstances) with the terms and costs of the actual loan being closed, and specifically informs the borrower whether the 10 percent tolerance limit on the sum of all fees to which it applies has been exceeded. If the borrower has questions about the settlement fees or the loan terms, the form, at the bottom of this page, directs the borrower to "please contact your lender."

Effective Date. Like the part of the New Rule requiring use of the new GFE, this part of the New Rule becomes

effective January 1, 2010.

Required Use

"Affiliated business arrangements" ("AfBAs") are exempt from scrutiny under RESPA § 8 and its criminal prohibition against referral fees. This exemption applies so long as three conditions are met: (1) The consumer is given an AfBA disclosure statement at the time of the referral, which informs the consumer about the nature of the relationship between the person who is making the referral, and the AfBA and the cost of the goods or services provided by the AfBA; (2) with certain exceptions, the consumer is not required to use the AfBA; and (3) the only thing of value that is received from the AfBA, other than payments that are otherwise permitted by RESPA, is a return on ownership interest.

With respect to the second of these three conditions, HUD has long taken the position that offering an incentive to a consumer to use an AfBA is not a "required use," whereas imposing a penalty upon the consumer for refusing to use an AfBA is a required use. In addition, Regulation X has long stated that providing a package of settlement services to a consumer at a discount is not a "required use" so long as the package is optional to the consumer, and the discount "is a true discount below the prices that are generally available" and are not made up by higher costs elsewhere in the settlement process. n7

Had this aspect of the New Rule not been subsequently withdrawn by HUD, it would have changed the current definition of a "required use" in significant ways. First, it states that a "required use" now includes offering an economic incentive to use an AfBA, as well as imposing an economic disincentive not to use an AfBA. Second, it indicates that the offering by a "settlement services provider" of a discounted package of settlement services provided by one or more AfBAs is not a "required use" of those companies so long as (i) the discounted price is less than the sum of the market prices of the individual settlement services included in the package, (ii) use of the package is optional to the consumer, and (iii) the discount is not made up by higher costs elsewhere in the process.

One key effect of these changes is to prohibit homebuilders from offering buyers incentives (such as upgrades) or discounts for agreeing to use the homebuilders' affiliated settlement service provider (such as mortgage lenders and title insurance companies). A builder is not a "settlement services provider." This effect is most clearly spelled out in the Regulatory Impact Analysis attached to the New Rule:

Under the final rule, builders will not be allowed to offer positive economic incentives for the homebuyer to use an affiliated lender or settlement service provider. An incentive would have to be general, *i.e.*, applicable to any lender or settlement service provider. It would be allowable for a builder to pay a portion of the buyer's closing costs, but that offer could not depend on whether the buyer uses an affiliated lender or settlement service provider. n8

HUD's stated rationale for taking this action is its belief that "the average consumer will gain by formally separating the home purchase and loan decisions." In this regard, HUD assumes that the average consumer is unable to accurately value builder incentives and that most builders will "offset the cost of the incentive by charging a higher interest rate, home price or closing costs" (despite the fact that the current rule prohibits them from doing so). HUD thus seems to be saying that, because it is unable to take effective enforcement action against those builders who offer incentives but who raise prices elsewhere in the process to make up for the incentive, it will simply prohibit all builders from offering incentives.

Effective Date. This part of the New Rule was originally scheduled to become effective on January 16, 2009. Facing a lawsuit filed by the National Association of Builders, n9 HUD first delayed the effective date of this portion of the New Rule until April 16, 2009; then until July 16, 2009; and finally, withdrew it altogether. n10 Subsequently, however, HUD revisited the issue when it published an Advance Notice of Proposed Rulemaking aimed at "Strengthening and Clarifying RESPA's 'Required Use' Prohibition." n10.1

In the Notice, HUD asks interested persons to provide: (1) information focused on tailoring the "required use" definition "to reach abusive incentive schemes but not beneficial discounts or packages," (2) information relating to forward loan commitments obtained by homebuilders for use by their customers, and (3) various other items of information concerning home sellers use of discounts or upgrades as an incentive to use an affiliated provider. Comments are due by September 1, 2010.

Average Cost Pricing

The price that a settlement service provides another settlement service provider for a particular settlement service, such as for a credit report, often varies from one loan to another. While many providers would have liked to charge all of their customers an average price for such a service, they were discouraged from doing so by fears that such a practice would be construed as a violation of RESPA § 8; *i.e.*, that borrowers could assert an illegal overcharge or unearned fee if the average price exceeded the actual cost of their particular service. In the New Rule, HUD made it clear that average cost pricing does not violate Section 8 so long as the provider charges the same average price for every transaction within the class of transactions defined by the provider (based on the period of time, type of loan and geographic area), and recalculates the average price at least every six months. (HUD had proposed a more rigid formula, but backed off in the face of critical comments.) Average cost pricing, however, may not be used for settlement services, the price of which is based on the loan amount or the value of the property. This provision of the New Rule took effect on January 16, 2008.

Simplified Servicing Disclosure Statement

Since 1990, Regulation X has required lenders to provide borrowers, within three business days after receipt of their loan application, with a servicing disclosure statement that generally discloses whether the lender expects to service the loan. A suggested format for such statement was provided in Appendix MS-1. In 1996, Congress simplified this requirement. The New Rule finally implements this 1996 simplification by creating a new model servicing disclosure statement.

Aftermath

The New Rule has generated a significant amount of controversy. As indicated, the National Association of Builders sued HUD to overturn the new "required use" definition. The National Association of Mortgage Brokers also filed suit against HUD, challenging the new disclosure regime created by the New Rule, particularly with respect to its required disclosure of yield spread premiums as borrower credits. And various industry groups have lobbied Congress to force HUD to withdraw or postpone the effectiveness of the New Rule to allow for coordinated and comprehensive mortgage reform involving not only HUD but also the Federal Reserve Board, which has rule-making authority under the Truth-in-Lending Act. Despite lawsuits n11 and lobbying efforts n12 by industry groups to invalidate or postpone the effective date of the new disclosure regime, the New Rule became effective on January 1, 2010.

With regard to the industry lobbying effort, members of the United States House of Representatives at least appear to be listening. On May 12, 2009, they passed and sent to the United States Senate for consideration H.R. 1728, the "Mortgage Reform and Anti-Predatory Lending Act." Section 106 of this bill would force HUD to suspend implementation of its new GFE/HUD-1/1A requirements pending development of a joint proposal with the Federal Reserve Board.

HUD FAQs

As expected, numerous implementation issues have arisen as a result of the New Rule. HUD has attempted to provide guidance to the industry with respect to many of these issues by publishing on its website a series of answers to

"frequently asked questions" ("FAQs"). See http://www.hud.gov/offices/hsg/ramh/res/respa_hm.cfm (last visited June 2010). The most recent version of these FAQs, now 62 pages long, is dated April 2, 2010.

Most of the FAQ's address questions regarding the new GFE. Among these questions are:

- How to fill in the blanks on page 1 in the "Important Dates" section related to rate locks if you do not offer rate locks?
- How to fill in the blanks on page 1 in the "Summary of your loan" section with respect to loans with nontraditional features (*e.g.*, interest-only loans, bi-weekly payment loans, loans with conditional preferred rate features)?
- How to disclose originator charges on page 2 in connection with loans for which the borrower will pay "discount points" and the lender will pay a "yield spread premium?"
- How to disclose "title services and lender's title insurance" when the borrower is permitted to shop for some but not all of those title services?
- Whether transfer taxes need be disclosed where state law and/or custom obligates the seller to pay those taxes?
- How many providers must be included on the list of providers supplied by the Loan Originator with regard to services for which borrower may shop?
- What specific circumstances will qualify as "changed circumstances?"
- What constitutes "origination services" that will be included in Block 1?
- What is a "no cost" loan and how must it be disclosed?
- May Loan Originators provide pre-approvals without having to give a GFE?
- Are lenders bound by GFEs provided by a mortgage broker?

The New HUD-1/1A has also drawn its share of questions, such as the following:

- How should a tolerance violation "cure" be disclosed on the HUD-1/1A.
- How should borrower charges that are paid by the Loan Originator, the seller or a third party be reflected on the HUD-1/1A?
- When a mortgage broker closes a loan in its own name using funds supplied by a table-funding lender, in whose name must the HUD-1/1A be completed?
- If state law so requires, may fees be itemized that the New Rule requires be aggregated?
- How to differentiate on the HUD-1/1A deductible origination points from other origination charges?

The FAQs should be consulted whenever there is a question concerning how a particular loan term or fee should be disclosed on the new GFE or HUD-1/1A form.

FOOTNOTES:

(n1)Footnote 1. *73 Fed. Reg. 1672* (January 9, 2008) .

(n2)Footnote 2. *73 Fed. Reg. 1725-1726* .

(n3)Footnote 3. *73 Fed. Reg. 44522, 44563-44565* (July 30, 2008) .

(n4)Footnote 3.1. *74 Fed. Reg. 43232, 43279-43285, 43331-43333* (August 26, 2009) .

(n5)Footnote 4. Letter from Alphonso Jackson, Acting Secretary, U.S. Department of Housing and Urban Development, to Dr. John Graham, Administrator, Office of Information and Regulatory Affairs, Office of Management and Budget (March 22, 2004) (www.hud.gov/news/letter.pdf); and *70 Fed. Reg. 37646* (June 29, 2005) , providing Notice of the RESPA Reform Roundtables.

(n6)Footnote 5. *73 Fed. Reg. 14030 -14124* (March 14, 2008).

(n7)Footnote 6. *73 Fed. Reg. 44522, 68204* (November 17, 2008) .

(n8)Footnote 7. *24 C.F.R. § 3500.2*.

(n9)Footnote 8. FR-5180-F-02 at p. 3-89.

(n10)Footnote 9. RESPA News Monthly (January 2009) at p. 7.

(n11)Footnote 10. *74 Fed. Reg. 2369* (January 15, 2009) (delaying effective date of required use definition until April 16, 2009); *74 Fed. Reg. 10172* (March 10, 2009) (delaying effective date again until July 16, 2009 and reopening issue for public comment); *74 Fed. Reg. 22822* (May 15, 2009) (withdrawing rule).

(n12)Footnote 10.1. *75 Fed. Reg. 31334* (June 3, 2010) .

(n13)Footnote 11. RESPA News Monthly (December 2008) at p. 14.

(n14)Footnote 12. RESPA News Monthly (February 2009) at p. 8.

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12 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage
CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice § 11.10

§ 11.10 The Legality of Mark-Ups/Overcharges

While the YSP class actions ground to a halt, another Section 8 claim against mortgage brokers (and other settlement service providers) began to take hold. Specifically, plaintiffs in several class actions alleged that the practice of some settlement service providers in (i) charging their customer more than it cost them to obtain a particular settlement service from a third-party provider ("marking-up" a charge for a settlement service) or (ii) charging their customer an "unreasonable" amount for a settlement service which they perform themselves ("overcharging" for a settlement service), violated section 8(b) of RESPA. Section 8(b) states that "no person shall give and no person shall accept any portion, split or percentage of any charge ... for ... a settlement service ... other than for services actually performed. n1 In Policy Statement II, HUD indicated that it considered Section 8(b) to be violated in both of the above scenarios. n2 Courts, however, have disagreed.

With respect to the practice of marking-up a settlement service, the Fourth, Seventh and Eighth Circuit Courts of Appeal have indicated that such a practice is not actionable under Section 8(b); n3 the Second and Third Circuits have said that it may be actionable; n4 and the Eleventh Circuit has said that it may be actionable but indicated in dicta that merely ordering the settlement service from the third-party provider constitutes the rendering of a service upon which a mark-up can be justified. n5 The U.S. Supreme Court may eventually be called upon to definitively decide this issue.

With respect to the practice of "overcharging" for a settlement service, all courts that have specifically addressed this issue to date are in agreement that Section 8(b) provides no cause of action. n6

A New Wrinkle

In *Cohen v. JP Morgan Chase*, n7 the plaintiff alleged that Chase had charged her a "post closing fee" but had not provided *any* services in return for that fee. The district court dismissed plaintiff's complaint for failure to state a claim under RESPA section 8(b) because: (i) the fee was analogous to an "overcharge" which was not actionable under section 8(b); and (ii) the plaintiff failed to allege that the fee had been split with a third party. On appeal, the Second Circuit Court of Appeals reversed, finding that section 8(b), in addition to prohibiting splits of fees between two parties where one party performs no services and mark-ups of third-party fees, can reasonably be read, n8 as HUD has read it, to prohibit a charge by a settlement service provider where "no, nominal or duplicative work is done." n9

FOOTNOTES:

(n1)Footnote 1. 12 U.S.C. § 2607(b).

(n2)Footnote 2. *Haug v. Bank of America*, 317 F.3d 832 (8th Cir. 2003) ; *Boulware v. Crossland Mortgage Corporation*, 291 F.3d 261 (4th Cir. 2002) ; *Krzalic v. Republic Title Co.*, 314 F.3d 875 (7th Cir. 2002) .

(n3)Footnote 3. *Kruse v. Wells Fargo Home Mortgage, Inc.*, 383 F.3d 49 (2d Cir. 2004) ; *Santiago v. GMAC Mortgage Group, Inc.*, 417 F.3d 384 (3d Cir. 2005) .

(n4)Footnote 4. *Sosa v. Chase Manhattan Mortgage Corp.*, 348 F.3d 979 (11th Cir. 2003) .

(n5)Footnote 5. *Kruse v. Wells Fargo Home Mortgage, Inc.*, 383 F.3d 49 (2d Cir. 2004) ; *Santiago v. GMAC Mortgage Group, Inc.*, 417 F.3d 384 (3d Cir. 2005) .

(n6)Footnote 6. 12 U.S.C. § 2605(f).

(n7)Footnote 7. 498 F. 3d 111 ((2d Cir. Aug 6, 2007) .

(n8)Footnote 8. HUD Statement of Policy 2001-1, 66 Fed. Reg. 53052, 53059 (Oct. 18, 2001) .

(n9)Footnote 9. *See also Busby v. JRHBW Realty, Inc.*, 513 F. 3d 1314, 1324 (11th Cir. 2008) (overturning district court's denial of class certification of claim that \$149 "Administrative Services Commission Fee" paid by buyer to real estate broker violated section 8(b) of RESPA as a fee for which no services were provided); and *Busby v. JRHBW Realty, Inc.*, Case No. 2;04-CV-2799-VEH (N.D. Ala. decided April 20, 2009) (granting summary judgment on plaintiffs' RESPA § 8(b) claim).

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13 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 11 Mortgage Brokers *

10A-11 Real Estate Brokerage Law and Practice § 11.11

§ 11.11 Mortgage Brokers and the Subprime Mortgage Crisis

The origins of the subprime crisis, the initial indicators of which surfaced in 2007, can be traced back to the long refinance boom which ended only a few years earlier when mortgage interest rates began their steady climb from record low levels. During the boom, industry players (investment banks, mortgage lenders and mortgage brokers alike) profited handsomely from unprecedented origination activity, and, no doubt, expected those levels of profitability to continue. As interest rates inched higher, however, originations (and profits) declined.

To reverse this decline, keep up the flow of originations to the secondary market and increase home ownership (at the urging of government agencies), lenders and brokers began to aggressively market more exotic loan products. These included interest-only and payment-option adjustable rate mortgages ("ARMs"), originally intended for use by sophisticated real estate investors and professionals ("Nontraditional mortgage loans" or "NTMs"); reduced documentation loans, originally intended for use by self-employed borrowers and other borrowers who possessed the necessary income and/or assets to qualify but, for one reason or another, had difficulty being able to document that ability consistent with Fannie/Freddie underwriting standards ("stated income" loans); "2/28" or "3/27" ARM loans, ARM loans with an initial 2- or 3-year period during which the interest rate would remain fixed; and so-called "80-20 piggyback" loans, 80% loan-to-value ("LTV") first-lien loans combined with 20% LTV second-lien loans, designed to eliminate the need for expensive private mortgage insurance.

Marketing efforts concerning these more exotic loan products were often directed to borrowers for whom these loans may not have been a good fit and were boosted by the use of below-market "teaser" rates that would be in effect, typically, for only a short initial period. Moreover, the features of these various types of loans were often combined to make the loan "work," i.e., so that the loan could close. The result was as desired--more originations. But this increase in originations also sowed the seeds for the current crisis.

Speculation and fraud also contributed to this crisis. Real estate speculators used these exotic products to purchase properties without having to put up a lot of their own money or prove income and assets. Borrowers (and/or loan officers in some cases) exaggerated income on stated income loans (dubbed by some, for this reason, as "Liar's loans") in order to obtain loans for which they would not otherwise have qualified. And criminals found that many of the features of these loans made it easier to perpetrate property-flipping and other illegal schemes.

Efforts to deal with this crisis have been and are being made at both the federal and state level, with increased scrutiny over mortgage brokers being a focus of many of these efforts. At the federal level, Congress enacted the "Secure and Fair Enforcement for Mortgage Licensing Act of 2008" (the "SAFE Act"), Title V of the "Housing Economic Recovery Act of 2008," H.R. 3221, P.L. 110-289, on July 30, 2008. The SAFE Act mandates a uniform nationwide licensing system for all loan originators, including originators who work for state- and federally-chartered depository institutions and independent mortgage bankers and mortgage brokers. Required elements of the system include the establishment of a national mortgage loan originator database and the assignment of a unique identifier to each originator to facilitate tracking; and, for loan originators who work for independent mortgage bankers and brokers, individual licensing testing and continuing education requirements that meet specified standards. The SAFE Act requires this uniform licensing system to be accomplished by the passage of legislation enacted at the state level and determined by HUD to be consistent with the federal mandates contained in the SAFE Act or, in states which fail to enact such legislation, through the adoption of a federal licensing regime established and administered by HUD. HUD issued a proposed regulation to implement the SAFE Act mandates on December 15, 2009 n1

On May 20, 2009, Congress also enacted the Fraud Enforcement and Recovery Act of 2009, P.L. 111-10) (the "FERA"). The FERA, among other things, makes it a crime for a mortgage broker to knowingly make a false statement or report to a person in the mortgage lending business or to any person that makes in whole or in part a federally related mortgage loan as defined in RESPA. And Congress continues to consider placing additional anti-predatory lending restrictions on mortgage lenders and mortgage brokers. n2

States have been active in the area of loan originator licensing to fulfill the SAFE Act mandates. n3 In addition, state regulators are increasingly cooperating with both federal regulators and each other (by agreement or through AARMR) to leverage their ability to supervise mortgage lenders and mortgage brokers, particularly those who do business in multiple states. This trend appears likely to continue.

FOOTNOTES:

(n1)Footnote 1. 74 *Fed. Reg.* 66548 .

(n2)Footnote 2. *See, e.g.*, H.R. 1728, which was passed by the United States House of Representatives and sent to the Senate on May 12, 2009.

(n3)Footnote 3. All jurisdictions except Florida appear to have taken action to bring their mortgage loan originator licensing requirements in line with the SAFE Act's requirements. *See* <http://mortgage.nationwidelicensingsystem.org/sir/Pages/default.aspx#> (last visited June 2010).

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14 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 12 Business Brokers, Business Opportunity Brokers and Finders *

10A-12 Real Estate Brokerage Law and Practice 12.syn

§ 12.syn Synopsis to Chapter 12: Business Brokers, Business Opportunity Brokers and Finders *

§ 12.01 Introduction

[1] Scope of the Chapter

[2] Brokers and Finders Generally

[3] State Licensing Generally

§ 12.02 Business Broker's Entitlement to Commission

[1] In General

[2] The Majority Rule

[a] Divisibility of Value of Realty and Personalty

[b] Requirement of Real Estate Broker's License

[c] Restrictiveness of Statutory Definition of "Broker"

[3] The New York Rule

[a] Sale of Business as Going Concern

[b] Application of the Rule in States Other than New York

[4] The Mississippi Rule

[a] Recovery of Commission on Personalty

[b] Statutory Construction

[5] The Modified New Jersey Rule

[a] In General

[b] Construction of Broker's Statute

[c] Agreement to Apportion Commission

§ 12.03 Oral Compensation Agreements

[1] Application of the Statute of Frauds Generally

[2] Quantum Meruit Under the Statute of Frauds

[3] Estoppel as Basis for Recovery

[4] Fraud and the "Kroeger" Rule

§ 12.04 Statutory Regulation

§ 12.05 Business Brokerage Forms

[1] Standard Listing Agreement

[2] Standard Buyer's Fee Agreement



15 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 12 Business Brokers, Business Opportunity Brokers and Finders *

10A-12 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 12 discusses business opportunity brokers and their relationship to real estate brokerage law. A business opportunity broker is a person who brings together sellers and buyers of businesses (§ 12.01[2]). Numerous issues arise as to whether such brokers must be licensed as real estate brokers since many business sales involve real estate. An all-too-frequent occurrence is for a business broker to have to sue for his or her commission pursuant to the brokerage agreement after having successfully brought a buyer and seller together. Often, sellers take advantage of the fact that the business sale involved real estate and argue that no commission is due because the business broker was not licensed as a real estate broker. Courts have generally reacted to this dilemma in one of four ways:

- a majority of courts have denied the unlicensed business broker compensation if the business sale included real estate unless the brokerage agreement stated that the real estate interest was divisible from the personal property portion of the sale (§ 12.02[2]);
- The New York rule allows an unlicensed business broker to recover a commission if the real estate transfer was not the dominant purpose of the sale (§ 12.02[3]).
- The Mississippi rule allows the unlicensed business broker to recover a commission only on the personal property, but only if the transfer of real estate was not the dominant purpose of the transaction (§ 12.02[4]).
- The modified New Jersey rule allows the unlicensed business broker to recover a commission based upon the value of the personal property of the transaction, regardless of the relative value of the real estate. This rule also allows the broker to prove the value from surrounding circumstances (§ 12.02[5]).

Chapter 12 also discusses obstacles presented when a business broker's contract is oral and the effect of the statute of frauds when the business includes real estate (§ 12.03). Brokers in this situation have sometimes been able to recover their commission under theories of quantum meruit (§ 12.03[2]) and estoppel (§ 12.03[3]). This chapter also discusses the legislative response to this issue which has been to expand the definition of a broker under real estate brokerage licensing laws to include business brokers. The result is that many states have integrated business brokerage activities

into the real estate brokerage licensing scheme (§ 12.04). The chapter concludes with a standard listing agreement form (§ 12.05[1]) and a standard buyer's fee agreement (§ 12.05[2]).



16 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 12 Business Brokers, Business Opportunity Brokers and Finders *

10A-12 Real Estate Brokerage Law and Practice § 12.01

§ 12.01 Introduction

[1] Scope of the Chapter

This chapter is concerned with the regulation and conduct of business opportunity brokers, business brokers, and finders, who negotiate contracts and bargain on behalf of others for the sale, transfer or lease of personal property, assets and ongoing businesses, for a fee, commission or the expectation of a fee or a commission. The chapter focuses on the four basic approaches that the courts take when interpreting the business broker's or business opportunity broker's right to collect commissions. In addition, the problems of recovery of compensation for business brokers and business opportunity brokers under oral and written employment contracts are analyzed, and the statutory framework under which the business broker and business opportunity broker operates is examined.

Some statutes define what interests qualify as a business opportunity. For example, *California Business & Professions Code § 10030* defines a business opportunity as including "the sale or lease of the business and goodwill of an existing business enterprise or opportunity." When the seller is a corporation, this provision has been interpreted to mean that there is no requirement that the sale include every business in which a corporation is engaged. n0.1 It is generally held that the sale of a business opportunity includes the transfer of "goodwill" n0.2 which has been defined to mean the expectation of public patronage. n0.3

Several states have enacted laws aimed at protecting purchasers of new businesses or franchises. These laws have a different purpose and thus define the term business opportunity in that context. n0.4 Though there may be overlap, these definitions typically are not the same. A business opportunity in the context of real estate licensing laws typically refers to the sale of an existing business or the sale of a portion of an existing business.

[2] Brokers and Finders Generally

A broker (engaged in what is commonly called "brokerage") acts on behalf of other parties in negotiating contracts relative to property beyond his or her possession or control in matters of trade, commerce and navigation for compensation. n1 The term encompasses almost every branch of business, real estate, as well as personal property, and involves individuals or entities whose purpose it is to bring together buyer and seller. A finder, middleman, or business opportunity broker is one who acts as an intermediary for the purpose of finding, introducing and bringing together parties to some business opportunity, leaving the ultimate negotiation and consultation of the business transaction to the

principals. n2

There is a well-defined distinction between the finder, the business opportunity locator and the middleman on the one hand and the broker on the other. n3 The middleman or finder is not subject to the rules governing brokers, but is employed merely to bring together parties who desire to exchange, buy or sell property. The parties thereafter make their own contracts, without representation by the middleman or finder, and may or may not pay a commission for the work done.

The finder's employment is based solely on his or her ability to find a prospect to buy particular property or businesses. The finder owes no fiduciary duty to an employer, as the finder's only obligation is to introduce the principals to each other. n4 A right to compensation attaches only if a sale results from the negotiations between the principals the finder has brought together. n5 In contrast, it is generally recognized that brokers owe fiduciary duties to their employers, and have generally earned their commissions when they provide a ready, willing and able buyer pursuant to the terms of their listing agreement, whether or not the buyer and seller subsequently consummate the transaction. n6 It happens on occasion that a finder participates more actively than merely introducing the parties, and when the finder undertakes the role of a broker, he or she will be treated as a broker and will be subject to the fiduciary obligations and licensing requirements of a broker. n6.1

[3] State Licensing Generally

Whether a business broker will be required to have either a business broker's license or real estate broker's license depends upon the applicable state statutory regulations and the judicial interpretations of these statutes. n7 Judicial interpretations and opinions cover a broad spectrum of decisions, and the scope of the opinions relate directly to whether or not the particular state has a licensing requirement, the language utilized in the various statutes and regulations, and the judicial opinions in that state interpreting the language of those regulations.

Several rules or approaches have emerged from these judicial decisions, including:

- (1) the so-called "Majority Rule," which denies any compensation to the unlicensed business broker in the sale of a business that includes real estate unless, according to the terms of the commission agreement, that real estate interest was divisible from the personalty portion of the sale; n8
- (2) the "New York rule" minority approach which allows the unlicensed business broker to collect his or her fee on the entire transaction if the transfer of real estate is not the dominant purpose of the sale; n9
- (3) the "Mississippi rule" which allows the unlicensed broker to recover a commission on the personalty alone, but only if the transfer of real estate is not the dominant purpose of the transaction; n10 and
- (4) the modified "New Jersey rule" which allows recovery by the unlicensed business broker based upon the value of the personalty portion of the transaction, regardless of the relative value of the real property, and further, allows the unlicensed business broker to prove such value from surrounding circumstances. n11

All fifty states and the District of Columbia require the licensing of persons who act as real estate brokers or otherwise offer their services as real estate agents. n12 The same is not true of business brokers and business opportunity brokers. However, the sales of most ongoing businesses generally include either real estate owned by that business, or a leasehold interest for the premises occupied by the business. As a result, most sales of business assets and sales of ongoing businesses involve some type of transfer or conveyance of real estate interest, and based upon the jurisdiction in which the transaction takes place various regulations and licensing requirements relate to the regulation of duties owed, obligations incurred, and the payment of commissions on all or a part of the sale.

Some states define the term real estate broker to include those who sell or negotiate the sale or exchange of a business, business opportunity, or the goodwill of a business. n12.1 Under such a statute an unlicensed individual involved in the sale of a business may be unable to sue to collect on any agreed upon commission. n12.2

The trend in most states appears to be integration of business brokerage activities into the real estate broker licensing scheme. Some states, like Oregon, separately license and regulate business opportunity brokers. n13 Under the Oregon statute, an unlicensed individual who engages in an isolated business brokerage transaction requires neither a business broker's license nor a real estate broker's license if he or she did not "intend" for the transaction to result in the sale of real estate. n14 Similarly, in California, it has been held that an intermediary who merely introduces two parties in a real estate transaction is not a "broker" for the purposes of the state's licensing laws. n15 While these approaches allow an unlicensed person to recover a commission in some circumstances, there are states that disallow any compensation if the transaction involves any real estate. n16

The subject transaction may be covered by a state's securities laws if corporate stock is being sold. The purchase of a business through a stock transaction may fall under the regulations for a securities transaction and license rather than for a real estate or property transaction and license. n17

FOOTNOTES:

(n1)Footnote 0.1. *See Salazar v. Interland, Inc.*, 152 Cal. App. 4th 1031, 1037, 62 Cal. Rptr. 3d 24, 28 (2007) , *reh'g denied*, 2007 Cal. App. LEXIS 1389 (July 23, 2007) .

(n2)Footnote 0.2. *See Salazar v. Interland, Inc.*, 152 Cal. App. 4th 1031, 1038, 62 Cal. Rptr. 3d 24, 28 (2007) , *reh'g denied*, 2007 Cal. App. LEXIS 1389 (July 23, 2007) .

(n3)Footnote 0.3. *Cal. Bus. & Prof. Code § 14100.*

(n4)Footnote 0.4. *See, e.g., Conn. Gen. Stat. § 36b-61 (6)* which states in part, that a business opportunity means "means the sale or lease, or offer for sale or lease of any products, equipment, supplies or services which are sold or offered for sale to the purchaser-investor for the purpose of enabling the purchaser-investor to start a business" in which the seller makes certain representations.

(n5)Footnote 1. *Thomas v. C.I.R.*, 254 F.2d 233 (11th Cir. 1958) .

(n6)Footnote 2. Annot., 24 A.L.R.3d 1160, 1164 (1969) . *See also Weiner, Broker/Finder: Can You Collect?*, 59 Mich. B.J. 330 (1980).

(n7)Footnote 3. *See also* ch. 2 *supra* for a comparison of the roles of brokers, finders and salespersons.

(n8)Footnote 4.

New York: See Northeast Gen. Corp. v. Wellington Advertising, Inc., 82 N.Y.2d 158, 604 N.Y.S.2d 1, 624 N.E.2d 129 (1993) (the court rejected the argument that finders have fiduciary duties; an investment banker/business consultant, who was privy to critical adverse information about a prospect he was presenting to a client for a possible merger with his client's business, was held to have no fiduciary obligation to disclose the information before the merger was finalized).

(n9)Footnote 5.

New York: A business broker was not entitled to a finder's fee for a business acquisition when there was

no continuing connection between the finder's initial efforts and the merger that came about, and the business parties involved had already met some two months before the finder mentioned the subject of the acquisition. *Edward Gottlieb, Inc. v. City & Commercial Communications PLC*, 200 A.D.2d 395, 606 N.Y.S.2d 148, 1994 N.Y. App. Div. LEXIS 269 (1st Dept. 1993) .

See also *Kronish v. Koffman*, 199 A.D.2d 136, 605 N.Y.S.2d 79, 1993 N.Y. App. Div. LEXIS 12022 (1st Dept. 1993) (in assessing the role of the finder in the sale of real property, and of the finder's entitlement to a commission, it is not merely introducing the parties but the nature and purpose of their meeting which is significant).

(n10)Footnote 6. For more on the "ready, willing and able" requirement, see ch. 5 *supra*.

(n11)Footnote 6.1. Cf. *Bienert v. Dickerson*, 276 Ga. App. 621, 624-625, 624 S.E.2d 245, 249 (2005) (business broker has a fiduciary or confidential relationship with the seller).

(n12)Footnote 7. See generally Comment, *Recovery of Commissions by Unlicensed Real Estate Brokers*, 80 Dick. L. Rev. 500, 502-504 (1976).

(n13)Footnote 8. See § 12.02[2] *infra*.

(n14)Footnote 9. See § 12.02[3] *infra*.

(n15)Footnote 10. See § 12.02[4] *infra*.

(n16)Footnote 11. See § 12.02[5] *infra*.

(n17)Footnote 12. See also ch. 6 *supra* for discussion of licensing statutes.

(n18)Footnote 12.1. See Fla. Stat. § 475.01(1)(a); Mich. Comp. Laws § 339.2501(d).

See also *Meteor Motors, Inc. v. Thompson Halbach & Associates*, 914 So. 2d 479, 482 (Fla. Dist. Ct. App. 2005) (real estate broker licensing law includes non-real estate transactions under its purview when a business is the property being sold).

(n19)Footnote 12.2. Cf. *G.C. Timmis & Co. v. Guardian Alarm Co.*, 468 Mich. 416, 427-428, 662 N.W.2d 710, 716-717 (2003) (One need not possess a real estate broker's license for merely identifying and advising a client about a purchase of a business. Unless the investment advisor's actions can reasonably be characterized as selling, buying or negotiating the purchase or sale of real estate for another for a fee, the advisor is not required to possess a real estate license.).

(n20)Footnote 13. See Or. Rev. Stat. § 696.610. Other statutes are cited in § 12.04 *infra* .

(n21)Footnote 14. *Moody v. Hurricane Creek Lumber Co.*, 290 Or. 729, 625 P.2d 1306 (1981) (en banc).

(n22)Footnote 15. *Tyrone v. Kelley*, 9 Cal. 3d 1, 106 Cal. Rptr. 761, 507 P.2d 65 (1973) .

(n23)Footnote 16. See *Chapin v. Neuhoff Broadcasting-Grand Island, Inc.*, 268 Neb. 520, 526, 684 N.W.2d 588, 593 (Neb. 2004) .

(n24)Footnote 17. See *Bertha v. Remy International, Inc.*, 414 F. Supp. 2d 869, 877-881 (E.D. Wis. 2006) , applying Wisconsin law; 49 Wis. Op. Att'y Gen. 4 (1960) .

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17 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 12 Business Brokers, Business Opportunity Brokers and Finders *

10A-12 Real Estate Brokerage Law and Practice § 12.02

§ 12.02 Business Broker's Entitlement to Commission

[1] In General

Courts in the various jurisdictions have applied four distinct analyses to determine when a business broker, who is not licensed as a real estate broker, may recover a commission or finder's fee for bringing parties together. The "majority rule" focuses on the divisibility of the real and personal property in the sale of a business. The "New York rule" examines whether the sale of the business as a going concern predominates in the transaction. Under the "Mississippi rule," a commission is recoverable unless the real estate is the dominant feature of the sale. Finally, the "modified New Jersey rule" permits a business broker to be compensated as long as separate value can be proven, by agreement or otherwise, for the non-real estate aspects of the transaction.

Some business brokers enter into contracts with prospective purchasers in order to protect their commissions. In *Plaza Properties, Ltd. v. Prime Business Investments, Inc.*, n1 in return for the broker providing certain information regarding a laundry, n1.1 the broker and the prospective purchaser signed a contract whereby the purchaser agreed to negotiate only through the broker for the purchase of a laundry. The purchaser agreed that if he violated the terms of the contract, he would be liable to the broker for any lost commission. Subsequently, the purchaser acquired the laundry using the services of another broker who received less than one-third of what the first broker would have been entitled to under its listing agreement with the seller. The broker sued the purchaser for its commission. n1.2 One defense asserted by the purchaser was lack of consideration. The court found that the contract clearly provided that the consideration consisted of the information provided to the purchaser regarding the business. The purchaser was found to be liable for the broker's commission and the broker's attorneys fees. n1.3

Some courts distinguish between a sale of assets and a sale of corporate stock for purposes of applying statutes regulating the activities of real estate brokers. Courts recognizing this distinction hold that a sale of corporate stock is exempt from real estate broker licensing laws. n1.4 However, other courts have held that sales of corporate stock are covered by real estate broker licensing laws. n1.5

[2] The Majority Rule

[a] Divisibility of Value of Realty and Personality

In most jurisdictions, the rule followed is that the unlicensed broker will receive no commission if any real estate is involved in the sale of the business unless, according to the terms of the commission agreement, the real and personal property values are divisible. n1.6 The majority rule n2 (also known previously as the "New Jersey rule") is based on the 1933 New Jersey Decision in *Kenney v. Patterson Milk and Cream Company*, n3 which denied recovery of a commission to the unlicensed broker who negotiated the sale of the dairy's real and personal property. The plaintiff lost his suit because the sales contract provided that the consideration was to be paid in a lump sum amount and was therefore incapable of being divided. The court reasoned that the business broker could only recover if the portion of the contract involving the sale of realty could be severed from the portion of the contract which involved the sale of personalty. n4

Most agreements involving the sale of a business by an unlicensed broker do not separate the sale into real and personal property. Instead, the agreement typically is for the sale of "the business." The majority rule thus outright bars any compensation for the unlicensed broker. The rationale for the majority rule is that the transaction is viewed as a whole and the sale would not have occurred but for the sale of the real estate. n4.1 Thus, under the majority rule, the unlicensed broker is not entitled to any commission from the sale of business assets which include an interest in real estate no matter how de minimis. n4.2

[b] Requirement of Real Estate Broker's License

A court's determination, under the majority rule of whether a real estate broker's license is required in the sale of a business which appears to involve both realty and personalty may depend upon the characterization given to certain property interests under state law. While it is generally held that a leasehold interest is real property, n5 it has been held in some instances that leasehold interests were instead personal property. n6

[c] Restrictiveness of Statutory Definition of "Broker"

Another factor a court may consider in a determination to follow the majority approach is the relative restrictiveness of the particular state's statutory definition of a real estate broker. Courts in states with restrictive statutory definitions of "real estate broker" may follow the view that a real estate broker's license is not required, n7 while a court in a state following a broad statutory definition of the term would most likely follow the view that a real estate broker's license is required. n8 In *Thomas v. Jarvis*, n9 the Kansas Supreme Court held that the plaintiff, a specialist in the field of corporate mergers and acquisitions, who had negotiated the sale of three corporations controlled by the defendants, was required to be licensed under the Real Estate Broker Statute. The court observed:

There are many cases throughout the United States on the question of whether or not a business broker is required to obtain a real estate brokers license. The determination of the necessity for real estate brokers license where the sale is of both real and personal property is usually held to depend upon the language of the particular statute under consideration. In some cases a business broker has been deemed to be a real estate broker within licensing statutes, but in other cases under other statutes a contrary conclusion has been reached. The plaintiffs rely upon those cases which hold that the business brokers are not real estate brokers within the statutory definition. The plaintiff's position, in substance, is that it was not the intent of the legislature to extend K.S.A. 1972 supp. 58-3002, to a situation such as is presented in this case, where the intention of the parties was to sell a going business and where the real estate sold was only incidental to the sale of the going concern. In support of their position the plaintiffs rely on decisions in New York, Arkansas and Colorado, which follow what is usually referred to as the New York rule. It is the minority rule in the United States ... the statutory definition of real estate broker in these states is more restrictive than are the statutory definitions in Kansas under 58-3002 and in those states which adopt the contrary position.

The majority rule adopted in the United States is based upon *Kenney v. Patterson Milk & Cream Co.*, 110 N.J.L. 141, 164 A. 274 ... in those states which follow the majority rule and require a business

broker to have a real estate brokers license, the statutory definition of a real estate broker is comparable to the broad statutory definition provided in 58-302.

We believe that the statutory language used in K.S.A. 1972 supp. 58-3002, is determinative of the issues in the present case. The sale of assets of Salina Manufacturing and Jarrett Electric to Butler fits squarely within the category of, "any transaction which does ... result in the sale ... of any real estate" n10

[3] The New York Rule

[a] Sale of Business as Going Concern

In 1926, the New York Court of Appeals ruled in the case of *Weingast v. Rialto Pastry Shops, Inc.* n11 in what has become known as the "New York rule" that the business broker is not required to be licensed as a real estate broker where the dominant or central feature of the agreement is the sale of a business as a going concern as opposed to the sale of real property. n12 The court relied on two major factors to allow the business broker to recover his commission despite the fact that he had no real estate broker's license. First, holding that the business broker had to be licensed would result in harsh punishment: not only is one who engages in the acts of a real estate broker without a license not entitled to recover a commission, but he is also subject to criminal prosecution. n13 Second, the court found that the legislature had not intended that the statutory definition of "real estate broker" cover the type of individual before the court. The court reasoned that while the lease of the restaurant was an important part of the total agreement, the most significant element was the transfer of the business with all of its equipment and accompanying "good will" as an integrated whole rather than as separate purchases of realty and personalty. n14

The New York statute that was the subject of the *Weingast* case provided that the term "real estate broker" meant "any person, firm, or corporation, who, for a commission or other valuable consideration, lists for sale an "interest in real estate." n15 The *Weingast* court observed that the provision was not broad enough to cover, nor was it intended to cover, every transaction in which an interest in real estate may be part of the subject of the transfer. The court reasoned that the statute would not apply to one who exercises the calling of selling or exchanging businesses as going concerns, although as part of the good will, such sale may include the right to continue business in particular location, in this case a lease of the store or building. The court reasoned that a person who makes a specialty of procuring purchasers for restaurants, drug stores, grocery stores, and the like as going concerns, where a lease simply facilitated the continuance of the business under new ownership at a new location, did not make that individual a real estate broker within the law. n16

This same view was followed and restated in *Dodge v. Richmond*, n17 wherein the court held that the mere inclusion of an item of real estate in a sale involving the transfer of assets of a business would not be sufficient to bar an action for the recovery of a commission. The court emphasized that the inclusion of real estate in a business, without more, does not establish that a person is carrying on the business of a real estate broker so as to bring him within the purview of the statute that prohibits unlicensed brokers from receiving a commission. The court found that the statute was not broad enough to cover every transaction which an interest in real estate was involved, and the court asserted that in looking to the nature of the transaction as well as the purpose of the statute, if an item of real estate or an interest in real estate is a mere incident or incidental feature to the transaction, the statute requiring licensure should not apply. This rule would apply even though the cost of the real estate could be a significant feature in the transaction, so long as it was not deemed to be the dominant feature in the sale.

Under the New York rule, if the transaction's dominant feature is the transfer of real property, a party who does not have a real estate broker's license will be barred from collecting a fee for endeavors in the nature of brokerage services. n17.1

[b] Application of the Rule in States Other than New York

Similar views have been reached by courts in other states. In *Atlanta Realty Company v. Sloan*, n18 a Georgia court asserted that the term "business" did not mean "property," but rather connoted the activity, the energy, the capacity, and the opportunities by which results are reached. Without alluding to the real property as an incidental portion of the sale, the court concluded that it could not, as a matter of law, hold that a business broker necessarily sells interests in real property when a business is sold. The court therefore concluded that it was unnecessary for a broker to secure a real estate broker's license in order to operate as a business broker.

Prior to the enactment in Colorado of a broker licensing statute in 1965, Colorado courts had also adopted the New York rule. In the 1963 case of *Cary v. Borden Company*, n19 an action was brought to recover a commission and fee as a finder and business broker because of services rendered by the plaintiff in aiding the first defendant to acquire a dairy from the second defendant. The plaintiff sued to recover his commission and the court ruled that the plaintiff's lack of a real estate broker's license would not prevent him from recovering a commission even though realty was involved. The court applied what it called the "dominant feature" rule holding:

As we view it, the fact that realty, if separately considered, would fall within the descriptive words of the statute, cannot justify the isolation of it for the purpose of treating it as the subject of a separate sale; the realty must be regarded as constituting an essential part of the exceptional and unitary subject matter of the sale--the sale of a going concern in which the realty involved was "not a dominant feature." We will not extend the statute by implication so as to make the conduct of "the plaintiff" criminal. n20

The court cited *Weingast v. Rialto Pastry Shop* n21 and *Dodge v. Richmond* n22 in holding that, "he, who pursuant to an agreement, negotiates or aids in the transfer of a going business may recover a commission despite the fact that real estate forms an incident of the transaction and he has not a real estate broker's license. This is true even though such item may be a significant though not a dominant feature of the transaction." n23

The case contrasted its holding to the majority rule. It cited *Kenney v. Patterson Milk & Cream Co., Inc.* n24 as holding that, "if a contract be in its nature entire, and one part of it satisfies the statute, and in others it does not, then it is altogether void." n25 It found supporting views in California, Ohio and Washington. As stated earlier, the *Cary* case was decided prior to the passage of the Colorado licensing statute.

Some years after the *Cary* case, *Broughall v. Black Forrest Development Company* n26 was decided by the Supreme Court of Colorado, sitting *en banc*. In *Broughall*, the plaintiff brought an action against the seller of a radio station to recover a fee for finding a buyer. When the case was dismissed in favor of the seller, the plaintiff-finder appealed. The court held that where the sale involved the change of ownership or interest in a business owning a leasehold interest, the transaction came within the ambit of the real estate statute and, thus, the plaintiff was precluded from recovering any finder's fee because he was not a currently licensed real estate salesman or broker. This later case relied on the fact that the applicable Colorado statute n27 defined a "real estate broker" as "anyone who negotiates or attempts or offers to negotiate the listing, sale, purchase, exchange or lease of a business or business opportunity, or ... includes the act of a finder who brings two parties together." n28 The court found that it was the intent of the statute to align the state with the rule requiring a finder or a broker to have a real estate broker's license if the sale of a business included any interest in real estate.

The court cited the *Cary v. Borden Company* n29 case and specifically noted that subsequent to the *Cary* decision the legislature amended the Colorado statute n30 evidencing the legislative intent to align Colorado with the majority rule.

In *Lieff v. Medco Professional Services Corporation*, n30.1 the court addressed the issue of whether Colorado's licensure requirements applied to the sale of a business where immediately after the closing the seller's leasehold was terminated and the buyer entered into a substitute lease. The unlicensed broker in this case assisted in the sale of all the stock of the defendant's company. The broker subsequently sued for the unpaid portion of his commission. The defendant contended that the brokerage contract was void and unenforceable because the plaintiff was not a licensed

real estate broker. Resolution of this case centered around the issue of whether the sale involved an interest in real property. When the brokerage contract was entered into, the broker and seller believed that a lease existed prior to the sale between the business and its landlord. The court found that the business possessed an interest in real estate consisting of, at the very least, a tenancy at will. It was undisputed that contemporaneously with the transfer, a long-term lease was substituted for the tenancy at will.

With the exception of licensed securities brokers, Colorado law requires a real estate license for anyone:

[n]egotiating or attempting or offering to negotiate the listing, sale, purchase, exchange, or lease of a business or business opportunity or the goodwill thereof or any interest therein when such act or transaction involves, directly or indirectly, any change in the ownership or interest in real estate, or in a leasehold interest or estate, or in a business or business opportunity which owns an interest in real estate or a leasehold ... n30.2

This provision had previously been held to apply to the sale of a business where an interest in real estate was transferred. n30.3 The broker argued that the statute required licensure only where the seller's leasehold interest is actually transferred as part of the transaction. The broker distinguished his case on the basis that no interest in real estate passed to the buyer as part of the transaction. The court rejected these arguments and found that this sale was subject to the licensure requirements. It stated:

We conclude that there is no requirement that real estate or a leasehold be *transferred* from one legal entity to another to trigger the licensure requirements. Rather, where, as here, the corporation whose entire stock is sold holds a leasehold that becomes the buyer's leasehold as a result of the sale, whether by transfer from the seller or otherwise, an indirect change in a leasehold interest [sic], and therefore, the licensure requirements apply. (emphasis in original) n30.4

The holding in *Lieff* effectively requires that anyone acting as a broker in the sale of a business in Colorado must have a real estate broker's license. It is difficult to envision any business that can operate without occupying real estate either as a tenant or owner. n30.5 Even businesses that only conduct business on the World Wide Web must have an earth-based location where their computers, personnel, and inventory are located. The court's interpretation of this statutory provision extends real estate brokerage licensure requirements to anyone acting as business broker in Colorado.

Lieff illustrates that business brokers are best protected by obtaining licensure as real estate brokers. It seems to be an all-too-common occurrence for business sellers to attempt to avoid paying a commission by asserting that a business broker should have been licensed as a real estate broker.

[4] The Mississippi Rule

[a] Recovery of Commission on Personality

The so-called "Mississippi rule" allows the business broker to recover a commission on the personality alone, provided that the transfer of the real estate is not the dominant purpose of the sale. n31 The rule derives from the 1970 case of *Quick Shop of Mississippi, Inc. v. Bruce*. n32 In that case, the plaintiff was a licensed real estate broker in Georgia but not in Mississippi. He sued to recover a commission in connection with the sale of an ongoing business. The defendant-corporation defended the suit by contending that the plaintiff-broker was barred from recovering a brokerage commission because he was unlicensed and the transaction involved a real estate lease.

The plaintiff contended, however, that although he was not a licensed real estate broker in Mississippi, he was principally a business broker and that the sale in question was of an ongoing business which involved as its dominant feature, not real estate, but the established reputation, good will and other elements of the going enterprise (all of which are personality). He sought recovery based on the value of these items only and not on the value of the defendant's

nonrenewable lease, lot or fixtures.

The jury found for the plaintiff-broker on the court's instructions that the plaintiff was neither entitled to nor claimed a commission on the value of the real estate, and that the plaintiff could not recover anything if "the predominant feature of the contract involved the sale of real estate." n33

On appeal, the Mississippi Supreme Court sustained the jury verdict. Like the New York court, the Mississippi court analyzed the statute requiring licensure of real estate brokers, and found it to be penal in nature. Under that analysis, the Mississippi court concluded that the application of the statute could not be extended by implication. Since the statute did not expressly contemplate barring an unlicensed broker from a commission on anything other than real estate, the jury verdict would be enforced. n34

[b] Statutory Construction

Under the Mississippi rule, courts tend to narrowly construe real estate brokerage licensing statutes that are penal in nature, thereby leaving the business broker able to recover a commission on only the non-real estate value of the sale, provided that there is a factual showing that the real estate portion of the transaction does not constitute a dominant part of the sale. The court in *Quick Shops* n35 did not establish any specific criteria or rules to make this determination and the matter is left in each case to the trier of fact.

[5] The Modified New Jersey Rule

[a] In General

As stated earlier, the majority rule is based on the 1933 New Jersey decision in *Kenney v. Paterson Milk and Cream Company*. n36 The basis for the decision has been previously cited as the New Jersey rule. The New Jersey Supreme Court, however, revisited and modified this rule in 1982 in the case of *Kazmer-Standish Consultants v. Schoeffel Instruments Corp.* n37 In *Kazmer-Standish*, the plaintiff-broker sued for a commission from the sale of an ongoing business that included an interest in real estate. The business had substantial real estate holdings, and the court held that:

(1) a business broker is not included within the definition of a real estate broker under the New Jersey Statute; and

(2) a broker in the sale of an ongoing business may recover a commission in the sale of the personalty not only when the personalty is separately valued in the commission agreement, but also when the valuation appears in the sales agreement or can be proven from the surrounding circumstances.

South Carolina has adopted the modified New Jersey rule. In *Roberts v. Gaskins*, n37.1 the Court of Appeals of South Carolina stated this rule as follows:

[A] business broker unlicensed as a real estate broker may enforce a commission contractually earned on the sale of the personal property of a business, irrespective of the form of sale, even though the sale may include real estate; provided, of course, no commission can be based either directly or indirectly on the value of the real property involved. n37.2

[b] Construction of Broker's Statute

In determining whether business brokers should be treated like real estate brokers under the state's statutes, the *Kazmer-Standish* court noted that unlike some jurisdictions, the New Jersey statute did not expressly apply to the brokerage of business opportunities. n38 Further, the court noted that the purpose of the legislation was to "protect consumers by excluding 'undesirable, unscrupulous, and dishonest persons ... from the real estate business.'" n39 Based

upon this stated purpose, the court reasoned that there was nothing in the legislative text or history which would indicate that the licensing statute was "intended to protect businessmen from business brokers." n40

[c] Agreement to Apportion Commission

The court in *Kazmer-Standish* noted that while New Jersey courts had been somewhat uncritical in their consistent adherence to the *Kenney* rule, that rule did not preclude any commission to an unlicensed broker if the sale of the business included real property. *Kenney*, stated the court, "permits a broker to recover a commission on the personalty in the sale of a business that also includes real estate if the listing agreement apportions the commission between the personalty and realty." n41

While acknowledging that *Kenney* represented the prevailing majority rule in the United States, the court noted that the rule has been criticized for: (1) failing to recognize that broker licensing acts are intended to protect consumers of residential properties and not businessmen; (2) depriving the broker of money he has "truly" earned; and (3) failing to take into account modern economic conditions. n42

The *Kazmer-Standish* court went on to distinguish its new rules from those adopted in other minority rule jurisdictions. The court noted that both the New York and Mississippi Rules deny a commission to a business broker unless the personal property is the dominant feature of the transaction. The New Jersey Court stated that it felt the broker should not be deprived of a commission merely because the value of the real estate was greater than the value of the other assets in the going concern. The court recognized that the personalty of an ongoing business could be substantial and provide the basis for a significant commission and still be less valuable than the real property involved in the sale. The court felt that it was more equitable and reasonable to permit recovery on that part of the sale of an ongoing business represented by personal property, regardless of the relative values of the real and personal property, where there was an absence of legislative direction prohibiting recovery. The court reasoned that brokers should be paid when they perform in accordance with their agreements and held that honest brokers should not be deprived of commissions on the sale of personal property, because of the state's regulation of real estate brokers. n43

FOOTNOTES:

(n1)Footnote 1. 240 Ga. App. 639, 524 S.E.2d 306 (Ga. App. 1999) *aff'd*, 273 Ga. 97, 538 S.E.2d 51 (Ga. 2000) .

(n2)Footnote 1.1. 240 Ga. App. 639, 641, 524 S.E.2d 306, 308 (Ga. App. 1999) *aff'd*, 273 Ga. 97, 538 S.E.2d 51 (Ga. 2000) . The information provided included the name of the laundry, location, asking price, and monthly rent.

(n3)Footnote 1.2. The broker also sued the corporation which the purchaser organized. It was this corporation which actually purchased the laundry. The trial court found the corporation liable also, but this was reversed since the only basis for liability was the contract between the broker and the individual purchaser.

(n4)Footnote 1.3. 240 Ga. App. 639, 524 S.E.2d 306, 309 (Ga. App. 1999) *aff'd*, 273 Ga. 97, 538 S.E.2d 51 (2000) . The attorneys fees were awarded under Ga. Code Ann. § 13-6-11 on the basis of bad faith in the defendant's carrying out the provisions of the contract.

(n5)Footnote 1.4. See:

Federal: Gruber v. Owens-Illinois, Inc., 899 F.2d 1366, 1372-73 (3d Cir. Pa. 1990) , applying Pennsylvania law.

(n6)Footnote 1.5. See:

Federal: Cooney v. Ritter, 939 F.2d 81, 88 (3d Cir. 1991) (finding New Jersey licensing act applied to a

sale of corporate stock); *Shochet Securities, Inc. v. First Union Corp.*, 663 F. Supp. 1035, 1037 (S.D. Fla. 1987) (finding sale of corporate stock within Florida's licensing provisions).

California: All Points Traders, Inc. v. Barrington Associates, 211 Cal. App. 3d 723, 734, 259 Cal. Rptr. 780, 786 (Cal. Ct. App. 1989) (holding that real estate broker's license was required when negotiating the sale of 100% of corporate stock), *review denied*, 1989 Cal. LEXIS 2746 (Sept. 7, 1989) .

Colorado: Lieff v. Medco Professional Services Corp., 973 P.2d 1276, 1278 (Colo. Ct. App. 1998) (There is no requirement that real estate or a leasehold be transferred from one legal entity to another to trigger the licensure requirements. Where the corporation whose entire stock is sold holds a leasehold that becomes the buyer's leasehold as a result of the sale, the licensure requirements apply.), *cert. denied*, 1999 Colo. LEXIS 363 (Apr. 12, 1999) .

Georgia: Everett v. Goodloe, 268 Ga. App. 536, 540-541, 602 S.E.2d 284, 289 (2004) (sale of stock did not remove the transaction from the ambit of the real estate code).

Utah: Sachs v. Lesser, 2008 UT 87, 207 P.3d 1215 (2008) (The sale of all of a corporation's stock was covered by the Utah Real Estate Broker's Act where the real property owned by the corporation was the dominant feature of the sale.) *reh'g denied*, 2009 Utah LEXIS 116 (Apr. 17, 2009) .

Washington: Springer v. Rosauer, 31 Wash. App. 418, 641 P.2d 1216 (1982) (A person authorized to find a buyer for all of the stock of a corporation for compensation has been held to be a real estate business opportunity broker within the meaning of the real estate broker licensing law.), *review denied*, 97 Wn.2d 1024 (1982) .

See also:

North Carolina: Shortt v. Knob City Inv. Co., 58 N.C. App. 123, 129, 292 S.E.2d 737, 740 (1982) (The former shareholder's sale of 100 percent of the corporate stock constituted a sale by the defendant corporation of the property in question, for the purposes of determining whether the plaintiff was entitled to a commission under the exclusive listing agreement.), *petition denied*, 306 N.C. 744, 295 S.E.2d 480 (1982) .

(n7)Footnote 1.6. See *Kazmer-Standish Consultants, Inc. v. Schoeffel Instruments Corp.*, 89 N.J. 286, 291, 445 A.2d 1149, 1151-1152 (1982) .

(n8)Footnote 2. Cases in which the courts applied the Majority Rule include the following:

United States: Dellwood Enters., Inc. v. Pacific American Real Estate Fund, 653 F.2d 350 (8th Cir. 1981) (applying Minn. law); *Media Services Group, Inc. v. Lesso, Inc.*, 45 F. Supp. 2d 1237, 1250 (D. Kan. 1999) (applying Kansas law); *Doran v. Imeson Aviation, Inc.*, 419 F. Supp. 586 (D. Wyo. 1976) .

Arizona: Bonasera v. Roffe, 8 Ariz. App. 1, 442 P.2d 165 (Ariz Ct. App. 1968) .

California: Abrams v. Guston, 110 Cal. App. 2d 556, 243 P.2d 109 (Cal. Ct. App. 1952) .

Georgia: Beschenko v. Fulton Federal Savings & Loan Assoc. of Atlanta, Inc., 244 Ga. 733, 261 S.E.2d 643 (Ga. 1979) .

Illinois: J. H. Chapman Group, Ltd. v. Pita Baking Co. 205 Ill. App. 3d 1031, 150 Ill. Dec. 834 563 N.E.2d 961 (Ill. App. Ct. 1990) .

Indiana: GDC Environmental Services, Inc. v. Ransbottom Landfill, 740 N.E.2d 1254, 1258-1259 (Ind. App. 2000) ; *Folsom v. Callen*, 126 Ind. App. 201, 131 N.E.2d 328 (Ind. Ct. App. 1956) .

Kansas: Thomas v. Jarvis, 213 Kan. 671, 518 P.2d 532 (Kan. 1974) .

Kentucky: Lockridge v. Hale, 764 S.W.2d 84 (Ky. Ct. App. 1989) .

Missouri: Knight v. Johnson, 741 S.W.2d 842, 845-846 (Mo. App. 1987) .

Nebraska: Ford v. American Medical International, Inc., 228 Neb. 226, 422 N.W.2d 67, 70 (1988) .

Ohio: De Metre v. Savas, 93 Ohio App. 367, 51 Ohio Op. 155, 113 N.E.2d 902 (Ohio Ct. App. 1953) .

Pennsylvania: Burns v. Gartzman, 139 Pa. Super. 453, 11 A.2d 708 (Pa. Super. Ct. 1940) .

Texas: Swor v. Tapp Furniture Co., 146 S.W.3d 778, 782-783 (Tex. App. 2004) ; *David Gavin Co. v. Gibson*, 780 S.W.2d 833 (Tex. App.--Houston [14th Dist.] 1989, writ denied) .

Washington: Schmitt v. Coad, 24 Wash. App. 661, 604 P. 2d 507 (1979) , review denied, 93 Wash.2d 1016 (1980) .

Wisconsin: Payne v. Volkman, 183 Wis. 412, 198 N.W. 438 (Wis. 1924) .

(n9)Footnote 3. 110 N.J.L. 141, 164 A. 274 (1933) .

(n10)Footnote 4. *Id.*, 164 A. at 276 .

(n11)Footnote 4.1. See *Thomas v. Daubs*, 291 Ill. App. 3d 682, 226 Ill. Dec. 15, 684 N.E.2d 1011, 1014 (Ill. App. 1997) ; *GDC Environmental Services, Inc. v. Ransbottom Landfill*, 740 N.E.2d 1254, 1259 (Ind. App. 2000) ; *Business Brokerage Centre v. Dixon*, 874 S.W.2d 1, 3 (Tenn. 1994) .

(n12)Footnote 4.2. See *GDC Environmental Services, Inc. v. Ransbottom Landfill*, 740 N.E.2d 1254, 1259-1260 (Ind. App. 2000) .

(n13)Footnote 5. *De Metre v. Savas*, 93 Ohio App. 367, 51 Ohio Op. 155, 113 N.E.2d 902 (1953) .

(n14)Footnote 6. *Salisbury v. Alskog*, 144 Wash. 88, 256 P. 1030 (1927) ; see also *Backar v. Western States Producing Co.*, 382 F. Supp. 1170 (D. Tex. 1974) .

(n15)Footnote 7. *Vander Sluys v. Finfrook*, 158 LA. 175, 103 So. 730 (1925) .

(n16)Footnote 8. *Id.*

(n17)Footnote 9. 518 P.2d 532 (Kan. 1974) .

(n18)Footnote 10. *Id.* at 735 .

(n19)Footnote 11. 243 N.Y. 113, 152 N.E. 693 (1926) .

(n20)Footnote 12. Cases in which the courts have applied the New York approach include the following:

Arkansas: Frier v. Tesry, 230 Ark. 302, 323 S.W.2d 415 (Ark. 1959) .

Florida: Schidler v. Florida Real Estate Comm'n, 144 So. 2d 862 (Fla. Ct. App. 1962) .

Massachusetts: Business Brokers Int'l Corp. v. Roderick, 24 Mass. App. Ct. 957, 510 N.E.2d 301 (Mass. Ct. App. 1987) .

New York: Weingast v. Rialto Pastry Shop, Inc., 243 N.Y. 113, 152 N.E. 693 (1926) .

Oregon: Moody v. Hurricane Creek Lumber Co., 616 P.2d 514 (Or. Ct. App. 1980) , *aff'd*, 625 P.2d 1306 .

(n21)Footnote 13. *Weingast v. Rialto Pastry Shop, Inc.*, 243 N.Y. 113, 114-115, 152 N.E. 693, 695 (1926) .

(n22)Footnote 14. *Weingast v. Rialto Pastry Shop, Inc.*, 243 N.Y. 113, 116-117, 152 N.E. 693, 694 (1926) .

(n23)Footnote 15. *Id.* at 1922 N.Y. Laws, Ch. 672 § 440.

(n24)Footnote 16. *Weingast v. Rialto Pastry Shop, Inc.*, 243 N.Y. 113, 114-115, 152 N.E. 693, 695 (1926) .

(n25)Footnote 17. 5 A.D.2d 593, 173 N.Y.S.2d 786, 1958 N.Y. App. Div. LEXIS 5937 (1st Dept. 1958) .

(n26)Footnote 17.1. *See, e.g., Panarello v. Segalla*, 6 A.D.3d 515, 516, 775 N.Y.S.2d 360, 361, 2004 N.Y. App. Div. LEXIS 4117 (N.Y. App. Div. 2004) , *appeal dismissed*, 4 N.Y.3d 739, 790 N.Y.S.2d 650, 824 N.E.2d 51 (N.Y. 2004) ; *Berg v. Wilpon*, 271 A.D.2d 629, 707 N.Y.S.2d 861, 862, 2000 N.Y. App. Div. LEXIS 4525 (N.Y. App. Div. 2000) ; *G.C. Fortune Mgt. Co. v. Stockade Mobile Home Park*, 246 A.D.2d 739, 741, 667 N.Y.S.2d 489, 490 (N.Y. App. Div. 1998) , *appeal denied*, 91 N.Y.2d 810, 670 N.Y.S.2d 404, 693 N.E.2d 751 (N.Y. 1998) ; *Levinson v. Genesee Assocs.*, 172 A.D.2d 400, 401, 568 N.Y.S.2d 780, 781, 1991 N.Y. App. Div. LEXIS 5012 (N.Y. App. Div. 1991) ; *N.Y. Real Property Law § 442-d.*

(n27)Footnote 18. 91 Ga. App. 370, 85 S.E.2d 635 (1955) .

(n28)Footnote 19. 386 P.2d 585 (Colo. 1963) .

(n29)Footnote 20. *Id.* at 587 .

(n30)Footnote 21. 243 N.Y. 113, 152 N.E. 693 (1926) .

(n31)Footnote 22. 5 A.D.2d 593, 173 N.Y.S.2d 786, 1958 N.Y. App. Div. LEXIS 5937 (1st Dept. 1958) .

(n32)Footnote 23. *Cary v. Borden Co.*, 386 P.2d 585, 587 (Colo. 1963) .

(n33)Footnote 24. 110 N.J.L. 141, 164 A. 274 (1933) .

(n34)Footnote 25. *Cary v. Borden Co.*, 386 P.2d 585, 587 (Colo. 1963) .

(n35)Footnote 26. 593 P.2d 314 (Colo. 1978) .

(n36)Footnote 27. *Colo. Rev. Stat. § 12-61-101(2)(i) et seq.* This statute was revised in 1973.

(n37)Footnote 28. *Colo. Rev. Stat. § 12-61-10* (1973).

(n38)Footnote 29. *386 P.2d 585 (Colo. 1963)* .

(n39)Footnote 30. The 1963 version of the statute cited is *Colo. Rev. Stat. § 117-1-2(1)*.

(n40)Footnote 30.1. *973 P.2d 1276 (Colo. App. 1998)* , *as modified on denial of rehearing* (1998), *cert. denied* (1999).

(n41)Footnote 30.2. *Colo. Rev. Stat. § 12-61-101(2)(i)*.

(n42)Footnote 30.3. *See Broughall v. Black Forest Development Co.*, *196 Colo. 503, 593 P.2d 314* (1974) (leasehold interest transferred with sale); *Brakhage v. Georgetown Assocs., Inc.*, *33 Colo. App. 385, 523 P.2d 145, 146* (Colo. App. 1974) (corporation's interest in real property transferred with the sale).

(n43)Footnote 30.4. *Lieff v. Medco Professional Services Corp.*, *973 P.2d 1276, 1278 (Colo. App. 1998)* , *as modified on denial of rehearing* (1998), *cert. denied* (1999).

(n44)Footnote 30.5. An argument could be made that a business operating out of a cooperative unit does not own real estate since its interest in the cooperative stock would be considered personal property in many jurisdictions. Given the scarcity of cooperatives as a form of holding property and the even more scarce nature of commercial cooperatives, this argument would be of limited use.

(n45)Footnote 31. Cases following the Mississippi rule include the following:

United States: Cooney v. Ritter, *939 F.2d 81* (3d Cir. 1991) (applying New Jersey law); *Abrahamson v. Gulf Coast Jewelry & Specialty Co.*, *445 F.2d 802* (5th Cir. 1971) (applying Alabama law).

Georgia: Moreland v. Kilgore, *64 S.E.2d 295* (Ga. Ct. App. 1951) .

Mississippi: Quick Shops of Mississippi, Inc. v. Bruce, *232 So. 2d 351* (Miss. 1970) .

Pennsylvania: Sloenfeld v. Meches, *70 A.2d 377* (Pa. Super. Ct. 1950) .

(n46)Footnote 32. *232 So. 2d 351* (Miss. 1970) .

(n47)Footnote 33. *232 So. 2d 351, 352* (Miss. 1970) .

(n48)Footnote 34. *232 So. 2d 351, 354* (Miss. 1970) .

(n49)Footnote 35. *232 So. 2d 351* (Miss. 1970) .

(n50)Footnote 36. *110 N.J.L. 141, 164 A. 274* (1933) .

(n51)Footnote 37. *89 N.J. 286, 445 A.2d 1149* (1982) .

(n52)Footnote 37.1. *486 S.E.2d 771* (S.C. App. 1997) .

(n53)Footnote 37.2. *486 S.E.2d 771, 777* (S.C. App. 1997) .

(n54)Footnote 38. *445 A.2d at 1151* .

(n55)Footnote 39. *445 A.2d at 1151* .

(n56)Footnote 40. *445 A.2d at 1151* .

(n57)Footnote 41. *Id.* at 1151-52 .

(n58)Footnote 42. *Id.* at 1152 .

(n59)Footnote 43. *Id.* at 1153 .

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18 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 12 Business Brokers, Business Opportunity Brokers and Finders *

10A-12 Real Estate Brokerage Law and Practice § 12.03

§ 12.03 Oral Compensation Agreements

[1] Application of the Statute of Frauds Generally

No matter which approach a particular state chooses to follow, there is an additional obstacle that the unlicensed finder or business broker will have to overcome: that is, that the commission agreement must satisfy the statute of frauds if any interest in real property is involved. n1 The commission agreement must be in writing to satisfy the statute of frauds, unless the sale involves only personal property and not an interest in real estate.

Further, even though the statute of frauds generally has no application in the case of personal property, there may be other statutes preventing the recovery of a fee under an oral employment agreement. In *McCooey v. Forstmann Leff Associates, Inc.*, n1.1 the New York Appellate Division held that the statute of frauds (*New York General Obligations Law Section 5-701(a)(10)*), barred an oral promise "to pay compensation for services rendered in negotiating ... a business opportunity." n2

[2] Quantum Meruit Under the Statute of Frauds

The case of *Minichiello v. Royal Business Funds Corp.* n3 specifically addressed the question of whether the business opportunity broker could recover in *quantum meruit* despite the lack of a writing as required by the New York statute of frauds. The *Minichiello* court examined the New York Law Revision Commission's comments on the amendment to the statute of frauds to determine whether recovery of a fee or commission, the business opportunity broker or finder depended upon a written agreement, and whether the legislature intended to bar any recovery in *quantum meruit* in the absence of a writing. n4

The court noted at the outset that the statute of frauds had been amended in 1964 to specifically provide that "negotiating" included "procuring in introduction to a party to a transaction or assisting in the negotiation of a transaction" and was made applicable to "a contract implied in fact or in law". n5 Construing the meaning of the statute as originally enacted in 1949 as it applied to the case, the *Minichiello* court cited the recommendation of the New York Law Revision Commission in proposing the 1964 amendment. The Commission had noted that:

In recent years there have been a substantial number of reported cases of claims for commissions for services rendered in the sale of a going business or business opportunity. Under existing law there is no

requirement that business broker's contracts for commissions be in writing. The nature of the transaction is such that, in the absence of a requirement of a writing, unfounded and multiple claims for commissions are frequently asserted, and employers often seek to escape liability by denying the fact of employment. These controversies are commonly resolved by juries on conflicting testimony, with the consequent danger of erroneous verdicts. n6

Thus, the Commission believed that the danger of erroneous verdicts in allowing a jury to determine a finder's fee case on oral testimony warranted a requirement that the commission agreement be in writing.

The *Minichiello* decision was cited in the 1993 case of *Fidelity Business Brokers, Inc. v. Gamaldi* n7 where licensing was an important factor. In *Gamaldi*, the plaintiff brought an action to recover real estate and business broker's commission pursuant to an alleged oral agreement made with the defendant. The plaintiff-broker sought to recover a commission for services rendered in connection with procuring a buyer for certain grocery stores and real property owned by the defendant. The court allowed the recovery of the commission under the theory of *quantum meruit* by holding that licensed real estate brokers are expressly exempt from the requirements of the statute of frauds. The court held that neither recovery of damages for breach of contract, nor recovery for quantum meruit, was precluded by the absence of a signed writing evidencing the party's agreement. n8

An interestingly contrary result can be reached, however, if the plaintiff is able to show that although unlicensed, his actions were merely those of a "finder" and that he did not engage in "negotiations" as contemplated by the statutes. In *Loyd v. Saffa*, n9 the Court of Appeals of Oklahoma allowed the plaintiff to recover his fee based on an oral agreement, in the face of the fact that the plaintiff had no license whatsoever. A most striking aspect of the case was that the transaction did not involve the sale of the business but was solely a real estate deal. The plaintiff-finder located a purchaser who he introduced to the plaintiff-seller, and the transaction was completed. The finder sued for his agreed-upon fee, and the seller objected on the grounds that the finder was not a licensed real estate broker. Upon appeal from a grant of judgment to the seller, the Court of Appeals held that a finder did not act as a broker within the meaning of the applicable statute if he did not participate in the negotiation process and that the seller could not disavow the existence of an oral agreement after admitting it in connection with a motion for summary judgment. Stating that although Saffa did agree to pay a finder's fee as alleged, Loyd negotiated or attempted to negotiate a transaction which made him a real estate broker within the meaning of the definition under the Oklahoma statute. Remanding the case, the Court of Appeals stated that the issue to be tried was whether the finder performed the contractual role of a "middleman" and put "the parties in a position where they could and did make their own deal." n10 If such was the case, Loyd was entitled to recover his commission, notwithstanding the fact that he was not licensed.

Soon after *Minichiello* was decided, the Second Circuit, in a diversity case involving a New York business broker and a Florida paper corporation, applied the New York rule in a *quantum meruit* suit for services rendered to the company in its negotiations for acquisition of a foreign corporation. In *Lee v. St. Joe Paper Company*, n11 the plaintiff was an industrial and management consultant who acted as both a broker and salesman of raw materials and machinery to be used in the production of paper. The plaintiff-broker suggested to the defendant company that it should invest overseas. The defendant-investor told the plaintiff to gather information about a factory in Ireland, which the plaintiff did. After a series of meetings between the defendant and the Irish company, an investment agreement was made.

When the broker's demand for commission was refused, he brought an action in *quantum meruit* since he had no written employment contract with the defendant. The court based its decisions solely on *Minichiello* and denied the plaintiff any recovery. The Second Circuit found it unnecessary to analyze the case any further than to say that the New York Court of Appeals decision "made it clear that the statute [of frauds] does indeed bar [the finder's] action." n12

[3] Estoppel as Basis for Recovery

While the New York approach embodied in *Minichiello* appears to foreclose any recovery by an unlicensed finder or

business broker under an oral agreement where the applicable statute of frauds requires a writing, the Supreme Court of California has held that although there is no finders exception to that state's statute of frauds, an unlicensed finder faced with a statute of frauds defense to his claim for a fee is entitled to invoke the doctrine of estoppel against that defense, and may also assert an action for fraud even though the allegedly fraudulent promise is unenforceable as a contract by reason of the statute of frauds. n13

In *Tenzer v. Superscope, Inc.*, n14 the plaintiff sued the defendant for a finder's fee, claiming that the chairman of the board of directors had asked him to help save the company from bankruptcy by finding a cash purchaser for the corporate headquarters. The plaintiff, Tenzer, asserted in his complaint that he was orally promised a fee of ten percent of the \$16 million sales price for "finding, referring and assisting in reaching the eventual transaction with the buyer of [Superscope's property]." n15 Tenzer claimed that he had in no way been involved in any of the specific negotiations which lead to the consummated sale. In addition to his claim for breach of contract and unjust enrichment, Tenzer asserted causes of action for estoppel and fraud.

The court noted that although California case law held that a finder in a real estate transaction need not be licensed as a real estate broker to collect his finder's fee, n16 the cases do not indicate any finders exception to the statute of frauds. However, the court found that Tenzer was entitled to a trial on his claims of unjust enrichment and fraud despite the bar of the statute of frauds. They ruled that Tenzer had alleged facts sufficient to invoke the estoppel doctrine and thus foreclose Superscope from relying upon the statute of frauds as a defense. They concluded that the allegations that Superscope had received the benefit from Tenzer's performance but relied on the statute of frauds to avoid paying the commission suggested a case of unjust enrichment. In such cases, said the court, the doctrine of estoppel to plead the statute of frauds may be applied in the interests of fairness.

The court made a further distinction between real estate brokers and finders, who need not be licensed brokers. In citing *Keeley v. Price*, n17 the court noted that licensed real estate brokers cannot assert equitable remedies to avoid the bar of the statute of frauds. The rationale for the strict application of the statute of frauds to bar claims by licensed real estate brokers was that real estate brokers are licensed only after they have demonstrated a knowledge of the laws relating to real estate transactions. This rationale, however, was held inapplicable to finders and the court therefore declined to extend the scope of *Keeley* to unlicensed finders such as Tenzer. Thus, the court was able to overcome the statute of frauds through the estoppel claim of Tenzer.

[4] Fraud and the "Kroeger" Rule

The *Tenzer* case also considered the issue of fraud. Tenzer alleged that Superscope defrauded him of his fee by falsely promising to pay him for his services as a finder without any intention of keeping its part of the bargain, and that Tenzer had acted in reliance upon the false promise to his detriment. The court took the opportunity to disapprove the so-called "Kroeger" rule, which had derived from a line of cases beginning with *Kroeger v. Baur* n18 that had held that an action for fraud cannot be maintained where enforcement of the allegedly fraudulent promise is barred by the statute of frauds.

The court felt that the *Kroeger* approach was inconsistent with the general rule "that the statute of frauds, having been enacted for the purpose of preventing fraud, shall not be made the instrument of shielding, protecting or aiding the party who relies upon it in the perpetration of a fraud or in the consummation of a fraudulent scheme." n19

The result in *Tenzer* prevents the use of the statute of frauds as a means to defraud the finder out of his commission.

FOOTNOTES:

(n1)Footnote 1. *But cf. Bienert v. Dickerson*, 276 Ga. App. 621, 624-625, 624 S.E.2d 245, 249 (2005) . This case involved the sale of a business. Among the business assets were two condominiums. The commission agreement was oral. The real estate commission claims were dismissed, but the business broker was allowed to recover a commission on the business sale.

(n2)Footnote 1.1. 190 A.D.2d 624, 594 N.Y.S.2d 13 (App. Div. 1st Dept. 1993) .

(n3)Footnote 2. *Id.* at 14 , quoting *Freedman v. Chemical Constr. Corp.*, 43 N.Y.2d 260, 267, 401 N.Y.S.2d 176, 372 N.E.2d 12 (1977) .

(n4)Footnote 3. 18 N.Y.2d 521, 277 N.Y.S.2d 268, 223 N.E.2d 793 (1966) , *cert. denied*, 389 U.S. 820, 88 S. Ct. 41, 19 L. Ed. 2d 72 (1967) .

(n5)Footnote 4. *Id.*, 277 N.Y.S.2d at 272 .

(n6)Footnote 5. *Id.*, 277 N.Y.S.2d at 270 .

(n7)Footnote 6. *Id.*, 277 N.Y.S.2d at 271 , citing the 1949 Report of the New York Law Review Commission (N.Y. Legis. Doc., 1949, No. 65(G), p. 615).

(n8)Footnote 7. 593 N.Y.S.2d 315, 1993 N.Y. App. Div. LEXIS 1021 (App. Div. 2d Dept. 1993) .

(n9)Footnote 8. *Id.* at 316 .

(n10)Footnote 9. 719 P.2d 844 (Okla. Ct. App. 1986) .

(n11)Footnote 10. *Id.* at 848 .

(n12)Footnote 11. 371 F.2d 797 (2d Cir. 1967) .

(n13)Footnote 12. *Id.* at 799 .

(n14)Footnote 13. *Tenzer v. Superscope, Inc.*, 39 Cal. 3d 18, 216 Cal. Rptr. 130, 702 P.2d 212 (1985) .

(n15)Footnote 14. 39 Cal. 3d 18, 216 Cal. Rptr. 130, 702 P.2d 212 (1985) .

(n16)Footnote 15. *Id.* at 132 .

(n17)Footnote 16. *Tyrone v. Kelley*, 9 Cal. 3d 1, 106 Cal. Rptr. 761, 507 P.2d 65 (1973) .

(n18)Footnote 17. 27 Cal. App. 3d 209, 103 Cal. Rptr. 531 (1972) .

(n19)Footnote 18. 46 Cal. App. 2d 801, 117 P.2d 50 (1941) .

(n20)Footnote 19. *Tenzer v. Superscope, Inc.*, 39 Cal. 3d 18, 216 Cal. Rptr. 130, 136, 702 P.2d 212 (1985) .

* This chapter was revised by Richard Melamed, Esq. of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas.
Additional updates were contributed by Sandra Bullington, Esq.



19 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 12 Business Brokers, Business Opportunity Brokers and Finders *

10A-12 Real Estate Brokerage Law and Practice § 12.04

§ 12.04 Statutory Regulation

The prevailing trend has been to expand the definition of "broker" under the various state real estate licensing acts to include business brokers and/or business opportunity brokers. Other states, that previously had followed the New York rule, have amended their statutes to either expressly include business brokers within the meaning of "real estate broker" or have included the functions of a business broker within the definition of real estate brokerage. Twenty-one states currently legislate business brokerage through the real estate licensing act. n1

The Washington statute defines the term "business opportunity" to include "business, business opportunity and goodwill of an existing business or any combination thereof." n2 Under this definition, all business brokers are subject to the state's licensing requirements, regardless of whether an interest in real estate is involved in the business transaction. Other states, such as Massachusetts, have included within the scope of their real estate brokerage statutes the negotiation or closing of any transaction which does or is calculated to result in the sale ... of any real estate. n3 Substantially similar language has been held by the Supreme Court of Kansas to be sufficiently descriptive for courts to find appropriate legislative intent to regulate business brokers. n4

It is also quite common in statutory definitions of real estate brokers, to provide that any single act, transaction, or sale (meaning those within the definition) shall constitute engaging in business within the meaning of the real estate licensing act. n5 Although this provision does not deal directly with business brokers, when it is combined with other clauses, such as those already mentioned, it has a cumulative effect which results in the coverage of such brokers. This type of statute is actually aimed at those who seek to escape the licensing requirements by arguing that such statutes were intended to regulate only professional real estate brokers and not individuals who just negotiate or close a single isolated real estate deal. It has been said that even standing alone, the broad impact of the statutory language at least partially neutralizes the business brokers argument that he is not engaged in the business of a real estate broker and that a particular business transaction on incidentally involves the transfer or sale of real estate.

Although the statutes in most jurisdictions do not include all three provisions, most contain at least one, and some contain even two. n6 Thus, even without express language bringing the business broker or finder within the ambit of the legislation regulating real estate brokers, courts, depending upon their view of public interest in regulating such individuals, may well see such statutory language as a mandate to require the business broker or finder to comply with the statutory scheme for the licensing and regulation of real estate brokers.

FOOTNOTES:

(n1)Footnote 1.

Arkansas: Ark. Code Ann. § 7-1302.

California: Cal. Bus. & Prof. Code § 10131.

Colorado: Colo. Rev. Stat. § 12-61-101.

District of Columbia: D.C. Code Ann. § 45-1402.

Florida: Fla. Stat. Ann. § 475.01.

Hawaii: Haw. Rev. Stat. § 467-1(4).

Idaho: Idaho Code § 54-2022.

Indiana: Ind. Code Ann. § 25-34.1-23.

Louisiana: La. Rev. Stat. Ann. § 37:1431.

Massachusetts: Mass. Gen. Laws Ann. Ch. 112, § 89.

Michigan: Mich. Comp. Laws Ann. § 339.2501.

Minnesota: Minn. Stat. Ann. § 82-17.

Nevada: Nev. Rev. Stat. Ann. § 645.030.

New Jersey: N.J. Stat. Ann. § 45:15-1.

New York: N.Y. Real Prop. Law § 442-D.

Ohio: Ohio Rev. Code Ann. § 473-1.

Pennsylvania: Penn. Stat. Ann. § 455.302.

South Dakota: S.D. Code Laws Ann. § 36-21-1.1.

Utah: Utah Code Ann. § 61-2-2.

Washington: Wash. Rev. Code Ann. § 18.85.010.

Wisconsin: Wis. Stat. Ann. § 452.01.

(n2)Footnote 2. *Wash. Rev. Code Ann. § 18.85.010.*

(n3)Footnote 3. *Mass. Gen. Laws Ann. Ch. 112, § 89.*

(n4)Footnote 4. *Thomas v. Jarvis*, 518 P.2d 532 (Kan. 1974) .

(n5)Footnote 5. *N.J. Stat. Ann. § 45:15-2*. A number of other states and the District of Columbia also have similar provisions.

(n6)Footnote 6. The statutes of thirty-eight states and the District of Columbia include at least one of these clauses.

* This chapter was revised by Richard Melamed, Esq. of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas.
Additional updates were contributed by Sandra Bullington, Esq.



20 of 108 DOCUMENTS

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PART IV Specialized Fields of Brokerage

CHAPTER 12 Business Brokers, Business Opportunity Brokers and Finders *

10A-12 Real Estate Brokerage Law and Practice § 12.05

§ 12.05 Business Brokerage Forms

[1] Standard Listing Agreement Standard Listing Agreement

STANDARD LISTING AGREEMENT n1

This Agreement (herein so called) is entered into on this date between (hereafter called "Broker") and the owner(s) or authorized representative of the owner(s) and/or of the legal entity which owns the Business (herein so called) described below (hereafter called "Seller", whether one or more, or authorized representative).

In consideration of the mutual covenants contained in this Agreement and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereby agree as follows:

Seller hereby grants the Broker the EXCLUSIVE RIGHT TO SELL and authority to act as agent to arrange the sale of the Business or part thereof described as follows:

A. Name:

.....

B. Location:

.....

C. Form of Ownership (check one): ☐ Sole Proprietorship; ☐ Corporation; ☐ Partnership; ☐ Limited Partnership; ☐ Other (specify, e.g. Trust, etc.)

D. Owned by the following:

.....

E. Assets Included in Sale:

.....

F. Liabilities to be Assumed:

.....

G. Real Estate Included in Sale:

.....

H. Sale Price: \$

....

(Subject to adjustment for variation in asset value at closing. Above Sale Price is based upon inventory on hand, at cost, value of \$

..... and other value(s), if any of

.....).

Payable as Follows:

(1) Cash at Closing

\$

.....

(2) Assumption of Existing Indebtedness

(3) Seller Financing

(4) Other (Specify)

SALE PRICE \$.....

I. Of the total Sales Price, \$

..... is apportioned to the real estate interest to be conveyed or assigned and \$

..... is apportioned to the non-real estate assets to be conveyed or assigned. n2

2. Seller hereby grants the EXCLUSIVE RIGHT TO SELL to Broker for a primary period of months from the date of this Agreement. After the primary period, this Agreement shall continue until terminated by operation of law or upon ten (10) days written notice of termination delivered by one (1) party to the other by certified mail, return

receipt requested. If not otherwise terminated, this Agreement shall terminate on, 19....

3. If the Seller effects the sale of a Related Business during the existence of this Agreement or within two (2) years after the termination of this Agreement and such sale is made by any purchaser or prospective purchaser with whom Broker or any cooperating broker had any contact regarding the sale of the Business during the existence of this Agreement, Broker shall be entitled to a commission on the sale in accordance with paragraph 10 hereof. (The term "Related Business" shall mean and include any property and/or Business that is directly related to the Business described above, e.g., Real Estate or other property connected with the Business, etc., and that is owned in whole or part by the same persons or legal entities that own the Business. "Related Business" shall also mean and include other businesses and/or other locations if such business and/or other locations are engaged in the same general business activities as such Business described above.) n3

4. In any sale hereunder, Broker is expressly authorized to represent and to receive compensation from any and all parties to the sale or exchange of the Business and the receipt or accrual of any such compensation to Broker from such parties, other than Seller, shall not diminish Seller's obligation under this Agreement. If Broker is engaged to represent or receive compensation from any party to the sale of the Business, other than Seller, Broker will disclose such relationship to Seller, in writing within a reasonable time after such relationship arises.

5. At all times during the existence of this Agreement, Seller shall cooperate with Broker in showing the Business, providing information to prospective purchasers and furnishing prospective purchasers reasonable information within Seller's knowledge or subject to Seller's control concerning all aspects of the Business. Seller shall refer to Broker all inquiries he may receive or be aware of concerning sale of the Business.

6. Seller represents and warrants that all information previously or hereunder furnished to Broker is true and correct and/or complete and accurate in all material respects. Seller understands and acknowledges that all information supplied to Broker as described above, will be relied on by Broker when promoting the Business to prospective purchasers. Broker will make no independent investigation with respect to any and all claims, demands, causes of action or liability whatsoever, including costs, expenses and reasonable attorney's fees, arising out of a breach of the warranty to supply information as described above.

7. In the event Broker procures a purchaser for the Business under the terms described above or any other terms acceptable to Seller, Seller agrees to thereupon execute a written letter of intent or an offer to purchase with the purchaser, which document shall contain the essential terms and conditions of the proposed sale. Thereafter, Seller shall cause to be executed and delivered to the purchaser such documents as shall be necessary to vest in the purchaser good and marketable title to the Business.

8. In connection with the sale of the Business, the Seller, at the request of purchaser, shall execute a Covenant Not to Compete in a form reasonably acceptable to the purchaser.

9. Upon the execution of this Agreement, Seller shall pay to Broker a non-refundable retainer in the amount of \$ In the event a commission is earned and payable upon the occurrence of any event as described in paragraph 11 of this Agreement, the retainer shall be applied as a credit to such commission. If no commission is due or earned by Broker, then Broker shall keep the retainer as compensation for services hereunder. However, in the event a commission is due or earned by Broker hereunder, neither the retainer, nor the retention thereof by Broker, will be considered liquidated damages payment, waiver, estoppel, accord and satisfaction, release or other discharge of Seller's obligation to pay the commission otherwise due or earned by Broker hereunder. n4

10. For services rendered by Broker under this Agreement, Seller shall pay broker a commission in cash equal to a certain percent or percentages of the Sales Price of said Business or Related Business, such percentage of the Sale Price to be on a scale as follows:

A.

B. In no event shall the commission payable to Broker be less than \$

..... (minimum commission).

11. The commission described in paragraph 10 shall be earned and payable, in cash, to Broker at Broker's office in County, Texas upon the occurrence of any of the following events: n5

A. The sale of the Business during the existence of this Agreement.

B. The sale of the Business at any time within two (2) years after the termination of this Agreement, if such sale is made to any purchaser or prospective purchaser with whom the Broker (or any cooperating broker), Seller, or any agent or employee of Seller had any contact regarding same during the existence of this Agreement.

C. Broker obtains an offer to purchase the Business upon terms and conditions specified in Paragraph 1 or upon other terms and conditions acceptable to Seller from a ready, willing and able prospective purchaser.

D. Seller accepts in writing an offer from a prospective purchaser and Seller then fails to complete the sale of the Business.

E. Seller violates the terms of this Agreement and/or breaches any material warranty or representation made herein, or withdraws the Business from the market and/or otherwise attempts to terminate this Agreement prior to its expiration date.

F. The sale of a Related Business as described in Paragraph 3.

12. The term "sale" is defined as any transfer, conveyance, merger, consolidation, exchange, creation of partnership, franchise, indenture or disposition of the Business, including, without limitation, the sale, consignment, assignment, lease or hypothecation of the Business or a Related Business, its capital stock, assets or any portion thereof (other than in the ordinary course of business), or the employment of a prospective purchaser with whom Broker, any cooperating Broker or Seller had any contact during the existence of this Agreement.

13. The term "Sale Price" shall mean any and all amounts of money or other consideration paid or conveyed to Seller, or for Seller's benefit, or paid or conveyed by a purchaser in connection with a sale of the assets or capital stock of the Business or a Related Business plus all liabilities and/or obligations assumed by a purchaser. This shall include, without limitation, cash, stocks, bonds, indentures, debentures, promissory notes, negotiable instruments, real or personal property, letters or lines of credit, loans, payments under employment and consulting agreements, non-competition agreements, partnership agreements, rental agreements, or lease agreements, options, payments pursuant to option agreements, capital investments, the assumption or discharge of liabilities, or any combination of the above or any other consideration or things of value. In addition, Sale Price shall specifically include any and all payments made or to be made by a purchaser that are contingent upon future events, such as a license, franchise, or royalty agreements, payments based on future sales or profits and all other items of a contingent nature. Any portion of the Sale Price that is dependent upon contingent payments shall be negotiated in good faith by the parties hereto and shall be based on reasonable expectations of payments to the benefit of the Seller. n6

14. Seller represents and warrants that Seller is duly authorized to represent all owners, direct or indirect, of the

Business, and all such owners are bound by the terms and conditions of this Agreement. Further, Seller represents and warrants that Seller, the principals of Seller, or Seller's agents or representatives will not take any action which will impair the salability or marketability of the property or Business that is subject to this Agreement.

15. Seller represents and warrants that, except for Broker, Seller has not employed or agreed to compensate, or shall not employ or agree to compensate, any other broker, dealer, salesman or agent with regard to the subject sale for or during the term of this Agreement.

16. Seller hereby indemnifies and holds harmless Broker and its agents, employees, officers, directors, shareholders, co-brokers and affiliates against any and all losses, claims, damages expenses or liabilities whatsoever, joint or several, which may arise out of or in connection with the performance of this Agreement, or the performance of Broker in connection with this Agreement. This indemnification and hold harmless agreement of Seller shall not apply to any intentionally wrongful acts of Broker or the gross negligence of Broker, its agents, employees, officers, directors, shareholders, co-brokers, and affiliates. Further, the indemnity shall be cumulative and shall be in addition to any other liability which may be imposed upon Seller.

17. Seller agrees to notify broker of the closing date, time and location at least three (3) days prior to such closing.

18. In no event shall Broker be required to participate in any evaluation of the Business, including, without limitation, any accounting, inventory, appraisal, audit, verification or other similar evaluation either for Seller or for a prospective purchaser, and Seller hereby expressly releases and discharges Broker from any responsibility or liability in connection with any such evaluation. Seller hereby accepts sole and final responsibility for the evaluation of the Business. Further, Seller hereby expressly releases and discharges Broker from any responsibility or liability in connection with the integrity, creditworthiness or actions of any prospective purchaser or purchaser of the Business.

19. The parties agree that any claim or action brought concerning this Agreement shall be brought in County, ... and agree to forebear from filing a claim in any other county or jurisdiction. The performance and construction of this Agreement shall be governed by the laws of the State of Any amount due which is not timely paid shall bear interest at the maximum rate permitted by law from the date due until paid.

20. This Agreement shall be binding upon all parties to this Agreement, their heirs, executors, successors, administrators, representatives or assigns.

21. If any terms, provision or condition of this Agreement shall be held to be invalid, void or unenforceable, the remainder of the provisions hereof shall remain in full force and effect and this Agreement shall be construed as if such invalid, void or unenforceable provision had not been contained herein.

22. In any litigation arising under the terms and conditions of this Agreement, the prevailing party shall be entitled to reasonable legal fees and expenses in addition to any amount of the judgment.

23. By signing below, the Seller represents and warrants that Seller has read and understands this Agreement. Further, if this Agreement is signed by more than one (1) person or representative, it shall constitute the joint and several obligation of each.

24. Seller acknowledges that Broker has not guaranteed the sale of the above Business. Broker will use best efforts to represent Seller as its exclusive agent with EXCLUSIVE RIGHT TO SELL the Business until this Agreement is terminated.

25. This Agreement sets forth the entire Agreement and understanding between the parties and cannot be modified, amended, supplemented or rescinded except in writing and executed by the parties hereto.

26. The parties hereby agree that a facsimile copy of this Agreement will be deemed an original for all purposes, and each hereby waives the necessity of providing the original copy of this Agreement to bind the other.

27. Seller hereby grants Broker an interest in the proceeds from the sale of Business to secure the payment of Broker's commission due under this Agreement. Seller authorizes and instructs any person or entity who may be handling the closing of the Business to pay and disburse out of the sale proceeds directly to Broker, an amount equal to the commission due under the terms of this Agreement. Such person or entity handling the closing of the sale of the Business is entitled to rely on the written instructions and directions of the Broker for the payment of the commission due hereunder as long as he person or entity handling the closing is given a copy of this Agreement. Seller and Broker, jointly and severally, covenant and agree to indemnify and hold harmless the person or entity handling the closing of and from any claim arising from or relating to the authorization contained in this paragraph. n7

28. Special Conditions:

DATED this day of, 19.....

BROKER:

SELLER:

Owner (if sole proprietorship) or name of owing entity

By: By:

Owner or Duly Authorized Representative

ACCEPTED BY:

Individually

Broker Title Individually

[2] Standard Buyer's Fee Agreement

STANDARD BUYER'S FEE AGREEMENT

This Standard Buyer's Fee Agreement ("Agreement") is entered into on this date between ("Broker") and ("Buyer").

WHEREAS, Buyer desires to purchase a going concern ("Business"), whether a sole proprietorship, corporation, partnership, or other entity, via the purchase of assets, stock or other indicia of ownership.

WHEREAS FURTHER, Broker and Buyer enter into this Agreement for good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged and hereby agree as follows:

1. Buyer hereby engages Broker as Buyer's agent to arrange the acquisition of a business (the "Purchase") under the terms and conditions as hereinafter set forth. Broker is authorized to cooperate with other Brokers ("Cooperating Brokers") and to divide any fee earned hereunder with Cooperating Brokers. The primary term of this Agreement is for a period of months from the date of this Agreement. After the primary term, this Agreement shall continue until terminated by operation of law or upon ten (10) days written notice, certified mail, return receipt requested of termination by one party to the other. If not otherwise terminated, this Agreement shall terminate on

2. For services rendered by Broker under this Agreement, Buyer shall pay to Broker a commission in cash equal to either a fixed fee or the percent or percentages of the Purchase Price (as hereafter defined) of said Business as follows:

.....% of that portion of the sales price related to real estate;

.....% of that portion of the sales price related to non-real estate assets; n8

In no event shall the Commission payable to the Broker be less than \$

3. The commission described in the immediately preceding numbered paragraph shall be earned and payable to Broker, in cash upon the occurrence of any of the following events: n9

a. The Purchase of a Business during the existence of this Agreement.

b. The Purchase of a Business (any time within two (2) years after this Agreement terminates, if such Purchase is made from any seller with whom the Broker (or any Cooperating Broker), Buyer or any agent or employee of Buyer had any contact regarding same during the existence of this Agreement as long as Broker's supplies Buyer with a written list of his contacts within thirty (30) days after the expiration of this Agreement.

c. Buyer signs a binding offer to Purchase a Business during the term of this Agreement.

d. Buyer enters into a binding offer to Purchase, then fails to complete the Purchase of the Business through no fault of the Seller.

e. Buyer violates this Agreement and/or breaches any material warranty or representation made herein.

4. The term "Purchase" as used herein, is defined as any transfer, conveyance, merger, consolidation, exchange, creation of partnership, indenture or other acquisition of a Business, including without limitation the purchase, taking for consignment, assignment, lease, or transfer of a Business, its capital stock, assets, or any portion thereof, to or for the benefit of Buyer or for Buyer's benefit, whether directly or indirectly. It also shall include the employment of the Buyer by a Seller introduced to Buyer by Broker, Broker's agents or any Cooperating Broker. n10

5. The term "Purchase Price" shall mean any and all amounts of money or other consideration paid or conveyed to a Seller, or for a Seller's benefit, or paid or conveyed by the Buyer or for the Buyer's benefit in connection with the Purchase of assets or capital stock of a Business, plus all liabilities and/or obligations assumed by the Buyer. Purchase price shall include, without limitation, cash, stock, bonds, indentures, debentures, promissory notes, negotiable instruments, real or personal property, letters or lines of credit, loans, payments under employment and consulting agreements, non-competition agreements, partnership agreements, rental or lease agreements, options, payments pursuant to option agreements, capital investments, the assumption or discharge of liabilities, or any combination of the above or any other consideration or things of value. In addition, Purchase Price shall specifically include any and all payments made or to be made by the Buyer that are contingent upon future events, such as license, franchise, or royalty

agreements, payments based on future sales or profits and all other items of a contingent nature. A portion of the Purchase Price that is dependent upon such contingent payments shall be negotiated in good faith by the parties hereto and shall be based on reasonable expectations of payments to be paid by the Buyer to a Seller.

6. Buyer warrants that Buyer has or will have \$ as an equity investment to be made for the Purchase of a Business. Buyer will immediately notify Broker of any developments which adversely effect the equity investment of Buyer for the Purchase. n11

7. In no event shall Broker be required to participate in any evaluation of a Business, including without limitation, any accounting, inventory, appraisal, audit, verification or other similar evaluation either for Buyer or for a Seller and Buyer hereby expressly releases and discharges Broker from any responsibility of liability in connection with any such evaluation. Buyer hereby accepts sole and final responsibility for the evaluation or valuation of a prospective Business to be Purchased. Further, Buyer hereby releases and discharges Broker from any responsibility or liability in connection with the financial information given to the Buyer by the Seller through the Broker, or the integrity or other actions of any Seller of a Business.

8. Buyer hereby indemnifies and holds Broker and Broker's agents, employees, officers, directors, shareholders, Cooperating Brokers and affiliates harmless against any and all losses, claims, damages, expenses or liabilities whatsoever, joint or several, which may arise out of or in connection with the performance of a Broker in connection with this Agreement. This indemnification and hold harmless agreement of Buyer shall not apply to any intentionally wrongful acts of Broker or the gross negligence of Broker, its agents, employees, officers, directors, shareholders, Cooperating Brokers or affiliates. Further, the indemnity shall be cumulative and shall be in addition to any other liability which may be imposed on the Buyer.

9. This Agreement shall be binding on all parties to this Agreement, their heirs, executors, successors administrators representatives or assigns.

10. If any term, provision or condition of this Agreement shall be held to be invalid, void or unenforceable, the remainder of the provisions hereof shall remain in full force and effect and this Agreement shall be construed as if such invalid, void or unenforceable provision had not been contained herein.

11. This Agreement sets forth the entire Agreement and understanding between the parties and cannot be modified, amended, supplemented or rescinded except in writing and executed by the parties hereto.

12. Buyer agrees to notify Broker of the closing date, time and place for any prospective Purchase for which Broker shall be entitled to a commission pursuant to this Agreement, at least three (3) days prior to the actual date of closing.

DATED this day of, 199.....

Broker:.....Buyer:

FOOTNOTES:

(n1)Footnote 1. This exclusive business brokerage agreement gives the broker exclusive authority to find a buyer for an ongoing direct sales business. As in an exclusive right to sell real estate listing contract, the principal is foreclosed from competing with the broker by selling the business himself during the life of the agreement (see paragraph 11A). Also, under the extension period of two years provided for in Paragraph 11B, the broker will be entitled to a commission should the owner, subsequent to termination of the agreement, actually sell to a party as the result of negotiations initiated by the broker during the life of the agreement.

Ordinarily the brokerage commission under this agreement is earned only upon consummation of the sale of the

business to a prospect first submitted, directly or indirectly, by the broker during the life of the agreement. Under Paragraph 11 of the agreement, the broker will earn his commission if a proposed sale is not consummated due to the fault of the principal, but "fault" is defined such that the principal can back out of any deal that does not completely satisfy its specifications.

It should be noted that the sale contemplated by this agreement does not require the broker to have a real estate license, but does apportion the sale price between the non-real estate interests and any interest in real estate. The business broker who is not a licensed real estate broker should still be entitled to recover a commission on such a sale, despite any real estate licensing statute which includes business brokers within its definition of real estate brokers and the judicial interpretation of the applicable statute.

(n2)Footnote 2. For the broker's protection, the listing agreement carefully apportions the value of the real estate versus the non-real estate assets in keeping with the majority rule requirements.

(n3)Footnote 3. This Standard Listing Agreement contemplates the situation where the creative Seller might attempt to circumvent the payment of the Broker's commission by restructuring an asset sale into a corporate sale of stock, or, structuring a sale of the real estate with a long term lease of the business assets and thereby denying brokerage commissions because the "business" itself did not sell. This paragraph is also intended to pre-empt the Seller from putting the Buyer in business without the sale of his assets, and otherwise attempt to circumvent the broker's commission.

(n4)Footnote 4. This paragraph is an optional paragraph guaranteeing the broker some type of compensation in exchange for the services performed in the packaging and marketing of the business opportunity. The provision can be reworded or deleted if necessary. In many jurisdictions, the appraisal, packaging and initial production of the marketing brochure for the business opportunity is a service offered by the broker separate and apart from the listing of the sale of the business, but such activity is properly addressed under treatises discussing appraisal laws.

(n5)Footnote 5. Ordinarily the payment of the commission is conditioned upon the successful closing of the transaction. The sections of this paragraph however, go beyond the closing to provide for a protection period for the broker's commission in the event the Seller sells the business to one of the broker's prospects after the termination of the listing period (§ 11b); provides for a commission to the broker upon presentation of a ready, willing and able purchaser even if the Seller defaults in his performance (§ 11c and d); and further provides for the payment of a commission in the event Seller wishes to withdraw the business from the market (§ 11e); this last section and provision does not render the listing agreement irrevocable, but rather, provides for liquidated damages in the event the Seller wishes to terminate the listing agreement prior to its expiration.

(n6)Footnote 6. The definition of "sales price" is an important inclusion in any listing agreement. Sellers often have a different interpretation of the total amount paid for the business versus their understanding of the value upon which the brokerage commission will be based. Ordinarily, the brokerage commission is expressed in the listing agreement as a percentage of the sales price. Many Sellers consider inventory of the business sold at cost to be additional to the sales price and not an item to be included in the total upon which the brokerage commission is computed. Further, through the apportioning of the sales price under IRS Form 8954, funds allocated to covenants not to compete are not only depreciable but are also considered to be compensation paid to the individual rather than the selling entity, and are therefore not considered part of the sales price by most Sellers.

(n7)Footnote 7. This section of the listing agreement is intended to give the broker some control over the payment of his commission in the event there is a successful closing of the business sale. By assigning the broker an interest in the proceeds, it is contemplated that the escrow agent or other entity handling the transaction then has a fiduciary duty not only to the Seller and Buyer but also to the broker giving the broker some leverage in the event of a dispute with the Seller regarding his commission.

(n8)Footnote 8. In keeping with current trends toward dual agency and Buyer's brokerage, a standard Buyer's fee agreement has been included for those instances wherein the broker contracts with the Buyer to present various business opportunities for a commission or fee to be paid by the Buyer. By use of this agreement, the broker insulates himself from creating an agency with the Seller and thereby negates any fiduciary duties that may be owed to the Seller.

(n9)Footnote 9. For the broker's protection, the listing agreement carefully apportions the value of the real estate versus the non-real estate assets in keeping with the majority rule requirements.

(n10)Footnote 10. Ordinarily the payment of the commission is conditioned upon the successful closing of the transaction. The sections of this paragraph however, go beyond the closing to provide for a protection period for the broker's commission in the event the Seller sells the business to one of the broker's prospects after the termination of the listing period (§ 11b); provides for a commission to the broker upon presentation of a ready, willing and able purchaser even if the Seller defaults in his performance (§ 11c and d); and further provides for the payment of a commission in the event Seller wishes to withdraw the business from the market (§ 11e); this last section and provision does not render the listing agreement irrevocable, but rather, provides for liquidated damages in the event the Seller wishes to terminate the listing agreement prior to its expiration.

(n11)Footnote 11. This paragraph addresses the situation where in an effort to avoid payment of a brokerage commission (or for other reasons unknown to the broker) the parties elect to not complete a sale of the business, but rather, transact some type of employment agreement or joint venture agreement. The restrictive listing agreements that provide for a commission only in the event of a "sale" are often subject to creative rearrangements once the Seller and Buyer come to know one another better through their negotiations.

* This chapter was revised by Richard Melamed, Esq. of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas.
Additional updates were contributed by Sandra Bullington, Esq.



21 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13 Cooperatives, Condominiums, and Time-Sharing *

10A-13 Real Estate Brokerage Law and Practice 13.syn

§ 13.syn Synopsis to Chapter 13: Cooperatives, Condominiums, and Time-Sharing *

§ 13.01 Brokers Must Follow Different Rules for Co-ops, Condominiums, and Time-Shares

§ 13.02 Brokers May Be Subject to Special Licensing Requirements Depending on Form of Real Estate

[1] Sales of Cooperatives, Condominiums, and Time-Sharing Interests May Be Subject to Securities Regulations

[2] Sale of Condominium or Cooperative May Be Classified as Sale of Securities

[a] Securities Sales Subject to State Regulation

[b] Federal Test Looks for Expectation of Profits Through Third Party's Efforts

[c] Risk Capital Test Requires Investment to Be Subject to Risk of Enterprise

[i] Hawaii Risk Capital Test Widely Accepted

[ii] California Risk Capital Test Uses Flexible Analysis

[d] Evidence of Indebtedness Subject to Regulation

[3] Time-Sharing Interest Classified as Sale of Securities

§ 13.03 Rights of First Refusal May Restrict Seller's Ability to Transfer Unit

[1] Right of First Refusal Grants Board Degree of Control Over Ownership

[2] Restrictions on Sales May Not Apply to Leases

[3] Validity of Restraints on Alienation May Depend on Form of Real Estate

[a] Rights of First Refusal Are Valid Restraints on Alienation in Cooperative Context

[b] Rights of First Refusal on Condominium Sales May Be Invalid

[4] Broker Must Obtain Waiver of Right of First Refusal

§ 13.04 Sample Right of First Refusal Provisions



22 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13 Cooperatives, Condominiums, and Time-Sharing *

10A-13 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 13 discusses real estate brokerage issues that are unique to cooperatives, condominiums, and time-shares. Some states impose special licensing or registration requirements upon brokers who deal in these common interest communities. In particular, some states require that brokers who represent the developer in the initial sale of a unit must have special licensure or registration. Issues as to whether these forms of real estate ownership are securities are discussed (§ 13.02[2]). Various tests are applied to determine whether a condominium offering is actually a securities offering (§ 13.02[2][b] and [c]). Time-share units are subject to similar scrutiny with respect to the securities issue (§ 13.02[3]). If a condominium offering is found to be a security, numerous disclosure and registration issues arise with respect to the unit itself and the broker. Many cooperative and condominium projects impose a right of first refusal which inures to the benefit of the other unit owners. This aspect of these property regimes affects a unit owner's ability to sell his or her unit (§ 13.03). Sample provisions granting a right of first refusal are included in this chapter (§ 13.04).

For additional discussion on these and other issues, see the following other publications:

- Condominium Law and Practice, ch. 2, *Blue Sky Laws and Other Disclosure Requirements*, ch. 18, *The Securities Law Implications of Condominium Marketing Programs Which Feature a Rental Agency or Rental Pool*, ch. 55, *Time-Sharing and Interval Ownership Arrangements* (Matthew Bender).
- Cooperative Housing Law and Practice, § 3A.02, *State Blue Sky Laws*, ch. 7, *Cooperative Apartment Sales and Resales*, ch. 17, *Time-Sharing*, ch. 19, *Liability of Brokers and Sellers of Cooperative Interests for Non-Disclosure or Erroneous Representations* (Matthew Bender).



23 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13 Cooperatives, Condominiums, and Time-Sharing *

10A-13 Real Estate Brokerage Law and Practice § 13.01

§ 13.01 Brokers Must Follow Different Rules for Co-ops, Condominiums, and Time-Shares

Within the past three or four decades, new concepts in property ownership have developed, bringing with them distinct types of brokerage problems. Cooperatives have an older history, but a generation ago few, if any, consumers would have been familiar with such concepts as the condominium or time-sharing. Today, however, there is hardly a member of the public who is not familiar with these terms or who is not personally acquainted with someone who owns a cooperative, condominium, or time-share unit.

This chapter is devoted to an analysis of the brokerage problems that are peculiar to cooperatives, condominiums, and time-sharing, with particular emphasis placed on the special broker licensing or registration requirements these types of ownership entail (§ 13.02 below) as well as the broker's role in overcoming or complying with restraints upon the transfer of condominium or cooperative units (§ 13.03 below).

* This chapter has been revised by Roslyn K. Myers, Esq., B.A., University of California, Berkeley; J.D., Fordham University School of Law; a member of the New York, Washington D.C., Connecticut, Minnesota, and Wisconsin bars. Additional updates were contributed by Sandra Bullington, Esq. It was previously revised by Charles J. Jacobus, Esq., a partner in the firm of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas.



24 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage
CHAPTER 13 Cooperatives, Condominiums, and Time-Sharing *

10A-13 Real Estate Brokerage Law and Practice § 13.02

§ 13.02 Brokers May Be Subject to Special Licensing Requirements Depending on Form of Real Estate

[1] Sales of Cooperatives, Condominiums, and Time-Sharing Interests May Be Subject to Securities Regulations

Ordinarily, a person selling or leasing any type of residential, commercial, or industrial property on behalf of a client needs no additional authorization to act beyond a brokerage license. n1 However, such an individual may have to file for additional authority when the subject property consists of any of the following:

- cooperative housing;
- condominiums; or
- time-sharing interests.

All states have adopted condominium and/or cooperative enabling statutes, n1.1 and some have issued extensive regulations governing public offerings of this type of real estate. Although a broker's license is all that is needed to act as broker for the seller or purchaser of isolated condominium units that are being resold by an individual unit owner, some states require additional forms to be completed and filed if the broker is acting as the selling agent (sometimes referred to as a "broker-dealer") because of the securities implications involved in the offering of the unit for sale. n2 This is true irrespective of whether the condominium project that is being marketed consists of new construction or involves the conversion of existing rental structures to condominium status.

Practice Note

Individuals who purchase multiple apartments from the original sponsor may be deemed sponsors in their own right, and are therefore subject to the same securities marketing restrictions that apply to the original sponsor (including the requirement that the sales staff file for additional authorization as broker-dealer).

While cooperatives and home owner association projects are not as commonplace as condominiums, some states subject these types of real property interests to the same requirements as are applied to condominiums, including the special licensing of brokers who are acting on behalf of the sponsor or developer. n3 Shares in a cooperative housing

corporation representing units occupied by purchasers under proprietary leases have been held by the U.S. Supreme Court to be the acquisition of a residence and not securities subject to federal regulation. n4 Thus, brokers involved in isolated sales of stock in cooperative housing corporations, as with condominium units, are not required to register under federal law. n5 When a purchaser is motivated exclusively by a desire to occupy or develop the land personally, no security is involved. n6

[2] Sale of Condominium or Cooperative May Be Classified as Sale of Securities

[a] Securities Sales Subject to State Regulation

The term "investment contract" is interpreted broadly, extending to "[n]ovel, uncommon, or irregular devices" employed to promise profits from the use of another's money. n7 The Securities and Exchange Commission classifies an investment contract as a sale of securities if it is offered with any one of the following three specified rental arrangements:

- (1) **Economic benefits to the purchaser:** The condominiums, with any rental arrangement or other similar service, are offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of the promoter, or a third party designated or arranged for by the promoter, from rental of the units.
- (2) **Rental pool arrangement (RPA):** The condominium offering includes participation in a rental pool arrangement. An offering that includes the mere offer of an option to participate in an RPA, regardless of whether the offeree chose to participate, triggers the application of securities laws. n8
- (3) **Material restrictions:** the offering of a rental or similar arrangement requires that the purchaser (a) hold his or her unit available for rental for any part of the year; (b) use an exclusive rental agent; or (c) otherwise acquiesce to material restrictions on the occupancy or rental of his or her unit. n9

The sale of condominium or cooperative units may be classified as sales of securities and therefore be subject to state regulation if the sales are defined as "investment contracts." There are three tests commonly used in the condominium, cooperative and time-share context to determine whether a particular transaction constitutes an investment contract:

- (1) the federal test (also known as the Howey test);
- (2) the risk capital test (also known as the California and Hawaii tests); and
- (3) the evidence of indebtedness definition.

[b] Federal Test Looks for Expectation of Profits Through Third Party's Efforts

At its core, an investment contract under federal securities law has three elements; it is:

- (1) an investment in a common venture;
- (2) premised on a reasonable expectation of profits; and
- (3) to be derived solely from the entrepreneurial or managerial efforts of others. n10

An offer of an investment contract must involve an investment of money and a common enterprise (horizontal commonality describing a common enterprise among several investors, or vertical commonality describing a common

enterprise between the investor, seller, promoter or some other party). n11 RPAs fit this definition because they create a horizontal commonality with other parties and satisfy the "third party efforts" requirement. Thus, any condominium sold with an RPA option is subject to securities regulations. n12 Generally, individual sales of cooperative or condominium apartments do not constitute investment contracts. This is true even though the purchaser intends to make some profit from the acquisition and the marketability of the unit depends to some degree upon the conduct of the management and other owners and tenants. Courts have held that these attributes "do not convert what is in reality a real estate asset into a federal 'security.'" n13 While the federal test purports to focus upon economic realities by examining the substance rather than the form of a transaction, n14 as a practical matter the test has generated confusion and criticism for its failure to do so. For example, the test does not clarify under what circumstances non-cash values, such as services or goods, are recognized as consideration for a security. n15 In addition, the federal test takes "an unduly restrictive view" of what constitutes profits. n16 Profits consist either of the appreciated value of invested capital or of earnings received for invested capital. Cost savings apparently do not qualify as profits. n17 This narrow definition has been criticized as economically unrealistic. n18 Finally, the federal test does not clarify whether an investment contract exists when profits result substantially, but not solely, from the efforts of someone other than the investor. The test, as originally conceived, required that the efforts be made "solely" by third parties. n19 Subsequent U.S. Supreme Court cases have de-emphasized this aspect of the original formulation without blatantly revising the third prong. n20 Subsequent decisions discussing the federal test have interpreted these Supreme Court opinions in divergent ways. n21 These are the primary criticisms of the federal test.

[c] Risk Capital Test Requires Investment to Be Subject to Risk of Enterprise

[i] Hawaii Risk Capital Test Widely Accepted

The Hawaii risk capital test provides that an interest will be found to constitute an investment contract when:

- (1) An offeree furnishes initial value to an offeror;
- (2) A portion of this initial value is subject to the risks of the enterprise;
- (3) The furnishing of the initial value is induced by the offeror's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above the initial value, will accrue to the offeree as a result of the operation of the enterprise; and
- (4) The offeree does not receive the right to exercise practical and actual control over the managerial decisions of the enterprise. n22

As compared to the federal test, the Hawaii risk capital test has several advantages. The Hawaii test:

- (1) uses the term "value," clearly contemplating the exchange of both cash and non-cash consideration;
- (2) applies the term "benefits" broadly to include a wider array of returns than simply profits;
- (3) focuses on the practical and actual investment control, weighing both the quality and the quantity of the parties' managerial efforts; n23 and
- (4) arguably does not restrict its application to start up capital. n24

The Hawaii risk capital test has been accepted favorably and at least one commentator has suggested that this test might eventually replace the federal test in a majority of jurisdictions. n25

[iii] California Risk Capital Test Uses Flexible Analysis

The California test defines risk capital as that which is invested by a person, acting upon a solicitation, in order to obtain a benefit. n26 This risk capital test does not require that benefits come "solely" through the efforts of others, a controversial component of the federal test. n27 As compared to the Hawaii test, the California risk capital test focuses not so much on whether the investors derive their profits solely from the efforts of others, but rather on whether the promoter is relying on the investors for a substantial portion of the initial capital necessary to launch the enterprise. n28 The California risk capital test uses a loose definition of the term "benefit." The risk capital test rejects the concept of expected financial profit as determinative; instead, it asks whether persons risking capital expect some form of benefit or return. A benefit need not be material. n29 Thus, the test gives courts greater flexibility in assessing the quality as well as the quantity of each party's efforts.

Despite the advantage of this greater flexibility as compared to the federal test, the California risk capital test has been criticized. The courts are unsettled about whether the risk capital test deals only with original "start-up" capitalization or whether it also encompasses transactions involving subsequent capitalization by existing enterprises. n30 This limitation seems to unnecessarily defeat at least one purpose of the test. n31

[d] Evidence of Indebtedness Subject to Regulation

Evidence of indebtedness has been defined as a security subject to regulation. n32 "The term 'evidence of indebtedness' is not limited to a promissory note or other simple acknowledgment of a debt owing." n33 It encompasses all contractual obligations a party may have to pay in the future for consideration presently received. n34 The construction given to the term "security" in the Stolen Property Act, 18 U.S.C. § 2311, includes this term.

[3] Time-Sharing Interest Classified as Sale of Securities

Based on the tests outlined above, the sale of time-sharing interests or "interval ownership" interests constitutes a security sale subject to state regulation. n35 In such transactions, the investor purchases the right to use a condominium for a period of time with reliance on the seller to maintain the property. The format of such interests varies greatly from project to project. In some ventures of this type, the individual purchaser receives either a fee or a leasehold interest, while in others the interest may be as ephemeral as a club membership or "vacation license." In many of the early time-share ventures, the purchaser's interest lasted indefinitely whereas sponsors of more recent programs have tended to limit the duration of the purchaser's interest to a specified period of time (such as twenty years).

Time-sharing arrangements meet the requirements of the three tests outlined above for the following reasons:

1. The required expectation of profit is present even though the profit to be realized is in the form of benefits to be derived from the use of the property and not a tangible form of profit such as capital gains. n36
2. The risk capital test is met because the investor (a) assumes the risk that the venture will succeed; (b) expects the benefit of the use of the unit over a specified period of time; and (c) has no control over the investment. n37
3. The sale of a time-sharing interest is an evidence of indebtedness because the investor, by contractual obligation, is promised future benefits and rights in exchange for presently paid consideration. n38

The increasing variety and complexity of these interests are due, in part, to the efforts of sponsors or promoters to avoid classification as a security (and the resulting duty to register with the S.E.C. or state Blue Sky Law administrator). These efforts, however, have not proven successful. A number of jurisdictions have already classified time-shares as a

security, thereby necessitating compliance with local securities laws that mandate, among other things, the qualification of the promoter's broker as a broker-dealer. n39 Aside from the other securities, many states have adopted special licensure for time-share agents. The states simply require a real estate broker or agent licensure. However, some states will require a separate broker licensure. n40 Other states require a separate license only, not requiring the real estate brokerage licensure. n41

FOOTNOTES:

(n1)Footnote 1. An agent or salesperson selling units in a common interest community may be subject to licensing in that capacity. However, not all states require licensure of salespersons involved in the sale of timeshares. *See National Resort Mart, Inc. v. Hitchcock*, 88 S.W.3d 459, 462 (Mo. Ct. App. 2002) (Missouri does not require licensure of those selling or listing time-shares).

(n2)Footnote 1.1. *See*:

Alabama: Ala. Code § 35-8A-101 et seq. (Uniform Condominium Act, effective Jan. 1, 1991).

Alaska: Alaska Stat. § 34.08.010 et seq. (Common Interest Ownership, effective Jan. 1, 1986).

Arizona: Ariz. Rev. Stat. §§ 33-1201-33-1270 (Uniform Condominium Act, effective Jan. 1, 1986); 32-2197.

Arkansas: Ark. Code Ann. § 18-13-101 et seq. (Horizontal Property Act, effective 1987); § 18-14-101 *et seq.* (Time-Sharing).

California: Cal. Bus. & Prof. Code §§ 11003-11033.1; Cal. Civ. Code §§ 659, 783, 1350 et seq.

Colorado: Colo. Rev. Stat. § 38-33-101 et seq.

Connecticut: Conn. Gen. Stat. § 47-200 et seq.

Delaware: Del. Code Ann, tit. 25, § 81-101 et seq. (Uniform Common Interest Ownership Act 2008).

District of Columbia: D.C. Code § 42-1901.01 et seq.

Florida: Fla. Stat. §§ 718.101 et seq. (Condominium Act); 719.101 *et seq.* (Cooperatives); 721.01 *et seq.* (Time-Sharing Act).

Georgia: Ga. Code Ann. § 44-3-70 et seq.

Hawaii: Haw. Rev. Stat. § 514B-1 et seq.

Idaho: Idaho Code Ann. §§ 55-1501-55-1527.

Illinois: 765 Ill. Comp. Stat. 605/1 et seq.

Indiana: Ind. Code Ann. § 32-25-1-1, et seq.

Iowa: Iowa Code §§ 499B.1-499B.19.

Kansas: Kan. Stat. Ann. §§ 58-3101-58-3129.

Kentucky: Ky. Rev. Stat. Ann. §§ 381.805-381.990.

Louisiana: La. Rev. Stat. Ann. §§ 9:1121.101-9:1124.115; 9:1131.2-9:1131.30 (Time-Sharing).

Maine: Me. Rev. Stat. Ann. tit. 33, §§ 560-587; 593-594; 1601-101-1604-119.

Maryland: Md. Code Ann. Real Prop. §§ 11-101-11-143 (Condominiums); 11A-101-11A-129 (Time-Sharing) Md. Code Ann., Corps. & Ass'ns § 5-6B-01 et seq. (Cooperative Housing Corporation Act).

Massachusetts: Mass. Gen. Laws ch. 183A, § 1 et seq. ; ch. 183B, § 1 et seq. (Time-Shares).

Michigan: Mich. Comp. Laws §§ 559.101-559.275 § 125.1471, et seq. (consumer housing cooperatives).

Minnesota: Minn. Stat. §§ 515.01-515.29; 515A.01-515A.4-117.

Mississippi: Miss. Code Ann. §§ 89-9-1-89-9-37.

Missouri: Mo. Rev. Stat. § 448.010 et seq.

Montana: Mont. Code Ann. §§ 70-23-101-70-23-1002.

Nebraska: Neb. Rev. Stat. §§ 76-801-76-894; 76-1701-76-1741.

Nevada: Nev. Rev. Stat., §§ 117.010-117.120; § 116.001 et seq.

New Hampshire: N.H. Rev. Stat. Ann. § 356-B:1, et seq. , and § 479-A:1 et seq.

New Jersey: N.J. Stat. Ann. § 46:8B-1, et seq. (condominiums) and § 46:8D-1, et seq. (cooperatives).

New Mexico: N.M. Stat. Ann. §§ 47-7A-1-47-4D-20.

New York: N.Y. Real Prop. L. §§ 339-d-339-ii; N.Y. Gen. Bus. L. §§ 353-c-353-e.

North Carolina: N.C. Gen. Stat. § 47A-1, et seq. (Unit Ownership Act), § 47C-1, et seq. (Condominium Act) and § 47F-1-101, et seq. (Planned Community Act).

North Dakota: N.D. Cent. Code §§ 47-04.1-01-47-04.1-13.

Ohio: Ohio Rev. Code Ann. §§ 5311.01-5311.27.

Oklahoma: Okla. Stat. tit. 60, § 501-530.

Oregon: Or. Rev. Stat. § 94.550, et seq. (Planned Communities) and § 100.005, et seq. (Condominium Act)

Pennsylvania: 68 Pa. Cons. Stat. §§ 3101-3414.

10A-13 Real Estate Brokerage Law and Practice § 13.02

Rhode Island: R.I. Gen. Laws § 34-36.1-1.01 et seq.

South Carolina: S.C. Code Ann. §§ 27-31-10-27-31-440; 27-32-10-27-32-250.

South Dakota: S.D. Codified Laws §§ 43-15A-1-43-15A-28; 43-15B-1-43-15B-7.

Tennessee: Tenn. Code Ann. §§ 66-27-101-66-27-123; 66-32-101-66-32-137. Tenn. Code Ann. § 66-27-201, et seq. (Condominium Act).

Texas: Tex. Prop. Code § 82.001, et seq. (Condominium Act).

Utah: Utah Code Ann. §§ 57-8-1-57-8-35.

Vermont: Vt. Stat. Ann. tit. 11, § 1581, et seq. (Cooperative Housing Ownership Act) tit. 27, §§ 1301-1339.

Virginia: Va. Code Ann. §§ 55-79.1-55-79.97; 55-360-55-400.

Washington: Wash. Rev. Code § 64.32.010, et seq. (Horizontal Properties Regime Act) and § 64.34.005, et seq. (Condominium Act).

West Virginia: W. Va. Code § 36A-1-1, et seq. (Unit Property Act) and § 36B-1-101, et seq. (Common Interest Ownership Act).

Wisconsin: Wis. Stat. §§ 703.01-703.38.

Wyoming: Wyo. Stat. Ann. §§ 34-20-101-34-20-104.

(n3)Footnote 2. Offers and Sales of Condominiums or Units in a Real Estate Development, Securities Act Release No. 33-5347, 1 *Fed. Sec. L. Rep. (CCH) P 1049* (Jan. 4, 1973) (listed at 17 C.F.R. § 231.5347 (1988)) (alerting "persons engaged in the business of building and selling condominiums ... to their responsibilities under the Securities Act and to provide guidelines for a determination of when an offering of condominiums or other units may be viewed as an offering of securities.").

(n4)Footnote 3. See Rohan & Reskin, *Real Estate Transactions: Condominium Law and Practice*, ch. 17D (Matthew Bender).

(n5)Footnote 4. See *United Housing Found. v. Forman*, 421 U.S. 837, 95 S. Ct. 2051, 44 L. Ed. 2d 621 (1975) .

(n6)Footnote 5. See also *Grenader v. Spitz*, 537 F.2d 612 (2d Cir. 1976) .

(n7)Footnote 6. *Joyce v. Ritchie Tower Properties*, 417 F. Supp. 53, 55-56 (N.D. Ill. 1976) ; *Aschenbach v. Covenant Living Centers-North, Inc.* 482 F. Supp. 1241, 1243 (E.D. Wis. 1980) (finding that nonassignable, nontransferrable residency contracts which were entered into for the primary purpose of acquiring low-cost living space did not constitute investment contracts). Accord *R.J. Wolf v. Banco Nacional de Mexico*, 549 F. Supp. 841, 851 (N.D. Cal. 1982) .

(n8)Footnote 7. *SEC v. C.M. Joiner Leasing Corp.*, 320 U.S. 344, 351, 64 S. Ct. 120, 124, 88 L. Ed. 88 (1943) ; *SEC v. W. J. Howey Co.*, 328 U.S. 293, 299, 301, 66 S. Ct. 1100, 1103, 90 L. Ed. 1244 , reh'g denied, 329 U.S. 819, 67 S. Ct. 27, 91 L. Ed. 697 (1946) .

(n9)Footnote 8. *Hocking v. Dubois*, 885 F.2d 1449, 1459-62 (9th Cir. 1988) .

(n10)Footnote 9. 38 Fed. Reg. 1735, 1736 (1973) .

See generally: What is "investment contract" within meaning of § 2(1) of Securities Act of 1933 (15 U.S.C. § 77b(1)) and § 3(a)(10) of Securities Exchange Act of 1934 (15 U.S.C. § 78c(a) (10), both defining term "security" as including investment contract, 134 A.L.R. Fed 289 (1996) ; "Common enterprise" element of Howey test to determine existence of investment contract regulable as "security" within meaning of Federal Securities Act of 1933 (15 U.S.C. § 77a et seq.) and Securities Exchange Act of 1934 (15 U.S.C. § 78a et seq.), 90 A.L.R. Fed 825 (1988) ; "Risk capital" test for determination of whether transaction involves security, within meaning of federal Securities Act of 1933 (15 U.S.C. § 77a et seq.) and Securities Exchange Act of 1934 (15 U.S.C. § 78a et seq.), 68 A.L.R. Fed 89 (1984) ; What constitutes an "investment contract" within the meaning of state Blue Sky Laws, 47 A.L.R. 3d 1375 (1973).

(n11)Footnote 10. *SEC v. W. J. Howey Co.*, 328 U.S. 293, 298-299, 301, 66 S. Ct. 1100, 1102-1104, 90 L. Ed. 1244 , reh'g denied, 329 U.S. 819, 67 S. Ct. 27, 91 L. Ed. 697 (1946) ; *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 558, 99 S. Ct. 790, 796, 58 L. Ed. 2d 808 (1979) ; *United Hous. Found. Inc. v. Forman*, 421 U.S. 837, 852, 95 S. Ct. 2051, 2060, 44 L. Ed. 2d 621 , reh'g denied, 423 U.S. 884, 96 S. Ct. 157, 46 L. Ed. 2d 115 (1975) . Accord *Nebraska v. Irons*, 574 N.W.2d 144 (Neb. 1998) .

(n12)Footnote 11. *Hocking v. Dubois*, 885 F.2d 1449, 1456 (9th Cir. 1988) .

See also "Common enterprise" element of *Howey* test to determine existence of investment contract regulable as "security" within meaning of Federal Securities Act of 1933 (15 U.S.C. § 77a et seq.) and Securities Exchange Act of 1934 (15 U.S.C. § 78a et seq.), 90 A.L.R. Fed. 825 (1988) .

(n13)Footnote 12. *Hocking v. Dubois*, 885 F.2d 1449 (9th Cir. 1988) .

(n14)Footnote 13. *Lee v. Echotree Asocs. Ltd. Partnership*, Civ. No. 89-1377, 1990 U.S. Dist. LEXIS 7732, at *8 (E.D. Pa.) .

(n15)Footnote 14. *United Hous. Found. Inc. v. Forman*, 421 U.S. 837, 851-52, 95 S. Ct. 2051, 2060, 44 L. Ed. 2d 621 , reh'g denied, 423 U.S. 884, 96 S. Ct. 157, 46 L. Ed. 2d 115 (1975) .

(n16)Footnote 15. *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 558, 99 S. Ct. 790, 796, 58 L. Ed. 2d 808 (1979) .

(n17)Footnote 16. *Securities Administrator v. College Assistance Plan*, 533 F. Supp. 118, 121 (D. Guam 1981) .

(n18)Footnote 17. *United Hous. Found. Inc. v. Forman*, 421 U.S. 837, 851-52, 95 S. Ct. 2051, 2060, 44 L. Ed. 2d 621 , reh'g denied, 423 U.S. 884, 96 S. Ct. 157, 46 L. Ed. 2d 115 (1975) .

(n19)Footnote 18. *United Hous. Found. Inc. v. Forman*, 421 U.S. 837, 863-64, 95 S. Ct. 2051, 2066, 44 L. Ed. 2d 621 , reh'g denied, 423 U.S. 884, 96 S. Ct. 157, 46 L. Ed. 2d 115 (1975) (Brennan, Douglas, and White, dissenting).

(n20)Footnote 19. *SEC v. W. J. Howey Co.*, 328 U.S. 293, 299, 301, 66 S. Ct. 1100, 1103--1104, 90 L. Ed. 1244 , reh'g denied, 329 U.S. 819, 67 S. Ct. 27, 91 L. Ed. 697 (1946) .

(n21)Footnote 20. *United Hous. Found. Inc. v. Forman*, 421 U.S. 837, 852, 95 S. Ct. 2051, 2060, 44 L. Ed. 2d 621 , reh'g denied, 423 U.S. 884, 96 S. Ct. 157, 46 L. Ed. 2d 115 (1975) ; *International Brotherhood of Teamsters v. Daniel*, 439 U.S. 551, 558, 561, 99 S. Ct. 790, 796-97, 58 L. Ed. 2d 808 (1979) .

(n22)Footnote 21. Compare *SEC v. National Executive Planners Inc.*, 503 F. Supp. 1066, 1071 (M.D. N.C. 1980)

and *Fulk v. Bagley*, 88 F.R.D. 153, 163 (M.D. N.C. 1980) (referring to requirement that efforts be made "solely" by third parties) with *Williamson v. Tucker*, 632 F.2d 579, 593-594 (5th Cir. 1980) (characterizing Forman as having "liberalized" the federal test).

(n23)Footnote 22. *Hawaii v. Hawaii Market Center, Inc.*, 52 Haw. 642, 485 P.2d 105, 109 (1971) . The Hawaii Supreme Court derived this test from a commentator's analysis of securities transactions. See Coffey, *The Economic Realities of a Security: Is There a More Meaningful Formula?*, 18 W. Res. L. Rev. 367, 377 (1967).

The Hawaii test has been adopted by several jurisdictions including Washington (*Wash. Rev. Code* § 21.20.005(12); see also *Christgard Inc. v. Christensen*, 29 Wash. App. 18, 627 P.2d 136, 139 n.1 (Wash. App. 1981)) and Guam (see *Securities Administrator v. College Assistance Plan*, 533 F. Supp. 118, 124 (D. Guam 1981)) .

(n24)Footnote 23. See *Securities Administrator v. College Assistance Plan*, 533 F. Supp. 118, 123 (D. Guam 1981) (noting that the Hawaii test "defines investment contracts with pragmatic economic realism").

(n25)Footnote 24. See 533 F. Supp. at 123-24 & n.18 (noting that the article from which the test was derived indicates "that the term 'initial value' refers only to the 'initial' or 'first' step of a transaction ... [and] was not intended to be a term of art denominating the 'initial' capitalization of a new enterprise").

(n26)Footnote 25. See Long, *State Securities Regulation*, 32 Okla. L. Rev. 541, 578 (1979).

(n27)Footnote 26. *Silver Hills Country Club v. Sobieski*, 55 Cal. 2d 811, 13 Cal. Rptr. 186, 188-189, 361 P.2d 906, 908-909 (Cal. 1961) (establishing California definition).

(n28)Footnote 27. See *State ex rel. Healy v. Consumer Business Sys. Inc.*, 5 Or. App. 19, 482 P.2d 549, 555 (Or. App. 1971) .

(n29)Footnote 28. *State v. Consumer Business Sys., Inc.*, 5 Or. App. 19, 482 P.2d 549, 555 (1971) .

(n30)Footnote 29. *Silver Hills Country Club v. Sobieski*, 55 Cal. 2d 811, 13 Cal. Rptr. 186, 188-189, 361 P.2d 906, 908-909 (Cal. 1961) .

(n31)Footnote 30. *Securities Administrator v. College Assistance Plan*, 533 F. Supp. 118, 123 (D. Guam 1981) (noting that "[a]t least one decision states that the risk capital test encompasses only original capitalization. *Jet Set Travel Club v. Commissioner*, 21 Or. App. 362, 535 P.2d 109, 112 (Or. App. 1975) .")

(n32)Footnote 31. See *Securities Administrator v. College Assistance Plan*, 533 F. Supp. 118, 123 (D. Guam 1981) .

(n33)Footnote 32. See 15 U.S.C. § 77b(1). That section provides:

(1) The term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, pre-organization certificate or subscription, transferable share, investment contract, voting- trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, or, in general, any interest or instrument commonly known as a "security," or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

(n34)Footnote 33. *United States v. Austin*, 462 F.2d 724, 736 (10th Cir.) , cert. denied, 409 U.S. 1048, 93 S. Ct. 518 (1972) .

(n35)Footnote 34. *United States v. Austin*, 462 F.2d 724, 736 (10th Cir.) , cert. denied, 409 U.S. 1048, 93 S. Ct.

518 (1972) . See also *Thomas v. Texas*, 919 S.W.2d 427 (1988) (applying definition of indebtedness).

(n36)Footnote 35. Blue Sky L. Rep. (CCH) § 71,294 (opinion by the Alaska Division of Banking, Securities, Small Loans and Corporations).

See also Blue Sky L. Rep. (CCH) § 71,287 (Michigan applying both the *Howey* test and the risk capital test).

(n37)Footnote 36. Blue Sky L. Rep. (CCH) § 71,294 (applying definition promulgated in *United States v. Austin*).

(n38)Footnote 37. Blue Sky L. Rep. (CCH) § 71,294 (applying test promulgated in *SEC v. W.J. Howey Co.*).

(n39)Footnote 38. Blue Sky L. Rep. (CCH) § 71,294 (applying test promulgated in *Hawaii v. Hawaii Market Center, Inc.*).

(n40)Footnote 39. See Rohan & Furlong, *Timesharing and Consumer Protection: A Precis for Attorneys*, 10 William Mitchell L. Rev. 13, 30 (1984); Rohan and Reskin, *Real Estate Transactions: Condominium Law and Practice*, § 17C.01 (Matthew Bender). For a list of jurisdictions that require registration of time-sharing projects as securities, see Blue Sky L. Rep. (CCH) PP 71,294, 39,728, 1641.

(n41)Footnote 40. Hawaii, Illinois, South Carolina, South Dakota, Virginia and Wisconsin.

(n42)Footnote 41. Alabama, Maryland, Montana, South Dakota and Utah.

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25 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage
CHAPTER 13 Cooperatives, Condominiums, and Time-Sharing *

10A-13 Real Estate Brokerage Law and Practice § 13.03

§ 13.03 Rights of First Refusal May Restrict Seller's Ability to Transfer Unit

[1] Right of First Refusal Grants Board Degree of Control Over Ownership

By definition, a right of first refusal requires a unit owner, when he receives an offer to purchase (or lease) that unit, to give the other co-owners (generally, through the management group) the right to purchase (or lease) the unit or to furnish a purchaser (or lessee) on the same terms offered by the prospective purchaser or lessee. Thus, if the other co-owners do not, for whatever reason, desire to have the prospective purchaser or lessee as a neighbor, they may exclude him by purchasing (or leasing) the unit on the same terms. n1 This, of course, gives the control that the owners of condominium units demand.

Some state statutes contain provisions with respect to rights of first refusal which limit the application or exercise of such rights. n2

The control of occupancy of condominium units by the "right of first refusal" device may be understood by comparing and contrasting this device and problems encountered in its use with the same device in the ordinary stock-cooperative.

[2] Restrictions on Sales May Not Apply to Leases

Some state statutes mention only restrictions on the sale of a unit and make no mention of leasing. Such provisions do not "appear to preclude a unit owner from leasing his unit without first offering the unit to his neighbors." n3 Assuming that a condominium's documents impose restrictions on the leasing of a unit, it is unclear whether such restrictions would be invalidated by the broad property interests created by other state statutes, such as those providing that each unit and its companion common interest constitutes real estate with all rights incidental to real property separate from the other units. n4

[3] Validity of Restraints on Alienation May Depend on Form of Real Estate

[a] Rights of First Refusal Are Valid Restraints on Alienation in Cooperative Context

Right of first refusal provisions raise two questions:

(1) whether they constitute restraints on alienation and, thus, are unenforceable; and

(2) whether they involve the possibility of a violation of the rule against perpetuities. n5

The stock cooperative has no great difficulty in controlling the transfer of individual leaseholds by the imposition of a right of first refusal or preemptive option. n6 If an individual owner wishes to sell his apartment subject to such a provision, he must offer it to the corporation which has a specified period of time in which to decide whether to purchase the interest or not. If the corporation does not desire to exercise its option, then the individual tenant is generally free to sell to his prospective purchaser.

Such restraints are upheld in most states on the theory (more fully explained below) that the social value of the restraint outweighs the public-policy arguments against it. n7 Not all writers and courts agree, however, on whether a right of first refusal is such a restraint. It has been said alternatively that rights of first refusal:

- are direct restraints on alienation;
- are only partial restraints on alienation (on the theory that a unit owner is not restricted altogether from selling, but rather is only prevented from selling at a price that the other unit owners are willing to pay); and
- are not restraints on alienation at all (on the theory that the purpose of such restraints is not to prevent the sale of a unit, but rather to allow a particular person or persons to buy). n8

But whether or not viewed as restraints, or only as partial restraints, the law is quite well settled that such provisions are valid and enforceable in the cooperative area. Whether they will be held valid and enforceable in the condominium area is another matter.

[b] Rights of First Refusal on Condominium Sales May Be Invalid

Whether rights of first refusal are considered valid restraints on alienation in the condominium context is unclear. If the whole body of law pertaining to restraints on the alienation of a fee were applied to determine the legality of a condominium's right of first refusal, the restraint would probably be held invalid. Restraints on the alienation of a fee have, in general, been held invalid. In cases involving merely a lease (as in the cooperative area), such restraints are upheld if reasonable and applied even-handedly without reference to race, creed or color.

The following suggestion by one writer should form the backbone of decisions in the condominium field in the area of control by restraints on alienation by the device of right of first refusal:

[T]he reasonableness of a restraint ought not to depend on a mechanical distinction between freeholds and leaseholds. The proper function of a court is to balance the legitimate benefits to be derived from the restriction against the inconvenience, possible economic loss, and impairment of free choice that it is likely to cause. If the burden of providing an alternative sale were left on the unit owner after his customer had been turned down, a court would probably find on balance that the restraint was unreasonable. The balance is more nicely drawn when the venture is bound to match the offer that it refuses to sanction. Because this resembles the garden-variety right of first refusal, a court is likely to give approval, unless its demonstrable purpose be to facilitate discrimination. n9

At least one court has applied a balancing test to such restrictions. *Gale v. York Center Community Cooperative* n10 provides a useful analysis of the problem of rights of first refusals in the condominium context because, as one author noted, "the [cooperative housing] association [in *Gale*] was as close to a condominium as one could get without actual

division of fee title interests." n10.1 In *Gale*, seventy-two families were living in a subdivision, and all were members of a nonprofit corporation organized for the purpose of establishing and maintaining a cooperative-housing community. Legal title to the real estate was held by the association. The individual members built their own homes and obtained their own financing. Under the agreement, when a member wished to withdraw from the nonprofit corporation, he was required to give written notice to the board of directors. The board then had a specified period in which to exercise its options to purchase the membership at a price determined according to a method set forth in the agreement or one of the following would occur:

- If the option was not exercised within that period, the member had the right to sell the membership on the open market. If so sold, the association had the right to redeem the membership within a specified number of days.
- If this right was not exercised, the purchaser could then request and would receive membership within a specified number of days.

The agreement further provided that a member could, upon written request, obtain a deed from the association for the purpose of obtaining a loan secured by a mortgage on the premises he occupied. After obtaining the loan, the agreement required the member to reconvey the premises to the association.

In *Gale*, such conveyances were made to members who then refused to reconvey the premises to the association per the agreement. The association brought an action to compel reconveyance. The lower court directed the recalcitrant members to reconvey the premises to the association. The members appealed on the ground that the above-mentioned restrictions on their right to transfer their memberships constituted a violation of the rule against restrictions on alienation and were therefore void. In upholding the lower court decision that the restraints were not void as violating the rule against restraints on the alienation of real property, the court applied a balancing test, weighing the utility of the restraint with the injurious consequences that would flow from its enforcement and concluded that "the restrictions on transfer of a membership are reasonably necessary to the continued existence of the cooperative." n11 In evaluating restrictions on a seller's right to transfer interests, the court reasoned as follows:

[T]he crucial inquiry should be directed at the utility of the restraint as compared with the injurious consequences that will flow from its enforcement. If accepted social and economic considerations dictate that a partial restraint is reasonably necessary for their fulfillment, such a restraint should be sustained ... [T]he law of property ... is not a mathematical science but takes shape at the direction of social and economic forces in an ever changing society, and decisions should be made to turn on these considerations. n12

If the rule applied in the cooperative context is carried into the condominium area, rights of first refusal in condominium declarations will be upheld (if reasonable and non-discriminatory), and the dual aims of such provisions (to reduce the risk of financial interdependence by excluding the economically undesirable, and to promote the project's inner harmony by bringing together compatible members) will be achieved. n13 The *Gale* agreement in the condominium area would probably be held invalid, the association not being bound to purchase. As Professor Berger has stated,

if the burden of providing an alternative sale were left on the unit owner after his customer had been turned down, a court would probably find on balance that the restraint was unreasonable. The balance is more nicely drawn when the venture is bound to match the offer that it refuses to sanction. Because this resembles the garden-variety right of first refusal, a court is likely to give approval unless its demonstrable purpose be to facilitate discrimination. n14

[4] Broker Must Obtain Waiver of Right of First Refusal

The broker representing either the purchaser or the seller of a condominium or cooperative unit on resale is usually the one who must bear the burden of complying with the requirements of the project governing transfer of a unit owner's interest. In the case of a condominium, the burden is two-fold:

- (1) to secure a written waiver of the board of manager's "right of first refusal"; and
- (2) to secure a written statement from the board certifying either that the outgoing seller has paid all common charges for which he was responsible or, in the alternative, setting forth the amount the seller will owe the condominium as of the closing date.

The various state condominium statutes invariably mandate that the incoming purchaser take the unit in question subject to the lien of the seller's unpaid common charges if no "estoppel letter" has been obtained from the board of managers.

Processing the resale of a cooperative apartment requires many of the same steps as the resale of a condominium unit. The broker processing the application must take the action necessary to induce the cooperative housing board of directors not to veto the proposed sale (or sublease as the case may be). This usually requires submission of the following documents:

- the contract of sale between the parties;
- substantial personal and financial references of the purchaser; and
- an appearance before the cooperative's board of directors by the prospective purchaser for a personal interview.

An additional step that must be taken in processing the resale of a cooperative (that is not found in the case of a condominium resale) is that of inducing the board of directors to approve the "recognition agreement" submitted to it by the institutional lender that is financing the purchaser's acquisition of the apartment in question and that is taking back a security interest in the stock and lease.ⁿ¹⁵ Execution of a recognition agreement is necessary because of the nature of the interest being transferred in the sale of a cooperative unit. Unlike the condominium situation, where the lender is financing an interest in real property with the property itself serving as the security for the loan, a lender financing the purchase of shares in a cooperative corporation takes a security interest in the stock and proprietary lease subject to the board of directors' acceptance of the financing of the stock purchase.

FOOTNOTES:

(n1)Footnote 1. Except, of course, for purposes of unlawful discrimination. Irrespective of the desirability of having the closely confined community of a condominium consist of compatible people, the use of discriminatory practices to restrict occupancy on the basis of race, creed, color, religion, or national origin is against public policy and is generally unenforceable. Some of the condominium enabling acts contain express provisions to this effect. *See, e.g., N.Y. Real Prop. L. § 339-V(2)*, expressly authorizing condominium bylaws to contain

provisions governing the alienation, conveyance, sale, leasing, purchase, ownership, and occupancy of units, provided ... that the by-laws shall contain no provision restricting the alienation, conveyance, sale, leasing, purchase, ownership and occupancy of units because of race, creed, color or national origin.

In many of the states where condominium legislation exists but does not contain an express prohibition on discrimination, the same result will be obtained because of other legislation or case law prohibiting discrimination in the development and transfer of housing. It is clear in most of these jurisdictions that no discriminatory practices can be upheld, and it should make no difference that the practice is not expressed in writing but is simply followed. Similarly,

it would seem that even in those jurisdictions where there are no fair-practice housing statutes, the employment of a right of first refusal or other protective device to achieve discriminatory purposes would be unenforceable.

(n2)Footnote 2. *See, e.g.,*

Georgia: Ga. Code Ann. § 44-3-110 (providing that any right of first refusal or other restraint on free alienability of the condominium units is void unless the condominium instruments provide for the furnishing to any unit owner requesting the same a statement certifying the association's waiver of or refusal to exercise its right of first refusal).

Massachusetts: Mass. Gen. Laws Ann. ch. 183A, § 12(c) (providing that the condominium bylaws *may* provide for "a right of first refusal by the organization of unit owners in case of the sale of a unit ...").

District of Columbia: D.C. Code § 45-1855 (providing that any right of first refusal or other restraint on free alienability of the condominium units is void unless the condominium instruments provide for the furnishing to any unit owner requesting the same a statement certifying the association's waiver of or refusal to exercise its right of first refusal).

(n3)Footnote 3. Schwartz, *Condominium: A Hybrid Castle in the Sky*, 44 *B.U.L. Rev.* 137, 146 (1964).

(n4)Footnote 4. Schwartz, *Condominium: A Hybrid Castle in the Sky*, 44 *B.U.L. Rev.* 137, 146 (1964) (citing *Mass. Gen. Laws Ann. ch. 183A, § 3*, which provides in substance that each unit and its interest in the common elements shall constitute real estate and may be the subject of all of the rights incidental to real estate as if it were sole and entirely independent of the other apartments).

Provisions like *Mass. Gen. Laws Ann. ch. 183A, § 3*, are common, and thus this same question may be asked in the following states as well:

Alaska: Alaska Stat. §§ 34.08.010, 34.08.090.

Arizona: Ariz. Rev. Stat. §§ 33-1201--33-1270, 32-2197.

Arkansas: Ark. Code Ann. § 18-13-101 et seq.

California: Cal. Civ. Code § 783.

Colorado: Colo. Rev. Stat. § 38-33-102.

Connecticut: Conn. Gen. Stat. §§ 47-73, 47-74(a).

Florida: Fla. Stat. § 718.106(1), (3).

Hawaii: Haw. Rev. Stat. § 514A-4.

Indiana: Ind. Code §§ 32-1-6-2(c), 32-1-6-4, 32-1-6-5.

Iowa: Iowa Code § 499B.10.

Kansas: Kan. Stat. Ann. §§ 58-3104, 58-3105.

Kentucky: Ky. Rev. Stat. Ann. §§ 381.820, 381.830.

Maryland: Md. Code Ann. Real Prop. § 11-106.

Michigan: Mich. Comp. Laws §§ 559.101--559.275.

Minnesota: Minn. Stat. §§ 515.04, 515.05.

Mississippi: Miss. Code Ann. § 89-9-3.

Missouri: Mo. Rev. Stat. § 448.050.

Nebraska: Neb. Rev. Stat. §§ 76-804, 76-806.

Nevada: Nev. Rev. Stat. §§ 117.010(2), 117.040(4).

New Jersey: N.J. Stat. Ann. §§ 46:8A-4, 46A-6.

New York: N.Y. Real Prop. L. §§ 339-c(15), 339-g, 339-h.

North Carolina: N.C. Gen. Stat. § 47A-5.

Ohio: Ohio Rev. Code Ann. §§ 5311.01(1), 5311.03(a), 5311.03(B).

Oklahoma: Okla. Stat. tit. 60, §§ 503(b), 504.

Rhode Island: R.I. Gen. Laws §§ 34-36-3(8), 34-36-4, 34-36-6.

South Carolina: S.C. Code Ann. §§ 27-31-40, 27-31-60.

Utah: Utah Code Ann. §§ 57-8-3(8), 57-8-4, 57-8-6.

Virginia: Va. Code Ann. §§ 55-79.4, 55-79.6.

Washington: Wash. Rev. Code §§ 64.32.030, 64.32.040.

Wisconsin: Wis. Stat. Ann. §§ 703.04, 703.05.

(n5)Footnote 5. *See* Rohan & Reskin, *Condominium Law & Practice* § 10.03[2][b] (Matthew Bender).

(n6)Footnote 6. The preemptive right in the cooperative area should also apply to the tenant's stock in the corporation. Since an absolute restraint on alienation of the stock may be void as to creditors, the preemptive option in event of levy by creditors may be the only effective way of preserving the entity. *See* Note, 61 *Harv. L. Rev.* 1407, 1419 (1948), and cases cited therein; McCullough, *Cooperative Apartments in Illinois*, 26 *Chi.-Kent L. Rev.* 303, 313, n.77 (1948) (stating the option to repurchase the stock would appear valid in Illinois provided it was set forth in the stock certificate, but that an absolute restriction against the transfer of stock without prior consent would be invalid in Illinois). *See also* N.Y. *Coop. Corp. L. § 14(h), (i)*, (expressly authorizing such a provision).

(n7)Footnote 7. See Note, *Condominium-- A Comparative Analysis of Condominium Statutes*, 13 *De Paul L. Rev.* 111, 117 (1963), and citations therein.

(n8)Footnote 8. See Note, *Condominium--A Comparative Analysis of Condominium Statutes*, 13 *DePaul L. Rev.* 111, 117 (1963); Ramsey, *Condominium: The New Look in Co-ops*, 9 *Prac. Law.* 21, 28 (Mar. 1963).

(n9)Footnote 9. Berger, *Condominium: Shelter on a Statutory Foundation*, 63 *Colum. L. Rev.* 987, 1019 (1963).

(n10)Footnote 10. 21 *Ill. 2d* 86, 171 *N.E.2d* 30 (1961) (involving a cooperative peculiarly like a condominium in many respects).

(n11)Footnote 10.1. Hershman, *Operating Problems*, The Practical Problems of Condominium 42 (Ass'n of the Bd. of the City of N.Y. 1964).

(n12)Footnote 11. *Gale v. York Center Community Cooperative*, 21 *Ill. 2d* 86, 171 *N.E.2d* 30, 33-34 (1961) .

(n13)Footnote 12. *Gale v. York Center Community Cooperative*, 21 *Ill. 2d* 86, 171 *N.E.2d* 30, 33-34 (1961) .

The court further stated that:

[E]nforcement of the restraints in question would not appear to produce injurious consequences to the public. They would not tend to keep the property in the same family and concentrate wealth (reasons often given for the rule), but would seem to some extent to prevent retention of one family. The member is not prevented from liquidating his interest and therefore consuming the property (another reason often given for the rule being that such restraints would prevent such liquidation and consumption). Creditors are not prevented from satisfying their claims (another reason often given for the rule). Members are encouraged to improve their homes (another reason often given for the rule is that restraints on alienation may deter the improvement of the property) and the value of any improvement will be realized when they liquidate their interest. Cooperative ownership of residential property in this country seems to be increasing in popularity, and the extent to which these partial restraints would keep property out of commerce is entirely problematical.

Id.

The reasoning applied to cooperatives in the above quotation is equally applicable to right of first refusal provisions in condominium documents.

(n14)Footnote 13. See Berger, *Condominium: Shelter on a Statutory Foundation*, 63 *Colum. L. Rev.* 987, 1018 (1963).

(n15)Footnote 14. Berger, *Condominium: Shelter on a Statutory Foundation*, 63 *Colum. L. Rev.* 987, 1019 (1963).

(n16)Footnote 15. A "recognition agreement" is essentially an agreement between the lender and owner of the cooperative apartment building (the board of directors acting on behalf of the other cooperators designated the lessor in the agreement) under which the lessor recognizes that the loan to the purchaser (the lessee) is secured by a mortgage on the proprietary lease and by a security interest in the lease and the stock in the cooperative corporation. The recognition agreement provides for the following:

- the lessor's consent to the mortgage and security interest taken by the lender;
- the lessor's consent not to recognize any further mortgage on or assignment of the lease or pledge of

the stock;

- the lessor's promise not to terminate the lease;
- the lender's rights upon lease default or default on the loan;
- the lender's option to require maintenance payments through the lender;
- the lender's right to surrender or assign the proprietary lease and stock; and
- the lender's liability to the lessor arising out of claims by the lessee.

For illustrative litigation in this area, see:

Florida: Backus v. Smith, 364 So. 2d 786 (Fla. 1st DCA 1978) ; *Buckley Towers Condominium, Inc. v. Buchwald*, 356 So. 2d 1306 (Fla. 3d DCA 1978) .

Georgia: Hoover & Morris Dev. Co. v. Mayfield, 233 Ga. 593, 212 S.E.2d 778 (1959) .

Washington: Felice v. Clausen, 22 Wn. App. 608, 590 P.2d 1283 (1979) .

Wisconsin: LeFebvre v. Osterndorf, 87 Wis. 2d 525, 275 N.W.2d 154 (1979) .

* This chapter has been revised by Roslyn K. Myers, Esq., B.A., University of California, Berkeley; J.D., Fordham University School of Law; a member of the New York, Washington D.C., Connecticut, Minnesota, and Wisconsin bars. Additional updates were contributed by Sandra Bullington, Esq. It was previously revised by Charles J. Jacobus, Esq., a partner in the firm of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas.



26 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13 Cooperatives, Condominiums, and Time-Sharing *

10A-13 Real Estate Brokerage Law and Practice § 13.04

§ 13.04 Sample Right of First Refusal Provisions

Following are examples of right of first refusal provisions. The first is adapted from the declaration of a Florida condominium.

Restriction on conveyancing. In order to assure a community of congenial residents and thus protect the value of the units in this condominium project, the sale, leasing, and mortgaging of units shall be subject to the following provisions until this declaration is terminated or until the building is no longer tenatable, whichever occurs first.

(1) No apartment owner may dispose of a unit or any interest therein by sale or by lease without approval of the board of governors of the association of unit owners, which approval shall be obtained in the manner provided in this subsection of the condominium Declaration.

(a) A unit owner intending to make a sale or a lease of his apartment or of any interest therein shall give notice to the owner's association of such intention together with:

- (i) the name and address of the intended purchaser or lessee;
- (ii) such other information as the association reasonably may require; and
- (iii) the terms of the proposed transaction.

The giving of such notice shall constitute a warranty and representation by the unit owner to the owner's association, and any purchaser or lessee produced by the association as provided in this subsection of the condominium Declaration, that the unit owner believes the proposal to be bona fide in all respects.

(b) Within [insert number of days] days after receipt of such notice, the board of governors of the association shall give notice to the person desiring to sell or lease his unit of either of the board's decision to either:

(i) approve the transaction or

(ii) furnish a purchaser or lessee approved by the association who will accept the transaction upon terms as favorable to the seller as the terms stated in the notice, except that a purchaser or lessee furnished by the association may have not less than *[insert number of days]* days subsequent to the date of approval within which to close the transaction.

(c) The approval of the board of governors of the association shall be in recordable form, signed by any *[insert number]* members of the board, and shall be delivered to the purchaser or lessee.

(d) The failure of the board to act within such *[insert number of days]*-day period shall be deemed to constitute approval, following which, nevertheless, the association shall prepare and deliver written approval in recordable form, as aforesaid. The unit owner giving such notice shall be bound to consummate the transaction with such purchaser or lessee as may be approved and furnished by the association. n1

The following covenants and restrictions on the sale, leasing, or other alienation of a unit in a condominium--another example of this type of provision from a residential condominium--are adapted from Dunbar's Fountain View Condominium Development in Chicago.

Covenants and Restrictions as to Sale, Leasing and Other Alienation

(1) **Sale or Lease.** (a) Any owner who wishes to sell or lease his unit (or any lessee of any unit wishing to assign or sublease such unit) to any person not related by blood or marriage to the owner shall give to the association of apartment owners (hereinafter called the association) no less than *[insert number of days]* days' prior written notice of the terms of any contemplated sale or lease, together with the name and address of the proposed purchaser or lessee.

(b) The association shall at all times have the first right and option to purchase or lease such unit ownership upon the same terms, which option shall be exercisable for a period of *[insert number of days]* days following the date of receipt of such notice.

(c) If said option is not exercised by the association within said *[insert number of days]* days, the owner (or lessee) may, at the expiration of said period and at any time within *[insert number of days]* days after the expiration of said period, contract to sell or lease (or sublease or assign) such unit ownership to the proposed purchaser or lessee named in such notice upon the terms specified therein.

(2) **Gift.** (a) Any owner who wishes to make a gift of his unit ownership or any interest therein to any person or persons who would not be heirs at law of the owner under the laws of intestate succession of this state were he or she to die within *[insert number of days]* days prior to the contemplated date of such gift, shall give to the association not less than *[insert number of days]* days' written notice of his or her intent to make such gift prior to the contemplated date thereof, together with the name and address of the intended donee and the contemplated date of said gift.

(b) The association shall at all times have the first right and option to purchase such unit ownership or interest therein for cash at fair market value to be determined by arbitration as herein provided, which option shall be exercisable until the date of expiration as provided herein.

(c)(i) Within *[insert number of days]* days after receipt of said written notice by the association, the association and the owner desiring to make such gift shall each appoint a qualified real estate appraiser to act as arbitrators.

(ii) The two arbitrators so appointed shall, within *[insert number of days]* days after their appointment, appoint another qualified real estate appraiser to act as the third arbitrator.

(iii) Within *[insert number of days]* days after the appointment of said arbitrator, the three arbitrators

shall determine, by majority vote, the fair market value of the unit ownership to interest therein which the owner contemplates conveying by gift, and shall thereupon give written notice of such determination to the owner and the association.

(iv) The association's option to purchase the unit ownership or interest therein shall expire [*insert number of days*] days after the date of receipt by it of such notice.

(3) **Devise.** (a) In the event any owner dies leaving a will devising his unit or any interest therein to any person or persons not heirs at law or his descendants under the laws of intestate succession of this state, and said will is admitted to probate, the association shall have an option (to be exercised in the manner hereinafter set forth) to purchase said unit ownership or interest therein either from the devisee or devisees thereof named in said will or, if a power of sale is conferred by said will upon the personal representative named therein, from the personal representative acting pursuant to said power, for cash at fair market value which is to be determined by arbitration.

(b) Within [*insert number of days*] days after the appointment of a personal representative for the state of the deceased owner, the association shall appoint a qualified real estate appraiser to act as an arbitrator, and shall thereupon give written notice of such appointment to the said devisee or devisees or personal representative, as the case may be.

(c) (i) Within [*insert number of days*] days thereafter said devisee or devisees, or personal representative, as the case may be, shall appoint a qualified real estate appraiser to act as an arbitrator.

(ii) Within [*insert number of days*] days after the appointment of said arbitrator, the two so appointed shall appoint another qualified real estate appraiser to act as the third arbitrator.

(iii) Within [*insert number of days*] days thereafter, the three arbitrators shall determine, by majority vote, the fair market value of the unit or interest therein devised by the deceased owner, and shall thereupon give written notice of such determination to the association and said devisee or devisees, or personal representative, as the case may be.

(iv) The association's right to purchase the unit or interest therein at the price determined by the three arbitrators shall expire [*insert number of days*] days after the date of receipt by it of such notice if the personal representative of the deceased owner is empowered to sell, and shall expire [*insert number of months*] months after the appointment of a personal representative who is not so empowered to sell.

(v) The association shall be deemed to have exercised its option if it tenders the required sum of money to said devisee or devisees or to said personal representative, as the case may be, within the said option periods.

(vi) Nothing herein contained shall be deemed to restrict the right of the association or its authorized representative, pursuant to authority given to the association by the owner as hereinafter provided, to bid at any sale of the unit or interest therein or any deceased owner which is held pursuant to an order or direction of the court having jurisdiction over that portion of the deceased owner's estate which contains his unit or interest therein.

(4) **Consent of Voting Members.** The association shall not exercise any option set forth in this Agreement to purchase any unit or interest therein without the prior written consent of [*insert percentage*] percent of the voting members. The association may bid to purchase at any sale of a unit or any interest therein of any deceased owner which is held pursuant to an order or direction of a court upon the prior written consent of [*insert percentage*] percent of the voting members of the association, which consent shall set forth a maximum price which the association is authorized to bid and pay for said unit or interest therein.

(5) **Release or Waiver of Options.** Upon the written consent of [*insert number or percentage*] of the members of the association any of the options contained in this article may be released or waived and the unit or any interest therein which is subject to an option set forth in this article may be sold, conveyed, leased, given, or devised free and clear of the provisions of this article.

(6) **Proof of Termination of Option.** A certificate executed and acknowledged by the acting secretary of the association stating that the provisions of this article as set forth in this Agreement have been met by an owner, or duly waived by the association, and that the rights of the association hereunder have terminated, shall be conclusive upon the association and the owners in favor of all persons who rely thereon in good faith, and such certificate shall be furnished to any owner who has in fact complied with the provisions of this article or in respect to whom the provisions of this article have been waived, upon request.

FOOTNOTES:

(n1)Footnote 1. These restrictions on conveyancing are adapted from the documents of 400 South Ocean Boulevard, Palm Beach, Fla.

* This chapter has been revised by Roslyn K. Myers, Esq., B.A., University of California, Berkeley; J.D., Fordham University School of Law; a member of the New York, Washington D.C., Connecticut, Minnesota, and Wisconsin bars. Additional updates were contributed by Sandra Bullington, Esq. It was previously revised by Charles J. Jacobus, Esq., a partner in the firm of Jacobus, Boltz & Melamed, L.L.P., Houston, Texas.



27 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13A Leases (Including Leases with Options and Rights of First Refusal) *

10A-13A Real Estate Brokerage Law and Practice 13A.syn

§ 13A.syn Synopsis to Chapter 13A: Leases (Including Leases with Options and Rights of First Refusal) *

§ 13A.01 Unique Characteristics of Lease Transactions

§ 13A.02 Broker's License Requirement

§ 13A.03 Brokers' Roles and Duties Toward Client

[1] Fiduciary Duties of Fair Dealing and Best Efforts

[2] Representing the Lessor

[a] Identifying the Lessor's Goals

[b] Structuring the Lease Agreement: Basic Considerations

[3] Representing the Lessee

[a] Broker's Role and Initial Inquiries

[b] Special Considerations

[i] Geographic Factors.

[ii] Options for Future Needs.

[iii] Obtaining a Guarantor.

§ 13A.04 Compensation Is Based on Contract Provisions

[1] Application of General Contract Principles

[2] Protection Provisions

[3] Methods of Payment

[4] Refunding Commission Payments

[5] Additional Compensation Under Renewal or Purchase Options

[a] Broker Must Monitor as to Whether Lessee Exercises Options

[b] Courts Divided on Valid Exercise of Renewal Clause

[c] Renewal Option Implied Where Same Parties Broker New Lease

[d] The Obligation to Pay Commissions May Survive a Transfer of the Premises

[6] Compensation Based on Quantum Meruit

[7] Careful and Inclusive Drafting

§ 13A.05 Default

[1] Remedies Generally

[2] Lessor's Default

[a] Refusal to Pay Commission

[b] Refusal to Sign Contract

[c] Exercise of Renewal or Lease Option

[d] Possible Fraud Claim

[3] Lessee's Default

[a] No Compensation Prior to Taking Possession

[b] Agreement Dictates Methods of Payment of Commission

[c] When Agreement Is Silent on Commission

[4] Broker's Default

§ 13A.06 Sample Commission Provisions for Brokerage Services Agreements

[1] Flat Fee

[2] Percentage of Net Rental

[3] Percentage of Rent Collected

[4] Renewal Option

[5] Purchase Option/Right of First Refusal

§ 13A.07 Illustrative Form: Brokerage Agreement for Office Lease

§ 13A.08 Illustrative Form: Rental Inspection

[1] Use of Rental Inspection Form

[2] Form

§ 13A.09 Illustrative Form: Exclusive Subleasing Agreement



28 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13A Leases (Including Leases with Options and Rights of First Refusal) *

10A-13A Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 13A addresses a real estate broker's involvement in lease transactions. While a broker's procurement of a tenant is similar to finding a purchaser, there are differences between these transactions (§ 13A.01). Nearly all jurisdictions require that those who for compensation act on behalf of a landlord in renting or leasing real property must be licensed (§ 13A.02).

Chapter 13A discusses the duties that real estate brokers owe to their leasing clients as well as the role brokers play in lease transactions (§ 13A.03). The chapter also discusses the broker's compensation for participating in a lease transaction (§ 13A.04) and addresses the dispute that arises when a client refuses to pay the broker's compensation or otherwise defaults on the agreement with the broker (§ 13A.05). Sample commission provisions (§ 13A.06), an illustrative brokerage agreement for an office lease (§ 13A.07), and an illustrative rental inspection form (§ 13A.08) are included in this chapter.

For additional discussion of these and other issues, see the following other publications:

- Condominium Law and Practice, Ch. 44, *Use Restrictions and Occupancy Control* (Matthew Bender).
- Current Leasing Law and Techniques (Matthew Bender).
- Real Estate Financing, Ch. 7, *Drafting Ground and Space Leases to Promote Mortgageability*, and Ch. 7A, *Mortgageability of Ground and Space Leases* (Matthew Bender).



29 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13A Leases (Including Leases with Options and Rights of First Refusal) *

10A-13A Real Estate Brokerage Law and Practice § 13A.01

§ 13A.01 Unique Characteristics of Lease Transactions

Brokers involved in sale/purchase transactions have similar duties and responsibilities as those involved in lease transactions. However, lease transactions have their own unique characteristics and provisions that complicate the brokerage relationship. Sale/purchase transactions usually reach a certain point when compensation is owed the broker. This typically occurs at closing. Even when the transaction does not close, there is commonly some other terminating event that triggers the right to receive compensation or aborts the transaction with no right to compensation accruing.

In a lease transaction, on the other hand, timing issues are less clear. Compensation may be earned upon the execution of a lease and the occupancy of the property, and also upon future events, depending upon the lease document. The brokerage agreement may provide for additional compensation in the event that a renewal option, purchase option or right of first refusal contained in the lease is exercised by the lessee. The brokerage agreement may provide for an adjustment to compensation in the event the lessee adds or surrenders space. Thus, the broker must continuously monitor the transaction long after the initial lease is executed. These complicating factors make it even more imperative that the brokerage services agreement in a lease transaction be complete, anticipating all potential situations and providing a means for ongoing monitoring and verification.

* This chapter was written by Gregory P. Melnyk, Esq., Chicago, IL. Additional updates were contributed by Sandra Bullington, Esq., of Pleasant Valley, Virginia.



30 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13A Leases (Including Leases with Options and Rights of First Refusal) *

10A-13A Real Estate Brokerage Law and Practice § 13A.02

§ 13A.02 Broker's License Requirement

With the exception of Vermont, n1 all states and the District of Columbia require any person or entity who acts for or on behalf of another and for or in the expectation of receiving compensation with regard to the advertising, offer or negotiation of the rental or lease of real estate be licensed by the appropriate state authority. n2 Some states do provide an exemption from this general rule for individuals who are employed by the owner of the real estate and who rent, offer or negotiate the rental of that real estate as part of their usual and customary employment duties. n3

Concession agreements are generally construed to create only licenses rather than an interest in land, and thus those who negotiate such agreements typically do not need to be licensed as a real estate broker. It has been held that the negotiation of a license was not the negotiation of a listing, sale, exchange, purchase, rental, or leasing of real estate. n4

FOOTNOTES:

(n1)Footnote 1. *Vt. Stat. Ann. tit. 26 § 2211(b)(8)*.

(n2)Footnote 2. *See ch.6, Licensing of Brokers and Salespersons, § 6.07 infra* .

(n3)Footnote 3. *See, e.g.:*

Florida: Exemption for "[a]ny individual, corporation, partnership, trust, joint venture, or other entity which sells, exchanges or leases its own real property; however, this exemption shall not be available if and to the extent that an agent, employee, or independent contractor paid a commission or other compensation strictly on a transactional basis is employed to make sales, exchanges, or leases to or with customers in the ordinary course of an owner's business of selling, exchanging, or leasing real property to the public." *Fla. Stat. Ann. § 475.011(2)*.

Georgia: Exemption for "[a]ny person employed on a full-time basis by the owner of property for the purpose of providing property management services, selling, buying, leasing, managing, auctioning or otherwise dealing with such property." *Ga. Code Ann. § 43-40-29(a)(8)*.

Maine: "Real estate brokerage does not include ...[t]ransactions conducted by any person who is the owner or lessor of the real estate, or to their regular employees with regard to the employers' real estate,

provided that ... [t]he real estate transaction services rendered by the employee are performed as an incident to the usual duties performed for the employer." *Me. Rev. Stat. Ann. tit. 32 § 13002(1)(A)*.

Texas: Exemption for "an owner or his employee in renting or leasing his own real estate whether improved or unimproved." *Tex. Rev. Civ. Stat. Ann. Art. art. 6573(a) § 3(9)*.

(n4)Footnote 4. *See H.E.Y. Trust v. Popcorn Express Co., Inc.*, 35 S.W.3d 55, 58-59 (*Tex. App.* 2000) .

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31 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13A Leases (Including Leases with Options and Rights of First Refusal) *

10A-13A Real Estate Brokerage Law and Practice § 13A.03

§ 13A.03 Brokers' Roles and Duties Toward Client

[1] Fiduciary Duties of Fair Dealing and Best Efforts

Commercial leasing is an area in which real estate brokers have traditionally taken an aggressive role, representing both lessors and lessees. As in any brokerage transaction, the broker serves a central part by bringing the parties together, negotiating a mutually satisfactory agreement and bringing the entire transaction to closure.

Over time, the dollar value of lease transactions has increased and continues to escalate; the types of entities involved have changed and continue to evolve to reflect the development of new ways to maximize tax benefits while minimizing liability exposure. Nonetheless, the broker's role and basic responsibilities to the parties remain unchanged. A lessor has a property that the lessee wants to use and is willing to pay for. The broker can provide a valuable service by bringing these parties together and negotiating the details of the arrangement.

The broker's function is to work in its client's best interest in carrying out the duties assigned to the broker in the brokerage services agreement. The broker also owes its client the traditional duties of loyalty, confidentiality, obedience, disclosure, reasonable care and diligence and accounting. The broker also has a responsibility of fair dealing toward the non-client party. The broker must use its best efforts to accomplish its client's goals under the terms most favorable to the client.

[2] Representing the Lessor

[a] Identifying the Lessor's Goals

The broker's duty towards the lessor is to use his or her best efforts to procure a ready and willing lessee to enter into a lease agreement in accordance with the terms specified by or acceptable to the lessor. In order to do this, the broker must first identify exactly who the lessor is. The owner may be organized as any one of a number of entity types. The broker must ascertain who the legal owner of the property is and who has the authority to execute agreements on behalf of that entity.

The next step is to identify the lessor's goals for the transaction. One of the major considerations is what kind of lessee the lessor is interested in. Depending upon the lessor's level of sophistication, the broker may have to help the lessor

formulate these goals. The broker must be ready to educate the lessor with regard to the current market situation and conditions. The broker may have to enumerate various options available to structure an agreement that maximizes the benefits to the lessor.

[b] Structuring the Lease Agreement: Basic Considerations

The leasing broker structures the basic outline of the lease agreement. Basic areas that must be addressed by brokers before they can begin to do their jobs and professionally represent their clients in a lease transaction include:

- length of term the lessor wants to be tied to and what amount of net rent the lessor wants to realistically receive
- whether to include additional charges, such as real estate tax, insurance or common area maintenance kickers
- acceptability of provisions such as renewal or purchase options and rights of first refusal
- the lessor's willingness to subdivide the space and the smallest area the lessor is willing to lease to a single lessee
- what allowances the lessor is willing to extend and under what circumstances
- whether the lessor has any special requirements such as personal guarantees when certain types of entities are used

Additionally, the broker must identify any restrictions on the use of space. These restrictions may be due to covenants and restrictions of record affecting the real estate, zoning or other municipal regulation or the provisions of other leases the lessor has entered into.

The foregoing information is pivotal in enabling brokers to carry out their duties. However, brokers must keep in mind that during the initial phase of the relationship they are acting as information gatherers and providers, not legal counsel. In most jurisdictions, brokers may not dispense legal advice.

[3] Representing the Lessee

[a] Broker's Role and Initial Inquiries

The function of a broker representing the lessee in a lease transaction is not fundamentally different from representing a lessor. The broker must use his best efforts to identify space acceptable to the lessee and to negotiate a lease agreement in accordance with terms specified by or acceptable to the lessee. The lessee's broker must identify how the lessee is organized and who has the authority to execute agreements on behalf of that entity. The broker must also clearly identify the lessee's goals. The broker should be ready to assist the lessee by identifying relevant market conditions and other factors that the lessee can utilize as information and guidance in the lease negotiating process in order to maximize its benefits.

[b] Special Considerations

Geographic factors, parking and space issues, and provisions for future needs are important issues that are of particular importance to the lessee's broker. The lessee's broker should identify and determine the provisions that will be of importance to the lessee in the lease agreement.

[i] Geographic Factors. The broker must determine the geographic factors that are important to the lessee, such as availability and proximity to transportation services (both commuter and freight), and accessibility for employees and customers/clients. Other relevant basics include the amount of space desired, whether the client is interested in completed space or is willing to undergo a buildout, the type of space required, the design of the desired space, the term of the agreement and the gross rental the lessee is realistically willing to pay.

[ii] Options for Future Needs. Other provisions that the lessee may want to incorporate for future flexibility include an option to renew in order to lock in possible future costs and to guaranty future stability without obligating itself to a present long-term commitment. The lessee may also want a purchase option, or perhaps a right of first refusal, to ensure the possibility of future stability.

The lessee may want to provide for future needs by negotiating for anticipated or potential future space requirements. The lessee may want to incorporate provisions into the lease that grant it the right and privilege to add additional space or surrender occupied space at some unknown time during the term of the lease. This may require an additional right to relocate other tenants in the lessor's property to enable the lessee's contiguous expansion or provide for the lessee's relocation so that each party may maximize the efficient use of the property. If this right is procured, the lease agreement must also provide for who will pay the costs associated with any exercised relocation right.

A lessee's broker must identify the various allowances the lessee expects, whether for buildout of the existing space or relocation and moving allowances in the event a relocation right is exercised by either party.

[iii] Obtaining a Guarantor. Depending on the identity of the lessee, the lessor may require a personal guaranty. The broker must determine if the notion of a personal guaranty is acceptable to the lessee, and if so, who will act as guarantor. Any limitations to the guaranty, such as a dollar limit or time limits different from the lease term must also be formalized.

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32 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13A Leases (Including Leases with Options and Rights of First Refusal) *

10A-13A Real Estate Brokerage Law and Practice § 13A.04

§ 13A.04 Compensation Is Based on Contract Provisions

[1] Application of General Contract Principles

A real estate broker's right to compensation is based on contract, n1 namely the brokerage services agreement. The general provisions of contract law apply to real estate brokerage services agreements. Generally, a commercial real estate broker who finds a lessee ready, willing and able to lease the subject premises on the owner's terms is entitled to a commission pursuant to the provisions of the valid listing agreement. n1.1

The broker can only demand compensation from the party with whom he or she has a contractual relationship. n2 That compensation is earned only when the broker fulfills all of his or her duties under the terms of the real estate brokerage services agreement. n3 As a general rule, a broker earns a commission when he or she procures a lessee or lessor who is ready and willing to enter into a lease. n4 The contract can be oral or written, express or implied. n5 The contract must comply with the provisions of the statute of frauds if relevant in a particular jurisdiction. n5.1 The individual fact situation will determine if a contract is implied from the action of the parties. n6

It is also possible for the terms of the broker's compensation to be incorporated in the lease itself through a provision or incorporation of the brokerage agreement as an exhibit attached to the lease. n6.1 In one case where the lease contained a provision addressing the broker's compensation and the brokerage agreement was an exhibit to the lease, the parties failed to sign the brokerage agreement. When the landlord refused to pay the balance due on the broker's commission, the court found that all parties to the unexecuted brokerage agreement had assented to its terms and the brokerage agreement was a binding contract under which the broker could recover its unpaid commission. n6.2

The terms of the broker's compensation should be clearly stated. However, in *Vision Realty, Inc. v. Kohler*, n6.3 the listing agreement provided that the broker was due a 6% commission on the lease, but the agreement did not state the rent amount sought for the property. The broker and owner had verbally discussed what the property's rental rate would be. The property owner refused to pay the broker's commission on this ground when a tenant was procured through the broker's efforts. The court found that the essential terms in a real estate listing agreement include an adequate description of the property sufficient for identification and a reasonably certain expression of the amount of a commission to be paid. The agreement at issue was the listing agreement, not the lease. The failure to include the lease terms in the listing agreement did not affect the validity or the enforceability of the listing agreement.

If an ensuing lease agreement contradicts the brokerage agreement with respect to the broker's commission by decreasing or eliminating the broker's compensation, the owner will bear the burden of proving that the brokerage agreement was modified or extinguished by the subsequent lease agreement. n6.4 This will be difficult to prove unless the broker or the broker's authorized agent agreed to such a modification. The property owner should not assume that any agent employed by the broker has such authority.

It is crucial that the agreement between the broker and the broker's principal clearly indicate when the broker's commission is payable. The broker's preference will be to be paid as soon as possible. Ideally, the broker wants the commission to be paid in full upon execution of the lease. The argument for this position is that the broker has been hired to locate a tenant and not to ensure the tenant's performance of its lease obligations. If the tenant subsequently fails to perform, the landlord can pursue its legal remedies for breach of contract. However, the landlord would prefer to pay the commission after the tenant has taken occupancy of the premises and started paying rent. n6.5

Problems can arise if the lessor intends to pay the commission on a monthly basis as the rent is received and the lessee stops paying rent. In such a case, the broker often wants his or her commission even if the lessee has defaulted. Depending upon the facts of the case, the broker may still be entitled to receive his or her monthly commission payment. In *Hildebrandt v. Anderson*, n6.6 the lessor and lessee had entered into an earnest money agreement. The lessor and lessee subsequently executed a lease and the lessee took possession. At this time the lessor signed a promissory note as payment for the broker's commission and the lessor also executed a rent assignment assigning to the broker the amount due on the note payment. This note called for monthly payments. When the lessee subsequently stopped paying rent, the lessor stopped making the monthly payments due to the broker on the promissory note. The lessor argued that the commission was not payable until the rent had been paid. The court rejected this argument, stating that the broker earned his commission when the lessor-lessee transaction closed. The earnest money agreement was analogous to a contract to purchase, earnest money, or escrow agreement in a sales transaction. The earnest money agreement was completed by execution of the lease, and broker was entitled to payment in full at that time. The recital in the rent assignment that the note was issued "as and for broker's fee due and owing" correctly stated the status of the debt for which the note was issued as payment. Since the claim underlying the promissory note was a valid claim, the broker was entitled to continue receiving payments on the note despite the fact that the lessor had defaulted. n6.7

However, there are many lease transactions that do not fit neatly into the general rule. There are many circumstances in which compensation may not be due in its entirety when a lease transaction is executed by the parties or when additional commission payments are due the broker long after the original lease has been executed. For these instances, a careful drafting of the brokerage services agreement is invaluable.

[2] Protection Provisions

The brokerage services agreement must provide for notification and verification as well as procedures in the event of default.

For the protection of the parties, the contract must state how long the brokerage services agreement is in effect and specify if there are any protection periods. The protection period provides for payment of compensation to the broker if the lessor/lessee reaches an agreement with a party introduced to the lessor/lessee or the property by the broker during the term of the agreement but the transaction is not entered into by the parties until after the brokerage services agreement expires.

The agreement should also contain any exclusions from the brokerage services agreement. The exclusions provide protection for the lessor/lessee from paying compensation to a broker if one party enters into an agreement with a party or for property they originally had dealings with prior to entering into the brokerage services agreement.

[3] Methods of Payment

Compensation may be calculated on the stated net rent, a factor of rent received, adjustments for changes in rental rate during the term of the lease and additional amounts owed upon execution of options. The method of payment of compensation for procuring a lease may be in the form of a lump sum payable upon execution of the lease, or as a structured payment plan at specified times throughout the term of the lease. Even a lump sum payment can become more complicated depending upon the wording in the brokerage services agreement. n7

[4] Refunding Commission Payments

Depending on the agreement, the broker may have to refund part of a commission payment in the event of early termination of the lease. n8 Refunds may be required where compensation is based on the amounts paid by the lessee and the commission was paid in a lump sum when the lease was executed. The brokerage services agreement should contain a provision specifying what steps should be taken in the event of an early termination of the lease. No refund may be necessary if the commission were based instead on the amount payable by the lessee.

[5] Additional Compensation Under Renewal or Purchase Options**[a] Broker Must Monitor as to Whether Lessee Exercises Options**

Depending upon the brokerage services agreement, the broker may be entitled to receive additional compensation at various times in the future. If the lease contains renewal or purchase options, a right of first refusal or the right to add space the broker may be entitled to additional commission payments if the lessee exercises those options. The parties' brokerage agreement will determine whether a commission is due on the sale of a purchase option. The fact that there is a commission due on a sale of the premises does not mean that there is a commission due on the sale of a purchase option unless so provided for by the parties' agreement. n8.1

This potential future right to compensation requires that the broker continue to monitor the lease relationship possibly for years after the initial commission payment was received. If the lease contains a provision for early termination or surrender of space, the broker may be faced with the problem of refunding a commission payment years after it is spent.

[b] Courts Divided on Valid Exercise of Renewal Clause

Courts are divided over what constitutes a valid exercise of a renewal clause in a lease.

Some courts hold that if the same parties continue a lessor/lessee relationship originally brought about through the efforts of a broker, that broker is entitled to additional commission payments provided for in the brokerage services agreement. It is a reflection of the intention of the parties. n9 Other courts have strictly construed the language of both the lease and the brokerage services agreement and have denied any additional compensation where the parties negotiated a new lease instead of exercising a renewal clause. n10 And some courts hold that a broker is not entitled to a commission on a lease renewal or extension unless express language provides such a right. n10.1

Amerus Property Brokers v. Hicklin n11 represents a moderate approach. The listing agreement in that case provided in pertinent part that the landlord would pay the broker "a five percent (5%) commission on the gross lease (including negotiated renewals, exercised options or extensions by the Tenant) or one months rent--whichever is greater, payable when the Lease is executed." The plaintiff broker had located a tenant who executed a seventeen-month lease containing an option to renew for one three-year period. If the tenant exercised its option to renew, the rental was to be adjusted annually to reflect changes in the Consumer Price Index number. The tenant was responsible for general maintenance while the defendant landlord was responsible for improvements and repairs. A commission was paid to the broker upon execution of the lease.

The tenant was not totally satisfied with the premises, which affected its negotiations with the landlord concerning a subsequent lease term. The tenant and landlord eventually agreed to a second lease commencing at the expiration of the original seventeen-month term. This second lease called for reduced lease payments, but the tenant agreed to spend a certain amount making improvements to the premises. There was no C.P.I. escalator clause in this second lease. When the broker learned of the continued tenancy, it billed the landlord for its five percent commission. The landlord refused to pay, insisting that the second lease was a new lease, not a negotiated renewal. The issue before the court was whether this second lease was a "negotiated renewal" qualifying for a commission under the parties' listing agreement or whether it was a totally "new" lease that was beyond the parties' agreement.

In coming to a decision, the Supreme Court of Iowa stated that it was guided by the cardinal principle that the parties' intent controlled, and that, except in cases of ambiguity, the parties' intent was determined by what was stated in the contract. n12 The court found that the lease was a negotiated renewal. It stated that there was no serious dispute that the essentials of the lease agreement in the original and subsequent leases were the same: same parties, same property, and substantially the same rent. The reduction in the square footage rental price in the subsequent lease was directly proportional to the amount the tenant agreed to spend on maintenance and improvements. The court found that the variance in terms between the original and subsequent leases merely reflected the owner and the tenant's negotiations. Since the landlord's and tenant's enduring relationship was the product of the broker's initial efforts in procuring the tenant, the court concluded that the landlord had to be held to the bargain it memorialized in the initial agreement. The broker was entitled to its commission on the subsequent lease. n13

[c] Renewal Option Implied Where Same Parties Broker New Lease

At least one court has even attributed a renewal option into a lease based on language contained in the brokerage services agreement. In *Board of Regents of University System of Georgia v. A. B. & E., Inc.*, n14 the brokerage services agreement provided for additional compensation for renewals and extensions of the lease to be entered into. The lease that was eventually executed did not contain a renewal option. Upon the expiration of the original lease, the parties entered into a new lease. The court interpreted "renewals and extensions" to include "new" leases between the same parties and containing substantially the same terms. Therefore the broker was entitled to additional commission payments.

[d] The Obligation to Pay Commissions May Survive a Transfer of the Premises n15

A provision requiring the payment of a lease commission to an agent can survive a transfer of the leased property as illustrated by *Pollard & Bagby, Inc. v. Pierce Arrow, L.L.C., III*. n16 The property involved in this case was an apartment building. Pollard & Bagby, Inc. (Pollard) acted as the leasing agent for Willard R. Simmons (Simmons), the former owner of the property. Each lease was identical in form and contained a provision providing that the lessor would pay the agent 6% per month of the rental received from the lessee during the lease term and during any renewal and extension thereof or during the term of any new lease or by the holding over of the lessee with the lessor's permission. This provision also stated:

No sale, transfer or assignment by Lessor shall affect Agent's right to receive commissions, provided that in the event Lessor sells the premises, then upon Lessor's furnishing Agent with an agreement signed by the purchaser assuming Lessor's obligation to the Agent under this Lease, Agent will release the original Lessor from any further obligation to the Agent hereunder. n17

Simmons sold the property to Pierce Arrow, L.L.C., III (Pierce), but did not obtain from Pollard a release from further obligations under the leases. After Pierce acquired the property, it retained the services of a different leasing agent, but continued to pay commissions to Pollard until the term of each existing lease expired. As each lease expired, Pierce entered into a new lease with the same tenant and stopped paying commissions to Pollard on the rent paid by that tenant under the new lease.

Pollard filed a declaratory judgment action against Pierce and Simmons seeking a declaration that under the terms of the leases, Pollard was entitled to continue receiving commission on rents paid by any tenants who were initially procured by Pollard. Pierce and Simmons alleged in defense that their obligation to pay commissions to Pollard ceased when that tenant's lease with Simmons expired and the tenant entered into a new lease with Pierce. The trial court found that the term "new lease" as used in the commission provision did not include a lease entered into between a tenant and a new lessor. It granted summary judgment in favor of Pierce and Pollard. n18

The Supreme Court of Virginia reversed. It found the language of this commission provision to be unambiguous and that the plain language of its terms obligated the lessor to pay commissions to Pollard on all rental payments received from tenants procured by Pollard. It stated that Simmons was obligated to pay commissions as long as a tenant procured by Pollard continued to be a tenant of the leased premises. This obligation remained unchanged if an existing tenant executed a new lease for the premises. Since Simmons failed to obtain a release from the obligation as permitted by this provision, he remained liable for the performance of that obligation because the assignment of the leases to Pierce had no effect on Simmon's privity of contract with Pollard. Pierce, as an assignee "standing in the shoes" of Simmons, was also liable for Simmon's obligations to pay commissions under the leases. n19

The court also addressed Simmon's and Pierce's argument that the purchase agreement which provided that the property would be conveyed free and clear of management agreements at settlement. The court found no merit in this contention since the leases provided for commissions that were paid in consideration of Pollard's services rendered in procuring the lease and not as payment for management services. n20

In New Jersey, a purchaser incurred liability to the seller's broker for commissions on leases when the purchaser affirmatively assumed the seller's obligation to pay the commissions. n20.1 While an express promise to pay these commissions will satisfy this standard, determining whether there has been an affirmative assumption of this obligation requires an analysis of the facts and circumstances surrounding the assignment. n20.2 Such an affirmative assumption was found to exist where a schedule of lease commissions accompanied the brokerage agreement which listed the property for sale. The brokerage agreement stated that this schedule would be binding on the seller's heirs, successors, and assigns. In addition, the brokerage agreement was part of the sales contract and, pursuant to the sales contract, the seller assigned all of the leases for the properties existing tenancies to the purchaser, and the purchaser agreed to assume and perform the seller's obligations. n20.3

Not all lease provisions calling for the payment of a commission will survive a transfer of the property. In *Brannen/Goddard Company v. PNC Realty Holding Corporation of Georgia* n21 the court found that the commission agreement entered into by brokers and the property's original owner was a personal covenant binding only the original owner and any party assuming the original owner's obligation. When the property was transferred to a creditor upon the owner's default on his loan obligations, the agreement between the owner and lender specifically provided that the creditor did not assume any obligation of the owner that arose out of events occurring before the transfer. n22 It also appears that a transfer in the course of a lessor's bankruptcy proceeding will result in the transferee receiving the property free and clear of any contractual obligation to pay a broker's commission on the debtor's leases. n23

[6] Compensation Based on *Quantum Meruit*

Even without a continuing contractual relationship, a broker may prevail in a compensation claim based on a *quantum meruit* theory. n24

The following showing is required:

- the brokers provided a valuable service to the clients; and

- the clients availed themselves of the brokers' services to their benefit. n25

In general, however, courts are disinclined to grant relief under *quantum meruit*. As one court stated, "[a] real estate broker is not entitled to payment even on a *quantum meruit* basis when he has no express or implied contract with the party from whom he seeks commission." n26

A broker has been allowed to pursue compensation based on *quantum meruit* where the written listing agreement covered the sale of the property. In this case, after the nature of the transaction shifted, the resulting lease acknowledged that the broker was due a commission on the lease transaction. n27

If a broker is allowed to pursue compensation based on a theory of *quantum meruit* and the compensation is for services rendered over a period of time, it has been held that the statute of limitations begins to run when the final services have been performed. n28

[7] Careful and Inclusive Drafting

All brokerage services agreements should be as inclusive as possible to avoid questions of interpretation or intention in the future. The contract must provide a protection period and duration provisions, see § 13A.04[2]; rules on when compensation is earned and method of payment, see § 13A.04[1], [3]; and entitlements for additional compensation, see § 13A.04[5]. In general, entitlement issues and problems involving performance of the contract by the lessor, lessee or broker can be avoided with careful drafting of the brokerage services contract. The possible triggering events for earning and payment of compensation should be meticulously enumerated.

Provisions regarding the payment of a commission upon the lessee's exercise of an option to purchase should also be carefully drafted. Is compensation due the broker when a purchase option included in a lease is executed during the lease term? Or must the option be exercised during the listing agreement term? n29 Careful drafting is necessary to preserve a broker's right to receive a commission should the lessee exercise an option to purchase the demised premises since this determination will depend on the wording of the parties' agreement.

However, even with the most careful drafting, all problems cannot be avoided. There is no way to draft around persons who intentionally scheme to avoid their responsibilities, but the agreement can provide a roadmap of what everyone's responsibilities are, a method of determining if someone is in compliance with the terms of the contract and a procedure for redressing damage caused by non-compliance.

FOOTNOTES:

(n1)Footnote 1. *Estate of Saemann v. Tucker Realty*, 529 N.E.2d 126, 129 (Ind. Ct. App. 1988) . See also *Arthur Rubloff & Co. v. Drovers Nat'l Bank of Chicago*, 80 Ill. App. 3d 867, 871, 36 Ill. Dec. 194, 400 N.E.2d 614, 617 (1980) .

(n2)Footnote 1.1. See *New England Retail Props. v. Maturo*, 102 Conn. App. 476, 477, 925 A.2d 1151, 1154 (2007) , appeal denied, 284 Conn. 912, 931 A.2d 932 (2007) .

(n3)Footnote 2. *Arthur Rubloff & Co. v. Drovers Nat'l Bank of Chicago*, 80 Ill. App. 3d 867, 871, 36 Ill. Dec. 194, 400 N.E.2d 614, 617 (1980) ; see also *Wilmette Real Estate and Management Co. v. Luvisi*, 172 Ill. App. 3d 232, 122 Ill. Dec. 218, 526 N.E.2d 477, 478 (1988) .

(n4)Footnote 3. *Hawkins v. Smithson*, 181 Mich. App. 649, 652, 449 N.W.2d 676, 678 (Mich. 1989) .

Cf. *Burke v. Weitzman Group*, No. 04-02-00570-CV, 2003 Tex. App. LEXIS 821, at *8 (Tex. App. Jan. 29, 2003) (commission is earned based on the parties' commission agreement, the lessor cannot unilaterally modify the commission agreement terms by agreeing to an amendment of the lease).

(n5)Footnote 4. *See e.g.:*

California: McGill v. Fleming, 32 Cal. App. 2d 601, 90 P.2d 341 (1939) ;

D.C.: Mid Century, Ltd. v. United Cigar-Whelan Stores Corp., 109 F. Supp. 433 (1953) ;

Michigan: Schiffman v. Turner, 253 Mich. 73, 234 N.W. 100 (1931) ;

Mississippi: Lavecchia v. Reed, 163 So. 681 (1935) ;

New Jersey: Smith v. T.V.T. Corp., 23 A.2d 550 (1942) ; *Stevens v. Oschwald Realty Corp.*, 162 A. 619 (1932) , *aff'd per curium*, 168 A. 286 ;

New York: Fried v. David Berry Realty, 17 A.D.3d 405, 406-7, 792 N.Y.S.2d 630, 632, 2005 N.Y. App. Div. LEXIS 3777 (2005) ; *Tanenbaum v. Remford Corp.*, 185 Misc. 612, 57 N.Y.S.2d 415, 1945 N.Y. Misc. LEXIS 2257 (N.Y. Sup. Ct. 1945) .

North Carolina: Ross v. Perry, 12 N.C. App. 47, 54, 182 S.E.2d 655, 659 (1971) , *aff'd*, 281 N.C. 570, 189 S.E.2d 226 (1972) ;

Oklahoma: Lowenstein v. Holmes, 1913 OK 336, 40 Okla. 33, 135 P. 727 (1913) ;

Texas: Closner v. Gannaway, 32 S.W.2d 523 (1930) .

(n6)Footnote 5. *Gronich & Co., Inc. v. 649 Broadway Equities Co.*, 169 A.D.2d 600, 565 N.Y.S. 2d 18, 1991 N.Y. App. Div. LEXIS 588 (1991) (finding lessor liable to broker under theory of implied contract).

See also Joseph P. Day Realty Corp. v. Chera, 308 A.D.2d 148, 149, 762 N.Y.S.2d 373, 374-375, 2003 N.Y. App. Div. LEXIS 8080 (N.Y. App. Div. 2003) (broker who acts as the procuring cause on a commercial lease, and whose labors and expectation of compensation are expressly acknowledged by the parties to the lease, may recover commission from either the lessor or lessee under a theory of implied contract of employment).

(n7)Footnote 5.1. *See, e.g., Dow & Condon, Inc. v. Muros N. Ltd. P'ship*, 69 Conn. App. 220, 226, 794 A.2d 554, 558 (Conn. Ct. App. 2002) .

But see Killearn Partners, Inc. v. Southeast Props., 279 Ga. 144, 148-49, 611 S.E.2d 26, 29 (2005) , *overruled in part by, Amend v. 485 Props.*, 280 Ga. 327 (2006) (on other grounds) (The absence of a written agreement between a real estate professional and a client does not preclude the former from seeking to recover compensation under remedies found outside the scope of Brokerage Relationships in Real Estate Transactions Act, including those at common law.).

(n8)Footnote 6. *Arthur Rubloff & Co. v. Drovers Nat'l Bank of Chicago*, 80 Ill. App. 3d 867, 36 Ill. Dec. 194, 400 N.E.2d 614, 619 (1980) ("[s]imply because Plaintiff had acted as Defendant's broker on a prior occasion does not constitute grounds upon which it can be inferred that Plaintiff represented Defendant in the present transaction").

(n9)Footnote 6.1. *See Uhar & Co. v. Jacob*, 2010 U.S. Dist. LEXIS 43025, at *14 (D.D.C. May 3, 2010) ; *Staubach Retail Services-Southeast LLC v. H.G. Hill Realty Co.*, 160 S.W.3d 521, 523-24 (Tenn. Ct. App. 2005) .

(n10)Footnote 6.2. *See Staubach Retail Services-Southeast LLC v. H.G. Hill Realty Co.*, 160 S.W.3d 521, 525 (Tenn. Ct. App. 2005) .

(n11)Footnote 6.3. 214 Ore. App. 220, 225, 164 P.3d 330, 332 (2007) . See also *Wieneke Properties, Inc. v. Thiessen*, 94 Ore. App. 306, 310, 765 P.2d 815 (1988) (A fee agreement stating that amount of commission was six percent of final sales price was reasonably certain.), review denied, 307 Ore. 514, 770 P.2d 595 (1989) .

(n12)Footnote 6.4. See *Dorian M. Bennett, Inc. v. Shankle*, 974 So. 2d 777, 784 (La. Ct. App. 2007) .

(n13)Footnote 6.5. See *Williams Real Estate Co., Inc. v. CC&F Lincoln Street LLC*, 59 Mass. App. Ct. 714, 720-721, 797 N.E.2d 496, 500-501 (Mass. Ct. App. 2003) , citing 1 Donovan, Residential and Commercial Landlord-Tenant Practice in Massachusetts § 2.2.2 (MCLE 2001).

(n14)Footnote 6.6. 180 Or. App. 192, 42 P.3d 355 (Or. Ct. App. 2002) .

(n15)Footnote 6.7. 180 Or. App. 192, 198-199, 42 P.3d 355, 358 (Or. Ct. App. 2002) .

(n16)Footnote 7. *Hawkins v. Smithson*, 181 Mich. App. 649, 449 N.W.2d 676 (1989) .

(n17)Footnote 8. In *Laughlin v. Terry*, 110 S.W.2d 838 (1937) , the court held that the lessor was entitled to a refund of part of the commissions paid to the broker when a ninety-day termination provision in the lease was exercised. The brokerage services agreement provided that the commission was based on the "gross amount of rentals." The court interpreted this clause to mean that the commission should be calculated on the amounts the lessee was bound to pay. Since the lessee exercised its termination option, it was not required to pay further rent and the commission owed had to be reduced proportionately.

But see *Cumming v. Putnam Realty, Inc.*, 80 Ark. App. 153, 160 (Ark. Ct. App. Dec. 8, 2002) (pursuant to the parties' listing agreement, the broker was due a commission on the rent due for the initial lease term of 25 years even though the lessee could terminate the lease after a five-year period on six-months' notice).

(n18)Footnote 8.1. See *Office Buildings of Houston, Inc. v. Newman*, 2009 Tex. App. LEXIS 6154 (Tex. App. 2009) , petition for review dismissed, 2010 Tex. LEXIS 134 (Feb. 5, 2010) .

(n19)Footnote 9. See, e.g., *Rosenblum v. Lurie*, 128 Pa. Super. 480, 194 A. 204 (1937) (five-year lease contained two five-year renewal options, and lessee failed to exercise renewal option but instead entered into series of one-year leases with same lessor); *Odell v. Wessinger*, 54 Ga. App. 838, 189 S.E. 367 (1936) (lessee exercised renewal option within six-month extension on original renewal period).

(n20)Footnote 10. See e.g., *Brannen/Goddard Co. v. Sheffield, Inc.*, 240 Ga. App. 667, 524 S.E.2d 534, 535 (Ga. App. 1999) (a renegotiated commercial lease executed before expiration of the original lease which covered different and additional space at a reduced rate was a new lease rather than an extension or renewal within the meaning of the landlord's agreement to pay a commission to the broker for lease extensions); *Plumbing Industry Program, Inc. v. Good*, 120 So. 2d 639 (Fla. 1960) (holding that no additional commission owed because the parties entered into a new lease for different space); *Dooly v. Embry-Riddle Co.*, 2 Fla. Supp. 172 (1952) (holding that an exchange of space did not qualify as a lease renewal and therefore broker was not entitled to compensation); *M. J. Harris Co. v. Buckeye Sheriff Street Realty Co.*, 40 N.E.2d 949, 35 Ohio Law Abs. 373 (Ohio Ct. App. 1941) (holding that no commission was owed where the original lease was for a term of five years with a renewal option, and the parties instead executed a new one-year lease with renewal rights).

(n21)Footnote 10.1. See *Seay v. Bennett & Kahnweiler Associates*, 73 Ill. App. 3d 944, 947, 29 Ill. Dec. 912, 392 N.E.2d 609, 611 (Ill. App. Ct. 1979) ; *Murray v. Baker Props. L.P.*, 2009 Pa. Dist. & Cnty. Dec. LEXIS 197, at *13 (2009).

(n22)Footnote 11. 585 N.W.2d 245 (Iowa 1998) .

(n23)Footnote 12. 585 N.W.2d 245, 247 (Iowa 1998) .

(n24)Footnote 13. 585 N.W.2d 245, 249 (Iowa 1998) .

(n25)Footnote 14. *Board of Regents of University System of Georgia v. A. B. & E., Inc.*, 357 S.E.2d 100 (1987) .

(n26)Footnote 15. Section 13A.04[5][d] was written by Sandra Bullington, Esq.

(n27)Footnote 16. 258 Va. 524, 521 S.E.2d 761 (Va. 1999) .

(n28)Footnote 17. 258 Va. 524, 521 S.E.2d 761, 762 (Va. 1999) .

(n29)Footnote 18. 258 Va. 524, 521 S.E.2d 761, 762 (Va. 1999) .

(n30)Footnote 19. 258 Va. 524, 521 S.E.2d 761, 763-764 (Va. 1999) . *See also Sullivan & Wills Real Estate, L.L.C. v. Cruce*, 2010 Ala. Civ. App. LEXIS 108 (Ala. Civ. App. Apr. 23, 2010) (The terms of the original lease providing for a commission to the broker continued to apply even though the lessor and lessee had entered into a new lease which omitted the commission provision.).

(n31)Footnote 20. 258 Va. 524, 521 S.E.2d 761, 764 (Va. 1999) .

(n32)Footnote 20.1. *See Pagano Co. v. 48 S. Franklin Turnpike, LLC*, 198 N.J. 107, 109, 965 A.2d 1172, 1173 (2009) ; *VRG Corp. v. GKN Realty Corp.*, 135 N.J. 539, 556, 641 A.2d 519, 527 (1994) .

(n33)Footnote 20.2. *See Pagano Co. v. 48 S. Franklin Turnpike, LLC*, 198 N.J. 107, 109, 965 A.2d 1172, 1173 (2009) .

(n34)Footnote 20.3. *See Pagano Co. v. 48 S. Franklin Turnpike, LLC*, 198 N.J. 107, 117-19, 965 A.2d 1172, 1178-79 (2009) .

(n35)Footnote 21. 238 Ga. App. 387, 519 S.E.2d 35 (1999) *rev'd*, 274 Ga. 742, 559 S.E.2d 447 (2002) (on other grounds).

(n36)Footnote 22. 238 Ga. App. 387, 519 S.E.2d 35, 36-37 (1999) *rev'd*, 274 Ga. 742, 559 S.E.2d 447 (2002) (on other grounds).

(n37)Footnote 23. 11 U.S.C. § 363(f)(5). *See C.H.E.G., Inc. v. Millennium Bank*, 99 Cal. App. 4th 505, 515, 121 Cal. Rptr. 2d 443, 450 (Cal. Ct. App. 2002) , *review denied*, 2002 Cal. LEXIS 6975 (Cal. Oct. 16, 2002) .

(n38)Footnote 24. *See Coldwell Banker Commercial/Feist & Feist Realty Corp. v. Blancke P.W. L.L.C.*, 368 N.J. Super. 382 ; 846 A.2d 633 (2004) .

(n39)Footnote 25. *See Bau v. Sobut*, 50 Ill. App. 3d 732, 8 Ill. Dec. 486, 365 N.E.2d 724 (Ill. App. Ct. 1977) .

(n40)Footnote 26. *Woods Realty, Inc. v. Brimberry Trust*, 521 So. 2d 810, 814 (1988) ; *see also Prado v. Golemi*, 540 So. 2d 589 (La. Ct. App. 1989) .

(n41)Footnote 27. *See Chabott Petrosky Commer. Realtors v. Peterson*, 859 A.2d 77, 80 (Del. 2004) .

(n42)Footnote 28. *See Tesser v. Allboro Equipment Co.*, 2007 N.Y. Misc. LEXIS 8952, at *14-*15 (Sup. Ct. Dec. 31, 2007) .

(n43)Footnote 29. *Cf. Wright v. Shepherd*, 31 Kan. App. 2d 484, 66 P.3d 921 (Kan. Ct. App. 2003) (Brokers procured tenants who leased the property with an option to buy. The tenants exercised the purchase option 13 months

after the listing agreement expired. The owners refused to pay the brokers a sales commission. The court affirmed the summary judgment granted to the owners since under the listing agreement terms, the brokers were not entitled to a commission.).

* This chapter was written by Gregory P. Melnyk, Esq., Chicago, IL. Additional updates were contributed by Sandra Bullington, Esq., of Pleasant Valley, Virginia.



33 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13A Leases (Including Leases with Options and Rights of First Refusal) *

10A-13A Real Estate Brokerage Law and Practice § 13A.05

§ 13A.05 Default

[1] Remedies Generally

No matter how much time is spent drafting the brokerage services agreement, all possible scenarios cannot be anticipated. Since the right to receive compensation generally is based on contract, the remedies available to an aggrieved party are recoverable through an action for breach of contract. Although there is usually privity between the broker and only one of the other parties, the brokerage services agreement should address possible defaults by any of the three parties involved in the lease transaction: the lessor, the lessee and the broker. The remedies available depend upon who the defaulting party is and, to some extent, the nature of the default.

In addition to a contract cause of action, relief based on *quantum meruit* n1 may also be available.

[2] Lessor's Default

[a] Refusal to Pay Commission

There are several ways the lessor can be in default under the brokerage services agreement. The most obvious default is a failure or refusal to pay the agreed upon commission when a lease is executed. The remedy available for this and other types of default is money damages sought in a straight breach of contract action.

It is the broker's responsibility to monitor the status of the lease relationship to determine if an event occurs that triggers the broker's right to receive additional compensation.

In some instances a listing agreement will state that the broker earns a commission if during the term of the agreement a contract for the sale, transfer, or lease of the property is entered into by the property owner. In such a case, even though the property owner desires a sale of the property, the broker should be entitled to a commission by successfully procuring a lessee for the property. n1.1

[b] Refusal to Sign Contract

When the broker procures a ready and willing lessee and the lessor refuses to enter into the lease, the broker must prove

that the lessee met all of the lessor's requirements and that the lessor's rejection was arbitrary. n2

[c] Exercise of Renewal or Lease Option

Discovery of default may be difficult because of the fault of one of the parties, or because of the wording of the agreement. Often, the lessor does not inform the broker that the option has been exercised and an additional commission is owed.

Or, the lessee attempts to exercise his option but the lessor refuses to accept or acknowledge the exercise. n3 Option rights can mature years after the original lease transaction and may also be comprised of a series of options stretching over an extended period of time. In addition to the required pleading of proof in a contract action, the broker in this scenario will also have to prove that the option right existed, that an attempt to exercise that option was made and that the exercise of the option was timely made, in proper form and made to the proper parties.

For these reasons, the broker must assume the responsibility of continuously monitoring the status of the lease relationship.

[d] Possible Fraud Claim

A lessor who intentionally tries to avoid incurring liability for additional commission amounts may be liable to the broker under a fraud cause of action, in addition to a breach of contract claim. This can occur when the lessor induces the lessee not to exercise its option rights, n4 or when it attempts to avoid the additional compensation by canceling the original contract and entering into a "new" lease. In *Consolidated Realty Co. v. Graves*, n5 the lessor attempted to evade the commission obligation of a lease with a five-year renewal option by canceling the original contract and entering into a new lease for continued occupancy of the same space. In finding that the broker was entitled to receive a commission, the court was influenced by the bad faith of the lessor. This case supports a possible action in fraud if the broker can show that the lessor's actions were based on an intent to deprive the broker of his compensation.

[3] Lessee's Default

[a] No Compensation Prior to Taking Possession

If the lessee defaults prior to taking possession of the real estate the broker may not be entitled to receive compensation. If the prospective tenant is unable to meet its financial obligations, for example, the broker may not have fulfilled its obligations under its contract of employment. The default may be evidence that the broker did not procure a ready and willing lessee. n6

[b] Agreement Dictates Methods of Payment of Commission

If the lessee defaults on the lease after taking possession of the real estate, the broker's right to commission depends upon how the commission is calculated in the brokerage services agreement.

If the commission is based on the gross rental amount and the brokerage services agreement is silent on the procedure for a lessee default, the broker is entitled to retain the commission in full. However, if the commission calculation is based on the rental amounts received by the lessor, the broker's commission depends upon how payment was received. If the broker had received a lump sum payment, the broker would be required to refund a portion of that commission prorated over the remaining term of the lease. If commission payments were made in installments as rent was received, the broker's right to receive future installments would terminate.

[c] When Agreement Is Silent on Commission

The brokerage services agreement must reflect the parties' intentions regarding the compensation of the broker in the event of a lessee's default. The absence of a provision is a factor indicating the duty to pay is unconditional, and has been held to warrant payment of compensation. n7 If the lessor wants protection in the event of a lessee's default, the lessor should make a specific provision for that eventuality in the brokerage services agreement.

[4] Broker's Default

The broker owes the client the traditional fiduciary duties of loyalty, confidentiality, obedience, disclosure, reasonable care and diligence and accounting. The broker also owes any additional duties and obligations it specifically contracts for in the brokerage services agreement. If the broker breaches any of its duties, the client has a number of remedies available to it. The broker may lose all entitlement to compensation for a breach of its duties. The broker is also subject to money damages for breach of contract. The injured party may be entitled to a rescission of the transaction and restitution. Finally, since most jurisdictions require the broker to be a licensed real estate broker, the aggrieved party may seek sanctions against the broker from the appropriate regulatory authority. n8

When examining a broker's duty to disclose in the context of a commercial lease transaction, courts consider the fact that commercial property landlords and tenants are expected to be more sophisticated than a consumer. Even though there may be a statutory duty for a broker to deal honestly and fairly with all parties in the transaction, this does not mean that all nondisclosures will constitute a breach of a broker's duty, particularly when the breach concerns the duties of a broker representing a party other than the plaintiff. n9

FOOTNOTES:

(n1)Footnote 1. *Bau v. Sobut*, 365 N.E.2d 724 (1977) ; see § 13A.04[4] *supra*.

(n2)Footnote 1.1. *Cf. Colliers, Dow and Condon, Inc. v. Schwartz*, 77 Conn. App. 462, 468-471, 823 A.2d 438, 443-444 (Conn. Ct. App. 2003) (The listing agreement's express terms of the contract provided that the broker would be entitled to a commission for the sale or lease of the property. The trial court relied on the owners' parol testimony that they had not intended to retain the broker's services to lease the property. The appellate court held that the trial court's reliance on parol evidence to contradict the contract's express terms was improper.).

(n3)Footnote 2. *E.g., Milten v. Rapaport*, 339 Ill. App. 509, 90 N.E.2d 297 (1950) (finding that owner refused to execute a lease which the broker had procured from a ready and willing lessee).

(n4)Footnote 3. *See, e.g.: Hanscom v. Blanchard*, 105 A. 291 (1918) (finding that broker is entitled to commission where the optionee is ready and willing to exercise the option but is prevented by the refusal of the owner to comply with the terms of the agreement).

Leitner v. Foster, 181 N.E. 857 (1932) (finding that the lessor prevented the exercise of a ten year renewal option in order to avoid the commission owed to the broker).

(n5)Footnote 4. *Gent v. Midtown Holdings Corp.*, 10 A.D.2d 901, 200 N.Y.S.2d 281 (1960) (finding that the lessor induced the lessee not to exercise a renewal option in order to avoid incurring a broker's commission).

(n6)Footnote 5. 165 S.W.2d 26 (1942) .

(n7)Footnote 6. *See McLaughlin v. Stevens*, 296 F. Supp. 610 (1969) (interpreting law of Rhode Island):

[P]ayment of a brokerage fee should be conditional on ability of the party proffered to go forward. In the absence of any specific language in the contract of employment, or in a *quantum meruit* case, the risk that the proffered party will be unable to go forward should be placed on the broker.

296 F. Supp. at 615 .

For additional discussion of the "ready and willing" requirement, see ch.5 *supra*.

(n8)Footnote 7. *Bourgeois v. Jung*, 7 So. 2d 393 (1942) (holding that if the lessor did not intend to pay a real estate commission in the event of a default by the lessee, the lessor could have provided for that contingency in the brokerage services agreement).

(n9)Footnote 8. Grounds for sanctions against a broker are discussed *infra* in § 6.05[1], ch. 6, *Licensing of Brokers and Salespersons*.

The following are selected statutory provisions:

California: Cal. Bus. & Prof. Code § 10176.

Florida: Fla. Stat. Ann. § 475.25.

Michigan: Mich. Comp. Laws § 339.2512.

New Jersey: N.J. Rev. Stat. § 45:15-17.

New York: N.Y. Real Prop. Law § 442-e.

Texas: Tex. Rev. Civ. Stat. Ann. art. 6573a § 16.

(n10)Footnote 9. See *Blickman Turkus, LP v. MF Downtown Sunnyvale, LLC*, 2008 Cal. App. LEXIS 659, at *27 (Apr. 30, 2008) . In *Blickman* a duty to disclose did not exist because: (1) the plaintiff was the lessor, not a tenant; (2) the defendant represented the tenant; (3) the transaction involved commercial property; and (4) the matter allegedly concealed went not to the value of the property, or even the desirability of the transaction, but to facts learned by the broker after the transaction had been consummated, at least to the extent of executing an agreement binding on the parties.

* This chapter was written by Gregory P. Melnyk, Esq., Chicago, IL. Additional updates were contributed by Sandra Bullington, Esq., of Pleasant Valley, Virginia.



34 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13A Leases (Including Leases with Options and Rights of First Refusal) *

10A-13A Real Estate Brokerage Law and Practice § 13A.06

§ 13A.06 Sample Commission Provisions for Brokerage Services Agreements

[1] Flat Fee

This form can be used when the lessor contemplates leasing a single identified space to a single tenant. The advantage to the lessor is a known cost regardless of the value of the lease. The disadvantages to the lessor include assuming the risk for lessee default and agreeing to pay an amount that may not be reflective of market conditions; the lessor may overpay for the lease or not get the best deal possible because of the broker's zeal to conclude the deal as quickly as possible.

Real Estate Broker's Commission. As compensation for providing the services outlined in this Agreement lessor agrees to pay broker as follows:

- (a) _____ upon procuring a ready and willing lessee in accordance with the terms and provisions contained in this Agreement.
- (b) The commission will be paid to broker by lessor upon the execution of a lease and delivery of possession to lessee.
- (c) In the event of a subsequent default by lessee, Broker shall not be required to refund to lessor any amounts paid in accordance with Subparagraph (a), above.

[2] Percentage of Net Rental

This form can be used when the lessor has more than one space or is willing to subdivide space. It can also be used for a single transaction. The advantage to the lessor is that the payment will reflect current market conditions. Brokers will be encouraged to aggressively market the real estate for the best deal possible in order to maximize their own return. The lessor assumes the risk for lessee default.

Real Estate Broker's Commission. As compensation for providing the services outlined in this Agreement, lessor agrees to pay broker as follows:

- (a) _____ % of the net rental amount of any lease which complies with the terms and provisions

contained in this Agreement.

(b) The "net rental amount" is the total amount due from lessee less the amounts paid by lessee for real estate taxes, insurance premiums and common area maintenance expenses.

(c) The commission will be paid to broker by lessor upon the execution of each lease and delivery of possession to lessee.

(d) In the event of a subsequent default by lessee, broker shall not be required to refund to lessor any amounts paid in accordance with subparagraph (a), above.

[3] Percentage of Rent Collected

This form can be used when the lessor has more than one space or is willing to subdivide space. It can also be used for a single transaction. The advantage to the lessor is that the payment will reflect current market conditions while sharing the risk of a tenant default with the broker. It can also be used to spread out the payments to the broker over the term of the lease.

Real Estate Broker's Commission. As compensation for providing the services outlined in this Agreement, lessor agrees to pay broker as follows:

(a) _____ % of the net rents actually collected by lessor from any lease which complies with the terms and provisions contained in this Agreement.

(b) The "net rents actually collected" is the amount received by the lessor as a rental payment less the amounts paid by lessee for real estate taxes, insurance premiums and common area maintenance expenses.

(c) The commission will be paid to broker by lessee annually, in advance, commencing upon the execution of each lease and delivery of possession to lessee and every annual anniversary date (the "lease year") thereafter.

(d) In the event of a subsequent default by lessee, or other event which terminates the lease, broker shall refund to lessor the amount of commission paid for the current year, prorated from the date of default/termination to the last day of the lease year and any entitlement to future installments of the commission shall terminate.

[4] Renewal Option

This provision can be used when it is anticipated there may be a renewal option or extension provision in a lease to be entered into. It provides what additional compensation amount will be due and when it is payable. Since the final form of any lease that will be accepted by the owner cannot be predicted with certainty when the brokerage services agreement is negotiated, it is prudent to include this provision in all brokerage services agreements.

Additional Compensation. In addition to the compensation enumerated in the preceding section of this Agreement, if the lease executed by lessor contains a renewal option which is exercised by lessee, or the term of the lease is extended by lessor, lessor agrees to pay broker as follows:

(a) One-half of the amount of the commission enumerated in the preceding section of this Agreement.

(b) The additional commission will be paid to broker by lessor on the lease anniversary date following the renewal election or extension.

[5] Purchase Option/Right of First Refusal

This provision can be used when it is anticipated there may be a purchase option or right of first refusal in a lease to be entered into. It provides what additional compensation amount will be due and when it is payable. It is prudent to include this provision in all brokerage services agreements, because the final form of any lease that will be accepted by the owner cannot be predicted with certainty when the brokerage services agreement is negotiated.

Purchase Option/Right of First Refusal. In addition to the compensation enumerated in the preceding section of this Agreement, if the lease executed by lessor contains a Purchase Option or Right of First Refusal to Purchase, and lessee exercises that Option or Right, lessor agrees to pay broker as follows:

(a) _____% of the purchase price.

(b) This commission will be paid to broker by lessor at the closing of the sale of the real estate. If the sale does not close for any reason, no additional compensation will be owed to broker.

* This chapter was written by Gregory P. Melnyk, Esq., Chicago, IL. Additional updates were contributed by Sandra Bullington, Esq., of Pleasant Valley, Virginia.



35 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13A Leases (Including Leases with Options and Rights of First Refusal) *

10A-13A Real Estate Brokerage Law and Practice § 13A.07

§ 13A.07 Illustrative Form: Brokerage Agreement for Office Lease

Illustrative Form: Brokerage Agreement for Office Lease

BROKERAGE AGREEMENT FOR OFFICE LEASE

Agreement made this _____ day of _____, 19 _____, between
_____ hereinafter referred to as the "Owner" and _____ hereinafter referred to as the
"Broker".

W I T N E S S E T H:

WHEREAS, Owner owns approximately _____ square feet of vacant space in the building known as
_____, shown on the diagram attached hereto as Exhibit A; and

WHEREAS, Owner wishes to retain the services of Broker to represent it in the negotiation and leasing of the vacant
space.

NOW, THEREFORE, in consideration of the following and other good and valuable consideration, the receipt and
sufficiency of which is hereby acknowledged, it is agreed:

1. The vacant space may be leased in units no smaller than _____ square feet.
2. Broker shall market the vacant space. "Marketing" shall include but not be limited to: displaying appropriate signage,
placing advertising in print media and the Internet, and listing the vacant space in any multiple listing service in which
Broker participates.
3. Owner shall reimburse Broker _____ for signage and advertising costs.
4. Broker shall negotiate the lease of the vacant space with Prospective Tenants in accordance with the guidelines and
specifications attached hereto as Exhibit B.

Broker acknowledges that Owner has had dealings/negotiations with the following parties and that if Owner enters into a lease with any of the listed parties, no commission will be earned by Broker: _____.

5. Broker shall present all lease offers along with Prospective Tenants' financial statements, credit reports and references for Owner's review. Approval of the Prospective Tenant shall be in Owner's sole discretion. If Owner approves the Prospective Tenant, Owner will have a lease prepared for the Prospective Tenant's execution.

6. If and when, as a result of Broker's negotiations, (a) a written lease satisfactory in all respects to the Owner is entered into between and executed and delivered by the Prospective Tenant and Owner, or its assignee, as Landlord, or (b) if Owner enters into a lease with any Prospective Tenant to whom the Property was shown during the term of this Agreement within _____ days after termination of this Agreement, unless the Owner has entered into a Brokerage Agreement for Office Lease with another real estate broker, Owner will pay Broker one leasing commission based on the actual rents payable to the Owner under the Lease (irrespective of any commencement date set forth in the Lease) in accordance with the Schedule of Leasing Rates for the space in five (5) equal installments payable at the following times and in the following manner:

(a) the first installment, constituting twenty percent (20%) of the commission, shall be paid one-half (1/2) upon the execution and delivery of the Lease, and one-half (1/2) upon the date when, under the terms of the Lease, Prospective Tenant obtains possession or is obligated to commence the payment of rent on a regular and continuous basis, whichever shall be earlier;

(b) the next installment of twenty percent (20%) shall be paid one year after the date of the complete payment of the first installment; and

(c) the subsequent equal installments of twenty percent (20%) each shall be paid at one year intervals thereafter.

Owner shall have the privilege of accelerating the payment of any and all installments.

[OR]

6. If and when, as a result of Broker's negotiations, (a) a written lease satisfactory in all respects to the Owner is entered into between and executed and delivered by the Prospective Tenant and Owner, or its assignee, as Landlord, or (b) if Owner enters into a lease with any Prospective Tenant to whom the Property was shown during the term of this Agreement within _____ days after termination of this Agreement, unless the Owner has entered into a Brokerage Agreement for Office Lease with another real estate broker, Owner will pay Broker _____ as a flat fee [OR] _____ % of the base rent payable during the initial term of the lease.

7. In computing any commission due under this Agreement, the following rules govern:

(a) The following shall be excluded from the rental used to compute the leasing commission:

(i) Any increase in rent pursuant to any escalator provision contained in the Lease whereby Prospective Tenant pays a share of Owner's increase in taxes, costs or expenses or any "Cost of Living" increase and any Percentage Rentals payable by the Prospective Tenant in excess of fixed minimum (base) rent.

(ii) Rent upon any portion of the demised premises payable or credited by Owner to Prospective Tenant by reason of Owner's retaining as subtenant or otherwise any portion of the demised premises.

(iii) Rent payable by Prospective Tenant allocated specifically or otherwise in payment for utilities, electricity, services, heat and/or air-conditioning furnished or paid for by the Owner.

(iv) Rent payable by Prospective Tenant in payment for tenant improvements, decorations or installations constructed by or for Owner and reimbursed to Owner by way of additional rent under the Lease or by separate agreement.

(b) If the Lease between the Owner and Prospective Tenant or any agreement collateral to or affecting such Lease shall provide that the Owner, its parent corporation or any of its subsidiary or affiliated corporations, shall be required to assume Prospective Tenant's obligations under any lease covering any space occupied by Prospective Tenant (hereinafter referred to as "Present Space") or shall be required to indemnify Prospective Tenant as to any obligations respecting such Present Space then, in calculating the actual rentals involved in the Lease, there shall be deducted therefrom the total dollar amount of the obligations so undertaken pursuant to the assumption or indemnification agreement, and the commission shall be computed on the rentals remaining after the deduction. Thereafter, when the obligations shall be finally ascertained, Owner shall pay to the Broker the adjusted amount, if any, computed after deduction of the rent, brokerage commission, redecorating costs and all other expenses and obligations actually paid or reimbursed by Owner in connection with the Present Space, the computation to be according to the average rate of commission payable for the full term of the Lease.

(c) No commissions shall be paid to the Broker as a result of any renewal or extension of the Lease between Owner and Prospective Tenant, nor on renewals or extensions which result from the exercise of an option to renew or extend contained in the Lease.

[OR]

(c) In the event the Lease contains a renewal option and that option is exercised, Owner will pay Broker an additional commission in the amount of

_____ as a flat fee **[OR]**

_____ % of the base rent payable during the option period.

(d) If the Lease between Owner and Prospective Tenant shall provide that the Prospective Tenant shall have the right to cancel the Lease or surrender space at any time prior to the commencement of the term, then in the event that Prospective Tenant shall in fact so cancel the Lease or surrender space, no commission shall be deemed due or earned by the Broker, and the Broker shall repay promptly any sums which may have been previously paid by the Owner to the Broker. Moreover, if the Lease shall provide that Prospective Tenant may cancel the Lease upon a date which shall be after the commencement thereof but prior to the expiration of the term therein provided, then, any commissions shall be deemed due or earned only upon the uncancelable portion of the term (and on the termination penalty, if any) until Prospective Tenant's right to cancel expires without exercise and the balance (less the commission previously paid on the termination penalty, if any) of such commission shall then be paid by Owner to Broker following the last day on which the Prospective Tenant may exercise the right to cancel. If the

commission is paid for the period prior to the beginning of the period for which rent actually commences to accrue, then Broker will refund any amount paid by Owner based upon rentals for the period from the commencement date set forth in the Lease to the date upon which rent actually commences to accrue.

(e) If for any reason, including Owner's failure to complete the premises demised by the Lease because of inability to finance construction, acts of God, strikes or other labor difficulties, governmental restrictions, acts of public enemy, casualty or causes beyond Owner's control, Prospective Tenant does not commence the payment of rent, then no portion of the balance of the commission remaining unpaid shall be deemed to be due or earned, or will be paid to Broker by Owner, and Owner is and will be relieved from liability for the payment of any portion of the remaining balance of the commissions, and the Broker shall refund to the Owner all amounts previously paid hereunder.

(f) If the Prospective Tenant enters into a lease and subsequently defaults under the terms of the lease, the commission payable in accordance with Paragraph 6, above, will be recalculated based upon the base rent actually paid by the Prospective Tenant and Broker will refund all amounts previously paid in excess of the recalculated commission.

8. If for any reason whatsoever, including but not limited to, acts, omissions, negligence or the willful default of the Owner, its agents, employees or representatives, a Lease shall not be entered into between Owner and Prospective Tenant, no commission or brokerage or any portion thereof, will be deemed to be due or earned, or will be paid to Broker by Owner, and Owner is and will be relieved from liability for the payment of any and all commissions, claims or charges whatsoever. It is expressly agreed that Owner shall have the unqualified right, in its sole and absolute discretion, to refuse to enter into any Lease with Prospective Tenant for any reason whatsoever without incurring any obligation to the Broker for the payment of commissions or otherwise.

9. Broker may, in its discretion, cooperate and compensate other brokers in procuring Prospective Tenants. In the event of a claim for brokerage commissions by any other broker, then, upon final determination by a court or an arbitration that such other broker is entitled to commissions on the Lease, Broker will indemnify and save and hold the Owner harmless against all damages and costs (including reasonable attorney's fees) suffered by the Owner, but only to the extent of the commissions received or receivable by Broker.

10. This Agreement shall terminate on _____, 19 ____.

IN WITNESS WHEREOF, the parties have caused these presents to be signed and sealed the day and year first above written.

Owner _____

Broker

[Exhibit A is omitted.]

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* This chapter was written by Gregory P. Melnyk, Esq., Chicago, IL. Additional updates were contributed by Sandra Bullington, Esq., of Pleasant Valley, Virginia.



36 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13A Leases (Including Leases with Options and Rights of First Refusal) *

10A-13A Real Estate Brokerage Law and Practice § 13A.08

§ 13A.08 Illustrative Form: Rental Inspection

[1] Use of Rental Inspection Form

This form is to be completed by Lessee and Lessor prior to accepting occupancy of the leased premises and upon surrender of the leased premises. Lessee is advised to note all defects observed during the pre-occupancy inspection. This inspection form will be used by Lessor to evaluate the condition of the premises upon surrender by Lessee at lease termination and may affect the application of any security deposit.

[2] Form

RENTAL INSPECTION FORM

Address of Property: _____

Tenant: _____

Inspection Date: _____

Occupancy Date: _____

Inspection Date: _____

Surrender Date: _____

Number of Rooms: _____ (See floor plan attached hereto).

Room No. 1:

Floor Covering:

Type: _____

General Condition: _____

Special Comments: _____

Move-out Inspection: _____

Walls:

Type of Covering: _____
General Condition: _____
Special Comments: _____
Move-out Inspection: _____

Electrical: _____

Move-out Inspection: _____

Plumbing: _____

Move-out Inspection: _____

Telecommunications Equipment: _____

Move-out Inspection: _____

Furnishings:

Type: _____
No.: _____
General Condition: _____
Special Comments: _____
Move-out Inspection: _____

Pre-occupancy Inspection Initials:

Move-out Inspection Initials:

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37 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART IV Specialized Fields of Brokerage

CHAPTER 13A Leases (Including Leases with Options and Rights of First Refusal) *

10A-13A Real Estate Brokerage Law and Practice § 13A.09

§ 13A.09 Illustrative Form: Exclusive Subleasing Agreement

EXCLUSIVE REAL ESTATE SUBLEASE LISTING AGREEMENT

1. **Property.** In consideration of the terms of this Agreement and the listing for sublease of the real property commonly known as _____ as shown in the diagram attached hereto as Exhibit A (the "Property") with _____ ("Broker"), and Broker's agreement to use its best efforts to effect the sublease of the Property, the undersigned ("Lessee"), as lessee under a certain lease dated _____ (the "Primary Lease"), with _____ as lessor (the "Lessor"), a copy of which is attached hereto as Exhibit B, hereby grants Broker the exclusive right to sublease the property "as is, where is," subject to the Primary Lease and other matters of record, for a period commencing on the date hereof and ending at midnight on the _____ day after the date hereof (the "Term"), at rental terms as indicated on Exhibit C.

2. **Sublease Defined.** For purposes of this Agreement, the term "sublease" shall include a sublease under this agreement, an assignment of the Primary Lease and/or Lessor entering a lease directly with any prospective tenant.

Broker acknowledges that any sublease must be consented to by Lessor.

3. **Commission.** Subject to the terms hereof, Lessee agrees to pay Broker a lease commission in accordance with Broker's Schedule of Lease Commission, a copy of which is attached hereto as Exhibit D and incorporated herein by reference. The lease commission shall be earned and paid for services rendered if, during the Term, all, or any portion, of the Property is subleased to a tenant, whether or not the tenant was introduced to the Property by Broker.

Lessee shall pay Broker the lease commission upon Broker submitting a written offer from a qualified prospective tenant to sublease the Property in accordance with the terms contained in Exhibit C or upon Lessee or Lessor accepting a sublease within the Term, or within 180 days after the expiration of the Term, or any extension thereof, to a person or entity whose name appears on the list of prospective tenants submitted by Broker to Lessee no later than ten business days following the expiration of the Term.

Notwithstanding anything contained in this Agreement to the contrary, a commission shall not be payable with respect to any sublease to _____ or any entity owned, controlled or affiliated with the excluded party.

4. **Non-discrimination.** It is understood that it is illegal for either Lessee or Broker to refuse to display or lease the Property to any person because of race, color, religion, national origin, sex, marital status or physical disability.

5. **Lessee's Responsibilities.** Lessee warrants that it has authority to sublease the Property and that all documents supplied to Broker are true and complete copies and are in full force and effect.

Lessee agrees to immediately refer to Broker all inquiries from anyone interested in the Property. All negotiations are to be through either Broker, Lessee or Lessee's legal counsel, as determined by Lessee, but keeping the other fully informed. Broker shall, at Broker's cost and expense, advertise the Property, including without limitation: preparation and distribution of Broker's standard brokerage informational package (provided Broker shall first obtain Lessee's approval of the substance of any package and other advertising, but may make reasonable variations thereafter to accommodate presentation needs) and Lessee may authorize Broker, at Broker's cost and expense, to place a sign on the Property.

Lessee will promptly disclose to Broker and any prospective tenant any and all material information known to Lessee regarding the condition of the Property, including but not limited to, the presence and location of asbestos and other toxic, hazardous or contaminated substances, and underground storage tanks in, on or about the Property. Lessee has not been notified by any municipal or governmental authority of any uncured violation of any zoning or other applicable governmental regulation, including but not limited to federal and state EPA regulations respecting environmental hazards.

Lessee has not been notified by Lessor of any uncured event of default under any provision of the Primary Lease.

Lessee shall promptly notify Broker upon receipt of any notice during the Term regarding violations and acts of default covered by this paragraph.

Upon reasonable notice, Lessee shall grant Broker and prospective tenants access to the Property.

Lessee acknowledges that Broker is relying upon Lessee's warranties and statements contained herein and all materials supplied by Lessee and hereby indemnifies and agrees to hold Broker harmless from any action brought against Broker, including Broker's attorneys' fees, due to the information supplied by or withheld by Lessee.

6. **Broker's Responsibilities.** Broker agrees to make an inspection of the Property, to compile and have readily available all lease information, to professionally show the Property to prospective tenants and to continuously use its best efforts to Lease the Property.

Broker agrees to represent only Lessee and not prospective tenants. Broker agrees that it will work with and cooperate with all licensed real estate brokers in the geographic area in which the Property is located on the usual and customary participation basis used by real estate brokers in the area. Notwithstanding anything contained in this Agreement to the contrary, if a cooperating broker is or claims to be involved in any sublease of all or any portion of the Property (unless the claim is not a good faith legitimate claim), Broker shall be liable and responsible for payment of the cooperating compensation to that cooperating broker.

Broker shall have no authority to bind Lessee in any respect as to the Property or otherwise. Broker shall offer the Property for sublease only at the rental and other terms first approved by Lessee.

Broker shall advise Lessee, at least monthly, of all sublease prospects and contacts with whom Broker is in communication.

Broker shall have no responsibility with respect to the Property, its management or care.

7. **Notices.** All notices required herein shall be in writing and delivered (i) by personal service; (ii) sent by certified mail, postage prepaid, return receipt requested; (iii) sent by commercial delivery service; or (iv) sent by facsimile transmission with a confirmation copy by first class mail.

If to Broker:

Fax no. _____

If to Lessee:

Fax no. _____

8. **Entire Agreement.** This Agreement, and all Exhibits attached hereto, constitutes the entire agreement between Lessee and Broker and supercedes all prior discussions, negotiations and agreements, whether oral or written. This Agreement may not be amended or altered unless in writing and signed by both Lessee and Broker. Any purported amendment, modification or withdrawal not in writing is void and of no effect. This Agreement is binding upon the parties, their heirs, successors and assigns. Notwithstanding the foregoing, this Agreement may not be assigned by Broker without Lessee's prior written consent.

THIS AGREEMENT is entered into this _____ day of _____,
 _____.

Broker:

Lessee:

EXHIBIT D

Schedule of Lease Commission

Subject to the terms and provisions of the Exclusive Real Estate Sublease Listing Agreement to which this Schedule D is attached, the lease commission shall be _____ percent (_____%) of the aggregate amount of the "base rent" payable under the terms of the Sublease for the sublease term without extensions. For purposes of this Agreement, "base rent" excludes (i) any percentage or other types of additional rent payable by a sublessee and (ii) any portion of the based rent which is, as determined by Lessee or Lessor, based on providing the Lessee or Lessor with a recovery of contribution toward the cost of Lessee improvements, fixtures and other costs of the tenancy or payable by the Lessee or Lessor for improvements provided by the Lessee or Lessor.

In lieu of the foregoing commission rate, a commission rate of _____ percent (_____%) shall be used if the base rent shall be absolutely net to Lessee or Lessor, so that the sublease shall yield, net to the Lessee or Lessor, the specified base rent in each month and year during the Term, and the

Sublessee shall bear each and every item of expense or imposition of every kind and nature whatsoever, (including, but not limited to, insurance, real estate taxes, assessments and other impositions, burdens and levies, maintenance, repair, replacement and common area maintenance) for the payment of which the Lessee or Lessor is, shall or may become liable by reason of its rights, estate or interest in the Property and in the common areas which may be used by the Sublessee, or in or under the Sublease, or by reason of or arising from the ownership, operation, management, maintenance, repair, rebuilding, remodeling, renovation, use or occupancy of the Property, including without limitation buildings or improvements thereon, and such common areas.

All leasing commissions are due and payable upon sublease execution.

Initials:

* This chapter was written by Gregory P. Melnyk, Esq., Chicago, IL. Additional updates were contributed by Sandra Bullington, Esq., of Pleasant Valley, Virginia.



38 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice 14.syn

§ 14.syn Synopsis to Chapter 14: Federal Laws Affecting Real Estate Brokers *

§ 14.01 Introduction

§ 14.02 The Real Estate Settlement Procedures Act (RESPA)

[1] In General

[2] Applicability of the Act

[3] Anti-Kickback Provisions

[4] Disclosures of Assignments, Sale, or Transfer of Loan Servicing

[5] Escrow Accounting

[6] Disclosure of Fees

[a] Introduction

[b] Yield Spread Premium Controversy

[c] RESPA Reform Efforts

[d] Mark-ups/Overcharges

[7] Affiliated Business Arrangements

[8] Computerized Loan Origination

[9] Additional Policy Statements

[a] Rental of Office Space

[b] Lockouts

[c] Retaliation

[10] Examples

[a] Example 1

[b] Example 2

[c] Example 3

[11] Penalties

[12] Affiliated Business Arrangement Disclosure Statement Format

§ 14.03 The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA)

§ 14.04 Federal Truth-in-Lending Legislation

[1] Introduction

[2] Required Disclosures

[3] Other Recent Changes

[4] Offer or Extension of Credit

[5] Credit Advertising

[6] Enforcement

§ 14.05 Land Use Legislation

[1] In General

[2] Historic District and Landmarks Preservation Laws

[3] Air Rights

[4] Building Moratoria

[5] Laws Pertaining to Waterfront Property

[a] Zoning Criteria

[b] Recent Cases

[6] Wetlands Legislation

[a] In General

[b] Regulated Activity

[c] Exceptions

[d] Violations

[7] The Endangered Species Act

[a] In General

[b] Procedure for Designation

[c] Violations

[d] Penalties

§ 14.06 Reporting Requirements for Brokers Under the Tax Reform Act of 1986

§ 14.07 The Americans with Disabilities Act

[1] In General

[2] Scope of Title III of the Act

[3] New Construction

[a] In General

[b] Alterations

[c] Other Modifications

[d] Defenses

[i] In General.

[ii] Threat to the Health and Safety of Others.

[iii] Private Clubs.

[iv] Religious Organizations.

[v] Not "Readily Achievable."

[vi] Structural Impracticability.

[vii] Technical Infeasibility.

[viii] Residential Structures.

[ix] Asbestos Removal.

[x] Historic Structures.

[4] Responsible Parties

[5] Enforcement

§ 14.08 The Fair Housing Act

[1] In General

[2] Exceptions

[a] In General

[b] Single-Family Homes

[c] Rental of Apartments and Small Complexes

[d] Private Clubs and Religious Organizations

[e] Occupancy Limitations

[f] Housing for Older Persons

[3] Discriminatory Activities

[a] In General

[b] Sales or Rentals

[i] In General.

[ii] Steering.

[iii] Redlining.

[c] Discrimination Based on Terms or Conditions

[d] Discrimination in Advertising for Sale or Rental

[e] False Representations of Unavailability

[f] Blockbusting

[g] Discrimination in Brokerage Services

[h] Interference and Intimidation

[i] Discrimination Based on Familial Status

[j] Discrimination Based on Handicapped Status

[k] Exploitation

[4] Enforcement

§ 14.09 The Condominium and Cooperative Conversion Protection and Abuse Relief Act

[1] In General

[2] Scope

[3] Exemptions

[4] Prohibitions Under the Act

[5] Remedies

§ 14.10 The Agricultural Foreign Investment Disclosure Act

[1] Purpose

[2] Application of the Act

[3] Agricultural Land

[4] Disclosure Requirements

[5] Filing Requirements

§ 14.11 The Federal Trade Commission Act

[1] In General

[2] FTC Enforcement

[3] Brokerage Services

[4] Regulation of Leasing Activity

[5] Educational Correspondence Courses

§ 14.12 The Flood Disaster Protection Act of 1973

[1] In General

[2] Purpose of the Act

[3] The Flood Insurance Program

[4] The National Flood Insurance Reform Act of 1994

[a] Escrow of Flood Insurance Payments

[b] Forced Placement

[c] Portfolio Review

[d] Determination Fees

[e] Notice Requirements

[f] Recordkeeping Requirements

[g] FEMA Flood Hazard Determination Appeals

[5] Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance

§ 14.13 The Copyright Act of 1976

§ 14.14 Federal Asset Forfeiture Laws

[1] In General

[2] The Comprehensive Crime Control Act of 1984

[3] The Racketeer Influenced and Corrupt Organizations Act (RICO)

[a] In General

[b] Standards for Forfeiture

[c] Defenses to Forfeiture

[4] Rights of Mortgagees

[5] Forfeiture Procedures

[6] Broker Guidelines

§ 14.15 Interstate Land Sales Full Disclosure Act

[1] Purpose of the Act

[2] Defined Terms

- [3] Anti-Fraud Provisions
- [4] Regulations and HUD Guidelines
- [5] Subdivision Registration and Disclosures
- [6] Purchaser's Right of Revocation
- [7] Exemptions
 - [a] Introduction
 - [b] Non-Binding Reservation Agreements and Undivided Interests
 - [c] Exemptions under *15 U.S.C. § 1702(a)*
 - [i] Twenty-Five Lot Exemption
 - [ii] Improved Lot Exemption
 - [d] Exemptions under *15 U.S.C. § 1702(b)*
 - [i] One Hundred Lot Exemption
 - [ii] Twelve Lot Exemption
 - [iii] Scattered Site Exemption
 - [iv] Twenty Acre Lots Exemption
 - [v] Single-Family Residence Exemption
 - [vi] Mobile Home Exemption
 - [vii] Intrastate Exemption
 - [viii] The Metropolitan Statistical Area Exemption
 - [e] Regulatory Exemptions
- [8] Remedies
- [9] Statute of Limitations
- [10] Jurisdiction
- [11] Certification of Substantially Equivalent State Law
 - § 14.16 Civil Rights and Franchises



39 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 14 discusses major federal laws that affect the real estate brokerage industry. For an overview of federal disclosure requirements affecting real estate brokers, see Ch. 3A *above*. The statutory schemes discussed in this chapter include:

- The Real Estate Settlement Procedures Act (§ 14.02),
- The Foreign Investment in Real Property Tax Act of 1980 (§ 14.03),
- Federal Truth-in-Lending Legislation (§ 14.04),
- Land use legislation (§ 14.05),
- Reporting requirements for brokers under the Tax Reform Act of 1986 (§ 14.06),
- The Americans with Disabilities Act (§ 14.07),
- The Fair Housing Act (§ 14.08),
- The Condominium and Cooperative Conversion Protection and Abuse Relief Act (§ 14.09),
- The Agricultural Foreign Investment Disclosure Act (§ 14.10),
- The Federal Trade Commission Act (§ 14.11),
- The Flood Disaster Protection Act of 1973 (§ 14.12),
- The Copyright Act of 1976 (§ 14.13),
- Federal asset forfeiture laws (§ 14.14),

- Interstate Land Sales Full Disclosure Act (§ 14.15) (all new 2010).

It is crucial that brokers have at least a rudimentary understanding of these laws and how they affect their clients and the brokerage industry.

For additional discussion on these and other issues see the following other publications:

- Condominium Law and Practice, Ch. 21, *Federal Regulation of Sales and Marketing* (Matthew Bender).
- Cooperative Housing Law and Practice, Ch. 3, *Federal Law Affecting Cooperatives* (Matthew Bender).



40 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.01

§ 14.01 Introduction

The law has moved in the direction of imposing legal liability on real estate brokers, particularly where residential properties are involved, for nondisclosure of matters that cause damage to purchasers of real property. This is true even if there is not a fiduciary relationship between the broker and purchaser. Traditionally, real estate brokers have been faced with purchaser claims of misconduct where, for example, a purchased building is discovered to suffer from structural defects, n1 is subject to flooding, n2 or is infested by termites or other pests. n3 Other claims for liability against brokers have arisen out of health and safety code or building code violations filed against the property purchased. n4

With the explosion of case and statutory law governing virtually every aspect of the real estate sales transaction, and the almost bewildering proliferation of land use control legislation, real estate brokers, more than ever before, must keep abreast of legal developments that may impose new or potential legal duties and liabilities. This chapter highlights, for both real estate brokers and legal practitioners, the expanding federal legislation which now affects real estate licensees. The liability imposed upon real estate brokers extends to negligence, negligent misrepresentation, innocent misrepresentation, fraud, conspiracy, failure to exercise due diligence to inform or disclose information to the purchaser, and maintaining federal, state, and local standards imposed by the real estate brokerage business and the law of agency.

FOOTNOTES:

(n1)Footnote 1. *See, e.g., Byrn v. Walker*, 267 S.E.2d 601 (S.C. 1980) .

(n2)Footnote 2. *See, e.g., Young v. Joyce*, 351 A.2d 857 (Del. 1975) .

(n3)Footnote 3. *See, e.g., Weintraub v. Krobatsch*, 64 N.J. 445, 317 A.2d 68 (1974) .

(n4)Footnote 4. *See, e.g., Amato v. Rathbun Realty, Inc.*, 98 N.M. 231, 647 P.2d 433 (N.M. Ct. App. 1982) .

* This chapter was revised by Mary J. Burt, Esq. In 2006, Section 14.02 was revised by Robert M. Jaworski, Esq., and Section was 14.04 revised by Barbara S. Mishkin, Esq. Both are partners at Reed Smith, LLP and members of its Financial Services Regulatory Group, practicing, respectively, in the Firm's Princeton, New Jersey and Philadelphia, Pennsylvania offices. Their practice includes providing federal and state compliance advice and assistance to all kinds of financial institutions, performing compliance audits, preparing multi-state surveys, and, in conjunction with Reed

Smith litigators, defending individual and class actions brought against lenders. Mr. Jaworski is also a former Deputy Commissioner of the New Jersey Department of Banking and a frequent speaker and author on compliance-related topics. Section 14.15, written by Sandra R. Bullington, Esq. in 2000, has been adapted from Home Owner Associations and Planned Unit Developments--Law and Forms, ch. 6 (Matthew Bender) and was completely revised in 2010.

Additional updates throughout the chapter were contributed by Sandra Bullington, Esq.



41 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.02

§ 14.02 The Real Estate Settlement Procedures Act (RESPA)^{n*}

[1] In General

Since 1974, the vast majority of residential real estate transactions have been subject to the provisions of the Real Estate Settlement Procedures Act (RESPA). ⁿ¹ Additional transactions became subject to RESPA in 1992, when Congress added refinancings and second mortgages to coverage that previously applied primarily to first mortgages. ⁿ² RESPA was enacted to educate consumers about the real estate settlement process and to correct what were perceived to be abusive practices that caused unnecessarily high real estate settlement (closing or consummation) costs to be incurred by consumers. ⁿ³ Real estate brokers come within the scope of RESPA by providing a "settlement service," ⁿ⁴ and thus are subject to the anti-kickback provisions of RESPA. ⁿ⁵ RESPA has been called the principal federal statute regulating the activities of real estate brokers. ^{n5.1}

[2] Applicability of the Act

RESPA applies to any "federally related mortgage loan," ⁿ⁶ which by definition includes loans secured by residential properties designed for one- to four-family occupancy. ⁿ⁷ The Housing and Community Development Act of 1992 added subordinate liens and refinancings to the types of loans covered by RESPA. ⁿ⁸ Specifically exempted in RESPA are transactions involving extensions of credit (1) primarily for business, commercial, or agricultural purposes; or (2) to government or governmental agencies or instrumentalities. ⁿ⁹ Regulation X (Reg. X), the regulation that implements RESPA, lists more specific exceptions to RESPA coverage:

- (1) temporary financing (such as a construction loan);
- (2) lenders who make or invest in residential real estate loans aggregating \$1,000,000 or less per year;
- (3) loans on properties of 25 acres or more;
- (4) loans made for a business, commercial, or agricultural purpose, as defined by Regulation Z; ⁿ¹⁰
- (5) loans made on vacant land or unimproved property, unless the loan proceeds will be used to construct or place a structure or manufactured home on the property within 2 years from the date of settlement;

- (6) loans secured by residential property that is not located in a State; n11
- (7) conversions of federally related mortgage loans to different terms that are consistent with the provisions of the original mortgage instrument, as long as a new note is not required and even if a fee is charged;
- (8) secondary market transactions; and
- (9) assumptions of existing federally related mortgage loans in which the lender does not have the express right to approve a subsequent person as the borrower. n12

Thus, RESPA coverage generally applies to home purchase loans and refinances of home purchase loans, home equity loans, home improvement loans, and loans for condominiums, cooperatives, time-share interests, and manufactured homes.

[3] Anti-Kickback Provisions

Real estate brokers should be aware that Section 8 of RESPA (Section 8) n12.1 prohibits, in connection with a federally related mortgage loan, the giving or acceptance of any fee, kickback, or thing of value in return for the referral of settlement service business and the giving or accepting of any part of a settlement service charge except for services actually performed. n13 The intent of Section 8 is to eliminate higher costs to the borrower resulting from the inflation of loan origination and settlement charges by referral fees, kickbacks, rebates, and like payments that are used as inducements to those, such as real estate brokers, who are in a position to refer settlement business. n14 Real estate brokers are thus prohibited under Section 8 from receiving a fee or other thing of value for referring a person to another settlement service provider, such as a mortgage lender, mortgage broker, title insurance company, title insurance agent or appraiser. n14.1 Although an exception to Section 8 would permit a real estate broker who owns all or part of another settlement service provider, subject to certain conditions, to receive a return on his/her ownership interest in such provider and thus benefit from referrals to that provider, this exception requires that the "affiliated business arrangement" (AfBA) be legitimate, and not simply a sham designed to evade the Section 8 referral fee prohibition. n15

Both HUD and state officials have taken enforcement action in connection with AfBAs that they determined were not legitimate. In March 2005, for example, HUD entered into a settlement agreement with a real estate broker (Broker), a limited liability company the members of which were Broker's individual real estate agents (LLC), and a closing and escrow company (Escrow Company), who together formed an AfBA that provided title and closing services. HUD essentially determined that this AfBA was not legitimate because, among other things, it allowed LLC: (1) to acquire its ownership interest in the AfBA for less than fair market value, and (2) to redistribute its earnings from the AfBA to its real estate agent-members based on the volume of business each referred to the AfBA. n15.1 Also, in March 2005, the Commissioner of Insurance for the State of Colorado entered an Order against three title insurance companies for compensating "captive title re-insurance companies" that the Commissioner viewed as illegitimate. These captive re-insurance companies were owned by mortgage lenders and real estate brokers which were in a position to, and did, refer business to the title insurance company. n15.2 The Commissioner determined that the compensation paid to the captive re-insurance companies far exceeded the risk of loss that was transferred to them under the arrangement.

[4] Disclosures of Assignments, Sale, or Transfer of Loan Servicing

Amendments to RESPA in 1991 provided for disclosures to applicants relating to assignments, sale, or transfer of loan servicing. n16 The statute requires a person who makes federally related first-lien mortgage loans to disclose to each applicant at the time of loan application, or within 3 days after submission of the application: (1) whether the servicing of the loan may be assigned, sold, or transferred to any other person at any time while the loan is outstanding; (2) at the

lender's choice, for each of the most recent three calendar years completed, either the percentage of loans made by the person for which servicing has been assigned, sold, or transferred at the end of the most recent calendar year completed, or, if the person who makes the loan does not service any federally related mortgage loans, that there is a present intent on the part of the person to assign, sell, or transfer the servicing of the loan to another person. n17 The servicing disclosure must also contain the percentages of mortgage servicing loans originated by the lender in calendar year for which servicing has been assigned, sold, or transferred for the calendar year. n18 Compliance with this requirement is not required if the lender includes the language "[and have not serviced mortgage loans in the last three years.]" n19 Also required is an estimate of the percentage of loans that the lender anticipates it will make during the 12-month period following the closing of the loan. n20

A servicer of any federally related first-lien mortgage loan must notify the borrower in writing of any assignment, sale, or transfer of the servicing to any other person not less than fifteen days before the effective date of the transfer. n21 The new servicer must notify the borrower within 15 days after the effective date of the transfer. There is a general exception, however, if the notice is given to the borrower at the settlement. n22 The 2 notices may be combined into 1 if it is sent to the borrower at least 15 days before the transfer. The provisions also require the loan servicer to respond to inquiries from the borrower (qualified written request) within twenty days, and to make timely corrections to escrow accounts. n23 See Appendix MS-1 to Reg. X for a suggested form.

The Economic Growth and Regulatory Paperwork Reduction Act of 1996, n24 in a paragraph titled "Unnecessary Disclosure," made the following amendment to RESPA:

(a) Disclosure to Applicant Relating to Assignment, Sale, or Transfer of Loan Servicing. Each person who makes a federally related mortgage loan shall disclose to each person who applies for the loan, at the time of application for the loan, whether the servicing of the loan may be assigned, sold, or transferred to any other person at any time while the loan is outstanding.

This disclosure requirement replaces the more involved disclosure discussed above, which had previously been required to be given at the time of loan application, or within three days after submission of the application. In 1997, HUD proposed an amendment to its servicing disclosure rule to effect this new provision of the statute, but never adopted that proposal. n25

[5] Escrow Accounting

Section 10 of RESPA n26 establishes the statutory limits on the amounts that mortgage servicers n27 may require a borrower to deposit into an escrow account if the servicer chooses to establish one. (RESPA does not require the use of escrow accounts.) Section 10(a)(1) prohibits a servicer, at the time the escrow account is created, from requiring the borrower to make payments to the escrow account that exceed the maximum amounts calculated in accordance with the statute. These maximum amounts are calculated by analyzing how much money will be needed to cover disbursements for the mortgaged property, such as taxes and insurance, and to maintain a cushion of no more than one-sixth of the estimated total annual disbursements from the account.

Section 10(a)(2) prohibits the lender, over the life of the escrow account, from requiring the borrower to make payments to the escrow account that exceed allowable amounts. The maximum monthly amount that may be collected is equal to one-twelfth of the total annual escrow disbursements that the lender reasonably anticipates paying during a year, plus the amount necessary to maintain the cushion. No provision of Section 10 requires a servicer to collect the maximums allowable under the statute; the servicer may always collect less and is not required to collect any cushion at all.

Section 10 and section 6(g) of RESPA n28 govern the timing of disbursements from escrow accounts. Section 10 requires the servicer to follow "normal lending practices of the lender and local custom, provided that the selection of each such date constitutes prudent lending practice." Section 6(g) requires servicers to "make payments from the escrow

account for such taxes, insurance premiums, and other charges in a timely manner as such payments become due." n29

A final rule implementing sections 6(g) and 10 of RESPA and changes to RESPA made in section 942 of the National Affordable Housing Act n30 was published on October 26, 1994. n31 The effective date of this rule was extended to May 24, 1995, as a result of a February 15, 1995, rulemaking, n32 which also modified and clarified the October 1994 rule, because of questions on the rule. HUD issued further clarifications and corrections on December 19, 1994; n33 March 1, 1995; n34 May 9, 1995; n35 and January 21, 1998; n36 and published a notice of software availability on April 4, 1995. n37 To further confuse the RESPA situation, HUD streamlined Reg. X on March 26, 1996 n38 to comply with the Administration's regulatory reform initiatives.

The general consensus among courts considering the issue is that section 10(a) of RESPA does not afford consumers a private right of action for redress of violations of these escrow accounting rules. n38.1

[6] Disclosure of Fees

[a] Introduction

The requirement to disclose fees was greatly expanded under a regulation adopted by HUD in 1992. This regulation mandated that mortgage broker fees, however denominated, whether direct or indirect in regard to who pays, must be disclosed on both a good faith estimate and a HUD-1 settlement statement. n39 Mortgage brokers who are not exclusive agents of a lender and receive a loan application are also required to give a good faith estimate. n40

Since the early 1990s, class action attorneys have filed well over 150 lawsuits against mortgage bankers and mortgage brokers, alleging that the mortgage broker fees, particularly "yield spread premiums," n41 were illegal kickbacks under RESPA. These charges were made in spite of the HUD example of a yield spread premium in Reg. X. Following is the example:

"A" is a mortgage broker who provides origination services to submit a loan to a lender for approval. The mortgage broker charges the borrower a uniform fee for the total origination services, as well as a direct up-front charge for reimbursement of credit reporting, appraisal services or similar charges.

HUD's comments:

The mortgage broker's fee must be itemized in the good faith estimate and on the HUD-1 settlement statement. Other charges which are paid for by the borrower and paid in advance are listed as P.O.C. on the HUD-1 settlement statement, and reflect the actual provider charge for such services. Also, any other fee or payment received by the mortgage broker from either the lender or the borrower arising from the initial funding transaction, *including a servicing release premium or yield spread premium*, is to be noted on the good faith estimate and listed in the 800 series of the HUD-1 settlement statement. (Emphasis added.) n42

HUD has also indicated in its special information booklet, revised effective June 11, 1997, that "Your mortgage broker may be paid by the lender, you as the borrower, or both." n43 And, in a proposed rule governing mortgage broker fees, HUD, although indicating that it had never taken the position that yield spread premiums or any other class of back-funded or indirect fees are per se legal, did not take the position that such fees were per se illegal. Rather, HUD indicated that the issue in each case is whether the total compensation paid to a broker in a RESPA-covered transaction is or is not reasonably related to the value of the goods furnished or services performed. n44

The Federal Reserve Board interprets the payment of fees from a lender to a mortgage broker differently, saying that the disclosure of the yield spread premium is duplicative. Section 106(a)(6) of the Truth in Lending Act (TILA) n45 requires the disclosure of *borrower-paid mortgage broker fees* in the finance charge. Note that there is no mention of

lender-paid fees.

Paragraph 4(a)(3) of Reg. Z requires that all fees charged by a mortgage broker and paid by the consumer be included in the finance charge, whether the fee is paid to the broker or to the lender for delivery to the broker. A fee charged by a mortgage broker will be excluded from the finance charge only if it is the type of fee that would also be excluded when it is charged by the creditor. Fees paid by the funding party to a broker as a yield spread premium "are already included in the finance charge, either as interest or as points," and should not be double counted.

[b] Yield Spread Premium Controversy

Courts that have examined the issue of whether or not the payment by a lender to a mortgage broker of a yield spread premium or similar payment (for delivering a loan at a rate above the lender's "par rate") constitutes a prohibited referral fee under RESPA § 8 have reached different conclusions. In *Culpepper v. Inland Mortgage*,ⁿ⁴⁶ the Eleventh Circuit Court of Appeals reversed a district court's grant of summary judgment in favor of the lender. The district court had determined that the lender's payment of a yield spread premium to the broker constituted reasonable compensation for "goods furnished," namely, the loan itself, and not for the mere referral of settlement service business.ⁿ⁴⁷ The circuit court disagreed, finding that, on the facts presented, the payment could have been neither

(1) in return for a "good," since the lender, not the broker (who closed the loan in its own name with funds supplied by the lender), owned the loan from the outset, nor

(2) in return for "services actually performed," since the broker expends the same effort and provides the same quality and quantity of services whether it originates a loan at an interest rate that will provide it with a yield spread premium at closing or at a lower interest rate that will not generate such a payment.

In an earlier decision, *Barbosa v. Target Mortgage Corp.*, a Florida U.S. district court reached the opposite conclusion, finding that the payment of a yield spread premium by a lender to a broker did not constitute payment for a "referral" as defined in RESPA and, even if it did constitute such a payment, was an exempt payment on the basis that it was either reasonable compensation for goods furnished or for services actually performed.ⁿ⁴⁸

The court viewed the payment as not being for a "referral" based on evidence that the broker regularly referred loans to the lender at or below par, as well as above par, leading to a finding that the YSP payment was not made to "affirmatively influence" the broker to place the loan with the lender. The court also viewed the payment as being for services rendered by the broker to the borrower, finding it "entirely conceivable that the parties might structure the mortgage transaction to permit the borrowers and the lenders to share in paying the broker's commission."ⁿ⁴⁹

Another decision reaching essentially the same result as in *Barbosa* is *McWhorter v. Ford Consumer Finance*, in which a U.S. district court in Georgia granted the lender's motion for summary judgment.ⁿ⁵⁰

Many in the lending industry feared the lawsuits would keep coming until HUD took an even clearer stand on the legitimacy of mortgage broker fees, and published a rule to that effect. In October 1997, HUD proposed a new rule to deal with the issue of direct and indirect broker fees.ⁿ⁵¹ This proposal, if adopted, would have created a limited "safe harbor" by which lenders could pay and brokers could accept back-end compensation (including yield spread premiums and similar payments), and brokers could accept direct compensation from borrowers, free from any claim that the payments violate RESPA § 8. To qualify, the broker would have to:

- execute with the borrower a written mortgage broker contract in a form prescribed by HUD,
- adhere to all provisions in the contract,

- be properly licensed or registered in the state in which the secured property is located, and
- not receive total compensation (including compensation received from both the lender and the borrower) in excess of a level or amount to be determined by HUD and prescribed in the final rule.

The proposal drew substantial comment, and was not adopted. In April 1997, a Maryland Congressman introduced a bill that would place a moratorium on the class action lawsuits. n51.1 A companion bill was introduced in the Senate in June 1998. n51.2

While neither of these two bills moved through Congress, Congress did act on another front to resolve the controversy. In the conference report accompanying the Department of Veterans Affairs and Housing and Urban Development, and Independent Agencies Appropriations Act, 1999, n51.3 enacted October 21, 1998, n51.4 House and Senate conferees indicated that "Congress never intended payments by lenders to mortgage brokers for goods or facilities actually furnished or for services actually performed to be violations of [RESPA § 8]." n51.5 The conferees then directed HUD, with the help of industry representatives, federal agencies, consumer groups and other interested parties, "to clarify its position on lender payments to mortgage brokers within 90 days after the enactment of this appropriation Act." n51.6 HUD issued a Policy Statement on March 1, 1999 (Policy Statement I). n51.7

HUD took the position in Policy Statement I that it considers yield spread premiums not to be illegal *per se*, and to be legal if it is shown (1) that goods or facilities were actually furnished or services were actually performed for the total compensation paid to the mortgage broker; and (2) the compensation was reasonably related to the value of those goods or facilities or services. n51.8

HUD further stated that in determining whether goods or facilities were furnished or services were provided by the broker in return for the total compensation received by the broker, it "may be useful" to refer to its February 14, 1995 letter to the Independent Bankers Association of America (IBAA letter). n51.9 The IBAA letter, which is essentially replicated in the Policy Statement, provides that HUD will not pursue enforcement action under RESPA if it is satisfied that sufficient origination work was performed to justify compensation. In HUD's view, this requires the broker to take the loan application information and perform at least five other origination services (at least one of which is something other than a "counseling-type" activity) from a list of fourteen origination-type services identified by HUD. n51.10

HUD also indicated in Policy Statement I that, in determining whether the total compensation received by the broker was reasonably related to the value of the goods or facilities furnished or the services performed, the total compensation received by the broker must be commensurate with the amount normally charged for similar services, goods or facilities. This, in turn, requires consideration of fees paid in relation to price structures and practices in similar transactions and in similar markets. n51.11 HUD further indicated that, in undertaking this analysis, any "volume-based" compensation paid by a lender (compensation based on the volume of loans the broker delivers to the lender over a fixed period and which is paid in the form of either cash rebates on the amount of loans delivered in excess of a "threshold" or "floor amount" or a lower "start rate") must be considered as part of the total compensation received by the broker. n51.12

Finally, Policy Statement I provided additional guidance to lenders and brokers as to how best to disclose yield spread premium payments to customers. HUD indicated that such a payment would be appropriately disclosed as "Mortgage Broker fee from lender to XYZ Corporation (P.O.C.)," and suggested that other fees or payments from the borrower to the broker should identify that they are mortgage broker fees from the borrower. HUD also recommended that brokers disclose, during their initial discussions with the customer, the nature of the broker's services and the various methods of compensation the broker can receive. n51.13 Following a subsequent decision by the Eleventh Circuit Court of Appeals finding Policy Statement I to be ambiguous (and reinterpreting it to justify affirmance of a lower court's grant of class certification in a YSP case), n51.14 HUD issued a clarification of Policy Statement I on October 18, 2001 (Policy Statement II). n51.15 Policy Statement II was then relied upon and found controlling in decisions issued by the Eighth,

Ninth, and Eleventh Circuit Court of Appeals, seemingly ending this litigation saga. n51.16

[c] RESPA Reform Efforts

Regulatory developments, however, continued. On July 29, 2002, HUD proposed a massive overhaul of Regulation X which included proposed amendments to deal with the disclosure of mortgage broker fees, including yield spread premiums. n51.17

One of the amendments would require that all yield spread premiums be disclosed on the HUD-1 Uniform Settlement Statement (HUD-1) and the good faith estimate as payments from the lender to the borrower. (The HUD-1A version of the Uniform Settlement Statement would no longer be able to be used in connection with refinance or subordinate-lien loans in which a yield spread premium payment is made.) For a mortgage broker to receive a yield spread premium, the mortgage broker would have to disclose on its good faith estimate a direct "origination fee" which includes any anticipated yield spread premium payment (and which therefore will represent the mortgage broker's entire compensation in connection with the loan). The result will be that the broker would no longer collect indirect fees from the lender, only direct fees from the borrower.

Another amendment would prohibit mortgage brokers from retaining any portion of any points paid by the borrower to obtain a lower interest rate (discount points) from the lender. Any such payment would have to be disclosed as a payment by the borrower to the lender.

In addition, the proposal would amend HUD's model form good faith estimate to require disclosure of the following additional information:

- A description of the nature of the services that the lender and/or mortgage broker (defined in the proposal as "loan originators") will provide so as to "disabuse borrowers of the notion that brokers or other loan originators are acting as their agents."
- A statement indicating that borrowers have the option to pay settlement costs (1) using their own funds at settlement, (2) using additional borrowed funds, or (3) using a yield spread premium they receive from the lender in exchange for agreeing to pay an above par interest rate. (The good faith estimate would also have to disclose that the borrowers may lower the interest rate [and the monthly payment] by paying discount points to the lender.)
- The *total* origination charges of the mortgage broker and the lender, as a consolidated figure, and, on a new good faith estimate attachment, a breakdown of the charges that are included in that figure, grouped according to whether they are charges of the broker or the lender.

These changes were intended by HUD to insure that "brokers will have no incentive to seek out lenders paying the largest yield spread." However, they would not have affected lenders who close loans with their own funds and thereafter sell those loans at a profit in the secondary market.

The HUD proposal attracted numerous comments from the settlement services industry and consumer groups alike, and generated Congressional opposition as well. In the end, HUD was forced to withdraw the proposal. Subsequently, HUD indicated that it intends to publish a new reform proposal, and followed-up by holding a series of invitation-only RESPA Reform Roundtables to obtain input from a cross-section of representatives of industry, consumer organizations and other interested parties. n51.18 By mid-2006, however, no new reform proposal had surfaced.

[d] Mark-ups/Overcharges

While the YSP class actions ground to a halt, another Section 8 claim began to take hold. Specifically, plaintiffs in several class actions alleged that the practice of some settlement service providers in (i) charging their customer more than it cost them to obtain a particular settlement service from a third-party provider ("marking-up" a charge for a settlement service) or (ii) charging their customer an "unreasonable" amount for a settlement service which they perform themselves ("overcharging" for a settlement service), violated section 8(b) of RESPA. Section 8(b) states that "no person shall give and no person shall accept any portion, split or percentage of any charge ... for ... a settlement service ... other than for services actually performed." n51.19

In Policy Statement II, HUD indicated that it considered Section 8(b) to be violated in both of the above scenarios. n51.20 Courts, however, have disagreed. With respect to the practice of marking-up a settlement service, the 4th, 7th and 8th Circuit Courts of Appeal have indicated that such a practice is not actionable under Section 8(b); n51.21 the 2nd and 3rd Circuits have said that it may be actionable; n51.22 and the 11th Circuit has said that it may be actionable but indicated in dicta that merely ordering the settlement service from the third-party provider constitutes the rendering of a service upon which a mark-up can be justified. n51.23 The U.S. Supreme Court may eventually be called upon to definitively decide this issue. With respect to the practice of "overcharging" for a settlement service, all courts that have specifically addressed this issue to date are in agreement that Section 8(b) provides no cause of action. n51.24

[7] Affiliated Business Arrangements

Another amendment to RESPA permitted "controlled [now "affiliated"] business arrangements" (AfBAs) under certain conditions. n52 In 1983, Congress enacted the "controlled business arrangement" amendment to RESPA. This amendment, codified under section 461 of the Housing and Urban-Rural Recovery Act of 1983 (HURRA) n53 established that controlled business arrangements do not violate RESPA under certain conditions. A controlled business arrangement is one in which

- (1) a person who is in a position to refer business incident to or a part of a real estate settlement service involving a federally related mortgage loan, or an associate of the person, has either an affiliate relationship with or a direct or beneficial ownership interest or more than 1% in a provider of settlement services, and
- (2) one of the persons directly or indirectly refers business to that provider or affirmatively influences the selection of that provider. n54

A controlled or affiliated business relationship is permissible if the following three conditions are met:

- (1) a disclosure of the relationship between the parties giving and receiving the referral, with estimated charges for the referred business, is made at or prior to the time the referral is made (or, in the case of telephone referrals, up to three business days following the referral so long as the customer is told during the telephone conversation of the existence of the AfBA and that he/she would receive the disclosure within three business days thereafter n54.1);
- (2) use of a particular provider is not required; n54.2 and
- (3) nothing of value is received by the referring party beyond a return on ownership interest, return on franchise relationship, or payments otherwise permissible under Section 8(c) of RESPA. n55

Disclosures should be made in the format of the recommended statement set forth in *Section 14.02[12] infra* . While RESPA does not permit a person referring business to receive fees directly for referrals to such a provider, a person may receive a return on that investment. n55.1 Under RESPA's AfBA exception, a person who refers business to a settlement service provider in which the referring person has an ownership interest may receive compensation, albeit indirectly,

based on the financial growth of that provider. n55.2

The AfBA exemption is available only where referrals are made to a *bona fide* provider of settlement services, and not to shell entities or sham arrangements. n55.3

An entity receiving referrals must "provide" settlement service business. If the entity is not a *bona fide* provider of settlement services, then the arrangement does not meet the definition of an AfBA. If an arrangement is not an AfBA, it cannot qualify for the AfBA exemption, even if the three conditions are met. Therefore, an entity *must* be a *bona fide* provider of settlement services to be exempt.

When assessing whether an entity is a *bona fide* provider of settlement services, or a sham arrangement used as a conduit for referral fee payments, HUD initially asks these questions:

(1) Does the new entity have sufficient initial capital and networth, typical in the industry, to conduct the business for which it was created?

(2) Is the new entity staffed with its own employees?

(3) Does the new entity manage its own business affairs?

(4) Does the new entity have a business office separate from the parents? If it is located at the same business address as one of the parents, does it pay a general market value rent for the facilities?

(5) Is the new entity receiving a fee for providing substantial services? Does it incur the risks and receive the rewards of any comparable enterprise?

(6) Does the new entity perform all the substantial services itself? If not, how much work does it contract out?

(7) If the new entity contracts out some of its essential functions, does it contract services from an independent third party, or from a parent or affiliate? If the latter, does the new entity provide any functions that are of value to the settlement process?

(8) If the new entity contracts out work to another party, does payment for services or facilities provided bear a reasonable relationship to the value of the services or goods received? Or is the new entity receiving a "thing of value" for referring settlement service business to the party performing the service?

(9) Is the new entity actively competing in the market place for business from settlement service providers other than its parent, an affiliate, or the entity that created it?

(10) Is the new entity sending business exclusively to one of the settlement service providers that created it? n55.4

A negative response to any one of the following questions by itself may not be enough to determine whether the AfBA is a sham. Even if an entity is a *bona fide* provider, HUD wants to know if the three conditions of an AfBA have been met: (1) Did the consumer receive a written disclosure about the relationship and an estimate of the charges at the time of the referral? (2) Is the referring party requiring the consumer to use the controlled entity? (3) Is the only thing of value that comes from the arrangement, other than payments for services rendered, a return on ownership interest or franchise relationship?

In answering question number (3), HUD will consider additional questions:

- (1) Has each participant made an investment of its own capital, or has it received a "loan" from a recipient of the referrals?
- (2) Have the participants received an ownership interest based on a fair value contribution? Or is compensation based on the expected referrals?
- (3) Are distributions made in proportion to the ownership, or does the payment reflect the amount of business referred?
- (4) Are the ownership interests free from tie-ins to referrals of business, or have there been adjustments based on the amount of business referred?

If an entity does not meet the conditions of the AfBA exception, then any payments given or accepted in the arrangement may be subject to further analysis under RESPA. n55.5

[8] Computerized Loan Origination

In the age of computerized loan origination (CLO), many real estate brokers may also act as mortgage brokers. RESPA permits such arrangements so long the person providing the CLO service applies with other applicable laws and requirements. The broker may, for example, be required to provide a good faith estimate of closing costs. Additionally, almost all states require mortgage brokers to be licensed or certified. Real estate brokers with CLOs who are acting as mortgage brokers must comply with the laws of these states.

CLOs that provide services to consumers may charge them for services performed. n55.6 All charges for settlement services must be reported on the Good Faith Estimate and the HUD-1 or HUD-1A, including payments made outside of closing for CLO servicers. Providers whose products are made available on CLOs may reimburse consumers for any fee charged them by the CLO.

RESPA prohibits payments for the referral of a consumer to a service provider; however, payments for goods or facilities actually furnished or for services actually performed are permitted. Any payment must bear a reasonable relationship to the value of the goods, facilities, or services provided. A charge for which no services are performed or for which duplicative fees are charged is an unearned fee. For example, if a CLO lists only one service provider and only presents basic information on the provider's products, it appears that no compensable services are provided by the CLO, only a referral; and any payment for the CLO listing could be considered a referral fee in violation of RESPA. A company may not pay any other company for the referral of business.

There are no restrictions on the pricing of CLOs if the payments are not referral fees and are reasonably related to the value of the services provided. However, the value of a referral is *not* to be taken into account in determining whether the payment exceeds the reasonable value of the goods, facilities, or services. If these requirements are met, CLOs may charge settlement service providers a fee for each closed transaction arising from the use of the CLO. If a CLO charges different fees to different providers in similar situations, an incentive may exist for the CLO to steer the consumer to the provider paying the highest fees. HUD may scrutinize these circumstances to determine if the differentials constitute referral fees.

When a CLO is used in connection with an AfBA (affiliated business arrangement), the AfBA regulations apply. n55.7 Separate entities are a necessary component of the AfBA definitions. For example, if a real estate brokerage firm uses a CLO within its own business structure and there is no separate affiliated business entity involved, then the CLO is not being used in an AfBA with the real estate brokerage firm, and the AfBA rules do not apply.

Displays of information on settlement service providers should be neutral. Favoring one settlement service provider over others may influence the selection of a service provider. This could constitute an illegal referral under RESPA.

An agreement or understanding for the referral of business may be established by a practice, pattern, or course of conduct. If there is an affiliate relationship between the CLO and a favored service provider, the non-neutral presentation of information could constitute a required use violation. CLOs can, however, help consumers determine which products are most advantageous. If a CLO consistently ranks lenders and their mortgage products on the basis of some factor relevant to the borrower's choice of product, such as APR, HUD would consider this a neutral display of information. n55.8

[9] Additional Policy Statements

[a] Rental of Office Space

After the publication of the 1992 RESPA rule, HUD received numerous complaints alleging that settlement service providers, particularly lenders, were leasing desks or office space in real estate brokerage offices at higher than market rent in exchange for referrals of business. High rent payments for the desk or office space may be disguised kickbacks to the real estate broker for the referral of business to the lenders.

Although Section 8 of RESPA prohibits a person from giving or accepting any fee, kickback, or thing of value for the referral of business, RESPA *does* permit payments for goods or facilities actually furnished or for services actually performed. A thing of value includes a rental payment that is higher than that ordinarily paid for the facilities. When faced with a complaint that a lender is paying a high rent and getting referrals of business in return, HUD analyzes whether the rental payment is *bona fide* or is really a disguised referral fee.

The market value of the rental space may include a proportion of the cost for secretarial services, utilities, telephone, and other office equipment actually provided to the tenant. To distinguish between rental payments that include a payment for referrals, and a payment for the facility and equipment actually provided, HUD applies a "general market value" standard as the basis for the analysis. n55.9

The "general market value" is what a *non*-settlement service provider would pay for the same amount of space and services in the same or a comparable building. This standard allows payments for facilities and services actually furnished, but does not take into account any value for referrals. Some settlement service providers pay a higher rent than the general market value to reflect the value of referrals of business. Any excess is considered a referral fee. HUD will also look at whether the rent is based on the referrals made. If it is, HUD will consider it to be for the referral of business. Both cases represent violations of RESPA.

One "bogus" rental arrangement involved a title insurance company that paid a real estate broker \$100 for the "per use rental" of a conference room for closings. The "rental fee" was greater than the general market value for the use of the space. Also, the room was rarely actually used for closings. The "rent" was really a disguised referral fee in violation of RESPA. n55.10

[b] Lockouts

Lockouts most often occur where a real estate brokerage company leases space to a lender, then prevents other lenders from entering the company's space. Without other factors, this is probably not a RESPA violation. It does raise a question of whether the rental payment is *bona fide*. n55.11

HUD has indicated that it does not have the authority to regulate access to the offices of settlement service providers,

nor can it require a company to assist another company in its marketing activity. n55.12 Real estate brokers should consult an attorney to determine if state consumer or antitrust laws apply to lockout situations in their state.

[c] Retaliation

HUD also received many complaints about retaliation practices. In one complaint, financial service representatives in a real estate broker's office were given quotas of referrals and were threatened with the loss of their jobs if they did not meet them.

RESPA prohibits giving incentives for the referral of settlement service business, but is silent as to *dis*incentives. However, retaliatory actions against employees are more appropriately governed by State labor, contract, and other laws.

[10] Examples

HUD provided examples of how to apply the new RESPA rules in the rule that became effective on October 7, 1996. Following are summaries of three of them:

[a] Example 1

An existing RE broker and an existing title insurance company form a joint venture title agency (JV). Each participant contributes \$1000 towards the creation of JV, which will be an exclusive agent for the title company. The title company enters into a service agreement with JV to provide title search, examination, and title commitment preparation work at a charge lower than its cost. The title company also provides management for JV. JV is located in the title insurance company's office space. One employee of the title insurance company, who continues to do the same work she did for the title company, is "leased" to JV to handle closings and prepare policies. The RE broker participant is JV's sole source of business referrals. Profits of JV are divided equally between the RE broker and title company.

HUD Analysis. The JV is not a *bona fide* provider of settlement service business. The payments flowing through the arrangement are not exempt under RESPA. JV is undercapitalized for a full service title agency. Although there is an equal contribution of capital, the title company provides office space, much of the title insurance work, and management oversight for JV. JV has an employee, but she is leased from, and continues to be supervised by, the title company. JV receives all the referrals of business from the RE broker participant and does not compete for business in the market place. JV provides a few essential functions, but contracts many core title agent functions to the title company. Also, since the title company provides the search, examination, and title commitment work at less than its cost, it is providing a "thing of value" to the referring title agent, which is passed on to the RE broker participant in a return on ownership. This violates RESPA.

[b] Example 2

A lender and a real estate broker form a joint venture mortgage broker (MB). The real estate broker does not require prospective home buyers to use MB and provides the required AfBA disclosures at the time of the referral. The real estate broker is the sole source of MB's business. The lender and real estate broker each contribute an equal amount of capital towards MB, a sufficient initial capital investment typical in the industry. MB, using its own employees, prepares loan applications and performs all other functions of a mortgage broker. When it gets very busy, MB contracts out some of the loan processing work to third parties, including the lender participant. In these cases, MB pays all third parties a similar fee, reasonably related to the processing work performed. MB manages its own business affairs and rents space in the real estate broker's office at the general market rate. MB submits loan applications to numerous lenders; only a few go to the lender participant.

HUD Analysis. HUD would consider MB to be a *bona fide* provider of settlement service business. MB has sufficient

capital to perform the services of a mortgage broker. The participants' interests are based on a fair value contribution and free from tie-ins to referrals of business. MB has its own staff, manages its own business, and pays a fair "general market value rent" for its space. The outsourced work is not a substantial portion of the mortgage brokerage services provided by MB, and MB pays all third party providers a similar fee for similar services.

While the real estate broker participant is the sole source of referrals to MB, MB sends only a small percent of its business to the lender participant, and actively refers loan business to other lenders. MB meets the AfBA exemption requirements: the real estate broker provides the AfBA disclosure; does not require the use of MB; and the only return is based on the profits and not on referrals. This is a *bona fide* AfBA.

[c] Example 3

A mortgage banker sets up a limited liability mortgage brokerage company (LLC). The mortgage banker sells shares in divisions of the LLC to real estate brokers and agents. For \$500 each, the real estate brokers and agents may purchase separate "divisions" within the LLC to which they refer customers for loans. Ownership distributions are based on the business each real estate broker or agent refers to his/her division, and not on his or her capital contribution to the entity as a whole. The LLC provides all the substantial services of a mortgage broker; it does not contract out any processing to its mortgage banker owner; and it sends loan packages to its mortgage banker owner as well as other lenders.

HUD analysis. Although the LLC is a *bona fide* provider of mortgage brokerage services, the CBA fails to meet the third condition of the CBA exception: *ownership interests vary based on referrals made and not on the amount contributed to the capitalization of the LLC.* These payments are not *bona fide* returns on ownership interest, but instead are an indirect method of paying a kickback based on the number of referrals.

[11] Penalties

Violation of Section 8 of RESPA is a federal misdemeanor, punishable by up to a year in prison and a \$10,000 fine, and will subject the violator to a civil action for treble damages plus costs and attorney's fees. n56

For a violation of Section 10 of RESPA (escrow accounts), the Secretary of Housing and Urban Development can assess a civil penalty of \$50.00 for each failure unless it is an intentional disregard for the requirement, in which case the penalty imposed is \$100.00. In neither case can the penalty exceed \$100,000.00 in any twelve-month period. n57

Finally, violations of Section 6 of RESPA (servicing transfers) will provide consumers with a private right of action for actual damages plus, in the case of a pattern or practice of non-compliance, court-awarded damages of up to \$1,000 (with aggregate limits for class actions), plus court costs and attorneys fees. n58

[12] Affiliated Business Arrangement Disclosure Statement Format

To: _____ From: _____

 (Entity Making Statement)

Property: _____ Date: _____

This is to give you notice that [referring party] has a business relationship with [settlement services provider(s)]. [Describe the nature of the relationship between the referring party and the provider(s), including percentage of ownership interest, if applicable.] Because of this relationship, this referral may provide [referring party] a financial or other benefit.

[A.] Set forth below is the estimated charge or range of charges for the settlement services listed. You are NOT required to use the listed provider(s) as a condition for [settlement of your loan on] [or] [purchase, sale, or refinance of] the subject property. THERE ARE FREQUENTLY OTHER SETTLEMENT SERVICE PROVIDERS AVAILABLE WITH SIMILAR SERVICES. YOU ARE FREE TO SHOP AROUND TO DETERMINE THAT YOU ARE RECEIVING THE BEST SERVICES AND THE BEST RATE FOR THESE SERVICES.

[Provider and settlement service] [Charge or range of charges]

[B.] Set forth below is the estimated charge or range of charges for the settlement services of an attorney, credit reporting agency, or real estate appraiser that we, as your lender, will require you to use, as a condition of your loan on this property, to represent our interests in the transaction.

[Provider and settlement service] [Charge or range of charges]

Acknowledgment

I/we have read this disclosure form, and understand that [referring party] is referring me/us to purchase the above-described settlement service(s) and may receive a financial or other benefit as the result of this referral.

Signature

[INSTRUCTIONS TO PREPARER:] [Use paragraph A for referrals other than those by a lender to an attorney, a credit reporting agency, or a real estate appraiser that a lender is requiring a borrower to use to represent the lender's interests in the transaction. Use paragraph B for those referrals to an attorney, credit reporting agency, or real estate appraiser that a lender is requiring a borrower to use to represent the lender's interests in the transaction. When applicable, use both paragraphs. Specific timing rules for delivery of the controlled business disclosure statement are set forth in 24 C.F.R. § 3500.15(b)(1) of Regulation X. These INSTRUCTIONS TO PREPARER should not appear on the statement.]

FOOTNOTES:

(n1)Footnote *. Revised by Robert M. Jaworski, Esq. a partner at Reed Smith, LLP in Princeton, New Jersey, and a member of its Consumer Financial Services and Bank Regulatory Groups. He is also a former Deputy Commissioner of the New Jersey Department of Banking and a frequent speaker and author on compliance-related topics. His practice includes providing federal and state compliance advice and assistance to all kinds of financial institutions, performing compliance audits, preparing multi-state surveys, and, in conjunction with Reed Smith litigators, defending individual and class actions brought against lenders. Barbara S. Mishkin, Esq. is a partner at Reed Smith, LLP, in Philadelphia.

(n2)Footnote 1. 12 U.S.C. § 2601 *et seq.* RESPA regulations (Regulation X) are found at 24 C.F.R. pt. 3500, Apps. A and B. *See generally* Real Estate Financing, ch. 4A (Matthew Bender) for a full discussion of RESPA and Regulation X.

(n3)Footnote 2. Housing and Community Development Act of 1992, *106 Stat. 3873, 3874*, Oct. 28, 1992.

(n4)Footnote 3. *See 12 U.S.C. § 2601(a)*.

(n5)Footnote 4. *24 C.F.R. § 3500.2*.

(n6)Footnote 5. *12 U.S.C. § 2607*.

(n7)Footnote 5.1. *See Beyer v. Heritage Realty, Inc.*, 251 F.3d 1155, 1158 (7th Cir. 2001) .

(n8)Footnote 6. *12 U.S.C. § 2602(1); 24 C.F.R. § 3500.2(b)*.

(n9)Footnote 7. *12 U.S.C. § 2602(1)*.

(n10)Footnote 8. Housing and Community Development Act of 1992, *106 Stat. 3873, 3874*, Oct. 28, 1992.

(n11)Footnote 9. *12 U.S.C. § 2606*.

(n12)Footnote 10. *24 C.F.R. § 226.3(a)(1)*. Persons may rely on Regulation Z in determining whether the exemption applies.

(n13)Footnote 11. *24 C.F.R. § 3500.2(b)*.

(n14)Footnote 12. *24 C.F.R. § 3500.5(b)*.

(n15)Footnote 12.1. *12 U.S.C. § 2607*.

(n16)Footnote 13. *12 U.S.C. § 2607(b)*.

(n17)Footnote 14. *See S. Rep. No. 866, 93rd Cong., 2d Sess. (1974), 1974 U.S.C.C.A.N. 6551*.

(n18)Footnote 14.1. *See, e.g., In re Znet Financial LLC*, Sept. 17, 2003 (www.hud.gov/offices/hsg/sfh/res/znet.pdf) (mortgage lender paid real estate agents as "employees" for each consumer referred to lender; real estate agents allegedly performed little or no origination work); *In re Intertrust Mortgage LLC*, August 28, 2003 (www.hud.gov/offices/hsg/sfh/res/intertrust.pdf) (mortgage lender gave real estate agents chances to win money in a drawing in return for referrals); and *In re Coldwell Banker United Realtors*, July 22, 2003 (www.hud.gov/officers/hsg/sfh/res/cbunited.pdf) (acceptance by real estate brokers and agents of free or below cost "virtual tours" from title companies in return for referrals of business). HUD has recently become more aggressive in pursuing enforcement actions for violations of Section 8, having entered into more than a dozen Section 8-related settlements during 2005 alone.

(n19)Footnote 15. *12 U.S.C. § 2607(c)(4)* provides in pertinent part:

Nothing in this section shall be construed as prohibiting ... (4) affiliated business arrangements so long as (A) a disclosure is made of the existence of such an arrangement to the person being referred and, in connection with such referral, such person is provided a written estimate of the charge or range of charges generally made by the provider to which the person is referred (i) in the case of a face-to-face referral or a referral made in writing or by electronic media, at or before the time of the referral (and compliance with this requirement in such case may be evidenced by a notation in a written, electronic, or similar system of records maintained in the regular course of business); (ii) in the case of a referral made by telephone, within 3 business days after the referral by telephone, (and in such case an abbreviated verbal disclosure of the existence of the arrangement and the fact that a written disclosure will be provided within 3 business days shall be made to the person being referred during the telephone referral);

or (iii) in the case of a referral by a lender (including a referral by a lender to an affiliated lender), at the time the estimates required under section 5(c) are provided (notwithstanding clause (i) or (ii)); and any required written receipt of such disclosure (without regard to the manner of the disclosure under clause (i), (ii), or (iii)) may be obtained at the closing or settlement (except that a person making a face-to-face referral who provides the written disclosure at or before the time of the referral shall attempt to obtain any required written receipt of such disclosure at such time and if the person being referred chooses not to acknowledge the receipt of the disclosure at that time, that fact shall be noted in the written, electronic, or similar system of records maintained in the regular course of business by the person making the referral), (B) such person is not required to use any particular provider of settlement services, and (C) the only thing of value that is received from the arrangement, other than the payments permitted under this subsection, is a return on the ownership interest or franchise relationship.

See also the other provisions of 12 U.S.C. § 2607, 24 C.F.R. § 3500.14(f), App. B and HUD Statement of Policy, 1996-2, 61 Fed. Reg. 29258 -29264 (June 7, 1996). For certain exemptions applying to cooperative brokerage and referral arrangements as well as to agreements between real estate brokers, see 24 C.F.R. § 3500.14(g)(1)(v).

Issues sometimes arise with respect to RESPA and the concept of preemption. RESPA's general preemption provision (12 U.S.C. § 2616) provides in pertinent part:

This Act does not annul, alter, affect, or exempt any person subject to the provisions of this Act from complying with the laws of any State with respect to settlement practices, except to the extent that those laws are inconsistent with any provision of this Act, and then only to the extent of the inconsistency. The Secretary is authorized to determine whether such inconsistencies exist. *The Secretary may not determine that any State law is inconsistent with any provision of this chapter if the Secretary determines that such law gives greater protection to the consumer.* In making these determinations the Secretary shall consult with the appropriate Federal agencies. [Emphasis added.]

RESPA also contains a separate preemption provision with respect to its affiliated business arrangement exemption. See 12 U.S.C. § 2607(d)(6). For a discussion of the issue of preemption, see *Mortgage Banker's Ass'n v. New Jersey Real Estate Comm'n*, 102 N.J. 176, 506 A.2d 733 (N.J. 1986). For a discussion of the "benefits" a RESPA-type statutory scheme would have on certain deceptive practices at the state level, see Comment, *Protecting the Real Estate Consumer: Traditional Theories of Liability Revisited, and a Look at Nebraska's Proposed Real Estate Consumer Protection Act*, 65 Neb. L. Rev. 188 (1986).

(n20)Footnote 15.1. *In re Closings of Tulsa, LLC*, March 21, 2005 (www.hud.gov/offices/hsg/sfh/res/tulsamcgraw.pdf); see also *In re Title Ventures.com*, July 1, 2003 (www.hud.gov/offices/hsg/sfh/res/titleventures.pdf) (involving multiple title insurance agency AfBAs each owned by a common organizer and a different mortgage broker or real estate broker; AfBAs apparently did not satisfy the test for legitimacy outlined in Statement of Policy 1996-2). See also, *In re Downing Homes, LLC*, Dec. 15, 2005 (www.hud.gov/offices/hsg/sfh/res/downinghomes.pdf) and *In re Title Group Builders*, Dec. 15, 2005 (www.hud.gov/offices/hsg/sfh/res/titlegroup.pdf), both of which involve similar facts.

(n21)Footnote 15.2. *In re the Matter of the Certificates of Authority of Commonwealth Land Title Insurance Company; Lawyer's Title Insurance Company; and Transnation Title Insurance Company*, Order No. O-05-155 (March 4, 2005) (www.dora.state.co.us/insurance/enforcement/2005/005-155.pdf).

(n22)Footnote 16. 12 U.S.C. § 2605.

(n23)Footnote 17. 12 U.S.C. § 2605(a); 24 C.F.R. § 3500.21(c)(3).

(n24)Footnote 18. 24 C.F.R. § 3500.21(c)(3).

(n25)Footnote 19. 24 C.F.R. § 3500.21(c)(3)(ii).

(n26)Footnote 20. 24 C.F.R. § 3500.21(c)(3)(iii).

(n27)Footnote 21. 12 U.S.C. § 2605(b).

(n28)Footnote 22. 12 U.S.C. § 2605(b)(2)(C); 24 C.F.R. § 3500.21(d).

(n29)Footnote 23. 12 U.S.C. § 2605(e); see *Curran v. Washington Mutual Bank, F.A.*, 2006 U.S. Dist. LEXIS 19817 (W.D. Ark., March 2, 2006) (charging a fee for responding to a qualified written request held not actionable under RESPA).

(n30)Footnote 24. Cong. Rec. Sept. 28, 1998, Pages H11746-H11796.

(n31)Footnote 25. 62 Fed. Reg. 25740 (May 9, 1997) . More recently, HUD has indicated, in its July 29, 2002 proposal to amend Regulation X, that it would soon finalize a regulation to eliminate the need to provide this form and replace it with a single sentence on the GFE. 67 Fed. Reg. 49134, 49137 (July 29, 2002) . However, no such regulation has yet been adopted.

(n32)Footnote 26. 12 U.S.C. § 2609.

(n33)Footnote 27. At times RESPA uses the term "lender" and at other times it uses the term "servicer." A lender creates a loan obligation, but may or may not service the loan.

(n34)Footnote 28. 12 U.S.C. § 2605(g).

(n35)Footnote 29. 61 Fed. Reg. 46512 .

(n36)Footnote 30. Pub. L. 101-625, approved Nov. 28, 1990.

(n37)Footnote 31. 59 Fed. Reg. 53890 .

(n38)Footnote 32. 60 Fed. Reg. 8812 .

(n39)Footnote 33. 50 Fed. Reg. 65442 .

(n40)Footnote 34. 60 Fed. Reg. 11194 .

(n41)Footnote 35. 60 Fed. Reg. 24734 .

(n42)Footnote 36. 63 Fed. Reg. 3214 .

(n43)Footnote 37. 60 Fed. Reg. 16985 .

(n44)Footnote 38. 61 Fed. Reg. 13232 .

(n45)Footnote 38.1. *State of La. v. Litton Mortgage Co.*, 50 F. 3d 1298, 1301 (5th Cir. 1995) ; *Alison v. Liberty Sav.*, 695 F.2d 1086 (7th Cir. 1982) ; *McAnaney v. Astoria Fin. Corp.*, 357 F. Supp. 2d 578 (D.N.Y., 2005) ; *Chow v. Aegis Mortg. Corp.*, 286 F. Supp. 2d 956 (D. Ill. 2003) . But see *Heller v. First Town Mortgage Corp.*, 1998 U.S. Dist. LEXIS 14427 (S.D.N.Y., 1998) ; *Vega v. First Federal Sav & Loan Ass'n of Detroit*, 622 F. 2d 918 (6th Cir. 1980) .

(n46)Footnote 39. 24 C.F.R. § 3500, Appendix B.

(n47)Footnote 40. 24 C.F.R. § 3500.7(b).

(n48)Footnote 41. A "yield spread premium" is a fee paid to a mortgage broker by a lender. The fee is percentage-based, and is given in cases where the mortgage broker obtains a higher yield for the lender than the lender's quoted requirements. The fee is often in addition to the fee paid by the borrower to the mortgage broker.

(n49)Footnote 42. 24 C.F.R. § 3500, App. B, no. 13.

(n50)Footnote 43. 62 Fed. Reg. 31982 .

(n51)Footnote 44. 62 Fed. Reg. 53812, 53913 (Oct. 16, 1997) .

(n52)Footnote 45. 15 U.S.C. § 1605(a)(6).

(n53)Footnote 46. 132 F.3d 692 (11th Cir. 1998) , *reh'g denied*, 1998 U.S. App. LEXIS 13227 (11th Cir. June 22, 1998) .

(n54)Footnote 47. 953 F. Supp. 367 (N.D. Ala. 1997) .

(n55)Footnote 48. 968 F. Supp. 1548 (S.D. Fla. 1997) .

(n56)Footnote 49. 968 F. Supp. 1548, 1560 (S.D. Fla. 1997) .

(n57)Footnote 50. No. 1:96-CV-0572-JOF (N.D. Ga. Sept. 5, 1997).

(n58)Footnote 51. 62 Fed. Reg. 53912 (Oct. 16, 1997) .

(n59)Footnote 51.1. H.R. 1283, 105th Cong. (introduced Apr. 10, 1997).

(n60)Footnote 51.2. S. 2223, 105th Cong. (introduced June 25, 1998).

(n61)Footnote 51.3. H.R. 4194, 105th Cong. (1998).

(n62)Footnote 51.4. Pub.L.No. 105-276, 112 Stat. 2461 (1998).

(n63)Footnote 51.5. H.R. Conf. Rep. No. 105-769, at 260 (1998).

(n64)Footnote 51.6. H.R. Conf. Rep. No. 105-769, at 260 (1998).

(n65)Footnote 51.7. 64 Fed. Reg. 10080 (Mar. 1, 1999) .

(n66)Footnote 51.8. 64 Fed. Reg. 10084 -10085.

(n67)Footnote 51.9. 64 Fed. Reg. 10085 .

(n68)Footnote 51.10. 64 Fed. Reg. 10085 .

(n69)Footnote 51.11. 64 Fed. Reg. 10085 -10086.

(n70)Footnote 51.12. 64 Fed. Reg. 10081, 10086 .

(n71)Footnote 51.13. 64 Fed. Reg. 10087 .

(n72)Footnote 51.14. *Culpepper v. Irwin Mortgage Corporation* 253 F. 3d 1324 (11th Cir. June 15, 2001) , *cert denied* *Irwin Mortg. Corp. v. Culpepper*, 122 S.Ct. 930, 151 L.Ed. 2d 893, 2002 U.S. LEXIS 588, 70 U.S.L.W. 3464

(2002) .

(n73)Footnote 51.15. 66 *Fed. Reg.* 53052 (Oct. 18, 2001) .

(n74)Footnote 51.16. *Glover v. Standard Federal Bank*, 283 F.3d 953 (8th Cir., Minn. 2002) ; *Schuetz v. Banc One Mortg. Corp.*, 292 F.3d 1004 (9th Cir. 2002) ; *Heimmermann v. First Union Mortg. Corp.*, 305 F.3d 1257 (11th Cir. 2002) .

(n75)Footnote 51.17. 67 *Fed. Reg.* 49134 (July 29, 2002) .

(n76)Footnote 51.18. Letter from Alphonso Jackson, Acting Secretary, U.S. Department of Housing and Urban Development, to Dr. John Graham, Administrator, Office of Information and Regulatory Affairs, Office of Management and Budget (March 22, 2004) (www.hud.gov/news/letter.pdf); and 70 *Fed. Reg.* 37646 (June 29, 2005) , providing Notice of the RESPA Reform Roundtables.

(n77)Footnote 51.19. 12 U.S.C. § 2607(b).

(n78)Footnote 51.20. 66 *Fed. Reg.* 53052, 53058-53059 (Oct. 18, 2001) .

(n79)Footnote 51.21. *Haug v. Bank of America*, 317 F. 3d 832 (8th Cir. 2003) ; *Boulware v. Crossland Mortgage Corporation*, 291 F. 3d 261 (4th Cir. 2002) ; *Krzalic v. Republic Title Co.*, 314 F. 3d 875 (7th Cir. 2002) *cert. denied*, 539 U.S. 958, 123 S. Ct. 2641, 156 L. Ed. 2d 656 (2003) .

(n80)Footnote 51.22. *Kruse v. Wells Fargo Home Mortg., Inc.*, 383 F. 3d 49 (2d Cir. 2004) ; *Santiago v. GMAC Mortgage Group, Inc.*, 417 F. 3d 384 (3d Cir. 2005) .

(n81)Footnote 51.23. *Sosa v. Chase Manhattan Mortg. Corp.*, 348 F. 3d 979 (11th Cir. 2003) *reh'g, en banc, denied*, 90 *Fed. Appx.* 385 (11th Cir. 2003) .

(n82)Footnote 51.24. *Kruse v. Wells Fargo Home Mortg., Inc.*, 383 F. 3d 49 (2d Cir. 2004) ; *Santiago v. GMAC Mortgage Group, Inc.*, 417 F. 3d 384 (3d Cir. 2005) .

(n83)Footnote 52. *See generally* 12 U.S.C. § 2607(c)(4); 24 C.F.R. § 3500.15.

(n84)Footnote 53. Pub. L. 98-181, 97 *Stat.* 1230.

(n85)Footnote 54. 24 C.F.R. § 3500.15(a); 12 U.S.C. § 2602(7).

(n86)Footnote 54.1. Pub.L. 104-208, § 2103(f), 110 *Stat.* 3009.

(n87)Footnote 54.2. An exception has been made for the requirement by a lender for a buyer, borrower, or seller to pay for the services of an attorney, credit reporting agency, or real estate appraiser chosen by the lender to represent the lender's interest. An attorney or law firm is allowed to arrange for issuance of a title insurance policy for a client as part of the representation of that client in a real estate transaction. 24 C.F.R. § 3500.15(b).

(n88)Footnote 55. 12 U.S.C. § 2607(c)(4).

(n89)Footnote 55.1. *See* 12 U.S.C. §§ 2602(7) and 2607(c)(4)(C); *Gardner v. First American Title Ins. Co.*, 296 F. Supp. 2d 1011, 1016-1017 (D. Minn. 2003) .

(n90)Footnote 55.2. *See Gardner v. First American Title Ins. Co.*, 296 F. Supp. 2d 1011, 1017 (D. Minn. 2003) .

(n91)Footnote 55.3. 61 *Fed. Reg.* 29258 (June 7, 1996) .

(n92)Footnote 55.4. *61 Fed. Reg.* 29262 .

(n93)Footnote 55.5. *See* discussion in § 14.02[3] *above* concerning enforcement actions taken by HUD and state officials involving AfBAs.

(n94)Footnote 55.6. *61 Fed. Reg.* 29255 .

(n95)Footnote 55.7. *61 Fed. Reg.* 29257 .

(n96)Footnote 55.8. *61 Fed. Reg.* 29258 .

(n97)Footnote 55.9. *61 Fed. Reg.* 29262 .

(n98)Footnote 55.10. *61 Fed. Reg.* 29266 ; *see also, e.g., In re Hometown One Associates, Inc. d/b/a Remerica Hometown One*, September 12, 2005 (www.hud.gov/offices/hsg/sfh/res/remerica.pdf), one of several HUD settlements executed in 2005 concerning room rental arrangements found by HUD to be objectionable.

(n99)Footnote 55.11. *61 Fed. Reg.* 29265 .

(n100)Footnote 55.12. *61 Fed. Reg.* 29266 .

(n101)Footnote 56. *12 U.S.C. § 2607(d)(1)(2)*.

(n102)Footnote 57. *12 U.S.C. § 2609(d)(1)*.

(n103)Footnote 58. *12 U.S.C. § 2605(f)*.

* This chapter was revised by Mary J. Burt, Esq. In 2006, Section 14.02 was revised by Robert M. Jaworski, Esq., and Section 14.04 revised by Barbara S. Mishkin, Esq. Both are partners at Reed Smith, LLP and members of its Financial Services Regulatory Group, practicing, respectively, in the Firm's Princeton, New Jersey and Philadelphia, Pennsylvania offices. Their practice includes providing federal and state compliance advice and assistance to all kinds of financial institutions, performing compliance audits, preparing multi-state surveys, and, in conjunction with Reed Smith litigators, defending individual and class actions brought against lenders. Mr. Jaworski is also a former Deputy Commissioner of the New Jersey Department of Banking and a frequent speaker and author on compliance-related topics. Section 14.15, written by Sandra R. Bullington, Esq. in 2000, has been adapted from *Home Owner Associations and Planned Unit Developments--Law and Forms*, ch. 6 (Matthew Bender) and was completely revised in 2010.

Additional updates throughout the chapter were contributed by Sandra Bullington, Esq.



42 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.03

§ 14.03 The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA)

The Foreign Investment in Real Property Tax Act of 1980 (FIRPTA) n1 was enacted to eliminate the tax advantages foreign investors had long enjoyed over their domestic counterparts with respect to capital gains realized from the disposition of United States real estate. n2 This controversial statute was amended in 1984 to require withholding by the purchaser of ten percent of the proceeds of the sale of a United States real estate interest by a foreign person or entity. n3

The law also requires a real estate broker representing a foreign seller to notify the purchaser and the IRS that withholding of taxes may be required. n4 If the broker knows the seller is a foreign corporation, he or she is required to provide notice of that fact. Moreover, if the broker is acting on behalf of a foreign corporation, the statute creates a conclusive presumption that the broker knows that it is a foreign corporation. n5

Failure to provide the purchaser and the IRS with the required notice subjects the broker to the duty to withhold taxes, and the broker is liable for the tax up to the amount of the compensation he or she is to receive. Furthermore, the broker may also incur civil liability for failing to properly notify the purchaser, and may be subject to criminal sanctions under the conspiracy laws. n6

There are exemptions from the requirements if:

- (1) the seller furnishes to the purchaser an affidavit stating, under penalty of perjury, the seller's United States taxpayer identification number and that the seller is not a foreign person;
- (2) if the domestic corporation furnishes to the transferee an affidavit by the domestic corporation stating, under penalty of perjury, that the domestic corporation is not and has not been a United States real property holding corporation, or as of the date of the disposition, interests in the corporation are not United States real property interests;
- (3) the transferee receives a qualifying statement from the Secretary of the IRS as prescribed by regulations;

(4) the property is acquired by the purchaser for his or her use as a residence, and the amount realized for the property does not exceed \$300,000; or

(5) the disposition is of a share of a class of stock that is regularly traded on an established securities market. n7

The statute also provides limitations on the amount required to be withheld: n8

(1) the amount cannot exceed the transferor's maximum tax liability; or

(2) the Secretary of the Treasury has prescribed a reduced amount.

FOOTNOTES:

(n1)Footnote 1. *I.R.C. §§ 861(a)(5), 897, 6039C, 6652(g)*, as amended by the Tax Reform Act of 1984, codified at *I.R.C. § 1445*.

(n2)Footnote 2. For a full discussion of FIRPTA's background and development, see *Real Estate Financing*, ch. 4A (Matthew Bender).

(n3)Footnote 3. See generally Holdmann, *The New FIRPTA Withholding Rules--Brokers, Agents, Settlement Officers, Attorneys: Beware!*, 12 J. Real Estate Tax'n 261 (1985).

(n4)Footnote 4. *I.R.C. § 1445*.

(n5)Footnote 5. *I.R.C. § 1445*.

(n6)Footnote 6. Holdmann, *The New FIRPTA Withholding Rules--Brokers, Agents, Settlement Officers, Attorneys: Beware!*, 12 J. Real Estate Tax'n 261, 266 (1985).

(n7)Footnote 7. *I.R.C. § 1445(b)*.

(n8)Footnote 8. *I.R.C. § 1445(c)*.

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43 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.04

§ 14.04 Federal Truth-in-Lending Legislation*

[1] Introduction

Since most real estate sales are financed, real estate brokers should be familiar with the Federal Truth-in-Lending Act (TILA), n1 which is administered by the Federal Reserve Board of Governors. In general, TILA and Regulation Z n2 (Reg. Z) require mortgage lenders to disclose to consumers the total dollar payments for the life of the loan and the total finance charge. n3 TILA affects transactions in which (1) credit is offered or extended to consumers, (2) the creditors regularly extend credit, (3) the loans are to be repaid in more than four installments, and (4) the loans are intended primarily for personal, family, or household purposes. TILA also deals with certain elements of real estate broker advertising and the disclosure of the assumability of loans. n4

[2] Required Disclosures

For an average closed-end mortgage transaction, where a mortgage on real estate is taken as security, the following are among the items that must be disclosed:

- (a) the identity of the creditor;
- (b) the amount financed;
- (c) the notice of a right to receive a written itemization of the amount financed;
- (d) the finance charge;
- (e) the finance charge expressed as an annual percentage rate (APR);
- (f) additional disclosures if the loan has an APR that increase after consummation;
- (g) the total of payments;
- (h) a payment schedule;

- (i) a demand feature, if the loan has one;
- (j) the "total sale price;"
- (k) descriptions of specified terms, including, but not limited to, "amount financed" and "finance charge";
- (l) late charges;
- (m) a description of the security property; and
- (n) the assumption policy for residential mortgage transactions. n5

Disclosures must be given before consummation of the transaction. Some must be given within 3 business days of application, while others are typically given prior to or at the closing when the consumer becomes obligated on the credit transaction. Special rules apply to the timing of disclosures required for "residential mortgage transactions" n6 that are subject to the Real Estate Settlement Procedures Act. n7 For these loans, the disclosures required by TILA and Regulation Z must either be given at consummation or delivered or placed in the mail not later than three business days after the creditor receives the consumer's written application, whichever is earlier. n8 If a good faith estimate of finance charges (required by RESPA) is given, the lender need not provide an itemization of the amount financed. n9

Real estate brokers may be required to make the disclosures if the broker regularly extends consumer credit more than five times a year and the extension of credit involves a security interest in a dwelling. n10

In addition to the above disclosure requirements, certain mortgages are subject to "The Homeownership and Equity Protection Act of 1994" (HOEPA), contained in the Riegle Community Development and Regulatory Improvement Act of 1994 (Community Development Act). n11 HOEPA also imposed new disclosure requirements to assist consumers in comparing the cost of reverse mortgage transactions. This product provides periodic advances primarily to elderly homeowners and relies principally on the home's value for repayment.

Section 152 of the HOEPA added a new section 129 to TILA. HOEPA governs all mortgage transactions having rates or fees above a certain percentage or amount ("Section 32 mortgages," as found in Sec. 226.32 of Regulation Z). n12 Section 32 mortgages must comply with the following additional requirements:

- (1) The creditor must give the borrower the following notice: **"You are not required to complete this agreement merely because you have received these disclosures or have signed a loan application. If you obtain this loan, the lender will have a mortgage on your home. You could lose your home, and any money you have put into it, if you do not meet your obligations under the loan."** n13
- (2) The creditor must allow the borrower a three-day "cooling off" period (in addition to the three-day rescission period which must be allowed to consumers who refinance their mortgage) between the time a consumer is furnished with special disclosures about a Section 32 mortgage and the time the consumer becomes obligated under the loan. n14
- (3) The creditor must provide new Section 32 mortgage disclosures if, after giving the disclosures to the consumer and before consummation, the creditor changes any terms that make the disclosures inaccurate. n15
- (4) No "balloon" payments on Section 32 mortgages with a term under 5 years. n16

- (5) No negative amortization provisions. n17
- (6) No more than two periodic payments paid in advance from the proceeds. n18
- (7) No prepayment penalties, with certain exceptions. n19
- (8) A notice to assignee that the assignee could be liable for all claims and defenses that the borrower could assert against the creditor. n20
- (9) No refinancing within 12 months of a Section 32 mortgage with another Section 32 mortgage by the holder or the creditor of the Section 32 mortgage being refinanced. n20.1
- (10) No documenting closed-end loans as open-end loans in order to evade the Section 32 mortgage restrictions. n20.2
- (11) No "due-on-demand" or call provisions. n20.3
- (12) The creditor must verify and document the borrower's repayment ability or be presumed to be engaging in a pattern or practice of making loans without regard to the borrower's repayment ability. n20.4

In 1996, Congress directed the Board of Governors of the Federal Reserve System and the Secretary of Housing and Urban Development to take whatever action is necessary to simplify and improve the disclosures applicable to transactions subject to the Truth in Lending Act and the Real Estate Settlement Procedures Act, and to provide a single format for disclosures to satisfy the requirements of the two Acts. n21 A proposed regulation was published in the Federal Register on April 2, 1997, n22 indicating that legislative changes needed to be made before HUD and the Board could comply with the Congressional mandate.

Thereafter, HUD and the Board, in July 1998, submitted a report to Congress containing numerous recommendations for reform (FRB-HUD Report). n22.1 Among its more important recommendations were that:

- (1) the finance charge and Annual Percentage Rate (APR) concepts in TILA be retained, with the definition of finance charge being expanded to include virtually all costs the consumer is required to pay to close the loan;
- (2) creditors be required either to offer borrowers a package of settlement services at a guaranteed price, in which case the creditor would be exempt from RESPA section 8, or to provide a good faith estimate of closing costs that is accurate within a prescribed tolerance;
- (3) initial disclosures be provided either at borrower's first contact with the lender or broker and before they pay any significant fee, as recommended by HUD, or no later than three days after application, as recommended by the Board; and
- (4) additional substantive protections be established to protect consumers against abusive lending practices.

With regard to the last of these recommendations, HUD and the Board recommended that:

- (a) TILA "Section 32" limitations on balloon loans be expanded,

- (b) collection of lump-sum credit insurance premiums be outlawed, and
- (c) minimum standards for pre-foreclosure notices be prescribed.

Additionally, HUD recommended that:

- (a) Section 32 thresholds be lowered,
- (b) prohibitions against "loan flipping" and other abusive tactics be established,
- (c) foreclosure prevention strategies be ordered,
- (d) education and pre-closing counseling be required, and
- (e) Congress establish federal private remedies for victims of "unfair and deceptive acts and practices."

Almost immediately after its issuance, the FRB-HUD Report met with substantial criticism. Hearings were held in July and September, 1998, at which Congressional representatives expressed disappointment with the FRB-HUD recommendation for a dual-disclosure system, and that they did not attempt to resolve the RESPA section 8 YSP issue or address the issue of paperwork reduction. n22.2 Thereafter, efforts to achieve comprehensive RESPA/TILA reform went underground, with various interest groups continuing to engage in a dialogue with the FRB and HUD; and did not resurface until July 29, 2002 when HUD proposed a comprehensive overhaul of Regulation X which included many of the recommendations in the FRB-HUD Report. n22.3

Besides addressing the issue regarding disclosure of yield spread premiums, n22.4 this proposed overhaul would have made significant changes to the existing form of good faith estimate, the manner in which it is used and the consequences of using it incorrectly. HUD's intent was to convert the good faith estimate into something that consumers could and would use to shop for a mortgage loan. HUD recognized that the current form is inadequate for this purpose since

- (i) it is given too late (typically after the consumer has selected a loan originator and paid a significant fee) to be of any real value in shopping for a loan;
- (ii) it does not provide all of the information a consumer needs to effectively shop;
- (iii) the fee estimates included in it often do not correlate to the actual fees charged; and
- (iv) there is no mechanism to force lenders and brokers to provide more realistic estimates. n22.5

HUD's proposal would have also permitted lenders, and others,

- (1) to offer borrowers a "Guaranteed Mortgage Package" (GMP) of required settlement services at a fixed price, and
- (2) to enter into referral fee arrangements with those settlement service providers who participate in the GMP, free from Section 8 constraints. n22.6

The comment period for the proposal ended on October 28, 2002. n22.7 In March 2004, HUD withdrew its proposed RESPA reform rule, citing concerns expressed by members of Congress and key members of consumer and industry

groups. n22.8

[3] Other Recent Changes

On September 30, 1995, the Congress enacted the Truth in Lending Act Amendments of 1995 (1995 Amendments). n23 The 1995 Amendments addressed the concerns of mortgage lenders after a 1994 court decision, *Rodash v. AIB Mortgage Co.* n24 In the *Rodash* case, the U.S. Court of Appeals affirmed a district court opinion that allowed a consumer to rescind a home mortgage loan. The consumer was allowed to recover all fees and finance charges that had been paid, based in part on errors in the creditor's Truth in Lending Act disclosures. After the *Rodash* decision, a number of class action lawsuits were filed, involving thousands of mortgage loans, alleging similar violations, and seeking the remedy of rescission.

In response to mortgage lenders' concerns about their potential liability for finance charge violations that they viewed as minor, the Congress enacted a temporary moratorium on the litigation. The moratorium was replaced by the 1995 Amendments. The 1995 Amendments established new liability rules for loans consummated before and after September 30, 1995, established a new rule that includes all mortgage broker fees in the finance charge disclosure, and clarified the proper treatment of other fees. In May 1996, the Board published proposed regulations to implement the amendments with respect to loans made after September 30, 1995. n25

More recently, certain sections of TILA were amended by the "Economic Growth and Regulatory Paperwork Reduction Act of 1996." n26

In 2001, the Federal Reserve Board created a new Subpart F in Regulation Z (12 C.F.R. § 226.36) establishing rules that apply to all "electronic communication" provided under Regulation Z. "Electronic communication" is defined as an electronic message delivered between a creditor and a consumer in a format that allows visual text to be displayed on equipment such as a personal computer monitor. n27 Consistent with the Electronic Signatures in Global and National Commerce Act, 15 U.S.C. § 7001 *et seq.* (the "E-Sign Act"), electronic disclosures may only be given if:

- (1) the creditor has disclosed the requirements for accessing and retaining the disclosures in that format,
- (2) the consumer has demonstrated the ability to access the information electronically and affirmatively consents to electronic delivery, and
- (3) the disclosures are provided in accordance with certain requirements. n27.1

Amendments to Regulation Z in 2002 had the following effects:

- Lowered the APR trigger for first-lien loans from 10% to 8%; n27.2
- Effectively lowered the "points and fees" trigger ("points and fees" that exceed 8% of the "total loan amount") by including in the definition of "points and fees" any amounts paid at closing for optional credit life, accident, health, or loss-of-income insurance, and other debt-protection products written in connection with the loan. (Such amounts, if financed by the creditor, must also be deducted from the amount financed in calculating the "total loan amount."); n27.3
- Prohibited "due-on-demand" or call provisions in HOEPA loans; n27.4 and
- Enhanced the HOEPA 3-day "cooling off" disclosure to require disclosure of the "total amount borrowed" (with a \$100 tolerance) and to specify whether it includes the cost of any optional insurance. n27.5

Additionally, Section 226.34 prohibits creditors from performing certain acts or practices in connection with HOEPA loans, such as:

- Except in limited circumstances, refinancing within 12 months of a HOEPA loan with another HOEPA loan by the holder or the creditor of the first HOEPA loan; n27.6
- Wrongfully documenting closed-end loans as open-end loans in order to evade the HOEPA restrictions; n27.7 and
- Engaging in a pattern or practice of making loans without regard to the borrower's ability to repay. There is a presumption that a creditor violates this prohibition if the creditor generally does not verify and document the borrower's repayment ability. n27.8

In 2004, in addition to electing not to finalize an earlier proposed modification of the definition of "clear and conspicuous," the Federal Reserve Board made the following changes:

- Clarified that where Regulation Z requires a creditor to an "amount," the creditor is required to disclose a "numerical amount"; n27.9
- Amended the Official Commentary to provide "bright-line" guidance that where a creditor fails to provide the consumer with an address for sending the notification of rescission, the consumer may deliver such notice to the person or address to which the consumer has been directed to send payments; n27.10 and
- In circumstances where a transaction has been rescinded, clarified that although a court may modify the procedures for tendering money and property under section 226.15(d), such modification cannot affect a consumer's substantive right to rescind. Thus, where a consumer's rescission right is challenged by a creditor, a court will normally establish the consumer's rescission right and determine the amounts owed before establishing the procedures for the parties to tender any money or property n27.11

In 2005, several amendments to TILA were made by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005. n27.12 These amendments require new disclosures to be given in connection with closed-end mortgage loans and home equity lines of credit. Monthly billing statements for home equity lines of credit will need to include a "minimum payment warning" which informs the consumer that making the minimum payment will increase the interest the consumer pays and the time to repay the balance, together with other minimum payment information. In addition, such billing statements will need to include the payment due date, or if different, the earliest date on which a late fee may be charged and the amount of any late fee that would be charged if payment is made after such date.

The 2005 TILA amendments also require new disclosures advising the consumer of the nondeductibility of interest on the portion of a mortgage loan or home equity line of credit that exceeds the property's fair market value. For home equity lines of credit, this disclosure must appear in the disclosures required to be given at application. For closed-end mortgage loans, this new disclosure must be given at application. In addition, for both types of credit, a new nondeductibility disclosure must be included in advertisements for loan programs where the credit amount can exceed the property's fair market value.

The Federal Reserve Board is directed by the 2005 TILA amendments to prescribe regulations to implement the amendments. None of the amendments will be effective earlier than 12 months after the Federal Reserve Board publishes final regulations. Also, in 2005, the Federal Reserve Board issued a second advance notice of proposed rulemaking regarding the open-end (revolving) credit rules in Regulation Z. n27.13 An initial notice of proposed

rulemaking had been published by the Federal Reserve Board in 2004 to solicit comment on the open-end rules. n27.14 However, the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 became law shortly after the close of the comment period on the 2004 proposal. Accordingly, the Federal Reserve Board issued the second notice in order to reopen and extend the closed comment period and obtain comments on implementing the TILA amendments contained in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.

[4] Offer or Extension of Credit

The statute requires disclosure for those who "offer or extend" credit. n27.15 If a real estate broker regularly offers or extends credit out of commissions advanced to assist in completion of closings, TILA applies because the conduct would clearly constitute the extension of credit for personal, family, or household services. n28

A creditor includes a person originating, during any 12-month period, two or more Section 32 mortgage loans, or one or more such mortgage loans through a mortgage broker. A person that originates one Section 32 mortgage during a 12-month period is not covered. A person that originates three home-secured loans, two of which are secured by Section 32 mortgages, will be required to comply for the latter two transactions. Persons making fewer than five home-secured loans during a calendar year--that do not meet the definition of a Section 32 mortgage--are not subject to the act. n29

[5] Credit Advertising

TILA also provides for requirements applicable to advertisements made to promote or assist a loan subject to TILA. n30 These requirements apply to real estate brokers who advertise in the newspaper, offering properties for sale with financing available.

Only those credit terms that are actually available may be advertised, n31 and the rate must be disclosed as an annual percentage rate (APR) as defined by TILA. n32 If the APR is subject to variation after consummation of the transaction (as in the case of variable rate mortgages), this must also be disclosed. n33

The advertising terms that require additional disclosures include (1) the amount or percentage of any downpayment; (2) the number of payments or period of repayment; (3) the amount of any payment; and (4) the amount of any finance charge. n34 If any of these terms are used, the creditor must also include the following additional disclosures: (1) the amount or percentage of any down payment; (2) the terms of repayment; (3) the APR; and (4) any variable rate feature. n35

[6] Enforcement

TILA is enforced by either the regulatory agency charged with the enforcement against that particular creditor, or through a private cause of action, creating both civil and criminal liability. Criminal liability is imposed only for a willful and knowing violation of TILA, n36 and there is a broad exemption if the creditor notifies the consumer of the error and takes necessary corrective action. n37 Civil liability allows the consumer to recover not only actual damages but also a statutory penalty. n38 The statutory penalty in the case of an individual action is twice the amount of the finance charge, with a minimal recovery in the case of an individual action relating to a credit transaction not under an open end credit plan secured by real property or a dwelling of not less than \$200 or greater than \$2000. n39 The creditor may also be liable for damages under both federal and state statutes, n40 and for attorneys' fees. n41

FOOTNOTES:

(n1)Footnote *. In 2006, Section 14.04 was revised by Barbara S. Mishkin, a partner at Reed Smith, LLP in its Philadelphia, Pennsylvania office. Prior revisions of this section were prepared by Robert M. Jaworski and Peter E. Giamporcaro. Mr. Jaworski is a partner, and Mr. Giamporcaro is a counsel, at Reed Smith, practicing, respectively, in the Firm's Princeton, New Jersey and Philadelphia, Pennsylvania offices. All three are members of Reed Smith's

Financial Services Regulatory Group.

(n2)Footnote 1. *15 U.S.C. § 1601 et seq.*

(n3)Footnote 2. *12 C.F.R. pt. 226.*

(n4)Footnote 3. Practitioners are urged to study the valuable guidance provided by the Federal Reserve Board in the Commentary to Reg. Z.

(n5)Footnote 4. *15 U.S.C. § 1638(a)(13).*

(n6)Footnote 5. *15 U.S.C. § 1638(a); 12 C.F.R. § 226.18.*

(n7)Footnote 6. A "residential mortgage transaction" is defined in Regulation Z as a transaction in which a mortgage is "created or retained against the consumer's dwelling to finance the acquisition or initial construction of" the dwelling. *15 U.S.C. § 1602(w).*

(n8)Footnote 7. *12 U.S.C. § 2601 et seq.*

(n9)Footnote 8. *15 U.S.C. § 1602(w).*

(n10)Footnote 9. *12 C.F.R. Part 226 Supplement I, P 226.19(a)(1), Official Staff Commentary.*

(n11)Footnote 10. *12 C.F.R. § 226.2(17).*

(n12)Footnote 11. *Pub. L. 103-325, 108 Stat. 2160.*

(n13)Footnote 12. *15 U.S.C. § 1639.* Generally, a Section 32 mortgage will be one in which the borrower pays more than 8 percent in points and fees prior to or at closing, including fees paid to mortgage brokers, or where the APR exceeds the yield on US Treasury securities of comparable maturity by 8 percent, for first-lien loans, or 10 percent, for subordinate lien loans. *12 C.F.R. § 226.32(a)(1).*

(n14)Footnote 13. *12 C.F.R. § 226.32(c)(1).*

(n15)Footnote 14. *12 C.F.R. § 226.31(c)(1).*

(n16)Footnote 15. *12 C.F.R. § 226.32(c)(1)(i).*

(n17)Footnote 16. *12 C.F.R. § 226.32(d)(1)(i).*

(n18)Footnote 17. *12 C.F.R. § 226.32(d)(2).*

(n19)Footnote 18. *12 C.F.R. § 226.32(d)(3).*

(n20)Footnote 19. *12 C.F.R. § 226.32(d)(6)-(7).*

(n21)Footnote 20. *12 C.F.R. § 226.32(e)(3).*

(n22)Footnote 20.1. *12 C.F.R. § 226.34(a)(3).*

(n23)Footnote 20.2. *12 C.F.R. § 226.34(b).*

(n24)Footnote 20.3. *12 C.F.R. § 226.32(d)(8).*

(n25)Footnote 20.4. *12 C.F.R. § 226.34(a)(4).*

(n26)Footnote 21. Section 2101 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996.

(n27)Footnote 22. *62 Fed. Reg. 15624* .

(n28)Footnote 22.1. Joint Report to the Congress discussing Reform to the Truth in Lending Act and the Real Estate Settlement Procedures Act (Dep't of Housing and Urban Development; Federal Reserve Board, July 1998) (<http://www.federalreserve/boarddocs/rptcongress/tila.pdf>).

(n29)Footnote 22.2. *Mortgages/Rep. Lazio Reports Criticism of Report on Reform of Mortgage Loan Disclosure*, 70 BNA's Banking Report No. 10 (Sept. 21, 1998).

(n30)Footnote 22.3. *67 Fed. Reg. 49134* (July 29, 2002) .

(n31)Footnote 22.4. See discussion near the end of § 14.02[6].

(n32)Footnote 22.5. *67 Fed. Reg. 49135, 49159-49160* .

(n33)Footnote 22.6. *67 Fed. Reg. 49160 -49161*.

(n34)Footnote 22.7. *67 Fed. Reg. 49134* .

(n35)Footnote 22.8. Letter from Alphonso Jackson, Acting Secretary, U.S. Department of Housing and Urban Development, to Dr. John Graham, Administrator, Office of Information and Regulatory Affairs, Office of Management and Budget (March 22, 2004) (www.hud.gov/news/letter.pdf).

(n36)Footnote 23. Pub. L. 104-29, *109 Stat. 271*.

(n37)Footnote 24. *16 F.3d 1142 (11th Cir. 1994)*.

(n38)Footnote 25. *61 Fed. Reg. 26126* .

(n39)Footnote 26. Congressional Record - House, page H11750, Sept. 28, 1996. Secs. 2105, 2106, and 2107 of the Economic Growth and Regulatory Paperwork Reduction Act of 1996; Congressional Record - House, page H11750, Sept. 28, 1996.

(n40)Footnote 27. *12 C.F.R. § 226.36(a)*.

(n41)Footnote 27.1. *12 C.F.R. Part 226 Supplement I, P 226.36(b), Official Staff Commentary*.

(n42)Footnote 27.2. *12 C.F.R. § 226.32(a)(1)(i)*.

(n43)Footnote 27.3. *12 C.F.R. § 226.32(b)(1)*.

(n44)Footnote 27.4. *12 C.F.R. § 226.32(d)(8)*.

(n45)Footnote 27.5. *12 C.F.R. § 226.32(c)(5)*.

(n46)Footnote 27.6. *12 C.F.R. § 226.34(a)(3)*.

(n47)Footnote 27.7. *12 C.F.R. § 226.34(b)*.

(n48)Footnote 27.8. *12 C.F.R. § 226.34(a)(4)*.

(n49)Footnote 27.9. *12 C.F.R. § 226.2(b)(5)*; *12 C.F.R. Part 226 Supplement I, P 226.2(b), Official Staff*

Commentary.

(n50)Footnote 27.10. 12 C.F.R. Part 226 Supplement I, P 226.15(a)(2), *Official Staff Commentary*.

(n51)Footnote 27.11. 12 C.F.R. Part 226 Supplement I, P 226.15(d)(4), *Official Staff Commentary*.

(n52)Footnote 27.12. Pub. L. No. 109-8, *119 Stat. 23 (2005)*.

(n53)Footnote 27.13. *70 Fed. Reg. 60235 (Oct. 17, 2005)* .

(n54)Footnote 27.14. Fed. Reg. 70925 (Dec. 8, 2004).

(n55)Footnote 27.15. *15 U.S.C. § 1602(f)*.

(n56)Footnote 28. *de Jesus v. Banco Popular de Puerto Rico*, 918 F.2d 232, 234 (1st Cir. 1990) .

(n57)Footnote 29. *60 Fed. Reg. 15463* , Mar. 24, 1995.

(n58)Footnote 30. *12 C.F.R. § 226.24*.

(n59)Footnote 31. *12 C.F.R. § 226.24(a)*.

(n60)Footnote 32. *12 C.F.R. § 226.24(b)*.

(n61)Footnote 33. *12 C.F.R. § 226.24(b)*.

(n62)Footnote 34. *12 C.F.R. § 226.24(c)(1)*.

(n63)Footnote 35. *12 C.F.R. § 226.24(c)(2)*.

(n64)Footnote 36. *15 U.S.C. § 1640*.

(n65)Footnote 37. *15 U.S.C. § 1640*.

(n66)Footnote 38. *15 U.S.C. § 1640*.

(n67)Footnote 39. *15 U.S.C. § 1640(a)(2)(A)*

(n68)Footnote 40. *15 U.S.C. § 1640*.

(n69)Footnote 41. *15 U.S.C. § 1640*.

* This chapter was revised by Mary J. Burt, Esq. In 2006, Section 14.02 was revised by Robert M. Jaworski, Esq., and Section 14.04 revised by Barbara S. Mishkin, Esq. Both are partners at Reed Smith, LLP and members of its Financial Services Regulatory Group, practicing, respectively, in the Firm's Princeton, New Jersey and Philadelphia, Pennsylvania offices. Their practice includes providing federal and state compliance advice and assistance to all kinds of financial institutions, performing compliance audits, preparing multi-state surveys, and, in conjunction with Reed Smith litigators, defending individual and class actions brought against lenders. Mr. Jaworski is also a former Deputy Commissioner of the New Jersey Department of Banking and a frequent speaker and author on compliance-related topics. Section 14.15, written by Sandra R. Bullington, Esq. in 2000, has been adapted from Home Owner Associations and Planned Unit Developments--Law and Forms, ch. 6 (Matthew Bender) and was completely revised in 2010.

Additional updates throughout the chapter were contributed by Sandra Bullington, Esq.



44 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.05

§ 14.05 Land Use Legislation

[1] In General

There are several federal laws restricting land use. For example, the National Flood Insurance Program n1 restricts development in flood hazard areas, and the Federal Endangered Species Act n2 restricts development in designated critical habitats or other areas in which endangered species may be present. Under the Safe Drinking Water Act, n3 land use restrictions are enacted in counties located atop any aquifer recharge areas and wellhead protection areas. The Clean Water Act n4 creates a well preservation program by restricting development in wetlands areas.

Based on the activities they regulate, federal environmental laws can be categorized as pertaining to: (1) pollution control; (2) chemical regulation; or (3) environmental review and protection. Pollution control statutes regulate the discharge of contaminants in the air, the land, and the water. n5 They also create liability for the remediation of inactive waste disposal sites. For example, The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA) n6 creates restrictions on land use by prohibiting the deposit of hazardous materials on property and requiring clean up programs to remediate contaminated sites. n7

Chemical regulation statutes address the handling, use, manufacture, and transportation and distribution of material. n8 Environmental review and protection statutes impose substantive and procedural rule, in connection with other environmental programs. n9

[2] Historic District and Landmarks Preservation Laws

The National Historic Preservation Act was enacted in 1966. It requires consultation between federal agencies and the Advisory Council on Historic Preservation. n10 The Secretary of Interior is authorized under the Act to expand and maintain the National Register of Historic Places, composed of districts, sites, buildings, structures, and objects significant in American history, architecture, archeology, engineering, and culture. n11 The Secretary may accept a nomination from any person or local government for inclusion of a property in the National Register. n12 However, if the owner or owners of any privately owned property, or the majority of the owners of such properties within an historic district, object to the inclusion or designation, the property shall not be included in the National Register or designated as a national historic landmark until the objection is withdrawn. n13

Once a property is designated as a national historic landmark, the responsibility for preserving the property lies with the Secretary of the Interior. n14 Predictably, this impacts the ability to redevelop an area, district, or even a specific site. Real estate brokers are advised to check the National Register to determine whether a property is a national historic landmark.

[3] Air Rights

Air rights, separate units of real property created by the horizontal subdivision of real estate, may be defined as rights to occupy the space above, over, beneath, or on a designated parcel of land. n15 In recent years, there has been a growing interest in air rights projects throughout the United States. n16

It is important that real estate brokers determine the status of air rights to particular properties they are trying to sell, especially in large metropolitan areas. The possibility that a commercial property's air rights were previously transferred by a long-term lessee of the premises should always be considered. Appropriate inquiries should be made before a broker makes any representations to prospective purchasers with respect to the availability of development rights. n17

[4] Building Moratoria

To effectively service both sellers and buyers of real estate, real estate brokers also need to keep abreast of local zoning ordinances that may affect the right to develop particular pieces of real estate. One type of ordinance that is especially problematic is the building moratorium, sometimes referred to as an interim development control. n18

Moratoria are used to protect the overall land development plan by forestalling development until comprehensive plans for a new zoning ordinance can be finalized. The intent of the moratorium is to preserve the status quo of a district pending the adoption of permanent regulation. n19 Because the fundamental purpose of a moratorium is to prevent the vesting of property rights that may adversely affect the permanent zoning plan, land subject to a moratorium cannot be developed during the effective period of the ordinance. Therefore, the broker needs to be aware of the limitation in dealing with prospective purchasers of the property.

[5] Laws Pertaining to Waterfront Property

[a] Zoning Criteria

A real estate broker interested in selling waterfront property ought to be aware of several problems that might arise as to the use and development of such land. One factor of increasing significance is the "federal navigation servitude" n20 which allows the federal government to compel the removal of any obstruction to navigation without paying "just compensation" ordinarily required by the *Fifth Amendment to the United States Constitution*. The navigation servitude has been held to apply to all waters up to the high-water mark that are "navigable in fact," whether tidal or non-tidal. Moreover, it has been held to apply even to unnavigable tributaries of navigable waters. n21 The impact of the servitude on waterfront property may take several forms. It may result, for example, in the inability of the owner to construct a dock. In the extreme, it may even constitute a cloud on title that makes it impossible to develop the land because the developer will not be able to obtain financing. Lenders, of course, will decline to mortgage property when title cannot be insured.

Another issue of interest to real estate brokers with respect to waterfront properties is the question of the public's right to access to beaches and navigable waterways. This issue has been the subject of litigation in several jurisdictions. In these cases, the "public trust doctrine," which has been used to support the public's interest in protecting the environment, has also been applied to protect the right of public access to beaches and public waterways. n22

The public trust theory, with its origins in Roman law, flowed from the common law principle that the tidelands are held by the sovereign in trust for the public. Such lands could be conveyed, but these conveyances were always subject to the

public trust. n23

[b] Recent Cases

While a number of jurisdictions have recognized public rights in land related to public waterways, n24 New Jersey courts, in response to numerous suits against its shore communities by citizens claiming right to beach access, have given considerable attention to the public trust doctrine. In *Neptune City v. Avon-by-the-Sea*, n25 the New Jersey Supreme Court made clear that:

The public rights in tidal lands are not limited to the ancient prerogatives of navigation and fishing, but extend as well to recreational uses, including bathing, swimming and other shore activities. The public trust doctrine, like all common law principles, should not be considered fixed or static, but should be molded and extended to meet changing conditions and needs of the public it was created to benefit.
n26

The *Neptune City* court struck down an ordinance that discriminated against non-residents in terms of the fee required for use of a municipal beach. In holding that the ordinance was in violation of the public trust, the court noted that municipalities had legislative authority to charge users of the beach a fee for revenue purposes. n27 The court found, however, that the statute merely delegated to a municipality having a dedicated beach the state's police power over that area and the tide-flowed area seaward of the mean high water mark. The court noted that the proviso in the statute "indicated an affirmation of the state's paramount interest and inherent obligation to insure that such seaward land be equally available for the use of all citizens." n28

California courts, in a series of cases, have also considered the scope and effect of the public trust doctrine. n29 The state has been said to hold a trust interest on behalf of the public in tidelands n30 and in lands between high and low water in non-tidal navigable lakes. n31 It has been held that the public may use property for purposes such as commerce, navigation and fishing, as well as for environmental and recreational purposes. These lands may be conveyed to private persons only to promote trust uses, and grants not made for that purpose remain subject to the rights of the public. n32

In *State v. Superior Court of Placer County*, n33 the California Supreme Court held that riparian owners may use the shore zone (land between the low and the high-water marks) for "any purposes which are not incompatible with the public trust." n34 The court added, however, that if the state determined the use to be inconsistent with the public trust, the landowners would have to be compensated for the constructed improvements. n35

In a severe modification of prior lower court holdings, the U.S. Supreme Court in *Nollan v. California Coastal Commission* n36 and *Lucas v. South Carolina Coastal Council* n37 defended real property rights as they pertained to water. In *Nollan*, the Court held that a taking occurs when a land use regulation is imposed which fails to substantially advance the same legitimate state interest which the permit process was designed to advance. The lessees in this case had leased a beachfront lot with an option to purchase. Before acquisition, the California Coastal Commission granted a permit subject to the condition that the lessees grant an easement laterally along the beachfront of their lot to prevent the house from blocking the view of the ocean. The Court found that the essential nexus between the purpose of the permit condition and the permit process itself was lacking to support enforcement, and therefore constituted a taking.

In *Lucas*, a purchaser paid \$975,000.00 for two single-family residential beachfront lots in 1986. In 1988, the South Carolina Legislature adopted a statute that prevented new construction on beachfront sites along the state's Atlantic coastline. The South Carolina Supreme Court had held that it was within the state's police power to enact land use restrictions to prevent serious harm to beaches, recognizing a long line of cases holding that the government has the power to prohibit "noxious uses" of property. Relying on the precedent established in *Pennsylvania Coal Company v. Mahon*, n38 the South Carolina Supreme Court held that the government's power to redefine the range of interest

included in the ownership of property was necessarily constrained by constitutional limits.

The U.S. Supreme Court named two discreet categories of regulatory actions compensable: (1) regulations that compel the property owner to suffer a physical "invasion" of his or her property; and (2) regulations that deny all economically beneficial or productive use of the land. n39 The Court stated that when the owner of real property has been called upon to sacrifice all economically beneficial uses in the name of the common good (*i.e.*, to leave the property economically idle), he or she has suffered a taking. n40

[6] Wetlands Legislation

[a] In General

Wetlands legislation refers to the provisions of the Clean Water Act n41 that authorize the program that regulates activities in wetland areas. The program is conducted by the United States Corps of Engineers with oversight by the Environmental Protection Agency. Specifically, sections of the Clean Water Act require permits for discharging dredged or fill material from a point source into navigable waters. n42 "Navigable waters" is defined in the regulations as:

waters of the United States, including the territorial seas, which includes adjacent wetlands of rivers and harbors, tributaries of navigable waters and their adjacent wetlands; other interstate waters, their tributaries, and adjacent wetlands; and all other waters of the United States, which may include isolated lakes and wetlands, intermittent streams, prairie pot holes, and other waters. n43

The regulatory definition defines "wetlands" as those areas that are inundated or saturated by surface or ground water at a frequency or at a rate sufficient to support, and that under normal circumstances do support, a prevalence of vegetation typically adapted for life in saturated soil conditions. Wetlands generally include swamps, marshes, bogs, and similar areas. n44

The Federal Interagency Committee for Wetland Delineation has developed the Federal Manual for identifying and delineating jurisdictional wetlands. The manual attempts to clarify whether a particular area is a wetland by reference to three factors: (1) the presence of wetland vegetation; (2) the presence of hydric soils; and (3) the presence of wetland hydrology. Courts have held that adjacent wetlands, isolated wetlands, and man-made artificial wetlands are within the jurisdiction of the wetlands legislation because the areas affect the flow on interstate commerce. n45

[b] Regulated Activity

The Clean Water Act regulates only one activity, which is the discharge of a pollutant into "navigable waters" from a point source without a permit. n46 A "point source" is any discernible, confined, and discrete conveyance. n47 The "discharge" refers to the discharge of dredged or fill material, which is a pollutant under the Act. "Dredged material" is defined as material that is excavated or dredged from waters of the United States. n48 "Fill material" is any material used for the primary purpose of replacing an aquatic area with dry land or changing the bottom elevation of a body of water, n49 which includes dirt, rocks, sand, cement, rubble, and virtually any other item that can be deposited.

For a discharge to be regulated under the Act, the fill material must be discharged from a point source. Point sources include bulldozers, back hoes, and dump trucks. n50 Therefore, any kind of levees, grating, paving, road construction, and utility lines would be regulated activities.

[c] Exceptions

The Act provides for exemptions for *de minimis* or small discharges of dredged material that are incidental to dredging operations. n51 Land clearing is also exempt if it does not involve the discharge of dredged or fill material. n52 There is

also some indication that draining, without discharge, may not be regulated. n53

[d] Violations

Permits are required by anyone wishing to undertake any construction or development or any proposed development in an area that may be construed to be wetlands. If a permit is not obtained, the violator is subject to compliance orders, injunctive relief, and civil, criminal, and administrative penalties. The civil penalties can be as high as \$25,000.00 for each day of violation and for each day the violation occurs or continues. n54

The criminal violation subjects the individual or responsible corporate officer to a fine of not less than \$2,500.00 and not more than \$25,000.00 a day for each day of the violation, and imprisonment for not more than one year. n55 Willful violations of the Act subject the individual or responsible corporate officer to fines of not less than \$5,000.00 and no more than \$50,000.00 a day, or imprisonment for not more three years, or both. n56 Similarly, knowingly making false statements on a permit application results in a fine of not more than \$10,000.00 and imprisonment for not longer than two years. n57

The Corps can impose an administrative penalty of up to \$10,000.00 a day, without providing a hearing, for each day a violation occurs or continues, up to a maximum of \$25,000.00. n58 With a full hearing under the Administrative Procedures Act (APA), an administrative penalty can be assessed for \$10,000.00 a day for each day the violation occurs or continues up to a maximum of \$125,000.00. n59 Another method of enforcement available to the Corps or the EPA is to seek an injunction to restore the wetlands area to its original condition. n60

[7] The Endangered Species Act

[a] In General

In 1973, Congress enacted the Federal Endangered Species Act. n61 A "species" includes any species of animal or plant life as well as any subspecies of fish, wildlife, or plant. n62 The species must be federally listed to be entitled to protection n63 and critical habitats n64 may also be designated. n65 The Act vests authority in the Secretaries of Commerce, Agriculture, and Interior (along with the latter's Endangered Species Committee), n66 depending on their respective jurisdictions. The Secretaries may designate the critical habitats and make provisions regarding those habitats on the basis of the best scientific data available, after taking into consideration the economic impact, and any other relevant impact, of specifying a particular area as a critical habitat. n67 When designating a critical habitat, the Secretaries must comply with the National Environmental Policy Act. n68

The Act also protects individual animals, n69 and prohibits the "taking" of the habitat, which includes any activity which would harass the animals or disturb their environments so they do not want to occupy the area. n70

[b] Procedure for Designation

The procedure for designation begins when the Interior Secretary receives a petition to place a species on, or remove a species from, the endangered species list as established by the Secretary. The Secretary can then include either the plant life or animal life on his list of all species determined by him to be endangered species. The Secretary must review, at least once every five years, the list which is published pursuant to the Act. n71

The Secretary has the authority to treat any species as endangered even though it is not listed if he or she finds that: (1) the species so closely resembles in appearance a species which has been listed that enforcement personnel would have substantial difficulty in attempting to differentiate between a listed and unlisted species; (2) the substantial difficulty is an additional threat to an endangered or threatened species; and (3) such treatment of a non-listed species will substantially facilitate the enforcement and further the policy of the Act. n72 The Secretary then will develop plans for the conservation and survival of the endangered and threatened species that are listed. n73

[c] Violations

Prohibitions under the Federal Endangered Species Act are applicable to all persons, whether or not there is federal agency involvement with the project. The Act prohibits the removal and reduction of any endangered species from the area of federal jurisdiction, maliciously damaging or destroying any such species on any such area, or removing, cutting, digging up, damaging, or destroying any such species in knowing violation of any federal or state law or regulation. n74

The Act contains specific restrictions on the activities of all federal agencies. These federal agencies are required to use their authority to further the purposes of the Act by carrying a program for the conservation of endangered and threatened species which are listed. Each federal agency is required to insure that any action authorized, funded, or carried out by such agency is not likely to jeopardize the continued existence of any endangered or threatened species or result in the destruction or adverse modification of habitats of such species, as determined by the Secretary. n75

To enable compliance with the Act, federal agents are also required to conduct a biological assessment for the purpose of identifying any endangered or threatened species which is likely to be affected by their action, virtually assuring that some sort of biological profile will have to be established for every federal agency funded project. n76

[d] Penalties

Penalty and enforcement provisions of the statute are severe. Any person who knowingly violates any provision of the Act may be assessed a civil penalty by the Secretary of not more than \$25,000.00 for each violation, and each violation is considered to be a separate offense. No penalty can be assessed, however, until that person has given notice and an opportunity for a hearing with respect to the violation. n77

The criminal violations are equally severe. They provide for a fine of not more than \$50,000.00 or imprisonment for not more than one year, or both. Any person who knowingly violates any other regulation issued under the Act shall be fined not more than \$25,000.00 or imprisoned for not more than six months, or both. n78

FOOTNOTES:

(n1)Footnote 1. 42 U.S.C. §§ 4001-4129.

(n2)Footnote 2. 16 U.S.C. § 1531 et seq.

(n3)Footnote 3. 42 U.S.C. § 300g-7.

(n4)Footnote 4. 33 U.S.C. § 1344.

(n5)Footnote 5. Clean Air Act, 42 U.S.C. §§ 7402-7671(q); Resource Conservation Recovery Act, 42 U.S.C. §§ 6901-6992(k); Clean Water Act, 33 U.S.C. §§ 1251-1387; Safe Drinking Water Act, 42 U.S.C. §§ 300(f)-(j).

(n6)Footnote 6. 42 U.S.C. § 9601 et seq. See also Resource Conservation and Recovery Act (RCRA) § 7003 (42 U.S.C. § 6973).

(n7)Footnote 7. See generally ch. 15, *Real Estate Brokers and Environmental Laws* for a full discussion of CERCLA.

(n8)Footnote 8. Toxic Substances Control Act, 15 U.S.C. §§ 2601-2671; Emergency Planning and Community Right to Know Act, 42 U.S.C. §§ 11001-11050.

(n9)Footnote 9. National Environmental Policy Act (NEPA), 42 U.S.C. §§ 4321-4370(a); Endangered Species Act, 16 U.S.C. §§ 1531-1544; National Historic Preservation Act, 16 U.S.C. § 470.

(n10)Footnote 10. 16 U.S.C. §§ 470, 470a.

(n11)Footnote 11. 16 U.S.C. § 470a.

(n12)Footnote 12. 16 U.S.C. § 470a(4).

(n13)Footnote 13. 16 U.S.C. § 470(a)(6).

(n14)Footnote 14. 16 U.S.C. § 470a.

(n15)Footnote 15. See Powell on Real Property, ch. 18A, *Airspace Projects* P 263.1[1] (Matthew Bender).

(n16)Footnote 16. See Powell on Real Property, ch. 18A, *Airspace Projects* P 263.2 (Matthew Bender).

(n17)Footnote 17. See *Newport Assocs., Inc. v. Solon*, 30 N.Y.2d 263, 332 N.Y.S.2d 617, 283 N.E.2d 600 (1972), cert. denied, 410 U.S. 931, 93 S. Ct. 1372, 35 L. Ed. 2d 593 (1973) (a long-term lessee had the right to transfer undeveloped airspace over the leased premises to an office building under construction on his contiguous property). It should be noted that the holding in *Newport* does not apply to New York City by virtue of a change in the N.Y.C. Zoning Resolution. See *Macmillan, Inc. v. CF Lex Associates*, 56 N.Y.2d 386, 452 N.Y.S.2d 377, 437 N.E.2d 1134 (1982).

(n18)Footnote 18. See generally Annot., 30 A.L.R.3d 1196 (1970).

(n19)Footnote 19. Zoning and Land Use Controls § 45.03[5][b][i] (Matthew Bender).

(n20)Footnote 20. See generally Powell on Real Property, ch. 65, *The Law of Water* (Matthew Bender).

(n21)Footnote 21. See generally, Powell on Real Property, ch. 65, *The Law of Water* (Matthew Bender).

(n22)Footnote 22. See Frey, *The Public Trust in Public Waterways*, 7 Urban L. Ann. 219, 245 (1974); Sax, *The Public Trust Doctrine in National Resource Law: Effective Judicial Intervention*, 68 Mich. L. Rev. 471, 474 (1970).

(n23)Footnote 23. *Shively v. Bowlby*, 152 U.S. 1 (1894). The case traces the development of the public trust doctrine in the United States and recognizes that title to the area below the ordinary high water mark--whether in the king or in a subject, is held subject to the public right, *jus publicum*, of navigation and fishing. 152 U.S. at 13.

(n24)Footnote 24. See, e.g., *Southern Idaho Fish & Game Ass'n v. Picabo Livestock*, 96 Idaho 360, 96 Idaho 360, 528 P.2d 1295 (1974); see generally Annot., 6 A.L.R. 4th 1030.

(n25)Footnote 25. 61 N.J. 296, 294 A.2d 47 (1972).

(n26)Footnote 26. 61 N.J. at 309, 294 A.2d at 54.

(n27)Footnote 27. 61 N.J. at 302, 294 A.2d at 50.

(n28)Footnote 28. New Jersey courts have continued to refine the public trust doctrine as it applies to beach access. See, e.g., *Lusardi v. Curtis Point Property Owners Ass'n*, 86 N.J. 217, 430 A.2d 881 (1981); *Van Ness v. Borough of Deal*, 78 N.J. 174, 393 A.2d 571 (1978); *Hyland v. Borough of Allenhurst*, 148 N.J. Super. 437, 372 A.2d 1133, modified and remanded, 78 N.J. 190, 393 A.2d 579 (1977).

(n29)Footnote 29. *City of Alameda v. Todd Shipyards Corp.*, 632 F. Supp. 333 (N.D.Cal., 1986).

(n30)Footnote 30. *City of Berkeley v. Superior Court*, 26 Cal. 3d 515, 162 Cal. Rptr. 327, 606 P.2d 362, cert. denied, 449 U.S. 840, 101 S. Ct. 119, 66 L. Ed. 2d 48 (1980); see generally, Annot., 24 A.L.R.4th 870.

(n31)Footnote 31. *State v. Superior Court of Placer County*, 29 Cal. 3d 240, 172 Cal. Rptr. 713, 625 P.2d 256 , cert. denied sub nom. *Tahoe Shorezone Representation v. California*, 454 U.S. 865 (1981) .

(n32)Footnote 32. *City of Los Angeles v. Venice Peninsula Property*, 644 P.2d 792 (1982) , rev'd 466 U.S. 198 .

(n33)Footnote 33. 29 Cal. 3d 240, 172 Cal. Rptr. 713, 625 P.2d 256 , cert. denied sub nom. *Tahoe Shorezone Representation v. California*, 454 U.S. 865 (1981) .

(n34)Footnote 34. 625 P.2d at 261 .

(n35)Footnote 35. 625 P.2d at 261

(n36)Footnote 36. 107 S. Ct. 3141 (1987) .

(n37)Footnote 37. 112 S. Ct. 2886 (1992) .

(n38)Footnote 38. 260 U.S. 393, 43 S. Ct. 158, 67 L. Ed. 322 (1922) .

(n39)Footnote 39. *Lucas v. South Carolina Coastal Council*, 112 S. Ct. at 2893 . The *Lucas* decision also cites to *Nollan v. California Coastal Comm'n*, 107 S. Ct. 3141 (1987) , and *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 107 S. Ct. 1232 (1987) .

(n40)Footnote 40. 112 S. Ct. at 2895 ; see also *Tabb Lakes, Ltd. v. U.S.*, 10 F.3d 796 (Fed. Cir. 1993) (property owner precluded from developing without permit).

(n41)Footnote 41. 33 U.S.C. §§ 1251-1387.

(n42)Footnote 42. 33 U.S.C. § 1344.

(n43)Footnote 43. 33 C.F.R. § 323.2.

(n44)Footnote 44. 33 C.F.R. § 328.3.

(n45)Footnote 45. *United States v. Riverside Bayview Homes, Inc.*, 474 U.S. 121 (1985) ; *United States v. DeFelice*, 641 F.2d 1169 (5th Cir.) , cert. denied, 454 U.S. 940 (1981) .

(n46)Footnote 46. See *Washington Wilderness Coalition v. Hecla Mining Co.*, 870 F. Supp. 983 (E.D.Wash. 1994) (manmade ponds are not "navigable waters").

(n47)Footnote 47. 33 U.S.C. § 1362(14); see also *United States v. Lambert*, 915 F. Supp. 797 (S.D.W.Va. 1996) (" 'point source' embraces the broadest possible definition of any identifiable conveyance from which pollutants might enter U.S. waters"); see also *Murray v. Bath Iron Works Corp.*, 867 F. Supp. 33 (D.Me. 1994.)

(n48)Footnote 48. 33 C.F.R. § 323.2(c).

(n49)Footnote 49. 33 C.F.R. § 323.2(e).

(n50)Footnote 50. *Avoyelles v. Marsh*, 715 F.2d 897 (5th Cir. 1983) . See also *United States v. Lambert*, 915 F. Supp. 797 (S.D.W.Va. 1996) (" 'point source' embraces the broadest possible definition of any identifiable conveyance from which pollutants might enter U.S. waters.")

(n51)Footnote 51. 33 C.F.R. § 323.2(d).

(n52)Footnote 52. *Save Our Wetlands, Inc. v. Sands*, 711 F.2d 634 (5th Cir. 1983) .

(n53)Footnote 53. *Orleans Audubon Soc'y v. Lee*, 742 F.2d 901 (5th Cir. 1984) .

(n54)Footnote 54. 33 U.S.C. § 1344(s).

(n55)Footnote 55. 33 U.S.C. § 1319(c)(1).

(n56)Footnote 56. 33 U.S.C. § 1319(c)(2).

(n57)Footnote 57. 33 U.S.C. § 1319(c)(4).

(n58)Footnote 58. 33 U.S.C. § 1319(d).

(n59)Footnote 59. 33 U.S.C. § 1319(g)(2)(B).

(n60)Footnote 60. *United States v. Cumberland Farms of Connecticut*, 826 F.2d 1151 (1st Cir. 1987) , cert. denied, 44 U.S. 1061 (1988) .

(n61)Footnote 61. 16 U.S.C. § 1531 et seq.

(n62)Footnote 62. 16 U.S.C. §§ 1532(16), 1541.

(n63)Footnote 63. 16 U.S.C. § 1532(5)(A).

(n64)Footnote 64. See 16 U.S.C. § 1532(1)(5) for definition of "critical habitat."

(n65)Footnote 65. 16 U.S.C. § 1533(b)(2).

(n66)Footnote 66. See generally 16 U.S.C. § 1536(e).

(n67)Footnote 67. 16 U.S.C. § 1533(b)(2); see *Douglas County v. Babbitt*, 48 F.3d 1495 (9th Cir. 1995) ; cert. denied, 116 S. Ct. 698 .

(n68)Footnote 68. See *Catron County v. United States Fish & Wildlife*, 75 F.3d 1429 (10th Cir. 1996) .

(n69)Footnote 69. 16 U.S.C. § 1532(19).

(n70)Footnote 70. 16 U.S.C. § 1532(19).

(n71)Footnote 71. 16 U.S.C. § 1533(c)(2).

(n72)Footnote 72. 16 U.S.C. § 1533(e).

(n73)Footnote 73. 16 U.S.C. § 1533(f).

(n74)Footnote 74. 16 U.S.C. § 1538(a)(2)(B).

(n75)Footnote 75. 16 U.S.C. § 1536(a)(2).

(n76)Footnote 76. 16 U.S.C. § 1536(c)(1).

(n77)Footnote 77. 16 U.S.C. § 1540(a).

(n78)Footnote 78. 16 U.S.C. § 1540(b)(1).

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45 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.06

§ 14.06 Reporting Requirements for Brokers Under the Tax Reform Act of 1986

The Internal Revenue Service (IRS) promulgated regulations implementing the provisions of the Tax Reform Act of 1986, which imposed a new reporting requirement on the person responsible for closing real estate transactions. n1 Pursuant to the regulations, the "real estate reporting person" n2 is required to file with the IRS an information return on Form 1099-S and to provide the same information to the transferor. n3 A "real estate broker" may be subject to a monetary penalty for failure to comply with the reporting requirements. n4 The regulations apply only to certain real estate transactions and broadly define the concept of "real estate broker" such that a person may be deemed to be a real estate broker for purposes of the reporting requirements, even if that such person is not licensed to perform real estate brokerage services for a fee or commission.

The regulations define "reportable real estate" as including improved and unimproved land, any inherently permanent structure, including any residential, commercial, or industrial building, any condominium, and any stock in a cooperative housing corporation. n5 A return of information is not required on the following: gifts; sales by governmental units; transfers in full or partial satisfaction of any indebtedness secured by the property, including a foreclosure, a transfer in lieu of foreclosure, or abandonment; a transaction in which the money, services, or property is valued at less than \$600; and corporate and government transferors are exempt from the reporting requirements. n6

The "real estate broker" under the regulations, absent a specific designation in a designation agreement, n7 is generally the person listed as the settlement agent on the HUD-1 Uniform Settlement Statement prescribed under the Real Estate Settlement Procedures Act of 1974. n8 If no person is designated in the Uniform Settlement Statement, the person who prepared the settlement statement must fulfill the reporting requirements. n9 If there is not a statement providing for a written disposition of the gross proceeds, the regulations provide additional rules to determine who must comply with the reporting requirements. Thus, the regulations provide that the person subject to the reporting requirements is the first listed of the following persons who participate in the transaction as:

- (1) the attorney for the transferee who is "present at the occasion of the delivery of either the transferee's note or a significant portion of the cash proceeds to the transferor, or who prepares or reviews the preparation of the document(s) transferring legal or equitable ownership of the real estate";
- (2) the attorney for the transferor if he or she fulfills the requirements of 1 above; or

(3) the "disbursing title or escrow company that is most significant in terms of gross proceeds disbursed."
n10

If, under the above rules, more than one attorney would be deemed the real estate broker, then the attorney whose involvement in the transaction is most significant will be deemed to be the person subject to the reporting requirements. n11 If no person is responsible for closing the transaction, the real estate broker shall be the first listed of the following persons who participates in the transaction: (1) the mortgage lender; (2) the transferor's broker; (3) the transferee's broker; or (4) the transferee. n12

The real estate broker must report the following information pursuant to the regulations, in addition to any other information required by Form 1099-S:

- (1) the name, address, and taxpayer identification number (TIN) of the transferor;
- (2) a general description of the real estate transferred;
- (3) the closing date;
- (4) the entire gross proceeds, to the extent required by Form 1099;
- (5) an indication that the transferor received property or services as part of the consideration for the transaction, or may receive property (other than cash) or services in satisfaction of an obligation having a stated principal amount, or may receive, in connection with a contingent payment transaction, an amount of gross proceeds that cannot be determined with certainty and is therefore not included in the gross proceeds; and
- (6) the real estate reporting person's name, address, and TIN. n13

The regulations provide for magnetic media reporting for covered real estate transactions. However, there is an exception for persons who reasonably expect fewer than 250 transactions for a calendar year or persons who actually reported fewer than 250 transactions for the preceding calendar year. n14 In cases of undue hardship, the IRS may authorize the reporting on the prescribed paper Form 1099-S. n15

A TIN *must* be solicited from the transferor at or before closing. The solicitation may be made in person or in a mailing that includes other items. The transferor must furnish the TIN and certify that it is correct. n16 A solicitation must be made in writing, and explain that the person may be subject to civil or criminal penalties for failing to furnish a correct TIN. n17 The following is an example of how a solicitation may be worded:

You are required by law to provide [insert name of reporting person] with your correct taxpayer identification number. If you do not provide [insert name of reporting person] with your correct taxpayer identification number, you may be subject to civil or criminal penalties imposed by law. n18

The solicitation must contain space for the name, address, and TIN of the solicited person, as well as the certification that the TIN is in fact the correct one. n19 The solicitation must be retained by the reporting person for four years following the close of the calendar year that includes the date of closing. n20

A real estate broker or other reporting person must provide a written statement of the information to the person furnishing the TIN. The written statement must bear either the information shown on a completed Form 1099, or the following:

This is important tax information and is being furnished to the Internal Revenue Service. If you are required to file a return, a negligence penalty or other sanction may be imposed on you if this item is required to be reported and the IRS determines that it has not been reported. n21

The statement must be furnished before February 1 of the calendar year following the closing. n22

FOOTNOTES:

(n1)Footnote 1. The regulations implement the reporting requirements of *I.R.C. § 6045(e)*, which was added to the Code by the Tax Reform Act of 1986.

(n2)Footnote 2. The "real estate reporting person" must be one of the following, in this order: (1) the person responsible for closing the transaction (including an attorney or title insurance company); (2) the mortgage lender; (3) the seller's broker; (4) the buyer's broker; or (5) any other person designated by regulation. *I.R.C. § 6045(e)*; *26 C.F.R. § 1-6045-4(e)(4)*.

(n3)Footnote 3. *26 C.F.R. § 1.6045-4(a)*.

(n4)Footnote 4. *26 C.F.R. § 1-6045-4(n)*. Penalties would be imposed for: (1) failure to file a correct information return; (2) failure to furnish a correct statement to the transferor; (3) failure to comply with other information reporting requirements (including the furnishing of a TIN, or taxpayer identification number); (4) failure to comply with waiver an payment requirements; and (5) willful failure to supply information (including a TIN).

(n5)Footnote 5. *C.F.R. § 1.6045-4(b)*.

(n6)Footnote 6. *C.F.R. § 1.6045-4(c)*.

(n7)Footnote 7. *C.F.R. § 1.6045-4(e)(4)*. The parties to the real estate transaction may agree to designate a person as the "real estate broker" for the transaction. However, any person so designated must be one of the parties listed in § 14.06, *n.2 supra*. The designated person then becomes the "real estate broker" for purposes of the reporting requirements, assuming the designation agreement satisfies the requirements of the regulations. It should be noted, however, that *both* the designated person and the person who would otherwise be the "real estate broker" pursuant to the regulations must be parties to the designation agreement.

(n8)Footnote 8. *C.F.R. § 1.6045-4(e)(3)*. See § 14.02 *supra* for a discussion of the Real Estate Settlement Procedures Act.

(n9)Footnote 9. *C.F.R. § 1.6045-4(e)(3)(ii)* provides in pertinent part that:

a closing statement is any closing statement, settlement statement (including a Uniform Settlement Statement), or other written document that identifies the transferor and transferee, reasonably identifies the transferred real estate, and describes the manner in which the proceeds payable to the transferor are to be (or were) disbursed at, or in connection with, the closing.

(n10)Footnote 10. *C.F.R. § 1.6045-4(e)(3)*.

(n11)Footnote 11. *C.F.R. § 1.6045-4(e)(3)*.

(n12)Footnote 12. *C.F.R. § 1.6045-4(e)(4)*.

(n13)Footnote 13. *C.F.R. § 1.6045-4(h)*.

(n14)Footnote 14. *C.F.R. § 1.6045-4(k)*.

(n15)Footnote 15. C.F.R. § 1.6045-4(k)(2).

(n16)Footnote 16. C.F.R. § 1.6045-4(l).

(n17)Footnote 17. C.F.R. § 1.6045-4(l).

(n18)Footnote 18. C.F.R. § 1.6045-4(l).

(n19)Footnote 19. C.F.R. § 1.6045-4(l).

(n20)Footnote 20. C.F.R. § 1.6045-4(l)(iii).

(n21)Footnote 21. C.F.R. § 1.6045-4(m).

(n22)Footnote 22. C.F.R. § 1.6045-4(m).

* This chapter was revised by Mary J. Burt, Esq. In 2006, Section 14.02 was revised by Robert M. Jaworski, Esq., and Section 14.04 revised by Barbara S. Mishkin, Esq. Both are partners at Reed Smith, LLP and members of its Financial Services Regulatory Group, practicing, respectively, in the Firm's Princeton, New Jersey and Philadelphia, Pennsylvania offices. Their practice includes providing federal and state compliance advice and assistance to all kinds of financial institutions, performing compliance audits, preparing multi-state surveys, and, in conjunction with Reed Smith litigators, defending individual and class actions brought against lenders. Mr. Jaworski is also a former Deputy Commissioner of the New Jersey Department of Banking and a frequent speaker and author on compliance-related topics. Section 14.15, written by Sandra R. Bullington, Esq. in 2000, has been adapted from Home Owner Associations and Planned Unit Developments--Law and Forms, ch. 6 (Matthew Bender) and was completely revised in 2010.

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46 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.07

§ 14.07 The Americans with Disabilities Act

[1] In General

The Americans with Disabilities Act (ADA), n1 which became effective on July 26, 1992, provides access requirements for, and prohibits discrimination against, people with disabilities in public accommodations, state and local government, transportation, telecommunications, and employment. The primary focus for real estate licensees is Title III, n2 which broadly expands the concept of "disability" and imposes regulations on existing buildings. Title III applies to both the owner and the operator of public accommodations and commercial facilities. The Act specifically affects the real estate brokerage industry in that real estate licensees need to determine whether or not the product the licensee is selling is in compliance with the Act. A licensee should always be cautioned, however, that the statute is very detailed, and there are a number of gray areas in the statute that lack clear interpretation.

[2] Scope of Title III of the Act

The ADA's anti-discrimination provisions and requirements for the removal of barriers apply to "places of public accommodation," n3 and the accessibility requirements of the ADA with respect to new construction and alterations apply to "public accommodation" and "commercial facilities." n4

"Places of public accommodation" refers to twelve categories of retail and service businesses:

- (1) places of lodging;
- (2) food and drink establishments;
- (3) places of exhibitionary entertainment;
- (4) places of public gathering;
- (5) sales and rental establishments;
- (6) services establishments such as law firms, accounting firms, and banks;

- (7) public transportation stations;
- (8) places of public display or collection;
- (9) places of recreation;
- (10) educational facilities;
- (11) social service center establishments; and
- (12) exercise clubs. n5

This definition also includes real estate brokerage offices, even if they are located in private homes. n6

"Commercial facility" is defined as a facility

- (1) whose operations affect commerce;
- (2) intended for non-residential use; and
- (3) not expressly exempted from coverage under the Fair Housing Act of 1968. n7

The ADA prohibits discrimination against those with disabilities. Discrimination results in the denial of full and equal enjoyment of goods, services, facilities, privileges, advantages, and the facilities of any place of public accommodation. n8

[3] New Construction

[a] In General

Under the ADA, all new construction which becomes available for occupancy after January 23, 1993, must meet new structural requirements for disability access. The Act deals only with construction which becomes available for "first occupancy." Therefore, the Department of Justice regulations exempt projects for which a completed building permit application is certified as received by the appropriate government entity before January 26, 1992. If a building permit was issued after January 26, 1992, but had a certificate of occupancy before January 26, 1993, it is exempt from the Act's requirements. The new construction requirements apply to all commercial facilities. n9

Special barrier removal requirements came into effect on January 26, 1992, and apply only to facilities which are "places of public accommodation" as defined by the Act. n10 The Act requires removal of architectural and communication barriers that are structural in nature, where removal is readily achievable (easily accomplishable and able to be carried out without much difficulty or expense). n11 Barrier removal includes the installation of ramps, curb cuts in sidewalks and entrances, repositioning shelving, rearranging tables and chairs, repositioning telephones, adding rays to marking on elevator control buttons, installing flashing alarm lights, widening doors, eliminating turnstiles, and providing for alternate paths of travel. n12

[b] Alterations

All commercial facilities must be accessible to the maximum extent feasible whenever alterations are being performed on the facility. n13 Alteration is defined as any change that affects the feasibility of a facility. n14 If the alterations are

made to a lobby or work area of the public accommodation, an accessible path of travel to the altered area, and to the bathrooms, telephones, and drinking fountains serving that area, must be made accessible to the extent that the added accessibility is not disproportionate to the overall cost of the original alteration. Disproportionate cost is defined for the purposes of the Act as costs which exceed twenty percent of the original alteration. The "cost of alteration" means all costs incurred in renovating a particular portion of the facility within a three-year period. n15

[c] Other Modifications

The Act requires modifications to procedures so that disabled individuals are not excluded from regular programs. Places of public accommodation must make reasonable modifications to policies and procedures in order to accommodate individuals with disabilities and not create restrictions that tend to screen out individuals with disabilities (e.g., requesting that a blind person produce a driver's license as the sole means of identification or not allowing more than one person in a clothes-changing area when a disabled person needs the assistance of another). n16

The Act also requires that "auxiliary aids and services" be made available to insure effective communication with individuals with hearing, vision or speech impairments. These "auxiliary aids and services" include interpreters, listening headsets, television closed caption decoders, telecommunication devices for the deaf, video tech displays, Braille materials, and large print materials. n17

[d] Defenses

[i] In General. There are several defenses and exclusions available under the Act, but most are extremely narrow in scope.

[ii] Threat to the Health and Safety of Others. It is a legitimate defense under the Act to refuse to serve a disabled person or offer equipment, goods and services if such individual poses a direct threat to the health or safety of others (e.g., amusement park rides, rafting exhibitions or difficult swimming maneuvers). n18

[iii] Private Clubs. Private clubs are excluded under the Act. A private club is defined in the ADA as being in accordance with Title II of the 1964 Civil Rights Act. n19

[iv] Religious Organizations. Religious organizations are also exempt, even churches that operate day care centers, nursing homes or private schools. n20

[v] Not "Readily Achievable." Barrier removal is not required of public accommodation if it is not readily achievable. Readily achievable means "easily accomplishable and able to be carried out without much difficulty or expense." n21

[vi] Structural Impracticability. Structural impracticability is a defense if the circumstances are such that incorporating excessive disability features into the structure would destroy the structural integrity of the facility. n22

[vii] Technical Infeasibility. Public accommodations need not comply with the Act if it is technically infeasible to do so. Technical infeasibility refers to the existence of structural conditions requiring the removal or alteration of an essential part of the structural frame to make the facility comply with the requirements of the Act. n23

[viii] Residential Structures. Residential structures are normally not included in the Act unless they accommodate the public, in which case they would fall under the public accommodation portion of the statute. Similarly, owner-occupied boarding houses or bed and breakfast establishments are also not covered by the Act if they have five rooms or less. n24

[ix] Asbestos Removal. Asbestos removal projects do not trigger the "alterations" requirements of the Act. n25

[x] Historic Structures. "Qualified historic structures" need not comply with the requirements of the Act if compliance would "threaten or destroy the historic significance of the building of facility." n26

[4] Responsible Parties

In general, the ADA imposes the plans and building compliance obligations on the building owner, rather than the tenant or manager. n27 However, many landlords' leases require that all of the compliance expenses required by federal, state, or local law be borne by the tenant. In that case, it is presumed that the landlord could pass the cost on to the tenant.

The Department of Justice has suggested different formulas or standards for allocation of cost between landlords and tenants, but received comments criticizing these arbitrary standards. n28 The Department of Justice has indicated, however, that the time remaining on the lease should not be a factor in the allocation of responsibility. Rather, the term of the lease is irrelevant in determining what is readily achievable for the tenant. n29

It may be helpful to address the issue in the "compliance with laws" provision of the leases, particularly in situations where the building's occupancy is such that only one or two tenants may be responsible for complying with the ADA, while other tenants may be exempt.

An office building may not be required to be in compliance with the ADA prior to foreclosure. After foreclosure, however, when it becomes part of the lender's portfolio, it may become a place of public accommodation. The cost of barrier removal now will fall on the lender because of its change in use of occupancy or ownership. Prior to foreclosure, it may be wise for lenders to do an ADA audit of the building, similar to a toxic waste or environmental assessment audit.

[5] Enforcement

Both the Department of Justice and private individuals may maintain a cause of action to enforce Title III against commercial building owners. The Department of Justice may seek monetary damages or injunctive relief. n30 Private individuals are entitled to seek only injunctive relief under the statute, although a tort claim may create a cause of action for monetary damages. n31

The Department of Justice enforces the provisions of Title III by establishing a "pattern or practice" of discrimination, failure to comply with the provisions of the Act, or "that any person or a group of persons has been denied any of the rights granted by Title III and such denial raises an issue of general public importance." n32 The civil penalties imposed are \$50,000.00 for the first violation and \$100,000.00 for each subsequent violation. The Attorney General may also seek monetary damages on behalf of aggrieved individuals. Individuals who believe that they have been subjected to discrimination prohibited by the ADA can request the Department to investigate. n33

An individual has a right to bring a suit for injunctive relief if that individual has "reasonable grounds for believing that he or she is about to be subjected to discrimination." The private suit can be brought in court without pursuing the administrative remedies, and the individual may even be entitled to a court appointed attorney "if the court deems such appointment to be just under the circumstances." n34

FOOTNOTES:

(n1)Footnote 1. 42 U.S.C. § 12007.

(n2)Footnote 2. 42 U.S.C. § 12181.

(n3)Footnote 3. 42 U.S.C. § 12182(a).

(n4)Footnote 4. 42 U.S.C. § 12183(a).

(n5)Footnote 5. 42 U.S.C. § 12181(7).

(n6)Footnote 6. Title III Technical Assistance Manual, p. 4 (EEOC Mar. 24, 1992).

(n7)Footnote 7. 42 U.S.C. § 12181(2).

(n8)Footnote 8. 50 Fed. Reg. 35,544 (1991) .

(n9)Footnote 9. 42 U.S.C. § 12183. See also technical guidelines by the Architectural and Transportation Barriers Compliance Board, published on July 23, 1991. 56 Fed. Reg. 35,408 (1991) .

(n10)Footnote 10. 42 U.S.C. § 12181(7).

(n11)Footnote 11. 28 C.F.R. § 36.304.

(n12)Footnote 12. 42 U.S.C. § 12182 et seq.

(n13)Footnote 13. 42 U.S.C. § 12183(a)(2).

(n14)Footnote 14. See ADA Accessibility Guidelines, 56 Fed. Reg. 35408 (July 6, 1991) .

(n15)Footnote 15. 56 Fed. Reg. 35583 (July 26, 1991) .

(n16)Footnote 16. 42 U.S.C. § 12182(b)(1)(A)(i).

(n17)Footnote 17. 28 C.F.R. § 36.33.

(n18)Footnote 18. 42 U.S.C. § 12182(b)(3); 56 Fed. Reg. 35,564 (July 26, 1991) .

(n19)Footnote 19. 42 U.S.C. § 12187.

(n20)Footnote 20. 42 U.S.C. § 12187.

(n21)Footnote 21. 42 U.S.C. § 12181(a).

(n22)Footnote 22. 42 U.S.C. § 12183(a)(1).

(n23)Footnote 23. 28 C.F.R. § 36.406.

(n24)Footnote 24. 56 Fed. Reg. 35,582 (July 26, 1991) .

(n25)Footnote 25. 26 C.F.R. § 36.402(b)(1).

(n26)Footnote 26. 56 Fed. Reg. 35,584 (July 26, 1991) .

(n27)Footnote 27. 42 U.S.C. § 12182(a).

(n28)Footnote 28. 56 Fed. Reg. 35,555 (July 26, 1991) .

(n29)Footnote 29. 56 Fed. Reg. 35,556 (July 26, 1991) .

(n30)Footnote 30. 42 U.S.C. § 12188(b).

(n31)Footnote 31. *42 U.S.C. § 12188(a)(1)*.

(n32)Footnote 32. *28 C.F.R. § 36.503*.

(n33)Footnote 33. *28 C.F.R. § 36.502*.

(n34)Footnote 34. *28 C.F.R. § 35.01(a)*.

* This chapter was revised by Mary J. Burt, Esq. In 2006, Section 14.02 was revised by Robert M. Jaworski, Esq., and Section 14.04 revised by Barbara S. Mishkin, Esq. Both are partners at Reed Smith, LLP and members of its Financial Services Regulatory Group, practicing, respectively, in the Firm's Princeton, New Jersey and Philadelphia, Pennsylvania offices. Their practice includes providing federal and state compliance advice and assistance to all kinds of financial institutions, performing compliance audits, preparing multi-state surveys, and, in conjunction with Reed Smith litigators, defending individual and class actions brought against lenders. Mr. Jaworski is also a former Deputy Commissioner of the New Jersey Department of Banking and a frequent speaker and author on compliance-related topics. Section 14.15, written by Sandra R. Bullington, Esq. in 2000, has been adapted from Home Owner Associations and Planned Unit Developments--Law and Forms, ch. 6 (Matthew Bender) and was completely revised in 2010.

Additional updates throughout the chapter were contributed by Sandra Bullington, Esq.



47 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.08

§ 14.08 The Fair Housing Act

[1] In General

The Fair Housing Act, based on Title VIII of the Civil Rights Act of 1968, n1 seeks to provide, within constitutional limitations, fair housing throughout the United States. It is unlawful to discriminate in any aspect of the sale, rental, or financing of dwellings based on race, color, religion, national origin, sex, handicap, or familial status. n2

A housing transaction, for purposes of the Fair Housing Act, generally includes the sale or rental of a dwelling. n3 It also includes the inspection of a dwelling by a person engaged in a residential real estate transaction, and the making or purchasing of loans for, or the selling, brokering, or appraising of, residential real estate. n4

[2] Exceptions

[a] In General

The following types of housing transactions are exempted from the enforcement provisions of the Fair Housing Act: (1) certain sales of single-family homes; (2) certain rentals and buildings of four or less units; (3) most rentals by private clubs and religious organizations; (4) housing within reasonable governmental limitations on occupancy; and (5) certain housing for older persons. n5

[b] Single-Family Homes

There is a general exception for the sale or rental of real estate by an owner of a single-family home. n6 The following conditions must be satisfied in order to maintain an exception from the provisions of the Fair Housing Act:

- (1) the owner must not own or have an interest in more than three single-family houses at any one time;
- (2) if the owner was not the most recent occupant prior to the sale, the owner may not have made any similar sale within the preceding twenty-four months; and
- (3) the housing unit must be sold and rented only by the owner and without the services of a real estate

broker or agent, or any person in the business of selling or renting dwellings. n7

With respect to the third requirement, the phrase "in the business of selling or renting dwellings" is defined as:

- (1) participating in three or more sale or rental transactions within the preceding twelve months;
- (2) participating as an agent in two or more sale or rental transactions during the preceding twelve months, except in the sale of the seller's personal residence; and
- (3) owning any dwelling designed or intended for occupancy by five or more families. n8

This is commonly referred to as the "Mrs. Murphy" exception, and is available only to private individual owners of dwellings.

[c] Rental of Apartments and Small Complexes

Except for advertising, the prohibitions against discrimination of rental of rooms or units and dwellings do not apply if the dwelling is occupied by no more than four families, and the owner of the dwelling maintains and actually occupies one of the units as the owner's residence. n9

[d] Private Clubs and Religious Organizations

The exemptions for religious organizations allow them to limit the sale, rental, or occupancy of a non-commercial dwellings that they own or operate to persons of the same religion. This exemption is lost if the organization discriminates on the basis of race, color, sex, or national origin. n10

The exemption is not available to clubs that discriminate in the selection or admission of its members. The final interpretation, however, may be governed by local law. If the state law prohibits the private club status, it would logically result in the loss of the Fair Housing Act exemption. n11

Control, however, is important, and the restriction must have some basis related to the organization. In *United States v. Columbus Country Club*, n12 the court determined that the relationship between the Catholic Church and the club was not sufficient to support the exemption.

[e] Occupancy Limitations

The 1988 amendments to the Fair Housing Act contain a subsection that specifically states that nothing supersedes the applicability of any reasonable local, state, or federal restrictions regarding the maximum number of occupants permitted to occupy a dwelling. n13 This permits state and local governments to continue to impose reasonable limitations on maximum occupancy, so long as limitations apply to all occupants and do not result in discrimination on the basis of race, color, religion, sex, national origin, handicap, or familial status.

[f] Housing for Older Persons

The 1988 amendments to the Fair Housing Act added provisions that prohibit the denial of housing based on familial status, n14 thereby rendering illegal the "adults only" and "no children" policies of housing facilities. However, Congress included three specific exemptions from the familial status rules to reduce the impact of the familial status provisions on housing for older adults: (1) HUD-approved housing programs under a state or federal program; (2) housing for persons aged sixty-two or older; and (3) housing for persons aged fifty-five or older. n15 n16 Vacant units do not count in the overall calculation. The Act appears to apply to a married couple if at least one of the spouses is over age sixty-two. Resident employees are also exempt from the age requirement. n17

A cooperative apartment building was found to be a "dwelling" within the meaning of the Fair Housing Act. n18 The cooperative apartment complex violated the Fair Housing Act by discriminating against children. The complex allowed no more than two persons in studio and one-bedroom apartments. Evidence showed that the provision would exclude 92 to 95% of all families with children, but only 19 to 21% of families without children.

If the housing is for persons aged sixty-two or older, it must be intended for, and solely occupied by, persons who are aged sixty-two or older. n19

[3] Discriminatory Activities

[a] In General

Of particular interest to real estate licensees is the prohibition of discriminatory activities on the basis of race, religion, color, sex, handicap, familial status or national origin in the sale, rental or advertising of dwellings.

[b] Sales or Rentals

[i] In General. Section 804(a) of the Fair Housing Act states that it is unlawful to refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, familial status or national origin. A common violation is the refusal to rent or sell property to minorities. In these cases, the plaintiff can establish a prima facie case by showing that:

- (1) the plaintiff is a member of a protected class, which can include testers; n20
- (2) the plaintiff applied for and was qualified to rent or purchase the property;
- (3) the offer was rejected by the defendant;
- (4) the housing opportunity remained available after the rejection. n21

Real estate brokers should be cautioned that the playing field is not level, since the plaintiff is not required to prove that the defendant *intended* to discriminate. Once the plaintiff has made a prima facie case by proving that the conduct was discriminatory, the burden shifts to the defendant to show that the challenged practice could be justified on non-discriminatory grounds n22 or that the defendants were unaware that the plaintiff was a member of a protected class. n22.1 The effect of discrimination may also be referred to as "disparate impact," which is established by showing that the practice of the defendant will predictably result in racial discrimination or that it has a discriminatory effect. n23 One court, however, modified the disparate impact test, holding that discriminatory allegations could be defended with a lesser burden of proof. n24

Conduct such as steering, exclusionary zoning, redlining, and other actions by either individuals or governmental units that directly impact the availability of housing to their protected classes are prohibited under the Act. Special efforts to attract buyers, however, apparently do not fall within the prohibition. For example, in *South-Suburban Housing Center v. Greater South-Suburban Board of Realtors*, n25 a broker agreed to make special efforts to attract white buyers in a predominately African-American neighborhood. The Seventh Circuit held that this did not violate the Fair Housing Act, but merely provided additional information to white home buyers concerning the property they might not ordinarily know about or consider, and involved no lessening of efforts to attract African-American home buyers.

[ii] Steering. "Steering" is the practice of directing prospective home buyers interested in equivalent properties to different areas according to their race. n26 The conduct applies to rental situations and can occur for reasons other than race. The nature of the conduct of real estate agents makes them more likely defendants than almost any other party to a

real estate transaction.

There is also a practice called "benign steering," which is the intentional steering or restricting of housing for the express purpose of fostering integration rather than discrimination. A conflict was noted in *United States v. Starrett City Associates*.ⁿ²⁷ The Second Circuit said that quotas promote the Fair Housing Act Immigration Policy, which is designed to promote "immigration maintenance," but they contravene the anti-discrimination policy,ⁿ²⁸ designed to prevent "tipping." Tipping occurs when a neighborhood population reaches a certain level of minority concentration, resulting in the abandonment of the neighborhood by the majority.ⁿ²⁹

[iii] Redlining. Lenders and appraisers who delineate geographical areas on a map of a community as poor-risk areas solely because of the concentration of minorities and low-income households are engaged in a prohibited practice referred to as "redlining." Redlining is not directly applicable to real estate brokers.

[c] Discrimination Based on Terms or Conditions

The Fair Housing Act prohibits the imposition of discriminatory terms, conditions, or treatment on a sale or rental that is proposed or completed.ⁿ³⁰ This includes violations such as a request by the owner for a higher price because the buyer is foreign. The HUD regulations list four activities that are prohibited if they are based on any one of the seven protected classifications listed in subsection [a] above: (1) using different provisions of the lease or sales contract; (2) failing or delaying maintenance or repairs to sale or rental dwellings; (3) failing to process or accurately communicate an offer for the sale or rental of a dwelling; or (4) limiting the use of privileges, services, or facilities associated with the dwelling because of the protected classification of an owner, tenant, or person associated with the owner or tenant.ⁿ³¹ A similar prohibition applies to the denial of a sale or rental of a dwelling because of the refusal of the prospective buyer or tenant to provide sexual favors.ⁿ³²

[d] Discrimination in Advertising for Sale or Rental

Advertisements that indicate preference, limitation, or discrimination based on one of the seven protected classes are also prohibited.ⁿ³³ The prohibition includes all written or oral statements, regardless of the medium employed in the advertisement.ⁿ³⁴ The regulations specifically prohibit:

- (1) the use of any catch words or phrases implying the dwellings are or are not available to a member of a protected class;ⁿ³⁵
- (2) the selection of particular media for advertising locations that effectively discriminates against a protected class by denying them housing market information;ⁿ³⁶ and
- (3) the refusal to publish sale or rental advertising because of a protected classification, or charging different rates for such advertising based upon the classification.ⁿ³⁷

Several cases have alleged discriminatory advertising based on the lack of minority models in advertising. One case held that an advertisement can violate the Fair Housing Act if it "suggests to an ordinary reader that a particular race is preferred."ⁿ³⁸ The court went on to say that "the creator of an ad may not make choices or models that create a suggestion of a racial preference."ⁿ³⁹

In contrast, however, the court in *Housing Opportunities Made Equal, Inc. v. Cincinnati Enquirer, Inc.*ⁿ⁴⁰ held that the single publication of an advertisement which used a small number of all-white models did not, without more, violate the Fair Housing Act. Liability arises only if an advertiser had the opportunity, based upon either the large number of models, to use minority models in an advertisement, or if the advertisement was socially or intentionally discriminatory.ⁿ⁴¹ The court held that to construe the Fair Housing Act otherwise would violate the *First Amendment*.

[e] False Representations of Unavailability

Section 3604(d) of the Fair Housing Act makes it unlawful to provide inaccurate or untrue information about the availability of dwellings for sale or rent. These representations include falsely informing a minority that housing is not available in a majority neighborhood. n42

[f] Blockbusting

"Blockbusting" is generally defined as any profit-motivated effort to induce or attempt to induce a person to sell or rent a dwelling by representing to that person that there is an entry or possible entry into the neighborhood of persons of a protected class, while generating commissions for real estate agents. This occurs, for example, if a real estate agent represents that there is an influx of a minority group into a neighborhood that ultimately results in the flight of property owners out of that neighborhood and the generation of profits for the brokers. n43 Blockbusting has also been called panic peddling. n43.1

[g] Discrimination in Brokerage Services

Section 3606 of the Fair Housing Act makes it unlawful to deny any person access to, or membership or participation in, any multiple listing service, real estate brokerage organization, or facility relating to the business of selling dwellings. n44

[h] Interference and Intimidation

The Fair Housing Act states that it is unlawful to coerce, intimidate, threaten, or interfere with any person related to the enjoyment of any rights granted or protected by the Act. n45

[i] Discrimination Based on Familial Status

The Act prohibits discrimination on the basis of familial status, defined as a minor being domiciled with a parent, a person having legal custody of the minor, or the designee of such parent or legal custodian. n46 In *Gorski v. Troy*, n47 the court upheld a foster parent's right as a designee of a child's legal custodian, even though the foster parent had not yet achieved familial status.

[j] Discrimination Based on Handicapped Status

The 1988 amendments to the Fair Housing Act make it unlawful to discriminate on the basis of the sale or rental of a dwelling to: (1) any handicapped buyer or renter, based on the person's handicap; (2) a person who lives with or intends to live with the handicapped renter or buyer; or (3) any person associated with the handicapped renter or buyer. n48 There is also significant authority that an AIDS patient is handicapped, and refusal to issue a special use permit for AIDS patients violates the Fair Housing Act. n49 Some states have passed laws that shield an "owner or agent of real property" from liability for failing to disclose that an occupant or former occupant was afflicted with, or died from, AIDS. n50

Another exception involves drug abusers. Although drug abuse is *not* considered a handicap under the Act, the Fourth Circuit Court of Appeals in *United States v. Southern Management Corp.* n51 held that the refusal to rent to an individual because of former substance abuse was a violation of the Act.

[k] Exploitation

Housing discrimination claims can also be based upon an exploitation theory. To base a claim of discrimination on an exploitation theory, the plaintiffs must claim that as a result of racial residential segregation, a dual housing market

exists and the defendants have taken advantage of the situation by demanding unreasonable prices and terms in excess of prices and terms available to citizens of a different racial background for comparable housing. n51.1

[4] Enforcement

The 1988 amendments to the Act provide a comprehensive system of rules and procedures to enforce the Fair Housing Laws. n52 The rules establish a formal process by which the government must investigate all complaints filed with HUD, including a procedure for HUD to investigate activities on its own initiative. The amendments did not materially affect the rights of private persons to sue for violations, but did extend the statute of limitations from 180 days to two years to file a lawsuit in either federal or state court based on an alleged discriminatory housing practice. n53

The United States Supreme Court has held that the Fair Housing Act provides for vicarious liability. n54 However, this Act imposes liability without fault upon the employer in accordance with traditional agency principles in that it normally imposes vicarious liability upon the corporation but not upon its officers or owners. n55 Consequently, the right to control an employee is insufficient, by itself, to impose vicarious liability upon an officer of the corporation. n56 While the Court found that the right to control was insufficient by itself under traditional agency principles to establish a principal/agent relationship, it left the application of traditional vicarious liability rules to the lower courts. n57

FOOTNOTES:

(n1)Footnote 1. *See generally* 42 U.S.C. §§ 3601-3619.

(n2)Footnote 2. 42 U.S.C. § 3604. *See Fair Housing Council v. Roommates.Com, LLC*, 521 F.3d 1157 (9th Cir. 2008) .

(n3)Footnote 3. *But see Casa Marie, Inc. v. Superior Court of Puerto Rico*, 988 F.2d 252 (1st Cir. 1993) (Title VIII may proscribe discriminatory acts by person who are neither sellers nor lessors of property).

(n4)Footnote 4. 42 U.S.C. § 3605.

(n5)Footnote 5. 42 U.S.C. §§ 3603(b), 3607.

(n6)Footnote 6. 42 U.S.C. § 3603.

(n7)Footnote 7. 42 U.S.C. § 3603.

(n8)Footnote 8. 42 U.S.C. § 3603.

(n9)Footnote 9. 42 U.S.C. § 3603.

(n10)Footnote 10. 42 U.S.C. § 3607(a).

(n11)Footnote 11. *New York State Club Ass'n v. City of New York*, 487 U.S. 1 (1988) .

(n12)Footnote 12. 915 F.2d 877 (3d Cir. 1990) , *cert. denied*, 111 S. Ct. 2797 (1991) .

(n13)Footnote 13. 42 U.S.C. § 3607.

(n14)Footnote 14. 42 U.S.C. § 3607.

(n15)Footnote 15. 42 U.S.C. § 3607(b)(2).

(n16)Footnote 16. [Reserved]

(n17)Footnote 17. 24 C.F.R. § 100.303(a)(3); 24 C.F.R. § 100.305(e)(3).

(n18)Footnote 18. *United States v. Tropic Seas, Inc.*, 887 F. Supp. 1347 (D. Hawaii 1995) .

(n19)Footnote 19. 42 U.S.C. § 3607(b)(2)(B).

(n20)Footnote 20. *Gladstone Realtors v. Village of Bellwood*, 441 U.S. 91 (1979) .

(n21)Footnote 21. See *Mitchell v. Shane*, 350 F.3d 39, 47-48 (2d Cir. 2003) ; *Betsey v. Turtle Creek Assocs.*, 736 F.2d 983, 988 (4th Cir. 1984) ; *Metropolitan Hous. Dev. Corp. v. Village of Arlington Heights*, 558 F.2d 1283 (7th Cir. 1977) , cert. denied, 434 U.S. 1025 (1978) .

(n22)Footnote 22. *Village of Arlington Heights v. Metropolitan Dev. Corp.*, 429 U.S. 252 (1977) .

(n23)Footnote 22.1. See *Mitchell v. Shane*, 350 F.3d 39, 48-49 (2d Cir. 2003) (plaintiff bears burden of proving, by a preponderance of the evidence, that defendants' challenged actions were motivated by discrimination; without some evidence of knowledge of the prospective buyers' racial identity, it is impossible to infer such motivation).

(n24)Footnote 23. *Pfaff v. United States Dept. of Housing*, 88 F.3d 739 (9th Cir. 1996) ; *Huntington Branch NAACP v. Town of Huntington*, 844 F.2d 926 (2d Cir. 1974) ; *United States v. City of Blackjack*, 508 F.2d 1179 (8th Cir. 1974) , cert. denied, 422 U.S. 1042 (1975) .

(n25)Footnote 24. *Wards Cove Packing Co. v. Atonio*, 490 U.S. 642 (1989). In 1991, Congress nullified *Wards Cove* by requiring an employer to defend its unintentional discriminatory conduct by proving business necessity. See 42 U.S.C. § 2000e-2(k)(1)(A)(i).

(n26)Footnote 25. 935 F.2d 868 (7th Cir. 1991) .

(n27)Footnote 26. *Gladstone Realtors v. Village of Bellwood*, 441 U.S. 91 (1979) ; *Smith v. City of Cleveland Heights*, 760 F.2d 720 (6th Cir. 1985) , cert. denied, 474 U.S. 1056 (1986) .

(n28)Footnote 27. 840 F.2d 1096 (2d Cir.) , cert. denied, 488 U.S. 946 (1988) .

(n29)Footnote 28. 840 F.2d at 1101 .

(n30)Footnote 29. 840 F.2d at 1101 .

(n31)Footnote 30. 42 U.S.C. § 3604(b).

(n32)Footnote 31. 42 U.S.C. § 3604(b); 24 C.F.R. § 100.65(a).

(n33)Footnote 32. 24 C.F.R. § 100.65(b)(5).

(n34)Footnote 33. 42 U.S.C. § 3604(c).

(n35)Footnote 34. 24 C.F.R. § 100.75(b).

(n36)Footnote 35. 24 C.F.R. § 100.75(c)(1).

(n37)Footnote 36. 24 C.F.R. § 100.75(c)(3).

(n38)Footnote 37. 24 C.F.R. § 100.75(c)(4).

(n39)Footnote 38. *Ragin v. New York Times Co.*, 923 F.2d 995 (2d Cir. 1991) ; *Ragin v. Harry Macklowe Real*

Estate Co., 6 F.3d 898 (2d Cir. 1993) .

(n40)Footnote 39. 923 F.2d at 1001 .

(n41)Footnote 40. 943 F.2d 644 (6th Cir. 1991) .

(n42)Footnote 41. 943 F.2d at 648 .

(n43)Footnote 42. *Havens Realty Corp. v. Coleman*, 455 U.S. 363 (1982) .

(n44)Footnote 43. 42 U.S.C. § 3604(e); 24 C.F.R. § 100.85.

(n45)Footnote 43.1. *Pearson v. Edgar*, 153 F.3d 397, 399 (7th Cir. 1998) .

(n46)Footnote 44. 42 U.S.C. § 3606.

(n47)Footnote 45. 24 C.F.R. pt. 100.

(n48)Footnote 46. 42 U.S.C. § 3602(k).

(n49)Footnote 47. 929 F.2d 1183 (7th Cir. 1991) .

(n50)Footnote 48. 42 U.S.C. § 3604(f)(1); *Familystyle of St. Paul, Inc. v. City of St. Paul*, 923 F.2d 91 (8th Cir. 1991) .

(n51)Footnote 49. *Association of Relatives and Friends of Aids Patients v. Regulations and Permits Admin.*, 740 F. Supp. 95 (D.P.R. 1990) ; *Baxter v. Belleville*, 720 F. Supp. 720 (S.D. Ill. 1989) . But see *Ennis v. National Ass'n of Bus. & Educ. Radio, Inc.*, 53 F.3d 55 (4th Cir. 1995) ("merely being infected with the human immunodeficiency virus (HIV) is not per se a 'disability' within the meaning of the Americans with Disabilities Act").

(n52)Footnote 50. Indiana Code § 24-4.6-2.1-2,-4,-5. See ch. 3A above.

(n53)Footnote 51. 955 F.2d 914 (4th Cir. 1992) .

(n54)Footnote 51.1. See *Clark v. Universal Builders, Inc.*, 706 F.2d 204, 207, 210-211 (7th Cir. 1983) (recognizing an exploitation theory of housing discrimination); *Honorable v. Easy Life Real Estate Sys., Inc.*, 182 F.R.D. 553, 563 (N.D. Ill. 1998) (plaintiffs adequately alleged exploitation theory of housing discrimination).

(n55)Footnote 52. 42 U.S.C. § 3610.

(n56)Footnote 53. 28 U.S.C. § 2342(6).

(n57)Footnote 54. See *Meyer v. Holley*, 537 U.S. 280, 123 S. Ct. 824, 828, 154 L. Ed. 2d 753, 760 (2003) .

(n58)Footnote 55. See *Meyer v. Holley*, 537 U.S. 280, 123 S. Ct. 824, 831, 154 L. Ed. 2d 753, 763-764 (2003) .

(n59)Footnote 56. See *Meyer v. Holley*, 537 U.S. 280, 123 S. Ct. 824, 832, 154 L. Ed. 2d 753, 764 (2003) .

(n60)Footnote 57. See *Holley v. Crank*, 400 F.3d 667, 670 (9th Cir. 2004) , citing *Meyer v. Holley*, 537 U.S. 280, 291, 123 S. Ct. 824, 832, 154 L. Ed. 2d 753, 764 (2003) .

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48 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.09

§ 14.09 The Condominium and Cooperative Conversion Protection and Abuse Relief Act

[1] In General

The mid-to-late 1970s saw an expansion of condominium and cooperative housing development. Developers discovered that state enabling legislation (passed generally in the mid- 1960s in response to the National Housing Act of 1961), coupled with demand for low-cost housing, created a growing market for condominiums and cooperatives. Developer abuses began to appear, primarily from four sources: (1) forfeiture of deposits when condominium projects were not completed; (2) failure to disclose important information to purchasers; (3) self-dealing management contracts by developers, which allowed them to manage projects in perpetuity; and (4) forcing tenants out of their apartments in order to create condominiums, thereby causing significant problems for low-income or elderly residents. n1 While several states have passed statutes to prevent this type of abuse, the federal response to these problems was the Condominium and Cooperative Abuse Relief Act of 1980. n2

[2] Scope

The Act applies to all condominium and cooperative projects (1) created by conversions from rental properties; (2) where the real estate has five or more residential units in each residential structure, and the remaining real estate is designated for common ownership solely by the unit owners; and (3) the units or cooperative interests are offered for sale or lease, or are sold or leased by direct or indirect use of any means of instruments or transportation or communication of interstate commerce or the mails. n3

In a "condominium," portions of the real estate that are not designated as residential units are designated for common ownership solely by the owners of those units, with each owner having an undivided interest. n4 In a "cooperative," the individual interests are evidenced by membership in a cooperative association and a lease for the residential unit. n5

[3] Exemptions

The Act does not apply to the sale of a condominium unit or an interest in a cooperative by the federal, state, or local government or agency. n6 The Act also exempts projects in which all units are restricted to non-residential use. n7

[4] Prohibitions Under the Act

The Act primarily provides for termination of self-dealing contracts by the developer and declares certain types of leases in favor of the developer unconscionable. Unit owners are permitted to terminate certain management contracts or portions thereof that were created while the developer was in control of the project. To be eligible for termination, the contract must meet six requirements:

- (1) the contract must have been entered into after the effective date of the Act; n8
- (2) the project involved must be a conversion project; n9
- (3) the contract must be for operation, maintenance, or management of the project, the association, or the property serving the project; n10
- (4) the contract must be between the unit owners and the developer, or an affiliate of the developer; n11
- (5) the contract must have been entered into while the developer or affiliate controlled the unit owners' association or executive board; n12 and
- (6) the term of the contract must be more than three years, including a renewal period that can be exercised at the sole option of the developer or the affiliate of the developer. n13

Courts are divided on what types of self-dealing contracts are covered and how they may be terminated. Apparently, regardless of how the contracts are couched (as leases or other alternative contract arrangements), all contracts on the property that serve the unit owners can be terminated under the self-dealing contract provisions. n14 The issues center on whether or not a contract "serves the unit owners" and whether or not the beneficiary of that contract is an "affiliate of the developer." n15 An "affiliate of the developer" is a person who either controls a developer, is controlled by a developer, or is under common control with a developer. n16

The termination of the contract must occur within a two-year period beginning with the date on which any special developer control is terminated or the date on which the developer owns twenty-five percent or fewer of the units in the project, whichever is earlier. n17 Termination is accomplished by an affirmative vote of at least two-thirds of the unit owners other than the unit owned by the developer or an affiliate of the developer. n18

The theory of self-dealing contracts also includes developer reimbursement clauses (*i.e.*, clauses obligating unit owners to reimburse the developer for costs, attorneys' fees, judgments or any other fees incurred as a result of the management contract), which the Act declares to be against public policy and void. n19

[5] Remedies

The Act provides that any person aggrieved by a violation of the Act may sue in state or federal court. 15 U.S.C. § 3611(a). It expressly permits recovery of damages and any other relief deemed fair, just, and equitable. n20

FOOTNOTES:

(n1)Footnote 1. Barron, Federal Regulation of Real Estate Mortgage Lending § 4.01 (3d ed. WGL 1992).

(n2)Footnote 2. 15 U.S.C. § 3601.

(n3)Footnote 3. 15 U.S.C. § 3603(5).

(n4)Footnote 4. 15 U.S.C. § 3603(5).

(n5)Footnote 5. 15 U.S.C. § 3603(10).

(n6)Footnote 6. 15 U.S.C. 3603(1).

(n7)Footnote 7. 15 U.S.C. § 3603(2).

(n8)Footnote 8. 15 U.S.C. § 3607(a).

(n9)Footnote 9. 15 U.S.C. § 3607(a)(1).

(n10)Footnote 10. 15 U.S.C. § 3607(a)(1).

(n11)Footnote 11. 15 U.S.C. § 3607(a)(2).

(n12)Footnote 12. 15 U.S.C. § 3607(a)(3).

(n13)Footnote 13. 15 U.S.C. § 3607(a)(4).

(n14)Footnote 14. 5 *West 14th St. Commercial Corp. v. Five W. 14th Owner's Corp.*, 815 F.2d 188 (2d Cir. 1987), *cert. denied*, 44 U.S. 850 (1987) .

(n15)Footnote 15. *Brabert Realty Co. v. 20125 Owners Corp.*, 703 F. Supp. 314 (S.D.N.Y. 1989) .

(n16)Footnote 16. 15 U.S.C. § 3603(1).

(n17)Footnote 17. 15 U.S.C. § 3607(b).

(n18)Footnote 18. 15 U.S.C. § 3607(c). *See, e.g.*, 181 *East 73rd St. Co. v. 181 East 73rd Tenants Corp.*, 954 F.2d 45 (C.A.2, N.Y. 1992).

(n19)Footnote 19. 15 U.S.C. § 3609; *Park South Tenants Corp. v. 200 Cent. Park South Assoc., L.P.*, 941 F.2d 112 (2d Cir. 1991) .

(n20)Footnote 20. 15 U.S.C. § 3611(b).

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49 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers
CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.10

§ 14.10 The Agricultural Foreign Investment Disclosure Act

[1] Purpose

The Agricultural Foreign Investment Disclosure Act (AFIDA) became effective on February 2, 1979, in response to growing concern that foreign investment was resulting in higher taxes and driving up the cost of agricultural property. The purpose of AFIDA was to insure the collection of data to gauge the effect of foreign investment on the United States. n1

[2] Application of the Act

The disclosure requirements of AFIDA are generally applicable to transactions involving the acquisition or transfer of interest in agricultural land by foreign persons. n2 The term "foreign person" is defined as individuals who: (1) are not citizens of the United States or certain of its possessions; (2) do not have permanent resident status; or (3) are not paroled into the United States. n3 The term also includes a foreign government and, even if an entity is not an individual or government, a legal entity falls under the definition of a foreign person if it (1) is created under the laws of foreign government, (2) has its principal place of business outside the United States, or (3) is organized under the law of any state, has significant interest or substantial control, directly or indirectly, by a foreign individual, foreign government, or other foreign legal entity, or any combination thereof. n4

[3] Agricultural Land

Agricultural land is defined under AFIDA as any land within the United States used for agricultural, forestry, or timber production. n5 It includes both farming and ranching, n6 although no disclosure needs to be made if the agricultural land aggregates no more than ten acres and if the gross annual receipts from the sale of the farm, ranch, forestry, or timber products produced on the land do not exceed \$1,000.00. n7

[4] Disclosure Requirements

The disclosure must be made by any foreign person holding, acquiring, or transferring United States agricultural land. n8 The following information must be supplied to the Agricultural, Stabilization and Conservation Service (ASCS), and must be filed within ninety days of the transaction that triggers the reporting requirement:

- (1) the legal name and address of the foreign person making the report;
- (2) if the foreign person is an individual, the citizenship of such individual;
- (3) if the foreign person is not an individual or a government, the name of the entity and its nature, the country in which it was created or organized, and its principal place of business;
- (4) the type of interest held or required;
- (5) the legal description and acreage of the land;
- (6) the purchase price or other consideration of the land involved, and any purchase price or other consideration still to be paid;
- (7) if the reporting person is a transferor, the legal name and address of the transferee, the transferee's citizenship, if she or he is an individual, the nature of the entity if it is neither individual nor a government, the country in which the entity was created or organized, and its place of business;
- (8) the agricultural purpose, as of the date of the report, for which the foreign person intends to use the land;
- (9) if an agent is making the report, its name, address, and relationship to the foreign person;
- (10) the method of acquisition or transfer of land in any relationship with a foreign person to the previous owner, producer, manager, tenant, or sharecropper, as well as the nature of the rental agreement; and
- (11) the date the interest was acquired or transferred. n9

If the foreign person neither an individual nor a government, it must include additional information about the entity of ownership. n10

[5] Filing Requirements

The disclosures are generally required to be filed on Form ASCS-153 and filed in the ASCS County Office where the agricultural land is located. n11 If the land is located in more than one county, the disclosure may be made directly with the ASCS office in Washington, D.C. n12 If a responsible party fails to submit a report, file updated material, or knowingly submits incomplete, false, or misleading reports, the ASCS can impose of penalty of twenty-five percent of the fair market value of the interest owned by the foreign person as computed by the ASCS, n13 although the penalty may be reduced based on a variety of factors such as the nature of the information not reported and the method of discovery of the violation.

FOOTNOTES:

(n1)Footnote 1. 22 U.S.C. § 3103(d). *See also* Foreign Investment in U.S. Real Estate: A Comprehensive Guide (A.B.A. 1990).

(n2)Footnote 2. 7 U.S.C. § 3501.

(n3)Footnote 3. *See generally* 5 C.F.R. § 781.2.

(n4)Footnote 4. *See generally* 5 C.F.R. § 781.2.

(n5)Footnote 5. 7 U.S.C. § 3508(1).

(n6)Footnote 6. 7 C.F.R. § 781.2(b).

(n7)Footnote 7. 7 C.F.R. § 781.2(b).

(n8)Footnote 8. *See generally* 7 C.F.R. § 731.3(b)-(d).

(n9)Footnote 9. 7 C.F.R. § 781.3(e).

(n10)Footnote 10. *See generally*, 7 C.F.R. § 781.3(f).

(n11)Footnote 11. 7 C.F.R. § 781.3(a).

(n12)Footnote 12. 7 C.F.R. § 781.3(a).

(n13)Footnote 13. 7 C.F.R. § 781.4(b)(2).

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50 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.11

§ 14.11 The Federal Trade Commission Act

[1] In General

The Federal Trade Commission Act (FTCA) was originally passed in 1914, ⁿ¹ but it was not until the 1970s that there was a renewed emphasis by the Federal Trade Commission (FTC) on consumer protection, which fostered involvement of the FTC in real estate activities. Section 5 of the FTCA makes unlawful "unfair methods of competition." In real estate matters, the Act emphasizes the prevention of unfair and deceptive practices on the sale of land, new homes and mobile homes.

The scope of enforcement of the FTCA is undeniably broad, and has also been applied to regulate brokerage services, where enforcement has concentrated on broker misrepresentation and advertising. ⁿ² As discussed in *Section 14.04 supra*, the FTC also has a proportionate power under the Federal Truth and Lending Act involving the extension of credit.

[2] FTC Enforcement

In 1976, the FTC entered into a consent agreement with a broker who offered rental housing in a vacation area and represented that it had apartments available when it did not. ⁿ³ The FTC ordered the broker to cease and desist from such conduct and further ordered that additional disclosures be made in all future advertising. ⁿ⁴

The FTC also engaged in a industry-wide investigation of practices in the residential real estate brokerage industry. ⁿ⁵ The FTC concluded in its report that there was a high level of interdependence among brokers that caused a uniformly high commission rate, and that buyers and sellers were uninformed about who the agent represented. The report also found, however, that the interdependence among brokers provided benefits to the consumers.

The FTC has also been active in obtaining consent orders prohibiting price fixing by Multiple Listing Services (MLSs), and prohibits certain boycotting activities because of the refusal by an MLS to allow certain types of brokers to be included in its organization. ⁿ⁶

[3] Brokerage Services

Real estate licensees have organized over the years to form a number of trade associations, the largest and most notable being the National Association of Realtors (NAR). Under NAR there have been local boards organized as independent operations, although in most circumstances the board members are required to be members of NAR as well as the state association of realtors. All fifty states have some procedural mechanism for regulating real estate licensees.

The first opening for federal jurisdiction over the real estate brokerage industry was in 1950, when the Supreme Court in *United States v. National Association of Real Estate Boards* n7 held that price-fixing for real estate commissions was a per se reasonable restraint of trade. In a later case, n8 the Supreme Court determined that a real estate broker's conduct can invoke Sherman Act (antitrust) jurisdiction by demonstrating merely "a substantial affect on interstate commerce" generated by brokerage activity, rather than requiring proof that the broker was actually engaged in interstate commerce activity.

The primary focus of the FTC in regulating the real estate brokerage industry has been boycotting Multiple Listing Service (MLS) membership in Realtor trade associations. The function of the MLS is to provide a multiple listing service for its members. MLS members obligate themselves to attempt to obtain from sellers exclusive listings of real estate and to pool their exclusive listings through MLS, which serves as a central processing and distributing point for its members' listings. The MLS compiles the listings it receives into a member's listing book or computerized listing base. It updates the listing book at least monthly, and provides members with a daily update of new listings and new data on old listings. Using the information provided by the multiple listing service, member brokers are able to cooperate in bringing together buyers and sellers. The selling broker and listing broker then determine by their own agreement how the commission of the sale will be divided. In essence, the service serves as a trade exchange for the purchase and sale of real estate. n9 With the rapid expansion of internet services, many local and state Realtor associations list their inventory on the World Wide Web, diminishing the value of the MLS.

MLS, while requiring membership standards which must be reasonably related to the services provided, n10 has, of course, long recognized its pro-competitive effects. n11 In 1978, the FTC announced an industry-wide investigation of practices and maintains jurisdiction over interstate activity of broker services. Most FTC complaints have resulted in consent orders rather than litigation, which is generally pursued by the Department of Justice.

[4] Regulation of Leasing Activity

The FTC was particularly active in the 1970s concerning the anti-competitive potential of shopping center developers and their tenants. This activity resulted in a number of consent decrees against both developers and major tenants. n12 Some of the prohibitions contained in the orders included the following:

- (1) the prohibition of certain types of classes of tenants; n13
- (2) the right to approve the locations of other tenants and/or their store hours; n14
- (3) limitation of merchandise on other tenants; n15
- (4) types of advertising; n16 and
- (5) rights of first refusal to operate similar stores. n17

[5] Educational Correspondence Courses

The FTC has had been active in monitoring misrepresentations of correspondence courses relating to real estate. The seminal case involved misrepresentations as to earnings potential and job opportunities. n18 Similar actions have been instituted in subsequent cases involving representations relating to correspondence courses in real estate appraisals. n19

FOOTNOTES:

(n1)Footnote 1. 15 U.S.C. § 41 et seq.

(n2)Footnote 2. *Nichols Assocs.*, 56 F.T.C. 155 (1959) ; *American Business Exch., Inc.*, 54 F.T.C. 953 (1958) ; *Interstate Exch. Co.*, 54 F.T.C. 1446 (1958) .

(n3)Footnote 3. *Rentax, Inc.*, 87 F.T.C. 1340 (1976) .

(n4)Footnote 4. 87 F.T.C. at 1344 .

(n5)Footnote 5. 46 Antitrust and Trade Reg. Rep. (BNA) 965.

(n6)Footnote 6. *Metro MLS, Inc.*, 55 Fed. Reg. 20,201 (1990) ; *Multiple Listing Serv. of Greater Michigan City Area, Inc.*, 50 Fed. Reg. 42,010-42,022 (1985) ; *Orange County Bd. of Realtors, Inc.*, 50 Fed. Reg. 42,011 (1985) .

(n7)Footnote 7. 339 U.S. 485 (1950) .

(n8)Footnote 8. *McLain v. Real Estate Bd., Inc.*, 444 U.S. 232, 100 S. Ct. 502, 62 L. Ed. 2d 441, 1980-1 Trade Cas. (CCH) P63107 (1980) .

(n9)Footnote 9. *United States v. Realty Multi-List, Inc.*, 629 F.2d 1351 (5th Cir. 1980) .

(n10)Footnote 10. 629 F.2d at 1376 . See also *Thompson v. Metropolitan Multi-List, Inc.*, 934 F.2d 1566 (11th Cir. 1991) , *reh'g denied*, 946 F.2d 906 ; *cert. denied*, *DeKalb Bd. of Realtors v. Thompson*, 113 S. Ct. 295 .

(n11)Footnote 11. 629 F. 2d at 1367-69 ; *Grillo v. Board of Realtors*, 91 N.J. Super. 202, 219 A.2d 635, 644 (N.J. Super. Ct. 1966) .

(n12)Footnote 12. *People's Drug Stores, Inc.*, 87 F.T.C. 1 (1976) ; *Rich's, Inc.*, 87 F.T.C. 1372 (1976) ; *Food Fair Store, Inc.*, 86 F.T.C. 709 (1975) ; *The Rouse Co.*, 85 F.T.C. 38 (1975) ; *Tyson's Corner Regional Shopping Ctr.*, 83 F.T.C. 1598 (1974) .

(n13)Footnote 13. *Rich's Inc.*, 87 F.T.C. 1372 (1976) .

(n14)Footnote 14. *Gimbel Bros.*, 83 F.T.C. 1320 (1974) .

(n15)Footnote 15. *Federated Department Stores*, 93 F.T.C. 449 (1977) .

(n16)Footnote 16. *Sears Roebuck & Co.*, 89 F.T.C. 240 (1977) .

(n17)Footnote 17. *People's Drug Stores, Inc.*, 87 F.T.C. 1 (1976) .

(n18)Footnote 18. *American Business Builders, Inc.*, 14 F.T.C. 460 (1931) .

(n19)Footnote 19. *Boyd K. Miller*, 56 F.T.C. 712 (1960) ; *Lawrence C. Wilson*, 56 F.T.C. 189 (1959) .

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51 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.12

§ 14.12 The Flood Disaster Protection Act of 1973

[1] In General

A real estate broker's ability to list and effectively market property can depend greatly on whether the property is in a special flood hazard area (SFHA). Designation of a property as a SFHA may affect the purchaser's ability to obtain building permits and financing. If the property is damaged by flooding after consummation of a purchase transaction, questions may arise as to whether the broker should have known that the area was subject to flood hazards and whether or not the broker's failure to ascertain the flood hazard status amounts to fraud, misrepresentation, or deception. Recent changes to the flood laws offer more protection, as most lenders now must require flood hazard insurance on properties in a SFHA. n1

[2] Purpose of the Act

The National Flood Insurance Act of 1968 (1968 Act) was enacted to

- (1) authorize a flood insurance program by means of which flood insurance could be made available on a nationwide basis through the cooperative efforts of the federal government and the private insurance industry;
- (2) provide flexibility in the flood insurance program so it may be based on workable methods of pulling risks, minimizing costs, and distributing burdens equally among those who would be protected by flood insurance and the general public;
- (3) encourage state and local governments to make appropriate land use adjustments to constrict the development of land which was exposed to flood damage and minimize flood damage cost by flood losses;
- (4) guide the development of proposed future construction, where practicable, away from locations which were threatened by flood hazards;
- (5) encourage lending and credit institutions, as a matter of national policy, to assist in furthering the

objectives of the flood insurance program;

(6) assure that any federal assistance provided under the program would be related closely to all flood related programs and activities of the federal government; and

(7) authorize continuing studies of flood hazards in order to provide for a constant re-appraisal of the flood insurance program and its effect on land use requirements. n2

The Act was amended in 1969 to provide similar protection against damage resulting from mudslides caused by accumulations of water on or under the ground. n3 The Flood Disaster Protection Act of 1973 (1973 Act) provided for protection against damage and loss resulting from the erosion and undermining of shorelines by waves or currents in lakes or other bodies of water exceeding anticipated cyclical levels. n4 The 1973 amendments

(1) substantially increased the limits of coverage authorized under the national flood insurance program;

(2) provided for the expeditious identification and dissemination of information concerning flood-prone areas;

(3) required states or local communities, as a result of future federal financial assistance, to participate in the flood insurance program and to adopt adequate flood plain ordinances to effect enforcement provisions to reduce or avoid future flood losses; and

(4) required the purchase of flood insurance by property owners who are being assisted by federal programs or by federally supervised, regulated, or insured agencies or institutes in the acquisition or improvement of land or facilities to be located in identified areas having special flood hazards. n5

[3] The Flood Insurance Program

The National Flood Insurance Program (NFIP) is administered primarily under the 1968 Act and the 1973 Act. n6 The 1968 Act made Federally subsidized flood insurance available to owners of improved real estate or mobile homes located in special flood hazard areas if their community participates in the NFIP. An SFHA is an area within a flood plain having a one percent or greater chance of flood occurrence in any given year. SFHAs are delineated on maps issued by the Federal Emergency Management Agency (FEMA) for individual communities. A community establishes its eligibility to participate in the NFIP by adopting and enforcing floodplain management measures to regulate new construction and by making substantial improvements within its SFHAs to eliminate or minimize future flood damage.

The 1973 Act required the Comptroller of the Currency (OCC), Board of Governors of the Federal Reserve System (Board), Federal Deposit Insurance Corporation (FDIC), Office of Thrift Supervision (OTS), and National Credit Union Administration (NCUA) to issue regulations governing the lending institutions they supervise (regulated lenders). These agencies' regulations directed lenders to require flood insurance on improved real estate or mobile homes serving as collateral for a loan if the property was located, or was to be located, in a SFHA in a participating community. To implement statutory amendments enacted in 1974, the regulations required lenders to notify borrowers that their property is located in a SFHA and of the availability of Federal disaster assistance with respect to the property in the event of a flood.

The National Flood Insurance Reform Act of 1994 (Reform Act) revised the Federal flood insurance statutes. n7 The purpose of the Reform Act was to increase compliance with flood insurance requirements and participation in the NFIP in order to provide additional income to the National Flood Insurance Fund and to decrease the financial burden of flooding on the Federal government, taxpayers, and flood victims. n8 The Reform Act requires the OCC, Board, FDIC, OTS, and NCUA to revise their current flood insurance regulations and requires the Farm Credit Administration (FCA)

to promulgate flood insurance regulations for the first time. Also, for the first time, the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae) are required by the Reform Act to ensure that flood insurance requirements are met for the loans they purchase. n9

The joint final rule establishes new escrow requirements for flood insurance premiums, adds references to the statutory authority and the requirement for lenders and servicers to "force place" flood insurance under certain circumstances, enhances flood hazard notice requirements, sets forth new authority for lenders to charge fees for determining whether a property is located in a special flood hazard area, and contains various other provisions necessary to implement the National Flood Insurance Reform Act of 1994. n10

[4] The National Flood Insurance Reform Act of 1994

The Reform Act was passed to strengthen and enhance the NFIP. Depending on the location and activities of a regulated lending institution, a lender may want adequate flood insurance coverage from a safety and soundness perspective as a component of prudent underwriting and as a way to protect the lender's interest in its collateral.

[a] Escrow of Flood Insurance Payments

A regulated lender must require the escrow of flood insurance premiums for loans secured by residential improved real estate if the lender requires the escrow of funds to cover other charges associated with the loan, such as taxes and premiums for hazard or fire insurance. n11 The escrow provision applies to loans secured by residential improved real estate. The Reform Act applies to mobile home loans whether or not they are secured by real estate.

"Residential improved real estate" is defined in the Reform Act as improved real estate for which the improvement is a residential building. n12 This definition does not distinguish between mortgage loans secured by 1- to 4-family residential buildings and commercial loans secured by residential buildings. Thus, the Reform Act's escrow provisions can apply to both home mortgage loans and commercial loans. However, it will not apply to commercial loans unless the lender requires the escrow of other charges for those loans. n13

[b] Forced Placement

A regulated lender cannot make, increase, extend, or renew any loan secured by improved real property located in a SFHA unless the security property is covered by the minimum amount of flood insurance required by the statute. n14 The insurance must be in place at the time a lender makes a loan that is secured by improved real property located in a SFHA. n15 Additionally, a regulated lender or a servicer must purchase or "force place" flood insurance for the borrower if the lender or the servicer determines that adequate coverage is lacking. n16 Forced placement authority is designed to be used if, over the term of the loan, the lender or its servicer determines that flood insurance coverage on the security property is deficient under section 102(e) of the 1973 Act. These provisions apply to all loans outstanding on or after September 23, 1994. n17

A regulated lender must initiate procedures to force-place flood insurance whenever the amount of coverage in place is not equal to the lesser of the outstanding principal balance of the loan or the maximum stipulated by statute for the particular category of property securing the loan. The amount that must be force-placed is equal to the difference between the present amount of coverage and the lesser of the outstanding principal balance or the maximum coverage limit. n18

The agencies were not required to develop a specific form of notice to borrowers for use with the forced placement procedures. For example, a lender, or servicer acting on the lender's behalf, may choose to send the notice directly. n19 Others may decide to use the insurance company that issues the forced-placement policy to send the notice. n20 FEMA has developed the Mortgage Portfolio Protection Program (MPPP) to assist lenders in connection with forced placement

procedures. For information concerning the contents of the notification letters used under the MPPP, lenders should consult FEMA's MPPP Notice. n21

[c] Portfolio Review

The 1968 and 1973 Acts, as amended by the Reform Act, do not prescribe portfolio review as the means that a lender or servicer acting on its behalf must use to determine whether security property is adequately covered by flood insurance. The flood statutes do not require that determinations be made at any particular time, other than in connection with making, increasing, extending, or renewing a loan. Nonetheless, a regulated lending institution and servicer acting on its behalf may find it prudent to develop policies and procedures to ensure that, when a determination has been made that property securing a loan is located in a SFHA, they satisfy the requirements of the Reform Act's forced placement provision.

[d] Determination Fees

A lender, or servicer acting on the lender's behalf, may charge a reasonable fee for the costs of making a flood hazard determination under the following circumstances: (1) if the borrower initiates the transaction (making, increasing, extending, or renewing a loan) that triggers a flood hazard determination; (2) if the determination reflects FEMA's revision of flood maps; or (3) if the determination results in the purchase of flood insurance by the lender or servicer under the forced placement provision. n22

The statutory authority to charge a borrower a reasonable fee for a flood hazard determination extends to a fee for life-of-loan monitoring by either the lender, or servicer acting on behalf of the lender, or by a third party, such as a flood hazard determination company. n23 A determination fee may include, among other things, reasonable fees for the costs of an initial flood hazard determination, as well as reasonable fees for a lender, servicer, or third party to monitor the flood hazard status of a security property during the life of a loan. Thus, a determination fee may include, but is not limited to, a life-of-loan monitoring fee. Because the authority to charge a life-of-loan monitoring fee is based on the authority to charge a determination fee, the monitoring fee may be charged only if one of the specified events in the statute occurs.

[e] Notice Requirements

Borrower. Written notification of special flood hazards must be given to borrowers within a reasonable period before completion of the transaction. "Reasonable" notice will vary according to the circumstances of particular transactions. However, a borrower should receive notice timely enough to ensure that (1) the borrower has the opportunity to become aware of his or her responsibilities under the NFIP; and (2) where applicable, the borrower can purchase flood insurance before completion of the loan transaction. In light of these considerations, the joint final rule does not establish a fixed time period during which a lender provides notice to the borrower, although regard ten days is generally regarded as a "reasonable" time interval. n24

Appendix A to the joint final rule provided a sample form of notice, found at § 14.12[5] *infra*. Use of the sample form is not mandatory. However, lenders who want to revise and individualize the form must provide the borrower at a minimum with the information in the sample form of notice.

Servicers. Under the Reform Act, loan servicers must be notified of special flood hazards. n25 Since the servicer may not be identified prior to closing, the joint final rule requires notice to the servicer as promptly as possible after the lender provides notice to the borrower. Notice to the servicer must be given no later than the other loan data concerning hazard insurance and taxes is given. The lender may use the same notice for both the borrower and servicer. The notice to the servicer may be transmitted in written or electronic form.

Director of FEMA. When making, increasing, extending, renewing, selling, or transferring a loan secured by improved real estate or a mobile home located in a SFHA, regulated lenders must notify the Director of FEMA or the Director's designee of the identity of the loan servicer and of any change in the servicer. n26 The notice will enable FEMA to provide notice to the servicer 45 days before the expiration of a flood insurance contract, as required by section 1364(c) of the 1968 Act, as amended. The insurance provider is FEMA's designee to receive notice of the servicer's identity and of any change.

A regulated lender must use the standard flood hazard determination form (SFHD form) developed by FEMA n27 to determine whether the building or mobile home offered as security property is or will be located in a SFHA in which flood insurance is available under the 1968 Act. Any electronic format used by lenders must contain all mandatory fields indicated on the SFHD form. n28

Lenders may rely on third-party flood hazard determinations only if the third party guarantees the accuracy of the information provided to the lender. n29 The Reform Act also permits a lender to rely on a previous determination as to whether the security property is located in a SFHA. A lender is exempt from liability for errors in the previous determination if the previous determination is not more than seven years old and the basis for it was recorded on the SFHD form mandated by the Reform Act. However, there are two instances where a lender may not rely on a previous determination: (1) if FEMA's map revisions or updates show that the security property is now located in a SFHA, or (2) if the lender contacts FEMA and discovers that map revisions or updates affecting the security property have been made after the date of the previous determination.

A regulated lender may not rely on a previous determination unless the determination was made on FEMA's SFHD form. Section 1365 of the 1968 Act, as amended by the Reform Act, *42 U.S.C. 4104b*, states that a person increasing, extending, renewing, or purchasing a loan secured by improved real estate or a mobile home may rely on a previous determination if the basis for the previous determination was set forth on FEMA's SFHD form. n30

[f] Recordkeeping Requirements

The Reform Act made two recordkeeping requirements: (1) retention of a copy of the completed SFHD form, in either hard copy or electronic form, for the period of time the regulated lender owns the loan; and (2) retention of the record of the receipt of notice to the borrower and the servicer for the period of time the regulated lender owns the loan. Lenders must notify FEMA in writing of the identity of the loan servicer and/or of a transfer in servicing rights. However, lenders do not have to keep copies of the notice to the borrower and the servicer, as the Reform Act does not require it. n31

Lenders must also retain a record of the receipt of the notices by the borrower and the servicer for the period of time the lender owns the loan. The record of receipt should contain a statement from the borrower that the borrower has received the notification.

[g] FEMA Flood Hazard Determination Appeals

FEMA's final rule entitled "Review of Determinations for Required Purchase of Flood Insurance" and the preamble to that final rule n32 clarified that a request for a review of whether the subject property is actually in a SFHA must be submitted jointly by the lender and the borrower. FEMA is currently developing a "sample letter" with filing instructions for use by lenders and borrowers in submitting an appeal to FEMA.

The party who requests the appeal of a flood determination generally will bear the cost of the appeal. An appeal is typically initiated at the request of a borrower who believes the property securing the loan is, in fact, not located in an SFHA, despite a flood determination to the contrary. The appeal fee is not charged by the lender as an incident to or condition of the credit. Generally, under the 1973 Act, n33 the mandatory flood insurance requirement is temporarily

delayed until FEMA responds to an appeal. If FEMA fails to respond before the later of 45 days or the closing of the loan, the mandatory flood insurance purchase requirement is delayed until FEMA provides a response.

A second mortgage or a home equity loan that is secured by a building or mobile home is covered by the flood insurance requirements, unless one of the statutory exemptions specifically applies. n34

[5] Sample Form of Notice of Special Flood Hazards and Availability of Federal Disaster Relief Assistance

This form is found at 12 C.F.R. Part 22 Appendix A.

We are giving you this notice to inform you that:

The building or mobile home securing the loan for which you have applied is or will be located in an area with special flood hazards.

The area has been identified by the Director of the Federal Emergency Management Agency (FEMA) as a special flood hazard area using FEMA's Flood Insurance Rate Map or the Flood Hazard Boundary Map for the following community: _____. This area has at least a one percent (1%) chance of a flood equal to or exceeding the base flood elevation (a 100-year flood) in any given year. During the life of a 30-year mortgage loan, the risk of a 100-year flood in a special flood hazard area is 26 percent (26%).

Federal law allows a lender and borrower jointly to request the Director of FEMA to review the determination of whether the property securing the loan is located in a special flood hazard area. If you would like to make such a request, please contact us for further information.

_____The community in which the property securing the loan is located participates in the National Flood Insurance Program (NFIP). Federal law will not allow us to make you the loan that you have applied for if you do not purchase flood insurance. The flood insurance must be maintained for the life of the loan. If you fail to purchase or renew flood insurance on the property, Federal law authorizes and requires us to purchase the flood insurance for you at your expense.

- Flood insurance coverage under the NFIP may be purchased through an insurance agent who will obtain the policy either directly through the NFIP or through an insurance company that participates in the NFIP.

- Flood insurance also may be available from private insurers that do not participate in the NFIP. At a minimum, flood insurance purchased must cover the lesser of:

(1) the outstanding principal balance of the loan; or

(2) the maximum amount of coverage allowed for the type of property under the NFIP.

Flood insurance coverage under the NFIP is limited to the overall value of the property securing the loan minus the value of the land on which the property is located.

- Federal disaster relief assistance (usually in the form of a low-interest loan) may be available for damages incurred in excess of your flood insurance if your community's participation in the NFIP is in accordance with NFIP requirements.

_____Flood insurance coverage under the NFIP is not available for the property securing the loan

because the community in which the property is located does not participate in the NFIP. In addition, if the non-participating community has been identified for at least one year as containing a special flood hazard area, properties located in the community will not be eligible for Federal disaster relief assistance in the event of a Federally-declared flood disaster.

FOOTNOTES:

(n1)Footnote 1. Title V of the Riegle Community Development and Regulatory Improvement Act of 1994, which is called the National Flood Insurance Reform Act of 1994 (Reform Act), comprehensively revised the Federal flood insurance statutes. Pub. L. 103-325, tit. V, *108 Stat. 2160*, 2255-87 (Sept. 23, 1994).

(n2)Footnote 2. *42 U.S.C. § 4001(d), (e)*.

(n3)Footnote 3. *42 U.S.C. § 4001(f)*.

(n4)Footnote 4. *42 U.S.C. § 4001(g)*.

(n5)Footnote 5. *42 U.S.C. § 4002(b)*.

(n6)Footnote 6. These statutes are codified at *42 U.S.C. §§ 4001-4129*. The Federal Emergency Management Agency (FEMA) administers the NFIP; its regulations implementing the NFIP appear at 44 C.F.R. parts 59-77.

(n7)Footnote 7. A detailed description of the pertinent provisions of the Riegle Community Development and Regulatory Improvement Act, or CDRI Act, appears in the preamble to the joint notice of proposed rulemaking (proposal or NPRM). *See 60 Fed. Reg. 53962, 53963-65* (Oct. 18, 1995) . This preamble refers to the 1968 Act, the 1973 Act, and the Reform Act collectively as the Federal flood insurance statutes.

(n8)Footnote 8. H.R. Conf. Rep. No. 652, 103d Cong., 2d Sess. 195 (1994) (Conference Report).

(n9)Footnote 9. *42 U.S.C. § 4003(a)(2)*.

(n10)Footnote 10. *61 Fed. Reg. 45683* .

(n11)Footnote 11. *42 U.S.C. § 4012a(d)*.

(n12)Footnote 12. *42 U.S.C. § 4012a(d)(4)*.

(n13)Footnote 13. *61 Fed. Reg. 45690* .

(n14)Footnote 14. *42 U.S.C. § 4012a(a)*.

(n15)Footnote 15. *42 U.S.C. § 4012a(a)*.

(n16)Footnote 16. *42 U.S.C. § 4012a(e)*.

(n17)Footnote 17. *42 U.S.C. § 4012a(e)(4)*.

(n18)Footnote 18. *42 U.S.C. § 4012a(b)(1)*.

(n19)Footnote 19. *61 Fed. Reg. 45697* .

(n20)Footnote 20. *61 Fed. Reg. 45697* .

(n21)Footnote 21. Notice by FEMA, *60 Fed. Reg. 44881* (Aug. 29, 1995) .

(n22)Footnote 22. *42 U.S.C. § 4012a(h)(1)*.

(n23)Footnote 23. *61 Fed. Reg. 45694* .

(n24)Footnote 24. *61 Fed. Reg. 45695* .

(n25)Footnote 25. *42 U.S.C. § 4104a*.

(n26)Footnote 26. *See, e.g., 12 C.F.R. § 22.10*

(n27)Footnote 27. *See 60 Fed. Reg. 35276* (July 6, 1995) (codified at *44 C.F.R. § 65.16* and Appendix A to part 65).

(n28)Footnote 28. The agencies required regulated lending institutions to use the FEMA-devised SFHD form by means of a joint final rule issued without notice and comment prior to the issuance of the proposal to implement the other Reform Act amendments. The agencies' proposal incorporated that provision. *See 60 Fed. Reg. 35286* (July 6, 1995) .

(n29)Footnote 29. *See generally* the discussion of determination fees at *61 Fed. Reg. 45694* .

(n30)Footnote 30. *61 Fed. Reg. 45697* .

(n31)Footnote 31. *See generally* the discussion of record-keeping requirements at *61 Fed. Reg. 45698* .

(n32)Footnote 32. *See 60 Fed. Reg. 62213* (Dec. 5, 1995) (to be codified at *44 C.F.R. § 65.17*).

(n33)Footnote 33. *42 U.S.C. § 4012a(e)(3)*.

(n34)Footnote 34. *42 U.S.C. § 4012a(b)*.

* This chapter was revised by Mary J. Burt, Esq. In 2006, Section 14.02 was revised by Robert M. Jaworski, Esq., and Section 14.04 revised by Barbara S. Mishkin, Esq. Both are partners at Reed Smith, LLP and members of its Financial Services Regulatory Group, practicing, respectively, in the Firm's Princeton, New Jersey and Philadelphia, Pennsylvania offices. Their practice includes providing federal and state compliance advice and assistance to all kinds of financial institutions, performing compliance audits, preparing multi-state surveys, and, in conjunction with Reed Smith litigators, defending individual and class actions brought against lenders. Mr. Jaworski is also a former Deputy Commissioner of the New Jersey Department of Banking and a frequent speaker and author on compliance-related topics. Section 14.15, written by Sandra R. Bullington, Esq. in 2000, has been adapted from Home Owner Associations and Planned Unit Developments--Law and Forms, ch. 6 (Matthew Bender) and was completely revised in 2010.

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52 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.13

§ 14.13 The Copyright Act of 1976

The Copyright Act of 1976 n1 enables authors and talented creators to exercise exclusive control over their creations and the economic awards they generate. n2 The Act provides for both civil n3 and criminal n4 relief.

At first glance, it appears that real estate brokers have little reason to be concerned with copyright laws, unless they are authors or publishers. The value of the copyright in protecting the MLS interest, however, was the primary conflict in *Supermarket of Homes v. San Fernando Valley Board of Realtors*, n5 in which the Board of Realtors compiled the traditional multiple listing book containing descriptions of various properties for sale in their region. The Board limited access to the compilation by restricting the use of the book to licensed brokers. It could be shown to customers only in the presence of a broker. Sale or distribution of the copies by the broker was strictly prohibited. A real estate broker chose to copy certain pages and sell them to various customers. The Ninth Circuit Court of Appeals, however, upheld the copyright protection. The basic thrust of this decision is to make real estate brokers cautious in dealing with multiple listing information; simply misusing the information can result in both civil and criminal liability.

In *M.C.A.R. v. Realty Photo Master Corp.*, n6 the Realtors' association brought an action against a photographic service, alleging copyright infringement, unfair competition, unauthorized wiretapping, and misappropriation of trade secrets. The defendant counterclaimed for tortious interference with contractual relations, defamation, and breach of contract. The defendant provided photographic services to MCAR members, and used an MCAR customer access code to access the association's database of real estate listings. After photographing the properties, defendant fed the photos into its own computer, then provided its customers with software that combined its photos with the MCAR database.

The court determined that the Realtor database was entitled to copyright protection because it contained "marketing puffery" as well as factual information about the listed properties, thus possessing some degree of creativity. The court also found that the defendant had not misappropriated trade secrets. To be protected under Maryland law, a trade secret must be secret, its value must derive from the secrecy, and the owner of the information must use reasonable efforts to safeguard the confidentiality of the information.

In re Valdez n7 involved a real estate salesman who alleged that he held the copyright to certain photographs of real estate which he had listed with the broker prior to termination of his association with the broker. The court found that the salesman had proven ownership of the photographs through his certificates of registration from the U.S. Copyright

Office. The court also found that the photographs did not meet the statutory requirements to be considered work made for hire. The salesman was the author of the photographs and retained sole ownership of the copyrights. n8 However, the court also considered N.Y. Comp. Codes R. & Regs. tit. 19, § 175.14 which provided that:

A real estate salesman shall, upon termination of his association with a real estate broker, forthwith turn over to such broker any and all listing information obtained during his association whether such information was originally given to him by the broker or copied from the records of such broker or acquired by the salesman during his association.

The court found that the photographs were listing information and that the salesman was required to relinquish ownership of the photographs when he was required to turn them over to the broker upon his termination. This court also found that this regulation was not preempted by the Copyright Act since there was no inconsistency between the Copyright Act and state law. n9

FOOTNOTES:

(n1)Footnote 1. *17 U.S.C. §§ 101-810.*

(n2)Footnote 2. Abramson, *How Much Copying Under Copyright?: Contradiction, Paradoxes, Inconsistencies*, 61 Temple L. Rev. (1988).

(n3)Footnote 3. *17 U.S.C. §§ 502-505.*

(n4)Footnote 4. *17 U.S.C. § 506.*

(n5)Footnote 5. *786 F.2d 1400 (9th Cir. 1986) .*

(n6)Footnote 6. *878 F. Supp. 804 (D.Md. 1995) aff'd, 91 F.3d 132 (4th Cir. 1996) .*

(n7)Footnote 7. *2010 U.S. Dist. LEXIS 30160 (E.D.N.Y. Mar. 26, 2010) .*

(n8)Footnote 8. *2010 U.S. Dist. LEXIS 30160, at *13 (E.D.N.Y. Mar. 26, 2010) , citing 17 U.S.C. § 101(1) and (2).*

(n9)Footnote 9. *2010 U.S. Dist. LEXIS 30160, at *15-*21 (E.D.N.Y. Mar. 26, 2010) .*

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53 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.14

§ 14.14 Federal Asset Forfeiture Laws

[1] In General

A dramatic rise in drug-related crimes has resulted in increased law enforcement and the enactment of the Comprehensive Crime Control Act of 1984, n1 which provides for civil forfeiture of real property, and the Racketeer Influenced and Corrupt Organizations Act (RICO), n2 which provides for criminal forfeiture of real property. Both statutes give the government the power to seize and take control of real estate. A real estate licensee working with listings and management contracts needs to be aware of these statutes to avoid their enforcement against properties with which the licensee associated. This discussion is about the two statutes as they apply to real property.

[2] The Comprehensive Crime Control Act of 1984

If real property is used or intended to be used in any manner or part to commit to facilitate the commission of a violation of the Act, the real property is subject to forfeiture. However, no property shall be forfeited if the act was committed without the owner's knowledge or consent. n3 The language of the Act is extremely broad, subjecting to forfeiture all real property as well as any specific right, title, or interest in the real property. The Act has been applied to the joint tenancy interest of a spouse, a judgment lien, or mortgagee's interest, n4 as well as to tenancy in common interests n5 and fee simple title. n6 The Act has also been applied to residential property for small violations (*e.g.*, the sale of 12.8 grams of cocaine). n7

Regardless of the scope of the illegal activity, the entire tract upon which the lender has a mortgage may be subject to forfeiture even if the illegal activity occurred on only a small portion of the land, n8 and the value of the property subject to the severity of the violation is irrelevant. n9 In addition, an owner, lender, or lessor of property may forfeit its interest upon proof that the property is negligently entrusted to a tenant, borrower, or occupant who uses the property to commit illegal acts. n10 This puts a heightened duty of care on a real estate broker who manages a property, but who may not be doing all that a managing agent could do to prevent the premises from being used unlawfully. n11 The Act also provides for forfeiture of real property acquired in exchange for an illegal substance or as proceeds of an illegal drug transaction, n12 and applies to real property that is purchased with proceeds that are traceable to an illegal transaction. n13

Three standards exist for determining whether property is subject to forfeiture:

- (1) the substantial connection test;
- (2) the minimal connection test; and
- (3) the probable cause standard.

The "substantial connection" test requires the government to prove by a preponderance of the evidence that a substantial connection existed between the property and the criminal activity. n14 The minimal connection test is easier for the government to meet, as use of the property in any manner connected with an illegal drug transaction is sufficient to justify the forfeiture. n15

The Ninth Circuit Court of Appeals has adopted a probable cause standard, under which the government must present evidence that shows more than mere suspicion, but less than prima facie proof that the property was used to facilitate an illegal transaction. n16

[3] The Racketeer Influenced and Corrupt Organizations Act (RICO)

[a] In General

The Racketeer Influenced and Corrupt Organizations Act (RICO) requires divestiture of legitimate businesses involved in racketeering. n17 Any person who is convicted of investing, acquiring control of, or conducting an enterprise with, money derived from a pattern of racketeering activity is subject to the provisions of the Act. The term "enterprise" is construed to include virtually everybody and every type of business. n18 To establish a "pattern" of racketeering activity, the government must show at least two years of racketeering activity that occurred within ten years of each other. n19 The forfeiture provision applies to any interests in property that a RICO defendant may possess. n20 The entity itself may be a legitimate business, but if it is operated "directly or indirectly" as a criminal enterprise, then all of its assets may be subject to forfeiture. n21

[b] Standards for Forfeiture

Under RICO, the standard for forfeiture of property is whether or not the property is part of a criminal enterprise. n22 In addition, the government employs a relation-back doctrine under the Act. Once the government proves that the property was used to further an illegal drug transaction or that the property was purchased with funds from an illegal transaction, the government is deemed to have title to the property interest from the date of the illegal transaction. This doctrine serves to cut off the mortgagee, owner, or lessor who acquired the lien or ownership interest after the date of the illegal transaction. n23

[c] Defenses to Forfeiture

Under RICO, a statutory defense is provided for any owner in the subject property who establishes that the illegal activity occurred without the knowledge or consent of the owner. n24 The word "owner" includes virtually anyone who owns an interest in the property. n25 In a civil forfeiture, an innocent owner need not be a bona fide purchaser for value. n26

The "innocent owner" defense is available to an owner who can show (1) that it "was uninvolved in and unaware of the wrongful activity," and (2) that it "had done all that reasonably could be expected to prevent prescribed use of the property." n27 The owner is not innocent if the owner simply chose to ignore the use of the property; the owner must prove that it lacked actual knowledge of the misconduct. n28 Therefore, the owner, lender, lessor, or an agent of one of these should investigate its borrower or lessee and the property in order to satisfy the first prong of the ownership defense.

The second criterion for the ownership defense is that the defendant must show that it did all that reasonably could be expected to prevent the illegal use of the property. Therefore, owners and lessees should establish procedures for the investigation of borrowers and lessees and follow them faithfully in order to prevent illegal use of the property, if possible, and to establish a record that would enable it to claim the innocent owner defense. n29

While the "innocent owner" defense offers some comfort to real estate professionals and mortgage lenders, the costs of defending a forfeiture suit can be great. RICO provides that an owner's interest in real property will not be forfeited to the government if the owner is a transferee of the property from the criminal defendant and establishes that it is a bona fide purchaser for value of such property who, at the time of the purchase, was reasonably without cause to believe that the property was subject to forfeiture under RICO. n30 Therefore, it is suggested that owners, owner's agents, lenders, lessors and managing agents should take similar steps to investigate tenants.

[4] Rights of Mortgagees

Mortgage lenders may unknowingly finance property that has been, or will be, used for an illegal act. The *Takings Clause of the 5th Amendment to the United States Constitution* n31 has been utilized in cases where a mortgagee's interest becomes unenforceable. n32

The mortgagee must be an "innocent owner" n33 and must convince the court that a "taking" has occurred. The court must then determine the fair market value of the mortgage at the time of the taking. Some courts allow interest to accrue until the sale date, n34 while others cut off the interest accrual date as of the first illegal act, reasoning that to do otherwise would adversely affect the government's interest. n35 If the mortgage documents allow, some courts have awarded attorneys' fees and court costs to prevailing mortgagees. n36 An unsecured creditor has no standing to challenge a forfeiture. n37

[5] Forfeiture Procedures

The U.S. Attorney's office may bring an action for forfeiture under the Comprehensive Crime Control Act by filing a complaint in the United States District Court. n38 If the court finds probable cause to support an action against the identified property, the court will issue an order authorizing a warrant for the arrest (seizure). n39 The government must also provide public notice of the action and arrest in a newspaper for general circulation in the district. The claim must be filed within ten days after the warrant is served for the arrest of the property or within the time specified in the public notice. If the claim is not filed timely, the interest in the property may be lost. n40

Under RICO, the government commences a criminal procedure by filing an order for forfeiture with the federal district court in which the defendant was convicted of a RICO violation. n41 After the entry of the order, the government will publish a notice of its intent to dispose of the property. n42 The claimant must petition the court for a hearing to adjudicate the validity of its alleged interest in the property within thirty days of the final publication notice or its receipt of actual notice, whichever is earlier. n43 Failure to timely petition may result in loss of all interest in the property.

[6] Broker Guidelines

Real estate brokers may want to protect themselves when they act as agents for an innocent owner, lender, or landlord. Following are some guidelines for achieving this goal:

- (1) substantiate sources of income of the tenant or prospective purchaser;
- (2) note whether or not a proposed tenant or purchaser has a large income and little experience,

education, or skills;

(3) search the chain of title by obtaining a report from a title company and investigate any unusual conveyances, particularly property held for a short period of time;

(4) inquire about the source of any downpayments, deposits, or large pre-payments of rent;

(5) note cash payments for real property and the source of that cash;

(6) check two of the premises periodically to determine whether or not the property is operated as a "front" for criminal activity when possible;

(7) when possible, interview employees of the premises and discuss business with the employees of the premises;

(8) obtain financial statements from all prospective tenants and, if possible, purchasers; and

(9) investigate tax returns from three years prior.

FOOTNOTES:

(n1)Footnote 1. *21 U.S.C. § 881 et seq.*

(n2)Footnote 2. *18 U.S.C. § 1963 et seq. See generally* Annot., 79 *Minn. L. Rev.* 1447 (1995) and Annot., 56 *Ala. Law.* 83 (1995).

(n3)Footnote 3. *21 U.S.C. § 881(a)(7)* ("no property shall be forfeited under this paragraph, to the extent of an interest of an owner, by reason of any act or omission established by that owner to have been committed or omitted without the knowledge or consent of that owner.").

(n4)Footnote 4. *United States v. Pole No. 3172 Hopkinton*, 852 F.2d 636 (1st Cir. 1988) .

(n5)Footnote 5. *United States v. One Parcel of Real Estate Located at 116 Villa Rella Drive*, 675 F. Supp. 645 (S.D. Fla. 1987) .

(n6)Footnote 6. *United States v. Real Property Titled in Shashin, Ltd.*, 680 F. Supp. 332 (D. Haw. 1987) .

(n7)Footnote 7. *United States v. Santoro*, 866 F.2d 1538 (4th Cir. 1989) .

(n8)Footnote 8. *United States v. Reynolds*, 856 F.2d 675 (1988) ; *United States v. 30. 8 Acres, Bruce Township*, 665 F. Supp. 422 (M.D.N.C. 1987) ("Congress expressly contemplated forfeiture of an entire tract based on the drug-related activities on a portion of a tract.").

(n9)Footnote 9. *Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663, 94 S. Ct. 2080, 40 L. Ed. 2d 452 , *reh'g denied*, 417 U.S. 977 (1974) . *But see United States v. Chandler*, 36 F.3d 358 (4th Cir. 1994) , *cert. denied*, 115 S. Ct. 1792 ("excessive fines" clause may be available in certain instances).

(n10)Footnote 10. *Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663, 94 S. Ct. 2080, 40 L. Ed. 2d 452 , *reh'g denied*, 417 U.S. 977 (1974) .

(n11)Footnote 11. *United States v. Lots 12, 13, 14, and 15, Keeton Heights*, 869 F.2d 942 (6th Cir. 1989) , *dismissed on appeal after remand*, 925 F.2d 1466 (1991) .

(n12)Footnote 12. 21 U.S.C. § 881(a)(6).

(n13)Footnote 13. *United States v. One Parcel of Real Estate Located at 116 Villa Rella Drive*, 675 F. Supp. 645 (S.D. Fla. 1987) .

(n14)Footnote 14. *See United States v. 1976 Ford F-150*, 769 F.2d 525 (8th Cir. 1985) .

(n15)Footnote 15. *United States v. 1964 Beechcraft Baron Aircraft*, 691 F.2d 725 (5th Cir. 1982) ; *United States v. 1974 Cadillac El Dorado Sedan*, 548 F.2d 421 (2d Cir. 1977) .

(n16)Footnote 16. *United States v. \$5,644,540*, 799 F.2d 1357 (9th Cir. 1986) .

(n17)Footnote 17. 18 U.S.C. § 1961 et seq.

(n18)Footnote 18. *See* 18 U.S.C. § 1961(4).

(n19)Footnote 19. 18 U.S.C. § 1961(5).

(n20)Footnote 20. *United States v. Williams*, 809 F.2d 1072 (5th Cir.) , cert. denied, 484 U.S. 896 (1987) ; *United States v. Cauble*, 706 F.2d 1322 (5th Cir. 1983) ; cert. denied, 104 Sup. Ct. 996 (1984) .

(n21)Footnote 21. 18 U.S.C. § 1962(a).

(n22)Footnote 22. *United States v. Cauble*, 706 F.2d 1322 (5th Cir. 1983) , cert. denied, 104 S. Ct. 996 (1984) .

(n23)Footnote 23. *United States v. Four Parcels of Real Property etc.*, 870 F.2d 586, 1989 U.S. App. LEXIS 5180 (11th Cir. 1989) ; *Simons v. United States*, 541 F.2d 1351 (9th Cir. 1976) .

(n24)Footnote 24. 21 U.S.C. § 881(a)(6), (7).

(n25)Footnote 25. *United States v. 6960 Miraflores Ave.*, 995 F.2d 1558 (11th Cir. 1993) ; *United States v. Four Parcels of Real Property etc.*, 870 F.2d 586 (11th Cir. 1989) ; *In re Metmor Financial*, 819 F.2d 446 (4th Cir. 1987) .

(n26)Footnote 26. *United States v. 92 Buena Vista Ave.*, 113 S. Ct. 1126 (1993) .

(n27)Footnote 27. *Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663, 94 S. Ct. 2080, 40 L. Ed. 2d 452 , reh'g denied, 417 U.S. 977 (1974) . *See also United States v. 6640 SW 48th St.*, 41 F.3d 1448 (11th Cir. 1995) (mortgagee not innocent owner where he knew of the mortgagor's illegal drug activities before acquiring his mortgage interest).

(n28)Footnote 28. *United States v. Four Parcels of Real Property etc.*, 870 F.2d 586 (11th Cir. 1989) .

(n29)Footnote 29. *United States v. Fee Simple Parcel of Real Property*, 650 F. Supp. 1534 (E.D. La. 1987) .

(n30)Footnote 30. 18 U.S.C. § 1963(c).

(n31)Footnote 31. U.S.C. Const. Amend. 5.

(n32)Footnote 32. *See generally* Annot., *Right of Mortgagee and /or Lienor to Compensation when Property Subject to Mortgage and/or Lien is Taken by Federal Governmental Forfeiture Based on Criminal Acts of Owner*, 136 A.L.R. Fed. 593 (1997) .

(n33)Footnote 33. *See Shelden v. United States*, 7 F.3d 1022 (Fed. Cir. 1993) , rev'd and remanded; *United States v. 3 Parcels in La Plata County, Colorado*, 919 F. Supp. 1449 (D. Nev. 1995) .

(n34)Footnote 34. *See, e.g., United States v. 708- United States v. 708-709 West 9th St., 715 F. Supp. 1323 (W.D. Tex. 1983) ; United States v. One Condominium Apartment, 636 F. Supp. 457 (S.D. Fla. 1986) .*

(n35)Footnote 35. *See, e.g., United States v. 8. 4 Acres of Land, 648 F. Supp. 79 (D.C. S.C. 1986) , aff'd without op. 823 F.2d 549 (4th Cir.) .*

(n36)Footnote 36. *See, e.g., United States v. Federal Nat'l Mortgage Ass'n, 946 F.2d 264 (4th Cir. 1991) .*

(n37)Footnote 37. *See, e.g., United States v. \$3,000 in Cash, 906 F. Supp. 1061 (E.D. Va. 1995) .*

(n38)Footnote 38. Fed. R. Civ. P. C(2).

(n39)Footnote 39. Fed. R. Civ. P. C(3).

(n40)Footnote 40. Fed. R. Civ. P. C(6).

(n41)Footnote 41. 18 U.S.C. § 1963(j).

(n42)Footnote 42. 18 U.S.C. § 1963(l)(1).

(n43)Footnote 43. 18 U.S.C. § 1963(l)(2).

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54 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.15

§ 14.15 Interstate Land Sales Full Disclosure Act

[1] Purpose of the Act

The Interstate Land Sales Full Disclosure Act n1 (the ILSFDA or the Act) was enacted as part of the Housing and Urban Development Act of 1968. n2 This Act addressed wholesale interstate land fraud during the 1960s, in which unscrupulous promoters sold undesirable real estate such as Florida swampland, onto unsuspecting and ill-informed investors and consumers. n3 The Act is a consumer protection statute designed to prohibit and punish fraud in land development enterprises. n4

ILSFDA requires that developers provide disclosures in advance of a purchaser signing the sales contract. n5 Similar to the securities laws, n6 this Act is an anti-fraud statute that uses disclosure as its primary tool to protect purchasers from unscrupulous sales of undeveloped home sites. n7 Congress intended to ensure that prior to purchasing certain types of real estate, a buyer was apprised of the information needed in order to make an informed decision. n8 Courts have held that the Act should be liberally interpreted in order to prohibit and punish fraud in certain land development enterprises. n9 Exemptions to the Act are narrowly construed in order to further the Act's purpose of consumer protection. n10

The Act applies to any developer who directly or indirectly uses any means or instrument of transportation or communication in interstate commerce. n11 Arguments that ILSFDA applies only to raw, undeveloped land have been rejected. The Act's legislative history indicates that Congress was concerned with the sale of undeveloped lots pursuant to a common promotional plan. While Congress may have been primarily concerned with the sale of raw land, this Act applies to all lots, but provides an exemption for improved land on which a residential, commercial, condominium, or industrial building exists or where the contract of sale obligates the seller to erect such a structure within two years. n12 As discussed in § 14.15[7], below, there are several other exemptions.

Purchasers can pursue actions against the developer or the developer's agent. n13 This section will refer to the seller or developer. It should be understood, however, that agents are likewise subject to potential liability under the Act. n14

An ILSFDA claim does not require evidence of a duty. n15 Instead, a purchaser must show that the Act applied to the transaction in question and that the developer did not meet the ILSFDA's specific reporting, notice, or conduct requirements. n16 The consumer can unconditionally rescind the purchase and receive a refund of any monies paid for

some ILSFDA violations. n17 This is a powerful remedy. This particular remedy makes the Act of particular interest to consumers who have purchased a covered property during a period when real estate prices are declining. n18 Some consumers suffering from buyer's remorse during the recession which began in December 2007, have sought to rescind their purchase contracts due to a developer's carelessness in not complying with this Act.

Lenders who finance subdivisions should also be concerned with borrower compliance with the Act. A failure to comply with the Act which leads to multiple rescissions of purchase agreements can jeopardize loan repayment. During a recession, the developer may be unable to resell these lots. Even if the developer is able to resell the lots in a reasonable time period, the price may be greatly reduced from the price in the rescinded sales contract. When a lender's borrower is relying upon the two-year exemption, the lender should be aware of the consequences of its borrower failing to qualify for this exemption. The lender should also realize that the developer may allege that the lender was responsible for the developer's failure to timely complete the project.

Developers are advised to determine their duties and obligations under this Act, if any, prior to marketing or selling any "lot" in a "subdivision" through interstate commerce. n19 Each of these terms is defined under the Act. These terms are discussed in the next subsection. Building and selling a large number of residential buildings does not ensure that a developer knows of this Act. Real estate licensees should not assume that an experienced developer is aware of this Act. n20

Although the ILSFDA applies to the sale or lease of non-exempt lots, this section will usually refer only to the sale of lots. Readers should remember, however, that lease transactions are also covered by the Act. The regulations under the Act provide that the term "sale" "means "any obligation or arrangement for consideration to purchase or lease a lot directly or indirectly." The regulations also state that the terms "sale" or "seller" include in their meanings the terms "lease" and "lessor." n21

[2] Defined Terms

These eleven terms are defined in the ILSFDA at 15 U.S.C. § 1701: (1) Secretary, (2) person, (3) subdivision, (4) common promotional plan, (5) developer, (6) agent, (7) blanket encumbrance, (8) interstate commerce, (9) State, (10) purchaser and (11) offer. Each term is a term of art under the Act. Some additional terms are defined by regulation. n22

This Act is administered by the U.S. Department of Housing and Urban Development (HUD). The term "Secretary" refers to the Secretary of HUD. n23 Within HUD, there is an Office of Real Estate Settlement and Procedures Act (RESPA) & Interstate Land Sales. n24

The term "developer" means "any person who, directly or indirectly, sells or leases, or offers to sell or lease, or advertises for sale or lease any lots in a subdivision." n25 Despite this broad definition, not all sellers of lots will fall within this definition. Lenders are often excluded from this definition. n26 However, the term developer has been found to include a lender whose involvement with a developer had exceeded the lender's ordinary course of business. For example, a commercial bank that held itself out as a financial backer of a subdivision development exceeded its ordinary course of dealing. When a financial institution allows its name to be used in advertisements or announcements for a development, it is lending its prestige and good name to the sales effort. Such conduct is participation to an unacceptable degree in the marketing of the project. n27

When the developer is a corporation, officers and directors of the corporation can be considered developers under the Act when they are personally involved in the sale of the lots. However, simply being a corporate officer or director does not result in liability under the Act; the corporate officer or director must be personally involved in the fraud which gives rise to the liability. n28

A "subdivision" is "any land which is located in any State or in a foreign country and is divided or is proposed to be

divided into lots, whether contiguous or not, for the purpose of sale or lease as part of a common promotional plan." n29

ILSFDA provisions repeatedly refer to the sale or lease of "lots." This term is defined by regulation as "any portion, piece, division, unit, or undivided interest in land located in any State or foreign country, if the interest includes the right to the exclusive use of a specific portion of the land." n30

Although the Act does not define the term "condominium" or explicitly state that condominiums are covered by the Act, HUD and the courts have consistently interpreted this Act's reach to include the sale of condominium units. n31 Courts that have addressed this issue hold that the plain vanilla residential condominium falls squarely within the definition of "lots" under the Act. n32 These courts have relied on the fact that the Department of Housing and Urban Development has long considered condominium units to be "lots" within the meaning of the Act. n33

While condominium units are generally considered "lots" within the meaning of the Act, not all real estate subjected to the condominium form of property ownership will qualify as a lot under the Act. For example, nonresidential condominium hotel units were found not to qualify as lots under the Act, because these hotel interests were different from traditional condominium units. The unit owners had occupancy rights for fourteen days per year and the units were encumbered with use restrictions which made it clear that the owners were dedicating their units for use as rental hotel rooms. Given the use restrictions and the nonresidential, business purpose of the hotel units, these condominium units were not properly considered condominiums, and therefore they were not "lots" within the meaning of the Act. n34

The relevance of lots sold pursuant to a common promotional plan is that such lots are considered to be a subdivision under the ILSFDA. n35 The HUD guidelines state that a common promotional plan is any plan undertaken by a single developer or a group of developers acting together to offer lots for sale or lease. A common promotional plan is presumed to exist if land is offered by a developer or a group of developers acting in concert and the land is contiguous or is known, designated, or advertised as a common development or by a common name. n36 The number of lots covered by each individual offering has no bearing on whether or not there is a common promotional plan. n37

The HUD guidelines advise that these are the characteristics that are evaluated in determining the existence of a common promotional plan: a 10% or greater common ownership; same or similar name or identity; common sales agents; common sales facilities; common advertising; and common inventory. These are not exclusive factors. The presence of one or more of the characteristics does not necessarily denote a common promotional plan. Conversely, the absence of a characteristic does not demonstrate that there is no common promotional plan. n38

In one case, a common promotional plan was found even though the lots were located in non-contiguous subdivisions. The lands were known collectively by one or two common names, were offered in aggregate newspaper advertisements, and were sold through one sales office by salesmen who had authority to sell parcels from any of the various developments and who frequently showed parcels from several developments to a single purchaser. The court found that this sales scheme fell "easily" within the Act's regulation. n39

Common ownership or developers acting in concert are essential elements of a common promotional plan. However, common ownership alone would not constitute a common promotional plan. HUD considers the involvement of all principals holding a 10 percent or greater interest in the subdivision to determine whether there is a thread of common ownership. If there is common ownership or if the developers are acting in concert, and there is common advertising, sales agents or sales office, a common promotional plan is presumed to exist. n40

The HUD guidelines observe that the phrase common promotional plan is misunderstood by those who believe that promotion implies an enthusiastic sales campaign. Instead, any method used to attract potential purchasers is a promotional plan. These guidelines state that direct mail campaigns and free dinners may be the promotional plan of one developer while another developer's promotion may be limited to classified advertisements in a local newspaper. n41

The guidelines also state that brokers selling lots as an agent for any person who is required to register under the Act are also required to comply with the Act's requirements for those sales. Brokers selling lots for different individuals who do not own enough lots to come within the Act's jurisdiction generally would not be considered to be offering lots pursuant to a common promotional plan as long as they are merely receiving the usual real estate commission for such sales. n42 If the broker has an ownership interest in the lots or is receiving a greater than normal real estate commission, the broker may be offering lots pursuant to common promotional plan and may be required to comply with the Act's requirements. n43

[3] Anti-Fraud Provisions

ILSFDA's anti-fraud provision states in relevant part that with respect to the sale of any lot not exempt under *15 U.S.C. § 1702(a)*, n44 it is unlawful for any developer or agent, directly or indirectly, to obtain money or property in connection with a development by fraud or by means of a material false statement or any omission of a material fact necessary to make the statements made not misleading. n45 The regulations that implement the anti-fraud provisions are found at 24 C.F.R. Part 1715, subpart B.

Pursuant to *15 U.S.C. § 1711(a)(2)*, a three-year limitations period applies to actions brought under the anti-fraud provisions. The limitations period begins to run from the date of discovery of the violation, or the date on which discovery should have been made by the exercise of reasonable diligence. n46

Statements that are opinions or exaggerations concerning the qualities of a developer's project constitute non-actionable puffery rather than fraud. n47

[4] Regulations and HUD Guidelines

The Department of Housing and Urban Development is the agency responsible for administration of this Act. n48 HUD has been granted authority to promulgate rules and regulations relating to the ILSFDA. n49 Regulations implementing the Act are found at 24 C.F.R. Parts 1710, 1715 and 1720.

In 1979, the HUD Secretary published an interpretive rule regarding ILSFDA entitled "Guidelines for Exemptions Available under the Interstate Land Sales Full Disclosure Act." n50 That rule was superceded in 1984 n51 and rescinded in 1996, as part of a streamlining process. n52 This information is currently found on the HUD website where it is titled, "Full Disclosure Act Exemptions." n53 These Guidelines state that they are intended to clarify HUD policies and positions with regard to the statutory exemptions, and that the Guidelines are an interpretive rule and not a substantive regulation.

Courts accord deferential treatment to HUD's ILSFDA regulations. n54

[5] Subdivision Registration and Disclosures

When a developer's project is covered by ILSFDA, the developer must produce extensive material about contracts, the homeowners association and a detailed printed property report. n55 Developers must register their subdivisions with the Secretary of the Department of Housing and Urban Development. n56 Registration is accomplished by filing a statement of record which meets the Act's requirements. n57 The developer must also pay a fee to the HUD Secretary with this registration. n58

The Act specifically requires that land developers engaged in certain interstate sales or leases file a public statement of record for subdivisions of 100 or more lots with the U.S. Department of Housing and Urban Development (HUD) unless the lots are subject to an exemption. n59 A copy of a printed property report must be provided to the purchaser

10A-14 Real Estate Brokerage Law and Practice § 14.15

prior to the purchaser signing a sales contract with respect to a nonexempt lot. n60The printed property report is a condensed version of the statement of record filed with HUD. n61 It is unlawful for the developer of a covered subdivision to make use of interstate commerce or the mails to sell or lease any lot in a covered subdivision unless a statement of record with respect to such lot is in effect and a printed property report is furnished to the purchaser in advance of the signing of any contract or agreement for sale or lease by the purchaser. n62

Pursuant to 15 U.S.C. § 1705, the statement of record must contain the following information and be accompanied by these documents:

- (1) the name and address of each person with an interest in the lots in the subdivision to be covered by the statement of record and the extent of such interest;
- (2) a legal description of, and a statement of the total area included in the subdivision and a statement of the topography, together with a map showing the division proposed and the dimensions of the lots to be covered by the statement of record and their relation to existing streets and roads;
- (3) a statement of the condition of the title to the land comprising the subdivision, including all encumbrances and deed restrictions and covenants;
- (4) a statement of the general terms and conditions, including the range of selling prices or rents at which the developer proposes to dispose of the subdivision lots;
- (5) a statement of the present condition of the subdivision access, the existence of any unusual conditions relating to noise or safety which affect the subdivision and are known to the developer, the availability of sewage disposal facilities and other public utilities (including water, electricity, gas, and telephone facilities) in the subdivision, the proximity in miles of the subdivision to nearby municipalities, and the nature of improvements to be installed by the developer and the estimated schedule for completion;
- (6) in the case of any subdivision or portion thereof against which there exists a blanket encumbrance, a statement of the consequences for an individual purchaser of a failure, by the person or persons bound, to fulfill obligations under the instrument(s) creating such encumbrance and the steps, if any, taken to protect the purchaser in such eventuality;
- (7) (A) copy of its articles of incorporation, with all amendments, if the developer is a corporation; (B) copies of all instruments by which the trust is created or declared, if the developer is a trust; (C) copies of its articles of partnership or association and all papers pertaining to its organization, if the developer is a partnership, unincorporated association, joint stock company, or any other form of organization; and (D) if the purported holder of legal title is a person other than developer, copies of these documents for such person;
- (8) copies of the deed or other instrument establishing title to the subdivision in the developer or other person and copies of any instrument creating a lien or encumbrance upon the title or copies of the opinion or opinions of counsel in respect to the title to the subdivision in the developer or other person or copies of the title insurance policy guaranteeing such title;
- (9) copies of all conveyance forms to be used in selling or leasing lots to purchasers;
- (10) copies of instruments creating easements or other restrictions;
- (11) certified and uncertified financial statements of the developer as the Secretary may require; and

(12) other information and documents and certifications as the Secretary may require as being reasonably necessary or appropriate for the protection of purchasers. n63

The ILSFDA provides that if a developer fails to furnish the property report to the purchaser in advance of the latter's execution of the purchase agreement, the contract may be revoked at the purchaser's option within two years from the date of such signing, and the contract must clearly provide notice of this right. n64 The purchaser's option to rescind in this situation has been called an "absolute, unfettered right." n65

HUD's website allows users to search for approved subdivisions and developers by name and state. n66

[6] Purchaser's Right of Revocation

Pursuant to *15 U.S.C. § 1703(b)*, the purchaser of a non-exempt lot may, at his or her option, for a limited time revoke the sales contract. This right generally runs until midnight of the seventh day following the signing of the contract. The contract must clearly advise the purchaser of this right.

Pursuant to *15 U.S.C. § 1703(c)*, this right of revocation is extended to two years from the date a sales contract was signed and the purchaser incurs an obligation, if the seller was required to provide the purchaser with a property report and the seller failed to do so prior to the signing of the contract.

A buyer's revocation of a purchase agreement need not be done in writing. n67 A developer's attempt to contractually require a written revocation will not be enforced. n68 However, HUD recommends that the buyer who cancels the contract in person or by telephone, "immediately confirm the cancellation by certified mail." n69

The moment a purchaser signs a sales contract and incurs obligations is the moment when a purchaser should receive ILSFDA protection, either in the form of the developer's obligations to provide information before that moment, or alternatively, in the form of purchaser rights that exist as of that time. n70

Section § 1703(d) provides a two-year period in which a purchaser can revoke a contract for a lot which is not exempt under *15 U.S.C. § 1702*, when the contract omits certain terms intended to act as safeguards for the purchaser. n71 These safeguards require a specific description of the lot being purchased and require that the purchaser be informed as to the consequences and remedies of default by either the buyer or the seller. n72 These disclosures must be made prior to the execution of a sales contract. n73 The language, "not exempt under section 1702" has been held to mean that this two-year right of revocation does not apply to the sale of any lot that is exempt from any provision of the Act under § 1702. n74 Thus, if the sale of a lot is exempt from any ILSFDA provision under § 1702, then the sale is also exempt from the right of revocation granted in § 1703(d). n75

When a purchaser revokes a contract pursuant to the Act, the purchaser is entitled to receive all money the purchaser paid under the sales contract. n76 In order to exercise this right of revocation, the purchaser must tender to the seller an instrument conveying his or her rights and interests in the lot. The lot must be in a condition which is substantially similar to the condition in which it was conveyed to the purchaser. n77

One court has held that a purchaser was entitled to receive a refund of all monies paid to the seller, including amounts paid for option upgrades to the lot. n78 If the purchaser has lived in the lot, the purchaser is still entitled to a refund of all monies paid to the seller; the seller is not due any setoff for the rental value of the lot. n79

[7] Exemptions

[a] Introduction

Not every lot sale is subject to the Act. n80 The ILSFDA provides several exemptions to its registration and disclosure requirements. n81 The statutory exemptions are found in subsections (a) and (b) of § 1702. A developer cannot avail itself of these exemptions if the method of disposition is adopted for purposes of evading the Act. n82 A developer must act pursuant to a legitimate business purpose when seeking to fall within an exemption to the Act. n83

These are the exemptions under subsection (a) of § 1702:

- (1) the twenty-five lots exemption;
- (2) the improved lot exemption;
- (3) the evidence of indebtedness exemption (involving the sale of evidences of indebtedness secured by a mortgage or deed of trust on real estate);
- (4) the securities exemption (involving sale of securities issued by a real estate investment trust);
- (5) the government sales exemption (involving the sale or lease of real estate by any government or government agency); n84
- (6) the cemetery lots exemption;
- (7) the sale to builders exemption; and
- (8) the industrial or commercial development exemption.

These are the exemptions under subsection (b) of § 1702:

- (1) the one hundred lot exemption;
- (2) the twelve lot exemption;
- (3) the scattered site exemption;
- (4) the twenty-acre lot exemption;
- (5) the single-family residence exemption;
- (6) the mobile home exemption;
- (7) the intrastate exemption; and
- (8) the Metropolitan Statistical Area (MSA) Exemption.

There is an important difference between the exemptions listed in *15 U.S.C. § 1702(a)* and the exemptions found in § 1702(b). The exemption provisions in § 1702(a) create an exemption from the ILSFDA in its entirety, including the anti-fraud provisions found in § 1703(a)(2). The exemption provisions in § 1702(b), however, only create an exemption from the ILSFDA's registration and disclosure requirements. n85 Lots covered by a § 1702(b) exemption are subject to the anti-fraud provisions. Section 1702(a) has been described as providing full statutory exemptions, while § 1702(b) has been described as providing partial statutory exemptions which discharge a developer from ILSFDA's disclosure

and registration requirements, but not its anti-fraud provisions. n86

In addition to these statutory exemptions, HUD has the authority to create rules or regulations exempting lots from provisions of the Act. n87

A developer who is uncertain as to whether a project qualifies for an exemption can seek an Exemption Order pursuant to 24 C.F.R. § 1710.16. A developer can also seek an Advisory Opinion which is a formal written opinion of the Secretary as to jurisdiction in a particular case or the applicability of an exemption under 24 C.F.R. §§ 1710.5 through 1710.15, based on facts submitted to the Secretary. The instructions and format for obtaining an Advisory Opinion are contained in 24 C.F.R. § 1710.17 n88 and in part VIII of the HUD guidelines. n89 Another option is for a developer to seek a No Action Letter. The regulation addressing a No Action Letter states in part, "If the sale of lots is subject to the registration requirements of the Act but the circumstances of the sale are such that no affirmative action to enforce the registration requirements is needed to protect the public interest or prospective purchasers, the Secretary may issue a No Action Letter." n90

[b] Non-Binding Reservation Agreements and Undivided Interests

HUD guidelines indicate that non-binding reservation agreements do not trigger the Act's requirements. The HUD guidelines define a reservation agreement as "a non-binding agreement used to gauge market feasibility for a developer through which a potential purchaser expresses an interest to buy or lease a lot or unit at some time in the future." n91 A reservation agreement that can become a sales contract by virtue of some future event occurring at the seller's discretion will not qualify as an exempt non-binding reservation agreement. n92 An option agreement will not qualify as a non-binding reservation agreement since an option agreement is an arrangement for consideration in which a potential purchaser could forfeit money. n93

Also excluded from the Act's reach are the sales of undivided interests that do not carry with them the right of exclusive use of a specific lot. The HUD guidelines give this example of a sale of an undivided interest: a camping subdivision is sold as 400 undivided interests to tenants in common, where purchasers have a co-extensive, non-exclusive right to the use and enjoyment of all campsites on a space available basis and no purchaser has an expressed or implied exclusive right to repeatedly use or occupy any specific campsite. This camping subdivision would not be covered by the Act. n94

[c] Exemptions under 15 U.S.C. § 1702(a)

The following subsections will consider the two exemptions under 15 U.S.C. § 1702(a) which are used by developers.

[i] Twenty-Five Lot Exemption

The twenty-five lot exemption is found in 15 U.S.C. § 1702(a)(1). The HUD guidelines state that this subsection exempts the sale of lots in a subdivision that contains fewer than 25 lots. If a subdivision contains 25 or more lots, but fewer than 25 of those lots are offered for sale under a common promotional plan, those sales would be exempt. The guidelines give this example: in a subdivision of 28 lots in which 4 lots are not offered for sale because they are permanently dedicated to the public for a park, the sale of the remaining 24 lots is exempt. n95

If fewer than 25 lots are acquired in a larger subdivision, the offer of these lots may be subject to the Act if the acquiring party is acting in concert with the previous or current developer of the balance of the subdivision. Correspondingly, if fewer than 25 lots are acquired in a larger subdivision, the offer of the lots may be exempt if there is neither an identity of interest between the acquiring party and the previous or current developer nor any form of concerted action that constitutes a common promotional plan. n96

Since the fewer than 25 lots exemption is based upon the number of lots as opposed to the number of sales, resales of a

lot are not counted toward the fewer than 25 lots limit. n97

[ii] Improved Lot Exemption

The improved lot exemption is found at *15 U.S.C. § 1702(a)(2)*. n98 This exemption applies: (1) to the sale of any improved land on which there is a residential, commercial, or industrial building, *or* (2) the sale of land under a contract obligating the seller to erect such a building thereon within a period of two years. For purposes of the ILSFDA, a sale occurs when the purchaser signs the contract and incurs an obligation. n99

The purchaser's signature on a contract and incurrance of an obligation commences the two-year period for purposes of the improved lot exemption. n100 The developer's subsequent signature or ratification of the contract does not extend this two-year time period under the improved lot exemption as it is not the triggering event which commences the mandatory two-year building requirement. n101 The seller is not allowed to specify in the contract the date from which the two-year period is to commence. n102

Under the two-year completion exemption, the developer must have an unconditional commitment to complete construction within two years. n103 This is the prevailing view which has been applied uniformly by the courts which have addressed this issue. n104 Any qualification of this obligation or limitation on the consumer's remedies which renders the obligation illusory will disqualify the sale from the protection of this exemption. n105 The HUD guidelines state:

The contract must not allow nonperformance by the seller at the seller's discretion. Contracts that permit the seller to breach virtually at will are viewed as unenforceable because the construction obligation is not an obligation in reality. Thus, for example, a clause that provides for a refund of the buyer's deposit if the seller is unable to close for reasons normally within the seller's control is not acceptable for use under this exemption. Similarly, contracts that directly or indirectly waive the buyer's right to specific performance are treated as lacking a realistic obligation to construct. HUD's position is not that a right to specific performance of construction must be expressed in the contract, but that any such right that purchasers have must not be negated. For example, a contract that provides for a refund or a damage action as the buyer's sole remedy would not be acceptable.

Contract provisions which allow for nonperformance or for delays of construction completion beyond the two-year period are acceptable if such provisions are legally recognized as defenses to contract actions in the jurisdiction where the building is being erected. For example, provisions to allow time extensions for events or occurrences such as acts of God, casualty losses or material shortages are generally permissible. Also permissible, in the case of multi-unit construction, is a clause conditioning the completion of construction or closing of title on a certain percentage of sales of other units. The presale period cannot exceed 180 days from the date the first purchaser signs a contract in the project or, in a phased project, from the date the first purchaser signs a sales contract in a phase. Such a clause may not extend the overall two-year obligation to construct. n106

Typically a developer's obligation will be considered illusory if the purchase agreement denies the buyer basic contractual remedies such as specific performance. n107 One court stated that the issue in examining the provisions of the sales contract is whether the contractual language in question eviscerates the seller's obligation to complete construction within the two-years within the meaning of the Act. n108 Such an evisceration can occur through language excusing the developer's delay in performance or language which limits the buyer's remedies.

While federal law governs the interpretation of ILSFDA, state contract law determines whether the seller is obligated to complete construction within two years. n109 In determining whether an obligation to build within a two-year period is

real or illusory, courts distinguish between recognized defenses to nonperformance and limitations of remedies; the former typically will not render the obligation illusory while the latter may result in a finding that the obligation is illusory. n110 The requirement that this obligation be real does not require that the seller provide an unconditional guarantee which imposes strict liability for noncompliance since strict liability for completion is not necessary to prevent the fraud the Act is intended to prevent. n111 The fact that there are limited defenses for the developer's non-performance does not render the developer's obligation to perform within two years a nullity and hence illusory. n112

While the doctrine of impossibility of performance may prevent a developer's obligation to perform from being considered illusory, n113 if knowledge of the facts making performance impossible were available to the promisor before execution of the contract, the defense of impossibility is unavailable. n114 A legal impossibility exists only if the supervening event is not foreseeable. n115

Courts have strictly enforced the requirement that an obligation to build not be illusory. For example, a contract which limits the consumer's sole remedy to the return of his or her deposit eliminates the consumer's ability to enforce the developer's promise to complete construction within two years. n116 A developer who uses this type of provision will not qualify for the improved lot exemption. n117 A force majeure clause which limits exclusions to events beyond the seller's control and not within the seller's discretion, should result in a contract which "obligates" the seller to complete construction within the two-year period for purposes of the Act. n118

In considering the obligation to complete construction within the two-year period for purposes of compliance with the Act, it is irrelevant that construction is actually completed within the two-year period. n119 The issue is whether the obligation in the parties' contract was an unconditional obligation. n120

Not all restrictions on remedies will render an obligation illusory. For example, a limitation on recovering punitive damages would not render the obligation illusory because punitive damages are usually not recoverable for a breach of contract. A limitation on the recovery of special damages, however, would render the obligation illusory. n121 Furthermore, in some cases, contract provisions which have stated a remedy, but which have not limited the buyer to that remedy have been found to be acceptable in the context of the Act's improved lot exemption. n122

A savings clause will not prevent a contract with an illusory obligation provision from violating the act. One court to consider this issue stated that giving effect to developer's purported savings clause would encourage other developers to include the broadest list of potential all-encompassing excuses to extend completion dates beyond two years, and simply tack on a savings clause to avoid losing the exemption in the event the developer's contractual obligation was challenged under the Act. n123

[d] Exemptions under 15 U.S.C. § 1702(b)

[i] One Hundred Lot Exemption

The one hundred lot exemption is found in 15 U.S.C. § 1702(b)(1). Regulations addressing this exemption are found at 24 C.F.R. § 1710.6. The sale of lots in a subdivision is generally exempt from the Act's registration requirements if the subdivision contains fewer than 100 lots. The HUD guidelines indicate that the 100 lot count for purposes of the exemption excludes lots that are exempt from jurisdiction under 24 C.F.R. § 1710.5 (b) through (h). These other exemptions can be "piggybacked" onto the 100 lot exemption. n124 However, the 25 lot exemption discussed at § 4A.09[7][c][i], above, cannot be used in connection with the 100 lot exemption. n125 The HUD guidelines give the following example:

[A] developer of a subdivision containing a total of 129 lots ... qualifies for this exemption if at least 30 lots are sold in transactions that are exempt because the lots had completed homes erected on them.

The 30 exempt transactions may fall within any one exemption or a combination of exemptions noted in § 1710.5 (b) through (h) and may be either past or future sales. ... [T]he developer also could qualify if twelve lots had been sold with residential structures already erected on them, nine lots had been sold to building contractors and at least nine lots were reserved for either the construction of homes by the developer or for sales to building contractors. The reserved lots need not be specifically identified. n126

The 100 lot exemption applies to the number of the lots as opposed to the number of sales. Consequently, resales of a lot will not count toward the 100 lot limit. However, any sale or resale of a lot must comply with the anti-fraud provisions. n127

Developers who intend to piggy-back or stack another exemption onto the one hundred lot exemption must ensure that the requirements of both exemptions are met. Developers should also realize that there is a conflict of authority with respect to piggy-backing these exemptions. In *200 East Partners, LLC v. Gold*, n128 the court stated that because the developer failed to "perfect" an exemption for all units of its 115 lot project prior to the plaintiffs executing their purchase agreements, the developer had violated ILSFDA by failing to provide the plaintiffs with a printed property report. n129 The developer in this case had obtained an Advisory Opinion from HUD approving of its piggy-back plan to use both the improved lot exemption and the one hundred lot exemption. This court appeared to believe that the developer had acted to evade the Act. n130

The perfection approach of the court in *200 East Partners, LLC v. Gold* with respect to the piggy-backing or stacking of exemptions involving the one hundred lot exemption was criticized and rejected by the court in *Bodansky v. Fifth on the Park Condo, LLC*. n131 This court considered a 157-unit project. This developer knew nothing about ILSFDA when it began the project and thus the court found that this developer could not have had a plan to evade the Act. When the purchasers attempted to rescind their purchase agreements, the developer claimed that its sales were exempt from the Act under § 1702(a)(2) (improved lot exemption) and § 1702(b)(1) (one hundred lot exemption). This court found that the plain meaning of § 1702(b)(1) was that as long as the subdivision contained fewer than one hundred non-exempt lots, then the Act's registration and disclosure requirements did not apply to the sale of lots in that subdivision. The court found that the hundred lot exemption can still apply to a subdivision containing one hundred or more lots as long as all lots sold above the ninety-nine non-exempt lots maximum will be covered by a § 1702(a) exemption. The buyers in this case had argued that the one hundred lot exemption applied only if when the purchase agreement was signed, fewer than one hundred non-exempt lots were offered for sale in the subdivision. This court concluded that a violation of ILSFDA occurs when a developer sells one hundred or more non-exempt units in a condominium development, rather than when a developer offers for sale more than one hundred non-exempt units. n132

With respect to "perfecting" an exemption, the Bodansky court stated:

[T]he *200 East* court's interpretation of § 1702(b)(1) is unsupported by the text of the statute. The court's decision in *200 East* does not explain how the text of § 1702(b)(1) justifies a rule that a developer must "perfect" an exemption "prior" to the signing of any purchase agreement, much less what "perfecting" an exemption under ILSA would require. The notion that an exemption must be "perfected" at the time any particular purchase agreement is executed misapprehends the self-determining nature of the ILSA exemptions. See *24 C.F.R. § 1710.4(d)*. Furthermore, despite the issue being a matter of first impression in Florida ... the court did not closely examine the text of § 1702(b)(1) or *24 C.F.R. § 1710.6*. Although the court read HUD's Guidelines as not permitting a developer "to wait until the sale of a unit in excess of the first ninety-nine to qualify for an exemption for the remaining units," *id.*, the court provided no textual support (or otherwise) for this interpretation. The *200 East* court's interpretation of § 1702(b)(1) is thus unpersuasive. n133

The *Bodansky* court also concluded that a developer does not evade the ILSFDA by consciously acting to ensure that its subdivision meets the requirements of one or more exemptions. n134

The HUD guidelines state that if fewer than 100 lots are acquired in a larger subdivision, the offer of these lots will not be exempt if the acquiring party is acting in concert with the previous or current developer of the balance of the subdivision so as to create a common promotional plan for 100 or more lots unless sales of the other lots are otherwise exempt. However, if fewer than 100 lots are acquired in a larger subdivision, the offer of the lots may be exempt if there is neither an identity of interest between the acquiring party and the previous or current developer nor a form of concerted action constituting a common promotional plan. n135

The 100 lot exemption does not cap or otherwise limit the date of delivery, unlike the improved lot exemption found in 15 U.S.C. § 1702(a). n136

[ii] Twelve Lot Exemption

The twelve lot exemption is found in 15 U.S.C. § 1702(b)(2). Regulations for this exemption are found at 24 C.F.R. § 1710.7. The HUD guidelines state that this section exempts the sale of lots from the registration requirements of the Act if, beginning with the first sale after June 20, 1980, no more than twelve lots in the subdivision are sold in the subsequent 12-month period. Thereafter, the sale of the first twelve lots each period is exempt from the registration requirements if no more than twelve lots were sold in each previous 12-month period that began with the anniversary date of the first sale after June 20, 1980. The HUD guidelines give this example:

[I]f a developer's first lot sale after June 20, 1980 occurred on August 5, 1980 and no more than eleven additional lots in the subdivision were sold through August 4, 1981, the sales would be exempt. During the second year of operation under this exemption (beginning on August 5, 1981 in the example) at least the first twelve lot sales would be exempt. However, if lot sales exceed twelve in the second or any subsequent year, the exemption would terminate on the sale of the thirteenth lot. n137

Once eligibility has been terminated, the exemption is unavailable and cannot be recaptured by the same developer for the same subdivision even if there are fewer than twelve lots sold in subsequent years. n138 Thus, if there are more than 12 sales of lots in the second or any subsequent year, the exemption terminates on the sale of the 13th lot and may not be reinstated.

The HUD guidelines state that a developer may apply to the Secretary to establish a different twelve-month period for use in determining eligibility for the exemption, and the Secretary may allow the change if it is for good cause and consistent with the purpose of the exemption. n139

In determining eligibility for this exemption, all lots sold in the subdivision are included in the count, whether or not the lot is registered or the transaction is otherwise exempt, such as the sale of a home and lot package. This exemption extends to twelve lots, not twelve sales. Each lot would be counted in the sale of multiple lots. n140

[iii] Scattered Site Exemption

The scattered site exemption is found at 15 U.S.C. § 1702(b)(3). Regulations for this exemption are found at 24 C.F.R. § 1710.8. The HUD guidelines state that this section exempts from the Act's registration requirements the sale of lots in a subdivision consisting of noncontiguous parts if: (1) each noncontiguous part of the subdivision contains twenty or fewer lots; and (2) each purchaser or purchaser's spouse makes a personal, on-the-lot inspection of the lot purchased before signing a contract. n141

This exemption relieves the developers of small, scattered offerings of the requirement to register their subdivisions. The exemption may also apply to real estate brokers who have an ownership interest in more than one site, each containing 20 or fewer lots. Developers who rely on this exemption must understand the Act's definition of a

subdivision, how a common promotional plan is determined and what constitutes a site. n142

Lots that are contiguous when they are originally platted or developed are considered to remain contiguous. For purposes of this exemption, interruptions such as roads, parks, small bodies of water or recreational facilities do not serve to break the contiguity of parts of a subdivision. n143

[iv] Twenty Acre Lots Exemption

The twenty acre lot exemption is found at *15 U.S.C. § 1702(b)(4)*. Regulations for this exemption are found at *24 C.F.R. § 1710.9*. The HUD guidelines state that this section exempts the sale of lots in a subdivision from the registration requirements of the Act if, since April 28, 1969, each lot in the subdivision has contained at least twenty acres. In determining eligibility for the exemption, easements for ingress and egress or public utilities are considered part of the total acreage of the lot if the purchaser retains ownership of the property affected by the easement. n144

This exemption applies to the entire subdivision. Each lot in the subdivision must be twenty acres or larger in order for the subdivision to qualify. If a single lot offered in the subdivision is less than twenty acres in size, no lot in the subdivision qualifies for the exemption. If a developer has two sites which comprise the subdivision and only one of the sites contains lots that are all greater than twenty acres in size, the offering of these lots would not be exempt under this provision. All lots offered pursuant to a common promotional plan must be considered. n145

[v] Single-Family Residence Exemption

The single-family residence exemption is found at *15 U.S.C. § 1702(b)(5)*. Regulations for this exemption are found at *24 C.F.R. § 1710.10*. The HUD guidelines state that this section provides an exemption for the sale of lots that are limited to single-family residential use. The guidelines advise developers to carefully review the eligibility requirements for this exemption. n146

Under this exemption, lots offered under the same common promotional plan must comply with these two eligibility requirements:

- (1) The subdivision must meet all local codes and standards.
- (2) In the promotion of the subdivision, there cannot be offers, by direct mail or telephone solicitation, of gifts, trips, or dinners or the use of similar promotional techniques to induce prospective purchasers to visit the subdivision or to purchase a lot. n147

To meet this exemption, the lot must be located within a municipality or county where the local government or the State specifies minimum standards in the following areas for the development of subdivision lots within its boundaries: lot dimensions; plat approval and recordation; roads and access; drainage; flooding; water supply; and sewage disposal. n148 Each lot must be either zoned for single-family residences or, in the absence of a zoning ordinance, limited exclusively by enforceable covenants or restrictions to single-family residences. Manufactured homes, townhouses, and residences for one-to-four family use are considered single-family residences for purposes of this exemption. n149

The lot must be on a paved street or highway which has been built to applicable state or local government standards. If the roads are to be public roads they must be acceptable to the local government that will be responsible for maintenance. If the street or highway is incomplete, the developer must post a bond or other surety acceptable to the municipality or county in the full amount of the cost of completing the street or highway to assure completion to local standards. n150

The local government or a homeowners association must have accepted or be obligated to accept the responsibility for

maintaining the street or highway upon which the lot is located. If a homeowners association has accepted maintenance responsibility, the developer must, prior to signing of a contract or agreement to purchase, provide the purchaser with a good faith written estimate of the cost of carrying out this responsibility over the first ten years of ownership. n151

At closing, potable water, sanitary sewage disposal, and electricity must have been extended to the lot or the local government must be obligated to install the facilities within 180 days following closing. For subdivisions without a central water or sewage disposal system, there must be assurances that an adequate year-round potable water supply is available and that the lot is approved for the installation of a septic tank. n152

Under the single-family residence exemption, the sales contract must require delivery within 180 days after the signing of the sales contract of a warranty deed, which at the time of delivery is free from monetary liens and encumbrances. n153 At closing, a title insurance binder or title opinion reflecting the condition of title must be issued or presented to the purchaser showing that, subject only to exceptions which are approved in writing by the purchaser at the time of closing, marketable title to the lot is vested in the seller. n154 In addition, the purchaser or purchaser's spouse must make a personal, on-the-lot inspection of the lot purchased prior to signing a contract or agreement to purchase. n155

In order to qualify for this exemption, the sale must also comply with the Act's anti-fraud provisions. n156

[vi] Mobile Home Exemption

The mobile home exemption is found at *15 U.S.C. § 1702(b)(6)*. Regulations for this exemption are found at *24 C.F.R. § 1710.11*. The HUD guidelines state that for purposes of this exemption, a mobile home is a unit receiving a label in conformance with HUD Regulations implementing the National Manufactured Housing Construction and Safety Standards Act of 1974. n157 This section exempts the sale of a mobile home lot from the registration requirements of the Act when certain eligibility requirements are met.

[vii] Intrastate Exemption

The intrastate exemption is found at *15 U.S.C. § 1702(b)(7)*. Regulations for this exemption are found at *24 C.F.R. § 1710.12*. The HUD guidelines for this exemption state that the lot must be free and clear of all liens, encumbrances and adverse claims. Lots must meet six eligibility requirements in order to qualify for this exemption. n158

[viii] The Metropolitan Statistical Area Exemption

The Metropolitan Statistical Area (MSA) exemption is found at *15 U.S.C. § 1702(b)(8)*. Regulations for this exemption are found at *24 C.F.R. § 1710.13*. This exemption covers the sale or lease of lots in a subdivision located in a MSA. The eligibility criteria for the MSA Exemption are similar to those of the intrastate exemption. n159

[e] Regulatory Exemptions

The Secretary has established several regulatory exemptions from the Act's registration and full disclosure requirements. These exemptions are self-determining and do not require a submission to HUD. If a sale meets any one of the regulatory exemptions, the sale qualifies for exemption from the Act's registration requirements. However, qualifying sales must comply with the anti-fraud provisions. n160

A developer must satisfy the eligibility criteria at all times in order to qualify for a regulatory exemption. Exempt status ends when a developer fails to immediately comply with the eligibility criteria. The Secretary may deny the use of the exemption by an otherwise eligible subdivision, site or lot if there are reasonable grounds to believe that the use of any of these regulatory exemptions is not in the public interest in a particular case. In such a case, the developer will be given notice and an opportunity for hearing before a final determination is made. The proceedings would follow the requirements stated in the regulations at *24 C.F.R. § 1720.105, et seq.* and are patterned after the notice and time

requirements of a proceeding pursuant to 24 C.F.R. § 1710.45(b)(1). n161

These regulatory exemptions are listed in 24 C.F.R. § 1710.14. Subsection (a) states that the following transactions are exempt from the Act's registration requirements unless the Secretary has properly terminated the exemption:

- (1) The sale of lots, each of which will be sold for less than \$100, including closing costs, if the purchaser will not be required to purchase more than one lot.
- (2) The lease of lots for a term not to exceed five years if the terms of the lease do not obligate the lessee to renew.
- (3) The sale of lots to a person who is engaged in a bona fide land sales business.
- (4) The sale of a lot to a person who owns the contiguous lot which has a residential, commercial or industrial building on it.
- (5) The sale of real estate to a government or government agency.
- (6) The sale of a lot to a person who has leased and resided primarily on the lot for at least the year preceding the sale.

With respect to the regulatory exemption for the sale of lots to a person engaged in a bona fide land sales business, the HUD guidelines state that in order for a transaction to qualify for this exemption, the purchaser must be a person who plans to subsequently sell or lease the lot(s) in the normal course of business. The term business refers to an activity of some continuity, regularity and permanency, or means of livelihood. The sale or lease of lots to an individual who is buying the property for investment, to be sold at some unforeseeable time in the future, would not be exempt under this provision. This exemption is available on a lot-by-lot basis, although most transactions would include more than one lot. The entire subdivision need not qualify for this exemption. n162

[8] Remedies

ILSFDA provides courts with broad discretion to award a variety of remedies. The Act creates a private right of action for purchasers against developers who fail to comport with the disclosure and anti-fraud provisions of the Act. n163 In an ILSFDA action, in addition to revoking the contract, the court may order damages, specific performance, or such other relief as the court deems fair, just, and equitable. n164 When considering a remedy, the court may consider the contract price of the lot, the amount the purchaser actually paid, the cost of any improvements to the lot, the lot's fair market value when the relief is determined and the lot's fair market value at the time of purchase. n165 The court may also award interest, court costs, and reasonable amounts for attorneys' fees, independent appraisers' fees, and travel to and from the lot. n166

With respect to attorney's fees, the Act authorizes an award of reasonable attorney's fees to a purchaser or lessee. The award of such fees is not to the prevailing party. However, if state law requires the enforcement of a contract provision awarding attorney's fees to the prevailing party and the developer is the prevailing party under ILSFDA, the developer should be entitled to such an award. n167

[9] Statute of Limitations

The statute of limitations for ILSFDA claims is generally three years. n168 The commencement of the statute of limitations period depends on the type of violation being alleged. For some violations, the three-year period commences with the date of signing of the sales contract. For other violations, the three-year period commences upon discovery of

the violation or after discovery should have been made by the exercise of reasonable diligence. n169

Some buyers who have failed to timely exercise their right of rescission within the two-year period of *15 U.S.C. § 1703*(c) and (d), have tried to argue that the three-year statute of limitations period applies to this right of rescission when the developer failed to warn these buyers of their right to rescind. These arguments are generally unsuccessful. n170 Nothing in the Act states that a developer's failure to disclose the right to rescind in the purchase agreement obviates, tolls or extends the two-year deadline for rescission. n171 However, courts appear willing to consider the possibility that in certain circumstances, a developer's failure to provide the required notice of rescission rights might support a viable equitable tolling argument. n172

[10] Jurisdiction

United States District Courts and state courts are both granted jurisdiction over ILSFDA cases. n173 However, ILSFDA provides that if a case is brought in a State court of competent jurisdiction, the case cannot be removed to a federal court except where the United States or an officer or employee of the United States in his official capacity is a party. n174 Consequently, removal of most ILSFDA cases from a State court to a federal court is barred. n175

[11] Certification of Substantially Equivalent State Law

ILSFDA does not prevent or limit the authority of any State or local government to enact and enforce laws regarding land sales so long as those laws do not conflict with the Act. n176 There is no preemption in this area. n177

ILSFDA allows HUD to certify, and thereby adopt, a State law which is substantially equivalent to the federal act. n178 The Act's State law certification provision was designed to eliminate the burden on developers of duplicative State and federal registration requirements where the State standards equaled or exceeded the federal requirements. n179

ILSDA contains a procedure for obtaining State law certification. The State must apply to HUD, and a notice of the State's application must be published in the Federal Register for a thirty-day comment period. n180 The Secretary reviews the State's laws, regulations, and administrative procedures to determine if they meet the disclosure and protection provisions of the Act. n181 If a State fails to meet the standards for certification, the Secretary must notify the State in writing of the changes in State law, regulation, or administration that are needed in order to obtain certification. n182

After the Secretary has certified a State, the Secretary must accept for filing under ILSFDA, disclosure materials found acceptable, and any related documentation required by State authorities in connection with the sale or lease of lots located within the State. The Secretary may accept for filing, and declare effective as the Federal statement of record and property report, such materials and documentation found acceptable by the State in connection with the sale or lease of lots located outside that State. n183

The Secretary must periodically review the State's laws, regulations, and administrative procedures to determine if they continue to meet the federal requirements. If they do not, the Secretary must withdraw certification. n184

A developer still must pay filing fees to HUD even if the State has had its laws certified as being substantially equivalent. n185

Regulations concerning the certification of substantially equivalent State law are found at *24 C.F.R. §§ 1710.500 through 1710.559*.

As of September 5, 2009, HUD's website indicated that there were four States which had obtained certification. They are Arizona, California, Florida, and Minnesota. n186

FOOTNOTES:

(n1)Footnote 1. 15 U.S.C. § 1701, *et seq.*

(n2)Footnote 2. See *Winter v. Hollingsworth Properties*, 777 F.2d 1444, 1446 (11th Cir. Fla. 1985) .

(n3)Footnote 3. See *Winter v. Hollingsworth Properties*, 777 F.2d 1444, 1447 (11th Cir. Fla. 1985) ; *Sun Kyung Ahn v. Merrifield Town Ctr. Ltd. Partnership*, 584 F. Supp. 2d 848, 853 (E.D. Va. 2008) .

(n4)Footnote 4. See *Bartley v. Merrifield Town Ctr. L.P.*, 580 F. Supp. 2d 495, 498 (E.D. Va. 2008) .

(n5)Footnote 5. See *Sun Kyung Ahn v. Merrifield Town Ctr. Ltd. Partnership*, 584 F. Supp. 2d 848, 853 (E.D. Va. 2008) ; *Grove Towers Inc. v. Lopez*, 467 So. 2d 358, 361 (Fla. Dist. Ct. App. 1985) , *review denied*, 480 So. 2d 1294 (Fla. 1985) .

(n6)Footnote 6. See *Flint Ridge Development Co. v. Scenic Rivers Ass'n of Oklahoma*, 426 U.S. 776, 778, 779, 96 S. Ct. 2430, 2433-2434, 49 L. Ed. 2d 205, 211 (1976) , *reh'g denied*, 429 U.S. 875, 97 S. Ct. 198, 97 S. Ct. 199, 50 L. Ed. 2d 159 (1976) .

(n7)Footnote 7. See *Stein v. Paradigm Mirasol, LLC*, 586 F.3d 849, 853 (11th Cir. 2009) , *cert. denied*, 2010 U.S. LEXIS 2588 (Mar. 22, 2010) ; *Winter v. Hollingsworth Props., Inc.*, 777 F.2d 1444, 1446-47 (11th Cir. 1985) ; *Maguire v. South Homes of Palm Beach, L.L.C.*, 591 F. Supp. 2d 1263, 1267 (S.D. Fla. 2008) ; *Akers v. Classic Properties, Inc.*, 2003 Ohio 5436, 2003 Ohio App. LEXIS 4896, at *14 (Oct. 13, 2003) .

(n8)Footnote 8. See *Cost Control Marketing & Management, Inc. v. Pierce*, 848 F.2d 47, 48 (3d Cir. 1988) .

(n9)Footnote 9. See *Pigott v. Sanibel Development, LLC*, 576 F. Supp. 2d 1258, 1267 (S.D. Ala. 2008) ; *Schatz v. Jockey Club Phase III, Ltd.*, 604 F. Supp. 537, 541 (S.D. Fla. 1985) .

(n10)Footnote 10. See *Murray v. Holiday Isle, LLC*, 620 F. Supp. 2d 1302, 1308 (S.D. Ala. 2009) ; *Pigott v. Sanibel Development, LLC*, 576 F. Supp.2d 1258, 1268 (S.D. Ala. 2008) .

(n11)Footnote 11. 15 U.S.C. § 1703(a); 24 C.F.R. § 1710.3. See *Pigott v. Sanibel Development, LLC*, 576 F. Supp. 2d 1258, 1267 (S.D. Ala. 2008) .

(n12)Footnote 12. See *Winter v. Hollingsworth Properties*, 777 F.2d 1444, 1447 (11th Cir. Fla. 1985) .

(n13)Footnote 13. 15 U.S.C. § 1709.

(n14)Footnote 14. The term "agent" is defined in 15 U.S.C. § 1701(6). For cases discussing who qualifies as an agent, see *Santidrian v. Landmark Custom Ranches, Inc.*, 655 F. Supp. 2d 1260, 1267-68 (S.D. Fla. 2009) ; *Sewell v. D'Alessandro & Woodyard*, 655 F. Supp. 2d 1228, 1253-54 (M.D. Fla. 2009) ; *Palmer v. Ocean Club at Biloxi, LTD*, 2008 U.S. Dist. LEXIS 84782 (S.D. Miss. Oct. 21, 2008) ; *Santidrian v. Landmark Custom Ranches, Inc.*, 2008 U.S. Dist. LEXIS 81124, at *9-*10 (S.D. Fla. Oct. 14, 2008) ; *Paniaguas v. Aldon Cos.*, 2005 U.S. Dist. LEXIS 43488 (N.D. Ind. Aug. 17, 2005) ; *Tomlinson v. Village Oaks Development Co., LLC*, 2003 U.S. Dist. LEXIS 8488 (S.D. Ind. Apr. 17, 2003) ; *Kemp v. Peterson*, 940 F.2d 110, 113 (4th Cir. 1991) ; *Hammar v. Cost Control Marketing & Sales Management, Inc.*, 757 F. Supp. 698 (W.D. Va. 1990) ; *Bartholomew v. Northampton Nat'l Bank*, 584 F.2d 1288, 1292-93 (3d Cir. 1978) ; *McCown v. Heidler*, 527 F.2d 204, 206-7 (10th Cir. 1975) ; *Akers v. Classic Props.*, 2003 Ohio 5436, 2003 Ohio App. LEXIS 4896 (Oct. 13, 2003) .

(n15)Footnote 15. See *Paniaguas v. Aldon Cos.*, 2007 U.S. Dist. LEXIS 57608, at *36 (N.D. Ind. July 31, 2007) .

(n16)Footnote 16. See *Paniaguas v. Aldon Cos.*, 2007 U.S. Dist. LEXIS 57608, at *36 (N.D. Ind. July 31, 2007) .

(n17)Footnote 17. Regulations addressing a purchaser's revocation rights are found at 24 C.F.R. §§ 1715.1 through 1715.5.

(n18)Footnote 18. See generally Richard C. Linqanti, *A Brief Survey of Continuing Issues with the Interstate Land Sales Full Disclosure Act: Will the Fat Lady Never Sing?*, 23 *Probate & Property* 46 (Nov./Dec. 2009) This author states, "Every real estate downturn brings a resurgence of litigation under [this Act]." At p. 52, this author concludes that buyers will bring ILSFDA claims during a real estate market downturn because "the rescission remedy is a perfect cure for a bad business decision.

(n19)Footnote 19. See 15 U.S.C. § 1703. See generally William P. Sklar and Jennifer L. Dolce, *The Interstate Land Sales Full Disclosure Act's Two-Year Completion Exemption from the Condominium Developer's Perspective*, 73 *Fla. Bar. J.* 56 (Feb. 1999).

(n20)Footnote 20. Cf. *Bodansky v. Fifth on the Park Condo, LLC*, 2010 U.S. Dist. LEXIS 7577, at *3-*4 (S.D.N.Y. Jan. 29, 2010) (The project was to contain 157 units. The sponsor first learned of ILSFDA about two years after it began selling units. The sponsor had not filed any statement of record with HUD, nor had it provided purchasers with required notices.).

(n21)Footnote 21. 24 C.F.R. § 1710.1(b).

(n22)Footnote 22. See 24 C.F.R. § 1710.1.

(n23)Footnote 23. 15 U.S.C. § 1701(1).

(n24)Footnote 24. Pursuant to the HUD Website, the telephone numbers for this office are: 202-708-0502 and 202-708-4559 (fax). See <http://www.hud.gov/offices/hsg/dirhousei.cfm> (visited May 15, 2010). The address is Office of RESPA and Interstate Land Sales, Department of Housing and Urban Development, 451 7th Street, S.W., Room 9146, Washington, D.C. 20410.

(n25)Footnote 25. 15 U.S.C. § 1701(5).

(n26)Footnote 26. Cf. *Cumberland Capital Corp. v. Harris*, 621 F.2d 246 (6th Cir. 1980) (A financial institution was not a developer under the Act because any actions that appeared to classify it as a developer were only a small fraction of its lending duties.); *Bartholomew v. Northampton Nat'l Bank*, 584 F.2d 1288, 1294 (3d Cir. Pa. 1978) (Lenders were not developers under the Act.).

(n27)Footnote 27. See *Hammar v. Cost Control Marketing & Sales Management, Inc.*, 757 F. Supp. 698, 702-703 (W.D. Va. 1990) .

(n28)Footnote 28. See *Santidrian v. Landmark Custom Ranches, Inc.*, 2008 U.S. Dist. LEXIS 81124 (S.D. Fla. Oct. 14, 2008) ; *Parra v. Minto Town Park, LLC*, 2008 U.S. Dist. LEXIS 90837, at *4-*5 (S.D. Fla. Oct. 29, 2008) . See also *Kemp v. Peterson*, 940 F.2d 110, 113 (4th Cir. 1991) (Officers, directors, and participating planners may be held individually liable for violations of the Act, notwithstanding the absence of a clause in the Act establishing liability for controlling stockholders, officers and directors.).

(n29)Footnote 29. 15 U.S.C. § 1701(3).

(n30)Footnote 30. 24 C.F.R. § 1710.1.

(n31)Footnote 31. See *Winter v. Hollingsworth Properties*, 777 F.2d 1444, 1447-1449 (11th Cir. Fla. 1985) ; *Schatz v. Jockey Club Phase III, Ltd.*, 604 F. Supp. 537 (S.D. Fla. 1985) ; *Appalachian, Inc. v. Olson*, 468 So. 2d 266, 268 (Fla. Dist. Ct. App. 1985) , review denied, 482 So. 2d 347 (Fla. 1985) .

(n32)Footnote 32. See *Becherer v. Merrill Lynch, Pierce, Fenner & Smith*, 127 F.3d 478, 480 (6th Cir. 1997) . See also *Winter v. Hollingsworth Properties, Inc.*, 777 F.2d 1444, 1448 (11th Cir. 1985) (acknowledging HUD's definition of "lot" includes a condominium unit).

(n33)Footnote 33. See *Becherer v. Merrill Lynch, Pierce, Fenner & Smith*, 127 F.3d 478, 480-481 (6th Cir. 1997) , citing Guidelines For Exemptions Available Under the Interstate Land Sales Full Disclosure Act, 61 Fed. Reg. 13596, at 13601 (March 27, 1996) .

(n34)Footnote 34. See *Becherer v. Merrill Lynch, Pierce, Fenner & Smith*, 127 F.3d 478, 482-81 (6th Cir. 1997) .

(n35)Footnote 35. See *Pigott v. Sanibel Development, LLC*, 576 F. Supp. 2d 1258, 1274 n. 30 (S.D. Ala. 2008) , quoting *Tomlinson v. Village Oaks Development Co., LLC*, 2003 U.S. Dist. LEXIS 8488, at *8 n. 2 (S.D. Ind. Apr. 17, 2003) .

(n36)Footnote 36. Cf. *Pigott v. Sanibel Development, LLC*, 576 F. Supp. 2d 1258, 1278 (S.D. Ala. 2008) (Fourteen principal/investor units were subject to a common promotional plan with the other 94 units, so the project clearly constituted a single subdivision exceeding 100 units that were not exempt from the ILSFDA.); *Hammar v. Cost Control Marketing and Sales Management of Virginia, Inc.*, 757 F. Supp. 698, 700 (W.D. Va. 1990) (Where lots of Lake Monticello development were extensively advertised as a common unit by a common name, that development met the Act's definition of a subdivision as lots offered for sale as part of a common promotional plan.); *N & C Properties v. Windham*, 582 So.2d 1044, 1047-1048 (Ala. 1991) (Phase I and phase II of a twin condominium tower project was combined for ILSFDA exemption purposes where developer had retained an option to build a second phase, had reserved the land, and had issued promotional material depicting both towers. Phase I and II were part of common promotional plan), *cert. denied*, 1991 Ala. LEXIS 514 (Ala. June 7, 1991) ; *N & C Properties v. Pritchard*, 525 So.2d 1346, 1349 (Ala. 1988) (Phase I and Phase II of a single development constitute a common promotional plan, even though construction on Phase II had not yet begun and it had not been formally offered for sale, because developers cannot avoid application of the act simply by breaking the development into two smaller segments.), *cert. denied*, 488 U.S. 856, 109 S. Ct. 146, 102 L. Ed. 2d 118 (1988) .

(n37)Footnote 37. 61 Fed. Reg. 13596, 13602 (March 27, 1996) .

(n38)Footnote 38. 61 Fed. Reg. 13596, 13602 (March 27, 1996) .

(n39)Footnote 39. See *United States v. Dacus*, 634 F.2d 441, 444 (9th Cir. 1980) .

(n40)Footnote 40. 61 Fed. Reg. 13596, 13602 (March 27, 1996) .

(n41)Footnote 41. 61 Fed. Reg. 13596, 13602 (March 27, 1996) .

(n42)Footnote 42. See *Orsi v. Kirkwood*, 999 F.2d 86, 90 (4th Cir. Va. 1993) .

(n43)Footnote 43. 61 Fed. Reg. 13596, 13602 (March 27, 1996) .

(n44)Footnote 44. As discussed in § 4A.09[7][a], below, lots exempt under 15 U.S.C. § 1702(a) are exempted from ILSFDA in its entirety. Lots exempt under 15 U.S.C. § 1702(b) are only exempt from ILSFDA's registration and disclosure requirements. Thus, lots exempt under § 1702(b) are subject to the Act's anti-fraud provision. In addition, lots subject to ILSFDA in its entirety are subject to this anti-fraud provision.

(n45)Footnote 45. 15 U.S.C. § 1703(a)(2)(A).

(n46)Footnote 46. See *Akers v. Classic Properties, Inc.*, 2003 Ohio 5436, 2003 Ohio App. LEXIS 4896, at *15 (Oct. 13, 2003) .

(n47)Footnote 47. See *Gentry v. Cottages-Stuart, LLP*, 602 F. Supp. 2d 1239, 1252-1253 (S.D. Fla. 2009) (Statements that the condominiums (1) are a luxury development; (2) are extraordinary; (3) blend tropical charm with contemporary elegance; (4) combine materials and finishes of exceptional quality with timeless craftsmanship; (5) provide spacious patios from which to enjoy glorious sunrises over the water; and (6) that the developer consistently delivers products and service of the highest caliber to clients and residents, fell squarely within the scope of opinions, exaggerations and general characterizations that constitute puffery.).

(n48)Footnote 48. See *Pugliese v. Pukka Development Co.*, 550 F.3d 1299, 1301-302 n. 1 (11th Cir. 2008) .

(n49)Footnote 49. 15 U.S.C. §§ 1715, 1718. See *Pugliese v. Pukka Dev., Inc.*, 550 F.3d 1299, 1301-1302 n. 1 (11th Cir. 2008) .

(n50)Footnote 50. 44 Fed. Reg. 24010 (1979) . See *Disimone v. LDG South II, LLC*, 2009 U.S. Dist. LEXIS 5860 (M.D. Fla. Jan. 28, 2009) .

(n51)Footnote 51. 49 Fed. Reg. 31375 (1984) . See *Disimone v. LDG South II, LLC*, 2009 U.S. Dist. LEXIS 5860 (M.D. Fla. Jan. 28, 2009) .

(n52)Footnote 52. 61 Fed. Reg. 13596 (1996) . See *Disimone v. LDG South II, LLC*, 2009 U.S. Dist. LEXIS 5860 (M.D. Fla. Jan. 28, 2009) .

(n53)Footnote 53. See <http://www.hud.gov/offices/hsg/ramh/ils/ilsexemp.cfm> (site visited May 15, 2010).

(n54)Footnote 54. See *Winter v. Hollingsworth Properties*, 777 F.2d 1444, 1447 (11th Cir. 1985) ; *Bodansky v. Fifth on the Park Condo, LLC*, 2010 U.S. Dist. LEXIS 7577, at *18-*19 (S.D.N.Y. Jan. 29, 2010) ; *Adams-Lipa v. Tds Town Homes Llc*, 2009 U.S. Dist. LEXIS 53855, at *7 (M.D. Fla. June 25, 2009) ; *Caswell v. Antilles Vero Beach*, 2008 U.S. Dist. LEXIS 79701 (S.D. Fla. July 7, 2008) . See also *Aikin v. WCI Communities, Inc.*, 26 So. 3d 691, 696 (Fla. Dist. Ct. App. 2010) (The Guidelines are entitled to great weight in interpreting this Act.).

(n55)Footnote 55. See *Bartley v. Merrifield Town Ctr. L.P.*, 580 F. Supp. 2d 495, 498 (E.D. Va. 2008) ; *Bush v. Bahia Sun Assocs., Ltd. P'ship*, 543 F. Supp. 2d 1295, 1296-1297 (M.D. Fla. 2008) . See also 24 C.F.R. § 1715.20 (describing unlawful sales practices in connection with the Property Report or Offering Statement).

(n56)Footnote 56. 15 U.S.C. § 1504. See *Kemp v. Peterson*, 940 F.2d 110, 112 (4th Cir. 1991) ; *Bartley v. Merrifield Town Ctr. L.P.*, 580 F. Supp. 2d 495, 498 (E.D. Va. 2008) .

(n57)Footnote 57. 15 U.S.C. § 1504(a).

(n58)Footnote 58. 15 U.S.C. § 1504(b); 24 C.F.R. § 1710.35. As of Sept. 1, 2009, the registration fee was \$800 for subdivisions of 200 or fewer lots and \$1,000 for subdivisions of 201 or more lots.

(n59)Footnote 59. 15 U.S.C. §§ 1703(a)(1)(A); 1704 through 1706. See *Cost Control Marketing & Management, Inc. v. Pierce*, 848 F.2d 47, 48 (3d Cir. 1988) .

(n60)Footnote 60. 15 U.S.C. §§ 1703(a)(1)(B) and 1707. See *Murray v. Holiday Isle, LLC*, 620 F. Supp. 2d 1302, 1309 (S.D. Ala. 2009) .

(n61)Footnote 61. See *Bodansky v. Fifth on the Park Condo, LLC*, 2010 U.S. Dist. LEXIS 7577, at *8 (S.D.N.Y. Jan. 29, 2010) .

(n62)Footnote 62. See *Flint Ridge Dev. Co. v. Scenic Rivers Ass'n*, 426 U.S. 776, 778-79, 96 S. Ct. 2430, 2434, 49 L. Ed. 2d 205, 211 (1976) , quoting 15 U.S.C. sec. 1703(a)(1), *reh'g denied*, 429 U.S. 875, 97 S. Ct. 198, 97 S. Ct. 199, 50 L. Ed. 2d 159 (1976) . See also *Palmer v. Ocean Club at Biloxi, LTD*, 2008 U.S. Dist. LEXIS 84782 (S.D. Miss. Oct.

21, 2008) (The Act protects purchasers from abuse by real estate developers through interstate commerce and the use of the mails in the promotion and sale of properties offered as part of a common promotional plan.).

(n63)Footnote 63. See *Flint Ridge Development Co. v. Scenic Rivers Ass'n of Oklahoma*, 426 U.S. 776, 778, 779, 96 S. Ct. 2430, 2433-2434, 49 L. Ed. 2d 205, 211 (1976), *reh'g denied*, 429 U.S. 875, 97 S. Ct. 198, 97 S. Ct. 199, 50 L. Ed. 2d 159 (1976). See also 24 C.F.R. § 1715.25 (describing misleading sales practices in the context of promotional material describing the property and its amenities).

(n64)Footnote 64. 15 U.S.C. § 1703(c). See *Murray v. Holiday Isle, LLC*, 620 F. Supp. 2d 1302, 1309 (S.D. Ala. 2009).

(n65)Footnote 65. See *Murray v. Holiday Isle, LLC*, 620 F. Supp. 2d 1302, 1312 (S.D. Ala. 2009).

(n66)Footnote 66. See <http://hhhqunp003.hud.gov/HSNG/ILS/ILSSubdivisions.nsf/ILSSubdivisions.html> (site visited May 15, 2010).

(n67)Footnote 67. See *Gilmore v. Residences at Sandpearl Resort, LLC*, 2008 U.S. Dist. LEXIS 84034, at *5-*6 (M.D. Fla. Sept. 26, 2008).

(n68)Footnote 68. See *Gilmore v. Residences at Sandpearl Resort, LLC*, 2008 U.S. Dist. LEXIS 84034, at *5-*6 (M.D. Fla. Sept. 26, 2008).

(n69)Footnote 69. 24 C.F.R. § 1710.118. See *Gilmore v. Residences at Sandpearl Resort, LLC*, 2008 U.S. Dist. LEXIS 84034, at *5-*6 (M.D. Fla. Sept. 26, 2008).

(n70)Footnote 70. See *Sun Kyung Ahn v. Merrifield Town Center, L.P.*, 584 F. Supp. 2d 848, 856 (E.D. Va. 2008).

(n71)Footnote 71. See *Pugliese v. Pukka Development Co.*, 550 F.3d 1299, 1301 (11th Cir. 2008).

(n72)Footnote 72. See *Bartley v. Merrifield Town Ctr. L.P.*, 580 F. Supp. 2d 495, 498 (E.D. Va. 2008).

(n73)Footnote 73. See *Bartley v. Merrifield Town Ctr. L.P.*, 580 F. Supp. 2d 495, 498 (E.D. Va. 2008).

(n74)Footnote 74. Section 1702(a) exempts the sale of lots from all ILSFDA provisions. Section 1702(b) exempts the sale of lots from ILSFDA registration and disclosure requirements. Section 1703(c) allows the Secretary to provide for other exemptions by way of rules or regulations. Exemptions are discussed in § 4A.09[7], below.

(n75)Footnote 75. See *Pugliese v. Pukka Development Co.*, 550 F.3d 1299, 1306 (11th Cir. 2008); *Bartley v. Merrifield Town Ctr. L.P.*, 580 F. Supp. 2d 495, 499-500 (E.D. Va. 2008).

(n76)Footnote 76. 15 U.S.C. § 1703(e).

(n77)Footnote 77. See *Engle Homes, Inc. v. Krasna*, 766 So. 2d 311, 313 (Fla. Dist. Ct. App. 2000).

(n78)Footnote 78. See *Stein v. Paradigm Mirsol, LLC*, 551 F. Supp. 2d 1323, 1332 (M.D. Fla. 2008), *rev'd*, 586 F.3d 849 (11th Cir. 2009) (on other grounds), *cert. denied*, 2010 U.S. LEXIS 2588 (Mar. 22, 2010).

(n79)Footnote 79. See *Engle Homes, Inc. v. Krasna*, 766 So. 2d 311, 313 (Fla. Dist. Ct. App. 2000).

(n80)Footnote 80. See *Aboujaoude v. Poinciana Development Co. II*, 509 F. Supp. 2d 1266, 1270 (S.D. Fla. 2007).

(n81)Footnote 81. See *Bartley v. Merrifield Town Ctr. L.P.*, 580 F. Supp. 2d 495, 499 (E.D. Va. 2008); *Grove Towers, Inc. v. Lopez*, 467 So. 2d 358, 360 (Fla. Dist. Ct. App. 1985), *review denied*, 480 So. 2d 1294 (Fla. 1985).

(n82)Footnote 82. 15 U.S.C. § 1702(a) and (b). See *Gentry v. Cottages-Stuart, LLLP*, 602 F. Supp. 2d 1239, 1246-1247 (S.D. Fla. 2009) ; *Pigott v. Sanibel Development, LLC*, 576 F. Supp. 2d 1258, 1269 (S.D. Ala. 2008) .

(n83)Footnote 83. See *Gentry v. Cottages-Stuart, LLLP*, 602 F. Supp. 2d 1239, 1248-1249 (S.D. Fla. 2009) .

(n84)Footnote 84. See *Johnson v. Orr*, 551 F.3d 564, 570-571 (7th Cir. 2008) .

(n85)Footnote 85. See *Gentry v. Cottages-Stuart, LLLP*, 602 F. Supp. 2d 1239, 1246 (S.D. Fla. 2009) .

(n86)Footnote 86. *Bodansky v. Fifth on the Park Condo, LLC*, 2010 U.S. Dist. LEXIS 7577, at *9 (S.D.N.Y. Jan. 29, 2010) .

(n87)Footnote 87. 15 U.S.C. § 1702(c).

(n88)Footnote 88. Additional advice regarding Advisory Opinions is found in Part VIII of the HUD Guidelines at 61 Fed. Reg. 13596, at 13610-13611 (March 27, 1996) . Such an Advisory Opinion does not have the force of law and is entitled to respect to the extent that its interpretations have the power to persuade. An Advisory Opinion which does not explain how HUD reached its conclusions diminishes its persuasive power. See *Bodansky v. Fifth on the Park Condo, LLC*, 2010 U.S. Dist. LEXIS 7577, at *23 n. 12 (S.D.N.Y. Jan. 29, 2010) .

(n89)Footnote 89. 61 Fed. Reg. 13596, 13610-13611 (March 27, 1996) .

(n90)Footnote 90. 24 C.F.R. § 1710.18(a).

(n91)Footnote 91. 61 Fed. Reg. 13596, at 13602 (March 27, 1996) .

(n92)Footnote 92. 61 Fed. Reg. 13596, at 13603 (March 27, 1996) .

(n93)Footnote 93. 61 Fed. Reg. 13596, at 13603 (March 27, 1996) .

(n94)Footnote 94. 61 Fed. Reg. 13596, at 13603 (March 27, 1996) .

(n95)Footnote 95. 61 Fed. Reg. 13596, at 13603 (March 27, 1996) .

(n96)Footnote 96. 61 Fed. Reg. 13596, at 13603 (March 27, 1996) .

(n97)Footnote 97. 61 Fed. Reg. 13596, at 13603 (March 27, 1996) .

(n98)Footnote 98. See generally *Winter v. Hollingsworth Properties*, 777 F.2d 1444 (11th Cir. 1985) (discussion of this exemption in the context of a condominium sale).

(n99)Footnote 99. See *Winter v. Hollingsworth Properties*, 777 F.2d 1444, 1449 (11th Cir. 1985) (rejecting a seller's argument that a sale occurs when title is transferred).

(n100)Footnote 100. See *Sun Kyung Ahn v. Merrifield Town Center, L.P.*, 584 F. Supp. 2d 848, 856 (E.D. Va. 2008) .

(n101)Footnote 101. See *Sun Kyung Ahn v. Merrifield Town Center, L.P.*, 584 F. Supp. 2d 848, 856 (E.D. Va. 2008) .

(n102)Footnote 102. See *Sun Kyung Ahn v. Merrifield Town Center, L.P.*, 584 F. Supp. 2d 848, 854 (E.D. Va. 2008) .

(n103)Footnote 103. See 24 C.F.R. § 1715.15; *Aboujaoude v. Poinciana Development Co. II*, 509 F. Supp. 2d

1266, 1271 (S.D. Fla. 2007) .

(n104)Footnote 104. See *Aboujaoude v. Poinciana Development Co. II*, 509 F. Supp. 2d 1266, 1271 (S.D. Fla. 2007) .

(n105)Footnote 105. See, e.g., *Gentry v. Cottages-Stuart, LLLP*, 602 F. Supp. 2d 1239, 1245 (S.D. Fla. 2009) .

(n106)Footnote 106. 61 Fed. Reg. 13596, at 13,603 (March 27, 1996) .

(n107)Footnote 107. See *Gentry v. Cottages-Stuart, LLLP*, 602 F. Supp. 2d 1239, 1250 (S.D. Fla. 2009) .

(n108)Footnote 108. See *Aboujaoude v. Poinciana Development Co. II*, 509 F. Supp. 2d 1266, 1270 (S.D. Fla. 2007) .

(n109)Footnote 109. See *Stein v. Paradigm Mirasol, LLC*, 586 F.3d 849, 854 (11th Cir. 2009) , cert. denied, 2010 U.S. LEXIS 2588 (Mar. 22, 2010) ; *Aikin v. WCI Communities, Inc.*, 26 So. 3d 691, 695 (Fla. Dist. Ct. App. 2010) ; *Maguire v. South Homes of Palm Beach, L.L.C.*, 591 F. Supp. 2d 1263, 1267 (S.D. Fla. 2008) .

(n110)Footnote 110. See *Mailloux v. Briella Townhomes, LLC*, 3 So. 3d 394, 394 (Fla. Dist. Ct. App. 2009) (Under Florida contract law, the well-recognized defenses to contractual nonperformance which were included in the contract at issue --acts of God, impossibility of performance, and frustration of purpose--did not render the developer's obligation to complete construction within two years illusory under the ILSFDA.) .

(n111)Footnote 111. See *Delaura v. Lennar Homes, Inc.*, 2009 U.S. Dist. LEXIS 65146, at *6-*7 (M.D. Fla. July 22, 2009) ; *Harvey v. Lake Buena Vista Resort, LLC*, 568 F. Supp. 2d 1354, 1362-63 (M.D. Fla. 2008) , *aff'd*, 306 Fed. Appx. 471 (11th Cir. 2009) ; *Barry v. Midtown Miami No. 4, LLC*, 651 F. Supp. 2d 1320, 1325 (S.D. Fla. 2008) . But see 200 East Partners, LLC v. Gold, 997 So. 2d 466, 469 (Fla. Dist. Ct. App. 2008) (ILSFDA is a strict liability statute.), *reh'g denied*, 2009 Fla. App. LEXIS 3598 (Jan. 23, 2009) .

(n112)Footnote 112. See *Maguire v. South Homes of Palm Beach, L.L.C.*, 591 F. Supp. 2d 1263, 1268-1269 (S.D. Fla. 2008) .

(n113)Footnote 113. See *Gentry v. Cottages-Stuart, LLLP*, 602 F. Supp. 2d 1239, 1245 (S.D. Fla. 2009) .

(n114)Footnote 114. See *Harvey v. Lake Buena Vista Resort, LLC*, 306 Fed. Appx. 471, 472 (11th Cir. 2009).

(n115)Footnote 115. See *Harvey v. Lake Buena Vista Resort, LLC*, 306 Fed. Appx. 471, 472 (11th Cir. 2009).

(n116)Footnote 116. See *Aboujaoude v. Poinciana Development Co. II*, 509 F. Supp. 2d 1266, 1271-1272 (S.D. Fla. 2007) .

(n117)Footnote 117. See *Aboujaoude v. Poinciana Development Co. II*, 509 F. Supp. 2d 1266, 1271-1272 (S.D. Fla. 2007) .

(n118)Footnote 118. See *Stein v. Paradigm Mirasol, LLC*, 586 F.3d 849, 857-58 (11th Cir. 2009) , cert. denied, 2010 U.S. LEXIS 2588 (Mar. 22, 2010) .

(n119)Footnote 119. See *Harvey v. Lake Buena Vista Resort, LLC*, 568 F. Supp. 2d 1354, 1365 (M.D. Fla. 2008) , *aff'd*, 306 Fed. Appx. 471 (11th Cir. 2009) .

(n120)Footnote 120. See *Harvey v. Lake Buena Vista Resort, LLC*, 568 F. Supp. 2d 1354, 1365 (M.D. Fla. 2008) , *aff'd*, 306 Fed. Appx. 471 (11th Cir. 2009) .

(n121)Footnote 121. *Cf. Kaufman v. City Place South Tower, LLC*, 2008 U.S. Dist. LEXIS 84511, at *13 (S.D. Fla. Oct. 20, 2008) (Courts disfavor contracts ... that limit a purchaser's right to sue and/or seek special damages.)

(n122)Footnote 122. *See Marco Bay Associates v. Vandewalle*, 472 So. 2d 472, 474-475 (Fla. Dist. Ct. App. 1985) (contract which only stated the right of rescission satisfied the two-year build exemption), *review denied*, 482 So. 2d 350 (Fla. 1986) .

(n123)Footnote 123. *Harvey v. Lake Buena Vista Resort, LLC*, 568 F. Supp. 2d 1354, 1365 (M.D. Fla. 2008) , *aff'd*, 306 Fed. Appx. 471 (11th Cir. 2009) .

(n124)Footnote 124. This practice is also referred to as stacking the exemptions. *See Bodansky v. Fifth on the Park Condo, LLC*, 2010 U.S. Dist. LEXIS 7577, at *10 (S.D.N.Y. Jan. 29, 2010) .

(n125)Footnote 125. 61 Fed. Reg. 13596, at 13,604 (March 27, 1996) .

(n126)Footnote 126. 61 Fed. Reg. 13596, at 13,604 (March 27, 1996) .

(n127)Footnote 127. 61 Fed. Reg. 13596, at 13,604 (March 27, 1996) . The anti-fraud provisions are found at 17 U.S.C. § 1703(a)(2).

(n128)Footnote 128. 997 So.2d 466 (Fla. Dist. Ct. App. 2009) , *reh'g denied*, 2009 Fla. App. LEXIS 3598 (Fla. Dist. Ct. App. Jan. 23, 2009) .

(n129)Footnote 129. 997 So.2d 466, 469 (Fla. Dist. Ct. App. 2009) , *reh'g denied*, 2009 Fla. App. LEXIS 3598 (Fla. Dist. Ct. App. Jan. 23, 2009) .

(n130)Footnote 130. 997 So.2d 466, 469 (Fla. Dist. Ct. App. 2009) , *reh'g denied*, 2009 Fla. App. LEXIS 3598 (Fla. Dist. Ct. App. Jan. 23, 2009) .

(n131)Footnote 131. 2010 U.S. Dist. LEXIS 7577, at *10 (S.D.N.Y. Jan. 29, 2010) .

(n132)Footnote 132. 2010 U.S. Dist. LEXIS 7577, at *21-*22 (S.D.N.Y. Jan. 29, 2010) .

(n133)Footnote 133. 2010 U.S. Dist. LEXIS 7577, at *25-*26 (S.D.N.Y. Jan. 29, 2010) .

(n134)Footnote 134. 2010 U.S. Dist. LEXIS 7577, at *30 (S.D.N.Y. Jan. 29, 2010) .

(n135)Footnote 135. 61 Fed. Reg. 13596, at 13,604 (March 27, 1996) .

(n136)Footnote 136. *See Bartley v. Merrifield Town Ctr. L.P.*, 580 F. Supp. 2d 495, 500 (E.D. Va. 2008) .

(n137)Footnote 137. 61 Fed. Reg. 13596, at 13,605 (March 27, 1996) .

(n138)Footnote 138. 61 Fed. Reg. 13596, at 13,605 (March 27, 1996) .

(n139)Footnote 139. 61 Fed. Reg. 13596, at 13,605 (March 27, 1996) . The guidelines give the example of changing the year to coincide with the developer's fiscal or tax year.

(n140)Footnote 140. 61 Fed. Reg. 13596, at 13,605 (March 27, 1996) .

(n141)Footnote 141. 61 Fed. Reg. 13596, at 13,605 (March 27, 1996) .

(n142)Footnote 142. 61 Fed. Reg. 13596, at 13,605 (March 27, 1996) .

(n143)Footnote 143. *61 Fed. Reg. 13596, at 13,605* (March 27, 1996) .

(n144)Footnote 144. *61 Fed. Reg. 13596, at 13,605* (March 27, 1996) .

(n145)Footnote 145. *61 Fed. Reg. 13596, at 13,605* (March 27, 1996) .

(n146)Footnote 146. *61 Fed. Reg. 13596, at 13,605* (March 27, 1996) .

(n147)Footnote 147. *24 C.F.R. § 1710.10(b)*. Presumably these promotion restrictions would extend to a similar use of the Internet or e-mails.

(n148)Footnote 148. *24 C.F.R. § 1710.10(c)(1)*.

(n149)Footnote 149. *24 C.F.R. § 1710.10(c)(2)*.

(n150)Footnote 150. *24 C.F.R. § 1710.10(c)(3)*. This subsection states that paved means concrete or pavement with a bituminous surface that is impervious to water, protects the base and is durable under the traffic load and maintenance contemplated.

(n151)Footnote 151. *24 C.F.R. § 1710.10(c)(4)*.

(n152)Footnote 152. *24 C.F.R. § 1710.10(c)(5)*.

(n153)Footnote 153. *24 C.F.R. § 1710.10(c)(6)*. This subsection also states that if a warranty deed is not commonly used in the jurisdiction where the lot is located, a deed or grant which warrants that the seller has not conveyed the lot to another person may be delivered in lieu of a warranty deed.

(n154)Footnote 154. *24 C.F.R. § 1710.10(c)(7)*.

(n155)Footnote 155. *24 C.F.R. § 1710.10(c)(8)*.

(n156)Footnote 156. *24 C.F.R. § 1710.10(d)*. The anti-fraud provisions are discussed in the regulations at *24 C.F.R. § 1710.4 (b) and (c)*.

(n157)Footnote 157. *61 Fed. Reg. 13596, at 13,606* (March 27, 1996) . The National Manufactured Housing Construction and Safety Standards Act of 1974 is codified at *42 U.S.C. § 5401, et seq.*

(n158)Footnote 158. *61 Fed. Reg. 13596, at 13,606-13,607* (March 27, 1996) .

(n159)Footnote 159. *61 Fed. Reg. 13596, at 13,608* (March 27, 1996) .

(n160)Footnote 160. *61 FR 13596, at 13608* (March 27, 1996) .

(n161)Footnote 161. *61 FR 13596, at 13608-13609* (March 27, 1996) .

(n162)Footnote 162. *61 FR 13596, at 13609* (March 27, 1996) . See *Pigott v. Sanibel Development, LLC*, 576 F. Supp. 2d 1258, 1270-271 (S.D. Ala. 2008) .

(n163)Footnote 163. *15 U.S.C. § 1709(b)*. See *Pigott v. Sanibel Development, LLC*, 576 F. Supp. 2d 1258, 1261 (S.D. Ala. 2008) ; *Taylor v. Holiday Isle, LLC*, 561 F. Supp. 2d 1269, 1276 (S.D. Ala. 2008) .

(n164)Footnote 164. *15 U.S.C. § 1709(a)*. See *Bartley v. Merrifield Town Ctr. L.P.*, 580 F. Supp. 2d 495, 499 (E.D. Va. 2008) .

(n165)Footnote 165. 15 U.S.C. § 1709(a). See *Gentry v. Cottages-Stuart, LLP*, 602 F. Supp. 2d 1239, 1256 (S.D. Fla. 2009) .

(n166)Footnote 166. 15 U.S.C. § 1709(c). See *Gentry v. Cottages-Stuart, LLP*, 602 F. Supp. 2d 1239, 1256 (S.D. Fla. 2009) .

(n167)Footnote 167. See *Kamel v. Kenco/The Oaks at Boca Raton, LP*, 2008 U.S. Dist. LEXIS 61020, at *4-*5 (S.D. Fla. Aug. 11, 2008) (developer was the prevailing party in the buyers' state law and ILSFDA claims, under the contract terms was entitled to attorney's fees), *aff'd*, 2008 U.S. App. LEXIS 21762 (11th Cir. Oct. 16, 2008) .

(n168)Footnote 168. 15 U.S.C. § 1711.

(n169)Footnote 169. Compare 15 U.S.C. § 1711(a)(1), (b) and (c) with 15 U.S.C. § 1711(a)(2).

(n170)Footnote 170. See *Parr v. Maesbury Homes, Inc.*, 2009 U.S. Dist. LEXIS 119087, at *11-*13 (M.D. Fla. Dec. 22, 2009) ; *Ditthardt v. N. Ocean Condos, L.P.*, 580 F. Supp. 2d 1288, 1292 (S.D. Fla. 2008) ; *Taylor v. Holiday Isle, LLC*, 561 F. Supp. 2d 1269, 1272 (S.D. Ala. 2008) .

(n171)Footnote 171. See *Gentry v. Cottages-Stuart, LLP*, 602 F. Supp. 2d 1239, 1251 (S.D. Fla. 2009) ; *Taylor v. Holiday Isle, LLC*, 561 F. Supp. 2d 1269, 1274-1275 (S.D. Ala. 2008) .

(n172)Footnote 172. See *Taylor v. Holiday Isle, LLC*, 561 F. Supp. 2d 1269, 1276 (S.D. Ala. 2008) . See also *Ditthardt v. N. Ocean Condos, L.P.*, 580 F. Supp. 2d 1288, 1293 (S.D. Fla. 2008) (A § 1703(c) or (d) violation without more, does not constitute the extraordinary circumstances to support equitable tolling.).

(n173)Footnote 173. 15 U.S.C. § 1719. See *Engle Homes, Inc. v. Krasna*, 766 So. 2d 311, 313 (Fla. Dist. Ct. App. 2000) . (state and federal courts have concurrent jurisdiction of ILSFDA actions).

(n174)Footnote 174. 15 U.S.C. § 1719.

(n175)Footnote 175. See *Campus v. Holiday Isle, LLC*, 2007 U.S. Dist. LEXIS 88889, at *7 (N.D. Fla. Nov. 20, 2007) .

(n176)Footnote 176. 15 U.S.C. § 1708(e). See *Old Coach Dev. Corp. v. Tanzman*, 692 F. Supp. 424, 426 (D.N.J. 1988) , *aff'd*, 881 F.2d 1227 (3d Cir. 1989) .

(n177)Footnote 177. See *Cranberry Hill Corp. v. Shaffer*, 629 F. Supp. 628, 631 (N.D.N.Y 1986) .

(n178)Footnote 178. 15 U.S.C. § 1708(a).

(n179)Footnote 179. See 24 C.F.R. § 1710.500(a); *Cranberry Hill Corp. v. Shaffer*, 629 F. Supp. 628, 632 (N.D.N.Y 1986) .

(n180)Footnote 180. 15 U.S.C. § 1708(a).

(n181)Footnote 181. 15 U.S.C. § 1708(a)(1).

(n182)Footnote 182. 15 U.S.C. § 1708(c).

(n183)Footnote 183. 15 U.S.C. § 1708(b).

(n184)Footnote 184. 15 U.S.C. § 1708(d).

(n185)Footnote 185. 24 C.F.R. § 1710.500(f).

(n186)Footnote 186. See <http://www.hud.gov/offices/hsg/ramh/ils/ilsdevqa.cfm> (site visited May 15, 2010).

* This chapter was revised by Mary J. Burt, Esq. In 2006, Section 14.02 was revised by Robert M. Jaworski, Esq., and Section 14.04 revised by Barbara S. Mishkin, Esq. Both are partners at Reed Smith, LLP and members of its Financial Services Regulatory Group, practicing, respectively, in the Firm's Princeton, New Jersey and Philadelphia, Pennsylvania offices. Their practice includes providing federal and state compliance advice and assistance to all kinds of financial institutions, performing compliance audits, preparing multi-state surveys, and, in conjunction with Reed Smith litigators, defending individual and class actions brought against lenders. Mr. Jaworski is also a former Deputy Commissioner of the New Jersey Department of Banking and a frequent speaker and author on compliance-related topics. Section 14.15, written by Sandra R. Bullington, Esq. in 2000, has been adapted from Home Owner Associations and Planned Unit Developments--Law and Forms, ch. 6 (Matthew Bender) and was completely revised in 2010.

Additional updates throughout the chapter were contributed by Sandra Bullington, Esq.



55 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 14 Federal Laws Affecting Real Estate Brokers *

10A-14 Real Estate Brokerage Law and Practice § 14.16

§ 14.16 Civil Rights and Franchises

As discussed in § 2.01[3][c], *above*, many brokerages are franchisees. Issues regarding civil rights can arise in the granting of a brokerage franchise. A civil right is an enforceable right or privilege, which if interfered with by another gives rise to an action for injury. Civil rights include freedom of speech, press, assembly, the right to vote, freedom from involuntary servitude, and the right to equality in public places. Discrimination occurs when the civil rights of an individual are denied or interfered with because of their membership in a particular group or class. The federal and state governments have enacted laws to prevent discrimination based on a person's race, sex, religion, age, previous condition of servitude, physical limitation, national origin, and in some instances sexual preference. The most prominent civil rights legislation since the reconstruction era is the Civil Rights Act of 1964.

Section 1981 of Title 42 (Equal Rights Under the Law) prohibits racial discrimination in the making and enforcement of private contracts. n1 This section was enacted as part of the Civil Rights Act of 1866. n2 Section 1981 ensures, among other rights, that persons of all races shall have equal rights to make and enforce contracts.

Section 1981 proscribes only discriminatory conduct at the time of the initial formation of a contract and discriminatory conduct that impairs the right to enforce contract obligations through legal process. n3 Postformation conduct relating to contract terms and conditions, however, is not actionable under section 1981. Since discriminatory postformation conduct, including breach of contract, concerns the performance of existing contractual obligations, it is more appropriately governed by state contract law and Title VII. n4

Plaintiffs can use § 1981 to vindicate their civil rights when the acts of intentional discrimination prevent them from entering into contracts or from enforcing established contract rights. Impediments to enforcement arise only when a plaintiff is prevented from enforcing rights that are specifically enumerated in the contract. A plaintiff asserting a § 1981 claim may prove intentional discrimination through either direct or circumstantial evidence. n5

The denial of a real estate franchise on racially discriminatory grounds is a violation of § 1981. n6 In *Tyler v. Re/Max Mountain States, Inc.*, n7 the plaintiff alleged that he had been discriminated against on the basis of his race (African American) by denying him his franchise application. The jury found in the plaintiff's favor. The appellate court affirmed, finding that the plaintiff has sufficiently satisfied the requirements of the general rule applied in § 1981 cases which required that the plaintiff proffer evidence that the defendant's justifications were pretextual.

FOOTNOTES:

(n1)Footnote 1. *See generally* Cook and Sobieski, *Civil Rights Actions*, Chapter 5, "Equal Rights Under the Law (Civil Rights Act of 1866, 42 U.S.C. § 1981)" (LEXIS 2000).

(n2)Footnote 2. Act of April 9, 1866, ch. 31, § 1, *14 Stat. 27*.

(n3)Footnote 3. *See Patterson v. McLean Credit Union*, 491 U.S. 164, 109 S. Ct. 2363, 2374, 105 L. Ed. 2d 132 (1989).

(n4)Footnote 4. *See Patterson v. McLean Credit Union*, 491 U.S. 164, 109 S. Ct. 2363, 2374, 105 L. Ed. 2d 132 (1989).

(n5)Footnote 5. *See, e.g., Kendrick v. Penske Transportation Services*, 220 F.3d 1220, 1225 (10th Cir. 2000) .

(n6)Footnote 6. *See generally* Cook and Sobieski, *Civil Rights Actions*, § 5.14, "Discrimination in Granting of Business Franchises" (LEXIS 2000).

(n7)Footnote 7. *232 F.3d 808, 814 (10th Cir. 2000)* .

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56 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 15 Real Estate Brokers and Environmental Laws *

10A-15 Real Estate Brokerage Law and Practice 15.syn

§ 15.syn Synopsis to Chapter 15: Real Estate Brokers and Environmental Laws *

§ 15.01 Environmental Liability in Real Estate Transactions

- [1] The Growth of Environmental Awareness
- [2] Potential Environmental Liability of Sellers' and Buyers' Agents
- [3] The Impact of Mandatory Seller Disclosure Requirements
 - [a] Seller's Superior Knowledge
 - [b] Nature of Disclosure Required
 - [c] Benefits of Mandatory Seller Disclosure

§ 15.02 Duty of Care

- [1] Liability Depends Upon Standard of Care
- [2] The Duty to Inspect
 - [a] California: *Easton v. Strassburger*
 - [b] The Duty to Inspect in Other Jurisdictions

§ 15.03 Environmental Hazards

- [1] Overview
- [2] Asbestos

[2A] Chinese Drywall

[3] Radon

[4] Urea-Formaldehyde Foam Insulation

[5] Lead Paint

[6] Electromagnetic Fields

[7] Chlordane

[8] Underground Storage Tanks

[9] Mold

[a] Mold Basics

[b] Health Effects of Mold

[c] Mold and Real Estate

[d] Litigation and Legislation

[i] Litigation

[ii] Legislation

[10] Methamphetamine

[11] Other Hazards

§ 15.04 Managing Environmental Risk in the Sale of Nonresidential Property

[1] In General

[2] Environmental Transfer Laws

[3] Environmental Audits

§ 15.05 Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)

[1] Cleanup Liability Should Be Assumed by Appropriate Party

[2] Basic Structure of CERCLA

[a] Statutory Scheme

[b] Liability Provisions

[c] Liability for Owners and Operators

[d] Strict, Joint and Several Liability

[e] Third-Party Defenses

[3] Claims for Liability Under CERCLA Brought Against Brokers

§ 15.06 Green Building Issues Affecting Real Estate Brokers

[1] Green Building Defined

[2] Potential to Expand Green Building

[3] Green Building Trends in the Real Estate Market

[a] Legislation Encouraging Green Building, Including Compliance with LEED Standards

[b] Marketing Green Buildings and Buyer Demand

[c] Green Building Aspects of the American Recovery and Reinvestment Act

[4] Green Building Rating Systems

[5] Green Leases

[6] EcoBroker

[7] The Role of Brokers in the Green Marketplace

[8] Broker Liability

[9] Green Marketing Claims

§ 15.07 Conclusion



57 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 15 Real Estate Brokers and Environmental Laws *

10A-15 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 15 discusses environmental laws and their effect upon the real estate brokerage industry. Courts are often faced with claims made by purchasers who allege that a broker should have disclosed an environmental problem or hazard (§ 15.01[2]). This chapter discusses cases involving such claims, other information related to real estate brokerage and the presence of various environmental hazards affecting real estate for sale or lease, and the significance of mandatory seller-disclosure requirements as they relate to environmental hazards. (§ 15.01[3]).

A broker's liability for failing to disclose depends on the standard of care. This standard and how it has been defined by various courts and legislatures is discussed (§ 15.02). Specific environmental hazards discussed in this chapter include:

- asbestos (§ 15.03[2]),
- Chinese Drywall (§ 15.03[2A]) (*new!*)
- radon (§ 15.03[3]),
- urea-formaldehyde foam insulation (§ 15.03[4]),
- lead-based paint (§ 15.03[5]),
- electromagnetic fields (§ 15.03[6]),
- chlordane (§ 15.03[7]),
- underground storage tanks (§ 15.03[8]),
- mold (§ 15.03[9]),
- methamphetamine (15.03[10]).

Other less common environmental hazards are also discussed (§ 15.03[11]).

This chapter considers the management of environmental hazard risks in nonresidential realty (§ 15.04). Included in this discussion is coverage of environmental audits which are fairly routine in the purchase of commercial properties by sophisticated purchasers (§ 15.04[3]).

The primary federal legislation in this area is the Comprehensive Environmental Response, Compensation and Liability Act which is discussed in the context of brokers incurring liability under this Act (§ 15.05). CERCLA is a complex act which has spawned many court cases. For additional discussion on these and other issues surrounding environmental hazards see the following other publications:

- Berz, Spracker, and Storchak, *Environmental Law in Real Estate and Business Transactions* (Matthew Bender).
- Gerrard, *Brownfields Law and Practice: The Cleanup and Redevelopment of Contaminated Land* (Matthew Bender).
- Real Estate Financing, §§ 2.02[2][g], 2A.05[2], 2D.09, 2J.02[2][g], 3A.13[3][t], 9.02[3][e], 9.07[3][m], and 14.03[2], [4], and [7] and Ch. 4D, *The Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)* (Matthew Bender).
- Searcy, *A Guide to Toxic Torts* (Matthew Bender).
- Zamore, *Business Torts*, Ch. 38, *Liability for Environmental Impairment* (Matthew Bender).



58 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 15 Real Estate Brokers and Environmental Laws *

10A-15 Real Estate Brokerage Law and Practice § 15.01

§ 15.01 Environmental Liability in Real Estate Transactions

[1] The Growth of Environmental Awareness

The last several decades have been a time of growing awareness by Americans of the presence of environmental hazards in their homes and workplaces. The public's sensitivity to these hazards in every day life has intensified due to coverage in the media, renewed interest by state legislatures in dealing with contaminated sites, and a growing number of lawsuits linking numerous products found in the daily environment with human health problems. An influential component of this environmental awareness, at least in commercial transactions, has been the reluctance of lenders to make loans to purchasers of contaminated property. Even a purchaser who is willing to assume the environmental risk potentially associated with a property may be unable to obtain financing in this climate of environmental sensitivity.

When an environmental problem is discovered prior to the closing of a real estate transaction, the buyer may choose to abandon the transaction, seek to negotiate a price modification, or enter into an agreement with the seller allocating the cost of eliminating any hazard or taking other remedial action. Unfortunately, in too many cases the buyer is unaware that environmental problems and potential health hazards exist until after closing. At that time, the buyer's remedy may be limited to taking legal action against the seller, and possibly the real estate agents involved, for contribution to the cost of correction of the problem or other damages. This chapter provides an overview of the environmental problems and issues involved in real estate transactions and the resulting potential environmental liability of brokers and agents.

[2] Potential Environmental Liability of Sellers' and Buyers' Agents

The cases addressing a claim that a real estate broker or agent should be held responsible for an environmental problem discovered on property after the buyer has taken title readily reveal that such litigation has not developed a new jurisprudence. Instead, and not unexpectedly, such cases are resolved on the basis of familiar, existing principles of law that have evolved concerning the liability of real estate brokers for damages suffered by purchasers who discovered their property to be afflicted with more common defects, such as leaky basements and roofs. For that reason, it is useful to briefly review such traditional bases of the broker's or agent's liability.

The basis for such liability is premised on the broker's failure to satisfy a tort duty owed or a duty established by the contract between the client or customer and the broker. The nature and extent of such duty, in turn, is in part defined, or at least impacted, by the relationship, if any, between the broker and the party making the claim. In so-called

"traditional" real estate practice, the listing broker establishes an agency relationship with the seller, and a selling agent (that is, an agent other than the listing agent who introduces the buyer to the property) is generally thought to be an agent of the listing broker and thus a subagent of the seller. Both such agents, therefore, have agency obligations only to the seller of the property. n1 These agents' duties--of obedience, care, skill and disclosure of information--run only to the seller. Despite the absence of an agency relationship between either the listing or selling broker and the buyer, courts have repeatedly held that brokers and their sales associates nevertheless owe buyers an obligation of fairness and honesty. n2 Brokers also commonly act as "buyers agents" pursuant to an explicit contractual agency relationship with the buyer. In such status, the broker becomes a fiduciary of the buyer which, in some cases, has caused some courts to elevate the usual disclosure responsibilities imposed on them beyond the simple standard of fairness and honesty. n2.1 Some brokers also enter into non-agency relationships with buyers or sellers to provide to them real estate services. Even where the relationships between buyers, sellers and brokers are different than the traditional model, however, for the most part, plaintiffs, and thus courts, rely on the same legal theories commonly asserted against listing brokers and their agents (although the factual (agency) context in which those principles are applied differ and may therefore occasionally produce different results.) These theories include:

- fraud, n3
- strict liability, n4
- negligence, n5
- negligent misrepresentation, n6 and
- statutory liability. n7

These same theories are asserted by buyers making claims against brokers and agents when environmental hazards are the defects alleged. Buyers may also assert claims against brokers and agents based on alleged breach of statutory or regulatory duties to provide disclosures or refrain from misrepresentation.

[3] The Impact of Mandatory Seller Disclosure Requirements

EDITOR'S NOTE:

See Chapter 3A in volume 10 for a discussion of federal and state disclosure requirements affecting real estate brokers.

[a] Seller's Superior Knowledge

The seller usually has the most knowledge about the condition of his or her property offered for sale. In particular, the scope of the seller's knowledge is usually superior to that of the broker or buyer in this regard, since a person who has occupied the premises for any length of time will likely be more familiar with its condition than a person who has made a cursory inspection.

Recognizing the seller to be the best source of information about the condition of the property, at least 35 states and the District of Columbia have adopted laws expressly requiring the seller to disclose specified information about the features or condition of the property. n8 In other jurisdictions where seller disclosure is not mandated by law, many real estate professionals nevertheless require their seller-clients to submit written statements describing the physical condition of the property and its various features and systems. Such documentation, signed by a seller, provides the listing broker and cooperating agents, whether acting as subagents, buyer's agents or in another capacity, with a clear record of the information that the seller provided to the broker, should the broker's knowledge of the property's condition be placed in issue at a later date.

Some observers assert that seller disclosure statutes have limited applicability and value. One recent commentator, however, carefully analyzed such forms and their use, and concluded that "buyers, sellers and brokers have benefited from the widespread use of property condition disclosure forms." He also predicts that such forms are "likely to become longer, more carefully worded, and indispensable in residential home sales throughout the country." n8.1 In general, such statutes apply to residential sales in structures including up to four units. The disclosure statement usually must be provided to the buyer either before the signing of a sales contract or within a specific number of days thereafter. Some statutes provide that if the disclosure document reveals a material defect, the buyer may terminate the transaction within a specified time. n9

Brokers recognize, however, that some sellers are simply not knowledgeable about the condition or all aspects and features of the property offered for sale. In some cases, the seller may never have occupied the property or for other reasons may be unable to provide up-to-date, accurate information. For that reason brokers should be cautious against overreliance on sellers as the exclusive source of all information about a property. Brokers should also be alert for, and investigate, any inconsistencies between the representations made by a seller in the seller's disclosure statement and the broker's own observations of the property.

[b] Nature of Disclosure Required

An important issue raised by the seller property condition disclosure statement concept is the nature and extent of the defects the law requires a seller to disclose. Although a few states may cling to the principle of "caveat emptor" in realty sales, a seller's affirmative duty to disclose latent material defects is well established. n10

As a general rule, the disclosure requirement applies to material matters--those matters that might affect a reasonable buyer's decision to buy, or the terms and conditions of the buyer's purchase offer. Notably, most seller disclosure forms promulgated by law or regulation in the various states specifically reference--and thus require disclosure of--a variety of recognized residential environmental conditions and hazards, commonly including radon, lead-based paint, nearby "Superfund" sites, underground storage tanks, mold, urea-formaldehyde foam insulation, and others.

A related issue--whether a broker must disclose conditions located off the property site but which the buyer may nevertheless consider relevant--was addressed in *Strawn v. Canuso*. n11 In *Strawn*, new homebuyers were not told of the close proximity of an abandoned dump site which had, in fact, attained considerable notoriety as a highly contaminated site. The Supreme Court of New Jersey held that a builder-developer of residential real estate and a broker representing such a builder is "liable to a purchaser for nondisclosure of off-site physical conditions known to the broker and unknown to and not readily observable by the buyer if the existence of those conditions is of sufficient materiality as to affect the habitability, use, or enjoyment of the property and, therefore, to render the property substantially less desirable or valuable to the objectively reasonable buyer." n12 In response to the *Strawn* decision, the New Jersey Legislature enacted the New Residential Construction Off-Site Conditions Disclosure Act. n13

The Act requires sellers of new residential construction to provide buyers notice that lists of certain conditions and their location are available at city hall, and further provides the buyer five days to cancel a contract, presumably in light of information learned from such lists. Providing the notice satisfies the seller's duty under *Strawn* to disclose off-site conditions. The extent to which courts may apply *Strawn* to brokers involved in marketing existing, as opposed to new homes, and the geographic scope of the off-site defects that must be disclosed, remains to be fleshed out by subsequent cases. n13.1

One such case is *Ribak v. Centex Real Estate Corporation*. n14 In that case, also involving the sale of new rather than existing homes, the court appeared to rely on *Strawn* in holding that the materiality of how the defendant-sellers described a certain off-site condition (a wastewater treatment plant adjacent to the property) was a question for the jury. The clear inference of the court's conclusion is that although the condition was off the site it was one that the jury could

conclude ought to have been disclosed by the sellers.

[c] Benefits of Mandatory Seller Disclosure

The most obvious and indeed the intended benefit of mandatory seller disclosure laws is to cause sellers to affirmatively reveal adverse property features of which they are actually aware. Doing so allows the prospective buyer to make a purchase offer and acquire the property with full awareness of the positive as well as negative information known about the property. Disclosure may also eliminate litigation over whether or not a particular condition was disclosed, since the disclosure form serves as a clear record of the information provided to the buyer by the seller. n15

A shortcoming of seller disclosure statutes is that they are likely to have little or no effect with regard to problems that are wholly unknown to any party. Another concern is that explicit identification of environmental problems on (or even near) the property may result in buyers experiencing difficulty in obtaining financing for property. Some lenders who have foreclosed on polluted commercial properties have been threatened with potential liability for environmental cleanup costs. As a result, lenders may scrutinize residential loan applications more carefully when, prior to issuance of a loan commitment, the seller has disclosed that the property contains lead paint, asbestos or other toxic substances that may require remediation or removal. Of course, given the choice, most buyers would probably prefer to be advised of any environmental problems with or concerns about the property before, rather than after, the transaction is consummated, even if that means financing for purchase of a contaminated property is difficult, or even wholly unavailable.

FOOTNOTES:

(n1)Footnote 1. *Montoya v. McLeod*, 176 Cal. App. 3d 57, 221 Cal. Rptr. 353 (1985) ; *Licari v. Blackwelder*, 14 Conn. App. 46, 539 A.2d 609 (1988) ; *Vivian Arnold Realty Co. v. McCormick*, 19 Ariz. App. 289, 506 P.2d 1074 (1973) .

(n2)Footnote 2. See *Sawyer Realty Group Inc. v. Jarvis Corp.*, 89 Ill. 2d 379, 386, 432 N.E.2d 849, 852 (1982) ; *Gerber v. Keyes Col.*, 443 So. 2d 199, 200 (Fla. Dist. Ct. App. 1983) ; *Funk v. Tifft*, 515 F.2d 23 (9th Cir. 1975) .

(n3)Footnote 2.1. *Field v. Century 21 Klowden-Forness Realty*, 63 Cal. App. 4th 18, 73 Cal. Rptr. 2d 784 (1998) ; *Salahutdin v. Valley of California, Inc.* 24 Cal. App. 4th 555, 29 Cal. Rptr. 2d 463 (1994) .

(n4)Footnote 3. *Aiello v. Ed Saxe Real Estate Inc.*, 508 Pa. 553, 499 A.2d 282 (1985) ; *Sanfillipo v. Rarden*, 24 Ohio App. 3d 164, 493 N.E.2d 991 (1985) ; *Long v. Brownstone Real Estate Co.*, 335 Pa. Super. 268, 484 A.2d 126 (1984) ; *Zimmerman v. Northfield Real Estate, Inc.*, 156 Ill. App. 3d 154, 510 N.E.2d 409 (1986) .

(n5)Footnote 4. *Reda v. Sincaban*, 145 Wis. 2d 266, 426 N.W.2d 100 (1988) ; *Synowicz v. Mazur*, 148 Wis. 2d 952, 438 N.W.2d 596 (1989) ; *Bevins v. Ballard*, 655 P.2d 757 (Alaska 1982) ; *Spargnapani v. Wright*, 110 A.2d 82 (D.C. 1954) .

(n6)Footnote 5. *Gouveia v. Citicorp Person to Person Fin. Ctr. Inc.*, 101 N.M. 572, 686 P.2d 262 (Ct. App. 1984) ; *Sawyer v. Tildahl*, 275 Minn. 457, 148 N.W.2d 131 (1967) .

(n7)Footnote 6. *Maxwell v. Ratcliffe*, 356 Mass. 560, 254 N.E.2d 250 (1969) ; *Johnson v. Geer Real Estate Co.*, 239 Kan. 324, 720 P.2d 660 (1986) ; *Lyons v. Christ Episcopal Church*, 71 Ill. App. 3d 257, 27 Ill. Dec. 559, 389 N.E.2d 623 (1979) .

(n8)Footnote 7. *Young v. Joyce*, 351 A.2d 857 (Del. 1975) ; *Warren v. Le May*, 142 Ill. App. 3d 550, 491 N.E.2d 464 (1986) ; *Evans v. Teakettle Realty*, 736 P.2d 472 (Mont. 1987) .

(n9)Footnote 8. *Alaska Stat. §§ 34.70.010-34.70.200*; *Cal. Civ. Code §§ 1102-1102.17, 2079-2079.10*; *Conn. Gen. Stat. §§ 20-327b-327e*; *Del. Code Ann., tit. 6, §§ 2570-2578*; *D.C. Code Ann. §§ 42-1301-1311*; *Haw. Rev. Sta. §§ 508D-1-508D-20*; *Idaho Code §§ 55-2501-2508*; *765 Ill. Comp. Stat. 77/1-77/99*; *Ind. Code §§ 32-21-5-4-1-13*; *Iowa Code § 558A.1-558A.8*; *Ky. Rev. Stat. Ann. § 324.360*; *La. Rev. Stat. §§ 3196-3200*; *Me. Rev. Stat. Ann. tit. 33 §§*

171-179; Code Me. R. Ch. 330, § 6, 7, 14, 16-19; Md. Code Ann. [Real Prop.] § 10-702; *Mich. Comp. Laws* §§ 565.951-.958; *Minn. Stat. Ann* § 513.55; *Miss. Code Ann.*, §§ 89-1-501-89-1-525; *Mont. Code Ann.* § 70-16-703 (mold), § 75-3-606 (radon), and § 75-10-1305 (methamphetamine); *Neb. Rev. Stat.* § 76-2.120; *Nev. Rev. Stat* § 113.100-113.150; *N.H. Rev. Stat. Ann.* § 477:4-c (limited to private water supply, sewage disposal, and insulation); *N.H. Code Admin. R. Rea.* 701.04-.07; *N.J. R.S.* 56:8-19.1 (prohibiting award of punitive damages and attorney's fees against broker in a fraud action); *N.Y. Real Prop. Law* §§ 460-467; *N.C. Gen. Stat.* 1995 § 47E-1; *Ohio Rev. Code Ann.* § 5302.30; *Okla. Stat. Ann. tit. 60*, §§ 831-839; *Or. Rev. Stat.*, §§ 105.465-105.490; 68 Pa. Cons. Stat. §§ 7301-15; *R.I. Gen. Laws* §§ 5-20.8-1-5.20-8-12; *S.C. Code Ann.* § 27-50-40(A); *S.D. Codified Laws* §§ 43-4-37-43-4-44; *Tenn. Code Ann.* §§ 66-5-201-66-5-210; *Tex [Property] Code Ann.* § 5.008; *Va. Code Ann.* §§ 55-517-55-525; *Wash. Rev. Code* §§ 64.06.005-64.06.070; *Wis. Stat.* § 709.01-709.08.

(n10)Footnote 8.1. George Lefcoe, *Property Condition Disclosure Forms: How REALTORS(R) Eased the Transition from Caveat Emptor to Seller Tell All*, 39 *Real Prop. Prob. & Tr. J.* (2004).

(n11)Footnote 9. See, e.g., *Cal. Civ. Code* § 709.05.

(n12)Footnote 10. *Tahini Invest., Ltd. v. Bobrowsky*, 99 A.D.2d 489, 470 N.Y.S.2d 431, 1984 N.Y. App. Div. LEXIS 16680 (1984); *Lingsch v. Savage* 213 *Cal. App. 2d* 729, 733, 29 *Cal. Rptr.* 201, 203 (1963); *Restatement (Second) of Torts* 550 (1977).

(n13)Footnote 11. 140 *N.J.* 43, 657 A.2d 420 (N.J. 1995).

(n14)Footnote 12. 140 *N.J.* at 48, 657 A.2d at 431. On *Strawn*, see *Murray, Past or Present Environmental Contamination*, 25 *Real Estate L.J.* 191 (1996); *Booth, Wide Impact Seen for Off-Site Hazard Ruling*, N.J.L.J., May 1, 1995, p. 1 col. 2; *Goldshore & Wolf, Strawn Requires Buyers to Prove Damages*, N.J.L.J., May 8, 1995, p. 10, col. 1. See also *Gibby, Brokers Encouraged to Disclose Environmental Conditions Materially Affecting the Value of Residential Property*, 69 *Florida Bar J.*, Mar. 1995, pp. 52-57; *Gibby, Ground Cover(up): Real Estate Brokers Face Higher Duty to Disclose Environmental Hazards*, 81 *ABA J.*, Apr. 1995, p. 58.

(n15)Footnote 13. *N.J. St. Ann.* § 46:3C.

(n16)Footnote 13.1. In *Nobrega v. Edison Glen Assocs.*, 167 *N.J.* 520, 772 A.2d 368 (2001) the Supreme Court of New Jersey considered whether the Act applies to bar a New Jersey Consumer Fraud statute claim by a purchaser against a developer who had failed to disclose the existence of two nearby superfund sites. The court concluded that, in general, the New Residential Construction Off-Site Conditions Disclosure Act did operate to bar a purchaser from bringing a Consumer Fraud cause of action. Because the transactions at issue in that case occurred prior to the passage of the Act, however, it was necessary for the Court also to address whether the Act could be applied retroactively to preclude the Consumer Fraud Act claim. Despite the section of the Act providing for retroactive application, the court held that under the facts presented it would be "manifestly unjust" to bar the purchaser's claim because the transaction occurred without disclosure to the purchaser but before the notification process required by the Act had been implemented. Thus, the purchasers were allowed to proceed with their Consumer Fraud Act claims.

(n17)Footnote 14. 702 *So. 2d* 1316 (Fla. App. 1997).

(n18)Footnote 15. Another benefit may be the elimination of liability of the seller for innocent misrepresentation. See *Amyot v. Luchini*, 932 *P. 2d* 244 (Alaska 1997), which held that sellers who had provided the required disclosure form are not strictly liable for unintentional misrepresentations to purchasers, but would be liable only if the misrepresentation could be shown to have been negligent or intentional.

* Sections 15.01 through 15.04 of Chapter 15 were revised in 1998 and have been updated every year since then--most recently, in 2010--by Ralph W. Holmen, Associate General Counsel, National Association of Realtors(R). Section 15.06 was written by J. Cullen Howe who is an environmental law specialist in Arnold & Porter LLP's environmental practice

group. He is the managing editor of Environmental Law in New York, a monthly newsletter, and edits the Environmental Law Practice Guide, among other publications. He has recently co-authored chapters on climate change and green buildings for the Environmental Law Practice Guide (Mathew Bender). Mr. Howe updated Sections 5.05 and 5.06, having most recently added new subsections to § 5.06 in 2010. Section 15.05[2] was written and has been updated by Adam P. Storchak and Michael Mayer of Weil, Gotshal & Manges LLP, Washington, D.C. and is excerpted from Real Estate Financing ch. 4D (Matthew Bender). In 2006, an update to Section 15.05[2][e] describing EPA's final rule entitled "Standards and Practices for All Appropriate Inquiries" was contributed by Michael Allan Wolf and reprinted from Powell on Real Property(R) § PA.08[2][c][iii] (Michael Allan Wolf, ed. Matthew Bender). Chapter 15 was originally prepared by Christine B. Ludwiszewski, Esq. of Wheaton, Illinois.



59 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers
CHAPTER 15 Real Estate Brokers and Environmental Laws *

10A-15 Real Estate Brokerage Law and Practice § 15.02

§ 15.02 Duty of Care

[1] Liability Depends Upon Standard of Care

In assessing the potential liability of real estate professionals for environmental hazards discovered on the property after the purchase, a key question is the standard of care to which brokers will be held in connection with the discovery or disclosure of the hazard. A buyer who discovers an environmental problem on the property and seeks to hold the broker or agent legally responsible must show that the broker or agent failed to satisfy this duty of care. This standard of care is established by the statutory and/or case law of each jurisdiction.

[2] The Duty to Inspect

[a] California: *Easton v. Strassburger*

While it is generally well understood that brokers and agents are obligated to disclose environmental hazards of which they are actually aware, it is less clear whether they have a duty to investigate or inspect property for such hazards, or indications that such hazards might be present. Perhaps the first and probably most well-known case addressing the duty of a real estate professional to examine the condition of a property being offered for sale is *Easton v. Strassburger*,ⁿ¹ decided by a California appellate court in 1984. In that case, which involved the failure to disclose soil erosion problems and resulting cracks in the foundation, the court held that a real estate agent had a duty not only to disclose material facts, but also "to conduct a reasonably competent and diligent inspection of the residential property listed for sale and to disclose to prospective purchasers all facts materially affecting the value or desirability of the property that such an investigation would reveal."ⁿ²

In *Easton*, the agents had observed uneven floors in the home and netting on a slope that had been placed there to repair damage caused by a landslide, but they failed to suggest further testing or inform the buyers of the past problem with earth slides. The court said the uneven floors and the netting were "red flags" (i.e., readily observable indicators of potential problems) that the agents should have brought to the attention of the purchasers. The court concluded that an action against the broker could be based on negligence in failing to inspect the property and disclose any problems identified, in which case the purchaser need not allege or prove the broker had actual knowledge of the problem or that the facts were available only to the broker.

The court also reasoned that limiting a broker's obligation to disclose only those facts of which the broker has actual knowledge would provide a "disincentive" for the broker to seek out defects that are readily discoverable. The court pointed out that in residential transactions the buyer frequently relies on the broker's professional expertise, and that: "[i]f a broker were required to disclose only known defects, but not also those that are reasonably discoverable, he would be shielded by his ignorance of that which he holds himself out to know." n3 After the *Easton* decision, brokers in California were legally obligated to conduct an inspection of the property that included "more than a casual visual inspection and a general inquiry of the owners." n4

Subsequent to the decision in *Easton*, the California legislature codified the standard of care established in that decision for *residential* transactions for brokers acting as listing or cooperating agents. n5 *California Civil Code Section 2079(a)* provides:

It is the duty of a real estate broker or salesperson, licensed under ... the Business and Professions Code, to a prospective purchaser of residential real property comprising one to four dwelling units, ... to conduct a reasonably competent and diligent visual inspection of the property offered for sale and to disclose to that prospective purchaser all facts materially affecting the value or desirability of the property that an investigation would reveal, if that broker has a written contract with the seller to find or obtain a buyer or is a broker who acts in cooperation with that broker to find and obtain a buyer.

The duty to inspect under Section 2079 is limited by Section 2079.3, which provides that the inspection obligation "does not include or involve an inspection of areas that are reasonably and normally inaccessible to such an inspection" In the case of certain types of residential property, such as a condominium, cooperative or planned unit development, the duty to inspect is limited to the unit being offered for sale.

The California legislature further provided that the standard of care owed by a broker in carrying out its duties to the prospective purchaser "is the degree of care that a reasonably prudent real estate licensee would exercise," and that the standard of care will be measured by the knowledge a broker would be expected to possess in light of the education and experience requirements for licensure. n6

Subsequent California decisions address the limits of the duty established by Section 2079 and the applicability of that duty. A 1993 decision by the court that decided *Easton* offers real estate licensees an important limitation on their statutory duty under California law to make an inspection and disclose defects in residential property offered for sale. *Wilson v. Century 21 Great Western Realty*, n7 holds that any "red flags" on the property must be both evident and observable to a nonexpert in order for the broker's failure to disclose to be actionable. This is good news with regard to disclosure of problems of an environmental nature, because in most cases such problems are not readily discernible.

In the *Wilson* case, the purchaser sued a listing office alleging fraud and negligent misrepresentation based on the agent's failure to follow up on a conversation with a neighbor, who had suggested that the home might have foundation problems. The plaintiff, a general contractor, noticed sloping of the floors during a walk-through of the premises, but waived his right to a property inspection and was given a roofing and termite report done at the seller's expense.

The court found that the agent made no false positive assertions, and that the conversation with the neighbor was not sufficiently "factual" because the neighbor was interested in purchasing the property and may have mentioned a foundation problem as a means of getting a price reduction. Since the foundation problems were not discernible by a "visual inspection," the court held that the plaintiff's expectations of the agent exceeded that required by California's statutory duty to inspect. That is, the plaintiff sought to impose on the agent the duty to perform too intrusive an inspection, and to investigate comments that were too speculative. n8

An attempt by a purchaser to extend a broker's statutory duty to inspect to commercial property failed in *Smith v. Rickard*. n9 This case involved the purchase of a 50-acre commercial parcel containing an avocado orchard and a

residence. The court held that the presence of a residence on the property was insufficient to invoke the duties imposed with respect to residential sales in the Civil Code. In another case, *Murray v. Hayden*, n10 the California Court of Appeal declined to extend the inspection duty imposed on listing (seller's) brokers by *Easton* and *California Civil Code § 2079* to apply also to a broker hired by and acting as the agent of the buyer. The court held that a buyer's broker owes no duty to inspect residential property and to disclose to the buyer all facts materially affecting the value or desirability of the property that a reasonable investigation would reveal, reasoning that the seller's broker is in a better position to conduct an inspection and there would be a duplication of effort were the same duty imposed on the buyer's broker. Finally, in *Robinson v. Grossman*, n11 the court held that while *Easton* and *California Civil Code § 2079* require a broker to make the requisite inspection in good faith and not convey the seller's representations without a reasonable basis for believing them to be true, the broker is not required to "independently verify and confirm the accuracy of the seller's representations."

Later, the California Legislature provided for the distribution to consumers by real estate agents of a consumer information booklet that discusses common environmental hazards. A broker that provides the booklet is not required to provide additional information concerning such hazards, and the booklet is deemed adequate disclosure of potential environmental problems. The statute provides, however, that it does not in any way change "the duty of a seller or broker to disclose the existence of known environmental hazards on or affecting the real property." n12

[b] The Duty to Inspect in Other Jurisdictions

Notwithstanding this comprehensive and explicit duty imposed on brokers and agents in California, only a few other states have followed the California approach of defining the standard of care to impose on brokers the obligation to inspect and disclose adverse features of the property, which could include environmental problems. In *Gouveia v. Citicorp Person-to Person Financial Center, Inc.*, n13 the broker represented the townhouse he had listed for sale as in "All Top Shape" despite the fact that there were significant construction defects. The court relied directly on *Easton* and held that in New Mexico brokers "may have a duty to disclose defects that an inspection would reveal." n14

In Wisconsin, the Department of Regulation and Licensing used language similar to that of the *Easton* court in establishing its standard of disclosure for the real estate profession:

RL 24.07 INSPECTION AND DISCLOSURE DUTIES. (1) Inspection of Real Estate. (a) General Requirement. A licensee, when engaging in real estate practice which involves real estate improved with a structure, shall conduct a reasonably competent and diligent inspection of accessible areas of the structure and immediately surrounding areas of the property to detect observable, material adverse facts ...

(2) DISCLOSURE OF MATERIAL ADVERSE FACTS. A licensee may not exaggerate or misrepresent facts in the practice of real estate. A licensee, when engaging in real estate practice, shall disclose to each party, in writing and in a timely fashion, all material adverse facts that the licensee knows and that the party does not know or cannot discover through a reasonably vigilant observation, unless the disclosure of the material adverse fact is prohibited by law ... n15

This section of the Wisconsin Administrative Code was relied on by the court in *Grube v. Daun*, n16 where the court reversed the trial court's dismissal of a negligence claim brought by a purchaser against a real estate broker. The purchaser had discovered certain property contamination arising from a leaking underground storage tank on the property, and alleged in his complaint that the broker had "failed to investigate, discover and disclose the...contamination..." The trial court dismissed the negligence and other claims stated against the broker because the contract of sale contained an "as is" clause, but the Court of Appeals of Wisconsin reversed and held that the broker's failure to perform an inspection to discover might nevertheless have been negligent, in light of RL 24.07. In *Witt v. Coldwell Banker First United Realty*, n17 the Wisconsin Court of Appeals reversed the dismissal of a buyer's claim

against a broker for the broker's failure to investigate as required by RL 24.07 and discover and disclose the presence of asbestos wrap on heating pipes. In *Fulton v. Vogt*, n18 the court similarly concluded that the broker did not violate any of his legal duties by failing to discover and disclose an underground gas storage tank on property, since his duties did not include "a duty to discover hidden and not readily observable defects."

The broad disclosure obligation in the above-quoted rule was affected by a 1990 revision of the Wisconsin licensing statute, n19 which provides that a licensee need *not* disclose any information relating to the physical condition of the property "if a written report that discloses the information has been prepared by a qualified 3d party" and been furnished to the buyer, unless the broker has information that contradicts the report. *Conell v. Coldwell Banker Premier Real Estate*, n20 confirms that this provision "operates to relieve the broker from liability for disclosures related to the physical condition of property covered by" a third-party inspection. In *Conell*, a professional home inspector failed to discover a basement water problem and the buyer sued the broker for negligence, strict responsibility for misrepresentation and negligent misrepresentation. The trial court granted and the appellate court affirmed summary judgment in favor of the broker, based on *Wis. Stat. § 452.23*.

On the other hand, courts in several states have considered the inspection duty imposed on listing brokers under *Easton* and expressly or implicitly rejected adoption of a similar duty in their state. A particularly clear example of this is *Kubinsky v. Van Zandt Realtors*, n21 where the buyer of a home claimed that a listing broker had a duty to inspect the listed property over and above asking the seller if defects exist. In that case the property had certain problems in the foundation which the buyer discovered after occupying the home. The buyer relied on *Easton* as authority for the assertion that a duty of inspection should apply, but the court declined to follow that case, holding that "the imposition of such liability... should be left to the Texas legislature." n22 *Hagans v. Woodruff*, n23 reaches the same conclusion, citing *Kubinsky*. Likewise, the 4th Circuit in *Herbert v. Saffell*, n24 declined to extend Maryland law to embrace "the particularly broad theory of liability" announced in *Easton*, "leaving it to Maryland courts to effect such a sweeping change in Maryland law." n25 *Herbert* involved a claim that the broker should have discovered and disclosed to the buyer certain soil conditions and other terrain problems that precluded installation of a conventional septic system, making the property essentially uninhabitable. The West Virginia Supreme Court, in another case involving undiscovered foundation problems, also considered and rejected the inspection duty of *Easton*: "We decline to hold that a broker has an independent duty to inspect and uncover latent defects on residential premises." n26 Finally, while not explicitly referring to *Easton*, the Illinois Appellate Court has held that a listing broker has no obligation to conduct an inspection sufficient to discover defects such as a basement flooding problem. In *Munjal v. Baird & Warner*, n27 the court was "...unwilling to find a duty on the part of a real estate broker to discover latent material defects on property which a seller has not disclosed to him prior to sale... [W]e do not think that [seller's] broker...was obligated to make a full investigation as to whether there was an actual flooding problem in the house without clear evidence of same or without disclosure by the seller." n28 This result was subsequently confirmed in *Harkala v. Wildwood Realty, Inc.* n29

The decision in *Wilson v. Century 21 Great Western Realty*, n30 discussed above, the change in approach taken by the Wisconsin legislature, and the other cases cited above indicate there is not uniform support for imposing on brokers an affirmative and comprehensive duty to inspect for property defects, including environmental problems. Case law and developing legislation will undoubtedly continue to evolve to address each jurisdiction's approach on this important question.

FOOTNOTES:

(n1)Footnote 1. 152 Cal. App. 3d 90, 199 Cal. Rptr. 383 (1984) .

(n2)Footnote 2. 152 Cal. App. 3d at 102, 199 Cal. Rptr. at 390 .

(n3)Footnote 3. 152 Cal. App. 3d at 102, 199 Cal. Rptr. at 390 . The court said that the duty to disclose not only what the agent knew, but also what he should have known, is a widely acknowledged professional standard. The court relied in part on the Code of Ethics of the National Association of Realtors(R), which states: "REALTORS(R) shall

avoid ... concealment of pertinent facts relating to the property or the transaction He has an affirmative obligation to discover adverse factors that a reasonably competent and diligent visual investigation would disclose." National Ass'n of Realtors(R), Code of Ethics, art. 9. In 1986, in order to clarify the intent of that provision of the Code of Ethics (which was later renumbered as Article 2), NAR deleted the last quoted sentence and added the following additional language: "Realtors(R) shall not, however, be obligated to discover latent defects in the property, to advise on matters outside the scope of their real estate license, or to disclose facts which are confidential under the scope of their agency duties owed to their clients." National Ass'n of Realtors(R), Code of Ethics, art. 2.

(n4)Footnote 4. *152 Cal. App. 3d at 105, 199 Cal. Rptr. at 392* .

(n5)Footnote 5. *Cal. Civ. Code § 2079*.

(n6)Footnote 6. *Cal. Civ. Code § 2079.2*.

These obligations of the buyer do not, however, relieve the buyer of the duty to exercise due care. *California Civ. Code § 2079.5* provides that "[n]othing in this article relieves a buyer or prospective buyer of the duty to exercise reasonable care to protect himself or herself, including those facts which are known to or within the diligent attention and observation of the buyer or prospective buyer."

(n7)Footnote 7. *15 Cal. App. 4th 298, 18 Cal. Rptr. 2d 779 (1993)* .

(n8)Footnote 8. The court relied in part on *California Civil Code § 2079.3*, which states that "[t]he inspection to be performed pursuant to this article does not include or involve an inspection of areas that are reasonably and normally inaccessible to such an inspection"

(n9)Footnote 9. *205 Cal. App. 3d 1354, 254 Cal. Rptr. 633 (1988)* .

(n10)Footnote 10. *211 Cal. App. 3d 311, 259 Cal Rptr. 257 (1989)* .

(n11)Footnote 11. *57 Cal. App. 4th 634, 67 Cal Rptr. 2d 380 (1997)* .

(n12)Footnote 12. *Cal. Civ. Code § 2079.7*.

(n13)Footnote 13. *101 N.M. 572, 686 P. 2d 262 (N.M. App. 1984)* .

(n14)Footnote 14. *686 P.2d at 266* .

(n15)Footnote 15. *Wis. Admin. Code RL 24.07*.

(n16)Footnote 16. *173 Wis. 2d 30, 496 N.W.2d 106 (Wis App. 1992)* .

(n17)Footnote 17. *195 Wis. 2d 88, 537 N.W.2d 150 (unpublished), 1995 Wisc. App. LEXIS 683 (Wis. App. 1995)* .

(n18)Footnote 18. *220 Wis. 2d 714, 583 N.W.2d 673 (Wis. App. 1998)* .

(n19)Footnote 19. *Wis. Stat. § 452.23*.

(n20)Footnote 20. *181 Wis. 2d 894, 512 N.W. 2d 239 (Wis App. 1994)* .

(n21)Footnote 21. *811 S.W. 2d 711 (Tex. App. 1991)* .

(n22)Footnote 22. *811 S.W. 2d at 715* .

(n23)Footnote 23. *830 S.W. 2d 732 (Tex. App. 1992)* .

(n24)Footnote 24. *877 F.2d 267 (4th Cir. 1989)* .

(n25)Footnote 25. *877 F.2d 267* .

(n26)Footnote 26. *Teter v. Old Colony Co., 190 W.Va. 711, 719, 441 S.E.2d 728 (W.Va. 1994)* .

(n27)Footnote 27. *138 Ill. App. 3d 172, 485 N.E. 2d 855 (Ill. App. 1985)* .

(n28)Footnote 28. *485 N.E. 2d at 856* .

(n29)Footnote 29. *200 Ill. App. 3d 447, 558 N.E. 2d 195 (Ill. App. 1990)* .

(n30)Footnote 30. *15 Cal. App. 4th 298, 18 Cal. Rptr. 2d 779 (1993)* .

* Sections 15.01 through 15.04 of Chapter 15 were revised in 1998 and have been updated every year since then--most recently, in 2010--by Ralph W. Holmen, Associate General Counsel, National Association of Realtors(R). Section 15.06 was written by J. Cullen Howe who is an environmental law specialist in Arnold & Porter LLP's environmental practice group. He is the managing editor of Environmental Law in New York, a monthly newsletter, and edits the Environmental Law Practice Guide, among other publications. He has recently co-authored chapters on climate change and green buildings for the Environmental Law Practice Guide (Mathew Bender). Mr. Howe updated Sections 5.05 and 5.06, having most recently added new subsections to § 5.06 in 2010. Section 15.05[2] was written and has been updated by Adam P. Storchak and Michael Mayer of Weil, Gotshal & Manges LLP, Washington, D.C. and is excerpted from Real Estate Financing ch. 4D (Matthew Bender). In 2006, an update to Section 15.05[2][e] describing EPA's final rule entitled "Standards and Practices for All Appropriate Inquiries" was contributed by Michael Allan Wolf and reprinted from Powell on Real Property(R) § PA.08[2][c][iii] (Michael Allan Wolf, ed. Matthew Bender). Chapter 15 was originally prepared by Christine B. Ludwiszewski, Esq. of Wheaton, Illinois.



60 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 15 Real Estate Brokers and Environmental Laws *

10A-15 Real Estate Brokerage Law and Practice § 15.03

§ 15.03 Environmental Hazards

[1] Overview

Some products previously thought to be "miracle products" (e.g., urea-formaldehyde foam insulation, chlordane, lead-based paint, asbestos and others) have later been determined to also have unfortunate negative health implications for persons exposed to them. Because some of these products found their way into our homes, schools, offices and shopping centers, they have become the headaches of today's real estate professional. Prudent real estate professionals will become familiar with these environmental conditions and concerns and establish office policies that will help to limit their legal exposure to buyers who claim they unwittingly purchased property that suffers from one or more environmental problem.

This section provides an overview of the most commonly found environmental hazards as well as court decisions that have addressed the issue of the potential liability of real estate brokers involved in the sale of property afflicted with an environmental hazard. As indicated above, these cases generally apply the principles developed in connection with property defects other than environmental matters, as described above, in determining whether or not brokers, agents, and owners are to be held liable for environmental hazards found to affect the property. Thus, issues of primary importance are typically the defendant's actual knowledge of the presence or existence of the environmental problem or whether the defendants should have been aware of it, and whether the plaintiff acted reasonably in investigating for such concerns and/or relying on statements made by the broker or agent.

[2] Asbestos

Probably the most common environmental hazard found in existing buildings is asbestos. Due to its fire retardant quality and strength, asbestos was added to many products used in the construction industry, including insulation, vinyl floor tiles, roofing, siding and pipe wrapping. In 1964, Irving Selikoff published a definitive workⁿ¹ linking exposure to asbestos and lung diseases. Both the asbestos industry and the medical community had evidence at least thirty years prior to that study of the danger of industrial exposure to asbestos.ⁿ² Because it takes many years after exposure to asbestos before any diseases attributed to such exposure become manifest, researchers have had difficulty determining a dose-response relationship. As a result, the federal government has been reluctant to completely ban the use of asbestos or control exposure to it.

Asbestos poses a health risk because when it ages or is disturbed it may become "friable"--breaking off into microscopic particles that become airborne and can be breathed into the lungs of persons exposed. Current studies indicate that the risk of asbestos-related diseases, such as lung cancer, asbestosis and mesothelioma, is dependent upon the type of friable asbestos found on the property, as well as the size and concentration of the fibers. n3 Most of the asbestos used in building products appears to be "chrysotile" asbestos, which is least likely to cause lung disease. However, the public fear of asbestos exposure may make a building or home containing asbestos products difficult to sell or lease. At least one plaintiff has been able to convince a jury that an asbestos-related disease was acquired while working as a word processor in a federal office building. n4

Because of the health risks presented by friable asbestos, remedial measures may have to be taken. Once asbestos is found on a property, the parties generally have three possible responses:

- removal of the asbestos-containing products;
- enclosure of the space in which the asbestos is located; or
- encapsulation of the asbestos with another material.

The best approach to take will depend on the current condition of the asbestos, the possibility that the asbestos will be disturbed in the near future by renovation or decay, and the likelihood that, if disturbed, the asbestos would enter the building's air system. Removal is extremely costly because federal law requires asbestos to be disposed of as a hazardous material. n5 Removal costs are also higher because of the precautions that must be taken during the removal process to prevent release of asbestos fibers into the open air. Although in most states brokers do not have an affirmative obligation to inspect to discover environmental hazards like asbestos, prudent brokers will be alert for "red flags" indicating the possible presence of asbestos, and will inform potential buyers of the conditions observed.

The presence of asbestos on real property that is available for sale or lease has proven to be troublesome in both residential and commercial real estate transactions. For example, the potential purchaser of an older home may anticipate replacing the furnace, which would require removal of asbestos insulation and pipewrap on the old furnace in accordance with federal regulations. n6 It would not be uncommon for the estimated cost of this project to double due to the asbestos removal costs. Similarly, the purchaser of an office building in need of a complete refurbishing due to the age of the building may find that the cost of asbestos removal makes the purchase of the building prohibitive. Prior to approving loans on commercial buildings most lenders attempt to ensure that their investment will not lose value and avoid potential environmental liability by requiring environmental inspections that will identify the presence of hazardous substances, including asbestos.

Case law addressing claims against brokers for failing to disclose asbestos in a property is limited. In *Witt v. Coldwell Banker First United Realty, Inc.*, n7 the buyers alleged that the broker, who in this case was also the owner, failed in his duty to inspect the property and disclose the presence of asbestos-containing pipe insulation. The broker-owner claimed that he was not aware of the asbestos and so represented in the Seller's Real Estate Condition Report. The trial court granted summary judgment for the broker but the appellate court reversed, holding that the broker's failure to inspect and discover and disclose the asbestos may have been sufficiently negligent to sustain a claim for negligent misrepresentation. In addition, although not directly related to brokerage practice, many commercial brokers also act as building managers and thereby may be covered by a 1995 OSHA rule requiring owners and managers to disclose to building tenants that are employers any known asbestos or materials presumed to contain asbestos. n8 In *Olean Associate, Inc. v. Knights of Columbus*, n9 the plaintiffs discovered that the property they had purchased in 1990 contained considerably more asbestos than had been previously disclosed to them. An inspection report done for the sellers prior to the sale had indicated the full extent of the asbestos present, but that report was not provided to the purchasers. Plaintiffs learned of the more extensive asbestos in 1991 when a local government agency inspected the property. The parent company of plaintiffs brought suit in 1996 within the 5-year statute of limitations period, but when

that case was dismissed plaintiffs brought suit in their own name in 1997. The Missouri Court of Appeals held that plaintiffs' claims did not "relate back" to the earlier complaint filed by the parent, and affirmed dismissal of the case based on the statute of limitations. The court also held that claims with respect to additional areas of asbestos discovered in 1997 were also subject to dismissal as outside the statute of limitations. The court held that because the 1991 inspection revealed there to be more asbestos than previously believed the fraud was known much earlier and the newly discovered asbestos was "capable of ascertainment" in 1991, starting the running of the 5-year limitations period.

In *Salinas v. Skelton*,ⁿ¹⁰ the plaintiff alleged that the seller was aware of asbestos insulation on an enclosed boiler unit within the condominium purchased by the plaintiff, and that the seller intentionally failed to disclose such asbestos in response to a question about "Toxic Substances" on the seller's property condition disclosure statement. The court held that there was sufficient evidence for a jury to conclude that the seller had intentionally withheld such information from the purchaser and reversed a summary judgment ruling in favor of the defendant seller. With respect to the purchaser's claim against the seller's real estate agent, however, the court found no misrepresentation by the agent and noted that the property condition disclosure statement contained representations of the seller only, and not of the agent. For that reason, the court affirmed summary judgment in favor of the agent. Finally, in *Beshada v. Millard Realty*,ⁿ¹¹ the court had little trouble concluding that neither the real estate agent nor the seller were liable under theories of negligence, silent fraud and innocent misrepresentation, or for violation of the Michigan Consumer Protection Act for various problems with a home purchased by the plaintiff, including "asbestos in the basement," where the plaintiff had offered no evidence that either the seller or agent knew of the problems. In particular, the court specifically noted that the broker had not actively concealed any material information and served only as a conduit of information without an independent duty to disclose or confirm. The court's conclusion was also influenced by the fact that the purchaser had been put on notice of certain potential problems but took no action to identify or address them, and that in fact there had been no misrepresentation of fact by either defendant. And in *Kearns v. Huckaby*,^{n11.1} the court concluded that a real estate broker acting as a dual agent in a transaction had not been negligent or breached its contract with the buyers for representing that the roof of the home purchased by plaintiffs was slate, when in fact it was asbestos. The court noted that although the agent's representation was inaccurate, there was no evidence offered to show that the agent made that representation with knowledge that it was not true or with reckless disregard for the truth. The court also acknowledged that it was not possible to determine by observation whether the roof was slate or asbestos, and that the buyer had inspected the property and confirmed in the contract for sale that it he was relying on that inspection rather than any representations by the broker or agent of the broker.

[2A] Chinese Drywall

In December, 2008 the federal Consumer Product Safety Commission began to receive complaints related to drywall installed in residential homes. The complaints appeared to arise out of a "building boom" in the southeast United States following substantial hurricane activity in 2004 and 2005, including hurricanes Katrina and Rita. These complaints by consumers included a "rotten egg" smell, health concerns such as irritated and itchy eyes and skin, difficulty in breathing, persistent cough, bloody or runny noses, recurrent headaches, sinus infection, and asthma attacks apparently unrelated to other causes. Also reported were blackened and corroded metal components in homes and the frequent need for replacement of components in air conditioning units. Ultimately many of these problems were traced to, or at least suspected to be caused by, drywall installed that was marked as produced in China. The CPSC reports receiving nearly 3,300 complaints, primarily from residents in Florida but from 36 other states as well,^{n11.2} the District of Columbia, American Samoa, and Puerto Rico. These consumers expressed the belief that their health symptoms or the corrosion of certain metal components in their homes are related to the presence of such Chinese drywall. State and local authorities have also received similar reports.

The CPSC initiated an investigation and has now established a "Drywall Information Center"^{n11.3} including various reports and information about the problem. Although consulting with a professional home inspector is the best way to determine whether or not a home contains problematic drywall, homeowners may do a self-inspection prior to hiring an expert to look for indications of the presence of Chinese drywall. Those include a sulfuric acid or rotten egg odor, or

unexplained corrosion or blackening of internal wiring and air conditioning coils or air conditioning units. Another indication of Chinese drywall may be found on the source itself, which may display "Made in China" or the logo of a Chinese drywall manufacturer such as Knauf Plasterboard Tianjin or Taishan Gypsum.

On April 2, 2010 the CPSC issued guidance recommending that consumers remove all possible problem drywall identified in their homes, and that they check and also replace any damaged electrical, gas service, or other home systems or components n11.4 The CPSC has also issued technical guidance regarding identifying problem drywall in homes n11.5 as well as detailed guidance on repairing homes with problem drywall n11.6 and continues to investigate and provide information and advice to potentially affected homeowners. The costs of removing and replacing affected drywall depend on the extent and location of use of affected drywall in a home, but can range well into the tens or even hundreds of thousands of dollars. HUD has also announced efforts to assist adversely affected homeowners, including directing FHA to instruct mortgage lenders to provide temporary payment forbearance and relief from certain fees and penalties for homeowners required to remove and repair affected drywall. HUD is also providing Community Development Block Grants to assist states and local communities address rehabilitation efforts related to such drywall. n11.7

No litigation involving claims against real estate brokers or agents and affected drywall has yet been reported, but a series of lawsuits have been filed against manufacturers, distributors, and suppliers of Chinese drywall. All such federal cases have been consolidated in the Eastern District of Louisiana, and that court has already issued one decision awarding damages to seven plaintiffs against one drywall manufacturer totaling in excess of \$2.6 million. n11.8 That manufacturer defaulted, but the court nevertheless permitted extensive discovery and concluded there was evidence supporting the conclusion that the drywall had caused such extensive damage as to make the homes uninhabitable, and that correcting the problem caused by the drywall required removing drywall and all affected components, including all electrical wire, HVAC systems, appliances, carpets, cabinets, and flooring. Other claims against other defendants remain.

[3] Radon

Radon is a colorless, odorless naturally occurring radioactive gas that has been associated with lung cancer and is perhaps the most commonly inquired-about environmental hazard in residential home sales. Radon results from the decaying of uranium and radium occurring in the ground. The gas enters the home through openings in basement walls, floor cracks, unsealed sump pumps, and open sewer drains. Efforts to make homes more air-tight, such as by installing weatherproofing and/or new windows, have increased the concentration of radon gas found indoors because the gas has a more difficult time escaping.

Scientists have long been aware of the dangers of occupational exposure to radon in uranium mineworkers. Because the risk of lung diseases attributable to radon exposure depends on both the level of radon in the air and the length of the period of radon exposure, however, scientists have had difficulty establishing a dose-response relationship. n12

The U.S. Environmental Protection Agency (EPA) has established 4 picoCuries of radon per liter of air ("pCi/l") as the threshold level at which remedial action should be taken to lower the radon levels in a home. EPA is careful to acknowledge, however, that radon levels below 4pCi/l pose some level of risk also. n13 While the risks of lung cancer arising from long-term exposure to high levels of radon are well accepted, a number of researchers have considered and continue to examine the question of the magnitude of risk associated with exposure to lower levels, such as those that may be found in residential circumstances. The results remain inconclusive.

Radon is a prevalent problem, particularly in certain areas of the country. For example, radon screening tests performed by the Illinois Department of Nuclear Safety in 2,300 homes across the state showed that forty-five percent had radon levels in the basement above 4 pCi/l. n14

Testing for radon has become a familiar part of home inspection procedures in some areas of the country, while radon testing in other areas may be unusual and unfamiliar. Testing is required by many relocation services when they acquire a property and it is not uncommon to see clauses in sales contracts allowing for the test to be performed.

Indoor concentrations of radon depend on such factors as the method of building construction used, the concentration of radon in the soil, and the ventilation system in the building. Corrective action to remedy a radon problem involves sealing cracks and other openings in the basement and increasing ventilation. An "active mitigation system" may also be used. Such a system involves installation of a pipe that runs from below the foundation slab to above the roof line, into which is installed a fan to draw out the soil gases. Repairs usually are not expensive, and often range from \$500-\$2,500. Thus, the presence of radon in a property available for sale or lease will generally not cause the transaction to fall through. Real estate agents must anticipate the possibility that a property contains elevated radon levels and should be prepared to provide buyers and sellers information about radon, including the health implications and testing and mitigation procedures. Such information is easily obtained from U.S. EPA, or from state or local environmental or public health agencies. n15 A wealth of other information and publications about radon and its effects is available at US EPA's website. n15.1

Contracts for the sale of real estate may include specific provisions that address the parties' opportunity or obligation to test for and remedy any elevated radon levels. In some states, seller disclosure laws (discussed in § 15.01[3] above) explicitly address radon and require disclosure of any knowledge about radon levels in a home. In the case of most seller disclosure laws, the form that the seller is required to complete and provide to the purchaser simply includes radon as an item to be disclosed by the seller if any information is available. A few states impose a specific requirement that the seller or broker give an informational or "warning" statement to purchasers concerning radon or the potential health implications of elevated radon levels. n16 Montana's statute provides that sellers and seller's (real estate) agents who comply with this disclosure duty may not be held liable "based on the presence of radon gas or radon progeny in the building." n16.1

Only a few reported cases have involved radon, and, of those, only one involves a claim against a real estate broker. In *Snyder v. Roach Brothers Realtors*, n17 the plaintiffs had entered into a contract to purchase a home in which a radon mitigation system had already been installed. At the time of listing the seller had provided the broker with information about the system and had encouraged the broker to disclose it to prospective purchasers. The broker did in fact disclose to the plaintiff purchasers the results of the radon test that had been performed after installation of the system (which showed radon levels below 4 pCi/l), but did not disclose the system itself or the fact that before the system had been installed a test of the premises showed radon levels as high as 77 pCi/l. At a pre-closing inspection the purchasers noticed and inquired about the system, and as a result of learning of the system and the pre-mitigation radon levels the purchasers refused to complete the transaction. The purchasers demanded return of their earnest money deposit and this litigation followed when the sellers refused. The court held that the mitigation system should have been disclosed to the purchasers by the broker and that nothing about the physical appearance of the system would have drawn it to their attention. The court awarded the purchasers damages in the amount of their earnest money deposit and the expenses they had incurred in connection with seeking a mortgage loan for the purchase. Because the sellers had advised the broker to disclose the system to prospective purchasers, however, the court held that it was the failure of the broker, and not the seller, to make such disclosure and ordered the broker to indemnify the seller for the damages awarded to the purchasers.

One other case involved a real estate broker as a defendant, but it resulted in a jury verdict only and is not reported. The plaintiffs in *Radakovich v. Fila* n18 were the buyers of a Pennsylvania house who were told that the radon level in the home was 1.6 pCi/l. Two years after purchasing the house the buyers tested the home and found radon levels of 44 pCi/l, and upon further investigation discovered that earlier tests by the seller revealing elevated radon levels were never disclosed to the buyers. The buyers sued and recovered a judgment of \$30,000 against the sellers and broker on grounds of fraud, negligent misrepresentation, and violation of the state's consumer fraud act.

Other cases have addressed radon issues arising in the context of an inspection clause allowing the purchaser to perform a radon test and cancel the contract of sale or require remediation by the seller if elevated levels were found. For example, in *Pine Hill Development, Inc. v. Peterson*,ⁿ¹⁹ the court held that the defendant buyers could without penalty terminate a contract to purchase property where radon testing of the premises showed radon levels in the air of 5.7 pCi/l and 9536 pCi/l in the water. The contract specifically provided that "the sale was contingent on a radon air and water 'inspection' which was 'satisfactory to Buyer.' " The court found that the tests showed that remediation was required and that the defendant purchaser was permitted to terminate the contract because the seller refused to perform the necessary remediation. In *Wong v. Mercado*,ⁿ²⁰ a real estate broker and the seller prevailed in their suit against buyers who failed to go through with a home purchase because of the presence of radon gas at a level of 2.9pCi/l. The buyers were concerned about the radon level because their children were to occupy bedrooms in the basement of the home. The court rejected the buyers' attempt to be relieved of their contractual obligation to complete the purchase. The court concluded that the purchaser was "objectively unreasonable" in failing to go forward at the closing due to the radon level. The court further concluded that the sellers should have been given an opportunity by the buyers to take corrective action to reduce the radon level. The court awarded damages to both the broker and the seller of the property. In *Tanner v. Adams*,ⁿ²¹ the plaintiff had purchased a home and had it inspected pursuant to a contract provision allowing cancellation for "substantial structural, mechanical, electrical, plumbing, roofing, water or sewer defects." Although a radon test showed levels in excess of the EPA action level, the court refused to permit the purchaser to cancel the contract because of the radon since it was not a defect of the type contemplated in the inspection clause. In *Pannone v. Grandmaison*,ⁿ²² the court permitted a purchaser to cancel a contract for sale pursuant to a clause making the offer contingent on "Purchaser's approval of the result of ... a radon gas inspection." Although the radon levels were well below the EPA action level, the purchaser offered evidence of his personal sensitivity to radioactivity as a result of radiation exposure suffered during the Korean war. The court allowed him to cancel because he sought to do so in good faith based on a subjective rather than objective standard, taking into account his personal history.ⁿ²³ In *Kotkin v. Aronson*,ⁿ²⁴ the New Jersey Supreme Court similarly strictly construed a home inspection clause that gave the buyers the right to inspect the dwelling for "possible environmental conditions affecting the property such as presence of radon gas, ..." (Emphasis in original.)ⁿ²⁵ The contract gave the buyers the right to terminate the contract if any defects were discovered unless the sellers agreed to "repair and/or replace (the defect) ... at the Seller's own cost and expense." The sellers mitigated the radon discovered by the buyers to a level considered by the sellers to be safe, but because they did not completely eliminate all the radon the buyers nevertheless sought to terminate the contract. Noting that the parties could have but did not negotiate and establish in the contract a specified "safe" level of radon, the court affirmed the lower court's grant of summary judgment in favor of the buyers, canceling the sales contract and ordering the sellers to return the buyers' deposit. Finally, in *Pais-Built Homes, Inc. v. Beckett*,ⁿ²⁶ the court affirmed a judgment ordering a purchaser's down payment forfeited to the seller despite the purchasers' claim that they had been fraudulently induced into signing the contract by the seller's failure to disclose the level of radon on the property. The court held that claim was barred by the provision in the purchase contract that "all prior understandings, agreements, representations and warranties, oral or written, between Seller and Purchaser are merged in this contract; it completely expresses their full agreement and has been entered into after full investigation, neither party relying upon any statement made by anyone else that is not set forth in this contract." The court also acknowledged that "the level of radon present in the house was not a matter peculiarly within the [seller's] or the broker's knowledge," and that they had not shown that they could not ascertain the truth "through the exercise of due diligence."ⁿ²⁷

[4] Urea-Formaldehyde Foam Insulation

Urea-formaldehyde foam insulation (also commonly known as UFFI), was one of the miracle products of a decade intent on insulating an aging housing stock due to ever-increasing energy costs. UFFI is a mixture of a urea-formaldehyde-based resin, compressed gas and a foaming agent that is pumped into the cavity between the interior and exterior walls of a home, through holes in the exterior wall that are later patched. It is estimated that approximately one-half million homes nationwide contain UFFI. Many of these residences were later sided with aluminum or other materials to cover the holes used to install UFFI.

In 1982, the U.S. Consumer Product Safety Commission (CPSC) banned the sale and installation of UFFI in residences and schools because it contended that formaldehyde gas emitted by the insulation posed an unreasonable risk of causing certain health problems, including a variety of respiratory ailments or irritations, and even cancer. In 1983, the U.S. Court of Appeals for the Fifth Circuit overturned the CPSC's ban. n28 The court held that while the evidence presented by the CPSC did indicate the possibility of a link between UFFI and acute irritant effects as well as cancer, and that the CPSC's studies did suggest that "UFFI is not completely innocent," n29 the ban could not be justified because there was not substantial evidence that UFFI was carcinogenic. The CPSC never responded to the court's challenge by accumulating additional evidence. Massachusetts and Connecticut are the only states that prohibit the sale of UFFI. Because of the controversy, however, UFFI was rarely used after the mid-1980s. A CPSC publication entitled *An Update on Formaldehyde, 1997 Revision*, describes the health effects of formaldehyde gas, both from UFFI and other materials.

When the CPSC's ban on UFFI became effective, the National Association of Realtors(R) advised its members that the existence of a potential health hazard from UFFI was a material fact that should be disclosed to purchasers. Brokers were advised to obtain from sellers any information about the presence of UFFI in a home being sold, and to provide that information to purchasers, using a form for the buyers to sign to acknowledge that disclosure. The form also included a space for sellers to indicate that they had no knowledge whatsoever about the presence or absence of UFFI in the home.

UFFI became less of a concern after the Fifth Circuit overturned the CPSC ban. Despite the withdrawal of the ban, however, in October 1987, the Superior Court of Pennsylvania, in *Roberts v. Estate of Barbagallo*, n30 found a real estate agency liable to the purchaser for fraudulent concealment of UFFI and rescinded a sale. The home in question was sold after the CPSC banned the use of UFFI but before the Fifth Circuit overturned the ban. Four days after closing, the purchaser had a contractor inspect the premises in contemplation of renovating the property. Upon being told that the home was insulated with UFFI, the purchaser had the indoor air analyzed. It was found to contain 0.1 parts per million (ppm) formaldehyde fumes, an amount that the county health department found might cause irritation in normally healthy people. The purchaser's mother, who intended to reside in the home, suffered from a sinus condition and allergies.

The real estate agency had received information from the Board of Realtors(R) informing of the dangers of UFFI and advising that purchasers should be told when a home contains UFFI. The agency's listing agent was advised by the seller that insulation had been blown into the walls but the seller did not know if the insulation used was UFFI.

The court found no evidence that the formaldehyde fumes created an unreasonable risk or that the formaldehyde levels in the home were attributable to the insulation. However, it found the real estate agency liable for fraudulent concealment of a material fact for failing to disclose the potential presence of UFFI in the home. Thus, the basis for the court's holding appears to be that the broker failed to disclose general information about UFFI and the possibility that it might be present, rather than the failure to disclose the UFFI itself, which in fact the broker did not know about. Such a duty to advise purchasers of all potential environmental problems a property may suffer is a burdensome and onerous standard for brokers to satisfy, and has not been applied in other cases. The court appears to have been influenced in reaching this conclusion by the fact that the Board of Realtors(R) to which the broker belonged had recommended to its members that information concerning UFFI be disclosed to both buyers and sellers, and despite this recommendation the brokerage firm had adopted a policy of not making such disclosures. The court granted the purchaser her elected remedy--rescission of the sale. n31

In *Brock v. Tarrant*, n32 a Washington case, a listing broker prevailed in a suit alleging nondisclosure of UFFI to the purchaser. The facts indicated that the sellers had quite clearly concealed the presence of UFFI from the broker and the purchaser, and that the broker had no knowledge of the presence of UFFI. The purchasers sued the sellers, the listing broker and the selling broker for rescission or damages. The purchasers settled their claims against the sellers and the selling agent and the sale was rescinded. The purchasers assigned their claim against the listing broker to the sellers, and

the matter proceeded to a bench trial where the listing broker prevailed. The court awarded the listing broker \$22,279 in costs and attorneys' fees and the sellers unsuccessfully appealed. The sellers had failed to disclose to the listing broker their knowledge that the home contained UFFI, that they had suffered certain adverse health effects, and that there was a pending lawsuit against the installer regarding the insulation. Furthermore, the sellers had initialed a provision stating they knew of no material structural defects and that nothing on the property required attention or repair. The court found that the sellers had induced the listing broker to unknowingly list and sell defective property and affirmed the trial court's award. Finally, in *Catucci v. Lewis*, n33 the New Hampshire Supreme Court affirmed a jury verdict in favor of a seller and his real estate agent for failing to disclose UFFI in the home bought by the plaintiffs. Although the affirmance is on grounds unrelated to the broker's disclosure responsibility, there is no indication that the broker knew about the problem, and that appears to be the likely basis for the jury's conclusion that the broker was not liable to the purchaser for nondisclosure.

Although UFFI is no longer in use, it continues to be of concern when found in a building. When used, UFFI was mixed on the site by the contractor. Thus, there was no guarantee that manufacturers' guidelines regarding the amount of formaldehyde were followed. Theoretically, therefore, formaldehyde gas would be emitted from UFFI in different amounts and at different rates for each home containing UFFI, thereby presenting different degrees of risk. After UFFI hardens in the wall cavity, it is quite difficult to remove.

Indoor air pollution caused by formaldehyde vapors will continue to be a concern as long as building products are made with materials containing urea formaldehyde. For example, building trades are increasingly relying on particleboard and hardwood plywood in the construction of homes and buildings. Both products are bonded with urea-formaldehyde resins and can emit formaldehyde gas in the same way UFFI does. Since the *Roberts* case appears to be an anomaly and to be based on the specific facts there, the few cases discussed above seem to suggest that the risk of potential liability a real estate agent may face in the sale of residential housing that has urea-formaldehyde or other potentially toxic substances is small so long as the agent discloses all hazards that are actually known. Formaldehyde and/or UFFI are also items expressly indicated on many of the seller disclosure forms promulgated by states pursuant to their seller disclosure statutes or regulations. See § 15.01[3] above. Massachusetts further requires a seller of a residence containing UFFI to test for formaldehyde gas and to provide the test results, as well as the location of the UFFI and certain information prepared by the Department of Public Health, to any prospective purchaser. n34

[5] Lead Paint

EDITOR'S NOTE:

Real estate brokers have a duty to ensure compliance with federal disclosure requirements related to the actual or potential presence of lead-based paint in connection with the sale or rental of residential housing built before 1978. See Chapter 15A below an overview of the federal disclosure requirements as they affect brokers as well as sample forms conforming to federal disclosure requirements.

The ubiquitous presence of lead-based paint in our older housing stock is another insidious environmental flaw that poses severe health risks, particularly in children. It is estimated that seventy-five percent of housing built before 1980 contains some lead-based paint.

Lead poisoning affects the brain and kidneys and may cause nerve damage. Children are the most vulnerable victims of lead poisoning, which can occur when they eat lead-containing paint chips that have peeled or flaked off the walls or inhale dust particles containing lead. These particles are released into the air by the friction caused by opening windows and doors coated with lead-based paint. Homeowners who undertake renovations of older homes may disturb surfaces coated with lead-based paint and may release dangerous particles of lead dust into the air.

An additional source of lead in older homes is lead-containing pipes in the plumbing system. Lead enters the water supply through the corrosion of water pipes made from lead materials and containing lead-based solder.

Pursuant to the Residential Lead-Based Paint Hazard Reduction Act ("Federal Act"), n35 Federal regulations were adopted and became effective in September 1996 requiring owners of residential property built before 1978 being sold or leased, and brokers representing such owners, to disclose information about lead-based paint hazards to purchasers and tenants of the property. (For a more detailed discussion of these regulations, *see* Chapter 15A *below*.) Purchasers are also entitled to a ten-day period in which to conduct a lead-based paint risk assessment or inspection. n36 The law also requires a warning statement to be placed in all contracts to purchase such housing. *See* discussion of language requirements for sales contracts in § 15A.03[5][a] *below*. A similar warning statement must be provided to tenants leasing property built before 1978. *See* discussion of language requirements for leases in § 15A.03[5][b] *above*. These federal regulations do not, however, preempt any other applicable state or local requirements related to lead-based paint or disclosure thereof. Consequently, property owners and brokers must comply with these regulations include the duty of sellers to provide specified disclosures to residential real estate purchasers requirements discussed a laws or regulations. These requirements are the seller disclosure require § 15.01[3] *above*, almost all of which explicitly refer to lead-based paint. The seller disclosure laws and forms of virtually all states that have adopted them include a reference to and requirement that the known presence of lead-based paint be disclosed, and at least four states also impose on the owner and/or the owner's agent the duty to provide specific notification to prospective purchasers of the possible presence of lead-based paint or hazards. n37 In Rhode Island, the existence of a state statutory scheme requiring lead-based paint disclosure, similar to the Federal Act, was held to make a seller exempt from a claim under the state Deceptive Trade Practices Act (DTPA) notwithstanding the seller's alleged failure to disclose the presence of lead-based paint. n38 The DTPA provides an exception for "actions or transactions permitted under laws administered by the department of business regulation or other regulatory body or (state) officer... ." Another important decision applying Rhode Island law is *Wallace v. United States*, n39 where the court held that the Federal lead-based paint disclosure regulations "may establish a standard of care resulting in negligence liability (under Rhode Island law) if breached." Thus, under that decision, a violation of the Federal regulations could result in damages awarded for state common law tort (negligence) liability in addition to the possible civil penalties and damages provided for in the Federal Act.

The seriousness of penalties that may be imposed on a seller or the seller's broker for misrepresenting that a home is free of lead-based paint is demonstrated in *Piers v. Wheeler & Taylor*. n40 In that case the plaintiffs had specifically advised the real estate agent that they were aware of and concerned about the hazards of lead-based paint, and would not consider purchasing any homes that had not been delead. The home they purchased had been completely rehabilitated by an employee of the defendant real estate firm, but the work in the home was done without specific attention to or removal of the lead-based paint it contained. Another agent of the firm assisted the plaintiffs and expressly represented that it had been delead, when in fact it had not been. The owner, the real estate agent, and the firm were each held to have violated a Massachusetts statute that makes unlawful "unfair or deceptive acts or practices in the conduct of any trade or commerce... ." n41 Because of the conduct in affirmatively representing the home as delead when it was not, the plaintiffs were awarded double their damages against the seller and treble damages against the real estate agent and the firm, the latter on the basis of respondeat superior.

Another case also involved a claim against a real estate broker arising out of the broker's involvement in the sale of a residence containing lead-based paint, but with a different result because the nature of the broker's knowledge and conduct was fundamentally different. *Farrar v. Acker* n42 includes claims against a home seller, a real estate broker, and the broker's firm, asserting a variety of causes of action including failure to disclose, delead, and inspect for lead-based paint; negligence; misrepresentation; breach of implied warranty of habitability; and a claim under the Connecticut Unfair Trade Practices Act. The court granted the broker's motion to dismiss as to all counts, holding that the plaintiffs' complaint against the seller as well as the broker was deficient because the plaintiffs had failed to allege

that they did not know or have reason to know of the condition or risk involved and [the seller] knew or had reason to know of the condition and that [the seller] realized or should have realized the risk involved and that [the seller] had a reason to believe that the plaintiffs would not discover the condition or realize the risks. n43

The court also held that the complaint was factually insufficient to support any duty on the part of the broker "to warn [the buyers] of conditions that their own inspection of the property could have uncovered," n44 and that the seller and broker "could reasonably expect that the [buyers] would make their own examination and draw their own conclusions..." n45 The court rejected the plaintiffs' claim that there was an implied warranty of habitability made by the seller and broker, and also that the broker had misrepresented the property. The court found that the broker had not made any affirmative representations regarding the existence or nonexistence of lead-based paint on the premises, and that a claim for misrepresentation based on nondisclosure would have to be based on a duty to disclose, but that the court had already rejected any such duty by the broker. n46

Although the *Farrah* case represents only a decision on a motion to dismiss by a trial level court, the court's analysis represents a substantial departure from the broker disclosure responsibilities imposed by the Federal lead-based paint regulations and even those suggested in *Roberts v. Estate of Barbagallo*. n47 Each of those suggests a duty by the broker to warn prospective purchasers of the possible presence and dangers of hazards such as lead-based paint. *Farrah*, however, appears to not only relieve the broker of the duty to investigate for such hazards or even to advise the buyer of their possibility, but instead to place the obligation to understand the importance of and need for such investigation squarely on the shoulders of the buyer alone. Similarly, *Nunez v. J.L. Sims Company, Inc.* n48 held the seller and the seller's broker and agent not liable under the federal lead-based paint disclosure regulations and a multitude of common law claims where there was substantial if not complete compliance with the requirements of the regulations. Both the seller and agents n49 had also made considerable efforts to advise the purchasers of the possible existence of, and health hazards presented by, lead-based paint, and to afford the purchasers the opportunity to investigate and inspect the property. The seller and his agent had no knowledge of lead-based paint in the home, and they had not failed to disclose facts of which they had actual knowledge or of which they should have been aware in the exercise of reasonable skill and care. Thus, the court rejected the purchasers' common law claims for fraud, breach of contract, breach of fiduciary duty, and negligence per se. In ruling on the negligence per se claim, the court held that even if the agents had violated the federal lead-based paint disclosure regulations, a charge rejected by the court, such a violation could not under Ohio law provide a basis for application of negligence per se. On the other hand, a Federal District Court applying Maine common law allowed a claim for negligence based on allegations that a buyer's broker failed to comply with a Maine statute requiring brokers and agents to "[D]isclos(e) to the buyer material facts of which (the agent) has actual knowledge or, if acting in a reasonable manner, should have known concerning the transaction." n50 In that case the buyer alleged that the agent failed to comply with the federal lead-based paint regulations, and also alleged the agent was liable for "professional negligence" for failing to "warn [the buyers] of the risk that there would be lead paint in the home and the dangers thereof, a risk that they knew or should have known existed." n51 *Flowers v. ERA Unique Real Estate, Inc.* n52 involved a similar claim against both the sellers and the real estate agents involved in the sale of an apartment building purchased by the plaintiffs. Plaintiffs alleged that the sellers and agents were liable for negligent misrepresentation because they knew, or should have known, that the building contained lead-based paint. The court denied defendant real estate agents' motion to dismiss the latter claim, holding that the duty to disclose material facts imposed under the Illinois Real Estate License Act n53 allows real estate brokers and agents to be liable "for failing to disclose a latent defect to the buyer if the real estate broker or agent 'knew or should have known' of the latent defect." n54 In *Ayers v. United States* n54.1 the plaintiff sued the seller, the federal government (HUD), as seller of the property purchased by the plaintiff, and HUD's agent in selling the house, after learning that the house contained lead-based paint. The court held that no damages were available to the plaintiff from HUD under the Toxic Substances Control Act (TSCA) n54.2 or the Residential Lead-Based Paint Hazard Reduction Act (RLBPHRA), n54.3 or against the government's agent under TSCA or the Lead-Based Paint Poisoning and Prevention Act, n54.4 but the District Court held that it had jurisdiction over a claim for damages against HUD's agent under the RLBPHRA.

In *Chapman v. Mutual Service Casualty Insurance Company*, n55 the buyers sued a number of parties, including the real estate broker, involved in their purchase of a home containing lead-based paint that injured their young son. In ruling on the broker's motion for summary judgment, the court held that the "as is" clause in the contract of sale barred claims against the broker for misrepresentation or failure to warn the buyers about the dangers of or possible presence of

lead-based paint. The court also held, however, that the broker might be liable for other acts of negligence if the buyer could show a breach of the broker's duties to investigate and disclose as set forth in Wisconsin statute or regulation.

Another lead-based paint case involving a real estate broker but not presenting the question of the broker's liability for failing to disclose lead-based paint hazards is the decision of the Massachusetts Supreme Court in *Underwood v. Risman*, n56 where the defendant was the owner of the property, but was also a residential real estate broker. The court ruled that the owner was not liable under a Massachusetts statute making unlawful "unfair or deceptive acts or practices in the conduct of any trade or commerce" n57 for not disclosing the possibility of lead-based paint in a residential dwelling rented to a childless couple. The couple later had a child and sued the owner when it was discovered that the apartment had high amounts of lead-based paint and the child suffered from elevated levels of lead in his bloodstream. The owner had no knowledge of any lead-based paint or hazards in the unit, although he did testify that he was aware of the hazards associated with lead-based paint and that lead-based paint was more likely in older houses such as that rented. Nevertheless the court held that one cannot be liable "for failing to disclose what one does not know." And in *Dyer v. Criegler*, n58 the Maryland Court of Appeals held that a real estate agent who lists and promotes residential property for rent is not an "owner" within the meaning of the Maryland Lead Paint Act. The court therefore affirmed the trial court's dismissal of the plaintiff's complaint against the agent for failure to state a claim. The Court of Appeals noted that although the Act imposed on "owners" a duty to take protective measures to prevent lead poisoning and defined owner to include "leasing agents," such agents were within the scope of the definition of owner only if they also "own, hold, or control the whole or any part" of the property. The court further noted that this conclusion was consistent with the intent of the statutory scheme to impose duties regarding lead-based paint on those with the right to control the property, and that a real estate agent acting only to list, promote, and effect a sale or rental of property is without such control. n59 Moreover, in a comment that is interesting but clearly dicta, the court also described its conclusion as consistent with the "general law governing liability of real estate agents and brokers" because "there is no duty imposed on agents or brokers, acting for a seller, to investigate and ascertain if any defects exist on the property in question and to disclose any such defects to a buyer" (citations omitted). In *Dixon v. South Boston Corporation*, n59.1 the court interpreted and applied a Virginia statute that provides that real estate agents under contract with a seller or lessor to market property are immune from liability from lead poisoning arising from the condition of a residential dwelling if the agent complies with the requirements of the Federal Lead-Based Paint Hazards Reduction Act. The statute further provides that if the agent also maintains the property, he or she must maintain the premises in fit and habitable condition and otherwise comply with Virginia law to enjoy such immunity. And in *Price v. Hickory Point Bank & Trust* n59.2 the court held that whether or not an agent had knowledge of lead-based paint in the premises was not relevant to whether the agent could be liable for allegedly negligently failing to disclose lead paint, since a prima facie case of common law negligence was established by the agent's acknowledged violations of the federal lead-based paint disclosure regulations and a municipal code provision designed to protect human life or health.

Other litigation arising out of the presence of lead-based paint in residential dwellings frequently involves claims against landlords or property management agents, including public housing authorities, alleging liability for injuries suffered as a result of exposure to lead-based paint. These suits allege a variety of legal theories, including:

- common-law negligence, n60
- breach of the covenant to repair, n61
- breach of the warranty of habitability, n62
- violation of state consumer protection laws, n63
- statutory negligence, n64 and
- strict liability. n65

The result in some cases turns on whether the landlord had actual notice of the problem. In *Brown v. Wheeler*,ⁿ⁶⁶ for example, the landlords were not liable because there was no evidence that they knew or had reason to know of chipping, peeling or flaking lead-based paint on the premises, or that such a condition was hazardous. Subsequently the Maryland Court of Appeals held that actual notice to the landlord of the problem is not an element of a *prima facie* case of negligence where the plaintiff has shown a violation of a municipal ordinance and injury proximately caused by the violation.ⁿ⁶⁷ Similarly, *Juarez v. Wavecrest Management Team Ltd.*ⁿ⁶⁸ holds that the New York City lead abatement law allows a landlord to be charged with notice of lead-based paint hazards in a unit being rented, but not with notice that a child under the age of 7 resides there and is exposed to such hazards. Moreover, in *Antwaun v. Heritage Mutual Insurance Company*,ⁿ⁶⁹ the Supreme Court of Wisconsin held that "by 1989 the danger of lead paint in residential housing was so extensively known" that whenever the landlord knows or should know of peeling or chipping paint "it is foreseeable that lead paint may be present which, if accurate, would expose the inhabitants to an unreasonable risk of harm." Thus, the court held "that a landlord has a common law duty to test for lead paint when the landlord knows, or, in the exercise of ordinary care, should have known that the residence contained peeling or chipping paint." The Maryland Court of Appeals held likewise in *Brown v. Dermer*.ⁿ⁷⁰ Jury awards in cases against landlords have often been substantial.ⁿ⁷¹

In addition, two other cases recognize a broker's duty to disclose to purchasers known lead-based paint hazards in a home. In *Byrd v. Riley*^{n71.1}, the plaintiffs claim for fraud or negligence against the defendant for failing to disclose the lead-based paint in the property was dismissed based on defendant's assertion that he was functioning as a mortgage broker but not a real estate broker. The defendant asserted that acting as a mortgage broker he had no duty to disclose anything about the condition of the property, and in any event did not hold a real estate license. On appeal, the court noted the plaintiff's allegations that he was also acting as a real estate broker in finding and showing them possible homes to purchase. The court held that if the defendant was, in fact, functioning as a real estate broker (although not licensed to do so) he could be liable for fraudulent or negligent misrepresentation of the condition of the property, and in particular, the fact that the property contained lead based paint. The case was remanded to the trial court for a determination of whether defendant's role in the transaction was both as a mortgage and real estate broker, and if the latter, whether he had failed to fulfill any duty to disclose the lead-based paint.

In *Stanfill v. Mountain*^{n71.2} the plaintiff buyer alleged that a real estate broker acting as a "facilitator" in the transaction failed to disclose a number of defects in the property, including lead-based paint, underground storage tanks, and so-called "mold contamination." The court cited a Tennessee statute^{n71.3} that imposes on brokers a duty to disclose to each party to a transaction any adverse facts of which the broker has actual notice or knowledge. But the broker filed an affidavit affirming that he had no knowledge of the alleged defects and the plaintiff offered no evidence to rebut the broker's statement, and on that basis the trial court granted and the appellate court affirmed summary judgment in favor of the broker.

[6] Electromagnetic Fields

Another source of potential environmental concern that has been suggested is electromagnetic fields (EMFs), which many people fear may cause or exacerbate health problems, including cancer. Opinions vary even in the scientific community regarding whether any health risks are posed by EMFs. To date, no study has conclusively established that EMFs cause cancer or any other disease. A study published by the National Research Council (NRC) in 1996 concluded that "no conclusive evidence shows that exposure to residential electric and magnetic fields produce cancer, adverse neurobiological effects, or reproductive and developmental effects."ⁿ⁷² Moreover, scientists have not developed a theory as to how electromagnetic fields might affect biological systems. The NRC report acknowledges, however, that there remains a weak statistical correlation between "wire codes" and childhood leukemia. Another study published in 1997 likewise produced "little evidence that living in homes characterized by high measured time-weighted average magnetic-field levels or by the highest wire-code category increases the risk of acute lymphoblastic leukemia in children."ⁿ⁷³ Studies such as these are generally careful to point out that the possibility of a link between exposure to

EMFs and illness has not yet been excluded. A study released in June 1999 by the National Institute of Environmental Health Sciences, a division of the National Institutes of Health, concluded that "the scientific evidence suggesting that ELF-EMF exposures pose any health risk is weak," although "ELF-EMF exposure cannot be recognized as entirely safe because of weak scientific evidence that exposure may pose a leukemia hazard." The report further concludes that aggressive regulatory concern is "unwarranted," but calls for "passive" activity such as "educating both the public and the regulated community on means aimed at reducing exposures." n74 Although no other published studies yet conclusively link EMF exposure with adverse health effects, some public perception that there is or may be a danger persists.

Overhead high tension utility lines are an obvious source of EMFs. These lines are easily seen, giving concerned potential buyers of properties adjacent to such lines notice of their presence, so that they can make their own inquiries and assessment regarding any danger the high voltage lines may present. However, a utility may have announced plans to install such lines near the property at a later time, a fact that a potential buyer may not know.

Utility companies continue to insist that high tension wires and transformers pose no health hazard, leading one to believe that the only problem with residing within viewing distance of utility towers is an aesthetic one. However, a study released by the Swedish government, in October 1992, suggests that a connection exists between exposure to power lines and cancer, particularly in children. n75 A study released by the EPA was reluctant to state definitively what type or length of exposure was detrimental to health. n76 Other epidemiological studies have failed to find a conclusive connection. Thus, juries are left to decide, on a case-by-case basis, in claims against utility companies whether a plaintiff's cancer or other illness is caused by exposure to electromagnetic fields.

Until a clear dose-response relationship is found by the governmental agencies that monitor utility companies, many communities are adopting a policy of prudent avoidance. It is increasingly common to see lobbying efforts against utilities that wish to place high voltage towers near schools, parks or residential communities. n77 Because of the wide range of opinion by experts regarding the danger of electromagnetic fields, a prudent real estate agent should refrain from making any representation on this issue. Furthermore, real estate agents who list or sell properties contiguous to utility rights of way may even wish to consider obtaining acknowledgments from buyers that they recognize the uncertainty about the health implications of EMF exposure, the proximity of the utility wires, and perhaps even that they will not seek recourse from the broker should the property appear to be devalued at a later date.

An eminent domain case in New York state, *Criscuola v. Power Authority*, n78 held that the owners of the condemned property were not required to show the reasonableness of the public's fear or perception of health risk from exposure to high voltage power lines in order to recover damages attributable to that fear. The condemnees argued that they should not have to prove the "reasonableness" of the public perception as a separate and additional element of diminished market value. The court agreed, stating:

Whether the danger is a scientifically genuine or verifiable fact should be irrelevant to the central issue of its market value impact. Genuineness and proportionate dollar effects are relevant factors ... [that] should be left to the contest between the parties' market value experts, not magnified and escalated by a whole new battery of electromagnetic power engineers, scientists or medical experts. n79

This reasoning could lessen the burden of purchasers of homes near utility lines seeking damages for the reduced market value of their homes, especially as public awareness heightens and a course of prudent avoidance becomes more common.

Several courts have rebuffed property owner's claims that they suffered physical or economic injury as a result of nearby power lines. In *Reiss v. Consolidated Edison Company of New York*, n80 the plaintiff's property abutted a right of way carrying a high voltage transmission line. Fearing harm to their child's health from the EMFs emitted by the line they sought to sell their home. They then sued the power company claiming that the sale price was 30% below

comparable homes in the area not affected by EMFs due to the public perception of harm caused by EMFs. The court rejected that claim because there was no proof offered that the reduction in the sale price, if any, was caused by the EMFs, and also because there was no proof that EMFs caused a health hazard that would render the property safe and uninhabitable. Similarly, in *Borenstein v. Consolidated Edison Company of New York*,ⁿ⁸¹ the court rejected the plaintiff's claim for damages based on the alleged reduction in the value of plaintiff's property because of an adjacent power line. That conclusion was based on the fact that the power line was pre-existing when the plaintiffs purchased the property, as well as the court's conclusion that science is unable to yet conclude whether or not harm results from EMFs. In *Jordan v. Georgia Power Co.*,ⁿ⁸² the plaintiffs sought damages against a power company operating power lines on an easement next to the plaintiff's property. The complaint set forth counts for trespass, nuisance, negligence, negligent misrepresentation, conducting an inherently dangerous activity, and battery, and also alleged that the EMFs emitted were the cause of the non-Hodgkins lymphoma developed by one of the owners. Certain of the counts were dismissed by the court and the case was tried to a jury on the issue of causation. The jury's verdict concluded that the magnetic fields from the transmission lines were not the source of the plaintiff's non-Hodgkins lymphoma, and the court dismissed the remaining claims. The Court of Appeals reversed the verdict because of certain evidentiary errors in admitting expert testimony on the issue of EMFs as the cause of the plaintiff's non-Hodgkins lymphoma, but refused to reverse dismissal of the trespass, nuisance and property damage claims because "[T]he scientific evidence regarding whether EMFs cause harm is inconclusive; the invasive quality of these electric fields cannot presently cause a trespass."ⁿ⁸³ Finally, the plaintiffs in *San Diego Gas and Electric v. Covalt*ⁿ⁸⁴ claimed that power lines adjacent to their property caused cancer and produced emotional distress engendered by a fear of contracting cancer, and that the value of their property was diminished by the power lines. The court dismissed the personal injury claims for "fear of future illness" because there was no reliable medical or scientific opinion that it was more likely than not the plaintiffs would develop cancer in the future due to EMF exposure. The property damage claims were dismissed as being within the exclusive jurisdiction of the state Public Utilities Commission. That conclusion was later affirmed by the California Supreme Court.ⁿ⁸⁵

The appropriate course of action for real estate brokers and agents in disclosing the possibility of EMF dangers remains unclear. The considerable uncertainty, perhaps even unlikelihood, of whether EMFs cause physical injury, coupled with these cases and the very obvious nature of the usual source of EMF exposure--power transmission lines--may provide a basis for brokers to persuasively assert that they have no legal duty to disclose EMFs or the potential problems with EMFs.ⁿ⁸⁶

[7] Chlordane

Yet another environmental hazard that may be present in residential housing is the pesticide chlordane. A popular termiticide in use from the late 1940s to the late 1980s, chlordane was applied to the soil around the outside of a house as a means of treating subterranean termites. However, the pesticide often leached into the home through crevices in the foundation. Its use was banned in April 1988 after studies showed traces of chlordane remained in the air of treated homes and posed a potential health risk to occupants. Studies also showed that even one year after treatment detectable levels of chlordane were still present in homes. Chlordane was also found in soil treated thirty years earlier. Because of its prevalent use, any home treated for termites prior to the early 1980s probably was exposed to chlordane.

In *Smith v. Renaut*,ⁿ⁸⁷ a home buyer sought damages from a real estate agent and the brokerage firm for failing to disclose the presence of chlordane in the well water of the home purchased. The buyer, after learning of the contamination of the well water, sold the house for \$6,000 less than she paid for it. A jury awarded her compensatory damages in the amount of \$20,270, to be paid largely by the brokerage firm and the real estate agent, and the rest by the seller. It also awarded punitive damages in the sum of \$22,500 payable only by the agent and the brokerage firm. The appellate court reversed that verdict, holding that the agent and firm could not be liable for misrepresenting the presence of chlordane since there was no evidence that they had any knowledge that chlordane had been used, that a residue of chlordane remained in the well water, or even that chlordane is a carcinogen.

[8] Underground Storage Tanks

It was previously common practice to bury under ground the tanks used to store petroleum products, heating oil and chemicals used in building operations or activities. Not only did burying the tanks minimize the risk of fire, it also removed an eyesore. Placing tanks underground made it difficult, however, to check on the condition of the tank and repair any leaks that occurred. As a tank ages, the probability of leaks increases if it still contains liquid. While the cost of removing and replacing a leaking tank can be substantial, the cost of remediating the contamination the leak has caused in the groundwater or surrounding soil can be devastating.

Abandoned underground tanks are often not discovered until after a sale closes. Sometimes the property has changed hands many times since a tank was abandoned, with the result that succeeding buyers are never notified of its existence. A water or soil contamination problem is often the first sign of the existence of a leaking underground tank. The current owner of a property may be unwittingly saddled with the responsibility for cleaning up the resulting contamination without having known at the time of purchase that an underground tank was present on the property. Many states require that tanks be registered with the state fire marshal or other designated agency,ⁿ⁸⁸ but these laws are not always followed, especially by farmers and small business owners who may be unaware that such a requirement exists.

The growing concern about the environmental damage that underground tanks can cause resulted in federal law governing certain size tanks and those containing certain products.ⁿ⁸⁹ This federal law does not apply to farm or residential tanks of 1,100 gallons or less used for storing motor fuel, tanks containing heating oil for the premises where stored, or septic tanks. Most states have also enacted laws regulating underground storage tanks, which in some cases apply to tanks excluded from coverage under the federal regulatory regime.ⁿ⁹⁰ All tanks covered by federal law were required to be equipped with leak detection systems by 1993, and to meet rigorous requirements for corrosion, spill and overflow protection, or to be taken out of service completely, by December 1998.ⁿ⁹¹ Tanks covered by the federal rules must be registered with the appropriate state agency and any leaks must also be reported. Federal law and that of states generally applies to owners of the property where the tank is located, or to the operator of the tank, or both. It does not apply to real estate brokers involved in transactions where a tank is or may be located. Nevertheless, brokers should be alert to the possibility that a tank may be present on a property with which they are involved so that the purchaser does not unknowingly take on the obligation to upgrade or remove the tank.

One appellate court has held that a farm purchaser who was not told of the existence of an abandoned tank that had leaked into the groundwater could seek damages for cleanup costs from the seller's broker involved in the sale. In *Grube v. Daun*,ⁿ⁹² the broker argued that it was protected from liability for misrepresentations and failure to investigate because the purchase contract contained an "as is" clause. The trial court accepted this argument, but the appellate court reversed and remanded the case for a new trial. It held that a broker could be liable for any positive misrepresentations made about property sold on an "as is" basis. In this case the plaintiffs alleged that the broker made factual misrepresentations by stating that the property would be suitable for business, residential, recreation and family uses, and the court found those allegations sufficient to allege claims for misrepresentation. The court also held that once the seller or the seller's agent has made an affirmative representation about an aspect of the property, the buyer may rely on that statement and expect full and fair disclosure regarding that aspect. The broker also allegedly told the plaintiffs that he would find out and advise them about the depth of the wells, and the court found that this representation was sufficient to require full and complete disclosure about the wells. The court found that the "as is" provision in the sales contract afforded the broker no protection from the plaintiffs' misrepresentation claims, although it could be used as evidence in a trial that the plaintiffs did not or should not be permitted to rely on the broker's statements. In *Fulton v. Vogt*,ⁿ⁹³ the court held that the broker was not liable for failing to disclose an underground gas storage tank. The court reached that conclusion in part because the "as is" clause imposed on the purchaser the responsibility to ascertain the condition of the property, and also because, the court concluded, the broker's duties to inspect the property did not extend to include "a duty to discover hidden and not readily observable defects." In *Foss v. Madison Twentieth Century Theatres, Inc.*,ⁿ⁹⁴ the plaintiff sought from the prior owner and its real estate broker damages for the expenses he incurred in cleaning up contaminated soil resulting from leakage from an underground tank. The broker had prepared

and the sellers had signed and provided to the purchaser a form that incorrectly but inadvertently stated that they had no knowledge of any underground storage tanks on the property, when in fact they knew of a tank. Despite that unintentional misrepresentation, a survey secured by the buyer revealed the presence of the tanks. The buyer did not undertake any further investigation or inquiry about the status of the tanks, and proceeded to close on the transaction. When he was compelled to remove the tanks and clean up the contamination, he sought reimbursement from the sellers and broker. The court denied the claim, however, holding that the buyer had not relied on the seller's and broker's representations, and that they had no independent obligation to perform the cleanup or contribute to the new owner's cleanup costs.

In *Binette v. Dyer Library Association*, n95 the court reinstated claims for negligence and violation of the Maine Unfair Trade Practices Act against a broker who failed to disclose to a buyer the presence of a 3000-gallon underground tank on a property purchased. The court noted the broker's obligation was to disclose material defects of which he had knowledge or in the exercise of reasonable care should have knowledge. The broker was not aware of the tank, but the court also noted administrative regulations that require a broker to inquire of the owner as to any hazardous materials on or in the property, including underground storage tanks, and to convey what he learned to the buyer. The court thus reversed and remanded a summary judgment award in favor of the broker for consideration of the reasonableness of what the broker had done to discover the tanks and disclose the presence of the tanks to the buyer.

In *Smith v. Hauer*, n96 the sellers and their real estate broker and agent disclosed to the purchaser the presence of an underground oil storage tank on the property, but the purchasers nevertheless sued them when home heating oil was discovered in the home's water well some time after the purchasers occupied the property. The sellers and real estate agent had called the tank to the purchaser's attention and provided evidence that it had been tested and found not to have leaked, and that it was insured. The tank was also identified by the purchaser's inspector, who also provided notice that tanks may leak and testing is the only way to ascertain whether there is leakage. Moreover, it appeared that the oil contamination in the well did not come from the tank but from an oil supplier. The court concluded that neither the sellers nor the broker or agent had negligently, intentionally, or fraudulently misrepresented, omitted or concealed material facts and entered judgment in their favor.

Ramsden v. Farm Credit Services of North Central Wisconsin, ACA n97 involved a claim against a seller, the seller's agent acting as the auctioneer of the property, and the entity that financed the purchase of the property. The court held that although the agent in this context may not have had an obligation to affirmatively disclose that an underground storage tank on the property had leaked and contaminated the soil with benzene, once the agent undertook to make any representations he was obligated to do so truthfully. Because the agent was alleged to have knowledge of the contamination and to have made statements about that condition that were either false or that omitted material facts relevant to the condition about which he spoke, he could be liable to the purchaser for intentional or negligent misrepresentation. But in *Stanfill v. Mountain* n97.01 the broker's un rebutted disclaimer of any knowledge about the underground tanks was sufficient to allow him to defeat the buyer's claim for concealment or failure to disclose the underground storage tank on the property. *Brandt v. United States Liability Insurance Group* n97.1 addresses the related and important issue of whether a real estate firm and its agents are entitled to coverage under an errors and omissions liability insurance policy for claims alleging a failure to disclose contamination that was caused by the prior presence of an underground heating oil storage tank on the premises. The court held that policy language excluding from coverage "any claim, damages, claims expenses, loss, cost or expense arising out of...or in any way related to ...[t]he actual or alleged presence...of...contaminants [or] pollutants" was clear and unambiguous, and therefore the defendant real estate firm and its agent were not entitled to coverage under the policy. Finally, the buyers in *Russo v. DeWolfe Co., Inc.* n97.2 were told by their home inspector that it was likely that there was or had been an underground storage tank on the property. Their real estate broker told them he would find out more about it and prior to closing responded to their inquiry about the matter by indicating that it had been "taken care of." After closing the buyers discovered that there was, in fact, an underground tank on the property, and they sued the broker on a variety of theories based on those statements. The broker contended that it had not knowingly made a false statement because his statements were "too vague" and insufficient to sustain plaintiff's cause of action. The court held that whether or not

those statements were vague or were representations on which the buyer was entitled to rely involved issues of fact, and denied the broker's motion for summary judgment.

The prudent real estate agent will guard against claims like those advanced in these cases by asking the seller about underground tanks on the property, either at the present time or in the past, and by looking for signs of underground tanks when viewing the property. These signs include pipes protruding from the ground, odors of solvents or gasoline, staining of soil or water that appears oily. Such efforts to identify any underground tanks will protect the broker and agent and will also provide the parties an opportunity to address issues raised by the presence of the tank prior to entering into a transaction.

[9] Mold

Mold is a more recently recognized environmental concern that can afflict real estate use, occupancy, and real estate transactions. As a result of a very few highly publicized incidents where residents suffered adverse health effects attributed to the presence of various kinds of mold growth in homes and obtained substantial judgments in their favor, n98 many people have developed a new awareness of the potential effects that certain molds may have on human health.

[a] Mold Basics

Mold has been recognized as a potential health problem since biblical times. n99 Molds and mold spores are pervasively present throughout indoor and outdoor environments. Many, perhaps even most, molds are not harmful to humans, and some, such as those involved in producing some cheeses and antibiotics, are affirmatively beneficial. A few are believed to be quite harmful, the most well-known and recognized of which is *stachybotrys chartarum*, or so-called "black mold." Mold is quite prolific: spores spread easily through the air and can begin to develop tangible mold growth almost anywhere there is access to a moisture source and organic material as a food source. Such sources in or around the household commonly include wood, paper, or other fibrous material, such as that in carpeting or furniture. Household moisture sources, such as flooding, window, roof or plumbing leaks, high humidity or other dampness from household activities such as laundry, cooking, or showering, or basement dampness, create potential sources of mold growth. As a result, the most effective method to control or prevent mold growth in homes or other buildings is to monitor and eliminate sources of moisture where mold growth can propagate.

[b] Health Effects of Mold

Science has not yet developed a comprehensive understanding of the effects of mold on human health, but research has been done and more is ongoing. The National Academy of Sciences Institute of Medicine, sponsored by the U.S. Department of Health and Human Services and the Center for Disease Control and Prevention undertook "a comprehensive review of the scientific literature regarding the relationship between damp or moldy indoor environments and the manifestation of adverse health effects, particularly respiratory and allergic symptoms" n100 and on May 25, 2004 issued its report ("IOM Report.") n101 The news release announcing issuance of the IOM Report asserts that "[S]cientific evidence links mold and other factors related to damp conditions in homes and buildings to asthma symptoms in some people with the chronic disorder, as well as to coughing, wheezing, and upper respiratory tract symptoms in otherwise healthy people," but went on to acknowledge that "the available evidence does not support an association between either indoor dampness or mold and the wide range of other health complaints that have been ascribed to them." n102

Consistent with its charge, the IOM committee surveyed existing research and literature addressing the relationship between dampness, mold and other microbial growth in indoor environments and adverse human health outcomes of residents in such environments. The committee found sufficient evidence of an association between damp indoor environments and/or the presence of mold or other microbiologic agents and certain respiratory symptoms, but found

inadequate or insufficient evidence to determine the existence of an association between such indoor environments and more serious adverse health effects, such as cancer, fatigue, reproductive effects, lower respiratory illness in otherwise healthy individuals, skin symptoms, and neuropsychiatry symptoms. The committee also found insufficient evidence of a causal relationship between adverse health outcomes and such indoor environments. Nevertheless, the committee concluded that "excessive indoor dampness is a public-health problem." The committee identified a wide array of research needs related to making a more specific determination of whether, to what extent, and how adverse human health outcomes can result from dampness and microbial agents in indoor environments, and how such environments can be prevented and remediated.

Information and research about damp indoor environments and mold and their corresponding health effects continues to develop and is readily available on the Internet and from federal, state and local environmental or health agencies. In addition to the information and analysis provided in the CDC Report, other websites that address mold issues include the following:

<http://www.cdc.gov/health/mold.html>

<http://www.epa.gov/iaq/molds/moldresources.html>

www.cal-iaq.org/iaqsheets.htm#Mold

[c] Mold and Real Estate

The characteristics of mold described above make it a particularly vexing concern for real estate owners, operators, and real estate professionals. As noted above, and unlike other environmental concerns such as radon, lead-based paint or asbestos, there is not yet a well-developed understanding of the effects of mold exposure on human health, and what is understood suggests that a multitude of factors affect whether any particular individual will experience any symptoms if exposed to mold. These factors include the type of mold, the "amount" of mold, and the particular susceptibilities and health condition of the individual exposed to mold. Another difficulty is that mold spores, from which mold growth develops, are everywhere and easily spread, and they can begin to create mold growth and additional spore generation wherever there is access to moisture and organic material. Thus, the customary "disclose, test, and fix, if necessary" protocol that is often employed with respect to other environmental hazards simply does not readily apply to molds. Testing does not yield useful reliable results since it is unclear what "level" of mold spores cause health effects. Moreover, mold growth can occur quickly under favorable conditions, so mold growth could occur promptly after a test suggested the absence of a mold "problem." The prudent approach of most real estate owners and occupants, as well as parties to real estate transactions and their agents, will probably be limited to looking for signs of visible mold growth, taking action to eliminate it when found, and being alert to potential sources of moisture where mold growth is likely to occur. Indeed, a number of pamphlets and brochures published by state health agencies recognize that mold may pose some health concerns but acknowledge that the type and severity of those health effects are unpredictable and specific to particular individuals. Such pamphlets also commonly advise against "testing" because of its unreliability and uncertain benefits. n103 Several states (CA, NY, TX) have convened legislative task forces to consider the feasibility of developing mold testing or remediation standards and protocols, health effects, exposure limits, and the like, but none has so far achieved any success in doing so.

[d] Litigation and Legislation

[i] Litigation

Some commentators had predicted a "litigation explosion" of cases involving claims based on mold, and it is indeed the case that cases involving claims arising out of the presence of mold in homes are becoming more common. Despite the uncertainties about the health implications of mold exposure discussed above, in many cases the parties appear to accept

at face value and without challenge the plaintiffs' claims of adverse effects resulting from mold in their purchased or leased residence. n104 *Duman v. Campbell* n105 involved claims against both the seller and the seller's real estate agent arising out of the buyer's discovery of water leakage in a bathroom and water leakage and mold in the basement. The court upheld summary judgment in favor of the seller and agent with respect to leakage in the bathroom because it found that the buyer had an inspection performed and a sufficient opportunity to inspect. With respect to leakage and mold in the basement, however, the court reversed and held that summary judgment in favor of the seller was not appropriate because the seller's personal items prevented the buyer from conducting a suitable inspection, and the home inspector's report was ambiguous on the issue. With respect to the agent, the court noted that the agent could be liable for relaying to the buyers the seller's statement regarding the "dry basement" only if the agent had actual knowledge that the seller's representation was not true or the seller acted with "reckless disregard" for the truth. Since there was some evidence that a prior inspection of which the agent was aware had revealed wet/damp areas in the basement, the court held that summary judgment in favor of the agent was also inappropriate, and reversed the lower court's order of summary judgment in the agent's favor as well. In *Jeffries-Baxter v. Incognito* n106 however, the court granted summary judgment in favor of both the listing and selling real estate agents on the buyers' fraud claim because the buyer failed to offer any evidence that either real estate firm knew that mold existed on the property. The court declined to grant summary judgment to the sellers, though, holding that the buyers had advanced evidence from which a jury could reasonably conclude that the sellers knew that mold existed and failed to disclose same to the buyers. *FSR Brokerage, Inc. v. Superior Court of Los Angeles County* n107 involved a buyer's claim against both the buyers' and sellers' agents. The plaintiff buyers asserted that the sellers and their real estate agent fraudulently failed to disclose known defects, including that the wooden subsurface (below the dirt line) of the home was in contact with the soil, leading to mold growth within the home and mold-caused health problems suffered by residents.

Many cases involving real estate agents and mold reflect the recognition, as reflected in the IOM Report, that not simply mold but indoor moisture and dampness is an adverse property condition to be avoided, and about which disappointed purchasers seek remedies from sellers and agents. In *Clark v. Allen*, n108 in the regular course of living in their home the sellers had noted certain dampness problems in the crawl space and had repairs performed that they believed had corrected them. When they sold the home they checked a box on the disclosure form indicating that they knew of "current water leakage, water accumulation, excess dampness or other defects with the basement/crawl space," but without providing further detail. After closing, the purchasers discovered standing water, dampness, mold and rotted beams in the crawl space and sued the sellers, but the court denied their claim because there was no indication the sellers knew of those problems or that the work they had performed had not corrected the conditions they had previously identified. The court also held that the sellers were not liable for the affirmatively false statements made by their real estate agent that the crawl space had been treated with silicone (including a lifetime warranty), and that there would never be any water in the crawl space. That conclusion was based on a provision of Ohio law that precludes liability of a principal for misrepresentations by a real estate licensee unless the principal has actual knowledge of the misrepresentation. n109

In *Bynum v. Prudential Residential Services*, n110 the sellers had performed bathroom remodeling which the subsequent purchasers discovered to have been done improperly, leading to a variety of problems. Those included sewer water leaking into the backyard, sewer water collecting under the master bath, areas outside the hall bath being "soggy," and a leak in the attic believed to be responsible for allowing allegedly toxic stachybotrys mold to grow there. Because neither the sellers nor the agents were aware of these problems or the requirement that performing the bathroom remodeling work may have required municipal building permits, and because of the "as is" clause in the contract, the court rejected the various claims of the purchasers against the sellers and agents. In *Bryant v. Bulach*, a case involving the seller and buyer of a home in which water leakage and mold growth was discovered by the buyer after moving in, the court affirmed summary judgment for the seller based on caveat emptor. n111 The court applied the doctrine of caveat emptor to exonerate the seller because the water leakage and mold growth was discoverable upon reasonable inspection, the buyer had an unimpeded opportunity to inspect, and there was no evidence or allegation that the seller knew of the leakage or mold or otherwise committed fraud.

Larson v. Safeguard Properties and Chase Manhattan Mortgage Corp. n112 involved a claim against the seller (Chase) that it fraudulently failed to disclose the presence of mold in a home purchased by the plaintiffs. The contract for sale contained a "Mold Addendum" advising about the possible health effects of mold in the home, imposing on the buyer the risks of the presence of mold, providing for the buyer to hold the seller harmless, and suggesting the buyer conduct " 'due diligence using appropriate qualified experts.' " The contract also contained an "as is" clause. Despite those provisions, the court denied the seller's motion to dismiss for failure to state a claim, concluding that the "as is" clause does not bar a claim for intentional or fraudulent misrepresentation, and that the reasonableness of the buyers' inspection, their ability to discover the mold, and Chase's knowledge of the presence of the mold, were all questions of fact for trial. In *Coldwell Banker Residential Brokerage Company, Inc. v. Salazar*, n113 the plaintiff was a minor who claimed he had developed asthma caused by toxic mold in the house in which he lived with his mother, who purchased the house. The plaintiff alleged the seller and his agent had breached various duties of care, and, in particular, that the agent was negligent for failing "to conduct a reasonably competent and diligent inspection of the property and to disclose known or reasonably ascertainable defects, including the presence of dangerous microbial contamination," n114 had actively and intentionally concealed a defective and dangerous condition, and had committed fraud and misrepresentation. Ignoring the considerable uncertainty regarding the effects of exposure to mold on human health, the court noted that "An environmental test showed a dangerous level of mycotoxins and mold spores." n115 The court sustained the defendants demurrer, however, holding that the duty imposed under *Cal. Civil Code § 2079* is owed to the prospective purchaser, and because plaintiff was the minor child of the purchaser the defendant owed no such duty to him. Likewise, the court rejected plaintiff's other claims for relief based on the conclusion that the defendants owed him no duty as one not a party to the transaction or one who was entitled to rely on any alleged misrepresentations by the defendants.

Several cases from Michigan confirm the value of sellers and agents acting proactively to protect themselves contractually against claims based on the presence of mold. In *Hall v. Small* n116 the court affirmed summary disposition against the real estate agents involved in the sale based on the "Statement of Mutual Satisfaction" executed by the parties at closing. That statement provided for the buyers to hold the real estate agents harmless for "any condition that may occur... ." To the same effect is *Huhtasaari v. Stockemer and Meck Realty, Inc.*, n117 where the court dismissed the buyers' claim against the real estate agents due to mold in the home, holding that the release of such claims executed by the buyers in favor of the real estate firm was clear, unambiguous, and therefore valid. The court also affirmed dismissal of claims against the sellers for concealment and fraud, as well as innocent misrepresentation, based on the fact that the sellers made no representations about the presence or absence of mold except with respect to mold that had been previously identified in, but remediated from, the attic. The court further noted that the representations regarding mold in the attic had not been shown to be false.

In two other Michigan cases, releases signed by the purchasers in favor of the real estate agents representing the sellers were held to defeat the plaintiff-purchasers' claims for misrepresentation of conditions in the home sold, including the presence of mold due to water intrusion or dampness. n118 In *Crandall v. Grbic*, n119 the defendant real estate agent was held not to be liable under various theories where the buyer discovered roof and basement leaks, as well as mold growth in the basement, after moving in. The court held that the agent had not failed to satisfy his duty where he had recommended a professional inspection, which the plaintiff had performed but which did not reveal all the later-discovered problems, and because the agent had not withheld or misstated any information about the property of which he was aware. In *Werderman v. Liberty Ventures, LLC*, n120 the plaintiffs claimed that as soon as they moved into the house they purchased they discovered that it "exhibited an unsafe and unhealthy mold infestation, the effects of which forced (them) almost immediately to move out of the house." The court found that there was sufficient evidence presented to demonstrate that the brokers had but failed to disclose their actual knowledge of the mold that was present in the house to justify the trial court's denial of the broker's motion for directed verdict and judgment notwithstanding the verdict as to punitive damages.

More recent cases involving failure to disclose mold problems essentially assume that health hazards are associated with mold without citation, analysis, or even discussion. These include *Dube-Foreman v. D'Agostino* n121, where a real

estate purchaser sued the seller, who was also acting as the purchaser's exclusive buyer's representative, for fraudulent concealment of mold in the basement of the home purchased. The purchaser refused to close the transaction and terminated the contract when, on the day of closing, she discovered mold and standing water in an area of the basement that had been obscured from view both when the purchaser first viewed the property and during an inspection of the home. Although the purchaser had not attended the inspection and the contract for sale contained a clause explicitly stating that the purchaser had examined the property and agreed to accept it "AS IS," the court denied the seller's motion for summary judgment.

The court held that where the agent had fiduciary duties to the purchaser the specific disclaimer and AS IS language did not defeat a claim of fraud as a matter of law, since the agent could breach his fiduciary duty by "failing to disclose any information that could reasonably bear on ... consideration [of the transaction]." Thus, the court reversed the summary judgment because the agent had a duty to disclose the mold if she was aware of it, and there were questions of fact regarding the agents knowledge of the mold and the actions she may have taken to conceal it. In *Taylor v. Panico, Dopkin, et al.* n121.1 the Taylors contacted real estate agent Dopkin for assistance in purchasing a property and specifically advised her that a medical condition required that the property be free of any mold contamination. After entering into a contract to purchase property owned by the Panicos, the Panicos provided a property disclosure report that disclosed, among other things, a prior water leak. The Taylors requested Ms. Dopkin to arrange for an inspection of the property, and Dopkin facilitated the Taylors contracting with an inspection company which did not include a specific determination of the presence or amount of mold. The inspector's report identified certain concerns not including water leakage or mold.

A copy was provided to the Taylors by Dopkin, who indicated that the report was "acceptable." Upon inspecting the property herself Taylor noted concerns, including an allergic reaction, and initially indicated she wanted to cancel the contract. After discussion with Dopkin she elected to proceed with the closing, but upon discovering significant mold contamination, water leakage, and rodent infestation several months later, she sued Dopkin for fraudulent misrepresentation. The court granted summary judgment in favor of Dopkin. Taylor argued that Dopkin falsely stated that the inspection was "thorough and professional" and that the results were "acceptable." As Taylor had reviewed and signed the inspection contract which expressly advised that the inspection did not cover mold, and also had the opportunity to review the report and inspect the property before proceeding with the transaction, the court found that Taylor had not reasonably relied on either or those statements, which reliance was an essential element of her fraud claim.

Interestingly, some other recent cases involving water leakage in a variety of contexts not specifically involving claims against real estate professionals also note the presence of mold as a result of the leakage. Those cases also appear to infer concerns about negative health impacts of mold without inclusion of or reference to any specific factual allegations to that effect, n122 even though the essence of the plaintiffs complaints are water intrusion and flooding into a home not disclosed by the seller, and corresponding damage to the home. Presumably the allegations of mold growth are intended to make the damages claims more forceful, but the presence of other tangible (property) damage allows plaintiffs to avoid the difficulties associated with proving adverse health effects resulting from the mold. n123 An unusual case is *Williams v. Abrams*, n124 where a home inspector brought an action against a real estate agent alleging that injuries suffered as a result of exposure to "toxic mold" because the agent allegedly knew but failed to disclose to the inspector that there was such mold in the property. Two counts of the complaint alleged only vaguely "intentional misconduct" by the agent, and in response to the defendant's motion to strike those counts the plaintiff relied on a theory of battery as described in the Restatement of Torts (Second) § 16(1). The court noted that battery as defined by the Restatement required the defendant's intent to cause harm, and because there was no allegation of such intent, the court dismissed those counts.

n125 Claims against insurers for failure to provide coverage for property damage resulting from mold growth, and in some cases for personal injury attributed to mold growth after the insurer refused to provide coverage for the expense of mold remediation or prevention, have also been reported. Probably the most "infamous" of these was the lower court

decision in *Ballard v. Fire Ins. Exchange* n126 (\$32 million jury verdict for plaintiff, reduced on appeal to just over \$4 million). n127 Another reported decision is *Cooper v. American Family Mutual Ins. Co.*, n128 where the court held that the exclusion for mold applied to relieve the insurer from the obligation to pay a mold damage claim even though the mold was believed to be the result of water damage, which was not excluded from coverage. Another insurance issue is whether real estate professionals are entitled to coverage under errors and omissions insurance policies carried by such professionals, a question addressed in *Droegkamp v. Langdon*. n129 In that case, the plaintiffs had purchased a home from the defendants and later discovered that the garage roof and windows leaked and that the basement wall got wet. They sued the sellers and the real estate firm and agent that had listed the home for sale, alleging that the sellers and agents had intentionally or negligently misrepresented or failed to disclose those defects and seeking damages for diminished value, repair costs, personal injury, "mold problems," and loss of use. The errors and omissions carrier for both the listing firm and its agent sought a declaration that it was not obligated to provide coverage under the policy because of exclusions of claims for "intentional acts," bodily, physical or tangible property injury, or because of "pollution." The court held that the policy exclusion for intentional acts applied to allow the carrier to avoid providing coverage for the claims for breach of contract, intentional misrepresentation (common law and statutory), and statutory fraudulent misrepresentation. On the other hand, the policy exclusions did not apply to avoid coverage for the monetary and pecuniary damages sought for the claims based on strict liability misrepresentation, negligent misrepresentation, negligence, and rescission/restitution. The court noted that those claims did not allege intentionally wrongful conduct, and did not allege damage arising out of "pollution." Although only dicta, the court also expressed doubt that mold was a "pollutant" under the policy language, citing certain authority in Wisconsin to that effect. n130 Likewise, in *Eddy v. B.S.T.V. Inc.* n131 the Wisconsin Court of Appeals held that an exclusion in a real estate broker's professional liability insurance policy applied to negate the insurer's obligation to cover a broker against claims alleging the broker's failure to discover and disclose that the home being sold was "contaminated by mold." The policy excluded from coverage claims for "Bodily injury, property damage, personal injury, or advertising injury due to rendering or failure to render any professional service (including) services while ... acting (as) Real Estate Agents." The court held that broker's sale of the home "was in the course of 'rendering ... professional services' as real estate agents," and thus squarely within the cited coverage exclusion.

[iii] Legislation

In 2001 California took legislative action to address mold by adopting Senate Bill 732, signed into law on October 5, 2001 and effective January 1, 2002. That legislation deals with mold in several ways. First, it amended *Cal. Civil Code Section 1102.6* to add a question about mold to the property condition disclosure form which transferors of residential real estate are required to complete and deliver to the proposed transferee.

Second, the bill amended the California Health and Safety Code to add a new Chapter 18, known as the Toxic Mold Protection Act of 2001. n132 This Act directed the State Department of Health Services (DHS) to consider the feasibility of adopting permissible exposure limits (PELs) to mold in indoor environments, and if so, to adopt such PELs. DHS was also directed to consider and if possible adopt mold identification and remediation guidelines. Finally, the Act required sellers or transferors of commercial or industrial real property to provide written disclosure of any known presence of mold that exceeds the prescribed PELs. Residential property landlords must provide similar written disclosures to prospective and current tenants. These disclosure requirements do not apply, however, unless and until PELs are adopted.

The first of those tasks—the feasibility of adoption of permissible mold exposure levels, was addressed in a report issued by DHS (now the California Department of Public Health) in the CDPH report titled *Implementation of the Toxic Mold Protection Act of 2001*, issued in 2005. As noted on the CDPH website, its scientists "concluded that although recent studies have strengthened the evidence between living or working in a damp environment and increased risk for respiratory symptoms, the role of mold growth in these complex environments is still unclear. Damp buildings also encourage the growth of bacteria, dust mites and cockroaches, as well as degradation of wet building materials that can also release irritant chemicals indoors. Some or all of these chemicals or biological organisms may contribute to

occupant illness. For these and other reasons detailed in the report, science-based PELs for indoor molds cannot be established at this time." n133 Thus, the effectiveness of the disclosure provisions of the Act depends acutely on whether CDPH is actually able to adopt PELs. n134

CDPH's ability to complete the balance of its responsibilities is, however, hampered by a lack of financial resources to do so, in response to which the California legislature established, pursuant to AB 442, the Public Health Protection from Indoor Mold Hazards Fund. Once necessary funding is obtained, CDPH anticipates completing the work required by SB 732 at a cost of \$1,164,000 in approximately 4.5 years. Of particular interest and benefit to real estate professionals, **California, Civil Code section 2079.7** provides that disclosure of environmental hazards by a seller or broker to a prospective transferee is adequate if a consumer information booklet published by the California Department of Real Estate is provided to the transferee. A chapter on mold is included in that booklet, so that California real estate professionals can satisfy any duty they may be deemed to have with respect to disclosure of mold by providing that booklet. In Nevada, Kentucky, South Dakota and Michigan the mandatory seller property condition disclosure forms now specifically reference disclosure of mold known to be in the home. Louisiana has adopted legislation providing for a "mold information pamphlet" to be developed by the Real Estate Commission. The pamphlet may but is not required to be distributed by agents to buyers or tenants, but the law provides that if it is provided that must occur before a lease or contract for sale is entered into. The law also provides that an agent who provides the pamphlet to a buyer or tenant has no obligation to deliver any additional information regarding mold. n135 Montana adopted the "Montana Mold Disclosure Act" n136 that permits but does not require a "Mold Disclosure Statement" to be included in leases and sales contracts for inhabitable real property. The Act further provides that sellers, landlords and their agents shall disclose any knowledge of the presence of mold in a dwelling being sold or leased, but in the event the Disclosure Statement is included and any known mold disclosed, the seller, landlord and any agents have no liability in any action based on the presence of mold. In South Carolina real estate brokers and agents are required to disclose truthfully any known material defects, including specifically "moisture or mold problems and conditions." n137 Washington has enacted legislation requiring landlords to provide to tenants a mold information publication. n138 Some real estate firms and/or real estate associations have modified, or are considering modifying, their "form" listing and sales contract forms to include an item designed to elicit any known information about the presence of a mold or mold-producing moisture concern in property being offered for sale.

Various states have from time to time considered legislation that addresses various mold-related issues, such as licensing mold inspectors and remediators, remediation requirements or guidelines, mold health studies, the availability of insurance coverage for mold-related injuries or damages, disclosure requirements, and the like.

[10] Methamphetamine

Methamphetamine is an increasingly popular but dangerous illegal drug. The U.S. Drug Enforcement Agency has indicated that in some states it trails only marijuana and alcohol as the drug most often used, and some forms are believed to be more addictive than heroin. Because methamphetamine, or "meth" can be relatively easily manufactured, users or those who want to provide the drug to users are able to "cook" meth at home. Unfortunately, not only is the drug itself extraordinarily dangerous to users, but the chemicals and processes used in the manufacture of the drug may emit noxious fumes and leave a toxic residue throughout the home or location where it is made. That residue can seep in carpets, walls, HVAC systems and other components of the structure where meth is made and pose a serious health risk to subsequent occupants until that residue is eliminated.

These problems associated with use of a home as a meth production facility suggest that sellers and real estate agents should be alert to the fact or possibility that a residence being sold or leased may have been used for the purpose manufacturing meth. One case has held expressly that a listing (and selling) agent's knowledge of the former use of a home for meth production and failure to disclose that fact to the buyer constituted unlawful failure to disclose a material fact, negligent misrepresentation, and violation of the Washington consumer protection act. n139 In another case a broker and its agent were held not liable to the buyer for damages for failure to disclose the fact that the home had been

used as a meth lab where the broker offered evidence that it was not aware, and the seller had not disclosed to him, such prior use. Summary judgment in favor of the broker and agent was affirmed on appeal because the buyer failed to present evidence to controvert the brokers claim that it had no knowledge of the use of the property as a meth lab. n140 Moreover, although the state property disclosure form to be completed by the seller and provided by the broker specifically addressed whether the house may have been used in the manufacture of methamphetamine lab, the statute requiring the form to be provided allowed the buyer to recover against the broker only if the broker failed to disclose defects of which the broker was actually aware. A few states prohibit subsequent occupancy of a residential unit used as a meth production facility until the property has been "remediated" to remove the hazard, although there are not yet generally accepted, well-defined standards by which a property can be said to have been remediated so that there are no longer hazards in the property.

Because of the hazards associated with prior meth production on a property, sellers and agents in most jurisdictions are likely to be required to disclose any actual knowledge they may have that the property was previously used to produce meth. A few states have codified a duty to provide a specific written disclosure of known prior use of the property to produce meth. n141 Several other states include meth as an item on the disclosure form that sellers must complete and deliver to prospective buyers; n142 one state provides that prior use of property as a meth lab is "not material" to a transaction if the property has been cleaned up or deemed safe for habitation by a government entity; n143 and two others provide for property that has been used to manufacture methamphetamine to be clearly identified or listed on a public website and provide further that the owner has no obligation to disclose such prior use once the property has been sufficiently remediated and such listing or identification removed. n144 Yet another state provides that real estate owners, landlords, or agents are not required to report or otherwise disclose prior contamination of an inhabitable property that has been sufficiently remediated to allow it to be removed from the list of properties that had been reported as contaminated. n144.1

[11] Other Hazards

Several other cases involve environmental hazards or conditions not capable of being neatly categorized. As described in § 15.01[3][b] above, in *Strawn v. Canuso* n145 it was alleged that a real estate broker marketing a new home development had failed to adequately disclose to purchasers of those homes a nearby abandoned dump site which had attained considerable notoriety as a highly contaminated site. The Supreme Court of New Jersey held that a builder-developer of residential real estate and a broker representing such a builder is "liable to a purchaser for nondisclosure of off-site physical conditions known to the broker and unknown to and not readily observable by the buyer if the existence of those conditions is of sufficient materiality as to affect the habitability, use, or enjoyment of the property and, therefore, to render the property substantially less desirable or valuable to the objectively reasonable buyer." n146 Subsequently, the New Jersey Department of Environmental Regulation adopted rules imposing on real estate agents a duty to provide purchasers with notice of off-site conditions disclosed in recorded "deed notices" designed to provide notice that certain environmental remediation had been performed, and to compile lists of off-site conditions, but those rules were held to conflict with the New Jersey Disclosure Act and held unconstitutional. n147 *Haberstick v. Gundaker Real Estate Company, Inc.* n148 is similar to *Strawn*. In that case, agents for the defendant real estate company were engaged in marketing homes in a new home development immediately adjacent to a Federal Superfund National Priorities List site. The site was known to be seriously contaminated with "pesticides, dioxin, oils, solvents, unknown quantities of buried drums, waste buried in pits and contaminated soil." The agents were directed not to disclose the presence of such hazards but only to produce a "scientifically worded" report, and to do so only if asked about the hazards, in order to not "wave a flag" to potential buyers about the nature of the property next door." The Missouri Court of Appeal held that the agents had fraudulently misrepresented the property and were liable in damages to the purchasers because they had "falsely represented the nature of the surrounding area in a manner calculated to deceive Buyers and obtain an undue advantage over them." n149

In *Sheehy v. Lipton Industries, Inc.*, n150 the court reversed a summary judgment entered in favor of the broker and seller in a case brought by the purchaser of a property found to be contaminated by hazardous materials. The parties to

the transaction were aware of contamination of areas nearby and even adjacent to the property, and possible contamination of the property being sold had been an issue before the sale. In response to the plaintiff's inquiry about any hazardous materials on the property, however, the broker advised "Don't worry about it." The court noted that the statement could be deemed a false statement of fact "in the context of the whole (property negotiation and sale) situation," thereby raising a triable issue of fact. In *Kezer v. Mark Stimson Associates*, n151 the buyers had obtained several water test reports prior to closing which identified contaminants in the water although in amounts considered safe for human consumption. The broker was aware that the area was being monitored by the Maine Department of Environmental Protection because of an auto recycling yard located in the neighborhood and that a neighbor had complained that his well was contaminated, but did not advise the buyer of those facts. A Maine statute requires a broker to disclose "all material defects pertaining to the physical condition of the property," and a Real Estate Commission regulation requires a broker to ask the seller about any "current or previously existing known hazardous materials on or in the real estate." Since those requirements relate to disclosure of conditions on the property, however, the Supreme Court of Maine rejected the plaintiff's claim that a broker must disclose to a buyer information about environmental hazards in the neighborhood of the property being sold. The court further noted that another Real Estate Commission regulation requires a broker to ask a seller for specified information about a private water supply, and because the broker had failed to ask for that information he did not learn of or disclose to the buyer another test showing trace amounts of contaminants. The court held that the broker breached his duty to inquire as to unsatisfactory tests even though the test was subsequently provided to the buyers. But because the buyers were unable to demonstrate that they were harmed by the nondisclosure, in part because they elected to close on the sale after obtaining information about the prior test, the court affirmed summary judgment for the broker. The Court of Appeals of Arkansas reversed a summary judgment order entered in favor of the sellers and their real estate agent and against the purchasers in *Randles v. Cole*, n152 Purchasers discovered that the property they had purchased had been previously used as a landfill, but did not bring suit until more than three years after the purchase. The defendants moved for summary judgment based on the three-year statute of limitations for fraud claims, which the trial court granted. On appeal, the appellate court reversed, noting that plaintiffs alleged that the sellers and the agent had committed fraud by delivering a false disclosure form. That alleged fraudulent act created a disputed question of fact as to when the purchasers discovered, or reasonably should have discovered, the property's prior use as a landfill, which would start the running of the three-year statute of limitations. And in *Tanpiengco v. Tasto*, n153 the court affirmed a judgment holding a real estate firm and its agent liable for damages and attorneys fees under the Connecticut Unfair Trade Practices Act for the agent's knowing misrepresentation regarding a landfill adjoining and partly on the property purchased by the plaintiff.

In *Parker v. Shaker Real Estate, Inc.*, n154 the court affirmed a directed verdict entered by the court in favor of the defendant real estate brokers at the close of the plaintiffs' case. The plaintiff purchasers' claims against the real estate brokers involved in the transaction alleged fraudulent misrepresentation and failure to disclose, as well as innocent and negligent misrepresentation. The evidence showed that the property the plaintiffs purchased had been the site of a gasoline station in the 1930s and 1940s, but there was no evidence that the brokers had made any representations about the prior use of the property or even that they had knowledge of that prior use and history. The court also noted that the plaintiff had not offered any evidence that:

- (1) the brokers had failed to exercise reasonable care or competence in obtaining or communicating information regarding the prior use of the property, or that
- (2) the plaintiffs had relied on or otherwise were induced to purchase the property as a result of any representations by the defendants regarding the prior uses or even that
- (3) the purchasers had suffered any damage as a result of the prior use.

Coleman v. Watts n155 involved plaintiffs' claim that the former owners of the property had violated the Resource Conservation and Recovery Act n156 (RCRA) because the property purchased by plaintiffs contained hazardous substances as a result of jewelry-making operations conducted by the defendants on the property. Plaintiffs also alleged

various state law claims against the former owners and their brokers for nondisclosure of the presence of those substances and other adverse features of the property. The court granted defendant prior owners motion for summary judgment on the RCRA claim because the concentrations of hazardous substances on the property did not exceed the regulatory thresholds under RCRA. The court denied the defendant broker and owners motion for summary judgment on state law claims for fraud and intentional misrepresentation, negligence, and negligence per se, holding that there was some evidence that the broker and owner were aware or should have ascertained and disclosed the waste on the property (and certain other problems), but in fact concealed or failed to disclose those problems. *First Realty, Ltd. v. Frontier Insurance Company* n157 addressed whether the insurer had a duty to defend a realty firm alleged to have fraudulently or negligently failed to disclose the presence of a former municipal solid waste disposal site and hazardous materials identified on the seller's disclosure statement. The insurer had relied on a policy exclusion for "claims arising out of, relating to or based upon the ...presence of storage tanks, ..., hazardous materials, radon, gases or other material, irritant, contaminant, [or] pollutant." The court held that the insurer was obligated to provide coverage for the claim for failure to disclose the solid waste disposal site because the exclusion applied to claims related to "hazardous" materials but not necessarily those arising out of "solid waste," which could also include "innocuous rubbish." In *Jablonski v. Rapalje*, n158 the court declined to grant summary judgment to a real estate agent alleged to have failed to disclose an infestation of bats in the attic of a home. The court explicitly acknowledged that *caveat emptor* applies in New York unless there is "active concealment," but found that there was a triable issue of fact as to whether the real estate agent had knowledge of the bat infestation and had acted to thwart the plaintiff's ability to discover the infestation by advising the plaintiff that certain evidence of the infestation came from birds. Finally, in a case involving an environmental "condition" rather than a "hazard," the Supreme Court of Rhode Island in *Kennett v. Marquis* n159 affirmed a summary judgment ruling in favor of the seller's real estate agent who was alleged to have failed to disclose wetlands on the property sold to the plaintiffs. The court reached that decision based on its conclusion that there was no evidence that the agent "failed to exercise reasonable care in transmitting the ground water report, ... knew of the presence of the wetlands on the property, or ... delivered false information knowingly and intentionally." n160 Finally, *Hess v. Chase Manhattan Bank USA, N.A.*, n161 is a case where the buyers alleged the owner (Chase) and listing firm and agent failed to disclose that the property purchased by the plaintiff was "under investigation" by USEPA due to the former owners' acts of dumping hazardous waste on the property. The real estate firm and agent settled, and on appeal the Appellate Court reversed the lower court's decision dismissing the buyer's claims that the owner had violated the Missouri Merchandising Act, and entered judgment for the buyer on that claim. The court also affirmed the trial court's ruling denying the owner's motion for judgment notwithstanding the verdict, where the owner claimed it had no duty to affirmatively disclose the EPA's interest and involvement in the property because the parties had agreed that the owner made no representations, warranties or guarantees regarding the property. The appellate court held the owner had failed to properly raise those as affirmative defenses, and therefore the trial court had correctly denied the motion for judgment NOV.

FOOTNOTES:

(n1)Footnote 1. Selikoff, Churg & Hammond, *Asbestos Exposure and Neoplasia*, 188 J.A.M.A. 22 (1964).

(n2)Footnote 2. R. N. Gray, Attorney's Textbook of Medicine (Matthew Bender); Wood & Gloyne, *Pulmonary Asbestosis, A Review of One Hundred Cases*, 2 Lancet 1382-1384 (1934).

(n3)Footnote 3. Mossman, Bignon, Corn, Seaton & Gee, *Asbestos: Scientific Developments and Implications for Public Safety*, Science, Jan. 19, 1990, at 254.

(n4)Footnote 4. *Layne v. GAF Corp.*, 42 Ohio Misc. 2d 19, 537 N.E.2d 252 (Ohio Common Pleas 1988) . The verdict was against the manufacturer/seller of an asbestos-containing product used in the building as insulation, a fire-retardant and a noise reducer, which was the only nonsettling defendant in the case.

(n5)Footnote 5. 40 C.F.R. § 61.140 et seq.

(n6)Footnote 6. Residential home buyers are more likely to encounter asbestos after the closing when they attempt

renovations or updating the heating system.

(n7)Footnote 7. 195 Wis. 2d 88, 537 N.W.2d 150 (unpublished), 1995 Wisc. App. LEXIS 683 (Wis. App. 1995) .

(n8)Footnote 8. 29 C.F.R. 1910.1001, 1926.1101 (1995).

(n9)Footnote 9. 5 S.W.3d 518 (Mo. App. E.D. 1999) .

(n10)Footnote 10. 249 Ga. App. 217, 547 S.E. 2d 289 (Ga. App. 2001) .

(n11)Footnote 11. No. 244635, 2004 Mich. App. LEXIS 54 (Mich. App. Jan 13, 2004) .

(n12)Footnote 11.1. 2006 Ohio 5196 (Ohio Ct. App., Butler County Oct. 2, 2006) (2006).

(n13)Footnote 11.2. Alabama, Arizona, Arkansas, California, Connecticut, Delaware, Georgia, Illinois, Indiana, Kansas, Kentucky, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nevada, New Jersey, New York, North Carolina, Ohio, Oklahoma, Pennsylvania, South Carolina, South Dakota, Tennessee, Texas, Vermont, Virginia, Washington, West Virginia, Wisconsin, Wyoming

(n14)Footnote 11.3. <http://www.cpsc.gov/info/drywall/index.html>

(n15)Footnote 11.4. <http://www.cpsc.gov/info/drywall/hud10068.html>

(n16)Footnote 11.5. <http://www.cpsc.gov/info/drywall/InterimIDGuidance012810.pdf>

(n17)Footnote 11.6. <http://www.cpsc.gov/info/drywall/guidance0410.pdf>

(n18)Footnote 11.7.

http://portal.hud.gov/portal/page/portal/HUD/press/press_releases_media_advisories/2009/HUDNo.09-237 (sited visited June 2010).

(n19)Footnote 11.8. *In re Chinese Mfr'd Drywall Prod. Liab. Litig.*, No. 09-6687, MDL No. 2047, 2010 U.S. Dist. LEXIS 41190 (E.D. La. Apr. 27, 2010) .

(n20)Footnote 12. L.J. Cole, *Elements of Risk, The Politics of Radon* (AAAS Press 1993).

(n21)Footnote 13. Home Buyer's and Seller's Guide to Radon, 11 (U.S. EPA, July 2000).

(n22)Footnote 14. Chi. Trib., Feb. 11, 1990, Sec. 5 at 8.

(n23)Footnote 15. *E.g.*, The Home Buyer's and Seller's Guide to Radon, U.S. EPA (July 2000); A Citizens' Guide to Radon, U.S. EPA, 4th ed. 2002). Other EPA radon publications are described at <http://www.epa.gov/iaq/radon/pubs/index.html>.

(n24)Footnote 15.1. <http://www.epa.gov/radon/pubs/index.html>.

(n25)Footnote 16. *Fla. Stat. ch. 404.056*; *Mont. Code Ann. § 75-3-606*; *N.H. Rev. Stat. Ann. § 477:4-a*; R.I. Gen. Laws § 5-20.8(b)(2)(xii).

(n26)Footnote 16.1. *Mont. Code Ann. § 75-3-606*.

(n27)Footnote 17. 17 Pa. D. & C. 4th 60 (C.P. Chester Co. No. 90-00154, Aug. 27, 1992).

(n28)Footnote 18. No. GD 93-12049 (C. P. Allegheny, PA 1993).

(n29)Footnote 19. *No. CV 960132306, 1997 Conn. Super. LEXIS 2124 (Conn Super. 1997)* .

(n30)Footnote 20. *248 N.J. Super. 215, 590 A.2d 723 (1991)* . *Kutzin v. Pirnie, 124 N.J. 500, 591 A.2d 932 (1991)* overruled *Wong*, but only with respect to rule applied in calculating damages.

(n31)Footnote 21. *197 A.D. 2d 785, 602 N.Y.S. 2d 710, 1993 N.Y. App. Div. LEXIS 9846 (1993)* .

(n32)Footnote 22. *No. 088912, 1990 Conn. Super. LEXIS 1916 (Conn. Super. 1990)* .

(n33)Footnote 23. On this issue generally, see also P. Locke and P. Elliott, *Caveat Broker: What Can Real Estate Licensees Do About Their Potentially Expanding Liability for Failure to Disclose Radon Risks in Home Purchase and Sale Transactions*, 25 *Colum. J. Envtl. L.* 71 (2000).

(n34)Footnote 24. *815 A.2d 962 (N.J. 2003)* .

(n35)Footnote 25. *815 A.2d 962 (N.J. 2003)* .

(n36)Footnote 26. *297 A.D. 2d 726, 747 N.Y.S. 2d 781, 2002 N.Y. App. Div. LEXIS 8701 (2002)* .

(n37)Footnote 27. *297 A.D. 2d 726, 747 N.Y.S. 2d 781, 2002 N.Y. App. Div. LEXIS 8701 (2002)* .

(n38)Footnote 28. *Gulf South Insulation v. United States Consumer Prod. Safety Comm'n, 701 F.2d 1137 (5th Cir. 1983)* .

(n39)Footnote 29. *Gulf South Insulation v. United States Consumer Prod. Safety Comm'n, 701 F.2d at 1147* .

(n40)Footnote 30. *531 A.2d 1125 (Pa. Super. Ct. 1987)* .

(n41)Footnote 31. In so holding, the court cited Restatement, Second, of Torts, § 550. The court also found the seller was liable for the fraudulent conduct of its agent.

(n42)Footnote 32. *57 Wash. App. 562, 789 P.2d 112 (Wash. Ct. App. 1990)* .

(n43)Footnote 33. *140 N.H. 243, 665 A.2d 378 (1995)* .

(n44)Footnote 34. *Mass. Gen. Laws Ann. ch. 255 § 12I.*

(n45)Footnote 35. *42 U.S.C. § 4851 et seq.*

(n46)Footnote 36. *42 U.S.C. § 4851 et seq.*

(n47)Footnote 37.

Massachusetts: Mass. Gen. Laws. ch. 111 § 197A;

New Hampshire: N.H. Rev. Stat. Ann. § 477:4-a, 68;

Pennsylvania: PA Cons. Stat. Ann. § 7304(b);

Rhode Island: R.I.Gen.Laws § 23-24.6-16;

New Hampshire: N.H. Rev. Stat. Ann. § 477:4-a.

(n48)Footnote 38. *Lynch v. Conley*, 853 A.2d 1212 (RI 2004) .

(n49)Footnote 39. 335 F. Supp. 2d 252 (D.C.R.I. 2004) . The court in *Wallace* also concluded that the statute created disclosure duties only to the purchaser, and not to third parties such as the lessees of the purchaser. Thus, the court granted summary judgment in favor of the real estate agent on the lessees' claim under the civil liability (treble damages) provisions of the Act. *Id.*, 259-60 . Similarly, the court granted a lessor's motion to dismiss in a civil damages proceeding under § 4852(b)(3) of the Federal Act, concluding that the express terms of the Federal Act provided only for such remedies against lessors and purchasers, and not others residing in the premises. *Mason v. Morrisette*, 403 F.3d 28 (D.C.N.H. 2005) .

(n50)Footnote 40. 1998 Mass. Super. LEXIS 158 (Super. Ct. Mass. 1998) .

(n51)Footnote 41. Mass. Gen. Laws Ann. ch. 93A § 2.

(n52)Footnote 42. No. LPLCV 950555890S, 1998 Conn. Super. LEXIS 1612 (Sup. Ct. Conn. 1998) .

(n53)Footnote 43. *Farrah v. Acker*, No. LPLCV 950555890S, 1998 Conn. Super. LEXIS 1612, at *7, *8 (Sup. Ct. Conn. 1998) .

(n54)Footnote 44. *Farrah v. Acker*, No. LPLCV 950555890S, 1998 Conn. Super. LEXIS 1612, at *9 (Sup. Ct. Conn. 1998) .

(n55)Footnote 45. *Farrah v. Acker*, No. LPLCV 950555890S, 1998 Conn. Super. LEXIS 1612, at *12 (Sup. Ct. Conn. 1998) .

(n56)Footnote 46. On remand, the Superior Court granted summary judgment in favor of the seller, the only remaining defendant, holding that the plaintiff had stated neither a claim for negligence nor a claim for misrepresentation. *Farrah v. Acker*, 1999 Conn. Super. LEXIS 2184 (Conn. Super. Aug. 4, 1999) . The court concluded that even if the defendant had knowledge of the lead-based paint on the premises, he had no duty to disclose it since the buyers could have readily discovered it but elected not to have a professional inspection. The court also rejected the buyers' misrepresentation claim because there was no allegation that the sellers had made any representation about the presence or absence of lead-based paint on or in the home.

(n57)Footnote 47. 531 A.2d 1125 (Pa. Super. Ct. 1987) . This case is also discussed at § 15.03[4] above.

(n58)Footnote 48. 2003 Ohio 3386 (Ohio App. 1st Dist. 2003) .

(n59)Footnote 49. The broker and agent were "dual agents" representing both the purchaser and seller, although this fact played no part in the outcome of the case.

(n60)Footnote 50. *Keegan*, 2003 U.S. Dist. LEXIS 8618 (D. Me. May 22, 2003) .

(n61)Footnote 51. *Keegan*, 2003 U.S. Dist. LEXIS 8618 (D. Me. May 22, 2003) .

(n62)Footnote 52. 227 F. Supp. 2d 998 (N.D. Ill. 2002) .

(n63)Footnote 53. 225 Ill. Comp. Stat. § 454.

(n64)Footnote 54. *Flowers* also held that the provisions of the federal lead-based paint disclosure regulations that impose duties on real estate agents representing buyers is inconsistent with and exceeds the scope of the authority established by the Residential Lead-Based Paint Hazard Act, 42 U.S.C. § 4852d, statute authorizing promulgation of those regulations, which by its very terms applies only to agents of sellers. Thus, the purchaser's claim that a buyer's agent violated the regulations and Act was rejected. Following the result and reasoning of *Flowers* is *Keegan*, 2003 U.S.

Dist. LEXIS 8618 (D. Me. May 22, 2003) and *Griffin v. Bruner*, 341 Ill. App. 3d 321, 793 N.E.2d 974 (Ill. App. 2003) .

(n65)Footnote 54.1. 67 Fed.Cl. 776 (Ct. Cl. 2005) .

(n66)Footnote 54.2. 15 U.S.C. § 2601 et seq.

(n67)Footnote 54.3. 42 U.S.C. § 4851 et seq.

(n68)Footnote 54.4. 42 U.S.C. § 4822 et seq.

(n69)Footnote 55. 35 F. Supp. 2d 699 (E.D. Wis. 1999) .

(n70)Footnote 56. 414 Mass. 96, 605 N.E.2d 832 (1993) .

(n71)Footnote 57. Mass. Gen. Laws Ann. ch. 93A § 2.

(n72)Footnote 58. 142 Md. App. 109, 788 A.2d 227 (2002) .

(n73)Footnote 59. This decision was affirmed by the Maryland Supreme Court for essentially the same reasons underlying the Court of Appeals opinion. *Dyer v. Warren*, 371 Md. 576, 810 A.2d 938 (2002) .

(n74)Footnote 59.1. 68 Va. Cir. 458 (2005) .

(n75)Footnote 59.2. 362 Ill. App. 3d 1211 (2006) .

(n76)Footnote 60. *German v. Bronx United in Leveraging Dollars, Inc.*, 684 N.Y.S.2d 541, 1999 N.Y. App. Div. LEXIS 873 (N.Y. App. Div. 1999) ; *Casey v. Grossman*, 123 Md. App. 751, 720 A.2d 959 (1998) ; *Winston Properties v. Sanders*, 57 Ohio App. 3d 28, 565 N.E.2d 1280 (1989) .

(n77)Footnote 61. *Garcia v. Jiminez*, 184 Ill. App. 3d 107, 539 N.E.2d 1356 (1989) .

(n78)Footnote 62. *Winston Properties v. Sanders*, 57 Ohio App. 3d 28, 565 N.E.2d 1280 (1989) .

(n79)Footnote 63. *Hardy v. Griffin*, 41 Conn. Supp. 283, 569 A.2d 49 (Super. Ct. 1989) .

(n80)Footnote 64. *Tillman v. Johnson*, 610 So. 2d 866 (La. Ct. App. 1992) .

(n81)Footnote 65. *Ankiewicz v. Kinder*, 408 Mass. 792, 563 N.E.2d 684 (1990) .

(n82)Footnote 66. 109 Md. App. 710, 675 A.2d 1032 (Md. App. 1996) .

(n83)Footnote 67. *Brooks v. Lewin Realty*, 378 Md. 70, 835 A.2d 616 (2003) . See also *Polakoff v. Turner*, 385 Md. 467, 869 A.2d 837 (2005) .

(n84)Footnote 68. 649 N.Y.S.2d 115, 672 N.E.2d 135 (1996) .

(n85)Footnote 69. 228 Wis. 2d 44, 596 N.W.2d 456 , reconsideration denied, 604 N.W. 2d 574 (1999) .

(n86)Footnote 70. 357 Md. 344, 744 A.2d 47 (2000) .

(n87)Footnote 71. For example, in *Hardy v. Griffin*, 41 Conn. Supp. 283, 569 A.2d 49 (1989) , the jury awarded \$1 million.

(n88)Footnote 71.1. 2006 Mich. App. LEXIS 2907 (Mich. App. Oct. 3, 2006) (Unpublished).

(n89)Footnote 71.2. *2008 Tenn. App. LEXIS 74* (Tenn Ct. App. Feb. 12, 2008) .

(n90)Footnote 71.3. *Tennessee Code Annotated § 62-13-403(2)*.

(n91)Footnote 72. National Research Council, *Possible Health Effects of Exposure to Residential Electric and Magnetic Fields*, Executive Summary at 1 (1996).

(n92)Footnote 73. *The New England Journal of Medicine*, Vol 337 at 1.

(n93)Footnote 74. NIEHS Report on Health Effects from Exposure to Power-Line Frequency Electric and Magnetic Fields, ii-iii (National Institute of Environmental Health Sciences 1999).

(n94)Footnote 75. P. Brodeur, *The Great Power-Line Cover-Up*, 253 (Little, Brown & Co. 1993).

(n95)Footnote 76. EPA, *Evaluation of the Potential Carcinogenicity of Electromagnetic Fields*, EPA/600/6-90/005B (Oct. 1990).

(n96)Footnote 77. *Chi. Trib.*, Oct. 18, 1992, Sec. 18 at 3; Mar. 3, 1993, Sec. 5 at 1.

(n97)Footnote 78. *81 N.Y.2d 649, 602 N.Y.S.2d 588* (N.Y. 1993) .

(n98)Footnote 79. *602 N.Y.S.2d at 589* .

(n99)Footnote 80. *650 N.Y. Supp. 2d 480, 1996 N.Y. App. Div. LEXIS 12332* (N.Y. App. Div.) , *cert. denied*, *118 S. Ct. 1046* (1996) .

(n100)Footnote 81. *164 Misc. 2d 808, 1995 N.Y. Misc. LEXIS 194* (1995) .

(n101)Footnote 82. *219 Ga. App. 690, 466 S.E.2d 601* (Ga. App. 1996) .

(n102)Footnote 83. *466 S.E.2d at 606* .

(n103)Footnote 84. *41 Cal. App. 4th 539, 38 Cal. Rptr. 811* (Cal. App. 1995) .

(n104)Footnote 85. *13 Cal. 4th 893, 920 P.2d 669* (1996) .

(n105)Footnote 86. For a general overview of EMF litigation and some thoughts on that which might yet occur, see Anibogu, *The Future of Electromagnetic Field Litigation*, *15 Pace Envtl. L. Rev.* 527 (1998).

(n106)Footnote 87. *387 Pa. Super. 299, 564 A.2d 188* (1989) .

(n107)Footnote 88. *430 Ill. Comp. Stat. Ann. § 15/4*.

(n108)Footnote 89. *42 U.S.C. § 6991 et seq.*

(n109)Footnote 90. *42 U.S.C. § 6991 et seq.*

(n110)Footnote 91. *40 C.F.R. § 280.10 et seq.*

(n111)Footnote 92. *496 N.W.2d 106* (Wis. App. 1992) .

(n112)Footnote 93. *220 Wis. 2d 714, 583 N.W. 2d 673* (Wis. App. 1998) .

(n113)Footnote 94. *203 Wis. 2d 210, 551 N.W.2d 862* (Wis. App. 1996) .

(n114)Footnote 95. 688 A.2d 898 (Me. 1996) .

(n115)Footnote 96. No. CV000379046S, 2004 Conn. Super. LEXIS 2396 (Conn. Super. Aug. 20, 2004) .

(n116)Footnote 97. 223 Wis. 2d 704, 590 N.W.2d 1 (Wis App. 1998) .

(n117)Footnote 97.01. Supra, n. 158.

(n118)Footnote 97.1. 70 Pa. D&C 4th 449 (Ct. of Common Pleas 2005).

(n119)Footnote 97.2. 2006 Conn. Super. LEXIS 3175 (Conn. Super. Oct. 23, 2006) .

(n120)Footnote 98. *Allison v. Fire Ins. Exchange*, 98 S.W. 3d 227 (Tex. App. 2003) (damage award in excess \$32 million, reduced to slightly over \$4 million on appeal); *New Haverford Partnership v. Elizabeth Stroot*, 772 A.2d 792 (Del. 1999) (verdict for plaintiffs-tenants in excess of \$800,000 for health-related problems caused by mold in apartment).

(n121)Footnote 99. See Leviticus 14:33-57 for detailed description of mold, mold inspection, and decontamination.

(n122)Footnote 100. <http://www.iom.edu/CMS/3793/4703/20223.aspx>.

(n123)Footnote 101. The IOM Report is available for review and for purchase at http://www.nap.edu/catalog.php?record_id=11011.

(n124)Footnote 102. Noreen Clark, dean, School of Public Health, University of Michigan, Ann Arbor, and chair of the CDC committee that produced the report, further notes that "we were able to find sufficient evidence that certain respiratory problems, including symptoms in asthmatics who are sensitive to mold, are associated with exposure to mold and damp conditions. Even though the available evidence does not link mold or other factors associated with building moisture to all the serious health problems that some attribute to them, excessive indoor dampness is a widespread problem that warrants action at the local, state, and national levels."

(n125)Footnote 103. See e.g., Alabama Department of Health "Facts about Mold," <http://www.adph.org/IAQ/index.asp?ID=1597>; N.Y. State Dep't of Health, *Indoor Air Quality--Information about Mold* (2005), <http://www.health.state.ny.us/environmental/indoors/air/docs/mold.pdf>; William Berg and Peter C. Sherertz, Va. Dep't of Health, *Frequently Asked Questions About Flooding, Molds, and Health* (Oct. 21, 1999), <http://www.vdh.virginia.gov/Epidemiology/dee/PublicHealthToxicology/documents/pdf/moldQ&A.PDF>.

(n126)Footnote 104. See, for example, *Werderman v. Liberty Ventures, LLC*, 03-CH-1258 (Ill Cir. Ct. July 26, 2005), 368 Ill. App. 3d 78 (jury verdict for buyers for \$140,720 against sellers, brokers); *Johnson v. Gregg*, VerdictSearch No. 110212 (Cal. Super. Ct. Orange County. Nov. 18, 2003) (mediated settlement for \$1.274 million against condo association and manager); *Lynch v. Swantz*, 2004 WL 2048020 (Cal. Super. Ct. Monterey County July 23, 2004) (mediated settlement for tenant against landlord for \$149,000); *Sienkiewicz, et al. v. Palm Garden Apartments Limited Partnership, et al.*, Case No. 01CC0007 (Cal. Super. Ct. Orange County, Aug. 2, 2004) (mediated settlement for tenant for \$392,000 against landlord); *Nehasil v. Grenier*, 2004 WL 2784960 (Mich. Cir. Ct. Wayne County Apr. 30, 2004) (jury verdict for buyer for \$250,000 against seller; brokers settled); *Stevens v. Pirates Lane Condo., Mass.*, Essex County Super. Ct., No. 1996-00403, Nov. 25, 2003. (jury verdict for buyer for \$285,000 against condo seller); *Stidman v. Crawford*, 2003 WL 21703676 (Tex. Dist. Ct. Harris County June 5, 2003) (jury verdict for buyer for \$131,460 plus attorneys fees against seller; broker not liable); *Stevens v. Pirates Lane Condo., Mass.*, Essex County Super. Ct., No. 1996-00403, Nov. 25, 2003 (settled for buyer for \$115,000 against seller, broker); *Osborne v. Jauregui, Inc.*, 252 S.W.3d 70 (Tex. App. Austin 2008) (jury verdict for buyer for \$885,000 against builder; other defendants including brokers settled).

(n127)Footnote 105. *2002 Ohio 2253 (Ohio Ct. App. 2002)* .

(n128)Footnote 106. *2005 Phila. Ct. Com. Pl. LEXIS 438 (Pa. Com. Pl. Sept. 26, 2005)* .

(n129)Footnote 107. *No. B156982, 2002 Cal. App. Unpub. LEXIS 94 (Cal. App. Apr. 16, 2002)* . This unpublished decision addresses only a discovery dispute arising in the course of the litigation, however.

(n130)Footnote 108. *154 Ohio App. 3d 200, 796 N.E. 2d 965 (2003)* .

(n131)Footnote 109. *Ohio Rev. Code § 4735.68(B)*.

(n132)Footnote 110. *129 S.W.3d 781 (Tex. App. Houston 1st Dist. 2004)* .

(n133)Footnote 111. *2003 Ohio 1609 (Ohio Ct. App. 2003)* .

(n134)Footnote 112. *379 F. Supp. 2d 1149 (D. Kan. 2005)* .

(n135)Footnote 113. *117 Cal. App. 4th 158, 11 Cal. Rptr. 3d 564 (2004) depublication request denied, 2004 Cal. LEXIS 9462 (Cal. Sept. 29, 2004)* .

(n136)Footnote 114. *117 Cal. App. 4th 158, 162 (2004)* . This duty to inspect and disclose is imposed in California under *Cal. Civil Code § 2079*.

(n137)Footnote 115. *117 Cal. App. 4th 158, 162 (2004)* .

(n138)Footnote 116. *267 Mich. App. 330, 705 N.W. 2d 741 (2005) appeal denied, 474 Mich. 972, 707 N.W.2d 191 (2005)* .

(n139)Footnote 117. *2005 Mich. App. LEXIS 3210 (Mich. App. Dec. 20, 2005, unpublished opinion, not binding)*.

(n140)Footnote 118. *Hall v. Small, 267 Mich. App. 330; 705 N.W.2d 741 (2005), appeal denied, 474 Mich. 972, 707 N.W.2d 191 (2005). Sharpe v. Taber, No. 244040, 2004 Mich. App. LEXIS 527 (Mich. App. 2004)* .

(n141)Footnote 119. *36 Kan. App. 2d 179, 138 P.3d 365 (2006)* .

(n142)Footnote 120. *857 N.E.2d, 320* .

(n143)Footnote 121. *61 A.D. 3d 1255, 877 N.Y.S. 2d 740 (2009)* .

(n144)Footnote 121.1. *Taylor v. Panico, 2009 U.S. Dist. LEXIS 31678 (D. Colo. Apr. 14, 2009)* .

(n145)Footnote 122. For example, see *Brennan v. Kunzle, 37 Kan. App. 2d 365, 154 P.3d 1094 (2007) review denied, 2007 Kan. LEXIS 629 (Oct. 1, 2007)* ; *Lim v. Baker, 2007 Tex. App. LEXIS 9235 (Nov. 28, 2007)* ; *Williams v. Abrams, 2007 Conn. Super. LEXIS 535 (Conn. Super. Ct. Feb. 20, 2007)* .

(n146)Footnote 123. *Grossman v. Pouy, 23 Mass. L. Rep. 623 (Mass. Super. Ct. 2008)* ; *Nance v. Evje, 2007 Minn. App. Unpub. LEXIS 908 (Minn. Ct. App. 2007)* .

(n147)Footnote 124. *2007 Conn. Super. LEXIS 535 (Conn. Super. Ct. Feb. 20, 2007)* .

(n148)Footnote 125. [Reserved].

(n149)Footnote 126. *E.g., No. 99-05252 (Tex. Dist. Ct. 2001)*.

(n150)Footnote 127. 98 S.W. 3d 227 (Tex. App. 2003) .

(n151)Footnote 128. 184 F. Supp. 2d 960 (D. Ariz. 2002) .

(n152)Footnote 129. 266 Wis. 2d 1062, 668 N.W. 2d 563 (Wis. App. 2003) .

(n153)Footnote 130. Specifically, the court cited *Leverence v. U.S. Fid. & Guar.*, 158 Wis. 2d 64 (Ct. App. 1990).

(n154)Footnote 131. 280 Wis. 2d 508, 696 N.W.2d 265 (2005) .

(n155)Footnote 132. *Cal. Health and Safety Code* §§ 26100-26156.

(n156)Footnote 133.

<http://www.cdph.ca.gov/programs/IAQ/Documents/SB%20732%20Implementation%20Update%20July%202008.htm>.

(n157)Footnote 134. The California legislature also adopted Assembly bill 284, approved by the Governor on October 5, 2001, which further amends the Health and Safety Code to add a new Chapter 19. This legislation directs the California Research Bureau to perform a study and publish findings on fungal contamination affecting indoor environments by January 1, 2003. *Cal Health and Safety Code* §§ 26200-26204.

(n158)Footnote 135. *La. Rev. Stat.* 37:1470.

(n159)Footnote 136. *Mont. Code Ann* 70-16-702.

(n160)Footnote 137. *S.C. Code Ann.* 40-57-137(F), (K).

(n161)Footnote 138. Chapter 465, Laws of 2005, WA; *RCW* 59.18.060.

(n162)Footnote 139. *Bloor v. Fritz*, 143 Wn. App. 718, 180 P.3d 805 (Wash. App. 2008) .

(n163)Footnote 140. *Moore v. Williams*, 192 P.3d 1275 (Okla. Ct. of Civil App. 2008)

(n164)Footnote 141. *Minn. Stat.* § 152.0275 (2007), *Mont. Code Ann.* 75-10-1305 (2005); *N. H. Rev. Stat. Ann* § 477:4-g (2007); *Colo Re. Stat.* § 38-35.7-103 (2007); *Mo.R.S.* 442.606 (2008); *A.R.S* §12-1000 (2008); *K.R.S.* § 224.01.410(10) (2009).

(n165)Footnote 142. *See, e.g., S.D. Codified Laws* § 43-4-44(2007); 60 Okla. St. tit. § 833(2007).

(n166)Footnote 143. *N.R.S.* 40.770 (2007).

(n167)Footnote 144. Ark St. 8-7-1404 (2008); La R.S. 9 § 3198.1.F (2008).

(n168)Footnote 144.1. *Mont Code Ann.* 75-10-1306(5) (2009).

(n169)Footnote 145. 140 N.J. 43, 657 A.2d 420 (N.J. 1995) .

(n170)Footnote 146. 657 A.2d at 431 .

(n171)Footnote 147. *New Jersey Association of Realtors v. New Jersey Department of Environmental Protection*, 367 N. J. Super. 154 , 842 A.3d 262 (N.J. Super. Feb. 25, 2005) .

(n172)Footnote 148. 921 S.W.2d 104 (Mo. Ct. App. 1996) .

(n173)Footnote 149. 921 S.W.2d at 109 .

(n174)Footnote 150. *24 Mass. App. Ct. 188, 507 N.E.2d 781 (1987)* .

(n175)Footnote 151. *1999 Me. 184, 742 A.2d 898 (1999)* .

(n176)Footnote 152. *68 Ark. App. 7, 2 S.W.3d 90 (1999)* .

(n177)Footnote 153. *806 A.2d 1080 (Conn. App. 2002)* .

(n178)Footnote 154. *47 Conn. App. 489, 705 A.2d 210 (App. Ct. Conn. 1998)* .

(n179)Footnote 155. *87 F. Supp. 2d 944 (D. Ariz. 1998)* .

(n180)Footnote 156. *42 U.S.C. § 6972*.

(n181)Footnote 157. *378 F. 3d 729 (8th Cir. 2004)* .

(n182)Footnote 158. *788 N.Y. S. 2d 158, 2005 N.Y. App. Div. LEXIS 166 (NY App. Div. 2005)* .

(n183)Footnote 159. *798 A.2d 416 (R.I. 2002)* .

(n184)Footnote 160. *798 A.2d 416 (R.I. 2002)* .

(n185)Footnote 161. *2006 Mo. App. LEXIS 350 (Mo. App. WD March 28, 2006)* .

* Sections 15.01 through 15.04 of Chapter 15 were revised in 1998 and have been updated every year since then--most recently, in 2010--by Ralph W. Holmen, Associate General Counsel, National Association of Realtors(R). Section 15.06 was written by J. Cullen Howe who is an environmental law specialist in Arnold & Porter LLP's environmental practice group. He is the managing editor of *Environmental Law in New York*, a monthly newsletter, and edits the *Environmental Law Practice Guide*, among other publications. He has recently co-authored chapters on climate change and green buildings for the *Environmental Law Practice Guide* (Mathew Bender). Mr. Howe updated Sections 5.05 and 5.06, having most recently added new subsections to § 5.06 in 2010. Section 15.05[2] was written and has been updated by Adam P. Stochak and Michael Mayer of Weil, Gotshal & Manges LLP, Washington, D.C. and is excerpted from *Real Estate Financing* ch. 4D (Matthew Bender). In 2006, an update to Section 15.05[2][e] describing EPA's final rule entitled "Standards and Practices for All Appropriate Inquiries" was contributed by Michael Allan Wolf and reprinted from *Powell on Real Property(R) § PA.08[2][c][iii]* (Michael Allan Wolf, ed. Matthew Bender). Chapter 15 was originally prepared by Christine B. Ludwiszewski, Esq. of Wheaton, Illinois.



61 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 15 Real Estate Brokers and Environmental Laws *

10A-15 Real Estate Brokerage Law and Practice § 15.04

§ 15.04 Managing Environmental Risk in the Sale of Nonresidential Property

[1] In General

Many of the environmental problems discussed in the previous subsections are more common in residential transactions. Commercial real estate transactions have their share of environmental concerns, also, however. Indeed, commercial properties may be more likely to have environmental problems, those problems are likely to be much more expensive to correct or alleviate, and they may be less apparent. Given the sophistication of commercial buyers and sellers, however, they may rely less on the agents involved in the transaction than buyers and sellers of residential properties, and it is not uncommon to see courts evaluating the liability of commercial brokers differently than they evaluate the liability of residential brokers. Nevertheless, it is beneficial for commercial brokers to be aware of and alert for signs that a property may be afflicted with environmental concerns, even though few if any environmental laws impose any specific obligations, duties or even potential liabilities on commercial real estate practitioners. n1

[2] Environmental Transfer Laws

Some states have adopted laws specifically directed at requiring disclosure of or otherwise identifying and establishing a record of environmental hazards affecting nonresidential real estate at the time of a transaction involving the real estate. Such legislation may require a seller of certain kinds of property to disclose the environmental hazard to purchasers and/or the state itself prior to purchase, may require actual clean up of the hazard prior to the transaction, or may require recording of notice of the hazardous condition so that subsequent purchasers and others may become aware of the condition. For example, the New Jersey Industrial Site Recovery Act (ISRA) (formerly titled the Environmental Cleanup Responsibility Act) n2 was one of the first such laws passed and one of the most comprehensive. The ISRA applies to the sale or transfer of facilities with operations involving certain defined hazardous substances. It requires a cleanup plan to be developed and implemented in specified circumstances, and if the plan cannot be completed prior to the property transfer an Administrative Consent Order (ACO) allows the transaction to proceed only if an appropriate bond is posted to insure the cleanup is completed. Penalties are provided for noncompliance, which include rescission of the sale or transfer, criminal penalties and personal liability for corporate officers who knowingly participate in a violation.

Under the Illinois Responsible Property Transfer Act, n3 the seller of affected properties must provide the purchaser and its lender with a copy of a statutorily mandated form within thirty days of execution of the sales contract and not less

than thirty days prior to the closing. The Act applies to properties with underground storage tanks required to be registered and facilities subject to reporting under the federal Emergency Planning and Community Right to Know Act. A copy of the disclosure form must be recorded with the state environmental protection agency and the county recorder of deeds. If, upon delivery of the disclosure document, facts are revealed regarding environmental problems of which the buyer was unaware, the contract may be set aside. Failure to comply with the Act results in daily penalties up to \$10,000 per day.

The Pennsylvania Solid Waste Management Act n4 provides that the seller of property on which hazardous waste is currently being disposed (or has ever been disposed with the seller's knowledge) must state, in the description section of the deed, the specific location and description of the hazardous waste.

Other states that have adopted various kinds of statutory obligations imposed on environmentally contaminated property invoked at the time of transactions involving the property include:

- California, n5
- Colorado, n6
- Connecticut, n7
- Georgia n8
- Iowa, n9
- Indiana, n10
- Kentucky, n11
- Massachusetts n12
- Michigan n13
- Minnesota, n14
- Missouri, n15
- New York, n16
- Rhode Island n17
- South Carolina, n18
- Tennessee n19 and
- West Virginia. n20

[3] Environmental Audits

While property disclosure laws are helpful, only a complete environmental audit is likely to be conclusive as to the condition of the property, and even then an audit may not uncover all the problems that may exist on a property. Real

estate purchasers and lenders seeking to limit their liability under federal or state law (*see § 15.05 below*) mandating cleanup of environmentally contaminated properties have increasingly requested inspection by experts in soil, water, and other environmental problems.

The most commonly performed inspection is known as a "Phase I" audit. This is generally sufficient to identify an environmental problem or condition on a parcel of real estate, or at least to discover signs that a problem may exist and that more comprehensive inspection is required. Discovery of such a problem may lead a buyer or its lender to abandon a transaction or to seek to negotiate further with the seller concerning the obligation to clean up the property or otherwise mitigate the problem. In a typical Phase I audit, the inspector would perform a thorough visual inspection of the property and, to the extent possible, the adjoining sites. The condition of the vegetation, soil characteristics, water condition and hazardous substances used or stored on the premises would all be considered. Interviews would be conducted with present and past owners and occupants of the property to elicit information regarding the past uses in order to uncover any environmental risks. All available property records, including flood plain maps, easements, title documents and even old aerial photographs, would be carefully examined in an effort to evaluate current and past uses of the property. A review of permits and licenses issued pursuant to environmental, safety and/or health regulations, including permits issued to owners or tenants for underground tanks, would be conducted, as well as an evaluation of any tanks, fuel pumps, wells, ponds and wetlands on the premises. The auditor would also consult any available aerial photographs of the property and contiguous areas to determine previous uses and noticeable changes in the topography, drainage or vegetation.

Because a Phase I audit does not include thorough sampling and evaluation of many aspects of the property, it is not a guarantee that the property is without environmental problems. However, in light of the economic infeasibility of such testing, it should provide the next best alternative--a composite evaluation based on the available information and thorough visual inspection by a qualified expert. Obviously, purchasers would then evaluate the results of a Phase I audit to determine if further evaluation and testing is warranted before proceeding with a transaction. A more recent development is the promulgation by the American Society for Testing and Materials of "Transaction Screen" and "Phase 1 Audit" protocols. n21 ASTM, a national private standard-setting organization, developed these standards and also more comprehensive inspection protocols to provide for use by buyers and sellers generally accepted inspection standards and procedures. Those standards are specifically designed to allow property purchasers to take advantage of familiar inspection protocols that, when followed, will allow new purchasers acting in good faith to avoid liability for cleanup costs.

Property managers and owners will also want to conduct periodic audits of their tenants' activities to ensure compliance with environmental laws. Leases should contain standard clauses requiring compliance with all laws and regulations regarding use and disposal of hazardous materials by tenants and clauses holding the owners harmless for non-compliance by tenants.

FOOTNOTES:

(n1)Footnote 1. *Smith v. Rickard*, 205 Cal. App. 3d 1354, 254 Cal. Rptr. 633 (1988) .

(n2)Footnote 2. N.J.S. § 13:1K-6 *et seq.*

(n3)Footnote 3. 765 Ill. Comp. Stat. Ann. § 90/1 *et seq.*

(n4)Footnote 4. 35 Pa. Stat. § 6018.100.

(n5)Footnote 5. California Transfer Disclosure Law, *Cal. Health & Safety Code* § 25359.7; California Asbestos Notice Law, *Cal. Health & Safety Code* § 25915.

(n6)Footnote 6. Colorado Hazardous Waste Siting Act, *Colo. Rev. Stat.* §§ 25-15-200.1 to 220.

- (n7)Footnote 7. Connecticut Transfer Act, *Conn. Gen. Stat. Ann. § 22a-134(e)*.
- (n8)Footnote 8. Georgia Hazardous Site Response Act, *Ga. Code Ann. §§ 12-8-90 to 97*.
- (n9)Footnote 9. Iowa Hazardous Waste/Substance Management Law, *Iowa Code Ann. §§ 455B.411 to.432*.
- (n10)Footnote 10. Indiana Responsible Property Transfer Law, *Ind. Code §§ 13-7-22.5-1 to 22.5-22*.
- (n11)Footnote 11. Kentucky Hazardous Waste Planning and Management Law, *Ky. Rev. Stat. Ann. § 224.46-510 to 580*.
- (n12)Footnote 12. Massachusetts Hazardous Waste Management Act, *Mass. Ann. Laws ch. 21C, §§ 1 to 30*.
- (n13)Footnote 13. Michigan Environmental Response Act, *Mich. Comp. Laws §§ 299.601 to.618*.
- (n14)Footnote 14. Minnesota Environmental Response and Liability Act, *Minn. Stat. §§ 115B.01 to.24, 115B.16.2*.
- (n15)Footnote 15. Missouri Abandoned Site Law, *Mo. Rev. Stat. §§ 260.435 to.550*.
- (n16)Footnote 16. *New York Env'tl. Conserv. Law § 27-1317*.
- (n17)Footnote 17. Rhode Island Real Estate Disclosure Law, *R.I. Gen. Laws §§ 5-20.8-1 to.8-10,.8-2,.8-4*.
- (n18)Footnote 18. *S.C. Code Ann. § 30-5-36*.
- (n19)Footnote 19. Tennessee Hazardous Waste Management Act, *Tenn. Code Ann. §§ 68-212-101 to 121*.
- (n20)Footnote 20. West Virginia Waste Management Act, *W. Va. Code Ann. §§ 22-18-1 to 18-25*.
- (n21)Footnote 21. ASTM Standards E1528-96 and E1527-97.

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62 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers
CHAPTER 15 Real Estate Brokers and Environmental Laws *

10A-15 Real Estate Brokerage Law and Practice § 15.05

§ 15.05 Comprehensive Environmental Response, Compensation and Liability Act (CERCLA)

[1] Cleanup Liability Should Be Assumed by Appropriate Party

While real estate brokers and their subagents may have no direct liability under federal laws governing cleanup of polluted sites, their familiarity with the requirements of those laws is becoming increasingly essential. A purchaser (or its lender) who acquires unforeseen liability could claim the environmental condition of the property was a material fact that should have been disclosed prior to the purchase. Sale or lease of vacant land, the neighborhood dry cleaners, the florist shop on the site of a former gas station, a home in a new subdivision, a farm with a pond in which excess fertilizer was occasionally dumped, were once standard real estate transactions, soon forgotten by the broker after the closing. Today they must be viewed as potential environmental catastrophes, which, at the onset of the transaction, must be evaluated for the risks involved. An effort must also be made to assure that the liability for any cleanup is knowingly assumed by the appropriate party. Failure to identify and disclose the environmental condition of a property could result in the real estate agent being asked to contribute to the cleanup costs, should the applicable state environmental agency or the U.S. EPA discover a pollution problem. The following subsection surveys the developments in case law involving claims against current owners and their lenders under the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA).

[2] Basic Structure of CERCLA n1

[a] Statutory Scheme

CERCLA provides for both federal and state governments n1.1 to respond to releases and threatened releases of hazardous substances in order to protect the public health and the environment. n2 The Act provides for the use of the Hazardous Substance Response Trust Fund (the "Fund") to finance cleanups, and authorizes the Environmental Protection Agency ("EPA") to mandate and undertake investigation and remediation actions. n3 The EPA is authorized, upon determination that an "imminent and substantial endangerment to the public health or welfare or the environment" exists due to "an actual or threatened release of a hazardous substance from a facility," either to order the responsible parties to contain the hazardous wastes on the site or to initiate its own cleanup n4 and recover the costs of such cleanup from the responsible parties. n5 CERCLA allows for the imposition of a lien on real property subject to cleanup, in an amount equal to the money expended by EPA for investigation and cleanup. n6 The lien is created when response costs are first incurred by the United States, or when the EPA sends written notice of potential liability to the property owner.

n7 The Fund is available to finance cleanups when no responsible party can be found and held liable, or when the EPA chooses to do the cleanup and recover costs from responsible parties at a later time. n8

CERCLA authorizes the EPA to use the Fund to respond to threatened or actual releases of hazardous substances, pollutants or contaminants that present an imminent and substantial danger to the public health, welfare or the environment. n9 EPA may not, however, utilize the Fund to clean up releases of unaltered naturally occurring substances, releases from business, community and residential structures that result in exposure solely within such structures, and releases within public or private drinking water systems as a result of ordinary deterioration within those systems. n10

CERCLA also established a regulatory framework to govern cleanups. n11 The regulatory scheme, entitled the National Oil and Hazardous Substances Pollution Contingency Plan ("NCP"), n12 creates a system for the identification and ranking of hazardous waste sites by the EPA and for the investigation, evaluation and selection of appropriate action in response to actual or threatened releases of hazardous wastes. The NCP governs the Superfund site investigation and cleanup process and also sets standards that must be satisfied in non-Superfund cleanups for private parties to recover their cleanup costs from others. Thus, Familiarity with the procedural and substantive requirements of the NCP is essential for anyone conducting investigation or remediation work because costs may be recovered from other responsible parties only if they are in substantial compliance with the NCP. n13

One of the most vexing issues under CERCLA is the question of what cleanup standards apply. The statute as originally enacted provided little guidance, leaving it for the courts to adjudicate where the responsible parties, EPA, and the public could not agree. In 1986, Congress passed the Superfund Amendments and Reauthorization Act (SARA), which, besides increasing the fund to \$8.5 billion, imposed new reporting requirements and remedial action deadlines on EPA, required increased community participation in selecting remedies, and established more stringent cleanup standards, including a requirement for EPA to consider state environmental standards as applicable legal requirements under CERCLA. These standards required that the cleanup standard selected must assure protection of human health and the environment. n14 Where on-site cleanup occurs, the remedial action must at least attain legally applicable or relevant and appropriate federal and state standards, as set forth in other federal environmental statutes, including the Clean Water Act, the Clean Air Act and the Solid Waste Disposal Act. n15 Any promulgated state requirements that are more stringent than the federal requirements must be met when such state requirements have been identified to the EPA in a timely manner. n16 As a practical matter, the EPA and the states have significant discretion in approving cleanup standards, so the ultimate remedy selected for a site is often a matter of intense negotiation between the responsible party performing the work (or, more commonly, its environmental consultants) and the state or federal project managers responsible for oversight and approval of the work.

If the EPA chooses to clean the site itself, it may recover the cost of its actions from the current "owner and operator" of the waste site, n17 any person who owned or operated the waste site when hazardous substances were disposed of at the site, n18 the generators of the hazardous substances found at the site or who otherwise arranged for its disposal, the generators of the hazardous substances found at the site, n19 and the transporters of the hazardous substances to the site. n20 All four of these categories have been interpreted very broadly by courts.

[b] Liability Provisions

The elements that the EPA must establish in its *prima facie* case in order to recover the costs of cleanup are set forth in *United States v. Maryland Bank & Trust Co.*: n21

To establish liability under section 107(a) of the Act, the government must establish the following:

- (1) The site is a "facility;" n22

- (2) A "release" n23 or "threatened release" of any "hazardous substance" n24 from the site has occurred;
- (3) The release or threatened release has caused the United States to incur "response costs;" n25 and
- (4) The defendant is one of the persons designated as a party liable for costs. n26

The fourth element of the *prima facie* case, the definition of those parties that may be held responsible for the costs of cleanup, is crucial to the determination of lender liability. The Act includes as liable parties:

- (1) the owner and operator of a vessel or a facility;
- (2) any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous substances were disposed of;
- (3) any person who by contract, agreement, or otherwise arranged for disposal or treatment, or arranged with a transporter for transport for disposal or treatment, of hazardous substances owned or possessed by such person, by any other party or entity, at any facility or incineration vessel owned or operated by another party or entity and containing such hazardous substances; n27 and
- (4) any person who accepts or accepted any hazardous substances for transport to disposal or treatment facilities, incineration vessels or sites selected by such person, from which there is a release, or a threatened release which causes the incurrence of response costs, of hazardous substance. n28

[c] Liability for Owners and Operators

The reference to owner "*and*" operator in subsection 107(a)(1) of CERCLA has been interpreted disjunctively; that is, any person who is a current owner "*or*" operator may be held liable for response costs. n29

Under the Act, "owner or operator" includes any person owning or operating an onshore or offshore facility. n30 Section 107(a)(1) does not specify *when* a person must have been an owner of the property in order for liability to attach. The EPA has interpreted Section 107(a)(1) as imposing liability only on the person who is the owner at the time of cleanup. n31 Section 107(a)(2) explicitly imposes liability on those who own or operate a facility at the time of disposal. n32 This interpretation leaves an obvious potential gap: those persons who own property after disposal but prior to cleanup. One court to address this issue adopted the following interpretation: "Since this defendant is not alleged to be an owner at any time when the disposals complained of were made, but is alleged to have merely owned the site after such disposal and prior in time to plaintiff's ownership, it cannot be liable under the Act." n33 These so-called "innocent landowners" must demonstrate, among other things, that at the time of acquisition they undertook "all appropriate inquiry into the previous ownership in accordance with generally accepted good commercial or customary practice in an effort to minimize liability." n33.1 EPA has issued a final rule establishing standards for All Appropriate Inquiries (the "AAI rule") under which innocent landowners, bona fide purchasers and contiguous landowners may claim protection from CERCLA liability. n33.2

One issue of particular concern to developers and lenders is the risk of "owner" liability on account of contamination that has migrated to the subject property from a contiguous property. Although the language of section 107(a)(1) states that liability may be imposed only on the owner of property "from which there is a release" of hazardous substances, suggesting that the release must originate from the defendant's property, the risk of liability on account of migrating contamination has created significant uncertainty. Congress addressed this issue in the 2002 amendments to the statute, n33.3 creating an affirmative defense from liability for owners and operators of property contaminated solely by a release from another property owned by someone else. n34 This provision codified EPA's policy of non-liability for

owners of property contaminated with releases that migrated from other properties. To qualify for the defense, the owner or operator must demonstrate that it: (1) did not cause, contribute or consent to the release; (2) is not affiliated with another liable party; (3) took reasonable steps to stop any continuing release; (4) complied with land use restrictions established in connection with response activities at the facility; (5) is in compliance with any demands for information made by regulators; (6) provided all required legal notifications with respect to the contamination; and (7) at the time of acquisition of the property, undertook all appropriate inquiry and did not have reason to know of the contamination. n35

If a facility is owned by a state or local government as the result of bankruptcy, foreclosure, tax delinquency, abandonment, or similar means, the owner or operator is defined as the person who "owned, operated, or otherwise controlled activities" at the facility before ownership was transferred to the government. n36

While the terms "owner" and "operator" are jointly defined under the Act, it is useful to analyze the question of operator liability separately. Section 101(20)(A) of CERCLA excludes from this definition "a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility." n36.1 A "security interest" includes a right of mortgage, deed of trust, assignment, judgment lien, pledge, security agreement, factoring agreement, or lease and any other right accruing to a person to secure the repayment of money, the performance of a duty or any other obligation by a nonaffiliated person. n36.2 The limited legislative history under CERCLA provides some guidance in describing the extent of participation in the vessel or facility beyond which a person may become liable as an operator under the Act:

Operators of vessels do not include those individuals who are not *totally responsible* for the operation of a vessel. To fall within the definition, *the individual must have assumed the full range of operational responsibility*. For example, a pilot might be in charge of navigation of a vessel for a short duration, yet he does not meet the definition of "operator," since he neither mans nor supplies the vessel. In the case of a facility, an "operator" is defined to be a person who is carrying out operational functions for the owner of the facility pursuant to an appropriate agreement. n37

The scope of the exclusion for lenders was clarified by Congress in the Asset Conservation, Lender Liability, and Deposit Insurance Protection Act of 1996. n38 The Act defines "participate in management" to mean actually participating in the management or operational affairs of a vessel and not merely having the capacity to influence or the unexercised right to control facility operations. n39 A lender will be considered to participate in management if the lender exercises decision-making control over environmental compliance and undertakes responsibility for hazardous substance handling or disposal practices or if the lender exercises control comparable to that of a manager of the facility and assumes or manifests responsibility for day-to-day decision-making with respect to environmental compliance or responsibility for overall or substantially all of the operational functions of the facility. n39.1

The 1996 lender liability amendments to CERCLA were intended to alleviate concerns about the possible broad liability of banks and other financial institutions for the involvement in the business affairs of owners or operators of Superfund sites. The amendments effectively codify the previously invalidated EPA regulation on lender liability. n39.2 By explicitly excluding "capacity to influence" from the definition of "participate in management," the amendments nullify the rationale of previous cases that found lenders liable under CERCLA even if they did not participate in the management or operational affairs of the facility. n39.3

[d] Strict, Joint and Several Liability

Liability under CERCLA is strict, joint, and several. Strict liability has been consistently applied to owners, operators, waste generators, and transporters; fault or culpability need not be proven. n40 The Act states that the standard of liability under the Act should be the same as that which applies under the Federal Water Pollution Control Act (commonly known as the Clean Water Act). Section 311. n41 At the time of CERCLA's enactment it was well

established that liability under the Clean Water Act was strict. n42

Liability under CERCLA has also been held to be joint and several, at least to the extent that the cleanup costs cannot be easily apportioned between the defendants. n43 The legislative history of the Act indicates that Congress intended that issues of joint and several liability be resolved by application of the "traditional and evolving principles of common law." n44 Some courts have relied on this language to avoid imposition of a uniform rule of joint and several liability, n45 on the ground that the common law generally provides that where two or more persons acting independently cause a single harm, but there is a reasonable basis upon which to apportion liability, each person will be liable only for that portion of the total harm that she caused. n46 However, where two or more persons cause a single and indivisible harm, each is liable for the entire harm. n47 There are typically a number of contributors of hazardous waste at any site and the harm caused is generally found to be a single and indivisible harm; n48 the trend therefore has been for courts to impose joint and several liability on defendants in CERCLA cases. n49

In a handful of cases, courts have permitted defendants to try to establish that cleanup costs at the site are divisible. In these cases, the defendant bears the burden of establishing a factual basis for apportioning liability. n50 In the event a defendant is held liable for more than its equitable share of cleanup costs, or undertakes to clean up a property without assistance from other co-liable parties, CERCLA provides for a statutory right of contribution. n51

[e] Third-Party Defenses

Once a lender has been determined to be an owner or operator for purposes of liability under the Act, there remains one further argument that it can make in order to avoid liability. It can raise an affirmative defense under section 107(b) of CERCLA. n52

CERCLA provides for three limited affirmative defenses to section 107(a) liability:

There shall be no liability under subsection (a) of this section for a person otherwise liable who can establish by a preponderance of the evidence that the release or threat of release of a hazardous substance and the damages resulting therefrom were caused solely by--

(1) an act of God;

(2) an act of war;

(3) an act or omission of a third party other than an employee or agent of the defendant, or than one whose act or omission occurs in connection with a contractual relationship, existing directly or indirectly, with the defendant... if the defendant establishes by a preponderance of the evidence that (a) he exercised due care with respect to the hazardous substance concerned, taking into consideration the characteristics of such hazardous substance, in light of all relevant facts and circumstances, and (b) he took precautions against foreseeable acts or omissions of any such third party and the consequences that could foreseeably result from such acts or omissions; or

(4) any combination of the foregoing paragraphs. n53

Prior to the enactment of SARA, landowners had to establish three facts in order to prevail on the 1986 amendments to the statute, the third party defense under section 107(b)(3): that the third party's actions were the sole cause of the hazardous condition, that the owner exercised due care with respect to the hazardous substances on the land, and that the act or omission of the third party did not occur in connection with any direct or indirect contractual relationship with the secured lender. n54 Courts have also held that the acts or omissions of the third party must have occurred during the ownership or operation of the defendant and the defense therefore could not be claimed against third parties who were involved in the site before or after the ownership or operation of the site by the defendant. n55

However, present landowners continued to assert the third party defense, arguing that prior owners who generated or disposed of hazardous waste on the property, and not innocent current owners, should be liable under CERCLA, leading to the amendment of the Act to define "contractual relationship." n56

SARA clarified the third party defense for present landowners by defining the "contractual relationship" under which liability may attach, adopting standards which came to be known as the "innocent landowner defense." Under SARA, a current owner of land which acquired property contaminated with hazardous substances could escape liability as an owner if, at the time the defendant acquired the facility, having made appropriate inquiry into the status of the property, the defendant did not know or have reason to know that it was contaminated. n57

Amendments to CERCLA enacted in 2002 by the Small Business Relief and Brownfields Revitalizations Act ("Brownfields Act") n58 revised the "innocent landowner defense" again, this time requiring that the landowner, in addition to not having "reason to know" of the contamination, must provide "full cooperation, assistance, and facility access" to those authorized to address facility contamination, comply with land use restrictions in connection with that cleanup, and not impede the operation of controls connected with the cleanup. n59 The landowner also must take reasonable steps to stop continuing releases, prevent threatened future releases, and prevent or limit exposure to previously released hazardous substances. n60

For many years, real estate developers and their lenders were frustrated by the lack of any explicit guidance in the statute about what was required to meet the "all appropriate inquiry" standard. The Brownfields Act attempts to solve this problem by directing EPA to promulgate, within two years of enactment of the law, regulations defining the standard for what constitutes "all appropriate inquiry." n61 The statute adopted interim standards that applied to properties acquired before EPA promulgated the new rules. For properties acquired before May 31, 1997, courts were directed to take into account the following factors in deciding whether the buyer performed "all appropriate inquiry": (1) any specialized experience or knowledge of the buyer; (2) the relationship between the purchase price and the value of the property; (3) commonly known or reasonably ascertainable information about the property; (4) the obviousness of the presence of contamination; and (5) the ability to detect the contamination by appropriate inspection. n62 For properties acquired on or after May 31, 1997, the statute provided that "all appropriate inquiry" was satisfied by performance of the environmental due diligence standards developed in the mid-1990s by ASTM, a national standards organization. n63

On November 1, 2005, the EPA published its final rule titled "Standards and Practices for All Appropriate Inquiries," to be effective on November 1, 2006 (70 F.R. 66070, codified at 40 C.F.R. Part 312). Through changes included in the Small Business Liability Relief and Revitalization Act of 2002, the AAI standard is made applicable not only to innocent landowners (42 U.S.C. § 9601(35)(B)), but also to owners of properties contiguous to contaminated parcels (42 U.S.C. § 9607(q)) and to bona fide prospective purchasers (42 U.S.C. §§ 9601(40)(B) and 9607(r)). According to the agency's web site (http://www.epa.gov/swerosps/bf/regneg.htm#final_rule),

The new final regulation is not significantly different from the interim standard established by Congress in the Brownfields Amendments to CERCLA. The interim standard was the ASTM E1527-00 Phase I Environmental Site Assessment Process. The final rule differs in such areas as the definition of environmental professional, certain interviewing requirements, and the documentation of data gaps that may affect an environmental professional's ability to render an opinion regarding the environmental conditions of a property. A comparison of the requirements established in the final rule and the requirements of the interim standard are provided in a document titled "Comparison of the Final All Appropriate Inquiries Standard and the ASTM E1527-00 Environmental Site Assessment Standard."

The comparison can be found on-line at http://www.epa.gov/swerosps/bf/aai/compare_astm.pdf. n63.1

Also included in the Brownfields Act are measures intended to encourage the purchase, development, and reuse of so-called "brownfields"; properties contaminated through industrial use, but whose level of pollution is not so severe that they are designated as priority cleanup areas by EPA or statement environmental agencies. To encourage the redevelopment of brownfield properties, the Brownfields Act adopted a new prospective purchaser defense to CERCLA liability, codifying into law practices that the EPA previously had implemented through less formal regulatory guidance. The prospective purchaser defense creates a limitation on liability for persons who buy a contaminated property with knowledge of its existing contamination, provided they meet certain conditions. n64 The Brownfields Act also bars federal CERCLA enforcement against persons who clean up property under state voluntary cleanup programs. n65

The new "bona fide prospective purchaser" defense provides protection from CERCLA liability for new purchasers (and their tenants) of contaminated property. n66 To qualify for the defense, the purchaser must demonstrate that disposal of hazardous substances occurred before the purchase, the purchaser meets the "all appropriate inquiry" standard applicable to the innocent landowner defense, and the purchaser meets certain continuing obligations, such as providing notice or discovery of release of hazardous substances, and complying with government requests for information. n67 In addition, although the "bona fide prospective purchaser" is not required to undertake cleanup in order to qualify for the protection from liability, the new property owner, like the innocent landowner, must take "appropriate care" to prevent or limit exposure from the existing contamination. n68

The Brownfields Act also adopts a bar against enforcement by the federal government under CERCLA against a person who has or is conducting a cleanup at certain eligible brownfield sites in accordance with a state cleanup program. n69 The enforcement bar is not absolute, but EPA is discouraged from using authority to "reopen" a site cleaned-up by requirements that it notify the State and the United States Congress whenever it seeks to enforce against a site cleaned-up under a state program. n70 Excluded from eligibility are sites subject to a response action under CERCLA, or that are subject to a judicial or administrative order under several federal environmental statutes, as well as facilities subject to corrective action under the Resource Conservation and Recovery Act, among other exclusions. n71

[3] Claims for Liability Under CERCLA Brought Against Brokers

As indicated above, CERCLA does not impose on real estate brokers any obligations or liabilities, so long as they are working in the capacity of brokers. In two cases, however, claims for liability under CERCLA were brought against brokers on the basis that their actions made them liable for cleanup costs as PRPs. In *Tanglewood East Homeowners v. Charles-Thomas, Inc.*, n72 subdivision property owners brought an action based on CERCLA and RCRA arising out of the fact that the subdivision had been built on a site upon which toxic waste had accumulated. The defendants included the lender, developers, construction companies and the real estate agents and companies involved in the marketing and sale of the homes. In affirming the trial court's denial of defendant's motion to dismiss, the 5th Circuit concluded that because CERCLA defined disposal, for which one might be liable under CERCLA, as " 'placing of any ... hazardous waste into or on the land', those who move waste about the site may fall within the terms of that provision." n73 Thus, to the extent that the evidence could establish that any of the defendants, including the real estate brokers, were involved in such activities, including filling or grading areas where the waste was located, they might be liable under CERCLA. Of course, real estate brokers acting solely in their capacity as marketing agents would not normally be involved in such development or operational activities, and thus not be liable. In *Lentz v. Mason*, n74 the plaintiffs were property owners who had listed their property with the defendant real estate brokers for sale or lease. The brokers found a tenant who leased the property with the apparent intention to buy. After five months the owners obtained a Warrant for Removal of the tenant, and upon reentry found the premises in considerable disarray. Among the items remaining on the property were "off-specification basic torpedo tubes," which plaintiff alleged were releasing or had released various substances qualifying as hazardous under CERCLA. Plaintiff sought to hold the defendant real estate brokers liable under CERCLA for the costs associated with cleaning up those substances. The court rejected plaintiffs' claim that the brokers could be liable as operators or arrangers under CERCLA, noting that the brokers did not control the acts of the tenant, nor did they have the power to control or, indeed, any knowledge of the tenant's activities.

In *Seats v. Hooper*, n75 the purchasers discovered their property to contain pollutants that contaminated the water supply. They brought their action against the seller, the owner of the adjoining property, which was a landfill and the alleged source of the pollutants, and the real estate agents involved in the sale of the property. While the plaintiff purchasers asserted claims under CERCLA against the prior owner and the adjoining property owner, they apparently recognized that CERCLA does not provide a basis for liability by the real estate brokers and limited their claims against the brokers to various Pennsylvania statutory and common-law theories. Those theories included maintaining a public and private nuisance, fraud, latent defect, negligent misrepresentation and negligence, strict liability, ultrahazardous activity, statutory unfair trade practices, and breach of implied warranties and covenants. All but the fraud, negligence, negligent misrepresentation, latent defect and unfair trade practices claims were summarily rejected on the brokers' motion to dismiss.

FOOTNOTES:

(n1)Footnote 1. Section 15.05[2] was written by by Adam P. Storchak and Connie M. Ericson of Weil, Gotshal & Manges LLP, Washington, D.C.and is excerpted from Real Estate Financing, ch. 4D (Matthew Bender).

(n2)Footnote 1.1. *See, e.g., 42 U.S.C. § 9604(c)(3)*, providing for contracts and cooperative agreements for the cleanup of hazardous waste between the federal government and the states. Almost every state has enacted some type of legislation providing for cleanup of hazardous substances. Many of these state laws are modeled on CERCLA and contain similar liability schemes. For a summary of state cleanup laws, *see Berz, Spracker & Storchak, Environmental Law in Real Estate and Business Transactions*, ch. 4 (Matthew Bender).

(n3)Footnote 2. Section 104(a)(1) of CERCLA provides in part:

Whenever (A) any hazardous substance is released or there is a substantial threat of such a release into the environment, or (B) there is a release or substantial threat of release into the environment of any pollutant or contaminant which may present an imminent and substantial danger to the public health or welfare, the President is authorized to act, consistent with the national contingency plan, to remove or arrange for the removal of, and provide for remedial action relating to such hazardous substance, pollutant, or contaminant at any time (including its removal from any contaminated natural resource), or take any other response measure consistent with the national contingency plan which the President deems necessary to protect the public health or welfare or the environment

42 U.S.C. § 9604(a)(1).

(n4)Footnote 3. *42 U.S.C. § 9604(a)(1).*

(n5)Footnote 4. Section 106(a) of CERCLA provides in part:

In addition to any other action taken by a State or local government, when the President determines that there may be an imminent and substantial endangerment to the public health or welfare or the environment because of an actual or threatened release of a hazardous substance from a facility, he may require the Attorney General of the United States to secure such relief as may be necessary to abate such danger or threat, and the district court of the United States in the district in which the threat occurs shall have jurisdiction to grant such relief as the public interest and the equities of the case may require. The President may also, after notice to the affected State, take other action under this section including, but not limited to, issuing such orders as may be necessary to protect public health and welfare and the environment.

42 U.S.C. § 9606(a); Exec. Order No. 12,316, 46 *Fed. Reg.* 42,237 (1981) ; Exec. Order No. 12,286, 46 *Fed. Reg.* 9901 (1981) (delegating Presidential authority to mandate and undertake cleanups to the EPA).

(n6)Footnote 5. 42 U.S.C. § 9607(a).

(n7)Footnote 6. 42 U.S.C. § 9607(l).

(n8)Footnote 7. 42 U.S.C. § 9607(l)(2). One court has held that the constitutional due process requirements obligate EPA to provide a hearing before imposing the lien. *Reardon v. United States*, 947 F.2d 1509 (1st Cir. 1991) .

(n9)Footnote 8. See 42 U.S.C. § 9611(a).

(n10)Footnote 9. 42 U.S.C. §§ 9604(a)(1), 9611(a).

(n11)Footnote 10. 42 U.S.C. §§ 9604(a)(3), 9611(a)(1).

(n12)Footnote 11. 42 U.S.C. § 9605.

(n13)Footnote 12. National Oil and Hazardous Substances Pollution Contingency Plan, 40 C.F.R. Part 300.

(n14)Footnote 13. 40 C.F.R. § 300.700(c); *County Line Inv. Co. v. Tinney*, 933 F.2d 1508 (10th Cir. 1991) .

(n15)Footnote 14. 42 U.S.C. § 9621(d)(2)(A).

(n16)Footnote 15. 42 U.S.C. § 9621(d)(2)(A).

(n17)Footnote 16. 42 U.S.C. § 9621(d)(2)(A)(ii).

(n18)Footnote 17. 42 U.S.C. § 9607(a)(1). *Tanglewood East Homeowners v. Charles-Thomas, Inc.*, 849 F.2d 1568 (5th Cir. 1988) (holding that § 9607(a)(1) applied to current owners of adulterated sites); *New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1984) (holding that § 9607(a)(1) unequivocally imposes strict liability on the current owner of the facility).

(n19)Footnote 18. 42 U.S.C. § 9607(a)(2). *Atlantic Richfield Co. v. Blosenski*, 847 F. Supp. 1261 (E.D. Pa. 1994) (holding that CERCLA extends to those who owned or operated site at the time waste was buried even if they had nothing to do with the dumping and had no knowledge that hazardous substances were present).

(n20)Footnote 19. 42 U.S.C. § 9607(a)(3). *United States v. Summit Equip. & Supplies*, 805 F. Supp. 1422 (N.D. Ohio 1992) (sale of used equipment to scrap dealer where seller never asked dealer what he intended to do with the equipment constituted an arrangement for disposal under CERCLA).

(n21)Footnote 20. 42 U.S.C. § 9607(a)(4). Transporters are only liable under CERCLA only if they selected the facility. See, e.g., *Miami Co. Incinerator Qualified Trust v. Acme Waste Management Co.*, 61 F. Supp. 2d 724 (transporter selected disposal site because a flow control ordinance required transporter to use particular disposal site).

(n22)Footnote 21. 632 F. Supp. 573, 576 (D. Md. 1986) ; 42 U.S.C. § 9607(a).

(n23)Footnote 22. Section 101(9) of CERCLA provides:

The term "facility" means (A) any building, structure, installation, equipment, pipe or pipeline (including any pipe into a sewer or publicly owned treatment works), well, pit, pond, lagoon, impoundment, ditch, landfill, storage container, motor vehicle, rolling stock, or aircraft, or (B) any site or area where a hazardous substance has been deposited, stored, disposed of, or placed, or otherwise come to be located; but does not include any consumer product in consumer use or any vessel.

42 U.S.C. § 9601(9). Courts have defined "facility" broadly. "In order to show that an area is a 'facility,' the plaintiff need only show that a hazardous substance, as defined by CERCLA, has been placed there or has 'otherwise come to be located' there." *United States v. Conservation Chem. Co.*, 619 F. Supp. 162, 185 (W.D. Mo. 1985). See also *United States v. Conservation Chem. Co.*, 619 F. Supp. 162 (W.D. Mo. 1985) ("Simply put, the term 'facility' includes every place where hazardous substances come to be located.").

(n24)Footnote 23. Section 101(22) of CERCLA provides in part:

The term "release" means any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment (including the abandonment or discarding of barrels, containers, and other closed receptacles containing any hazardous substance or pollutant or contaminant), but excludes (A) any release which results in exposure to persons solely within a workplace, with respect to a claim which such persons may assert against the employer of such persons, (B) emissions from the engine exhaust of a motor vehicle, rolling stock, aircraft, vessel, or pipeline pumping station engine, (C) release of source, byproduct, or special nuclear material from a nuclear incident, as those terms are defined in the Atomic Energy Act of 1954 [42 U.S.C. § 2011 *et seq.*], if such release is subject to requirements with respect to financial protection established by the Nuclear Regulatory Commission under section 170 of such Act [42 U.S.C.A § 2210], or for the purposes of section 9604 of this title or any other response action, any release of source byproduct, or special nuclear material from any processing site designated under section 7912(a)(1) or 7942(a) of this title, and (D) the normal application of fertilizer.

42 U.S.C. § 9601(22). See *Vermont v. Staco, Inc.*, 684 F. Supp. 822 (D. Vt. 1988) (courts have broadly interpreted "release" to include any environmental presence of a hazardous substance originating from a known industrial, manufacturing or storage facility).

(n25)Footnote 24. Section 101(14) of CERCLA provides:

The term "hazardous substance" means (A) any substance designated pursuant to section 1321(b)(2)(A) of Title 33, (B) any element, compound, mixture, solution, or substance designated pursuant to section 9602 of this title, (C) any hazardous waste having the characteristics identified under or listed pursuant to section 3001 of the Solid Waste Disposal Act [42 U.S.C. § 6921] (but not including any waste the regulation of which under the Solid Waste Disposal Act [42 U.S.C. § 6901 *et seq.*] has been suspended by Act of Congress), (D) any toxic pollutant listed under section 1317(a) of Title 33, (E) any hazardous air pollutant listed under section 112 of the Clean Air Act [42 U.S.C. § 7412], and (F) any imminently hazardous chemical substance or mixture with respect to which the Administrator has taken action pursuant to section 2606 of Title 15. The term does not include petroleum, including crude oil or any fraction thereof which is not otherwise specifically listed or designated as a hazardous substance under subparagraphs (A) through (F) of this paragraph, and the term does not include natural gas, natural gas liquids, liquefied natural gas, or synthetic gas usable for fuel (or mixtures of natural gas and such synthetic gas).

42 U.S.C. § 9601(14).

(n26)Footnote 25. See 42 U.S.C. § 9607(a)(4).

"Response" costs have been interpreted to include the costs of investigations, monitoring and testing to identify the extent of danger to the public health, welfare or the environment, and to identify the extent of the release or threatened

release of hazard substances; the planning and implementation of a response action; and recovery of the costs associated with these actions, including costs of enforcement and oversight costs incurred by the staffs of the *EPA and the Department of Justice*. *United States v. Rohm & Haas Co.*, 2 F.3d 1265, 1276-1279 (3d Cir. 1993) ; *United States v. Northeastern Pharm. & Chem. Co. [NEPACCO]*, 579 F. Supp. 823, 850 (W.D. Mo. 1984) , *aff'd in part and rev'd in part*, 810 F.2d 726 (8th Cir. 1986) . See also *Tanglewood East Homeowners v. Charles-Thomas, Inc.*, 849 F.2d 1568, 1575 (5th Cir. 1988) ; *Wickland Oil Terminals v. Asarco, Inc.*, 792 F.2d 887, 892 (9th Cir. 1986) ; *State of N.Y. v. Shore Realty Corp.*, 759 F.2d 1032, 1042-43 (2d Cir. 1985) ; *Artesian Water Co. v. Government of New Castle County*, 659 F. Supp. 1269, 1285-91 (D. Del. 1987) , *aff'd*, 851 F.2d 643 (3d Cir. 1988) ; *United States v. Conservation Chem. Co.*, 628 F. Supp. 391, 404-08 (W.D. Mo. 1985) ; *Jones v. Inmont Corp.*, 584 F. Supp. 1425, 1429-30 (S.D. Ohio 1984) .

(n27)Footnote 26. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. at 576 .

(n28)Footnote 27. 42 U.S.C. § 9607(a)(3) imposes liability on anyone who generated hazardous waste and arranged for its transportation, disposal, or treatment, where that waste comes to be located at a facility from which a release has occurred that has necessitated expenditure of response costs. Generators are liable even if title to the hazardous waste is transferred to another person. Moreover, it need not be proven that a particular generator's hazardous waste constitutes the contamination that is the subject of the remedial action, as long as that generator's waste was detected at the site. See *Artesian Water Co. v. New Castle County*, 659 F. Supp. at 1282 (plaintiff need not prove "that the contaminants found near the Site actually flow from the Site."); *United States v. Wade*, 577 F. Supp. 1326, 1332-34 (E.D. Pa. 1983) (held that government need only "prove that a defendant's waste was disposed of at a site and that the substances that make the defendant's waste hazardous are also present at the site." *Id.* at 1332-34 (footnote omitted)).

(n29)Footnote 28. 42 U.S.C. § 9607(a).

(n30)Footnote 29. *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 577-78 (D. Md. 1986) . "An examination of the legislative history, sparse as it is, and the lone relevant case convinces the Court to interpret the language of subsection (1) broadly to include both owners and operators." *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 578 (D. Md. 1986) ; *State of New York v. Shore Realty Corp.*, 759 F.2d 1032 (2d Cir. 1985) .

(n31)Footnote 30. Section 101(20) of CERCLA provides:

(A) The term "owner or operator" means (i) in the case of a vessel, any person owning, operating, or chartering by demise, such vessel, (ii) in the case of an onshore facility or an offshore facility, any person owning or operating such facility, and (iii) in the case of any facility, title or control of which was conveyed due to bankruptcy, foreclosure, tax delinquency, abandonment, or similar means to a unit of State or local government, any person who owned, operated or otherwise controlled activities at such facility immediately beforehand. Such term does not include a person, who, without participating in the management of a vessel or facility, holds indicia of ownership primarily to protect his security interest in the vessel or facility.

(B) In the case of a hazardous substance which has been accepted for transportation by a common or contract carrier and except as provided in section 9607(a)(3) or (4) of this title, (i) the term "owner or operator" shall mean such common carrier or other bona fide for hire carrier acting as an independent contractor during such transportation, (ii) the shipper of such hazardous substance shall not be considered to have caused or contributed to any release during such transportation which resulted solely from circumstances or conditions beyond his control.

(C) In the case of a hazardous substance which has been delivered by a common or contract carrier to a disposal or treatment facility and except as provided in Section 9607(a)(3) or (4) of this title (i) the term "owner or operator" shall not include such common or contract carrier, and (ii) such common or contract carrier shall not be considered to have caused or contributed to any release at such disposal or

treatment facility resulting from circumstances or conditions beyond its control.

(D) The term "owner or operator" does not include a unit of State or local government which acquired ownership or control involuntarily through bankruptcy, tax delinquency, abandonment, or other circumstances in which the government involuntarily acquires title by virtue of its function as sovereign. The exclusion provided under this paragraph shall not apply to any State or local government which has caused or contributed to the release or threatened release of a hazardous substance from the facility, and such a State or local government shall be subject to the provisions of this chapter in the same manner and to the same extent, both procedurally and substantively, as any non-governmental entity, including liability under Section 9607 of this title.

42 U.S.C. § 9601(20).

(n32)Footnote 31. The owner during the cleanup benefits from the cleanup because of the resulting increase in the value of the land. An owner who bought without notice of the waste on the property, and paid the "uncontaminated" price, may escape liability by asserting the third party defense. 42 U.S.C. § 9607(b)(3).

(n33)Footnote 32. 42 U.S.C. § 9607(a)(2).

(n34)Footnote 33. *Cadillac Fairview/Cal., Inc. v. Dow Chem. Co.*, 14 *Envtl. L. Rep.* 20,376, 20,378 (C.D. Cal. 1984) . See Burkhardt, *Lender/Owners and CERCLA: Title and Liability*, 25 *Harv. J. on Legis.* 317, 327, n.26 (1988) for a discussion of the logic behind this holding.

(n35)Footnote 33.1. 42 U.S.C. § 9601(35)(B).

(n36)Footnote 33.2. 70 *Fed. Reg.* 66070 (Nov. 1, 2005) ; 40 C.F.R. part 312. The AAI rule took effect on November 1, 2006.

(n37)Footnote 33.3. The Small Business Liability Relief and Brownfields Revitalization Act, Pub. L. No. 107-118, 115 *Stat.* 2356 (2002).

(n38)Footnote 34. 42 U.S.C. § 9607(q).

(n39)Footnote 35. 42 U.S.C. § 9607(q).

(n40)Footnote 36. 42 U.S.C. § 9601(20)(A). This section was added by SARA. Congress's decision to add this language, thus limiting state and local government liability, while leaving other liability provisions unchanged, may be seen to confirm Congress' agreement with those decisions imposing lender liability.

(n41)Footnote 36.1. 42 U.S.C. § 9601(20)(A).

(n42)Footnote 36.2. 42 U.S.C. § 9601(G)(iv).

(n43)Footnote 37. H.R. Rep. No. 172, 96th Cong. 3d Sess., at 36 , reprinted in 1980 U.S. Code Cong. & Ad. News 6181-6182 (emphasis added). The extent to which the discussion of vessel operator liability applies to facility operator liability is unclear.

(n44)Footnote 38. Pub. L. No. 104-208, §§ 2501-2505, 110 *Stat.* 3009-462 to 3009-469 (1996).

(n45)Footnote 39. 42 U.S.C. § 9601(20)(F)(i).

(n46)Footnote 39.1. 42 U.S.C. § 9601(20)(F)(ii).

(n47)Footnote 39.2. *Kelly v. Tiscornia*, 1996 U.S. App. LEXIS 33616 (6th Cir. Dec. 19, 1996) (comparison of 1996 CERCLA amendments and EPA's earlier lender liability rule makes clear that the amendments codify the invalidated EPA rule). See also *Kelley v. EPA*, 15 F.3d 1100 (D.C. Cir. 1994) (CERCLA did not authorize EPA to issue rule construing lender liability).

(n48)Footnote 39.3. See *United States v. Fleet Factors Corp.*, 901 F.2d 1550, 1557-59 (11th Cir. 1990) (liability may be imposed if the secured creditor participates in the financial management of a facility to a degree indicating a capacity to influence the borrower's treatment of hazardous wastes); *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 579 (D. Md. 1986) (bank liable where it had foreclosed and held title to contaminated property at time of cleanup).

(n49)Footnote 40. *United States v. Monsanto*, 858 F.2d 160, 167 n.11 (4th Cir. 1988) ; *New York v. Shore Realty Corp.*, 759 F.2d 1032, 1042 (2d Cir. 1985) ; *North Carolina ex rel. Howes v. W.R. Peele, Sr., Trust*, 876 F. Supp. 733, 740 (E.D.N.C. 1995) ; *United States v. Chem-Dyne Corp.*, 572 F. Supp. 802, 805 (S.D. Ohio 1983) ; *Vermont v. Staco, Inc.*, 684 F. Supp. 822, 831 (D. Vt. 1988) (suggesting that present site operator may be liable without regard to fault or causation); *United States v. Conservation Chem. Co.*, 628 F. Supp. 391, 416-20 (W.D. Mo. 1985) (suggesting that current site operator may be liable where it controlled activities connected to the release).

(n50)Footnote 41. 42 U.S.C. § 9601(32).

(n51)Footnote 42. See *United States v. Chem-Dyne Corp.*, 572 F. Supp. at 805 . ("At the time of CERCLA's enactment, [section 311 of FWPCA] had been interpreted to impose a strict liability standard").

(n52)Footnote 43. See *United States v. Alcan Aluminum Corp.*, 315 F.3d 179, 187 (2d Cir. 2003) (the fact that defendant described its waste as benign "like homogenized milk" did not demonstrate divisibility of harm and defendant was jointly and severally liable); *United States v. Alcan Aluminum Corp.*, 964 F.2d 252, 270 (3d Cir. 1992) (no joint and several liability where defendant "can prove that the harm is divisible and that the damages are capable of some reasonable apportionment"); *Penn. Central Corp. v. United States*, 862 F. Supp. 437, 465 (Sp. Ct. R.R.R.A. 1994) ; *United States v. Wade*, 577 F. Supp. at 1337-39 ("[J]oint and several liability should be imposed in cases brought under § 107 of CERCLA unless the defendants establish that a reasonable basis exists for apportioning the harm amongst them.").

(n53)Footnote 44. 126 Cong. Rec. H11, 787 (Nov. 24, 1980); *United States v. Chem-Dyne*, 572 F. Supp. at 805-10 ; *State of Idaho v. Bunker Hill Co.*, 635 F. Supp. at 676; *United States v. Northeastern Pharmaceutical & Chemical Co.*, 579 F. Supp. 823, 844 (W.D. Mo. 1984) ; *United States v. A & F Materials Co.*, 578 F. Supp. 1249, 1255-57 (S.D. Ill. 1984) .

(n54)Footnote 45. *United States v. Chem-Dyne*, 572 F. Supp. at 810 .

(n55)Footnote 46. Restatement (Second) of Torts, § 881 (1977).

(n56)Footnote 47. Restatement (Second) of Torts, § 875.

(n57)Footnote 48. *United States v. Chem-Dyne*, 572 F. Supp. at 810 .

(n58)Footnote 49. Restatement (Second) of Torts, § 881 (1977). *United States v. Burlington Northern & Santa Fe Railway Co.*, 479 F.3d 1113 (9th Cir. 2007) (reversed district court's apportionment of liability because of paucity of evidence); *United States v. Rohm & Haas Co.*, 2 F.3d 1265, 1280 (3d Cir. 1993) ; *O'Neil v. Picillo*, 883 F.2d 176, 183 n.11 (1st Cir. 1989) .

(n59)Footnote 50. *In re Bell Petroleum Servs. Inc.*, 3 F.3d 889, 903 (5th Cir. 1993) ; *United States v. Alcan Aluminum Corp.*, 964 F.2d 252, 267-71 (3d Cir. 1992) .

(n60)Footnote 51. 42 U.S.C. § 9613(f)(1).

(n61)Footnote 52. 42 U.S.C. § 9607(b)(3).

(n62)Footnote 53. 42 U.S.C. § 9607(b).

(n63)Footnote 54. 42 U.S.C. § 9607(b). See Burkhardt, *Lender/Owners and CERCLA: Title and Liability*, 25 Harv. J. on Legis. 317, 350-351 (1988).

(n64)Footnote 55. See *State of N.Y. v. Shore Realty*, 759 F.2d at 1048 (2d Cir. 1985) (footnote omitted) ("the acts or omissions referred to in the statute are doubtless those occurring during the ownership or operation of the defendant"). See generally *Thaler v. PRB Metal Prods. Inc.*, 815 F. Supp. 99, 101 (E.D.N.Y. 1993) .

(n65)Footnote 56. 42 U.S.C. § 9601(35)(A).

(n66)Footnote 57. 42 U.S.C. § 9601(35)(A) and (B).

(n67)Footnote 58. Pub. L. No. 107-118, 115 Stat. 2356 (2002).

(n68)Footnote 59. 42 U.S.C. § 9601(35)(A) (as revised by Pub. L. No. 107-118, § 223(1)).

(n69)Footnote 60. 42 U.S.C. § 9601(35)(B)(i)(II) (as adopted by Pub. L. No. 107-118, § 223(2)).

(n70)Footnote 61. 42 U.S.C. § 9601(35)(B)(ii) (as adopted by Pub. L. No. 107-118, § 223(2)).

(n71)Footnote 62. 42 U.S.C. § 9601(35)(B)(iv)(I) (as adopted by Pub. L. No. 107-118, § 223(2)).

(n72)Footnote 63. 42 U.S.C. § 9601(35)(B)(iv)(II) (as adopted by Pub. L. No. 107-118, § 223(2)).

(n73)Footnote 63.1. This description of EPA's final regulation is written by Michael Allan Wolf and reprinted from Powell on Real Property(R) § PA.08[2][c][iii] (Michael Allan Wolf, ed. Matthew Bender).

(n74)Footnote 64. 42 U.S.C. § 9607(r) (as adopted by Pub. L. No. 107-118, § 222(b)).

(n75)Footnote 65. 42 U.S.C. § 9628(b) (as adopted by Pub. L. No. 107-118, § 231(b)).

(n76)Footnote 66. 42 U.S.C. §§ 9601(40) and 9607(r) (as adopted by Pub. L. No. 107-118, § 222).

(n77)Footnote 67. 42 U.S.C. § 9601(40) (as adopted by Pub. L. No. 107-118, § 222).

(n78)Footnote 68. 42 U.S.C. § 9601(40)(D) (as adopted by Pub. L. No. 107-118, § 222).

(n79)Footnote 69. 42 U.S.C. § 9628(b) (as adopted by Pub. L. No. 107-118, § 231(b)).

(n80)Footnote 70. 42 U.S.C. § 9628(b)(i)(B) (as adopted by Pub. L. No. 107-118, § 231(b)).

(n81)Footnote 71. 42 U.S.C. § 9601(39) (as adopted by Pub. L. No. 107-118, § 211(a)).

(n82)Footnote 72. 849 F.2d 1568 (5th Cir. 1988) .

(n83)Footnote 73. 849 F.2d at 1573 .

(n84)Footnote 74. 961 F. Supp. 709 (D. N.J. 1997) .

(n85)Footnote 75. Civ. No. 96-3244, 1997 U.S. Dist. LEXIS 14919 (E.D. Pa. 1997) .

* Sections 15.01 through 15.04 of Chapter 15 were revised in 1998 and have been updated every year since then--most recently, in 2010--by Ralph W. Holmen, Associate General Counsel, National Association of Realtors(R). Section 15.06 was written by J. Cullen Howe who is an environmental law specialist in Arnold & Porter LLP's environmental practice group. He is the managing editor of Environmental Law in New York, a monthly newsletter, and edits the Environmental Law Practice Guide, among other publications. He has recently co-authored chapters on climate change and green buildings for the Environmental Law Practice Guide (Mathew Bender). Mr. Howe updated Sections 5.05 and 5.06, having most recently added new subsections to § 5.06 in 2010. Section 15.05[2] was written and has been updated by Adam P. Stochak and Michael Mayer of Weil, Gotshal & Manges LLP, Washington, D.C. and is excerpted from Real Estate Financing ch. 4D (Matthew Bender). In 2006, an update to Section 15.05[2][e] describing EPA's final rule entitled "Standards and Practices for All Appropriate Inquiries" was contributed by Michael Allan Wolf and reprinted from Powell on Real Property(R) § PA.08[2][c][iii] (Michael Allan Wolf, ed. Matthew Bender). Chapter 15 was originally prepared by Christine B. Ludwizewski, Esq. of Wheaton, Illinois.



63 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 15 Real Estate Brokers and Environmental Laws *

10A-15 Real Estate Brokerage Law and Practice § 15.06

§ 15.06 Green Building Issues Affecting Real Estate Brokersⁿ¹

[1] Green Building Defined

The era of green building has arrived. Green building is the practice of increasing the efficiency of buildings and their use of energy, water, and materials, and reducing building impacts on human health and the environment through better siting, design, construction, operation, maintenance, and removal. Conventional buildings use enormous amounts of energy. According to a report by the U.S. Department of Energy (DOE), in 2005, buildings in the United States used 72% of all electricity generated and accounted for 80% of all electricity expenditures. ⁿ² A study by the Environmental Protection Agency (EPA) found that buildings account for 39% of total energy use, 12% of total water consumption, 68% of total electrical consumption, and 38% of greenhouse gas (GHG) emissions. ⁿ³ In fact, approximately one-third of all energy generated worldwide is used to power buildings. ⁿ⁴ In the United States, buildings use approximately three-fourths of all electricity generated. ⁿ⁵ Construction and demolition waste in the U.S. accounts for well over half of all non-industrial waste. ⁿ⁶ In addition, buildings emit huge amounts of greenhouse gases. Through the energy they consume, buildings account for approximately 40% of total GHG emissions in the United States. ⁿ⁷ In heavily urban areas, this percentage is much higher. ⁿ⁸ In fact, U.S. buildings emit more greenhouse gases than any country in the world except China. ⁿ⁹ As of December 2009, this number has grown to more than 2,400, and over 35,000 buildings were in the process of achieving some level of LEED certification. ^{n9.1}

The rise of green buildings has paralleled three other important trends. First, there is a growing worldwide consensus that climate change is occurring and is caused primarily by human activities, primarily from the burning of fossil fuels for energy. Similarly, there is a growing consensus that greenhouse gas (GHG) emissions must be reduced dramatically to avert a scenario where average global temperatures rise by 2-4 degrees C or more. ^{n9.2} Such a rise in temperatures could have potentially catastrophic consequences for the world's ecosystems. ^{n9.3} While the United States does not yet have a mandatory cap on GHG emissions, federal legislation will very likely be enacted in the next few years. Thus, GHG emitters will soon have to pay for the privilege of doing so. Second, energy prices, most notably petroleum, have increased in recent years. ^{n9.4} While prices experienced a dramatic decline in 2009 as a result of the worldwide economic crisis, most analysts expect this to be a short-term trend. Although the United States still consumes roughly a quarter of the oil produced worldwide, other nations, particularly China and India, are rapidly increasing the amount of oil they consume. Whether or not the world has reached a point of "peak oil," this growing worldwide demand for oil is unlikely to reverse course over the long term. Third, there is an increasing awareness that buildings consume enormous

quantities of energy and materials and are large generators of waste. The combination of these trends has brought two important and related issues to the forefront of public policy discussions: first, how to reduce GHG emissions and decrease demand for fossil fuels and other rapidly diminishing resources, and second, how to save money in the face of rising energy costs. Green buildings provide a compelling answer to both.

Despite their obvious advantages, green buildings are, for now, relatively rare. However, given the twin realities of a world that is rapidly warming and a world where fossil fuels are increasingly expensive, it is likely that green buildings will become the new norm.

[2] Potential to Expand Green Building

The building sector in the United States is enormous and is expected to expand in the near term. Currently, there are more than 82 million residential buildings and approximately 75 billion square feet of commercial floor space in the United States. By 2015, the nation is projected to add over 15 million households and 11 billion square feet of commercial space. n10 Thus, there is enormous potential to reduce energy consumption and greenhouse gas emissions by making residential and commercial buildings more energy efficient and environmentally sustainable. In addition, job growth in the green building industry is expected to increase. In November 2009, the U.S. Green Building Council at Booz Allen Hamilton, a consulting firm, issued a report finding that green building will support 7.9 million jobs from 2009 to 2013 and will add \$554 billion to the U.S. economy during this period. n10.1

Building energy efficiency is becoming an increasingly important issue. In 2007, DOE projected that energy use in the United States will increase by approximately 19% by 2025. n10.2 But that is only half of the problem. Not only do buildings in the U.S. use a lot of energy, they do so inefficiently. America uses twice as much energy per unit of economic output as Germany, and nearly three times as much as Japan. n10.3 Much of the energy produced for and used in buildings is wasted in a variety of ways. The culprits are many. For example, many buildings are poorly insulated, allowing heat to escape. In addition, although water heaters, appliances and light bulbs that use 10-75% less energy are available, inefficient, energy-intensive models are still widely used. In addition, buildings are often poorly designed. For example, most buildings do not take advantage of available features such as natural lighting, automatic shut-offs for lights, or individual lighting or thermal comfort controls. As a result, buildings use far more energy than is necessary.

[3] Green Building Trends in the Real Estate Market

[a] Legislation Encouraging Green Building, Including Compliance with LEED Standards

In recent years, several trends have developed. First, state and local governments have passed a variety of legislation either mandating or encouraging public and/or private entities to incorporate green building standards into new and existing buildings. n11 For example, Washington state has passed a law requiring all major public agency facilities with a floor area exceeding 5,000 square feet including state-funded school buildings and any remodeling over 5,000 square feet when the cost is greater than 50 percent of the assessed value, to meet or exceed the "silver" rating established by the U.S. Green Building Council's LEED green building rating system. n12 LEED is the most well-known and widely used green building system in the world. n13 In May 2007, Minnesota passed a bill entitled the "Next Generation Energy Act of 2007," which sets a state goal of certifying 100 commercial buildings as meeting LEED or other building rating systems by December 31, 2010." n14 New York offers a tax incentive program for developers and builders of environmentally friendly buildings through its Green Building Tax Credit (GBTC) program, which was enacted in 2000. n15 Several municipalities have programs that reward projects that meet LEED standards with density incentives. n16 These programs allow developers to request a larger building than is normally allowed under municipal codes if the project receives a specified level of LEED certification.

Cities have also instituted programs to make existing buildings more energy efficient. For example, in December 2009,

New York City passed an energy-efficiency legislative package for government, commercial, and residential buildings in New York City. The bills put into place a city plan announced in April 2009 to improve energy efficiency in existing buildings. In November 2009, the American Institute of Architects released a report finding that the number of mid-sized to large U.S. cities with green building programs increased by 50% to 138 during the past two years. n16.1

Although most of the legislation affecting green buildings has occurred at the state and local level, the federal government has begun to enact legislation that addresses energy efficiency and clean energy in buildings. The most recent example of this is the American Recovery and Reinvestment Act of 2009 (ARRA), which was enacted in February 2009. n17 The ARRA contains unprecedented federal government support for green buildings and related energy initiatives. Although it is unlikely that most real estate brokers will be directly affected by the ARRA, the sheer amount of federal funds available for green buildings makes it clear that encouraging green buildings has become a major federal initiative. Thus, it is worth looking at the provisions of the ARRA that deal with green buildings. These are set forth below.

[b] Marketing Green Buildings and Buyer Demand

Second, real estate developers have begun marketing green buildings as more energy efficient, healthier, and generally more desirable to live in. Developers including Hines, Forest City Enterprises, Louis Dreyfus Property Group, Corporate Office Properties Trust and Liberty Property Trust are building green buildings to satisfy tenant demand, reduce obsolescence risk, and assert market leadership over their competitors. These trends have resulted in a large number of green buildings coming to the market in a relatively short period of time as well as a growing demand from buyers for residential and commercial spaces that incorporate green features.

Several recent studies have confirmed that green buildings are in high demand. In April 2008, the CoStar Group released a report finding that green buildings outperform their non-green peers in key areas such as occupancy, sale price and rental rates, sometimes by wide margins. The study found that buildings that achieved some level of LEED certification sold for an astonishing \$171 more per square foot, had rent premiums of \$11.24 per square foot, n18 and had 3.8% higher occupancy rates than non-LEED buildings. n19 Another study concluded that buildings that were Energy Star-certified n20 had 3.3% higher rents, although it found a LEED rating had no statistically significant effect on commercial rent rates. n21 In November 2008, McGraw-Hill Construction released a report showing that green building construction starts increased from \$10 billion in 2005 to \$36-48 billion in 2008. The report estimates that these numbers could increase to \$96-140 billion in the next five years. n22 While the recent economic downturn has affected the entire real estate market, these studies suggest that green buildings will continue to be in high demand when the economy rebounds.

Although demand for green buildings is growing, many home buyers still perceive green buildings to be significantly more expensive than traditional buildings. This is sometimes referred to as the "green premium." A 2007 study found that respondents estimated that the additional cost of constructing a green building at 17% above conventional construction, a wildly inflated estimate. n23 To a certain extent, green buildings' upfront costs are greater when compared with traditional buildings. However, these upfront costs are marginal. A 2003 study found that the average premium on green buildings was around 2%, or \$3-5 per square foot, substantially lower than what is commonly perceived. n24 The study found that the majority of this increased cost is due to the increased architectural and engineering design time, modeling costs and time necessary to integrate sustainable building practices into projects. The study concluded that the earlier green building features are incorporated into the design process, the lower the cost. Another study in 2004 found that the cost per square foot for buildings seeking basic LEED certification fell into the existing range of costs for buildings of a similar program type. n25 In the fall of 2009, the New York City chapter of the U.S. Green Building Council released a report finding that there was no statistically significant difference in construction costs between LEED and non-LEED projects with respect to residential buildings (LEED projects averaged \$440/sf and non-LEED projects averaged \$436/sf). The report found that the median cost of LEED design fees were \$0.56/sf, the cost of LEED documentation was \$0.36/sf, and the commissioning cost was \$1.55/sf. However, the

report stated that the range in LEED fees was considerable, with some projects adding nothing for LEED design fees, while others added as much as \$6.62/sf. n25.1

However, the operating costs for green buildings are significantly less than those of conventional buildings because of reduced energy and water costs, reduced waste, improved indoor environmental quality and lower operations and maintenance costs. According to the 2003 study mentioned above, these savings can be as much as 10 times the initial investment. n25.2 Based on the study's findings, if \$40,000 is initially invested to incorporate green features into a \$2 million dollar project, the initial investment is repaid within two years. Over a 20-year period (based on a conservative 20-year life cycle of a building), these savings amount to \$400,000. There are other economic benefits as well. Green buildings have health benefits such as increased productivity and reduced absenteeism due to illness because of better indoor air quality. While these benefits are not directly tied into the cost of constructing and operating the buildings, they do offer indirect incentives for companies and individuals to purchase or lease space in these buildings.

[c] Green Building Aspects of the American Recovery and Reinvestment Act

The American Recovery and Reinvestment Act of 2009 (ARRA) allocates a large amount of federal money to a number of programs that fall under the rubric of promoting energy efficiency. Since buildings consume approximately 40% of energy used in the United States, President Obama made it clear during the 2008 campaign that making buildings more energy efficient would be a centerpiece of his energy policy in office. The ARRA follows through on that pledge, providing an overall allocation of \$16.8 billion to the Department of Energy for energy efficiency and renewable energy programs. n26

First, the law requires that \$5.5 billion be deposited in the Federal Buildings Fund (FBF), which is dedicated to the upkeep of federal buildings. n27 Of this money, \$4.5 billion is available for the purpose of converting General Services Administration (GSA) facilities to "High Performance Green Buildings," which is a building that, compared to similar buildings, reduces energy and water use, improves indoor air quality, takes greater advantage of natural light, makes use of nontoxic materials and products, and is situated so that public transportation can be used to reach it. n28 The federal government is taking it upon itself to make greater use of green buildings both to save money in building management and to serve as a model for the private sector. High-performance green buildings substantially cut a building's energy consumption and cost, are more reliable through the generation of onsite power, reduce the environmental impacts of the built environment, and provide jobs in the renewable energy and bio-based product industries, thereby reducing the country's reliance on imported oil and ultimately reducing greenhouse gases. n29 In addition, the ARRA contains \$3.84 billion in supplemental appropriations spread among the various service branches for Department of Defense operations and maintenance, which is meant to both improve and modernize facilities and barracks and "invest in the energy efficiency of Department of Defense facilities." n30 While not all of these supplemental appropriations will go to energy efficiency, a significant portion will.

The ARRA makes \$3.2 billion available to a program known as the Energy Efficiency and Conservation Block Grant (EECBG) program. EISA created this program which provides for federal grants to units of local government, Indian tribes, and States to reduce energy use and fossil fuel emissions, and for improvements in energy efficiency. n31 In addition, \$3.1 billion is for the State Energy Program. The State Energy Program was created in 1996 by consolidating two other programs--the State Energy Conservation Program (SECP) and the Institutional Conservation Program (ICP). The SECP provided states with funding for energy efficiency and renewable energy projects, and the ICP provided hospitals and schools with a technical analysis of their buildings, and identified the potential savings from proposed energy conservation measures. Through the consolidated State Energy Program, the Department of Energy provides a wide variety of financial and technical assistance to the states with the goal of improving energy efficiency and renewable energy on a state level. There are certain conditions to the receipt of grants, however, that could make them hard to obtain. For example, the governor of the state has to notify the Secretary of Energy that the governor has obtained assurances that the state utility commission will seek to implement, in formal proceedings, a general policy of what is called decoupling of rates (that utilities get financial incentives for encouraging customers to save energy) and

that the state or local government units have the authority to adopt building energy codes meeting the most recent International Energy Conservation Code or equivalent U.S. standards. n32 There are also state cost-sharing requirements.

Also included under the heading of energy efficiency is \$5 billion for the Weatherization Assistance Program. Created by the Energy Conservation and Production Act, the Weather Assistance Program enables low-income families to permanently reduce their energy bills by making their homes more energy efficient. n33 The ARRA increases the maximum benefit per dwelling unit from \$2,500 to \$6,500 and expands income eligibility from 150% of the federal poverty level to 200%.

[4] Green Building Rating Systems

These trends have required that real estate brokers become familiar with green building features such as energy efficient lighting and HVAC systems, improved indoor environmental quality, water efficient fixtures, sustainable and non-toxic building materials, etc. It has also required that brokers have at least a passing familiarity with commercial and residential green building rating systems. Briefly, LEED is a green building-rating system that addresses six major areas:

- sustainable sites,
- water efficiency,
- energy and atmosphere,
- materials and resources,
- indoor environmental quality, and
- innovation and design process.

LEED for New Construction, referred to as LEED-NC, is the most widely used LEED rating system and has four progressive levels of certification: Certified, Silver, Gold, and Platinum. Other LEED rating systems include LEED-EB, which applies to existing buildings, LEED-CI, which applies to commercial interiors, LEED-CS, which applies to building core and shell projects, LEED-Schools, and LEED-Homes. n34 At the end of construction or renovation, a project must submit verification that the particular design elements were actually implemented to receive certification. In addition, project developers must satisfy a number of prerequisites in some of the six categories and achieve a certain number of points before a building can attain LEED certification. Projects are awarded specific ratings depending on the number of points achieved. Different LEED rating systems have varied scoring systems based on a set of required prerequisites and a variety of credits in the six major categories listed above. For example, LEED-NC 3.0 has 100 possible points and buildings can qualify for four levels of certification: (1) Certified (40-49 points); (2) Silver (50-59 points); (3) Gold (60-79 points); and (4) Platinum (80-100 points). n35 n36 Since its inception, LEED has grown to encompass over 14,000 projects in 50 states and 30 countries covering 3.2 billion square feet of development area. n37

Another rating system is Green Globes from the Green Building Initiative (GBI). n38 Green Globes is an online building assessment tool for both residential and commercial structures. Green Globes helps both with the new construction of commercial buildings and with the maintenance and improvement of existing buildings. It is questionnaire driven and is generally acknowledged to be less cumbersome and less expensive to administer than LEED, although not as well known or rigorous. n39

Perhaps the most well known of the federal government green building initiatives is EPA's Energy Star program,

administered by DOE and EPA. n39.1 Energy Star is "a voluntary program to identify and promote energy-efficient products and buildings in order to reduce energy consumption, improve energy security, and reduce pollution through voluntary labeling of, or other forms of communication about, products and buildings that meet the highest energy conservation standards." n39.2 Energy Star began in 1992 as a voluntary labeling program that was designed by EPA to "identify and promote energy-efficient products to reduce greenhouse gas emissions." n39.3 Since that time, the program has been extended to cover new homes and commercial and industrial buildings. In this context, the program rates commercial buildings for energy efficiency and provides Energy Star qualifications for new homes that meet their standards for energy efficient building design. n39.4 EPA has created an on-line energy rating system for commercial buildings, referred to as "Portfolio Manager," which is an interactive energy management tool that allows users to track and assess energy and water consumption across their entire portfolio of buildings and compare them with other buildings of the same type and size across the country. n39.5 As of October 2007, Portfolio Manager also includes greenhouse gas (GHG) emissions factors. If a building achieves an Energy Star rating of 75, meaning that it uses less energy than 74.9% of other buildings in its category, it receives an Energy Star designation and is listed on the EPA web site as a superior user of energy. n39.6

Several building rating systems are focused on residential buildings. For example, in California, Build It Green is a non-profit membership organization whose mission is to promote healthy, energy and resource-efficient buildings in the state. n40 It applies to residential buildings and the organization has developed a rating program called "GreenPoint Rated" which provides an objective, third-party verification system that equips consumers to find green homes, understand green benefits, and recognize green features. Under the program, homes are graded on five categories: energy efficiency, resource conservation, indoor air quality, water conservation, and community. If a home meets the minimum point requirements in each category and scores at least 50 points, it earns the right to bear the GreenPoint Rated label. It also provides a score that allows prospective purchasers to evaluate and compare the environmental performance of different homes. n41 There are a number of similar federal, state and local organizations that encourage green homes, including n42 Built Green Colorado, n43 Built Green Seattle, n44 the California Green Builder Program, n45 and California Home Energy Rating System (HERS) to name a few. Brokers should familiarize themselves with the residential rating systems in their respective locales.

[5] Green Leases

A "green" lease is a lease of space in a green building. Although real estate brokers do not negotiate the terms of these leases, they should have an understanding of what they are and how they operate. Green buildings impact leases in three primary ways. First, green buildings impact the construction and design of the space. A normal lease requires the landlord to construct the core and shell and the tenant to build or pay for improvements to the space. A green lease requires that the landlord and tenant work together in an integrated design process. In addition, the tenant may require the landlord to represent and warrant that the building achieves some level of LEED certification. Second, green buildings impact a lease's economic provisions. Constructing a green building might be more expensive than a normal building. However, the operating costs are usually less. The lease may address how these costs and benefits should be allocated. Third, green buildings impact a lease's provisions relating to operations and maintenance. Green building systems have detailed operating and maintenance requirements. A landlord may prepare an operations manual for the building and require the tenant to comply with it. Conversely, a tenant may want to impose an obligation on the landlord to operate and maintain the building in accordance with certain green standards. Both parties may agree to use environmental friendly cleaning materials. The landlord may condition approval of tenant alterations on compliance with certain green building rating criteria. These requirements should be reflected in the lease.

Sometimes green leases are referred to as light-green, mid-green and dark-green. n46 A light-green lease does not contain commitments for achieving environmental targets. Obligations, if any, tend to be somewhat vague, such as requiring that alterations be performed in an "sustainable" or "environmentally appropriate" manner. A mid-green lease is more concrete in that it can establish such things as tenant reporting requirements relating to energy consumption. However, failure to achieve any agreed targets would not trigger any penalties. A dark-green lease includes such things

as energy targets and would require a remedial response if the targets are not met.

Many companies and government agencies require their space to satisfy an applicable LEED certification level for commercial interiors. These entities look to specify that the space will meet such standards. Landlords are not generally in a position to guarantee such certification level. The landlord and tenant should work together to craft a lease that adequately protects each of their respective interests and avoids liability outside of either of their control. Incentives such as free rent periods or rent abatements are good ways to incentivize a property owner to deliver a green space without undue penalty for items outside of his control. The improvements should also be properly insured in the event of a casualty event. A lease should spell out the increased cost when considering the replacement costs of green improvements to a space given that they typically cost more than regular improvements.

The two most prominent green leasing standards currently available are promulgated by the U.S. Green Building Council and the Building Owners and Managers Association (BOMA). USGBC's LEED program utilizes widely accepted standards to certify tenant spaces through its Commercial Interiors certification process.

One of the most common barriers to implementing energy efficient building practices and technology is the split incentive, where the landlord pays for capital improvements but the tenants, who pay the utility bills, get the benefits of energy savings. n46.1 The 2008 version of the Building Owners and Managers Association International Lease Guide (the BOMA Lease Guide) emphasizes that a green lease may help "overcome some of the barriers to investment in energy efficient and sustainable technologies." n46.2 One approach the BOMA Lease Guide recommends to address the conflict between tenants and landlords is to carefully define operating costs so that landlords and tenants agree to share the cost of energy efficiency improvements.

[6] EcoBroker

One of the most important roles of a real estate broker is to provide information about the particular green features of a new home or commercial space to potential buyers or lessees. However, there are as yet few mechanisms available to allow brokers to speak with authority about the sometimes technical features of green buildings. One program, Ecobroker, is attempting to change that. According to its website, EcoBroker is an educational and marketing program "designed to help communities across the United States and internationally take advantage of and encourage energy efficiency and sustainable design in real estate properties." n47 The program provides continuing education credits as a way to educate real estate brokers and industry affiliates about green buildings through a series of courses that allows them to become certified EcoBrokers[(R)] and address buyers' and sellers' increasing sensitivity to building features like energy efficiency and environmental design. The program also assists brokers in working through and providing solutions for issues that may arise in real estate transactions such as mold, radon and poor indoor air quality.

The program, which is available online, addresses environmental issues such as radon, asbestos, lead, water, mold, indoor air quality, and other issues that may arise during real estate transactions. It also covers energy efficiency technologies, sustainable energy options, and green mortgage options for energy efficiency improvements. It explains green home certification programs, such as Built Green[(R)] Colorado, Energy Star Qualified Homes, and LEED.

[7] The Role of Brokers in the Green Marketplace

Although green buildings are becoming more and more popular, there are still relatively few green residences and commercial spaces on the market. According to Chris Bartle, President of Green Key Real Estate, one of the first green real estate companies in the nation, 95% of his company's work involves assisting buyers and sellers in greening their properties either before or after sale. Thus, it is important that brokers, as part of their normal duties, be able to clearly and effectively explain to buyers the relative advantages of greening their properties and how to quickly and cost-effectively do so.

Most of the work of green brokers is currently focused on outreach and education. According to Mr. Bartle, Green agents and brokers are working to add data fields for green features to the various multiple listing services (MLS's) around the country. The California Association of Realtors (CAR) has established a Green Task Force that is working to educate clients about green homes. In addition, Build It Green has a Real Estate Council that is educating agents, brokers, mortgage brokers and appraisers about green homes and providing a means for them to network.

[8] Broker Liability

Because green building is a relatively new phenomenon, there is little analysis regarding the legal obligations and potential liabilities for real estate brokers. One potential pitfall for brokers is to misrepresent the green features of a residential or commercial building. This is relatively easy to do because builders or owners may themselves not fully or accurately understand the various building rating systems or whether certain features are, in fact, green. While it is common for brokers to carry insurance that covers them from such errors and omissions, perhaps the most important thing that brokers can do is to have a clear and complete understanding of a property's green features so they can accurately relay these features to potential purchasers. This requires that brokers independently verify these features before communicating them with potential purchasers.

In addition, brokers should use certified green building experts whenever possible and should clearly communicate that, although they are knowledgeable about these issues, they are not experts and that parties should do their own investigation or engage their own experts if they have any questions.

[9] Green Marketing Claims

Many real estate developers are marketing their buildings as environmentally friendly. In general, developers are prohibited by law from making any false or misleading statements about their buildings. At the federal level, the Federal Trade Commission (FTC) administers Section 5 of the FTC Act, which prohibits "unfair or deceptive" practices.ⁿ⁴⁸ In the environmental area the FTC first issued its "Guides for the Use of Environmental Claims," more commonly known as the "Green Guides," in the early nineties.ⁿ⁴⁹ The Green Guides, which are federal regulations, indicate how the FTC will apply Section 5 of the FTC Act. The most recent version of the Green Guides was released in 1998.

The Green Guides focus primarily on claims such as "recyclable," "recycled" and "biodegradable," although they also lay out some general principles. For example, with respect to claims that a product is "biodegradable," the Green Guides state the following: "An unqualified claim that a product or package is degradable, biodegradable or photodegradable should be substantiated by competent and reliable scientific evidence that the entire product or package will completely break down and return to nature, i.e., decompose into elements found in nature within a reasonably short period of time after customary disposal."ⁿ⁵⁰ The Guides go on to state the following: "Claims of degradability, biodegradability or photodegradability should be qualified to the extent necessary to avoid customer deception about : (1) the product or package's ability to degrade in the environment where it is customarily disposed; and (2) the rate and extent of degradation."ⁿ⁵¹

The Green Guides do not specifically address many of the current environmental, energy and carbon emission claims being made, such as claims that a building or product is carbon neutral. However, throughout 2008 the FTC held workshops on many of the newer types of environmental claims, including claims related to buildings and building materials, and indicated that it planned to release updated Guides.ⁿ⁵² As of April 2010 a revised version of Green Guides had not yet been released.

If the FTC determines that a claim is false or misleading, it can bring an administrative action or it can file an action in federal court.ⁿ⁵³ A number of remedies are available to the agency, the most common of which are injunctive relief, though in rare instances the FTC also seeks corrective advertising. Subsequent violations of any injunctive order can result in civil penalties of up to \$16,000 per violation.ⁿ⁵⁴

The FTC typically proceeds against claims made to consumers. In this regard, green claims regarding residential buildings impact consumers directly. However, many green building claims are commercial in nature. The FTC recognizes that many of the newer environmental claims are more commercial in nature and has warned the business community that it will not hesitate to bring cases outside of its traditional consumer framework, particularly in this area.

n55

FOOTNOTES:

(n1)Footnote 1. This section was authored by J. Cullen Howe. Mr. Howe is an environmental law specialist in Arnold & Porter LLP's environmental practice group. He is the managing editor of Environmental Law in New York, a monthly newsletter, and edits the Environmental Law Practice Guide, Brownfields Law and Practice, and Environmental Impact Review in New York. He is a co-editor of "The Law of Green Buildings," which is scheduled to be published in the fall of 2009. He is a LEED Accredited Professional.

(n2)Footnote 2. U.S. Dept. of Energy, 2007 Buildings Energy Data Book, § 1.1.3 (Sept. 2007), *available at* http://buildingsdatabook.eere.energy.gov/?id=view_book.

(n3)Footnote 3. U.S. Environmental Protection Agency, Buildings and the Environment: A Statistical Summary (Dec. 2004), *available at* <http://epa.gov/greenbuilding/pubs/gbstats.pdf>.

(n4)Footnote 4. U.N. Environment Programme, *Buildings and Climate Change: Status, Challenges and Opportunities* (2007).

(n5)Footnote 5. U.S. Dept. of Energy, 2008 *Buildings Energy Data Book* (Sept. 2008), *available at* http://buildingsdatabook.eere.energy.gov/docs%5CDataBooks%5CSEP_2008_BEDB.pdf.

(n6)Footnote 6. *Buildings and the Environment: A Statistical Summary* (EPA Dec. 2004), *available at* <http://epa.gov/greenbuilding/pubs/gbstats.pdf>.

(n7)Footnote 7. U.S. Environmental Protection Agency, *Buildings and the Environment: A Statistical Summary* (Dec. 2004), *available at* <http://epa.gov/greenbuilding/pubs/gbstats.pdf>. In 2008, the International Energy Agency released a publication, *Promoting Energy Efficiency Investments: Case Studies in the Residential Sector*, which estimated that existing buildings are responsible for more than 40 percent of the world's total primary energy consumption and for 24 percent of global CO₂ emissions. The publication is available at <http://iea.org/w/bookshop/add.aspx?id=326>.

(n8)Footnote 8. For example, buildings account for nearly 80% of GHG emissions in New York City. Inventory of New York City Greenhouse Gas Emissions (September 17, 2008) at 11, *available at* http://www.nyc.gov/html/planyc2030/downloads/pdf/emissions_inventory_2008.pdf.

(n9)Footnote 9. Kinzey, *The Federal Buildings Research and Development Program: A Sharp Tool for Climate Policy*, 2000 ACEEE Proceedings, Sec. 9.21.

(n10)Footnote 9.1. See U.S. Green Building Council, "About USGBC," *available at* <http://www.usgbc.org/DisplayPage.aspx?CMSPageID=124> (last visited June 2010).

(n11)Footnote 9.2. See generally The International Panel on Climate Change (IPCC), *Fourth Assessment Report* (2007), *available at* <http://www.ipcc.ch> (last visited June 2010).

(n12)Footnote 9.3. To give but one example, the IPCC, in its Fourth Assessment Report, projected that in many areas of the planet there will be an increase in frequency of heat waves, tropic cyclone intensity, changes in precipitation and temperature patterns, and decreases in water availability. See Intergovernmental Panel on Climate Change,

"Summary for Policymakers of the Synthesis Report of the IPCC Fourth Assessment Report," at 11, Nov. 16, 2007 ("IPCC Report"), available at http://www.ipcc.ch/pdf/assessment-report/ar4/syr/ar4_syr_spm.pdf (last visited June 2010). In May 2008, the U.S. Climate Change Science Program released a report entitled "*Scientific Assessment of the Effects of Global Change on the United States*" which confirmed many of these findings with respect to the United States. A summary of the findings is available at <http://www.climate-science.gov/Library/scientific-assessment/6-SA-FAQ-LO-RES.pdf> (last visited June 2010).

(n13)Footnote 9.4. In 2002, the price of a barrel of oil was approximately \$20. By July 2008, this price had risen to \$146. See "The Price of Oil Hits Yet Another Record," BBC News (July 3, 2008), available at <http://news.bbc.co.uk/2/hi/business/7486764.stm> (last visited June 2010).

(n14)Footnote 10. U.S. Dept. of Energy, Buildings Energy Data Book, § 2.2.1.

(n15)Footnote 10.1. The report is available at <http://www.usgbc.org/ShowFile.aspx?DocumentID=6435> (last visited June 2010).

(n16)Footnote 10.2. U.S. Department of Energy, Energy Information Administration, *Annual Energy Outlook 2008* (Dec. 2007).

(n17)Footnote 10.3. U.S. Dept. of Energy, Energy Information Administration, *Annual Energy Review 2005* (June 2006).

(n18)Footnote 11. The federal government has also passed a number of laws or instituted programs that at least indirectly promote energy efficiency in buildings, such as EPA's Energy Star program, which promotes the use of energy efficient products and materials, and the Energy Policy Act of 1992, which required states to establish minimum commercial building energy codes. In addition, the Energy Independence and Security Act of 2007 contains a number of provisions related to green buildings and energy efficiency.

(n19)Footnote 12. See Wash. Rev. Code §§ 28A.150; 28B.10; 39.04. A copy of the bill is available at <http://apps.leg.wa.gov/billinfo/summary.aspx?bill=5509>.

(n20)Footnote 13. Additional information about USGBC and LEED is available at <http://www.usgbc.org>.

(n21)Footnote 14. See *Minn. Stat. § 123B.65 et seq.*

(n22)Footnote 15. *N.Y. Tax Law § 19.*

(n23)Footnote 16. These municipalities include Seattle; Nashville; Acton, Massachusetts; Bar Harbor, Maine; Cranford, New Jersey; Portsmouth, New Hampshire; and Arlington County, Virginia.

(n24)Footnote 16.1. The report, entitled "Local Leaders in Sustainability," is available at <http://www.aia.org/advocacy/local/AIAB081637?dvid=&recspec=AIAB081637> (last visited June 2010).

(n25)Footnote 17. Pub. L. 111-5 (2009).

(n26)Footnote 18. The study reported that LEED-rated buildings sold for \$438 per square foot compared with \$267 for non-LEED-rated buildings.

(n27)Footnote 19. This study is available at <http://www.costar.com/partners/costar-green-study.pdf>.

(n28)Footnote 20. Energy Star is a voluntary program administered by EPA and the Department of Energy to identify and promote energy-efficient products and buildings to reduce energy consumption through voluntary labeling of products and buildings that meet the highest energy conservation standards. The program rates commercial buildings

for energy efficiency and provides Energy Star qualifications for new homes that meet their standards for energy efficient building design. If a building achieves an Energy Star rating of 75, meaning that it uses less energy than 74.9% of other buildings in its category, it receives an Energy Star designation and is listed on the EPA web site as a superior user of energy.

(n29)Footnote 21. P. Eichholtz, N. Kok, and J. Quigley, "Doing Well By Doing Good? An Analysis of the Financial Performance of Green Office Buildings in the USA," RICS Research Report (March 2009), *available at* <http://www.greenbiz.com/files/document/DoingWellbyDoingGood.pdf>.

(n30)Footnote 22. McGraw-Hill Construction, *Outlook 2009: Trends Driving Change* (Oct. 2008).

(n31)Footnote 23. "Energy Efficiency in Buildings: Business Realities and Opportunities," World Business Council for Sustainable Development (2007), *available at* <http://www.wbcsd.org/DocRoot/1KDpFci8xSi63cZ5AGxQ/EEB-Facts-and-trends.pdf>.

(n32)Footnote 24. G. Kats, *The Costs and Financial Benefits of Green Buildings*, A Report to California's Sustainable Building Task Force (2003).

(n33)Footnote 25. L. Fay Matthiessen and P. Morris, *Costing Green: A Comprehensive Cost Database and Budgeting Methodology* (July 2004).

(n34)Footnote 25.1. The report, entitled "Cost of Green in NYC," is available at http://joinus.urbangreencouncil.org/site/DocServer/Cost_Study_10.02.09.pdf?docID=201 (last visited June 2010).

(n35)Footnote 25.2. G. Kats, *The Costs and Financial Benefits of Green Buildings*, A Report to California's Sustainable Building Task Force (2003), *available at* <http://www.cap-e.com/ewebeditpro/items/O59F3481.pdf> (last visited June 2010).

(n36)Footnote 26. According to the Department of Energy's 2008 Budget, a total of approximately \$1.7 billion was received for implementation of its energy efficiency and renewable energy programs and approximately \$1.25 billion was requested for 2009. See summary of budget by appropriations, *available at* <http://www.cfo.doe.gov/budget/09budget/Content/ApprSum.pdf>.

(n37)Footnote 27. ARRA, Title III, Department of Energy Programs (Energy Efficiency and Renewable Energy).

(n38)Footnote 28. For a complete definition of "High Performance Green Building," see § 401 of the Energy Independence and Security Act of 2007 (42 U.S.C. § 6307).

(n39)Footnote 29. See the Environmental and Energy Study Institute report "High-Performance Green Buildings: A Look at Their Benefits and the Role of Federal Policy," *available at* http://www.eesi.org/052107_HPGB.

(n40)Footnote 30. Title III of the ARRA. The breakdown is as follows: Army: \$1.475 billion; Navy: \$657 million; Marine Corps: \$113 million; Air Force: \$1.096 billion; Army Reserve: \$98 million; Navy Reserve: \$55 million.

(n41)Footnote 31. Title V of the EISA (42 U.S.C. § 17151 *et seq.*).

(n42)Footnote 32. ARRA § 410 (Additional State Energy Grants).

(n43)Footnote 33. 42 U.S.C. § 6872.

(n44)Footnote 34. Information about these rating systems is available at <http://www.usgbc.org/DisplayPage.aspx?CMSPageID=222>.

(n45)Footnote 35. [Reserved].

(n46)Footnote 36. [Reserved].

(n47)Footnote 37. USGBC, Green Building By the Numbers (Jan. 2008), *available at* <http://www.usgbc.org/DisplayPage.aspx?CMSPageID=1718>.

(n48)Footnote 38. Additional information about Green Globes is available at <http://www.thegbi.org/home.asp>.

(n49)Footnote 39. For other green building rating systems, *see* Powell on Real Property(R) ch. 78B, Green Buildings (Michael Allan Wolf ed., LexisNexis Matthew Bender).

(n50)Footnote 39.1. More information about the Energy Star program is available at <http://www.energystar.gov> (last visited June 2010).

(n51)Footnote 39.2. *See* 42 U.S.C. § 6294a(a).

(n52)Footnote 39.3. Additional history of Energy Star is available at http://www.energystar.gov/index.cfm?c_about.ab.history (last visited June 2010).

(n53)Footnote 39.4. Information about Energy Star for homes is available at http://www.energystar.gov/index.cfm?c=new_homes.hm_index (last visited June 2010).

(n54)Footnote 39.5. Portfolio Manager is available at http://www.energystar.gov/index.cfm?c=evaluate_performance.bus_portfoliomanager (last visited June 2010).

(n55)Footnote 39.6. *See* Portfolio Manager is available at http://www.energystar.gov/index.cfm?c=evaluate_performance.bus_portfoliomanager (last visited June 2010).

(n56)Footnote 40. Additional information about Build It Green is available at <http://www.builditgreen.org>.

(n57)Footnote 41. Additional information about the GreenPoint Rated program is available at <http://www.builditgreen.org/node/5>.

(n58)Footnote 42. [Reserved].

(n59)Footnote 43. Information about Built Green Colorado is available at <http://www.builtgreen.org>.

(n60)Footnote 44. Information about Built Green Seattle is available at <http://www.builtgreen.net>.

(n61)Footnote 45. Information about the California Green Builder program is available at <http://www.cbia.org/go/cbia/government-affairs/green-building>.

(n62)Footnote 46. *See generally* Susan Bright, "Going Green" (New Law Journal Aug. 8, 2008).

(n63)Footnote 46.1. Steven A. Teitelbaum, BOMA's Lease Guide: Guide to Writing a Commercial Real Estate Lease Including Green Lease Language (2008).

(n64)Footnote 46.2. Steven A. Teitelbaum, BOMA's Lease Guide: Guide to Writing a Commercial Real Estate Lease Including Green Lease Language (2008).

(n65)Footnote 47. Additional information about Ecobroker is available at <http://www.ecobroker.com>.

(n66)Footnote 48. 15 U.S.C. §§ 41-51.

(n67)Footnote 49. A copy of Green Guides is available at <http://www.ftc.gov/bcp/grnrule/guides980427.htm>.

(n68)Footnote 50. *16 C.F.R. § 260.7(b)*.

(n69)Footnote 51. *16 C.F.R. § 260.7(b)*.

(n70)Footnote 52. *See, e.g.,* Federal Trade Commission, "Reporter Resources: The FTC's Green Guides," *available at* <http://www.ftc.gov/opa/reporter/greengds.shtm> (last visited June 2010).

(n71)Footnote 53. *15 USC §§ 45, 53 (2006)*.

(n72)Footnote 54. *16 C.F.R. § 1.98 (2009)*.

(n73)Footnote 55. J. Kohm, Associate Director, Division of Enforcement, "Green Marketing: Communicating Environmental Benefits to Effect Change and Sell Product," ABA Consumer Protection Conference (June 20, 2009).

* Sections 15.01 through 15.04 of Chapter 15 were revised in 1998 and have been updated every year since then--most recently, in 2010--by Ralph W. Holmen, Associate General Counsel, National Association of Realtors(R). Section 15.06 was written by J. Cullen Howe who is an environmental law specialist in Arnold & Porter LLP's environmental practice group. He is the managing editor of Environmental Law in New York, a monthly newsletter, and edits the Environmental Law Practice Guide, among other publications. He has recently co-authored chapters on climate change and green buildings for the Environmental Law Practice Guide (Mathew Bender). Mr. Howe updated Sections 5.05 and 5.06, having most recently added new subsections to § 5.06 in 2010. Section 15.05[2] was written and has been updated by Adam P. Storchak and Michael Mayer of Weil, Gotshal & Manges LLP, Washington, D.C. and is excerpted from Real Estate Financing ch. 4D (Matthew Bender). In 2006, an update to Section 15.05[2][e] describing EPA's final rule entitled "Standards and Practices for All Appropriate Inquiries" was contributed by Michael Allan Wolf and reprinted from Powell on Real Property(R) § PA.08[2][c][iii] (Michael Allan Wolf, ed. Matthew Bender). Chapter 15 was originally prepared by Christine B. Ludwiszewski, Esq. of Wheaton, Illinois.



64 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers
CHAPTER 15 Real Estate Brokers and Environmental Laws *

10A-15 Real Estate Brokerage Law and Practice § 15.07

§ 15.07 Conclusion

The still modest but slowly evolving body of case law addressing a real estate broker's liability to the purchaser for various environmental problems affecting the property purchased generally follows the principles of broker liability established in litigation involving more familiar, commonplace property flaws. Those cases hold brokers liable when misrepresentations are made because of fraudulent or negligent conduct. Courts appear reluctant to impose affirmative duties on real estate brokers to identify each and every potential environmental hazard a property may contain. Nevertheless, real estate professionals should remain diligently alert for indicators of environmental hazards, seek from sellers information about the environmental condition of the property, and share any relevant information with the potential buyers. These actions are likely to reduce substantially the possibility of a lawsuit against the real estate professional that may require the payment of damages for what is really someone else's problem. Lenders and insurance companies have made it clear that they are unwilling to shoulder the financial responsibility of cleaning up environmental problems that they did not create.

* Sections 15.01 through 15.04 of Chapter 15 were revised in 1998 and have been updated every year since then--most recently, in 2010--by Ralph W. Holmen, Associate General Counsel, National Association of Realtors(R). Section 15.06 was written by J. Cullen Howe who is an environmental law specialist in Arnold & Porter LLP's environmental practice group. He is the managing editor of Environmental Law in New York, a monthly newsletter, and edits the Environmental Law Practice Guide, among other publications. He has recently co-authored chapters on climate change and green buildings for the Environmental Law Practice Guide (Mathew Bender). Mr. Howe updated Sections 5.05 and 5.06, having most recently added new subsections to § 5.06 in 2010. Section 15.05[2] was written and has been updated by Adam P. Stochak and Michael Mayer of Weil, Gotshal & Manges LLP, Washington, D.C. and is excerpted from Real Estate Financing ch. 4D (Matthew Bender). In 2006, an update to Section 15.05[2][e] describing EPA's final rule entitled "Standards and Practices for All Appropriate Inquiries" was contributed by Michael Allan Wolf and reprinted from Powell on Real Property(R) § PA.08[2][c][iii] (Michael Allan Wolf, ed. Matthew Bender). Chapter 15 was originally prepared by Christine B. Ludwizewski, Esq. of Wheaton, Illinois.



65 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers
CHAPTER 15A Lead-Based Paint Disclosure *

10A-15A Real Estate Brokerage Law and Practice 15A.syn

§ 15A.syn Synopsis to Chapter 15A: Lead-Based Paint Disclosure *

§ 15A.01 Federal Lead-Based Paint Legislation

- [1] The Lead-Based Paint Poisoning Prevention Act
- [2] The Residential Lead-Based Paint Hazard Reduction Act
- [3] The Lead Exposure Reduction Act

§ 15A.02 Terminology Used by EPA and HUD Is Defined by Statute or Regulation

§ 15A.03 Mandatory Disclosures in Sale or Lease of Target Housing

- [1] Real Estate Agents' Duty to Disclose
- [2] Applicability and Scope of Disclosure Rules
- [3] Exceptions to Disclosure Rules
 - [a] Types of Residential Property
 - [b] Types of Lease Agreements
- [4] Timing of Disclosure
- [5] Mandatory Lead Warning Statements
 - [a] Contracts of Sale
 - [b] Contracts to Lease

[6] Further Rules of Disclosure

[7] Purchase Contracts Containing Contingency Clauses

§ 15A.04 Records to Be Maintained by Seller/Lessor/Agent

§ 15A.05 Liability for Failure to Comply with Disclosure Rules

§ 15A.06 Enforcement of Disclosure Rules

[1] Action by Persons to Force EPA/HUD to Comply

[2] Unlawful Actions Under *42 U.S.C. § 4852d*

[3] Civil Penalties Under *§ 42 U.S.C. § 3545*--HUD

[a] Civil Penalty and Hearings

[b] Appeals of Civil Penalties

[c] Payment and Collection of Civil Penalty

[4] Civil and Criminal Penalties Under *15 U.S.C. § 2615*--EPA

[a] Civil Penalty

[b] Criminal Sanctions

[5] Injunction Proceeding by HUD

[6] Civil Damages and Costs Awarded

§ 15A.07 Compliance with State Lead-Based Paint Disclosure Laws

[1] State Laws Are in Addition to Federal Disclosure Requirements

[2] Colorado

[3] Maryland

[4] Massachusetts

[5] Rhode Island

[6] Utah

§ 15A.08 Lead-Based Paint Disclosure Forms

[1] Addendum to Sales Contract

[2] Provisions Applicable to Leases

[3] Real Estate Contract--Sample Language for Risk Assessment Contingency

§ 15A.09 Guidance Provided by EPA and HUD for Interpreting Lead-Based Paint Disclosure Requirements

[1] Purpose of Guidance Provided by EPA and HUD

[2] HUD and EPA Guidance on Lead-Based Paint Disclosure Requirements--Part I (August 20, 1996)

[3] HUD and EPA Guidance on Lead-Based Paint Disclosure Requirements--Part II (December 5, 1996)



66 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers
CHAPTER 15A Lead-Based Paint Disclosure *

10A-15A Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Federal law mandates that real estate agents representing sellers and lessors disclose the presence of lead-based paint or lead-based paint hazards in residential transactions to buyers and lessees. Such disclosure involves some technical expertise. The terminology used by the administrative agencies that regulate disclosure is found in § 15A.02. In order to be able to carry out their disclosure responsibilities, real estate agents must be familiar with the following:

- the scope of the disclosure rules (§ 15A.03[2]),
- the exceptions to disclosure (§ 15A.03[4]),
- the timing of disclosure (§ 15A.03[6]), and
- all of the disclosure duties imposed on sellers and lessors (§ 15A.03[6]).

In addition, real estate agents must include in all purchase contracts or leases mandatory lead warning statements (set forth in § 15A.03[5]). Real estate agents and their brokerage firms must maintain records that demonstrate compliance with the disclosure requirements for each transaction. § 15A.04 discusses records to be maintained. If real estate agents comply with the disclosure requirements, their liability is limited. However, if they do not comply, they are liable for civil and criminal penalties imposed by administrative agencies, as well as for treble damages in a civil action. Section 15A.05 discusses real estate agents' failure or refusal to comply and § 15A.06 discusses the enforcement by administrative agencies and civil actions. Increasingly, states are enacting their own residential real estate disclosure statutes that are in addition to the federal disclosure requirements. § 15A.07 discusses compliance with state and local law. Federal forms for purchase contracts, provisions applicable to leases, and risk assessment contingency clauses are found in § 15A.08. In addition, interpretive guidance from the federal government for real estate agents to be able to comply with the disclosure requirements are contained in § 15A.09.

Related material in this treatise:

- Chapter 3A, *Federal and State-by-State Summary of Broker's Duty to Disclose*

- Section 15.03[5], *Lead Paint*



67 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers
CHAPTER 15A Lead-Based Paint Disclosure *

10A-15A Real Estate Brokerage Law and Practice § 15A.01

§ 15A.01 Federal Lead-Based Paint Legislation

[1] The Lead-Based Paint Poisoning Prevention Act

Congress addressed lead-based paint poisoning in residential housing by enacting the Lead-Based Paint Poisoning Prevention Act in 1971 (LPPPA) n1 in response to an increased awareness of the effects of lead poisoning in children. The purpose of LPPPA was to assess the nature and extent of the problems of lead-based paint hazards and to establish methods to remove these hazards from areas where children were at risk of exposure. n2 LPPPA focused on existing housing that was receiving federal assistance, was federally owned, and was constructed prior to 1978. n3

However, the implementation and enforcement of LPPPA was ineffectual. In order to force the United States Department of Housing and Urban Development (HUD) to carry out its own directives, individuals sued both HUD and others to enforce compliance. Plaintiffs were found to have rights under the LPPPA in the following cases:

- A preliminary injunction in Philadelphia was upheld that prohibited HUD from selling any residential property until it had complied with its own regulations and those of the local health department; n4
- HUD was ordered to both monitor and enforce the provisions of LPPPA instead of only acting in an advisory capacity in the District of Columbia; n5
- Residents of New York City brought a successful action to force the local health department to comply with LPPPA's provisions; n6
- Tenants in Philadelphia had a right to sue HUD for failure to enforce regulations to inspect housing for lead-based paint and to take remedial measures; n7
- Tenants in New York housing units owned by Freddie Mac were found to have a cause of action under 42 U.S.C. § 1983 and LPPPA for failure to comply with lead-based paint regulations; n8 and
- Tenants in Charleston, West Virginia had a valid claim under 42 U.S.C. § 1983 to assert that their

local housing authority had failed to fulfill its obligations under LPPPA. n9

LPPPA applies to housing receiving federal assistance. While initial HUD regulations implementing LPPPA were ineffective, subsequent amendments and regulations have endeavored to put some teeth and organization into the implementation of LPPPA. n10

[2] The Residential Lead-Based Paint Hazard Reduction Act

Congress enacted the Residential Lead-Based Paint Hazard Reduction Act in 1992 (the Act). n11 The intent was to eliminate lead-based paint and its hazards in all residential housing constructed prior to 1978. n12 The Act requires sellers, lessors, or agents in sales or leases of target housing to disclose any evidence of lead-based paint and its hazards to buyers or lessors. n13 HUD and the Environmental Protection Agency (EPA) promulgate regulations under the Act. n14 Though this Act was passed in 1992, and, pursuant to 42 U.S.C. § 4852d(d), the regulations mandating disclosure under the act should have taken effect in 1995, EPA and HUD did not promulgate the regulations until 1996, and the regulations became effective September 6, 1996, for owners of more than four residential dwellings, and December 6, 1996, in the case of owners of one to four residential dwellings. n14.1

The Act was based on the recognition by Congress that the continuing effects of exposure to lead-based paint hazards in residential housing are pervasive. n15 Lead-based paint poisoning affects approximately 3,000,000 children under the age of six in the United States. n16 Exposure to lead-based paint, even at low levels, can cause children to have intelligence quotient deficiencies, learning disabilities, reduced attention span, hyperactivity, impaired memory, and behavior problems. n17 Exposure at higher levels can even lead to death. n18 Exposure to lead-based paint hazards also poses health risks for pregnant women. n19 The Act recognizes that lead-based paint hazards are a national crisis being faced by our children that demands the full force and effect of the federal government. n20

[3] The Lead Exposure Reduction Act

Congress also enacted the Lead Exposure Reduction Act n21 in 1992. The Lead Exposure Reduction Act sets training and certification standards at both the federal and state level for individuals engaged in lead-based activities. n22 The EPA promulgates regulations under the Lead Exposure Reduction Act that implement and expand the provisions of the disclosure rules found in the Act. Effective June 1, 1999, the regulations were expanded to include disclosure of lead-based paint and its hazards by those performing renovations in target housing. n23

FOOTNOTES:

(n1)Footnote 1. 42 U.S.C. §§ 4821-4846.

(n2)Footnote 2. 42 U.S.C. § 4821(a).

(n3)Footnote 3. 42 U.S.C. § 4822(a)(1).

(n4)Footnote 4. *City-Wide Coalition Against Childhood Lead Paint Poisoning v. Philadelphia Hous. Auth.*, 356 F. Supp. 123, 130-131 (E.D. Pa. 1973) .

(n5)Footnote 5. *Ashton v. Pierce*, 716 F.2d 56, 65-67 (1983) , *order aff'd*, 716 F.2d 56 (D.C. Cir.) , *amended by* 723 F.2d 70 (D.C. Cir. 1983) .

(n6)Footnote 6. *New York City Coalition to End Lead Poisoning v. Koch*, 138 Misc. 2d 188, 524 N.Y.S.2d 314, 319 (1987) , *aff'd* (1st Dept) 239 App. Div. 2d 404, 526 N.Y.S.2d 918 (1988) .

(n7)Footnote 7. *Hurt v. Philadelphia Hous. Auth.*, 806 F. Supp. 515, 525-526 (E.D. Pa. 1992) .

(n8)Footnote 8. *German v. Federal Home Loan Mortg. Corp.*, 885 F. Supp. 537, 577 (S.D.N.Y. 1995) , *reh'g*

denied, 896 F. Supp. 1385 (S.D.N.Y. 1995) .

(n9)Footnote 9. *Simmons v. Charleston Hous. Auth.*, 881 F. Supp. 225, 230 (S.D. W. Va. 1995) .

(n10)Footnote 10. 24 C.F.R. § 35.100 et seq.

(n11)Footnote 11. 42 U.S.C. §§ 4851-4856.

(n12)Footnote 12. 42 U.S.C. § 4851a(1).

(n13)Footnote 13. 42 U.S.C. § 4852d.

(n14)Footnote 14. 42 U.S.C. § 4852d(a)(1); See 24 C.F.R. §§ 35.80-35.98 and 40 C.F.R. §§ 745.100-745.119.

(n15)Footnote 14.1. For cases discussing this delay, see *Sweet v. Sheahan*, 235 F.3d 80, 84-85 (2d Cir. 2000) ("... the agencies published the final regulations in the Federal Register on March 6, 1996--some four months after the effective date set by Congress."); *Wallace v. United States*, 335 F. Supp. 2d 252, 258 (D. R.I. 2004) ("reasons [for delay] never fully explained").

(n16)Footnote 15. 42 U.S.C. § 4851(3).

(n17)Footnote 16. 42 U.S.C. § 4851(1).

(n18)Footnote 17. 42 U.S.C. § 4851(2).

(n19)Footnote 18. Clifford L. Rechtschaffen, *The Lead Poisoning Challenge: An Approach for California and Other States*, 21 Harv. Envtl. L. Rev. 387, 391 (1997).

(n20)Footnote 19. Clifford L. Rechtschaffen, *The Lead Poisoning Challenge: An Approach for California and Other States*, 21 Harv. Envtl. L. Rev. 387, 390 (1997).

(n21)Footnote 20. 42 U.S.C. § 4851(7).

(n22)Footnote 21. 15 U.S.C. §§ 2681-2692.

(n23)Footnote 22. 15 U.S.C. § 2682.

(n24)Footnote 23. 40 C.F.R. §§ 745.80-745.88.

* This chapter was revised by Leslie Ann Shaner, Esq., of Lynchburg, Virginia.



68 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers
CHAPTER 15A Lead-Based Paint Disclosure *

10A-15A Real Estate Brokerage Law and Practice § 15A.02

§ 15A.02 Terminology Used by EPA and HUD Is Defined by Statute or Regulation

Numerous terms used in the disclosure rules for lead-based paint and its hazards are either defined by statute or regulation. An understanding of the effect of the disclosure rules for lead-based paint and its hazards requires an understanding of the terms that are presented below:

Administrator means the Administrator of the Environmental Protection Agency. n1

Agent means any party who enters into a contract with sellers or lessors, including any party who enters into a contract with a representative of sellers or lessors, for the purpose of selling or leasing target housing. This term does not apply to buyers or any buyers' representative who receives all compensation from buyers. n2

Available means in the possession of or reasonably obtainable by the seller or lessor at the time of disclosure. n3

Certified inspector means an individual who has been trained by an accredited EPA training program and certified by the EPA to conduct inspections. A certified inspector also samples for the presence of lead in dust and soil for purposes of abatement. n4

Common area means a portion of a building generally accessible to all residents/users including, but not limited to hallways, stairways, laundry and recreational rooms, playgrounds, community centers, and boundary fences. n5

Contract for the purchase and sale of residential real property means any contract or agreement in which 1 party agrees to purchase an interest in real property on which there is situated 1 or more residential dwellings used or occupied, or intended to be used or occupied in whole or in part, as a home or residence of 1 or more persons. n6

Deteriorated paint means paint that is cracking, flaking, chipping, peeling, or otherwise separating from the substrate of a building component. n7

Evaluation means risk assessment, inspection, or risk assessment and inspection. n8

Foreclosure means any of the various methods, statutory or otherwise, known in different jurisdictions, of enforcing

payment of a debt, by the taking and selling of real property. n9

Housing for the elderly means retirement communities or similar types of housing reserved for households composed of 1 or more persons 62 years of age or more at the time of initial occupancy. n10

Inspection means a surface-by-surface investigation to determine the presence of lead-based paint and a provision of a report explaining an investigation's results. n11

Knowingly means having actual knowledge of, acting with deliberate ignorance of, or reckless disregard of the prohibitions under 42 U.S.C. § 3545. n12

Lead-based paint means paint, or other surface coatings, that contain lead in excess of 1.0 milligrams per centimeter squared or 0.5 percent by weight or (1) in the case of other surface coatings on target housing, such lower level as may be established by the Secretary, or (2) in the case of any other paint or surface coatings, such other level as may be established by the Administrator. n13

Lead-based paint free housing means target housing that has been found to be free of paint or other surface coatings that contain lead equal to or in excess of 1.0 milligram per square centimeter or 0.5 percent by weight. n14

Lead-based paint hazard means any condition that causes exposure to lead from lead-contaminated dust, lead-contaminated soil, lead-contaminated paint that is deteriorated or present in accessible surfaces, friction surfaces, or impact surfaces that would result in adverse human health effects as established by the Administrator. n15

Lessee means an entity that enters into an agreement to lease, rent, or sublease target housing, including but not limited to individuals, partnerships, corporations, trusts, government agencies, Indian tribes, and nonprofit organizations. n16

Lessor means any entity that offers target housing for lease, rent, or sublease, including but not limited to individuals, partnerships, corporations, trusts, government agencies, housing agencies, Indian tribes, and nonprofit organizations. n17

Owner means any entity that has legal title to target housing, including but not limited to individuals, partnerships, corporations, trusts, government agencies, housing agencies, Indian tribes, and nonprofit organizations, except where mortgagees hold legal title to property serving as collateral for mortgage loans, in which case the owner would be the mortgagor. n18

Purchaser means an entity that enters into an agreement to purchase an interest in target housing, including but not limited to individuals, partnerships, corporations, trusts, government agencies, housing agencies, Indian tribes, and nonprofit organizations. n19

Residential dwelling means (1) a single-family dwelling, including attached structures such as porches and stoops or (2) a single-family dwelling unit in a structure that contains more than 1 separate residential unit, and in which each such unit is used or occupied, or intended to be owned or occupied, in whole or in part, as the residence of 1 or more persons. n20

Residential real property means real property on which there is situated one or more residential dwellings used or occupied, or intended to be used or occupied, in whole or in part, as the home or residence of 1 or more persons. n21

Risk assessment means an on-site investigation to determine and report the existence, nature, severity and location of lead-based paint hazards in residential dwellings, including (1) information gathering regarding the age and history of the housing and occupancy by children under age 6; (2) visual inspection; (3) limited wipe sampling or other

environmental sampling techniques; (4) other activity as may be appropriate; and (5) provision of a report explaining the results of the investigation. n22

Secretary means the Secretary of Housing and Urban Development. n23

Seller means any entity that transfers legal title to target housing, in whole or in part, in return for consideration, including but not limited to individuals, partnerships, corporations, trusts, government agencies, housing agencies, Indian tribes, and nonprofit organizations. The term seller also includes: (1) An entity that transfers shares in a cooperatively owned project, in return for consideration; and (2) An entity that transfers its interest in a leasehold where it is legally permissible to separate the fee title from the title to the improvement, in return for consideration. n24

Target housing means any housing constructed prior to 1978. However, target housing does not include the following types of residential property: (1) any housing for the elderly, except where a child under the age of six resides or may reside in the future, (2) any housing for the disabled, except where a child under the age of 6 resides or may reside in the future, and (3) 0-bedroom dwellings where the sleeping and living areas are combined, including but not limited to, efficiencies, studio apartments and lofts. n25

0-Bedroom Dwelling means any residential dwelling in which the living area is not separated from the sleeping area. The term includes efficiencies, studio apartments, dormitory housing, military barracks, and rentals of individual rooms in residential dwellings. n26

FOOTNOTES:

(n1)Footnote 1. 40 C.F.R. § 745.83.

(n2)Footnote 2. 24 C.F.R. § 35.86; 40 C.F.R. § 745.103.

(n3)Footnote 3. 24 C.F.R. § 35.86; 40 C.F.R. § 745.103.

(n4)Footnote 4. 40 C.F.R. § 745.223.

(n5)Footnote 5. 24 C.F.R. § 35.86; 40 C.F.R. § 745.103.

(n6)Footnote 6. 42 U.S.C. § 4851b(4); See 24 C.F.R. § 35.86 and 40 C.F.R. § 745.103.

(n7)Footnote 7. 40 C.F.R. § 745.223.

(n8)Footnote 8. 15 U.S.C. § 2681(4); 42 U.S.C. § 4851b(6); See 24 C.F.R. § 35.86 and 40 C.F.R. § 745.103.

(n9)Footnote 9. 24 C.F.R. § 35.86; 40 C.F.R. § 745.103.

(n10)Footnote 10. 24 C.F.R. § 35.86; 40 C.F.R. § 745.103.

(n11)Footnote 11. 15 U.S.C. § 2681(7); 42 U.S.C. § 4851b(12); See 24 C.F.R. § 35.86 and 40 C.F.R. § 745.103.

(n12)Footnote 12. 42 U.S.C. § 3545(m)(5).

(n13)Footnote 13. 15 U.S.C. § 2681(9); 42 U.S.C. § 4851b(14); See 24 C.F.R. § 35.86 and 40 C.F.R. § 745.103.

(n14)Footnote 14. 24 C.F.R. § 35.86; 40 C.F.R. § 745.103.

(n15)Footnote 15. 15 U.S.C. § 2681(10); 42 U.S.C. § 4851b(15); See 24 C.F.R. § 35.86 and 40 C.F.R. § 745.103.

(n16)Footnote 16. 24 C.F.R. § 35.86; 40 C.F.R. § 745.103.

(n17)Footnote 17. 24 C.F.R. § 35.86; 40 C.F.R. § 745.103.

(n18)Footnote 18. 24 C.F.R. § 35.86; 40 C.F.R. § 745.103.

(n19)Footnote 19. 24 C.F.R. § 35.86; 40 C.F.R. § 745.103.

(n20)Footnote 20. 15 U.S.C. § 2681(14); 42 U.S.C. § 4851b(23); See 24 C.F.R. § 35.86 and 40 C.F.R. § 745.103.

(n21)Footnote 21. 15 U.S.C. § 2681(15); 42 U.S.C. § 4851b(24).

(n22)Footnote 22. 15 U.S.C. § 2681(16); 42 U.S.C. § 4851b(25); See 24 C.F.R. § 35.86 and 40 C.F.R. § 745.103.

(n23)Footnote 23. 42 U.S.C. § 4851b(26); See 40 C.F.R. § 745.103.

(n24)Footnote 24. 24 C.F.R. § 35.86; 40 C.F.R. § 745.103.

(n25)Footnote 25. 15 U.S.C. § 2681(17); 42 U.S.C. § 4851b(27); See 24 C.F.R. § 35.86 and 40 C.F.R. § 745.103.

(n26)Footnote 26. 24 C.F.R. § 35.86; 40 C.F.R. § 745.103.

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69 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers
CHAPTER 15A Lead-Based Paint Disclosure *

10A-15A Real Estate Brokerage Law and Practice § 15A.03

§ 15A.03 Mandatory Disclosures in Sale or Lease of Target Housing

[1] Real Estate Agents' Duty to Disclose

The disclosure of the existence of lead-based paint and lead-based paint hazards in target housing, with certain exceptions, is mandatory under the federal statutes in both the sale and leasing of real estate. Real estate agents must be familiar with all of the provisions of residential real estate disclosure law because it is their duty to:

- (1) inform sellers/lessors of their obligations under the disclosure requirements,
- (2) inform sellers of buyers' opportunity to conduct an evaluation, and
- (3) inform sellers/lessors of their responsibility to certify and acknowledge all disclosures in writing.

Further, they must ensure that sellers/lessors have performed all of their obligations or personally ensure sellers' or lessors' compliance with these requirements. n1 Real estate agents must also be aware that states also may have their own lead-based paint disclosure requirements in addition to the federal rules. These must be strictly adhered to as well because liability can attach for a failure or refusal to comply in addition to the federal penalties. In many instances, lead-based paint disclosures are made as part of a state's property condition disclosure requirements. Real estate agents may have additional duties under these state statutes. (See §§ 3A.10[11], 3A.17[2] above .)

In addition, the federal law requires that mandatory lead warning statements must be included in all purchase contracts and leases. All records pertaining to real estate agents' disclosures to sellers/lessors must be strictly maintained in order to be able to prove compliance with the disclosure rules if enforcement by an administrative agency or a civil action is brought for a failure to disclose.

Federal and state residential real estate disclosure may seem ministerial in many respects. However, it must be stressed to real estate agents in their continuing education programs and by their brokerage firms that the enforcement of the disclosure rules is onerous. The fines that can be imposed are substantial, criminal penalties can be imposed, and damages in a civil action are trebled. As a result, real estate agents' careers can be severely damaged, if not destroyed, and brokerage firms' reputations will be harmed in the communities in which they operate. The residential real estate

disclosure rules are a serious matter.

The Office of Pollution Prevention and Toxics, the Office of Lead Hazard Control, and the Office of Lead-Based Paint Abatement and Poisoning Prevention issued 2 guides entitled *Interpretative Guidance for the Real Estate Community on the Requirements for Disclosure of Information Concerning Lead-Based Paint in Housing* dated August 20, 1996 and December 5, 1996 to assist the real estate community with compliance under the disclosure rules. These guides should be recommended reading for real estate agents. See § 15A.09 below for copies of these documents. In addition, the National Lead Information Center, a division of the Office of Pollution Prevention and Toxics, publishes the following documents that can be ordered by calling 1-800-424-5323 or by ordering them online at www.epa.gov/lead/nlicdocs.htm:

- Disclosure of Lead-Based Paint Hazards in Homes;
- Protect Your Family From Lead in Your Home in English and Spanish;
- EPA and HUD Real Estate Notification and Disclosure Rules;
- Lead; Requirements for Disclosure of Known Lead-Based Paint;
- Real Estate Disclosure Forms (Lease/Sale);
- Proposed Single Family Property Disposition Program--New Houses;
- HUD Announces New System for Consumers to Identify; and
- Finding a Qualified Lead Professional for Your Home.

See § 15A.03[2] below for a discussion of the applicability and scope of the disclosure rules; § 15A.03[4] below for a discussion of the exceptions to the disclosure rules; § 15A.03[4] below for a discussion of the timing of disclosure; § 15A.03[5] below for a discussion of mandatory lead warning statements in contracts; § 15A.03[6] below for a discussion of the information that has to be disclosed by sellers/lessors; § 15A.04 below for a discussion of the records to be maintained; § 15A.05 below for a discussion of failure or refusal to comply with disclosure requirements; § 15A.06 below for a discussion of the enforcement of the residential real estate disclosure requirements by the United States Department of Housing and Urban Development, the Environmental Protection Agency, and civil actions; and § 15A.07 below for a discussion of compliance with state and local law.

[2] Applicability and Scope of Disclosure Rules

Sellers, lessors, or sublessors, n2 and their agents n3 if applicable, must disclose to buyers/lessees the presence of lead-based paint and its hazards. n4 Sellers/lessors, n5 buyers/lessees, n6 and any agent n7 must acknowledge all disclosures in writing. These disclosure obligations do not imply a positive obligation on the seller or lessor to conduct any evaluation or reduction activities. n7.1 The federal disclosure law does not affect the validity or enforceability of any other term or provision of contracts of sale/lease or any type of mortgage loan securing an interest in real property. Failure to comply with the disclosure law does not create a defect in title. n8 The effective date for disclosure for sellers of more than 4 residential dwellings was September 6, 1996 n9 and December 6, 1996 for sellers of 1-4 residential dwellings. n10

The disclosure rules impose requirements on the sale or lease of target housing. The language of the statute and regulations imply strongly that the obligations created thereunder run from a seller to a purchaser, or from a lessor to a lessee. Consequently, a broker involved in the sale of target housing cannot be sued by the persons who lease the house

from the purchaser. Neither the statute nor the regulations indicate that sellers or lessors must comply with the disclosure obligations with respect to parties unconnected to the real estate transaction with which the seller or lessor was involved. n10.1

Several courts have held that a buyer's agent, even one that is compensated through a commission-sharing agreement with the seller's agent, is not included within the terms of 42 U.S.C. § 4852d(a)(4). n10.2 Section 4852d(a)(4) states in relevant part:

Whenever a seller or lessor has entered into a contract with an agent for the purpose of selling or leasing a unit of target housing, the regulations promulgated under this section shall require the agent, on behalf of the seller or lessor, to ensure compliance with the requirements of this section.

The applicable regulations define an agent as follows:

Agent means a party that enters into a contract with a seller or lessor, including any party that enters into a contract with a representative of the seller or lessor, for the purpose of selling or leasing target housing. This term does not apply to purchasers or any purchaser's representative who receives all compensation from the purchaser. n10.3

These courts' decisions not to impose a disclosure obligation upon a buyer's agent has been based upon the plain language of section 4852d(a)(4).

Practice Note:

Lead-based paint legislation, and subsequent state law cases, have applied traditionally to low-income housing that was poorly maintained. However, since 1996, real estate agents who are involved in any facet of the sale or lease of residential real estate must be familiar with the Act. Real estate agents should assume that buildings constructed prior to 1978 contain lead-based paint and its hazards. Lead-based paint becomes a hazard if it is deteriorated. Real estate agents should in their initial inspection of a home be able to determine if paint is cracking, flaking, chipping, peeling, or separating from the walls or woodwork.

[3] Exceptions to Disclosure Rules

[a] Types of Residential Property

The disclosure rules for sellers/lessors/agents of lead-based paint and its hazards do not apply to the following types of residential property:

- Any housing for the elderly, except where a child under the age of 6 resides or may reside in the future;
- Any housing for the disabled, except where a child under the age of 6 resides or may reside in the future; and
- 0-bedroom dwellings where the sleeping and living areas are combined, including but not limited to, efficiencies, studio apartments, and lofts. n11

[b] Types of Lease Agreements

The following types of leases of residential property are not subject to the disclosure rules:

- Leases of target housing found to be lead-based paint free by a certified inspector; n12
- Short-term leases of 100 days or less, where no lease modification can occur; n13 and
- Renewals of existing leases, whether a renegotiation of an existing lease or a ratification of a new lease, where disclosure has been previously made and no new information is available. n14

[4] Timing of Disclosure

All disclosures of the presence of lead-based paint and its hazards must be made prior to an offer and acceptance of contracts of sale or lease. Sellers/lessors do not have a duty to rectify the presence of lead-based paint and its hazards. Rather, the duty imposed upon sellers/lessors is to make full disclosure of the presence of lead-based paint and its hazards. n15

Buyers/lessees do not become legally obligated under a contract of sale or lease until after sellers/lessors/agents have fully complied with the disclosure rules. n16 If buyers/lessees make an offer prior to the necessary disclosures by sellers/lessors/agents, the disclosures must be made prior to accepting any offer of sale or lease. n17 If the subsequent disclosures reveal the presence of lead-based paint and its hazards after an offer has been made, buyers/lessees must be allowed to both review and amend the original offer of sale or lease. n18

[5] Mandatory Lead Warning Statements

[a] Contracts of Sale

All contracts for the sale of target housing, with the exception of a sale at foreclosure, n19 must contain a Lead Warning Statement printed in large type n20 in the language of the contract, e.g., Spanish or English, on a separate page n21 containing the following language:

Every purchaser of any interest in residential real property on which a residential building was built prior to 1978 is notified that such property may present exposure to lead from lead based paint that may place young children at risk of developing lead poisoning. Lead poisoning in young children may produce permanent neurological damage, including learning disabilities, reduced intelligence quotient, behavioral problems, and impaired memory. Lead poisoning also poses a particular risk to pregnant women. The seller of any interest in residential real property is required to provide the buyer with any information on lead-based paint hazards from risk assessments or inspections in the seller's possession and notify the buyer of any known lead-based paint hazards. A risk assessment or inspection for possible lead-based paint hazards is recommended prior to purchase. n22

Practice Note:

Real estate agents must verify that every residential contract contains an appropriate Lead Warning Statement. In order to avoid potential malpractice liability, all existing residential lease forms must be revised to include this language.

[b] Contracts to Lease

All leases must contain a Lead Warning Statement, either within the body of the contract or on a separate page, written in the language of a contract, e.g., Spanish or English, n23 using the following language:

Housing built before 1978 may contain lead-based paint. Lead from paint, paint chips, and dust can pose health hazards if not managed properly. Lead exposure is especially harmful to young children and pregnant women. Before renting pre-1978 housing, lessors must disclose the presence of lead-based

paint and/or lead-based paint hazards in the dwelling. Lessees must also receive a federally approved pamphlet on lead poisoning prevention. n24

Practice Note:

Real estate agents must verify that every residential lease contains an appropriate Lead Warning Statement. In order to avoid potential malpractice liability, all existing residential lease forms must be revised to include this language.

[6] Further Rules of Disclosure

Sellers/lessors/agents must certify in writing that they have:

- Provided buyers/lessees with a lead hazard information pamphlet approved by the EPA, n25 e.g., the pamphlet produced by the EPA, entitled *Protect Your Family From Lead in Your Home* or an equivalent EPA-approved state pamphlet; n26
- Disclosed to buyers/lessees any known information concerning the presence of lead-based paint and its hazards. n27 A lack of knowledge must also be disclosed; n28
- Provided buyers/lessees with any lead hazard evaluation report or records in the possession of sellers/lessors. n29 A lack of reports or records must also be disclosed; n30
- Disclosed to agents involved in the transaction any knowledge concerning lead-based paint and its hazards and provided agents with any reports or records available to the seller/lessor; n31 and
- Permitted a buyer a 10-day period to conduct a risk assessment or inspection of the property. The time frame can be modified if mutually agreed upon in writing by all parties; however, this provision can be waived by buyers. n32 Lessees do not have the right to conduct a risk assessment or inspection of the property.

With respect to the EPA-approved lead hazard information pamphlet or an equivalent EPA-approved state pamphlet, one court has found that an agent furnishing other information about lead-based paint hazards and the agent's emphasis on the importance of residential property inspections sufficed in fulfilling this obligation. n32.1

All disclosures made by sellers/lessors/agents of lead-based paint and its hazards must include specific information regarding:

- (1) any basis for the existence of lead-based paint and its hazards;
- (2) the specific location of the paint and its hazards; and
- (3) the condition of all painted surfaces found to contain the paint and its hazards. n33

Any records produced by sellers or lessors must include:

- (1) any information concerning common areas and
- (2) any information on individual units in multifamily housing if this information was obtained when the housing as a whole was evaluated. n34

See § 15A.08[1] below for an Addendum to Sales Contract and § 15A.08[2] below for a lead-based paint disclosure addendum to a lease.

Practice Note:

Signatures on the certifications should be acknowledged by a notary public to make it more difficult to allege falsification of a signature. This can easily be done by adding a notary's acknowledgment at the end of all lead-based paint disclosure forms.

[7] Purchase Contracts Containing Contingency Clauses

It has become standard practice for purchase contracts to contain a contingency based on a risk assessment or inspection that reveals the presence of lead-based paint or lead-based paint hazards. In this case, buyers are given a certain amount of time to request that the conditions revealed in a report be corrected by sellers. Sellers then have an option to either correct the problems or to make a counteroffer to sell the property "as is," and buyers are given a certain amount of time to accept a counteroffer or to accept the property "as is." However, a contingency that the validity of a purchase contract is contingent upon each party receiving, signing, and attaching to a completed lead-based disclosure certification form will not be upheld. This language precludes a plaintiff from seeking a remedy under 42 U.S.C. § 4852d and defeats the purpose of the disclosure rules. n35 See § 15A.08[3] below for the sample language for risk assessment contingency.

FOOTNOTES:

(n1)Footnote 1. 24 C.F.R. § 35.94(a)-(b)(1).

See *Smith v. Coldwell Banker Real Estate Services, Inc.*, 122 F. Supp. 2d 267, 274-275 (N.D. Conn. 2000) (summary judgment granted against seller's broker and agent for failing to deliver copy of lead-based paint report prior to the purchaser's contractual obligation to purchase arose; informing the purchasers of the existence of the report and the presence of lead-based paint and delivering a copy of the report at closing did not comply with the Residential Lead-Based Paint Hazard Reduction Act of 1992).

Nunez v. J.L. Sims Co., Inc., 2003 Ohio 3386, 2003 Ohio App. LEXIS 3075, at *10 (2003) .

Cf. *Flowers v. ERA Unique Realty, Inc.*, 227 F. Supp. 2d 998, 1000-1001 (N.D. Ill. 2002) , applying federal and Illinois law (a seller's broker or agent can be liable in Illinois for negligent misrepresentation for failing to disclose the presence of lead-based paint in an apartment building if the broker or agent knew or should have known of this latent defect).

See generally Rick Reibstein, *The Significance of the Federal Residential Lead-Based Paint Regulations*, 30 Ver. B. J. & L. Dig. 43 (Summer 2004).

(n2)Footnote 2. 24 C.F.R. § 35.82; 40 C.F.R. § 745.101. A sublease is subject to the disclosure provisions. The terms "lessor" or "lessee" include in their meanings the terms "sublessor" and "sublessee."

(n3)Footnote 3. 42 U.S.C. § 4852(a)(4); See 24 C.F.R. § 35.94(a) and 40 C.F.R. § 745.115(a).

(n4)Footnote 4. 24 C.F.R. § 35.80; 40 C.F.R. § 745.100.

(n5)Footnote 5. 42 U.S.C. § 4852d(a)(3); See 24 C.F.R. § 35.92(a)(2)-(3) and 40 C.F.R. § 745.113(a)(2)-(3).

(n6)Footnote 6. 24 C.F.R. § 35.92(a)(4)-(5); 40 C.F.R. § 745.113(a)(4)-(5).

(n7)Footnote 7. 42 U.S.C. § 4852d(a)(4); See 24 C.F.R. § 35.92(a)(6) and 40 C.F.R. § 745.113(a)(6).

(n8)Footnote 7.1. See *Nunez v. J.L. Sims Co., Inc.*, 2003 Ohio 3386, 2003 Ohio App. LEXIS 3075, at *7 (2003) .

(n9)Footnote 8. 42 U.S.C. § 4852d(c).

(n10)Footnote 9. 24 C.F.R. § 35.84(a); 40 C.F.R. § 745.102(a).

(n11)Footnote 10. 24 C.F.R. § 35.84(b); 40 C.F.R. § 745.102(b); See *Sweet v. Sheahan*, 235 F.3d 80, 89 (2d Cir. 2000) .

(n12)Footnote 10.1. See *Wallace v. United States*, 335 F. Supp. 2d 252, 259-260 (D. R.I. 2004) . See also *Gladysz v. Desmarais*, 2003 DNH 44, 2003 U.S. Dist. LEXIS 4252 , No. Civ. 02-208-B (D. N.H. Mar. 17, 2003) (unpublished decision) (children living in a home contaminated with lead-based paint, but who were not lessees of the property, could not bring suit under the Residential Lead-Based Paint Hazard Reduction Act of 1992 because they were not purchasers or lessees under the Act).

(n13)Footnote 10.2. See *Flowers v. ERA Unique Real Estate, Inc.*, 170 F. Supp. 2d 840, 843 (N.D. Ill. 2001) ; *Keegan v. Downing Agency, Inc.*, No. 03-56-P-H, 2003 U.S. Dist. LEXIS 8618, at *7 (D. Me. May 22, 2003) ; *Griffin v. Bruner*, 341 Ill. App. 3d 321, 326, 276 Ill. Dec. 215, 793 N.E.2d 974, 978 (Ill. Ct. App. 2003) .

(n14)Footnote 10.3. 24 C.F.R. § 35.86.

(n15)Footnote 11. 42 U.S.C. § 4822(e); 42 U.S.C. § 4851b(27); See 24 C.F.R. § 35.86 and 40 C.F.R. § 745.103.

(n16)Footnote 12. 24 C.F.R. § 35.82(b); 40 C.F.R. § 745.101(b).

(n17)Footnote 13. 24 C.F.R. § 35.82(c); 40 C.F.R. § 745.101(c).

(n18)Footnote 14. 24 C.F.R. § 35.82(d); 40 C.F.R. § 745.101(d).

(n19)Footnote 15. 24 C.F.R. § 35.88(a); 40 C.F.R. § 745.107(a).

(n20)Footnote 16. 24 C.F.R. § 35.88(a) and 40 C.F.R. § 745.107(a); See *Smith v. Coldwell Banker Real Estate Services, Inc.*, 122 F. Supp. 2d 267, 268 (Conn. 2000) .

(n21)Footnote 17. 24 C.F.R. § 35.88(b); 40 C.F.R. § 745.107(b).

(n22)Footnote 18. 24 C.F.R. § 35.88(b); 40 C.F.R. § 745.107(b).

(n23)Footnote 19. 24 C.F.R. § 35.82(a); 40 C.F.R. § 745.101(a).

(n24)Footnote 20. 42 U.S.C. § 4852d(a)(3).

(n25)Footnote 21. 42 U.S.C. § 4852d(a)(3); See 24 C.F.R. § 35.92(a) and 40 C.F.R. § 745.113(a).

(n26)Footnote 22. 42 U.S.C. § 4852d(a)(3); See 24 C.F.R. § 35.92(a)(1) and 40 C.F.R. § 745.113(a)(1).

(n27)Footnote 23. 24 C.F.R. § 35.92(b)(1); 40 C.F.R. § 745.113(b)(1).

(n28)Footnote 24. 24 C.F.R. § 35.92(b)(1); 40 C.F.R. § 745.113(b)(1).

(n29)Footnote 25. 42 U.S.C. § 4852d(a)(1)(A); See 24 C.F.R. § 35.88(a)(1) and 40 C.F.R. § 745.107(a)(1).

(n30)Footnote 26. The National Lead Information Center, a division of the Office of Pollution Prevention and Toxics, publishes this pamphlet. Copies can be ordered by calling 1-800-424-5323 or by ordering them online at www.epa.gov/lead/nlicdocs.htm.

While the regulation identifies a particular pamphlet approved by the EPA to be furnished to a prospective buyer, the regulation permits the furnishing of an equivalent pamphlet that has been approved for use in that state by the EPA. See *Nunez v. J.L. Sims Co., Inc.*, 2003 Ohio 3386, 2003 Ohio App. LEXIS 3075, at *10 (2003) citing 40 C.F.R. § 745.107(a).

(n31)Footnote 27. 42 U.S.C. § 4852d(a)(1)(B); See 24 C.F.R. § 35.88(a)(2) and 40 C.F.R. § 745.107(a)(2).

(n32)Footnote 28. 24 C.F.R. § 35.92(a)(2); 40 C.F.R. § 745.113(a)(2).

(n33)Footnote 29. 42 U.S.C. § 4852d(a)(1)(B); See 24 C.F.R. § 35.88(a)(4) and 40 C.F.R. § 745.107(a)(4).

(n34)Footnote 30. 24 C.F.R. § 35.92(a)(4)-(5); 40 C.F.R. § 745.113(a)(4)-(5).

(n35)Footnote 31. 24 C.F.R. § 35.88(a)(3); 40 C.F.R. § 745.107(a)(3).

(n36)Footnote 32. 42 U.S.C. § 4852d(a)(1)(C); See 24 C.F.R. § 35.90 and 40 C.F.R. § 745.110.

(n37)Footnote 32.1. See *Nunez v. J.L. Sims Co., Inc.*, 2003 Ohio 3386, 2003 Ohio App. LEXIS 3075, at *7-*8 (Ohio Ct. App. June 27, 2003) , *appeal denied*, 2003 Ohio 5772, 100 Ohio St. 3d 1471, 2003 Ohio LEXIS 2865 (Ohio 2003) , *reconsideration denied*, 2003 Ohio 6879, 100 Ohio St. 3d 1550, 800 N.E.2d 754, 2003 Ohio LEXIS 3564 (Ohio 2003) .

(n38)Footnote 33. 24 C.F.R. § 35.88(a)(2)-(3); 40 C.F.R. § 745.107(a)(2)-(3).

(n39)Footnote 34. 24 C.F.R. § 35.88(a)(4); 40 C.F.R. § 745.107(a)(4).

(n40)Footnote 35. *Smith v. Coldwell Banker Real Estate Services*, 122 F. Supp. 2d 267, 272 (Conn. 2000) .

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70 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers
CHAPTER 15A Lead-Based Paint Disclosure *

10A-15A Real Estate Brokerage Law and Practice § 15A.04

§ 15A.04 Records to Be Maintained by Seller/Lessor/Agent

Seller/lessors/agents must keep a copy of all documentation relating to every transaction for a period of up to 3 years from the date of each transaction. For a sales transaction, the period runs from a sale's completion date; and for a lease transaction, the period runs from the commencement of the leasing period. n1 The retention of the documents does not affect buyers'/lessors' ability to pursue their legal remedies for a violation of the disclosure rules. n2

Practice Note:

Although this regulation is ministerial, it is key to complying with the Act. Real estate brokerages must establish and maintain on a regular basis a filing system that is only applicable to lead-based paint. The duty to maintain the lead-based paint filing system should be delegated to a responsible staff member who should also be thoroughly familiar with the rules, as well as the civil and criminal penalties for failing to maintain an adequate filing system.

FOOTNOTES:

(n1)Footnote 1. 24 C.F.R. § 35.92(c)(1); 40 C.F.R. § 745.113(c)(1).

(n2)Footnote 2. 24 C.F.R. § 35.92(c)(2); 40 C.F.R. § 745.113(c)(2).

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71 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers
CHAPTER 15A Lead-Based Paint Disclosure *

10A-15A Real Estate Brokerage Law and Practice § 15A.05

§ 15A.05 Liability for Failure to Comply with Disclosure Rules

The burden of ensuring compliance with disclosure rules rests squarely on real estate agents if sellers/lessors contract with them for the sale or lease of residential property. n1 Real estate agents must not only inform sellers/lessors of the disclosure rules, n2 but must ensure that they comply. n3 If real estate agents inform sellers/lessors of their duties under the Act, liability does not attach to them if sellers/lessors fail to disclose the presence of known lead-based paint and its hazards. n4 Also, liability does not attach to sellers/lessors/agents where buyers' or lessees' legal representatives fail to forward disclosure materials to them if all necessary certifications are signed. n5

However, liability does attach if the facts of a case demonstrate that real estate agents have not complied with the disclosure requirements. In *Smith v. Coldwell Banker Real Estate Services, Inc.*, n6 the following facts were important in a determination that the real estate agent and the brokerage firm were liable to plaintiffs for trebled civil damages: n7

- The listing agent suggested that the sellers have a lead-based paint test done on the home that was built in the 1800s;
- The sellers had the test performed, and it revealed the presence of lead-based paint in January 1997;
- The sellers completed the lead-based paint disclosure form indicating the presence of lead-based paint and the report, returned it to the real estate agent, but failed to attach the report to the form;
- The real estate agent did not initial the lead-based paint disclosure form;
- The real estate agent requested the report but did not obtain a copy until 3 weeks before closing;
- The sellers and buyers entered into a purchase contract in the Spring of 1997;
- The buyers were verbally advised that there was lead-based paint in the home and were given a copy of the EPA handbook but were not given a copy of the report;
- The buyers never signed the lead-based paint disclosure form acknowledging receipt of the

lead-based paint information; and

- The lead-based paint report was given to the buyers at closing. n8

Clearly the real estate agent dropped the ball in this transaction. The court in finding against the real estate agent and brokerage firm stressed the importance of the timing of the disclosures. Disclosures have to be made prior to the acceptance of a purchase contract in order to allow buyers an opportunity to review the report and amend their offer if lead-based paint or lead-based paint hazards are found. n9

The greater liability for real estate agents and their brokerage firms is for a personal injury or wrongful death action brought under state law for damages caused by the presence of lead-based paint or lead-based paint hazards. A failure or refusal to comply with the federal or state residential real estate disclosure rules would be an element in any of these types of cases. However, in Virginia, sellers/lessors/agents are not liable in a personal injury or wrongful death case if the federal residential real estate disclosures are made. n10

FOOTNOTES:

(n1)Footnote 1. 42 U.S.C. § 4852d(a)(4); See 24 C.F.R. § 35.94(a) and 40 C.F.R. § 745.115(a).

(n2)Footnote 2. 24 C.F.R. § 35.94(a)(1); 40 C.F.R. § 745.115(a)(1).

(n3)Footnote 3. 24 C.F.R. § 35.94(a)(2); 40 C.F.R. § 745.115(a)(2).

(n4)Footnote 4. 24 C.F.R. § 35.94b); 40 C.F.R. § 745.115(b).

(n5)Footnote 5. 24 C.F.R. § 35.92(d); 40 C.F.R. § 745.113(d).

(n6)Footnote 6. *Smith v. Coldwell Banker Real Estate Services, Inc.*, 122 F. Supp. 2d 267 (Conn. 2000) .

(n7)Footnote 7. *Smith v. Coldwell Banker Real Estate Services*, 122 F. Supp. 2d 267, 273-274 (Conn. 2000) .

(n8)Footnote 8. *Smith v. Coldwell Banker Real Estate Services*, 122 F. Supp. 2d 267, 270-271 (Conn. 2000) .

(n9)Footnote 9. *Smith v. Coldwell Banker Real Estate Services*, 122 F. Supp. 2d 267, 272 (Conn. 2000) .

(n10)Footnote 10. Va. Code Ann. § 8.02-226.7.

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72 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers
CHAPTER 15A Lead-Based Paint Disclosure *

10A-15A Real Estate Brokerage Law and Practice § 15A.06

§ 15A.06 Enforcement of Disclosure Rules

[1] Action by Persons to Force EPA/HUD to Comply

A civil action n1 can be commenced by any person against the United States and any other governmental entity, to (1) restrain a violation of the Toxic Substances Control Act n2 or (2) compel the EPA or HUD to perform any delegated duty n3 found in the Toxic Substances Control Act. Jurisdiction is in the appropriate federal district court (1) where the violation occurred, (2) where the defendant resides, or (3) where the defendant has its principal place of business. n4 Similar cases can be consolidated. n5 Court costs, attorney's fees, and expert witness fees may be awarded in an initial action where appropriate. In a subsequent appeal, court costs and attorney's fees may also be awarded. n6

[2] Unlawful Actions Under 42 U.S.C. § 4852d

It is unlawful to knowingly (1) fail or refuse to comply with the disclosure rules for sellers, lessors, and agents; n7(2) fail or refuse the opportunity to buyers/lessees to conduct a risk assessment; (3) fail or refuse to obtain a certification and acknowledgment of disclosure; and (4) fail or refuse to comply with an agent's responsibilities. n8 If a violation is found, a monetary penalty can be imposed under 42 U.S.C. § 3545. n9

[3] Civil Penalties Under § 42 U.S.C. § 3545--HUD

[a] Civil Penalty and Hearings

A knowing and material violation of any of the disclosure rules will subject violators to a civil monetary penalty of up to \$10,000.00. n10 HUD issues a notice of hearing to violators, and a hearing may be requested by a violator after receipt of notice. If a hearing is not requested within 15 days of the notice, the Secretary may impose the civil monetary penalty. The decision by the Secretary under these circumstances is final and unappealable. n11

If a hearing is requested, the following factors are considered in determining the amount of the civil monetary penalty:

- The gravity of the offense;
- The ability to pay the penalty;

- Injury to the public;
- Benefits received;
- Deterrence of future violations; and
- Such other factors as the Secretary may consider appropriate. n12

[b] Appeals of Civil Penalties

An appeal to an appropriate court of appeals can be made no later than 20 days after the entry of an initial order. The only matters that can be heard on appeal are those addressed at the hearing stage. n13 However, upon a showing of extraordinary circumstances, the court of appeals may (1) consider objections that were not raised at an initial hearing or (2) remand the matter to the Secretary for the taking of additional evidence. n14

[c] Payment and Collection of Civil Penalty

The Secretary is authorized to compromise a civil penalty, as well as to collect the full amount. n15 The Attorney General is authorized to recover the amount of a civil penalty, plus any attorney's fees and expenses incurred by the United States, after the judgment becomes final. Jurisdiction for this proceeding is in the appropriate federal district court. n16 The validity or appropriateness of the civil penalty is not subject to review in a collection proceeding. n17

[4] Civil and Criminal Penalties Under 15 U.S.C. § 2615--EPA

[a] Civil Penalty

In addition to the civil penalties under 42 U.S.C. § 3545, a violator may also be subjected to civil and criminal penalties under 15 U.S.C. § 2615. n18 For each day that a violation continues, a civil penalty shall be imposed. n19 The civil penalty imposed by the EPA for each violation committed from July 29, 1997 to the present is \$11,000 and \$10,000 for each violation committed on or before July 28, 1997. n20

In 1997 the EPA began enforcing the disclosure rule. From 1997 through 1998, the EPA issued 22 Notices of Noncompliance to sellers, brokers, realtors, agents, and landlords for violations of the disclosure rule. n21 On July 28, 1998, the EPA filed 4 civil complaints with penalties of \$439,725.00 against the U.S. Department of the Navy, a real estate agency, and other individuals. n22 Another case in September 1998 was filed against a management firm and was settled because the firm voluntarily agreed to disclose and correct violations of the disclosure rule. n23 On February 4, 1999, the EPA issued another 4 civil complaints against landlords with proposed penalties of \$56,200. n24

The EPA encourages those affected by the disclosure rule to comply with the rule. There are two such policies:

- (1) the EPA Audit Policy (www.epa.gov/oeca/auditpol.html) and
- (2) the Small Business policy (www.epa.gov/oeca/smbusi.html). n25

Those willing to cooperate with the EPA will be in a better position than those who ignore their responsibilities under the disclosure rule.

The administrator, prior to issuing an order for the imposition of a civil penalty, must give notice of the action to the violator. The violator has 15 days from the date of the notice to request a hearing. n26 A hearing on the merits will determine the amount of the civil penalty. Factors that will either aggravate or mitigate the amount of the civil penalty

imposed include:

- The nature, circumstances, extent, and gravity of the violation(s);
- The ability to pay;
- The ability to continue to do business;
- A history of prior violations;
- Degree of culpability; and
- Such other matters as justice may require. n27

An appeal of the civil penalty may be made in the United States District Court for the District of Columbia, in the federal district court where the violator resides, or where the violator transacts business. The appeal must be perfected within 30 days of the date of the administrative order. n28

The administrator is authorized to collect the full amount and can also compromise the amount of the civil penalty. n29 The attorney general is authorized to recover the amount of the civil penalty, plus interest, after the judgment becomes final. Jurisdiction for this proceeding is in the appropriate federal district court. The validity, amount, or appropriateness of the civil penalty is not subject to review in a collection proceeding. n30

[b] Criminal Sanctions

A violator who knowingly and willfully violates the disclosure rules in a sale or lease transaction will face the following criminal sanctions. n31

- A fine up to \$25,000 for each violation;
- Imprisonment for up to 1 year; or
- Both.

[5] Injunction Proceeding by HUD

In addition to the civil monetary penalties by HUD and the EPA, the secretary may bring an injunction proceeding in the appropriate federal district court to prohibit continuing violations. n32

[6] Civil Damages and Costs Awarded

The Residential Lead Based Paint Hazard Reduction Act of 1992 (RLBPHRA) n33 provides for the imposition of penalties for violations of this Act. n34 A violator shall be jointly and severally liable to the buyer/lessee for treble damages for a knowing violation. n35 And, the court may award the prevailing party court costs, reasonable attorney's fees, and any expert witness fees. n36

The Toxic Substance Control Act (TSCA) n37 authorizes suit against the United States only for injunctive relief, and therefore vests exclusive jurisdiction in the United States District Courts. n38 Section 2619 of the TSCA creates a private right of action against any person, including the United States, for violations of the TSCA, however, 15 U.S.C. § 2619 does not mandate compensation for damages sustained as a result of a violation of any section of the TSCA. n39

Neither the TSCA nor the RLBPHRA n40 award damages for a violation of any section thereof. n41

FOOTNOTES:

(n1)Footnote 1. 42 U.S.C. § 4852d(a)(5); 15 U.S.C. § 2619.

(n2)Footnote 2. 15 U.S.C. § 2619(a)(1).

(n3)Footnote 3. 15 U.S.C. § 2619(a)(2).

(n4)Footnote 4. 15 U.S.C. § 2619(a).

(n5)Footnote 5. 15 U.S.C. § 2619(d).

(n6)Footnote 6. 15 U.S.C. § 2619(c)(2).

(n7)Footnote 7. 42 U.S.C. § 4852d(b)(5); 42 U.S.C. § 3545; See 24 C.F.R. § 35.96(a) and 40 C.F.R. § 745.118(a).

(n8)Footnote 8. 15 U.S.C. § 2689; 42 U.S.C. § 4852d(b)(1); See 24 C.F.R. § 35.96(e) and 40 C.F.R. § 745.118(e).

(n9)Footnote 9. 42 U.S.C. § 4852d(b)(1).

(n10)Footnote 10. 42 U.S.C. § 3545(f)(2); 42 U.S.C. § 4852d(b)(1); See 24 C.F.R. § 35.96(a) and 40 C.F.R. § 745.118(a).

(n11)Footnote 11. 42 U.S.C. § 3545(g)(1).

(n12)Footnote 12. 42 U.S.C. § 3545(g)(2).

(n13)Footnote 13. 42 U.S.C. § 3545(h)(1).

(n14)Footnote 14. 42 U.S.C. § 3545(h)(2).

(n15)Footnote 15. 42 U.S.C. § 3545(j).

(n16)Footnote 16. 42 U.S.C. § 3545(i).

(n17)Footnote 17. 42 U.S.C. § 3545(i).

(n18)Footnote 18. 40 C.F.R. § 745.118(f).

(n19)Footnote 19. 15 U.S.C. § 2615(a)(1); See 40 C.F.R. § 745.118(f).

(n20)Footnote 20. 40 C.F.R. § 745.118(f).

(n21)Footnote 21. *EPA Takes Enforcement Actions Against Violators of Lead Paint Disclosure Rule*, Enforcement Alert, EPA Office of Regulatory Enforcement, Vol. 1 No. 4 (Oct. 1998) (visited Oct. 18, 1999) <http://es.epa.gov/oeca/ore/enfalert/lead-pt.html>.

(n22)Footnote 22. *EPA Takes Enforcement Actions Against Violators of Lead Paint Disclosure Rule*, Enforcement Alert, EPA Office of Regulatory Enforcement, Vol. 1 No. 4 (Oct. 1998) (visited Oct. 18, 1999) <http://es.epa.gov/oeca/ore/enfalert/lead-pt.html>.

(n23)Footnote 23. *EPA Takes Enforcement Actions Against Violators of Lead Paint Disclosure Rule*, Enforcement Alert, EPA Office of Regulatory Enforcement, Vol. 1 No. 4 (Oct. 1998) (visited Oct. 18, 1999)

<http://es.epa.gov/oeca/ore/enfalert/lead-pt.html>.

(n24)Footnote 24. *Landlords Fined Under Lead Paint Disclosure Regulations*, Environmental News, Region 7, United States Environmental Protection Agency, (Feb 4, 1999) (visited Oct. 18, 1999) <http://www.epa.gov/region07/newsrel/n02499.htm>.

(n25)Footnote 25. *EPA Takes Enforcement Actions Against Violators of Lead Paint Disclosure Rule*, Enforcement Alert, EPA Office of Regulatory Enforcement, Vol. 1 No. 4 (Oct. 1998) (visited Oct. 18, 1999) <http://es.epa.gov/oeca/ore/enfalert/lead-pt.html>.

(n26)Footnote 26. 15 U.S.C. § 2615(a)(2)(A).

(n27)Footnote 27. 15 U.S.C. § 2615(a)(2)(B).

(n28)Footnote 28. 15 U.S.C. § 2615(a)(3).

(n29)Footnote 29. 15 U.S.C. § 2615(a)(2)(C).

(n30)Footnote 30. 15 U.S.C. § 2615(a)(4).

(n31)Footnote 31. 15 U.S.C. § 2615(b).

(n32)Footnote 32. 42 U.S.C. § 4852d(b)(2); See 24 C.F.R. § 35.96(b) and 40 C.F.R. § 745.118(b).

(n33)Footnote 33. 42 U.S.C. § 4851 et seq.

(n34)Footnote 34. 42 U.S.C. § 4852d(b).

(n35)Footnote 35. 42 U.S.C. § 4852d(b)(3); See 24 C.F.R. § 35.96(c) and 40 C.F.R. § 745.118(c); *Cudjoe v. Department of Veterans Affairs*, 426 F.3d 241, 246 (2005) .

(n36)Footnote 36. 42 U.S.C. § 4852d(b)(4); See 24 C.F.R. § 35.96(d) and 40 C.F.R. § 745.118(d).

(n37)Footnote 37. 15 U.S.C. § 2601 et seq.

(n38)Footnote 38. See *Ayres v. United States*, 66 Fed. Cl. 551, 561 (2005) reconsideration granted by, in part, reconsideration denied by, in part, transfer granted by, claim dismissed by, in part, motion denied, 67 Fed. Cl. 776 (2005).

(n39)Footnote 39. *Ayres v. United States*, 66 Fed. Cl. 551, 561 (2005) , reconsideration granted by, in part, reconsideration denied by, in part, transfer granted by, claim dismissed by, in part, motion denied, 67 Fed. Cl. 776 (2005) .

(n40)Footnote 40. 42 U.S.C. § 4851 et seq.

(n41)Footnote 41. *Ayres v. United States*, 67 Fed. Cl. 776, 778 (2005) . See also *Cudjoe v. Department of Veterans Affairs*, 426 F.3d 241, 247 (2005) ("Because an express, unambiguous waiver is required to waive sovereign immunity, we will not construe 'civil penalty' under 15 U.S.C. § 2688 broadly to include the private suit for money damages available under 42 U.S.C. § 4852d(b)(3).").

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73 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers
CHAPTER 15A Lead-Based Paint Disclosure *

10A-15A Real Estate Brokerage Law and Practice § 15A.07

§ 15A.07 Compliance with State Lead-Based Paint Disclosure Laws

[1] State Laws Are in Addition to Federal Disclosure Requirements

States and localities are beginning to enact statutes that are applicable to the disclosure by sellers/lessors/agents of lead-based paint and its hazards in residential housing. However, these state or local statutes are not within the jurisdiction of the EPA or HUD. Any state law disclosure requirements must be complied with, in addition to the federal disclosure requirements. n1 The state law requirements add another layer of potential liability for sellers/lessors/agents.

[2] Colorado

The Colorado Real Estate Commission has promulgated two forms for use in lead-based paint disclosure: (1) Lead-Based Paint Obligations of Seller and (2) Lead-Based Disclosure (Sales). See <http://www.dora.state.co.us/Real-Estate/comm.htm> for these forms.

[3] Maryland

Maryland's Lead Paint Act requires registration of rental properties built before 1950. Such properties must be registered with the State Department of the Environment. n1.1 The Act's stated purpose is "to reduce the incidence of childhood lead poisoning, while maintaining the stock of available affordable rental housing." n1.2 The Act also requires that property "owners" take specific precautionary measures, including maintenance and repair, to reduce the risk of tenant exposure to lead-based paint. In exchange for compliance, the Act provides limited liability to "owners" if a tenant suffers from lead poisoning and commences a lawsuit. n1.3

Maryland's high court has held that a leasing agent or real estate broker is not an "owner" under Maryland's Lead Poisoning Prevention Act n1.4 when the agent or broker does not own, hold or control the rental property. n1.5 The court stated that delivering possession to a tenant coupled with an agreement allowing the tenant to purchase the property does not constitute the "control" contemplated by the Act. n1.6 Merely being entitled to receive a commission in the event the tenant purchased the property did not lead to the conclusion that an agent or broker maintained "control" over the property. n1.7

[4] Massachusetts

Massachusetts has standard notification forms and other informational materials that inform buyers of the (1) possible presence of dangerous levels of lead, (2) the symptoms and treatment of lead poisoning, (3) liability for a failure to abate or contain lead hazards, and (4) prohibitions against unlawful discrimination. n2 Sellers must deliver to buyers prior to entering purchase contracts (1) a completed standard form and informational materials and (2) a letter of interim control or a letter of full compliance. Sellers and agents must disclose any knowledge to buyers of the presence of paint, plaster, or other accessible structural materials containing dangerous lead levels. n3 Sellers and agents must advise buyers of the availability of lead inspections, and buyers must be given a 10-day period in which to obtain an inspection. Agents must verbally inform buyers of the provisions of *Mass. Gen. Laws Ann. ch. 111, §§ 189A to 199B* and obtain a certification that buyers have been notified. n4 Sellers are liable for damages caused by any failure to comply, as well as penalties of up to \$1,000.00. Agents who fail to comply are engaged in an unfair and deceptive practice and subject to actions under *Mass. Gen. Laws Ann. ch. 93A*. n5

[5] Rhode Island

Rhode Island has the most extensive statute applicable to agents and sellers for disclosure of lead-based paint in the country. Agents and sellers must include the federal statutory language in every contract for the purchase and sale of residential real estate. In addition, inspection reports and educational materials must be given to buyers. A failure to include the lead-based paint statutory language or to provide inspection reports and educational materials can subject agents and sellers to a civil penalty ranging from \$100.00 to \$500.00 per occurrence. Also, buyers can void purchase contracts if not provided with the required lead-based paint information. n6

[6] Utah

The Utah Real Estate Commission has promulgated two forms for use in lead-based paint disclosure: (1) Disclosure and Acknowledgment Regarding Lead-Based Paint and/or Lead-Based Paint Hazards and (2) Lead-Based Paint Addendum to Real Estate Purchase Contract. See <http://www.eq.state.ut.us/eqair/HAPS/lead/index.htm> for these forms.

FOOTNOTES:

(n1)Footnote 1. 24 C.F.R. § 35.98; 40 C.F.R. § 745.119.

(n2)Footnote 1.1. See *Md. Code Ann., Envir. § 6-811*.

(n3)Footnote 1.2. See *Md. Code Ann., Envir. § 6-802*.

(n4)Footnote 1.3. See *Md. Code Ann., Envir. §§ 6-815 - 6-836*.

(n5)Footnote 1.4. *Md. Code Ann., Envir. § 6-801(o)*.

(n6)Footnote 1.5. *Dyer v. Otis Warren Real Estate Co.*, 371 Md. 576, 590, 810 A.2d 938, 940 (Md. 2002) .

(n7)Footnote 1.6. *Dyer v. Otis Warren Real Estate Co.*, 371 Md. 576, 590, 810 A.2d 938, 946 (Md. 2002) .

(n8)Footnote 1.7. *Dyer v. Otis Warren Real Estate Co.*, 371 Md. 576, 590, 810 A.2d 938, 947 (Md. 2002) .

(n9)Footnote 2. *Mass. Gen. Laws Ann. ch. 111, § 197A(a)*.

(n10)Footnote 3. *Mass. Gen. Laws Ann. ch. 111, § 197A(b)*.

(n11)Footnote 4. *Mass. Gen. Laws Ann. ch. 111, § 197A(b)(1)-(2)*.

(n12)Footnote 5. *Mass. Gen. Laws Ann. ch. 111, § 197A(e)*.

(n13)Footnote 6. *R.I. Gen. Laws § 5-20.8-11; See R.I. Gen. Laws §§ 23-24.6-1 et seq.*

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74 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers
CHAPTER 15A Lead-Based Paint Disclosure *

10A-15A Real Estate Brokerage Law and Practice § 15A.08

§ 15A.08 Lead-Based Paint Disclosure Forms

[1] Addendum to Sales Contract

Lead Warning Statement

Every purchaser of any interest in residential real property on which a residential building was built prior to 1978 is notified that such property may present exposure to lead from lead based paint that may place young children at risk of developing lead poisoning. Lead poisoning in young children may produce permanent neurological damage, including learning disabilities, reduced intelligent quotient, behavioral problems, and impaired memory. Lead poisoning also poses a particular risk to pregnant women. The seller of any interest in residential real property is required to provide the buyer with any information on lead-based paint hazards from risk assessments or inspections in the seller's possession and notify the buyer of any known lead-based paint hazards. A risk assessment or inspection for possible lead-based paint hazards is recommended prior to purchase.

Seller's Disclosure

- (a) Presence of lead-based paint and/or lead-based paint hazards in the housing (check (i) or (ii) below):
 - (i) _____ Known lead-based paint/and or lead-based paint hazards are present in the housing (explain),
 - (ii) _____ Seller has no knowledge of lead based paint and/or lead-based paint hazards in the housing.
- (b) Records and reports available to the seller (check (i) or (ii) below):
 - (i) _____ Seller has provided the purchaser with all available records and reports pertaining to lead based paint and/or lead-based paint hazards in the housing (list documents below),
 - (ii) _____ Seller has no reports or records pertaining to lead-based paint and/or lead-based paint hazards in the housing,

Purchaser's Acknowledgment (initial)

- (c) _____ Purchaser has received copies of all information listed above.
- (d) _____ Purchaser has received the pamphlet *Protect Your Family from Lead in Your Home* and has read and understood its contents.
- (e) _____ Purchaser has (check (i) or (ii) below):
 - (i) _____ received a 10-day opportunity (or mutually agreed upon period) to conduct a risk assessment or inspection for the presence of lead-based paint and/or lead-based paint hazards; or

(ii) _____ waived the opportunity to conduct a risk assessment or inspection for the presence of lead-based paint and/or lead-based paint hazards.

Agent's Acknowledgment (initial)

_____ Agent has informed the seller of the seller's obligations under 42 U.S.C. § 4852d and is aware of his/her responsibility to ensure compliance.

Certification of Accuracy

The following parties have reviewed the information above and certify, to the best of their knowledge, that the information they have provided is true and accurate.

_____	_____	_____	_____
Seller	Date	Seller	Date
_____	_____	_____	_____
Purchaser	Date	Purchaser	Date
_____	_____	_____	_____
Agent	Date	Agent	Date

NOTARY'S ACKNOWLEDGMENT OPTIONAL

[2] Provisions Applicable to Leases

Lead Warning Statement

Housing built before 1978 may contain lead-based paint. Lead from paint, paint chips, and dust can pose health hazards if not managed properly. Lead exposure is especially harmful to young children and pregnant women. Before renting pre-1978 housing, lessors must disclose the presence of lead-based paint and/or lead-based paint hazards in the dwelling. Lessees must also receive a federally approved pamphlet on lead poisoning prevention.

Lessor's Disclosure

- (a) Presence of lead-based paint and/or lead-based paint hazards in the housing (check (i) or (ii) below:
- (i) _____ Known lead-based paint/and or lead-based paint hazards are present in the housing (explain),
 - (ii) _____ Lessor has no knowledge of lead based paint and/or lead-based paint hazards in the housing.
- (b) Records and reports available to the lessor (check (i) or (ii) below:
- (i) _____ Lessor has provided the lessee with all available records and reports pertaining to lead based paint and/or lead-based paint hazards in the housing (list documents below),
 - (ii) _____ Lessor has no reports or records pertaining to lead-based paint and/or lead-based paint hazards in the housing,

Lessee's Acknowledgment (initial)

- (c) _____ Lessee has received copies of all information listed above.
- (d) _____ Lessee has received the pamphlet *Protect Your Family from Lead in Your Home* and has read and understood its contents.

Agent's Acknowledgment (initial)

(f) _____ Agent has informed the lessor of the lessor's obligations under 42 U.S.C. § 4852d and is aware of his/her responsibility to ensure compliance.

Certification of Accuracy

The following parties have reviewed the information above and certify, to the best of their knowledge, that the information they have provided is true and accurate.

_____	_____	_____	_____
Lessor	Date	Lessor	Date
_____	_____	_____	_____
Lessee	Date	Lessee	Date
_____	_____	_____	_____
Agent	Date	Agent	Date

NOTARY'S ACKNOWLEDGMENT OPTIONAL

[3] Real Estate Contract--Sample Language for Risk Assessment Contingency

This contract is contingent upon a risk assessment or inspection of the property for the presence of lead-based paint and/or lead-based paint hazards at the Purchaser's expense until 9 p.m. on the tenth calendar day after ratification (insert date 10 days after contract ratification or a date mutually agreed upon). (Intact lead-based paint that is in good condition is not necessarily a hazard. See the EPA pamphlet Protect Your Family from Lead in Your Home for more information.) This contingency will terminate at the above predetermined deadline unless the Purchaser (or Purchaser's agent) delivers to the Seller (or Seller's agent) a written contract addendum listing the specific existing deficiencies and corrections needed, together with a copy of the inspection and/or risk assessment report. The Seller may, at the Seller's option, within days after Delivery of the addendum, elect in writing whether to correct the condition(s) prior to settlement. If the Seller will correct the condition, the Seller shall furnish the Purchaser with certification from a risk assessor or inspector demonstrating that the condition has been remedied before the date of settlement. If the Seller does not elect to make the repairs, or if the Seller makes a counteroffer, the Purchaser shall have

_____ Days to respond to the counter-offer or remove this contingency and take the property in "as is" condition or this contract shall become void. The Purchaser may remove this contingency at any time without cause.

* This chapter was revised by Leslie Ann Shaner, Esq., of Lynchburg, Virginia.



75 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers
CHAPTER 15A Lead-Based Paint Disclosure *

10A-15A Real Estate Brokerage Law and Practice § 15A.09

§ 15A.09 Guidance Provided by EPA and HUD for Interpreting Lead-Based Paint Disclosure Requirements

[1] Purpose of Guidance Provided by EPA and HUD

Responding to questions from the real estate community about the federal lead-based paint disclosure requirements discussed in this chapter, EPA and HUD have published guidance in the form of questions and answers. Such guidance is available in two guidance documents reproduced below. The second guidance, which was issued December 5, 1996, clarifies some answers that appeared in the first, which was issued August 20, 1996.

Information about forthcoming guidance documents can be obtained from the National Lead Information Clearinghouse at (800) 424-LEAD.

[2] HUD and EPA Guidance on Lead-Based Paint Disclosure Requirements--Part I (August 20, 1996)

**INTERPRETIVE GUIDANCE FOR
THE REAL ESTATE COMMUNITY ON THE
REQUIREMENTS FOR DISCLOSURE OF INFORMATION
CONCERNING LEAD-BASED PAINT IN HOUSING**

August 20, 1996

**Prepared by the
Office of Pollution Prevention and Toxics
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Washington, D.C. 20460**

and

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U.S. Department of Housing and Urban Development
Washington, D.C. 20410**

TABLE OF CONTENTS

TOPIC	QUESTION #
INTRODUCTION	
EFFECTIVE DATE OF RULE	
General	1, 2
Sale Transactions	3
Rental Agreements	4, 5
APPLICABILITY	
Housing--Pre-1978	6
0-Bedroom Dwellings	7
Disabilities	8
Daycare	9
DISCLOSURE	
Co-ops and Condos	10
Authorized Representatives and Agents	11, 12
Type of Documents	
Summary vs. Reports	13, 14
Unit vs. Whole Building	15
Timing of Disclosure for Lessors	16, 17
Signatures on Disclosure Forms	18
LEAD-BASED PAINT FREE	19, 20, 21, 22
PAMPHLET ISSUES	
Approval	23
Empty Space	24
Reproduction	25, 26, 27
STATE PROGRAMS	28

**INTERPRETIVE GUIDANCE FOR
THE REAL ESTATE COMMUNITY ON THE
REQUIREMENTS FOR DISCLOSURE OF INFORMATION
CONCERNING LEAD-BASED PAINT IN HOUSING**

INTRODUCTION

On March 6, 1996, the Environmental Protection Agency (EPA) and the Department of Housing and Urban Development (HUD) published a final rule, "Lead; Requirements for Disclosure of Known Lead-Based Paint and/or Lead-Based Paint Hazards in Housing," (*61 FR 9064-9088*). This final rule requires persons selling or leasing most residential housing built before 1978 to provide purchasers and renters with a federally approved lead hazard information pamphlet and to disclose known lead-based paint and/or lead-based paint hazards. The specific requirements of the final rule are discussed in detail in the March 1996 notice. Other documents used in the development of this rule are included in a public docket available for inspection at EPA.

The requirements of the final rule are applicable as follows: (1) For owners of more than four residential dwellings, the requirements are applicable beginning on September 6, 1996, and (2) For owners of one to four residential dwellings, the requirements are applicable beginning on December 6, 1996.

Subsequent to the publication of the final rule, EPA and HUD have received questions from the real estate community about implementation of the rule. EPA and HUD have developed this "Interpretive Guidance" document to supplement the information presented in the final rule. This guidance will be expanded and updated as necessary.

To assist the general public, EPA and HUD made the document, "EPA and HUD Real Estate Notification and Disclosure Rule: Questions and Answers" available when they published the final rule. This document, EPA-747-F-96-001, March, 1996, and others may be obtained from the National Lead Information Clearinghouse (NLIC) at (800) 424-LEAD, or TDD(800) 526-5456 for the hearing impaired. Requests may also be sent by fax to (202) 659-1192 or by Internet E-mail to ehc @ cais.com.

EFFECTIVE DATE OF RULE

General

1. Q: What part of a sale or rental transaction must occur on or after the effective date for the rule to apply?

A: The rule generally applies if the buyer or renter becomes obligated under a contract to purchase or lease target housing on or after the effective date of the rule (September 6, 1996 or December 6, 1996, depending on the number of dwelling units owned).

2. Q: What is the effective date for sale or rental transactions involving cooperatives ("co-ops") and condominiums ("condos")?

A: EPA and HUD recognize that both the individual unit "owner" and the corporation or homeowner association may have an ownership interest in co-ops and condos (see answer to question # 10). However, EPA and HUD believe that when a co-op or condo unit is sold or rented, the focus of the transaction is the single unit. Therefore, as a matter of policy, EPA and HUD have determined that the effective date will be based on the number of dwellings "owned" (meaning in some cases, the number of co-op shares or condo units owned) by the individual seller or lessor as opposed to the number of units that comprise the co-op or condo. Where co-ops or condos are being directly sold or leased by the corporation (as in a renovated building being newly offered), however, the applicable date would depend on the number of units owned by the corporation.

Sale Transactions

3. Q: Is the rule effective for sales agreements entered into before the effective date, where closing occurs after the effective date?

A: The rule will not apply to target housing transactions where the sales agreement is signed and all contingencies have been removed before the effective date, even if closing occurs after the effective date.

Rental Agreements

4. Q: What is the effective date of the rule for the following situation? A real estate or property management firm represents 40 property owners who own four units each. Each of the 40 property owners' effective date would clearly be December 6, 1996 (four or less units) if they were managing their own properties. However, because the real estate or

property management firm is managing 160 rental units (40x4) on behalf of the owners, would they be subject to the September 6, 1996 effective date?

A: The effective dates in the rule refer specifically to the number of residential dwellings owned. Although the property manager is managing more than four properties, each individual owner only owns four properties. Therefore, the effective date for property managers of properties with four units each per owner would be December 6, 1996.

5. Q: In some cases, as in the New York City Rent Stabilization Law, owners must offer renewal leases to rent-stabilized tenants 120 to 150 days before their current leases expire. This 120-150 day period may occur prior to the September 6 effective date, but the renewal lease could start after the September 6 effective date. Must an owner include the disclosure forms with the 120-150 day offer of renewal, even though this occurs before the effective date?

A: The rule applies to obligations made on or after the effective date. Thus, the date upon which a renewal lease is offered is not particularly relevant under the rule. It is the date that the offer is accepted, if such acceptance constitutes an obligation to rent, that determines whether or not the rules apply. For written leases, this would mean that regardless of when the renewal leases are offered to the tenant, the rule would apply to all renewal leases signed by the tenant (and any contingencies have been removed) on or after the effective date. The rule does not apply to cases where the renewal leases have been signed by tenants (and contingencies removed) prior to the effective date, even if the lease does not begin until after the effective date.

APPLICABILITY

Housing -- Pre-1978

6. Q: Target housing is housing built before 1978. Does this include or exclude housing that was started in 1977, but not completed until 1978?

A: EPA and HUD consider "housing constructed before 1978" to mean housing for which a construction permit was obtained (or if no permit was obtained, housing in which construction was started) before January 1, 1978.

0-Bedroom Dwellings

7. Q: Would "0-bedroom dwellings" include college fraternity and sorority houses, dormitory suites, married student housing, and university-owned apartments?

A: The rule excludes "0-bedroom dwellings." The definition of "0-bedroom dwelling" includes "rentals of individual rooms in residential dwellings," and EPA and HUD believe that rentals of rooms in fraternity and sorority houses generally fit that model and would be exempt. The definition of "0-bedroom dwelling" also specifically includes dormitory housing, which would encompass typical dormitory suites. However, married student housing and university-owned apartments typically are not "0-bedroom dwellings" and would be covered by the rule if they meet the other criteria for target housing set out in the rule.

Disabilities

8. Q: What is the definition of housing for persons with disabilities?

A: Housing for persons with disabilities means communities or similar types of housing specifically designed for one or more persons with a physical or mental impairment which substantially limits one or more major life activities at the time of initial occupancy (HUD, Fair Housing Accessibility Guidelines, 56 FR 9472, 3/6/91).

However, the exclusion for persons with disabilities from the definition of "target housing" does not cover housing in which any child who is less than 6 years of age resides or is expected to reside.

Daycare

9. Q: Are daycare centers included in the scope of the final rule?

A: Section 1018 of Title X focusses specifically on residential housing. As such, the rule does not apply to commercial facilities such as daycare centers and nurseries, except where such facilities are part of a residential dwelling.

DISCLOSURE

Co-ops and Condos

10. Q: Who is responsible for disclosure in the case of co-ops or condos? What about common areas?

A: EPA and HUD recognize that co-ops and condos can be structured in a variety of ways. For example, in the case of co-ops, a corporation may be established and this corporation would own all the units and common areas comprising the co-op; individual unit "owners" would own shares in the corporation and might also own occupancy rights or lease a unit from the corporation. In the case of condos, individual condo unit owners may own their unit; all condo unit owners may jointly own the common areas and a homeowners association may be established to represent the interests of all the unit owners.

Under this rule, a person selling or leasing a co-op or condo unit (whether the unit owner owns the unit in its entirety or owns shares in a corporation) would be responsible for complying with disclosure requirements both with respect to the unit itself and to any associated interest in common areas that is transferred. In the case of a corporation or homeowner association owning an interest in all the units or common areas, the corporation or association would be responsible for disclosing information regarding those areas when their interest in them is sold or leased. Additionally, in the case of a corporation or homeowner association which does not have an ownership interest in the co-op or condo but represents the joint interests of all the unit owners, the corporation or association, acting as legal representative of the owners (see also question #11), would be responsible for disclosing information regarding the areas subject to the transaction. In such a case, an individual seller or lessor is responsible for timely notifying the corporation or association before a buyer or lessee becomes obligated, so that the corporation or association has an opportunity to comply with disclosure requirements.

Where the corporation or association is not a seller or lessor and is not a legal representative of the owners, the corporation or association has no disclosure responsibilities. However, in this case, the individual seller or lessor must obtain any information held by the corporation or association and include it in the disclosure to ensure compliance with this rule. Parties with the disclosure responsibilities must also sign the disclosure form certifying accuracy.

Authorized Representatives and Agents

11. Q: May a seller or lessor authorize a representative or agent to discharge the seller's or lessor's responsibilities under the rule, including signing the certification of accuracy required in the contract?

A: Yes. The seller or lessor may authorize a representative or agent to fulfill the seller or lessor's requirements under this rule; however, the seller or lessor is ultimately responsible for full compliance with the requirements of this rule. The representative must disclose the presence of lead-based paint or lead-based paint hazards if

known by either the representative or the seller or lessor and disclose and provide records available to the representative and the seller or lessor. The designated representative or agent may sign on behalf of the seller or lessor. If the representative or agent acting on behalf of the seller or lessor is also functioning as an Agent, as defined under 24 CFR 35.86 and 40 CFR 745.103, they are also required to carry out those duties and to sign the certification in that capacity.

12. Q: Given that the selling agent in real estate transactions may be prohibited by State or local law from direct communication with the seller, how can they inform the seller of his or her responsibilities under this rule?

A: Where State or local laws prohibit direct contact, EPA and HUD have determined that the selling agent may inform the listing agent of the seller's responsibilities under this rule and may sign the disclosure form to that effect. Regardless of the actions or involvement of the selling agent, however, the listing agent is still responsible for informing the seller of his or her duties under this rule.

Type of Documents

Summary vs. Reports

13. Q: The rule states that lessors must give each lessee copies of all records or reports relating to lead-based paint hazards in the target housing. But in some cases it may be impractical to give each lessee his or her own report--the document's length may make copying costs prohibitively high. In such situations, what steps may a lessor take to make the document available to a lessee without actually giving the lessee his or her own copy? For example, may the lessor give the lessee a summary of the document and give the lessee an opportunity to read a copy of the full document in the lessor's office?

A: The rule requires lessors to provide lessees with available records or reports pertaining to lead-based paint and/or lead-based paint hazards. However, EPA and HUD recognize that in some cases, the actual transfer of multiple voluminous technical documents may be burdensome for both lessors and lessees.

For lengthy court documents and construction documents, EPA and HUD have determined that these documents may be excerpted, provided that all information regarding lead-based paint and lead-based paint hazards is included along with sufficient background information, so that the context of the excerpt is clear.

For paint inspection and risk assessment reports, EPA and HUD have determined that lessors may provide lessees with a summary of all paint inspection and risk assessment reports, provided that the summary is prepared by a certified paint inspector or risk assessor. Where information about specific units is inconsistent with the conclusions as a whole, this information should be included along with the summary of general conclusions.

In situations where documents are excerpted or summarized, they must be accompanied by a list of all complete records and reports available to the lessee. If the lessor chooses to provide excerpts or summaries and document lists in lieu of complete copies, the lessor must provide the lessee with the opportunity to review the complete documents in a central location on the premises, if feasible, and the opportunity to receive copies of any documents not provided, upon request, and at no cost to the lessee.

In the case of sales transactions, the seller must provide complete documents to the buyer. In order to assure that future buyers have access to complete records and reports, EPA and HUD believe that complete document transfer, rather than excerpts or summaries, is necessary.

14. Q: What methods of distribution are available to a seller or lessor when providing copies of relevant materials to a

purchaser or lessee? May records and reports be provided via the Internet?

A: While EPA and HUD recognize that electronic transfer may be acceptable to some purchasers and lessees, the Agencies are concerned that relying exclusively on electronic distribution may deny some purchasers or lessees access to the information, due to the lack of access to the necessary technology. Therefore, EPA and HUD would deem electronic transfer of documents acceptable only if the purchaser or lessee agrees in writing to accept the documents in that format.

Unit vs. Whole Building

15. Q: In cases where there have been building-wide evaluation or reduction activities, must the contents of the reports be disclosed to every prospective purchaser or lessee of individual units that may not have been specifically addressed?

A: EPA and HUD believe that information and reports on other units in the target housing are directly relevant to prospective purchasers and lessees, if the information results from evaluation or reduction efforts in the target housing as a whole. In large multifamily properties, evaluations do not necessarily examine every dwelling unit in the housing. Rather, inspectors or risk assessors examine a representative sample of the dwelling units and apply the findings to the housing as a whole. While such evaluations might not include data on a specific unit, the fact that the evaluation was designed to provide information on the housing as a whole makes the report's findings relevant. If there is unit-specific information that was not part of a building-wide evaluation, such information must be disclosed only during sales or rentals of the specific units that were evaluated.

Timing of Disclosure for Lessors

16. Q: If a renter has a month-to-month lease arrangement, what is the responsibility of the owner (lessor) with respect to providing copies of the booklet and disclosure forms?

A: The rule excludes from its requirements short-term leases of 100 days or less, where no lease renewal or extension can occur. If both parties wish to extend a previously exempted short-term lease beyond the 100-day limit, all provisions of this rule must be satisfied in full before any such "extension" occurs.

In an "open-ended" month-to-month lease arrangement (i.e., an arrangement with no specified termination date), whether written or unwritten, the rule applies at the time of the initial lease agreement, since the parties have not limited the lease term to 100 days or less.

In some cases, leasing arrangements switch to "open-ended" month-to-month arrangements after an initial period of occupancy and may continue indefinitely. Under such circumstances, EPA and HUD interpret renewal to occur at the point when the lessee becomes obligated to this change in the rental period. Another significant change in the lease agreement constituting lease renewal would be a rental rate adjustment. Following any such alteration of terms, either an initial disclosure would be required if no disclosure had been made, or disclosure would be required of any new information obtained subsequent to an initial disclosure.

17. Q: Can an owner send the disclosure forms to all existing tenants at one time, without waiting for the tenants to renew their leases or must the owner wait for each tenant's renewal to come up?

A: Disclosure may be made any time before the lessee becomes obligated under a new lease (see response to question #18). However, if disclosure is made in advance of lease renewal and the owner subsequently obtains new information relevant to disclosure, this new information must be disclosed before the lessee becomes obligated under a new lease.

Signatures on Disclosure Forms

18. Q: Is an original signature required on the disclosure form?

A: No. The signature does not have to be original for purposes of the Federal rule. It may be reproduced, for example, by photocopy, facsimile, autopen or rubber stamp. EPA and HUD note that use of a reproduced signature does not relieve the signatory from its responsibility for compliance with this rule. Sellers and lessors are advised to ascertain whether original signatures are required under State law governing the execution of documents associated with sales or rental transactions.

LEAD-BASED PAINT FREE

19. Q: Can inspectors certified in one State perform inspections for the lead-based paint free exemption in another State?

A: Currently yes. An inspector certified to perform inspections in a State with its own certification and training requirements may perform inspections for the lead-based paint free exemption in that State and in other States. Inspectors are advised, however, that separate State laws may also apply to their activities. Within two years, a Federal program or authorized State program will be in place to certify inspectors. After such Federal or authorized State program takes effect, all inspections for purposes of the lead-based free exemption must be performed by an inspector certified in the Federal or Federally-authorized program applicable in the State where the inspection will take place.

20. Q: What sampling is required to support a determination of lead-based paint free? What sampling criteria should be used when conducting a "surface-by-surface investigation" in multi-family housing? Does Chapter 7 of the HUD Guidelines provide adequate criteria regarding how many and what type of samples need to be taken, or are the criteria to be used established by the State where the individual is certified?

A: The rule defines inspection as a (1) a surface-by-surface investigation to determine the presence of lead-based paint, and (2) the provision of a report explaining the investigation. Before EPA implements the Federal training and certification program and the State authorization program under TSCA, certified inspectors should use the sampling methodology provided by their certifying State for determining what number of units must be inspected to have a representative sample. If the State in which the inspector is certified does not provide a sampling protocol, the inspector should either sample every unit in multi-family housing or use the sampling guidelines provided in Chapter 7 of the HUD's "Guidelines for the Evaluation and Control of Lead-Based Paint Hazards in Housing," (HUD Guidelines), June, 1995 or subsequent updates.

21. Q: Do the States have the authority to alter the definition of lead-based paint in the rule that will be used to apply the lead-based paint free exemption?

A: No. The rule, at 24 CFR 35.86 and 40 CFR 745.103, states that a lead-based paint free finding must demonstrate that the building is free of "paint or other surface coatings that contain lead equal to or in excess of 1.0 milligrams per square centimeter or 0.5 percent by weight." The State standards are not applicable, whether more or less stringent, since a State cannot amend Federal requirements.

22. Q: Will lead-based paint free findings carry over once the EPA section 402/404 rule is implemented or will reinspections be required in States that do not have programs?

A: Prior to Federal or State implementation of section 402/404, reinspections will not be required for target housing that was already inspected and found to be lead-based paint free by a certified inspector. An inspection

conducted prior to Federal or State implementation of section 402/404 requirements by a non-certified inspector is acceptable if the past inspection report has been reviewed and approved in writing by a certified inspector.

Once the Federal or authorized State programs take effect, all new inspections for purposes of the lead-based free exemption must be performed by an inspector certified in the Federal or Federally-authorized State program applicable in the State where the inspection will take place. An inspection conducted prior to Federal or State implementation of section 402/404 requirements by a non-certified inspector will be acceptable, if the past inspection report has been reviewed and approved in writing by an inspector certified in the Federal or Federally-authorized State program applicable in the State where the inspection took place.

PAMPHLET ISSUES

Approval

23. Q: Can private groups seek approval under section 1018 for use of alternatives to the Federal pamphlet?

A: The rule provides flexibility for States to obtain EPA approval for use of alternative State information materials in lieu of the Federal Pamphlet "Protect Your Family from Lead in Your Home." However, this pamphlet approval process does not apply to private groups that seek to develop lead hazard information materials.

EPA and HUD specifically included these State pamphlet provisions to minimize the overlap between the Federal program and State laws and regulations that may already require the distribution of State information materials during sales or leasing transactions. While EPA and HUD cannot approve materials developed by a private group as a national alternative to the Federal pamphlet, private groups may ask States to consider using their pamphlets as a State alternative. States interested in developing an alternative pamphlet should contact their EPA regional offices.

Empty Space

24. Q: The back page of the booklet contains an empty rectangular space at the bottom. Is it permissible for an individual or private party, i.e. real estate firm, to place their name, address, company logo or advertising material in this space?

A: In the Notice of Availability for the final pamphlet (60 FR 39168 , August 1, 1995), EPA indicated that to encourage private reproduction of the pamphlet, space was added on the pamphlet's back cover for names and contact information of organizations that reprint and distribute the pamphlet.

Reproduction

25. Q: Do pages 12 (State Health and Environmental Agencies) and 13 (EPA Regional Offices and CPSC Regional Offices) of the Federal pamphlet have to be included? When the pamphlet is developed for use only in one State, the information on pages 12 and 13 may not be necessary.

A: Provided that the State and Federal regional information on the State developing the pamphlet is retained, the printer can reformat the information on page 12 and 13 to omit information on other State and regional offices.

26. Q: If a private-sector party or association wishes to reproduce the pamphlet at its own expense, do the graphic illustrations have to be included?

A: The pamphlet reproduced by a private organization must include all graphics provided in the original.

27. Q: Can the pamphlet be provided in an 8-1/2 x 14 inch format as an attachment to the sale or rental contract?

A: EPA has developed and made available an alternative format of the pamphlet on 8-1/2 x 14 inch legal paper to accommodate sellers or lessors who wish to provide the pamphlet as part of the contract. The attachment includes EPA's and HUD's sample disclosure and acknowledgement forms. Provided that the seller or lessor adds the appropriate regional and state contacts in the space provided, the legal size format may be used as an alternative to the 5-1/2 x 8-1/2 inch version of the pamphlet. The public may also revise the included sample disclosure and acknowledgement forms provided that the forms contain all the elements set out in the content requirements in 24 CFR 35.92 and 40 CFR 745.113. These materials may be obtained from the NLIC (see Information section of this document).

STATE PROGRAMS

28. Q: Can States obtain authorization to administer and enforce their disclosure programs in lieu of the Federal program?

A: No. EPA and HUD have determined that Title X does not provide authority to delegate the administration and enforcement of the section 1018 disclosure requirements to State programs. However, EPA and HUD believe that Title X provides flexibility to EPA to approve State alternatives to the Federal pamphlet. Additionally, the rule does not require the use of a Federal disclosure form as an attachment to sales and leasing contracts. States, sellers, landlords, and agents have flexibility to draft disclosure and acknowledgement attachments to fit their needs, provided that the attachments address the content requirements laid out in 24 CFR 35.92 and 40 CFR 745.113.

[3] HUD and EPA Guidance on Lead-Based Paint Disclosure Requirements--Part II (December 5, 1996)

INTERPRETIVE GUIDANCE FOR THE REAL ESTATE COMMUNITY ON THE REQUIREMENTS FOR DISCLOSURE OF INFORMATION CONCERNING LEAD-BASED PAINT IN HOUSING

PART II

December 5, 1996

Prepared by the

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TABLE OF CONTENTS

TOPIC	QUESTION #
INTRODUCTION	
EFFECTIVE DATE OF RULE	29
APPLICABILITY	
Trusts	30
Gifts	31
Housing in Lieu of Compensation	32
Mobile Homes	33
Rehabilitated Property	34
DISCLOSURE	
Who Must Disclose	35, 36, 37
What Must Be Disclosed	38, 39, 40, 41, 42
Disclosure Process	43, 44, 45, 46, 47
LEAD-BASED PAINT FREE HOUSING	48, 49
INSPECTIONS	
Auctions	50
Certified Inspectors	51
PAMPHLET ISSUES	52, 53

**INTERPRETIVE GUIDANCE FOR
THE REAL ESTATE COMMUNITY ON THE
REQUIREMENTS FOR DISCLOSURE OF INFORMATION
CONCERNING LEAD-BASED PAINT IN HOUSING
PART II**

INTRODUCTION

On March 6, 1996, the Environmental Protection Agency (EPA) and the Department of Housing and Urban Development (HUD) published a final rule, "Lead; Requirements for Disclosure of Known Lead-Based Paint and/or Lead-Based Paint Hazards in Housing," (*61 FR 9064-9088*). This final rule requires persons selling or leasing most residential housing built before 1978 to provide purchasers and renters with a federally approved lead hazard information pamphlet and to disclose known lead-based paint and/or lead-based paint hazards. The specific requirements of the final rule are discussed in detail in the March 1996 notice. Other documents used in the development of this rule are included in a public docket available for inspection at EPA.

The requirements of the final rule are applicable as follows: (1) For owners of more than four residential dwellings, the requirements were applicable beginning on September 6, 1996, and (2) For owners of one to four residential dwellings, the requirements are applicable beginning on December 6, 1996.

Subsequent to the publication of the final rule, EPA and HUD have received questions from the real estate community about implementation of the rule. EPA and HUD developed the first "Interpretive Guidance" document, dated August 20, 1996, containing questions 1-28, to supplement the information presented in the final rule. EPA and HUD have

developed this Part II of the "Interpretive Guidance" to answer additional questions received from the real estate community. This guidance will be expanded and updated as necessary.

The August 20, 1996 Interpretive Guidance, and other support documents, may be obtained from the National Lead Information Clearinghouse (NLIC) at (800) 424-LEAD, or TDD(800) 526-5456 for the hearing impaired. Requests may also be sent by fax to (202) 659-1192 or by Internet E-mail to ehc @ cais.com. The Interpretive Guidance documents and other lead information can also be accessed electronically as follows:

EPA's web site at <http://www.epa.gov/opptintr/lead/index.html>

HUD's web site at <http://www.hud.gov/lea/leahome.html>.

EFFECTIVE DATE OF RULE

29. If a contract is signed before the effective date of the rule but contingencies are satisfied after the effective date, would the contract be subject to the disclosure requirements of the rule?

EPA and HUD wish to clarify the discussion of the point of obligation as it relates to contingencies in questions numbered 3 and 5 in the August 20, 1996 document for sellers and lessors. Only contracts or leases signed on or after the effective date are subject to the rule. Contracts signed before the applicable effective date are not subject to the requirements, even if they have contingencies that are satisfied or otherwise lifted after the effective date or the closing occurs after the effective date. This is because the terms and conditions of the contract were negotiated, agreed upon, and endorsed by the parties before the 1018 rule became effective, and the rule cannot be applied retroactively to require a change in those terms and conditions.

APPLICABILITY

Trusts

30. In the rule, the term "owner" is defined to include trusts. However, trustees are not specifically listed as "owners." Are trustees intended to be exempt from the rule requirements? In the case of a trust, which party (the beneficial owner or the trustee) is expected to comply with the rule?

In cases where a trustee has been given authority to sell or lease target housing by a beneficial owner, the trustee would have the responsibility to comply with the requirements of this rule. Otherwise, the responsibility would rest with the beneficial owner. In both cases, the effective date for compliance would be determined by the number of units owned by the beneficial owner involved in the particular transaction.

Gifts

31. Does the rule cover owners who give property away, i.e., there is no sale or exchange of money or other consideration?

No. The rule does not cover a situation where property is transferred as a gift.

Housing in lieu of compensation

32. Is housing that is provided in lieu of monetary compensation included in the rule?

Yes. Housing that is provided in lieu of monetary compensation to employees, pastors, etc. is not exempt.

Mobile homes

33. Are mobile homes included in the definition of "target housing" under the disclosure rule?

Yes. Mobile homes (manufactured housing) built before 1978 are included in the definition of "target housing." Although these units may have been constructed largely of pre-finished materials, some surfaces, both interior and exterior, may have been painted with lead-based paint. Therefore, EPA and HUD cannot exempt mobile homes as a class. Houseboats, recreational vehicles, etc. are not considered "target housing."

Rehabilitated property

34. Is a pre-1978 residential property subject to the rule if the property has been completely rehabilitated, such that all pre-1978 painted components have been removed or replaced after 1977?

EPA and HUD will consider amending the disclosure rule to exempt residential properties in which all interior and exterior architectural components, such as doors, windows, walls and all other painted surfaces (including any outbuildings, fences, signs, etc) that were painted prior to December 31, 1977 have been removed or replaced after December 31, 1977.

DISCLOSURE**Who Must Disclose****Co-ops and condos**

35. Who is responsible for disclosure in the case of cooperatives or condominiums ("co-ops or condos")? What about common areas?

This question originally appeared as number 10 in the "Interpretive Guidance" document dated August 20, 1996. EPA and HUD recognize that the response to question 10 was confusing and, upon further reflection, now offer the following guidance in lieu of the response to question 10.

Under the final rule implementing Section 1018, the disclosure responsibility rests with the owner(s) of the target housing which is being sold or leased. Generally, the "owners" in co-op and condo arrangements are the persons who purchase shares in the co-op and possess occupancy rights to individual units or purchase a condo unit and a percentage of the common area, or lease individual units from the co-op or condo. The co-op corporation or condo association represents the joint interests of these owners. EPA and HUD believe that, in such situations, the responsibility for disclosure regarding the unit being sold or leased should reside with the individual owners of the unit. This responsibility also includes disclosure of information concerning common areas.

Lead-based paint information, particularly regarding common areas, may not be in the hands of the individual owners. In such cases, it may be administratively more efficient for individual owners to arrange for disclosure of information through the corporation or association. But in no instance should information held by the corporation or association be withheld, as it is considered known information held by the individual owners or reasonably obtainable by the owners, i.e. the corporation or association simply holds such information for the benefit of the individual owners and in no way does the representative arrangement shield the individual owners from disclosure responsibility.

On occasion, a co-op or condo association, rather than an individual unit owner, may possess occupancy rights (however denominated) to a unit being transferred at the point of transfer. In these cases, the co-op or condo association, rather than a unit owner, must comply with the disclosure requirements of the rule.

In co-op arrangements where owners purchase shares and also lease access to individual units from the co-op, EPA and HUD consider the purchase of shares to be the primary transaction for purposes of the disclosure rule. Therefore, in those cases, EPA and HUD do not consider the co-op to be a lessor and the individual unit "owner" to be the lessee and would not impose separate disclosure requirements on the co-op as lessor under this rule.

Timeshares

36. Who must disclose in sales or leases involving timeshares?

Timeshares, like co-ops and condos, can be structured in a variety of ways. Nevertheless, the owner(s) of a timeshare must disclose in any sale or lease of the timeshare, if the unit qualifies as target housing. Thus, as with all sales or leases under the final rule, the disclosure responsibility rests with the owner(s) of the target housing who is selling or leasing a timeshare, and such an obligation is not affected by multiple-ownership arrangements.

Owners who are selling or leasing a timeshare should disclose any information they have about the presence of lead-based paint or lead-based paint hazards in the timeshare. In this case, EPA and HUD would consider "reasonably obtainable" records to include those records retained by the management company for the timeshare.

Owners of timeshares who lease the unit should note the relief from disclosure responsibility provided in 24 CFR § 35.82(c) and 40 CFR § 745.101(c). These provisions exclude short-term leases of 100 days or less, where no lease renewal or extension can occur, from coverage under the final rule. In the case of timeshares, EPA and HUD have interpreted this exclusion to mean leases of 100 consecutive days per visit.

New owners

37. Does the purchase of a rental unit require the new owner (buyer), who has received disclosure, to disclose that information to the current renter?

In this situation, disclosure is required only if there is a new lease or when renewal of the lease takes place. If there is a significant change in the lease, i.e., a new owner decides to change the name on the lease or the amount of rent is changed, this constitutes renewal, and disclosure of any information not previously disclosed should take place at that time.

What Must Be Disclosed

Property

38. Does the disclosure requirement extend to garages, tool sheds, other outbuildings, signs, fences, and mechanical equipment on the property?

Yes, if these items are affixed to the residential portion of the property. The Lead Warning Statement required by the statute states that the purchaser is notified that the residential real property may present exposure to lead. Thus, disclosure of known lead-based paint or lead-based paint hazards associated with any items that are affixed to the property must be made. However, because section 1018 is limited to contracts for sale or lease of housing, the regulations apply only to those items that are located on that part of the real property that is used

primarily for purposes associated with residential use. EPA and HUD consider garages for personal vehicles, storage sheds, play areas and play equipment, air conditioners, storage tanks for home fuel, yards, driveways, fences and signs to be examples of items that are associated with residential use, in addition to structures actually used by people as living quarters. For most urban and many suburban residential lots, the entire property is normally considered as being devoted to residential use. In the case of real property that is used for nonresidential as well as residential purposes, a judgment should be made as to which part of the property is used primarily for residential purposes.

Mini-blinds

39. If a home has lead-containing non-glossy vinyl mini-blinds, must this be disclosed to fulfill the 1018 disclosure requirements?

No. For purposes of section 1018, lead-containing mini-blinds in and of themselves are not a lead-based paint hazard and their mere presence need not be disclosed. The lead in lead-containing non-glossy mini-blinds is not a component of paint or any other surface coating and, therefore, does not fall within the definition of "lead-based paint" under 24 CFR § 35.85 and 40 CFR § 745.103. Further, because a "lead-based paint hazard" as defined under 24 CFR § 35.85 and 40 CFR § 745.103 is a condition that causes exposure to lead in paint, or lead-contaminated dust or soil, the lead in mini-blinds could not constitute a lead-based paint hazard by virtue of its presence in the mini-blinds. However, if the lead stabilizer in lead-containing mini-blinds breaks down into dust, it could contribute to lead contaminated dust and, therefore, could become a lead-based paint hazard which would have to be disclosed. Lead-contaminated dust, by definition, means dust with lead above certain levels regardless of the source.

Home test kits

40. EPA's pamphlet "Protect Your Family from Lead in Your Home" states that recent studies suggest that home test kits for lead are not always accurate, and that consumers should not rely on home test kits to assure safety. Therefore, does the use of home test kits for lead constitute knowledge of lead-based paint for disclosure purposes?

Yes. If an owner has information obtained from the use of a home test kit for lead, that information must be disclosed; however, the owner should also disclose information about the reliability of the test kit results.

Information subject to disclosure

41. Must records/reports involving lead-based paint or lead-based paint hazards that no longer exist be disclosed?

Yes. Lessors and sellers are obligated to disclose all known information, including information which shows that the lead-based paint or lead-based paint hazards have been corrected. Section 1018 provides for disclosure of any available lead hazard evaluation reports, and the rule requires the disclosure of the existence of any available records or reports pertaining to lead-based paint or lead-based paint hazards.

Existing summaries

42. When lessors provide a summary of an inspection report or risk assessment, in lieu of a full report, may they use a summary prepared before the effective date of this rule?

Yes. A summary prepared prior to the effective date of the section 1018 rule may be used in lieu of a paint inspection or risk assessment report, since the rule cannot be applied retroactively to summaries done before the rule. In question #13 of the August 20, 1996 Interpretive Guidance Document, EPA and HUD discussed generally

how lessors may provide summaries in lieu of complete inspection and risk assessment reports.

Disclosure Process

Disclosure forms

43. May sellers, lessors, and agents develop their own disclosure forms?

Sellers, lessors, and agents may develop their disclosure forms as long as the forms meet the requirements of 24 CFR § 35.92 and 40 CFR § 745.113. Persons developing disclosure forms are advised to determine whether they must meet additional state requirements before finalizing their forms. For example, in some states, licensed real estate agents must have forms which they develop approved by an attorney before any forms may be used as part of a real estate transaction.

Type size

44. How large must the type size be for the Lead Warning Statements included on the disclosure forms?

The type size of the Lead Warning Statements must be as large or larger than the predominant type size on the disclosure form. This is illustrated in the sample disclosure forms included in the preamble to the final rule (60 FR 9074 -75, March 6, 1996).

42 U.S.C. 4852d

45. The regulations at 24 CFR § 35.92(a)(6)(i) and (b)(5)(i) and 40 CFR § 745.113(a)(6)(i) and (b)(5)(i) require agents to sign the disclosure forms, indicating that they have informed sellers or lessors of their obligations under 42 U.S.C. 4852d. What does 42 U.S.C. 4852d refer to?

The citation 42 U.S.C. (United States Code) 4852d is the authority under which the section 1018 disclosure rule was written. Therefore, the agent is certifying that the seller or lessor has been informed of the requirements of the statute as implemented by the final rule.

Some copies of the sample disclosure forms that have been distributed have incorrectly listed the citation as 42 U.S.C. 4582d. EPA and HUD have corrected subsequent versions of the sample disclosure forms, but are aware that some persons may still be using copies of the forms containing the incorrect cite.

Multiple lessees

46. How many lead information pamphlets must be distributed in a lease transaction involving multiple lessees? In college towns, large living units are frequently rented on a yearly basis by groups of students, all of whom are required to sign as lessees. In those cases, must each individual lessee be given a pamphlet, or can one copy be provided per lease transaction?

Lessors must provide one copy of the pamphlet per lease transaction; however, in cases involving multiple lessees, lessors should make additional copies of the pamphlet readily available and offer them to everyone who signs the lease.

Lessee refusal to sign

47. How do lessors fulfill their disclosure requirements when lessees refuse to accept the lead information pamphlet

and/or refuse to sign the disclosure forms?

When a lessee is unavailable for signature or refuses to accept the pamphlet and/or sign the disclosure form, lessors may certify attempted delivery of the pamphlet, disclosure information, and disclosure form. This certification may be included on the copy of the disclosure form retained by the lessor or attached to that disclosure form and should indicate exactly how delivery was attempted and what occurred (e.g., sent material certified mail and never heard from lessee; lessee refused to sign disclosure form).

For example, lessors may deliver the pamphlet, disclosure information, and disclosure form by certified mail, return receipt requested. Lessors should then retain the signed certified mail receipt in their records as evidence that the material was delivered to the lessees. In cases where the lessee refuses to sign the disclosure form, lessors may certify in writing that the delivery was attempted and indicate why a signed and dated disclosure form could not be obtained.

LEAD-BASED PAINT FREE HOUSING

Recordkeeping for exemption

48. What type of paperwork should a rental property owner maintain to prove that the property is lead-based paint free? Should the inspector or risk assessor provide a lead-based paint free certificate, or a letter to the owner?

A rental property owner should maintain a copy of the inspection report that is prepared by a certified inspector and indicates there is no lead-based paint in or on the target housing in order to prove that the property is lead-based paint free.

Abatement

49. If I own a number of pre-1978 homes which I lease to the public, and I "abate" them through encapsulation and/or enclosure, can I take advantage of the lead-based paint free exemption?

The regulations at 24 CFR § 35.82(b) and 40 CFR § 745.101(b) exclude from coverage leases of target housing that have been found to be lead-based paint free by an inspector certified under the Federal certification program or under a federally accredited State or tribal program. Lead-based paint free housing is target housing that has been found to be free of paint or other surface coatings that contain lead equal to or in excess of 1.0 milligram per square centimeter or 0.5 percent by weight.

Lead-based paint that has been encapsulated or enclosed would not result in a finding by a certified inspector that the target housing is free of lead-based paint. Therefore, the lead-based paint free exemption would not be available to excuse a lessor from the disclosure requirements under the final rule.

INSPECTIONS

Auctions

50. How does the 10 day inspection period apply to real estate sold at auctions? Real estate auctions take place at a set time and set place. Typically, there is a period of "due diligence" prior to the auction when all potential buyers are permitted to view the property, ask any questions and conduct any testing, such as a termite inspection or a test of structural soundness. Would it be permissible for the seller to give potential buyers any information on lead-based paint and allow lead-based paint inspections during this period as well?

Prior to an auction not associated with a foreclosure proceeding (which would be exempted under the rule), there is typically a period of "due diligence" that allows all potential buyers to view the property, ask any questions and conduct any testing, such as a termite inspection or a test of structural soundness. EPA and HUD have determined that during this due diligence period, the seller may give potential buyers any information on lead-based paint, allow lead-based paint inspections, and otherwise comply with this rule.

EPA and HUD are considering the appropriate way to address auctions lacking a "due diligence" period.

Certified Inspectors

51. Where can I find a certified inspector or information on certified inspections?

HUD has a current list of certified inspectors available electronically. HUD's website address is <http://www.hud.gov/lea/leahome.html>. EPA is in the process of developing a pamphlet entitled "Finding a Qualified Lead Professional for Your Home" (EPA-747-F-96-006), which will assist owners in asking appropriate questions when hiring professional to do this work. This information will be available in the near future from the National Lead Information Clearinghouse (NLIC) (see information in Introduction).

PAMPHLET ISSUES

Information changes

52. Has any of the information in the Federal pamphlet changed?

Yes. Some of the telephone numbers for State agencies have changed. The following list provides the status of numbers only for States which have had changes. If a state is not listed below, the phone number listed in the pamphlet remains the primary contact number.

State	Phone as listed	Status of phone line
Alabama	205-242-5661	Change to 334-613-5373
Alaska	907-465-5152	Also 907-745-3236
Arizona	602-542-7303	Change to 602-230-5830
Connecticut	203-566-5808	Change to 860-509-7299
Hawaii	808-832-5860	Also 808-586-5800
Idaho	208-332-5544	Change to 208-334-6584
Illinois	800-972-2026	Not accessible from outside state
Indiana	317-382-6662	Change to 317-232-8219
Iowa	800-972-2026	Not accessible from outside state
Kentucky	502-564-2154	Also 502-564-4537
Louisiana	504-765-0219	Also 504-765-2547
Massachusetts	800-532-9571	Not accessible from outside state
Minnesota	612-627-5498	Also 612-215-0890
Mississippi	601-960-7463	Also 601-961-5011
Missouri	314-526-4911	Also 800-575-9267
Montana	406-444-3671	Also 406-444-5267

Nebraska	402-471-2451	Typo 402-471-2541
New Mexico	505-841-8024	Change to 505-768-4390
New York	800-458-1158	Not accessible from outside state
North Carolina	919-715-3292	Also 919-715-5381
Oklahoma	405-271-5220	Change to 405-290-8247
Pennsylvania	717-782-2884	Change to 717-783-8451
Tennessee	615-741-5683	Also 615-532-7778
Virginia	800-523-4019	Not accessible from outside state
Washington	206-753-2556	Change to 360-753-3855
Wisconsin	608-266-5885	Change to 608-266-5817

Different formats

53. Is the Federal pamphlet, "Protect Your Family from Lead in Your Home" available in different versions?

Yes. See the list below for information about the availability of both the Federal pamphlet and sample disclosure forms from various sources.

1018 DOCUMENT AVAILABILITY

PAMPHLET--"PROTECT YOUR FAMILY FROM LEAD IN YOUR HOME"

- (1) 3-Color, 8.5 x 5.5", in English or Spanish
- (2) B&W, 8.5 x 11", "double sided double," in English or Spanish
- (3) 3-Color or B&W, 8.5 x 5.5", "Internet single sided on 11" paper," in English or Spanish
- (4) B&W, 8.5 x 14", "quad version," in English or Spanish (includes sample disclosure forms for rental & sales)

SAMPLE LEAD DISCLOSURE FORMS

- (5) 8.5 x 11", for rental leases, in English or Spanish
- (6) 8.5 x 11", for home sales, in English or Spanish

SOURCE

Single copies of (1) available free from:

National Lead Information Clearinghouse (NLIC)

Phone: 800-424-LEAD

Fax: 202-659-1192

Multiple copies of (1) available from:

U.S. Government Printing Office

Phone: 202-512-1800

\$26.00 for 50 copies

Printable electronic files of (3) through (6) available from:

Internet at Internet address: <http://www.epa.gov/lead-pm>

Available for loan to public from the U.S. EPA:

Color separated negatives of (1)

B&W camera ready copy of (2), (4)-(6)

FAX to U.S. EPA at 202-260-0770

Attention: 1018 Lead Document Control Officer

* This chapter was revised by Leslie Ann Shaner, Esq., of Lynchburg, Virginia.



76 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 16 The Broker's Role in Property Management *

10A-16 Real Estate Brokerage Law and Practice 16.syn

§ 16.syn Synopsis to Chapter 16: The Broker's Role in Property Management *

§ 16.01 Introduction

§ 16.02 Regulation of Professional Property Managers

[1] General Qualifications

[2] Broker Licensing Requirements

§ 16.03 The Budgeting Process

[1] Introduction

[2] Expense Budget Items

[a] Base Rental Income

[b] Vacancy Forecast

[c] Percentage Rental Income

[d] Extra Tenant Services

[e] Interest Income

[f] Management Fees

[g] Leasing Commissions

[3] The Capital Budget

§ 16.04 Legal Aspects of the Owner-Manager Relationship

- [1] Introduction
- [2] Contractual Issues
- [3] Practical Considerations
- [4] Manager Self-Dealing

§ 16.05 The Property Management Agreement

- [1] Introduction
- [2] General Legal Issues
- [3] Specific Agreement Provisions
 - [a] Identification of the Property and the Parties
 - [b] Term of the Agreement
 - [c] Manager's Responsibilities
 - [i] Rent.
 - [ii] Leases.
 - [iii] Operations.
 - [A] Inspections.
 - [B] Third-Party Contracts.
 - [C] Manager's Employees.
 - [D] Independent Contractor Considerations.
 - [d] Lawsuits
 - [e] Record Reporting and Maintenance
 - [f] Risk Allocation
 - [i] Insurance.
 - [A] Property Insurance.
 - [B] Liability Insurance.

[C] Workers Compensation.

[D] Comprehensive Automotive Insurance.

[E] General Insurance Considerations.

[ii] Indemnity.

[g] Repairs and Maintenance

[h] Basic Documents

[i] Termination

§ 16.06 Legal Aspects of the Manager-Tenant Relationship

[1] Introduction

[2] Types of Leasehold Estates

[a] Term Tenancy

[b] Periodic Tenancy

[c] Tenancy at Will

[d] Tenancy at Sufferance

[3] Elements of a Valid Lease

[a] The Requirement of a Writing

[b] Identification of the Parties

[c] Description of the Lease Term and the Premises

[d] Rent

[4] Other Standard Lease Provisions

[a] Legal Use of the Premises

[b] Assignment and Subleasing

[c] Security Deposits

[d] Landlord's Obligations

[i] Delivery of Possession.

[ii] Quiet Enjoyment.

[iii] Maintenance and Repair.

[e] Tenant's Obligations

[i] General.

[ii] Removal of Fixtures.

[f] Tenant Indemnity

[g] Environmental Issues

[5] The Uniform Residential Landlord and Tenant Act

[a] Introduction

[b] Prohibited Provisions

[c] Presumed Provisions

[d] Unconscionability

[e] Building Rules

[f] Tenant's Obligations and Landlord's Remedies

[g] Landlord's Obligations and Tenant's Remedies

[6] Landlord's Tort Liability

[a] Introduction

[b] Undisclosed Dangerous Conditions

[c] Premises Open to the Public

[d] Failure to Maintain Common Areas

[e] Criminal Activity

§ 16.07 Forms

[1] Property Management Agreement

[2] Hazardous Materials Testing Procedures Agreement

§ 16.08 Code of Professional Ethics of the Certified Property Manager



77 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers

CHAPTER 16 The Broker's Role in Property Management *

10A-16 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 16 discusses the real estate broker's role in managing income-producing property. This specialized industry entails legal duties and responsibilities to both the property owner and the tenants. Some brokers are not involved in property management while others devote most of their energies to this activity. Regardless, in most jurisdictions, property managers usually must be licensed as a broker in the jurisdiction where the property is located.

While sales generally involve short-term relationships between real estate brokers and their clients, property management usually involves a relationship that lasts a year or more. Brokers who manage income-producing property are involved in the budgeting process with their clients. A properly prepared budget functions as a road map and allows both the property owner and the broker-manager to respond to budget areas that do not perform as anticipated.

Chapter 16 discusses the licensing and regulation of professional property managers (§ 16.02), the budgeting process (§ 16.03), the legal aspects of the owner-manager relationship (§ 16.04), the property management agreement (§ 16.05), and the legal aspects of the manager-tenant relationship (§ 16.06). The chapter concludes with illustrative forms for property management (§ 16.07[1]) and hazardous materials testing (§ 16.07[2]), and the Code of Ethics of the Certified Property Manager (§ 16.08).

For additional discussion of these and other related issues see the following publications:

- Current Leasing Law and Techniques (Matthew Bender).
- Real Estate Financing, Ch. 7, *Drafting Ground and Space Leases to Promote Mortgageability*, Ch. 7A, *Mortgageability of Ground and Space Leases*, and Ch. 14, *Financing Shopping Centers* (Matthew Bender).



78 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 16 The Broker's Role in Property Management *

10A-16 Real Estate Brokerage Law and Practice § 16.01

§ 16.01 Introduction

The professional management of income-producing property by someone other than the property owner is a highly specialized and fast-growing industry. To comply with the relevant licensing laws in most jurisdictions, virtually all professional property managers are also licensed real estate brokers. Many of the skills required to be a successful broker, such as market familiarity, financial training, and strong interpersonal skills, serve the professional property manager equally well.

Property management activities may constitute a small, incidental portion of a broker's business, or may be a broker's primary source of revenue. At either extreme, and in every case in between, however, a property managing broker must be aware of the significant legal differences between selling real estate and managing it. In our increasing litigious society, the prudent broker simply cannot afford to ignore these differences.

One significant difference is the likely duration of the relationship between the property owner and the property manager. Brokers may be accustomed to discrete transactions: find a buyer, close the deal, and move on to the next transaction. In such an environment, a single misunderstanding or contractual difficulty on a single deal is unlikely to be of major significance. What is lost in one deal can perhaps be regained in the next. This, however, is not the case in property management. Once the owner and the property manager have entered into a management agreement, both parties are locked into the terms for the duration of the agreement--often a year or longer. Once the manager/landlord enters into a lease agreement with a tenant, both parties are likewise locked into the terms of the lease for an extended period. For this reason alone, a broker who is considering entering into property management must become familiar with the many important legal issues that present themselves when negotiating a management agreement and entering into tenant leases.

This chapter provides an overview of the legal duties and responsibilities of the professional property manager to the property's owner and to its tenants. The chapter is divided into two sections that reflect these two broad areas of the property manager's duties.

First, the chapter examines the relationship between the property manager and the property owner. As mentioned above, for a real estate broker, accustomed to the temporally limited relationship that typically attends the sale of real estate, the ongoing nature of the property manager relationship may present the greatest single challenge. A second, related

challenge will likely result from the level of detail required to properly document the legal and financial relationship. The chapter will examine the legal nature of the relationship, and how the choices the parties make regarding the legal nature can affect the parties' duties and authorities. The chapter will also address the essential elements of a management contract and the budgeting process.

Second, the chapter examines the relationship between the property manager, as landlord, and the tenant(s) of the managed property. Although perhaps superficially similar to a selling broker's relationship with a buyer, the law governing this relationship is quite different from that with which a real estate broker is most likely familiar. The chapter analyzes the various legal forms that a tenant's leasehold estate may take, the essential and discretionary elements of a tenant lease, summarizes the more notable effects of the Uniform Residential Landlord And Tenant Act, and also discusses the changing sources of tort and environmental liability that confront the modern-day landlord.

The chapter includes a form of a property management agreement and the Institute of Real Estate Management's Code of Ethics for Property Managers, which is a useful reference whether the manager is a member or not. The chapter is intended for real estate professionals who desire a practical overview of the law governing the relationships between the property manager, the owner, and the tenant.

FOOTNOTES:

(n1)Footnote 1. For a detailed discussion of property management activities, *see* Property Management Handbook (R. Cushman & N. Rodin eds., Wiley 1985).

* This chapter was prepared by Brian J. Jordan, Esq., of Ryley, Carlock & Applewhite, Phoenix, Arizona. Additional updates were contributed by Sandra Bullington, Esq.



79 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 16 The Broker's Role in Property Management *

10A-16 Real Estate Brokerage Law and Practice § 16.02

§ 16.02 Regulation of Professional Property Managers

[1] General Qualifications

Although the field of property management is not yet subject to the level of regulation of some other professions, a broker who is considering managing property should be familiar with the qualifications required for the job. The Institute of Real Estate Management (IREM) is a subsidiary of the National Association of Realtors and was formed in 1933. Individuals wishing to become IREM members must meet strict educational and experience requirements, and also must pass written examinations given by IREM. Successful candidates become Certified Property Managers (CPM). While IREM membership and designation as a CPM are not legal prerequisites to being a property manager, most sophisticated owners look for a CPM designation in their property managers.

A second, more important qualification is the requirement that property managers be licensed real estate brokers because they manage and collect rents on behalf of a third-party owner. n1 All states have enacted some form of legislation governing the activities and practices of real estate brokers. While these statutes are primarily applied to brokers involved in the purchase and sale of real estate, those who rent or lease property for others are also subject to the real estate licensing statutes.

[2] Broker Licensing Requirements

Broker licensing statutes tend to be broadly construed by courts in light of their remedial purpose to protect the public from unscrupulous practices. n2 In addition to this broad judicial construction, most of these statutes expressly define the term "broker" very broadly. In most states, any individual who acts on behalf of another in connection with the sale or rental of real estate that the individual does not own is a broker and is subject to all relevant regulations. n3 Under virtually any professional property management agreement, the manager will be required to be a licensed broker in the jurisdiction in which the property is located. A full time property manager, who may not be engaged in any of the traditional activities of a broker, cannot permit his license to lapse without risking, at minimum, disciplinary proceedings. n4

FOOTNOTES:

(n1)Footnote 1. *See, e.g.:*

District of Columbia: D.C. Code §§ 42-1702, 42-1703.

Montana: Mont. Code Ann. § 37-51-601 (licensure as a property manager).

Nebraska: Neb. Rev. Stat. § 81-885.04.

Oregon: Or. Rev. Stat. § 696.022.

South Carolina: S.C. Code Ann. § 40-57-20 (licensure as a property manager).

South Dakota: S.D. Codified Laws Ann. § 36-21A-47.

Tennessee: Tenn. Code Ann. § 62-13-104.

Most other jurisdictions that do not expressly require that property managers be licensed brokers impliedly do so. *See, e.g., Ariz. Rev. Stat. § 32-2121(A)(6), (8)* (a specific provision excepting a limited class of property managers from licensing requirement includes all others by implication).

(n2)Footnote 2. *See, e.g.:*

California: In re Thomas, 765 F.2d 926 (9th Cir. 1985) .

Illinois: Sawyer Realty Group, Inc. v. Jarvis Corp., 432 N.E.2d 849 (Ill. 1982) .

Wyoming: Toavs v. State, 635 P.2d 1172 (Wyo. 1981) .

(n3)Footnote 3. *See, e.g.:*

District of Columbia: Kassatly v. Yazbeck, 734 F. Supp. 13 (D. D.C. 1990) .

Mississippi: Furr Marketing, Inc. v. Orval Kent Food Co., Inc., 682 F. Supp. 884 (S.D. Miss. 1988) .

New Jersey: Oscar Mayer Corp. v. Mincing Trading Corp., 744 F. Supp. 79 (D. N.J. 1990) .

(n4)Footnote 4. *See, e.g., Ariz. Rev. Stat. § 32-2165* (acting as a broker without a license is a felony). Additionally, most property management agreements provide that the manager must keep currently licensed. One court has held that breach of such a provision, even though the state did not require that the manager be licensed, constituted breach of the management contract and cause for its termination. *See Cobin v. Rice, 823 F. Supp. 1419 (N.D. Ind. 1993) .*

* This chapter was prepared by Brian J. Jordan, Esq., of Ryley, Carlock & Applewhite, Phoenix, Arizona. Additional updates were contributed by Sandra Bullington, Esq.



80 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 16 The Broker's Role in Property Management *

10A-16 Real Estate Brokerage Law and Practice § 16.03

§ 16.03 The Budgeting Process

[1] Introduction

The first step in negotiating a property management agreement is for the property manager and the property owner to clearly identify the property owner's objectives. In today's increasingly complex financial world, property owners range from a single individual to large financial institutions acting in the role of manager or advisor to several pension plans. n1 While all rational property owners seek to maximize the after-tax present value of the profit stream from the property, some owners are more concerned about short-term profitability, others may focus on longer term appreciation and tax related benefits, while still others may seek preservation of the property's value and a reliable, predictable cash flow. The manager must clearly understand the owner's expectations and priorities with regard to the property.

After the manager clearly understands what the owner wants out of the property management relationship, the owner and the manager should jointly develop a detailed base operating budget for the property. A properly prepared budget will operate as a road map of the property and should permit the manager and owner to anticipate and respond to fluctuations in the property's financial performance. A budget should contain sufficient flexibility to permit the manager to respond to inevitable, but unforeseen, variations in the property's financial performance without unnecessary delay caused by requiring the owner's prior review and approval.

[2] Expense Budget Items

The accounting details of forecasting and preparing an expense budget are beyond the scope of this chapter, but the property expense budget should include, at a minimum, the following major items:

[a] Base Rental Income

This is probably the most straight forward component to determine. The manager must carefully review the relevant provisions of all of the tenants' leases to determine the monthly rent during the budget period. If any leases expire during the budget period, the manager must determine, based upon experience and direct contact with the tenant, the likelihood of lease renewal or vacancy. Other factors that should be considered in forecasting base rental income include tenant payment histories and any lease escalation provisions that may become effective during the budget period. In the commercial context, the manager may wish to consider the relative financial health of the tenants and the

economic outlook for the tenants' particular businesses or industry groups.

[b] Vacancy Forecast

As part of the projection of base rental income, the manager will have developed a forecast of the number of units that may become vacant during the budget period. Combined with the units that are vacant at the beginning of the budget period, this provides the basis for the vacancy forecast. The manager must forecast both when and how much currently vacant space is likely to be leased, the particular month during which new vacancies will occur, and the likely duration of the new vacancies. The vacancy forecast should consider the likelihood that tenant incentives, such as free rent or an improvement allowance, will be required to economically lease the vacant space. This component of the vacancy forecast will have a direct impact on the expense categories of advertising, repair, and lease-up.

[c] Percentage Rental Income

Percentage rents are common in commercial leasing to retail businesses, such as strip malls and shopping centers, and in office buildings that have some retail space, such as a gift shop or restaurant. Percentage rents are based upon either gross or net sales, and typically contain a minimum or "base" rental to be used in case of poor sales. Percentage rents usually present the manager with some forecasting difficulties because many of the key factors that will determine a particular tenant's rent are wholly beyond the manager's, and in some cases the tenant's, ability to fully predict or control. In addition, some tenants may be unwilling or unable to provide information that the manager needs, such as sales forecasts, future pricing projections, internal personnel changes, and the effects of potential competitors. Nevertheless, the manager should avoid the temptation to simply adjust last year's percentage rent upward or downward by some arbitrary figure.

A second forecasting difficulty associated with percentage rents is attempting to determine monthly fluctuations. Unlike a base rental amount, which is usually fixed during the lease term, percentage rents can and typically do vary widely during a budget period. Perhaps the most familiar source of fluctuation is the effect of holiday shopping on the fourth quarter income of retail operations. On the other hand, a yogurt or ice cream store may receive the majority of its income during the summer months. If an expense budget is to be a truly effective management tool, these monthly fluctuations must be accurately forecasted to alert the owner to months that may require unusual additions of capital far enough in advance so that efficient preparations may be made to obtain the required funds.

[d] Extra Tenant Services

Extra services, such as premium utilities for air conditioning, computer installations or additional security services, should be identified for each particular tenant. The manager should consider potential increases in rent for those tenants that required extra services in the prior period, as well as the potential of existing or new tenants having similar requirements.

[e] Interest Income

Interest may be earned on rental income and tenant security deposits that are placed in a federally insured interest bearing account. The manager should estimate the average monthly balances that will be deposited into these accounts and determine the rate of interest that should be received.

[f] Management Fees

In the residential setting, most management agreements provide that the manager is to be paid a fixed management fee with commissions or other incentives for leasing and re-leasing rental units. Most office and commercial property management contracts provide that the manager is to be paid based on a percentage of the gross rental income from the property. The manager should review the appropriate provisions of the management agreement to determine the exact

basis of compensation for purposes of forecasting this item.

[g] Leasing Commissions

As a licensed real estate broker, many property managers also have brokerage agreements with the owner that provide that the manager is entitled to leasing commissions. This component may be estimated by combining the leasing and renewal estimates from the vacancy forecast with the relevant commission provisions of the brokerage agreement.

[3] The Capital Budget

In addition to the expense budget items discussed above, the owner and manager should agree on a budget of capital improvement and acquisition items. A capital expenditure is one that is expected to yield economic benefits to the property beyond the particular accounting period in which the expenditure is made. As a result, the expenditure is properly amortized over the expected useful life of the asset. n3

Unlike expense items, most capital budget items are non-recurring. Therefore, the capital budget typically does not contain specific categories that may be usefully compared from year to year for forecasting purposes. The usual basis for developing a capital budget is the inspection and maintenance records of the property. These documents can be reviewed to determine what improvements will be required during the upcoming accounting period to maintain and enhance the property's long-term rentability and value. The manager should develop a recommended list, in some form of priority order, of the capital expenditures the property will require in the upcoming fiscal year.

Because most capital expenditures are discretionary in any one accounting period, the owner will usually base approval of a capital budget item on some form of return-on-investment calculation. The manager should be aware that there is no bright-line distinction between capital and expense items. The accounting and tax consequences of this choice can be significant, and, in extreme cases, the characterization of an item as expense or capital may be determinative of whether or not the expenditure is approved by the owner.

FOOTNOTES:

(n1)Footnote 1. While beyond the scope of this chapter, a broker acting as a property manager for an institutional owner that manages and invests employee retirement assets may be impacted by the Federal Employee Retirement Income Security Act (ERISA), 29 U.S.C. § 1001, *et seq.* ERISA includes as a "party in interest" any person or entity "providing services" to an employee benefit plan, which almost certainly includes the manager of the plan's investment properties. Depending upon the amount of discretion that the management agreement delegates to the property manager, the manager may further be classified as a "fiduciary" under ERISA. *See* 29 U.S.C. § 1002(21)(A). ERISA contains a number of prohibited transactions and conflicts of interest that affect the property manager. For a more detailed discussion of the impact of ERISA on property management, *see* Property Management Handbook 66-71 (R. Cushman & N. Rodin eds., Wiley 1985).

(n2)Footnote 2. Several states have specific requirements that interest income on security deposits be returned to the tenant upon termination of the lease. The manager should determine the impact of the appropriate jurisdiction's regulations on this expense item.

(n3)Footnote 3. This method of depreciation for purposes of management accounting differs from the rather arbitrary depreciation schedules associated with depreciation for federal and state income tax purposes.

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81 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 16 The Broker's Role in Property Management *

10A-16 Real Estate Brokerage Law and Practice § 16.04

§ 16.04 Legal Aspects of the Owner-Manager Relationship

[1] Introduction

In light of the growing number of sophisticated institutional entities either owning or managing property, many important issues arising out of the legal nature of the owner-manager relationship assume added importance. This section will discuss some important legal aspects of the owner-manager relationship.

The manager may be a member of a trade or professional organization that has developed standardized management agreement contract forms. Some form property management agreements simply designate the manager as either the "agent" or "independent contractor" of the owner, without proper concern for whether these broad labels adequately define the legal relationship into which the parties wish to enter. At one end of the spectrum, where the owner is a fully staffed institutional entity, the manager's authority may be limited to daily management of the property with limited discretion. In such a case, the manager would more likely function as an independent contractor, or perhaps even as an employee of the owner, and would be without an agent's authority to act for and bind the owner. In this case, both parties would desire a detailed management agreement, specifically outlining the limits of the manager's authority and specifying those limited circumstances, if any, under which the manager is authorized to act as the owner's agent.

In the more typical owner-manager relationship, the fully staffed professional property manager exercises virtually total discretion in managing the property. The manager acts as an agent, with full authority to act for and bind the passive owner. Such an owner would rely heavily on the manager's expertise, and this owner would want to place provisions in the management agreement to protect his or her ultimate control of the property and to avoid unanticipated risk exposure. The owner and manager, or their legal representatives, must recognize these legal differences and take them into proper account when negotiating the management agreement.

[2] Contractual Issues

One of the major issues that confronts the parties to any management agreement is whether the manager will enter into contracts with third parties on its own behalf, or whether the owner will be in contractual privity with the third-party contractors. In most jurisdictions, the answer to this issue is affected by the level of disclosure to the third-party contractor of the owner's existence and identity as the manager's principal.

Where both the owner's existence and identity are known to the third-party contractor, the owner is a fully disclosed principal. n1 In this situation, the owner and the third-party contractor will be directly liable to each other for all contracts executed by the managing agent, but the managing agent generally incurs no independent contractual liability to the third party. n2 This rule of no agent liability may, of course, be modified by the expression of a contrary intent by the owner and the manager. n3

If the third-party contractor is aware of the owner's existence but not of its identity, the owner is a partially disclosed principal. n4 If the third-party contractor is aware of neither the owner's identity nor the owner's existence, the owner is an undisclosed principal. n5 A managing agent will be liable upon breach of any contract executed on behalf of a partially disclosed or undisclosed owner. n6

In all three cases, the owner, and not the manager, is generally entitled to enforce contract rights against the third-party contractor. n7 In an action against the owner, the third-party contractor may raise any defense to the contract it would have had against the agent and may escape being compelled to specifically perform the contract for the undisclosed principal if the nondisclosure was fraudulent. n8

[3] Practical Considerations

One example of the employment of a third-party contractor is when an owner determines that proper management of the property requires retention of on-site security personnel. To meet this need, the owner may instruct the manager to provide the property with adequate security, leaving the specifics of meeting this directive to the manager's discretion. In this case, the manager would act as the principal to the security contract, and the security company would be the agent of the manager. If this is the intent of the parties, the form of the manager's contracts should be carefully examined. The manager should execute the contract in its own name, with no reference to the owner. Any ambiguous form of signature, such as "Managing Company, Inc., as managing agent for Owner," runs the risk of incorrectly implying that the owner is intending to be a party to the contract.

The more common arrangement, however, is for the owner to expressly designate the manager as the owner's agent, with the owner being the actual contracting party. Under this classic agency relationship, the owner will be legally responsible for the commitments entered into by the manager. The arrangement gives rise to the risk that the owner may be unintentionally bound by the manager acting outside the scope of its real authority. n9 For example, even if the management agreement expressly prohibits the manager from entering into a certain type of agreement (*e.g.*, a lease that permits free subleasing and assignments), the owner may well be bound by the manager entering into such an agreement if the tenant reasonably believed that the manager was acting within its agency authority.

A prudent owner may reduce the risk of being bound under the theory of apparent authority by reserving and enforcing the right to review and approve all form documents, such as leases, contracts, and purchase orders. These documents should include some form of express limitation on the manager's signature authority. For example, a form lease may include a statement such as the following:

Owner may not be bound by any modification to any term or provision of this form of lease unless the modification is expressly agreed to in writing by the Owner; or

The term of this lease, including any right or option to renew, may not exceed one (1) year without the express written consent of Owner.

Similarly, the form of purchase order may include a notation similar to the following:

Any purchase that, in the aggregate, exceeds One Thousand Dollars (\$1000) must be approved in writing by Owner.

Other protections that a prudent owner should consider include indemnification from the manager, including some form of bond or personal guarantee, and regular inspections of the lease, contract, and purchase order files. Regardless of these protections, however, the owner must realize that any delegation of signature authority to the manager entails the risk of being bound by the manager's unauthorized acts. If the owner fails to minimize this risk, the value of the property could be significantly compromised by unintended long term obligations and commitments.

[4] Manager Self-Dealing

A second broad area of legal protection with which the owner should be concerned is manager self-dealing. Many managers are sophisticated business persons in charge of integrated property management operations. As a result, they may have financial interests in landscaping, security, construction, or facility maintenance companies. If the manager is permitted to hire these affiliated companies to perform services on the property, the owner risks paying too much for the service. Competitive bidding protections may be compromised, supervision and remedying of inferior performance may be reduced, and the owner may wind up paying for many overhead and profit components twice.

The owner should seek to protect itself by requiring the manager to fully disclose any proposed contractual agreement between the manager and any entity in which the manager has any interest. After full disclosure, the owner should seek to reserve the right to withhold consent to the agreement in the owner's sole discretion. Even if the terms of the written contract are favorable, the owner may wish to avoid the potential future problems that may arise from a less than arm's length relationship. Some management agreements provide that the owner reserves the right to select and terminate all contracts. While this type of provision provides the owner with some protection against manager self-dealing, it has the drawbacks of being an after-the-fact remedy and possibly exposing the owner to liability under an interference with contract theory.

FOOTNOTES:

(n1)Footnote 1. See, e.g., *Flatiron Paving Co. v. Wilkin*, 725 P.2d 103 (Colo. Ct. App. 1986) (the principal is "disclosed" only where the third-party contractor is aware of the principal's existence and the principal's identity).

(n2)Footnote 2. See, e.g., *Benjamin Plumbing, Inc. v. Barnes*, 470 N.W.2d 888 (Wis. 1991) .

(n3)Footnote 3. See, e.g., *Cahn v. Fisher*, 805 P.2d 1040, 1043 (Ariz. Ct. App. 1990) (recognizing the general rule of no agent liability, but ruling that the parties "were certainly free to agree otherwise."). The manager/agent may also incur liability by breaching the implied warranty of authority to act for the principal. See, e.g., *James G. Smith & Assocs. v. Everett*, 439 N.E.2d 932 (Ohio Ct. App. 1981) . If the manager/agent contracts in breach of this warranty, liability will be for actual damages without the standard contract limitations on foreseeability. See *Dubern v. Girard Trust Bank*, 454 F.2d 565 (3d Cir. 1982) .

(n4)Footnote 4. See *Benjamin Plumbing, Inc. v. Barnes*, 470 N.W.2d 888, 893 (Wis. 1991) .

(n5)Footnote 5. See *James G. Smith & Assocs. v. Everett*, 439 N.E.2d 932, 935 (Ohio Ct. App. 1981) .

(n6)Footnote 6. See *Strand v. Courier*, 434 N.W.2d 60 (S.D. 1988) (recognizing that this rule is limited to executory contracts, where neither owner nor manager has yet performed). The third-party contractor must elect to enforce the contract against either the owner or the manager and may not, of course, obtain multiple judgments on a single contract. See *Crown Controls, Inc. v. Smiley*, 756 P.2d 717, 722 (Wash. 1988) (rejecting the traditional election of remedies doctrine in favor of joint and several liability, but reaffirming the existence of a single remedy).

(n7)Footnote 7. See *Interbras Cayman Co. v. Orient Victory Shipping Co., S.A.*, 663 F.2d 4 (2d Cir. 1981) .

(n8)Footnote 8. See, e.g., *Quick Erectors, Inc. v. Seattle Bronze Corp.*, 524 F. Supp. 351 (E.D. Mo. 1981) ; Restatement (Second) of Agency § 302, cmt. d.

(n9)Footnote 9. *See generally* Restatement (Second) of Agency § 8.

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82 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 16 The Broker's Role in Property Management *

10A-16 Real Estate Brokerage Law and Practice § 16.05

§ 16.05 The Property Management Agreement

[1] Introduction

After the manager and the owner have come to a mutual agreement concerning the objectives of managing the property, the property's projected financial performance and the legal nature of the owner-manager relationship, the best interests of both parties is usually served by reducing the agreement to writing. The term "property management" is not a term of art and may encompass as many, or as few, services as the parties wish. The level of service provided by the property manager will vary with the size and complexity of the property and the sophistication and degree of involvement of the owner.

[2] General Legal Issues

The property management agreement is the legal basis of the contractual relationship between the property owner and the property manager. The agreement should, at a minimum, clearly set forth the manager's duties and obligations, authority to act for the owner, and the basis for the manager's compensation. The manager should pay careful consideration to the drafting of the management agreement. Poor or unartful drafting could expose the manager to unnecessary liability or lead to the unsatisfactory termination of the owner-manager relationship.

Most sophisticated owners or managers will likely begin negotiations by proposing that their form agreement be used. Not surprisingly, these form agreements tend to focus exclusively on the rights and remedies of one party to the exclusion of the other party. The manager should assume that any form agreement provided by the owner will be slanted in the owner's favor, and the manager should be certain to review and understand the operation and effect of each of the agreement's provisions.

One of the first things to consider when drafting a management agreement is the nature of the relationship between the parties. In general, the relationship may be either that of principal and agent, or the manager may be an independent contractor. Most form agreements provide for an agency relationship. Regardless of whether the parties choose to execute an unaltered form agreement or conduct extensive negotiations to reach a customized agreement, the choice of what legal form the relationship will take will affect virtually every aspect of the relationship.

The typical, standard form of a property management agreement creates an agency relationship between the owner and

the manager. n1 Absent anything to the contrary in the agreement, standard principles of agency and contract law will govern the relationship. The manager will be held to the fiduciary duties of loyalty, n2 obedience, n3 and due care n4 in his or her relationship with the owner. The owner has the duty to reasonably compensate the manager n5 and to reimburse the manager for expenses reasonably incurred on the owner's behalf, including indemnification from legal liability. n6

[3] Specific Agreement Provisions

[a] Identification of the Property and the Parties

The first issue that must be addressed in the agreement is proper legal identification of the property and the parties. This is an easy area for the manager to overlook. For most residential properties, the street address may be sufficient. For more complex properties, a detailed description of the specific buildings and facilities being covered is generally advisable. The manager's fee will likely be based upon some percentage of gross rent, so the precise extent of the property from which the gross rents are to be calculated is very important.

The correct legal identity of the parties is equally important. The manager should ensure that the owner is a financially viable entity rather than some form of limited liability shell. The owner's name should be styled identically to the way it appears on the conveyance documents of record affecting the property. If the owner is a partnership, the manager should consider having all of the partners sign the agreement. The manager should resist any attempt by the partners to include an exculpation provision. n7 n8- If the owner is a corporation, the manager may wish to consider requiring a statement from the corporate secretary that the individual who is signing on the corporation's behalf is authorized to do so. The broker should be aware of the applicable regulations that may require that the agreement be in the name of and signed by the licensed broker, rather than some legal entity.

[b] Term of the Agreement

As with most contracts, the management agreement may be either for a fixed term or periodic, such as month to month or year to year, unless one party elects to terminate in accordance with the agreement's provisions. A mutually acceptable term of the management agreement is largely determined by the competing desires of the parties. The parties should check the appropriate regulations to determine if the relevant jurisdiction has enacted any such restrictions.

Owners are typically unwilling to enter into long term management agreements that may limit their ability to control the manager's performance or sell the property. Managers, on the other hand, typically desire a substantial guaranteed term, usually at least one year, in light of the significant amounts of time and money required to set up effective property management operations. Regardless of the term to which the parties ultimately agree, the management agreement should include provisions for early termination for uncured breaches of the agreement, suitable notice provisions, and default procedures for renewals in the absence of notice to the contrary.

[c] Manager's Responsibilities

[i] Rent. The agreement should state the manager's authority to bill and collect rents, execute leases, terminate tenancies, and handle security deposits. If the agreement provides that the tenants pay rent directly to the manager, the owner should require a provision in the agreement requiring the manager to maintain separate bank accounts and records for the funds, as well as requiring appropriate bonds for the manager's employees. The separate account requirement is especially important in the case of a manager who manages multiple properties for several different owners. The owner may wish to specify the bank in which the funds must be kept and the manner in which the account is styled.

[ii] Leases. The agreement should require the manager to use its best efforts to efficiently lease the property at rental rates economically acceptable to the owner. The agreement may contain a tenant qualification procedure and

guidelines for advertising the property for lease. Given the multitude of federal and local statutes and regulations that govern residential property rental, the owner may wish to provide that certain advertising be reviewed by counsel. n9

The agreement should include an owner-approved tenant lease form as an "Exhibit" and a provision expressly permitting the manager to execute the form lease on behalf of the owner. The owner may wish to provide the manager with additional flexibility by permitting the manager to modify some of the approved terms without the owner's prior approval. For the protection of both the owner and the manager, any such provision should be narrowly drafted. It should clearly specify the exact lease provision(s) to which it is addressed, and it should clearly state the limits of the manager's ability to modify the approved provision. The owner may also wish to prevent the manager from executing leases with terms longer than a certain duration or in excess of a particular dollar amount. The management agreement should also state that the manager may not execute any lease containing any unapproved provisions without the written approval of owner. As discussed in § 16.04[3] *supra*, the prudent owner will place on the form lease a statement of the limitation of the manager's authority to modify the standard lease provisions.

[iii] Operations.

[A] Inspections. The agreement should specify both the frequency and extent of the manager's obligation to inspect the property. If performed regularly and properly, routine inspections can cost-effectively avoid costly future repairs. This provision should also include a requirement that the manager issue a comprehensive written report of the inspection to the owner within a reasonable time after each inspection. The owner may wish to consider adding a requirement that the current status of any unremedied problem identified on an inspection report must be specifically addressed on all subsequent reports until it is fully remedied. The agreement may also specify that the manager is required to maintain a log of all tenant complaints, along with a record of the corrective actions taken.

[B] Third-Party Contracts. The agreement should specify the manager's authority to execute contracts with third parties, such as security, maintenance, and landscape contractors. Given the variety of needs a property may have, it is probably not practical to include approved forms of service contracts as exhibits to the management agreement. Nevertheless, it is in both parties' interest to have the manager's ability to bind the owner clearly defined. As a general matter, if the manager is responsible for the result, the manager should also be permitted to select and terminate the contractor.

[C] Manager's Employees. At a minimum, the agreement should specify the individual employee(s) of the manager who will be responsible for the daily management of the property. The owner will probably want to provide that the individual devote all of his or her time and efforts to managing the owner's property. Because of the importance of stability in good tenant relations, the owner may also insist on notice and approval rights before the on-site manager can be replaced. Finally, the owner may wish to consider including a provision permitting termination if this individual becomes unavailable to manage the property for any reason.

The agreement should also specify if any of the manager's employees, in addition to the on-site manager, are considered to be "key" by the owner. As with the on-site manager, the owner may wish to provide in the agreement how much of the key employees' time must be devoted to the property and permit termination if the key employees become unavailable.

The agreement should specify the manager's powers to hire, supervise, and fire its own on-site property maintenance personnel. In this area, it is typically in the owner's best interest to have the individuals be employees of the manager, rather than employees of the owner. Such an arrangement gives the manager greater control over the personnel and should save the owner from such potential obligations as tax withholding, workers compensation insurance, and ascertaining and maintaining records of employees' legal status as residents of the United States.

[D] Independent Contractor Considerations. In its dealings with the third parties discussed above, the manager may expose the owner to unintended liability under the theory of *respondeat superior*. A detailed discussion of the law

of *respondeat superior* is beyond the scope of this chapter, but the manager and owner should bear the following principles in mind during the negotiation of the management agreement. If the owner exercises too much control and places too many restrictions on the details of how the manager is to obtain the desired result, the manager's status as an independent contractor may be lost, and the owner may be subject to joint and several liability for the negligence of the manager and the manager's employees. Courts have generally looked to the following factors in determining whether an agent is an employee or a general contractor for purposes of imputing third-party liability to the owner.

First, is the manager engaged in a distinct business or occupation? In most cases, the answer will be "yes." This will be especially true where the manager manages multiple properties for more than one owner. In the case of a manager who manages a single property, or where the owner also manages properties, the owner should take care that the manager is sufficiently independent so as to be considered a separate business from the owner.

Second, what level of skill is required? If the jurisdiction requires managers to be licensed brokers, this factor should favor a determination of independent contractor. If the particular jurisdiction does not require a license for the particular management arrangement that is being contemplated, the agreement should include a recitation that the manager is being selected in consideration of the manager's skill and experience in the field.

Third, does the manager provide its own tools and facilities? If the owner provides the manager with an office, administrative supplies, or other required items, the manager is more likely to be considered an employee. If the management agreement provides that the manager receives rent-free space from which to conduct its management activities, the owner should consider including a provision specifying that the manager is entitled to exclusive use of the space and is solely responsible for its maintenance and operation.

Fourth, what is the term of the agreement? The shorter or more definite the term, the more likely a court is to find the relationship to be that of an independent contractor. Open-ended agreements that provide for automatic renewal may appear to be employment contracts.

Fifth, how is the manager compensated? In most management agreements, the manager is paid based upon completion of the job of leasing and managing the property, making the manager an independent contractor. The owner should beware of including any compensation provisions that are dependent upon the length of time employed, or other such "employer-employee" type method.

Finally, what is the expressed intent of the parties? Although this factor will not control the determination, in a close case, a property management agreement that expressly states that the manager is an independent contractor could be decisive.

[d] Lawsuits

The agreement should specify the manager's authority to commence and prosecute legal actions against tenants and third-party contractors. Based upon the relative sophistication and experience of the parties, the owner should consider how much latitude the manager should be given in this area. At a minimum, the owner should insist that all judgments and other judicial relief obtained by the manager run to the benefit of the owner. Depending upon the jurisdiction, the agreement may also address the entity that will be the plaintiff in rent-collection suits and forcible detainer actions.

[e] Record Reporting and Maintenance

This is the area of negotiations that typically receives the lion's share of attention from both parties. Larger owners may legitimately require a high degree of standardization in their accounting reports for federal and state tax reporting purposes, and the owner may be dealing with multiple management companies in several different states.

Managers may have a preexisting record-keeping system that is geared toward day-to-day property management. Ideally, the manager's system can accommodate the owner's reasonable record keeping and reporting requirements. The manager should have available for the owner's review an accounting procedures manual, which includes procedures for balancing and reconciling bank accounts, cash management practices, rent collection procedures, delinquent account procedures, payroll procedures, and accounts payable procedures. The owner should be careful, however, of dictating so many accounting details to the manager that the manager begins to resemble more of an employee than an independent contractor.

The owner has to remain constantly apprised of changing market conditions, and the agreement should require the manager to provide reasonably frequent updates about market conditions and recommend responses and action steps. Given the owner's critical need for the property records, prudent owners will ensure that the agreement provides that all property records and reports are the property of the owner, and that the manager will maintain them at a specified location, available for the owner's inspection at all reasonable times.

Regardless of the type of records provided for in the agreement, the owner should insist on periodic outside audits of the manager's records. The auditor should be of the owner's choosing, and the owner should bear the expense of the audit. The manager should agree, upon reasonable notice, to meet and cooperate with the owner's auditors and to provide the owner's auditor with free access to the property's records. The agreement should provide the manager with an opportunity to review and respond to the audit report. If the audit identifies deficiencies in internal controls or documentation, the manager should be responsible for prompt correction of the deficiencies and may also be required to pay an appropriate portion of the audit expense or reimburse the owner for any negative financial impacts of the deficiencies.

[f] Risk Allocation

Risk allocation between the owner and the manager is a critical issue that must be addressed in any management agreement, regardless of its relative complexity. The two primary methods of risk allocation are insurance and indemnity.

[i] Insurance.

Insurance is the decision to transfer by contract the risk of loss from the owner or manager to an insurance company. In all but the simplest of property management situations, an insurance broker or agent will be required to identify and purchase the various types of insurance necessary. As a general matter, the manager should attempt to avoid responsibility for determining what insurance is required for the property or from what entity it should be purchased. These determinations call for expertise that most property managers would have no reason to possess.

The manager should be required to purchase and keep in force throughout the term of the agreement sufficient property, liability, automobile, workers compensation and other forms of insurance as are necessary to protect the owner's property interests from damage by third parties.

[A] Property Insurance. The property insurance agreement should insure the property for full replacement cost against all risk of physical loss, including, where geographically appropriate, water damage, flood, and earthquake. Protection should include full replacement cost, including any costs associated with regulatory compliance, removal of debris prior to reconstruction, loss of rental revenue, and loss of records. The owner should consider the deductible amount carefully in light of its ability to absorb losses and should attempt to obtain a combined single deductible.

[B] Liability Insurance. The liability insurance agreement should insure against any liability to third parties resulting from personal injury or property damage. The protection should extend to host liquor liability, claims for false arrest, libel or slander, and the criminal acts of third parties. n10

[C] Workers Compensation. Workers compensation insurance pays for required benefits to workers who are injured in the course of their employment, and typically preempts any other action for job-related injuries. Failure to maintain required workers compensation insurance may be illegal and expose the employer to financial liability far beyond the relatively low cost of maintaining this coverage. n11

[D] Comprehensive Automotive Insurance. The comprehensive automobile insurance agreement should insure against liability resulting from property damage or personal injury caused by the ownership, use, or maintenance of any motor vehicle. The policy should also include coverage for third party medical payments and for physical damage to the motor vehicle involved.

[E] General Insurance Considerations. In light of the nationwide trend towards joint and several liability, comparative negligence, and lawsuits against deep-pocket defendants, the owner should consider a high-limit umbrella coverage policy. The management agreement should identify whether the manager or the owner is to be the named insured, provide that the unnamed party is to be named as an additional insured, and require the policies to contain a waiver of the insurer's rights of subrogation against the unnamed party.

[ii] Indemnity. Indemnity provisions attempt to allocate the risks inherent in the property management situation by shifting them to one party, rather than to a third-party insurer. Liability to third parties arising out of property management should probably remain with the manager. The manager is in the best position to protect against this liability by proper maintenance of the property and by maintaining good tenant relations. The manager will wish to limit its liability to only those damages that result from the manager's negligence, while the owner will request indemnification for all losses or damage it suffers for any reason other than its own negligence. The manager should have counsel review the indemnification language and require the owner to purchase the appropriate insurance to protect the manager from liability for the acts of third parties not under the manager's control.

[g] Repairs and Maintenance

Minor repairs and day-to-day maintenance should be included in the approved budget. To the extent that required repairs are within the budget, the agreement should permit the manager to proceed without any additional review or approval from the owner. In the event of an unforecasted item, the agreement should be flexible enough to permit the manager to respond appropriately, but should also require the manager to make a full report of the incident to the owner as soon as reasonably possible. Failure to provide sufficient flexibility in this area may result in uncorrected situations that violate the law or tenant lease provisions.

[h] Basic Documents

All easements, covenants, restrictive agreements, and any other documents that place valid restrictions on the use of the property should be included as exhibits to the agreement. The agreement should provide that the manager will familiarize itself with the terms and conditions of these documents and will manage the property so as to comply with their provisions. Depending upon the complexity of the documents, they should be reviewed and summarized by counsel. In addition, the owner should be required to furnish to the manager copies of all required building permits and occupancy certificates.

[i] Termination

The agreement should contain specific, objective grounds for early termination that clearly set forth the remedies of the terminating party. For example, because the manager is a licensed broker, the agreement might provide that the manager will conduct its business on behalf of the owner in accordance with the highest professional and ethical standards. The Code of Ethics of the Real Estate Management Institute, which is included in this chapter as § 16.08 *infra*, may be a useful reference. Any material failure to adhere to this requirement would be grounds for termination and, if appropriate, resultant damages. The owner may try to preclude the manager from receiving earned, but unpaid,

compensation at the time of a for-cause early termination.

Long term property management agreements may adversely affect the property's marketability. As a result, the owner may also insist that the agreement be terminable upon the sale of the property. Because this event is wholly outside of the manager's control and does not necessarily include any malfeasance by the manager, the manager may counter by requesting some extended notice period or liquidated damage provision in return for granting this concession to the owner.

The manager should seek to include early termination provisions for the owner's material breach of the agreement, violation of the law, or insolvency. This provision could likewise provide for the owner to be liable to the manager for damages caused by the terminating event. Before drafting such a provision, the manager should give consideration to the applicable jurisdiction's application of the standard rule invalidating liquidated damages clauses that are, in fact, penalties. n12

A crucial aspect of any termination provision is specifying which, if any, of the management agreement's obligations of the parties survive termination. The owner will require that the manager turn over all property records and vacate any office space on the property at termination. The owner should also include a provision providing for a post-termination audit.

FOOTNOTES:

(n1)Footnote 1. *See generally* 3 Am. Jur. 2d Agency § 18.

(n2)Footnote 2. *See, e.g., County of Cook v. Barrett*, 344 N.E.2d 540 (Ill. Ct. App. 1985) (comparing the duty of loyalty to that owed by a trustee to a beneficiary). Among other obligations, this duty requires that the manager reveal to the owner any adverse interests that the manager may have. *See, e.g., Byron Culver & Assocs. v. Jaoundi Indus. & Trading Corp.*, 1 Cal. App. 4th 300, 1 Cal. Rptr. 2d 680 (1991) .

(n3)Footnote 3. This duty requires the manager to faithfully carry out all of the owner's reasonable directions. *See generally* Restatement (Second) of Agency § 385. An exception to this duty may arise when the manager's compensation is tied to the particular action in question. *See Thomas v. Bourdette*, 608 P.2d 178 (Or. Ct. App. 1980) .

(n4)Footnote 4. The scope of this duty will be determined by both custom and any special ability of the manager. *See United States Liab. Ins. Co. v. Haidinger-Hayes, Inc.*, 463 P.2d 770 (Cal. 1970) . Because the manager is a licensed professional, this duty will tend to be broad. *See Hopkins v. Wardley Corp.*, 611 P.2d 1204 (Utah 1980) .

(n5)Footnote 5. *See Transcontinental Underwriters Agency v. American Agency Underwriters*, 680 F.2d 298 (3d Cir. 1982) .

(n6)Footnote 6. *See* Restatement (Second) of Agency §§ 438-39.

(n7)Footnote 7. Such a provision is typically designed to limit the manager's recovery to the partnership assets that are the subject of the management agreement. The other assets of the partnership, and the personal assets of the partners, could not be reached by the manager in the event of a lawsuit.

(n8)Footnote 8-. Footnote reserved.

(n9)Footnote 9. *See generally* Powell on Real Property(R) § 16.05 (Michael Allan Wolf ed., Matthew Bender).

(n10)Footnote 10. *See* § 16.06[6][e] *infra* for a discussion of landlord liability for third-party criminal activity.

(n11)Footnote 11. *See, e.g., Ariz. Rev. Stat. § 23-907* (providing that uninsured employers are barred from raising assumption of the risk as a defense, bear the affirmative burden of rebutting the presumption of negligence, and are

liable for actual damages plus a minimum penalty of \$1,000.00).

(n12)Footnote 12. *See generally* 22 Am. Jur. 2d *Damages* § 684 (noting that courts generally refuse to enforce liquidated damages provisions that are, in fact, penalty clauses).

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83 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 16 The Broker's Role in Property Management *

10A-16 Real Estate Brokerage Law and Practice § 16.06

§ 16.06 Legal Aspects of the Manager-Tenant Relationship

[1] Introduction

The principles that govern the relationship between the manager in its role as landlord and the property's tenants arise from two distinct bodies of law: contract and property. As a contract, the parties to the lease must be legally capable of entering into the lease, the purpose of the lease may not be illegal, and the lease must contain a valid offer, a valid acceptance, and legally sufficient consideration. As a conveyance of real property, the lease gives rise to an exclusive leasehold estate in land in favor of the lessee.

Under common-law principles, which tended to favor the lessor, the conveyance of the leasehold interest to the lessee was viewed as distinct from the contractual covenants of the parties. Therefore, if the landlord failed to maintain the property, the tenant's sole remedy was contractual. The tenant could not withhold rent or break the lease. Recognizing that these common-law principles are largely outdated in modern landlord-tenant relationships, the National Conference of Commissioners on Uniform State Laws approved the Uniform Residential Landlord And Tenant Act in 1972. n1 This Act places significant limitations on the landlord's common-law rights, but applies only to residential leases. Common-law principles still largely govern all non-residential leases and all leases of any type in jurisdictions that have not adopted the Act or some similar statutory scheme.

[2] Types of Leasehold Estates

The execution of a valid lease gives rise to property rights in the lessee and contractual duties and obligations on the part of both parties. A breach of these rights, duties, and obligations gives rise to certain remedies. This section will examine those rights and remedies.

A lease creates a possessory interest in real property. n2 The tenant obtains the exclusive use and possession of the leased premises for a period of time, after which period possession reverts to the landlord/owner. n3 The common law recognizes four different kinds of leasehold estates. n4 Most landlord-tenant relationships fall into one of the first two categories.

[a] Term Tenancy

A term tenancy is one that expires by its terms at the end of a fixed or readily computable period of time. n5 The common law imposed no limit on the length of time to which the parties could agree, but some states have limited the permissible duration of a lease by statute. n6 A term tenancy expires without notice at the end of the specified term. This feature of the term tenancy can be significant because if the time of termination is uncertain, as it may be in the case of the other leasehold estates, the parties may have rights and remedies that would not be otherwise available. n7

[b] Periodic Tenancy

A periodic tenancy is one that continues indefinitely until one of the parties provides the other with the required notice to terminate the leasehold at the end of a specified period. n8 The primary distinction between the periodic and term tenancies is the method of determining the termination date. n9

[c] Tenancy at Will

A tenancy at will is one that may be terminated by either party, at any time, without notice. n10 This leasehold estate may arise by express agreement, but is more likely to be implied by law from the conduct of the parties. n11 A number of jurisdictions have chosen to ameliorate the harsh common-law rule of no notice by requiring that some notice be given to terminate a tenancy at will. n12 Unlike the previous two tenancies, the tenancy at will is automatically terminated by the death of either the landlord or the tenant. n13

[d] Tenancy at Sufferance

A tenancy at sufferance exists when an individual is in wrongful possession of the land of another without a valid lease. The usual manner in which a tenancy at sufferance arises is by a tenant failing to vacate the leased premises at the expiration of the lease term. n14 The tenant at sufferance is, in most respects, viewed by the law as a trespasser. n15

[3] Elements of a Valid Lease

[a] The Requirement of a Writing

As stated above, a lease is a contract, and therefore must satisfy all of the prerequisites of a valid contract. As a result, leases are generally subject to the Statute of Frauds and leases for terms exceeding one year must be in writing to be effective. n16 As a general matter, the writing must identify the parties to the lease, identify the premises that are being leased, specify the duration and rental rate of the lease, and be signed by the party to be charged. n17 Obviously, the one-year statutory minimum should not be taken to mean that leases for shorter durations need not be reduced to a writing. The prudent landlord and tenant will insist that their agreement be set forth in writing to minimize the chance of honest mistakes and misunderstandings.

[b] Identification of the Parties

The parties to the lease should be identified as clearly as possible. If the tenant and all other necessary parties have not signed the lease in their proper capacities, the landlord will have difficulty in legally enforcing the lease. In the residential setting, the landlord should ensure that both spouses sign and that both have the capacity to contract under the laws of the governing jurisdiction. In the commercial setting, the tenant entity should be given its correct legal description (corporation, limited partnership, limited liability company, etc.) and its state under which laws it exists. In addition, the landlord should consider requiring some form of assurance from a corporation's secretary that the individual who is executing the lease on the corporation's behalf is, in fact, empowered to do so.

[c] Description of the Lease Term and the Premises

The term of the lease should be clearly stated as well. n18 As discussed above, the law raises certain presumptions

absent the parties' expression of a contrary intent. If the parties intend the lease to be of a specific type and duration, they must so state, or risk the presumption of being bound by a tenancy other than that which they intended. n19

When providing the description of the leased premises, the landlord should keep the following items in mind. In the residential setting, the apartment and street number should be all that is required to sufficiently identify the leased premises. If the residential lease includes land, the correct legal description, either metes and bounds or a reference to a recorded plat, should be attached as an exhibit to the lease. If the tenant is also entitled to use additional space, such as a parking space or off-site storage, this should be specified in the lease. If a commercial building includes common areas, such as entryways and stairways, the lease should state what rights the tenant has to use and occupy these areas. Finally, the lease should state the rights and obligations of the parties to maintain and improve various portions of the leased premises. This is particularly important in the commercial setting, where tenant improvements are often a key negotiating point between the parties.

[d] Rent

As is the case with all contracts, a lease must be supported by valuable consideration to be enforceable. n20 Rent is the consideration that the tenant pays to the landlord for the use and occupancy of the leasehold property. n21 No particular form of words is required to create the tenant's obligation to pay rent, and in the absence of an agreement to the contrary, the law will imply an obligation to the tenant to pay the reasonable value for the use and occupation of the leased property. n22 Rent is typically a set monthly dollar amount in residential leases, but any condition or covenant performed by the tenant can serve as rent. n23 In the commercial setting, where rental rates often vary with the profitability of the tenant's business, rent can become a relatively complex formula that requires several variables to compute.

[4] Other Standard Lease Provisions

[a] Legal Use of the Premises

One of the landlord's major considerations is what, if any, limits to place upon the tenant's use of the leased premises. Absent any provision to the contrary, the law will generally permit the tenant to use the leased premises for any lawful purpose, n24 provided that purpose does not damage the landlord's reversionary interest. n25 Mere statements of permitted use, such as "leased premises are to be used for a drive-in movie theater," are insufficient to restrict the tenant's use of the premises to that purpose only. n26 To effectively limit the tenant's use of the premises, the lease should contain an affirmative statement that the tenant will not put the premises to the particular use that the landlord wishes to avoid. n27 The commercial landlord must be careful, however, not to include a restrictive provision that, in conjunction with zoning or deed restrictions, prohibits any commercial use whatsoever. n28 Such an overbroad restriction will likely be self-defeating if the landlord seeks legal enforcement, particularly in light of the courts' resolution of any doubts against the party who drafted the restriction. n29

[b] Assignment and Subleasing

As a general proposition of common law, the tenant's leasehold interest is freely assignable by the tenant absent a lease provision to the contrary. n30 Most leases provide that the tenant may sublease or assign n31 only with the landlord's prior written consent, which the landlord may grant in its discretion. n32 There is some disagreement among the state courts as to whether the landlord is required to be reasonable in exercising this discretion. n33 Sophisticated tenants may insist that the assignment provision require the landlord to be reasonable. The landlord should check the rule in the relevant jurisdiction to determine whether this point is moot or worth negotiating.

[c] Security Deposits

Leases commonly provide that the tenant must deposit a sum of money with the landlord that acts as security for the

tenant's performance of its lease obligations. One purpose of the security deposit is to provide the tenant with a monetary incentive to properly maintain the leased premises. Absent a lease or statutory provision to the contrary, the security deposit becomes a debt of the landlord, but the landlord may freely use the deposit until termination of the lease, when the debt becomes due. n34 Due in part to the frequency of landlord-tenant disputes in this area, many states have modified the common law to place tenant-oriented restrictions upon the landlord in handling residential tenant security deposits. n35

The security deposit arrangement is personal between the landlord and the tenant. In general, if the landlord transfers the property, the sale agreement will provide that the new owner assumes both the benefit and obligation of tenants' security deposits. n36 The obligation of the landlord to refund a security deposit does not, however, run with the land absent such an assumption. n37 Thus, tenants may not recover their security deposits from a subsequent owner unless the subsequent owner has either assumed the prior owner's obligations or has received credit on the purchase price for the amount of the deposits. n38

[d] Landlord's Obligations

[i] Delivery of Possession. One of the primary obligations of the landlord is to deliver possession of the leased premises in a condition suitable for the contemplated use to the tenant at the beginning of the lease term. n39 As a general matter, if the landlord breaches this duty, the tenant is not liable for any rent during the period of nonpossession and may also be entitled to resulting consequential damages. n40 The landlord may seek to protect against consequential damages, particularly in commercial leases, by including a postponement of possession provision such as the following:

Landlord and Tenant agree that, if for any reason Tenant is unable to take possession of the lease premises at the commencement of the lease term, no term or condition of this Lease shall be affected thereby. Tenant's sole and exclusive remedy shall be Landlord's waiver of rent payments until Landlord is able to provide Tenant with possession of the lease premises.

[ii] Quiet Enjoyment. A second obligation of the landlord under most leases is to provide the tenant with "quiet enjoyment" of the leased premises throughout the term of the lease. Even in the absence of an express covenant, most states will impute this obligation to the landlord. n41 A landlord breaches the covenant of quiet enjoyment by substantially interfering with the tenant's use and enjoyment of the leased premises. n42 To permit the tenant to recover damages, the interference must usually be of such magnitude that it amounts to evicting the tenant, either actually or constructively. n43 Lesser interferences with the tenant's use of the leased premises are not usually sufficient to entitle the tenant to damages. n44 In general, the actions of a third party that substantially interfere with the tenant's use of the leased property will not constitute a breach of quiet enjoyment n45 unless the landlord has the right to control the third party. If the tenant is able to establish that the landlord has breached the covenant of quiet enjoyment, the tenant is entitled to the difference between the rental value of the leased premises and the agreed-upon rent, n46 as well as reasonably foreseeable consequential damages. n47 As is the case in any contract action, however, the tenant bears the burden of establishing its consequential damages with reasonable certainty. n48

[iii] Maintenance and Repair. The third obligation of the landlord under most leases is to maintain and repair the leased premises. n49 Unlike the implied covenant of quiet enjoyment, however, the landlord incurs this obligation only if the lease so provides. n50 If the lease obligates the landlord to make repairs, the landlord should ensure that it retains the right of entry, that the tenant is obligated to promptly notify the landlord of items requiring repair, and that the landlord is entitled to a reasonable period of time following the notice to complete the repairs.

[e] Tenant's Obligations

[i] General. The lease agreement should provide the specific time and place at which the tenant is obligated to make its rental payments, as well as provide for late payment and insufficient funds charges. In addition to standard

remedies for nonpayment of rent, the lease should expressly provide the landlord with a lien on the tenant's personal property located on the leased premises. Some states provide for such a lien by statute, n51 but some do not. n52 The landlord should include a clear lien provision in either event, because many states strictly construe the landlord's lien rights against the landlord. n53 The tenant should also be required to comply with all applicable laws and regulations, and should be required to use the leased premises in a reasonable manner and refrain from negligently or intentionally causing damage.

[ii] Removal of Fixtures. One area that should be given particular attention in the commercial lease is the provision governing removal of fixtures. "Fixture" is a legal term of art that refers to any goods that "become so related to particular real estate that an interest in them arises under real estate law." n54 The general rule provides that tenant fixtures remain with the leased property and become the property of the landlord upon termination of the lease. n55 An exception to this general rule is the case of "trade fixtures," which are those items of personal property that are necessary for a commercial tenant to carry on its business. Trade fixtures, absent an agreement in the lease to the contrary, may be removed by the tenant at the termination of the lease. n56 The lease should clearly specify that, if the tenant elects to remove its trade fixtures upon termination, the tenant must return the leased premises to the condition that existed at the time the tenant took possession.

[f] Tenant Indemnity

A number of theories exist under which a landlord may be liable for property damage and personal injuries that occur to tenants and their guests. One way in which the landlord may seek protection against this liability is to place a form of indemnity in the lease agreement. As discussed in § 16.05[f][ii] *supra*, indemnification is a contractual agreement by which parties allocate risk of loss. Under the general law of indemnity governing contracting parties of equal bargaining power, one party may undertake responsibility for the other party's negligence.

A number of jurisdictions have modified this rule in the landlord-tenant context. Standard exculpatory clauses that purport to release the property manager from liability for its own negligence have been held void as contrary to public policy by courts. n57 In addition, a number of states have enacted legislation that expressly forbids enforcement of such indemnity provisions as contrary to public policy. n58 Nevertheless, particularly in commercial leases, the landlord should consider including some form of tenant indemnity in the lease specifying that the tenant will hold the landlord harmless from losses that result from the tenant's negligence and excluding the tenant's recovery of consequential economic damages.

The following is a landlord-oriented indemnity provision:

Tenant shall defend, indemnify, and hold Landlord fully free and harmless on demand for, from, and against any and all liability, damages, costs, and expenses, including attorney's fees, arising from any negligent, reckless, or intentional act or omission of Tenant, or the officers, directors, contractors, licensees, agents, servants, employees, guests, invitees, or visitors of Tenant in or about the Project. Tenant hereby agrees that Landlord shall not be liable for injury to Tenant's business or any loss of income, or for damage to the goods, wares, merchandise or other property of Tenant, Tenant's employee's, invitees, customers, or any other person in or about the Premises, resulting from fire, steam, electricity, gas, water, or rain, or from breakage, leakage, obstruction or other defects of pipes, sprinklers, wires, appliances, plumbing, air conditioning or lighting fixture, or from any other cause.

[g] Environmental Issues

Many commercial tenants engage in activities that generate hazardous wastes. n59 In 1976, the United States Congress enacted the Resource Conservation and Recovery Act, n60 which regulates the handling of hazardous wastes from "cradle to grave." n61 An often overlooked matter is the landlord's and the property owner's exposure to liability for the costs of cleaning up hazardous wastes that a tenant handled improperly. n62 The landlord should consider obtaining

protection from its tenants by including appropriate provisions in the lease.

At a minimum, the lease should require the tenant to strictly comply with all environmental regulations, including all reporting and record-keeping requirements. The lease should specifically provide the landlord the right to enter the leased premises at all reasonable times to inspect the operation. The lease should require the tenant to promptly provide the landlord with copies of any reports or other information that the tenant obtains in connection with the use or clean-up of any hazardous materials on the premises. In the event that the tenant is unable or unwilling to perform required remedial activities, the lease should also give the landlord and its agents the right to enter the premises, conduct the remediation, and bill the tenant for the costs. Finally, the lease should contain a specific environmental indemnity from the tenant to the landlord for any costs or damages arising from environmental contamination of the property.

The flip side of the foregoing discussion is the liability of the landlord to the tenant as the result of environmental contamination existing, but undisclosed, at the time of the lease. The likely form of this action would be breach of warranty, either express or implied. Landlords should certainly resist any attempt by the tenant to include any express environmental warranty in the lease. In addition, the landlord (and its employees) should be careful to avoid making any oral representations concerning the environmental condition of the leased premises. Sophisticated tenants leasing property may insist on performing an environmental inspection. n63

[5] The Uniform Residential Landlord and Tenant Act

[a] Introduction

The Uniform Residential Landlord and Tenant Act (the "Act") is a model law that reflects the general movement of the law to a more favorable view of tenant's rights and attempts to provide cross-jurisdictional uniformity to landlord-tenant law. As of the end of 2005, the Act had been substantially adopted in twenty-one states. n64 The Act is fairly comprehensive and its provisions should be considered by landlords even in the jurisdictions in which it has not been enacted.

The Act is generally viewed as expanding tenant's rights by making the parties' obligations interdependent. n65 The following is a brief overview of the Act's more significant provisions. All jurisdictions that have adopted the Act have altered it to some degree, thereby partially defeating one of the Act's goals. In those jurisdictions that have adopted the Act, the manager must be fully conversant with its provisions as adopted.

[b] Prohibited Provisions

The Act prohibits leases that provide that the tenant waives its remedies under the Act, authorizes any confession of judgment, agrees to pay the landlord's legal fees, or agrees to any limitation of the landlord's liability. n66 In the event that the relevant jurisdiction adopts the Act in the future, the landlord should be aware that at least one state has refused to apply this provision retroactively where both the lease and the alleged violation occurred prior to the Act's effective date. n67

[c] Presumed Provisions

The Act provides that, unless otherwise specified in the lease, the tenant is liable for the fair rental value of the use and occupancy of the leased premises and is considered to have a leasehold estate from month to month. In addition, rent is presumed to be payable on the beginning date of the rental period, at the leased premises, and without demand by the landlord. In the event of a mid-rental period termination, rent is presumed to be equally apportioned from day to day. n68

[d] Unconscionability

Following in the footsteps of the Uniform Commercial Code, the Act provides courts with the discretion to refuse to enforce any part of a lease that it finds, as a matter of law, to be unconscionable. n69 The comments state that the test for determining unconscionability is "whether, in light of the background and setting of the market, the condition of the particular parties to the rental agreement, settlement or waiver of right or claim are so one sided as to be unconscionable at the time of the making of the agreement or settlement." n70

[e] Building Rules

The Act sets forth specific conditions that a landlord must meet before building rules will be enforceable against tenants. To be enforceable, a rule must: (i) be reasonably related to promoting tenant convenience, safety, or welfare; (ii) apply equally to all tenants; (iii) be sufficiently explicit to provide notice of what is required for compliance; (iv) not be designed to evade the landlord's obligations; and (v) be disclosed to the tenant at the time of lease execution. If a rule that significantly changes a tenant's lease agreement is adopted subsequent to the execution of a tenant's lease, that tenant's written consent is required before the rule may be applied to that tenant. n71

[f] Tenant's Obligations and Landlord's Remedies

The Act requires that the tenant comply with all applicable health and safety laws, maintain the leased premises in a clean and safe condition, avoid damaging the premises, and act so as to not disturb other tenants' right to peaceful enjoyment of the premises. n72 If the tenant is in material non-compliance with these obligations, the landlord may deliver written notice of the breach and that the lease will terminate in not less than thirty days. n73 If the tenant fails to remedy the breach within fourteen days, the lease terminates as provided in the notice, and the landlord may recover actual damages, obtain injunctive relief, and recover reasonable attorney's fees. n74 Alternatively, if the breach is one that may be remedied by repair, fourteen days after notice the landlord may enter and repair the premises and bill the tenant. n75

[g] Landlord's Obligations and Tenant's Remedies

The Act limits how much a landlord may demand in security deposits and provides for how deposits must be handled and returned. n76 The Act imposes obligations on a landlord regarding disclosure of the owner and manager, n77 and delivering possession of the leased unit at the commencement of the lease term. n78 The Act also places rather broad maintenance obligations on the landlord. n79 If the landlord is in material non-compliance with any of these obligations, the tenant may give notice and terminate the lease, subject to the landlord remedying the non-complying condition within fourteen days. n80 The tenant may recover actual damages, obtain injunctive relief, and recover reasonable attorney fees, as well as recover all security deposits and prepaid rent. n81

[6] Landlord's Tort Liability

[a] Introduction

At common law, a landlord was not liable to tenants for injuries resulting from dangerous conditions existing on the leased premises. n82 The general rule of non-liability has been substantially modified, and in some cases even turned on its head, n83 and landlords may now be liable to tenants and others based upon the general law of negligence. n84 This shift of liability from tenant to landlord is reflected in the growing number of jurisdictions that have, by statute, implied a warranty of habitability into residential leases. n85 The implied warranty, however, is contractual in nature, and its primary use to date has been as a tenant defense in a dispute concerning nonpayment of rent, rather than as the basis for tort recovery. n86 The following discussion will focus on the areas of potential landlord liability beyond breach of the implied warranty of habitability.

[b] Undisclosed Dangerous Conditions

One significant area of landlord liability arises from failure to disclose concealed, dangerous conditions on the leased premises that are known to the landlord but not to the tenant. n87 The landlord cannot avoid liability by claiming uncertainty about the existence of the danger. If the landlord has enough information from which a reasonable person would conclude that an unreasonable risk of harm exists, the landlord is under an affirmative duty to communicate this information to the tenant. n88 The landlord will not be liable for injury caused by conditions the tenant should have discovered. n89

A New Jersey court has refused to find that a real estate broker and agent had a duty to discover latent defects in residential rental property they managed. That court stated that it could not see how the public interest would be furthered by imposing a duty to search "every nook and cranny of the rental premises to discover latent defects." The court also stated that it specifically declined to impose a duty to inspect for hidden defects upon a broker which had merely agreed to accept the rent on the owner's behalf, pay maintenance fees, and be the contact person for repairs. n89.1

[c] Premises Open to the Public

A second general area of landlord liability is the case of land that is leased for a purpose that involves admission of the public. n90 The landlord must exercise reasonable care to inspect and repair those portions of the leased premises that will be open to the public before transferring the premises to the tenant. The landlord may not escape this liability by having the tenant agree to make the necessary inspection or repair. n91 This is an obvious source of landlord liability in every commercial lease and has been applied by the courts to a wide variety of commercial settings. n92 By its terms, this rule does not apply to dangerous conditions that arise on the leased premises after they have been transferred to the tenant, but the landlord may be liable for failure to timely make subsequent repairs if the landlord has contracted with the tenant to do so. n93

[d] Failure to Maintain Common Areas

A landlord may also be held liable for injuries that occur to tenants and others in common areas over which the landlord retains control. n94 This type of liability can arise from dangerous conditions that the landlord fails to repair in parking lots, stairways, elevators, rest rooms, tenant recreation areas, or any other area of a building that the landlord maintains for the tenants' benefit. n95 Liability will attach if, by the exercise of reasonable care, the landlord could have discovered and repaired the dangerous condition and the unreasonable risk that it created. n96 Whether remedial actions taken by a landlord are reasonable is a question of fact to be judged in light of all of the circumstances. n97

[e] Criminal Activity

In a relatively recent legal development, a landlord may be held liable for tenants' damages resulting from the criminal acts of third parties. n98 In general, liability will arise if the landlord has notice of prior criminal activity and the area in which the crime occurs is under the exclusive control of the landlord. n99 The key to liability is failure to take adequate precautions after notice of criminal activity. Among the steps a prudent landlord may take to mitigate liability for criminal acts of third parties are installing modern security devices, ensuring that lighting is adequate and properly maintained, or hiring professional security personnel. n100 In today's increasingly crime-conscious society, it is not unusual for a prospective tenant to inquire about the occurrence of any prior criminal activity on the premises. If the landlord knows, or should know, that criminal activity has occurred, the landlord must respond truthfully, even though this may result in a lost tenant. n101

FOOTNOTES:

(n1)Footnote 1. 7B U.L.A. 427. *Section 16.06[5] infra* provides a brief overview of the more significant provisions of the Act, but every jurisdiction that has adopted the Act has done so with some changes. Nothing will substitute for being

familiar with the Act as adopted in the jurisdiction in which the manager is operating.

(n2)Footnote 2. O.C.G.A. § 44-7-1 provides that a lease for less than five years, which does not purport to create an estate, passes no property right from the landlord. The "tenant" obtains only a usufruct, or the temporary right to possess the land.

(n3)Footnote 3. *Belle Fourche Pipeline Co. v. State*, 766 P.2d 537, 105 O.&G.R. 423 (Wyo. 1988) .

(n4)Footnote 4. A number of states have, by statute, reduced the number of leasehold estates that may be created.

See, e.g.:

North Dakota: N.D. Cent. Code § 47-04-02. This provision states, "Estates in real property in respect to the duration of their enjoyment are: 1. Estates of inheritance or perpetual estates; 2. Estates for life; 3. Estates for years; or 4. Estates at will."

See also Restatement (Second) of Property: Landlord & Tenant, § 1.4 Lease for a Fixed or Computable Period of Time; § 1.5 Periodic Tenancy; § 1.6 Tenancy at Will; and § 1.7 Tenancy That Is Terminable on Some Event.

(n5)Footnote 5. Restatement (Second) of Property § 1.4 (1977).

(n6)Footnote 6.

Alabama: Alabama Code § 35-4-6 (99 years on all leases).

California: Cal. Civ. Code § 717 (51 years for agricultural leases).

Nevada: Nevada Rev. Stat. § 111.200 (99 years, except for agricultural leases).

(n7)Footnote 7. *See generally* Restatement (Second) of Property: Landlord & Tenant, § 1.7 Tenancy That Is Terminable on Some Event; *Byrd Cos. v. Birmingham Trust National Bank*, 482 So. 2d 247, 252 (1985) , quoting Thompson on Real Property ("A tenancy for years must be certain as to commencement, duration and termination. But if it does end on a date certain it is a term tenancy not a tenancy at will.").

(n8)Footnote 8.

California: *Wallace v. Daley*, 220 Cal. App. 3d 1028, 270 Cal. Rptr. 85 (1990) .

New York: *Stauber v. Antelo*, 163 A.D.2d 246, 558 N.Y.S.2d 67 (2d Dept. 1990) .

(n9)Footnote 9. Restatement (Second) of Property § 1.5, cmt. b (1977).

(n10)Footnote 10. Restatement (Second) of Property § 1.6 (1977).

(n11)Footnote 11. *See* Kan. Stat. Ann. § 58-2501 (tenancy at will presumed unless shown otherwise).

(n12)Footnote 12. These periods vary widely. *See:*

Colorado: Colo. Rev. Stat. § 13-40-107 (tenancy at will requires three days' notice to terminate).

California: Cal. Civ. Code § 789 (tenancy at will may be terminated by thirty days' notice).

Georgia: O.C.G.A. § 44-7-7 (sixty days' notice from landlord or 30 days' notice from tenant required to terminate tenancy at will).

Maine: Me. Laws tit. 14 § 6002 (at-will tenancy requires thirty days' notice to terminate).

(n13)Footnote 13. *See* Restatement (Second) of Property § 1.6, cmt. e (1977).

(n14)Footnote 14. *See:*

Georgia: Seligman v. Savannah Wholesale Co., Inc., 363 S.E.2d 785 (Ga. Ct. App. 1987) .

New York: Mastas v. Extra Closet, Inc., 146 Misc. 2d 698, 553 N.Y.S.2d 582 (1990) (ruling that, as tenants at sufferance, the holdover tenants were entitled to thirty days' notice under New York law).

Ohio: Craig Wrecking Co. v. S.G. Loewendick & Sons, Inc., 526 N.E.2d 321 (Ohio. Ct. App. 1987) (recognizing a landlord's option to evict the holdover tenant or bind it to a new lease).

(n15)Footnote 15. The tenant at sufferance is actually worse off than a trespasser in at least two respects. First, the tenant remains liable for reasonable rent to the landlord for use and occupation of the premises. *See:*

Federal: In re Orient River Invs., Inc., 112 B.R. 126 (Bankr. E.D. Pa. 1990) .

Maine: McFarland v. Stewart, 50 A.2d 194, 197 (Me. 1946) .

Second, the tenant at sufferance is unable to gain title to the premises by means of adverse possession because the possession is, by definition, with the landlord's permission.

See Watkins v. Arnold, 69 Ark. 263, 62 S.W. 904 (1901) . *See also Estate of Wells v. Estate of Smith*, 576 A.2d 707, 710 (D.C. App. 1990) (To establish title by adverse possession, a claimant must demonstrate actual, open and notorious, exclusive, continuous, and hostile possession of the premises for the prescribed statutory period. A permissive entry does not ripen into adverse possession, no matter how long actual possession continues, until the holder disavows the ownership of the landowners by unequivocal conduct. There must be proof of a claim, act or declaration of hostility so manifest and notorious that actual notice will be presumed in order to change a permissive or otherwise non-hostile possession into one that is hostile.).

(n16)Footnote 16. *See:*

Arizona: Ariz. Rev. Stat. § 44-101.

Arkansas: Ark. Code Ann. § 4-59-101.

Connecticut: Conn. Gen. Stat. § 52-550.

Idaho: Idaho Code § 9-503.

Maine: Maine provides that no leasehold estate, regardless of duration, greater than a tenancy at will can be created unless the lease is in writing. Me. Laws tit. 33, § 162.

(n17)Footnote 17. *See generally* Restatement (Second) of Property § 2.2. The requirement that the lease be signed by "the party to be charged" means that the lease is enforceable against the tenant if the tenant has signed, regardless of whether or not the landlord has signed.

(n18)Footnote 18. *See, e.g., Player v. Chandler*, 382 S.E.2d 891, 893-94 (S.C. 1989) .

(n19)Footnote 19. *See generally* Restatement (Second) of Property § 2.3.

(n20)Footnote 20. *See* Restatement (Second) of Contracts §§ 71-81.

(n21)Footnote 21.

Ohio: Dayton Metro. Hous. Auth. v. McKee, 524 N.E.2d 180 (Ohio Ct. App. 1987) .

Tennessee: Galbreath v. Harris, 779 S.W.2d 392 (Tenn. Ct. App. 1989) .

(n22)Footnote 22. *See generally* 49 Am. Jur. 2d *Landlord and Tenant* § 516.

(n23)Footnote 23. *See Tatro v. Lehouiller*, 513 A.2d 610 (Vt. 1986) .

(n24)Footnote 24. *See In re Ames Dept. Stores, Inc.*, 127 B.R. 744 (Bankr. S.D.N.Y. 1991) ; 49 Am. Jur. 2d *Landlord and Tenant* § 230.

(n25)Footnote 25. *See State v. Mann*, 463 N.W.2d 883 (Iowa 1990) .

(n26)Footnote 26. *See Ewing v. Adams*, 573 So. 2d 1364, 1368 (Miss. 1990) ; 49 Am. Jur. 2d *Landlord and Tenant* § 240.

(n27)Footnote 27. *See Ray-Ron Corp. v. DMY Realty Co.*, 500 N.E.2d 1163, 1165 (Ind. 1986) .

(n28)Footnote 28. *See Sippin v. Ellam*, 588 A.2d 660 (Conn. Ct. App. 1991) (finding that a landlord was not entitled to enforce any portion of such an illegal lease).

(n29)Footnote 29. *See Bonwell v. Stone*, 128 A.D.2d 1013, 513 N.Y.S.2d 547, 547 (3d Dept. 1987) .

(n30)Footnote 30. *See* Restatement (Second) of Property § 15.1. This general freedom of alienation does not apply to a tenancy at will. Some jurisdictions have modified the common-law rule in favor of non-assignability. *See Ky. Rev. Stat. Ann. § 383.180* (assignment of a lease of less than two years duration without the landlord's written consent constitutes forfeiture of the leasehold).

(n31)Footnote 31. An assignment operates to transfer all of the lessee/assignor's interest in the leasehold premises. In a sublease, the lessee/sublessor retains some reversionary rights in the leasehold. *See generally* 49 Am. Jur. 2d *Landlord and Tenant* § 392. An agreement by which a tenant permits third parties non-exclusive access to the leased premises for a fee is not a sublease or an assignment, and therefore does not require the landlord's approval under a lease's sublease provision. *See Hilton Head Air Serv., Inc. v. Beaufort County*, 418 S.E.2d 849 (S.C. Ct. App. 1992) (ruling that the subject agreement was a license, rather than a sublease, and therefore not subject to the lease provision requiring consent for the sublease or assignment of the leasehold).

(n32)Footnote 32. *But see* Hawaii Rev. Stat. § 516-63 (residential leases may be assigned without the landlord's consent provided the landlord is given a copy of the assignment and the assignee agrees to assume all of the lessee/assignor's obligations under the lease).

(n33)Footnote 33. *Compare* Warner v. Konover, 553 A.2d 1138 (Conn. 1989) (a landlord must exercise discretion to approve a lease assignment consistent with good faith and fair dealing) with Leonard, Street & Deinard v. Marquette Assocs., 353 N.W.2d 198, 201 (Minn. Ct. App. 1984) (a landlord is not required to consent to an assignment, even if withholding of the consent is unreasonable).

(n34)Footnote 34. *See* Restatement (Second) of Property § 12.1, cmt. 1.

(n35)Footnote 35. *See, e.g.:*

Arkansas: Ark. Code Ann. §§ 18-16-304 to 306 (deposit limited to two months' rent; tenant entitled to double recovery of wrongfully withheld sums).

Colorado: Colo. Rev. Stat. § 38-12-103 (landlord must provide written statement of reasons for retaining deposit; failure to do so forfeits right to deposit; tenant may recover treble damages, fees, and costs if landlord wrongfully retains deposit; burden on landlord to show good faith).

Connecticut: Conn. Gen. Stat. § 47a-21[b] (deposit may not exceed two months' rent; limited to one month from tenants age sixty-two or older).

Florida: Fla. Stat. § 83.49 (requires landlord to return deposit plus interest).

Kansas: Kan. Stat. Ann. § 58-2550[a] (limited to one months' rent for unfurnished apartment, 1.5 months' rent for furnished, with an additional 0.5 month's rent available for pet deposit).

In addition, where the landlord is a licensed broker, the laws and regulations governing brokers also applies to the accounts held by the landlord on behalf of the tenants.

(n36)Footnote 36. *See generally* Restatement (Second) of Property § 16.1, cmt. c.

(n37)Footnote 37. *See* Castlebrook, Ltd. v. Dayton Properties Limited Partnership, 604 N.E.2d 808, 813 (Ohio Ct. App. 1992) .

(n38)Footnote 38. *See id.*

(n39)Footnote 39. *See:*

Louisiana: Moore v. Cameron Parish School, 511 So. 2d 62 (La. Ct. App. 1987) .

Maryland: Kessler v. Equity Management, Inc., 572 A.2d 1144 (Md. Ct. App. 1990) .

Restatement (Second) of Property § 5.1.

(n40)Footnote 40. *See, e.g.:*

Louisiana: Moore v. Cameron Parish School, 511 So. 2d 62 (La. Ct. App. 1987) .

Texas: Fabrique, Inc. v. Corman, 796 S.W.2d 790 (Tex. Ct. App. 1990) .

But see In re TM Carlton House Partners, Ltd., 93 B.R. 859 (Bankr. E.D. Pa. 1988) (leased premises were 13% smaller than contemplated in the lease; the tenant's damages from reduced class size and inability to use custom-made furniture were not "reasonably foreseeable" and therefore not recoverable).

(n41)Footnote 41. *See*:

Federal: Stinson, Lyons, Gerlin & Bustamante, P.A. v. Brickell Bldg. 1 Holding Co, Inc., 923 F.2d 810 (11th Cir. 1991) ; *Infinity Broadcasting Corp. of Illinois v. Prudential Ins. Co. of America*, 869 F.2d 1073 (7th Cir. 1989) .

Maryland: Bocchini v. Gorn Management Co., 515 A.2d 1179 (Md. Ct. App. 1986) .

Massachusetts: Carey's Inc. v. Carey, 517 N.E.2d 850 (Mass. Ct. App. 1988) .

North Carolina: Marina Food Assoc., Inc. v. Marina Restaurant, Inc., 100 N.C. App. 82, 394 S.E.2d 824 (N.C. Ct. App. 1990) .

Pennsylvania: Lichtenfels v. Bridgeview Coal Co., 531 A.2d 22 (Pa. Super. Ct. 1987) .

Tennessee: Morrison v. Smith, 757 S.W.2d 678 (Tenn. Ct. App. 1988) .

Texas: HTM Restaurants v. Goldman, 797 S.W.2d 326 (Tex. Ct. App. 1990) (noting, however, that the parties could defeat the implied covenant with express language to the contrary).

But see Conille v. Secretary of Hous. & Urban Dev., 840 F.2d 105, 112 (ruling that incorporating Massachusetts' implied covenant of quiet enjoyment as the federal rule of decision would frustrate congressional purposes underlying the national Housing Act).

(n42)Footnote 42. *See Infinity Broadcasting Corp. of Illinois v. Prudential Ins. Co. of America*, 869 F.2d 1073 (7th Cir. 1989) .

(n43)Footnote 43. *See*:

Tennessee: Hess's Dept. Stores, Inc. v. Ernest W. Hahn, Inc., 901 F.2d 552 (6th Cir. 1990) .

North Carolina: Marina Food Assoc., Inc. v. Marina Restaurant, Inc., 100 N.C. App. 82, 394 S.E.2d 824 (N.C. Ct. App. 1990) (failure to repair roof amounted to constructive eviction, which "automatically" breached covenant of quiet enjoyment).

A tenant may be held to have waived a claim for constructive eviction, however, by waiting too long to surrender the property. *See JMB Properties Urban Co. v. Paolucci*, 604 N.E.2d 967 (Ill. Ct. App. 1992) (reversing the trial court's judgment in favor of the tenant and ruling that tolerating alleged conditions rendering the leasehold untenable for more than four years before quitting the premises waived the claim for constructive eviction).

(n44)Footnote 44. *See*:

Alaska: Berrey v. Jeffcoat, 785 P.2d 20 (Alaska 1990) (eviction notice was retracted prior to tenant's detrimental reliance).

Georgia: Georgia Hardwick, Cook & Co. v. 3379 Peachtree, Ltd., 363 S.E.2d 31 (Ga. Ct. App. 1987) (extensive renovation activities during which tenant remained open for business).

(n45)Footnote 45. See:

Arizona: Dillon-Malik, Inc. v. Wactor, 728 P.2d 671 (Ariz. Ct. App. 1986) (exercise of governmental zoning power).

Tennessee: Marshalls of Nashville, Inc. v. Harding Mall Assoc., Ltd., 799 S.W.2d 239 (Tenn. Ct. App. 1990) (negligence of properly hired independent contractor).

(n46)Footnote 46. See *Madison Assocs. v. Bass*, 511 N.E.2d 690 (Ill. Ct. App. 1987) .

(n47)Footnote 47.

New York: Union City Union Suit Co, Ltd. v. Miller, 162 A.D.2d 101, 556 N.Y.S.2d 864 (1st Dept. 1990) (cover cost of purchasing goods from third party).

Texas: Kerrville HRH, Inc v. City of Kerrville, 803 S.W.2d 377 (Tex. Ct. App. 1987) (lost profits).

(n48)Footnote 48. See:

Federal: In re Electroformex Lab., Inc., 76 B.R. 894 (Bankr. D. R.I. 1987) .

New York: Ciraolo v. Miller, 138 A.D.2d 443, 525 N.Y.S.2d 861 (2d Dept. 1988) .

(n49)Footnote 49. See:

Illinois: Chem-Pac, Inc. v. Simborg, 495 N.E.2d 1124 (Ill. Ct. App. 1986) .

Missouri: Harrison v. Roberts, 800 S.W.2d 40 (Mo. Ct. App. 1990) .

(n50)Footnote 50. See:

Arizona: Thomas v. Goudreault, 786 P.2d 1010 (Ariz. Ct. App. 1989) .

North Carolina: Mudusar v. V.G. Murray & Co., Inc., 396 S.E.2d 325 (N.C. Ct. App. 1990) .

(n51)Footnote 51. See:

New Mexico: N.M. Stat. Ann. § 48-3-5.

Oklahoma: Okla. Stat. tit. 41, § 133.

Oregon: Or. Rev. Stat. § 87.162.

(n52)Footnote 52. *See:*

Montana: Mont. Laws § 70-24-430 (no lien rights; a landlord may sell abandoned property only after reasonable efforts to contact the tenant have failed).

See also Messmore v. Roth, 366 S.E.2d 318 (Ga. Ct. App. 1988) (no common-law right to landlord lien).

(n53)Footnote 53. *See, e.g., Paris Am. Corp. v. McCausland*, 759 P.2d 1210 (Wash. Ct. App. 1988) .

(n54)Footnote 54. § 9-313, 3A U.L.A. 420, cmt. 2.

(n55)Footnote 55. *See generally* 35 Am. Jur. 2d *Fixtures* § 2.

(n56)Footnote 56. *See Goldie v. Bauchet Properties*, 540 P.2d 1, 6 (Cal. 1975) ("Although 'trade fixtures' are normally removable by the tenant upon termination of the lease, provisions to the effect that fixtures, including trade fixtures, will belong to the landlord on termination of the lease for breach by the tenant are valid and controlling.")

(n57)Footnote 57. *See, e.g., Crawford v. Buckner*, 839 S.W.2d 754, 757-59 (Tenn. 1992) , expressly overruling the contrary holding of *Schratter v. Development Enter., Inc.*, 584 S.W.2d 459 (Tenn. Ct. App. 1979) .

(n58)Footnote 58. *See, e.g.:*

Illinois: ILCS 705/1 (such a provision is against public policy and wholly unenforceable).

Massachusetts: Mass. Gen. L. ch. 186 § 15.

(n59)Footnote 59. The universe of hazardous wastes is rather large. *See* 40 C.F.R. § 261.31-.33.

(n60)Footnote 60. 42 U.S.C. § 6901, *et. seq.*

(n61)Footnote 61. *See Chemical Waste Management, Inc. v. Hunt*, 504 U.S. 334, 337-338, 112 S. Ct. 2009, 2011, 119 L. Ed. 2d 121, 129 (1992) .

(n62)Footnote 62. The 1980 Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. § 9601 *et seq.* , commonly referred to as "Superfund," imposes cleanup liability on all "responsible parties." "Responsible party" includes any current or former owner or operator of the site.

(n63)Footnote 63. Before consenting to such a pre-lease inspection, the landlord should obtain an agreement similar to the form Hazardous Materials Testing Procedures at § 16.07[2] *infra* .

(n64)Footnote 64. The Act has been substantially adopted in some form in Alabama, Alaska, Arizona, Connecticut, Florida, Hawaii, Iowa, Kansas, Kentucky, Michigan, Mississippi, Montana, Nebraska, New Mexico, Oklahoma, Oregon, Rhode Island, South Carolina, Tennessee, Virginia and Washington.

(n65)Footnote 65. *McCall v. Fickes*, 556 P.2d 535 (Alaska 1976) .

(n66)Footnote 66. See § 1.403, 7B U.L.A. 450-51.

(n67)Footnote 67. See *Fuentes v. Owen*, 310 So. 2d 458 (Fla. Ct. App. 1975) .

(n68)Footnote 68. § 1.401, 7B U.L.A. 447.

(n69)Footnote 69. § 1.303, 7B U.L.A. 444.

(n70)Footnote 70. Comment to § 1.303, 7B U.L.A. 444-45. The only annotated decision finding a lease term to be unconscionable under this provision noted that the jurisdiction had "adopted a standard of inequity in place of a standard of unconscionability." *Ramirez-Eames v. Hover*, 775 P.2d 722, 725 (N.M. 1989) .

(n71)Footnote 71. § 3.102, 7B U.L.A. 475.

(n72)Footnote 72. § 3.101, 7B U.L.A. 474. This duty has been held to include the acts of those on the leased premises with the tenant's express or implied consent. See *New Hampshire Ins. Co. v. Hewins*, 627 P.2d 1159, 1161 (Kan. Ct. App. 1981) (noting that the Kansas legislature had chosen to impose "a greater responsibility on the tenant insofar as persons on the premises with his consent are concerned.")

(n73)Footnote 73. § 4.201, 7B U.L.A. 492.

(n74)Footnote 74. § 4.201, 7B U.L.A. 492.

(n75)Footnote 75. § 4.202, 7B U.L.A. 495.

(n76)Footnote 76. § 2.101, 7B U.L.A. 453.

(n77)Footnote 77. § 2-102, 7B U.L.A. 458.

(n78)Footnote 78. § 2-103, 7B U.L.A. 459.

(n79)Footnote 79. § 2.104, 7B U.L.A. 460-61.

(n80)Footnote 80. § 4.101, 7B U.L.A. 478.

(n81)Footnote 81. § 4.101, 7B U.L.A. 478.

(n82)Footnote 82. See Restatement (Second) of Torts §§ 355-56.

(n83)Footnote 83. See *Becker v. IRM Corp.*, 698 P.2d 116, 122 (Cal. 1985) (a lessor of residential property "is strictly liable in tort for injuries resulting from a latent defect in the premises when the defect existed at the time the premises were let.") A more recent California lower court decision has declined to extend the *Becker* strict liability analysis to commercial leases. See *Mora v. Baker Commodities, Inc.*, 210 Cal. App. 3d 771, 258 Cal. Rptr. 669, 672-73 (Cal. Ct. App. 1989) .

(n84)Footnote 84. See, e.g., *Stephens v. Stearns*, 106 Idaho 249, 678 P.2d 41, 50 (Idaho 1984) .

(n85)Footnote 85. See *Pugh v. Holmes*, 405 A.2d 897, 901 n.2 (Pa. 1979) (citing statutory and decisional authority in 40 jurisdictions for the implied warranty). But see *Young v. Morrissey*, 329 S.E.2d 426, 429 (S.C. 1985) ("As a general rule, there is no implied warranty of fitness or habitability in leases. A lessee takes the leased premises, in the absence of an express warranty, or of fraud or misrepresentation, in the condition and quality that they are in.") *superseded by statute as stated in*, *Robinson v. Code*, 2009 S.C. App. LEXIS 252 (2009) . For a discussion, and rejection, of the extension of the implied warranty to commercial leases, see *Fireman's Fund Ins. Co. v. BPS Co.*, 491 N.E.2d 365, 370 (Ohio Ct. App. 1985) .

(n86)Footnote 86. See Prosser and Keeton on Torts § 63, at 435 n.12 (West 5th ed. 1984). This treatise cites five cases with conflicting results on the question.

(n87)Footnote 87. See Restatement (Second) of Property § 17.1; Prosser and Keeton on Torts § 63, at 436-37 (West 5th ed. 1984).

(n88)Footnote 88. See Prosser and Keeton on Torts § 63, at 436 (West 5th ed. 1984).

(n89)Footnote 89. See *Herren v. Bonham*, 825 P.2d 1321, 1322-23 (Okla. 1992) .

(n90)Footnote 89.1. See *Rogers v. Bree*, 329 N.J. Super. 197, 747 A.2d 299, 302-303 (2000) (tenant's fingers were severed when they touched exposed electrical wires on a washing machine supplied with the home). See also *Reyes v. Egner*, 404 N.J. Super. 433, 466, 962 A.2d 542, 562-63 (App. Div. 2009) (following *Rogers v. Bree* in a case involving a short-term vacation rental of a house) aff'd, 2010 N.J. LEXIS 385 (N.J. Apr. 8, 2010) .

(n91)Footnote 90. See, e.g., *Darrington v. Wade*, 812 P.2d 452, 458 (Utah Ct. App. 1991) cited in Restatement (Second) of Torts § 17.2 (those who lease property for admission of the public have higher duty of care than do ordinary landlords).

(n92)Footnote 91. See *Rollo v. City of Kansas City*, 857 F. Supp. 1441, 1444-45 (D. Kan. 1994) ; Restatement (Second) of Torts § 359.

(n93)Footnote 92. See *Rollo v. City of Kansas City*, 857 F. Supp. 1441, 1444-45 (D. Kan. 1994) ; Restatement (Second) of Torts § 359.

(n94)Footnote 93. See *Nichols v. Marsden*, 483 A.2d 341, 344 (Me. 1987) . Cf. *Westbrook v. M & M Supermarkets, Inc.* 203 Ga. App. 345, 416 S.E.2d 857 (Ga. Ct. App. 1992) (ruling that the customer lacked contractual privity with the landlord and therefore had no standing to sue the landlord for breach of its contractual duty to maintain the parking lot).

(n95)Footnote 94. See Restatement (Second) of Torts § 17.3.

(n96)Footnote 95. See Prosser and Keeton on Torts § 63, at 440-43 (West 5th ed. 1984).

(n97)Footnote 96. See Restatement (Second) of Property § 17.3.

(n98)Footnote 97. See *Danner v. Myott Park, Ltd.*, 306 N.W.2d 580, 582 (Neb. 1981) (a tenant's guest was injured by falling on ice-covered stairs; verdict for the defense reversed based upon the trial court's improper instruction that the landlord was entitled to wait until the storm ended before taking action on the stairs; the reasonableness of the landlord's decision to wait was a question of fact for the jury).

(n99)Footnote 98. The seminal decision in this area is *Kline v. 1500 Massachusetts Ave. Apt. Corp.*, 439 F.2d 477 (D.C. Cir. 1970) , which ruled that residential apartment owners had a duty to protect tenants from foreseeable criminal acts. In the wake of *Kline*, an increasing number of courts have imposed this duty upon landlords. See Prosser and Keeton on Torts § 63, at 442-43 ns. 14-15 (West 5th ed. 1984), citing cases.

(n100)Footnote 99. For a recent application of *Kline* to a commercial setting, see *Doe v. Dominion Bank of Washington, NA*, 963 F.2d 1552 (D.C. Cir. 1992) , rev'g 795 F. Supp. 456 (D.D.C. 1991) , in which the trial court had granted a directed verdict for the defendant-landlord because the tenant failed to introduce sufficient evidence of the foreseeability of the tenant's rape. The circuit court ruled that, even though the plaintiff failed to establish that any prior rape had occurred at the leased premises, the "condition of the premises," which the trial court had not considered, was a critical factor in assessing the reasonableness of the landlord's conduct. 963 F.2d at 1560-61 .

(n101)Footnote 100. For a good discussion of the subject, see Marvin F. Milich, *Protecting Commercial Landlords*

from *Liability for Criminal Acts of Third Parties*, 15 Real Est. L.J. 238 (Winter 1986).

(n102)Footnote 101. See *Dilbeck v. Yates*, 419 S.E.2d 154 (Ga. Ct. App. 1992) (a landlord was liable for damages resulting from a burglary after the landlord failed to disclose prior burglaries in response to the tenant's inquiry prior to signing the lease).

* This chapter was prepared by Brian J. Jordan, Esq., of Ryley, Carlock & Applewhite, Phoenix, Arizona. Additional updates were contributed by Sandra Bullington, Esq.



84 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 16 The Broker's Role in Property Management *

10A-16 Real Estate Brokerage Law and Practice § 16.07

§ 16.07 Forms

[1] Property Management Agreement Property Management Agreement

PROPERTY MANAGEMENT AGREEMENT

(..... **APARTMENTS**)
(with optional HUD provisions)

This Property Management Agreement ("Agreement") is made and entered into as of, 19
("Commencement Date"), by and between:

.....

.....

.....

.....

(hereinafter "Owner"); and

.....

.....

.....

.....

(hereinafter "Agent");

concerning the operation and management of that certain unit garden apartment complex described as:

.....

.....

.....

including all fixtures, improvements, and items of personal property used in conjunction with or located on the real property. All of the foregoing are referred to as the "Property."

RECITALS

1. Possession. Subject to the terms, covenants, and restrictions contained in this Agreement, Owner grants Agent possession of the Property with the sole and exclusive right to lease, rent, operate, maintain, and manage the Property.
2. Commencement. The obligations of Agent under this Agreement shall commence on the Commencement Date and shall continue in full force and effect until the complete termination of this Agreement in accordance with the provisions of Paragraph 21.
3. Definitions. As used in this Agreement:
 - a. "HUD" means the United States Department of Housing and Urban Development.
 - b. "Secretary" means the Secretary of the United States Department of Housing and Urban Development.
 - c. A "Mortgage" is an instrument of agreement between the Owner, as mortgagor, and a lender or mortgagee, creating a lien on the Property as security for the payment of debt, which is insured by the United States Department of Housing and Urban Development.
 - d. "Mortgagee" means any holder of the Mortgage.
 - e. "Principal Parties" means the Owner and the Agent.
 - f. "Consenting Parties" means the Secretary and the Mortgagee.
 - g. "Lender" means, a corporation or its successors and assigns.
4. HUD Requirements (OPTIONAL). The Property is subject to a Mortgage which is insured by HUD under Section 223(f) of the National Housing Act, and the Owner has entered into a Regulatory Agreement dated with the Secretary. Under the Regulatory Agreement, the Owner is obligated to provide for management of the Property in a manner satisfactory to the Secretary. The Owner has furnished the Agent with copies of the Regulatory Agreement. In performing its duties under this Agreement, the Agent will comply with all pertinent requirements of the Regulatory

Agreement and the directives of the Secretary. In the event of a conflict between this Agreement and the rights and requirements of HUD or the Mortgagee under the Regulatory Agreement, the rights and requirements of HUD or the Mortgagee shall prevail.

5. Rentals. The Agent will offer for rent and will rent the dwelling units, parking spaces, and concessions on the Property. In addition, the Agent will perform the following duties:

- a. The Agent will show the Property and vacant dwelling units at the Property to prospective tenants.
- b. The Agent will accept and process applications for rentals. If an application is rejected, Agent, to the extent legally required, will inform the applicant of the reason for the rejection. A current list of prospective tenants will be maintained.
- c. The Agent will prepare all dwelling leases and permits, and will execute all dwelling leases and permits in the name of, and as the authorized and disclosed agent for, the Owner of the Property. The terms of all leases will comply with the pertinent provisions of the Regulatory Agreement and the directives of the Secretary which are made known by Owner to the Agent. Dwelling leases will be in a form approved by the Owner, but individual dwelling leases and parking permits need not be submitted for the approval of the Owner.
- d. The Owner will furnish the Agent with rent schedules showing basic rents for dwelling units and other charges for facilities and services at the Property. In no event will these rents and other charges be in excess of the "maximum monthly gross for living units" as approved by the Secretary from time to time.
- e. The Agent will collect, deposit, and disburse security deposits, if required, in accordance with the terms of each tenant's lease. Security deposits will be deposited by the Agent, separate from all other accounts and funds, with a bank or other financial institution whose deposits are insured by an agency of the United States government. This account will be carried in the Property's name and designated of record as "....."

6. Trust Account; Assignment of Rents. Any funds collected by Agent on behalf of Owner shall be held by Agent in a bank account or accounts, in trust for the benefit of Owner. Owner grants to Agent the right and authority to withdraw from such bank accounts any or all disbursements which, under this Agreement, are to be made at the expense of Owner, including any compensation or payments to be made to Agent under Paragraph 18. Owner assigns to Agent any and all rents from the Property in an amount equal to any unpaid operating expenses incurred by Agent on behalf of Owner for the Property. This assignment of rents shall be for the purpose of securing any payment due Agent and the performance of all obligations of Owner which have been performed by Agent on behalf of Owner or the Property. From time to time (but not more frequently than monthly), Agent shall remit to Owner any excess funds accumulated in the Property bank accounts. The excess, for purposes of this Agreement, shall be determined by taking the total income collected from the Property on behalf of Owner during the preceding calendar month and subtracting all expenses paid or accrued on behalf of the Property (including all installments of principal and interest due from time to time on the Mortgage or on any other indebtedness secured by the Property and including all real estate taxes and assessments) and further subtracting a reasonable operating reserve equal to Dollars (\$.....).

7. Enforcement of Leases. The Agent will use its best efforts to secure full compliance by each tenant with the terms of the applicable lease. Voluntary compliance will be emphasized. The Agent will counsel tenants and make referrals to community agencies in cases of financial hardship or under other circumstances deemed appropriate by the Agent so that involuntary termination of tenancies may be avoided to the maximum extent consistent with sound management of the Property. Nevertheless, the Agent may terminate any tenancy when, in the Agent's judgment, sufficient cause (including, but not limited to, nonpayment of rent) for such termination occurs under the terms of the tenant's lease. For this purpose, the Agent is authorized to consult with legal counsel approved by the Owner to bring actions for eviction and to execute notices to vacate and judicial pleadings incident to such actions. The Agent must keep the Owner

reasonably informed of all actions. Subject to the Owner's approval, attorney fees and other necessary costs incurred in connection with such actions may be paid out of the Property bank accounts as Property expenses.

8. Authorization. Owner authorizes Agent to perform the following acts in the name of Agent, Owner, and/or the Property, and Owner assumes and agrees to pay, when due, all expenses and obligations incurred in connection with the performance by Agent of these acts:

a. To do all things necessary to ensure that the Property is maintained in an attractive condition and good state of repair consistent with the general condition of the Property as of the Commencement Date; to make or cause to be made, as needed to properly maintain the Property, repairs, alterations, additions, or replacements; and to purchase materials and supplies to accomplish the foregoing and to purchase necessary operating supplies. Agent shall obtain the approval of Owner for any single capital expenditure in excess of Five Thousand Dollars (\$5,000.00).

b. To advertise in any appropriate media the availability for rental of units located on the Property; to sign, renew, or cancel leases and/or rental agreements for said rental units; to collect rents due or to become due and give receipts; to terminate tenancies and to sign and serve such notices as are appropriate; to institute and prosecute actions; to recover possession of premises; to sue for and recover rents and other sums due; and, when expedient, to settle, compromise, or release such actions, suits, or controversies, or reinstate such tenancies.

c. To hire, discharge, and supervise all labor and employees required for the operation and maintenance of the premises, including, without limitation, a resident manager. All employees shall be deemed employees of Agent and not employees of Owner. Charges made to Owner's account for employees' salary and wages shall include all applicable state and federal taxes, insurance premiums, 401K profit sharing contributions (not to exceed% of salary), employees' welfare benefits as may be required by law, and applicable group health insurance premiums under a plan deemed acceptable by Agent. Moreover, Owner also agrees to pay the costs incident to the hiring of employees, including the cost of background checks, employment advertising, administration of polygraph examinations, bond premiums, and employment agency fees, if required. Agent shall not be responsible or liable to Owner or any third party (including tenants at the Property) for the criminal acts or omissions of Agent's employees or any acts or omissions performed or omitted outside the scope of their employment.

d. To make and enter into the name of the Owner any contracts for electricity, gas, water, telephone, pool maintenance, lawn service, cleaning, trash, rubbish hauling, and other services, as Agent shall deem advisable with respect to the Property. To the extent available, all of these contracts shall contain a-day notice of cancellation provision for the benefit of Agent and/or Owner. Owner shall assume the obligations of any such contracts. Agent agrees to use his best efforts to secure such purchase and service contracts at the most favorable prices and terms available. Owner agrees to allow the Property to become a member of the Multihousing Association and to pay all reasonable costs for maintaining membership in this organization.

e. To establish and review, from time to time, with Owner, resident qualifications, the dollar amount of security deposits, security deposit withholdings, nonrefundable redecorating charges, the form of all leases, rental agreements, notices, and any other agreements to be executed by residents.

f. To establish and review, from time to time, with Owner, a rental schedule for all units located in the Property, and to use its best efforts to adhere to such schedules as may be in effect from time to time to ensure the maximum income to Owner from the Property.

Notwithstanding the authorization contained in this Paragraph 8, Agent shall not be obligated to provide any services other than those management services customarily provided in the normal operation of the Property.

9. Budgets. Annual operating budgets for the Property will be approved by the Owner. Agent will use its best efforts to

see that annual disbursements for each type of operating expenses itemized in the approved budget will not exceed the amount authorized by the approved budget. The Agent will prepare a recommended operating budget for each fiscal year during the term of this Agreement and will submit the recommended operating budget to the Owner at least (.....) days before the beginning of each fiscal year. The Owner will promptly inform the Agent of any changes from the recommended operating budget prepared by Agent, and the Agent will keep the Owner informed of any actual or anticipated deviation from the receipts or disbursements stated in the approved budget.

10. Records and Reports. The Agent will have the following responsibilities with respect to records and reports:

a. The Agent will establish and maintain a comprehensive system of records, books, and accounts in a manner reasonably satisfactory to the Owner and the Consenting Parties. All records, books, and accounts will be subject to examination at all reasonable hours by any authorized representative of the Owner or either of the Consenting Parties.

b. With respect to each fiscal year ending during the term of this Agreement, the Agent will have an annual financial report prepared on a cash basis by a person reasonably acceptable to the Owner based upon the preparer's examination of the books, records, and accounts of the Owner and the Agent. The report will be certified by the preparer and the Agent and will be submitted to the Owner within (.....) days after the end of the fiscal year for the Owner's further certification and submission to the Secretary and the Mortgagee. Compensation for the preparer's services will be paid out of the Property bank accounts as an expense of the Property.

c. The Agent will prepare a monthly report comparing actual and budgeted figures for receipts and disbursements and will submit each such report to the Owner within (.....) days after the end of the relevant month.

d. The Agent will furnish such information (including occupancy reports) as may be reasonably requested by the Owner from time to time with respect to the financial, physical, or operational condition of the Property.

e. By the (.....) day of each month, the Agent will furnish the Owner with an itemized list of all delinquent rental accounts as of the last day of the previous month.

f. By the (.....) day of each month, the Agent will furnish the Owner with a statement of receipts and disbursements during the previous month, and reconciled bank statements for the Agency Accounts.

g. Except as otherwise provided in this Agreement, off-site bookkeeping, clerical, and other management overhead expenses will be borne by the Agent out of its own funds and will not be treated as Property expenses.

h. Upon request of the Lender, HUD, or Owner, Manager will make available to the Lender or HUD, at a reasonable time and place, its books and records of any "identity-of-interest" companies that supply goods and services to the Property. Records and information shall be sufficient to permit the Lender and HUD to determine the services performed, the date performed, the location, the time consumed in providing the service, the charges made for the services and related materials, and the per-unit and total charges levied for the service.

11. Insurance. Prior to the commencement of Agent's obligations pursuant to this Agreement, Owner shall obtain, with Agent's assistance, all of the following types of insurance with insurance companies and through brokers or agents that it may select:

a. General public liability insurance with minimum limits of \$..... for any one person injured, \$ for any one accident, and \$ for property damage. The insurance policy will name both Owner and Agent as insured parties.

b. Fire and extended coverage hazard insurance in an amount equal to the replacement cost of the Property, net of land

cost, or market value, whichever is greater. This insurance policy shall name Owner, Agent, and such other persons as Owner may direct as insured parties, as their respective interests may appear.

c. Any other necessary property, public liability, fidelity, or workmen's compensation insurance adequate to protect the interests of the parties. All of these insurance policies shall name Agent and/or Owner as insured parties, as their interest may appear.

d. The cost of any premiums or policies required and obtained under this paragraph 11 shall be the obligation of Owner.

All of these policies of insurance must be continuously maintained during the full term of this Agreement.

12. Fidelity Bond. The Agent will furnish, at its own expense, a fidelity bond in the principal sum of Dollars (\$.....), which is at least equal to the gross potential income of the Property for two months. The fidelity bond is intended to protect the Owner and the Consenting Parties against misappropriation of Property funds by the Agent or its employees. The Owner shall provide a bond of a like kind to cover its on-site personnel (if any); however, the cost of a fidelity bond for on-site personnel shall be paid from Property income as a Property expense. In no event shall any employee be covered by more than one fidelity bond. The other terms and conditions of the bond and the surety will be subject to the reasonable approval of the Owner and the Consenting Parties.

13. Bids, Discounts, Rebates, Etc. The Agent will obtain contracts, materials, supplies, utilities, and services on the most advantageous terms to the Property (as determined after a reasonable investigation), and the Agent is authorized to solicit bids, either formal or informal, for items that can be obtained from more than one source. The Agent will secure and credit to the Owner all discounts, rebates, or commissions obtainable with respect to purchases, service contracts, and all other transactions entered into on the Owner's behalf.

14. Tenant-Management Relations. The Agent will encourage good-faith communications with its residents.

15. On-Site Management Facilities. Subject to the further agreement of the Owner and Agent as to more specific terms, the Agent will maintain a management office within the Property, and the resident manager will reside in one of the dwelling units on the Property.

16. Compliance with Governmental Orders. The Agent, at the Owner's expense but subject to the limitation stated in Paragraph 8(a), will take such actions as may be necessary to comply promptly with any and all governmental orders or other requirements affecting the Property, whether imposed by federal, state, county, or municipal authority. Nevertheless, the Agent shall take no such action so long as the Owner is contesting (or has affirmed its intention to contest) any such order or requirement. The Agent will notify the Owner in writing of all notices of such orders or other requirements, within seventy-two (72) hours from the time of their receipt by Agent.

17. Nondiscrimination. In the performance of its obligations under this Agreement, the Agent will comply with the provisions of any federal, state, or local law prohibiting discrimination in housing on the grounds of race, color, sex, creed, national origin, or disability, including Title VI of the Civil Rights Act of 1964 (Public law 88-352, 78 Stat. 241), all requirements imposed by or pursuant to the Regulations of the Secretary (24 CFR, Subtitle A, Part 1) issued pursuant to that Title, the regulations issued pursuant to Executive Order 11063, and Title VIII of the 1968 Civil Rights Act.

18. Management Fee; Administrative Charges. Owner agrees to pay Agent as basic compensation for providing the property management services described in this Agreement a monthly fee in an amount equal to percent (.....%) of the gross receipts derived from the operation of the Property ("Management Fee"). For purposes of this paragraph, "gross receipts" shall include all income from apartment rental, furniture rental, laundry income, late charges, contract or deposit forfeitures, redecorating charges, security deposit withholdings, non-refundable security

deposits, and any other service income, but shall exclude any applicable sales taxes collected and paid and refundable security deposits collected.

19. Reimbursement. Owner agrees to promptly reimburse Agent for any monies that Agent may advance on behalf of or for the benefit of the Property or Owner if such reimbursement may not reasonably be made from funds held in the Property bank accounts. Notwithstanding the foregoing, Agent shall not be obligated to make any advances to or for the benefit of the Property or Owner. Any amounts advanced by Agent shall bear interest at the rate of percent (.....%).

20. Indemnity. Owner agrees, on demand, to indemnify, defend, and hold harmless Agent for, from, and against any and all losses, damages, liabilities, claims, and costs assessed against, incurred by, or claimed against Agent arising out of any actions brought by third parties in connection with the management of the Property or this Agreement, unless the losses, damages, liabilities, claims, or costs are caused by the sole negligence of Agent.

21. Term. The initial term of this Agreement shall be for a period of (.....) years following the Commencement Date. Upon the expiration of the initial term, this Agreement will automatically renew for additional twelve month periods unless terminated under Paragraph 22 below.

22. Termination. This Agreement shall be in full force and effect throughout the initial term and any extended term, except as provided below:

a. If Owner shall sell or otherwise transfer title to the Property, Owner shall immediately pay to Agent any accrued and unpaid Management Fees and other advances owed to Agent pursuant to this Agreement. If the Owner sells or otherwise transfers title to the Property, this Agreement shall be binding upon the Owner's successor unless Agent elects to terminate the Agreement upon at least (.....) days written notice or unless the Owner's successor elects to terminate this Agreement by giving (.....) days prior written notice and paying the Termination Fee (as defined below).

b. Owner shall have the right to terminate this Agreement during the initial term or any extended term only "for cause" if any material default of this Agreement is not cured by Agent within (.....) days of receipt of written notice of the default. For the purposes of this Agreement, "for cause" shall mean any material default or material breach of this Agreement which constitutes gross negligence, willful malfeasance, or fraud.

c. Agent shall have the right to terminate this Agreement during the initial term or any extended term if the Owner fails to perform any of its duties and obligations under this Agreement within (.....) days after written notice by Agent to Owner.

d. In the event it is alleged or charged that the Property or any equipment on the Property or act or omission of Owner fails to comply with or is in violation of any statute, ordinance, law, or regulation of any governmental body and in the event Agent believes in its good faith discretion that potential damage or liability may result to Agent from Owner's acts or omissions, Agent may immediately cancel this Agreement by giving written notice to Owner.

e. In the event this Agreement is terminated pursuant to Paragraph 22(a) above, Owner shall immediately pay to Agent a fee equal to Dollars (\$) per month (without proration) for each full or partial month remaining in the initial term or the extended term, as applicable. This fee shall be called a "Termination Fee." In the event this Agreement is wrongfully terminated, Owner, in addition to any other damages (compensatory or punitive) that may be recoverable, shall pay the Termination Fee.

f. Any cancellation by Agent pursuant to Paragraph 22(a), (c), or (d) shall not release Owner from any indemnities contained in this Agreement, shall not terminate any liability or obligation of Owner to Agent for the payment of any

sums due (or that will become due) under this Agreement, and shall not be construed as evidence of or an admission of any fault or liability on the part of Agent.

23. Limitations on Hiring and Contracting. Owner covenants and agrees that Owner shall not hire or contract with any manager or employee of Agent, without Agent's written consent, for a period of six (6) months from the date of termination of this Agreement. Agent covenants and agrees that it will not enter into any contract or agreement for services or materials for the Property with any entity in which Agent possesses any interest whatsoever without first disclosing such interest to Owner and receiving Owner's express written consent to the contract or agreement, which consent may be granted or withheld in the Owner's sole discretion.

24. Assignment. Neither party may assign the benefits or obligations under this Agreement without the prior written consent of the other party; however, Agent may assign its duties and obligations under this Agreement to a property management company controlled by the principals of Agent.

25. Entire Agreement. This Agreement contains the entire agreement of the parties. The parties may not alter, amend, or modify this Agreement except by an instrument in writing executed by all of the parties.

26. Owner Acknowledgment and Disclosure. Owner acknowledges that Agent is in the business of leasing and managing similar properties in the State of and elsewhere and may be offering other properties for rent at the same time. Owner specifically agrees that this shall not be a conflict of interest or cause for termination. Whenever Agent deems it necessary or appropriate, Agent may disclose to any third party the identity of Owner as principal.

27. Governing Law. This Agreement shall be governed by and construed in accordance with the laws of the State of The Parties irrevocably consent to jurisdiction and venue in the state courts of the State of and the federal district court in the District of The Parties agree that they will not attempt to remove or transfer any action properly brought in the State of

28. Notices. All required or permitted notices under this Agreement shall be in writing and, to be effective, shall be delivered by hand delivery, facsimile telecopy, U.S. certified mail/return receipt requested, or overnight express delivery to the addresses and telecopy numbers set forth at the beginning of this Agreement. All notices delivered by hand delivery or facsimile telecopy shall be deemed received on the date of hand-delivery or facsimile transmission. All notices delivered by overnight express delivery shall be deemed received on the next business day after deposit of the notice with an overnight express delivery service. All notices delivered by U.S. certified mail/return receipt requested shall be deemed received on the third day after deposit of the notice in a regular receptacle for U.S. mail.

29. Bank Accounts. All bank accounts for the Property (including the Security Deposit Account) will be maintained at or such other financial institution located in acceptable to Owner and Agent. Agent shall not be responsible for any loss arising out of the insolvency of the approved financial institution.

30. Third Party Conduct. Agent shall not be liable or responsible to Owner or any third party (including tenants at the Property) for the negligent or criminal acts or omissions of any tenant or any other person on the Property with or without the permission of Agent.

31. Waiver. THIS AGREEMENT, ITS TERM, AND THE CANCELLATION RIGHTS SPECIFIED IN THE AGREEMENT ARE NEGOTIATED UNDERSTANDINGS AND AGREEMENTS OF EXPERIENCED AND SOPHISTICATED BUSINESSMEN, AND THIS AGREEMENT IS ENTERED INTO WITH THE KNOWLEDGE AND INTENTIONAL WAIVER OF ANY APPLICABLE STATUTE, RULE OF LAW, OR ADMINISTRATIVE REGULATION TO THE CONTRARY.

The parties have executed this Agreement as of the Commencement Date.

"Owner"

.....

By:

Its:

"Agent"

.....

By:

Its:.....

ENDORSEMENT OF CONSENTING PARTIES

Mortgagee's Endorsement:

Date:.....

....., as the mortgagee identified in the foregoing Management Agreement, dated, by and between and, hereby consents to said agreement.

MORTGAGEE:

.....

By:

Its:.....

Witness:

.....

Secretary's Endorsement:

Date:.....

The Secretary of the Department of Housing and Urban Development hereby consents to the foregoing Management Agreement, dated, by and between and

.....

Secretary of Housing and Urban Development

By:

Its:.....

[2] Hazardous Materials Testing Procedures Agreement

HAZARDOUS MATERIALS TESTING PROCEDURES AGREEMENT

In order to determine the existence or presence of any Hazardous Material (as defined below) in or about the Property, Lessee will have the right, at Lessee's sole cost and expense, to conduct additional physical tests, studies, evaluations, audits, or surveys on the Property (collectively, "Lessee Environmental Surveys"), subject to the following terms and conditions:

A. Lessee will have the right to retain a qualified engineer or consultant selected by Lessee and approved by Landlord to conduct Lessee Environmental Surveys on the Property. The engineer or consultant selected by Lessee and approved by Landlord will be referred to as the "Consultant."

B. If Landlord approves the Consultant, Lessee and the Consultant will develop a written plan describing the type of testing to be done, the location of any and all drill holes or wells, and the nature of the borings to be performed. Lessee will deliver the written plan to Landlord for its approval.

C. Landlord will have the right (but not the obligation) to approve, review, and monitor any and all physical tests, studies, evaluations, audits, or studies in or about the Property which are made or implemented in connection with the findings of any Lessee Environmental Surveys, including, without limitation, the review and approval of the number, type, extent, and location of any test or monitoring wells or drillings.

D. Lessee and Lessee's Consultant must not make any contacts or communications to any governmental agency, department, district, or board in connection with the findings of any Lessee Environmental Surveys without the prior written approval of Landlord; however, Lessee and Lessee's Consultant will have the right to contact any governmental agency, department, district, or board for information without the prior approval of Landlord. Landlord's approval to disclosures may be given or withheld in Landlord's sole and absolute discretion.

E. All written reports, evaluations, and surveys produced by any Consultants in connection with any of the Lessee Environmental Surveys (whether preliminary, interim, or final in nature) must be submitted by the Consultant to Landlord concurrently with the submission of the items to Lessee.

F. Prior to the issuance of any final report by any Consultant which will set forth any "baseline" determination for the Property and/or any recommendations relating to the removal, monitoring, cleanup, or containment of any Hazardous Materials, Landlord will be given the opportunity to make comments, ask questions, and offer recommendations to the Consultant preparing the Lessee Environmental Surveys.

G. Lessee and Lessee's Consultant must maintain in strict and complete confidence any and all information, reports, evaluations, and surveys generated in connection with any of the Lessee Environmental Surveys, and Lessee and Lessee's Consultant agree not to make any disclosure of any such information, reports, evaluations, and surveys to any other person or entity without the prior written consent of Landlord (whose consent may be withheld in Landlord's sole and absolute discretion). All Consultants are required to enter into confidentiality agreements with Landlord, in the form prescribed by Landlord, prior to being provided any material information about this Agreement or the Property or performing any work on the Property. Notwithstanding the foregoing, Lessee will have the right to disclose information, reports, evaluations, and surveys generated in connection with any of the Lessee Environmental Surveys to any lender from whom Lessee seeks financing in connection with the Property, so long as Lessee obtains the agreement of the lender to keep confidential the information furnished. Lessee further will be allowed to make disclosures mandated by law. In the event Lessee purchases the Property, then, after close of escrow for the Property, Lessee will no longer have the obligation to keep such information confidential.

H. Unless otherwise specified, any approvals required of Landlord under these Hazardous Materials Testing Procedures will not be unreasonably withheld by Landlord and will be provided on a reasonably timely basis.

I. The provisions of these Hazardous Materials Testing Procedures will apply to all additional or follow-up work performed by the environmental consultant who performs the Environmental Report.

J. As used in this Hazardous Materials Testing Agreement, the term "Hazardous Material" will mean any hazardous or toxic wastes, materials, or substances which, as of the time of testing, is defined as a "hazardous substance" under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), 42 U.S.C. § 9601 *et seq.*, as amended by the Superfund Amendments and Reauthorization Act (SARA).

Foregoing Terms and conditions are agreed to and approved

"Lessee"

"Landlord"

By:

By:.....

Its:.....

Its:.....

* This chapter was prepared by Brian J. Jordan, Esq., of Ryley, Carlock & Applewhite, Phoenix, Arizona. Additional updates were contributed by Sandra Bullington, Esq.



85 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 16 The Broker's Role in Property Management *

10A-16 Real Estate Brokerage Law and Practice § 16.08

§ 16.08 Code of Professional Ethics of the Certified Property Manager¹

Introduction

To establish and maintain confidence in the honesty, integrity, professionalism, and ability of the professional property manager is fundamental to the future of the Institute of Real Estate Management and its members. This Code and performance pursuant to its provisions will be beneficial to the general public and contribute to the continued development of a mutually beneficial relationship among CERTIFIED PROPERTY MANAGER (CPM) members, candidates for membership, REALTORS, clients, employers, and the public.

The Institute of Real Estate management, as the professional society of property managers, seeks to work closely with all other segments of the real estate industry to protect and enhance the interest of the public. To this end, members of the Institute have adopted and, as a condition of membership, subscribe to this Code of Professional Ethics. By doing so, they give notice that they clearly recognize the vital need to encourage fair and equitable practices and competition among all who are engaged in the profession of property management.

Those who are members of the Institute are dedicated individuals who are sincerely concerned with the protection and interests of those who come into contact with the industry. To this end, members of the Institute have subscribed to this professional pledge:

I pledge myself to the advancement of professional property management through the mutual efforts of members of the Institute of Real Estate Management and by any other proper means available to me.

I pledge to seek and maintain an equitable, honorable, and cooperative association with fellow members of the Institute and with all others who may become part of my business and professional life.

I pledge myself to place honesty, integrity, and industriousness above all else; to pursue my gainful efforts with diligent study and education to the end that service to my clients shall always be maintained at the highest possible level.

I pledge myself to comply with the principles and declarations of the Institute of Real Estate Management as set forth in its bylaws, Regulations, and this Code of Professional Ethics.

Article 1**Fiduciary Obligation to Clients**

A Certified Property Manager shall at all times exercise loyalty to the interests of the client and shall not engage in any activity which could be reasonably construed as contrary to the best interests of the client. A Certified Property Manager shall not represent any personal or business interests divergent or conflicting with those of the client, unless the client is first notified in writing of the activity or potential conflict of interest, and consents in writing to such representation. A Certified Property Manager, as a fiduciary for the client, shall not accept, directly or indirectly, any rebate, fee, commission discount, or other benefit, monetary or otherwise, which has not been fully disclosed to and approved by the client.

Article 2**Disclosure**

A Certified Property Manager shall not disclose to a third party any confidential or proprietary information which would be injurious or damaging to a client concerning the client's business or personal affairs without the client's prior written consent, unless such disclosure is required or compelled by law or regulation.

Article 3**Accounting and Reporting**

A Certified Property Manager shall at all times keep and maintain accurate financial and business records concerning each property managed for the client, which records shall be available for inspection at all reasonable times by the client. A Certified Property Manager shall furnish to the client, at mutually agreed upon intervals, regular reports concerning the client's properties.

Article 4**Protection of Funds**

A Certified Property Manager shall not commingle personal funds with the funds of a client but shall keep a client's funds in a special account in an insured financial institution or as otherwise directed in writing by the client. A Certified Property Manager shall at all times exert due diligence for the maintenance and protection of the client's funds against all reasonably foreseeable contingencies and losses.

Article 5**Relations With Other Members of the Profession**

A Certified Property Manager shall not make, authorize or otherwise encourage any unfounded derogatory or disparaging comments concerning the practices of another Certified Property Manager. A Certified Property Manager shall not exaggerate or misrepresent the services offered as compared with the services offered by other property managers. Nothing in this Code, however, shall restrict legal and reasonable business competition by and among property managers.

Article 6**Contract**

Any written contract between a Certified Property Manager and a client shall be in clear and understandable terms, and shall set forth the specific terms agreed upon between the parties, including a general description of the services to be provided by and the responsibilities of the Certified Property Manager.

Article 7**Duty to Firm or Employer**

A Certified Property Manager shall at all times exercise loyalty to the interests of the employer or firm with whom a Certified Property Manager is affiliated and shall be diligent in the maintenance and protection of the interests and property of the employer or firm. A Certified Property Manager shall not engage in any activity which could be reasonably construed as contrary to this obligation of loyalty and diligence and shall not accept, directly or indirectly, any rebate, fee, commission, discount, or other benefit, monetary or otherwise, which could reasonably be seen as a conflict with the interests of the employer or firm. A Certified Property Manager shall at all times exercise due diligence for the protection of the funds of the employer or firm against all reasonably foreseeable contingencies and losses.

Article 8**Managing the Property of the Client**

A Certified Property Manager shall not exaggerate, misrepresent or conceal material facts concerning the client's property or any related transaction. A Certified Property Manager shall exercise due diligence in the maintenance and management of the client's property and shall make all reasonable efforts to protect it against all reasonable contingencies and losses.

Article 9**Duty to Former Clients and to Former Firms or Employers**

All obligations and duties of a Certified Property Manager to clients, firms, and employers as specified in this Code shall also apply to relationships with former clients and former firms and employers. A Certified Property Manager shall act in a professional manner when, for whatever reason, relationships are terminated between a Certified Property Manager and clients and firm or employer. Nothing in this section, however, shall be construed to cause a Certified Property Manager to breach obligations and duties to current clients and firm or employer.

Article 10**Compliance With Laws and Regulations**

A Certified Property Manager shall at all times conduct business and personal activities with the knowledge of and in compliance with applicable federal, state, and local laws and regulations, and shall maintain the highest moral and ethical standards consistent with the membership in and the purposes of the Institute of Real Estate Management.

Article 11**Equal Opportunity**

A Certified Property Manager shall not deny equal employment opportunity or equal professional services to any person for reasons of race, color, religion, sex, familial status, national origin, age, or handicap.

Article 12**Duty to Tenants and Others**

A Certified Property Manager shall competently manage the property of the client with due regard for the rights, responsibilities, and benefits of the tenant and others lawfully on the property. A Certified Property Manager shall not engage in any conduct which is in conscious disregard for the safety and health of those persons lawfully on the premises of the client's property.

Article 13
Enforcement

Any violation by a Certified Property Manager of the obligations of this Code shall be determined in accordance with and pursuant to the bylaws and rules and regulations of the Institute of Real Estate Management. Disciplinary action for any violation of any portion of this Code shall be carried out by the Institute of Real Estate Management in accordance with the bylaws and rules established by the Governing Council of the Institute. The result of such disciplinary action shall be final and binding upon the affected Certified Property Manager, and without recourse to the Institute, its officers, councilors, members, employees, or agents.

FOOTNOTES:

(n1)Footnote 1. Revised November 1990. Reproduced with the permission of the Institute of Real Estate Management of the NATIONAL ASSOCIATION OF REALTORS(R).

* This chapter was prepared by Brian J. Jordan, Esq., of Ryley, Carlock & Applewhite, Phoenix, Arizona. Additional updates were contributed by Sandra Bullington, Esq.



86 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 17 Alternative Dispute Resolution Involving Real Estate Brokers *

10A-17 Real Estate Brokerage Law and Practice 17.syn

§ 17.syn Synopsis to Chapter 17: Alternative Dispute Resolution Involving Real Estate Brokers *

§ 17.01 Arbitration and Mediation Are the Two Primary Methods of ADR

[1] Arbitration and Mediation Differ in Many Ways

[2] ADR Programs in the Real Estate Industry

[a] NAR Requires Arbitration of Contractual Disputes Between Members

[b] NAR Dispute Resolution System Based on Mediation

§ 17.02 Statutes and Other Provisions Governing Arbitration

[1] The Federal Arbitration Act

[a] FAA Preempts State Law if There Is Impact on Interstate Commerce

[b] Choice of Law Provision May Avoid Preemption by the FAA

[2] The Uniform Arbitration Act

[3] The Revised Uniform Arbitration Act

[4] State Laws Regarding Arbitration

§ 17.03 Attorneys' Fees and Costs in Arbitration and Mediation

[1] The Right to Recover Fees in Arbitration and Mediation

[2] Clauses Allowing Awards of Attorneys' Fees are Strictly Construed

§ 17.04 Arbitration Has Shortcomings and Risks

- [1] Risks Associated with Arbitral Finality and Relinquished Judicial Rights
- [2] Risks Associated with Arbitral Finality and Collateral Estoppel
- [3] Arbitration Can Be Costly and Time-Consuming
 - [a] Arbitration Procedures May Be Complex and Burdensome
 - [b] Arbitration Does Not Preclude Judicial Intervention
 - [i] Court Enforces Broker's Lien During Arbitration
 - [ii] Arbitration as a Condition Precedent to Judicial Relief
 - [iii] Multiple Parties Can Result in Multiple Proceedings
- [4] Mandatory Arbitration Provisions May Be Prohibited or Rejected
 - [a] Arbitration Prohibited Due to Superior Bargaining Power
 - [b] Adhesion Contracts Negate Agreement to Arbitrate
 - [c] Unconscionable or Illegal Arbitration Provisions Will Not Be Enforced

§ 17.05 An Agreement to Arbitrate Is Required for Mandatory Arbitration

- [1] Express Mutual Agreement Is Required to Compel Arbitration
 - [a] Arbitration Will Be Compelled if the Arbitration Agreement Is Valid
 - [b] Non-Signatories May Not Compel Arbitration
 - [i] Mutual Consent to Arbitration Required to Compel Arbitration
 - [ii] Non-Parties to Contracts May Not Compel Arbitration
 - [c] Non-Signatories to a Contract May Be Compelled to Arbitrate
- [2] Members of Realtor(R) Boards Are Required to Arbitrate
 - [a] Broker's Decision to Arbitrate May Not Be "Voluntary"
 - [b] Realtor(R) Association Members Are Bound by Arbitration
 - [c] Arbitration Not Limited to Disputes Arising During Membership
 - [d] Nonmembers May Compel Arbitration with Association Members

[e] Association Members May Not Compel Arbitration with Nonmembers

[3] Appeal of Court Decision on Motion to Compel Arbitration

§ 17.06 Court Actions Allowed Despite Agreement to Arbitrate

[1] Courts Construe Contracts to Determine if Arbitration Agreements Are Enforceable

[2] Courts May Grant Prejudgment Remedies to Parties Involved in Arbitration

§ 17.07 Judicial Review of Arbitration Proceedings Is Limited

[1] Burden of Proof in Challenging an Arbitration Award

[2] Judicial Standard of Review of Arbitration Award

[3] Statutory Bases for Vacating or Correcting an Arbitration Award

§ 17.08 Matters to Be Considered When Entering Into an Agreement to Arbitrate



87 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 17 Alternative Dispute Resolution Involving Real Estate Brokers *

10A-17 Real Estate Brokerage Law and Practice Scope

Scope

SCOPE

Chapter 17 examines laws, practices, and procedures as they relate to the involvement of real estate brokers in alternative dispute resolution (ADR). The two primary methods of alternative dispute resolution, arbitration and mediation, are discussed and distinguished (§ 17.01). Against that background, the agreement of many brokers to be subject to binding arbitration, through their membership in the National Association of Realtors(R) (NAR) and their association with local real estate boards, is examined, as is the NAR mediation-based Homesellers/Homebuyers Dispute Resolution System (DRS) (§ 17.01[2]).

This chapter focuses on ADR as it relates to real estate brokers and closely examines issues that repeatedly have been raised in reported cases and disputes involving brokers as parties. Arbitration is covered extensively because arbitration is a fundamental element of the NAR Code of Ethics affecting all member brokers. An overview of statutes and other provisions governing arbitration is presented (§ 17.02).

Often overlooked, many of the shortcomings and risks that brokers have been exposed to in arbitration are identified and discussed (§ 17.04). Requirements for arbitration agreements are addressed and seeming inconsistencies in those requirements are detailed (§ 17.05[1]). The professional requirement that brokers subject themselves to arbitration and the manner in which that often negates the "voluntary" nature of the decision to submit to arbitration is closely examined, as are some of the effects of arbitration compelled through the NAR (§ 17.05[2]).

Principles of arbitral finality and the limitations placed upon judicial review of arbitral awards are discussed (§ 17.07). The chapter concludes with a list of matters that brokers should consider when entering into an agreement to arbitrate (§ 17.08).



88 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 17 Alternative Dispute Resolution Involving Real Estate Brokers *

10A-17 Real Estate Brokerage Law and Practice § 17.01

§ 17.01 Arbitration and Mediation Are the Two Primary Methods of ADR

The two most popular methods of alternative dispute resolution are mediation and arbitration. Real estate brokers, who frequently encounter arbitration through their local real estate boards, are typically less familiar with mediation.

"Arbitration is the submission of a dispute to one or more impartial persons for a final and binding decision. Through contractual provisions, the parties may control the range of issues to be resolved, the scope of relief to be awarded, and many procedural aspects of the process." n1 Similar to litigation, arbitration is an adversarial process with prevailing parties determined based upon the judgment of one or more arbitrators after all parties to the dispute have been given opportunity to be heard.

Mediation is a form of alternative dispute resolution that has gained in popularity because of its reported success in resolving disputes. Parties to mediation work out a solution to their dispute with the help of a mediator--a neutral third person. The mediator's role is not to decide the issue, like a judge or an arbitrator, but to help each party evaluate goals and options to help in finding a solution that works for everyone.

Both mediation and arbitration are espoused as effective, less costly and less time-consuming alternatives to litigation. Similar types of clauses are used in contracts to invoke arbitration and to invoke mediation. A court will, therefore, apply arbitration case law in deciding issues involving mediation. n2

[1] Arbitration and Mediation Differ in Many Ways

Despite their surface similarities, mediation is different from arbitration in many ways, including:

- An arbitrator usually has the authority to enter a binding decision. A mediator usually does not.
- Parties to arbitration usually forfeit their rights to have their dispute litigated. Parties to mediation usually retain the right to pursue arbitration or litigation should their attempt at mediation fail. n3

Confusion abounds, however, due to the failure of real estate professionals, their legal advisors and even the courts to recognize the difference between "arbitration" and "mediation." For example, an Oklahoma appellate court was called

upon to resolve issues relating to the following "mediation" clause that appeared in an agreement between a salesperson (contractor) and a broker (RE/MAX):

MEDIATION.

Contractor agrees that if any dispute regarding commissions or any other matter should arise between contractor and any other RE/MAX Associate, Broker or Sales Office, such dispute will be referred to mediation for determination in the following manner:

A. Contractor will report such dispute in writing to the manager of RE/MAX and will give the manager his or her full cooperation in the manager's efforts to settle the dispute in as simple and amicable a manner as possible.

B. If, after all reasonable efforts, the manager is unable to effect a settlement acceptable to all parties to the dispute, the dispute will be referred to a mediation committee. Such committee will consist of three members of the RE/MAX Organization who shall be selected by RE/MAX Manager/Broker from a representative pool of RE/MAX Sales Agents. Each party to the dispute shall appear personally and state his or her case in as clear and concise a manner as possible. The decision of the mediation committee shall be final and binding upon all parties concerned. n4

The broker terminated the salesperson's/contractor's contract and she sued for damages arising out of several causes of action, including breach of contract. RE/MAX moved the court to compel arbitration. The trial court refused to compel arbitration and held that the selection process for the mediation committee was inequitable as it would subject the plaintiff to a decision by a person selected by the defendant and over whom the defendant exerted control. The trial court rested its decision on the unfairness of the arbitration panel, and the appellate court agreed: "Arbitration is the referral of a dispute by the voluntary agreement of the parties to one or more impartial arbitrators for a final and binding decision as a determination of their dispute." n5 At no point in the reported opinion is the transformation of the "mediation" clause into an "arbitration" clause acknowledged or explained. One assumes that the "final and binding" nature of the decision of the "mediation committee" was sufficient, in the eyes of the court, to justify its interpretation in contradiction of the actual terminology used in the agreement.

[2] ADR Programs in the Real Estate Industry

Parties may specifically agree to participate in alternative dispute resolution. Parties may be compelled to participate in ADR as a result of statutes, rules of civil procedure, or their decisions to become members of professional associations that require agreements to engage in ADR as a condition of membership in the associations.

[a] NAR Requires Arbitration of Contractual Disputes Between Members

The use of alternative dispute resolution (ADR) by members of the real estate industry, as a tool to resolve conflicts, has steadily increased. The National Association of Realtors(R) (NAR) is the largest trade and professional association in the real estate industry. Article 17 of the NAR Code of Ethics requires that members affiliated with different companies arbitrate their contractual disputes instead of taking them to court. n6 When all the parties in a case are members of the NAR, courts faced with an arbitrable dispute will typically dismiss the case. n6.1 Courts often reason that the constitution and by-laws of a voluntary association, when subscribed or assented to by the members, becomes a contract between each member and the association and that when Realtors(R) voluntarily submit to their organizations' authority, they are bound by its rules. n6.2

Real estate brokers usually become involved in arbitration through their local real estate board or, if different members of different boards are involved, through interboard panels under the auspices of their state association. The only disputes subject to arbitration under the regulations of the NAR are those that arise from real estate transactions and

concern disputes over money. Though local boards typically do not become involved in disputes between members of the same company, they may do so pursuant to voluntary agreement of the parties. n6.3 Additionally, it is generally accepted that local boards may arbitrate disputes between members and nonmembers if both sides agree in writing to allow the local board to settle the dispute. n7

[b] NAR Dispute Resolution System Based on Mediation

In response to disgruntled home purchasers contacting local real estate associations and boards, the National Association of Realtors(R) developed a mediation program as part of its Homesellers/Homebuyers Dispute Resolution System (DRS) for buyers, sellers, and real estate professionals. DRS, a program offering mediation as a means of resolving disputes arising during the real estate buying and selling process, has been in effect since 1989. Reasons enunciated by the NAR for its decision to utilize mediation instead of arbitration for its Homesellers/Homebuyers Dispute Resolution System include the following:

- Arbitration is adversarial. Mediation is not.
- All parties must accept mediation settlements.
- Real estate practitioners depend heavily on repeat and referral business and it was believed that mediation would more probably allow continued goodwill among the parties.
- Arbitrators render binding decisions and parties would be forced to give up their rights to pursue litigation. It was feared that many buyers and sellers would be reluctant to forfeit their rights to judicial relief.
- *Parties displeased with the results of arbitration could claim that their forfeit of recourse to the courts had not been properly disclosed to them.* n8

The NAR claims additional benefits attributable to mediation, which include that:

- Mediation is less expensive than litigation and it is faster than litigation.
- Mediation allows parties to identify frivolous claims and valid disputes without requiring a costly court action.
- Parties to mediation actively participate in the mediation process and control the outcome of the mediation.
- Parties, having themselves reached the terms and conditions of a settlement agreement, are more willing to honor and comply with the agreement.
- Parties to mediation have great flexibility regarding the manner in which their dispute can be resolved.
- Mediation is a private process and is usually only open to the mediator, the parties and their legal counsel.
- A condition to mediation may be a confidentiality agreement regarding the proceedings.
- Brokers can offer mediation to their clients.

- The personal, private and informal nature of mediation may allow disputing parties to preserve their business relationship. n9

A party who attempts to escape mediation by filing a court action for a matter covered by the mediation provision may find that this action prevents a return to mediation once that party has pursued litigation. In *Santana v. Olguin*, n10 the sales contract contained a mediation provision which used the Homesellers/Homebuyers Dispute Resolution System. The parties, by signing the contract, acknowledged receipt of a brochure on this system. The provision called for mediation of most disputes or claims arising out of the sales contract, including disputes against a real estate broker. The trial court had dismissed the buyer's claims against the seller and her Realtor(R), because the buyer failed to submit her claims to mediation prior to filing suit. On appeal, the buyer argued that the trial court had erred in applying this provision. The court disagreed. This court stated that although the provision did not require that submission to mediation precede litigation, this sequence was implied when considering the totality of the provision. The court found that mediation is intended to provide an alternative to litigation and thus creates a condition precedent to litigation requiring that the parties first mediate their disputes. n11

Despite the many benefits of mediation, it is the process of arbitration that is utilized to resolve the majority of disputes involving brokers.

FOOTNOTES:

(n1)Footnote 1. American Arbitration Association Glossary of Dispute Resolution Terms (2002), *available at* <http://www.adr.org/index2.1.jsp>.

(n2)Footnote 2. *See, e.g., Coburn v Grabowski*, CV 960134935, 1997 Conn. Super. LEXIS 1478, 2-3 (Conn. Super. Ct. 1997) (unreported).

(n3)Footnote 3. *Mediation; Mediation in Real Estate Disputes; Loss Prevention Bulletin*, Real Estate Today, November, 1995 (No. 10, Vol. 28; p. S1).

(n4)Footnote 4. *Ditto v. RE/MAX Preferred Properties, Inc.*, 861 P.2d 1000, 1001 (Okla. App. 1993) .

(n5)Footnote 5. *Ditto v. RE/MAX Preferred Properties, Inc.*, 861 P.2d 1000, 1002 (Okla. App. 1993) .

(n6)Footnote 6. *See Holly Heckathorne, Why go to court when you can arbitrate?*, Real Estate Today, May, 1995 (Vol. 28, No. 5, p. 12).

(n7)Footnote 6.1. *See:*

Colorado: Jorgensen Realty, Inc. v. Box, 701 P.2d 1256, 1257 (Colo. Ct. App. 1985) .

Florida: Elbadramany v. Stanley, 490 So. 2d 964, 966 (Fla. Dist. Ct. App. 1986) .

Oklahoma: Rogers Realty, Inc., v. Smith, 2003 OK CIV APP 74, 76 P.3d 71, 72 (Okla. Ct. App. 2003) , *rehearing denied*, 2003 Okla. Civ. App. LEXIS 58 (Okla. Ct. App., Aug. 29, 2003) .

(n8)Footnote 6.2. *See Rogers Realty, Inc., v. Smith*, 2003 OK CIV APP 74, 76 P.3d 71, 72 (Okla. Ct. App. 2003) , *rehearing denied*, 2003 Okla. Civ. App. LEXIS 58 (Okla. Ct. App., Aug. 29, 2003) .

(n9)Footnote 6.3. *Cf. Winter Park Real Estate and Investments, Inc. v. Anderson*, 160 P.3d 399, 404-405 (2007) (National Association of Realtors(R) Code of Ethics & Standards of Practice, art. 17 does not apply to disputes between

Realtors(R) who are members of the same firm. Arbitration between members of the same firm is voluntary and may proceed only by written agreement of all parties.).

(n10)Footnote 7. Lee Hess, *Reduce your risk for arbitration.*, Real Estate Today, Sept. 1990 (Vol. 23, No. 8, p. 38).

(n11)Footnote 8. Gabriella Filisko, *A different route; Homesellers/Homebuyers Dispute Resolution System*, Real Estate Today, Nov., 1990 (Vol. 23, No. 10, p.11).

(n12)Footnote 9. *Mediation; mediation in real estate disputes; Loss Prevention Bulletin*, Real Estate Today, Nov., 1995 (No. 10, Vol. 28, p. S1).

(n13)Footnote 10. *41 Kan. App. 2d 1086, 208 P.3d 328 (2009)* .

(n14)Footnote 11. *41 Kan. App. 2d 1086, 1094, 208 P.3d 328, 335 (2009)* . See also *Rupp v. Ayres (In re Fabbro)*, 411 B.R. 407, 426 (Bankr. D. Utah 2009) (The listing agreement contained a mediation provision. Mediation was not attempted. The failure to comply with this prerequisite barred the trustee's recovery for breach of contract.); *Lange v. Schilling*, 163 Cal. App. 4th 1412, 1417, 78 Cal. Rptr. 3d 356, 359 (2008) (Standard California residential property purchase agreement paragraph 17 will be enforced. To recover attorney fees under the agreement, a party cannot commence litigation before attempting to resolve the matter through mediation.); *Crandall v. Grbic*, 36 Kan. App. 2d 179, 197-98, 138 P.3d 365, 379 (2006) (The mediation clause in the purchase contract required that plaintiffs attempt mediation before filing suit.).

* This chapter was written by Georgia Lewis Leonhart, Esq. Ms. Leonhart is a member of the Maryland Bar.



89 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 17 Alternative Dispute Resolution Involving Real Estate Brokers *

10A-17 Real Estate Brokerage Law and Practice § 17.02

§ 17.02 Statutes and Other Provisions Governing Arbitration

Federal laws, state laws, civil rules of procedure and court rules regarding local practice and procedures may govern arbitration agreements. Additionally, rules, procedures and practices established by professional organizations, such as the National Association of Realtors(R), may require and govern arbitration involving their members. Further, private entities that provide arbitration services, such as the American Arbitration Association, also have myriad assortments of rules, regulations and procedures.

It is important that brokers realize that there are different sources that may govern their agreement to arbitrate in ways that may substantially affect the brokers' rights and responsibilities under arbitration agreements. In the event of significant disputes, it is important that brokers realize that there may be available to them several sources of rights, remedies, and defenses. The following summarizes the major sources providing legal regulation of arbitration agreements.

[1] The Federal Arbitration Act

The Federal Arbitration Act n1 (also referred to by its acronym, "FAA," and as the United States Arbitration Act) appears at Title 9 of the *United States Code, Sections 1-16*. The FAA governs written arbitration agreements or clauses contained in contracts regarding maritime transactions or commerce. "Commerce" is broadly defined to include "commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation." n2 One example of probable application to a broker would arise if the broker were dealing in transactions involving parties and properties located in different states.

The United States District Courts are empowered to compel arbitration required by agreements governed by the FAA, which action would be brought pursuant to the Federal Rules of Civil Procedure and applicable local district court rules. The defendant contesting arbitration is entitled to have the issue heard by a jury. n3 In the absence of specific provisions within the arbitration clause or agreement, the district courts have broad powers, including the power to appoint arbitrators, n4 and to compel the attendance of witnesses and production of documents and things. n5

[a] FAA Preempts State Law if There Is Impact on Interstate Commerce

There are times when state law and federal law are in conflict regarding the enforceability of an agreement to arbitrate, and the courts must determine which law applies. For example, Alabama state laws regarding consumer protection prohibit specific enforcement of an agreement to submit a controversy to arbitration. n6 The Supreme Court of Alabama considered that statutory prohibition against enforcement of arbitration agreements in response to a brokerage firm's motion to compel arbitration with a disgruntled homebuyer. The plaintiff had filed suit against the real estate brokers arising out of the plaintiff's purchase of a home. The contract between the parties contained a binding arbitration clause that stated as follows:

IF THERE IS ANY DISPUTE between or among Seller, Buyer, or any brokers concerning this purchase agreement or the subject property, such dispute shall be satisfied by binding arbitration under the American Arbitration Commercial Rules then in effect. All parties waive their rights to commence any action in any court of law, and all parties shall be bound by the decision of the arbitrators. n7

The plaintiff, upon discovering that the home he had purchased was a restructured mobile home with several structural defects, instituted civil suit against the real estate brokerage firm and listing agent for causes of action including fraud, conspiracy and negligence. The brokerage firm's motion to compel arbitration under the Federal Arbitration Act n8 was granted by the trial court. n9 The appellate court reversed, determined that the plaintiff was not bound by the arbitration clause and issued a writ of mandamus requiring the trial court to vacate its order requiring arbitration.

In refusing to compel arbitration, the court determined that the underlying transaction did in not substantially involve or affect interstate commerce in a way that would require application of the FAA. Finding that Alabama law applied to prohibit specific enforcement of the agreement to submit the controversy to arbitration, the Alabama Supreme Court reasoned as follows:

The crucial issue is whether the contract or transaction satisfies the interstate-commerce criterion for the applicability of the Federal Arbitration Act, 9 U.S.C. § 2 , which in pertinent part reads as follows:

"A written provision in ... a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract ... shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." ...

The Federal Arbitration Act preempts contrary state law (specifically contrary law based on *Ala. Code 1975, § 8-1-41(3)* and public policy) and renders enforceable a written predispute arbitration agreement but only if that agreement appears in a contract evidencing a transaction that "involves" interstate commerce. ...

The party seeking to compel arbitration has the burden of proving the effect on, or involvement in, interstate commerce necessary to invoke the FAA. n10

The facts that a percentage of the broker's commission would be paid to another broker from out of state and that monies paid by the plaintiff/homebuyer were drawn from an account at an out-of-state bank were not sufficient to meet the broker's burden and invoke application of the Federal Arbitration Act. n11 However, the Supreme Court of Alabama found that a real estate brokerage transaction affected interstate commerce where the buyers were residents of Texas who relocated to Alabama and purchased the subject property, the buyers financed the purchase with a loan obtained from the mortgagee's Florida office, and the buyers' home warranty was furnished by a business that operates throughout the United States. n11.1

[b] Choice of Law Provision May Avoid Preemption by the FAA

If an agreement affects interstate commerce then the broad enforcement policies of the Federal Arbitration Act may

apply because the FAA generally preempts state law on the enforceability of arbitration clauses. If an agreement expressly provides that it is to be governed by state law, however, the enforceability of the arbitration clause will usually be governed by the state law and not by the federal law. An agreement to arbitrate is a matter of contract and an explicit choice of law provision should control. n12

[2] The Uniform Arbitration Act

The Uniform Arbitration Act (UAA) was enacted in 1955 and is considered one of the most successful uniform acts. All fifty states, the District of Columbia and Puerto Rico have some form of general arbitration statute. Of those, 35 states adopted the UAA without change and 14 others adopted substantially similar legislation.

The UAA was instrumental in establishing that arbitration agreements can be valid, binding and enforceable. Contrary to much case law then existing, it gave courts the power to enforce arbitration agreements and the power to enforce arbitration awards.

[3] The Revised Uniform Arbitration Act

The Uniform Arbitration Act was revised during a process involving more than five years of study and drafting. The Revised Uniform Arbitration Act (referred to by some as the RUAA and by others, including the National Conference of Commissioners on Uniform State Laws, as the 2000 Uniform Arbitration Act or the 2000 UAA) was unanimously passed by the NCCUSL on August 3, 2000. The changes to the UAA of 1955 are pervasive:

The RUAA includes provisions on such matters as utilizing new means of electronic communications in arbitration; whether courts or arbitrators decide arbitrability; provisional remedies; arbitrator disclosure of interests and relationships; immunity of arbitrators and arbitration organizations; the arbitrator's power to order prehearing conferences and decide dispositive motions; discovery; court enforcement of pre-award rulings by arbitrators; punitive damages, attorney's fees, and other remedies; court awards of attorney's fees to arbitrators, arbitration and other prevailing parties in litigation involving arbitration matters; which section of the RUAA are waivable; and a phased-in effective date for when the RUAA will apply to all arbitration agreements. n13

The state case decisions discussed in this chapter, to the extent that they rely upon the Uniform Act, regard the UAA of 1955. One cannot predict with certainty the extent of the impact that the 2000 UAA will have upon brokers involved in arbitration. One may be certain, however, that the 2000 UAA heralds a period of rapid change. State legislatures may adopt the 2000 UAA in its entirety, may make less encompassing amendments to their existing laws, or may continue with their existing laws. Close attention must be paid to changes in state laws and the manner in which those changes will affect arbitration clauses and agreements.

[4] State Laws Regarding Arbitration

All states have laws regarding arbitration. State laws may be titled with reference to arbitration or to alternative dispute resolution. Remaining alert to changes that may result from the revisions to the Uniform Arbitration Act, changes to state laws and the impact of those changes on existing case law should be monitored. In addition to those laws, the cautious broker who is considering use of an arbitration clause or who is involved in an arbitration proceeding should also check state laws regarding consumer protection and relevant real estate transactions.

FOOTNOTES:

(n1)Footnote 1. 9 U.S.C. §§ 1-16.

(n2)Footnote 2. 9 U.S.C. § 1.

(n3)Footnote 3. 9 U.S.C. § 4.

(n4)Footnote 4. 9 U.S.C. § 5.

(n5)Footnote 5. 9 U.S.C. § 7.

(n6)Footnote 6. *Ala. Code* § 8-1-41(3).

(n7)Footnote 7. *Ex parte Learakos*, 2001 Ala. LEXIS 267, 2 (Ala. July 13, 2001) .

(n8)Footnote 8. 9 U.S.C. § 1, *et seq.*

(n9)Footnote 9. *Ex parte Learakos*, 2001 Ala. LEXIS 267, 3 (Ala. July 13, 2001) .

(n10)Footnote 10. *Ex parte Learakos*, 826 So. 2d 782, 784-85 (Ala. 2001) , *reh'g denied*, 826 So. 2d 782 (Ala. 2002) .

(n11)Footnote 11. *Ex parte Learakos*, 826 So. 2d 782, 785 (Ala. 2001) , *reh'g denied*, 826 So. 2d 782 (Ala. 2002) .

(n12)Footnote 11.1. *See Cartwright v. Maitland*, 30 So. 3d 405, 2009 Ala. LEXIS 191, at *7 (Ala. 2009) .

(n13)Footnote 12. *See* New York Law Journal, Apr. 28, 1999, Court Decisions, p. 25, *Court to Decide Mortgagors' Challenge Despite Arbitration Clause in Contract*; *Mirza v. National Standard Mortgage Corp* (reporting on decision rendered by Westchester County, City Court of Yonkers).

(n14)Footnote 13. Timothy J. Heinz, *The Revised Uniform Arbitration Act: Modernizing, Revising and Clarifying Arbitration Law*, 2001 J. Disp. Resol. 1, 2-3 (2001).

* This chapter was written by Georgia Lewis Leonhart, Esq. Ms. Leonhart is a member of the Maryland Bar.



90 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 17 Alternative Dispute Resolution Involving Real Estate Brokers *

10A-17 Real Estate Brokerage Law and Practice § 17.03

§ 17.03 Attorneys' Fees and Costs in Arbitration and Mediation

A great motivation in a party's decision to use arbitration or mediation instead of litigation to resolve disputes is the belief that to do so will reduce one's expenses--most notably the amount of attorneys' fees incurred, and that to do so will reduce that amount of time one must devote to resolution of the dispute. Anticipated reductions in fees, expenses and time expended support policy considerations in favor of alternative dispute resolution.

A realistic fact incident to litigation is that the attorneys' fees may often come to exceed the amount of the original claim. For example, as noted by the Supreme Court of Arizona regarding the "third appellate decision in a lawsuit involving a disputed real estate commission in the amount of \$6,382.50:" n1

Unfortunately, this case has dragged on because attorneys' fees have overcome the original claim. ... "We recognize that the attorneys' fees in this case have not simply become a case of the tail wagging the dog; the attorneys' fees have become the dog. The attorneys' fees incurred by all parties have exceeded the amounts in issue by such a vast amount that the substantive issues have diminished in intrinsic importance and serve only to direct or deflect the mounting liabilities for attorneys' fees. It would appear to this court that this case would have been ideally suited for binding arbitration." This too is a case that seems suited to arbitration; such an alternative dispute resolution would have saved time, money, and the unwarranted drain on the court system caused by such a lengthy legal battle over a proportionately small amount of money. n2

[1] The Right to Recover Fees in Arbitration and Mediation

Entitlement to attorneys' fees arising out of arbitration is generally governed in the same manner as litigation. Although some courts have permitted an award of fees to the prevailing party in an arbitration proceeding, the American Rule is generally applied so as to allow such recovery only if the award is authorized by the agreement of the parties or a frivolous lawsuit or claim was filed. A frivolous action is one that has no reasonable basis in law or equity and cannot be supported by a good faith argument for the extension, modification or reversal of existing law. It was found, therefore, that a broker was not entitled to an award of attorneys' fees in a dispute arising out of an arbitrator's decision to award 25% of a real estate commission instead of the 50% that had been orally agreed to by the opposing parties, both real estate brokers. n3

Further, attorneys' fees may be specifically excluded by virtue of the specific statute under which arbitration is conducted. For example, the Illinois version of the Uniform Arbitration Act expressly excludes awards of attorneys' fees from the statutory scope of arbitration--though fees could be considered and resolved in arbitration pursuant to a specific contractual agreement to do so. n4

Regarding mediation and as an additional incentive to encourage parties to resolve matters through court-annexed alternate dispute resolution programs, it has been held that a prevailing party may recover fees for time spent in an unsuccessful mediation process. The reasoning of the court was that parties might be reluctant to participate in mediation if they are precluded from recovering their costs. n5

[2] Clauses Allowing Awards of Attorneys' Fees are Strictly Construed

Attorneys' fees are a major factor to be considered in pursuing or defending against any claim--including one subject to arbitration. Receiving a favorable decision from an arbitrator without receiving an award of one's attorney's fees (to which one believed herself or himself entitled) can be considered tantamount to winning the proverbial battle while losing the war.

For example, a purchaser of real property brought a complaint against the sellers and the sellers' broker seeking damages and attorneys' fees. The purchaser alleged five causes of action including negligence, misrepresentation and infliction of emotional distress. Breach of contract was not alleged. The real estate purchase contract that governed the sale included a clause allowing an award of attorneys' fees, as follows: "Should arbitration or suit be brought to enforce the terms of this contract or any obligation herein, including any action by Brokers to recover commissions, the prevailing party shall be entitled to reasonable attorney's fees." n6

Before trial all parties agreed to binding arbitration. The arbitrator found for the defendants, allowed the defendants to recover their costs, but did not award attorneys' fees. Defendants appealed the decision to court and the matter was remanded to the arbitrator to determine whether attorneys' fees were to be awarded and, if so, in what amount. On remand the arbitrator specifically found that the defendants, as prevailing parties, were entitled to their costs but were not entitled to an award of attorneys' fees as the claims regarded torts and did not arise out of a contractual proceeding to enforce the terms of the contract. n7

The real estate brokers may have been awarded their attorneys fees, had the underlying contract included a broader clause that provided "for recovery of attorneys' fees in actions 'arising out of' the agreement or to which the agreement 'gives rise' " instead of the subject provision that specifically limited "fee recovery to proceedings 'brought to enforce the terms of this contract or any obligation herein.'" n8 Additionally, the parties while voluntarily stipulating to be bound by arbitration prior to trial could have included a clause within the stipulation for arbitration that expressly authorized or required an award of attorneys' fees to the prevailing party. n9

FOOTNOTES:

(n1)Footnote 1. *Leo Eisenberg & Co., Inc. v. Payson*, 162 Ariz. 529, 530, 785 P.2d 49, 50 (1989) .

(n2)Footnote 2. *Leo Eisenberg & Co., Inc. v. Payson*, 162 Ariz. 529, 535-536, 785 P.2d 49, 55-56 (1989) (citation omitted).

(n3)Footnote 3. *Horizon Investment & Development Corp. v. Geib*, 163 Wis. 2d 966, 473 N.W.2d 610 (Wis. Ct. App. 1991) .

(n4)Footnote 4. *Grubb & Ellis Co. v. First Colonial Trust Co.*, No. 94 C 3706, 1995 U.S. Dist. LEXIS 13256, 9-11 (N.D. Ill. Sept. 6, 1995) .

(n5)Footnote 5. Scott E. Mollen, *Realty Law Digest*, New York Law Journal, Nov. 1, 2000 (referring to *Soberman*

v. *Groff Studios Corp.*, No. 99 Civ. 1005, 2000 U.S. Dist. LEXIS 12671 (S.D.N.Y. July 21, 2000)) .

(n6)Footnote 6. *Moshonov v. Walsh*, 22 Cal. 4th 771, 774, 996 P.2d 699, 701 (Cal. 2000) .

(n7)Footnote 7. *Moshonov. v. Walsh*, 22 Cal. 4th 771, 774-775, 996 P.2d 699, 701 (Cal. 2000) .

(n8)Footnote 8. *Moshonov. v. Walsh*, 22 Cal. 4th 771, 774, 996 P.2d 699, 701 (Cal. 2000) .

(n9)Footnote 9. *Moshonov. v. Walsh*, 22 Cal. 4th 771, 774, 996 P.2d 699, 701 (Cal. 2000) .

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91 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 17 Alternative Dispute Resolution Involving Real Estate Brokers *

10A-17 Real Estate Brokerage Law and Practice § 17.04

§ 17.04 Arbitration Has Shortcomings and Risks

Though widely used and touted as the most effective alternative to litigation, an agreement to arbitrate instead of to litigate may be fraught with significant shortcomings and risks. Like the proverbial wolf in sheep's clothing, arbitration can prove to be risky business for the unsophisticated and the uninformed. Mandatory arbitration clauses have been found to be oppressive, unfair, unconscionable or substantially in derogation of consumer rights. As a result, many state consumer protection measures, including those relating to predatory or abusive home loan lending practices, include prohibitions against the use of mandatory arbitration clauses--though some courts have refused to enforce those provisions as being contrary to the overriding federal policy of the Federal Arbitration Act to encourage the use of arbitration. n1

The Code of Ethics of the National Association of Realtors(R) requires that arbitration be used to settle disputes between member Realtors(R) from different companies whose disputes arise from their relationship as real estate professionals. It is recognized, however, that arbitration has many shortcomings that may directly affect brokers.

Although arbitration is less stressful and expensive than litigation, it can still be time-consuming, stressful, and expensive. You can become engrossed in preparing for the process, which takes valuable time away from listing and selling homes. It's not uncommon for agents to hire attorneys, but often the attorneys may not be familiar with arbitration proceedings or real estate law. The hearings themselves are stressful for the claimant as well as the respondent. The buyer is often asked to appear as a witness in the proceedings and seldom has positive feelings for either party once the arbitration process is over. ... Finally, arbitration may cause hard feelings with the real estate community. n2

As discussed more fully below, specific risks encountered in mandatory and binding arbitration include the following:

- The parties typically relinquish all judicial rights, including their rights to engage in discovery, their rights to a court or jury trial, and their rights of appeal;
- The decision of an arbitrator will almost always be deemed final, even if premised upon errors of fact or errors of law (a concept referred to as "arbitral finality");

- Factual findings made by arbitrators are almost always binding upon the parties to the arbitration, even if erroneous and even if raised in regard to issues or causes of action different from those that were arbitrated (a concept referred to as "collateral estoppel"); and
- Arbitration can become very costly and time-consuming (as costly and time-consuming as litigation).

And so it can be, in the worse case scenario, that a broker may, after expending considerable time and financial resources, be bound in the arbitrated matter and in any future matters arising out of the same operative facts by an erroneous determination made by an arbitrator, without the benefit of any meaningful opportunity of appeal.

[1] Risks Associated with Arbitral Finality and Relinquished Judicial Rights

An arbitrator's decision rendered pursuant to a binding arbitration agreement is almost always deemed final and not subject to reversal or modification by a reviewing court even if the decision was premised upon an error of fact or an error in interpreting the applicable law. This element of arbitral finality is considered a benefit by many in that it purports to avoid the time and expense associated with judicial appeals. Yet, as noted by a California appellate court, arbitral finality can expose one to significant risk:

A party's decision to enter into a contract with an arbitration provision is not without significant risk. Parties entering into arbitration agreements do so with the knowledge that reviewing courts will not overturn an arbitrator's award, even if the arbitrator erred in interpreting the law. Neither will a reviewing court overturn an arbitrator's decision to refuse to award attorney fees to the party claiming to have prevailed, even in disputes subject to an attorney fees provision. n3

The risks inherent in relinquishing one's judicial rights by agreeing to mandatory and binding arbitration have received legislative acknowledgement. As a result, many statutes have been enacted in an attempt to ensure that members of the general public are informed of those rights that they are relinquishing and to ensure that that their agreement is truly voluntary.

Specifically regarding real estate contracts, for example, California provides that any contract conveying real property, or otherwise related to real estate sales transactions between principals and agents, that contains a provision for binding arbitration of any dispute between the principals to the transaction must include a provision clearly titled "ARBITRATION OF DISPUTES." Additionally, to ensure that it is not overlooked in a lengthy, detailed document, the provision for binding arbitration must be set out in bold type, or in contrasting red and, if included in a typed contract, must be set out in capital letters. n4 Each party is required to indicate assent to the arbitration provision on a line appearing immediately before or after the arbitration provision. The arbitration provision must read as follows:

NOTICE: BY INITIALLING IN THE SPACE BELOW YOU ARE AGREEING TO HAVE ANY DISPUTE ARISING OUT OF THE MATTERS INCLUDED IN THE "ARBITRATION OF DISPUTES" PROVISION DECIDED BY NEUTRAL ARBITRATION AS PROVIDED BY CALIFORNIA LAW AND YOU ARE GIVING UP ANY RIGHTS YOU MIGHT POSSESS TO HAVE THE DISPUTE LITIGATED IN A COURT OR JURY TRIAL. BY INITIALLING IN THE SPACE BELOW YOU ARE GIVING UP YOUR JUDICIAL RIGHTS TO DISCOVERY AND APPEAL, UNLESS THOSE RIGHTS ARE SPECIFICALLY INCLUDED IN THE "ARBITRATION OF DISPUTES" PROVISION. IF YOU REFUSE TO SUBMIT TO ARBITRATION AFTER AGREEING TO THIS PROVISION, YOU MAY BE COMPELLED TO ARBITRATE UNDER THE AUTHORITY OF THE CALIFORNIA CODE OF CIVIL PROCEDURE. YOUR AGREEMENT TO THIS ARBITRATION PROVISION IS VOLUNTARY.

WE HAVE READ AND UNDERSTAND THE FOREGOING AND AGREE TO SUBMIT

DISPUTES ARISING OUT OF THE MATTERS INCLUDED IN THE "ARBITRATION OF DISPUTES" PROVISION TO NEUTRAL ARBITRATION. n5

Arbitral finality and the other limitations upon judicial review of arbitration proceedings are discussed more fully at § 17.07.

[2] Risks Associated with Arbitral Finality and Collateral Estoppel

In accordance with the concept of arbitral finality, an arbitrator is almost always deemed the final judge of both law and fact and the arbitrator's conclusions of law and findings of fact are binding, even if they are erroneous. n6 The factual findings made by an arbitrator are not only binding regarding the issue arbitrated, but often will be deemed binding upon the parties in subsequent judicial actions through the doctrine of collateral estoppel. Collateral estoppel prevents a party from again litigating a legal or factual issue that was already litigated in a prior proceeding and that was required for the judgment rendered in that prior proceeding. Collateral estoppel applies even if the subsequent proceeding is based on a different cause of action and even if the first determination was incorrect.

Collateral estoppel is available to preclude an issue when:

- The issue is identical to an issue raised and necessarily determined in a prior proceeding.
- The previous proceeding resulted in a final judgment on the merits.
- The issue was essential to the judgment rendered in the previous proceeding.
- The party against whom collateral estoppel is asserted was a party or was in privity with a party to the prior proceeding.
- The party to be prevented from again raising the issue had a fair opportunity to be heard on the issue in the prior proceeding. n7

An arbitration award constitutes a final judgment on the merits for the purpose of collateral estoppel. n8 For example, in a case arising out of a fee dispute between brokers, plaintiff was required to submit the matter to arbitration because arbitration was a requirement of her involvement in a multiple listing service. An arbitration panel decided that the plaintiff was not entitled to a commission on the sale of a home because she was not the procuring cause of the sale. Subsequently the plaintiff brought a lawsuit alleging breach of contract; wrongful interference with contractual relations, and fraud and misrepresentation. The trial court dismissed the claims for failure to state claims upon which relief can be granted. n9

The Court of Appeals of Minnesota first confirmed that the arbitrator is the final judge of both law and fact and that the arbitrator's conclusions of law and findings of fact are binding, even if erroneous. The court then found that recovery under each of the causes of action asserted was precluded because of the factual finding and legal determination of the arbitrator that plaintiff was not the procuring cause of the sale. Plaintiff was precluded from again litigating the question of whether she was the procuring cause without regard to whether she had presented a different basis of recovery. The trial court's decision to dismiss the claims was, therefore, affirmed. n10

[3] Arbitration Can Be Costly and Time-Consuming

Though arbitration is repeatedly touted as a simplified and expedited alternative to a time-consuming and costly courtroom trial, arbitration can be almost as formal as a court trial. It may include discovery; it may authorize the use of subpoenas; and it may require testimony from and use of expert witnesses.

Arbitration may be completed more quickly than litigation and it is generally believed that formal arbitration procedures involving not only the parties but also others such as their attorneys, witnesses, and court reporters, should be reserved for cases involving large amounts of money or extremely complex issues. Yet, as conceded within the National Association of Realtors(R) Journal of Property Management, arbitration may well cost as much as a trial. n11

[a] Arbitration Procedures May Be Complex and Burdensome

Many of the rules, practices and procedures that have developed regarding arbitration are detailed, voluminous, complex and as difficult to understand and to administer as are the rules of civil procedure relating to litigation. As the conduct of one involved in litigation is governed by a myriad assortment of rules of civil procedure (*e.g.*, state rules, subject matter rules, county rules, and the rules of the specific court in which one is appearing), the conduct of one involved in arbitration is similarly governed by a myriad assortment of rules, regulations and procedures, including those set forth in federal acts, state acts, local acts, administrative rules relating to specific industries or professions, and those "voluntarily" adopted through one's membership in trade associations and through contract.

Rules, regulations and procedures governing alternative dispute resolution and arising from different sources may be inconsistent and contradictory. They may invoke the powers of the courts for enforcement. Additionally, such rules, regulations and procedures are subject to amendment or modification. Parties contemplating alternative dispute resolution, parties involved in alternative dispute resolution, parties challenging alternative dispute resolution, and their respective legal representatives must examine all sources governing the mechanism for alternative dispute resolution that they are considering, or in which they are involved (*see* § 17.02).

Examples of some provisions that a person contemplating or involved in arbitration instead of litigation would probably not expect to encounter include the following:

1. Arbitrators may have the equivalent of subpoena power--enabling them to issue summonses to compel the appearance of parties or witnesses and enabling them to compel the production of documents or things. If the person served with the summons fails to appear, that person may be punished for contempt by the courts in the same manner as one would be punished for failure to appear before the courts. n12
2. Paradoxically, by appearing at an arbitration proceeding--even for the purpose of objecting to the proceeding--one may waive his or her right to challenge the results of the proceeding. One's failure to appear, however, may be deemed a consent to entry of the arbitrator's award and, by failing to appear, one may lose his or her right to reject an award made by the arbitrators. n13

[b] Arbitration Does Not Preclude Judicial Intervention

Though the scope of a court's review of an arbitral decision is extremely limited, resort to courts regarding arbitration issues is not. From pre-arbitration proceedings to post-judgment relief, the arbitration field provides fertile ground for parties seeking judicial intervention. It is not uncommon to have the parties litigate the issue of whether an arbitration agreement is enforceable. n14 Among the most common actions are those seeking a judicial determination whether arbitration is required--generally in the form of a motion to compel arbitration. Even if arbitration is required, prejudgment remedies such as attachment or emergency judicial relief may be sought. n15 Following arbitration, disgruntled parties may raise judicial challenges to the arbitrator's ruling, most often in the form of an action to vacate the decision. Conversely, a party that prevailed in arbitration may be forced to seek judicial enforcement of the arbitrator's award. Further judicial intervention may be required to resolve issues relating to attorneys' fees. n16

Through such mechanizations, alternative dispute resolution can become the source of even more disputes and, instead of netting savings of expenses and time, can become more costly than if the matter simply proceeded to litigation in the

first instance.

[i] Court Enforces Broker's Lien During Arbitration

In assessing the likelihood of whether an arbitration agreement may increase one's exposure to litigation instead of reducing or eliminating it, brokers must carefully examine the interplay between contractual provisions, rights and obligations imposed by virtue of one's professional associations, and matters regulated by statute.

For example, in allowing a broker to bring suit to enforce a lien arising out of an arbitrator's award of commissions due, the United States District Court for the Northern District of Illinois found that the arbitrator had no power to enforce a lien in favor of the broker against property pursuant to the Illinois Commercial Real Estate Broker Lien Act. In discussing the role of the arbitrator in enforcing a broker's lien, the court noted as follows:

There being no statutory basis for other than judicial enforcement of the broker's lien, no arbitrator is empowered to do so. Of course the arbitrator can (as was done here) determine whether a broker was entitled to a commission to begin with and, if so, how much. But once that has been done, the lien remedy is wholly statutory and thus wholly judicial. n17

[ii] Arbitration as a Condition Precedent to Judicial Relief

Whether arbitration is a condition precedent to judicial relief is determined based upon the intentions of the parties.

Whether an agreement makes arbitration a condition precedent to an action in court depends on the language of the arbitration clause. While it is true that in the absence of express language a provision for arbitration may be construed, by implication, to be a condition precedent to suit, that implication must be so plain that a contrary intention cannot be supposed. It must be a necessary implication. n18

For example, use of the word "shall" in the following language excerpted from a contract for the sale and purchase of residential property, was held sufficient to require dismissal of defendant's motion to dismiss on the basis that mediation was a condition precedent to the bringing of a court action: "Any dispute or claim arising out of or relating to this contract, the breach of this contract or the services provided in relation to this contract shall be submitted to mediation in accordance with the Rules and Procedures of the Connecticut Residential Real Estate Mediation Rules of the American Arbitration Association." n19

Arbitration will typically toll the running of the statute of limitations regarding the precise subject of the arbitration (which in the case of brokers often involves claims for fees in the form of commissions) as between the parties to the arbitration/arbitration agreement. n20

[iii] Multiple Parties Can Result in Multiple Proceedings

Additionally, it is possible that an agreement only binding certain parties to an arbitration agreement, without binding others, can result in having one forced to deal with a complaint in a piecemeal fashion through multiple cases--requiring arbitration with one party and requiring litigation with another. A standard Realtors(R) purchase contract in which buyer and seller agreed that any dispute between them would be decided by binding arbitration while reserving to a broker the right to refuse to agree to arbitration, can force a buyer to file multiple cases. The ultimate result could be two separate proceedings--a trial that could go before a judge and jury, and arbitration, requiring the same witnesses to be called in each and the same evidence to be presented in each. The potential for waste of time and resources is obvious. n21

[4] Mandatory Arbitration Provisions May Be Prohibited or Rejected

Mandatory arbitration provisions may be prohibited as a matter of public policy or law if one party has superior bargaining power over the other, if the provisions are included within an adhesion contract, if the provisions are incident to otherwise illegal contracts or if the provisions are unconscionable.

[a] Arbitration Prohibited Due to Superior Bargaining Power

Various states have enacted laws restricting or prohibiting the use of mandatory arbitration agreements in contracts arising out of certain relationships in which one party almost always has superior bargaining power. For example, the Arkansas Code provides that a written agreement to submit to arbitration any *existing* controversy is generally valid, enforceable and irrevocable. n22 Such written agreements to submit to arbitration any future or prospective controversy between the parties will not be deemed valid or enforceable if applied to personal injury or tort matters, employer-employee disputes, or to any insured or beneficiary under any insurance policy or annuity contract. n23

The Supreme Court of Arkansas, addressing an appeal from a decision affirming an award made by an arbitration panel of a local board of Realtors(R), applied the statutory prohibition against the enforcement of arbitration in the context of employer-employee disputes. That dispute arose out of a contest between a licensed real estate broker and her former employee over a real estate commission on the sale of a property. n24 The court found that the question of applicability of the Uniform Arbitration Act was a jurisdictional question and that in the case of a claim for fees or commission earned by a broker incident to the sale of property, whether basis for such jurisdiction exists is determined as of the time that the sale is consummated and the commission becomes payable. n25 In that case the instrument through which the sale was consummated was executed after the employer-employee relationship had been terminated and the state law prohibition against arbitration arising out of an employer-employee dispute did not apply. n26

[b] Adhesion Contracts Negate Agreement to Arbitrate

Adhesion contracts are generally defined as form contracts imposed by one party with superior bargaining power upon another party who is not in a position to negotiate the terms but can only "take them or leave them." n27 A California appellate court considered the following factors in determining that an arbitration agreement, within a condominium's declaration of covenants, constituted an adhesion contract and was, therefore, not enforceable:

- The purchasers of units at the condominium complex faced a "take it or leave it" proposition. They had to purchase subject to the declaration of covenants, conditions and restrictions, or they could not purchase at all.
- The purchasers had no opportunity to negotiate the provisions of the declaration of covenants, conditions and restrictions.
- The condominium homeowners could not amend the mandatory arbitration provision of the declaration of covenants, conditions and restrictions. n28

Yet, even provisions in adhesion contracts may be enforced, unless they are unconscionable.

[c] Unconscionable or Illegal Arbitration Provisions Will Not Be Enforced

A two-prong test is applied to determine if an arbitration clause is unconscionable. An arbitration clause that is procedurally unconscionable and substantively unconscionable will not be enforceable.

Substantive unconscionability is generally defined as contract terms that are one-sided and impose terms so harsh as to "shock the conscience." Procedural unconscionability arises out of the manner in which the contract was negotiated and the circumstances of the parties and focuses on oppression and surprise. Oppression typically arises from inequality of

bargaining power, the absence of real negotiation and the absence of a meaningful choice. Surprise typically arises when significant terms are hidden in a lengthy, wordy form prepared by the party with superior bargaining power. n29

Additionally, provisions requiring arbitration and arbitration awards will not be enforced if to do so would violate public policy. For example, it is against public policy to enforce an arbitrator's award based upon an illegal contract, such as when an individual seeks a fee for providing services as a real estate broker when he or she was not properly licensed as a real estate broker. n30

FOOTNOTES:

(n1)Footnote 1. See, Neal J. Morse, *The predatory lending obstacle course: do more restrictive laws on predatory lending curb abuses or just discourage lenders from servicing the borrowing needs of nonstandard borrowers?*, Mortgage Banking, Apr. 1, 2002.

(n2)Footnote 2. Lee Hess, *Reduce your risk for arbitration.*, Real Estate Today, Sept., 1990 (Vol. 23, No. 8, p. 38).

(n3)Footnote 3. *Rogers v. Peinado*, 85 Cal. App. 4th 1, 10, 101 Cal. Rptr. 2d 817, 823 (Cal. Ct. App. 2000) (Citations omitted).

(n4)Footnote 4. Cal. Civ. Proc. § 1298(a) and (b).

(n5)Footnote 5. Cal. Civ. Proc. § 1298(c).

(n6)Footnote 6. See, e.g., *Lawhead v. Ulwelling, Hollerud & Schulz*, No. C7- 00-1425, 2001 Minn. App. LEXIS 146, 6 (Minn. Ct. App. 2001) .

(n7)Footnote 7. *Landmark Partners, Inc. v. Michael Investments*, No. C6- 01-1345, 2002 Minn. App. LEXIS 166, 8 (Minn. Ct. App. 2002) .

(n8)Footnote 8. See, e.g., *Landmark Partners, Inc. v. Michael Investments*, No. C6- 01-1345, 2002 Minn. App. LEXIS 166, 8 (Minn. Ct. App. 2002) .

(n9)Footnote 9. *Lawhead v. Ulwelling, Hollerud & Schulz*, No. C7- 00-1425, 2001 Minn. App. LEXIS 146, 4-5 (Minn. Ct. App. 2001) .

(n10)Footnote 10. *Lawhead v. Ulwelling, Hollerud & Schulz*, No. C7- 00-1425, 2001 Minn. App. LEXIS 146, 7-10 (Minn. Ct. App. 2001) .

(n11)Footnote 11. See Lloyd D. Hanford, Jr., *Solving real estate issues by arbitration*, National Association of Realtors(R) Journal of Property Management, Jan., 1989 (Vol. 54, No. 1, p. 22).

(n12)Footnote 12. See, e.g., *In re Arbitration Between Carroll and ERA Maui Real Estate*, 81 Haw. 264, 915 P.2d 1365, 1367 (Haw. Ct. App. 1996) (referring to H.R.S. § 658-7).

(n13)Footnote 13. See *Fiala v. Schulenberg*, 256 Ill. App. 3d 922, 929, 628 N.E.2d 660, 664 (Ill. App. Ct. 1993) .

(n14)Footnote 14. See, e.g., New York Law Journal, Apr. 28, 1999, Court Decisions, p. 25, *Court to Decide Mortgagors' Challenge Despite Arbitration Clause in Contract*; *Mirza v. National Standard Mortgage Corp* (reporting on decision rendered by Westchester County, City Court of Yonkers).

(n15)Footnote 15. See, e.g., *Yellin v. Premier Development*, 1994 Conn. Super. LEXIS 1398, 1-2 (Conn. Super. Ct. 1994) .

(n16)Footnote 16. See, e.g., *Grubb & Ellis Co. v. First Colonial Trust Co.*, No. 94 C 3706, 1995 U.S. Dist. LEXIS

13256 (N.D. Ill. Sept. 6, 1995) .

(n17)Footnote 17. *Grubb & Ellis Co. v. First Colonial Trust Co.*, No. 94 C 3706, 1995 U.S. Dist. LEXIS 13256, 8 (N.D. Ill. Sept. 6, 1995) .

(n18)Footnote 18. *Coburn v Grabowski*, CV 960134935, 1997 Conn. Super. LEXIS 1478, 4 (Conn. Super. Ct. 1997) (unreported) (citation omitted).

(n19)Footnote 19. *Coburn v Grabowski*, CV 960134935, 1997 Conn. Super. LEXIS 1478, 4-5 (Conn. Super. Ct. 1997) (unreported).

(n20)Footnote 20. *See Paishaian v. Eccelston Props.*, 92 Civ. 5487, 1993 U.S. Dist. LEXIS 11347 (S.D.N.Y. Aug. 12, 1993) .

(n21)Footnote 21. *See* Ronald Rossi, *Arbitration Clause, Hearing Can Be Sticky Business*, The Orlando Sentinel, July 22, 2001, Metro, Homes, p. J18.

(n22)Footnote 22. *Ark. Code Ann. § 16-108-201(a)*.

(n23)Footnote 23. *Ark. Code Ann. § 16-108-201(b)*.

(n24)Footnote 24. *Lancaster v. West*, 319 Ark. 293, 891 S.W.2d 357 (Ark. 1995) .

(n25)Footnote 25. *Lancaster v. West*, 319 Ark. 293, 298, 891 S.W.2d 357, 360 (Ark. 1995) .

(n26)Footnote 26. *Lancaster v. West*, 319 Ark. 293, 298, 891 S.W.2d 357, 360 (Ark. 1995) .

(n27)Footnote 27. *See, Villa Milano Homeowners Association v. Il Davorge*, 84 Cal. App. 4th 819, 827, 102 Cal. Rptr. 2d 1, 6 (Cal. Ct. App. 2000) .

(n28)Footnote 28. *Villa Milano Homeowners Association v. Il Davorge*, 84 Cal. App. 4th 819, 827-828, 102 Cal. Rptr. 2d 1, 6 (Cal. Ct. App. 2000) .

(n29)Footnote 29. *Villa Milano Homeowners Association v. Il Davorge*, 84 Cal. App. 4th 819, 828, 102 Cal. Rptr. 2d 1, 7 (Cal. Ct. App. 2000) review denied, 2000 Cal. App. LEXIS 901 (Nov. 27, 2000) and 2001 Cal. LEXIS 1250 (Feb. 21, 2001) .

(n30)Footnote 30. *Lindenstadt v. Staff Builders, Inc.*, 55 Cal. App. 4th 882, 889, 64 Cal. Rptr. 2d 484, 488 (Cal. Ct. App. 1997) .

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92 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 17 Alternative Dispute Resolution Involving Real Estate Brokers *

10A-17 Real Estate Brokerage Law and Practice § 17.05

§ 17.05 An Agreement to Arbitrate Is Required for Mandatory Arbitration

Arbitration is based on contract. n1 An agreement to arbitrate is generally recognized as an agreement favored by law that is intended to promptly settle disputes and intended to avoid litigation. n2 Yet, when one agrees to binding arbitration, one relinquishes his or her constitutional right to a jury trial. The "right to pursue claims in a judicial forum is a substantial right and one not lightly to be waived." n3 The stated position of most jurisdictions, therefore, is that an agreement to be bound by arbitration must be made voluntarily by a person or entity aware of the rights that are being relinquished.

[1] Express Mutual Agreement Is Required to Compel Arbitration

The general underlying proposition of the law relating to arbitration is that an express mutual agreement is required to compel arbitration. A party cannot be compelled to arbitrate unless there is an agreement requiring arbitration. Courts have reasoned that the right to arbitration depends upon the existence of a contract to arbitrate, and a petition or motion to compel arbitration is simply a means of seeking specific enforcement of the contract. Contract law is applied to determine whether the parties formed a valid agreement to arbitrate. n4 In most situations parties will be required to arbitrate a matter only if there is a written agreement to arbitrate, making the threshold question in any petition to compel arbitration whether there is an agreement to arbitrate. n5

[a] Arbitration Will Be Compelled if the Arbitration Agreement Is Valid

Before compelling a party to arbitrate a court must perform a limited review to ensure that a valid agreement to arbitrate exists between the parties and that the dispute or controversy is subject to mandatory arbitration under the agreement. n6 With consideration of the strong public policy in favor of arbitration, however, a person contending that arbitration does not apply is typically required, by case law or by statute, to notify the other party of that fact so the other party can proceed with a motion to compel arbitration without incurring expense and delay attributable to the arbitration process. n7

If a valid arbitration agreement exists between the parties, a motion or petition to compel arbitration will typically be granted. Sometimes this result is required by statute, such as in California where the Code of Civil Procedure requires that "On petition of a party to an arbitration agreement alleging the existence of a written agreement to arbitrate a controversy and that a party thereto refuses to arbitrate such controversy, the court shall order the petitioner and the

respondent to arbitrate the controversy if it determines that an agreement to arbitrate ... exists" unless a specified exception applies. n8

Conversely, if a valid agreement to arbitrate does not exist, as determined under contract law, the petition to compel arbitration must be denied. n9 The contractual requirement that there be a "meeting of the minds" to form a contract often precludes enforcement of contractual provisions requiring arbitration if the provisions are obscure, hidden, or included within boilerplate language contained within an adhesion contract. For example, a binding arbitration clause contained in a "declaration of covenants, conditions and restrictions" would not be applied to prevent homeowners and a homeowners association from seeking relief for construction and design defect damages in a judicial forum. n10

[b] Non-Signatories May Not Compel Arbitration

A party's signature upon a contract or other document containing an arbitration agreement or clause is evidence of that party's consent to be bound by the agreement to arbitrate. In many jurisdictions, therefore, one must be a signatory in order to compel arbitration. n10.1 Exceptions in which an arbitration agreement may be enforced by or against nonsignatories include where a nonsignatory is a third party beneficiary of the agreement and when a nonsignatory and one of the parties to the agreement have a preexisting agency relationship that makes it equitable to impose the duty to arbitrate on either of them. n10.2

In determining whether a party is a signatory, however, the documents pertaining to the transaction should be read in totality. n10.3 It may not be necessary for the party to have signed the one document containing the arbitration clause if it is clear from all the documents that the parties intend for the party who is technically a non-signatory to be covered by the arbitration provision. n10.4

For example, in a case involving the attempts of defendants to compel arbitration pursuant to an arbitration provision contained within a title insurance policy, it was held that only those persons or entities who signed the policy could compel arbitration. n11 Specifically, plaintiffs, who purchased property and subsequently discovered defects in their title to that property, sued the title insurance company, the attorney who represented the title insurance company and the real estate agents. All of the defendants moved to compel arbitration.

The title insurance policy contained an arbitration provision that allowed either the company or the insured to demand binding arbitration pursuant to the Title Insurance Rules of the American Arbitration Association, unless applicable law prohibited such a demand for arbitration. n12 Pursuant to the express terms of the title insurance policy issued by the title insurance company, the Supreme Court of Alabama reversed the lower court's order denying the motion to compel arbitration, as it related to the title insurance company and its attorney (in his capacity as its agent), and held that both were entitled to arbitration. n13 The court narrowly construed the binding arbitration agreement and concluded, however, that the real estate brokers (referred to as "agents") were not permitted to compel arbitration as they had not signed the title insurance policy. n14 However, in a subsequent case, this court stated that it had made clear that in some circumstances where the subject arbitration provision does not specifically limit its reach to signatories, nonsignatories may enforce the arbitration provision. n14.1

[i] Mutual Consent to Arbitration Required to Compel Arbitration

Sellers and brokers may be prohibited from compelling arbitration if they have failed to sign or initial the arbitration clause in a jurisdiction requiring a party's signature as evidence of consent to be bound by the arbitration clause. Though at least one contrary decision has been rendered, n15 the failure of one party to initial an arbitration clause usually negates mutual consent to binding arbitration. Premised upon such reasoning, a petition of a seller, who had not initialed the arbitration clause, to compel arbitration with buyer, who did initial the arbitration clause, was denied. It is generally recognized that to hold otherwise would result in a situation where the seller could refuse to initial such provision after the buyer had done so--making "arbitration" a remedy to be sought at the seller's sole whim and benefit, to the obvious

detriment of the buyer. n16 As stated by one appellate court:

We note that if there were no mutuality of remedy requirement, the seller--which is usually the offeree in the real estate sales context--would have absolutely no incentive to initial the arbitration provision and thereby bind itself to arbitrate disputes. This is because ... the offeror (usually the buyer) would be bound to arbitrate all disputes (provided it had initialed the arbitration provision) even if the seller did not agree to do so. Thus, once the buyer initialed this provision, the seller could have its cake and eat it too: the seller could force the buyer to arbitrate if the seller thought it was in its interest to do so, and could refuse to arbitrate if it believed it was disadvantageous to do so. n17

Consider, for example, a case arising out of the sale of an apartment complex. The buyers initiated suit against the sellers of the property alleging misrepresentation and failure to disclose plumbing defects, and against the brokers (who had represented both buyers and sellers) alleging negligent failure to discover and disclose the defects. The buyers dismissed their claim against the brokers, without prejudice, upon discovering that their claim was probably not covered by the brokers' insurance. Most of the sellers then filed claims for indemnity against the brokers and the brokers filed a petition to compel arbitration. The petition to compel arbitration was denied and the appellate court affirmed on the basis that there was no agreement to arbitrate. n18

The brokers claimed the action was subject to arbitration on the basis of an arbitration clause in the purchase agreement between the sellers and buyers which provided that, "If a controversy arises with respect to the subject matter of this Purchase Agreement or the transaction contemplated herein (including but not limited to the parties' rights to ... the payment of commissions as provided herein), Buyer, Seller and Agent agree that such controversy shall be settled by final binding arbitration" n19 As required by law, the arbitration clause included a notice requiring that each party signify by initialing the clause their voluntary acceptance of the arbitration clause. Buyers initialed the arbitration clause. The sellers did not. For that reason, in applying applicable contract law, it was determined that there was no mutual assent by the "Buyer, Seller and Agent" to submit controversies to binding arbitration and there was, therefore, no enforceable agreement to arbitrate.

[ii] Non-Parties to Contracts May Not Compel Arbitration

To compel arbitration, one is typically required to be a party to the contract or agreement containing the arbitration clause. For example, a homeowner whose home was not sold sued real estate brokers. The homeowner claimed that the sale of his home was not consummated and he was not, therefore, able to acquire another property, because of the brokers' breach of fiduciary duty and their negligent failure to disclose a title defect. Both of the transactions were under contract and neither contract closed. The parties to the contract (buyer and seller) had waived mediation and arbitration, yet the brokers sought to compel arbitration. The court found that the brokers could not compel arbitration as they were not parties to the contract between the buyer and seller, nor were they third-party beneficiaries to the contract--but were instead simply incidental participants. n20

[c] Non-Signatories to a Contract May Be Compelled to Arbitrate

Though usually not able to compel arbitration, non-signatories may be bound by an agreement to arbitrate and may, therefore, be compelled to arbitrate if that decision is justified by principles of contract law and agency. Similarly, third-party beneficiaries to contracts may be compelled to arbitrate. This situation often arises in the context of broker memberships in professional associations and multiple listing services.

For example, in considering an appeal from an order compelling arbitration between a real estate company seeking to recover a commission allegedly earned by one of its brokers and another real estate company, a Florida appellate court held that the real estate company challenging arbitration was compelled to arbitrate. The court's decision was based solely upon the agreement made by one of the real estate company's individual brokers to submit the claim for

arbitration incident to her application for membership in a local board of Realtors(R). n21 The court set forth the following points in support of its position:

- Any doubt regarding the scope of an arbitration clause will be resolved in favor of arbitration, which is considered a preferred method of dispute resolution.
- Upon applying principles relating to general agency and contract law, a non-signatory real estate company may be bound to arbitrate on the basis of an agreement by one of its brokers to submit the claim to arbitration.
- The non-signatory real estate company received the economic and professional benefits of its broker's membership in the local real estate board and, as a third-party beneficiary was bound by the individual broker's agreement to arbitrate. n22

Principles of agency law may allow a party to compel arbitration even though that party technically did not sign the agreement containing the arbitration clause. In *Van Nguyen v. Hung Tran*, n22.1 the purchase agreement listed the cooperating brokers as the agents of the buyers. The buyers had signed the purchase agreement, but the cooperating brokers had not signed this agreement. In a subsequent dispute, the cooperating brokers sought to compel the buyers and listing brokers to arbitrate. The court held that cooperating brokers, as agents of one of the parties to the agreement containing the arbitration clause, may compel their principal to arbitrate but they may not compel arbitration against listing brokers, who did not sign the agreement and had no preexisting confidential or contractual relationship with cooperating brokers. n22.2

By contrast, an intermediate Hawaiian appellate court in *Sher v. Cella* n22.3 considered a similar situation where the purchasers sought to compel the listing broker to arbitrate based on an arbitration agreement in the sales contract. These brokers had not signed the sales contract. The purchasers sought to use agency principles to compel arbitration by the listing brokers. This court stated that the purchasers, as principals were attempting to bind their agents, which was a "manifest reversal of traditional agency rules." The court found that a non-signatory agent may, under certain circumstances, invoke an arbitration provision against an unwilling principal who was a signatory to an agreement containing an arbitration provision. However, the obverse was not necessarily true where the principal who is a signatory to a contract containing an arbitration provision seeks to enforce that provision against a non-signatory agent. The purchasers could not use agency principles to invoke the arbitration clause in this manner. n22.4

With respect to third party beneficiaries of a contract, it is a general rule that a third party beneficiary may not avoid otherwise enforceable contract provisions. Thus, a third party beneficiary of a contract containing an arbitration clause can be subject to that clause and compelled to arbitrate on the demand of a signatory. n22.5 However, in order to compel arbitration by a third party beneficiary, some courts require that the claim sought to be arbitrated be related to the contract conferring the third party beneficiary status. A third party beneficiary will be bound by the terms of the underlying contract if the claims asserted by that beneficiary arise from its third party beneficiary status. In one case, the dispute involved construction defects. Since this claim did not arise out of the commission due to the broker under the sales contract, the broker could not be bound to the arbitration provision in that sales contract. n22.6

[2] Members of Realtor(R) Boards Are Required to Arbitrate

An agreement to arbitrate may be imposed incident to one's membership in a professional association. The majority of real estate brokers are required to arbitrate by virtue of their membership in the National Association of Realtors(R) (NAR) or other real estate boards or associations, and by their membership in multiple listing services. The Code of Ethics of NAR, the largest trade and professional association in the real estate industry, requires that members affiliated with different companies arbitrate their contractual disputes instead of taking them to court. n23

Local Realtor(R) boards require their members to agree to arbitration. For example, all local Realtor(R) boards in New Jersey require their members to abide by the Code of Ethics and fee arbitration and dispute resolution mechanisms promulgated by the National Association of Realtors(R). n24

Further, a written agreement is not required to compel arbitration between brokers. For example, a real estate broker, seeking 50% of the commission for the sale of commercial real estate pursuant to an oral agreement with another broker, was entitled to arbitration pursuant to the terms of the brokers' memberships in the Greater Madison Board of Realtors(R). n25

It has been held, however, that the agreement to submit to arbitration found in the Realtors'(R) Code of Ethics does not apply to disputes, contractual or noncontractual, that arise between Realtors(R) associated with the same brokerage firm. n25.1 In coming to this conclusion, this court stated that although the purpose of the Code of Ethics was to promote ethical behavior of Realtors(R), the court could find nothing in the Code indicating that it was intended to interfere with specific, privately contracted employment-type relationships between members of the same firm. n25.2 This court observed that the National Association of Realtors(R) Arbitration Manual, which accompanied the Code, stated that arbitration between or among members of the same firm was voluntary, and "may proceed only by written agreement of all parties." n25.3

[a] Broker's Decision to Arbitrate May Not Be "Voluntary"

A basic underlying tenet regarding the enforceability of arbitration agreements is that the parties to arbitration agreements voluntarily relinquished their constitutional right to a trial by jury in exchange for the time and cost benefits generally associated with arbitration. The requirement that brokers submit to arbitration or other means of alternative dispute resolution, however, is almost universally imposed as a condition precedent of the broker's involvement with organizations and associations that are critical to the broker's professional success.

In today's national and international markets, access to resources and information provided by professional associations and organizations is often required to ensure a broker's successful management of his or her career. When tools and services necessary to one's career as a broker require arbitration, a claim that a broker voluntarily made an informed choice to arbitrate may be based on little more than illusion. Many brokers never "voluntarily" decided to be bound by arbitration--they just decided to utilize tools and services necessary to their careers.

Consider, for example, New York's industry residential Web site, formed by an alliance of leading brokerages under the auspices of the Real Estate Board of New York (REBNY) and touted as "the most technologically sophisticated and inclusive on the Internet" giving sellers maximum exposure of their properties and offering "buyers the most complete account of Manhattan apartments available for rent or purchase." As a condition precedent of working on the residential Web site, however, each broker is required to subject herself or himself to arbitration: "All brokers working on the industry Web site will be bound to follow the Real Estate Board's Code of Ethics and be subject to REBNY's arbitration procedures." n26

Clearly, the residential Web site multiple listing system is intended to be an indispensable tool for a broker's success. As explained in an earlier edition of Real Estate Weekly:

The New York City real estate industry has joined the rest of the country in creating a listing service that will feature virtually every piece of Manhattan residential property that is being sold or rented.

Over 115 companies--ranging in size from large firms that employ numerous brokers to one-person operations--have agreed to participate in the service by posting 100 percent of their listings within 72 hours of receiving them. Another 40 to 50 firms have expressed interest in joining the service. ...

Multiple listing systems are used throughout the country and are beneficial to buyers, who have

access to the maximum number of listings, and sellers, who are assured the maximum number of customers. ...

Brokers who participate in the listing service will be required to adhere to REBNY's code of ethics and to be governed by REBNY's arbitration policy on disputes between brokers. n27

Is this a voluntary agreement to be bound by mandatory arbitration? Or is it a version of an unconscionable adhesion contract?

[b] Realtor(R) Association Members Are Bound by Arbitration

Subject only to very limited exceptions, if parties are required to submit to binding arbitration, they shall be bound by the arbitrator's decision. n28 On appeal from an action filed by a broker to vacate, modify and correct an arbitration award, a Louisiana appellate court was called upon to determine whether the parties were bound by arbitration. The underlying case arose out of the broker's claim for commission on the basis that she was entitled, as the procuring cause, to a commission attributable to a residential real estate sale. All of the parties involved in the commission dispute were members of the New Orleans Metropolitan Association of Realtors(R), a member of the National Association of Realtors(R). All members agreed that:

By becoming or remaining a member and by signing or having signed the agreement to abide by the Bylaws of the Board, every member, where consistent with applicable law, binds himself or herself and agrees to submit to arbitration by the Board's facilities all disputes as defined by Article 17 of the Code of Ethics and ... all disputes with any other member ... n29

The arbitrator's award was affirmed on the bases that:

- All parties in dispute about the commission were members of the real estate board and were, therefore, subject to the provision for mandatory, binding arbitration.
- There is a strong public policy in favor of arbitration and arbitration awards are presumed valid.
- Errors of law or fact are insufficient to invalidate an arbitrator's award. n30

Arbitration of a commission dispute among Realtors(R) has been ordered when the parties to a referral fee agreement had previously consented to arbitrate disputes arising among themselves while each was a member of a Realtors(R) organization. These parties had not rescinded their consents to arbitrate when the disputes between them arose. Each was still a member of the Realtors(R) organization that set forth guidelines and procedures for such arbitration. The court stated that these parties could not defeat the arbitration of transactions and fee disputes that arose during their membership in the Realtor(R) organization by withdrawing from membership after the dispute arose. n31

[c] Arbitration Not Limited to Disputes Arising During Membership

The push for arbitration is so strong that one broker may be allowed to compel arbitration against another broker through membership in a local real estate board by joining the board after the incident underlying the professional dispute between brokers arose. For example, a New York court ruled that one broker was allowed to compel arbitration against another broker despite the following facts:

- Arbitration would not have been required under the Federal Arbitration Act;
- The broker seeking compulsory arbitration reinstated his membership in the real estate board specifically to avail himself of its compulsory arbitration requirement;

- The broker seeking compulsory arbitration was not a member of the real estate board at the time the underlying fee dispute between the parties arose; and
- The defendant broker sought a stay of arbitration claiming that the plaintiff could not compel arbitration by joining the real estate board after the dispute arose. n32

As basis for its decision to compel arbitration, the trial court reasoned that the New York Court of Appeals required that agreements to arbitrate be deferred to and that all doubts were to be resolved in favor of arbitration. The court concluded that arbitration is strongly favored in all situations where an agreement to arbitrate does not expressly preclude it. As nothing in the arbitration provisions of the real estate board expressly precluded arbitration of pre-existing disputes, arbitration was compelled. n33

[d] Nonmembers May Compel Arbitration with Association Members

In addition to requiring arbitration between brokers, a broker's membership in some real estate associations may require that the broker submit to arbitration at the demand of a nonmember. For example, two brokers who were members of the Helena Association of Realtors(R), Inc., upon becoming members of that voluntary trade organization, signed a form consenting to arbitrate disputes between themselves and other members. The form and the association's rules also bound the brokers to arbitrate any matter arising out of a business dispute with a Realtor(R) member rising out of any agency relationship at the insistence of the nonmember client involved. A client of two brokers invoked arbitration of her claim against them and a Montana appellate court affirmed the trial court's decision to compel arbitration despite the fact that there was no contract between the brokers and the client that contained an arbitration clause. n34

[e] Association Members May Not Compel Arbitration with Nonmembers

Though binding and mandatory as between brokers who are members of local real estate boards and associations, a local board's requirement of arbitration between members to resolve commission disputes was found inapplicable to a case instituted by one member broker against defendants who included another member broker, non-member prospective purchasers and non-member sellers. The factual background to the case was somewhat convoluted. Defendants included the sellers of the property involved and the broker with whom they entered into a listing agreement. The property was multiple listed and the plaintiff broker showed the property to its customers. Those same customers then went to a different broker to again see the same property and purchased the property through that broker rather than through the plaintiff. The plaintiff broker sued for tortious interference with contract, breach of contract and for the lost commission. n35

As members of the Long Island Board of Realtors(R) and Multiple Listing Services, both brokers (plaintiff and defendant) had agreed to be bound by the terms of the Code of Ethics and Standards of Practice of the National Association of Realtors(R). Article 14 of the Code provided that, "In the event of a controversy between REALTORS associated with different firms, arising out of their relationship as REALTORS, the REALTORS shall submit the dispute to arbitration in accordance with the regulations of their Board or boards rather than litigate the matter." The defendant broker moved to stay the court proceedings and to compel arbitration. n36

Noting that a court cannot compel arbitration in the absence of a contract provision that expressly and clearly encompasses the subject matter of the dispute, the court refused to compel arbitration. The trial court held that although the code mandated arbitration of commission disputes between brokers, it neither expressly nor impliedly compelled arbitration of tort claims involving both members and non-members. n37

[3] Appeal of Court Decision on Motion to Compel Arbitration

A lower court ruling on a motion to compel arbitration can be immediately appealed as a final judgment. n38 So held Maryland's intermediate appellate court in a case arising out of a brokerage firm's claim to entitlement to a percentage of an 8% commission of the sale of commercial real estate on the basis that it was the procuring cause of the sale.

In that case, the plaintiff, claiming to have been the procuring cause of the sale, filed suit against the purchaser of the property and the listing broker alleging unjust enrichment, interference with business relations, and conspiracy. The defendant, listing broker, moved to compel arbitration pursuant to the NAR Code of Ethics and Arbitration Manual, to which both brokers agreed to be bound by virtue of their membership in the Anne Arundel County Association of Realtors(R). The trial court denied the motion to compel on the basis that this action involved claims in tort while the NAR provision regarded actions arising out of contract n39

It is well settled that when an appellate court reviews a trial court's ruling regarding a motion to compel arbitration, the appellate court applies a de novo standard of review. n40 The Maryland appellate court reversed, finding that the tort claims all required a finding that the plaintiff was the procuring cause of the sale and that the issue of determining whether the broker was the procuring cause was precisely the type of issue subject to mandatory arbitration under the NAR Code of Ethics and Arbitration Manual. n41 Finally, though arbitration of the contractual claims between the brokers would not eliminate plaintiff's tort claims against the purchasers, the arbitrator's decision on the issue of procuring cause would be determinative regarding plaintiff's ability to prevail on its tort claims. n42

FOOTNOTES:

(n1)Footnote 1. *See Gravillis v. Coldwell Banker Residential Brokerage Co.*, 143 Cal. App. 4th 761, 771, 49 Cal. Rptr. 3d 531, 538 (2006) , rehearing denied, 2006 Cal. App. LEXIS 1775 (Oct. 20, 2006) ; *Sher v. Cella*, 114 Haw. 263, 267, 160 P.3d 1250, 1254 (Haw. Ct. App. 2007) , reconsideration denied, 114 Haw. 181, 158 P.3d 299 (Haw. Ct. App. 2007) , cert. denied, 2007 Haw. LEXIS 327 (Haw. Nov. 9, 2007) .

(n2)Footnote 2. *See, e.g., Coburn v Grabowski*, CV 960134935, 1997 Conn. Super. LEXIS 1478, 6 (Conn. Super. Ct. 1997) . *See also Lane v. Urgitus*, 145 P.3d 672, 678 (Colo. 2006) (In Colorado, arbitration is a favored method of dispute resolution.).

(n3)Footnote 3. *Villa Milano Homeowners Association v. Il Davorge*, 84 Cal. App. 4th 819, 829, 102 Cal. Rptr. 2d 1, 7 (Cal. Ct. App. 2000) review denied, 2000 Cal. App. LEXIS 901 (Nov. 27, 2000) and 2001 Cal. LEXIS 1250 (Feb. 21, 2001) .

(n4)Footnote 4. *Marcus & Millichap Real Estate Investment Brokerage Co. v. Hock Investment Co.*, 68 Cal. App. 4th 83, 88, 80 Cal. Rptr. 2d 147 (Cal. Ct. App. 1998) .

(n5)Footnote 5. *Villa Milano Homeowners Association v. Il Davorge*, 84 Cal. App. 4th 819, 824, 102 Cal. Rptr. 2d 1, 4 (Cal. Ct. App. 2000) .

(n6)Footnote 6. *In re Arbitration Between Carroll and ERA Maui Real Estate*, 81 Haw. 264, 915 P.2d 1365, 1368 (Haw. Ct. App. 1996) .

(n7)Footnote 7. *In re Arbitration Between Carroll and ERA Maui Real Estate*, 81 Haw. 264, 915 P.2d 1365, 1368-1369 (Haw. Ct. App. 1996) .

(n8)Footnote 8. Cal. Civ. Proc. § 1281.2.

(n9)Footnote 9. *Villa Milano Homeowners Association v. Il Davorge*, 84 Cal. App. 4th 819, 826, 102 Cal. Rptr. 2d 1, 5 (Cal. Ct. App. 2000) review denied, 2000 Cal. App. LEXIS 901 (Nov. 27, 2000) and 2001 Cal. LEXIS 1250 (Feb. 21, 2001) .

(n10)Footnote 10. *Villa Milano Homeowners Association v. Il Davorge*, 84 Cal. App. 4th 819, 822-823, 102 Cal.

Rptr. 2d 1, 2-3 (Cal. Ct. App. 2000) review denied, 2000 Cal. App. LEXIS 901 (Nov. 27, 2000) and 2001 Cal. LEXIS 1250 (Feb. 21, 2001) .

(n11)Footnote 10.1. *But see Sher v. Cella, 114 Haw. 263, 268, 160 P.3d 1250, 1255 (Haw. Ct. App. 2007) , reconsideration denied, 114 Haw. 181, 158 P.3d 299 (Haw. Ct. App. 2007) , cert. denied, 2007 Haw. LEXIS 327 (Haw. Nov. 9, 2007) ("The principle that a non-signatory agent may, under certain circumstances, invoke an arbitration provision against an unwilling principal who is a signatory to an agreement containing an arbitration provision is settled under Hawaii law... . The obverse is not necessarily true where, as here, the principal who is a signatory to a contract containing an arbitration provision seeks to enforce that provision against a non-signatory agent.").*

(n12)Footnote 10.2. *See Nguyen v. Tran, 157 Cal. App. 4th 1032, 1036-37, 68 Cal. Rptr. 3d 906, 909 (2007) .*

(n13)Footnote 10.3. *See Fradella v. Seaberry, 952 So. 2d 165, 2007 Miss. LEXIS 184, at *29 (Mar. 22, 2007) .*

(n14)Footnote 10.4. *Id.*

(n15)Footnote 11. *First Am. Title Ins. Corp. v. Silvernell, 744 So. 2d 883, 888 (Ala. 1999) .*

(n16)Footnote 12. *First Am. Title Ins. Corp. v. Silvernell, 744 So. 2d 883, 885 (Ala. 1999) .*

(n17)Footnote 13. *First Am. Title Ins. Corp. v. Silvernell, 744 So. 2d 883, 886 (Ala. 1999) .*

(n18)Footnote 14. *First Am. Title Ins. Corp. v. Silvernell, 744 So. 2d 883, 888 (Ala. 1999) .*

(n19)Footnote 14.1. *See Cartwright v. Maitland, 30 So. 3d 405, 2009 Ala. LEXIS 191, at *13 (Ala. Aug. 28, 2009) (Realtors(R) who were not signatories to the underlying sales contract were allowed to compel arbitration.)*

(n20)Footnote 15. *Grubb & Ellis Co. v. Bello, 19 Cal. App. 4th 231, 23 Cal. Rptr. 2d 281 (Cal. App. 1993) .*

(n21)Footnote 16. *Phillips v. American Underwriters Life Insurance Co., B147850, 2002 Cal. App. Unpub. LEXIS 3268 (Mar. 8, 2002) .*

(n22)Footnote 17. *Marcus & Millichap Real Estate Investment Brokerage Co. v. Hock Investment Co., 68 Cal. App. 4th 83, 91 n.6, 80 Cal. Rptr. 2d 147, 151 n.6 (Cal. Ct. App. 1998) .*

(n23)Footnote 18. *Marcus & Millichap Real Estate Investment Brokerage Co. v. Hock Investment Co., 68 Cal. App. 4th 83, 85, 80 Cal. Rptr. 2d 147 (Cal. Ct. App. 1998) .*

(n24)Footnote 19. *Marcus & Millichap Real Estate Investment Brokerage Co. v. Hock Investment Co., 68 Cal. App. 4th 83, 86, 80 Cal. Rptr. 2d 147, 148 (Cal. Ct. App. 1998) .*

(n25)Footnote 20. *Hill v. Bluntzer, 701 So. 2d 901, 901-902 (Fla. Dist. Ct. App. 1997) .*

(n26)Footnote 21. *Martha A. Gottfried, Inc. v. Paulette Koch Real Estate, Inc., 778 So. 2d 1089 (Fla. Dist. Ct. App. 2001) .*

(n27)Footnote 22. *Martha A. Gottfried, Inc. v. Paulette Koch Real Estate, Inc., 778 So. 2d 1089, 1090 (Fla. Dist. Ct. App. 2001) .*

(n28)Footnote 22.1. *157 Cal. App. 4th 1032, 68 Cal. Rptr. 3d 906 (2007) .*

(n29)Footnote 22.2. *157 Cal. App. 4th 1032, 1034, 68 Cal. Rptr. 3d 906, 907-908 (2007) .*

(n30)Footnote 22.3. *114 Haw. 263, 160 P.3d 1250 (Haw. Ct. App. 2007) , reconsideration denied, 114 Haw. 181,*

158 P.3d 299 (Haw. Ct. App. 2007) cert. denied, 2007 Haw. LEXIS 327 (Haw. Nov. 9, 2007) .

(n31)Footnote 22.4. 114 Haw. 263, 267-68, 160 P.3d 1250, 1254-55 (Haw. Ct. App. 2007) . reconsideration denied, 114 Haw. 181, 158 P.3d 299 (Haw. Ct. App. 2007) cert. denied, 2007 Haw. LEXIS 327 (Haw. Nov. 9, 2007) . The court also stated that in order for a non-signatory agent to invoke an arbitration agreement against a signatory principal, two conditions had to be met: (1) the signatory must rely on the terms of the written contract in asserting claims against the non-signatory, thus using the contract as a weapon against the non-signatory in a manner that gives the non-signatory standing to invoke other terms in that contract; and (2) a signatory to a contract with an arbitration provision raises allegations of substantially interdependent and concerted misconduct by both the non-signatory and one or more of the signatories to the contract.

(n32)Footnote 22.5. See *Sher v. Cella*, 114 Haw. 263, 269, 160 P.3d 1250, 1256 (Haw. Ct. App. 2007) , reconsideration denied, 114 Haw. 181, 158 P.3d 299 (Haw. Ct. App. 2007) cert. denied, 2007 Haw. LEXIS 327 (Haw. Nov. 9, 2007) .

(n33)Footnote 22.6. See *Sher v. Cella*, 114 Haw. 263, 270, 160 P.3d 1250, 1257 (Haw. Ct. App. 2007) , reconsideration denied, 114 Haw. 181, 158 P.3d 299 (Haw. Ct. App. 2007) cert. denied, 2007 Haw. LEXIS 327 (Haw. Nov. 9, 2007) .

(n34)Footnote 23. See Holly Heckathorne, *Why go to court when you can arbitrate?*, Real Estate Today, May, 1995 (Vol. 28, No. 5, p. 12).

(n35)Footnote 24. *Venture Resources Group v. Greater N.J. Regional Multiple Listing Serv.*, No. 95-0401 (MLP), 1995 U.S. Dist. LEXIS 21177 ; 1996-1 Trade Cas. (CCH) P71,397 (D.N.J. Aug. 24, 1995) (not for publication).

(n36)Footnote 25. *Horizon Investment & Development Corp. v. Geib*, 163 Wis. 2d 966, 473 N.W.2d 610 (Wis. Ct. App. 1991) .

(n37)Footnote 25.1. See *Winter Park Real Estate and Investments, Inc. v. Anderson*, 160 P.3d 399, 404 (Colo. Ct. App. 2007) .

(n38)Footnote 25.2. See *Winter Park Real Estate and Investments, Inc. v. Anderson*, 160 P.3d 399, 404-405 (Colo. Ct. App. 2007) .

(n39)Footnote 25.3. See *Winter Park Real Estate and Investments, Inc. v. Anderson*, 160 P.3d 399, 405 (Colo. Ct. App. 2007) citing National Association of Realtors(R) Arbitration Manual § 44(4).

(n40)Footnote 26. Steven Spinola, *Negatives Fail to Affect Manhattan's Market; 2001 Goals Include Infrastructure Initiatives, Reducing Development Costs and Office Rents*, New York Law Journal, Jan. 16, 2001.

(n41)Footnote 27. Natalie Keith, *Peace is at hand as MLS sides join together.*, Real Estate Weekly Nov. 8, 2000.

(n42)Footnote 28. Cf. *NRT Mid-Atlantic, Inc. v. Innovative Properties, Inc.*, 144 Md. App. 263, 288, 797 A.2d 824, 838 (Md. Ct. Sp. App. 2002) . A broker sued another broker; their arbitration agreement covered the contractual dispute over whether the plaintiff was the procuring cause of the sale and therefore entitled to half the commission. That issue was subject to binding arbitration. However, the trial court should have stayed the case pending arbitration of the contractual dispute, both because the buyers were not parties to the arbitration agreement and because the arbitration does not dispose of the tort claims. However, that may be the effect of the arbitration, because how the arbitration is resolved will affect whether the plaintiff will have evidence sufficient to make out prima facie cases in its tort claims.

(n43)Footnote 29. National Association of Realtors(R), *Code of Ethics and Arbitration Manual*, § 44(a) (1996).

(n44)Footnote 30. *P&M Equities v. Latter & Blum, Inc.*, 692 So. 2d 1255, 1257-1258 (La. Ct. App. 1997) .

(n45)Footnote 31. See *Lane v. Urgitus*, 145 P.3d 672, 679-681 (Colo. 2006) .

(n46)Footnote 32. New York Law Journal, Sept. 12, 1997, In Brief Decisions of Interest, p. 1, *Arbitration: Real Estate Board arbitration is proper despite broker's earlier non-membership. McQuillan v. Berliner*, New York, Justice McMahon.

(n47)Footnote 33. New York Law Journal, Sept. 12, 1997, In Brief Decisions of Interest, p. 1, *Arbitration: Real Estate Board arbitration is proper despite broker's earlier non-membership. McQuillan v. Berliner*, New York, Justice McMahon.

(n48)Footnote 34. *Walker v. Helena Ass'n of Realtors(R), Inc.*, 303 Mont. 224, 15 P.3d 414 (Mont. 2000) .

(n49)Footnote 35. *Kathy Young Realty Corp. v. Century 21 Jimco Realty*, NYLJ, Apr. 5, 1995, p. 32, col. 1, Sup.Ct., Naussau Co., McCaffrey, J.).

(n50)Footnote 36. *Kathy Young Realty Corp. v. Century 21 Jimco Realty*, NYLJ, Apr. 5, 1995, p. 32, col. 1, Sup.Ct., Naussau Co., McCaffrey, J.).

(n51)Footnote 37. *Kathy Young Realty Corp. v. Century 21 Jimco Realty*, NYLJ, Apr. 5, 1995, p. 32, col. 1, Sup.Ct., Naussau Co., McCaffrey, J.).

(n52)Footnote 38. *NRT Mid-Atlantic, Inc. v. Innovative Properties, Inc.*, 144 Md. App. 263, 797 A.2d 824 (May 6, 2002) .

(n53)Footnote 39. *NRT Mid-Atlantic, Inc. v. Innovative Properties, Inc.*, 144 Md. App. 263, 797 A.2d 824 (May 6, 2002) .

(n54)Footnote 40. *First Am. Title Ins. Corp. v. Silvernell*, 744 So. 2d 883, 886 (Ala. 1999) .

(n55)Footnote 41. *NRT Mid-Atlantic, Inc. v. Innovative Properties, Inc.*, 797 A.2d 824 (Md. Ct. Spec. App. 2002) .

(n56)Footnote 42. *NRT Mid-Atlantic, Inc. v. Innovative Properties, Inc.*, 797 A.2d 824 (Md. Ct. Spec. App. 2002) .

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93 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers

CHAPTER 17 Alternative Dispute Resolution Involving Real Estate Brokers *

10A-17 Real Estate Brokerage Law and Practice § 17.06

§ 17.06 Court Actions Allowed Despite Agreement to Arbitrate

Certain matters are reserved for judicial resolution even if the parties have entered into an arbitration agreement. Court actions are generally required or allowed to determine if an agreement to arbitrate is enforceable, to determine if a contract should be revoked for fraud or similar basis for revocation, to obtain prejudgment remedies, to determine issues regarding attorneys' fees and costs, to enforce arbitration judgments and awards, and for other matters.

[1] Courts Construe Contracts to Determine if Arbitration Agreements Are Enforceable

Arbitration is contractual. n1 If the underlying agreement or contract is unenforceable, whether premised upon statute or case law, the arbitrators are deprived of jurisdiction. Therefore, if a party challenges not only the arbitration clause, but challenges the validity of the entire agreement or contract of which it is a part, it is the role of the court and not of the designated arbitrators to decide the challenge. If it is alleged that fraud permeates the entire contract, including the arbitration provision, that provision is no more enforceable than the rest of the contract and the whole contract's validity becomes a question for the court. n2

[2] Courts May Grant Prejudgment Remedies to Parties Involved in Arbitration

The fact that an arbitration agreement exists should not deter a broker from seeking prejudgment remedies or emergency judicial relief (such as an injunction). An arbitration agreement may not serve as a bar to prejudgment remedies such as attachment of real property or other assets intended to protect the broker's right to ensure the availability of assets to pay an arbitration award if one is granted.

Brokers are frequently involved in disputes over their entitlement to commissions. Fact situations frequently encountered are those in which more than one member works with the same buyer, requiring a determination of which procured the buyer and which, therefore, was entitled to the commission. This is generally referred to as "procuring cause."

To sustain a finding that an agent is the procuring cause of a sale, there must be evidence that [the agent] originated a course of events which without a break in their continuity created a cause of which the sale was the result. It is not enough that [the agent's] services merely contributed to the result. They must be the producing and effective means thereof. n3

Similarly, frequent disputes arise where the broker's services are utilized pursuant to contract to locate property for a prospective purchaser or to locate prospective purchasers for a seller but the deal is not finalized or consummated until after the contract with the broker has terminated. A court may intervene to protect the broker's interest in her or his commission while arbitration proceedings are pending.

For example, a plaintiff real estate broker was retained by the defendant pursuant to a written agreement to negotiate the purchase of a condominium site in Connecticut. In exchange for his services the broker was to receive a commission of 5% of the purchase price. The agreement further provided that it would terminate on a specific date or was terminable at the election of either party upon 30-days notice but even after termination of the agreement the commission would be due if the defendant within six months of termination purchased a property that had been identified by the plaintiff or regarding which the plaintiff had been involved in negotiations on behalf of the defendant. The agreement included an arbitration clause that stated as follows: "Any dispute between us shall be handled by binding arbitration in accordance with the rules of procedure of the American Arbitration Association then in effect." n4 The plaintiff engaged in extensive investigation, research and negotiation regarding a specific property, which was offered for sale to the defendant at \$650,000. The defendant rejected that offer, the agreement between the parties was terminated, and the defendant later purchased the same property for \$655,000.

Plaintiff filed suit seeking, among other things, that the court issue a prejudgment attachment against the real property, pending resolution of his claim to his commission. Defendant took the position that the agreement to arbitrate deprived the court of all jurisdiction in the matter and moved that the proceedings be stayed pending arbitration.

Though the court generally stayed the proceedings pending arbitration, it also granted plaintiff's request for a prejudgment remedy in the form of an attachment on the defendant's real estate in the amount of \$32,750--that being the amount of the disputed commission. n5 In reaching its decision that it had jurisdiction to determine the whether prejudgment relief should be granted, the court first applied the general rule that under the common law an agreement to arbitrate does not serve to defeat the jurisdiction of the courts, which are properly called upon to resolve judicial questions such as those regarding the validity of the contract, the types of issues subject to arbitration and whether the right to arbitrate was waived. n6 Then, in deciding to order prejudgment attachment, the Connecticut appellate court joined the trend established by courts in other jurisdictions (including Oregon, New York, Massachusetts and California) and found no inconsistency between the goal of arbitration as a means to achieve non-judicial resolution of controversies and one's legitimate interest in assuring the existence of resources to satisfy a judgment if one was obtained. n7 The court stated:

The basis of these rulings is that a prejudgment remedy does not interfere with the arbitration of a dispute but assures the availability of assets to pay an arbitration award if one is granted. Thus the granting of a stay of action (to permit arbitration of the controversy) does not preclude the granting of such a remedy. n8

FOOTNOTES:

(n1)Footnote 1. *See Gravillis v. Coldwell Banker Residential Brokerage Co.*, 143 Cal. App. 4th 761, 771, 49 Cal. Rptr. 3d 531, 538 (2006) , rehearing denied, 2006 Cal. App. LEXIS 1775 (Oct. 20, 2006) ; *Sher v. Cella*, 2007 Haw. App. LEXIS 243, at *9 (Apr. 11, 2007) , reconsideration denied, 2007 Haw. App. LEXIS 323 (May 4, 2007) .

(n2)Footnote 2. New York Law Journal, Apr. 28, 1999, Court Decisions, p. 25, *Court to Decide Mortgageors' Challenge Despite Arbitration Clause in Contract*; *Mirza v. National Standard Mortgage Corp* (reporting on decision rendered by Westchester County, City Court of Yonkers).

(n3)Footnote 3. *Lawhead v. Ulwelling, Hollerud & Schulz*, No. C7- 00-1425, 2001 Minn. App. LEXIS 146, 5 n.2 (Minn. Ct. App. 2001) (citing to *The Spring Co. v. Holle*, 248 Minn. 51, 56, 78 N.W.2d 315, 318 (1956)) .

(n4)Footnote 4. *Yellin v. Premier Development*, 1994 Conn. Super LEXIS 1398, 1-2 (Conn. Super. Ct. 1994) (unreported).

(n5)Footnote 5. *Yellin v. Premier Development*, 1994 Conn. Super LEXIS 1398, 12-13 (Conn. Super. Ct. 1994) (unreported).

(n6)Footnote 6. *Yellin v. Premier Development*, 1994 Conn. Super LEXIS 1398, 5 (Conn. Super. Ct. 1994) (unreported).

(n7)Footnote 7. *Yellin v. Premier Development*, 1994 Conn. Super LEXIS 1398, 7-8 (Conn. Super. Ct. 1994) (unreported).

(n8)Footnote 8. *Yellin v. Premier Development*, 1994 Conn. Super LEXIS 1398, 9 (Conn. Super. Ct. 1994) (unreported).

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94 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers

CHAPTER 17 Alternative Dispute Resolution Involving Real Estate Brokers *

10A-17 Real Estate Brokerage Law and Practice § 17.07

§ 17.07 Judicial Review of Arbitration Proceedings Is Limited

Arbitral awards are presumed valid and judicial review is very limited. Any person who elects to challenge an arbitration award bears a severe burden. Among other things:

- Arbitration awards are construed to uphold their validity whenever it is possible to do so.
- It is presumed that the arbitrator did not exceed his or her authority.
- Judicial review of an arbitrator's award is generally more limited than appellate review of a court decision.
- An award will not be vacated even the arbitrator made gross errors in judgment or gross mistakes of fact, unless the errors or mistakes are apparent on the face of the award. n1

[1] Burden of Proof in Challenging an Arbitration Award

The generally accepted and often voiced position of the courts is that arbitration is strongly favored and generally approved as a less expensive and quicker means of settling litigation and reducing the burden on the courts by relieving some docket congestion. For that reason, the party attempting to overturn an arbitration award bears the burden of proof. n2

The evidence required to meet that burden must be certain and direct. For example, a party attempting to set aside an arbitration award on the basis that the arbitrators on the panel were not impartial bears the burden of proof. Evidence must be presented to show the manner in which partiality was shown. As stated by the Supreme Court of Arkansas in rejecting a claim that an arbitration panel was not impartial in awarding a commission to a real estate broker arising out of the sale of a property, "The interest, partiality, or bias that will suffice to overturn an arbitration award must be certain and direct rather than remote, uncertain, or speculative." n3

Arbitrators are considered the judges of both fact and law and the awards issued by them are presumed valid. Mere errors of judgment are insufficient to overturn an arbitrator's award. n4 Though variations exist, a party challenging an

arbitration decision usually must prove his or her case by clear and convincing evidence.

Generally, courts will overturn an award only if it is proven by clear and convincing evidence that the arbitrators:

- Exceeded their authority;
- Dispensed their own brand of justice;
- Issued a perverse misconstruction of the contract;
- Committed positive misconduct;
- Demonstrated a manifest disregard for the law;
- Acted illegally; or
- Acted in violation of public policy. n5

[2] Judicial Standard of Review of Arbitration Award

In keeping with the strong policies supporting arbitral finality, the general rule is that courts may not interfere with an arbitration award. More specifically:

- Courts may not examine the merits of the underlying controversy.
- Courts may not examine that sufficiency of the evidence supporting the awards.
- Courts may not examine the reasoning supporting the decision.
- Courts may not set aside an arbitration award even if the arbitrator made an error of law or fact. n6

A limited exception to this rule exists when the underlying contract calling for arbitration is illegal and, therefore, unenforceable. The power of the arbitrator depends upon the existence of a valid contract. As noted by California appellate courts:

[T]he rules which give finality to the arbitrator's determination of ordinary questions of fact or of law are inapplicable where the issue of illegality of the entire transaction is raised in a proceeding for enforcement of the arbitrator's award. When so raised the issue is one for judicial determination upon the evidence presented to the trial court, and any preliminary determination of legality by the arbitrator ... should not be held to be binding upon the trial court. n7

Such limitations upon a reviewing court's power over an arbitrator's decision may, however, be modified by statute. For example, the New Jersey Alternative Dispute Resolution Act (ADRA) provides that the Chancery Division may vacate an award made by an ADRA arbitrator if the arbitrator committed prejudicial error by erroneously applying the law to the facts and issues presented. The Act does not provide for further appellate review. n8 Yet an appellate court may entertain such an appeal in the absence of a motion to dismiss. n9

[3] Statutory Bases for Vacating or Correcting an Arbitration Award

Judicial review of binding arbitration awards is generally limited to the statutory grounds for vacating or correcting such

an award. n10 For example, Title 9 of the California Code of Civil Procedure sets forth specific bases upon which an arbitrator's award will be vacated or corrected, including that:

- The award was the result of corruption, fraud or undue means.
- Misconduct of a neutral arbitrator substantially prejudiced the rights of a party to the arbitration.
- The arbitrators exceeded their powers.
- The arbitrator's refusal to grant a reasonable request to postpone the hearing or to hear material evidence substantially prejudiced a party.
- There was an evident miscalculation of figures.
- There was an evident error in describing a person, thing or property referred to within the award. n11

Arbitrators do not exceed their powers merely by making an erroneous decision on a legal or factual issue so long as the issue was within the scope of the controversy before the arbitrator. The arbitrator's resolution of those issues is precisely what the parties bargain for in reaching an agreement to be bound by arbitration. n12

The scope of arbitration is that agreed upon by the parties. An error of law by an arbitrator will not defeat an award if the award is based on issues raised by the pleadings. For example, an arbitrator's award of damages in favor of a property purchaser and against an individual found by the arbitrator to be a partner of the broker who sold the property was upheld. The decision was solely premised upon the defendant's referral to the selling broker and an oral agreement to share fees--despite the defendant's position that an oral agreement between brokers to share fees does not create a partnership exposing one to liability for the other's wrongdoing and despite the fact that there were no allegations of the existence of a "partnership" in the underlying complaint. n13 The court reasoned that the arbitrator derived his power from the arbitration agreement and the scope of that power would not be deemed limited by the civil complaint that was filed before arbitration was invoked. n14

The court held that it is for the arbitrator, and not for the court, to determine which issues are necessary for the ultimate decision, and to determine the meaning or extent of the arbitration agreement. The arbitrator determined that the existence of a "partnership" and the exposure to liability engendered by the existence of a partnership were among the issues submitted by the parties and, absent corruption, misconduct or other impropriety, the court found that the arbitrator did not exceed his powers. n15

FOOTNOTES:

(n1)Footnote 1. *Hayes v. Ennis*, 278 Ill. App. 3d 121, 127, 662 N.E.2d 910, 913 (Ill. App. Ct. 1996) .

(n2)Footnote 2. *See Lancaster v. West*, 319 Ark. 293, 299-300, 891 S.W.2d 357, 361 (Ark. 1995) .

(n3)Footnote 3. *Lancaster v. West*, 319 Ark. 293, 300, 891 S.W.2d 357, 361 (Ark. 1995) .

(n4)Footnote 4. *See, e.g., Horizon Investment & Development Corp. v. Geib*, 163 Wis. 2d 966, 473 N.W.2d 610 (Wis. Ct. App. 1991) .

(n5)Footnote 5. *Horizon Investment & Development Corp. v. Geib*, 163 Wis. 2d 966, 473 N.W.2d 610 (Wis. Ct. App. 1991) .

(n6)Footnote 6. *Lindenstadt v. Staff Builders, Inc.*, 55 Cal. App. 4th 882, 889, 64 Cal. Rptr. 2d 484, 488 (Cal. Ct. App. 1997) .

(n7)Footnote 7. *Lindenstadt v. Staff Builders, Inc.*, 55 Cal. App. 4th 882, 890, 64 Cal. Rptr. 2d 484, 488 (Cal. Ct. App. 1997) .

(n8)Footnote 8. N.J.S.A. 2A:23A-13(c)(5) and 2A:23A-18(b).

(n9)Footnote 9. *Schenck v. HJI Assocs.*, 295 N.J. Super. 445, 449-450, 685 A.2d 481, 483 (N.J. Super. Ct. App. Div., 1996) .

(n10)Footnote 10. *Moshonov. v. Walsh*, 22 Cal. 4th 771, 775, 996 P.2d 699, 702 (Cal. 2000) .

(n11)Footnote 11. Cal. Civ. Proc. § 1286.2 and § 1286.6.

(n12)Footnote 12. *Moshonov. v. Walsh*, 22 Cal. 4th 771, 775-776, 996 P.2d 699, 702 (Cal. 2000) .

(n13)Footnote 13. *Hall v. Superior Court*, 18 Cal. App. 4th 427, 22 Cal. Rptr. 2d 376 (Cal. Ct. App. 1993) .

(n14)Footnote 14. *Hall v. Superior Court*, 18 Cal. App. 4th 427, 435, 22 Cal. Rptr. 2d 376, 381 (Cal. Ct. App. 1993) .

(n15)Footnote 15. *Hall v. Superior Court*, 18 Cal. App. 4th 427, 435, 22 Cal. Rptr. 2d 376, 381-382 (Cal. Ct. App. 1993) .

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95 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers

CHAPTER 17 Alternative Dispute Resolution Involving Real Estate Brokers *

10A-17 Real Estate Brokerage Law and Practice § 17.08

§ 17.08 Matters to Be Considered When Entering Into an Agreement to Arbitrate

A decision to arbitrate can have serious consequences and the language of an arbitration clause merits serious consideration. Arbitration language should not be cavalierly disregarded as "form" or "boiler plate" language and it may be wise to seek informed legal advice before entering into a contract that includes an arbitration clause. Care should be taken to ensure that there is no conflict between the governing laws of different jurisdictions as they apply to a specific agreement to arbitrate. The language and structure of the arbitration agreement should be reviewed to anticipate any potential influence it could have regarding any challenge to the arbitration process or to an arbitration award.

If the language of the agreement to arbitrate does not clearly and accurately state the intent of the parties, their true intentions may be thwarted. Additionally, if one's agreement to arbitrate is truly voluntary, the terms and conditions of an arbitration clause should be subject to negotiation and modification with the intention of avoiding pitfalls and reducing one's risk and exposure to liability.

Questions that a broker should ask and have answered when considering an arbitration agreement or when involved in the arbitration process include the following:

(1) Is the language specific regarding the types of problems or issues that will be submitted to arbitration?

Often the types of issues most appropriate for arbitration are those where the solutions are more readily determined on the basis of factual testimony and expert opinions rather than arguments of law. Issues not specifically included within the scope of arbitration may be excluded from arbitration resulting in multiple actions. Care must be taken to ensure that the scope is as limited or as broad as the parties intend.

(2) Who can compel arbitration and who can be compelled to be a party to the arbitration?

It is important to anticipate the identity of parties who may be involved in a dispute arising under the arbitration agreement. Failure to include all affected parties could result in multiple actions arising out of the same incident, and could subject a party to both arbitration and litigation arising out of the same underlying dispute. Also, have all parties to the arbitration clause or agreement actually signed the document containing the clause or constituting the agreement? A person who has not signed may not be bound by the agreement.

(3) Is the agreement to arbitrate mandatory and binding?

If the agreement to arbitrate is mandatory and binding, be certain that it says so.

(4) What laws will be applied to interpret or enforce the arbitration agreement?

It is probable that there will be conflicting sources of rules, laws, procedures or regulations that may govern the agreement to arbitrate. The parties to the arbitration agreement may choose the law that will be applied to effectuate their agreement. The agreement to arbitrate is contractual and such a provision (commonly referred to as a "choice of law" provision) will generally be enforced.

(5) Who will serve as arbitrator and how is the arbitrator selected?

Arbitrators must be impartial. The parties to an arbitration agreement should confirm that disclosure of the interests and relations of potential arbitrators is provided for; and that the provisions for selection of arbitrators are fair and designed to ensure that impartial arbitrators are selected. Further, as determined by an Oklahoma appellate court in affirming a trial court's refusal to grant a broker's motion to compel arbitration, arbitrator impartiality is very important to the arbitration process and an arbitration clause cannot be enforced if it excludes a party from the selection process. n1

(6) When does the arbitration process begin and what time limits apply to the process?

Does arbitration commence upon demand of any party, or is time to be allowed for the possibility of private settlement negotiations or for the less adversarial alternative dispute method of mediation? Further, though parties to arbitration agreements generally seek expedited resolution of their disputes, care should be taken to ensure that sufficient time is allowed to properly prepare and present one's position in the dispute.

(7) Which procedural rules and practices will govern the arbitration process?

Arbitration practices and procedures are governed by laws, rules, codes and regulations from many sources, including those enacted by the federal government, those enacted by state governments, those enacted by local governments, and those adopted by professional associations (such as the National Association of Realtors(R) and the American Arbitration Association). Because an agreement to arbitrate is contractual, the parties' choice as to the procedural rules and practices that will govern their agreement will usually be enforced. If the procedures to be followed are to be under the auspices of a private association or other entity (*e.g.*, the National Association of Realtors(R) or the American Arbitration Association), state that fact within the arbitration agreement.

(8) How will monetary issues be determined and resolved?

Many monetary issues are encountered in arbitration. How are damages to be awarded? What provisions are made to satisfy an award of damages? Are attorney's fees allowed? If so, to whom and under what circumstances will an award of attorney's fees be made? Is an award of attorney's fees to a prevailing party mandatory or discretionary? Who will bear the costs of the proceeding, and how are those costs defined? How will the arbitrators be paid? Is interest on the arbitrator's award allowed? Interest on the arbitrator's award is typically allowed from the date of the award, n2 and if it is not the intent of the parties that interest be allowed, they must state that fact. In the absence of provisions resolving the monetary issues, parties cannot fairly assess their exposure to liability.

FOOTNOTES:

(n1)Footnote 1. *Ditto v. RE/MAX Preferred Properties, Inc.*, 861 P.2d 1000, 1003 (Okla. App. 1993) .

(n2)Footnote 2. *See, e.g., Horizon Investment & Development Corp. v. Geib*, 163 Wis. 2d 966, 473 N.W.2d 610 (Wis. Ct. App. 1991) .

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96 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers
CHECKLISTS *

10A-CL Real Estate Brokerage Law and Practice .syn

§ Synopsis to Appendix CL: CHECKLISTS *

Scope



97 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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PART V Other Issues Affecting Brokers
CHECKLISTS *

10A-CL Real Estate Brokerage Law and Practice

Scope

Checklist 1 Client Interview--Facts and Documents

NOTE:

The following checklist provides a reference for matters that should be discussed with an owner who is about to sign a listing agreement with a real estate broker or who wishes to have an attorney draft this type of agreement rather than use the broker's form agreement.

A. Facts

- (1) Names, addresses and telephone numbers of parties.
 - (a) Broker.
 - (b) Salesperson.
 - (c) Owner.
- (2) Type, number and expiration date of license held by broker or salesperson.
- (3) Broker's qualifications, experience and specialties.
- (4) Type of real estate to be listed, such as:
 - (a) Single-family.
 - (i) Owner-occupied.
 - (ii) Rented or leased.
 - (b) Multi-family.

- (c) Commercial or industrial.
 - (d) Unimproved.
 - (e) Other.
- (5) Specific information about property to be purchased, sold, exchanged or leased, including:
- (a) Legal description.
 - (b) Address.
 - (c) Description of improvements and other distinguishing features.
 - (d) Fixtures and other property to be included in sale or exchange.
 - (e) Manner in which title is held.
- (6) Existing defects on premises that might be hazardous to invitees or future occupants.
- (7) Lead-Based Paint Disclosure, if applicable [*see Ch. 15A above* for discussion of lead-based paint disclosure requirements].
- (8) State-required seller's disclosure, if applicable.
- (9) Type of transaction sought by owner, such as:
- (a) Sale.
 - (b) Exchange.
 - (c) Lease.
- (10) If property is a single-family residence, details such as:
- (a) Number of bedrooms.
 - (b) Number of bathrooms.
 - (c) Total number of rooms.
 - (d) Number of square feet.
 - (e) Size of garage, if any.
 - (f) Size of basement, if any.
 - (g) Type of exterior (*e.g.*, wood siding, stucco, brick).
 - (h) Type of roof (*e.g.*, wood shake, composition shingle, tile).

(i) Amount of annual property taxes.

(11) If income property, details such as:

(a) Number of units.

(b) Gross scheduled income.

(c) Vacancy allowance.

(d) Rent controls.

(e) Operating expenses.

(f) Net operating income.

(g) Loan payments.

(h) Cash flow.

(i) Service contracts.

(j) Laundry leases.

(k) Amenities provided to tenants.

(12) Terms and conditions of lease sought by owner, including:

(a) Term of lease.

(b) Monthly rental amount/percentage lease terms.

(c) Options to purchase/right of first refusal.

(d) Renewal options.

(e) Ability to divide space.

(f) Option to lease additional space/surrender space.

(g) Escalators.

(h) Common area maintenance (CAM) charges.

(i) Services and amenities available to tenant.

(j) Security deposit.

(k) Buildout allowance/rent abatement.

- (l) Tenant exclusivity.
- (13) Terms and conditions of sale or exchange sought by owner, including:
 - (a) Price.
 - (b) Amount of liens and encumbrances on property.
 - (c) Date of transfer of possession.
 - (d) Rent roll.
 - (e) Service contracts.
 - (f) Seller financing availability.
- (14) Defects in title that may not be easily cured.
- (15) Possible deficiencies in estimate of amount of land in particular tract.
- (16) Restrictions that may affect use of land by prospective buyer, such as:
 - (a) Restrictive covenants.
 - (b) Easements.
 - (c) Zoning restrictions.
- (17) Parties excluded from broker's right to earn commission.
- (18) Broker protection periods.

B. Documents

- (1) Appraisals.
- (2) Surveys.
- (3) Title reports.
- (4) Licenses held by brokers and by salespersons, if any.
- (5) Articles of Incorporation and other relevant corporate documents of any party that is a corporation.
- (6) Partnership agreements and other relevant partnership documents of any party that is a partnership.
- (7) Notes for any debt secured by property.
- (8) Deeds of trust (mortgages).

- (9) Inspection reports (including, but not limited to, environmental surveys, engineering reports, building code inspections, lead-based paint surveys, radon surveys, etc.)
- (10) Leases and service contracts.
- (11) Insurance policies.
- (12) Deeds and any other recorded documents.
- (13) Photographs of property.
- (14) Diagrams of property and buildings.
- (15) Books, records, financial statements and balance sheets of property, if commercial property.
- (16) If property is subdivided, copies of plat maps and approvals.
- (17) Certificate of Occupancy or other municipal license.

Checklist 2 Preliminary Determinations

A. Determinations Regarding Broker

- (1) Determine whether client needs broker to accomplish desired transaction.
 - (a) Determine whether owner knows of any interested buyers/tenants.
 - (b) Determine whether owner has time, knowledge and ability to complete each step of transaction.
 - (c) Determine time within which transaction must be accomplished.
 - (d) Determine whether prospective buyers/tenants can be easily reached and method of doing so.
- (2) If broker is needed to consummate desired transaction, determine which of following brokers is best suited for owner's needs:
 - (a) Finder--leaves negotiation to parties.
 - (b) Full service--undertakes negotiations and follows through with transaction.
 - (c) Experienced specialist in particular type of property and area.
 - (d) Member of multiple listing service.
- (3) Determine whether broker or salesperson's license is active and in good standing.

B. Listing Agreement

- (1) Determine which type of listing contract owner should seek.
 - (a) Consider advantages and disadvantages of open listing agreement, including:
 - (i) Broker is not entitled to any commission unless broker is procuring cause of sale/lease.
 - (ii) It may be difficult to find broker who is willing to agree to open listing contract.
 - (b) Consider advantages and disadvantages of exclusive agency agreement, including:
 - (i) Broker is not entitled to commission if property is sold, exchanged, purchased or leased through owner's efforts.
 - (ii) Exclusive agency agreement may lead to conflict if ultimate purchaser/tenant has had contact with both broker and owner and owner arranges sale/lease.
 - (c) Consider advantages and disadvantages of exclusive-right-to-sell agreement, including:
 - (i) Widespread use of this form among brokers makes it easier to find broker willing to enter this type of contract.
 - (ii) Broker is entitled to commission if property is sold, exchanged, purchased or leased through anyone's efforts.
- (2) If broker uses standard contract form, verify that form contains following provisions:
 - (a) Asking price/rental rate of property.
 - (b) Commission amount expected on sale/lease.
 - (c) Payment terms of sale price/rental.
 - (d) Duration of listing contract.
 - (e) Provision defining how and when commission is earned.
 - (f) Description of property.
 - (g) Parties excluded from commission payment.
- (3) Verify that broker's form for exclusive agency or exclusive-right-to-sell listing contract *does not* include following terms:
 - (a) Term granting broker power to execute signed agreement of sale/lease for owner.
 - (b) Term granting broker option to purchase/lease property covered by listing contract.
 - (c) Term providing duration period that exceeds one year.

(d) Term providing automatic renewal clause.

(e) Term requiring cancellation notice to terminate contract at end of term set forth in contract.

C. Determinations Regarding Broker's Fee

(1) Ascertain whether owner desires to negotiate fee with broker before entering into contract.

(a) Advise owner that high value of readily salable/leasable property may warrant lower fee.

(b) Advise owner that unique property suited for limited number of buyers/tenants may limit broker's expense in finding purchasers/tenants.

NOTE:

If advertising the property would serve no useful purpose due to the limited number of persons who might be interested, the expense saved the broker may furnish a basis for negotiating a lower fee.

(2) Determine basis of broker's compensation, such as:

(a) Percentage of sales price/gross rental.

(b) Flat fee on readily salable/leasable property.

(c) Percentage of sales price/gross rental over specified amount.

(d) Net amount over sales price/gross rental.

(e) Payment of advertising/signage costs.

(3) Ascertain conditions that will entitle broker to commission, for example [see chs. 4 and 5]:

(a) On procuring ready, able and willing buyer/tenant.

(b) On transfer of title/execution of lease.

(4) Ascertain amount due broker on default of buyer or owner.

(5) Determine when commission is earned and payable, such as:

(a) On entering sale exchange or lease agreement.

(b) On consummation of sale/execution of lease.

(c) On procuring buyer/tenant even if no agreement for sale, exchange or lease is reached.

(6) Determine number of days from date listing agreement terminates within which broker is entitled to compensation if property is sold to, exchanged with, purchased from or leased to parties with whom broker had negotiated.

(7) If parties contemplate installment sale/seller financing, determine manner of commission payment, such as:

- (a) Full commission payable at closing.
- (b) Portion of commission payable at closing, with balance represented by promissory note.

(8) Determine whether buyer/tenant, owner or both pay commission.

D. Duties and Authority of Broker

(1) Determine whether listing agreement should require broker to pursue any specific course of action with regard to procuring buyers/tenants, such as:

- (a) Obtaining cooperation of other brokers through multiple listing services, and whether cooperating broker is to act as agent of property owner, listing broker, both or neither.
- (b) Advertising in particular newspapers on particular days of week; number of times per week.
- (c) Placing signs on property.
- (d) Holding "open house" tours.

(2) Determine days and times when agent may show property.

(3) Determine whether broker is to hold funds in escrow.

(4) Determine whether broker has responsibility to ensure compliance with federal lead-based paint disclosure requirements [see Ch. 15A *above* for discussion of lead-based paint disclosure requirements].

E. Restrictions on Use

(1) Determine whether there are restrictions on use of property that may affect sale/lease, such as:

- (a) Easements.
- (b) Restrictive covenants or equitable servitudes.
- (c) Zoning restrictions.

NOTE:

An early check of the zoning status may be valuable; for instance, the residence owner in an area where spot zoning has occurred which permits commercial establishments may have property that is more valuable for commercial purposes than residential.

- (d) Boundary disputes.
- (e) Quantity and quality of land.

NOTE:

Representations concerning the quantity or quality of land should be qualified by advising the broker to

require any prospective purchasers to make their own examination or tests if these are material elements to be considered in the sale.

- (f) Mechanics' liens that might be filed.
 - (g) Other liens on property.
 - (h) Restrictive lease provisions of other tenants.
- (2) Determine whether there are defects in title that may not be easily cured, such as:

NOTE:

The broker should be advised of existing defects that may prevent or delay the seller's ability to furnish marketable title. A seller who fails to warn of title defects may be liable to the broker for a commission if the seller cannot convey title after the broker has found a ready, willing and able buyer [see ch. 5].

- (a) Outstanding tax liens on property.
 - (b) Outstanding judgment liens on property.
- (3) Determine whether sale and broker's fee should be made conditional on clearing any possible clouds on title that might affect sale.

Checklist 3 Drafting Guide for Listing Agreement

NOTE:

The following checklist presents matters that should be considered when reviewing or drafting a listing agreement. An owner's options with respect to a listing agreement are to use the broker's form or request that his or her attorney either draft a listing agreement or modify the broker's form. Brokers typically use a form that is supplied by the broker's local or state Realtor(R)'s association.

A broker's "standard" listing agreement may not meet a client's needs. These forms often contain insufficient blank space to make significant modifications. Should the broker's listing agreement need material modification, one solution is to modify the form through riders. If an attorney opts for using the broker's form with riders, the attorney must ensure that the rider does not conflict with the form and that if there is a conflict that the rider will control. However, modifying the broker's form through riders can become confusing if there will be numerous changes. In this case, it may be best for the attorney to draft a complete listing agreement that addresses the owner's needs.

In reviewing, modifying, or drafting a listing agreement, an attorney should consider the following:

- (1) **Put it in writing.** Listing agreements should be in writing. Even if an oral listing agreement is valid, a well-drafted agreement can minimize or avoid disputes.
- (2) **Comply with applicable statutes and regulations.** Review applicable statutes and regulations to determine specific requirements for listing agreements. For example a listing agreement may by statute or regulation be required to contain disclosures regarding brokerage relationships.

- (3) **Review the listing form used by the broker.** If there is a standard listing agreement form used by a local Realtors(R) association, consider following its provisions where possible as this is the form that is generally interpreted by courts.
- (4) **Identify the broker.** State the name and address of the broker.
- (5) **Identify the owner.** The owner's complete name should be spelled correctly. If an individual is conveying the property, the owner's marital status should be stated. If a business entity is conveying the property, the authority for the conveyance should be included..
- (6) **Avoid confusing terms.** If the owner is using the broker to obtain a tenant, do not use the terms "lessor" and "lessee" as these words are easily reversed. Use "landlord" and "tenant" instead. Other terms that are too similar and may cause confusion should also be avoided.
- (7) **Write numbers as words and numerals.** Write numbers as both words and numerals (e.g., five (5)). This will reduce the chance for errors.
- (8) **Date the listing agreement.** The listing should be dated (usually the date on which the agreement is executed). Including a blank for the date in the first paragraph makes it easy to find the date.
- (9) **Identify the type of agency.** The document should specify what type of listing is being entered into by the parties (e.g., exclusive right to sell, exclusive agency, or open).
- (10) **State an expiration date.** A definite expiration date for the listing should be included. While the time period of the listing should be stated, it is better to state a definite expiration date rather than risk an argument over when the agreement expired.
- (11) **Address cancellation of the agreement.** A provision should address possible cancellation of the listing. The provision should state under what conditions the owner may cancel the listing and the consequences.
- (12) **Identify the real property.** A correct legal description including both a street address and survey reference, if available should be used in the listing.
- (13) **Preserve confidentiality.** To the extent allowed by the applicable brokerage law, the owner will want the broker to preserve the confidentiality of the owner's private information.
- (14) **Address personal property.** If the conveyance will include personal property, list each item. Depending on the facts and circumstances, it may be prudent to state that certain personal property will not be conveyed.
- (15) **State the purpose.** The listing should state whether the broker is seeking a buyer or a tenant for the property.
- (16) **State the sales price or rent.** The desired price or rental amount the owner seeks should be stated. It is in the owner's interest to make this amount and the payment terms optimal. If the amount is below the fair market value, the owner may have to pay the commission if the broker brings an offer for the listed amount when that offer is rejected by the owner.
- (17) **Specify financing terms.** Financing terms should be stated including any financing or assistance

that the seller is willing to provide (e.g., cash only, cash with seller financing amount and terms, payment of some or all closing costs, provisions for VA or FHA financing, assumption of an existing mortgage).

(18) **State the broker's commission.** The broker's commission should be stated. Commissions are usually stated as a percentage of the selling price or rent amount. If an exclusive right to sell (or lease) listing is involved, the document should include a statement on its face in bold type that the broker earns a commission on a sale (or lease) when the property is sold (or leased) regardless of who procures the buyer (or tenant)

(19) **State when the commission is earned.** The agreement should identify when the commission is earned. With a sale, from an owner's perspective the commission should be contingent on title closing. With a rental, from an owner's perspective, the commission should be contingent upon the tenant's payment of rent.

(20) **Allocate risks.** The parties should provide for contingencies that might cause a deal to fall through and allocate the risks. In a sale, if the commission is contingent on title passing, the risk is on the broker if the buyer cannot obtain financing or breaches the agreement before closing. In a rental, if the tenant cannot pay rent the broker will not be entitled to a commission. The listing agreement should also allocate the risk if the owner cannot convey marketable title.

(21) **State the broker's duties.** Broker supplied listing agreements usually do not detail the efforts the broker must take in marketing the property. The broker's duties can be stated in greater detail so that if the owner becomes dissatisfied with the broker's efforts, the owner will have an objective basis for terminating the listing agreement.

(22) **State the owner's duties.** The agreement should state the owner's duties such as allowing the property to be shown, allowing the broker to post signs, and requiring that the owner refer inquiries to the broker.

(23) **Provide for subagency.** A provision should be included to address subagency or cooperating with other brokers.

(24) **Address use of a lockbox.** A provision should address whether a lockbox will be used. Risks associated with a lockbox should be allocated.

(25) **Retaining an earnest money deposit.** A provision should address the retention of an earnest money deposit by the broker and the terms and conditions of disposition of the deposit should the buyer default.

(26) **Include an integration clause.** An integration clause can avoid disputes where one party alleges that verbal agreements are also part of the parties' agreement.

(27) **Preclude illegal discrimination.** A provision can state that the broker will not engage in any unlawful discrimination in marketing and showing the property.

(28) **Consider a clause for attorney's fees and costs.** A provision may address attorney's fees and court costs.

(29) **Consider the use of alternative dispute resolution.** The parties may opt to resolve disputes through alternative dispute resolution rather than litigation.

(30) **Consider including an extension clause.** The agreement can contain an extension clause to extend the owner's liability for a commission for a stated period of time beyond expiration of the listing period should the owner convey the property to a buyer (or tenant) identified by the broker. If the agreement contains an extension clause, the agreement also should require that the broker within a short period after expiration of the listing agreement, deliver to the seller a listing of all parties to whom the property has been shown by the broker.

(31) **Avoid automatic renewals.** Some listing agreements include a stated term, but also provide that the agreement remains in force past the stated term until the owner gives the broker written notice of termination. This clause is often not to the owner's benefit as the owner may mistakenly assume that the agreement has expired. This type of renewal provision is invalid in some jurisdictions.

(32) **Allow for renewal.** The parties can provide for a voluntary and intentional renewal of the listing agreement.

(33) **Address a potential broker's lien.** If the jurisdiction statutorily allows a broker's lien, the listing agreement should address this possibility. Often this type of statutory lien is confined to non-residential transactions.

(34) **Properly incorporate riders.** If a rider is used to modify the broker's listing agreement, the rider should be attached as an exhibit and incorporated into the printed form through appropriate language (e.g., "Attached to this agreement and marked exhibit _____ is a rider consisting of _____ pages each of which has been _____ [signed or initialed] by the parties; the exhibit, by this reference, is incorporated in this agreement as though set forth in full.").

(35) **Avoid inconsistencies.** When modifying a broker's listing agreement, line out inconsistent portions of the printed form. State in the rider and also on the printed form that provisions of the rider supersede any inconsistent provisions appearing in printed form.

(36) **Initial alterations.** All parties should initial all deletions or alterations that appear on the printed form.

(37) **Obtain signatures.** The broker and all parties (including spouses) having an interest in the property should sign the listing agreement.

(38) **Include contact information.** In addition to having all parties sign, telephone numbers, fax numbers, e-mail addresses, and addresses should be included.

Checklist 4 Drafting Guide for Listing Agreement

NOTE:

Many of the items in the checklist above also apply to a buyer broker agreement

(1) **Put it in writing.** Buyer broker agreements should always be in writing. Never advise a client to enter into an oral buyer broker agreement.

(2) **Comply with applicable statutes and regulations.** Review applicable statutes and regulations to determine specific requirements for buyer broker agreements.

- (3) **Review the agreement typically used by the broker.** If there is a standard buyer broker agreement form used by a local Realtors(R) Association, follow its provisions as closely as possible as this is the form that is generally interpreted by courts. The buyer broker agreements' terms should comport as closely as possible to eliminate any confusion.
- (4) **Identify the buyer.** The buyer's complete name should be spelled correctly. If an individual is purchasing the property, the buyer's marital status should be included. If a business entity is purchasing the property, the authority for the conveyance should be included.
- (5) **Identify the type of agency.** The document should disclose what type of buyer agency is being entered into by the parties (i.e., exclusive buyer agency, disclosed dual agency, designated agency).
- (6) **State an expiration date.** State a definite expiration date. Though the time period of the agreement should be stated, it is preferable to state a definite expiration date rather than risk an argument over when the agreement has expired.
- (7) **Address the broker's commission.** The agreement should clearly address who pays the commission due a buyer's broker and when the commission is earned. In a residential agreement, the home buyers almost always are planning on the seller paying the commission of the buyer's broker. Identifying the source of the broker's compensation is crucial.
- (8) **Describe the desired property.** The agreement should describe the property the buyers are seeking to purchase. The geographical search area should also be stated.
- (9) **State the buyer's price range.** The agreement should state the price range of the property being sought by the buyer.
- (10) **State the buyer's duties.** The buyer's duties may include an agreement to work exclusively with the broker during the term of the agreement and to provide the broker with necessary financial information to establish the buyer's ability to purchase property. The buyer should agree to contact the broker if the buyer independently learns of a property the buyer may have an interest in.
- (11) **State the broker's duties.** A buyer should expect loyalty and confidentiality from a buyer's broker. The broker may agree to provide the buyer with available MLS information and to the extent allowed, identify properties that the broker knows to be coming on the market, in advance of this information being made available to the general public. The broker should be expected to negotiate the best deal for the buyer.
- (12) **Address cancellation.** The agreement should address when and under what circumstances the buyer or the broker can cancel the agreement and the consequences.
- (13) **Write numbers as words and numerals.** Write numbers as both words and numerals (e.g., five (5)). This will reduce the chance for errors.
- (14) **Date the agreement.** The buyers broker agreement should be dated (usually the date on which the agreement is executed). Including a blank for the date in the first paragraph makes it easy to find the date.
- (15) **Preserve confidentiality.** To the extent allowed by the applicable brokerage law, the buyer will want the broker to preserve and maintain the buyer's private information.

(16) **Consider an extension clause.** The agreement may provide that the broker is due a commission if the buyer subsequently purchases property which was located by the broker while the agreement was in effect.

(17) **Properly incorporate riders.** If a rider is used to modify the broker's agreement, the rider should be attached as an exhibit and incorporated into the printed form through appropriate language (e.g., "Attached to this agreement and marked exhibit _____ is a rider consisting of _____ pages each of which has been _____ [signed or initialed] by the parties; the exhibit, by this reference, is incorporated in this agreement as though set forth in full.").

(18) **Avoid inconsistencies.** When modifying a broker's agreement, line out inconsistent portions of the printed form. State in the rider and also on the printed form that provisions of the rider supersede any inconsistent provisions appearing in printed form.

(19) **Initial alterations.** All parties should initial all deletions or alterations that appear on the printed form.

(20) **Include an integration clause.** An integration clause can avoid disputes where one party alleges that verbal agreements are also part of the parties' agreement.

(21) **Preclude illegal discrimination.** A provision can state that the broker will not engage in any unlawful discrimination in locating a suitable property for the buyers.

(22) **Consider a clause for attorney's fees and costs.** A provision may address attorney's fees and court costs.

(23) **Consider the use of alternative dispute resolution.** The parties may opt to resolve disputes through alternative dispute resolution rather than litigation.

(24) **Obtain signatures.** The broker and buyer should sign the agreement.

(25) **Include contact information.** In addition to having all parties sign, telephone numbers, fax numbers, e-mail addresses, and addresses should be included.

Checklist 5 Related and Subsequent Procedures

A. Completion of Transaction

(1) Draft one of following agreements and have it executed:

(a) Purchase agreement.

(b) Exchange agreement.

(c) Lease.

(2) Draft or, if preprinted forms are used, review financing and security instruments

(3) Arrange escrow and title insurance.

(4) Prepare deeds and related transfer documents.

B. Handling Client's Complaint Against Broker

(1) If owner is dissatisfied with broker's services, determine whether broker has engaged in any of following acts or conduct:

- (a) Misrepresentation.
- (b) Fraud.
- (c) Incompetency, bad faith or dishonesty.
- (d) Failure to comply with escrow requirements.
- (e) Failure to furnish certain documents.

NOTE:

Discriminatory conduct may also violate the federal Fair Housing Act of 1968 [42 U.S.C. §§ 3601-3631].

(2) If broker has engaged in conduct listed in (1), *above*, file complaint with State Real Estate Commission and local real estate association to which broker belongs, if any.

(3) Consider filing lawsuit against broker.

* Checklists 1, 2, and 5 were adapted for this treatise from Boyer, Florida Real Estate Transactions (Matthew Bender) by Gregory P. Melnyk, Esq. of Cichocki & Armstrong, Ltd., Chicago, Illinois. Checklists 3 and 4 were adapted from former Section 2A.05 of this treatise by Sandra R. Bullington, Esq.



98 of 108 DOCUMENTS

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PART V Other Issues Affecting Brokers

APPENDIX A: Bibliography

10A-A Real Estate Brokerage Law and Practice APPENDIX A:.syn

§ A.syn Synopsis to Appendix A: Bibliography

- [1] General
- [2] Broker Licensing
- [3] Listing and Listing Agreements
- [4] Antitrust and Unfair Practices
- [5] Discrimination
- [6] Fees and Commissions
- [7] Broker's Liability
- [8] Unauthorized Practice of Law
- [9] Fiduciary Duties
- [10] Mortgage Issues and Mortgage Brokers



99 of 108 DOCUMENTS

Real Estate Brokerage Law and Practice

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100 of 108 DOCUMENTS

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101 of 108 DOCUMENTS

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APPENDIX A: Bibliography

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102 of 108 DOCUMENTS

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103 of 108 DOCUMENTS

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106 of 108 DOCUMENTS

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107 of 108 DOCUMENTS

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108 of 108 DOCUMENTS

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