



Ethics: Video™

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Personal
Motivations

Duty to Client

Professional Relationships Compromised

Conflict of interest

A **conflict of interest** arises when a broker or their agent, acting on behalf of a client, has a competing professional or personal bias which hinders their ability to fulfill the fiduciary duties they have undertaken on behalf of their client.

conflict of interest

When a broker or agent has a positive or negative bias toward a party in a transaction which is incompatible with the duties owed to their client.

In a professional relationship, a broker's financial objective of compensation for *services rendered* is not a conflict of interest.

However, fees and benefits derived from conflicting sources need to be **disclosed** to the client. This includes compensation in the form of:

- professional courtesies;
- familial favors; and
- preferential treatment by others toward the broker or their agents. [See **RPI Form 119**]

Similarly, the referral of a client to a financially controlled business, owned or co-owned by the broker needs to be disclosed by use of an **affiliated business arrangement (ABA)** disclosure. [See **RPI Form 519**]

affiliated business arrangement

A business arrangement in which a broker may lawfully profit from referring a client to a service provider the broker owns. Here, the broker is required to make a disclosure of their ownership interest to the client.

A conflict of interest addresses the broker's personal relationships potentially at odds with the agency duty of care and protection owed the client.

Thus, a conflict of interest creates a fundamental **agency dilemma** for brokers; it is not a compensation or business referral issue.

Unless disclosed and the client consents, the conflict is a breach of the broker's fiduciary duty of good faith, fair dealing, and trust owed to the client when the broker continue to act on the client's behalf.



1. A(n) _____ occurs when a broker or agent has a positive or negative bias toward a party in a transaction which is incompatible with the duties owed to their client.
 - a. fiduciary breach
 - b. unlawful detainer
 - c. conflict of interest
2. A conflict of interest creates a fundamental _____ for brokers.
 - a. existential crisis
 - b. agency dilemma
 - c. moral hazard



Situations Involving a Conflict of Interest

To disclose or not to disclose?

A **conflict of interest**, whether patent or potential, is disclosed by the broker at the time it occurs or as soon as possible after the conflict arises. Typically, the conflict arises prior to providing a buyer with property information or taking a listing from a seller.

The disclosure creates transparency in the transaction. It reveals to the client the bias held by the broker which, when disclosed, allows the client to take the bias into consideration in negotiations. The disclosure and consent does not neutralize the inherent bias itself. However, it does neutralize the *element of deceit* which would breach the broker's fiduciary duty if left undisclosed.

Potential overlaps of allegiance or prejudice which cause a conflict that a broker or their agent need to disclose include:

- the broker or their agent holds a direct or indirect *ownership interest* in the real estate, including a partial ownership interest in a limited liability company (LLC) or other entity which owns or is buying, leasing, or lending on the property;
- an individual related to the broker or one of their agents by *blood or marriage* holds a direct or indirect ownership interest in the property or is the buyer;
- an individual with whom the broker or a family member has a *special pre-*

existing relationship, such as prior employment, significant past or present business dealings, or deep-rooted social ties, holds a direct or indirect ownership, leasehold, or security interest in the property or is the buyer;

- the broker's or their agent's concurrent representation of the opposing party, a *dual agency situation*; or
- an *unwillingness* of the broker or their agent to work with the opposing party, or others, or their brokers or agents in a transaction.

Simply, a **conflict of interest** arises and is disclosed to the client when the broker:

- has a *pre-existing relationship* with another person due to kinship, employment, partnership, common membership, religious affiliation, civic ties, or any other socio-economic context; and
- that relationship might hinder their *ability to fully represent* the needs of their client.

Unfortunately, comprehensive rules do not yet exist which establish those instances where a conflict of interest arises and needs to be disclosed. [See **RPI** Form 527]

Thus, brokers are left to draw their own conclusions when situations regarding a property or a transaction with or involving third-parties arise. In practice, brokers, and especially agents, all too often err on the side of nondisclosure, putting their brokerage fee, if not their license itself, at risk. [Calif. Business and Professions Code §10177(o)]

Generally, if a broker even questions whether it is appropriate to disclose a potential conflict of interest to a client, they should disclose it. The existence of any concern is reason enough for a prudent broker to be prompt in seeking their client's consent to the potential conflict. By timely disclosing a conflict of interest and obtaining consent, the broker immediately creates an honest working relationship with their client.

Fundamentally, a broker who becomes aware they have a conflict of interest, but is reluctant to disclose it and seek the client's consent, is advised to consider rejecting or terminating the employment with that individual.



1. Timely disclosure of a conflict of interest:
 - a. neutralizes the inherent bias itself.
 - b. neutralizes the element of deceit which would breach the broker's fiduciary duty if left undisclosed.
 - c. invalidates the purchase, sale or lease.

2. Pre-existing relationships which may present a conflict of interest include:
 - a. kinship, employment or partnership.
 - b. common membership, religious affiliation or civic ties.
 - c. Both a. and b.

The image shows two men in dark suits and light shirts standing in a well-lit room with wooden floors and a chandelier. They are both holding and looking at large sheets of paper, likely real estate contracts. In the center of the image, there is a white rectangular box with a blue border containing the text 'Obtain Client's Consent' in a bold, blue, sans-serif font.

Obtain Client's Consent

Relative's Participation in a Transaction

A relative owns the property sold

A seller's broker needs to disclose their acquisition of any direct or indirect interest in the seller's property. Likewise, the broker also needs to disclose whether a family member, a business owned by the broker, or any other person holding a special relationship with the broker will acquire an interest in the seller's property. [See **RPI Form 527**]

For example, consider a broker's brother-in-law who makes an offer to buy property the broker listed. The purchase agreement states the broker is to receive a fee and that they represent the seller exclusively.

The broker does not disclose to the seller that the buyer is their brother-in-law.

The broker opens two escrows to handle the transaction. The first escrow facilitates the sale and transfers the property from the seller to the broker's brother-in-law.

The second escrow is for the sole purpose of transferring title to the property from the brother-in-law to a limited liability company (LLC) in which the broker holds an ownership interest. Both escrows close and the broker receives their fee.

The seller discovers the buyer was their broker's brother-in-law and the true buyer was an entity partially owned by the broker. The seller demands a return of the brokerage fee, claiming the broker had a conflict of interest which breached the fiduciary duty they owed to the seller since it was not disclosed and the seller did not consent.

In this instance, the broker is not entitled to retain the brokerage fee they received from the seller. Further, the seller is entitled to recover any property value at the time of the sale in excess of the price they received. Alternatively, the seller may set the sale aside due to the failure of the broker's agency with the seller and the conflict of interest with the buyer.

A broker cannot act for more than one party in a transaction, including themselves, without disclosing their **dual agency** and obtaining the **client's consent** at the time the conflict arises. [Bus & P C §10176(d); see **RPI Form 117**]

dual agency

The agency relationship that results when a broker represents both the buyer and the seller in a real estate transaction.

Also, a seller's broker has an affirmative duty to disclose to the seller their agency or other conflicting relationship they might have with the buyer. The duty to disclose exists even if the seller fails to inquire into whether the broker has a relationship with the buyer.

Further, failure to disclose a broker's personal interest as a buyer in a transaction when they are also *acting as a broker* on behalf of the seller constitutes grounds for discipline by the Real Estate Commissioner. [**Whitehead v. Gordon** (1970) 2 CA3d 659]

Disclosure of a direct or indirect interest

A buyer's broker needs to disclose to the buyer the nature and extent of any direct or indirect interest the broker or the broker's agents hold in any property presented to the buyer.

For example, a buyer's broker shows the buyer several properties, one of which is owned by the broker and others, vested in the name of an LLC. The broker does not inform the buyer of their indirect ownership interest in the property.

The buyer later decides to purchase the property owned by the LLC. An offer is prepared on a purchase agreement with an agency confirmation provision stating the broker is the agent for both the buyer and seller. The offer is submitted to the LLC. [See **RPI Form 159**]

The broker, aware the buyer will pay a higher price for the property than the initial price offered by the buyer, presents the buyer with a

counteroffer from the LLC at a higher selling price. The buyer accepts the counteroffer.

Here, the broker has a duty to promptly disclose their ownership interest in the property to the buyer the moment the conflict arises. The conflict of interest in the broker's ownership is a **material fact** requiring disclosure since the buyer's decisions concerning acquisition of the property might be affected.

As a result of the nondisclosure, the buyer can recover the fee received by the broker and the increase in price under the counteroffer.

Had the buyer known the broker held an ownership interest in the property when it was first presented, the buyer might have negotiated differently when setting the price and terms for payment. Alternatively, the buyer may have retained a different broker who was not compromised by a conflict of interest.



1. An agent or broker representing a seller needs to disclose whether a family member or a(n) _____ will acquire an interest in the seller's property.
 - a. a business owned by the broker
 - b. any person holding a special relationship with the broker
 - c. Both a. and b.

2. Failure to disclose a broker's personal interest as a buyer in a transaction when they are also acting as a broker on behalf of the seller:
 - a. is acceptable so long as the broker timely discloses the conflict of interest after the close of escrow.
 - b. constitutes grounds for discipline by the Department of Real Estate (DRE).
 - c. is an example of implicit bias.



Conflicts of Interest when Acting as a Principal

Taking a fee when acting as a principal

A broker acting solely as a **principal** in the sale of their own property is not restricted in their conduct by compliance with agency obligations. The broker selling or buying property for their own account acts solely as the *seller* or *buyer*. The licensee has no conflict due to the existence of their license since they are not holding themselves out as a broker or agent acting on behalf of another person in the transaction. [**Robinson v. Murphy** (1979) 96 CA3d 763]

However, when a *broker-seller* receives a brokerage fee on the sale of their own property, or on the purchase of their own property, the broker subjects themselves to real estate agency requirements.

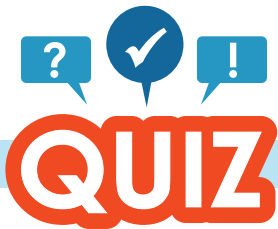
For example, a broker sells their residence. The residence is in violation of safety requirements for occupancy due to known defects in the foundation. The broker does not tell the buyer about the foundation defects.

Out of the proceeds the broker receives on closing the sale of the property, the broker-seller pays themselves a brokerage fee, claiming to *exclusively represent themselves* (which is not an agency and does not require a license).

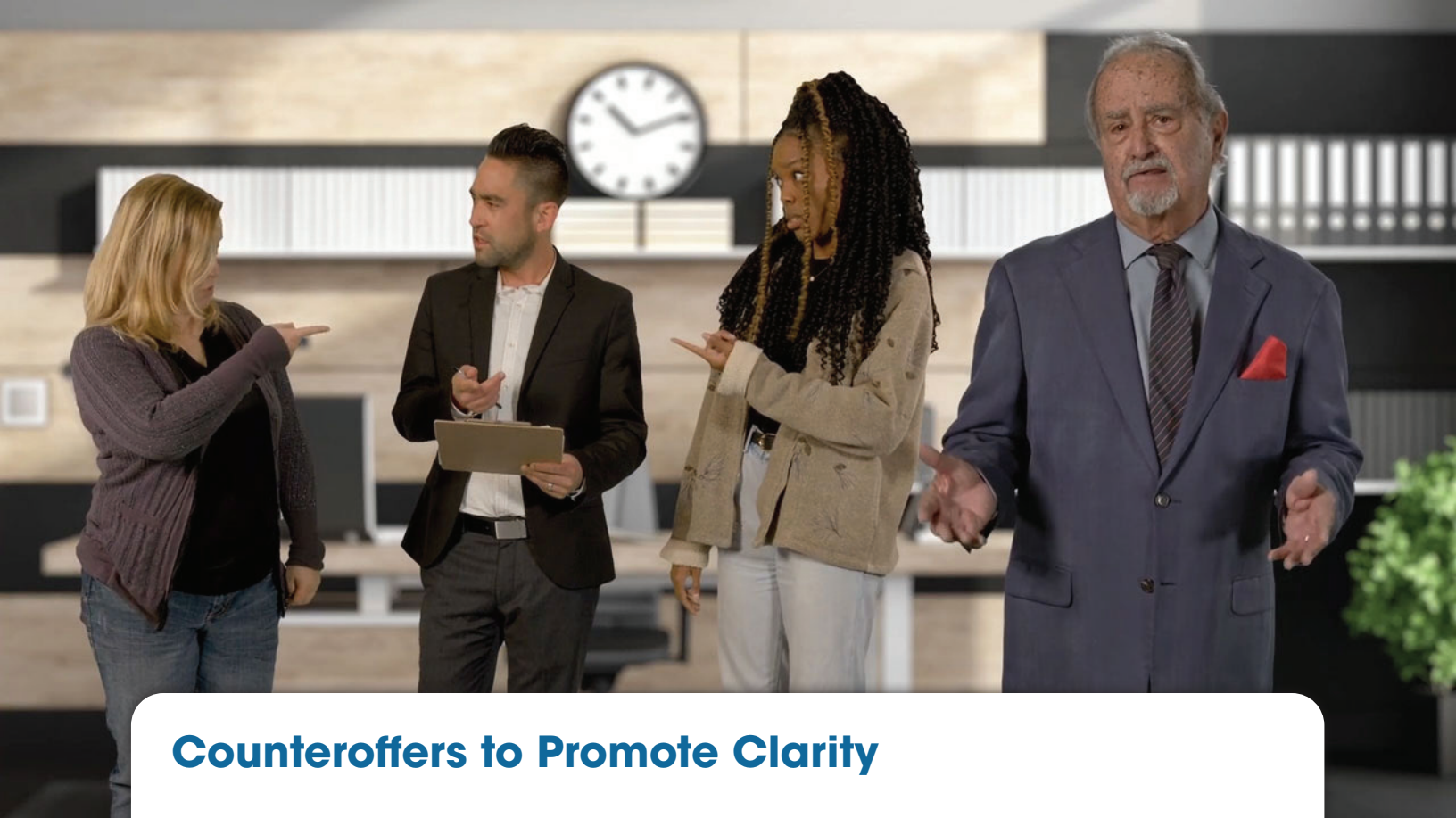
The buyer later discovers they have to demolish the residence and rebuild it with an adequate foundation. The buyer obtains a money judgment against the broker for breach of their general agency duty owed to all parties in a real estate transaction to disclose known property defects.

The broker is unable to pay the money judgment. The buyer seeks payment from the **Real Estate Recovery Account**.

Recovery is received from the *Real Estate Recovery Account* since the broker held themselves out as *acting as a real estate broker* in the transaction by receiving a fee. The broker's license is then suspended. Before the broker can reactivate their license, they need to reimburse the Recovery Account. [**Prichard v. Reitz** (1986) 178 CA3d 465]



1. When a broker sells their own property and receives a brokerage fee on the sale, the broker:
 - a. is acting solely as a principal.
 - b. immediately subjects themselves to real estate agency requirements.
 - c. Neither a. nor b.



Counteroffers to Promote Clarity

Defacing a previously signed document

A broker or agent may not alter a document once it is signed without that party's prior consent.

Consider a broker who submits an offer to the seller which has been signed by a buyer. The seller is unwilling to accept all the terms contained in the offer. However, the seller will agree to sell if the buyer concedes to a larger down payment, a greater interest rate on the carryback note and a shorter escrow period.

The buyer's broker strikes out the down payment amount, the interest rate and the escrow period entries on the purchase agreement form signed by the buyer. The seller's changes are then entered by *interlineation* to replace the original entries. This activity is called **defacing**.

defacing

When a document is modified on its face, usually by striking copy and interlineation, after it is signed by one or both parties.

The seller signs the form where it provides for the seller's signature, and initials and dates all the changes, an improper technique referred to as *change and initial*.

The original offer as altered on its face is then presented to the buyer for their approval. The buyer is to indicate approval by also initialing and dating the changes to form a binding agreement.

Counteroffers: prepared for clarity

This altering of a signed document is *improper practice*. The broker needs to prepare, and have the seller sign, a separate **counteroffer** form containing the changes. The *counteroffer* is then presented to the buyer for consideration and acceptance. [See **RPI** Form 180]

counteroffer

An alternative response to an offer received consisting of terms different from those of the offer rejected.

Here, “acceptance” by the seller of the buyer’s offer by signing and altering a purchase agreement offer submitted by a buyer was not an acceptance at all. The alterations written on the buyer’s offer constituted a *rejection* of the buyer’s offer.

Any counteroffer arrangement constitutes a *new offer*. Good brokerage practice requires a new offer be presented on a separate form. By using a separate counteroffer form, the broker promotes clarity for interpreting just what has been agreed upon in the event of a dispute. More importantly, *defacing* of a signed document is avoided. [See **RPI** Form 180]

The change-and-initial method of preparing a counteroffer often creates uncertainty as to when and who placed which terms in the agreement. Further, the agreement is interpreted against the individual creating the uncertainty, typically the seller who countered by defacing and initialing a signed original document. [Calif. Civil Code §1654]

A counteroffer may be made when the original offer submitted is not acceptable and is either:

- rejected; or
- allowed to expire unaccepted.

A *rejection* can occur by a written rejection stating no counteroffer is forthcoming. It may also be rejected by submitting a *counteroffer* which is an alternative set of terms to the original offer. After a rejection has been communicated, the original offer can no longer be accepted to form a binding agreement. [See **RPI** Form 184]

The rejection on receipt of a purchase agreement offer by preparing and submitting a counteroffer takes place in one of two circumstances:

- by incorporating the terms in the offer into a new offer which is then modified with alternative or additional provisions on the counteroffer form; or

- by preparing an entirely *new offer* on a newly prepared purchase agreement form which is submitted as a counteroffer. [See **RPI** Form 150]

Analyzing the counteroffer form

The counteroffer form has four sections, each with a separate purpose explained as follows:

- *Reference to prior offer*: The purpose of a counteroffer is to reference a prior written offer and state the terms and conditions contrary or in addition to those in the original offer which are agreeable to the party countering.
- *The agreement offered*: The offer submitted and rejected by a counteroffer has all its terms and conditions “incorporated” into the counteroffer. Terms which are additional to or in conflict with those of the prior offer are then entered on the counteroffer to create the terms and conditions of the new offer. Any terms in conflict with the terms of the original offer override and become the terms of the counteroffer.
- *Time for acceptance*: The counteroffer expires at the time and on the date stated for expiration. When no specific date is given, a reasonable time to accept is permitted, unless the counteroffer is first withdrawn.
- *Signatures*: The transaction participant making the counteroffer signs and dates the offer. The brokers sign the counteroffer only to acknowledge their participation in the negotiations. [See **RPI** Form 180]

The rules for preparing and submitting a counteroffer, and those for accepting a counteroffer to buy and sell real estate, are the same rules applied to determine whether an offer made by a seller has been submitted to the buyer or an acceptance by the buyer has occurred to form a *binding agreement*.

Real estate agents instinctively consider submitting written offers from a buyer to a seller to comply with the rule requiring a written agreement, signed by the buyer and seller to form a real estate agreement. Likewise, they need to **automatically submit** written counteroffers from sellers to buyers when the seller will not accept all aspects of the buyer’s offer. [See **RPI** Form 180]



QUIZ

1. _____ occurs when a document is modified by striking copy or interlineation after it is signed by one or both parties.
 - a. Defacing
 - b. Defilement
 - c. Constructive fraud

2. An alternative response to an offer received consisting of terms different from those of the offer rejected is referred to as a(n):
 - a. ultimatum.
 - b. counteroffer.
 - c. dual offer.

Timely Disclose



Property Related Disclosures

General duty to voluntarily disclose

A broker and their sales agents are to disclose the *physical nature and condition* of a property when first providing property information to individuals interested in making an offer to purchase. Thus, brokers and agents have a duty to **timely disclose** to all parties involved in a real estate transaction any significant physical aspects of a property that may affect the property's market value or the buyer's decision to purchase.

A broker has a **general duty** to all parties in any type of sales transaction to disclose to buyers at the earliest possible moment their awareness of any property defects. The duty to disclose known conditions on one-to-four unit residential property requires the seller's broker to provide prospective buyers or their agents with the seller's **Transfer Disclosure Statement (TDS)**. [See **RPI Form 304**]

general duty

The duty a licensee owes to non-client individuals to act honestly and in good faith with up-front disclosures of known conditions which adversely affect a property's value.

To be effective, property disclosures including the *TDS* are to be provided to the buyer as soon as practicable – meaning as soon as possible – upon the commencement of negotiations and prior to making an offer. [Calif. Civil Code §§1102 et seq.]

When the disclosures are not timely made, the buyer may:

- *cancel* the offer on discovery of the broker's failure to disclose known defects prior to the buyer entering into a purchase agreement with the seller; or
- close escrow on the purchase and seek *recovery* of the costs to cure the untimely disclosure of known defects.

Any attempt to have the buyer of a one-to-four unit residential property waive their right to the mandated property disclosure statement (TDS) is unenforceable. [CC §1102]

Special fiduciary agency duty

A seller's broker and their agents have a special **fiduciary duty**, owed solely to a seller who has employed the broker, to diligently market the listed property for sale. The objective of this employment is to locate a prospective buyer who is ready, willing and able to acquire the property on the listed terms.

fiduciary duty

The duty owed by an agent to act in the highest good faith toward the principal and not to obtain any advantage over their principal by the slightest misrepresentation, concealment, duress or undue influence.

On locating a prospective buyer, either directly or through a buyer's agent, the seller's agent owes the prospective buyer, and thus also the buyer's agent, a limited, non-client *general duty* to voluntarily provide critical factual information on the listed property, collectively called disclosures of **material facts**.

material fact

Information about a listed property which may affect the property's value or alter a client's decision to purchase or sell the property. Thus, all material facts need to be timely disclosed.

What is limited about the duty is not the extent or detail to which the seller's agent may go to provide information, but the **minimal quantity of fundamental information** and data about the listed property which the seller's agent will hand to the prospective buyer or the buyer's agent before the seller enters into a purchase agreement.

The information disclosed by the seller's agent need only be sufficient enough in its content to place the buyer on *notice of facts* which may have an adverse effect on the property's value or interfere with the buyer's intended use.

Transparency as public policy objective

In California's public policy pursuit of transparency in property information between sellers and buyers, the disclosure obligations of the seller's agent to voluntarily inform prospective buyers about the fundamentals of the listed property act to eliminate asymmetry and power relationships in sales transactions.

The seller's agent may not:

- deliver up less than the minimum level of information to put the buyer on notice of the property's fundamentals affecting value;
- give unfounded opinions or deceptive responses in response to inquiries; or
- stifle inquiries about the property in a vigorous pursuit of the best financial advantage possible for the seller (or the seller's broker).



1. When property disclosures are not timely made, the buyer may:
 - a. cancel the offer on discovery of the broker's failure to disclose known defects prior to the buyer entering into a purchase agreement with the seller.
 - b. bclose escrow on the purchase and seek recovery of the costs to cure the untimely disclosure of known defects.
 - c. Either a. or b.
2. Information about a listed property which may affect the property's value or alter a client's decision to purchase or sell the property are classified as:
 - a. material facts.
 - b. cosmetic factors.
 - c. opinions.



The Broker's Unlawful "As-Is" Sale

All property conditions disclosed – always

Consider a seller's agent who is aware the seller's residence fails to conform to building regulations. The defect, if known to a buyer, would likely affect the price they are willing to pay. The defect is a material fact.

The broker knows the buyer who is interested in making an offer is not aware of the violations and might reconsider the price they are willing to pay for the property if they learn of the violations. The broker decides not to disclose their knowledge of the defect.

In an attempt to cover the omission, the broker writes an **"as-is" clause** into the purchase agreement. The "as-is" disclaimer states the buyer accepts the property in its current "as-is" condition.

"as-is" clause

An unenforceable provision stating the buyer accepts the property without a full disclosure of known conditions. Properties are sold "as-disclosed," never "as-is."

After the buyer acquires the property, the city refuses to provide utility services to the residence due to the building violations.

The buyer demands their money losses from the broker, claiming the broker breached their general agency duty to disclose conditions of the property known

to the broker before the buyer agreed to purchase.

The broker claims the buyer waived their right to collect money damages when they signed the purchase agreement with the “as-is” disclaimer.

Does an “as-is” disclaimer shield the broker from liability for the buyer’s losses caused by the building violations?

No! The seller’s broker has a *general duty* owed to all parties to a transaction. The general duty requires the seller’s broker to disclose all property conditions known, or ought to have been known, to the seller’s broker due to their mandated inspection that affect the value and marketability of the property. The duty is not excused by writing an “as-is” disclaimer into the purchase agreement in lieu of making the factual disclosures before an agreement is entered into with the seller. **[Katz v. Department of Real Estate (1979) 96 CA3d 895]**

A broker and their agents need to advise a prospective buyer or tenant of any known *material facts that may affect the value or desirability of the purchased or rented property.*

Four categories of conditions contribute to or detract from the value of property:

- *physical condition of soil and improvements;*
- *land use and title conditions;*
- *operating income and expenses; and*
- *location hazards and surrounding area impact.*

Marketability disclosure

Consider a buyer who seeks property for investment purposes. The broker recommends an apartment complex as the source of spendable income and equity buildup for the buyer.

The broker analyzes the suitability of an income property which is for sale by preparing an **Annual Property Operating Data Sheet (APOD)** and reviewing it with the buyer. [See **RPI Form 352**]

However, the property’s scheduled rental income is represented to be far greater than the actual income. Additionally, the broker represents the property is in excellent physical condition. However, the property requires extensive renovation due to deferred maintenance.

The broker makes these representations based on information received from the seller. The broker does not investigate maintenance, expense, and income records of the property to check the accuracy of the seller's representations. Further, the broker does not advise the buyer the seller is the source of the property information.

At the urging of the seller, the buyer is dissuaded from inspecting the property by the broker.

Relying solely on the broker's representations as to the operating income and condition of the property, the buyer purchases the property.


After closing, the buyer realizes the operating income is far less than the scheduled income stated on the property operating statement. The buyer discovers tenants are delinquent in the payment of rent and incurs extensive deferred maintenance expenses. These conditions collectively reduce the projected net spendable income, and in turn the property's *market value*.

Eventually, the buyer defaults and loses the property in foreclosure.

A broker marketing property as an income-producing investment owes a duty to a buyer to research and disclose whether the property produces *adequate income* to meet expenses.

Alternatively, the broker may include a contingency provision in the purchase agreement calling for the buyer to confirm the representations or cancel the agreement prior to closing.

Brokers cannot merely pass on statements made by the seller as to the property's condition and income and expenses generated by the property without first reviewing them for apparent inaccuracies. When property information is passed on to others, the broker needs to advise them about the source of the information and any known need for further investigation into their accuracy. Thus, the broker is liable to the buyer for the buyer's lost property value. [**Ford v. Cournale** (1973) 36 CA3d 172]



QUIZ

1. A provision which states the buyer accepts the property without a full disclosure of known conditions is known as a(n):
 - a. as-is clause.
 - b. liar clause.
 - c. conflict of interest disclosure.
2. The seller's agent's general duty to the buyer _____ by writing an "as-is" disclaimer into the purchase agreement in lieu of making the factual disclosures before an agreement is entered into.
 - a. is excused
 - b. is not excused
 - c. is legally avoided



The Borrower and Mortgage Broker Relationship

The accurate representation of mortgage terms

The *essential terms* of a mortgage are to be disclosed to the borrower by a broker soliciting or arranging a mortgage.

For example, consider a real estate broker who advertises they can arrange mortgages with a low monthly payment schedule — a “bait and switch” advertising trick, as mortgages of the type advertised are not really available. A borrower, seeking a mortgage with the low payment schedule advertised by the broker, retains the broker to perform these services.

The borrower asks specific questions of the broker concerning the interest rate, late charges, due date, the final balloon payment and mortgage closing costs.

The broker tells the borrower the balloon payment will be “small.” The broker further misrepresents the probable interest rate and the day of the month on which late charges are incurred. The broker provides the borrower with “approximations” of the closing costs that are significantly lower than the actual closing costs. The broker also fails to accurately disclose other important mortgage aspects, such as that the monthly payments are interest only, or that late charges are equal in amount to the monthly interest payment.

Further, the **financial disclosure** statement the broker prepares and hands to the borrower is lengthy and contains complex wording. Rather than reading the

disclosure statement, the borrower relies on the broker's oral representations and signs the mortgage documents.

On closing, the borrower ends up with a mortgage with less favorable terms than verbally represented by the broker. The borrower incurs additional and unexpected expenses, such as high late charges, an early due date and graduated monthly payments. The additional expenses ultimately create an excessive financial burden for the borrower. The borrower defaults on the mortgage and the secured property is sold at a foreclosure sale.

Later, the borrower discovers the broker was aware of the actual mortgage terms and costs for origination before the borrower signed the mortgage documents.

Here, the broker's failure to disclose the actual interest rate, the exact amount of the late charge, the size of the balloon payment and the actual closing costs breached the broker's **agency duty** owed to the borrower.

The borrower can recover all their money losses caused by the broker's misrepresentation and for failing to discuss important provisions in the mortgage documents. [**Wyatt v. Union Mortgage Company** (1979) 24 C3d 773]

As the borrower's broker arranging a mortgage, a licensee needs to fully and accurately disclose all **essential facts** of the mortgage transaction which may affect the borrower's decision to participate in the transaction. [Calif. Business and Professions Code §§10130, 10131(d), 10176(a), 10176(i)]

The broker's duty to disclose, and their obligation to deal fairly with borrowers, commences on their first contact with prospective borrowers to solicit employment. Thus, the broker will disclose essential facts before entering into a listing agreement. [**Realty Projects Inc. v. Smith** (1973) 32 CA3d 204]

Even after the broker is employed as the agent of the borrower, their duty to disclose and provide accurate representation is not completely fulfilled by merely providing the mortgage documents to the borrower. The provisions in the documents need to be *discussed with the client* to ensure the client has an understanding sufficient to make a well-informed decision regarding the mortgage. [Bus & P C §10241]

Mortgage broker solicitation of a mortgage borrower

Mortgage borrowers and holders of trust deed notes frequently retain the services of a broker to represent them. The service they render is to locate a lender or trust deed investor who will make a mortgage or buy or lend on a trust deed note.

Typically, the mortgage broker solicits these borrowers and note holders seeking to represent them by locating institutional or private money lenders or investors and arranging the financing sought. When soliciting employment as a mortgage

broker, the broker may not represent the existence of a willing lender when one does not exist.

Consider a real estate owner who contacts a broker to arrange a trust deed mortgage.

The owner informs the broker of their desired mortgage terms. The broker is asked if they know of a lender willing to originate such a mortgage. The broker does not now know of a lender who would be willing to make the mortgage sought by the owner, but states they can arrange funding for this type of mortgage.

Based on these representations, the owner enters into a mortgage broker listing with the broker. [See **RPI** Form 104]

The broker's attempts to locate a lender are unsuccessful.

The owner later discovers the broker never knew of a real estate lender who would originate a mortgage on the borrower's terms. The owner files a complaint with the California Department of Real Estate (DRE), claiming the broker had a duty to honestly represent the fact that no lenders were known by the broker who made mortgages on the terms sought at the time the owner employed the broker.

The broker's false claim that a lender existed is cause for the DRE to revoke or suspend the broker's license. [Bus & P C §10177(d)]

Also, the broker may be fined up to \$10,000, imprisoned up to six months or both. [Bus & P C §10185]

No "free services" under a listing

"Free" is a word commonly exploited in sales promotions to induce a buyer to believe they will receive something without paying for it, usually an extra portion of the product sought. However, there are rarely "free lunches" as most everything "free" comes with a cost.

A specific service rendered by a broker or agent which contributes to arranging a transaction may not be represented as provided "free" when the broker will be compensated by way of receiving a fee on closing the transaction.

For example, consider a broker who wants to induce a seller to enter into an *exclusive right-to-sell listing* to employ the broker and their agents to market the property and locate a buyer.

The broker offers “free advertising” in the marketing of the seller’s real estate, without any charge of the cost to the seller. Believing the advertising incentive is an extra service or a cost normally charged separately from the broker fee, the seller enters into an exclusive listing agreement with the broker. No other broker offers this service for “free,” giving this broker a competitive advantage.

However, a seller’s broker is duty bound to advertise the seller’s property no matter who is to pay the advertising costs, whether the broker or seller. Advertising is part of the *due diligence* imposed on a broker to take all reasonable steps to locate a buyer when employed under an exclusive right-to-sell listing.

Thus, the broker, by use of the “free advertising” gimmick, has represented an activity as free that a diligent broker is *obligated to provide* for a client – again, no matter who agrees to pay for it. The advertised activity is not free, but is offered in expectation of receiving compensation under the listing – when a buyer is located through advertising. [**Coleman v. Mora** (1968) 263 CA2d 137]

The broker’s bargain under an exclusive listing agreement consists of fulfilling one essential duty — the diligent pursuit of their client’s real estate goals. Advertising is a fundamental and integral part of this duty. Thus, the broker cannot represent as “free of charge” a brokerage activity normally performed in a transaction on which they are to be paid a fee.



1. A mortgage broker needs to fully and accurately disclose _____ of a mortgage transaction which may affect the borrower’s decision to participate in the transaction.
 - a. only minimal details
 - b. only the most critical elements
 - c. all essential facts

A man in a grey suit and white shirt is looking out from a prison cell. The cell is made of black metal bars. The background shows other cells and a concrete floor.

\$10,000

≤ 1 YEAR

Kickbacks as a RESPA Violation

Duplicate charges for services

When property prices rise, **kickbacks** in real estate sales become infectious.

kickback

A fee improperly paid to a transaction agent who renders no service beyond the act of referring when the transaction agent is already providing another service in the transaction for a fee.

Although kickbacks, often in the form of **referral fees**, were banned by the *Real Estate Settlement Procedures Act (RESPA)* in 1974, they remain under the radar in many forms and for many reasons. In fact, they continue to be one of the most pervasive RESPA violations.

Referral fees become unlawful kickbacks when received by a broker or agent who negotiated a fee-generating home sale when that broker or agent renders no service to the other provider in exchange for the referral fee beyond the referral. Referral fees of the kickback variety are improper and attack the efficiency of the real estate market. Worse, kickbacks increase the *cost of doing business*, the cost of which is always passed on to buyers and sellers in the sales transactions.

Kickbacks absolutely result in the elimination of better and cheaper competition.

Instead of being directed by agents to legitimate lenders, escrows, title insurers or other types of third-party service providers, buyers are referred to those businesses providing kickbacks to the broker or agent.

Kickbacks to brokers and agents representing sellers and buyers in a home sales transaction are openly undertaken in an unlawful effort by a third-party service provider to garner a larger share of the available business. This is a corrupting business policy. Legitimate operators find it difficult, if not impossible, to compete with fraud without themselves stooping to the same corrupt kickback practices.

Any person who violates RESPA may be fined up to \$10,000 or imprisoned for up to one year, or both.

RESPA violators are liable, to the person charged for the settlement service, for three times the amount paid for the settlement service. In addition, RESPA violations are often combined with other private lawsuit claims such as antitrust violations, exposing violators to additional civil liability. [12 United States Code §2607(d)]



1. Kickbacks were prohibited in 1974 under the
 - a. Real Estate Settlement Procedures Act (RESPA).
 - b. Equal Credit Opportunity Act.
 - c. The Housing Financial Discrimination Act.

2. A(n) _____ is a fee paid to an agent who renders no service in exchange for a referral fee beyond the referral itself when the agent is already providing another service for a fee.
 - a. discount
 - b. refund
 - c. kickback



RESPA Controls Indirect Kickbacks

Indirect kickbacks from third-party service providers

The mere *referral-steering* of a client is not a **service** rendered in exchange for a kickback, but is already a service owed the client to care for, protect and give them advice in the sales transaction.

Any payment between brokers or agents and third-party service providers, over and above the fee received from the seller on the sales transaction, may only be received in exchange for performing a *significant portion* of the services rendered by the provider paying the agent an additional fee. However, brokers and agents rarely perform services on behalf of service providers beyond the referral (which was done on behalf of the client, not the provider), and therefore cannot receive a referral fee – the **kickback**.

Referral fees are not the only form of kickback which violate RESPA.

Indirect kickbacks commonly provided by third-party services in exchange for referrals from brokers and agents include:

- entry into a “referral contest” drawing for referring a lead;
- paying for sporting events or theater tickets;
- throwing a party for anyone who referred business;
- paying the admission to a real estate seminar/education;

- paying for real estate listing advertising; and
- paying for subscriptions to 800 numbers and call-capture numbers.

However, promotional and educational activities are allowed when:

- they are not conditioned on the referral of business; and
- they do not involve the payment of expenses (rent, IT services, supplies, equipment, etc.) incurred by a broker or agent in a position to refer business. [12 Code of Federal Regulations §1024.14(g)(vi)]

Another classic example of kickbacks is found in so called “*closed offices*,” where brokers ban third-party service providers from competing legitimately for business with their one chosen service provider – their “preferred” lender or title insurer.

In addition, lenders may not pay a fee to a real estate broker representing a principal in the sale the lender is to finance, unless the broker has performed a significant service on behalf of the lender. For instance, a broker may receive a second fee, the so-called *referral fee*, if they render significant mortgage origination services.



1. Indirect kickbacks commonly provided by third-party services in exchange for referrals from brokers and agents include:
 - a. throwing a party for anyone who referred business.
 - b. paying for real estate listing advertising.
 - c. Both a. and b.

broker

agent



Referral Fees Between Brokerages

Permitted compensation for a referral

Referral fees are allowed between two brokers when the broker receiving the referral fee is not providing another service in the home sales transaction such as financing, insurance, escrow, etc.

referral fee

A fee paid by one service provider to another for referring a client to them. Referral fees are prohibited by the Real Estate Settlement Procedures Act (RESPA) when consumer financing funds the purchase of one-to-four unit residential property.

Compensation for a referral permitted by or between brokers under RESPA includes:

- payments to the buyer's broker by the seller's broker, and referral arrangements between real estate agents and brokers;
- payment to any person of a bona fide salary or compensation or other payments of goods or facilities actually furnished or for services actually performed; and
- an employer's payment to its own employees for any referral activities. [Calif. Business & Professions Code §10177.4; 12 USC §2607]

However, brokers and agents need to adhere to specific California Department of Real Estate (DRE) rules and codes when paying or accepting referral fees from other brokers or agents.

Agents are prohibited from accepting a fee or other benefit from *any person other than their employing broker*. Agents are also forbidden from paying a fee to any other broker or agent without first directing the payment through the agent's employing broker. [Bus & P C §10137]

Most importantly, as a *fiduciary* matter, brokers and their agents need to advise their clients of the dollar amount of any compensation received from service providers related to the real estate transaction in which their client is involved. If the compensation (monetary or otherwise) is not disclosed, agents and their employing broker are subject to their client recovering all fees received, as well as license suspension or revocation. [See **RPI** Form 119]

Fees prohibited by RESPA cannot be legalized by disclosure or consent of the client. [Bus & P C §10176(g)]

Bottom line: referral fees are prohibited between brokers and third-party providers with one exception. In order for a broker or agent to receive a referral fee when they are receiving a fee on a home sales transaction, a *tangible service besides the referral* needs to be performed for the business paying the referral fee.



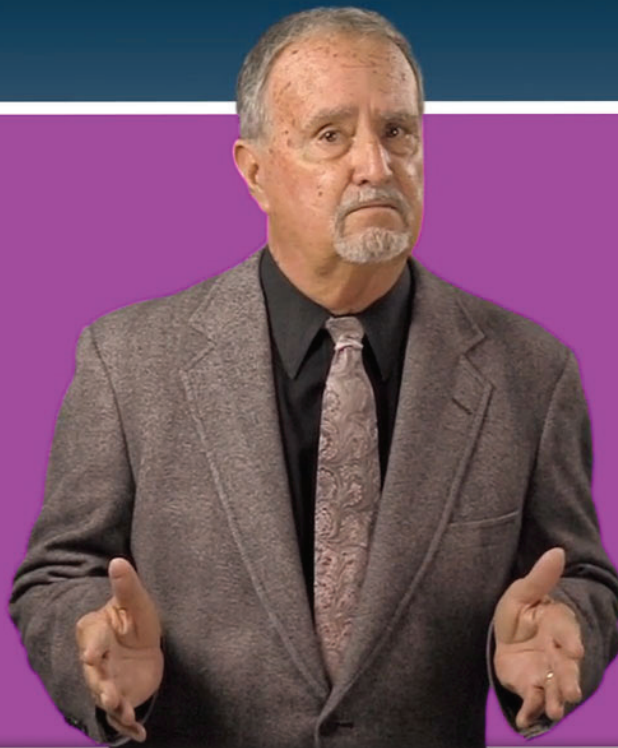
1. Agents are prohibited from accepting a fee or other benefit from any person other than:
 - a. their employing broker.
 - b. their client.
 - c. Either a. or b.

2. Fees prohibited by the Real Estate Settlement Procedures Act (RESPA):
 - a. cannot be legalized by disclosure or consent of the client.
 - b. can be legalized, so long as the client knowingly consents to the fee in writing.
 - c. are only collectable if they are not challenged by the client or the agent's employing broker.

National
Association
of Realtors®
(NAR)

California
Association
of Realtors®
(CAR)

Association
of Realtors®
(AOR)



MLS
access

MLS Access for Non-CAR Members

Association membership cannot be a prerequisite to MLS access

Many real estate licensees wrongly believe they need to join the *National Association of Realtors® (NAR)*, the *California Association of Realtors® (CAR)* or the *local Association of Realtors® (AOR)* branch of CAR to practice real estate in California. Licensees all too often equate these trade union leviathans to the *Department of Real Estate (DRE)* due to their past close liaison via past Real Estate Commissioners.

Other licensees have a slightly better grasp on the implications of membership or non-membership in the real estate trade union versus DRE licensing to protect members of the public. Still, many brokers and agents mistakenly believe that union membership is necessary in order to access their local MLS.

This impression is not unfounded. Before 1976, most real estate trade union boards owned and required all access to the **MLS** to bundle into membership in their association. Such practice was prohibited in 1976. [**Marin County Board of Realtors, Inc. v. Palsson** (1976) 16 C3d 920]

Association membership cannot be a prerequisite to MLS access.

However, an association is allowed to exact a “reasonable fee” from nonmembers for MLS access. Yet, the bundling continues with the AORs claiming ownership of data generated by all the published listings, giving access only to their card-

carrying members.

To access an AOR-owned MLS, an individual needs to:

- have a valid California real estate license;
- be a broker, or a sales agent under a broker who is a member of the MLS;
- apply for access to the MLS; and
- pay a fee, which varies by AOR.

If an agent's broker is not a member of an AOR, the agent is not required to be a member of an AOR. However, if a broker is a member of an AOR, their agents need to also be members of the AOR in order to access the broker's MLS.

No other restrictions apply. Real estate agents and brokers can continue to access an MLS without paying unnecessary dues or entangling themselves in a trade union's bureaucracy, codes and arbitration rules.

Unlawful MLS price fixing

Consider a group of local real estate trade associations who each operate their own multiple listing service (MLS). Each association provides their own MLS support services to their subscribers. They also set the price for these support services independently, based on cost.

Some are efficient and very successful at providing these services, incurring less than \$10 in total costs per subscriber monthly. Others are inefficient and incur costs of \$50 per subscriber monthly to provide their MLS support services.

The associations then form a separate corporation in which they are shareholders in order to create and operate a county-wide MLS. The MLS corporation as the new regional MLS independently contracts with each association to provide MLS support services for the subscribers produced by that association.

To assure the continued viability of those smaller associations with disproportionately higher operating costs for their inefficient service, the associations collaborate to set the minimum fee all associations will charge at \$25 per subscriber monthly.

The less efficient associations by agreement are paid a fixed monthly

cash subsidy on top of the support services fee paid by the subscribers they generate since those associations are operating at a loss. With the **fee fixed** for services, the efficient associations agree not to charge less and compete to deprive the less efficient associations of subscribers.

When competitive organizations, such as neighboring associations, *join together* to eliminate their separate MLS database operations in favor of a single county-wide MLS which is more effective and efficient, can they then *collude* to set the fee charged for the MLS services each will provide? Further, can they ban any discounting or rebates by the efficient and more competitively operated associations?

The simple answer is no. **Price fixing** is unlawful!

The fee which reimbursed the associations for the cost of their MLS support services cannot be legally set by agreement between the competing associations. This is particularly the case when the larger, more efficient associations received millions of dollars in excess MLS support services fees over the actual cost they incurred to provide those services.

This arrangement provided the large associations with huge financial rewards at the improper expense of their subscribers. [**Freeman v. San Diego Association of Realtors** (9th Cir. 2003) 322 F3d 1133]

It was the likelihood that some of the associations would go out of business under an efficient county-wide MLS which led to the price being fixed at a *supracompetitive* and unlawful level. This led to the banning of competitive pricing by each association for providing the MLS subscriber services the brokers need by agreeing to no discounts or rebates to their broker-subscribers.

However, if competition or **economic darwinism** had been properly allowed to occur, the more efficient associations would have brought about the demise of the less productive associations to the financial benefit of all of the MLS users.



QUIZ

1. _____ cannot be a prerequisite to Multiple Listing Service (MLS) access.
 - a. Department of Real Estate (DRE) licensure
 - b. Payment of a fee
 - c. Association membership in a real estate trade union

Ethics: Glossary

A

affiliated business arrangement..... 2

A business arrangement in which a broker may lawfully profit from referring a client to a service provider the broker owns. Here, the broker is required to make a disclosure of their ownership interest to the client.

“as-is” clause18

An unenforceable provision stating the buyer accepts the property without a full disclosure of known conditions. Properties are sold “as-disclosed,” never “as-is.”

C

conflict of interest..... 1

When a broker or agent has a positive or negative bias toward a party in a transaction which is incompatible with the duties owed to their client.

counteroffer12

An alternative response to an offer received consisting of terms different from those of the offer rejected.

D

defacing..... 11

When a document is modified on its face, usually by striking copy and interlineation, after it is signed by one or both parties.

dual agency..... 7

The agency relationship that results when a broker represents both the buyer and the seller in a real estate transaction.

F**fiduciary duty**16

The duty owed by an agent to act in the highest good faith toward the principal and not to obtain any advantage over their principal by the slightest misrepresentation, concealment, duress or undue influence.

G**general duty**15

The duty a licensee owes to non-client individuals to act honestly and in good faith with up-front disclosures of known conditions which adversely affect a property's value.

K**kickback**26

A fee improperly paid to a transaction agent who renders no service beyond the act of referring when the transaction agent is already providing another service in the transaction for a fee.

M**material fact**16

Information about a listed property which may affect the property's value or alter a client's decision to purchase or sell the property. Thus, all material facts need to be timely disclosed.

R**referral fee** 30

A fee paid by one service provider to another for referring a client to them. Referral fees are prohibited by the Real Estate Settlement Procedures Act (RESPA) when consumer financing funds the purchase of one-to-four unit residential property.