Chapter 1: Brokerage activities: agent of the agent

After reading this chapter, you will be able to:

- understand an employing broker’s responsibility to continually oversee the real estate activities of the agents they employ;
- appreciate the office policies, procedures, rules and systems a broker implements to comply with their duties owed to clients and others;
- develop a business model for implementing the supervisory duties required of a broker;
- use an employment agreement to establish the duties of a sales agent employed under a broker and the agent’s need to comply with the broker’s office policies; and
- discuss how a licensees status relates to labor regulations, taxation and issues of liability.

Key Terms

- business model
- clients
- licensed activities
- independent contractor (IC)
- listing agreement

As brokerage services became more prevalent in California in the mid-20th century and the public demanded greater consistency and competence in the rendering of these services, the state legislature began standardizing and regulating:

- who is eligible to become licensees and offer brokerage services;
- the duties and obligations owed by licensees to members of the public; and
• the procedures for soliciting and rendering services while conducting licensed activities on behalf of clients.

Collectively, the standards set the minimum level of conduct expected of a licensee when dealing with the public, such as competency and honesty. The key to implementing these professional standards is the education and training of the licensees.

Individuals who wish to become real estate brokers are issued a broker license by the California Department of Real Estate (DRE) only after completing extensive real estate related course work and meeting minimum experience requirements. On receiving the license, brokers are presumed to be competent in skill and diligence, with the expectation that they will conduct themselves in a manner which rises above the minimum level of duties owed to clientele and other members of the public.

For these reasons, the individual or corporation which a buyer or seller, landlord or tenant, or borrower or lender retains to represent them in a real estate transaction may only be a licensed real estate broker.

To retain a broker to act as a real estate agent, the buyer or seller enters into an employment contract with the broker, called a listing agreement. [See RPI Forms 102 and 103]

Brokers are in a distinctly different category from sales agents. Brokers are authorized to deal with members of the public to offer, contract for and render brokerage services for compensation, called licensed activities. Sales agents are not.1

A real estate salesperson is strictly an agent of the employing broker. Agents cannot contract in their own name or on behalf of anyone other than their employing broker. Thus, an agent cannot be employed by any person who is a member of the public. This is why an agent’s license needs to be handed to the employing broker, who retains possession of the license until the agent leaves the employ of the broker.2

Only when acting as a representative of the broker may the sales agent perform brokerage services which only the broker is authorized to contract for and provide to others, called clients.3

Further, a sales agent may only receive compensation for the real estate related activities from the employing broker. An agent cannot receive compensation directly from anyone else, e.g., the seller or buyer, or another licensee.4

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1 Calif. Business and Professions Code §10131
2 Bus & P C §10160
3 Grand v. Griesinger (1958) 160 CA2d 397
4 Bus & P C §10137

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Thus, brokers are the agents of the members of the public who employ them, while a broker’s sales agents are the agents of the agent, the individuals who render services for the broker’s clients by acting on behalf of the broker.5

As a result, brokers are responsible for all the activities their agents carry out within the course and scope of their employment.6

When a broker employs a sales agent to act on behalf of the broker, the broker is to exercise reasonable supervision over the activities performed by the agent. Brokers who do not actively supervise their agents risk having their licenses suspended or revoked by the DRE.7

Here, the employing broker’s responsibility to the public includes:

- on-the-job training for the agent in the procedures and practice of real estate brokerage; and
- continuous policing by the broker of the agent’s compliance with the duties owed to buyers and sellers.

The sales agent’s duties owed to the broker’s clients and others in a transaction are equivalent to the duties owed them by the employing broker.8

The duties owed to the various parties in a transaction by a broker, which may be carried out by a sales agent under the employing broker’s supervision, oversight and management, include:

- the utmost care, integrity, honesty and loyalty in dealings with a client; and
- the use of skill, care, honesty, fair dealing and good faith in dealings with all parties to a transaction in the disclosure of information which adversely affects the value and desirability of the property involved.9

To ensure a broker’s agents are diligently complying with the duties owed to clientele and others, employing brokers need to establish office policies, procedures, rules and systems relating to:

- soliciting and obtaining buyer and seller listings and negotiating real estate transactions of all types;
- the documentation arising out of licensed activities which may affect the rights and obligations of any party, such as agreements, disclosures, reports and authorizations prepared or received by the agent;
- the filing, maintenance and storage of all documents affecting the rights of the parties;
- the handling and safekeeping of trust funds received by the agent for deposit, retention or transmission to others;

5 Calif. Civil Code §2079.13(b)
6 Gipson v. Davis Realty Company (1965) 215 CA2d 190
7 Bus & P C §10177(b)
8 CC §2079.13(b)
9 CC §2079.16
• advertisements, such as flyers, brochures, press releases, multiple listing service (MLS) postings, etc.;
• agents’ compliance with all federal and state laws relating to unlawful discrimination; and
• the receipt of regular periodic reports from agents on their performance of activities within the course and scope of their employment.  

One method a broker uses to implement the requirement for supervision of employed agents is to develop a **business model**. So intended, the broker outlines the means and manner by which agents produce and service listings, and how purchase agreements are negotiated and closed.

The creation of a plan for office operations logically starts by establishing categories for itemizing administrative and licensed activities, then a written presentation of the conduct required of agents to achieve the broker’s objectives for each item. [See Figure 1]

Categories of business and licensed activities include:

- **administrative rules**, covering a description of the general business operations of the brokerage office, such as office routines, phone management, sign usage, budgetary allocations for agent-support activities (advertising, FARMing, etc.), agent interviews, goal setting and daily work schedules;
- **procedural rules**, encompassing the means and methods to be used by agents to obtain measurable results (listings, sales, leases, mortgages, etc.);
- **substantive rules**, focusing on the documentation needed when producing listings, negotiating sales, leases or mortgages and fulfilling the duties owed by the broker to clientele and others;
- **compliance checks**, consisting of periodic (weekly) and event-driven reports (a listing or sale) to be prepared by the agent, and the review of files and performance schedules by the broker, office manager or assistants, such as listing or transaction coordinators; and
- **supervisory oversight**, an ongoing and continuous process of training agents and managing their activities which fall within the course and scope of their employment.

The rules and procedures established by the broker to meet their responsibility to manage and oversee the conduct of their agents when acting on behalf of the broker needs to be agreed to in writing between the broker and the employed agents. A written **employment agreement** details the duties of the sales agent and the agent’s need to comply with an office manual which contains the broker’s policies, rules, procedures and other conduct the broker deems necessary to fulfill their responsibility for supervision. [See Figure 2 and Figure 3, RPI Forms 505 and 506]
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### Administrative
- E&O insurance
- workers’ compensation insurance
- automobile insurance binder
- general comprehensive business insurance
- agent policy manual (on procedural, substantive and compliance activities)
- new agent qualifications and interview procedures
- institutional advertising franchise affiliation
- trade organization membership
- MLS subscriptions
- employment contracts with sales agents
- agent pay, advances, and escrow disbursements
- production goals
- phone/floor-time coverage
- hours/agents’ work schedules
- business cards
- storage of documents (three years)
- office meetings/attendance
- agent contribution to expenses
- bank trust accounts
- general business bank accounts
- forms to be used
- use of coordinators
- use of office equipment
- use of affiliated services
- use of controlled businesses
- attorney inquiry/referral to broker
- trust fund handling (deposit and log)
- email content
- public record inspection
- servicing property listings (MLS, signs, ads, property profiles, open houses, correspondence, showings, check lists, rents, etc.)
- servicing buyers (listings, property profiles, broadcasts, wants, showings, qualifying, check lists, etc.)
- client lists and follow-up
- preparing offers (documents/disclosures and addenda checklists, duty checklists, advice on use of arbitration, forfeiture, escrow, title, misc. provisions, fee provisions, etc.)
- FSBO submission of offers (fee arrangements, listings, dual agency, etc.)
- preparation of documents, use of attorneys, added provisions
- pay contingent on file audit and completeness
- listing logs transaction logs
- trust fund logs periodic reports
- listing reports
- sales reports
- schedule of report due dates
- other events which trigger notices or reports to management
- instructions on propriety of acts within the course and scope of employment
- degree of enforcement being tight and disciplined, or lax and allowing great discretion
- use of assistants to provide oversight

## Figure 1
**Forming a Business Model**

<table>
<thead>
<tr>
<th>Category</th>
<th>Items to Consider</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative</td>
<td>E&amp;O insurance, workers’ compensation insurance, automobile insurance binder, general comprehensive business insurance, agent policy manual, new agent qualifications and interview procedures, institutional advertising franchise affiliation, trade organization membership, MLS subscriptions, employment contracts with sales agents, agent pay, advances, and escrow disbursements, production goals, phone/floor-time coverage, hours/agents’ work schedules, business cards, storage of documents (three years), office meetings/attendance, agent contribution to expenses, bank trust accounts, general business bank accounts</td>
</tr>
<tr>
<td>Organizational Procedures</td>
<td>forms to be used, use of coordinators, use of office equipment, use of affiliated services, use of controlled businesses, attorney inquiry/referral to broker, trust fund handling (deposit and log), email content, public record inspection, servicing property listings (MLS, signs, ads, property profiles, open houses, correspondence, showings, check lists, rents, etc.), servicing buyers (listings, property profiles, broadcasts, wants, showings, qualifying, check lists, etc.), client lists and follow-up</td>
</tr>
<tr>
<td>Substantive Activities</td>
<td>taking property listings (addenda and disclosure check lists, deposits, property profiles, further approvals, fee setting, seller profiles, etc.), preparing offers (documents/disclosures and addenda checklists, duty checklists, advice on use of arbitration, forfeiture, escrow, title, misc. provisions, fee provisions, etc.), FSBO submission of offers (fee arrangements, listings, dual agency, etc.), preparation of documents, use of attorneys, added provisions</td>
</tr>
<tr>
<td>Compliance</td>
<td>pay contingent on file audit and completeness, listing logs transaction logs, trust fund logs periodic reports, listing reports, sales reports, schedule of report due dates, other events which trigger notices or reports to management</td>
</tr>
<tr>
<td>Supervision</td>
<td>continuous daily oversight, constant follow-up on compliance with procedures and substantive activities, instructions on propriety of acts within the course and scope of employment, degree of enforcement being tight and disciplined, or lax and allowing great discretion, use of assistants to provide oversight</td>
</tr>
</tbody>
</table>
Licensed employees of the broker

A DRE licensee acting on behalf of a broker is both an agent and employee of their employing broker. Thus, a licensee who acts under the supervision of a broker, whether they are a salesperson or broker-associate, represents the broker as an agent of the broker.\(^{11}\)

An agent’s right to a fee arises under the agent’s written employment agreement with their broker, not a listing agreement with the client which is entered into with the broker. Through the broker-agent employment agreement, the agent is entitled to a share of the fees received by the broker on sales, leases or mortgage originations in which the agent participated. [See Figure 2 and Figure 3, RPI Forms 505 and 506]

**RPI (Realty Publications, Inc.)** publishes two employment agreements covering all material aspects of the employment used by a broker employing a licensee to perform agent duties on their behalf. These employment agreements are:

- **Broker-Agent Employee Agreement** [See Figure 2, RPI Form 505]; and
- **Independent Contractor Employment Agreement — For Sales Agents and Broker-Associates** [See Figure 3, RPI Form 506]

Brokers typically negotiate fee sharing arrangements which call for the use of an independent contractor (IC) agreement to document their employment of agents. [See Figure 3, RPI Form 506]

Alternatively, brokers may choose other pay and tax withholding arrangements documented by an **employee agreement** form. [See Figure 2, RPI Form 505]

An IC agreement, in contrast with an employee agreement form, is used to avoid withholding and employer contributions by real estate brokers. [See RPI Form 506 §2.13]

Regardless of the written employment agreement used and signed by the agent, the broker and agent are DRE compliant.

Employee under labor law

Despite the labels given to these agent employment forms, an agent or broker-associate is always an employee of the broker under California’s labor law. Thus, the broker is liable as an employer for their agent’s wrongful conduct. Even if an IC agreement is used to document the employment, an agent may not permissibly act independently of the broker. The broker employing agents using an IC agreement still owes a duty of supervision to the agent as well as a mandated **worker’s compensation** policy. [See Figure 3, RPI Form 506]

Both **RPI employment agreements** include provisions covering:

- broker supervision of licensed agent activities;

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\(^{11}\) Calif. Civil Code §2079.13(b)
agent obligations owed to their broker, including providing auto
insurance coverage and naming the broker as an additional insured;
• broker obligations owed to their agents, including maintaining
membership in professional organizations agreed to and providing
worker's compensation insurance; and
• duties owed to clients and the public.

Also, the written employment agreement needs to spell out the
compensation the agent is to receive for representing the broker in soliciting
and negotiating listings, purchase agreements, leases and financing.12

[See Figure 2 and Figure 3, RPI Forms 505 and 506]
Most sales agents receive compensation from their brokers based on a negotiated percentage of contingency fees received by the brokers for completed sales, leases or mortgages solicited, negotiated or processed by the agents.

Both types of employment agreements require all documents and funds received on listings and sales to be entered into and taken in the name of the broker. Also, all advertising and business cards identify the agent as acting for the broker as an associate licensee.

Further, the agent is subject to supervision by their broker since employing brokers are mandated to actively manage their brokerage business. This DRE mandated supervision cannot be contracted away or eliminated by use of an IC agreement. Thus, a broker may not permit their agents to have total discretion in their handling of listings or negotiating sales, leases or mortgages.

Whether the broker withholds state and federal income tax on payment of an agents’ compensation depends on the type of employment agreement the broker and agent enter into. [See Figure 2 and Figure 3, RPI Forms 505 and 506]

A sales agent licensed by the DRE and employed by a broker under an IC agreement and paid based on the broker’s receipt of a contingency fee will not be treated as an employee for purposes of income tax withholding or payroll contributions.13

The chief advantage for a real estate broker to use an IC agreement is the simplification of the bookkeeping process. An IC agreement avoids withholding for income taxes or Medicare and social security benefits from the agent’s fee while also avoiding employer contributions.

In turn, the broker files a 1099 report with the Internal Revenue Service (IRS) naming each agent and stating the fee amount each received as an employee of the broker under a contingent-fee, IC agreement.

To further simplify disbursement of the agent’s share of the fee, some brokers instruct and authorize escrow to disburse to the agent the amount of fees due the agent from the broker. These fees accrue to the broker on the close of a sales escrow. However, this “through system” of payment leaves the broker without adequate records for 1099 and workers’ compensation reporting and audits.

A sales agent entering into an IC agreement reports their fees received from their broker as business income (Schedule C). In turn, the agent expenses all the business-related costs of operations incurred while acting within the course and scope of their employment with the broker. It does not

13 Internal Revenue Code §3508
matter what degree of control the broker actually exercises over the agent’s activities, whether none, enough to satisfy DRE supervisory requirements or total oversight as needed for first year licensees.

However, even though the agreement is called an “independent contractor” agreement — an arrangement designed solely for income tax reporting purposes — the agent remains an agent of their employing broker and not a separate operator independent of their broker.
When testing the conduct of an agent while engaged in real estate related activities, the IC provision in the broker-agent employment agreement cannot and does not change the agent’s classification as an agent of the broker under California real estate and labor laws.\textsuperscript{14}

Thus, brokers who use an IC agreement are not to delude themselves to believe that somehow the agent may permissibly act independently of the broker with no supervision.

Consider a sales agent who is employed by a broker under an IC agreement. The broker gives the agent total discretion in handling of clients and documentation of listings and sales. As a matter of risk management, the IC agreement includes a provision calling for the agent to hand the broker a binder for liability insurance coverage for the agent’s car, naming the broker as an insured. The IC agreement also requires all documents and funds received on listings and sales to be entered into and taken in the name of the broker, and all advertising and business cards to identify the agent as acting for the broker as an associate licensee.

One day, while the sales agent is driving to list a property, the agent collides with another vehicle, injuring the driver. The driver makes a demand on the agent’s broker to pay for the driver's money losses incurred due to the agent’s negligence.

The broker rejects the demand, claiming the agent is an independent contractor, not an agent (much less an employee) of the broker, and thus the broker has no liability for the losses inflicted on the driver by the agent.

The driver claims the broker is liable for their losses since the agent is a representative of the broker and was acting within the course and scope of their employment when the injuries occurred.

Can the driver injured by the agent’s negligence recover their money losses from the agent’s broker?

Yes! The sales agent is the agent of the broker as a matter of law, without concern for the type of employment agreement they have entered into.

\textbf{The IC: an agent of the broker}

In spite of the IC employment agreement allowing total discretion to the agent in the conduct of handling of listings and sales, the agent is continuously subject to supervision by the broker. Sales agents are agents of the broker, without regard to the tax purpose of their employment agreement. The injury presented in the prior scenario occurred while the agent was acting within the course and scope of their agency with the broker. Thus, the broker cannot escape liability for their agent’s negligence.\textsuperscript{15}

\textsuperscript{14} Gipson, supra
\textsuperscript{15} Gipson, supra
The broker who hires agents who use their own vehicles to conduct brokerage activities needs to be a named insured on the agent's car insurance policy as a matter of the broker's risk management. The employing broker also needs to maintain general comprehensive business liability insurance and professional liability coverage, also known as errors and omissions insurance, or simply, E&O insurance.

In part, supervision is critical to the reduction of the broker's exposure to risks of liability for their sales agents' failure to inspect, disclose, advise and care for clients.

Under real estate law, a sales agent is considered both an agent and an employee when acting within the course and scope of employment with a broker.\textsuperscript{16}

However, an agent is not always treated as an employee under state and federal income tax withholding rules.

For example, licensed real estate sales agents, as well as broker-associates, are excluded employees for purposes of the California Unemployment Insurance Law. Even though a sales agent is considered both an agent and an employee under California real estate law, a broker does not have to contribute to the state unemployment insurance fund on behalf of the agent.

Receipt of compensation by a licensed real estate agent under an employment agreement, paid as a contingency fee for closing transactions, is the only test required for the broker to avoid paying unemployment benefits. When the agent is paid a contingency fee, not an hourly wage, the agent will be denied unemployment benefits regardless of the level of supervision and control the broker exercises over the agent's real estate related activities.\textsuperscript{17}

A sales agent is entitled to payment of minimum hourly wages from a broker if the agent is classified as an employee by California labor laws. This labor law classification is unrelated to tax law treatment. A labor law employee comes about due to the broker's conduct, including constant supervision and total control over the agent's means, manner and mode of engaging in activities requiring a real estate license.

However, as agents of their broker, most agents by the nature of daily scheduling for appointments, property viewings and document preparation have a high level of discretion and control over when they conduct different aspects of their business. This is especially true of the hours spent outside of their broker's office.

Typically, the agents' time in the office spent at the desk, or on the phones or floor, rarely take up more than one day a week, usually less than 20% of the

\textsuperscript{16} Grand, supra

\textsuperscript{17} Calif. Unemployment Insurance Code §650
time spent on real estate related listings and sales. Little additional time is spent in the office at staff meetings. As a result, agents are rarely considered employees, except for the public policy purpose of judging their conduct as a licensee under California real estate law.

As an outside salesperson who regularly works more than half of their time away from their place of employment, selling items or obtaining contracts for services, a real estate sales agent is excluded from collecting a minimum wage from their broker.18

Workers’ compensation coverage for employees

Brokers often ignore or are unfamiliar with workers’ compensation requirements for their agents. Erroneously, employing brokers — of which there are about 23,600 with one or more agents — often believe real estate agents and broker-associates working for them under IC agreements are not employees.

However, under labor laws, a broker’s employees include:

- their licensed sales agents (including ICs);
- other brokers working under their license as broker-associates; and
- their licensed and unlicensed administrative staff.19

A broker who is unlawfully uninsured or forces their employees to carry their own workers’ compensation insurance faces:

- a stop order from the Division of Labor Standards Enforcement (DLSE) under the California Department of Industrial Relations (DIR), preventing the broker from conducting business until proof of insurance is provided;
- civil penalties and fines up to $100,000; and
- reimbursement claims from current and former agents for premiums they paid for workers’ compensation coverage.20

For a broker who employs one or more agents, the broker’s workers’ compensation insurance policy is in addition to policies for any business, vehicle and E&O insurance coverage.

Exclusions under workers’ compensation law

Arrangements exist which exclude workers’ compensation insurance requirements for:

- broker-owners; and
- corporate officers and directors.

The broker-owner of a sole proprietorship is not required to obtain workers’ compensation coverage for themselves. They are not an employee, they are the self-employed owner.

18 Calif. Labor Code §1171
19 Lab C §2750.5
20 California Department of Real Estate Bulletin, Fall 2004, Page 10
When a broker and their spouse (or child or parent) are the sole owners of the individually owned or corporate brokerage company, workers’ compensation insurance coverage for the owners is not compulsory. Thus, only immediate family members who are the sole owners of the company are excluded from workers’ compensation coverage for themselves. However, the broker’s spouse or relative needs to be clearly defined as part owner, either as a general partner or as an officer of the corporation.21

Immediate family members (a spouse, child or parent), licensed or unlicensed, who are not co-owners and are employed by the broker are required to be covered by workers’ compensation — as are all other employees of the broker. This includes the spouse of the broker who is a licensee under their supervision, whether or not the broker employs any other person.22

Officers and directors of a corporation are not required to have workers’ compensation coverage for themselves if they are paid only as owners of the corporation.

However, an officer or director is to be covered by workers’ compensation insurance if:

• they render services as an agent of the corporation for a fee (e.g., taking a listing, negotiating for clients); and
• the corporation is also owned by non-officer owners.23

Here, when officers or directors are the sole owners of the corporation, an officer rendering real estate-related services for a fee need not be covered by workers’ compensation insurance.

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21 Lab C §4150
22 Lab C §3700
23 Lab C §3351(c)
To ensure a greater degree of consistency and competence in the rendering of brokerage services, California law regulates:

- who is eligible to become licensees and offer brokerage services;
- the duties and obligations licensees owe to members of the public; and
- the procedures for soliciting and rendering services while conducting licensed activities.

Only licensed brokers are authorized to provide brokerage services to members of the public. Sales agents are representatives of the licensed broker, and render brokerage services on the broker’s behalf.

When a broker employs a sales agent, the broker is to exercise reasonable supervision over the activities performed by the agent. Brokers who do not actively supervise their agents risk having their licenses suspended or revoked by the California Department of Real Estate (DRE).

The duties owed to the various parties in a transaction by a broker, which may be carried out by a sales agent under the employing broker’s supervision, oversight and management, include:

- the utmost care, integrity, honesty and loyalty in dealings with a client; and
- the use of skill, care, honesty, fair dealing and good faith in dealings with all parties to a transaction in the disclosure of information which adversely affects the value and desirability of the property involved.

Most sales agents receive compensation from their brokers as independent contractors (ICs) based on a negotiated percentage of contingency fees received by the brokers for completed sales, leases or mortgages solicited, negotiated or processed by the agents.

However, even though the agreement is called an “independent contractor” agreement, the agent is an agent of their employing broker and not a separate operator independent of their broker.

As an outside salesperson who regularly works more than half of their time away from their place of employment, a real estate sales agent is excluded from collecting a minimum wage from their broker. However, all real estate brokers in California have to provide workers’ compensation insurance coverage for their sales agents.