

# Legal Update

Part 2  
Edition 9.0



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## Part 2

### Edition 9.0

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## CHAPTER

# 01

## ETHICS REQUIREMENTS

### Learning Objectives

After this chapter, you will be able to

- Identify and define the three basic types of ethics.
- Name the three elements of the Canons of Professional Ethics and Conduct.
- Define competency and why it is important in the real estate profession.
- Explain how to handle an unrepresented buyer.



### Ethics Requirements for Real Estate Professionals

Remember back in Real Estate 101 when you learned about your fiduciary duties? Was there also a conversation about your ethical duties to the clients? To consumers? To other professionals?

There are three basic types of ethics.

- \* Personal Ethics – integrity and responsibility
- \* Business Ethics – industry standards/expectations
- \* Legal Ethics – required by law

**Personal ethics** relate to the impression you want to present to your peers and consumers. What level of integrity is important to you? Is it important that others see you as responsible? A strong sense of what is right

and wrong is a foundation of your personal ethics code.

Personal ethics are reflected in your level of professionalism. Professionalism is always a hot topic in business. Professionalism is something that is often difficult to identify and regulate, as it is different from one person to the next. We often disagree about what is appropriate professional behavior and what is not.

When considering what is professional, an excellent starting place is empathy. How would you feel in the other person's position? What is their perspective?

## Consider this...

John has 12 listings and the market is HOT! Every listing gets at least three offers and many get more. He is so busy that he doesn't have time to respond to all of the text, emails and phone calls from buyer agents asking questions about his listings. (Especially since so few of those calls turn into anything. After all, if their buyer is serious, they'll submit an offer.)

Jane is working with a buyer who is interested in one of John's listings. The market is so tight for buyers that her clients are getting discouraged. They've submitted four offers, all at list price or above, and still don't have a contract. They are stressing. They like John's listing but are concerned about previous foundation work. They want to know if there is a transferrable warranty on the work before they waste everyone's time with an offer.

Jane has reached out to John by text, email and voicemail but cannot get a response. Her buyers are doubting her. After all, it doesn't make sense that the listing agent wouldn't be working to get the house sold. Right?

1. Can you understand John's point of view?
2. Can you understand Jane's point of view?
3. Can you understand how Jane's clients are feeling?
4. How could John and Jane handle this situation better?

**Business ethics** are guidelines agreed upon by members of a particular business or even an industry. Generally, these guidelines are put forth as Codes. Doctors, lawyers, some real estate associations and other professionals often subscribe to a Code of Ethics.

**Legal ethics** in real estate are those rules that are required by the Texas Real Estate License Act (TREL), the Rules of the Commission and other various Texas codes and federal acts & requirements.

Most brokers have a set of business ethics within their brokerages. Sometimes they are in writing but in every case, the sales staff is likely to follow the example of leadership. A Broker who expects their staff to do business at a level of professionalism that they do not subscribe to themselves will often be disappointed.

The Texas Administrative Code lays out what we refer to as the Canons of Professional Ethics and Conduct.

They are:

- \* Fidelity

This has to do with our fiduciary duties. We have a primary obligation to our clients and their best interest. Our own interests are never placed above that of the client. This means our position should be known, clearly, to all parties. We are required to be honest with all parties whether we represent them or not. In addition, license holders must be faithful and observant to the trust placed in them by the consumer. Always remember that though an agent may be working on multiple transactions, the consumer is focused on one and it is of vital importance to them. License holders must treat the transaction and the parties with great respect.

- \* Integrity

Real estate professionals have an obligation to avoid misrepresentation of anything while performing their duties. This means consistent exercise of prudence and caution when serving the public.

- \* Competency

A real estate license alone does not determine one's competency in the market place. Competency is an all-inclusive term for knowledge and understanding of anything a reasonable person would consider when buying or selling real estate. What is happening in the neighborhood as far as construction, schools, property related lawsuits, drainage issues, etc. are all topics a reasonable buyer would want to know about. A competent professional can have these conversations and direct their clients to sources for accurate information on topics they are concerned about. Competency often means knowing what questions to ask. Your real estate license, a Multiple Listing Service (MLS) or even the location of your brokerage are not the determining factor of geographic competence.

Competency can be geographical or by discipline. Discipline has to do with the type of real estate you have knowledge of. A residential broker/agent likely is not competent to sell raw land, commercial properties, industrial parks or etc. Competency means getting the proper training whether it is residential sales, property management, farm and ranch, raw land, leasing, industrial or any other discipline.

## Consider this...

Greg is a relatively new commercial agent working for a commercial real estate firm. He does not have vast knowledge of any marketplace. So, when his brother says he is moving back to Texas and only about 1 ½ hours from Greg, he offers to represent him on his home purchase. After all, it is the same Multiple Listing Service and residential sales are the easiest.

1. What information, if any, should Greg share with his brother?
2. Is Greg putting his brother's interest before his own?
3. What is the best way for Greg to have handled this situation?

## Unrepresented Buyers

An unrepresented buyer calls you on one of your listings, they insist upon seeing the property as soon as possible, and you set the appointment and show the property. Now what?

The law says you will provide the Information About Brokerage Services (IABS) form to this buyer. The law also requires that you disclose who you represent orally or in writing, at first contact. Make sure the buyer understands that you represent the seller and only the seller and the buyer has several choices regarding representation. For example, if the buyer wants representation, your broker could find someone in your brokerage to represent them as an appointed person by the intermediary (your broker), or the buyer could find an agent from another company, or the buyer could hire an attorney to represent them. The buyer may insist on not being represented. Often a buyer may not want to be represented believing they will save money if there is no other agent involved. How these types of situations are handled is a decision between you and your broker.

A buyer can be unrepresented; however, be sure you are not caught in a trap of wanting to help them which causes you to give advice or assistance in ways that could be considered representation of the buyer.

## No Thank You. Just Looking.

**Christa is a listing agent and has a property listed. Today she gets a call from unrepresented buyers, Steve and Suzie, who want to see the property. She agrees to meet them at the home at 3:30 pm.**

*Later at the property:*

*Christa: Hi, I am Christa with We Sell It All Realty.*

*Steve: Good afternoon, I am Steve. This is my wife, Suzie and our new baby Franky.*

*Christa: Oh my goodness, he is sooooo cute!!*

*Suzie: Franky is a girl.*

*Christa: My apologies, well, here is a form I have to give you. I need you to sign it and return it to me before we leave. I have made an extra copy for you.*

*Suzie: I want to read it first.*

*Christa: Certainly, it is not a contract or anything just a form required by the state or Texas REALTORS® or someone.*

*Steve: Ok, could we see the house?*

*Suzie: This form is all about representation. Didn't Steve tell you we do not want anyone to represent us?*

*Christa: I know you told me you did not want to be represented, however, if I show you this house it will be an intermediary thing and I will have to have this signed for my broker.*

*Suzie: Inter-what? What are you talking about? We never had had to sign anything to see a house and we are not starting now...*

*Christa: Oh well, okay, let's go, we can worry about all this paperwork stuff later.*

## DISCUSSION

1. What are Christa's choices if unrepresented buyers don't want to sign the IABS?
2. How would you have handled this? Could there be additional questions Christa could have asked?

# CHAPTER 02

## AGENCY

### Learning Objectives

After this chapter, you will be able to

- Explain the intermediary process. Explain the difference between intermediary with appointments and intermediary without appointments.
- Describe the difference between a rebate and a referral fee and who may receive each.



### Residential Rental Locators

A person must be licensed by TREC to locate apartment units for prospective tenants, if they receive compensation for the service, unless they are employees of the apartment owner or otherwise exempt. The apartment locator is subject to the same duties of fidelity, integrity and competency as any other TREC license holder.

### Examples of Recent TREC Cases with Violations by Apartment Locators

In four cases originating out of the same apartment locating firm, 9 sales agents, the designated broker and the brokerage were found to have submitted fraudulent rental applications, forging documents and references, including fake jobs, fake pay stubs and fake rental

reference. Some of the agents had licenses that expired so unlicensed activity violations were added. (Four Agreed Orders were entered)

### Seller Term Requirement Sheets or Seller Offer Guidelines

Have you ever received offer instructions or seen them in the MLS? Offer instructions give pertinent information such as the seller contact, the broker and agent contact, survey availability, possession opportunities, timeframes getting to the seller, and office hours.

While requiring proof of funds and a pre-approval letter IS a best practice, issues can arise when there are staunch requirements for structuring the offer. Issues can arise in the following situations:

- \* Asking for a percentage amount for earnest money – when Texas does not even legally require it in a contract.
- \* Requirements for option money amounts and time constraints.
- \* Limiting the timelines for the buyer approval on credit worthiness in the Third Party Financing Addendum.

The concern comes when agents are dictating what should happen and what the terms should be without instruction from your client. Putting things like “*offers with missing documentation or not correctly filled out will not be presented to seller*” could put you in violation. Did your seller really instruct you to do so and are those instructions in writing. All of us want to protect our clients, but do not overstep your authority making those decisions.

There are some situations such as foreclosure, relocation, or a brokerage owner business model who will structure certain contract requirements. Being the principal does afford the opportunity to generate the rules but remember - it is not the agent’s decision.

Keep in mind also that if the term sheet you require for offers in effect makes the only variable the purchase price, you may have inadvertently created an auction situation. That would mean you would have to be licensed as an auctioneer and follow the Auctioneer Laws administered by the Texas Department of Licensing and Regulation.

## Intermediary Refresher - Intermediary Means “Enter the Middle”

By law, Texas does not permit dual agency. Instead, the statute sets out a process known as intermediary if a broker is going to represent both parties to a transaction. So as an agent of the broker who is an intermediary, you are stepping into the middle of the transaction and facilitating; and if appointments are properly made, giving advice.

For clarity, what and how does intermediary happen? First, the broker must decide if they are willing to offer intermediary at their firm. The clients must also agree to the intermediary – whether with appointments or no appointments. The consumer is introduced to the concept of intermediary through the Information About Broker Services form. The statutory disclosure and preemptive consent to intermediary is usually contained in the listing agreements and buyer agreements between the clients and the broker. Once the situation presents itself [a seller and buyer who are represented by the same broker want to negotiate on a particular property], there is a secondary notice if appointments are

to be made so the parties will know who will represent whom. Note also that if consent to intermediary was not preemptively given previously, written consent to intermediary can also be obtained at the time the intermediary situation presents itself. TEXAS REALTORS® has a form, TXR 1409, Intermediary Relationship Notice, available for members to use or a broker can have an attorney draw up an appropriate notice form.

The broker has final say whether they will appoint or not. There must be at least two agents, not including the broker, in order to appoint. Sole brokers with no or one agent can only be intermediary with NO APPOINTMENTS. If appointments are made, the agents can give advice and opinions to their appointed client. Without appointments, neither the broker nor any agent can give advice or opinions.

The statute specifies four tenets that must be obeyed during intermediary, whether there are appointments or not:

1. the buyer cannot be told the seller would accept a price less than asking price,
2. the seller may not be told the buyer would pay more than the price submitted in a written offer,
3. no confidential information may be shared unless permitted in writing by a party, and
4. all parties must be treated impartially and fairly.

## DISCUSSION

1. An agent brings in a listing to the brokerage. Later a call comes in to the brokerage from a prospect and it is passed to the brokerage’s buyer agent. The buyer agent--eager to sell the property--makes an appointment to meet the prospect. Who does the buyer agent represent?
2. An agent represents both the buyer and seller in a transaction. The agent says, “Don’t worry, I can represent you both and get this deal done. We don’t need another agent in the mix. It will go easier if it’s just me, after all I know what the seller wants.”

Since there are no appointments, there is only one agent who will facilitate the paperwork between the parties. No advice or opinions mean that the agent cannot advise the buyer. The agent says, “You tell me the terms and I will fill in the blanks.” The buyer asks, “Should we offer more?” The agent shrugs his shoulders and shakes his head because he cannot give advice or opinion. The seller asks, “Should we counter this offer?” The agent looks at the seller but can offer NO advice or opinion! What is wrong with this scenario?



## Recent TREC Cases - Agency Violations

### Case 1

A sales agent scheduled a showing for his client's interested buyers. Prior to the showing, the sales agent arrived and accessed the home. The sales agent was videotaped going through dresser drawers and viewing items in the drawers of bedroom furniture located in the master bedroom. The agent was also on tape going into other parts of the home for a prolonged period of time. No items were taken or damaged, but the sales agent did not have authority to access these areas while showing a home or at any time. (Agreed Order)

### Case 2

A buyer's agent left the buyer and an A/C technician (doing an estimate for repairs) in the property alone (the agent did not schedule enough time for the appointment) and gave the key to the buyer and told the buyer to put the key back in the lockbox and lock up when they were done. No damage or harm, just an upset seller because she had not known about or consented to the unescorted buyer and A/C technician on her property. (Agreed Order).

### Case 3

A sales agent represented a commercial tenant and entered into a representation agreement that was a custom form (Agreement). The agent was paid a commission on a commercial lease transaction after the commercial lease was finalized but after the Agreement expired and he kept the retainer fee. By the terms of the Agreement, the agent was to either be paid a commission on the lease or keep the \$2,000 retainer fee paid upfront-not both. The agent demonstrated bad faith and untrustworthiness when he kept both.

In addition, the agent failed to disclose to his client that the landlords were willing to enter into a 3-to-5 year lease instead of a 10-year lease. The agent continued to push for a 10-year lease when his client told him he was more comfortable with a shorter-term lease, and that his goal was to be the first float center in San Antonio. By continuing to push for a longer lease term and more commission on renewals and expansions, the agent placed his own interests above that of his client's interests to his client's detriment. During the delay for the extended negotiations, another float center opened up in the area first. [Final Order by Commission after the SOAH (State Office of Administrative Hearing) hearing].

## Rebates and Referral Fees

**What is the difference between a rebate and a referral fee?** A **rebate** can be cash or anything of value and is part of a license holder's commission that the license

holder gives to a party of the transaction. A **referral fee** is something of value given by a license holder to someone for sending a prospective buyer, seller, landlord or tenant his way.

**Who can receive a rebate or referral fee?** A **rebate** can only be given to a party of a real estate transaction where the license holder represents one of the parties. A **referral fee** may only be given to a licensed broker or sales agent, unless the value of the gift is less than \$50 and is not cash, cash like, (i.e. a gift card) rent bonuses, or discounts. A person not licensed as a real estate broker or sales agent may receive a **referral fee** in very limited circumstances if they are engaged in the business of selling goods or services to the public and other factors are met. This exception is hardly ever used and can be found in 22 TAC §535.20(b).

**Some details to consider:** If the **rebate** is provided to someone other than the license holder's client, the client and sponsoring broker must first provide written consent. A license holder may not receive a **rebate** from a person other than their client without first disclosing to their client that the license holder intends to receive the payment. The license holder's client must consent prior to receiving the payment. However, this does not include **referral fees** between license holders. A **rebate** to a buyer from a license holder may be subject to restrictions by the buyer's lender. The buyer should notify and obtain the consent of the buyer's lender to address any impact the rebate may have on the determination regarding the buyer's credit worthiness.

## DISCUSSION

1. Can our team set up a "VIP" club for people who refer someone to the team more than 3 times a year? If they are in our "VIP" club, we will send them a box of goodies every month.
2. Can a license holder offer to enter an unlicensed person in a drawing to win a cruise for referring a potential lessee or buyer?
3. Is a locator permitted to rebate a portion of the locator's fee to the tenant?

## A Business Proposal to Raise Funds for Local Booster Clubs

XYZ Realty, LLC. would like to enter into a verbal or written (if necessary) agreement with your high school band booster club under which XYZ Realty would make a donation to the band booster club each time a booster club member refers someone to XYZ Realty that ends up using XYZ's brokerage services to buy or sell their personal real estate.

All sales, listings, and/or referrals by booster club members that result in a purchase or a sale will generate a donation to the booster non-profit organization of 20% of the commission earned by XYZ Realty in the first year of the agreement. A 15% of the commission in year two, and 10% of the commission in years three and beyond will be donated, until the promotion is terminated by either party.

### Example of a Sale for Booster Club Member

XYZ Realty, LLC sells a house for \$500,000. The commission paid by the seller is 3% to the buyer's agent and 3% to the listing agent for a 6.0% total commission. The total commission of 6% is \$30,000. XYZ's portion of the commission is \$15,000. XYZ Realty would make a donation of 20% of the \$15,000 commission to the booster club which would be \$3,000. The donation from XYZ Realty to the booster club would be paid on the first of each month following the closing. The annual donation target would be \$45,000/year.

To avoid conflicts, XYZ Realty, LLC requests that donated funds do not support student scholarships. The booster club may spend the donations any other way they see fit.

The booster club will recognize XYZ Realty at any banquets, football games and all other events when possible to promote the new fundraising concept.

The booster club can terminate this agreement at any time if not satisfied with our services.

Sincerely,  
XYZ Realty

## DISCUSSION

1. Is this arrangement permissible under TREC Rules? Why or why not?
2. Are there other ways to accomplish what XYZ is trying to do?

## Recent TREC Cases - Rebate Violations

### Case 1

A buyer banked at a credit union that had an association with a broker. Together they had a lending program that if the buyer met certain criteria (such as obtaining the home loan from that credit union), the broker would rebate 20% of broker's commission to the buyer at closing. The buyer chose to use the broker associated with his credit union. The sales agent told the buyer he was eligible for a rebate but did not write the conditions for the rebate into the buyer representation agreement OR anywhere else.

During the transaction, the buyer decided to change his lender to Wells Fargo, not knowing that he would 'lose' the rebate. Wells Fargo found out about the rebate promise shortly before closing and refused to permit the buyer to receive the rebate. (Agreed Orders for brokerage and agent, Advisory Letter for the designated broker)

### Case 2

The buyer agreed to use a broker for the purchase of a new home after the broker told the buyer he would rebate \$11,000 of the \$13,000 of his commission to the buyer. As closing approached, the buyer asked the broker how he would get the rebate. The broker didn't give the buyer a firm answer.

At closing, the entire commission was listed on the HUD-1 Closing Statement as payable to the broker. After closing, buyer demanded his rebate and after months of evasion, the broker refused to pay stating that the lender was not informed of the rebate and it should have been listed on the Closing Statement. Therefore, it was against federal law for the broker to pay the rebate. (Agreed Order for making a false promise of rebate, failing to disclose conditions of rebate and not making any effort to notify lender or title company of rebate in advance of closing is not outweighed by federal law after the fact.)

# CHAPTER 03

## ADVERTISING ISSUES

### Learning Objectives

After this chapter, you will be able to

- Identify forms of communication that are considered advertising.
- Identify the agent/broker information that must be on advertisements to comply with TREC Rules.
- Give examples of typical copyrighted material an agent may encounter.
- Explain how to avoid copyright infringement.



### §535.155 - Advertisements

- (a) Each advertisement must include the following in a readily noticeable location in the advertisement:
- (1) the name of the license holder or team placing the advertisement; and
  - (2) the broker's name in at least half the size of the largest contact information for any sales agent, associated broker, or team name contained in the advertisement.
- (b) For the purposes of this section:
- (1) "Advertisement" is any form of communication by or on behalf of a license holder designed to attract the public to use real estate brokerage services and includes, but is not limited to, all publications, brochures, radio or television

broadcasts, all electronic media including email, text messages, social media, the Internet, business stationery, business cards, displays, signs and billboards. Advertisement does not include:

- (A) a communication from a license holder to the license holder's current client; and
- (B) a directional sign that may also contain only the broker's name or logo.

Additionally,

- (4) "Contact Information" means any information that can be used to contact a license holder featured in the advertisement, including a name, phone number, email address, website address, social media handle, scan code or other similar information.

### TREC Case Study 3

Susie Sales Agent posted this message on Facebook:

“HELP!!! I am looking for buyers and sellers. If you know someone who is looking, I would appreciate the referral. All friend referrals that close will receive a gift card from me. The more you refer, the more money you can make . . . If you don't know anyone looking, please keep my business in your prayers.”

#### DISCUSSION

1. Is this an advertisement subject to TREC advertisement rules? If so, what should be included on the Facebook page?
2. Does this arrangement violate TREC referral rules?

### Social Media Litmus Test

How do you know if your postings on social media are considered an advertisement? Focus on the intent of the message. Is the message “designed to attract the public to use real estate brokerage services?” If the answer is YES, it is advertising.

Here's a handy litmus test: “If I put this on a postcard and mailed it to a neighborhood would I need to add my brokerage name, etc.?” If the answer is yes, all of the advertising rules apply.

### Using Copyrighted Material

As listing content, like photos of a property, becomes more and more publicly accessible, real estate agents and brokers have increased exposure to copyright infringement. Improper use of listing content can create legal problems. Therefore, it is crucial that you know what rights you have, and what you can and cannot do with someone else's listing content.

### Copyright Definition

A copyright is a form of legal protection provided to authors of “original works of authorship” (a work that is independently created and possesses at least some minimal degree of creativity).

The work must be fixed in a tangible form of expression, meaning it should be in a sufficiently permanent form such that the work can be perceived, reproduced, or communicated for more than a short time. Things like books, plays, paintings, and photographs can all have copyright protection, but you cannot protect things like ideas, facts, or short phrases or slogans.

### Copyright Ownership

Generally, the author who created the work, like the writer, the painter, or the photographer is the owner. However, when a work is made for hire, the author is not the person who actually created the work. Instead, the party that hired the individual is considered the author and the copyright owner of the work. For instance, when the work is created by an employee within the course and scope of his or her employment, the employer is considered the author and owner of the work.

### Copyright Ownership Rights

Copyright owners own certain exclusive rights, like the right to reproduce the work, the right to distribute the work, the right to display the work, and the right to create new works from the original work. A work generated from the original work is known as a derivative work.

### Sharing Copyright Ownership Rights

A copyright owner can grant or share certain rights with another through an assignment or license agreement.

- \* **Assignment:** When a copyright owner transfers ownership of the copyright to another person or entity. This is similar to a sale of a home.
- \* **License:** When a copyright owner only transfers some of his or her rights for a limited period of time or a limited purpose. With a license, you transfer your rights in the copyright to another person or entity, but you retain actual ownership of the copyright. This is similar to a lease of a home. Many license agreements will be non-exclusive, meaning the copyright owner can license the work to many different people or entities.

Sometimes, website owners may include a license in their terms of use or through an agreement that comes in the form of a pop-up box that must be clicked to accept.

### Copying and Use of Information from the Commission's Website

Information may be copied from the Commission's website and posted on a third-party website, so long as the information is not presented in a misleading way and does not imply that the third-party website is endorsed by the state of Texas or the Commission. If information from the Commission's website is copied and posted on a third-party website, that website must identify the Commission as the source of the information and include the Internet address from which the information was copied and the date the information was copied from the Commission's website.

## Copyright Infringement

Copyright infringement is the violation of one or more of the copyright owner's exclusive rights. A copyright infringement case requires proof of: (1) ownership of a valid exclusive copyright right, and (2) defendant's infringement of that right. Basically, copyright infringement is using a work without permission. You can only sue for infringement if you have registered your work with the U.S. Copyright Office.

*Fourth Estate Public Benefit Corporation v. Wall-Street.com*, 586 U.S. \_\_\_\_ (2019); 139 S. CT. 881

The federal Copyright Act of 1976 prohibits a copyright owner from suing for copyright infringement until "registration of the copyright claim has been made." Prior to the Fourth Estate decision, some courts interpreted this to mean that simply filing a copyright application for a work was enough to file a copyright infringement suit. However, other courts held that actually obtaining a registration at the U.S. Copyright Office was required before suing. The first interpretation was more favorable to copyright plaintiffs because the actual registration can take several months.

In this case, Fourth Estate sued Wall-Street.com for copyright infringement after Wall-Street.com posted Fourth Estate's articles without permission. However, these articles were not registered at the U.S. Copyright Office.

The U.S. Supreme Court held that copyright owners must obtain a copyright registration from the U.S. Copyright Office before suing for copyright infringement, finding that "registration has been made" can only mean one thing: that the Copyright Office's act of granting registration and not filing an application determines whether registration has been made.

This decision may encourage some copyright owners to register their works more promptly and may delay infringement suits.

## Protection From Copyright Infringement Claims

Copyright issues will typically impact real estate license holders through their use of photographs when marketing the property. If a license holder uses listing content in a way that is inconsistent with the rights granted to that license holder, then the copyright owner might sue for copyright infringement. Therefore, it is critical that license holders ensure that when, for instance, they upload a photographer's photograph to the MLS or when they post someone else's video on their website, they have the right to do so. Here are some ways license holders can protect themselves:

- \* Do not use content, like a photograph, unless you have permission.

- \* Review existing agreements so that you know what rights you have and make sure your use complies.
- \* Ensure future agreements, like license agreements, have given you the necessary rights.

### Copyright Scenario 1

A seller and listing broker enter into a listing agreement for the sale of property. The listing broker enters into a non-exclusive license agreement with a photographer to take photos of the property for marketing purposes.

The listing broker uploads the photos to the MLS. The property never sells and the seller and listing broker agree to terminate their agreement. The seller decides to try again and enters into a new listing agreement with a new listing broker. The new listing broker finds the photographs of the property and decides to reuse them.

#### DISCUSSION

1. Is it okay for the second listing broker uses the photos?
2. Other than copyright law, what other rules and regulations may you need to consider when using the photos?
3. The photos were posted on the MLS. Can't the second listing broker reuse them for her listing?
4. What should the second listing broker do to make sure they can legally reuse the photos?

### Copyright Scenario 2

An agent has decided she wants to create a website. She lives and works in San Antonio so she wants to use photographs of San Antonio landmarks on her website. She searches online and finds the perfect photo of the Alamo, taken by a well-known photographer. She downloads the photo and posts it on her website, making sure to credit the photographer.

#### DISCUSSION

1. Should the agent have posted the photo?
2. Does the fact that the agent gave credit to the photographer matter?
3. What should the agent do to obtain proper authorization to use the photo?

# CHAPTER 04

## TITLE ISSUES AND CLOSING

### Learning Objectives

After this chapter, you will be able to

- Discuss the issues associated with closings where the seller of the property is an LLC or Trust.
- Identify what types of documents and bank accounts should be in place for an LLC or Trust to appropriately obtain their proceeds from a sale.
- Explain the ramifications of an unnotarized T-47 delivered at closing.
- Identify the two reasons a listing agent should not switch title companies for the purpose of closing a backup or second contract.
- Name one FIRPTA best practice an agent/broker should take with a seller.



### Closing LLCs

The market has experienced a surge of investors buying residential property to renovate and flip. These investors often take title in the name of a limited liability company (“LLC”).

LLCs are a popular entity structure for holding investment property because of the insulation from risk exposure and potential tax benefits, but also because of the perceived ease of administration. Investors can go online to file the Certificate of Formation with the Texas Secretary of State. Unfortunately, that is as far as many go. Many fail to create an operating agreement (also known as a company agreement) to establish the particular authority, or even the exact number, of the manager(s) or member(s). This results in situations where the

title company can only rely on the Certificate of Formation’s designation of manager(s) or member(s) and a written statement from such persons. Such a statement may be a certificate or affidavit stating that the only member(s) or manager(s) are those listed in the formation documents and that such persons have the authority to sign on behalf of the company for the contemplated transaction. But these affidavits are often self-serving, leaving title companies and the LLCs themselves open to greater risk of fraud or unauthorized persons conducting transactions on the LLC’s behalf. In an effort to provide some relief, the legislature passed a bill this session that allows a third party to rely on an Affidavit of Authority to Transfer real property by an LLC or other covered entity (H.B. 1833). The Affidavit must contain all the information required in the statute and is restricted based on

the size of the transaction. Additionally, it is specific as to who can sign the Affidavit. The Affidavit is not in lieu of an operating agreement, but may be relied on by the title company. It is highly preferable for all involved to have an operating agreement in place.

In addition to these challenges, when an LLC sells property, title companies often find that the investors using the LLC structure to hold title to the property have never opened a bank account in the name of the LLC. Instead, the investors request the sales proceeds be paid to the individual member(s) of the LLC.

There are two problems with issuing the sales proceeds to an individual instead of the actual seller, the LLC. The first issue has to do with the fiduciary duty title companies owe to lenders. In *Home Loan Corp. v. Texas American Title Co.*, 191 S.W.3d 728 (Tex. App.—Houston [14th Dist.] 2006, pet. denied), the court ruled that a title company owes a fiduciary duty to the lender to close according to the lender’s closing instructions. Since that ruling, most lenders have inserted language in their closing instructions to the effect that the title company is not authorized to close the transaction if the title company is not prepared to complete and deliver the transaction as shown on the settlement statement. If the title company pays sales proceeds to an individual or entity who is not the “seller” reflected on the settlement statement, it violates its fiduciary duty to the lender.

However, even if the settlement statement were specifically to reflect a line item payment of seller’s proceeds to an individual other than the LLC, a second issue remains regarding the purpose and protection of the LLC structure. An LLC can shield an individual from personal liability and set up a structure for writing off expenses for income tax purposes. However, the payment of the LLC’s proceeds to an individual could support a potential claim that the LLC is a sham or a mere “alter ego” of the individual, thereby potentially subjecting the individual to liability and tax issues that the LLC was formed to protect against.

This is because Texas courts have held that an LLC member may be held individually liable for debts of an LLC if the LLC is a mere alter ego of the member. An alter ego may be found when the LLC and individual are so unified that holding only the LLC liable would work an injustice. One of the factors used by courts in determining whether such unity exists is the degree to which individual property has been kept separately and has not been commingled with LLC property. See, e.g., *Watkins v. Basurto*, 2011 WL 1414135 (Tex.App.—Houston [14th Dist.] Apr. 14, 2011, no pet.); *Doyle v. Kontemporary Builders, Inc.*, 370 S.W.3d 448 (Tex.App.—Dallas 2012, pet. denied); and *In re Arnette*

(*Ward Family Foundation v. Arnette*), 2011 WL 2292314 (Bankr. N.D. Tex. June 7, 2011).

Therefore, the failure to maintain a bank account for the LLC and commingling its real estate proceeds with individual funds can bolster the position of creditors and other organizations wishing to “pierce the corporate veil” to reach beyond the LLC to the individual’s assets. It is in the best interest of the title company, the LLC, and its members that the LLC’s proceeds be disbursed into an account in the name of the LLC.

## Closing Trusts

Many homeowners have placed their homes in trust to avoid probate. However, similar to the LLC issues discussed above, because the home is often the only asset in the trust, the homeowners never set up a bank account for the trust. Upon closing, the trustee of the trust asks the title agent to pay the proceeds directly to the individuals (trustees and/or beneficiaries of the trust). For the same reasons as above, paying an individual that is not the official seller in the transaction is problematic and can subject the title company to liability.

When listing a property held in the name of a trust or LLC, real estate agents can do a great service to their clients by encouraging them to set up a bank account in the name of the LLC or trust as soon as possible, if one has not already been established. This allows them time to provide the necessary paperwork required by the bank and avoids closing delays occasioned when sellers must wait for the activation of a new bank account to receive proceeds.

## Commission Disbursement Authorizations and Instructions

Many real estate brokers ask the title agent to split the commissions up between the broker and agents. This is done by written authorization from the broker, which is commonly referred to as a Commission Disbursement Authorization (“CDA”). Under the Real Estate License Act (Chapter 1101 of the Texas Occupations Code), which governs brokers and sales agents, brokers may only pay commission to license holders.

Specifically, Texas Occupations Code Section 1101.651 states:

“A licensed broker may not pay a commission to or otherwise compensate a person directly or indirectly for performing an act of a broker unless the person is:

- (1) A license holder; or
- (2) A real estate broker licensed in another state who does not conduct in this state any of the negotiations for which the commission or other compensation is paid . . . .”

A common challenge comes when a license holder has been advised to set up an LLC through which to run his or her real estate activity for tax purposes. The title company receives a CDA from the broker directing a specific portion of the commission to be paid to the license holder. The license holder then asks the title company to pay such commission portion to his/her LLC. But, unless the LLC itself is licensed, the commission cannot be paid to the LLC. Paying the LLC in this situation would:

- i) cause the title company to violate the instructions provided in the broker's CDA;
- ii) subject the broker to penalties and fines imposed by the Texas Real Estate Commission ("TREC") for paying commission to a non-licensed person or entity [a violation of TREC Rule §535.147]; and
- iii) potentially create an IRS audit issue because the 1099 issued by the broker to the license holder would not match the license holder's tax return.

Unless the license holder gets his or her LLC formally licensed with TREC, the license holder should not ask the title company to pay the license holder's commission to the LLC.

## T-47 Misconceptions

Some real estate agents pay little attention to the importance of having the T-47 notarized and executed by all sellers listed on the contract within the timeframe specified in the contract.

Paragraph 6(c)(1) of the TREC One to Four Family Residential Contract (Resale) (the "Contract") states, "Within \_\_\_ days after the Effective Date of this contract, Seller shall furnish to Buyer and Title Company Seller's existing survey of the Property and a Residential Real Property Affidavit (T-47 Affidavit). If Seller fails to furnish the existing survey or affidavit within the time prescribed, Buyer shall obtain a new survey at Seller's expense . . . ." (emphasis added).

Listing agents often assume that their clients can comply with the above paragraph by delivering an unnotarized T-47, which could then just be resigned and formally notarized at closing. However, the Contract specifically requires that Seller deliver an "affidavit." By definition, an affidavit is a sworn statement. A statement that is not sworn cannot be an affidavit and, therefore, if the T-47 does not contain the sworn notarization contemplated by the promulgated form within the time specified, the Seller has not "furnished" the affidavit in accordance with the Contract. The ramifications of this failure, as stated in the Contract, are that the Buyer can then obtain a new survey at Seller's expense.

Additionally, a title company can rely on a T-47 affidavit signed by only one of two or more individuals named as the "Seller" in order to approve the survey. However, if the T-47 affidavit is not signed by all individuals who are listed as "Seller" in the Contract, then the "Seller," as that term is defined, arguably did not provide the required affidavit. Again, under the consequences outlined in Para. 6(c)(1) of the Contract, Buyer would be able to obtain a new survey at Seller's expense.

## Back-Up and Second Contracts

After a contract "falls through" or otherwise appears as if it will not close, sellers often jump to sign a new contract with a new buyer, even though the first contract has not been formally released by all parties. Often, the new buyer signs a contract, pays the option fee, deposits the earnest money, and incurs other expenses before learning that the seller cannot close because the first contract was not properly terminated and remains in dispute. It is thus prudent for buyer's agent to ask for evidence that all parties have been fully released from their obligations under the first contract before entering into a contract with seller.

If the first contract has not been fully released, the second buyer may be better off entering into a back-up contract with seller. The TREC Addendum for Back-up Contract still requires that the option fee be paid and earnest money be deposited in accordance with the contract, but it defers the time for performance of all other obligations under the contract until the first contract is terminated and the backup becomes "primary." If the option fee is properly paid, buyer's unrestricted right to terminate begins immediately and, after becoming primary, extends for the number of days stated in Paragraph 23 of the contract (assuming use of a standard TREC contract). This gives the buyer the option to wait until becoming primary to spend any money on inspections, and it keeps seller from being in default if the first contract is not terminated by a specific time.

Listing agents, knowing that the title company cannot and will not close a second contract on the property until the first one has been fully released, may switch the title company for the closing of the second contact.

This is a mistake for two reasons:

- i) if the second buyer knows that the first contract has not been fully terminated and released, and the first buyer later makes a claim under the first contract, the second buyer has no protection under the title insurance policy. This is because the owner's title policy excludes coverage for matters that are known to the insured, but not the title company, on the date of the



- policy, unless such matters appear in the public records; and
- ii) if the second buyer does NOT know about the first contract, the second buyer may have protection under the title policy; however, as with any insurance contract, the title company (insurer) is subrogated to the rights of the buyer (the insured) to go after the party at fault. At closing, the seller signs a “warranty deed” to the buyer. The warranty deed “warrants” that title is free and clear of encumbrances (except as otherwise stated therein). When the seller does not disclose the pre-existing first contract, the title company can step into the shoes of the buyer and pursue the seller under the warranty deed. Thus, a real estate agent that encourages opening the second contract with a second title company for the sole purpose of closing without regard to the unreleased first contract is not only doing a disservice to his or her clients, but could be found by TREC to be acting negligently or in bad faith.

## Escrow Requests to Avoid

There are several requests title company escrow officers receive from real estate agents that should be avoided. Below are some common examples.

1. Real estate agents should not ask the escrow officer to select or order the buyer’s residential service contract.

The buyer, and not the escrow officer, should handle the process of ordering a residential service contract (“RSC”), also known as a “home warranty.” The buyer can send the invoice to the escrow officer to be collected and paid at closing. The escrow officer has limited or no familiarity with the structure, features, or size of the home subject to the RSC, and the escrow officer is unaware of the particular coverages the buyer may want included in the RSC’s coverage. Real estate agents do a disservice to their clients if they do not encourage them to be involved in this process. Title companies and real estate agents can end up in conflict with the buyer after closing if the buyer is not involved in selecting the RSC coverages, and then buyer ends up having to pay for repairs for which RSC coverage was available but not selected.

2. Real estate agents should not ask the escrow officer to pass checks between buyer and seller at closing.

Sometimes real estate agents ask that the title company deliver a check from buyer to seller, or vice versa, at closing for funds that are not shown

on the settlement statement (often referred to as the “Closing Disclosure”). However, in any transaction where the buyer has a lender, any monies that need to be transferred between Seller and Buyer at closing must be reflected on the Closing Disclosure. The title company has a fiduciary relationship with the lender, which requires the title company to close as instructed on lender’s written closing instructions. Typical lender closing instructions contain language similar to the following:

“The escrow agent shall close the transaction and disburse funds only in accordance with the Closing Disclosure. If any party to the transaction requests that his/her funds be disbursed in any manner different from the Closing Disclosure, the escrow agent shall advise us of the request and obtain prior approval from us before any funds are disbursed in a manner different from the Closing Disclosure.”

This means that payments for matters connected with the sale of the property, such as leasebacks, non-realty items, or credits from Seller to Buyer, must be reflected on the Closing Disclosure. To ask the escrow officer to aid them in circumventing the Closing Disclosure via “side payments” not reflected thereon is to ask the title company to violate its fiduciary duty to the lender. In addition, “side deals” not reflected on the Closing Disclosure could also subject those involved to liability for mortgage fraud.

3. Real estate agents should not ask the escrow officer to delay closing due to a dispute between the listing agent and the buyer’s agent as to the commission split.

Technically all of the commission belongs to the listing broker. In the event of a dispute, the law would require the title company to pay the listing broker all of the commission, and the buyer’s broker would have to pursue the listing broker for their split owed to them. To try to hold up a closing based on such a dispute is a violation of the agent’s fiduciary duty to act in the best interest of the client.

4. Real estate agents should not ask the escrow officer to notarize pre-signed documents.

With the exception of Online Notaries (who are subject to a separate set of stringent regulations), a Texas notary cannot notarize the signatures of persons that do not sign or acknowledge a document in the notary’s physical presence. Texas notaries must also review sufficient identification that meets the standards required by state notary

regulations. Asking a notary to notarize documents of a client who is not present is asking the notary to break the law.

5. Real estate agents should not ask the escrow officer to pay an entity (LLC's) or trust seller's proceeds directly to an individual client.

See the above section on Closing LLCs.

6. Real estate agents should not ask escrow officers to pay their individual agent commissions to their own unlicensed LLCs.

See the above section on Closing LLCs.

7. Real estate agents should not be delivering option fee monies to title companies instead of the listing agent or sellers.

See the above section on Closing LLCs.

## **FIRPTA Best Practices**

The day of closing is NOT a good day to learn that the seller is a foreign person.

This is not something to ignore and assume title or someone else is going to take care of FIRPTA.

A commonly used listing agreement under "other notices" has a paragraph regarding "foreign status". On every listing appointment, there is an action that each seller should take to answer the question regarding their foreign status or not foreign status. A prudent broker will have a list of CPAs or attorneys who are familiar with FIRPTA to provide to a seller with a foreign status. The CPA or attorney can guide the seller and advise them regarding their tax obligations under this law. A license holder should NOT take it upon themselves to determine whether or not the seller has a tax obligation under FIRPTA. However, it will be important for the buyer of any property of a foreign status seller to know this has been taken care of in advance of the closing date, since the law requires the buyer to withhold from the sales proceeds an amount sufficient to comply with applicable tax law and deliver the same to the IRS.

It is not the title company's job to take care of these issues for the seller or the buyer.

### TREC Promulgated Contracts

**20. FEDERAL TAX REQUIREMENTS:** If Seller is a "foreign person," as defined by Internal Revenue Code and its regulations, or if Seller fails to deliver an affidavit or a certificate of non-foreign status to Buyer that Seller is not a "foreign person," then Buyer shall withhold from the sales proceeds an amount sufficient to comply with applicable tax law and deliver the same to the Internal Revenue Service together with appropriate tax forms. Internal Revenue Service regulations require filing written reports if currency in excess of specified amounts is received in the transaction.

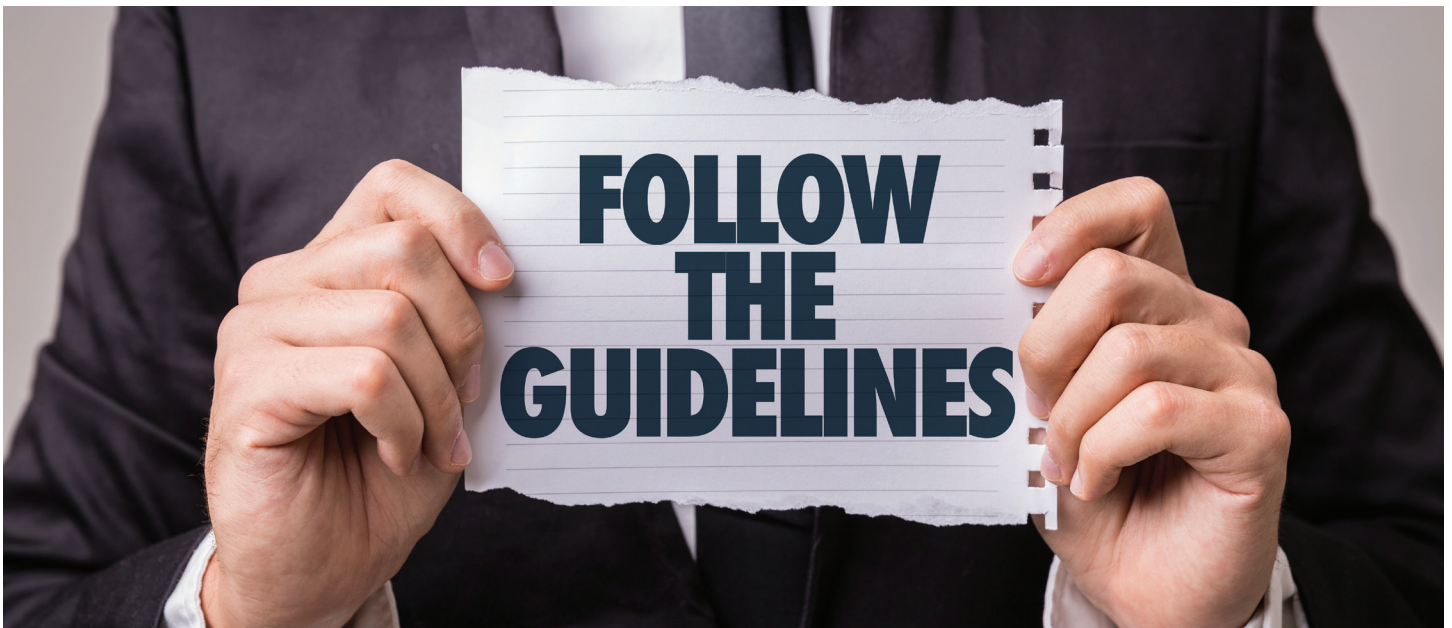
# CHAPTER 05

## RESPA COMPLIANCE

### Learning Objectives

After this chapter, you will be able to

- Identify what is allowable and not allowable to be paid by title companies for a broker or agent under the Texas Dept. of Insurance's Rule P-53.
- Discuss the issues surrounding Marketing Service Agreements between title companies and brokers that have led to increased scrutiny from the CFPB.
- Be familiar with TREC Rule §535.148 that addresses consumer protection issues involving settlement service providers.



RESPA – Real Estate Settlement Procedures Act . . . and related rules affecting relationships with title companies and title agents.

The Real Estate Settlement Procedures Act (12 U.S.C. 2601 et seq.) was enacted by Congress in 1974. Regulation X (12 C.F.R. Part 1024), which implements the act (the act and Regulation X collectively referred to herein as “RESPA”), states: “No person shall give and no person shall accept any fee, kickback or other thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or part of a settlement service involving a federally related mortgage loan shall be referred to any person. A company may not pay another company or employees of the other company for the referral of settlement service business.”

Settlement services are generally those services provided in connection with purchasing property, such as title insurance and settlement, real estate brokerage, mortgage lending, appraisals, home inspections, surveys, casualty insurance and home warranties.

### Rule P-53

Because RESPA's prohibition on providing a “thing of value” in exchange for referral of business is somewhat vague, the Texas Department of Insurance promulgated Procedural Rule P-53 (“P-53”) to help define “thing of value” for the Texas title industry. Under that rule, title companies are prohibited from paying, contributing or sharing in the cost of any part of the business expenses of a real estate broker or agent. The rule defines “business expenses” to mean any cost to operate or promote

the business of the broker or agent, and specifically prohibits a title company from contributing or paying any part of the costs of: open houses held by brokers or agents; providing prizes, food, beverages, gifts, decorations, entertainment or professional services given at open houses; and parties or receptions which promote an agent or broker, amongst other examples of real estate broker and agent “business expenses.”

P-53 does, however, specifically allow a title company to pay for advertising and promotional opportunities, as long as the payment is at market rates for the advertising and not conditioned on the referral of business. That means a title company can pay to advertise or promote itself at an event of an agent or broker, as long as the payment is at market rate and the title company does in fact promote itself at the event. If the payment is above market rate or the title company does not show up to promote itself, it is more likely that the payment would be viewed as pretense for providing “thing of value” exchange for referral of business.

However, the specific prohibition against paying or contributing anything towards an open house or other event just promoting the properties and activities of the real estate broker or agent controls, irrespective of the advertising opportunity. P-53 requires that a title company or title agent keep auditable records supporting compliance with the rule. Failing to comply with the rule can subject the violators to steep civil penalties, in addition to the civil and criminal penalties that may be imposed by RESPA.

RESPA itself also emphasizes the need for payments for a “thing of value” to reflect market value, stating, “If payment of a thing of value bears no reasonable relationship to the market value of the goods or services provided, then the excess is not for services or goods actually performed or provided. These facts may be used as evidence of a violation of [RESPA].” (12 C.F.R. §1024.14(g)(2)).

## Marketing Service Agreements

Marketing service agreements (“MSAs”) between real estate brokers and title companies have commonly been used to establish and define the terms under which the title company may promote and advertise itself through the broker. However, in recent years, MSAs have come under increasing scrutiny from the Consumer Financial Protection Bureau (“CFPB”), the federal agency responsible for enforcing RESPA. The reasons are numerous, including but not limited to:

- 1) the fee amounts vary widely and are not usually directly related to the amount of advertising or promotional benefit to be received by the title company, making it hard to prove market value;

- 2) fees paid are above and beyond what would reasonably be required for a title company to participate in a particular event to promote itself; and
- 3) unless the title company or title agent can provide evidence that its marketing materials are continuously displayed, and that it promotes itself at each event, it is not in compliance with the rule.

Under CFPB Consent Order 2014-CFPB-0015, Lighthouse Title Inc. was ordered to pay a \$200,000.00 civil penalty for violation of RESPA’s anti-kickback provisions. CFPB found that, among other things, Lighthouse did not determine a fair market value for the services it allegedly received under numerous MSAs; it did not diligently monitor its brokers to ensure that it received the services for which it contracted; it believed that if it did not enter the MSAs that the brokers would refer their business to other companies; and the brokers referred significantly more transactions to Lighthouse when they had an MSA as compared to when they didn’t. The latter is what was intended, since the purpose of “advertising” and “marketing” a business is to get more business, and yet the CFPB cited this as evidence of a violation!

MSAs may cause additional issues when the service provider, e.g. an inspector, is “ranked” on a real estate broker’s website or other advertising materials based on amount paid for the advertising. That ranking may mislead the public into believing the ranking is based on quality of service provided by the service provider. For example, if a broker’s website ranks service providers as platinum, gold or silver simply based on the amount paid for the MSA, such may imply that the ranking is based on quality or relative value to the consumer. The Texas Real Estate Act prohibits misleading or deceiving advertisements (Texas Occupations Code §1101.652(b)), and under Texas Real Estate Commission (“TREC”) Rule §535.155(d)(19), an advertisement may be misleading if it contains a claim to a special or relative quality standard unless it includes a disclosure of the objective criteria upon which the claim is based. Ranking solely based on amount of payment may be misleading advertising.

RESPA does allow the splitting of charges made or received for rendering a settlement service involving a federally related mortgage provided it is for services actually rendered, and the fee is paid whether the transaction is completed or not. The services rendered must be actual, necessary and distinct from services already provided. If the payment to the real estate agent or broker exceeds market value for such services, the excess is considered a kickback violating RESPA. Nominal services or services which must be duplicated by the service provider are not actual, necessary or distinct.

TREC recently revised Rule §535.148 to provide clarity about consumer protection issues when paying or receiving funds to/from other settlement service providers, to detail who is considered a settlement service provider that mostly parallels the definition in RESPA, and what activity is not prohibited.

See Appendix A for TREC Rule §535.148 (d)(e) and (h)

In addition to RESPA compliance issues, it is important to remember that if a real estate broker or agent receives a payment from a service provider for actual, necessary and distinct services rendered, the broker or

agent must disclose to and obtain the consent of the party to whom the service is rendered (see TREC Rule §535.148(b)). Additionally, the client of the broker or agent receiving the compensation must consent to the payment, whether or not the client is the recipient of the service (see TREC Rule §535.148(a)).

See Appendix B for the article “RESPA Do’s and Don’ts for Co-Marketing, Social Media, & Other Web-Based Marketing Tools” from the National Association of Realtors.

## Case Summary

### Investor Class Action Lawsuit Against Zillow Gains Traction in Amended Complaint

Investors claim that Zillow’s “co-marketing program” was designed to allow participating real estate agents to refer mortgage business to participating lenders in violation of RESPA.

The lawsuit, which had previously been dismissed for lack of specificity, gained legs, when a judge declared that the amended complaint contains enough particularized facts to support a claim that Zillow maintained an arrangement, in which lenders paid for a portion of agents’ advertising costs in return for mortgage referrals that violated RESPA. The case is still in the early stages—this ruling simply means that the case will likely be heard on its merits after Zillow’s motion to dismiss was denied.

Based on facts alleged in the suit, “the Court can draw a reasonable inference that Zillow designed the co-marketing program to allow agents to provide referrals to lenders in violation of RESPA, and that such referrals were occurring.” The allegations claim that there was “an understanding between Zillow and the co-marketing participants, that in exchange for lenders paying a portion of agents’ advertising costs, lenders would receive mortgage referrals from their partnering agents.” That arrangement was not documented, but “evidenced by participating agents allegedly providing, and Zillow allegedly tracking, referrals to participating lenders.”

In Zillow’s co-marketing scheme, vendors pay a portion of a real estate agent’s advertising costs on Zillow in exchange for appearing on an agent’s online listings. These lenders appear on the agent’s listings as “preferred lenders,” and are sent the lead when Zillow users provide an agent with their contact information. While the judge originally declared these costs to be protected under RESPA’s safe harbor provision, the additional information provided in the amended complaint made a difference. These preferred lenders were paying, according to the complaint, “more than fair market value for the advertising they received and therefore fell outside RESPA’s safe harbor provision.”

## Discussion Scenarios

Break into three groups with each group assigned a different scenario. Each group will answer the discussion questions below and report back to the class.

### Scenario A

A brokerage has established a tiered Vendor Sponsorship program. The more a vendor pays for sponsorship, the more face-to-face access time will be given to the sales agents for that office. Sponsorship would be limited to only three of each type of vendors (this includes home inspectors, title companies and lenders). Sponsorship benefits are advertised by the brokerage as a limited number of your vendor type to compete against for agent referrals. Sponsoring vendors would appear on the brokerage's preferred vendor list and promoted throughout the office; only sponsoring vendors may leave marketing materials for distribution to agents; permitted to sponsor a team meeting by providing breakfast or lunch; almost exclusive interaction with agents at that office. Sponsorship fees can range from \$1100.00 - \$2500.00 per month. The more you pay, the higher your tier and the more personal access time you will be given to the brokerage agents.

### Scenario B

A brokerage has a program where three home inspectors pay a monthly fee to contribute to the cost of marketing software purchased by the broker for the benefit of the broker and sponsored agents. Only three inspectors will be used to help cover the cost and will appear on a preferred inspectors list that will be provided to all agents at that office. The preferred inspectors would also appear on the marketing software portal. The only qualifications for selecting which home inspectors would participate is based upon which ones are willing to put up the funds.

### Scenario C

A brokerage rents office space within the real estate office to a mortgage broker.

## DISCUSSION

1. Does this program violate RESPA? What about TREC Rule §535.148 or TREC Advertising Rule §535.155?
2. What factors may be important in determining whether it violates RESPA or TREC Rules?
3. Is this program in the best interest of the broker's client (read fiduciary duty here)?

# CHAPTER 06

## INSPECTOR AND LENDER RELATIONSHIPS AND DUTIES IN THE REAL ESTATE TRANSACTION

### Learning Objectives

After this chapter, you will be able to

- Describe the standard to which an inspector conducts business.
- Identify which party to the transaction receives the inspection report.
- Identify who should be allowed on the premises or to accompany an inspector on an inspection.
- Define the basic duty of a mortgage loan officer.
- Describe the license holder's responsibilities to the buyer concerning lenders and mortgage loan originators.



Inspectors are individuals licensed by TREC to perform inspections of real property when it is part of a real estate transaction. Inspectors provide information on the performance of certain systems in the property. For residential properties, they are required to use the TREC standard report form and are guided by rules known as “Standards of Practice” to ensure consistency throughout the home inspection process. A home inspection is a limited visual survey and basic performance evaluation of the systems and components of the house. It does not require the use of specialized equipment and is not a comprehensive investigative or exploratory probe to determine the cause or effect of deficiencies noted by the inspector. TREC does not require inspectors to inspect to any of the various building codes. However, an inspector is free to inspect to a

higher standard (such as to various codes or recognized safety hazards), as long as they do so competently.

An inspector cannot:

- \* Perform a hydrostatic test unless they are also licensed as a plumber;
- \* Perform a mold assessment unless they are also licensed by the Texas Department of Licensing and Regulation;
- \* Test for the presence of wood-destroying insects unless they are also licensed by the Texas Department of Agriculture;
- \* Accept employment to repair, replace, maintain or upgrade systems or components of property covered by the Standards of Practice within 12 months of the date the inspector performed an inspection on the property;

- \* Disclose inspection results or client information without prior approval from the client;
- \* Pay or receive a fee or other valuable consideration to or from any other settlement service provider (newsflash – brokers and sales agents are considered settlement service providers).

## Inspector FAQ's

### Should a buyer's or seller's agent ask the inspector for a copy of the inspection report prepared for the buyer?

To answer this question, you need to remember who the inspector's client is and which party you represent. Who is the inspector's client? The person who contracts with the inspector and pays for the inspection services (usually this is the buyer). See the article below.

### Where Does That Inspection Report Go?

After an inspection is performed, often times the inspector will go over the findings with the potential buyer to let them know about all of the deficiencies that the inspector observed during the course of the inspection. By rule, the inspector must have the report sent to the client no later than 48 hours after the inspection is paid for, unless otherwise agreed to in writing. In most cases, the agent or broker that represents the buyer would like a copy of the inspection report sent to them as well. The inspector is only allowed to send the report to the inspector's client, as they are the ones that own the report. If the buyer's agent would like a copy of the report, the buyer must give their permission to the inspector in order for the inspector to do so. If an agent is unable to attend the inspection with the buyer, then it would be a good idea to inform the buyer to ask the inspector to send them a copy of the inspection report at the time of the inspection. This will help ensure that the inspector obtains the permission from the buyer to do so, and it makes sure that the agent gets the report at the same time the buyer does. In most situations, it is a good idea for the buyer to allow the inspector to send the agent the report. However, there are some situations where that may not be a good idea. One situation in particular is when there is an intermediary situation. In that situation, the inspector may choose to not send the report to the agent directly. It would be best, in that scenario, for the buyer to send the report to the agent themselves if they choose to do so. The issue here is that if a broker represents a

buyer and a seller and has not appointed separate agents to each party, neither the broker nor the broker's agents may give advice to either party in the transaction. Further, if the broker or an agent gets a copy of the report, they are now aware of material defects in the property. Being that they also represent the seller, that information must be conveyed to the seller as well. If the seller is aware of the material defects to a property, then they should modify the Seller's Disclosure Notice to reflect the known issues.

Contributed by Lee Warren, Chair of the Texas Real Estate Inspector Committee. Mr. Warren is a licensed Professional Inspector and a Broker.

### Can an inspector allow the buyers to accompany him/her during the inspection if the buyer's agent and the sellers are not present?

Presumably, the buyer has a signed contract where the seller has already given consent to allow access the property "at reasonable times." Section 7 of the One to Four Family Residential Contract states that the "Seller shall permit Buyer and Buyer's agents access to the Property at reasonable times. Buyer may have the Property inspected by inspectors selected by Buyer and licensed by TREC or otherwise permitted by law to make inspections." So, as long as the seller is notified and agrees to the time of the inspection, both the buyer and the inspector have the seller's permission to be there, with or without the buyer's agent.

### Is it a violation for the inspector to provide access to the home since the inspector is not a broker or agent?

The inspector has not committed a TREC violation simply by allowing access to the property. Remember, licensed inspectors, like real estate license holders, go through a criminal background check and this distinguishes them from an unlicensed assistant. Whether or not an inspector can access the lockbox to enter a home depends on whether the MLS rules in their area allows them to have access, and whether the rules allow access for just the inspector, or the inspector and the buyer. If the MLS rules do not, the seller, seller's agent or the buyer's agent will have to be present to provide access to the buyer for the inspection.

### Is the inspector or the buyer's agent liable if the buyer damages or removes something from the home during the inspection?

The question of liability is a civil matter. The answer



would turn on the particular facts of the case, including local MLS access rules, the terms of the listing agreement and contract, any directions given by the seller regarding the need for an agent to be present and whether the inspector or agent knew or should have known what the buyer was doing.

## Lender Relationships and Duties

The basic duty of a mortgage loan officer is to provide the best information possible about the mortgage loan process and give the consumer the choices that are available to them to make the best choice about a mortgage loan AND to assist the consumer in meeting the contract deadlines the consumer has agreed to meet.

Mortgage loan originators are licensed through the Nationwide Multistate Licensing System (NMLS).

Education requirements for licensure of mortgage loan originators (MLOs) includes annual continuing education. The SAFE Act requires state-licensed MLOs to complete:

- a. Three hours of federal law and regulations;
- b. Two hours of ethics that shall include instruction on fraud, consumer protection, and fair lending issues;
- c. Two hours of training related to lending standards for the nontraditional mortgage product market; and
- d. One hour of undefined instruction on mortgage origination.

Consumers and real estate license holders should consult with a mortgage loan originator before determining the timeframes put in the Third Party Financing Addendum to ensure the timeframes are realistic. Connecting a buyer with a mortgage loan originator early in the process of a home search is the prudent action to take. And assisting the consumer in understanding it not just a “suggestion” that the consumer’s financial documents be sent to the lender, it is the ONLY way the lender can make an informed decision about approving this consumer for a mortgage loan.

As a real estate license holder, one of your responsibilities is to offer choices to the buyer consumer about mortgage lending and to help the consumer understand a contract is an obligation with real deadlines to meet and consequences for not meeting those deadlines. Furthermore, in the current environment with many choices for lending, some lenders are not competent to handle a mortgage loan that does not fit into a strict criteria. Be aware, some lenders have no interest in your particular consumer - it is just another application in a long line of applications. Another of the real estate

license holder’s responsibilities is to make certain the mortgage lender and title company have all the amendments to the contract as soon as they are executed.

What a lender doesn’t want to hear:

“We lowered the price last week, why can’t you close it tomorrow?”

“The seller is giving the buyer cash in lieu of repairs”

“We don’t have to tell anyone the buyer has to sell the home they have in order to buy this one, do we?”

“Couldn’t you just create a pre-qualification letter and talk to the buyer later?”

“The buyer is not working now, couldn’t we just use the job they used to have?”

# RULE §535.148, RECEIVING AN UNDISCLOSED COMMISSION OR REBATE

Proposed rule expected to be approved at august 2019 commission meeting.



## AGENDA ITEM 22

### ADOPTED RULE ACTION FROM THE AUGUST 12, 2019, MEETING OF THE COMMISSION CHAPTER 535 GENERAL PROVISIONS

#### Subchapter N. Suspension and Revocation of Licensure §535.148. Receiving an Undisclosed Commission or Rebate

#### §535.148. Receiving an Undisclosed Commission or Rebate.

(a) A license holder may not receive a commission, rebate, or fee in a transaction from a person other than the person the license holder represents without first disclosing to the license holder's client that the license holder intends to receive the commission, rebate or fee, and obtaining the consent of the license holder's client. ~~[This subsection does not apply to referral fees paid by one licensed real estate broker or sales agent to another active licensed broker or sales agent.]~~

~~(b) - (c) (No change.)~~

(b) - (c) (No change.)

(d) ~~A license holder may not pay or receive a fee or other valuable consideration to or from any other settlement service provider for, but not limited to, the following: [A license holder may not accept a fee or payment for services provided for or on behalf of a service provider to a real estate transaction the payment of which is contingent upon a party to the real estate transaction purchasing a contract or services from the service provider].~~

(1) the referral of inspections, lenders, mortgage brokers, or title companies;

(2) inclusion on a list of inspectors, preferred settlement providers, or similar arrangements; or

(3) inclusion on lists of inspectors or other settlement providers contingent on other financial agreements.

(e) In this section, "settlement service" means a service provided in connection with a prospective or actual settlement, and "settlement service provider" includes, but is not limited to, any one or more of the following:

(1) a federally related mortgage loan originator;

(2) a mortgage broker;

(3) a lender or other person who provides any service related to the origination, processing or funding of a real estate loan;

(4) a title service provider;

(5) an attorney;

(6) a person who prepares documents, including notarization, delivery, and recordation;

(7) a person who provides credit report services;

(8) an appraiser;

(9) an inspector;

(10) a settlement agent;

(11) a person who provides mortgage insurance services;

(12) a person who provides services involving hazard, flood, or other casualty insurance, homeowner's warranties or residential service contracts;

(13) a real estate agent or broker; and

(14) a person who provides any other services for which a settlement service provider requires a borrower or seller to pay.

~~(f) (e)~~ A license holder must use TREC No. RSC-2, Disclosure of Relationship with Residential Service Company, to disclose to a party to a real estate transaction in which the license holder represents one or both of the parties any payments received for services provided for or on behalf of a residential service company licensed under Texas Occupations Code Chapter 1303.

~~(g) (f)~~ The Texas Real Estate Commission adopts by reference TREC No. RSC-2, Disclosure of Relationship with Residential Service Company,

approved by the Commission for use by license holders to disclose payments received from a residential service company. This document is published by and available from the Texas Real Estate Commission, P.O. Box 12188, Austin, Texas 78711-2188, [www.trec.texas.gov](http://www.trec.texas.gov).

[\(h\) This section does not prohibit:](#)

[\(1\) normal promotional or educational activity that is not conditioned on the referral of business and that does not involve the defraying of expenses that otherwise would be incurred;](#)

[\(2\) a payment at market rates to any person for goods actually furnished or for services actually performed; or](#)

[\(3\) a payment pursuant to a cooperative brokerage or referral arrangement or agreement between active licensed real estate agents and real estate brokers.](#)

# RESPA DO'S AND DON'TS FOR CO-MARKETING, SOCIAL MEDIA, & OTHER WEB-BASED MARKETING TOOLS

## RESPA DO'S AND DON'TS FOR CO-MARKETING, SOCIAL MEDIA, & OTHER WEB-BASED MARKETING TOOLS

Real estate brokers and agents are subject to the Real Estate Settlement Procedures Act (RESPA) when engaging in transactions involving federally related mortgage loans. RESPA generally prohibits any person from giving or receiving any “thing of value” in exchange for the referral of settlement service business. Liabilities for RESPA violations may be severe, ranging from significant fines to imprisonment. Below are some guidelines for real estate professionals when engaging in co-marketing activities via social media and other web-based marketing tools:

### DO

- Do ensure that each co-marketing party pays its proper share of the advertisement.
  - Each party’s share should be based on the proportionate split of the fair market value for any and all services in connection with the advertisement (e.g., creation, design, distribution, etc.); and
  - Each party’s share should be equal to each advertised settlement service provider’s prominence in the advertising.
- Do ensure that the agreed upon marketing is actually performed and that any payment made in connection with such services is the fair market value for the services performed.
  - Remember—just because a social media platform is “free” for users to join or post in, it does not mean that all uses of the platform are offered at no cost or that there are no costs associated with the development of the advertisement.
  - Be aware of what may constitute a thing of value, and remember it does not require a transfer of money. Any benefit or concession (a “quid pro quo”) may be a “thing of value.”
- Do include the word “Advertisement” in a prominent location on each party’s information included on the co-marketing materials.
- Do document procedures to calculate co-marketing charges and/or create a standardized rate sheet for the fair market value of such marketing.
- Do consider maintaining written agreements of the co-marketing arrangement to demonstrate compliance with RESPA Section 8 as well as federal and state laws and regulations governing your co-marketing efforts, including those regarding advertising, privacy, and licensing requirements, as applicable.
- Do ensure that the advertisements are distributed to the general public, such as publicly-facing, broadly-reaching websites, and cannot be viewed as “targeting” specific consumers.
- Do ongoing oversight of the co-marketing arrangement that may be required by either or both co-marketing participants.

## DO NOT

- DO NOT enter into the arrangement with a co-marketing party without getting the necessary corporate authorization for such arrangement for yourself or for your co-marketing party.
- DO NOT directly or indirectly defray expenses that would otherwise be incurred by anyone in a position to refer settlement services or business to you, by use of a co-marketing arrangement.
  - Payments by settlement services providers to third party real estate listing aggregator sites that reduce your advertising costs can create a direct RESPA violation.
- DO NOT exchange any “thing of value” with anyone for a referral, no matter how small the “thing of value” is. RESPA does NOT have an exception for minimal “kickback” amounts and even a small amount (i.e., \$5 coffee giftcard) is considered a “thing of value” under the law.
- DO NOT require or allow your co-marketing party to endorse you, exclusively or otherwise, or vice versa, e.g.:
  - Do not allow either co-marketing party to refer to the other as a “preferred” service provider, or a “partner,” or some other similar designation.
  - Beware of any perceived endorsements, such as “likes,” follows, re-postings, tagged pictures with one another, and other favorable commentary on referral sources’ pages, whether such activity is conducted from your personal or your business accounts. Remember that promotion of business activities generally should be conducted from business accounts/pages, not personal ones.
- DO NOT enter into co-marketing arrangements before considering the implications of any other concurrent relationship with the co-marketing party (e.g., lead sales, desk rentals, etc.).
- DO NOT direct any of the co-marketing efforts to specific consumers with whom either co-marketing party has a relationship or over whom either party has the ability to influence the selection of a settlement service provider (as compared to marketing of general distribution).
- DO NOT evaluate or adjust the compensation paid under an arrangement based on “capture rate,” which is the percentage of referrals that convert to actual clients or customers.
- DO NOT allow one party to act as a “gatekeeper” when dealing with a third-party marketing company. Both parties should have a separate agreement with third-party marketing firms.
- DO NOT perform services for the other co-marketing party that are outside the terms of the agreement. For example, if a real estate agent and a lender are co-marketing, the lender should not “incubate” or cull leads on behalf of the real estate agent as that is outside the terms of the co-marketing agreement and is not a compensable service.
- DO NOT share the cost of leads generated through websites or arrangements. Each party must pay the fair market value of the leads they purchase.

*Disclaimer: This document is provided for informational/instructional purposes only and does not constitute the giving of legal advice by NAR. Consult with a RESPA attorney to make sure you understand and properly comply with any and all applicable laws. As a reminder, some state and local laws prohibit or otherwise restrict activities that may be permissible under RESPA.*

## APPENDIX



## HELPFUL LINKS

TREC Rules

<https://www.trec.texas.gov/rules-and-laws>

TREC News and Articles

<https://www.trec.texas.gov/news-articles>

Commission & Committee Meeting Schedules

<https://www.trec.texas.gov/apps/meetings/>

Consumer Financial Protection Bureau (CFPB) Final Rules (Topic “RESPA”):

<https://www.consumerfinance.gov/policy-compliance/rulemaking/final-rules/?topics=real-estate-settlement-procedures-act>



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