May 2007

Legal Update

A WRA Publication Exclusively for the Designated REALTOR®

Please Route to:

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Inside This Issue

3
RESPA Compliance

4
Duties to Clients and Customers

6
Title Insurance Troubles

6
Sham Company Litigation Settlements

7
Limiting Scope of Non-Brokerage Services

10
Legal Hotline Questions and Answers

11
Resources

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Referrals to Service Providers

A major class-action lawsuit recently filed in Minnesota has brought to the forefront some important issues regarding the interplay of the referral of clients and customers to affiliated service providers and a real estate broker's fiduciary duties to his or her clients. The lawsuit involves allegations that would normally be found in action brought by the U.S. Department of Housing and Urban Development (HUD) to enforce the Real Estate Settlement Procedures Act (RESPA). Instead, the allegations were filed under state law. This highlights the fact that practices that may violate RESPA, and other conduct closely associated with those practices, may violate other laws as well. In other words, RESPA is not the only potential source of liability for illegitimate behavior involving referrals to service providers.

This *Legal Update* begins by describing the Minnesota lawsuit and reviewing some basic RESPA provisions that have allegedly been violated. Wisconsin law and ethics provisions that would also appear to be violated had this conduct occurred in Wisconsin are examined, and the troubling status of the title insurance business nationwide is reviewed. Recent enforcement activity involving kickbacks made through sham companies is reported, followed by discussion and review of precautions brokers can take to reduce risk of liability when agents refer parties to service providers or even order services for them. The *Update* concludes with Hotline questions and answers pertinent to referrals of service providers.

The Lawsuit

The class-action lawsuit was filed by a group of buyers on February 21, 2007, against a large real estate company. The buyers allege that the company engaged in deceptive and misleading conduct and breached its fiduciary duties under Minnesota law when it steered them to its affiliated title and settlement services company without disclosing that the title company's fees are among the highest in Minnesota, significantly higher than those available from nonaffiliated firms.

The real estate broker and agents also did not disclose that:

- The affiliated title insurance company retains at least 75 percent of each insurance premium.
- The real estate company trained and pressured its agents to steer all closing and title insurance business to the affiliated company instead of a lower-priced competitor.
- The real estate company created internal barriers that made it difficult for agents to refer clients to other title companies.
- Financial incentives were offered to agents and managers to direct business to the affiliated title company. The financial incentives included the ability to receive commission checks immediately at the closing table instead of waiting until later, payment of marketing and business expenses, increased company retirement plan contributions and eligibility for "bonus pools."

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- They were aware of lower cost title insurance and closing service providers who were not identified or recommended to their clients.

This all occurred against the backdrop of the company's self-portrayal on its Web site as a full-service company that works with parties through every step and detail of the home buying and selling experience. A buyer's representative, the Web site claimed, would "provide a list of potential qualified vendors (e.g., title company, home inspector, etc.) if the buyer does not know of any." On the other hand, the Web site did proclaim that the company was a one-stop shopping resource providing comprehensive title insurance and closing services.

While most past lawsuits involving affiliated settlement service providers have been filed in federal court and based on claims under RESPA, this suit is based on state and common law. The buyers bringing the lawsuit did receive the standard RESPA Affiliated Business Arrangement (ABA) Disclosure Statement, but indicated that it did not go far enough and failed to satisfy other fiduciary duties the brokers and agents had under state law. The ABA Disclosure Statement was perceived as implying that all relevant facts were being revealed when in fact it did not indicate the affiliate's high rates nor address the internal company culture and incentives geared at steering consumers to the affiliate.

Minnesota common and statutory law requires brokers to act in the best interests of their clients at all times, and to disclose material facts that may affect a client's interests, such as what is the real estate company's and its agents' interest in having buyers use affiliated providers and whether there are any conflicts of interest created thereby. A real estate broker is bound to put a client's best interests ahead of the company's and must not profit from the relationship unless the client consents.

The lawsuit is about consumer protection and money: lower prices are assumed to be in a consumer's best interest. Each buyer, on average, would have saved hundreds of dollars if the title work had been ordered from a different title insurance company. The class action, which asks for what lawyers estimate to potentially be millions of dollars in refunds and damage awards to more than 10,000 clients (all buyers of the real estate company referred to the affiliated title insurance company over the last six years), may be seen as part of a backlash against title insurance and real estate industry practices.

This lawsuit is gathering national attention because many large real estate brokerages have one or more affiliated service providers, including title insurance and mortgage companies. These affiliated service providers produce revenue. If these service providers charge more than their competitors, the higher price is frequently justified with the claim that the affiliated company is more reliable, familiar and timely, and provides a high level of quality service. When these affiliate relationships have been properly structured to comply with federal anti-steering and anti-kickback rules, they have withstood numerous legal challenges. But the allegations in this class action seek to make brokers accountable beyond compliance with RESPA.

This is a case of first impression tackling novel public policy issues, and it may set a precedent that ripples across the country, setting the foundation for similar suits against brokerage companies who do not live up to the standards established with respect to referrals to affiliated service providers.

It will likely be a long time before any decisions will be made in this case, but the issues merit discussion now so that precautions may be taken to guard against any similar allegations, litigation or potential liability. The following discussion first pro-

vides a quick review of some RESPA concepts and then evaluates whether the alleged facts (assuming them to be true for purposes of discussion) constitute violations of RESPA or Wisconsin law. This lawsuit was not filed under RESPA because a RESPA suit does not permit a class action or monetary damages in a civil action.

RESPA Compliance

Section 8 of RESPA prohibits a person from giving or accepting anything of value in exchange for the referral of settlement service business. A real estate broker who has an interest in a title company or some other settlement service provider can refer a customer to that entity and not violate RESPA, but only if:

1. The broker provides the required ABA Disclosure Form.
2. The customer is not required to use the affiliated title company's or other settlement service provider's services.
3. Nothing of value, other than a possible return on an ownership interest or franchise relationship, is paid to or received by the broker in return for the referral.
4. The ownership interest or franchise relationship does not involve any sham companies.

Settlement Service Providers provide services in connection with the purchase or sale of a property that is paid for, directly or indirectly, out of the funds at settlement. RESPA regulates all settlement service providers involved in the home buying process. A settlement service is defined as "any service provided in connection with a real estate settlement" including, but not limited to:

1. The origination, processing or funding of a federally related mortgage loan
2. Mortgage broker services such as counseling, taking applications, obtaining verifications and appraisals, lender-borrower communications, etc.
3. Title searches, title examinations, title commitments, title insurance, abstracts and other related services
4. An attorney's legal services
5. Closing document preparation
6. Credit reports
7. Appraisals
8. Property inspections
9. Pest and fungus inspections
10. Property surveys
11. Conducting the closing or settlement
12. Mortgage insurance
13. Hazard, flood or casualty insurance; and home warranties
14. Flood zone certification
15. Mortgage life, disability or similar insurance
16. Real property taxes and assessments
17. Real estate brokerage services

This list is broad but not all-inclusive. Services that occur at or prior to the purchase of a home are typically considered settlement services. Anything listed on a HUD-1 form and paid for by the buyer or seller could be a settlement service, and the company providing it a settlement service provider. Services that occur after closing are usually not considered settlement services. This generally, but not always, includes moving companies, gardeners, painters, interior decorators and home improvement contractors.

An **Affiliated Business Arrangement** (ABA) exists when a person in a position to refer settlement business, such as a real estate broker, or an "associate" of such person, has an affiliate relationship with, or a direct or beneficial ownership interest of more than 1 percent in, an entity to which the business is referred, such as a joint venture title or mortgage entity. A referral to an affiliated settlement service provider is not an illegal kickback under RESPA if the following conditions are met.

1st. The broker or other party who refers business to an affiliated or owned settlement service provider must provide a separate written disclosure statement to each consumer who is being referred. The disclosure must be in the RESPA ABA Disclosure Statement format and state the nature of the relationship, explaining the ownership and financial interest between the referring party and each settlement service provider being referred. The disclosure statement must also give an estimated price, or range of prices, generally charged by the affiliated settlement service providers.

2nd. The person being referred must not be required to use the affiliated settlement service provider's business.

3rd. The only thing of value that is received from the arrangement is a return on the ownership interest or franchise relationship between the affiliated providers.

Thing of Value is "any payment, advance, funds, loan, service, or other consideration." It can be an item of personal property, salaries, commissions, fees, duplicate payments of a charge, stock, dividends, distributions of partnership profits, franchise royalties, credits representing money that may be paid at a future date, the opportunity to participate in a money-making program, retained or increased earnings, increased equity in a parent or subsidiary entity, special bank deposits or accounts, special or unusual banking terms, services of all types at special or free rates, sales or rentals at special prices or rates, lease or rental payments based in whole or in part on the amount of business referred, trips and payment of another's expenses or the reduction in credit against an existing obligation.

A **Sham Company** is a company that was created for the sole purpose of appearing to meet the ABA excep-

tion to RESPA's prohibition against referral fees. Some settlement service providers join together to form companies that do little or no work and are intended to hide the payment of excessive fees or referral fees. If an entity is not a bona fide settlement service provider and serves primarily as a conduit for referral fees, the ABA violates RESPA and is illegal. For example, a lender and a real estate broker may jointly fund a new subsidiary that purports to be a mortgage broker but which has no staff and minimal funding, does no work, receives all business by referrals from the broker, out-sources all work to the lender and pays dividends to both parent companies (the broker and the lender). Such a sham arrangement pays the broker who does no work and bears no business risk in return. HUD carefully monitors ABAs to ensure they are not simply "sham companies."

Referrals to Separate Entities

A RESPA compliance specialist has advised that if an employee receives a referral fee for referring business to the employer, there is no violation of Section 8 of RESPA. If, however, there are two entitles involved, such as a company and an affiliate or associate, then there is a violation. For example, if a real estate company has an affiliated title company and charges its agents a transaction fee, and the company waives the transaction fee if the parties are referred to the affiliated title company, the waiver of the transaction fee would appear to be a "thing of value." If the waiver of the transaction fee were a thing of value, the described practice would appear to be a violation. Similarly, if a salaried manager (an employee) is paid a bonus that is dependent upon the volume of referrals made by the manager's agents to an affiliated title company or mortgage company, the bonus is a thing of value and appears to be another Section 8 RESPA violation. Section 8 of RESPA expressly prohibits giving positive incentives –"things of value" – for the referral of settlement service business.

By way of contrast, employers sometimes threaten and carry out disincentives for the failure to refer business to affiliated agencies. The following are excerpts from RESPA Statement of Policy 1996-3 (www.hud.gov/offices/hsg/sfh/res/res0607b.cfm) concerning this issue:

HUD also has received complaints concerning retaliation practices used to influence consumer referrals. In one complaint, financial service representatives in a real estate broker's office were given specific quotas of referrals of home buyers to an affiliated lender and were threatened with the loss of their jobs if they did not meet the quotas.

Commenters on the proposed rules also alleged that some employers were engaging in practices of retaliation or discrimination against employees and agents who did not refer business to affiliated entities. Reprisals could range from loss of benefits, such as fewer sales leads, higher desk fees, less desirable workspace and, ultimately, loss of job.

While Section 8 of RESPA expressly prohibits giving positive incentives, or "things of value," for the referral of settlement service business, the Act is silent as to disincentives. If HUD were to find that Section 8 also prohibited disincentives for failure to make referrals, HUD would find itself being called upon to resolve numerous employment disputes under RESPA. Retaliatory actions against employees are more appropriately governed by state labor, contract and other laws.

Returning to the allegations in the lawsuit, the alleged financial incentives or other benefits or things of value bestowed upon real estate agents for referring buyers to the affiliated title company would appear to be clear RESPA violations. But is compliance with RESPA enough? The argument can be made that RESPA, as federal law, pre-empts state law – RESPA has established the minimum standards for adequate disclosure even though state law offers additional consumer protection. However, some believe that the ABA disclosures are general and vague and just don't do enough to get the message through to the consumer that they have a choice and don't have to use the affiliated provider. Clearly that is a premise of the lawsuit.

The training and general expectation that all title and closing work be referred to the affiliated title company are more difficult to pinpoint and may be viewed as an unspoken disincentives, i.e., "go along with the program and get those buyers to 'our' title company if you wish to keep your job." Disincentives fall outside of RESPA, which perhaps makes this behavior subject to scrutiny under state law.

Duties to Clients and Customers

Wisconsin law specifies the duties owed to persons in a transaction which arguably are violated by the conduct alleged in the lawsuit. These include:

- Wis. Stat. § 452.133(1) **Broker's duties to all persons in a transaction**. A broker who is providing brokerage services to a person in a transaction owes all of the following duties to the person:

  (a) The duty to provide brokerage services honestly and fairly.

- Wis. Stat. § 452.133(2) **Broker's duties to a client**. A broker providing brokerage services to his or her client owes the client the duties that the broker owes to a person under sub. (1) and all of the following additional duties:

  (a) The duty to loyally represent the client's interests by doing all of the following:

1. Placing the client's interests ahead of the broker's interests.

(b) The duty to disclose to the client all information known by the broker that is material to the transaction and that is not known by the client or discoverable by the client through reasonably vigilant observation, except for confidential information under sub. (1)(d) and other information the disclosure of which is prohibited by law.

In other words, a broker must provide brokerage services to all parties in an honest and fair manner. A broker must not place the interests of the broker ahead of the interests of a client and must disclose to a client information that is material to the transaction.

Applying these provisions to the allegations in the lawsuit, it would appear that steering a client to an affiliated title company that is significantly more expensive than other title companies in the market because it will result in kickbacks for the referring agents and increase overall revenues for the affiliated title insurance company would not appear to place the client's interests ahead of the brokers' and agents' interests. It is arguably also not very fair or honest when it comes to a customer. However, determining whether a fiduciary duty has been breached may be difficult because good faith, honesty and fairness are somewhat subjective standards. Providing that a broker placed his or her interests ahead of the interests of a client may be somewhat more straightforward.

- Wis. Stat. § 452.133(3) **Prohibited conduct**. In providing brokerage services, a broker may not do any of the following:

  (c) Except as provided in s. 452.19, refer, recommend or suggest to a party to the transaction the services of an individual or entity from which the broker may receive compensation for a referral or in which the broker has an interest, unless the broker has disclosed the fact that he or she may receive compensation or has disclosed his or her interest in the individual or entity providing the services.

While an ABA Disclosure Statement generally describes that there is a relationship – an interest in the affiliated title company – and that there may be a financial benefit, the financial benefit intended to be referenced is the return on the ownership or franchise interest. The ABA Disclosure Statement was not intended to be referencing the fact that there are kickbacks or other financial benefits involved for the agents making the referral. The statute requires that the existence of referral fees and kickbacks be disclosed, and the ABA Disclosure Statement arguably does not cover those financial incentives.

The REALTOR® Code of Ethics contains provisions similar to those found in the Wisconsin Statutes that also appear to have been violated by the conduct alleged in the lawsuit.

- REALTOR® Code of Ethics, Article 1:
  When representing a buyer, seller, landlord, tenant or other client as an agent, REALTORS® pledge themselves to protect and promote the interests of their client. This obligation to the client is primary, but it does not relieve REALTORS® of their obligation to treat all parties honestly. When serving a buyer, seller, landlord, tenant or other party in a non-agency capacity, REALTORS® remain obligated to treat all parties honestly. (Amended 1/01)
- REALTOR® Code of Ethics, Article 2:
  REALTORS® shall avoid exaggeration, misrepresentation or concealment of pertinent facts relating to the property or the transaction. (Amended 1/00)
- REALTOR® Code of Ethics, Article 6:
  REALTORS® shall not accept any commission, rebate or profit on expenditures made for their client, without the client's knowledge and consent.

  When recommending real estate products or services (i.e., homeowner's insurance, warranty programs, mortgage financing, title insurance,

etc.), REALTORS® shall disclose to the client or customer to whom the recommendation is made any financial benefits or fees, other than real estate referral fees, the REALTOR® or REALTOR®'s firm may receive as a direct result of such recommendation. (Amended 1/99)

- Standard of Practice 6-1
  REALTORS® shall not recommend or suggest to a client or a customer the use of services of another organization or business entity in which they have a direct interest without disclosing such interest at the time of the recommendation or suggestion. (Amended 5/88)

The conduct alleged in the lawsuit would also appear to be in violation of these ethical standards because the allegations reflect a failure to protect and promote the interests of clients, a concealment of pertinent facts and no disclosure or consent to the full range of financial benefits involved.

Plainly at least some of the conduct alleged in the lawsuit might be found to be in violation of Wisconsin law and the Code of Ethics if complaints were filed in the appropriate forums: with the Department of Regulation and Licensing (DRL), with the local REALTOR® association and perhaps even in civil court. In other words, it appears feasible that the same sorts of claims made in the Minnesota lawsuit could also be made in Wisconsin were the same sorts of practices discovered.

Title Insurance Troubles

HUD investigators receive information on hundreds of alleged kickback schemes every year and have numerous investigations or negotiations underway nationwide. A central thread running through many of the kickback arrangements that HUD investigates is title insurance. Though most consumers are unaware, a substantial portion of the title premium they pay at closing does not go to the national insurance company underwriting the actual title policy. Frequently, 80 percent or more goes to the local title agent or lawyer who ordered the policy, and who may also be handling the closing. If a consumer pays title charges of $1,500, for example, $300 of that might pay for the actual title insurance policy while the remaining $1,200 may go to the closing or title agent. With that much money on hand, it makes it easy to see that the title agent may wish to kick back a portion of the money to real estate agents or loan officers who referred the business. Such a kickback paid or received solely for a referral violates federal law.

The U.S. Government Accountability Office (GAO) recently released a report to Congress regarding "Actions Needed to Improve Oversight of the Title Industry and Better Protect Consumers." The GAO found:

Certain factors raise questions about the extent of competition and the reasonableness of prices that consumers pay for title insurance. Consumers find it difficult to comparison shop for title insurance because it is an unfamiliar and small part of a larger transaction that most consumers do not want to disrupt or delay for comparatively small potential savings. In addition, because consumers generally do not pick their title agent or insurer, title agents do not market to them, but to the real estate and mortgage professionals who generally make the decision. This can create conflicts of interest if those making the referrals have a financial interest in the agent. These and other factors put consumers in a potentially vulnerable situation where, to a great extent, they have little or no influence over the price of title insurance, but have little choice but to purchase it. Furthermore, recent investigations by HUD and state insurance regulators have identified instances of alleged illegal activities within the title industry that appeared to take advantage of consumers' vulnerability by compensating REALTORS®, builders and others for consumer referrals. Combined, these factors raise questions about whether consumers are overpaying for title insurance.

GAO recommends that HUD and state insurance regulators take actions to improve consumers' ability to comparison shop for title insurance and strengthen the regulation and oversight of the title insurance market. GAO urges Congress to explore the need for modifications to RESPA, including increasing HUD's enforcement authority.

The full GOA Title Insurance report may be read online at www.gao.gov/new.items/d07401.pdf.

With this in mind, it is not surprising that many recent HUD enforcement actions involve title insurance. Some of these involve kickback schemes operated through the use of sham companies.

Sham Company Litigation Settlements

One recent HUD settlement regarding RESPA kickback violations involved activity in Tennessee.

HUD claimed First American Title Insurance Company (First American) made payments through sham affiliated businesses in the Memphis area in violation of RESPA's anti-kickback and unearned fee provisions. HUD's investigation determined that First American created or acquired eight affiliated title companies with various builders, real estate agents and mortgage brokers. HUD found that the companies were paid for certain title and settlement work they did not perform – services that were essentially provided by First American. HUD concluded that the companies were sham businesses used to make referral payments back to the builders, real estate agents and mortgage brokers in violation of RESPA.

First American agreed to make a $680,000 payment to the U.S. Treasury and cease any further business operations involving the sham business affiliations. In its settlement with HUD, First American further agreed that if it formed affiliated companies in the Memphis area in the future, each company would:

- Have sufficient initial and operating capital to perform settlement services;
- Be staffed with employees who work for that entity and are not shared with any other title entity, builder, real estate agent, mortgage broker or other settlement service provider;
- Have an office for its use in conducting business that is separate and apart from that of any other title entity;
- Comply with HUD policy statements with regard to the performance and payment for title services;
- Actively compete in the marketplace for title insurance business and seek business from parties other than the builders, real estate agents and mortgage brokers or other settlement service providers with which it has an affiliate relationship; and
- Refrain from business practices that provide unearned fees or kickbacks in return for the referral of settlement service business.

"The law is clear on this point," said Brian Montgomery, HUD's assistant secretary for housing and FHA commissioner. "Parties that perform real work in the mortgage transaction deserve bona fide compensation, but fabricating sham affiliations for the purpose of obscuring kickbacks violates the law."

The full text of the HUD news release regarding this settlement may be found online at www.hud.gov/news/release.cfm?content=pr05-097.cfm.

Minnesota Sham Business Settlement

Ironically, the most recent settlement announced with respect to an alleged sham business/illegal kickback situation was also in Minnesota and also involved First American Title Insurance Company. In a consent order reached between First American, the Minnesota Commissioner of Commerce and HUD, First American has agreed to pay a $500,000 civil penalty to Minnesota regulators to settle allegations that it created 35 sham businesses that generated referrals from over 600 partners, including real estate agents and brokers, mortgage originators, building contractors and land developers. First American agreed to pay the civil penalty and create educational material for consumers, but maintained that the affiliated businesses it created since 1995 complied with state and federal law.

First American granted its partners an 80-percent interest in the alleged sham businesses for a typical investment of $500. First American allegedly ran the companies without compensation, hiring, training and supervising employees. Some of the businesses shared workers, office space and equipment, the settlement alleged.

The Minnesota Department of Commerce did not stop with that. They also sent enforcement letters to real estate agents alleged to have participated in sham affiliated business arrangements with First American. According to an alert posted on the Minnesota Association of REALTORS® Web site (www.mnrealtor.com/laws/pdfs/RESPAtalking.pdf), these agents are being asked to admit to the allegations made against them and pay a fine of $1,000 to $2,000. The agents, depending upon the facts of each situation, are alleged to have accepted kickbacks, rebates or other things of value for the referral of a sham affiliated business arrangement, urged homeowners to purchase a title insurance policy which constitutes the solicitation of the sale of title insurance without a title insurance agent license, failed to act in the best interests of the client or failed to completely or accurately disclose the agents' affiliated business arrangement.

Clearly the creation of sham companies to create a means of channeling kickbacks – in a manner that might appear on the surface to be legitimate – is illegal, not a clever way to beat the system and produce compensation for agents referring parties to affiliated settlement service providers, as has been touted on some real estate blogs.

Limiting Scope of Non-Brokerage Services

Given all of the trouble in the air involving the referral of parties to service providers, it is prudent for brokers to make sure they have taken precautions to ensure that they are not exposed to liability.

The public may believe that it is an agent's fiduciary obligation to find the best people and companies at the best price to work on the transaction. Nothing in the existing DRL-approved contracts or forms suggests anything to the contrary – the topic is simply not addressed. This is not surprising because selecting and retaining settlement service providers does not appear to fall within the scope of real estate practice as defined under Wisconsin law. The law establishes certain obligations and duties that all Wisconsin real estate licensees must fulfill when providing brokerage services. But brokerage services entail primarily marketing and negotiation, and much of what happens after an offer is accepted – basic implementation and closing – are extras that most agents traditionally and customarily provide to their clients and customers. The scope of other

extra services that may be provided can arguably be described through disclosure and defined by contract.

Brokers may consider providing parties with written descriptions of the types and scope of extra services they will provide to the parties in a transaction, delineating the parameters of broker responsibility with respect to referrals to service providers and the hiring of settlement service providers and other contractors. This might be done by adding provisions to agency agreements – listing contracts, buyer agency agreements, etc. – or providing separate written information sheets, particularly to customers or as part of listing presentations. Brokers would also be wise to establish office policies specifying the procedures and steps to be taken for making referrals to service providers and any affiliated settlement service providers. Brokers who already describe extra services provided and have policies for referring parties to service providers may wish to review them to ensure that maximum liability protection is provided.

Referrals the Right Way

Clients and customers may ask REALTORS® to refer them to contractors and other service providers. Although this may be beneficial to the consumer to have such a recommendation, this practice may lead to licensee liability if the referral is not handled properly. Consumers expect that the service providers they are referred to are competent, reputable, provide quality services and are reasonably priced – or are the least expensive competent provider.

Competence and Quality Service

The Court of Appeals of Kentucky ruled that a real estate agent did not guarantee the competency of a pest control company when the agent recommended the pest control company to a buyer. The court considered whether the buyer's broker could be liable to the buyer for recommending the pest control company to them when the lender required a termite inspection. The buyer asked his buyer's agent for a list of pest control companies, and he gave the buyer a list of three companies. The buyer selected and hired a pest control company to perform the inspection.

The court considered whether the buyer's broker breached its fiduciary duty to the buyer by recommending a pest control company that allegedly did not perform its required duties in a satisfactory manner. The court ruled that making a recommendation does not guarantee performance when the buyer's broker had also given the buyer the names of two other pest control companies.

REALTOR® Practice Tips: When helping parties find professional inspectors and contractors (such as contractors for inspections and repairs), REALTORS® should carefully follow these steps:

- Prepare a list of professional service providers. Do not recommend or endorse one particular provider because a recommendation that does not present the party with options may result in liability should problems or questions of competency later arise. Instead, maintain a list with the names and contact information, such as telephone numbers and Web sites, of at least three professionals in each field, and include any available references from past users. Any provider included on the list should be certified in his or her field, if applicable, and at minimum should hold all applicable credentials for the type of work being performed. Put the list on a sheet of company letterhead, and include a disclaimer that the company's agents cannot personally endorse these professionals.
- Disclose relationships and compensation. Any business, financial or personal company or agent affiliations with any listed service providers should be stated on the list or disclosed when the list is distributed. This should eliminate any hidden conflicts of interest. Wisconsin law requires disclosure if the agent making the referral has any interest in the service provider being referred and if the agent may receive compensation for the referral, before or at the time of the referral. If a licensee will receive compensation from anyone other then his or her client, the prior written consent of all parties is required per Wis. Admin. Code § RL 24.05.
- ABA Disclosure Statement. If one of the referred settlement service providers on the list of professional service providers is an affiliate of the real estate broker/company, provide the ABA Disclosure Statement as required by RESPA. Make sure there are no sham companies in the affiliated company model.
- Shop around. Encourage the parties to check out various providers in the area to make sure they are getting the best deal. Have them contact service providers on the broker's list as well as investigating others in the yellow pages or other sources. Tell them to investigate services and pricing until they are comfortable with their selection.
- Avoid referral fees. It is wise to not ask for or accept a referral fee from any name on the referral list. Earning a fee just for referring business (except to other real estate brokers) violates RESPA if the contractor or company is a settlement service provider like a home inspector, appraiser or title company. The best policy is to not accept fees unless actual goods or services are provided.
- Let service providers do their jobs. Licensees may wish to avoid accompanying an inspector through the house, because this may imply that the licensee is supervising the professional. Reinforce that the party hired the inspector and let the party deal directly with the inspector. Similarly, do not volunteer to inspect work performed on the house unless you wish to be considered the profes-

sional's supervisor. Instead, suggest that the buyer engage an appropriate expert to inspect this work if the buyer wants a professional evaluation.

Ordering Services for Parties

Clients and customers sometimes may ask REALTORS® to retain service providers on their behalf. Sometimes the party is pushed for time or may simply believe that this is part of the agent's job. However, this practice may pose serious legal risks for the licensee and always should be avoided if at all possible.

Let the party select and engage the needed providers. Include language in the agency agreement or other disclosure document indicating that it is important for parties to choose and hire their own service providers so that they can judge the price range, credentials and reputations of local providers and pick the one they are most comfortable with. They are paying for a professional on whose report they are going to rely, so they should be the ones to select. Indicate that is why selecting and engaging professionals needed to implement the offer and complete the transaction is not part of the services being provided.

If the broker must retain a contractor for a party, it is critical that this request be handled properly.

Negligent Hiring or Supervision of Contractors

While negligent supervision often relates to an employer/employee relationship, Wisconsin cases have recognized claims arising from the failure to properly supervise the work of an independent contractor. For example, in ***A.E. Inv. Corp. v. Link Builders, Inc.***, 62 Wis. 2d 479, 214 N.W.2d 764 (1974), the Wisconsin Supreme Court recognized that an architect could be found liable for failing to adequately supervise the construction of a building. The case that REALTORS® are most affected by, however, is ***Chapman v. Mutual Service Cas. Ins. Co.***, 35 F.Supp.2d 699 (E.D. Wis. 1999). The buyers sued the seller, real estate broker and others for negligence resulting in the LBP poisoning sustained by their four-year-old son after they moved into their recently purchased home. The real estate broker was accused of negligent hiring, supervision and inspection of the contractor the real estate agent hired to paint the seller's house in order to meet the FHA loan requirements.

The Court found that the real estate company owed buyers a common-law duty to exercise reasonable care when hiring, training and supervising a painting contractor, as an independent contractor, to paint the seller's house when all parties believed that the painter was working for the real estate broker as an employee. The seller was not responsible because the real estate agent was the one who selected the painter, contacted the painter, negotiated the price and gave the painter instructions. The seller was not given a choice of painters, did not speak to the painter and relied upon the agent to supervise the painting.

The broker argued that he did not hire the painter, but rather served as a liaison between the painter and the seller who paid the painter's fees and signed the painter's contract proposal. The court found that this point was not critical because the seller, the buyers and the painter reasonably believed that the painter was working for the broker. In other words, the court's holding in this regard focused more closely on the parties' perceptions and less closely on the actual contractual dealings with the painter.

General legal principles dictate that one who contracts with an independent contractor is not liable to others for the negligence of the independent contractor. However, this principle does not apply when the person hiring the independent contractor is negligent in selecting, instructing or supervising the contractor. The hiring party also may remain liable if that party retains supervision rights such that the independent contractor is not entirely free to do the work in his or her own way.

- **Key Point:** The lesson for REALTORS® from the ***Chapman*** case is clear: a REALTOR® who acts as a liaison between a party and a contractor or other service provider risks liability if he or she actually hires, or is perceived to have hired, any providers who work on a party's property or provide services for the real estate transaction. A REALTOR® may be held liable for damages resulting from a negligent performance by the retained contractor if the REALTOR® is found to have been negligent in hiring, instructing or supervising the contractor or his or her work. Therefore, REALTORS® should always avoid hiring contractors for parties.

- **REALTOR® Practice Tips:** Real estate agents should recognize that it is not a part of their duties to hire contractors for clients or customers. The better practice is to give parties a list of local credentialed contractors and service providers, then leave them to determine which contractor best meets their needs and to hire the contractor. If an agent finds that it is necessary that he or she hire contractors in a particular situation, the agent should have the parties give specific written authorization to hire service providers and sign a release from liability for any damages caused by the provider. Use a written engagement letter or work order memo if forced to retain a contractor for the party, specify that the party is responsible for the bill and require the contractor to follow all safe work practices required by applicable law. See the model forms for this process on pages 12 and 13 of the May 2004 *Legal Update*, online at www.wra.org/LU0405.

Legal Hotline Questions and Answers

Is it legal for a selling agent to condition an offer to purchase on the buyer using the selling agent's title company? Must the owner go through the listing broker's affiliated title company to do the transaction?

RESPA rules forbid a broker from requiring a seller or buyer to use their related title services. Also, the proper RESPA disclosure in the ABA format must be given. See the November 2006 *Legal Update*, "RESPA and the Real Estate Broker," online at www.wra.org/LU0611, for more information.

A broker is concerned about a disclosure being provided by a realty company regarding their affiliation with a specific title insurance company and mortgage companies. The disclosure indicates that the realty company may receive financial or other benefits if those companies are also used.

RESPA prohibits any fee splitting or fees being paid merely for referrals. An ABA Disclosure Statement must be given to avoid RESPA liability. See the sample statement on page 16 of the February 2005 *Legal Update*, online at www.wra.org/LU0502. The statement also serves to fulfill the disclosure requirements under Wis. Admin. Code § RL 24.05(3).

According to the DRL-approved listing contract, the listing broker is obligated to market the property and secure a buyer. Is the broker also obligated to order title work, deal with all judgments on title, obtain payoffs, etc., when there is no cooperation whatsoever from the seller? Is this just a courtesy rather than an obligation?

Pursuant to the terms of the listing contract, the listing broker is not obligated to provide financial services for the seller. Although the broker may assist the seller with credit, debt and payoff issues should be referred to legal counsel.

A buyer's agent wrote an offer for a couple that was accepted. The buyer works for a title company and specified her employing title company as the one she wished to order title work from and where she wanted to close. The seller contractually agreed to close at the chosen title company. Weeks into the contract, the buyer's agent and the buyer received a phone call from a different title company requesting information in order to complete the title work. That company told the buyer that the closing was to be in their office, not the office of the buyer's employer. Apparently, the listing agent decided to work with a title company he likes – the seller told the buyer directly that he left those details up to the listing agent. The buyer is furious because the listing agent and seller are expecting the buyer to close at a competitor's company and at a higher price. The buyer did disclose who her employer was in the offer. What is the buyer's recourse?

The buyer should insist on proceeding with the offer as written, and should consult with her attorney as necessary to make sure the seller abides by the contract terms. The seller and listing agent cannot dictate the buyer's choice of title company in this situation per section 9 of RESPA.

Another company brought in an offer on a listed property. The other company is also part owner of a title company and a lending company. They did not disclose that they are owners in these businesses. Must they disclose this to the buyers and the seller?

An ABA Disclosure Statement in the format required by RESPA must be given when a broker is referring a consumer to an affiliated settlement service provider in order to avoid liability under Section 8 of RESPA. If the other company refers the buyer to the affiliated title company or lender, they must give an ABA disclosure to the buyer at that time. If no referral is made, no disclosure is necessary. Many companies make the disclosure in all transactions to ensure potential liability is minimized.

If a real estate company has an affiliated title company and charges its agents a transaction fee, is it a RESPA violation if the company waives the transaction fee if the parties are referred to the affiliated title company?

The waiver of the transaction fee would appear to be a "thing of value." A "thing of value" is broadly defined in section 3(2) of RESPA to include, without limitation, monies, things, discounts, salaries, commissions, fees, duplicate payments of a charge, stock, dividends, distributions of partnership profits, franchise royalties, credits representing monies that may be paid at a future date, the opportunity to participate in a money-making program, retained or increased earnings, increased equity in a parent or subsidiary entity, special bank deposits or accounts, special or unusual banking terms, services of all types at special or free rates, sales or rentals at special prices or rates, lease or rental payments based in whole or in part on the amount of business referred, trips and payment of another person's expenses or reduction in credit against an existing obligation. If the waiver of the transaction fee was seen as a thing of value, the described practice would appear to be a violation.

If a salaried manager (an employee) is paid a bonus that is dependent upon the volume of referrals made by the manager's agents to an affiliated title company or mortgage company, is that a RESPA violation?

Again, the bonus is a thing of value and is an incentive, not a disincentive. Thus, there appears to be another Section 8 RESPA violation.

Resources

The Complaint in the Lawsuit: www2.mnbar.org/sections/real-property/GradyVBurnetRealty022107.pdf.

"Major Realty Firm Charged with Breach of Fiduciary Duty over Title Affiliate Recommendations," by Kenneth R. Harney, online at realtytimes.com/rtcpages/20070305_realtyfirm.htm.

HUD's RESPA Web page: www.hud.gov/offices/hsg/sfh/res/respa_hm.cfm.

RESPA Settlement Agreements: www.hud.gov/offices/hsg/sfh/res/resetagr.cfm.

Affiliated Business Arrangement (ABA) Disclosure Statement Format: Page 16 of the February 2005 *Legal Update*, online at www.hud.gov/offices/hsg/sfh/res/resappd.cfm.

"RESPA and the Real Estate Broker," November 2006 Legal Update, online at www.wra.org/LU0611.

Minnesota Department of Commerce Sham Business Settlement - Consent Order: www.state.mn.us/mn/externalDocs/Commerce/First_American_Consent_Order_030807051941_FirstAmericanJVSettlement.pdf.

Chart Showing the Sham Set-Up: www.state.mn.us/mn/externalDocs/Commerce/Chargt_showing_organization_of_companies_030807052224_Title_Insurance_Chart_Hi_Rez.pdf.

News Release Regarding "Crack Down on Sham Title Insurance Affiliations:" www.state.mn.us/portal/mn/jsp/common/content/include/contentitem.jsp?contentid=536913586.

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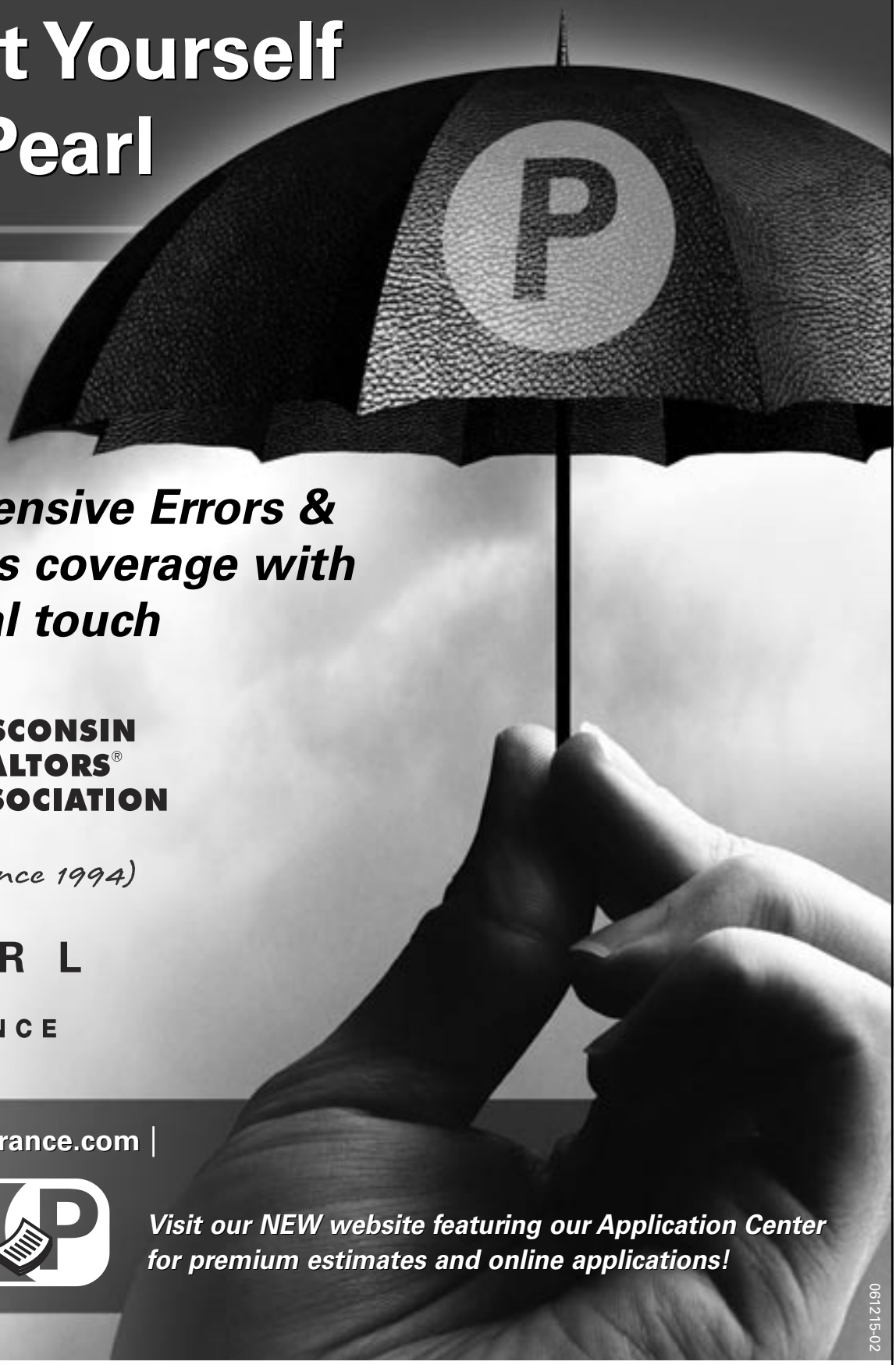

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