Ethics

2nd Edition

First 15 pages only.

3 B.R.E. Approved Credit Hours
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PREFACE:

This is the textbook for our course, *Ethics, 2nd Edition*. It is one of the five, three-hour courses required by the BRE. We call these the “Five Mandatory Courses”:

1. **Ethics**: Describes the real estate license law enforced by the BRE and the *Code of Ethics and Professional Conduct* as practiced by members of the National Association of REALTORS®.

2. **Agency**: Explains the common law of agency as applied to California real estate brokerage.

3. **Trust Funds**: Details the fiduciary responsibilities of brokers when acting as escrows for their clients’ real estate transactions.

4. **Fair Housing**: Describes the federal and California fair housing and lending laws.

5. **Risk Management**: Provides licensees with the knowledge needed to avoid costly disputes with their clients arising from professional errors and omissions in the performance of their duties.

To save space we use the following abbreviations and terms:

- **BPC**: The Business and Professional Code of California.
- **BRE**: Bureau of Real Estate (subsequent to June 2013, it will be known as the Bureau of Real Estate (BRE)).
- **CAR®**: California Association of REALTORS®.
- **CC**: The Civil Code of California.
- **NAR®**: National Association of REALTORS®.

You can find all California codes at [www.leginfo.ca.gov/calaw.html](http://www.leginfo.ca.gov/calaw.html). Unless otherwise stated, all legal cases are California cases. In citing cases, we specify only the names of the litigants and the year of the decision.

The forms cited in this course are from CAR®.

We also follow a few typographic conventions:

We use margin notes to provide definitions and short footnotes. We use the symbol ☛ to direct your attention to an adjacent margin note.

Side bars like this one are used for long notes. Content in the margin notes, side bars, and in the appendices is not tested in the final exam.
First 15 pages only.
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INTRODUCTION

Most real estate brokers are paid only after escrow closes. Closing is often difficult. Buyers want their dream home at below-market price; sellers overvalue their homes. Title insurers, inspectors, lenders, geologists, and appraisers are all potential deal killers. The unexpected happens with regularity – mortgage rates increase, crazy neighbors appear, major defects are discovered.

When a problem threatens a deal, the temptation to obscure, over promise, conceal, or misrepresent can be overwhelming. Many licensees give into temptation; they bend or break the truth. The consequences can be litigation, license discipline, and a loss of public confidence in our profession.

1.1 OVERVIEW

This course is about ethical conduct in the real estate brokerage profession and the California license law which enforces it.

Over generations brokers have developed standards which, when practiced by the majority of licensees, benefit everyone involved – brokers, principals, and the public.

This course discusses two parallel but independent standards of professional conduct a.k.a. “ethics”:

1. California Real Estate License Law (the “License Law”): As described in the Business and Professional Code (BPC) and implemented by BRE Regulations, and

2. NAR®’s Code of Ethics (The “Code”): As described in its 17 Articles and associated “Standards of Practice.”

The License Law is enforced by the Commissioner whose principal power is to grant, restrict, and revoke licenses; the Code is enforced by local grievance committees of the NAR®. This course proceeds as follows:

In the remainder of this section we discuss ethics in relation to morals and the law.

In the second section, we describe California Real Estate License Law; the law which empowers the BRE Commissioner to license individuals to practice real estate brokerage and to revoke or suspend licenses for dishonesty, fraud, or incompetence.

Section three is the heart of the course – an abridged and annotated presentation of NAR®’s Code of Ethics as practiced by over one million REALTORS® (as of 2009). We also compare the Code to the License Law and we describe how NAR® enforces its Code on members.
1.2 **ETHICAL IDEAL**

The underlying ethical principle for both the *Code* and License Law is this: **The real estate agent must use his abilities as if he was his client.** A body of law has evolved over the centuries to fully describe this principle: the Law of Agency (see our course, *Agency*).

As an agent, the ideal real estate broker gives no thought to his commission or to his own self interests but subordinates his personal objectives to that of his client. The client’s only duty to his agent is to compensate him according to the terms of his agency agreement.

The agent’s client may be despicable BUT the agent is his “samurai”; true and loyal.

Just as the samurai’s loyalty was limited by his military code (“Bushido”), the law limits the agent’s loyalty in the interest of public policy. Some examples: 1) the agent must be honest and fair in dealing with third parties, 2) he must not illegally discriminate, 3) he must make specific disclosures, and 4) he must never break the law on his client’s behalf.

1.3 **FINDING THE LAW**

The statutes comprising California real estate law are mostly found in the Business & Professional Code (BPC) and the Civil Code (CC). These two legal codes (and the other 27) can be found here. The regulations the BRE has written to implement the real estate law, called the BRE Regulations, can be found here.

'§' means “section” and ‘§§’ means “sections.”

The law which gives the BRE the authority to grant, revoke, and suspend licenses is known as “License Law.” Its statutes are found primarily in the BPC. In particular, BPC §§ 10176 and 10177 specify most of the ethical violations for which the BRE may suspend, restrict, or revoke licenses.
The Real Estate License Law (or “License Law”) is the State law designed to protect the public from fraud, dishonesty, and incompetence in real estate transactions. The text of the law is found mostly in the BPC (BPC §10000 et seq.) and its derivative law, the BRE Regulations (based on the BPC). License Law is enforced by the Commissioner’s power to suspend and revoke the license of licensees who violate the License Law.

The Commissioner grants real estate licenses. The most common acts requiring a license are set forth in BPC §10131. These include any act in which an individual is paid by a principal for the sale, exchange, rent, lease, rent collection, or financing of real property located in California.

Prior to 2012, the Commissioner’s power to enforce License Law was limited to his power to grant, restrict, suspend, and revoke real estate licenses. However, in 2012, two California senate bills (SBs) were signed into law which considerably enhance the Commissioner’s powers. SB 53 gives the BRE the authority to levy fines of up to $2,500 dollars on offenders of the Real Estate Law and SB 706 permits the BRE to request an administrative law judge to require violators to pay the costs of BRE's investigation and enforcement actions.

2.1 THE FOUNDATION: BPC §§10176, 10177

This section is from Chapter 1 of the BRE’s Reference Book, A Real Estate Guide. All section references (“§”) are from the Business and Professional Code (“BPC”). Sidebars (paragraphs in shaded boxes like this one) contain our comments.

BPC §§ 10176 and 10177 constitute the foundation for most license suspensions or revocations. §10176 is concerned with the actions of a real estate licensee performing licensed acts within the scope of the Real Estate Law. As a general rule, the licensee must have been acting as an agent in a real estate transaction before the section will apply. The provisions of some parts of §10177, on the other hand, will apply to situations where the licensee was not necessarily acting as an agent. The following is a brief discussion of the various grounds for disciplinary action against a licensee and the reasons for which a real estate license may be denied.

Misrepresentation. §10176(a)

Many complaints received by the Commissioner allege misrepresentation on the part of the broker or salesperson. Included also as a cause for discipline under this section is failure of a broker or salesperson to disclose to his or her principal material facts of which the principal should be made aware. If the misrepresentation was not important, and the person to whom it was made would have proceeded with the transaction anyway, the misrepresentation probably would not be material. However, an Attorney General’s opinion holds that damage or injury need not be present to
support an action under this section. The reason is that the California Real Estate Law concerns the conduct of licensees rather than the settling of disputes about damages or injuries between licensees and their clients.

**False promise. §10176(b)**
A false promise and a misrepresentation are not the same thing. A misrepresentation is a false statement of fact. A false promise is a false statement about what the promisor is going to do. Many times a false promise is proved by showing that the promise was impossible to perform and that the person making the promise knew it was impossible.

**Continued misrepresentation. §10176(c)**
This section gives the Commissioner the right to discipline a licensee for “a continued and flagrant course of misrepresentation or making of false promises through real estate agents or salespersons.”

**Dual agency. §10176(d)**
Failure to inform all principals that the licensee is acting as agent for more than one party in the transaction.

**Commingling. §10176(e)**
Commingling takes place when a broker has mixed the funds of a principal with the broker’s own money. (Conversion is misappropriating and using principal’s funds. Conversion, of course, can be a more serious offense.)

**Definite termination date. §10176(f)**
Failure to include a specified termination date on all exclusive listings relating to transactions for which a real estate license is required. The exclusive listing itself must be clear as to expiration.

**Secret profit. §10176(g)**
Secret profit cases usually arise when the broker, who already has a higher offer from another buyer, makes a low offer, usually through a “dummy” purchaser. The broker then sells the property to the interested buyer for the higher price. The difference is the secret profit.

**Listing-option. §10176(h)**
A licensee who has used a form which is both an option and a listing must inform the principal of the amount of profit the licensee will make and must obtain the written consent of the principal approving the amount of such profit before the licensee may exercise the option. This section does not apply where a licensee is using an option only.

**Dishonest dealing. §10176(i)**
“Dishonest dealing” is a sort of catch-all section similar in many ways to §10177(f). The difference is that under §10176(i) the acts must have been those requiring a license while there is no such need under §10177(f).

**Signatures of prospective purchasers. §10176(j)**
Brokers must obtain a written authorization to sell from a business owner before securing the signature of a prospective purchaser to any agreement providing for compensation to the broker if the purchaser buys the business.
Since the Financial Crisis, the BRE has rigorously enforced this and the following code.

**Obtaining a license by fraud. §10177(a)**
Statements of fact in an application for a license; procurement of a license by fraud, misrepresentation, or deceit (e.g., failure to reveal a previous criminal record).

**Convictions. §10177(b)**
Criminal conviction for a felony or a crime substantially related to the qualifications, functions, or duties of a real estate licensee.

**False advertising. §10177(c)**
 Includes subdivision sales as well as general property sales.

**Violations of other sections. §10177(d)**
This section is the Department’s authority to proceed against the licensee for violation of any of the other sections of the Real Estate Law, the Regulations of the Commissioner, and the Subdivided Lands Law.

**Misuse of trade name. §10177(e)**
Use of any trade name or insignia of membership in any real estate organization if the licensee is not a member of that organization.

**Conduct warranting denial. §10177(f)**
An essential requirement to the issuance of a license is that the applicant be honest and truthful. If any of the acts of a licensee establish that a licensee is not possessed of these characteristics, §10177(f) will apply. This section also authorizes disciplinary actions when a real estate licensee has either had a license denied or a license issued by another agency of this state, another state, or the federal government, revoked or suspended for acts which if done by a real estate licensee would be grounds for the suspension or revocation of a California real estate license.

**Negligence or incompetence. §10177(g)**
The Department proceeds in those cases where the licensee is so careless or unqualified that to allow the licensee to handle a transaction would endanger the interests of clients or customers.

**Supervision of salespersons. §10177(h)**
Disciplinary action may result if a broker fails to exercise reasonable supervision over the activities of the broker’s salespersons.

**Violating government trust. §10177(i)**
Using Government employment to violate the confidential nature of records thereby made available.

**Other dishonest conduct. §10177(j)**
Any other conduct which constitutes fraud or dishonest dealing.

**Restricted license violation. §10177(k)**
Violation of the terms, conditions, restrictions and limitations contained in any order granting a restricted license.
Inducement of panic selling.  §10177(l)
To solicit or induce the sale, lease, or the listing for sale or lease, of residential property on the grounds, wholly or in part, of loss of value, increase in crime, or decline in the quality of the schools due to the present or prospective entry into the neighborhood of a person or persons of another race, color, religion, ancestry, or national origin.

Violation of Franchise Investment Law.  §10177(m)
Violation of any of the provisions of the Franchise Investment Law (Division 5 commencing with §31000 of Title 4 of the Corporations Code) or any regulations of the Corporations Commissioner pertaining thereto.

Violation of Corporations Code.  §10177(n)
Violation of any of the provisions of the Corporations Code or of the regulations of the Commissioner of Corporations relating to securities as specified in §25206 of the Corporations Code.

Failure to disclose ownership interest.  §10177(o)
Failure to disclose to buyer the nature and extent of ownership interest a licensee has in property which is the subject of a transaction in which the licensee is an agent for the buyer. Also, failure to disclose such ownership on the part of licensee’s relative or special acquaintance or entity in which licensee has ownership interest.

There are additional sections in the BPC which provide for the revocation or suspension of licenses. These violations could be included under §10177(d) of the law. The following are brief summaries:

<table>
<thead>
<tr>
<th>BPC §</th>
<th>Summary</th>
</tr>
</thead>
<tbody>
<tr>
<td>10137</td>
<td>employing or compensating any unlicensed person to perform acts requiring a license.</td>
</tr>
<tr>
<td>10138</td>
<td>false advertising.</td>
</tr>
<tr>
<td>10140</td>
<td>advertising of acts which require a license must contain a designation disclosing that the licensee is performing such acts.</td>
</tr>
<tr>
<td>10141</td>
<td>broker must cause notice of sales price to be given to both buyers and sellers within one month after the sale is completed.</td>
</tr>
<tr>
<td>10141.5</td>
<td>specifies a broker’s responsibility for recording trust deeds.</td>
</tr>
<tr>
<td>10142</td>
<td>licensee must give a copy of any contract to the party signing it at the time it is signed.</td>
</tr>
<tr>
<td>10145</td>
<td>specifies licensee’s responsibilities in handling trust funds.</td>
</tr>
<tr>
<td>10148</td>
<td>requires retention and availability for inspection and copying of all listings, deposit receipts, cancelled checks, trust records, etc. for a three year period.</td>
</tr>
<tr>
<td>10160</td>
<td>brokers shall retain and make available for inspection the licenses of salespersons in the broker’s employ.</td>
</tr>
<tr>
<td>10161.8</td>
<td>broker must notify BRE when a salesperson is employed or terminated.</td>
</tr>
<tr>
<td>10162</td>
<td>all active brokers must maintain a definite place of business in California.</td>
</tr>
</tbody>
</table>
brokers maintaining more than one place of business must first procure branch office licenses.

failure to make licenses available for inspection and to maintain a place of business.

requires the licensing of individuals, other than licensees, engaged in prepaid rental listing services and makes a willful violation of the law a misdemeanor.

violation of any of the CC §1102, et seq. which deal with use of the Real Property Transfer Disclosure Statement.

suspension without hearing if license procured by fraud, misrepresentation, deceit, or by the making of any material misstatement of fact in the application for license.

violations while performing acts under §10131.6 (mobile home sales).

compensation for referring customers to escrow, pest control, home warranty, title insurer or underwritten title company or controlled escrow company.

final judgment in a civil action against a licensee upon the grounds of fraud, misrepresentation, or deceit.

broker terminates a salesperson for cause and fails to notify the Commissioner.

automatic suspension of a real estate license if the Commissioner pays a claim against a licensee from the Recovery Account. No license reinstatement until full reimbursement to the fund, with interest.

2.2 SELLER BEWARE! A CASE HISTORY

Buyers have three options when presented with disclosures late in escrow: a) waive liability, b) cancel, or c) **complete the sale and sue the seller and his broker.**

Consider the case of *Jue v. Smiser.*

**The Facts**

On April 1, 1992, Ken and Victoria Smiser listed their home in Oakland with Tabaloff & Company. On April 22 an article about their home appeared in the *San Francisco Chronicle.* The article stated that their home was designed by Julia Morgan, the celebrated architect of Hearst Castle. Geoffrey and Charlene Jue read the article and called Tabaloff to make an appointment to see the home. When they toured it, the listing agent gave them a brochure which stated the home was an “**Authenticated, Julia Morgan Design, built 1917**” [emphasis added].

The Jue’s made a full-price offer contingent on the sale of their home. The Smiser’s countered requesting the Jue’s remove the contingency. The Jue’s accepted.

On June 8th, the Jue’s signed documents required to close on June 11. After signing a note, deed of trust, and other closing documents, they were asked by Tabaloff to sign an addendum containing the following:

*Buyer and Seller acknowledge that the residence … is commonly known to be a Julie Morgan design and that there are no plans*
The Jue’s refused to sign the disclaimer.

Over the next two days the Jue’s attempted to verify that the Smiser’s home was a Julia Morgan. They spoke to an expert who concluded that the home was, in fact, designed by Morgan. They also spoke to Morgan’s goddaughter who was unaware of any proof the home was designed by her godmother.

The next day, on June 9th, the Jue’s signed the disclaimer; escrow closed on schedule two days later.

**The Suit**

Three months later (November, 1992), the Jue’s filed suit against Tabaloff, two of Tabaloff’s agents, and the Smiser’s. The Jue’s claimed negligent misrepresentation, fraud, and other standard complaints.

On February 1993, the defendants (the Smiser’s and Tabaloff) had the case dismissed. They successfully argued to the trial court that they had disclosed to the Jue’s in their June 9th addendum that the home might not be a Julia Morgan and the Jue’s acknowledged this disclosure and completed the sale. The trial court accepted this reasoning, dismissed the case, and awarded Tabaloff and the Smiser’s a judgment against the Jue’s for $43,118.59 in attorney fees and court costs.

The Jue’s appealed.

The Jue’s argued that the fact that they acknowledged the misrepresentation and decided to proceed with their purchase did not preclude their suit for damages. They quoted the following from a 1948 decision, *Bagdasarian v. Gragnon*:

> When a party learns that he has been defrauded, he may, instead of rescinding, elect to stand on the contract and sue for damages, and, in such a case his continued performance of the agreement does not constitute a waiver of his action for damages.

**The Decision**

The appellate court agreed with the reasoning in *Bagdasarian* and allowed the buyers to sue both the Smiser’s and Tabaloff for misrepresentation. In their decision they wrote:

> Sound public policy considerations support our decision. The Legislature has enacted a series of statutes designed to foster honesty and full disclosure in real estate transactions (CC §§ 1102 et seq., 2079 et seq.) Our decision should encourage sellers and their representatives to investigate and learn the “true facts” pertaining to real property before it is offered for sale. Possession and communication of such knowledge will be of benefit to all parties in the course of negotiations leading to execution of a sale agreement.
Conclusion

Buyers presented with material disclosures late in escrow may acknowledge the disclosure, complete the sale, and then subsequently sue the seller and his broker for misrepresentation for not having made the disclosures earlier.

2.3 Special Topics

In this section we present noteworthy columns from BRE’s quarterly Real Estate Bulletin and Realty Times pertaining to ethics and professional conduct.

2.3.1 Realtor® Duty to Cooperate is a Narrow One

by Bob Hunt for Realty Times, March 13, 2012
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Real estate professionals who are NAR® members are, for the most part, rightfully proud of NAR’s Code of Ethics. They have all agreed to abide by it, and when a fellow REALTOR® appears to be acting contrary to the Code, most react with consternation.

Article 3 (see below) of the Code enjoins REALTOR®s to “cooperate with other brokers”; and, in this day when short sales and REOs are dominating the inventory, I think it’s a fair guess to say that a lot of REALTOR®s feel that Article 3 is being widely violated. Phone calls go unreturned. Offers languish in some netherworld of non-response. Listings stipulate a veritable obstacle course of requirements that must be met before an offer will be considered. Distressed property listing agents dismiss their disclosure duties as a relic of some bygone era. The list goes on and on. If this is cooperation, can you imagine what adversarial relations would be like?

It would be a mistake, however, to think that behavior which may range from arrogant to rude and boorish necessarily constitutes a violation of Article 3. REALTOR®s forget sometimes what the Code of Ethics is and is not meant to do.

The Code is not a comprehensive set of rules for living. It does not supplant the Ten Commandments, or the strictures of any other religious tradition. It is not the Boy Scout Oath. The Code of Ethics, like other professional codes of ethics, is meant to apply in specific ways to specific kinds of situations that may arise in the course of a certain kind of business. It may, indeed, be based upon certain general ethical principles – most notably the Golden Rule – that themselves are not specific to a particular kind of business or profession. But it does not constitute a general guide for behavior.

The Code, for example, prohibits false advertising or making false statements about a competitor; but it doesn’t prohibit making false statements in general. You can cheat on your spouse without violating the REALTOR® Code of Ethics; although you may have some answering to do with respect to certain other rules of behavior.

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