Ethics

2nd Edition

First 15 pages only.

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

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

1. **Ethics:** Describes the real estate license law enforced by the DRE 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.

The DRE requires each licensee to take the Five Mandatory Courses before renewing their licenses for the **first time**. When renewing for the **first time**, salespersons who received their original (i.e., first) license between October 1st, 2001 and September 30th, 2007 need only these five courses to fulfill their entire continuing education requirement while all other licensees renewing for the **first time** (brokers, corporations, officers, and salespersons who were awarded their first license on or after October 1st, 2007) need these five courses and an additional 30 hours of CE. Any licensee renewing **after the first time**, may take any or all of the Five Mandatory Courses again and receive full credit towards their 45-hour CE requirement.

To save space we use the following abbreviations and terms:

- **BPC** The Business and Professional Code of California.
- **CC** The Civil Code of California

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 the California Association of REALTORS®. We are aware that not all brokerage firms use these forms but we believe they are representative of the forms used in the industry.

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.
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1 INTRODUCTION

Most real estate brokers are paid only after escrow is closed. Closing is rarely easy. Buyers want a dream home at a bargain 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 the temptation and bend or break the truth. The consequences are often litigation, license discipline, and almost always a stain on 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 general public.

This course discusses two parallel but independent standards of professional conduct aka “ethics”:

1. California Real Estate License Law ☞ (the “License Law”): As described in the Business and Professional Code (BPC) and implemented by the DRE 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 National Association of Realtors®. 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 DRE Commissioner to license individuals to practice real estate brokerage in California and to revoke or suspend the licenses of individuals found guilty of dishonesty, fraud, or incompetence.

Section three is the heart of the course, an abridged and annotated presentation of the National Association of REALTOR®’s Code of Ethics as practiced by over one million REALTOR®’s. We also compare the Code to the License Law where the code and the License Law speak to the same issue and we describe how NAR® enforces its Code on members.
1.2 ETHICAL IDEAL

The underlying ethical principal for both the Code and License Law is: 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 principal: 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 clients. 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 composing California real estate law are mostly found in the Business and Professional Code (BPC) and the Civil Code (CC). These two codes together with all California codes can be found at www.leginfo.ca.gov/calaw.html. The regulations the DRE has written to implement the real estate law, called the DRE Regulations, can be found at www.dre.ca.gov/relaw_pdf/Regs.pdf.

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

The law which gives the DRE 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 DRE may suspend, restrict, or revoke licenses.

2 REAL ESTATE LICENSE LAW

Real Estate License Law: State law enacted to protect the public from fraud, dishonesty and incompetence in the purchase and sale of real estate.

The Real Estate License Law (or “License Law”) is the State law designed to protect the public from fraud, dishonesty, and incompetence in the real estate transactions. The text of the law is found mostly in the Business and Professional Code (BPC §10000 et seq.) and its derivative law, the DRE Regulations (based on the BPC). License Law is enforced by the Commissioner primarily by the Commissioner’s power to suspend and revoke the license and any license who violates it.

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 participates in arranging the sale of real property in California once the buyer and seller have been brought together.
§10176 and §10177 of the BPC constitute the foundation for most license suspensions or revocations. §10176 is concerned with the actions of a real estate licensee performing or attempting to perform any of the 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. (See 2.3.1 for a related DRE article on “Undisclosed Compensation”).

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.

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.

Since the Mortgage Crises, the DRE has been ruthless in enforcing this and the following code.

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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 provides for 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>
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<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>10138.6</td>
<td>advertising of acts which require a license must contain a designation disclosing that the licensee is performing such acts.</td>
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<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>
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<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 DRE 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>
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<tr>
<td>10163</td>
<td>brokers maintaining more than one place of business must first procure branch office license(s).</td>
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<tr>
<td>10165</td>
<td>failure to make licenses available for inspection and to maintain a place of business.</td>
</tr>
<tr>
<td>10167</td>
<td>requires the licensing of individuals, other than licensees, engaged in prepaid rental listing services and makes a willful violation of the law a misdemeanor.</td>
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<tr>
<td>10176.5</td>
<td>violation of any of the CC §1102, et seq. which deal with use of the Real Property Transfer Disclosure Statement.</td>
</tr>
<tr>
<td>10177.1</td>
<td>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.</td>
</tr>
<tr>
<td>10177.2</td>
<td>violations while performing acts under §10131.6 (mobile home sales).</td>
</tr>
<tr>
<td>10177.4</td>
<td>compensation for referring customers to escrow, pest control, home warranty, title insurer or underwritten title company or controlled escrow company.</td>
</tr>
<tr>
<td>10177.5</td>
<td>final judgment in a civil action against a licensee upon the grounds of fraud, misrepresentation, or deceit.</td>
</tr>
<tr>
<td>10178</td>
<td>broker terminates a salesperson for cause and then fails to notify the Commissioner.</td>
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</tbody>
</table>
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 8, they signed documents required to close on June 11. After signing a note and 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 available at the Oakland City Hall verifying same.*

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 an earlier decision, Bagdasarian v. Gragnon (31 Cal.2d 744, 1948):

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 benefit to all parties in the course of transactions 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 FROM R. E. BULLETIN

The DRE provides guidance concerning frequently encountered legal and ethical problems confronting licensees in its quarterly Real Estate Bulletin. In this section we present several noteworthy columns pertaining to ethics and professional conduct.

2.3.1 UNDISCLOSED COMPENSATION

From the DRE’s Real Estate Bulletin, Summer 2003 subtitled, “Grounds for Revocation of License”.
Summary: The prohibition against an agent taking a “secret profit” includes any compensation, direct or indirect, no matter how trivial—this includes mark-ups and the practice of adding a surcharge to another vendor’s bill for a product or service. All compensation must be disclosed to the client before the agent requests payment.

One of the functions of the Department’s Audit Section is to investigate complaints involving the handling of client’s funds in real estate transactions. Many transactions require specific disclosures to the parties as to how the money was or will be distributed. In this regard, auditors frequently find that licensees have not fully disclosed all of their compensation to their clients (i.e., sellers, lenders, borrowers).

Compensation can come in many forms, including real estate commissions, property management fees, loan origination fees, and mortgage loan servicing fees. These different types of compensation are normally disclosed on a purchase contract, property management agreement, Mortgage Loan Disclosure Statement, or loan servicing agreement.

The real estate market is very competitive and with inflation affecting many fixed operating costs, some licensees have looked for different ways to at least cover part of their overhead. The problem often discovered by auditors is that some licensees collect from or charge clients in excess of costs incurred. This additional amount of money is therefore considered to be income and must be disclosed to the licensee’s clients. This disclosure should be made whether these clients are buyers or sellers of real estate, investors or borrowers in loan transactions, or owners of rental property.

The following are some examples of additional compensation earned by licensees that should be disclosed to clients prior to collection:

- A licensee maintaining a property management company who also owns and uses a maintenance company to perform work on behalf of a property owner.

  In this particular situation, the licensee should disclose in writing to the property owner, the related business and the costs of specific services including compensation to the broker being charged to the owner.

- Late fees earned by the licensee.

  Any portion of a late fee going directly or indirectly to a licensee should be disclosed to the property owner or investor.

- Returned check/bank fees over and above the amount being charged to the licensee.

  For example, a real estate broker deposits into his or her trust account a mortgage payment received from a borrower for a trust deed investor and the check for the mortgage payment subsequently bounces a few days later. The real estate broker is charged $15 by the bank for the returned check. The real estate broker in return charges the borrower $25 for the returned check. The additional $10 earned by the real estate broker should be disclosed to the borrower and the investor prior to collection by the broker.