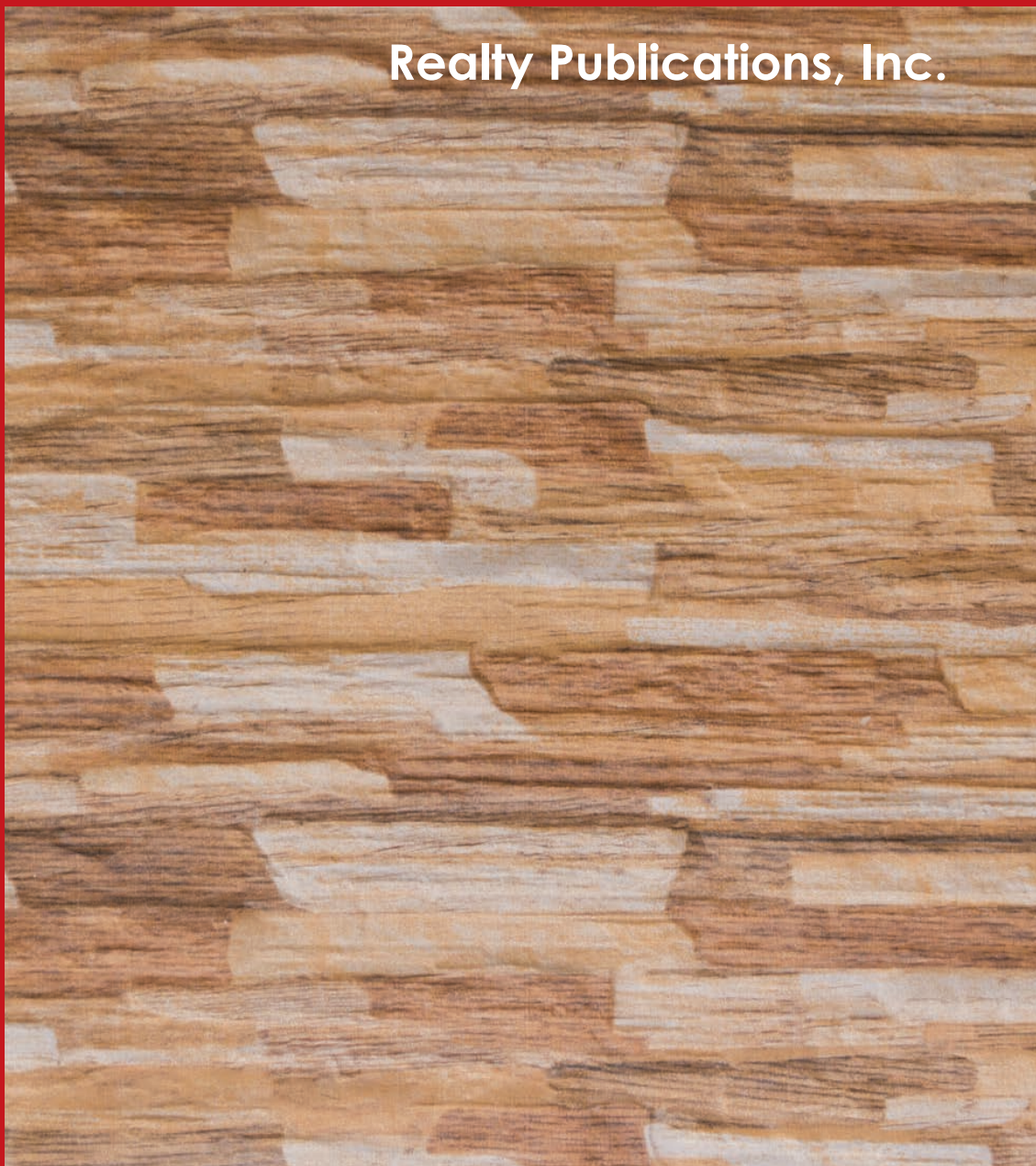




# California Real Estate Practice

Realty Publications, Inc.



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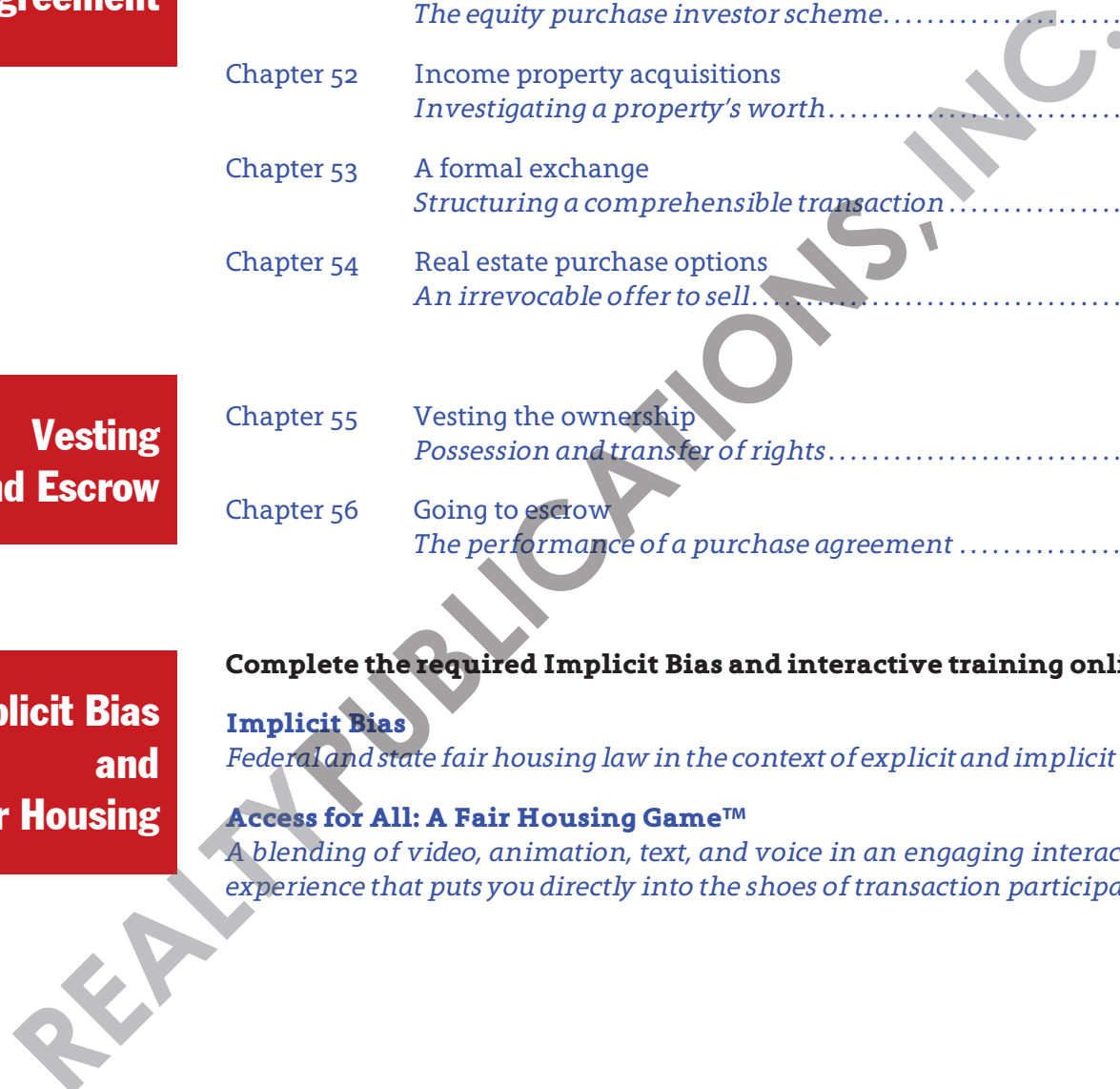
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# Brokerage activities: agent of the agent

After reading this chapter, you will be able to:

- understand an employing broker's responsibility to continually oversee the real estate activities of the agents they employ;
- appreciate the office policies, procedures, rules and systems a broker implements to comply with their duties owed to clientele and others; and
- discuss how licensee status relates to labor regulations, taxation and issues of liability.

**clients**

**independent contractor  
(IC)**

**licensed activities**

**listing agreement**

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

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

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

## Chapter 1

### Learning Objectives

### Key Terms

### Introduction to agency



**listing agreement**

A written employment agreement used by brokers and agents when an owner, buyer, tenant or lender retains a broker to render real estate transactional services as the agent of the client. [See **RPI** Form 102 and 103]

## Broker vs. sales agent

**clients**

Members of the public who retain brokers and agents to perform real estate related services.

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

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

To retain a broker to act as a real estate agent, the buyer or seller enters into an employment contract with the broker, called a **listing agreement**.

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

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

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

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

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

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

<sup>1</sup> Calif. Business and Professions Code §10131

<sup>2</sup> Bus & P C §10160

<sup>3</sup> **Grand v. Griesinger** (1958) 160 CA2d 397

<sup>4</sup> Bus & P C §10137

<sup>5</sup> Calif. Civil Code §2079.13(b)

<sup>6</sup> **Gipson v. Davis Realty Company** (1963) 215 CA2d 190

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

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

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

The sales agent's duties owed to the broker's clients and others in a transaction are equivalent to the duties owed them by the employing broker.<sup>8</sup>

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

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

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

- *soliciting* and obtaining buyer and seller listings and *negotiating* real estate transactions of all types;
- the *documentation* arising out of licensed activities which may affect the rights and obligations of any party, such as agreements, disclosures, reports and authorizations prepared or received by the agent;
- the *filing, maintenance and storage* of all documents affecting the rights of the parties;
- the handling and safekeeping of *trust funds* received by the agent for deposit, retention or transmission to others;
- *advertisements*, such as flyers, brochures, press releases, multiple listing service (MLS) postings, etc.;
- agents' compliance with all federal and state laws relating to *unlawful discrimination*; and
- the receipt of regular *periodic reports* from agents on their performance of activities within the course and scope of their employment.<sup>10</sup>

## Responsibility for continuous supervision

## The employing broker's management

<sup>7</sup> Bus & P C §10177(h)

<sup>8</sup> CC §2079.13(b)

<sup>9</sup> CC §2079.16

<sup>10</sup> California Department of Real Estate Regulations §2725

One method a broker uses to implement the requirement for supervision of employed agents is to develop a **business model**. So intended, the broker outlines the means and manner by which agents produce and service listings, and how purchase agreements are negotiated and closed. The creation of a plan for office operations logically starts by establishing categories for itemizing administrative and licensed activities, then a written presentation of the conduct required of agents to achieve the broker's objectives for each item. [See Figure 1]

## Business and licensed activities

**licensed activities**  
Dealing by DRE licensees with members of the public to offer, contract for and render real estate brokerage services for compensation.

Categories of business and **licensed activities** include:

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

The rules and procedures established by the broker to meet their responsibility to manage and oversee the conduct of their agents when acting on behalf of the broker needs to be agreed to in writing between the broker and the employed agents. A written **employment contract** details the duties of the sales agent and the agent's need to comply with an office manual which contains the broker's policies, rules, procedures and other conduct the broker deems necessary to fulfill their responsibility for supervision.

Also, the written employment agreement needs to spell out the **compensation** the agent is to receive for representing the broker in soliciting and negotiating listings, purchase agreements, leases and financing.<sup>11</sup>

## The (not so) independent contractor

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

<sup>11</sup> DRE Regs. §2726

Within each category of activity covering the broker's management of their agents' conduct for producing, servicing and negotiating listings and sales, is a list of items to be considered.

**Administrative**

- E& O insurance
- workers' compensation insurance
- automobile insurance binder
- general comprehensive business insurance
- agent policy manual (on procedural, substantive and compliance activities)
- new agent qualifications and interview procedures
- institutional advertising franchise affiliation
- trade organization membership
- MLS subscriptions
- employment contracts with sales agents
- agent pay, advances, and escrow disbursements
- production goals
- phone/floor-time coverage
- hours/agents' work schedules
- business cards
- storage of documents (3 years)
- office meetings/attendance
- agent contribution to expenses
- bank trust accounts
- general business bank accounts

**Organizational Procedures**

- forms to be used
- use of coordinators
- use of office equipment
- use of affiliated services
- use of controlled businesses
- attorney inquiry/referral to broker
- trust fund handling (deposit and log)
- e-mail content
- public record inspection
- servicing property listings (MLS, signs, ads, property profiles, open houses, correspondence, showings, check lists, rents, etc.)
- servicing buyers (listings, property profiles, broadcasts, wants, showings, qualifying, check lists, etc.)
- client lists and follow-up

**Substantive Activities**

- taking property listings (addenda and disclosure check lists, deposits, property profiles, further approvals, fee setting, seller profiles, etc.)
- preparing offers (documents/disclosures and addenda checklists, duty checklists, advice on use of arbitration, forfeiture, escrow, title, misc. provisions, fee provisions, etc.)
- FSBO submission of offers (fee arrangements, listings, dual agency, etc.)
- preparation of documents, use of attorneys, added provisions

**Compliance**

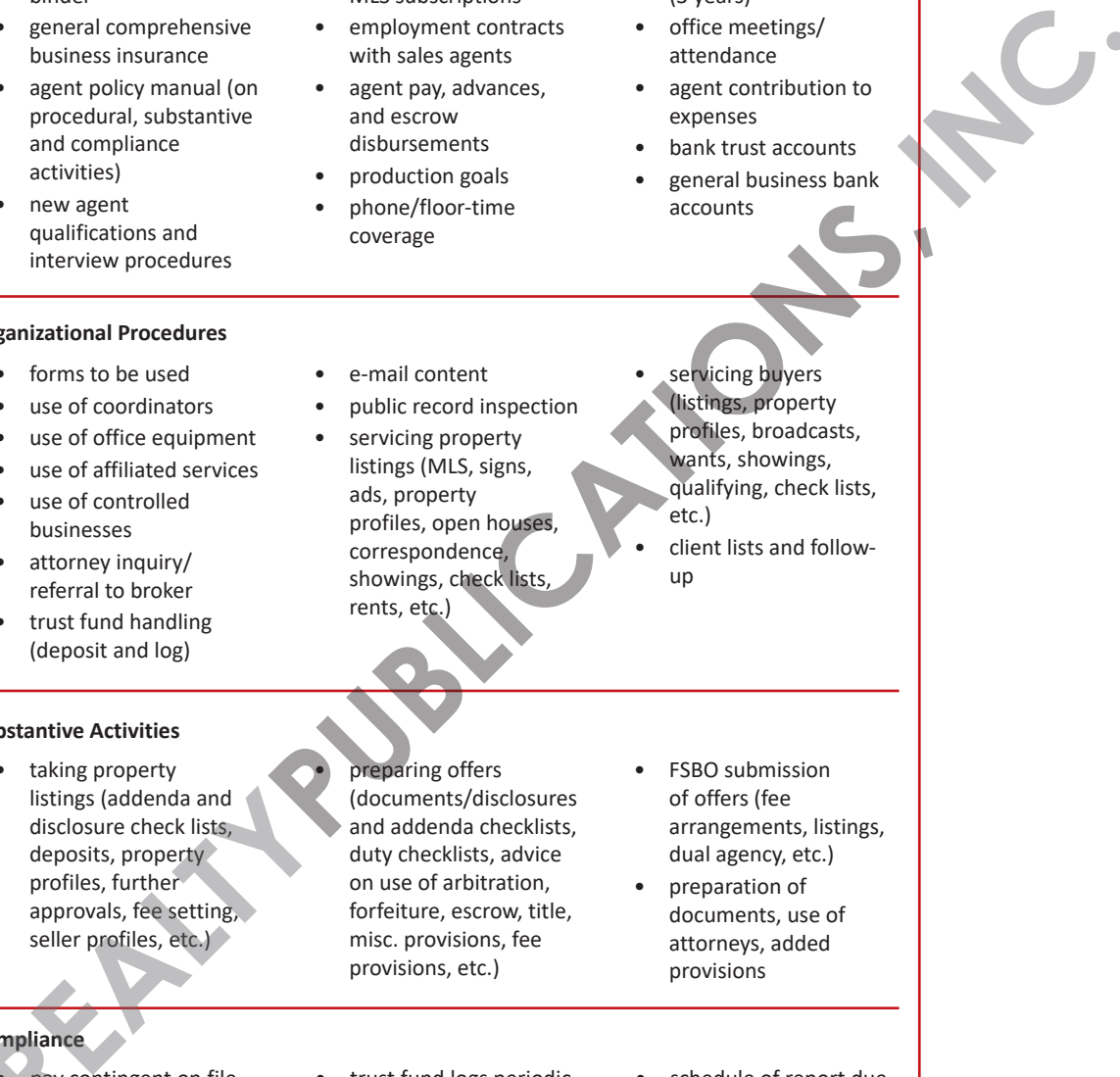
- pay contingent on file audit and completeness
- listing logs transaction logs
- trust fund logs periodic reports
- listing reports
- sales reports
- schedule of report due dates
- other events which trigger notices or reports to management

**Supervision**

- continuous daily oversight
- constant follow-up on compliance with procedures and substantive activities
- instructions on propriety of acts within the course and scope of employment
- degree of enforcement being tight and disciplined, or lax and allowing great discretion
- use of assistants to provide oversight

**Figure 1**

**Forming a Business Model**



**independent contractor (IC)**

A type of employment arrangement used by a real estate broker when hiring licensed sales agents and other brokers as their supervised employees to avoid employer contributions and withholdings for income taxes.

Whether the broker withholds state and federal income tax on payment of an agents' compensation depends on the type of employment agreement the broker and agent enter into, i.e., an **independent contractor (IC)** or *employee-employer (EE)* agreement. [See **RPI** Form 506]

A sales agent licensed by the DRE and employed by a broker under an *independent contractor* agreement and paid based on the broker's receipt of a contingency fee will not be treated as an employee for purposes of income tax *withholding* or payroll *contributions*.<sup>12</sup>

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

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

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

**Business income**

For sales agents entering into an IC agreement, they report their fees received from their broker as business income (Schedule C). In turn, the agent expenses all the business-related costs of operations incurred while acting within the course and scope of their employment with the broker. It does not matter what degree of control the broker actually exercises over the agent's activities, none or enough to satisfy DRE supervisory requirements or total oversight as needed for first year licensees.

However, even though the agreement is called an "independent contractor" agreement — an arrangement designed solely for income tax reporting purposes — the agent is an agent of their employing broker and definitely not a separate operator independent of their broker.

When testing the conduct of an agent while engaged in real estate related activities, the IC provision in the broker-agent employment agreement cannot and does not change the agent's classification as an agent of the broker under California real estate and labor laws.<sup>13</sup>

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

<sup>12</sup> Internal Revenue Code §3508

<sup>13</sup> Gipson, *supra*

Consider a sales agent who is employed by a broker under an IC agreement. The broker gives the agent *total discretion* in handling of clientele and documentation of listings and sales.

As risk management, the IC agreement includes a provision calling for the agent to hand the broker a binder for liability insurance coverage for the agent's car, naming the broker as an insured. The IC agreement also requires all documents and funds received on listings and sales to be entered into and taken in the name of the broker, and all advertising and business cards to identify the agent as acting for the broker as an associate licensee.

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

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

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

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

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

In spite of the IC employment agreement allowing total discretion to the agent in the conduct of handling of listings and sales, the agent is continuously **subject to supervision** by the broker. Sales agents are agents of the broker, without regard to the tax purpose of their employment agreement. The injury presented in the prior scenario occurred while the agent was acting within the course and scope of their agency with the broker. Thus, the broker cannot escape liability for their agent's negligence.<sup>14</sup>

The broker who hires agents who use their own vehicles to conduct brokerage activities by going to and from appointments, meetings and properties needs to be a named insured on the agent's car insurance policy as a matter of the broker's risk management. The employing broker also needs to maintain general comprehensive business liability insurance and professional liability coverage (errors and omissions insurance). Claims of tortious conduct of all sorts may arise out of listings and sales transactions solicited and negotiated by their agents and coverage is needed to defend or pay these claims.

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

**Agent  
imposes  
liability on  
broker**

**The IC: an  
agent of the  
broker**

<sup>14</sup> Gipson, *supra*

## Unemployment insurance benefits

For the purposes of administering real estate law, a sales agent is considered both an *agent and an employee* when acting within the course and scope of employment with a broker.<sup>15</sup>

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

For example, licensed real estate sales agents, as well as associated brokers, are excluded employees for purposes of the **California Unemployment Insurance Law**. Even though a sales agent is considered both an agent and an employee under California real estate law, a broker does not have to contribute to the state unemployment insurance fund on behalf of the agent. In turn, the agent cannot collect unemployment benefits from the state if terminated from the employ of the broker.

Receipt of compensation by a licensed real estate agent under an employment agreement, paid as a *contingency fee* for closing transactions, is the **only test required** for the broker to avoid paying unemployment benefits. When the agent is paid a **contingency fee**, not an hourly wage, the agent will be denied unemployment benefits regardless of the level of supervision and control the broker exercises over the agent's real estate related activities.<sup>16</sup>

## Minimum wage exclusion

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

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

Typically, the agents' time in the office spent at the desk, or on the phones or floor, rarely take up more than one day a week, usually less than 20% of the time spent on real estate related listings and sales. Little additional time is spent in the office at staff meetings. As a result, agents are rarely considered employees, except for the public policy purpose of judging their conduct as a licensee under California real estate law.

As an *outside salesperson* who regularly works more than half of their time away from their place of employment, selling items or obtaining contracts for services, a real estate sales agent is excluded from collecting a **minimum wage** from their broker.<sup>17</sup>

<sup>15</sup> Grand, *supra*

<sup>16</sup> Calif. Unemployment Insurance Code §650

<sup>17</sup> Calif. Labor Code §1171

Consider an agent who is employed by a broker under an IC agreement. The broker does not have a policy manual, training program or any requirements as to what forms to use and what duties are to be fulfilled by the agent (a dereliction of the broker's duties of supervision). Once a month, the agent reports to the broker by preparing and presenting a transaction log noting the listings and sales activity the agent has been involved in during the month.

After several months of employment and no sales, the broker terminates the agent. During the employment, the broker disbursed funds to the agent as an advance draw against fees yet to be earned by the agent. Any amounts not reimbursed are payable to the broker on termination. Thus, by agreement, the broker calls due the amounts advanced and unpaid, and makes a demand on the agent for payment at the time of termination.

The agent claims they are entitled to an offset since they are an employee of the broker and thus entitled to a minimum wage in amounts which exceed the advances received from the broker. The agent makes a demand on the broker for unpaid wages at the minimum rate per hour worked.

To be due an hourly wage, the agent needs to demonstrate that the actual working relationship with the broker was more than just an agent of the broker employed as required by real estate law, but that of an employee under the labor code.

To continue the previous example, the agent has to demonstrate that the relationship while employed by the broker included total control by the broker over every **means, manner and mode of conduct** used by the agent to carry out licensed activities on behalf of the broker, such that the agent was nearly without discretion to make decisions and operate on their own.

Here, the broker's supervision and management of the agent by implementing policies and procedures for the negotiation of real estate transactions were nearly nonexistent.

While the sales agent was an agent of the broker, the sales agent was not under *common law control* of the broker as a *servant* hired to perform as directed under constant supervision. Thus, the sales agent was not an *employee* for the purposes of the labor law, and was not entitled to receive a minimum wage.<sup>18</sup>

Further and separately, the issue of being an employee excluded from collecting a minimum wage based on the agent's classification as an *outside salesperson* was not of concern in the previously discussed example.<sup>19</sup>

However, even if the broker had controlled an agent's activities, hours, scheduling and production of listings and sales, the agent still would have been outside the office more than half of the hours spent working for the broker. Thus, an agent who spends half of their working time outside the

**An employee  
under the  
labor law**

**Means,  
manner and  
mode of  
conduct**

<sup>18</sup> CC §2079.13(b); Lab C §1171; *Grubb & Ellis Company v. Spengler* (1983) 143 CA3d 890

<sup>19</sup> *Grubb & Ellis Company, supra*



office while classified as an employee under the labor law is definitely **excluded** from collecting a minimum wage due to their labor law status as an outside salesperson.

## Workers' compensation coverage for employees

For purposes of workers' compensation insurance law, the relationship between a broker and their employed agents is that of an employer and their employees. As a consequence, all real estate brokers in California have to provide **workers' compensation insurance** coverage for their sales agents.<sup>20</sup>

A broker who is **unlawfully uninsured** or forces agents to carry their own workers' compensation insurance faces:

- a *stop order* from the Department of Industrial Relation's Division of Labor Standards Enforcement (DLSE), preventing the broker from conducting business until proof of insurance is offered up;
- *civil penalties* and fines up to \$100,000; and
- *reimbursement claims* from current and former agents for premiums they paid.<sup>21</sup>

For a broker who employs one or more agents, the broker is required to be covered by workers' compensation insurance, in addition to any business, vehicle and professional liability insurance (errors and omissions coverage). The insurance coverages provide the broker with a financial safety net against agent-imposed liability by shifting the risk of loss to the insurance companies.

Thus, the well supervised real estate brokerage business, as owned and managed by a broker who runs a properly conducted operation with concern for inherent risks, provides an enduring professional environment in which their sales agents will flourish.

<sup>20</sup> Lab C §§3200 et seq

<sup>21</sup> California Department of Real Estate Bulletin, Fall 2004, Page 10

## Chapter 1 Summary

To ensure a greater degree of consistency and competence in the rendering of brokerage services, California law regulates:

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

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

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

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

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

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

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

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

**Chapter 1**  
**Key Terms**

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