

**“Let the Broker Beware”
(Supervision of Independent Contractors)**

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By Edward I. Sumber, Board Counsel

Over the past 25 years, the real estate brokerage industry has changed dramatically. The use of the computer, the presence of the internet, the shift to buyer brokerage as well as seller brokerage and the consolidation of small firms into large firms which dominate our marketplace, could hardly be envisioned.

These dramatic changes have resulted in more aggressive supervision of real estate licensees by real estate regulators as well as a dramatically enlarged and expanded Realtor® Code of Ethics to address the changing marketplace. At the same time there have been virtually no changes in the very burdensome laws requiring broker supervision of salespersons.

What is the Duty of the Broker to Supervise Salespersons?

Regulation Section 175.21 under Article 12-A of the Real Property Law (19 NYCRR §175.21) sets forth in detail the obligation of a broker to supervise a salesperson. This Regulation states:

“(a) The supervision of a real estate salesperson by a licensed real estate broker, required by subdivision l(d) of §441 of the Real Property Law, shall consist of regular, frequent and consistent personal guidance, instruction, oversight and superintendence by the real estate broker with respect to the general real estate brokerage business conducted by the broker, and all matters relating thereto.

(b) The broker and salesperson shall keep written records of all real estate listings obtained by the salesperson, and of all sales and other transactions effected by, and with the aid and assistance of, the salesperson, during the period of his association, which records shall be sufficient to clearly identify the transactions and shall indicate the dates thereof. Such records must be submitted by the salesperson to the Department of State with his application for a broker’s license.

(c) ...”

Article 11 of the Realtor® Code of Ethics affirms the level of competence expected of Realtors®:

“Article 11: The services which REALTORS® provide to their clients and customers shall conform to the standards of practice and competence which are reasonably expected in the specific real estate disciplines in which they engage; specifically, residential real estate brokerage, real property management, commercial and industrial real estate brokerage, real estate appraisal, real estate counseling, real estate syndication, real estate auction, and international real estate.

REALTORS® shall not undertake to provide specialized professional services concerning a type of property or service that is outside their field of competence unless they engage the assistance of one who is competent on such types of property or service, or unless the facts are fully disclosed to the client. Any persons engaged to provide such assistance shall be so identified to the client and their contribution to the assignment should be set forth. (Amended 1/95)”

The Department of State Focus

On May 18, 2010, Secretary of State Lorraine Cortés-Vázquez, made a public announcement about the DOS actions against “dishonest licensed real estate professionals, leading to numerous revocations, suspensions and fines.” DOS announced that it would initiate a real estate education campaign aimed at helping prospective purchasers, sellers and renters to learn their rights when engaging a real estate professional’s services. Secretary Cortés-Vázquez stated:

“By and large, the vast majority of real estate professionals in New York are hard workers who follow the rules, but as with any trade, some people abuse those rules, and those individuals should no longer have the privilege to work in the industry.”

The Department of State, which licenses nearly 123,000 real estate brokers and salespersons, now has at its website homepage (www.DOS.State.NY.US) a new brochure which sets forth “what you need to know before entering into a real estate transaction.”

The DOS news release from Secretary Cortés-Vázquez also set forth examples of revoked licenses of persons previously licensed by the Department of State.

How Can a Principal Broker Supervise in 2010?

In an environment in which offices may have 50-100 licensees or in larger firms with hundreds to thousands of licensees, how can a principal broker, responsible under DOS Regulations for “frequent and consistent personal guidance, instruction oversight and superintendence”, possibly meet these obligations? Salespersons now often work at home, use the internet as their contact vehicle, and rarely, in some instances, visit with or report to their principal brokers. The entire business model for the real estate brokerage industry has changed dramatically. Individual salespersons are attempting to brand themselves by creating their own websites, creating “team” images and by self promotion in advertising based on business models which did not exist when Article 12-A of the Real Property Law was created and the Regulations were placed into effect.

The New York Model

Roberts Real Estate, Inc. v. Department of State was an important landmark decision by the New York State Court of Appeals (80 NY2d 116, 589 NYS2d 392 (1992)). The New York high Court indicated that when a supervising broker is unaware (does not have “actual knowledge”) of the actions of a salesperson and upon finding that the salesperson has acted improperly, relinquishes the commission or refunds the commission, even though there may be a failure to supervise, the penalty to the principal broker is limited to a fine pursuant to Real Property Law §442-C. Such protections for the principal broker are not generally available under the Realtor® Code of Ethics nor are they available in most other jurisdictions.

The Independent Contractor Conundrum

Anyone who has run a real estate brokerage office knows that it is virtually impossible to recognize during an interview which prospective salesperson will become effective and productive. Selling real estate requires a unique ability to tune in to the wants and needs of consumers and a personality which allows the salesperson to work toward the customer or client’s specific objectives. If a real estate broker was required to “employ” new sales personnel as employees and pay minimum wages, until an individual’s productivity could be determined, the entire structure of the real estate brokerage business would require revamping. During the past few years of intense economic contraction and real estate sales contraction, brokers have suffered, alongside their salespersons, substantial economic losses in income and net worth.

The independent contractor relationship which requires payment of compensation to salespersons based only on sales production, requires that the employing broker not “direct and control” the salesperson. In the independent contractor relationship the

DOS requirement to supervise the activities of the salesperson does not give the principal broker the right to direct and control. The principal broker, accordingly, cannot instruct a salesperson to be in the office at a particular time, work specific hours or to take specific customers to properties designated by the principal broker. However, monitoring the activities of the salesperson comes under the function of supervision and must consist of "regular, frequent and consistent personal guidance, instruction, oversight and superintendence..." This has always been a fine line for principal brokers to deal with.

For many years, principal brokers were discouraged from creating office manuals because they might be construed as an indication of direction and control. This was lessened after the 1986 amendments to the Workers Compensation Law (Sections 2 and 201) and Labor Law (Section 511) which outlined clearly the circumstances under which a salesperson would be considered an independent contractor in New York. What is required of the principal broker is that there be a written contract with the salesperson in the form prescribed by statute and that the principal broker and salesperson live to the letter of New York law. Doing so also complies with the Internal Revenue Code provisions (IRC Section 3508) that indicate that if a real estate salesperson has a written contract he or she will be presumed to be independent contractor.

Policy Manuals in the Age of Technology

Rapid changes in technology have rendered policy manuals created 10 or 15 years ago virtually useless. Salespersons often market themselves individually now and forget that they are required to identify their brokerage affiliation. This is a requirement of the Department of State.

Many issues have arisen, particularly with respect to advertising and the failure of principal brokers to monitor the internet sites of their sales personnel. In particular, blogs in which sales personnel participate are especially dangerous.

The failure, therefore, of a principal broker to create social media policies and to monitor the postings and advertising of salespersons is likely to expose licensees and their brokers to violations of New York License Law and other federal and state laws. The principal broker is therefore in jeopardy. It is also well known that the duty to supervise in the area of fair housing is an obligation which is clearly a threat to principal brokers who may not adequately train, monitor and supervise sales personnel.

Accordingly, the creation of an office policy manual is now considered virtually essential. Such manuals should be carefully reviewed by counsel so that they comply with the requirements of the independent contractor relationship. Manuals should also be customized to reflect New York Law. Manuals are readily available for the real estate brokerage industry which are intended for National use. New York's License Law is now almost 90 years old with provisions that never contemplated the types of

technology which currently exist. Accordingly, having counsel familiar with the independent contractor requirements and the requirements under Article 12-A of the Real Property Law is essential.

How Can the Principal Broker Possibly Monitor Internet Activity?

In large firms it is clear that having someone within the firm monitor the internet activities of salespersons is essential. For smaller firms, where hiring a person to perform this “overhead” activity is impractical, once a broker establishes the various policies which salespersons must adhere to, small firms must consider how to monitor postings by individual salespersons. Technologies already exist such as “google alert” or “twitter search” which provide communications to the principal broker when the principal broker’s firm name is used or the salesperson’s name is used and/or appears in a post.

Critical to the broker’s policy guidelines to be provided to salespersons are the following:

1. Fair housing restrictions and discussions about fair housing.
2. Prohibitions against libelous statements about other industry professionals.
3. Anti-trust issues and particularly, prohibiting discussions about commissions or commission splits between brokerage firms.
4. Standards regarding the forwarding of information appearing on the internet without verifying the accuracy of the materials. Virtually everyone has received false information over the internet which often can be verified by checking on snopes.com or similar sites.
5. Virus protection and standards for transmitting data received from the internet should be established so that salespersons do not invite viruses that destroy the brokerage firm’s files.

Salespersons often do not understand that it is the principal broker who must authorize internet advertising and other information which is disseminated over the internet. As such, it is appropriate for a brokerage firm to consider requiring particular software or database programs in order for the firm to maintain its recordkeeping requirements as designated by the Department of State’s Regulations. The inability to translate salespersons’ programs into those which the brokerage firm itself must maintain, could be construed as a failure by the brokerage firm to supervise the salesperson.

Also a legitimate guideline to be established by principal brokers is a policy regarding the maintenance and/or deletion of business e-mails. Since 2006, information maintained via the internet and through e-mails is subject to discovery under the Federal Rules of Civil Procedure, in connection with lawsuits. These rules govern the discovery of electronically stored information and make it clear that e-mails, attachments, instant messages, text messages, blog logs, back up tapes, histories of web

surfing and voicemail are subject to discovery in civil lawsuits. The brokerage firm should have a policy requiring that such data be maintained for a minimum period of three years by the salesperson in order to comply with DOS regulations.

Realtor® offices are encouraged to review the excellent article by Mariwyn Evans in Realtors® Magazine Online which appeared in the January 2010 edition. Ms. Evan's article entitled "Adapt Policies for a Smooth-Running Office" is available at Realtor.org.

Advertising

One of the primary areas of concern for the Realtor® community in New York regarding supervision is the issue of advertising. Because many salespersons now advertise independently, principal brokers should always insure under their policy manuals that all advertising be approved by the principal broker. Specific reference should be made to Section 175.25 of the DOS Regulations which states:

"Section 175.25 Advertising. (a) All advertisements placed by a broker must indicate that the advertiser is a broker or give the name of the broker and his telephone number.

b) all advertisements placed by a broker which state that property is in the vicinity of a geographical area or territorial subdivision must include as part of such advertisement the name of the geographical area or territorial subdivision in which such property is actually located."

These regulations are in the process of being amended by the Department of State and it is anticipated that new regulations will have been adopted by the end of 2010.

Specific reference should also be made to Article 12 of the Realtor® Code of Ethics which states:

"REALTORS® shall be honest and truthful in their real estate communications and shall present a true picture in their advertising, marketing and or presentations. REALTORS® shall ensure that their status as real estate professionals is readily apparent in their advertising, marketing and other representations, and that the recipients of all real estate communications are, or have been, notified that those communications are from a real estate professional. (Amended 1/08)"

An Orderly System

The failure to create an organized and comprehensive policy manual and a system to monitor the activities of salespersons will surely render a broker vulnerable to inappropriate behavior of salespersons who do not know their obligations or choose to disregard them. In either event the principal broker has significant liabilities which need to be addressed. Proof that a system is in place and that diligent action was taken will surely mitigate the exposure of the principal broker in the current environment. Doing less cannot be justified.

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