

## **Referral Arrangements: Real Estate Agents May Be Unknowingly Violating NYS Insurance Laws**

By: John Dolgetta, Esq.

In an opinion issued on May 31, 2011 (the "Opinion"), a senior attorney for the State of New York Insurance Department, Sapha S. Maloor, Esq., pointed out the very real risks real estate agents face when referring business to attorneys and title agencies in the normal course of their day-to-day work. (A copy of the Opinion can be found on the Insurance Department's website at <http://www.ins.state.ny.us>). The Opinion points out that certain referral arrangements violate the Insurance Law and harsh penalties can be imposed as a result. This article will highlight the inherent conflicts and problems that arise when setting up formal or informal business referral arrangements between real estate agents, title agents and attorneys.

### **Real Estate Transactions in New York**

In New York many real estate transactions involve the use of title agents or title agencies (as opposed to dealing directly with title insurance companies) which offer title insurance policies to prospective purchasers. It is customary for title agents, as well as other real estate professionals such as real estate agents, attorneys, lenders, home inspection companies, etc. to use referrals as a critical component of their businesses. Normally, a real estate agent will refer a client to a few different attorneys (usually three or more). Similarly, an attorney may refer a client to one or more real estate agents or brokers who have experience and expertise in a certain market or area in order to list and sell a client's home.

The attorney for the purchaser will usually choose one of several different title insurance companies or agencies to provide title insurance for a particular real estate transaction. It is not customary for the real estate agent or broker to refer a client to a specific title insurance agent or title insurance company or recommend that an attorney use a particular title agent or company. With the rise of "one-stop-shop" business models, there are many real estate professionals, including attorneys, real estate agents and others who or which have set up or have ownership in a title insurance agency. These real estate professionals often "recommend" that the parties use that title insurance agency. As far as attorneys go, there are severe restrictions that govern the referral of business by an attorney to a title company that is owned wholly or in part by that attorney. There have been many Ethics Opinions issued by the Committee on Professional Ethics of the New York State Bar Association on this subject. This article, however, focuses on referrals made by a real estate agent to a title company owned by or affiliated with that agent's firm.

### **Certain Referrals Violate the NYS Insurance Law**

The specific question presented to the State Insurance Department was as follows: “[m]ay a residential real estate broker refer its clients to a list of “pre-approved” or “recommended” attorneys if the attorneys have an informal arrangement with the real estate broker to refer all of their clients to the real estate broker’s affiliate title agent?” While the fact pattern is very specific, one must be very careful to review and scrutinize any of the arrangements or referral policies (whether informal or not) that are currently in place between the title agents, attorneys and real estate brokers.

In the specific fact pattern presented in the Opinion, the real estate broker basically refers clients to attorneys that are on a “recommended” or “approved” list. There does not have to be a formal or actual list. There could simply be a verbal policy in place whereby the licensees of the brokerage firm are told to refer business to an attorney or list of attorneys. The attorney is then “required”, “requested” or “expected” to refer his or her client to the title insurance agency owned by or “affiliated” with the real estate brokerage firm. In the event the attorney elects not to refer clients to the “affiliated” title agency or stops making referrals to the title agency the real estate broker simply removes the attorney or attorneys from the so-called “recommended” or “approved” list. What more commonly occurs is the attorney is simply not referred any additional real estate clients. This is what the Opinion refers to as a “quid pro quo” arrangement (i.e., the Latin phrase for “this for that”) and it is strictly prohibited by the Insurance Law.

#### **Relevant Provision: Section 6409(d) of the Insurance Law**

The Opinion cites the relevant provisions of Section 6409(d) of the Insurance Law (the “Law”) which states as follows:

**“No title insurance corporation or any other person acting for or on behalf of it, shall make any rebate of any portion of the fee, premium or other charge made, or pay or give to any applicant for insurance, or to any person, firm or corporation acting as agent, representative, attorney, or employee of the owner, lessee, mortgagee or the prospective owner, lessee, or mortgagee of the real property or any interest therein, either directly or indirectly, any commission, any part of its fees or charges, or any other consideration or valuable thing, as an inducement for, or as compensation for, any title insurance business. Any person or entity who accepts or receives such a commission or rebate shall be subject to a penalty equal to the greater of one thousand dollars or five times the amount thereof.”**

#### **Clarity about Violations**

While the Law seems to be straightforward as to what constitutes a violation, a more detailed review of the language reveals that almost anything can be deemed to be a

violation, especially where the provision provides that no title insurance corporation or any person acting on behalf of one may "...pay or give...any other consideration or valuable thing, as an inducement for...any title insurance business." Any referral by someone who owns a title agency or title company could potentially constitute a violation of the Law.

Most, if not all, real estate business activity is based on referrals. If a person or company refers business to another person or business, the latter business will likely refer work back to the referring source and vice versa. If a person no longer continues to refer work to a person or entity, referrals are likely to end. The Opinion intimates that because the referral of business ceases when referrals stop, there is a stated or unstated quid pro quo and a violation of the Law.

### **"The Thing of Value"**

The actual referral, as interpreted under Section 6409(d) above, becomes the thing of value inducing the reciprocal referral. Therefore, if the referral is the "valuable thing" being exchanged a violation of the Law would occur and cause the violator to incur harsh penalties equal to the greater of \$1,000 or five times the amount of the value of the thing being given. The "thing" could potentially be legal fees charged, commissions earned, title insurance premiums and fees charged, etc. This could potentially become costly and the penalties severe. Further, the Law goes on to provide that *any* person who "accepts or receives" such a "rebate or commission", or for that matter a "thing of value," will be in violation of the Law. Attorneys, real estate brokers, title agents or any person involved in any type of "quid pro quo" arrangement are therefore subject to this provision of the Insurance Law.

### **What Should Real Estate Professionals Do?**

It would seem that the safest way to proceed is for a real estate agent or broker to never refer business to an attorney when the referring brokerage firm owns a stake in a title agency or title insurance company. More importantly there appears to be an inherent danger in having a "recommended" or "approved" list of attorneys provided to its clientele. The latter option, however, is an integral part of the services that a real estate agent offers. Agents are in a unique position to know which attorneys work in a specific area and agents assist clients who are not familiar with an area or do not have or know of an attorney to use.

### **Are Referrals Now Illegal?**

The Insurance Law seems to make it very difficult to have any sort of referral arrangement in place, especially if you own or are affiliated with a title company. To be safe, it would seem that no one should make any referrals or request that referrals be made in return. "Recommended" lists are inadvisable. In a perfect world a person

would only refer to another person or business strictly on the basis of expertise, knowledge, high level of service, etc. Unfortunately, the latter is not always the case and the Law must protect against arrangements that may be harmful to the general public. Therefore, when real estate professionals want to put in place a “recommended” list or a “referral” list, they should think twice about it. When real estate agents want to refer work to certain professionals, there should be clear and conspicuous notification to the client that no one is required to refer a particular attorney, title agency or other real estate professional. The client and/or attorney should be allowed to choose whatever entity (e.g., attorney, title company, etc.) he or she would like to use without any pressure, whether express or implied, from the real estate agent or any person for that matter.

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