



**SPECIAL REPORT  
(First in Series)**

**SHORT SALE NEGOTIATORS  
Fiduciary Duties / Contractual Relationships / MLS Issues**

In the current real estate market, a significant number of transactions are short sales. The enactment of federal legislation (HAFA) to streamline and provide rules for short sales is expected to further increase the number of attempted short sale closings. The increase in short sale transactions has caused changes in how buyers, sellers, real estate brokers, agents and lenders conduct business. The traditional ways of handling a transaction do not always fit in a short sale, nor, in many instances, do traditional rules. New business models are being created, and opportunities for fraud schemes and ambiguities are abundant. Many agents are using the services of short sale negotiators. Real estate professionals are faced with multiple and complicated legal and ethical issues and new rules and regulations that have been enacted to address these changes.

The Giardinelli Law Group, APC has prepared this Special Report to discuss some of the duties and obligations of agents and the contractual relationships involved in the use of short sale negotiators, and MLS listing issues. Subsequent reports should be available soon covering other topics related to short sales (flipping schemes, additional MLS Rules issues, DRE Regulations, legislation and reporting violations). We acknowledge and thank the California Department of Real Estate (“DRE”) for permission to use material from the recent short sale article by Wayne Bell and Mark Tutera published in the *DRE California RealEstateBulletin*, Spring 2010.

**Short Sale Defined**

A short sale is a transaction where title transfers and the sale price is insufficient to pay the total of all liens and costs of sale, and where the seller does not bring sufficient liquid assets to the closing to cure all deficiencies. Before foreclosure by the lender or lienholder that holds the trust deed on a residential property (referred to in this article as the “Lender”), the Lender agrees to allow the homeowner to “sell short” -- sell the property for less than the outstanding amount owed on the mortgage loans -- and release the property from the trust deed the lender holds. The lender benefits by removing the non-performing loan asset from its financial books, avoiding the costs and time delays of foreclosure, and incurring the holding costs associated with owning the property after foreclosure (such as taxes, maintenance, insurance, eviction, and

listing and selling). The homeowner benefits by avoiding the foreclosure action which severely damages a credit rating and ability to obtain financing for a replacement residence in a shorter time frame. However, an undesirable factor for the homeowner is that the “shortage” may be treated as “debt forgiveness” by the lender and in some circumstances may be taxable as “phantom income.” There are both federal and state laws that govern tax issues. In some circumstances where the lender has recourse, the lender may even have a potential claim for damages for the “deficiency” (shortfall).

### **Use of Short Sale Negotiators**

Completing a successful short sale often requires time-consuming negotiations with the lender or lender’s representative. Many agents or offices are inexperienced, unskilled, or just too busy to efficiently and effectively conduct such negotiations. They prefer to utilize the services of a third-party negotiator who often has an established relationship with a person in the lender’s loss mitigation department. Use of such a third-party negotiator, particularly one who is not “in-house,” may raise a multitude of legal and ethical issues, including questions relating to fiduciary and ethical duties, license requirements, contractual relationships, compensation, disclosure, confidentiality, compliance with MLS Rules and civil and criminal law, insurance coverage and liability. Some brokerages bring the negotiators in-house and under the umbrella of the supervision of the broker and the company’s insurance coverage.

### **DRE License Required for Negotiators**

Real estate licensees who take short sale listings must ensure that the third party conducting the negotiations is properly licensed. The DRE has made it clear that a real estate broker or salesperson license is mandatory to represent the parties to a short sale, unless negotiations are conducted by an attorney or the party. If the negotiator is a licensee, then he or she must have a supervising broker. Careful consideration must be given to whom the fiduciary duty is owed. Is the negotiator an agent of the seller, a dual agent, or an employee/agent of the listing broker, the cooperating broker or both?

If the transaction involves a loan secured directly or collaterally by liens on real property, California Business and Professions Code section 10131(a) and (d) requires a person to be licensed who negotiates as a representative of another for the purchase, sale or exchange of real property, or who, for or in expectation of compensation, acts in a representative capacity for another to negotiate loans or perform services for borrowers or lenders. (Narrow exceptions exist for attorneys acting in the course and scope of their law practice and a person or entity acting solely on his or its own behalf).

A license is required regardless of the title used by the negotiator. For example, none of the following are exempt from the license requirement: debt negotiator, debt resolution expert, loss mitigation practitioner, foreclosure rescue negotiator, short sale processor, short sale facilitator, short sale coordinator, or short sale expeditor. Persons who engage in short sale negotiations without a DRE license are in violation of California law and could be fined and/or imprisoned under section 10139 of the Business and Professions Code. Persons who knowingly hire them may also be in serious difficulty.

## **Obligations of Listing and Selling Brokers and Agents**

### *Seller's Written Agreement and Disclosure*

The listing broker/agent must have the seller's written agreement for the negotiator to provide services. This is required for several reasons:

- (1) The listing broker/agent must disclose to the seller that the negotiator's services will be used.
- (2) The negotiator must have authority from the seller (borrower) to communicate on the seller's behalf with Lender.
- (3) The agreement of the seller is required regarding compensation to be paid to the negotiator.
- (4) Use of the negotiator must be disclosed to the buyer's agent.

These requirements may be met by completing the appropriate C.A.R. Form – Short Sale Addendum and providing the buyer's agent a copy of the form. In addition, it is this author's opinion that an agency disclosure form may often be required. If the licensed negotiator is acting on behalf of the seller (and/or buyer) in a principal/agency capacity, an Agency Disclosure form is mandatory.

### *Relationships between Listing Broker or Agent and Negotiator and/or Outside Broker*

The listing agent generally has an independent contractor relationship with the listing broker. The negotiator may be an employee, an affiliated independent contractor, or an outside vendor of either the listing broker or the listing agent. If the negotiator is not an affiliated licensee of the listing broker, he must himself be a broker or be affiliated with another "outside" broker. The listing broker/agent should have a clear written agreement establishing the relationship with the negotiator.

If the negotiator is affiliated with an outside broker, there should be a written agreement between the listing broker and the outside broker confirming that the outside broker will meet the fiduciary and legal duties to supervise the negotiator's activities, not delegate tasks requiring a license to unlicensed persons, and provide insurance coverage for worker's compensation and liability coverage for negligence or unintentional misprerensetations by the negotiator to the lender, buyer, seller or others. The agreement between the brokers should also establish their rights regarding commission splits and method for compensating the negotiator for his services. Providing for mediation or arbitration and attorney fees in the brokers' agreement is also advisable.

Additional issues arise if the lender requires or designates a negotiator or if the listing broker/agent is also the buyer's agent (dual agency) and uses a negotiator who is an employee or independent contractor of the lender. In a dual agency transaction, the agent has a fiduciary duty to the seller to negotiate the best terms for the seller, not obtain the highest price for the Lender. All appropriate disclosures regarding affiliate business relationships and referrals must be made to comply with the Real Estate Settlement Procedures Act ("RESPA").

Compensation to Negotiator

The negotiator must comply with all DRE regulations and California law for advance fees. Disclosure of all fees, including short sale negotiator compensation, must be made on the HUD 1 Statement. Payment to the negotiator must be made through escrow. Conditions for valid payment to a short sale negotiator include the following:

- Seller consent (written),
  - Agency Disclosure,
  - DRE license affiliated with licensed broker,
  - Performance of licensed activities,
  - Entitlement to compensation as an agreed commission split, a flat fee, or hourly rate as an independent contractor or employee of the listing agent, listing broker, or outside broker.
- Will the fees still be due if the transaction fails to close or if the lender fails to grant approval?

Listing Broker/Agent Liability

Claims for breach of fiduciary duty, failure to disclose, or failure to supervise may be brought by a seller or buyer. DRE discipline and criminal and/or civil liability may attach even if the listing broker/agent is unaware that the negotiator is engaged in mortgage fraud.

MLS Listing Re Short Sale Negotiator Fees

Short sales present a special problem with conditional compensation being offered to a cooperating broker. The listing agent may not be entirely sure what the commission will be until the terms of a short sale are approved by the lender. The Multiple Listing Service (MLS) has adopted NAR-approved language giving participants in the MLS the ability to disclose or may require disclosure to other participants that there is a potential for a short sale. If the property is being listed as a short sale, that should be disclosed in the private agent remarks section.

A listing that requires the buyer's agent to pay a portion of the negotiator's fee may be a prohibited contingent offer of compensation. To avoid an MLS Rule violation, rather than requiring the cooperating broker to pay a stated amount of the negotiator's fee, the listing agent may lower the percentage of the commission offered to the cooperating broker, subject to discussion with the seller and full written disclosure.

The purpose of the MLS is to exchange information regarding available properties for sale or lease and to establish legal relationships with other participants by making blanket unilateral offers of compensation. The MLS Rules govern the behavior of the participants. However, it must be abundantly clear that the Rules do not alter California law, including the DRE regulations, Statutory Law, and Case Law.

MLS Rule 7.12 sets forth the criteria for an offer of compensation as being a specific dollar or percentage amount. The Rule states, "... The amount of compensation ... may not contain any provision that varies the amount of compensation offered based on conditions precedent or subsequent or on any performance, activity or event." Rule 7.16 limits the manner by which compensation may be altered.

There are a number of rules relating to the rights of brokers who present offers that may also impact this issue and will be a topic of the next report. In the next report, we will discuss these issues and the Code of Ethics, particularly Articles 1, 2, 3, 7, 9, 12, and 16, as they apply to this subject matter. See for example MLS Rules 7.16, 9.4, 9.5, 9.6 and 9.7.

As with all real estate communications, all statements in the MLS must be accurate and truthful. (For example, see Rule 12.10)

In our next article we will discuss the impact of the Code of Ethics, other MLS rules, flipping, and several fraud schemes.

**IMPORTANT POINTS TO REMEMBER:**

- A real estate licensee's fiduciary duty is to his client and CANNOT be signed away.
- A listing agent's duties cannot be delegated to an unlicensed third party.
- A dual agency disclosure does not eliminate the listing agent's duty to the seller which may conflict with getting the best price for the investor.
- A real estate licensee who is collecting an advance fee for performing the short sale MUST follow the federal law, DRE guidelines and California law for advance or other fees.
- Not getting the best offer for the seller may expose the seller to a higher potential deficiency judgment and a greater tax liability.

The authors of this month's newsletter are John V. Giardinelli and Sylvia J. Simmons, Attorneys with THE GIARDINELLI LAW GROUP, APC. They can be reached at [jvg@glawgroupapc.com](mailto:jvg@glawgroupapc.com) and [Sylvia@glawgroupapc.com](mailto:Sylvia@glawgroupapc.com) or 951/ 245-9163.

THE GIARDINELLI LAW GROUP, APC

Riverside County Office  
31772 Casino Drive, Suite C  
Lake Elsinore, CA 92530  
951 / 245-9163

Orange County Office  
1601 East Orangewood Avenue, Suite 175  
Anaheim, CA 92805  
714 / 978-2060

*This article is a copyrighted publication and may not be reproduced or transmitted in any form or by any means without written permission. This article does not necessarily reflect the point of view of the Association or other person or entity who publishes it. This article provides legal information abridged from statutes, court decisions, and administrative rulings and contains opinions of the writers. Legal information is not the same as legal advice, which is the application of law to an individual's specific circumstances. Although every effort is made to ensure the information is accurate and useful, it is recommended that you consult with a lawyer to obtain professional assurance that the information provided and your interpretation of it is appropriate for a particular situation. To request further information or to comment on this article, contact The Giardinelli Law Group, APC, at [jvg@glawgroupapc.com](mailto:jvg@glawgroupapc.com), or 951/ 245-9163 and visit our website at [www.glawgroupapc.com](http://www.glawgroupapc.com)*