

Finders Keepers: Federal and State Regulation of Unlicensed Real Estate ‘Brokers’ and ‘Finders’

Gary S. Kessler*

Philip G. McNicholas**

Kessler Collins PC

Dallas, TX

Introduction

In the United States, each state is responsible for regulating its domestic real estate market. To protect the best interests of consumers in the real estate markets, all states require real estate brokers to be trained and licensed. All of the states also maintain regulatory bodies to monitor real estate transactions and to prevent brokering by unlicensed individuals. A related issue for state regulatory bodies with a less obvious solution is whether to permit unlicensed individuals simply to introduce potential parties to real estate transactions. These individuals, known as “finders,” are hired to bring parties together so that the parties may negotiate their own purchase contract or lease. In states where finders are legal, an individual without a real estate license can be compensated for organizing a real estate transaction so long as that individual’s involvement is restricted to conform with state guidelines. The difference between a “finder” and a “broker” frequently depends on whether additional authority—that is, the power to negotiate—has been given.

The federal government has tangentially interceded in this area by regulating the compensation of unlicensed individuals for referring potential clients to licensed brokers. The *Real Estate Settlement Procedures Act* (“RESPA”) prevents most types of reimbursement to unlicensed individuals for referring business to licensed real estate brokers relating to real estate settlement services. However, RESPA’s authority is limited to situations in which a licensed broker ultimately mediates the transaction, whereas finders join parties so that they can reach an agreement without a broker. It therefore falls upon the states to decide whether to prohibit or permit real estate finders.

States have taken varied positions on the approval of unlicensed real estate finders. A recent New York appellate court’s ruling, which reversed the lower court’s decision to distinguish between the legality of unlicensed brokers and finders, has brought this debate into light. Some states view the sanctioning of unlicensed finders as providing an easy way for individuals to sidestep real estate licensing requirements; these states have enacted restrictive legislation as a way to deter prospective unlicensed finders. Other states believe that finders offer a different service from real estate brokers and decrease costs for consumers by adding competitors for real estate clients.

First, this article will consider RESPA’s regulation of unlicensed individuals as intermediaries in real estate transactions. Then, the authors will summarize the present legislation of unlicensed brokers and finders in California, Texas and Ohio. The recent New York State appellate court’s reversal in *Futersak v. Perl* will then be reviewed, along with New York’s changed stance toward real estate finder’s fee agreements. Finally, the authors will discuss the significance of *Futersak* and its potential impact on other states.

Federal Legislation—RESPA

In 1974, Congress passed RESPA, which provides in relevant part that:

No person shall give and no person shall accept any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.¹

In other words, RESPA prohibits the payment of any consideration in exchange for the referral of business to licensed real estate brokers relating to a real estate settlement, so long as a federally related mortgage loan is involved.² A broker cannot pay any consideration to an unlicensed individual for referrals, even if such consideration was legal under state law.

RESPA only regulates referrals relating to settlement services, which essentially means that the business is meant for a licensed broker. “Settlement services” are defined as any service provided in connection with a real estate settlement including, but not limited to, title searches; title examinations; the provision of title certificates; title insurance; services rendered by an attorney; the preparation of documents; property surveys; the rendering of credit reports or appraisals; pest and fungus inspections; services rendered by a real estate agent or broker; the origination of a federally related mortgage loan (including, but not limited to, the taking of loan applications, loan processing, and the underwriting and funding of loans); handling of the processing; and closing or settlement.

In a nutshell, RESPA regulates real estate transactions in which a licensed broker is ultimately the facilitator. However, states must independently decide whether to intervene when a finder is used in place of a broker.

State Legislation—California

According to California law, a licensed real estate broker can only compensate another licensed broker or a licensed salesperson who is employed by the broker for real estate services. Unlicensed brokering is not permitted. Even if someone has

earned a percentage of commission, it is illegal to compensate an unlicensed individual if he or she performed real estate services while unlicensed.

On the contrary, there is no prohibition against “finders” under California law so long as the finder does not perform any services requiring a real estate license. California has a specific finder’s fee exemption that can apply if the finder’s activity is limited to the introduction of the parties and if the finder is not involved in any role in the negotiations. As such, assuming that a real estate finder is careful to limit his or her activity to introducing potential parties, a compensation agreement could be enforceable in California.

Payment to an individual who is employed by the broker to perform acts not requiring a real estate license is also legal. However, it is illegal for a broker to employ or compensate an unlicensed individual *for acts that do require a real estate license*. If an unlicensed employee crosses the line and performs services requiring a license, it would be considered a violation, and the broker and employee could face civil and criminal penalties in California.

State Legislation—Texas

In Texas, a licensed broker cannot:

pay a commission to or otherwise compensate a person directly or indirectly for performing an *act of a broker* unless the person is a license holder or a real estate broker licensed in another state who does not conduct in this state any of the negotiations for which the commission or other compensation is paid.³

A broker is defined broadly to include an individual who “aids or offers or attempts to aid in locating or obtaining real estate for purchase or lease”; “procures or assists in procuring a prospect to effect the sale, exchange, or lease of real estate”; and “procures or assists in procuring property to effect the sale, exchange, or lease of real estate.”⁴ Accordingly, both unlicensed brokers and unlicensed finders are banned in Texas.

Also, Texas expands upon RESPA’s influence by specifying that a licensed broker in Texas who offers to or actually pays cash to an unlicensed person for a referral is subject to disciplinary action under Texas state law.⁵ The individual making the referral and receiving cash compensation would be considered an unlicensed person who is engaged in the business of real estate brokering; that person could face civil penalties and criminal charges.⁶ There is one exception, however: gifts of merchandise with a retail value of \$50 or less are not considered valuable consideration.⁷

State Legislation—Ohio

Ohio law prohibits payments to unlicensed individuals who perform brokering duties. To receive any compensation for referring a prospective real estate client—including the referral of a buyer, seller, landlord or tenant—an individual must be licensed either as an Ohio real estate broker or a real estate salesperson.

Ohio Revised Code § 4735.01 lists acts that require a real estate license if performed for a fee. For example, a real estate license is needed by anyone who “directs or assists in the procuring of prospects or the negotiation of any transaction ... which does or is calculated to result in the sale, exchange, leasing or renting of any real estate.” Hence, similar to Texas law, Ohio defines the acts of brokers to encompass finders, and requires both activities to be licensed.

Under Ohio Administrative Code § 1301:5-5-06, an exception to § 4735.01 exists in that an Ohio broker can pay a referral fee to a broker who is licensed in another state and refers prospects to the Ohio broker. The out-of-state broker who refers business to a broker licensed in Ohio can only perform those acts that do not require possession of an Ohio real estate broker license, with an exception for commercial transactions. That is, under Ohio Revised Code § 4735.022, out-of-state brokers can perform acts that would usually require an Ohio license on commercial property, so long as they work with a licensed Ohio broker and meet certain other requirements.

Violation of § 4735.01 results in a first-degree misdemeanor and fines of up to \$1,000 per day during the violation. Licensed brokers and agents who compensate unlicensed individuals could also be subject to penalties.

Recent Case Law—*Futersak v. Perl* (New York)

In a recent case, the courts had to interpret New York State’s unlicensed broker statute as either prohibiting or permitting finder’s fees. See *Futersak v. Perl*, 2011 NY Slip Op 04629, Decided on May 31, 2011, a case originating in the Supreme Court for Nassau County in New York State and eventually appealed to the Appellate Division, Second Department, of the Supreme Court of New York. These decisions inevitably redefined the breadth of New York’s regulation of its real estate market.

Futersak filed a lawsuit, claiming that he and Perl had entered into a valid written agreement whereby Futersak would merely introduce Perl to a prospective seller of real estate and that he would retain a 15% interest in any subsequent purchase by Perl. After Perl purchased the real estate and refused to pay, Futersak pursued a breach of contract claim against Perl, who defended against the suit by arguing that Futersak was barred from recovery by New York Real Property Law § 442-d as an unlicensed broker. In pertinent part, § 442-d reads as follows:

[n]o person... shall bring or maintain an action in any court of [New York] for the recovery of compensation for services rendered ... in the buying, selling, exchanging, leasing, renting or negotiating a loan upon any real estate without alleging and proving that such person was a duly licensed real estate broker or real estate salesman on the date when the cause of action arose.

The Supreme Court for Nassau County took into consideration opposing motions for summary judgment, and ruled that there was a difference between brokers and finders, based on the quality and quantity of service, and that an individual serving solely as a finder could be compensated without violating § 442-d. The court, therefore, ruled that Futersak had a valid contractual right to be paid for introducing Perl to the seller; Futersak's *prima facie* case for breach of contract was established, and Futersak was granted his motion for summary judgment.

On appeal, the Appellate Division of the Supreme Court of New York also considered Real Property § 442-d, but concluded that "this prohibition applies even if the services rendered are characterized as those of a 'finder.'" The court ruled that Futersak was barred from recovery because he was an unlicensed finder, reversed Futersak's summary judgment and granted summary judgment for Perl.

Significance

The New York appellate court's ruling in *Futersak* increased regulation of New York real estate transactions. The *Futersak* decision disables an unlicensed broker or finder in New York State from obtaining legally enforceable contract rights.

The court's decision may reduce the confidence New Yorkers have that their contracted-for rights will be enforced and may increase broker fees due to decreased competition. However, New York's real estate market will improve, hopefully, for consumers because deals will be proctored by trained and licensed individuals.

As for nationwide impact, regulatory bodies in other states will certainly (1) observe the effects of the *Futersak* appellate reversal in New York State and (2) judge whether New York's real estate market is safer and fairer for consumers or if broker fees increase because of less competition from finders. In either case, it is likely that other states will respond to *Futersak* by either increasing regulation or sanctioning finders. Only time will tell. However, state laws and court rulings should be checked routinely for changes.

***GARY S. KESSLER** is the President of Kessler Collins PC and regularly handles real estate issues.

****PHILIP G. MCNICHOLAS** is an Associate of Kessler Collins P.C.

¹ RESPA.

² Most loans meet the "federally related" standard that includes loans made by federally insured lenders as well as loans intended to be sold to a federal institution such as Fannie Mae or Freddie Mac.

³ TREL § 1101.651(a).

⁴ TREL § 1101.002(1)(A)(vii) – (ix).

⁵ TREL § 1101.652(b)(11) & (26).

⁶ TREL § 1101.351(a).

⁷ Rule 535.20(a).