

COMMERCIAL REAL ESTATE FAQs

SPAIN HASTINGS WARD CAREY & CHAMBERS

1. What legal protective measures can/should be taken specifically to protect a broker/agent in the case where a client who we are representing in the sale or lease of a property fails to disclose to the broker/agent material items that should be disclosed?

- ✓ Communicate in writing to your client their duty to disclose all known defects and material items.
- ✓ Explain the importance of full disclosure.
- ✓ Internal documents which lays out the procedure for discussions.
- ✓ Request a copy of all inspection reports, as well as any prior reports.

Agents and Brokers should be careful on how they counsel their clients. A license holder should explain to the client about the promulgated forms and why it is important to fully disclose information. License holders should have a methodology for discussing full disclosure with their clients and an internal document that lays out this procedure. If litigation arises, a license holder needs to be able to show the following:

- (1) there was no actual knowledge and
- (2) that the client was counseled to fully disclosure known material facts.

Under Texas law, a seller has no duty to disclose facts that are unknown to him. A similar finding is true for real estate brokers and agents as well. Texas courts have held a real estate broker had no duty to disclose, or even investigate whether, a bulkhead on a seaside home was illegal and liable to be removed by the government. Further, Texas courts have held a real estate agency and agent were not and could not be held liable for fraudulent misrepresentation for failing to disclose the location of subterranean mines beneath the property sold.

The well-established rule in Texas is that a defendant “has no duty to disclose material facts of which it *should have* known.” There is no duty to disclose absent actual knowledge even if material facts should be suspected.

A party or license holder is not liable for a misrepresentation or a concealment of a material fact made by a party or license holder unless the party or license holder knew of the falsity of the misrepresentation or concealment and failed to disclose the party or license holder’s knowledge of the falsity of the misrepresentation or concealment.

2. Where is the line between broker and attorney and are there best safe common practices as to the best method for broker comments and suggested contract or lease changes to be communicated?

- ✓ Do not give advice as to the legal effect of contracts or documents.
- ✓ Use and fill out factual information only on the TREC promulgated forms.
- ✓ Do not make representations as to validity of title.
- ✓ Do not draft agreements for the sale, lease or purchase of property.
- ✓ Strike and add information to a TREC promulgated form on instructions from client.

Practice of Law	Broker Services
Advise as to the legal effect of documents	Negotiating offers and proposals
Advice on the status or validity of title	Using contract form promulgated by TREC
Preparing documents as to the legal rights of parties to the transaction.	Filling out contracts used by TREC
Striking provisions of the TREC forms in advice to client	Striking provisions of the TREC forms on instructions from client
Drafting lease purchase agreements or options	Providing factual statements on forms

When negotiating contracts binding the sale, exchange, option, lease or rental of any interest in real property, a real estate licensee shall use only those contract forms promulgated by the Texas Real Estate Commission for that kind of transaction. There are several exceptions.

1. A licensee may not practice law, offer, give, nor attempt to give advice, directly or indirectly; the licensee may not act as a public conveyancer nor give advice or opinions as to the legal effect of any contracts or other such instruments which may affect the title to real estate; the licensee may not give opinions concerning the status or validity of title to real estate; and the licensee may not attempt to prevent nor in any manner whatsoever discourage any principal to a real estate transaction from employing a lawyer.
2. A licensee may not undertake to draw or prepare documents fixing and defining the legal rights of the principals to a transaction.
3. In negotiating real estate transactions, the licensee may fill in forms for such transactions, using exclusively forms, which have been approved and promulgated by the Texas Real Estate Commission or such forms as are otherwise permitted by these rules.
4. When filling in such a form, the licensee may only fill in the blanks provided and may not add to or strike matter from such form, except that licensees shall add factual statements and business details desired by the principals and shall strike only such matter as is desired by the principals and as is necessary to conform the instrument to the intent of the parties.
5. A licensee may not add to a promulgated earnest money contract form factual statements or business details for which a contract addendum, lease or other form has been promulgated by the commission for mandatory use.
6. Nothing herein shall be deemed to prevent the licensee from explaining to the principals the meaning of the factual statements and business details contained in the said instrument so long as the licensee does not offer or give legal advice.
7. It is not the practice of law as defined in this Act for a real estate licensee to complete a contract form, which is either promulgated by the Texas Real Estate Commission or prepared by the Texas Real Estate Broker-Lawyer Committee and made available for trial use by licensees with the consent of the Texas Real Estate Commission.
8. Where it appears that, prior to the execution of any such instrument, there are unusual matters involved in the transaction which should be resolved by legal counsel

before the instrument is executed or that the instrument is to be acknowledged and filed for record, the licensee shall advise the principals that each should consult a lawyer of the principal's choice before executing same.

9. Texas law provides for the suspension

a. It provides that a license or certificate holder, who is not a licensed attorney, cannot draft an instrument other than a form promulgated by TREC, an attorney, or one of the parties to the transaction, that transfers or otherwise affects an interest in real property.

b. A license or certificate holder may not advise a person regarding the validity or legal sufficiency of an instrument of the validity of title to real property.

Conduct that falls within these two categories will result in suspension or revocation of the license or certificate of registration.

Examples of when an attorney should be consulted:

1. Brokers should use caution when a divorced seller wants to sell his property. Brokers should instruct the prospective seller to consult an attorney to ensure the party has the right to sell the property. Brokers should also use caution when a prospective buyer seeks property while a divorce is pending.

2. During a pending foreclosure, where the lender makes a "short sale" agreement with the buyer, the broker should have both parties employ the assistance of attorneys in drafting the provisions into the standard forms.

3. Under the revised Property Code, lease-purchase agreements are treated as executory agreements. There are significant penalties for sellers who do not strictly comply with the executory agreement provisions of Subchapter D, Chapter 5 of the Property Code. Brokers and agents should instruct parties to consult attorneys for these transactions.

4. Brokers should be on the lookout for mortgage fraud and should instruct their clients not to enter into suspect transactions without consulting an attorney.

3. Are attorneys "due" a commission by default? How to properly, professionally handle related discussions with attorneys.

No, but they are owed a fee for their services. Brokers are not allowed under the Texas Real Estate License Act to share their commissions with attorneys. The License Act prohibits brokers from sharing fees received for services as a real estate agent with anyone not licensed as a real estate broker or salesman in Texas or any other state. When an attorney performs a brokerage service, he must seek his fee for that service directly from one of the principals in the transaction. It is permissible for a listing broker to reduce his fee so the seller can pay an attorney. This arrangement would be a private agreement between the listing broker and the seller. Brokers should not participate in any arrangement designed to circumvent the portion of the act, which prohibits splitting compensation.

However, if the attorney is a principal in the transaction, not acting for another person, then it follows that brokers may share a fee with the principal. Texas law prohibits sharing a broker's fee with a person not licensed as a broker or salesman "for services as a real estate agent." The important language in the definition of "real estate agent" under the act is that the person performs the act "for another person."

4. Dual agency pitfalls?

A broker may not represent both a buyer/tenant and a seller/landlord. If a dual agency relationship arises, by accident or otherwise, the broker must either comply with notice and consent requirements to act as an intermediary, or must choose to represent only one of the two parties. Failure to disclose this dual agency may result in administrative, civil, and criminal penalties.

Intermediary status was created by statute in 1996. It allows a broker to participate in a transaction in a limited capacity on behalf of two principals provided that specific disclosures have been made and the parties have consented. Dual agency was repealed in Texas on October 1, 2000. The prohibition of dual agency ensures that the real estate practitioner does not find himself in the difficult position of trying to satisfy both buyer and seller. The broker/agent would run the risk of one of the parties walking away feeling dissatisfied about the focus and representation they received in the transaction. This dissatisfaction could lead to legal action, especially if problems arise from the transaction.

A brokerage firm, in initially executing a listing contract with a seller or a buyer representation agreement with a buyer, would provide an explanation of an intermediary relationship in the event such a relationship developed at some point in the future. Both the listing agreement and the buyer representation agreement authorize the broker to act as an intermediary and to appoint associated licensees to work with the parties in the event the buyer wants to purchase a property listed with the firm. When this occurs, the broker becomes an intermediary and may appoint licensees to represent the parties in the transaction. The intermediary will notify both parties in writing of the appointments of licensees. The appointed licensees would provide advice and opinions to their respective parties during negotiations and the intermediary should be careful not to favor one party over the other.

The intermediary role is the only way to handle in-house transactions. When a dual agency situation arises, the brokerage firm can do the following:

- (1) represent one of the parties and work with the other party as a customer rather than as a client; or
- (2) obtain permission in writing from both parties to be an intermediary and appoint licensees to work with the parties.

Only a broker can contract with the parties to act as an intermediary between them. The intermediary is authorized to negotiate a transaction between the parties, but not to give advice or opinions to the parties during the course of the negotiations. Both the intermediary and appointed licensees are obligated to treat the parties honestly and are prohibited from revealing confidential information. A broker is required to disclose his representation of a party, orally or in writing, upon the first contact with a party or a licensee representing another party.

5. How to correctly handle negotiating multiple offers.

- ✓ Submit all offers to the client.
- ✓ Convey all known information, which will affect the principal's decision.
- ✓ Deal fairly and honestly with all parties.
- ✓ All offers must be presented to the seller unless otherwise instructed.
- ✓ The agent should notify buyers' agents multiple offers have been received.

Some brokers believe the "first-in-time, first-in-right" rule applies to handling multiple offers. However, this rule while it appears logical, has no legal merit. According to Texas law, the listing agreement is nothing more than an invitation to receive bids. The buyer is actually making the offer, not the seller. According to the Statute of Frauds, a contract for the sale of real estate is not enforceable until placed in writing and signed by the seller. Until the seller agrees to the offer by signing the contract, there is no binding enforceable contract of sale.

Therefore, sellers are not required to accept an offer, even an offer at or above asking price. A seller presented with multiple offers can decide to accept one and reject others, reject all and hope for higher offers, reject all outright, or do nothing. The seller is under no obligation to reply at all to any offer.

However, if the seller accepts none of the offers, he may be liable for the broker's commission if a buyer is ready, willing, and able. The broker's role in assisting the seller is described in Texas law as "a licensee (broker) shall convey to the principal all known information which would affect the principal's decision on whether or not to accept or reject offers." Brokers should avoid the appearance of impropriety when counseling the seller in the decision-making process.

Additionally, both seller and broker should be aware of the provisions in the Federal Fair Housing Act regarding discrimination in the sale or rental of housing. The section states that "it shall be unlawful to refuse to sell or rent after the making of a bona fide offer, or to refuse to negotiate for the sale or rental of, or otherwise make unavailable or deny, a dwelling to any person because of race, color, religion, sex, familial status or national origin." It is also unlawful to discriminate on the basis of handicap.

Taking these factors into consideration, a seller must be neutral in making a decision on selling or renting. The decision-making process should be documented carefully to avoid lawsuits. The documentation of the selection process should support the seller's choice as the one most likely to reach closing with the fewest difficulties.

If a broker receives multiple offers, all offers must be presented to the seller unless otherwise instructed by the seller. All offers should be submitted promptly. Additionally, the listing agent should notify the buyers' agents that multiple offers have been received.

6. How to best secure a "first right" or "first offer" on a contract for sale or lease agreement?

- ✓ Option on contract or lease
- ✓ Right of first refusal

An option is the strongest right that can be granted to give a party flexibility in the future. The option gives a grantee the right, but not the obligation, to lease, buy or otherwise control a specified asset in the future. The option is given in exchange for an option fee and provides the terms on which the grantee can exercise the option, including the corresponding dates for closing and delivery of the optioned asset. In exchange for the option fee, the seller agrees not to sell to anyone else within the time period agreed upon.

A right of first refusal is a provision in an agreement in which the owner of a property agrees to give one specific party the first opportunity to purchase or lease the property before it is offered for sale or lease to others. It does not entitle the holder of the right to force the other party to sell or lease the property. Instead, the holder of the right can require the seller to sell or lease to him for the same price and terms the seller is willing to accept from a third party. Brokers may be reluctant to list a property that is subject to a right of first refusal unless the broker is also promised a commission when the holder of the right exercises his right and purchases the property. An owner may resist granting the right because of how it affects the marketability of the property.

A right of first offer is sometimes granted in favor of the buyer in real estate transactions. The holder has the first right to make an offer for the purchase of the property before the owner can sell to a third party. The holder gives the owner of the property a specific time period in which to accept or reject the offer made. If the owner rejects the offer, he may sell the property to any third party so long as he does not accept an offer lower than that made by the holder of the right of first offer. Generally, a right of first offer is used when the property owner is unwilling to give an option or right of first refusal. This right is actually preferable to a right of first refusal because it minimizes the effect on the marketability of the property. The holder of this right can also be afforded additional protection by requiring the owner to make an offer to the holder, allowing the holder to “smoke out” the price the owner is willing to accept. However, the owner is not obligated to reduce the asking price even if it is unreasonable.

There is no bright line rule on the best practices for securing an option, right of first refusal, or right of first offer. Each outcome will depend on the parties involved, the property in question, and other circumstances specific to the transaction.

7. Fiduciary duties of real estate professionals?

Duties of real estate professionals are defined by case law, statutes, the TREC Canons of Professional Ethics and Conduct for Real Estate Licensees, and the National Association of Realtors’ (NAR) Code of Ethics and Standards of Practice.

A. Common-Law Duties

1. Good faith and fair dealing
2. Loyalty, may not act adversely to the client’s interests.

B. Statutory Duties

1. Deceptive Trade Practices-Consumer Protection Act (DTPA)-real estate professionals violate the DTPA by failing to disclose information of which they have knowledge or by affirmative misrepresentations; and
2. Real Estate Fraud Act-applies to all real estate transactions regardless of dollar amount. The broker will be liable for a false representation of a past or existing material fact made to induce the person to enter into a real estate contract and the person relied on it. Additionally, fraud can be a false promise to perform an act that is material that induced the party to enter into a contract and the party relied on the false promise.

C. TREC duties-TEXAS ADMIN. CODE § 531.1-3

1. Fidelity-The licensee, in performing duties to the client, must:
 - a. treat other parties to a transaction fairly;
 - b. be faithful and observant to the trust placed in the agent;

- c. perform his or her duties scrupulously and meticulously; and
 - d. place no personal interest above the interest of his or her client.
2. Integrity-A licensee has a special obligation to perform his or her responsibilities and use caution to avoid misrepresentation by acts of commission or omission.
 3. Competency-A licensee should:
 - a. be knowledgeable as a real estate practitioner;
 - b. be informed on market conditions that affect the real estate business;
 - c. continue his or her education in the intricacies involved in marketing real estate for others;
 - d. stay informed about national, state and local issues and developments in the real estate industry; and
 - e. exercise judgments and skill in the performance of his or her work.

D. NAR Code of Ethics and Standards (duties to clients)

1. Realtors pledge themselves to protect and promote the interests of their clients.
2. Realtors shall avoid misrepresentation or concealment of material facts.
3. Realtors shall cooperate with other brokers except when it is not in the best interest of the client.
4. Realtors shall not acquire an interest in, buy, or sell any real property for themselves, immediate family members, their firms or members thereof, or entities in which they have ownership, without making their position known to the buyer or seller of the property.
5. Realtor shall not provide professional services concerning a property where they have a present or contemplated interest unless the interest is specifically disclosed to all affected parties.
6. Realtors shall not accept any commission or profit on expenditures made for their client without the client's knowledge and consent.
7. Realtor shall not accept compensation from more than one party without disclosure to all parties and informed consent from clients.
8. Realtors shall keep funds for other persons in a special account in an appropriate financial institution.
9. Realtors shall assure that all agreements related to real estate transactions are in writing in clear and understandable language.

8. When does the meter start running on “performance” in a lease transaction?

If we are looking at ‘strict performance’ typically we look to the effective date of the lease as the date when the obligations to perform commence for the parties to the lease. The effective date is typically the date when all of the parties to the agreement have signed the final lease. However, there are some performance issues that may effect ‘when’ performance begins. It will be evaluated on a case-by-case basis with a review of the relationship of the parties, the promises made, the agreements signed prior to the lease as well as the actual lease itself. For the most part though, performance will begin once the parties execute the lease and all of the conditions precedent to the commencement have occurred.

That said, however, there are some performance implications which could be made as to performance requirements prior to the actual lease signing. For example, if a tenant signs a letter of intent and that letter outlines some obligations of the landlord or tenant in order to fulfill conditions necessary to execute the lease, it stands to reason that the parties have a duty to perform at that point as well. Acting in good faith, the parties have a duty to satisfy any conditions precedent to the actual lease signing if those conditions are material or substantive to

the actual execution of the lease itself. In other words, at all times the parties must act diligently in order to satisfy the pre-lease conditions as well as any provisions of the actual lease itself.

Overall, however, performance typically begins upon execution of the lease and through the giving of any consideration for that lease. The parties and brokers/agents should normally look to the four corners of the lease to determine the duty to perform under that lease, however, other documents may affect that commencement particularly if consideration is given prior to the lease. Additionally, the actions of the parties may imply that performance was expected in certain situations.

9. Texas law on condemnation.

Condemnation is the procedure by which private property is taken by government for public use. The power of eminent domain is not explicitly granted in either the Federal or Texas Constitution, but is assumed or implied to exist when a taking by a government entity is used for public use. The right of any entity to exercise eminent domain must be authorized by statute. Condemnation is subject to four restraints: (1) public use, (2) public necessity, (3) just or adequate compensations and (4) due process.

With regard to a taking for public use, “a governmental or private entity may not take private property through the use of eminent domain if the taking: (1) confers a private benefit on a particular private party through the use of the property; (2) is for a public use that is merely a pretext to confer a private benefit on a particular private party; or (3) is for economic development purposes, unless the economic development is a secondary purpose resulting from municipal community development or municipal urban renewal activities to eliminate an existing affirmative harm on society from slum or blighted areas under” Each case must be evaluated on its own merits to determine whether a public use has been achieved. However, there are multiple entities as defined by statute that are not affected by TEX. GOV'T CODE § 2206.001.

The Texas Constitution requires payment of adequate compensation to the property owner when a taking occurs. The term property in this context has been interpreted to mean not only the physical area being condemned, but also every right that accompanies and is incidental to the property. Texas statutes refer to adequate damages in condemnation cases in terms of market value. “Market value” is defined as the price the property will bring when bought by someone who desires to buy the property. Market value is not necessarily determined by current usage of the property. Instead, Texas law permits the consideration of the highest and best use to which the land can reasonably be adapted in ascertaining market value.

Finally, the element of due process requires that the condemnee must be provided reasonable notice and a reasonable opportunity to be heard and to present a claim or defense. The general condemnation procedure is divided into three parts:

- (1) the negotiation between the condemnee and the condemnor,
- (2) the hearing before the special commissioners and
- (3) an appeal from the special commissioner's award.

The condemnor must make an attempt to purchase the land from the owner. Once the negotiations fail, the condemnor can begin judicial proceedings. The petition for condemnation must contain the following elements:

- (1) a description of the land,

- (2) a statement of the purpose for which the land is being condemned,
- (3) the name(s) of the owner(s), if known, and
- (4) a statement that the parties were unable to reach a purchase price.

If any of these elements are defective or absent, the proceedings can be dismissed.

Landowners have a post condemnation right to repurchase the property taken by a public entity when the public use for which the property was taken expires within ten years after the condemnation. Within 180 days after the public use terminates, the government entity owning the property must notify the landowner of his right to reacquire the property. The landowner then has 180 days from receipt of the notice to inform the government entity of his intent to exercise his right to repurchase. An offer of sale based on fair market value must be tendered to the landowner. The landowner must repurchase the land within 90 days after the offer is tendered or the right is forfeited.

When faced with condemnation, the following issues should be considered and analyzed by the landowner:

- (1) monetary payment,
- (2) procedural elements of condemnation, and
- (3) provisions of the easement agreement.

Many times the landowner concentrates on the amount of payment he will receive for his land. Because the burden of proving a higher market value is on the landowner, an appraiser and possibly an attorney are key components to this analysis. However, the landowner should be aware that professional fees are not recoverable in any judgment and the landowner could potentially become a net loser if the fees are not offset by a higher payment. It is probably a good idea to find out what special commissioners and prior trial courts have awarded for comparable land in the county where the landowner's property lies.

Several procedural steps can be taken to insure due process is followed. Utilizing these procedures may actually improve the landowner's chances of getting a more favorable out-of-court settlement.

First, the landowner should check the authenticity of the condemnor's power of eminent domain. What type of entity is condemning the property and what statute provides it power to condemn property? When a condemnor is challenged on its right to condemn property, the burden falls on the condemnor to show affirmative action taken by a governing body establishing a determination of convenience and necessity to serve the public for this particular project. A right to enter property to condemn arise whenever the condemnor first proposes to take the land. If the landowner rejects the condemnation attempts, the condemnor can get a temporary or permanent restraining order to prevent the landowner from interfering with the condemnor's activities. The landowner may choose to document the condition of the property with comprehensive photographs prior to performance of operations by the condemnor on the property.

Next, the landowner will want to make sure the condemnor adheres to the procedural guidelines established by statute.

Finally, if possible, some effort to determine the judge's appointments to the special commission should be made. Appointments shall be made giving preference to appointees that may be agreed upon between the parties. A party may not dismiss a condemnation proceeding after the special

commissioners have made an award. If the condemnor dismisses and refiles to condemn the same property, the court will enter the award from the first proceeding and the court shall award the property owner three times the amount of all the expenses and fees allowed the property owner prior to the dismissal.

The most important aspect of the condemnation process may be negotiation of the agreement terms. The agreement will govern the right and duties of the parties. The statute of frauds requires that a promise or agreement involving a contract for the sale of land be in writing. Several things to consider include the following:

- (a) an accurate description of the easement or right-of-way;
- (b) timing for termination of the easement;
- (c) written timetable for construction;
- (d) routes of ingress and egress;
- (e) assignment of easement rights;
- (f) indemnity provisions; etc.

Additionally, the landowner should be reasonable, fair and courteous, in an attempt to seek to reach a reasonable settlement agreement out of court. If at any point in the discussions, it appears the parties will be unable to agree on damages, the condemnor can begin condemnation proceedings.

Clearly, the condemnor's rights are given significantly more deference than those of the condemnee. However, the sooner landowners act, and act properly to protect their interests, the greater their choice of alternatives.

Steps in the Condemnation Process

1. A Certificate of Public Conveyance and Necessity is determined by the condemnor.
2. Advance survey crews may enter the condemnee's land.
3. The condemnor makes an offer to purchase the land at any price.
4. The condemnor may petition the court whenever the landowner does not accept the offer.
5. A three-person special commission is appointed to conduct a hearing on compensation.
6. Hearing conducted.
7. Special Commissioners determine and post compensation due the landowner with judge.
8. Condemnor can take possession of the land by posting proper security with the court.
9. Any appeal is before the first Monday following the 20th day after the award was filed.
10. If appealed, a formal trial by jury is conducted to determine the outcome of the case.