

# UNIT 1

## Texas Contract Law

### LEARNING OBJECTIVES

*When you have completed this unit, you will be able to*

- › **describe** the composition and duties of the Texas Real Estate Commission (TREC);
- › **describe** the unauthorized practice of law and how to avoid it;
- › **describe** the composition and duties of the Broker-Lawyer Committee;
- › **explain** TREC's rules regarding the use of promulgated forms and **give** examples of the exceptions to TREC's rules regarding the use of promulgated forms;
- › **describe** the requirement by Section 5.008 of the Texas Property Code for sellers to provide to buyers a written notice of a property's condition, including exceptions and the buyer's rights upon receipt of the disclosure; and
- › **describe** how the Deceptive Trade Practices Act (DTPA) applies to real estate agents.

### KEY TERMS

Broker-Lawyer Committee	Rules of The Texas Real	Texas Real Estate License
Deceptive Trade Practices Act (DTPA)	Estate Commission	Act (TRELA)
promulgate	Texas Real Estate Commission (TREC)	

### TEXAS REAL ESTATE LICENSE ACT

Real estate agents in Texas were first licensed through the Securities Division of the Secretary of State's office, beginning in 1939 with passage of the Real Estate Dealers License Act (House Bill 17, 46th Legislature, Regular Session).

In 1949, the Texas Legislature established the **Texas Real Estate Commission (TREC)**. The commission administers the act (Senate Bill 28, 51st Legislature, Regular Session). The act has been revised many times, most recently in 2015.

The act's name was changed to the **Texas Real Estate License Act (TRELA)** in 1955. The purpose of TRELA is to protect the public through regulation of real estate license holders, real estate inspectors, residential service companies, and entities offering timeshare interests.

The Texas Real Estate Commission (the Commission) is a self-directed, semi-independent state agency. The policy-making body of the Texas Real Estate Commission is a nine-member commission appointed by the governor with the advice and consent of the senate for overlapping six-year terms. Six members must be active in real estate as full-time brokers for five years immediately preceding appointment. Three members must not be licensed by the commission and have no financial interest in real estate, except as consumers.

The commission has broad rule-making authority, and the **Rules of the Texas Real Estate Commission** have the full force and effect of law. The authority of the Commission to promulgate contract forms is established in the part of TRELA that is reproduced in the following:

Sec. 1101.155. RULES RELATING TO CONTRACT FORMS.

(a) The commission may adopt rules in the public's best interest that require license holders to use contract forms prepared by the Texas Real Estate Broker-Lawyer Committee and adopted by the commission.

(b) The commission may not prohibit a license holder from using for the sale, exchange, option, or lease of an interest in real property a contract form that is:

- (1) prepared by the property owner; or
- (2) prepared by an attorney and required by the property owner.

(c) A listing contract form adopted by the commission that relates to the contractual obligations between a seller of real estate and a license holder acting as an agent for the seller must include:

- (1) a provision informing the parties to the contract that real estate commissions are negotiable; and
- (2) a provision explaining the availability of Texas coastal natural hazards information important to coastal residents, if that information is appropriate.

Before engaging in the business of completing any contract forms that bind the sale, lease, temporary lease, or rental of any real property, the license holder should become thoroughly familiar with what the rules and law do and do not permit.

## UNAUTHORIZED PRACTICE OF LAW

TRELA specifically prohibits license holders from practicing law by giving opinions or counsel regarding the validity or legal sufficiency of an instrument that addresses real property rights or as to the status of title to real estate. Throughout the act, it is clearly established that, prior to signing a purchase contract, the license holder must give a buyer written advice to have the abstract covering the property examined by an attorney of the buyer's selection or to obtain an owner's title insurance policy prior to closing. Failure to do so may result in disciplinary action by TREC.

License holders who choose to become REALTORS® subscribe to a REALTOR® Code of Ethics that demands a very high level of professional conduct. The National Association of REALTORS® Code of Ethics advises against the unauthorized practice of law. Again, license holders are to advise their clients/customers to seek an attorney's advice for matters that require it.

TRELA clearly establishes that it is a violation of the act for the license holder to draw a deed, note, deed of trust, will, or other written instrument that transfers or may transfer an interest in or title to real property. However, the act goes on to give permission for a license holder to complete a contract form that may bind the sale, exchange, option, lease, or rental of any interest in real property as long as the forms used have been prepared by or are required by the property owner, have been adopted by the real estate commission, prepared by an attorney licensed by the State of Texas, and approved by that attorney for a particular type of transaction. The applicable law is as follows:

Sec. 1101.654. SUSPENSION OR REVOCATION OF LICENSE OR CERTIFICATE FOR UNAUTHORIZED PRACTICE OF LAW.

(a) The commission shall suspend or revoke the license or certificate of registration of a license or certificate holder who is not a licensed attorney in this state and who, for consideration, a reward, or in a pecuniary benefit, present or anticipated, direct or indirect, or in connection with the person's employment, agency, or fiduciary relationship as a license or certificate holder:

(1) drafts an instrument, other than a form described by Section 1101.155, that transfers or otherwise affects an interest in real property; or

(2) advises a person regarding the validity or legal sufficiency of an instrument or the validity of title to real property.

(b) Notwithstanding any other law, a license or certificate holder who completes a contract form for the sale, exchange, option, or lease of an interest in real property incidental to acting as a broker is not engaged in the unauthorized or illegal practice of law in this state if the form was:

(1) adopted by the commission for the type of transaction for which the form is used;

(2) prepared by an attorney licensed in this state and approved by the attorney for the type of transaction for which the form is used; or

(3) prepared by the property owner or by an attorney and required by the property owner.

The license holder is free to explain to the principals the meaning of the factual statements or business details contained in the contracts as long as no legal advice is offered or given.

Using the promulgated contract forms listed, license holders may discuss the forms with the buyer and seller and help them fill in the blanks on the forms. A license holder must never provide legal advice to buyers and sellers. For example, explaining the legal effect of the terms of a contract, deed or other legal document is considered the unauthorized practice of law. Furthermore, while a license holder can fill in the blanks in a promulgated contract, it is considered the unauthorized practice of law for a license holder to delete or add text to the promulgated contracts unless required by a principal, or to combine or change forms to create a new contract such as a contract for deed or lease-purchase contract (which are not TREC-promulgated contracts).

TREC takes very seriously any complaints involving the unauthorized practice of law. Even if a complaint unrelated to the contract itself is filed against a license holder, TREC often reviews the entire transaction file and may find and prosecute contract-related violations. While not always characterized as the unauthorized practice of law, TREC may label the violation as negligence or fraud. Under Section 1101.652(b), the Commission can take disciplinary action against a license holder who acts negligently or incompetently, or who engages in fraud or misrepresentation while acting as a real estate agent. In either case, there can be serious consequences for failing to comply with the contract-related rules and laws.



## IN PRACTICE

License holders often get into trouble with TREC for the unauthorized practice of law by filling in paragraph 11, Special Provisions, of the TREC-promulgated residential contract with language that goes beyond “factual statements and business details” as specified in the paragraph. An example of this type of violation is when the license holder attempts to create an “appraisal contingency” in paragraph 11. A license holder should never try to draw up language that creates a legal contingency because that goes beyond factual statements and business details. Using words like *contingent upon* or *subject to* creates legal contingencies. Also, a license holder should not insert provisions that materially affect the legal rights and duties of the parties to the contract as that too may be considered the unauthorized practice of law.

Another problem area is when a license holder attempts to create language in paragraph 11 where there is an existing TREC addendum that addresses the matter. An example of this is when a license holder addresses financing matters in paragraph 11 without using the proper TREC-promulgated financing addendum. See the following list for items that should not be addressed in paragraph 11.

Although buyers or sellers may insert their own text into paragraph 11, if they wish to add legal contingency language, the license holder should advise them to discuss such matters with an attorney.

## CASE STUDY *Johnson v. Conner*, 260 S.W.3d 575 (Tex.App.—Tyler 2008)

In a case involving a previous version of the TREC Farm and Ranch contract, a broker inserted the following language regarding minerals in a paragraph addressing reservation of mineral interests, “None of the above are available to be conveyed.” However, the sellers signed a deed at closing that conveyed to the buyers all rights the sellers had in the property and did not explicitly reserve the mineral rights. The seller did not notice that the deed conveyed everything at closing and less than two years later learned that the buyers were receiving payments on an oil and gas lease on the property. The sellers sued the buyers in an attempt to reform the deed. Both the broker and the seller thought that the phrase in the contract meant that the sellers were keeping and not conveying their mineral rights. The trial court ruled in favor of the buyers and the sellers appealed.

The sellers tried to argue to the appellate court that the deed was executed by mutual mistake and the buyers knew that the sellers’ true intent was to keep the minerals as was reflected in the contract. The buyers, on the other hand, argued that they thought they were purchasing 100% of what sellers owned. Mutual mistake can be used to void a contract or reform a deed and is used as a legal argument in contract litigation when both parties are mistaken about the same material fact in a contract (see Unit 3 for a discussion of mutual mistake).

The court, relying on the plain language used in the contract, concluded that the phrase meant that the sellers had no minerals to convey, and because the sellers did not explicitly reserve any mineral interests in the deed, they conveyed all of the estate they owned at the time they signed the deed to the buyers at closing. The appellate court, therefore, upheld the trial court’s decision.

The takeaway is that this case clearly addresses the consequences that might result from a license holder attempting to draft language in a contract that materially affects the legal rights of the parties. In this case, the sellers and their broker assumed that what the broker inserted in the contract clearly and unambiguously reserved the mineral rights. The court, however, concluded that, based on the plain meaning of the word *available*, the contract clearly and unambiguously on its face meant that the sellers had no minerals to convey to the buyers.

The following is a list of poorly drafted phrases that are cited in a TREC Ethics continuing education course book. These phrases are ambiguous or deal with matters otherwise addressed in promulgated addenda, and could be considered to be negligence or the unauthorized practice of law if drafted by a license holder.

- This contract is subject to a satisfactory appraisal report.
- This contract is subject to the buyer selling buyer's existing home.
- Buyer agrees not to require seller to complete any repairs.
- Buyer may begin to move in three days before closing.
- If for some reason buyer cannot obtain financing, the parties will renegotiate owner financing at that time.
- Seller shall provide buyer with an allowance at closing in the amount of \$1,000.00.

### **C A S E S T U D Y**    TREC Complaint

A TREC complaint was filed against a sales agent. According to the order revoking the agent's license, the agent negotiated a contract for the purchase of real property between the buyer and seller using a TREC-promulgated residential contract. The agent added a clause in paragraph 11, Special Provisions, that the seller would pay the agent's sponsoring broker a \$3,000 administration fee. In addition, the agent urged the buyer to sign a written termination of contract although the reason stated for the termination was not addressed in the terms of the contract. Apparently, the agent told the buyer that the contract as drafted and negotiated by the agent gave the buyer the right to terminate the contract if the buyer so wished, although, in fact, that was not the case. The contract did not include an option to terminate under paragraph 23.

The order concludes that the agent gave the buyer legal advice by telling the buyer that he had the right to terminate the contract; the agent should have told the buyer to discuss the matter with a private attorney. Furthermore, the order concludes that the agent was negligent in failing to negotiate an option period for the buyer to terminate the contract under paragraph 23.

The final conclusions of law held that the agent acted negligently or incompetently, was dishonest, misused a TREC-promulgated form, and improperly gave legal advice. His license was revoked (it was a default order meaning that he never showed up for the hearing) and he was ordered to pay an administrative penalty of \$5,000.

This case illustrates several problems. The agent misused the form by adding a broker fee in Special Provisions. The agent gave legal advice to the buyer when he told the buyer that he could terminate the contract when in fact the buyer could not, although the buyer would have been able to terminate if the agent had utilized the termination option in paragraph 23.



## IN PRACTICE

Regarding the TREC complaint process, many of the TREC complaints involving misuse of the contract forms that are summarized in this course are resolved by agreed order or, as in the previous case, by default because the license holder failed to timely respond to the notice of hearing. License holders should always timely respond to any and all correspondence from TREC regarding a filed complaint. Often, the matter can be dealt with by providing the license holder's side of the story and honestly responding to the allegations in the complaint. A license holder can hire an attorney to represent the license holder, although an attorney is not required.

When an investigation is opened, the TREC investigator speaks with all the parties, including the complainant, the respondents (the license holders), and any other interested parties that can help with the fact-finding process. Once the investigation is complete, the investigator files a report with the attorney assigned to the complaint. The attorney decides whether to take the case to a hearing, close the case, or issue an advisory letter. If the case goes to a hearing before a State Office of Administrative Hearings (SOAH) judge, the license holder has the opportunity to defend herself against the allegations of a violation of the Real Estate License Act or the Rules of the Commission. If a hearing is held, the SOAH judge will issue an order after the hearing, and if SOAH find that the license holder violated the act or rules, the license holder may appeal any adverse decision to the Commission and ultimately to district court.

That said, most complaints filed with TREC do not go to hearing; they are often closed based on insufficient evidence or by the issuance of an advisory letter. If the complaint is serious and is ultimately set for hearing, the matter can be resolved without going to a hearing before SOAH if the license holder agrees to the terms of an agreed order. In the case described previously, the sales agent apparently failed to timely respond to the notice of hearing and TREC issued a default order against the agent revoking his license and assessing the administrative penalty.

The lesson learned here is that license holders should respond to correspondence from TREC regarding any matter involving their licenses, whether it concerns renewal, continuing education, or a complaint. Failure to timely respond only makes matters worse and can ultimately result in suspension or revocation of a license and/or payment of an administrative penalty, depending on the severity of the case.

## THE BROKER-LAWYER COMMITTEE

One of the advisory committees that exists under the statutes of TREL A is the **Broker-Lawyer Committee**.

The committee is composed of six Real Estate Commission appointees (who are licensed real estate brokers), six lawyers appointed by the president of the State Bar of Texas, and one public member, appointed by the governor. They serve staggered six-year terms.

The Broker-Lawyer Committee drafts and revises contract forms for use by real estate license holders. The purpose is to expedite real estate transactions and reduce controversies while protecting the interests of the parties involved.

This Broker-Lawyer Committee does not **promulgate**, or publish, forms for mandatory use by license holders; only TREC has been given rule-making authority. The Broker-Lawyer

Committee develops forms and recommends their adoption, but it is TREC that promulgates the forms through notice and comment rulemaking for mandatory use.

The Broker-Lawyer Committee meets regularly to review existing forms, new case law concerning Texas real estate contracts, and input on the forms from license holders, attorneys, and the general public. If the committee proposes to make changes to existing promulgated contracts or creates new contract forms or addenda, the committee must recommend the changes or new forms to the Commission, which then adopts the forms through the rulemaking process. The adoption of promulgated contract forms by the Commission through rulemaking is a two-step process that allows for notice to and comment from the public. The forms are first proposed in a public meeting; the forms are then published in the Texas Register for notice and comment. Oftentimes, the forms are sent back to the committee to address pertinent issues raised during the notice and comment period. Once the Commission finally adopts the forms, which typically happens at its next public meeting, license holders are required to use the new forms as of the effective date of the rule adopting the form, unless an exception permits the use of an alternate form.



### IN PRACTICE

License holders should be aware of when the Commission makes changes to the contract forms through the rulemaking process. A license holder is a member of the public and as such, may comment on proposed revisions to the contracts or may recommend changes to the Broker-Lawyer Committee. The TREC website publishes the agendas for upcoming commission meetings at [www.trec.texas.gov](http://www.trec.texas.gov).

The act clearly establishes the membership in and responsibilities of the committee. Carefully review the following text of the act:

#### SUBCHAPTER F

#### TEXAS REAL ESTATE BROKER-LAWYER COMMITTEE

Sec. 1101.251. DEFINITION OF COMMITTEE. In this subchapter, “committee” means the Texas Real Estate Broker-Lawyer Committee.

Sec. 1101.252. COMMITTEE MEMBERSHIP.

(a) The Texas Real Estate Broker-Lawyer Committee consists of 13 members appointed as follows:

- (1) six members appointed by the commission;
- (2) six members of the State Bar of Texas appointed by the president of the state bar; and
- (3) one public member appointed by the governor.

(b) Appointments to the committee shall be made without regard to the race, creed, sex, religion, or national origin of the appointee.

Sec. 1101.254. POWERS AND DUTIES.

(a) In addition to other delegated powers and duties, the committee shall draft and revise contract forms that are capable of being standardized to expedite real estate transactions and minimize controversy.

(b) The contract forms must contain safeguards adequate to protect the principals in the transaction.



## USE OF PROMULGATED FORMS

TREC rule 537.11 addresses the use of standardized forms and lists the forms that are currently promulgated (published), for mandatory use by a license holder when the form fits a particular transaction. Some forms, such as the Sellers' Disclosure of Property Condition, are approved by the commission for voluntary use by license holders. This means that license holders can use other versions of the Sellers' Disclosure Notice if applicable.

The promulgated forms available through TREC are listed below. The forms change regularly; visit <https://www.trec.texas.gov/agency-information/forms-and-contracts> for information about current forms, including the date the form was promulgated and the current version number of the form. Earlier versions of forms may not be used; to do so could be considered the unauthorized practice of law, a violation of the act, which can result in suspension or revocation of a license. The version number (form number) of the form is included in the bottom-right corner of each page of the form (see Figure 1.1). Pay attention to the form numbers. In addition to providing version control, it's possible you might hear a form called by its number instead of its name (e.g., 20-14 instead of One to Four Family Residential Contract).

**FIGURE 1.1:** One to Four Family Residential Contract Version Number

Initialed for identification by Buyer \_\_\_\_\_ and Seller \_\_\_\_\_ TREC NO. 20-14

Remember that you must use promulgated forms unless one of the four exceptions (see “537.11. Use of Standard Contract Forms” later in this unit) comes into play.

### Texas Real Estate Commission forms

#### ■ Promulgated contracts

- Unimproved Property Contract
- One to Four Family Residential Contract (Resale)
- New Home Contract (Incomplete Construction)
- New Home Contract (Completed Construction)
- Farm and Ranch Contract
- Residential Condominium Contract (Resale)

#### ■ Promulgated addenda

- Addendum for Sale of Other Property by Buyer
- Addendum for Back-up Contract
- Addendum for Release of Liability on Assumed Loan and/or Restoration of Seller's VA Entitlement
- Seller's Temporary Residential Lease
- Buyer's Temporary Residential Lease
- Seller Financing Addendum
- Environmental Assessment, Threatened or Endangered Species, and Wetlands Addendum
- Addendum for Coastal Area Property
- Addendum for Property Located Seaward of the Gulf Intracoastal Waterway
- Addendum for Property Subject to Mandatory Membership in an Owners' Association



- Third Party Financing Addendum
- Loan Assumption Addendum
- Addendum for Reservation of Oil, Gas and Other Minerals
- Short Sale Addendum
- Addendum for Property in a Propane Gas System Service Area
- Addendum Concerning Right to Terminate Due to Lender's Appraisal
- Addendum for Authorizing Hydrostatic Testing
- **Promulgated amendment**
  - Amendment to Contract
- **Promulgated resale certificates**
  - Condominium Resale Certificate
  - Subdivision Information, Including Resale Certificate for Property Subject to Membership in a Property Owners' Association
- **Promulgated notice**
  - Notice of Buyer's Termination of Contract
  - Notice Concerning Easements and Rights-of-Way
  - Consumer Protection Notice
  - Texas Real Estate Consumer Notice Concerning Hazards of Deficiencies
- **Promulgated consumer disclosures**
  - Disclosure of Relationship with Residential Service Company
  - Information About Brokerage Services
- **Approved optional/voluntary use forms**
  - Notice to Prospective Buyer
  - Seller's Disclosure of Property Condition
  - Texas Real Estate Consumer Notice Concerning Hazards or Deficiencies
  - Addendum for Seller's Disclosure of Information on Lead-Based Paint and Lead-Based Paint Hazards as Required by Federal Law
  - Non-Realty Items Addendum

Appendix 1 is an example of the real estate contract most frequently used in Texas, the One to Four Family Residential (Resale) Contract. The following short summary of each clause provides an introduction to the contract that will be more fully explained in Unit 6.

1. *Parties*—identifies the seller and the buyer, also known as principals to the contract, and the parties intent to sell and to buy
2. *Property*—details the legal description and address of the property, a basic requirement of a real estate contract; lists items to be conveyed or excluded from the sale
3. *Sales Price*—establishes the cash down, loan amount, type of loan(s), and sales price
4. *License Holder Disclosure*—A relatively new paragraph that provides the disclosure required by law when a license holder is a party to a transaction or is acting on behalf of certain family members or businesses owned or held in trust by the license holder
5. *Earnest Money*—specifies the amount of earnest money and identifies the escrow agent (where the earnest money will be held in trust)

6. *Title Policy and Survey*—addresses title policy and survey matters
7. *Property Condition*—deals with seller’s disclosure matters; inspection and repairs; lead-based paint; environmental matters; buyer’s acceptance of property condition as-is; and residential service contract/home warranty option
8. *Brokers’ Fees*—notes that payments of brokers’ fees are contained in separate written agreements; broker’s fees should not be addressed in paragraph 11
9. *Closing*—establishes the closing date and identifies buyer and seller responsibilities at closing; contains certain seller representations
10. *Possession*—specifies when the buyer may take possession of the property
11. *Special Provisions*—provides a blank space for additional factual statements and business details of the sale not covered by other paragraphs in the contract form or not included in other addenda or disclosures. The single-most paragraph in the contract that license holders can get in trouble with TREC for the unauthorized practice of law
12. *Settlement and Other Expenses*—identifies which party pays certain expenses at closing
13. *Prorations*—addresses items such as taxes that are to be prorated and the timing of such prorations
14. *Casualty Loss*—specifies the seller’s responsibility for a casualty loss before closing and the buyer’s options if such loss occurs
15. *Default*—specifies the remedies available to each party in the event the other party breaches the contractual agreements
16. *Mediation*—encourages peaceable resolution of disputes through mediation
17. *Attorney’s Fees*—specifies how the expenses of litigation are to be paid
18. *Escrow*—provides that the escrow agent is not a party to the contract and how the escrow agent will distribute the earnest money at closing or if the transaction does not close
19. *Representation*—clarifies that covenants, representations, and warranties in the contract survive closing; provides for a remedy if seller representations are untrue; and provides for the seller to continue to show the property and negotiate back-up offers
20. *Federal Tax Requirements*—outlines the procedures for the buyer to follow if the seller is a *foreign person* as defined by applicable federal law
21. *Notices*—requirements for delivery of notices affecting the contract
22. *Agreement of Parties*—clarifies the understanding that no other agreements are to be relied on and identifies any TREC addenda or other forms to be a part of the contract
23. *Termination Option*—provides the buyer with an unrestricted right to terminate the contract for any reason within a specified number of days after the effective date (if the buyer pays the option fee to the seller)
24. *Consult an Attorney*—provides notice to both parties that real estate license holders cannot give legal advice and advises both parties to seek legal counsel for advice before signing; includes *Date of Final Acceptance* (establishing the *effective date* of the contract) and the signature block—an agent should never discourage a party from hiring a lawyer

The last page of the contract has the broker information, option fee receipt, and contract and earnest money receipt. The broker information section details the brokers involved in the transaction and the fee to be paid to the “other broker” by the listing broker. The broker information section is not part of the contract between the parties and is not a separate contract between the brokers. License holders should print and not sign their names in this section.

In addition to itemizing the current inventory of available forms, the commission establishes the dos and don'ts for the completion of those forms. A careful reading of the rules tells license holder all they need to know:

Section 537.11. Use of Standard Contract Forms

- (a) When negotiating contracts binding the sale, exchange, option, lease or rental of any interest in real property, a real estate license holder shall use only those contract forms approved for mandatory use by the Texas Real Estate Commission (the Commission) for that type of transaction with the following exceptions:
  - (1) transactions in which the license holder is functioning solely as a principal, not as an agent;
  - (2) transactions in which an agency of the United States government requires a different form to be used;
  - (3) transactions for which a contract form, or addendum to a contract form, has been prepared by a property owner or prepared by a lawyer and required by a property owner; or
  - (4) transactions for which no mandatory contract form or addendum has been approved by the Commission, and the license holder uses a form:
    - (A) prepared by a lawyer licensed by this state, or a trade association in consultation with one or more lawyers licensed by this state, for the particular type of transactions involved that contains:
      - (i) the name of the lawyer or trade association who prepared the form;
      - (ii) the name of the broker or trade association for whom the form was prepared;
      - (iii) the type of transaction for which the lawyer or trade association has approved the use of the form;
      - (iv) any restrictions on the use of the form; and
      - (v) if it is an addendum that changes the rights, obligations or remedies of a party under a contract or addendum form approved by the Commission for mandatory use, the form must also include:
        - (I) a statement about how the addendum changes the rights, obligations or remedies of a party, with a reference to the relevant paragraph number in the mandatory use form;
        - (II) a statement that the form is not a mandatory Texas Real Estate Commission form; and
        - (III) a statement that Commission rules prohibit real estate license holders from giving legal advice; or
    - (B) prepared by the Texas Real Estate Broker-Lawyer Committee (the committee) and approved by the Commission for voluntary use by license holders.

- (b) A license holder may not:
- (1) practice law;
  - (2) directly or indirectly offer, give or attempt to give legal advice;
  - (3) give advice or opinions as to the legal effect of any contracts or other such instruments which may affect the title to real estate;
  - (4) give opinions concerning the status or validity of title to real estate;
  - (5) draft language defining or affecting the rights, obligations or remedies of the principals of a real estate transaction, including escalation, appraisal or other contingency clauses;
  - (6) add factual statements or business details to a form approved by the Commission if the Commission has approved a form or addendum for mandatory use for that purpose;
  - (7) attempt to prevent or in any manner whatsoever discourage any principal to a real estate transaction from employing a lawyer; or
  - (8) employ or pay for the services of a lawyer, directly or indirectly, to represent a principal to a real estate transaction in which the license holder is acting as an agent.
- (c) This section does not limit a license holder's fiduciary obligation to disclose to the license holder's principals all pertinent facts that are within the knowledge of the license holder, including such facts which might affect the status of or title to real estate.
- (d) It is not the practice of law for a license holder to fill in the blanks in a contract form authorized for use by this section. A license holder shall only add factual statements and business details or shall strike text as directed in writing by the principals.
- (e) This section does not prevent the license holder from explaining to the principals the meaning of the alternative choices, factual statements and business details contained in an instrument so long as the license holder does not offer or give legal advice.
- (f) When a transaction involves unusual matters that should be reviewed by a lawyer before an instrument is executed, or if the instrument must be acknowledged and filed of record, the license holder shall advise the principals that each should consult a lawyer of the principal's choice before executing the instrument.
- (g) A license holder may employ and pay for the services of a lawyer to represent only the license holder in a real estate transaction.
- (h) A license holder shall advise the principals that the instrument they are about to execute is binding on them.
- (i) Forms approved by the Commission may be reproduced only from the following sources:
- (1) electronically reproduced from the files available on the Commission's website;

- (2) printed copies made from copies obtained from the Commission;
- (3) legible photocopies made from such copies; or
- (4) computer-driven printers following these guidelines:
  - (A) The computer file or program containing the form text must not allow the end user direct access to the text of the form and may only permit the user to insert language in blanks in the forms. Blanks may be scalable to accommodate the inserted language. The Commission may approve the use of a computer file or program that permits a principal of a license holder to strike through language of the form text. The program must be:
    - (i) limited to use only by a principal of a transaction; and
    - (ii) in a format and authenticated in manner acceptable to the Commission.
  - (B) Typefaces or fonts must appear to be identical to those used by the Commission in printed copies of the particular form.
  - (C) The text and order of the text must be identical to that used by the Commission in printed copies of the particular form.
  - (D) The name and address of the person or firm responsible for developing the software program must be legibly printed below the border at the bottom of each page in no less than six point type and in no larger than 10 point type.
- (j) Forms approved or promulgated by the Commission must be reproduced on the same size of paper used by the Commission with the following changes or additions only:
  - (1) The business name or logo of a broker, organization or printer may appear at the top of a form outside the border.
  - (2) The broker's name may be inserted in any blank provided for that purpose.
- (k) Standard Contract Forms adopted by the Commission are published by and available from the Commission at P.O. Box 12188, Austin, Texas 78711-2188 or [www.trec.texas.gov](http://www.trec.texas.gov).

In most cases, license holders are required to use TREC-promulgated forms. There are four instances in which license holders are not required to use TREC-promulgated contract forms.

As noted in 22 TAC Section 537.11, a license holder is not required to use a promulgated form when buying or selling her own home. A license holder may use a TREC-promulgated form in such instances, but is not required to use one.

If a principal (buyer or seller) wishes to use her own form or a form created by an attorney and required by the principal, the license holder may use such form. Homebuilders often use their own contract forms or forms created by an attorney or a professional organization of which the builder is a member. The license holder should be very careful using contract forms she may not be familiar with under this exception.

If a transaction involves a government agency and the agency requires use of a different form, such as in the sale of a HUD home, a license holder may use that form rather than a TREC-promulgated form.

If there is no TREC-promulgated form for a particular transaction, for example, a commercial contract form or long-term lease, a license holder can use a form created and approved by an attorney for the type of transaction involved. The Texas Association of REALTORS® (TAR) has created commercial contract forms and long-term lease forms for use by REALTORS® as there are no TREC-promulgated forms for these types of transactions. In addition, the Texas Apartment Association (TAA) makes lease forms available for use by its members as well. License holders may not use such forms unless they are members of TAR or TAA.

### CASE STUDY

A complaint was filed against a TREC broker. The broker negotiated a contract for the purchase of a motel using obsolete TREC-promulgated residential contracts instead of having an attorney prepare a commercial contract. Apparently the broker negotiated the sale of the motel twice to two different potential purchasers. In both contract negotiations, in addition to using the wrong form, the broker failed to provide any legal description in the property section, failed to correctly identify the escrow agent, and failed to insert an effective date in the contracts. With respect to the first contract, the broker collected earnest money from the buyers, but deposited the earnest money into the broker's operating account rather than depositing it with an escrow agent or into a properly identified trust account.

In the agreed order, the broker agreed to a three-month probated suspension of his license.

As public records, the TREC-promulgated contract forms are available to any person. However, TREC forms are intended for use only by licensed real estate brokers or sales agents who are trained to use such forms. Mistakes in the use of a form may result in financial loss or a contract that is unenforceable. A notice on TREC's website advises non-license holders who wish to use the forms to contact a real estate license holder or an attorney for assistance.

## SELLER DISCLOSURE REQUIREMENTS

On or before the effective date of a contract for the sale of property, sellers of residential property of not more than one unit must deliver a Seller's Disclosure Notice to the buyer, disclosing the seller's knowledge of the condition of the property pursuant to Section 5.008 of the Texas Property Code. The notice is required in almost all residential transactions, the most notable exception being the sale of a new property by a builder.

Section 5.008 of the Texas Property Code requires "a seller of residential property comprising not more than one dwelling unit located in this state to give to the purchaser of the property" a written notice of the property's condition. Form OP-H, Seller's Disclosure Notice (see Appendix 2), contains the language required by the Property Code.

Notice that TREC seller's disclosure is an optional form, not a promulgated form. The disclosure is required of the seller, but the Property Code does not dictate which form the seller needs to use. All the information on this form is required by the Property Code and is also on the Texas Association of REALTORS® (TAR) Seller's Disclosure of Property Condition form as well as some of the REALTOR® associations' and some brokers' forms. TAR forms also include additional disclosure items.

Sellers can limit their future liability by disclosing everything they know about the property. Even things that have been repaired or replaced need to be disclosed on the notice to the extent required in the notice requirements.

The seller's disclosure is discussed in paragraph 7B of the TREC-promulgated contract forms; we will use the One to Four Family Residential Contract as an example. Paragraph 7B (see Figure 1.2) gives the parties three choices for negotiations.

Paragraph 7B(1) is the easiest disclosure option and probably the best choice. In order for this to be available, the listing agent must have the form completed in advance. Many agents take a blank seller disclosure form in their listing packet and get the seller to complete it as soon as they list the property. Then they are ready to provide it when a buyer becomes interested.

Buyers need to review the seller's disclosure notice before making an offer. That way, buyers know what they are making an offer on "in its present condition" and can negotiate appropriately.

**FIGURE 1.2:** Paragraph 7B of the One to Four Family Residential Contract

**B. SELLER'S DISCLOSURE NOTICE PURSUANT TO §5.008, TEXAS PROPERTY CODE (Notice):**

(Check one box only)

- (1) Buyer has received the Notice.
- (2) Buyer has not received the Notice. Within \_\_\_\_\_ days after the effective date of this contract, Seller shall deliver the Notice to Buyer. If Buyer does not receive the Notice, Buyer may terminate this contract at any time prior to the closing and the earnest money will be refunded to Buyer. If Seller delivers the Notice, Buyer may terminate this contract for any reason within 7 days after Buyer receives the Notice or prior to the closing, whichever first occurs, and the earnest money will be refunded to Buyer.
- (3) The Seller is not required to furnish the notice under the Texas Property Code.

Paragraph 7B(2) is for the buyer's agent who is preparing an offer but has not been able to get a completed seller's disclosure from the listing agent. The buyer can make an offer and ask the seller to provide the notice within a certain number of days. The risk for the sellers is that even if they deliver the disclosure within the proper time frame, the buyer can terminate the contract, for any reason, within seven days and receive the earnest money back. If the sellers never deliver it, the buyer has a right to terminate and receive the earnest money back up to the day of closing.

Paragraph 7B(3) is for the seller, who (by law) is not required to furnish the notice. Contrary to popular belief, investors and relocation companies are required to provide the notice. As per Section 5.008(e) of the Texas Property Code, the notice is not required for transactions

- (1) pursuant to a court order or foreclosure sale;
- (2) by a trustee in bankruptcy;
- (3) to a mortgagee by a mortgagor or successor in interest, or to a beneficiary of a deed of trust by a trustor or successor in interest;
- (4) by a mortgagee or a beneficiary under a deed of trust who has acquired the real property at a sale conducted pursuant to a power of sale under a deed of trust or a sale pursuant to a court ordered foreclosure or has acquired the real property by a deed in lieu of foreclosure;
- (5) by a fiduciary in the course of the administration of a decedent's estate, guardianship, conservatorship, or trust;
- (6) from one co-owner to one or more other co-owners;
- (7) made to a spouse or to a person or persons in the lineal line of consanguinity of one or more of the transferors;



(8) between spouses resulting from a decree of dissolution of marriage or a decree of legal separation or from a property settlement agreement incidental to such a decree;

(9) to or from any governmental entity;

(10) of a new residence of not more than one dwelling unit which has not previously been occupied for residential purposes; or

(11) of real property where the value of any dwelling does not exceed five percent of the value of the property.

Section 5.008 also states the following:

(c) A seller or seller's agent shall have no duty to make a disclosure or release information related to whether a death by natural causes, suicide, or accident unrelated to the condition of the property occurred on the property or whether a previous occupant had, may have had, has, or may have AIDS, HIV related illnesses, or HIV infection.

(d) The notice shall be completed to the best of seller's belief and knowledge as of the date the notice is completed and signed by the seller. If the information required by the notice is unknown to the seller, the seller shall indicate that fact on the notice, and by that act is in compliance with this section.

(f) The notice shall be delivered by the seller to the purchaser on or before the effective date of an executory contract binding the purchaser to purchase the property. If a contract is entered without the seller providing the notice required by this section, the purchaser may terminate the contract for any reason within seven days after receiving the notice.

Section 5.008(g) of the Property Code also provides definitions for two terms in the seller disclosure notice:

(1) "Blockable main drain" means a main drain of any size and shape that a human body can sufficiently block to create a suction entrapment hazard.

(2) "Main drain" means a submerged suction outlet typically located at the bottom of a swimming pool or spa to conduct water to a recirculating pump.

As stated previously, failure to provide the disclosure can produce negative results for the seller. When the seller fails to provide and the buyer of a previously occupied single-family residence fails to receive the seller disclosure as required by Section 5.008 of the Texas Property Code, the contract may be terminated at the sole option of the buyer.

The Seller's Disclosure Notice is usually prepared by the seller at the time a property is listed and is available online through the MLS or from the listing agent. Sellers are required to fill out the form to the best of their knowledge. If information is unknown to the sellers, that fact may be indicated on the notice. The sellers and their agent have no duty to disclose that a death by natural causes, suicide, or accident unrelated to the condition of the property occurred on the property or whether a previous occupant had, may have had, has, or may have AIDS, HIV related illnesses, or HIV infection.

The Texas Legislature has amended Section 5.008 of the Texas Property Code almost every session in recent years. House Bill 890, 85<sup>th</sup> Leg. R.S. (2017), as signed by the governor adds a notice to the Texas Seller's Disclosure Notice that the property may be located near a military installation and may be affected by high noise or air installation compatible use zones or other operations. For additional information or studies, the notice suggests that buyers access the

military installation website or the website of the city and county in which the installation is located. The effective date of the law is September 1, 2017.

An owner, seller, builder, or landlord of a single-family residential property or their real estate agent is not responsible for obtaining or disclosing information about the location of registered sex offenders. However, they are not prohibited from doing so. They may, for business purposes or as a matter of policy, choose to provide such information. A listing agent providing such information to prospective buyers is advised to discuss this policy with the seller before taking a listing. Sellers and real estate agents may direct prospects to the Texas Department of Public Safety website, where they may search the Sex Offender Registry. TAR prints this website address in a public information statement on the Seller's Disclosure Notice that it publishes.

## DECEPTIVE TRADE PRACTICES ACT

The **Deceptive Trade Practices Act (DTPA)**—Consumer Protection Act, Chapter 17, Subchapter E, Business and Commerce Code is a Texas consumer protection statute that makes unlawful “false, misleading, or deceptive acts or practices” in the advertising, offering for sale, selling, or leasing of any real or personal property. The false, misleading, or deceptive acts that are most applicable to real estate license holders include the following:

- Representing that something is new or original when it is not or that it is of a particular quality when it is not
- Advertising property with no intention of selling the property as advertised
- Making false statements of fact concerning the reasons for a price reduction
- Misrepresenting the authority of an agent to negotiate the final terms of a sales contract
- Representing that a warranty guarantees or confers rights or remedies not included
- Representing that work has been done on real or personal property when the work has not been done

The DTPA does not apply to claims against a licensed broker or sales agent, with certain exceptions. The three circumstances under which the DTPA *does apply* to the actions of real estate agents are

- a misrepresentation of a material fact that is not advice, judgment, or opinion;
- a failure to disclose information if it was intended to induce the consumer into a transaction that the consumer would not have entered into had the information been disclosed; or
- an unconscionable action or course of action that is not advice, judgment, or opinion.

Thus, while a real estate agent may not be sued under the DTPA for giving bad advice related to a real estate transaction, the agent can be liable for fraud, misrepresentation, or failing to disclose factual information. In a DTPA lawsuit filed against a real estate agent, the consumer must prove that the agent's deceptive act was the producing cause of the damages. Producing cause has been described in court cases as an act that is, “a substantial factor that brings about injury and without which the injury would not have occurred.” A consumer is not, however, required to prove that a defendant acted knowingly or intentionally. The suit must be filed within two years after the deceptive act occurred—or within two years after the consumer discovered the deceptive act.

Defenses to the DTPA include (1) a reasonable offer of settlement within specified time limits, (2) written notice to the consumer prior to consummation of the sale that the broker

is relying on written information prepared by others, and (3) the impossibility of the broker's knowing that the information was false or inaccurate. The act also permits recovery of court costs and attorneys' fees if the lawsuit was ruled frivolous or harassing.

Recovery under the DTPA is limited to economic damages—costs of repair and replacement. However, if the defendant is found to have committed the act *knowingly*, then damages for mental anguish may also be awarded and up to three times the amount of economic damages. If the defendant is found to have committed the act *intentionally*, then the economic and mental anguish damages may be trebled. In addition to consumer compensation, the DTPA allows for civil penalties of up to \$20,000 per violation, with an additional penalty of up to \$250,000 for deceptive acts or practices that target the elderly. Errors and omissions (E&O) insurance does cover fraud or intentional violations of the DTPA. [*St. Paul Insurance Company v. Bonded Realty, Inc.* 583 S.W.2d 619 (Tex. 1979)]

Under Section 1101.805 of the License Act, parties to a contract and license holders are protected from liability for misrepresentation or concealment of material facts by each other or by a subagent unless the party or license holder knew of the falsity or concealment. A broker, however, is fully liable for the acts of the broker's sponsored sales agents.

#### **C A S E S T U D Y**     *Sherman v. Elkowitz*, 130 S.W.3d 316 (Tex.App. 2004)

This case addresses whether a listing agent and the agent's sponsoring broker (license holders) are liable under the Texas Deceptive Practices Act (DTPA) for seller's disclosures under the Seller's Disclosure Notice required by Section 5.008 of the Property Code.

Buyers purchased a home from sellers; both parties were represented by real estate agents. The sellers provided a Seller's Disclosure Notices to the buyers that disclosed various defects and termite treatments. Shortly after the buyers moved in, they discovered various other defects with the property and also learned that the sellers had sued the previous owners for failing to disclose the defects. The later-discovered defects and lawsuit were not disclosed on the Seller's Disclosure Notice to the buyers.

The buyers sued the sellers and the license holders on a variety of legal theories, including alleged violations of DTPA. While the trial court granted a directed verdict in favor of the license holders, the trial court ruled against the sellers. The buyers appealed the directed verdict in favor of the license holders.

The buyers argued that the license holders were liable for the sellers' failure to disclose the lawsuit and later-discovered defects because of a statement in the TAR Sellers' Disclosure Notice which states that "Listing Broker and Other Broker have relied on this notice as true and correct and have no reason to believe it to be false or inaccurate." The court held that the statement was not an affirmative representation by the license holders of the condition of the property. Only if the license holders knew that the sellers' statements were false, the license holders had a duty to tell the buyers. Although the license holders were generally aware of the previous lawsuit, there was no evidence to show that they were aware of the defects at issue in the lawsuit.

Furthermore, the court concluded that, as a matter of law, there was no duty to disclose the previous lawsuit because it had been dismissed before the seller listed the property. In so concluding, the court looked at the statutory notice required by Section 5.008 of the Property Code that requires in some instances disclosure of matters that occurred in the past, such as "previous flooding" or "previous termite treatment." The court held that because there was no such language in reference to lawsuits that the statute only required the disclosure of pending lawsuits.

## SUMMARY

Real estate in Texas is governed by state law. The Texas Real Estate License Act (TRELA) and the TREC Rules are enforced by the Texas Real Estate Commission (TREC).

The Broker-Lawyer Committee drafts and edits contract forms for use by real estate license holders, and TREC approves and promulgates them.

Real estate license holders must use the promulgated forms except in specific exempted cases. Failure to use these forms where required might lead to the suspension or revocation of one's license for the unauthorized practice of law. The unauthorized practice of law also includes giving legal advice, changing or combining promulgated contracts to create a different contract, and adding text to a promulgated contract that is not factual statements or business details.

Promulgated contract forms cannot be altered except as a requirement of the parties.

The Texas Property Code requires most sellers of residential property (with some exceptions) to provide to the purchaser a written notice of the property's condition. TREC has provided a form for this purpose.

The Deceptive Trade Practices Act (DTPA) protects consumers from license holders who engage in false, misleading, or deceptive acts or practices.

# UNIT 1 REVIEW QUESTIONS

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- The purpose of the Texas Real Estate License Act (TRELA) is to
  - protect real estate license holders.
  - protect real estate brokers from unscrupulous salespeople.
  - protect the public.
  - keep the cost of real estate services under control.
- The Texas Deceptive Trade Practices Act (DTPA) is a consumer protection law which protects the public from
  - false or misleading acts.
  - deceptive acts.
  - unconscionable acts.
  - all of these.
- Which action might leave a license holder open to a charge of practicing law without a license?
  - License holder advises the seller that the property probably won't sell because it is overpriced.
  - License holder advises the buyer in writing that a title policy, as well as a survey, should be obtained.
  - License holder advises both the seller and the buyer that, in his opinion, title to the subject property is encumbered.
  - License holder adds factual statements and business details to a promulgated form as requested by the client.
- In which of the following situations is a license holder *NOT* required to use a contract promulgated by the Texas Real Estate Commission (TREC)?
  - The license holder's broker provides an alternative contract.
  - The license holder is working as his father's agent to sell his father's house.
  - The buyer's attorney has drafted a contract that the buyer insists on using.
  - The buyer doesn't like the TREC contract and asks the license holder to draft a different sales contract.
- What should a license holder do in transactions for which there is no TREC promulgated contract?
  - Change an existing TREC-promulgated contract to meet the needs of this transaction.
  - Write a contract according to the wishes of the principal.
  - Ask the buyer and the seller to work together to draft a contract.
  - Use a form prepared by the Broker-Lawyer Committee and made available for trial use by license holders with the consent of TREC.
- The Texas Deceptive Trade Practices Act (DTPA) has two features that are designed to deter wrongdoers. These two features are
  - treble damages and a mental anguish award.
  - actual damages and a minimum punitive award of \$1 million.
  - 10 times actual damages and attorneys' fees.
  - treble damages and actual damages.
- The Texas Property Code Section 5.008 requires all of the following to provide a seller's disclosure *EXCEPT*
  - one spouse to another in a divorce proceeding.
  - an out-of-state investor who has never seen the property.
  - a sale in which the improvements are worth less than half of the land assessment.
  - a local investor who has never lived in the property.
- Section 5.008 of the Texas Property Code requires
  - most sellers of residential property to provide the buyer with a written notice of the property's condition.
  - all sellers of residential property to provide the buyer with a written notice of the property's condition.
  - most sellers of residential property to provide the buyer with TREC Form OP-H, Seller's Disclosure of Property Condition.
  - all sellers of residential property to provide the buyer with TREC Form OP-H, Seller's Disclosure of Property Condition.

9. Which of the following is *NOT* a promulgated form adopted by the Texas Real Estate Commission (TREC)?
- A. A contract for the sale of a farm
  - B. A contract for the resale of a condominium
  - C. A contract for the sale of a five-unit residential building
  - D. A contract for the sale of a duplex
10. If the disclosure is provided to the buyer after the contract is fully executed, the
- A. buyer may terminate the contract within ten days after receipt of the disclosure.
  - B. buyer may terminate the contract within seven days after receipt of the disclosure.
  - C. buyer has no right to terminate the contract.
  - D. seller is required to pay all of the buyer's closing costs.

