

RESPA PRIMER ON  
Joint Ventures &  
Affiliated Business  
Arrangements

## About RESPRO®

The Real Estate Services Providers Council, Inc. (RESPRO®) is a nationwide non-profit trade association that unites providers from across the home buying and financing industry towards one common goal: a business and regulatory environment that better enables them to efficiently offer one-stop shopping through subsidiaries, joint ventures and other strategic alliances.

## About This Primer

RESPRO® receives numerous inquiries about how to form and operate joint ventures, limited liability corporations (LLCs), partnerships, and other “affiliated business arrangements” (AfBAs) under the Real Estate Settlement Procedures Act (RESPA).

We therefore thought it would be helpful to set forth some General Principles and “Do’s and Don’ts” when establishing and maintaining affiliated business structures under RESPA.

The basis for this *RESPA Primer on Joint Ventures and Affiliated Businesses* is the *RESPA Statement of Policy 1996-2—Regarding Sham Affiliated Business Arrangements*, originally published in the Federal Register on June 7, 1996 by the Department of Housing and Urban Development (HUD), which at that time was RESPA’s primary regulator. As of July 21, 2011, the authority for RESPA transferred to the Consumer Financial Protection Bureau (CFPB), which adopted HUD’s previous RESPA statements of policy and RESPA’s implementing regulation. The *1996-2 Statement of Policy* sets forth the factors that the RESPA regulator uses to determine whether a business arrangement is a “sham” or a “bona fide” provider of settlement services under RESPA.

One federal appeals court, the Sixth Circuit Court of Appeals, has ruled that this HUD Policy Statement arguably exceeded HUD’s statutory authority and that the guidelines were too vague to be enforceable. *Carter v. Welles-Bowen Realty, Inc.*, 736 F.3d 722 (6th Cir. 2013). But the CFPB does not necessarily agree and to date no other court has had occasion to consider the question. Therefore, the most conservative approach is to assume that the *1996-2 Statement of Policy* would be viewed as having continued applicability.

The list of Do’s and Don’ts in this RESPA Primer is not necessarily a list of items that absolutely must be done, or that can never be done. As the *1996-2 Statement of Policy* makes clear, the taking of any one action or the response to any one

factor “may not be determinative.” Instead, the entire panoply of factors will be considered and balanced by the CFPB in reaching a determination of legality or illegality.

Accordingly, the list of Do’s and Don’ts is a conservative guide to joint venture conduct. Joint ventures that do not adhere to this list may still be able to pass muster under the 1996-2 Statement of Policy depending upon the precise circumstances at hand.

Finally, please consult legal counsel familiar with RESPA with respect to the validity of any particular business structure. This is an area that is highly dependent upon particular facts. While we hope this information is useful, it should not be used as a substitute for your own independent legal analysis.

RESPRO® thanks its legal counsel for their work in preparing this Guide:

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## Other RESPRO® Publications

RESPRO® publishes other publications providing guidance on RESPA and state law issues:

- ▶ RESPA Guide to Affiliated Business Arrangement Disclosures
- ▶ RESPA Guide to Referral Fees: Do’s and Don’ts for Salespersons
- ▶ Survey of State Affiliated Business Laws

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# General Principles

## 1. Section 8 of RESPA

Section 8 of RESPA prohibits giving or accepting fees or other “thing of value” for the referral of real estate settlement service business that involves federally-related mortgage loans.

## 2. Definition of “Affiliated Business Arrangement”

An “affiliated business arrangement” (AfBA) under RESPA exists where a person in a position to refer settlement service business or an associate of that person has an affiliated relationship with or an ownership interest of more than 1% in another settlement provider.

## 3. Definition of “Joint Venture”

A “joint venture” is a type of affiliated business arrangement in which two or more providers (usually unaffiliated providers) form a separate settlement services entity in which each provider has an ownership interest. However, as the 1996-2 *Statement of Policy* makes clear, it also applies to situations where the venture is a wholly-owned subsidiary of only one entity (*i.e.*, a real estate broker), so long as another entity (*i.e.*, a lender) is involved in creating the provider, performing services for it, and/or receiving referrals from it.

## 4. “Affiliated Business Exemption”

An affiliated business arrangement is exempt from RESPA’s Section 8 prohibition if:

- ▶ Written disclosure of the arrangement and the range of charges is provided at or prior to the referral;
- ▶ The consumer is not required to use the affiliate or joint venture partners being referred; and
- ▶ The only thing of value to be obtained from the arrangement other than payments otherwise allowed under RESPA is a bona fide return on an ownership interest (*i.e.*, dividends) or franchise interest (*i.e.*, royalties).

The consequence of a failure to satisfy all of these statutory criteria is not settled. Under one view, which the authors of this *Primer* believe is the correct one, if any of these statutory criteria are not met, the AfBA and its members will be considered to be disqualified from RESPA’s AfBA exemption. If a person is not exempt from RESPA, they still have to be shown to have violated Section 8—*i.e.*, to have obtained a referral fee or to have split settlement service charges improperly. On the other hand, however, the CFPB and/or the plaintiffs’ bar are likely to take the

position (erroneous, in the view of the authors of this *Primer*) that this gives rise to an automatic RESPA violation. Indeed, one district court in the Fourth Circuit has taken the position (again, erroneous, in our view) that if the AfBA is found to be a “sham” under the 1996-2 *Statement of Policy*, there is a per se violation of RESPA. See *Minter v. Wells Fargo Bank, N.A.*, 2011 U.S. Dist. LEXIS 47588 (D. Md. May 3, 2011).

## 5. Characteristics of a Legitimate “Joint Venture”

In response to complaints concerning the formation of “sham AfBAs” and joint ventures in the settlement services marketplace, HUD issued on June 7, 1996 a *Statement of Policy* which outlines what factors the RESPA regulator—currently the CFPB—will consider in determining whether an AfBA or “joint venture” is permissible under RESPA or whether an AfBA is a “sham.” The 1996-2 *Statement of Policy* indicates that the CFPB will consider such factors as:

### Capitalization

- ▶ Whether the affiliate or joint venture was (when it was formed) and/or is currently adequately capitalized (based on a capitalization level that is standard in the industry).
- ▶ Whether the affiliate or joint venture is fairly and proportionately capitalized (*e.g.*, a real estate broker cannot be given its 50% interest in the joint venture for promising to promote the venture among its agents while its lender partner puts up \$30,000 in capital).
- ▶ Whether the capital contributed by one partner was loaned to it by the other and whether there is a bona-fide obligation to repay any such loan (*i.e.*, it is preferable that each side put up its own capital, but if a loan is made, it ought to be on fair market terms and there ought to be a bona fide obligation to repay it).

### Characteristics of a Legitimate Business

- ▶ Whether the affiliate or joint venture has its own employees vs. leased or borrowed employees. (Having its own employees who do the core services of what the joint venture was established to do is very important.)
- ▶ Whether the affiliate or joint venture has its own management vs. management from partner. (If management is provided by a partner of the JV, the partner ought to be paid fair value.)

- ▶ Whether the affiliate or joint venture has a separate office and/or pays fair rent for a subleased office. (A separate office is preferable.)
- ▶ Whether the affiliate or joint venture otherwise has the look and feel of an independent, legitimate business (*e.g.*, it has its own signage, business cards, contact information, website, etc.; it engages in marketing and advertising; it does not subcontract out an excessive amount of the services it needs to operate).

### **The Performance of Valuable, Substantial Settlement Services**

- ▶ Whether the affiliate or joint venture performs substantial services and is subject to risk.
- ▶ Whether the affiliate or joint venture performs services primarily through its own employees; to the extent the AfBA or joint venture subcontracts services, does it do so primarily through its partners and, in any event, does it pay the fair value for the services it subcontracts?

### **Competition and Exclusivity**

- ▶ Whether the affiliate or joint venture actively competes for new business.
- ▶ Whether the affiliate or joint venture does not send business exclusively to the creator/joint venture partner.

### **Adherence to the AfBA Test**

- ▶ Has the affiliate or joint venture ensured that no adjustments to ownership interests or distributions on such interests are based on the amount of business referred? (This is critical; the RESPA regulator has reemphasized that this item must be complied with.)

## Communications and Other Conduct Surrounding the Establishment and Operation of the AfBA

- ▶ The CFPB believes that facts and communications about the creation and operation of a joint venture (particularly the initial operations) may be highly relevant to whether there was a prohibited referral agreement. The CFPB also appears to take a subjective view of Section 8 of RESPA, which would inquire as to whether the purpose and operation of the affiliate or joint venture was simply to blatantly pay for business.
- ▶ The authors of this Primer do not believe that this subjective perspective is proper or viable; however, in light of the CFPB's view, it can be helpful to articulate a legitimate business purpose for the formation of the affiliate or joint venture.
- ▶ Likewise, care should be taken and to avoid communications, statements, or other conduct that might suggest a purpose to pay for or obtain things of value in return for referrals. Rather, communications and conduct should be consistent with the expectation of bona fide returns on interest and the various factors indicating that the joint venture is a legitimate and independent business.

## Joint Venture Do's

**DO:** Adequately capitalize the affiliate or joint venture and staff it with its own employees.

**DO:** Ensure that the affiliate or joint venture does (through its own employees) meaningful and necessary settlement services if it is to be compensated for performing them.

**DO:** Ensure that the affiliate or joint venture partners/stockholders each put up their own real capital, and that the value of such respective contributions is proportional to their respective interests in the entity.

**DO:** Ensure that dividends or partnership distributions are paid in proportion to the stockholders'/partners' ownership interests in the affiliate or joint venture.

**DO:** Ensure that the monies and other things of value provided to the affiliate or joint venture for performance of settlement services bear a reasonable relationship to the value of those services (without considering the value of any referral).

**DO:** Ensure that the affiliate or joint venture and its partners/stockholders provide consumers with affiliated business disclosure forms at or prior to any referral.

**DO:** Feel free to offer consumers discounts for purchasing packages of multiple services, so long as the services are separately available and the discount is genuine (i.e., prices were not raised and then lowered to achieve the discount).

**DO:** Proceed carefully when renting space from an affiliate or joint venture partner who might make referrals to the affiliate or joint venture, and ensure that the rental payment is below what you have determined fair market value to be for such office space and services.

**DO:** Pay fair value for any services or facilities to be provided by the affiliate or joint venture's creator or its partners, especially where it is anticipated that the affiliate or joint venture will make referrals to the creator or to the partner.

**DO:** Actively compete for new business even if you expect to receive the majority of your business from one affiliate or joint venture source.



## . . . and Don'ts

**DON'T:** Form your affiliate or joint venture in a manner that makes it appear like a shell (i.e., an entity that has far too few employees to perform the services to be provided and/or one that is undercapitalized).

**DON'T:** Subcontract out most of the meaningful functions involved in operating the affiliate or joint venture to the partners, stockholders or third parties.

**DON'T:** Give one affiliate or joint venture partner (e.g., the partner in a position to make referrals to the venture) an ownership interest in the venture for less than a fair value contribution.

**DON'T:** Pay dividends or partnership distributions in proportion to the amount of business referred or adjust ownership interest according to the amount of business referred.

**DON'T:** Let the affiliate or joint venture receive monies for services it did not perform or for services that you or a third party performed for it.

**DON'T:** Forget to instruct employees on how and when to make disclosures and how to get them acknowledged.

**DON'T:** Force consumers to accept referrals to the affiliate or joint venture by suggesting that you cannot or will not provide another settlement service unless they accept the referral.

**DON'T:** Pay rent to a person that is referring settlement service business based on a percentage lease or on a valuation of office space that considers the value of the settlement provider's business or reflects a premium for the location in the settlement service provider's office.

**DON'T:** Accept free management services, office space, and support services from an affiliate joint venture partner to whom referrals will be made.

**DON'T:** Refuse to compete for new business or contractually require an affiliate or joint venture partner to bar access to competitors or to always deal with the affiliate or joint venture.







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