

**SUNSET EVALUATION REPORT**  
**REAL ESTATE BROKERS AND SALESMEN**  
**Chapter 467, Hawaii Revised Statutes**

**A Report to the Governor and the Legislature of the State of Hawaii**

**Submitted by the**  
**Legislative Auditor of the State of Hawaii**

**Report No. 83-7**  
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## FOREWORD

Under the "sunset law," licensing boards and commissions and regulated programs are terminated at specified times unless they are reestablished by the Legislature. Nationally, the first sunset law was passed in 1976. Within three years, 30 more states had enacted similar legislation. The rapid spread of sunset legislation reflects increasing public concern with what it sees as unwarranted government interference in everyday activities.

Hawaii's Sunset Law, or the Hawaii Regulatory Licensing Reform Act of 1977, scheduled for termination 38 occupational licensing programs over a six-year period. These programs are repealed unless they are specifically reestablished by the Legislature. In 1979, the Legislature assigned the Office of the Legislative Auditor responsibility for evaluating each program prior to its repeal.

This report evaluates the regulation of real estate brokers and salespersons under Chapter 467, Hawaii Revised Statutes. It presents our findings as to whether the program complies with the Sunset Law and whether there is a reasonable need to regulate real estate brokers and salespersons to protect public health, safety, or welfare. It includes our recommendation on whether the program should be continued, modified, or repealed.

Our approach to the evaluation of the regulation of real estate brokers and salespersons is described in Chapter 1 of this report under "Framework for Evaluation." That framework is also used for all our other sunset evaluation reports. It is based on the policies enunciated by the Legislature in the Sunset Law. The first and basic test we applied was whether an identifiable danger to public health, safety, or welfare could result from the conduct of the occupation or profession being regulated. Then the other criteria for the evaluation were applied.

We acknowledge the cooperation and assistance extended to our staff by the Real Estate Commission, the Department of Commerce and Consumer Affairs, and other officials contacted during the course of our examination.

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## **Chapter 1**

### **INTRODUCTION**

The Hawaii Regulatory Licensing Reform Act of 1977, or Sunset Law, repeals statutes concerning 38 state licensing boards and commissions over a six-year period. Each year, six to eight licensing statutes are scheduled to be repealed unless specifically reenacted by the Legislature.

In 1979, the Legislature amended the law to make the Legislative Auditor responsible for evaluating each licensing program prior to its repeal and to recommend to the Legislature whether the statute should be reenacted, modified, or permitted to expire as scheduled. In 1980, the Legislature further amended the law to require the Legislative Auditor to evaluate the effectiveness and efficiency of the licensing program, even if he determines that the program should not be reenacted.

#### **Objective of the Evaluation**

The objective of the evaluation is: To determine whether, in light of the policies set forth in the Sunset Law, the public interest is best served by reenactment, modification, or repeal of Chapter 467, Hawaii Revised Statutes.

#### **Scope of the Evaluation**

This report examines the history of the statute on licensing of real estate brokers and salesmen and the public health, safety, or welfare that the statute was designed to protect. It then assesses the effectiveness of the statute in preventing public injury and the continuing need for the statute.

#### **Organization of the Report**

This report consists of three chapters: Chapter 1, this introduction and the framework developed for evaluating the licensing program; Chapter 2, background information on the regulated industry and the enabling legislation; and Chapter 3, our evaluation and recommendation.

## Framework for Evaluation

Hawaii's Regulatory Licensing Reform Act of 1977, or Sunset Law, reflects rising public antipathy toward what is seen as unwarranted government interference in citizens' lives. The Sunset Law sets up a timetable terminating various occupational licensing boards. Unless reestablished, the boards disappear or "sunset" at a prescribed moment in time.

In the Sunset Law, the Legislature established policies on the regulation of professions and vocations. The law requires that each occupational licensing program be assessed against these policies in determining whether the program should be reestablished or permitted to expire as scheduled. These policies, as amended in 1980, are:

1. The regulation and licensing of professions and vocations by the State shall be undertaken only where reasonably necessary to protect the health, safety, or welfare of consumers of the services; the purpose of regulation shall be the protection of the public welfare and not that of the regulated profession or vocation.
2. Where regulation of professions and vocations is reasonably necessary to protect consumers, government regulation in the form of full licensure or other restrictions on the professions or vocations should be retained or adopted.
3. Professional and vocational regulation shall be imposed where necessary to protect consumers who, because of a variety of circumstances, may be at a disadvantage in choosing or relying on the provider of the services.
4. Evidence of abuses by providers of the services shall be accorded great weight in determining whether government regulation is desirable.
5. Professional and vocational regulation which artificially increases the costs of goods and services to the consumer should be avoided.
6. Professional and vocational regulation should be eliminated where its benefits to consumers are outweighed by its costs to taxpayers.
7. Regulation shall not unreasonably restrict entry into professions and vocations by all qualified persons.



We translated these policy statements into the following framework for evaluating the continuing need for the various occupational licensing statutes.

Licensing of an occupation or profession is warranted if:

1. There exists an identifiable potential danger to public health, safety, or welfare arising from the operation or conduct of the occupation or profession.
2. The public that is likely to be harmed is the consuming public.
3. The potential harm is not one against which the public can reasonably be expected to protect itself.
4. There is a reasonable relationship between licensing and protection of the public from potential harm.
5. Licensing is superior to other optional ways of restricting the profession or vocation to protect the public from the potential harm.
6. The benefits of licensing outweigh its costs.

**The potential harm.** For each regulatory program under review, the initial task is to identify the purpose of regulation and the dangers from which the public is intended to be protected.

Not all potential dangers warrant the exercise of the State's licensing powers. The exercise of such powers is justified only when the potential harm is to public health, safety, or welfare. "Health" and "safety" are fairly well understood. "Welfare" means well-being in any respect and includes physical, social, and economic well-being.

This policy that the potential danger be to the public health, safety, or welfare is a restatement of general case law. As a general rule, a state may exercise its police power and impose occupational licensing requirements only if such requirements tend to promote the public health, safety, or welfare. Under particular fact situations and statutory enactments, courts have held that licensing requirements for paperhangers, housepainters, operators of public dancing schools, florists, and private land surveyors could not be justified.<sup>1</sup> In Hawaii, the State Supreme Court in 1935 ruled that legislation requiring photographers to be licensed bore no reasonable relationship to public health,

1. See discussion in 51 *American Jurisprudence*, 2d., "Licenses and Permits," Sec. 14.



safety, or welfare and constituted an unconstitutional encroachment on the right of individuals to pursue an innocent profession.<sup>2</sup> The court held that mere interest in the practice of photography or in ensuring quality in professional photography did not justify the use of the State's licensing powers.

**The public.** The Sunset Law states that for the exercise of the State's licensing powers to be justified, not only must there be some potential harm to public health, safety, or welfare, but also the potential harm must be to the health, safety, or welfare of that segment of the public consisting mainly of consumers of the services rendered by the regulated occupation or profession. The law makes it clear that the focus of protection should be the consuming public and not the regulated occupation or profession itself.

Consumers are all those who may be affected by the services rendered by the regulated occupation or profession. Consumers are not restricted to those who purchase the services directly. The provider of services may have a direct contractual relationship with a third party and not with the consumer, but the criterion set forth here may be met if the provider's services ultimately flow to and adversely affect the consumer. For example, the services of an automobile mechanic working for a garage or for a U-drive establishment flow directly to his employer, but his workmanship ultimately affects the consumer who brings a car in to his employer for repairs or who rents a car from his employer. If all other criteria set forth in the framework are met, the potential danger of poor workmanship to the consuming public *may* qualify an auto mechanic licensing statute for reenactment or continuance.

**Consumer disadvantage.** The consuming public does not require the protection afforded by the exercise of the State's licensing powers if the potential harm is one from which the consumers can reasonably be expected to adequately protect themselves. Consumers are expected to be able to protect themselves unless they are at a disadvantage in selecting or dealing with the provider of services.

Consumer disadvantage can arise from a variety of circumstances. It may result from a characteristic of the consumer or from the nature of the occupation or profession being regulated. Age is an example of a consumer characteristic which may cause the consumer to be at a disadvantage. The highly technical and complex nature of the occupation is

2. *Terr. v. Fritz Kraft*, 33 Haw. 397.

an illustration of occupational character that may result in the consumer being at a disadvantage. Medicine and law fit into the latter illustration. Medicine and law were the first occupations to be licensed on the theory that the general public lacked sufficient knowledge about medicine and law to enable them to make judgments about the relative competencies of doctors and lawyers and about the quality of services provided them by the doctors and lawyers of their choice.

However, unless otherwise indicated, consumers are generally assumed to be knowledgeable and able to make rational choices and to assess the quality of services being provided them.

**Relationship between licensing and protection.** Occupational licensing cannot be justified unless it reasonably protects the consumers from the identified potential harm. If the potential harm to the consumer is physical injury arising from possible lack of competence on the part of the provider of service, the licensing requirement must ensure the competence of the provider. If, on the other hand, the potential harm is the likelihood of fraud, the licensing requirements must be such as to minimize the opportunities for fraud.

**Alternatives.** Depending on the harm to be protected against, licensing may not be the most suitable form of protection for the consumers. Rather than licensing, the prohibition of certain business practices, governmental inspection, or the inclusion of the occupation within some other existing business regulatory statute may be preferable, appropriate, or more effective in providing protection to the consumers. Increasing the powers, duties, or role of the consumer protector is another possibility. For some programs, a nonregulatory approach may be appropriate, such as consumer education.

**Benefit-costs.** Even when all other criteria set forth in this framework are met, the exercise of the State's licensing powers may not be justified if the costs of doing so outweigh the benefits to be gained from such exercise of power. The term, "costs," in this regard means more than direct money outlays or expenditure for a licensing program. "Costs" includes opportunity costs or all real resources used up by the licensing program; it includes indirect, spillover, and secondary costs. Thus, the Sunset Law asserts that regulation which artificially increases the costs of goods and services to the consumer should be avoided; and regulation should not unreasonably restrict entry into professions and vocations by all qualified persons.





## Chapter 2

### BACKGROUND

Chapter 467, Hawaii Revised Statutes, regulates real estate activity in Hawaii. It requires individuals and firms to be licensed by the Real Estate Commission in order to do business as real estate brokers or salespersons. This chapter provides some background information on the real estate occupation and its regulation.

#### Occupational Characteristics

**History.** Real property is the land and all improvements on the land. Under the English common law system, the principle of private property made it necessary to codify the methods used in transferring real property from one owner to another. Initially, property transfers were handled by attorneys acting for buyers and sellers under the common law. However, the rapid growth of cities during the industrial revolution added greatly to the complexity and number of real estate transactions. The real estate profession developed in the 1800s in response to a need for individuals with business ability who could negotiate sales and leases and who could provide other business services. Work which had been performed by attorneys was gradually taken over by persons specializing in the real estate field.<sup>1</sup>

The first real estate trade association was organized in New York in 1847. By the turn of the century, more than 40 similar associations had been formed across the nation. In 1908, these groups joined together to establish the National Association for Real Estate Exchanges, partly in response to an increasing number of grievances leveled against real estate agents.<sup>2</sup> Land speculation in the 1900s attracted numerous unscrupulous persons looking for quick profits. This led to an increasingly negative view of the real estate business. The new association sought to overcome this by: (1) establishing ethical standards for the practice of real estate, (2) taking action for sound public policy on real estate matters, and (3) pooling skills and information and knowledge through education and research.<sup>3</sup>

1. Frederick Case, "The Search for Professionalism," *Real Estate Brokerage*, Prentice-Hall, 1965, p. 250.
2. *Ibid.*
3. Maury Seldin, *The Real Estate Handbook*, Dow-Jones Irwin, 1980, p. 419.



By 1913, the national association had developed a code of ethics to govern the conduct of its members, and in 1916, it adopted the term *realtor* to designate members of the association.<sup>4</sup> Shortly thereafter, the group began a nationwide campaign in favor of licensing laws which would cast out unscrupulous and ignorant dealers from the profession. This campaign resulted in the passage of 22 state licensing laws by 1929 and 33 such laws by 1948. Today, licensing laws are in effect in all 50 states.<sup>5</sup>

The real estate industry ranks third in size among all U. S. industries. In 1976, the national income generated by the real estate industry and related industries was \$165 billion, or one-eighth of the total national income.<sup>6</sup> In 1980, more than 580,000 persons sold real estate as their primary occupation and many more engaged in the business on a part-time basis.<sup>7</sup>

The dominant professional organization for these practitioners is the National Association of Realtors. It operates through local boards and state associations which are charged with enforcing the national code of ethics. These professional groups promote the interests of real estate practitioners through educational programs and political action. In 1979, the national association had more than 750,000 members. By November 1982, this number had dropped to approximately 615,000 due to the declining economic climate for the real estate business.<sup>8</sup>

A second national organization which is active in the real estate field today is the National Association of Real Estate Licensing Law Officials. This group was founded in 1929 to improve the administration and enforcement of licensing laws. Its membership includes real estate commissioners and officials from the 50 states.<sup>9</sup>

**Real estate in Hawaii.** The principle of private property was not a part of the traditional Hawaiian social system. Under this system, land was held by a number of chiefs

4. Alvin Arnold and Jack Kusnet, *The Arnold Encyclopedia of Real Estate*, Warren, Gorham and Lamont, 1978, p. 540.

5. National Association of Real Estate License Law Officials, Interstate Cooperation Committee, *1981 NARELLO Annual Report*.

6. Arnold, *Arnold Encyclopedia*, p. 658.

7. U. S. Bureau of Labor Statistics, *Occupational Outlook Handbook*, 1982, 1982, p. 248.

8. "S. F. Real Estate Capital for Few Days," *San Francisco Examiner*, November 14, 1982.

9. Seldin, *The Real Estate Handbook*, p. 49.

who had the authority to distribute and redistribute it at will among the people. When the political fortune of one chief waned, a new chief would take over the land and redistribute it again.

When King Kamehameha I conquered all the Hawaiian Islands in the early part of the 19th century, he divided his lands according to the Hawaiian tradition. Upon his death in 1819, his successor preserved the original division of lands made by King Kamehameha I with only a few minor adjustments. Thus, although authority over the land remained with the Crown, King Kamehameha I and his successors came to recognize the right of the people to hereditary succession to the land.

As land tenure became more secure, there were more transfers of land between one occupant and another and an increasing number of land disputes. Coupled with the transition to a constitutional monarchy, it became necessary to make a final distribution of land between the Crown and the government and, ultimately, the people. The Great Mahele was entered into by King Kamehameha III in 1848 in order to make this distribution. It set the stage for introduction of the concept of private property into the islands.

The real estate business was founded soon after the Great Mahele. In 1850, the king appointed an agent to manage the Crown's lands. Pursuant to the Crown's authority, many of these lands were leased, mortgaged, and sold over the next 43 years. In 1851, the minister of the interior was authorized to appoint agents for the sale of government lands in fee simple to the people.<sup>10</sup> For the rest of the century, real estate activity escalated.

By 1916, Honolulu businessmen were considering organizing a real estate trade association similar to those in other parts of the United States. The Honolulu Realty Board was actually founded in 1922.<sup>11</sup> It was instrumental in obtaining passage of the Hawaii real estate licensing law in 1933.<sup>12</sup> By 1936, 81 salesmen and 130 brokers were

10. Robert McTierney, *An Analysis of the Role of Government Agencies and Professional Organizations in the Development and Structure of the Honolulu Real Estate Business (Industry) (1850-1960)*, M.B.A. Thesis, University of Hawaii, January 1962, pp. 6-11, 53, 304-305.

11. "Annual Report of the Honolulu Realty Board for the Year Ending December 31, 1927," 1928, p. 2.

12. "Protection to Public Seen in Real Estate License Law; Bill for Hawaii Considered," *Honolulu Advertiser*, March 17, 1929.



licensed to practice in the Territory of Hawaii. This number increased to 1,744 and 1,100 respectively in 1960<sup>13</sup> and, by 1982, more than 23,000 real estate agents were licensed.

The major professional organizations in Hawaii today are the Honolulu Board of Realtors and five other local boards which have been established in Hilo, Kona, Maui, Molokai, and Kauai. In addition, the Hawaii Association of Realtors is a statewide association which was established in 1968. These seven professional associations are chartered by the National Association of Realtors and are responsible for enforcing its code of ethics. In addition, they engage in various educational and political activities which promote real estate interests in Hawaii. In 1979, they had a combined membership of approximately 9,500. By October 1982, this number had dropped to about 7,500.<sup>14</sup>

Hawaii's real estate industry has boomed in the years since the real estate licensing law was passed, and especially in the years since statehood. One index of real estate activity is the number of deeds which are recorded at the Bureau of Conveyances. In 1935, slightly under 3,200 deeds were recorded. This number rose to 9,800 in 1960,<sup>15</sup> and 16,000 in 1971. It peaked in 1980 when nearly 29,000 deeds were recorded. In 1981, the number went down to 23,000 due to the impact of high interest rates and the recession.<sup>16</sup>

Another indicator of real estate growth in Hawaii is the value of property transferred. In 1935, the value of land conveyed through recorded deeds was slightly over \$6 million. This figure rose to \$108 million in 1960, slightly under \$1 billion in 1971, and \$4.5 billion in 1981.<sup>17</sup>

**Real estate practices.** The transfer of ownership or possession of real property from one person to another is a complex transaction involving a negotiation between

13. McTierney, *Analysis of the Role of Government Agencies*, p. 261.

14. "Realtor Number Reflect Downturn," *Pacific Business News*, October 4, 1982.

15. McTierney, *Analysis of the Role of Government Agencies*, p. 249.

16. State of Hawaii, Department of Planning and Economic Development, *The State of Hawaii Data Book: 1981*, p. 511.

17. *Ibid.*

two or more parties to settle the terms of the transfer, the development of agreements based upon the settlement terms, and the implementation of these agreements. Property transfers are complicated by local, state, and federal laws and regulations. Most people employ a real estate agent to assist them through this process.

Real estate agents deal with a wide variety of property transactions, including the rental, lease, purchase, sale and exchange of residential, commercial, industrial and agricultural property. There are two general types of real estate agents for whom licenses are required: the broker and the salesperson. The broker is responsible for managing a real estate business and may carry out all phases of a real estate transaction. Salespeople are employed by or contract independently with brokers to obtain property listings, locate interested parties, negotiate transfer terms, and draw up agreements. The salesperson must be affiliated with a broker who is ultimately responsible for ensuring that the transaction is properly carried out.

In order to practice real estate effectively, a real estate agent should have knowledge of real estate laws and regulations, the steps in real estate transactions, the papers and instruments used in these transactions, methods and available sources of financing for property transfers, and methods of assessing the general market value of properties. In addition, the real estate agent must be aware of the laws and standards of conduct governing the relationship among brokers and salespersons and their clients.

### **Statutory History of Regulation**

The real estate licensing law was enacted in 1933 as a direct result of the nationwide campaign in favor of such laws sponsored by the National Association of Real Estate Boards. The members of the Honolulu Realty Board were active proponents of the licensing law.<sup>18</sup>

Act 140, SLH 1933, established the Real Estate Commission in order to minimize fraudulent and unscrupulous real estate transactions. The commission was authorized to issue licenses to real estate brokers and salespersons who possessed a good reputation for honesty, truthfulness and fair dealing, and who had not been convicted of a felony or misdemeanor involving moral turpitude. The commission was also authorized to

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18. "Protection to Public," *Honolulu Advertiser*.



suspend or revoke licenses. No person, copartnership, or corporation was permitted to practice real estate in the Territory without a duly issued license.

Since its enactment, the real estate licensing law has been amended more than 40 times. About one-half of these amendments were made before 1970. In general, the rationale for amending the law has been to protect the public, to increase the professional quality of real estate practice, and to improve the administration of the law. Some of the more significant amendments are summarized below.

In 1935, Act 126 authorized the Real Estate Commission to expend funds to investigate alleged violations of the licensing law. In 1941, Act 205 added a two-year residency requirement for licensees, and a one year experience requirement was added for brokers. In 1949, the commission was authorized under Act 276 to give a written examination to candidates for licensure, and good character was added as a prerequisite for licensure. In 1957, Act 48 established a bonding requirement for all licensees.

In 1959, Act 163 raised the experience requirement for brokers to two years. Eight years later, in 1967, the real estate recovery fund and the real estate education fund were established under Act 187. In the same year, the bonding requirement for brokers and salespersons was repealed.

In 1971, the residency requirement was reduced to one year, and brokers and salespersons were required to meet the minimum educational standards in order to qualify for licensure. In 1973, Act 150 authorized the commission to issue certificates of registration to real estate schools and instructors, and the residency requirement was repealed. Five years later, two public members were added to the commission, bringing it up to the present nine member size. Finally, in 1981, Act 81 expanded the commission's regulation of real estate agents to include time share sales and acquisition agents acting as brokers and salespersons.

### **Nature of Regulation**

The Real Estate Commission consists of nine members who are appointed by the Governor and confirmed by the Senate. The chairman is designated by the Governor. All commissioners must be U. S. citizens who have resided in the state for at least three years preceding appointment. Four commissioners must be licensed real estate brokers who were actively engaged in the real estate business for three years prior to their

appointment. Two commissioners must be public members. Four commissioners must be from Honolulu, and one commissioner each from the counties of Hawaii, Maui, and Kauai. The commissioners serve without pay but are reimbursed for their expenses.

The commission is empowered to grant licenses to real estate brokers and salespersons; to regulate the professional conduct of brokers and salespersons; to inspect client trust funds; to suspend or revoke licenses; to issue certificates of registration to real estate schools and instructors; and to fine licensees up to \$500 for violations of the licensing law and rules. The commission also has the responsibility for administering the real estate recovery fund and the real estate education fund.

In addition to these broad general powers, the commission has many more specific duties, including developing written examinations for broker and salesperson applicants; monitoring the activities of real estate schools; publishing and disseminating reports; and intervening on behalf of the defendant in court cases involving the real estate recovery fund.

The commission issues licenses to salespersons, individual brokers, corporate brokers, copartnership brokers, and branch offices of brokerage firms. Certain persons are exempted from licensing. These include owners or persons acting under powers-of-attorney from owners, who are not engaged in the real estate brokerage or development business; receivers and trustees, and personal representatives acting under any court order or trust agreement; and, under certain circumstances, custodians and caretakers of real property. Table 2.1 portrays the number and kinds of licenses which were issued by the real estate commission as of September 29, 1982.

**Salespersons.** A real estate salesperson is any person who buys, sells, leases, rents, or lists real property, or who solicits prospective purchasers of real property for others for compensation or other valuable consideration. This includes persons who engage in the sale of options on real property.

Real estate salespersons may only work under the direction of a licensed broker. Salespersons may be employed directly by brokers, or they may be associated with brokers as independent contractors. In order to qualify for a salesperson's license, applicants must meet the following requirements: be a legal resident of the State of Hawaii who has attained the age of majority; possess good character and have a reputation for



**Table 2.1**  
**Number of Licenses by Category and Active Status**  
**September 29, 1982**

	<i>Active</i>	<i>Inactive</i>	<i>Total</i>
Salespersons	10,473	6,248	16,721
Individual Brokers	4,767	472	5,239
Independent Brokers	1,357	—	1,357
Principal Brokers	1,202	—	1,202
Brokers-in-Charge	103	—	103
Broker-Salespersons	2,105	—	2,105
Inactive Brokers	—	472	472
Copartnership Brokers	16	2	18
Corporation Brokers	1,191	111	1,302
Branch Offices	103	—	103
<b>Total All Licenses</b>	<b>16,550</b>	<b>6,833</b>	<b>23,383</b>

Source: Department of Commerce and Consumer Affairs, *Geographic Report*, September 1982.

honesty, truthfulness, and fair dealing; complete 40 hours in an approved real estate course; and pass a written examination on real estate principles.

The law and the commission's rules establish many standards of business conduct which licensed salespersons must follow. For example, salespersons may not accept a commission or other compensation from any person other than their broker. They may not be employed by more than one broker at a time, and, the name of their broker must be registered with the commission. Salespersons who are not registered to practice with licensed Hawaii brokers must place their licenses on inactive status. In addition, there are numerous standards governing the salesperson's handling of real estate transactions.

**Brokers.** A broker is any person who buys, sells, leases, rents, or lists real property, or who solicits prospective purchasers of real property, on behalf of others for compensation or other valuable consideration. This includes persons who negotiate the exchange of real property and sell options on real property.

The definition of a broker includes individuals, corporations, or copartnerships. Separate licenses are issued for each.

**Individual brokers.** In order to qualify for an individual broker's license, an applicant must be a legal resident of the State of Hawaii who has attained the age of majority. The broker applicant must possess good character and have a reputation for honesty, truthfulness, and fair dealing; must have satisfactorily completed 46 hours in an approved real estate course; and pass a written examination. In addition, the applicant must have previously engaged in real estate sales on a full-time basis for two years as a licensed Hawaii salesperson, and must have executed at least ten real estate transactions in the State. Education and experience requirements may be waived for applicants who meet certain equivalency standards set by the commission.

The law and the commission's rules establish many standards of business conduct which licensed brokers must follow. For example, there are rules which prohibit commingling client trust funds with broker funds and regulate the manner in which client trust funds must be handled.

**Corporate and copartnership brokers.** A broker's license may be issued to corporations, provided that their real estate business is placed under the direct management of an officer or employee of the corporation who holds an individual broker's license. This officer or employee is known as a principal broker. A broker's license may be issued to copartnerships, provided that every member of the copartnership who actively engages in the real estate business holds a broker's license.

Corporations and copartnerships are also required to comply with numerous business practice standards in the statutes and commission rules which govern the manner in which the real estate business of these entities may be conducted.

**Branch offices.** The commission's rules require branch offices established by brokerage firms to be licensed. These branch offices must be managed by licensed individual brokers who are appointed by the principal brokers of the brokerage firms. They must adhere to the same business practice standards that apply to other licensed brokerage firms.

**Registration of real estate schools.** According to commission records, 15 real estate schools were certified and active in September 1982, along with 26 real estate instructors. The commission issues certificates of registration to real estate schools and instructors who meet certain standards. These certificates of registration are intended to qualify the



schools to offer real estate courses to salesperson and broker applicants. At a minimum, an approved course must include the following subjects:

- . Estates, interests, and rights of real property;
- . Documents, acts, or occurrences by which real property is transferred or otherwise affected;
- . Rights and duties of an agent; and,
- . State licensing laws.

The commission is responsible for developing curriculum guides for certified schools to use in their training programs.

Registered real estate schools are subject to various requirements set forth in the statutes and rules and commission policies. For example, they must maintain a sufficient number of registered instructors and they must comply with certain advertising standards. Failure to comply with commission guidelines may result in decertification of the schools.

Instructors employed by registered real estate schools must be certified by the commission as well. The commission has established various standards for certification of instructors. For example, they must have practiced real estate in Hawaii as licensed brokers for a period of at least three years or have equivalent educational qualifications.

**Real estate recovery fund.** The real estate recovery fund was established in 1967 by Act 187, to furnish financial protection to consumers in their dealings with real estate licensees. It is a trust fund based on fees assessed from real estate brokers and salespersons during the licensing process. The recovery fund is tapped when a court judgment is made against licensees who are found to have committed fraud, misrepresentation, or deceit in their real estate transactions. No more than \$10,000 may be recovered per person per judgment, including reasonable court costs and attorney fees. In addition, no more than \$40,000 may be paid out of the fund per licensee. When the recovery fund is tapped for payment, the license of the broker or salesperson is automatically terminated. A new license cannot be issued until the broker or salesperson repays the fund in full plus six percent annual interest.

**Real estate education fund.** The real estate education fund was also created in 1967 to furnish the commission with a financial source for educational activities. It is a trust fund which is built by the interest earned by the recovery fund and by a portion of the license fees paid by real estate brokers and salespersons. The education fund may be used for a wide variety of activities which may benefit the consumer, licensees, the commission, or the commission's staff. These activities include classes, media exposure, participation in national associations, publications, research, seminars, and studies.





## Chapter 3

### EVALUATION OF THE REGULATION OF REAL ESTATE BROKERS AND SALESPERSONS

This chapter contains our evaluation of the regulation of real estate salespersons and brokers under Chapter 467, Hawaii Revised Statutes. It includes our assessment of the regulatory operations of the Real Estate Commission and our recommendations on continued regulation of real estate salespersons and brokers.

#### Summary of Findings

We find as follows:

1. There is a potential for economic injury to consumers through incompetent or unscrupulous practice by real estate salespersons and brokers, and therefore, they should continue to be licensed.
2. Many of the commission's rules result in restrictive or unnecessary regulation. This includes the regulation of branch and site offices and the regulation of business and trade names.
3. Some licensing requirements are irrelevant, such as residency and good moral character, and some are overly restrictive, such as the broker experience requirement of performing a prescribed number of local real estate transactions.
4. The category of inactive licenses is unnecessary and creates needless paperwork for the Department of Commerce and Consumer Affairs (DCCA). Conditions imposed by the board beyond those required by statute for the restoration of forfeited licenses also create a needless and potentially awesome workload.
5. There is a considerable backlog of real estate complaint cases which is now being handled by DCCA's newly reorganized Regulated Industries Complaints Office. While it is too soon to evaluate the effectiveness of the new office, it is evident that there is a need for a strong case management system.
6. The size of the real estate recovery fund exceeds any claims that might reasonably be expected to be made on it for years to come. Assessments for the fund

should be suspended and policies on claims against the fund need to be liberalized. The education fund has also grown beyond expectations and revenues accruing to the fund should be lowered.

### **The Need for Regulation**

There is potential for financial loss to the consumer in real estate transactions due to incompetence, fraud, misrepresentation, deceit and the mishandling of client trust funds. Despite numerous state and federal laws designed to regulate the real estate industry, many consumers have been injured.

There are numerous opportunities for malpractice in any real estate transaction due to the nature of the product, market forces, and the characteristics of the parties involved. Each transaction is unique and complex. Each piece of property has its own distinctive quality as well as its unique location. The price of any single piece of property may vary within broad limits due to such characteristics as the quality of the neighborhood. The transaction is complicated by intangibles in negotiating sale or lease prices based on the knowledge and respective bargaining strengths of the buyer and seller. Incompetence, poor judgment or dishonesty in any of the above areas could be injurious to consumers.

The need to protect the public from the potential harm of financial losses is corroborated by complaints and civil suits filed by consumers. In 1981, 215 complaints were filed against real estate agents in Hawaii and 41 civil suits were initiated in the courts against the real estate recovery fund. During the first seven months of 1982, 106 complaints were filed against licensees<sup>1</sup> and 34 civil suits were initiated against the recovery fund.<sup>2</sup>

1. Real Estate Commission, *Master List*, Complaints, 1981, 1982.
2. Real Estate Commission, *Recovery Fund Logs*.



Consumers in Hawaii have been damaged by various kinds of malpractice. There have been cases of misrepresentation in which brokers have overstated the value of the land and its potential for resort development. Brokers have also misrepresented the resale value of homes, promising falsely to repurchase the homes should these investments not live up to their promise. Consumers have also been sold out-of-state lands for which there was no clear title. Misuse of client funds is not uncommon; brokers have failed to distribute profits on investment properties and have diverted large sums from client trust funds.

Losses in some of these cases have been substantial. In one case involving several defendants, the court awarded damages of \$560,000 to plaintiffs for misrepresentation and breaches of contract on the sale of two lots of Kona land. The court also ordered the recovery fund to pay \$60,000 to the plaintiffs. Other cases involve smaller amounts but may be equally as injurious to the consumer.

In order to protect the public, both salespersons and brokers should continue to be licensed for reasons discussed below.

**Salespersons.** Salespersons have the most direct contact with consumers. During fiscal year 1982, a number of complaints were filed against licensed salespersons, and recovery fund awards have been made as a result of improper conduct by licensed salespersons. Some of the problems include misrepresentation, the mishandling of client funds, or the failure to properly draft and execute contractual documents.

Although salespersons must work under the direction of a licensed broker, this is insufficient to insure public protection because of one principal condition intrinsic in the occupation: real estate activities are highly decentralized, and therefore brokers cannot exercise supervision and control over all of the activities of their salespersons.

There is evidently what amounts to a national consensus on the need to license salespersons. Currently, all states license salespersons and require that they pass a written examination prior to licensure. In addition, 39 states have education requirements for salespersons.<sup>3</sup>

3. National Association of Real Estate License Law Officials, Interstate Cooperation Committee, *1981 NARELLO Annual Report*, pp. 17-22.



**Broker.** The term “broker” includes individual brokers, corporation brokers and copartnership brokers. They are also referred to collectively as “real estate firms” in the commission’s rules.

All states currently license individual brokers and require that they pass a written examination prior to licensure. In addition, 44 states have prelicensure education standards and 45 states require brokers to meet experience requirements.<sup>4</sup>

These requirements seek to ensure that brokers are actually as knowledgeable as they should be in order to carry out their responsibilities independently for all parts of a real estate transaction. They are responsible for opening and maintaining client trust funds, for managing the business operations of a firm, and for supervising other licensees. During fiscal year 1982, numerous complaints and recovery fund suits were initiated against brokers and recovery fund awards have been made against brokers for fraud, misrepresentation and deceit.

Licensing is also needed for corporations and copartnerships as many salespersons and brokers work for these firms. Currently, 40 states require corporations which engage in real estate operations to be licensed, and 36 states require real estate copartnerships to be licensed.<sup>5</sup>

Chapter 467, HRS, requires licensed corporations to place their real estate business under the direct management of a principal broker, and it also requires every member of a copartnership to be a licensed individual broker. These requirements are needed to pinpoint accountability for the real estate activities of a firm and to give consumers dual protection against both the corporation and the copartnership and its salespersons and brokers.

### Scope of Regulation

While there is a continued need to regulate salespersons and brokers, the commission has adopted rules which regulate activities for which there exists no public need for protection. This has occurred in: (1) the licensing of branch and site offices, and (2) the regulation of trade and business names.

4. *Ibid.*

5. *Ibid.*, pp. 36–40.

**Regulation of branch and site offices.** The commission's rules require that branch and site offices of brokerage firms be licensed. A branch office is defined as any place of business other than the principal place of business, or site offices, of a brokerage firm. A site office is defined as a temporary place of business where real estate transactions relating to a specific project may be carried out for a limited period of time.<sup>6</sup>

There is no statutory requirement for licensing branch or site offices and we find little justification for requiring commission approval of these offices. Complaints brought against branch and site offices would be the same as complaints filed against the licensed brokerage firms. Therefore, there is no added protection for the consumer.

There is, however, a need to pinpoint responsibility for branch and site offices by making sure that these operations are under the direct management control of a licensed individual broker. Branch and site office operations often cannot be properly supervised and directed by a principal broker working at a main office which may be on a different island. To ensure proper supervision, all that is needed is for real estate firms to register with the commission the location of all branch and site offices and the names of the licensed individual brokers who have been appointed to take management responsibility for these offices.

**Regulation of business names.** The commission has also promulgated rules which regulate the names under which brokers may do business. One rule prohibits the use of the names, initials, or nicknames of salespersons and unlicensed persons for business names unless approved by the commission. Another rule prohibits brokers from advertising using trade names which are not approved by both the commission and the business registration division (BREG) of the Department of Commerce and Consumer Affairs.<sup>7</sup>

These rules are not necessary to insure consumer protection. They result in a duplication of efforts by the commission and BREG, and they create unnecessary paperwork and delays in processing applications.

6. State of Hawaii, Title 16, Department of Regulatory Agencies, Chapter 99, "Real Estate Brokers and Salesmen," Section 16-99-2.

7. Title 16, Chapter 99, Section 16-99-19(a) and Section 16-99-11(a).



Corporations and partnerships must apply to BREG in order to obtain their articles of incorporation, statements of partnership registration, or certificates of limited partnership. In processing these applications, BREG reviews a master list of business names in order to determine if the proposed corporate or partnership names are the same as, or confusingly similar to, previously registered names. If so, the applications are denied. Despite the fact that the names are cleared by BREG, the commission also reviews and approves these names according to its own guidelines which prohibit the use of certain proper names. In fiscal year 1982, the commission processed almost 200 license applications and 25 name change applications from corporations and partnerships.

Corporations and partnerships, as well as individual brokers, may do business under trade names. The commission's rule requires these brokers to obtain commission and BREG approval of their trade names if they decide to advertise their services. BREG will not approve trade names which are the same as, or confusingly similar to, names already registered. In fiscal year 1982, the commission processed more than 150 trade name applications from brokers.

There is no need for the commission to regulate and approve business and trade names, especially since this largely duplicates the statutory responsibility of DCCA. The commission only needs to know what names brokers are operating under. This can be done by adding a provision to the rules which simply requires brokers to inform the commission of whatever trade names they adopt.

### **Licensing Requirements**

In fiscal year 1982, the department issued over 2,600 new licenses to salespersons, brokers, and branch offices. In terms of recordkeeping and paperwork, the real estate licensing program is one of the largest of all the board and commission programs at DCCA.

Improvements should be made to reduce the workload by eliminating those licensing requirements which provide little consumer protection but which do create unnecessary work for applicants and DCCA. Improvements should also be made to increase the equity with which applicants are treated. This can be done by changing the statutes and commission rules and practices in the areas described below.



**Unnecessary requirements.** Applicants are asked for irrelevant information which serve little purpose. Among these are requirements on legal residency, good moral character, criminal history, and insanity.

Section 467-9.5(1), HRS, requires all licensees to be legal residents of Hawaii. License application forms require individual applicants to declare that they are legal residents of the State. However, the term legal residency is not defined in the statutes, rules, or application instructions. The commission's executive secretary interprets this to mean that applicants must have local addresses. As it is not clear what this provision means, it should be deleted.

The statutes also require applicants to possess good moral character and to demonstrate this by submitting two notarized character references. According to the rules, applicants may also be required to submit three additional character references, including two from licensees. These requirements serve little useful purpose as most applicants can come up with these references and they provide no real assurance of good character.

In the application form, applicants are asked if they have ever been convicted of any crime other than a traffic violation. Questions on applicants' criminal history violate the intent of Act 205, SLH 1974, which expressly prohibits a licensing board from considering certain past criminal records in its licensing decision. Denial of applications based on conviction information can only be made after formal administrative investigation and hearing.

If the commission is committed to making inquiries about criminal histories, it should establish clearcut policy as to what information it will ask for and why, and this policy should be in conformance with Act 205, SLH 1974. In addition, the commission should develop adequate application instructions so that applicants clearly understand what information they are required to reveal. Until such time as these corrective measures are taken, the question should be eliminated from the license application form.

Finally, Section 467-14(16), HRS, requires the commission to deny license applications from individuals who have been adjudicated insane or incompetent. This standard is vague and it is not currently being enforced. It should be deleted.

**Brokers' experience requirements.** To qualify for a broker's license, applicants must have 46 hours of an approved curriculum for brokers, pass the examination, and meet experience requirements. According to statute, experience requirements are: (1) two years of full-time experience as a licensed Hawaii salesperson, or (2) equivalent experience or education in the selling or management of real estate.<sup>8</sup> These standards appear to be reasonable as 45 other states have set experience requirements for broker applicants, 23 states require two years of experience and at least ten require more than two years of experience.<sup>9</sup>

However, some of the commission's rules and policies which implement the experience standard are unfair, restrictive and arbitrary. The commission has expanded the experience requirement by requiring, in addition to the two years of experience, that applicants "shall have participated in at least ten written real estate transactions."<sup>10</sup> Of these ten, three must be executed listings contracts or commercial or industrial listings and three must be sales contracts that have closed escrow, or industrial or commercial leases, or their equivalent as determined by the commission. The rule also requires all ten transactions to be executed in Hawaii. No allowance is made for applicants with extensive sales experience elsewhere.

The ten transaction requirement was established arbitrarily, and it has no valid basis as a criterion for competency. According to interviews with commissioners, this standard was established in 1982 based on the commissioners' judgment that good salespersons working full-time should be able to complete a transaction every other month. We find little justification for the ten transaction rule. It is restrictive and without any statutory basis. Brokers have been licensed in Hawaii for the past 48 years without having to meet this requirement and there is no evidence that it is needed now.

The ten transaction rule detracts rather than adds to public protection because of the arbitrary and inequitable manner in which it is now being implemented. The commission will waive the requirement for attorneys who have been in practice in Hawaii

8. Section 467-9.5(4), HRS.

9. 1981 NARELLO Annual Report, pp. 17-22.

10. Title 16, Chapter 99, Section 16-99-38.



for two years. All other applicants must meet this requirement. The effect is to discriminate unfairly between attorneys and all other applicants. There is no provision, for example, to give equivalent credit to those holding graduate degrees with a specialization in real estate.

The commission will also waive the full two years experience requirement for attorneys who have been in practice in Hawaii for two years. However, it will only waive 1.5 years of this requirement for other applicants.<sup>11</sup> It is almost impossible for these other applicants to realize the full benefit of the 1.5 years waiver as they must also meet the ten transaction requirement. To get the benefit, they would have to complete ten transactions within six months, a difficult feat in today's market.

The commission's rules on experience also discriminate against salespersons. Up to one year of experience may be waived for licensed brokers or salespersons from another state. For brokers, the equivalent experience is determined on a one to one ratio. For salespersons, this experience is calculated on a one to three ratio. In other words, it would take one year of experience for a broker to receive a one year waiver for out-of-state work, but three years of experience for a salesperson to receive a one year waiver.

The rules on experience should be amended to comply with the statutes which provide for a waiver based on equivalent "experience or education in the selling or management of real estate." The equivalency standards set by the commission should be based on competency indicators that are fair and equitably applied to all applicants.

**Examinations.** In recent years, the commission has made substantial improvements in its handling of examinations. Most notable has been the streamlining of the exam applications process and the updating of the written examinations. The commission has also separated the salesperson and broker exams which were previously one and the same. Our review of the examination process reveals that there remains one major problem area, that of guidelines for reexaminations.

The written examinations are designed to test entry level skills. Yet, the commission has adopted arbitrary rules relating to examinations which are not based on entry level competency considerations.

11. Title 16, Chapter 99, Section 16-19-39.



Applicants for real estate licenses must take and pass the examination given by the Educational Testing Service, a national testing organization, before they can apply to DCCA for a license. One rule requires individuals who fail to apply for licenses within 90 days of passing the examination to be reexamined.<sup>12</sup> This is actually a punitive measure used against late applicants rather than a competency requirement. This will be discussed further in the next section.

A second rule allows the commission to require reexamination of licensees who have fallen delinquent in their renewal payments.<sup>13</sup> This again is not competency based because it exempts from reexamination those individuals who assumed military or political office while their payments were still current, but who subsequently failed to pay their renewal fees.

A third rule authorizes the commission to reexamine licensees at any time after their licenses have been suspended.<sup>14</sup> However, there are no guidelines setting forth the circumstances under which reexamination should be required. Furthermore, license suspensions are subject to various conditions which must be met prior to reinstatement of the licenses. These conditions are included in the commission's order of suspension. Requiring reexamination of individuals who already have entry-level skills, and who have fulfilled the conditions of suspension and reinstatement of their licenses, serves no useful purpose.

Finally, the basic contradiction is that the commission has not adopted any rule requiring the reexamination of licensees who have been on inactive status for many years. In view of the inconsistencies in the commission's rules relating to reexaminations, and in light of the fact that there is no overriding need to test continuing competency of licensees, the commission's rules relating to reexamination should be repealed.

**Late applications.** Commission rules require applicants to submit their applications for licensure with DCCA within 90 days of passing the written examination given by the Educational Testing Service. As noted earlier, if they fail to do so, they are considered unsuccessful candidates and must retake the written examination.

12. Title 16, Chapter 99, Section 16-99-29(f).

13. Title 16, Chapter 99, Section 16-99-8(3).

14. Title 16, Chapter 99, Section 16-99-9.

According to interviews with commissioners and staff, the late application rule is designed to make sure that individuals only take the written examination when they are serious about applying for their license. The imposition of a fixed deadline is supposed to encourage individuals to submit their applications on time.

The current rule is a modified version of an old rule which was in effect through June 28, 1982. This old rule allowed individuals to submit their license applications within *one year* of passing their written examination without having to be reexamined. Numerous applicants failed to meet the one year deadline and filed appeals with the commission. The commission changed the deadline to 90 days, in part, to alleviate this problem.

Until March 1982, the commission automatically denied all late applications but offered individuals the opportunity to appeal through informal conferences with the commission. The informal conference procedure resulted in inequitable treatment of late applicants as some individuals simply dropped out when faced with the option whereas others with similar qualifications went to informal conferences and received their licenses.

The commission discontinued its practice of offering informal conferences to late applicants in March 1982. Instead, it routinely denied late applications and informed the applicants of their right to appeal these denials through formal hearings.

In July 1982, the commission accepted a recommended order from the hearings officer which stated that the commission cannot waive the application deadline for any applicant, due to the wording of the rule. In accepting the order the commission established a legal precedent for all subsequent decisions on late applications. In short, the commission found itself in the position of having to deny these appeals.

The rule's rigidity, and its enforcement since July 1982, have created problems for applicants. In one case, a salesperson applicant passed the examination in August 1980 and filed a late application in March 1982. The salesperson asked for an extension of the one year deadline because she had forgotten to file an application for a new inactive license. The commission had routinely denied this application in March and informed the applicant of her right to appeal the denial through a formal hearing.



After a series of miscommunications involving the applicant's failure to understand the legal terminology of hearings documents, and the department's misrouting of correspondence from the applicant, a formal hearing was finally held in October 1982. This hearing resulted in a recommended order by the hearings officer sustaining the commission's denial decision based on the July 1982 case precedent. The net effect was that the applicant lost her original investment in seeking the salesperson license, amounting to nearly \$500, as well as more than eight months time during which she could have taken steps to requalify for a new license.

The rule has also created an unreasonable and unnecessary workload for the department's hearings office. As of October 29, 1982, 13 other appeals had been filed with this office relating to late application denials. Nine of these cases have been denied in the hearings officers' recommended orders, one case was dismissed due to the complainant's failure to show up at the hearing, and three cases are pending.

The problems under the old rule will continue through June 1983 when the one year deadline provision will expire. However, the new 90-day rule is even more restrictive than the old rule and problems can be expected to continue. It is probable that more denials will be appealed to the hearings office with an equal lack of success. The rule should be repealed as it serves no useful purpose as far as ensuring the competency of new licensees. It adds unnecessary bureaucratic requirements, and creates unnecessary hardship for new applicants.

The commission has already established a two-year time limit on prelicensure education under Rule 41. In order to ensure competency, it should establish a similar two-year time limit on examination results. This would allow applicants two years to apply for their licenses after they pass the written examination. This should provide adequate public protection as the examination is not revised that often.

### **License Categories**

Currently, there are the following categories of licenses: active, inactive, forfeited, suspended and revoked licenses. The inactive and forfeited categories impose unnecessary requirements on licensees and create an unnecessary workload for DCCA. They serve no useful purpose and should be repealed.



**Inactive licenses.** In 1973, Act 142 created an inactive license category to allow salespersons and individual brokers to place their licenses "on ice" while they work in fields closely related to real estate, such as the mortgage and escrow businesses. Inactive licenses can be maintained by paying renewal fees which are the same as the renewal fees for active licenses. They can be re-activated upon application to the commission without additional requirements being imposed on the licensees.

Over the years, the inactive license category has been broadened to include purposes other than that envisaged by Act 142, SLH 1973. The commission's rules require salespersons and individual brokers to place their licenses on inactive status when they are not registered to work under a licensed broker, or, in the case of brokers, when they are not working independently. The rules also require licensees to place their licenses on inactive status when they leave the State. In addition, any license may be voluntarily placed on inactive status. All that is required to re-activate inactive licenses is submittal of a written application. The commission re-issues active licenses on a routine basis.

Because of the broadened usages for the inactive license category, the number of inactive licenses has grown to the point where in September 1982, more than 6,800 licensees had placed their licenses on inactive status, or nearly 30 percent of all licensees. This represents an increase of more than 2,500 from the June 1981 figure of slightly more than 4,000 inactive licensees, or a 62 percent increase in slightly over one year. This means that DCCA must process over 6,800 inactive license renewals for no discernible reason.

Ninety-one percent of the inactive licenses belong to salespersons who are required to de-activate their licenses when not registered to practice with a broker. This high number is undoubtedly due to the poor economic climate and the fact that brokers are not hiring salespersons. The requirement that these individuals pay the same fee to maintain their inactive licenses as they would pay to maintain active licenses places an unnecessary and unfair financial burden on them. These fees for inactive licenses have no relationship to program costs.

The statutory fee schedule for inactive licenses and renewal of inactive licenses should be repealed. In addition, the commission should repeal its rules relating to the inactive license category. In their place, the rules should simply provide that any licensee may request inactive status by writing to the commission when they do not intend to

practice. They may return to active status by filing a written application, paying the current renewal fee, and fulfilling current licensing renewal requirements. This is the procedure used by the nursing board.

**Forfeited licenses.** According to law, licensees who fail to pay license renewal fees will have their licenses forfeited. These may be restored upon written application and payment of fees and a penalty of \$10.<sup>15</sup>

To these statutory provisions, the commission has adopted a rule with additional requirements for restoration of forfeited licenses. If the license has been forfeited for more than one year, the licensee may have to take real estate courses; if forfeited for more than two years, the licensee may have to retake the examination.<sup>16</sup>

The commission has no statutory authority for imposing these requirements as the law requires only a written application, payment of back fees, and payment of a \$10 penalty fee as a condition for restoration. Furthermore, the commission has no guidelines as to when delinquent licensees have to take real estate courses or written examinations. This means that for licenses forfeited for over one year, the commission must decide each application for restoration on a case by case basis.

On September 29, 1982, 2,388 licenses were on forfeit status since January 1981, or approximately nine percent of all licenses. Table 3.1 shows the number and types of licensees who were delinquent in their payments.

Table 3.1  
Number and Types of Licensees That Are Delinquent

	<i>Active</i>	<i>Inactive</i>	<i>Total</i>
Salespersons	1,092	1,017	2,109
Individual Brokers	135	56	191
Brokerage Firms	48	31	79
Branch Offices	9	—	9
<b>Total</b>	<b>1,284</b>	<b>1,104</b>	<b>2,388</b>

Source: Department of Commerce and Consumer Affairs, *Geographic Report*, September 1982.

15. Section 467-11, HRS.

16. Title 16, Chapter 99, Section 16-99-8.



It can be seen from this table that the vast majority, or 88 percent, of those with forfeited licenses were salespersons. It is probable that many of them simply could not afford to maintain their licenses during the present poor economic climate.

All licenses were subject to be renewed at the end of December 1982. The poor economic climate will undoubtedly result in more persons forfeiting their licenses, and more licenses in forfeit status for periods longer than one year and two years.

This poses an enormous workload potential for the commission and the department. If just one-fourth of the more than 2000 individuals who are currently delinquent by more than one year in their payments eventually submit restoration applications, the commission will have to handle over 500 applications on a case by case basis.

In fiscal year 1982, the commission acted on 40 license restoration applications. Some of these applications were denied outright, others were conditionally approved, and still others were approved outright. The commission's decisionmaking involved informal conferences with some, but not all, applicants. It resulted in such unusual decisions as approval of restoration for an individual who had been out of practice for more than 14 years, while denying applications of several individuals who had been out of practice for less than four years. These latter licensees were not allowed to be brought current by the payment of fees and penalties as provided for in the statutes.

The commission's rules which provide for additional conditions for restoration of licenses should be repealed. The commission should simply provide for restoration of licenses when statutory requirements are fulfilled; i.e., upon written application and payment of fees and penalty.

### **Regulatory Operations**

**Complaints.** The most serious deficiency in the real estate regulatory program is the handling of consumer complaints against licensees. According to commission logs, 89 cases filed in 1982 and 99 cases filed in 1981 were still open in October 1982. In addition, 37 cases filed in 1980, five cases filed in 1979, and one case filed in 1978, were awaiting prosecution on November 3, 1982. This results in a grand total of 231 cases that are pending.



The backlog of 231 consumer complaints against licensees is a serious problem. For one thing, the active cases are generally the more serious complaint cases which are under investigation or awaiting prosecution. Closed cases are more likely to be less serious cases, some of which have been disposed of through informal resolution. For another thing, when cases age by even one year there is a real danger that witnesses and evidence will be lost. Finally, a reason for the greatest concern is that unscrupulous or incompetent licensees may continue to practice until their cases have gone through formal administrative hearings and have been acted upon by the commission. This increases the exposure of the public to malpractice.

The Legislature's establishment of the compliance resolution fund in 1982 under Act 60 was designed to clear up the backlog of cases at DCCA. The fund is supported by a surcharge on all licensees and will provide the department's Regulated Industries Complaints Office (RICO) with the means to hire investigators and attorneys.

In November 1982, the responsibility for intake of all new complaint cases was centralized in RICO as well as the responsibility for investigating and prosecuting complaints against licensees. In December 1982, RICO was to assume the responsibility for handling all complaints relating to unlicensed activities which had previously been the responsibility of the Office of Consumer Protection.

It is still too early to evaluate the effectiveness of the new compliance resolution program. However, it is possible to identify some of the pitfalls which will face the new complaints system and to identify areas in which policies and procedures need to be developed.

Under the old system, there were serious problems with the investigation process. These problems included such aspects as failure to routinely interview complainants and all licensees involved in disputes, to collect all relevant documents associated with these transactions and to investigate thoroughly the ownership of disputed properties. In some complaint cases, the poor quality of investigations led to a premature closing of cases which involved serious ongoing malpractice by licensees. Had these cases been investigated properly and prosecuted, financial losses to consumers could have been prevented.

For example, three complaints were filed against a licensed broker in early 1979 alleging that the broker had failed to forward closing documents or distribute profits on the sale of out-of-state investment properties to consumers for approximately six months. All three cases were closed without thoroughly investigating the circumstances surrounding why the broker held on to client funds for such a long period of time.

Two of the complaint cases were closed without any substantive review because the complainants eventually received their documents and moneys. The third case was investigated briefly as the complainant said that there was a "deeper problem here" and thought it possible that the situation might get worse. The investigation report did note that the broker may have violated the statutes by failing to account for client funds within a reasonable period of time, but failed to document thoroughly the questionable transaction.

Subsequent events showed that the licensee was in a difficult financial situation at the time the complaints were filed and began to divert large sums of money from client trust accounts in late 1979 and 1980. Hawaii investors continued to invest in lands administered by the broker until late 1980. When the investors finally caught on to the broker's financial problems, it was too late to recover their money and the corporation went bankrupt in May 1981. Numerous lawsuits are pending against this corporation for various illegal activities and a court judgment of \$1.8 million has already been made in favor of the plaintiffs in one case. This is now being appealed by the defendants.

In a second example, numerous complaints were filed with the real estate commission between March 1978 and August 1981 against two brokers for problems associated with the sale of out-of-state lands to investors. During this same period, civil suits were brought against the licensees. The courts found that illegal activities did take place. One judgment of more than \$5,000 was awarded in August 1981 against the recovery fund. A second judgment was entered in favor of the plaintiffs in another case involving the same brokers. In June 1982, the court awarded more than \$20,000 from the recovery fund to the plaintiffs as victims of fraud, misrepresentation, and deceit. Notwithstanding the civil judgments which have been rendered by the courts, the complaints which had been filed with the commission are still awaiting prosecution. If the department had investigated thoroughly the early complaint cases which were filed against the brokers and if the attorney general's office had aggressively prosecuted these cases, much of the



damage caused by the brokers could have been forestalled. As it was, consumers continued to purchase lands sold by the brokers through August 1981.

Under the new compliance resolution program, RICO will handle the intake, investigation and prosecution of all consumer complaints filed against licensees. To ensure effective and efficient management of complaint cases, it should institute a case management system. Such a system should set policies and priorities for the handling of different types of cases, establish standard operating procedures for investigations and establish internal oversight and monitoring of the work of the investigations branch. According to our interviews with RICO, such policies and procedures are only in the early stages of formulation and implementation.

In developing policies, the department should recognize that it is the only agency with the authority to prevent malpractice by revoking licenses, thereby protecting the public from continuing abuse. The department's primary role, therefore, is to protect the public-at-large. Its overall disciplinary policies should place priority on investigating and prosecuting cases which involve serious potential or actual injury with the objective of disciplining licensees or preventing them from continuing to practice. Settlements of these kinds of cases should be entered into by the legal staff only when there is insufficient evidence for prosecution.

The department's secondary role is to help consumers to obtain redress. Informal settlements should be sought in the form of reimbursements or restitution. Even in these cases, an investigation of the circumstances surrounding the complaints is warranted to insure that they do not involve serious malpractice. The department should seek to identify the types of complaint cases which might foretell such malpractice and flag those cases for more thorough investigation.

Because of the large number of complaints related to real estate, the department should place a high priority on developing procedures for real estate cases specifically. This should include the development of a manual of operating procedures tailored to the field and a training program for investigators.

As part of its case management system, RICO should also develop a master log as a control showing to whom cases are assigned, time spent on investigations, and their status. This is currently being done manually with some serious problems, resulting in



an inability to report on the status of all cases under investigation at any given time. During our review, we were unable to obtain complete information on which cases were under investigation.

In addition to developing a more effective system of handling consumer complaints, the commission should consider an additional strategy that could be helpful to consumers as well as to licensees in their real estate transactions: the development of a residential property transfer code.

**Residential property transfer code.** The greatest potential for serious economic injury to consumers in real estate transactions is related to the transfer of residential property from one owner to another. These property transfers often involve individuals' entire life savings. Many of the complaints and the civil suits which are filed each year relate to this type of real estate transaction.

In order to reduce the number of problems which arise, and to ease the difficulties which face both consumers and licensees in residential real estate transactions, the commission should develop a residential property transfer code for legislative enactment. This code could be patterned after the landlord-tenant code which is set forth in Chapter 521, HRS.

The new code should be developed after a period of research and planning which would identify the nature of residential real estate transactions in Hawaii, the kinds of problems commonly associated with such transactions, and alternative ways in which consumer-licensee interactions in these transactions can be mediated by a code. In taking the lead in planning the new code, the Real Estate Commission should seek input from the realty boards along with consumers.

The implementation of such a code would have several advantages. It would set into law various standards of practice for residential property transfers. This would serve as due warning to those involved in these transactions about their respective roles and responsibilities. Problems could also be prevented if these respective expectations are made clear. And it would increase consumer access to information about standards of real estate practice and provide them with a more substantive basis for recovery of damages in civil courts.

**Real estate recovery fund.** The real estate recovery fund is the most important feature of the real estate licensing law in providing compensation to consumers injured by licensees. Access to the fund is limited to cases of fraud, misrepresentation, and deceit. Damages are limited to \$10,000 per person and \$40,000 per licensee.

Over the years, the fund has grown rapidly to a point where it amounted to \$1,145,072 at June 30, 1982. Between July 1, 1978 and June 30, 1982, the fund collected \$739,300 from licensees. It paid out \$120,191 as follows: \$118,651 for claims against the fund, and \$1,540 for legal fees.

The commission does not keep records on the status of cases filed against the recovery fund; therefore, we could not determine how many cases are currently pending against the fund. However, there is a definite trend towards a larger number of cases initiated in recent years. There were 25 cases filed in 1979, 19 in 1980, 41 in 1981, and 44 as of September 1982. However, the number of claims paid and the amounts paid out have not increased. This is shown in Table 3.2.

**Table 3.2**

**Claims Paid  
1979-1982**

<i>Fiscal Year</i>	<i>No. of Payments</i>	<i>Total Paid</i>
1979	5	\$37,968
1980	4	40,786
1981	3	18,900
1982	5	20,997

Source: Department of Commerce and Consumer Affairs, accounting records.

Since the fund now exceeds \$1,100,000, even were \$40,000 paid out in claims each year, there would be sufficient funds for the next 27 years. Consideration should be given to suspending recovery fund assessment fees collected from new licensees until the fund drops to its legally established minimum balance of \$150,000. When the fund reaches this minimum, it would be a simple matter to go back and assess the \$50 fee of all licensees who received their licenses after the suspension went into effect, and to reinstitute the collection of this fee from new licensees.



Section 467-17, HRS, also provides that when the fund's balance falls below \$150,000, brokers will be assessed a special \$25 renewal fee and salespersons will be assessed a special \$15 renewal fee in order to rebuild the fund. These special fees should only be applied after back fees have been collected from licensees who received their new licenses during the suspension period.

The low amount paid out in claims suggests that access to the fund should be liberalized to allow any person aggrieved by an act or conduct of a licensee to recover from the fund instead of limiting it to grounds of fraud, misrepresentation, or deceit. A person harmed by a licensee's incompetence, for example, should have recourse to the recovery fund. The limit of \$10,000 should be raised in recognition of the increase in real estate prices since 1967 when the current limit was established. The consumer's price index shows 1980 homeownership costs to be 221.3 percent of the 1967 level.<sup>17</sup> This would mean an increase of the \$10,000 limit to over \$20,000 to remain comparable with 1967 prices. Finally, the maximum limit of \$40,000 per licensee should be removed as this discriminates unfairly against those consumers who file later claims against the licensee.

**Real estate education fund.** At the same time that the real estate recovery fund was created, Act 187, SLH 1967, provided that the interest earned by the investment of recovery fund moneys would be deposited to a new real estate education fund to be used by the commission for educational purposes. In addition to interest earnings, the fund receives \$5 from each new licensee and \$10 from each biennial renewal fee.

Over the past 14 years, income has exceeded expenditures to a point where, on June 30, 1982, the education fund's balance amounted to \$920,272. This is a net increase of \$78,496 over the fund's balance of \$841,776 on June 30, 1981, or a 9 percent growth after expenditures.

Commission expenditures from the fund have increased correspondingly. In FY 1979-80, the commission spent \$66,277. This amount doubled to over \$132,000 in FY 1980-81. In FY 1981-82, the commission spent approximately \$119,000 for its

17. State of Hawaii, Department of Planning and Economic Development, *The State of Hawaii Data Book, 1981*, p. 305.

education program. In 1982, the commission approved an ambitious five year educational plan which calls for the expenditure of \$331,900 for FY 1982-83.<sup>18</sup> The budget for 1982-83 includes expenditures for the operations of the education office, a University of Hawaii real estate chair, licensee education including newsletters and seminars, consumer education, etc. Even if the budget is adhered to and the entire \$331,900 is expended, the education fund's balance on June 30, 1983 is projected to be \$1,046,582, for a net increase after expenditures of approximately 14 percent.

Because of the size and growth of the education fund, new revenues should be drawn down to lower levels. Section 467-19, HRS, provides that the interest from the recovery fund account shall be deposited to the credit of the real estate education fund. Because the corpus of the education fund is so large, and because there is a provision in the law to collect education fund fees from licensees, the Legislature should amend Section 467-19, HRS, to require that interest from the recovery fund accrues to the recovery fund.

## Conclusion

We find that there is evidence that consumers have been injured by improper and incompetent practices by real estate salespersons and brokers, therefore, regulation should be continued. At the same time, numerous improvements are needed in the statutes, in the commission's rules, and in its operations. These improvements fall in three major areas. *First*, the scope of licensing now goes beyond that required for public protection; these restrictions should be removed. *Second*, there are numerous licensing requirements that result in unnecessary paperwork and inequitable treatment of applicants; these, too, should be removed. *Third*, greater effort must be made to be more responsive to injured consumers by expediting the complaints process. Our specific recommendations follow.

18. Minutes of the Real Estate Commission, June 1982.



## ***Recommendations***

*We recommend the following:*

- 1. Chapter 467, HRS, be reenacted to continue the licensing of real estate salespersons and brokers.*
- 2. The commission cease regulating those activities for which there is no demonstrated need, that is, the licensing of branch and site offices and the regulation of business names.*
- 3. Chapter 467, HRS, be amended to remove licensing requirements relating to residency, good moral character and insanity, and the application form be amended to remove the question on criminal convictions.*
- 4. The commission's rules be amended to remove the requirement for 10 transactions to qualify for a broker's license and to establish experience waiver standards that are more equitable.*
- 5. The commission's rules on reexamination for delinquent and suspended licensees be repealed.*
- 6. The commission amend its rules on late applications by permitting applicants to apply for licenses within two years of passing the written examination without having to retake the examination.*
- 7. Chapter 467, HRS, be amended to repeal the provisions relating to the inactive licensing category and the commission's rules be amended to allow licensees to become inactive upon written request and to provide for restoration of licenses upon application, payment of fees, and fulfillment of licensing renewal requirements.*
- 8. The commission amend its rules on the restoration of forfeited licenses by deleting those conditions for restoration which go beyond the statutory requirements of a written application and payment of appropriate fees and penalty.*
- 9. The Department of Commerce and Consumer Affairs institute an efficient and effective case management system for the handling of real estate complaint cases with emphasis on developing policies and procedures and the proper training of the investigative staff.*

10. *As part of an effort to strengthen consumer protection, the commission consider developing a residential property transfer code.*

11. *Chapter 467, HRS, be amended to liberalize access to the recovery fund by removing the limit of \$40,000 per licensee and by raising the limit of \$10,000 per injury to \$20,000 and finally, by allowing access to the fund for injuries caused by any act of a licensee instead of limiting it to grounds of fraud, misrepresentation, and deceit.*

12. *The department suspend the collection of fees for the real estate recovery fund until such time as it reaches the minimum balance of \$150,000.*

13. *Chapter 467, HRS, be amended to provide that interest earned on the recovery fund accrues to the recovery fund rather than the education fund.*



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**APPENDIX**  
**RESPONSES OF AFFECTED AGENCIES**

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## COMMENTS ON AGENCY RESPONSES

A preliminary draft of this Sunset Evaluation Report was transmitted on December 17, 1982 to the Real Estate Commission and to the Department of Commerce and Consumer Affairs for their review and comments. A copy of the transmittal letter to the commission is included as Attachment 1 of this appendix. A similar letter was sent to the department. The responses from the commission and the department are included as Attachments 2 and 3. The commission included seven exhibits with its response which are not included in this appendix but are available for inspection at our office.

The commission has responded to each of our recommendations in some detail. For a full picture of the reasons behind the differences of opinion between the commission and our report, we suggest that the reader compare the full text of the commission's response with Chapter 3 of the report. For convenience, the commission's comments on each of our recommendations are summarized below.

1. The commission agrees that Chapter 467 be reenacted to continue the licensing of real estate brokers and salespersons.
2. The commission disagrees that it should cease regulating branch and site offices but, with one exception, it agrees that business names could be regulated by the Business Registration Division of the Department of Commerce and Consumer Affairs.
3. The commission agrees that licensing provisions relating to good moral character and insanity should be removed, and it is developing a policy on criminal history. The commission believes that the residency requirement should be retained.
4. The commission disagrees that the requirements for ten transactions to qualify for a broker's license should be removed but it will consider amending its rules to eliminate any inequities that may exist in waiving the experience requirements.
5. The commission disagrees that its rules on delinquent and suspended licensees should be repealed.
6. The commission hesitates to accept our recommendation on late applications to allow applicants to apply for licenses within two years of passing the written examination without having to retake the examination.

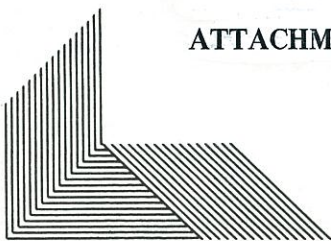
7. The commission is reviewing provisions relating to the inactive license category.
8. The commission disagrees with our recommendation that it amend its rules on the restoration of forfeited licenses by deleting those conditions for restoration which go beyond statutory requirements.
9. The commission concurs with our recommendation that the Department of Commerce and Consumer Affairs institute an efficient and effective case management system.
10. The commission agrees with the general intent of our recommendation to adopt a residential property transfer code.
11. The commission disagrees with our recommendation to remove the limit of \$40,000 per licensee that can be paid out from the real estate recovery fund and suggests that it be raised to \$50,000. It agrees that limit of \$10,000 per injury should be raised to \$20,000. The commission will consider allowing access to the fund for the negligent acts of licensees.
12. The commission disagrees with our recommendation that the department suspend the collection of fees for the real estate recovery fund until such time as it reaches the minimum balance of \$150,000.
13. The commission disagrees that the interest earned on the recovery fund should accrue to the recovery fund rather than the education fund.

The Department of Commerce and Consumer Affairs agrees that the most serious deficiency in the real estate regulatory program is the handling of complaints against licensees. The department states that it has already begun to formalize a case management system by devising policies on priorities, and developing training programs, manuals of operating and investigation procedures, a master logging system and real estate education programs.



ATTACHMENT 1

THE OFFICE OF THE AUDITOR  
STATE OF HAWAII  
465 S. KING STREET, RM. 500  
HONOLULU, HAWAII 96813  
(808) 548-2450



CLINTON T. TANIMURA  
AUDITOR  
RALPH W. KONO  
DEPUTY AUDITOR

December 17, 1982

*COPY*

Mr. G. A. Morris, Chairman  
Real Estate Commission  
Department of Commerce and Consumer Affairs  
State of Hawaii  
Honolulu, Hawaii 96813

Dear Mr. Morris:

Enclosed are 9 preliminary copies, numbered 4 through 12, of our *Sunset Evaluation Report, Real Estate Brokers and Salesmen*. These copies are for review by you, other members of the board, and your executive secretary. This preliminary report has also been transmitted to Dr. Mary G. F. Bitterman, Director, Department of Commerce and Consumer Affairs.

The report contains our recommendations relating to the regulation of real estate brokers and salesmen. If you have any comments on our recommendations, we would appreciate receiving them by January 17, 1983. Any comments we receive will be included as part of the final report which will be submitted to the Legislature.

Since the report is not in final form and changes may possibly be made to it, access to this report should be restricted solely to board members and those officials whom you might wish to call upon to assist you in your response. We request that you exercise controls over access to the report and ensure that the report will not be reproduced. Should you require additional copies, please contact our office. Public release of the report will be made solely by our office and only after the report is published in its final form.

We appreciate the assistance and cooperation extended to us.

Sincerely,

Clinton T. Tanimura  
Legislative Auditor

Enclosures

ATTACHMENT 2



GEORGE R. ARIYOSHI  
GOVERNOR

MARY G. F. BITTERMAN  
DIRECTOR

DICK H. OKAJI  
LICENSING ADMINISTRATOR

REAL ESTATE COMMISSION

STATE OF HAWAII  
PROFESSIONAL & VOCATIONAL LICENSING DIVISION  
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS

P. O. BOX 3469  
HONOLULU, HAWAII 96801

January 17, 1983

RECEIVED  
JAN 17 4 38 PM '83  
OFC. OF THE AUDITOR  
STATE OF HAWAII

Mr. Clinton T. Tanimura  
Legislative Auditor  
465 So. King St., Room 500  
Honolulu, HI 96813

SUBJECT: Sunset Evaluation  
Real Estate Brokers & Salesmen - Chapter 467, Hawaii  
Revised Statutes

Dear Mr. Tanimura:

In response to your recent preliminary draft on the Sunset Evaluation Report, Real Estate Brokers and Salesmen, Chapter 467, Hawaii Revised Statutes (HRS), we submit the following comments. Our comments will follow the recommendations that were contained in the evaluation.

General Comments in response to the Summary of Findings on page 3-1 of the report:

1. We concur that Chapter 467, HRS, should continue in force and effect in order to protect the public from incompetent or unscrupulous acts of real estate salesmen or brokers.
2. We agree that some of our rules may need either revision, specific legislative authorization or deletion based on your comments. It should be noted, however, that some of the recommendations contradict each other, as will be pointed out in our detailed comments.
3. We concur that a strong case management system is needed to handle complaints against real estate licenses. Such a system is being developed by the Regulated Industries Complaints Office, which started to handle real estate complaints in November, 1982.
4. The comments about the recovery and education funds are not entirely in line with what we perceive to be the future of both of these funds.



Mr. Clinton T. Tanimura  
January 17, 1983  
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Specific Comments:

On pages 3-23 and 3-24 there is a list of thirteen recommendations. We would like to comment on them individually, and the Department of Commerce and Consumer Affairs may wish to additionally comment on those items that directly affect its licensing activities.

1. Chapter 467, HRS, be reenacted to continue the licensing of real estate salespersons and brokers.

Comment: We agree.

2. The Commission cease regulating those activities for which there is no demonstrated need, that is, the licensing of branch and site offices and regulation of business names.

Comment: (a) Licensing of branch and site offices. The licensing of branch and site offices is nothing new to the Hawaii Real Estate Commission nor to other states. In your report you cite the need to pinpoint responsibility for branch and site offices and suggest that these firms "register" with the Commission the location of all branch and site offices and the names of the licensed individual brokers.

We have had problems in the past with a branch office having no broker-in-charge - principally, an Oahu broker who opens a branch office on one of the neighbor islands and periodically "flies" in to check on the sales staff. There is no responsible broker available to assist the licensee or public in resolving a question or problem about real estate on a particular real estate transaction.

The problem of a "site office" has been that over a period of time the office which was initially opened to handle sales of a particular project has, in fact, with the passage of time and practice, become a "branch office" and a definite place of business which may not necessarily conform to local zoning requirements. Thus, sales agents handled resales, rentals and listings for other real estate out of the site office.

By definition, a site office is to be used for real estate acts relative to a specific real property, condominium project or subdivision. Furthermore, the site office must be situated on or adjacent to the specific property, condominium project or subdivision. The report overlooks a very important aspect of a site office operation under current rules, a branch office requires a "broker-in-charge", a site office does not. Thus, a salesman unsupervised by a licensed broker, could be operating the site office for a real estate firm. The suggestion could be interpreted that you are requiring a licensed broker for a site office to register with the Commission. This could cause an unnecessary



Mr. Clinton T. Tanimura  
January 17, 1983  
Page 3

burden and the cost to a real estate firm to hire a broker for a "site office" which is temporary in nature. All that is required under current rules for a site office is that they register with the Commission and that the registration is good for a 6-month period and may be renewed upon application. We do not issue a "site office" license. Our concern is to make sure a site office doesn't become a permanent place of business.

Basically, we license a branch office and register a site office. It is a question of semantics, and we feel that we should continue this practice and suggest that we go to the legislature and obtain their authorization in order to continue this practice.

(b) Regulation of business names. Since the Business Registration Division (BREG) processes corporate and trade names, we have by and large let this become a staff function. The only reason we get involved is to insure that the name, if it reflects the name of a natural person, is licensed as a broker. We do this to insure that the consumer is assured that the person whose name is in "lights" is licensed. Basically, it's truth in advertising. If a well known entertainer suddenly decided to sell his name to a real estate firm, and he had no affiliation, it's safe to assume the public would be deceived with that form of representation.

With the exception stated above, we concur that the regulation of names should be handled by BREG. In order to eliminate the problems relating to names, we suggest that there should be better coordination between BREG and the Professional & Vocational Licensing Division (PVL). One alternative would be to require applicants to clear the name with BREG and PVL concurrently before BREG processes the paperwork.

In addition, we are hoping the Department of Commerce and Consumer Affairs' efforts to computerize a major portion of the recordkeeping and processing for PVL will minimize the problems associated with the clearance of business names.

3. Chapter 467, HRS, be amended to remove licensing requirements relating to residency, good moral character and insanity, and the application form be amended to remove the question on criminal convictions.

(a) Good moral character, insanity, criminal convictions.

Comment: We concur with the suggestions relating to good moral character and insanity and will take the necessary steps to determine a policy in obtaining the previous criminal history of an applicant.



It should be pointed out that PVL has deleted any question on insanity on the application for license form.

Attached is a proposed policy the Commission is taking under consideration. Exhibit 1.

(b) Residency. The Commission believes that a residency requirement should be maintained. To further implement the requirement, the Commission is considering the test for residency set forth in the Attorney General's opinion (copy attached as Exhibit 2).

The Commission will explore other means to implement the residency requirement by investigating residency requirements for attorneys and the University of Hawaii.

Residency, the Commission feels, is important because of the nature of the real estate business. To establish a business does not require substantial capital investment. A person could fly to Hawaii, take the examination, obtain a license, receive thousands of dollars in earnest money deposits and skip town in a matter of a few months. A good case in point could be the sale of time share interests by a foreign or mainland developer.

4. The Commission's rules be amended to remove the requirement for 10 transactions to qualify for a broker's license and to establish experience waiver standards that are more equitable.

Comment: (a) Ten transaction rule. This rule was adopted in 1982, in an effort to clarify Section 467-9.5(4), HRS. The ten transactions are evidence that an applicant for a broker's license has had at least two years of full-time experience as a licensed Hawaii salesman. The Commission feels that the actual experience gained is a more useful measurement than mere reliance on forty hours a week.

The Commission has been concerned with how we are to determine if an applicant meets the two-year experience criteria when a salesman who is an "independent contractor" files an application and there is no evidence from the principal broker to show that the salesman has been engaged in real estate on a full-time basis for at least two years.

There have been instances where a broker has certified that a salesman has had no sales, leases, rentals, or commissions, but has worked "full-time" in real estate. Other instances involve an applicant stating he has had a 40-hour a week full-time job and is working full time in real estate, another 40 hours a week, and for that additional 40 hours, he has virtually no sales, leases, rentals or commissions.



In previous years, a statement was required from the principal broker or broker-in-charge attesting to the fact that the individual has met the criteria, and it could be checked. With the advent of the "independent contractor" status, the broker is no longer required to keep those records on his salesmen or broker-salesmen.

The Commission believes the ten transactions rule is an essential part of carrying out its statutory mandate to ensure that persons who receive a broker's license have at least two years experience as a real estate salesman as required by Section 467-9.5(4), HRS.

The Commission adopted this rule after much discussion and through the rule-making process. We feel that because an individual with a broker's license can operate on his own and can have salesmen and broker-salesmen working under him, experience in Hawaii real estate is important. We informally reviewed complaints against our licensees and believe that one of the reasons for most of the complaints is licensee inexperience. We have now begun a formal study of the complaints against our licensees for the last five years.

(b) Experience requirement. For years, the Commission had an informal policy with respect to the experience requirement and waivers for that requirement. We adopted this rule in 1982 after eight years of discussion and subsequent public hearing. We are now in the process of reviewing all of our rules for a hearing in 1983. We will consider the comments by the auditor to eliminate the inequities that may exist in the rules relating to waiver of the experience requirement.

5. The Commission's rules on reexamination for delinquent and suspended licensees be repealed.

(a) Delinquent (forfeited) licenses. Section 467-11, HRS, provides that when a license is forfeited, which occurs when the biennial renewal fees are not paid, the license "may" be restored upon application. The rule which has been in existence since 1974, required the payment of the biennial renewal fee, along with a penalty fee for restoration if application was within two years of forfeiture. If application was after two years, the Commission had the option of requiring the applicant to retake the examination. This was based on the applicant's job activities during the period of forfeiture, i.e., if he was still affiliated with real estate and was aware of the various changes in the laws, etc. The Commission feels that reexamination as a condition to reinstatement helps ensure that individuals who have forfeited their licenses have retained at least entry-level skills before being reinstated.



(b) Exemption for military and political office. The Commission felt the sensitivity or nature of these positions required special consideration. Your comments with respect to this rule will be considered in our review of our rules.

6. The Commission amend its rules on late applications by permitting applicants to apply for licenses within two years of passing the written examination without having to retake the examination.

Comment: 90-day time limit for applications. The problem of late applications has been an administrative nightmare.

At first, there was no limit on when an applicant who successfully passed the licensing examination had to apply for his license. Thus, a person who passed the examination could apply for a license five years later.

The no limit policy was changed to a one-year rule. It is the Commission's understanding that the one-year requirement was originally requested by the Department to alleviate paperwork and recordkeeping. The one-year rule required that applicants who successfully passed the licensing examination apply for a license within one year from the date of the examination.

The one-year rule was recently changed to the present 90-day rule. With all the effort a person put into taking the examination, the 90-day period was introduced to eliminate the problem of the applicant forgetting to apply for a license within a specified time.

The Commission also believes the 90-day rule is more in line with our rule permitting reexamination as a condition to reinstatement of a forfeited license than either a one-year rule or a two-year rule.

Under a one-year rule, a new applicant would have up to three years from the time he completed the required real estate course (two years to take the examination and one year from the date of the examination to apply for a license) while a licensee who forfeited his license had two years from the time he forfeited his license to reinstate his license without reexamination.

Under the 90-day rule, a new applicant has two years and three months from the time he completed the required real estate course (two years to take the examination and 90 days from the date of the examination to apply for a license) while a licensee who forfeited his license had two years from the time he forfeited his license to reinstate his license without reexamination.

If the legislature feels that a statutory amendment is required for the filing of a license application, the Commission will seek such legislation. However, with the overriding concern being that of licensee competency and consumer protection, the Commission is hesitant with accepting the two-year guideline proposed by the auditor.



7. Chapter 467, HRS, be amended to repeal the provisions relating to the inactive licensing category and the Commission's rules be amended to allow licensees to become inactive upon written request and to provide for restoration of licenses upon application, payment of fees, and fulfillment of licensing renewal requirements.

Comment: Inactive licenses. This category of license has been the "safe harbor" for those who for numerous reasons, such as a job situation and the conflict that they would have with an active license cannot hold an active license. We understand that other states, most recently California, have removed the inactive license category and we will seek their comments in coming up with our recommendations.

It should be noted that the Commission has looked at the possibility of requiring education for those licensees who were inactive for a period of time.

However, to require this would require a legislative change and consideration should also be given to requiring the same for active licensees. We are in the process of reviewing this possibility as it is one of the items in our five-year educational plan. (Copy of Education Plan is attached as Exhibit 3.)

Prior to acting on this recommendation, it is hoped that we will be able to complete our review and provide the legislature a comprehensive report on this subject.

8. The Commission amend its rules on the restoration of forfeited licenses by deleting those conditions which go beyond the statutory requirements of a written application and payment of appropriate fees and penalty.

Comment: We believe that a standard policy should be adopted for suspensions and restorations by the legislature and implemented through rules that would provide a cut-off period when a person with suspended license or a person requesting restoration has to apply.

However, we will still consider some form of re-education in order to protect the consumer from licensees who have not kept up with the real estate practices and principles.

9. The Department of Commerce and Consumer Affairs institute an efficient and effective case management system for the handling of real estate complaint cases with emphasis on developing policies and procedures and the proper training of the investigative staff.

Comment: We concur and have discussed this program with RICO prior to their taking over our complaint function in November, 1982.



10. As part of an effort to strengthen consumer protection, the Commission consider developing a residential property transfer code.

The Commission would welcome the opportunity to explore the development of a residential property transfer code. However, the Commission would ask the Auditor to clarify what is intended by this recommendation since this is the first time such a code has been mentioned to the Commission.

The Commission does agree with the general intent to establish standards of practice for property transfers; not just residential but all types of property, including timesharing rental and leasing activities. We already have started to look at a Code of Ethics and Professional Conduct - in particular, California (see Exhibit 4).

We believe that a thorough review of this subject might be undertaken, and if the legislature concurs, a Resolution requesting such a study would be welcomed.

11. Chapter 467, HRS, be amended to liberalize access to the recovery fund by removing the limit of \$40,000 per licensee and by raising the limit of \$10,000 per injury to \$20,000 and finally, by allowing access to the fund for injuries caused by any act of a licensee instead of limiting it to grounds of fraud, misrepresentation, and deceit.

Comment: The proposal to remove the limit of \$40,000 per licensee - and replacing it with no limit - could bankrupt the fund. A case in point is the case mentioned in the report, International Syndications whose total claims amounted in 1974-75 to \$560,000. That was only one firm selling an undivided interest in land. There are other cases, such as the Hawaii-Nevada case which involved limited partnership sales, that could result in a substantial drain on the fund. (see enclosed newspaper article on Hawaii/Nevada. Exhibit 5.)

The Commission would like to point out that the original limit was \$20,000 which was raised to \$40,000 in 1977, (S.L.H. 1977, c. 197). The Commission would agree to raise the limit to \$50,000 per licensee. This would be in line with the guideline established by the Auditor (p. 3-21 of preliminary draft) in increasing the limit per injury (from \$10,000 to \$20,000).

To expand the fund to cover "negligent" acts of the licensee is another positive suggestion the Commission will consider.

Before a no limit policy is adopted, it is suggested that (1) the \$10,000 per injury be raised to \$20,000; (2) a Code of Ethics and Professional Conduct be developed so we have a measure of "incompetence" (see recommendation and comment #10); and (3) the possibility of mandating and providing for Errors and Omissions Insurance for Licensees be investigated. This could be



put out to bid by the Real Estate Commission, payable by the licensees via the recovery fund or by a special assessment. This would lessen the civil type of complaints. There would have to be a deductible to the licensee. If this insurance was not available on the open market, a panel similar to the medical claims conciliation panel could be established. The requirement to have this type of insurance would be a prerequisite for licensing similar to the requirement of a contractor having workers' compensation, liability insurance and a bond in order to retain an active license. (S.L.H. 1982, c. 175) This could afford the consumer added protection. Again, if the legislature concurs, we would be willing to explore the option.

The report faults the Commission for not keeping records on the status of cases filed against the recovery fund. The Commission does keep a log of cases where the claimant's attorney has served a copy of the complaint on the Commission. The case is on pending status until such time as the claimant's attorney or the recovery fund attorney notifies the Commission of the disposition of the case.

12. The department suspend the collection of fees for the real estate recovery fund until such time as it reaches the minimum balance of \$150,000.

Comment. This recommendation cannot be reconciled with Recommendation Eleven. In Recommendation Eleven, we are asked to abandon any restriction relating to the grounds for recovery or the amount of recovery against a licensee from the Recovery Fund. In Recommendation Twelve, we are asked to suspend collection of fees for the Recovery Fund until the amount in the fund decreases to \$150,000. As previously stated, without limits on recovery from the fund, one recovery fund case could cause severe financial problems for the fund.

In fiscal 1981-82, there were approximately 2,500 new licensees and about \$125,000 contributed to the Recovery Fund. With the number of licensees decreasing and timesharing sales activity being covered by the Recovery Fund, we do not see the build up of income as a problem especially if we increase the limit per incident to \$20,000 and the limit per licensee to \$50,000.

13. Chapter 467, HRS, be amended to provide that interest earned on the recovery fund accrues to the recovery fund rather than the education fund.

Comment: Currently, the education fund has two sources of revenue:

- (1) interest from the recovery fund; and
- (2) \$10.00 of every original license application and license renewal (\$5.00 per year)



Mr. Clinton T. Tanimura  
January 17, 1983  
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We believe that with the adoption of a five-year educational plan, it is premature to start reducing the funds placed in the education fund. One of the proposals in our five-year plan could require a substantial amount of startup costs and a higher level of funding by all licensees. This is a "Real Estate Research Center" similar in scope to the Texas Real Estate Research Center or comparable locally to our Legislative Reference Bureau (see Exhibit 6). We are in the process of conducting a study on this subject and hope that before July 1983, the study will be completed. Any changes in funding should be deferred until we have had the opportunity to implement our five-year educational plan.

#### Conclusion:

The Real Estate Commission appreciates the support the auditor has given to our basic mission as well as the recommendations for improvement.

While your report cites the need to continue to license salesmen and brokers for the protection of the consumer and suggests some changes in the rules, etc., the report fails to mention some of the biggest problems the Commission has, which was pointed out in a January 1981 report prepared by the Social Science Research Institute, University of Hawaii, entitled "An Examination of the Administration of Real Estate Regulatory Functions in Hawaii". (See recommendations enclosed Exhibit 7).

This report, was funded by the Education Fund in response to S.R. 166, S.D. 1 (1980) and points out that the department needs additional staffing and computerizing of the Professional & Vocational Licensing Division. With over 23,000 real estate licensees we see the need for computerization to resolve the unnecessary delays that are caused by the "mass of paperwork".

The questions of organization, adequate staffing, and legal counsel are other items cited in our report but not mentioned in yours. Perhaps those questions relating to the rules would not be there if we had adequate legal support.

In closing, we appreciate the opportunity this report gave us to clarify our position. In addition your report gave us "fuel" to continue our activities in developing a code of ethics and Professional Conduct Code as well as the opportunity to consider expanding the Recovery Fund to cover all acts of a licensee perhaps by providing mandatory Errors & Omissions insurance.

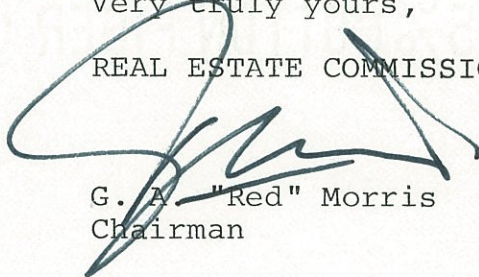


Mr. Clinton T. Tanimura  
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Mahalo for your consideration of our comments.

Very truly yours,

REAL ESTATE COMMISSION

A large, stylized handwritten signature in dark ink, likely belonging to G. A. 'Red' Morris, is written over the typed name and title.

G. A. "Red" Morris  
Chairman

Members:

Edwin Shiroma, Vice Chairman, Oahu Member  
Toru Kawakami, Kauai Member  
Ralph Yagi, Maui Member  
Constance Smales, Public Member  
Gloria Damron, Oahu Member  
Joseph F. Blanco, Oahu Member  
Gregg T. Yamanaka, Public Member



ATTACHMENT 3

GEORGE R. ARIYOSHI  
GOVERNOR



STATE OF HAWAII  
OFFICE OF THE DIRECTOR  
DEPARTMENT OF COMMERCE AND CONSUMER AFFAIRS  
1010 RICHARDS STREET  
P. O. BOX 541  
HONOLULU, HAWAII 96809

MARY G. F. BITTERMAN  
DIRECTOR  
Commissioner of Securities  
Bank Examiner

DONALD D.H. CHING  
DEPUTY DIRECTOR

January 17, 1983

The Honorable Clinton T. Tanimura  
Legislative Auditor  
State of Hawaii  
465 South King Street, Room 500  
Honolulu, Hawaii 96813

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OFC. OF THE AUDITOR  
STATE OF HAWAII

Dear Mr. Tanimura:

Thank you for the opportunity to comment on your sunset evaluation report on real estate brokers and salesmen.

The Department of Commerce and Consumer Affairs agrees with your comment that the most serious deficiency in the real estate regulatory program is the handling of consumer complaints against licensees. As stated in your report, the Legislature's passage of Act 60, 1982 Session Laws of Hawaii, and the centralization of the investigation and prosecution of complaints in the Regulated Industries Complaints Office is designed to clear up the backlog of cases.

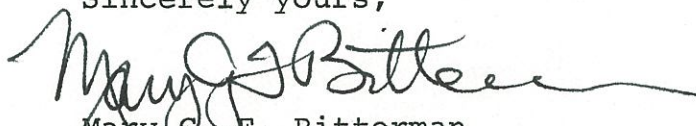
Even though it is still too early to evaluate the effectiveness of these measures significant results have already been recorded. Out of the over three hundred fifty backlogged cases transferred to the new office, over thirty-five have been closed and over sixty set for hearing within the past three months. With the continued diligent work of the office, all new consumer complaints will be processed on a real time basis significantly shorter than that which existed under the old system (See Attachment A).

The Regulated Industries Complaints Office has already begun to formalize its case management system. Policies on assigning priority to certain types of cases and settlement criteria are being devised. Training programs, manuals of operating and investigation procedures, master logging

The Honorable Clinton T. Tanimura  
Legislative Auditor  
State of Hawaii  
January 17, 1983  
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system, and real estate education programs are also being developed. It is the office's intention to finalize all policies, procedures, and manuals within the year.

Sincerely yours,

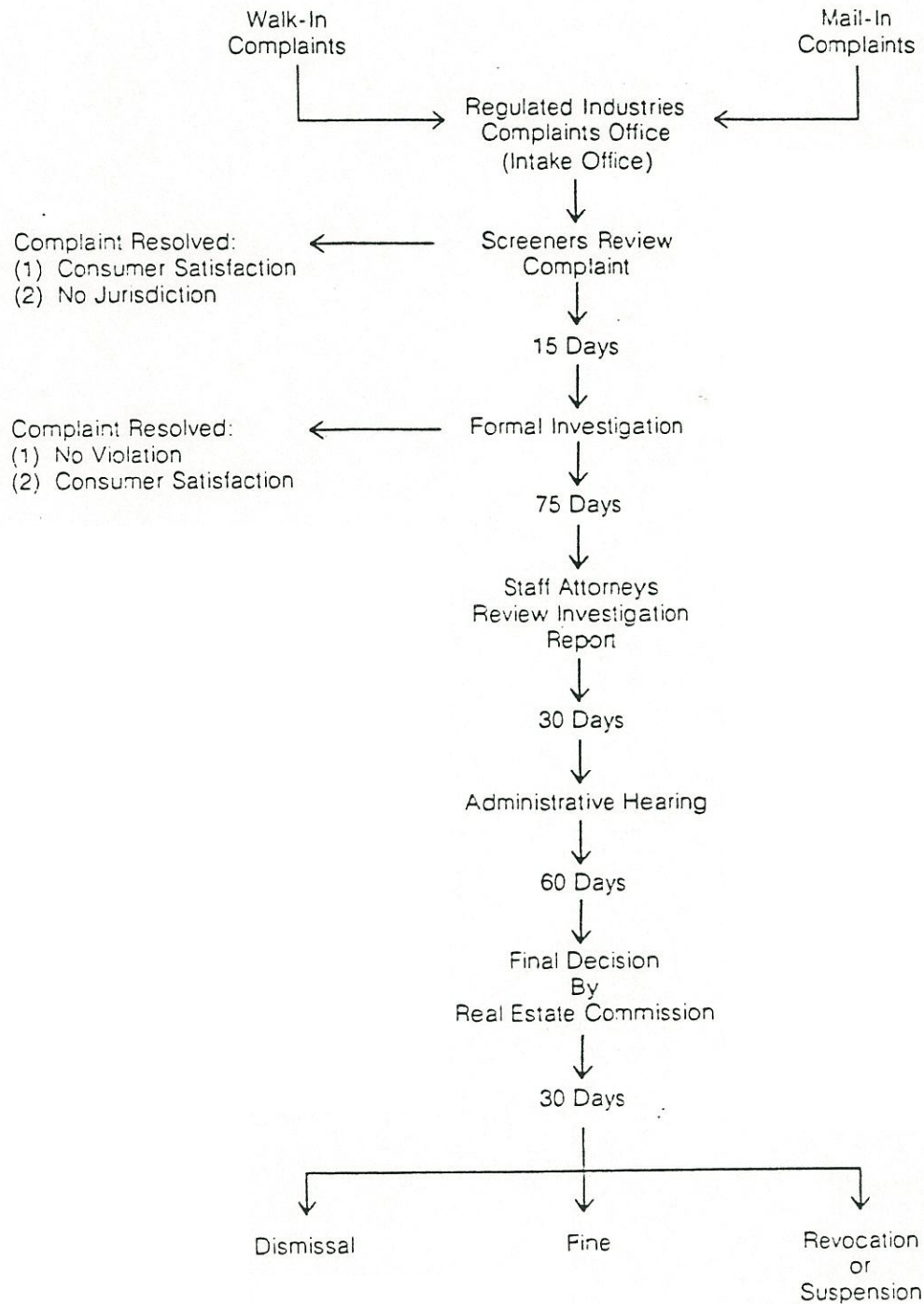


Mary G. F. Bitterman  
Director

Attachment



NEW COMPLAINT RESOLUTION FLOWCHART  
(effective November 8, 1982)



ATTACHMENT A