

DEPARTMENT OF BOATING AND WATERWAYS

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Information Letter

Date: ***June 27, 2001***

TO: ***Licensed Yacht and Ship Brokers***

FROM: ***Dave Trillo, Associate Boating Administrator***
Eddie Chavez, Associate Boating Administrator

SUBJECTS: ***1) Questions from the industry, 2) General documents requested during an inspection, 3) Inspection results, and 4) New facsimile number.***

Questions from the Industry:

In the Department's previous information letter dated October 27, 2000, the Department summarized the new laws that were signed by the Governor and became effective January 1, 2001. The publication of that letter prompted several questions from the brokerage industry concerning the new law changes. Therefore, below is the Department's response to those questions.

1. AB 2119 (effective January 1, 2001) amended Harbors and Navigation Code ("Code")¹ section 719 to add an additional prerequisite for a broker's license under the Yacht and Shipbrokers Act ("Act"):

¹ All references are to the Harbors and Navigation Code unless otherwise indicated.

(a) A person shall be deemed qualified to submit an application for a broker's license if, as shown on the department's records, the person meets all of the following requirements:

...(2) Has not been cited for a violation of this article within the preceding two years.

This prerequisite will apply to salespersons and unlicensed persons who apply for a broker's license. The Department will have to determine whether the applicant was "cited" for a violation of the Act within two years of the date of the application.

QUESTION:

What constitutes a "citation" by the Department?

ANSWER:

Neither the term "cited" nor "citation" are defined in the Act nor do they appear elsewhere in the Act. However, Black's Legal Dictionary, Sixth Edition, defines "citation" as:

A writ issued out of a court of competent jurisdiction, commanding a person therein named to appear on a day named and do something therein mentioned, or show cause why he [sic] should not.

It is also:

An order, issued by the police, to appear before a magistrate or judge at a later date.

In the context of yacht and shipbroker cases, the citation would typically be an accusation issued under Government Code Section 11503 or a statement of issues issued under Government Code Section 11504, or an agency pleading issued under Government Code Section 11415.60(b). An accusation is issued when the Department proposes to suspend or revoke a person's license and a statement of issues is issued when the Department proposes to deny a person's license; an agency pleading under Government Code Section 11415.60(b) is issued prior to entering into a settlement agreement when the issue in an adjudicative proceeding is the revoking, suspending, limiting or conditioning of an occupational license. All three arise in connection with quasi-adjudicative actions under the Administrative Procedure Act.

Harbors and Navigation Code Section 719(a)(2) would typically apply when a licensed salesperson applies for a broker's license, or an unlicensed person does so. In the case of a licensed salesperson, the Department would look at whether the Department had caused an accusation to be issued within the previous two years in an attempt to adversely affect the applicant's salesperson's license because of a violation of the Yacht and Shipbroker's Act. In the case of an unlicensed person, the Department would review whether it had caused a statement of issues to be issued within the previous two years in an action to deny a person a license because of a violation of the Yacht and Shipbroker's Act. In both cases, the Department would also review its records to see whether it had issued a pleading within the past two years prior to entering into a settlement agreement in connection with a violation of the Act.

"Citations" would also include writs issued by a court within the previous two years in connection with civil or criminal cases for conduct on the part of the applicant in violation of the Yacht and Shipbroker's Act.

It is important to note, in this context, that letters of warning issued by the Department would not constitute "citations" for purposes of denying a brokers' license under Section 719(a)(2). The Department often utilizes letters of warning as an educational tool in connection with minor technical violations and does not consider that they rise to the level of a "citation" for purposes of denying licensing under Section 719(a)(2).

2. SB 1967 added three new subsections to Harbors and Navigation Code section 732, authorizing the Department to suspend or revoke a license where a broker or salesperson:

... (k) *Demonstrates negligence or incompetence in performing any act for which he or she is required to hold a license.*

... (l) *As a broker licensee, fails to exercise reasonable supervision over the activities of his or her salespersons, or, as the person designated by a corporate or partnership*

licensee, fails to exercise reasonable supervision and control over the activities of the corporation or partnership for which a yacht and ship broker's license is required.

... (m) *Fails to act in accordance with, or disregards, his or her fiduciary duty toward a principal.*

QUESTION:

What is the legal definition of the underlined terms and how does it apply to the Yacht and Ship Broker industry?

ANSWER:

To correctly implement the new subsections, we must first ensure that we understand their meaning. In determining the meaning of any statute, we must discern the intent of the Legislature when it enacted the statute. To determine legislative intent, we first look at the words of the statute, giving them their usual and ordinary meaning. (*Kimmel v. Goland* (1990) 51 Cal.3d 202, 208.)

A. Fiduciary Duty

The ordinary meaning of a statutory term may be derived simply by consulting the dictionary, which provides the following definition of "fiduciary duty":

A very broad term embracing both technical fiduciary relations and those informal relations which exist when one person trusts in or relies upon another.

(Black's Law Dict. rev. 6th ed. (1990), p. 626.) The ordinary meaning of a statutory term may also be derived from relevant case law. (*People v. Curtis* (1969) 70 Cal.2d 347, 355.) Under California case law, a fiduciary relationship is formed whenever trust and confidence is reposed by one person in the integrity and fidelity of another. (*Estate of Cover* (1922) 188 Cal. 133, 143; *Nicholson v. Rose* (1980) 106 Cal.App.3d 457, 462; *Pierce v. Lyman* (1991) 1 Cal.App.4th 1093, 1101-1102.).² Thus, a fiduciary relationship is formed when a client signs a listing agreement as required under section 716 and in encompassed in any act for which a license is required.

Case law has defined the various aspects of fiduciary duty in detail, and we may rely upon these cases in implementing section 732(m). This includes case law regarding a trustee's duties towards a beneficiary under a trust agreement, because California law equates the fiduciary duties of a trustee with those of an agent. (Civ. Code sec. 2333(c); *Webb v. Saunders* (1947) 79 Cal.App.2d 732.) Real estate case law dealing with fiduciary duty is particularly pertinent, because the Act was derived from the Real Estate Law, and because the structure and practices of the real estate industry closely parallel the yacht and shipbroker industry.

There are two general duties of a fiduciary, which are summarized below. Citations are to real estate case law in which the duty is discussed:

² Throughout the Act, the term "principal" is used to refer to a broker's client. California law defines a "principal" as one who is represented by an "agent" in dealings with third persons. (Civil Code sec. 2295.) An agent stands in a fiduciary relationship with his or her principal. (*Michelson v. Hamada* (1994) 29 Cal.App. 4th 1566; *Kennard v. Glick* (1960) 183 Cal.App.2d 246.)

- Duty of loyalty. A broker must act in good faith and in the best interests of the principal. The broker must be honest and truthful. The broker may not represent or benefit from interests adverse to his principal. (*Rezos v. Zahm* (1926) 78 Cal.App. 728; *Burch v. Argus Properties, Inc.* (1979) 92 Cal.App.3d 128, 131.) This includes deriving a personal benefit from the broker-client relationship or helping another to derive personal benefit from the broker-client relationship.
- Duty of care and diligence. A broker is obligated to exercise reasonable skill and care in the performance of his or her duties. Brokers are subject to the standard of care that would be exercised by a reasonably prudent broker acting in a similar capacity. (*Wilson v. Hisey* (1957) 147 Cal.App.2d 433, 438.) (See below for further discussion of breach of the duty of care or *negligence*.)

The following are specific duties that derive from the three general duties discussed above. Again, citations are generally to real estate cases:

- Duty to investigate and disclose material facts which might affect the principal's decision. A buyer's agent has a fiduciary duty to disclose material information to the buyer so that the buyer may make an informed decision. This duty derives both from the duty of loyalty and the duty of care. It may require the broker to investigate facts not known to him/her. (*Field v. Century 21 Klowden-Forness Realty* (1998) 63 Cal.App.4th 18, 25-26.)
- Duty to disclose a relationship with another party. This is necessary to avoid a conflict of interest and thus breach of the duty of loyalty. A seller's broker must disclose any relationship with a buyer even if the broker has no financial interest in the buyer or the transaction (other than right to commission). (*Smith v. Zak* (1971) 20 Cal.App.3d 785, 794-795.) Thus, a broker may not represent both a buyer and seller without full disclosure and consent from both the buyer and seller.
- Duty to disclose self-interested transaction. As with dual representation, this is necessary to avoid a conflict of interests and thus breach of the duty of loyalty. Where the broker has an economic interest in a transaction, he or she may not proceed unless the conflict is disclosed fully to the client and the client consents. In the context of trust law, this concept is referred to as the prohibition against "self-dealing" or "secret profits."³ (*Van de Kamp v. Bank of America* (1988), 204 Cal.App.3d 819.)

³ The prohibition against self-dealing also is reflected in the requirements of section 714, which designates a broker as the trustee for any funds provided by any person in connection with a transaction for which a license is required. The broker may only use the funds entrusted as authorized by the person providing the funds and may not derive any profit from the funds without full disclosure and consent.

Some of the above duties are now contained in two or more provisions of the Act. In fact, the Act prior to the SB 1967 amendments already incorporated many of the above duties, consistent with the fiduciary duty relationship between broker and client. For example, a breach of the duty of care and diligence would constitute both a violation of

section 732(m) (breach of fiduciary duty) and section 732(k) (negligence). Similarly, a broker who represents both buyer and seller without disclosing the dual representation and obtaining consent from both parties would be in violation of both section 732(m) (breach of fiduciary duty) and section 732(d). The Act requires a person to demonstrate through the written licensing examination "a general understanding of the obligations between principal and agent, and of the fiduciary relationship between them..." (section 721(a)(7).)

B. Negligence

In the discussion of fiduciary duty above, we noted that a broker owes a client a duty to act with care and diligence in handling any transaction within the scope of the Act. Breach of the duty of care and diligence is negligence, which is a separate ground for discipline under section 732(k).

Negligence is a broad term that is well-defined under California case law. The California Supreme Court recently discussed negligence by professionals such as yacht brokers in *Delaney v. Baker* ((1999) 20 Cal.4th 23):

General "negligence" is the failure "to exercise the care a person of ordinary prudence would exercise under the circumstances." (*Flowers v. Torrance Memorial Hospital Medical Center* (1994) 8 Cal.4th 992, fn. omitted.) "Professional negligence" is one type of negligence, to which general negligence principles apply. "With respect to professionals, their specialized education and training do not serve to impose an increased duty of care but rather are considered additional 'circumstances' relevant to an overall assessment of what constitutes 'ordinary prudence' in a particular situation. Thus, the standard for professionals is articulated in terms of exercising 'the knowledge, skill and care ordinarily possessed and employed by members of the profession in good standing....' " (*Id.* at pp. 997-998.)

We may rely on the above general expression of professional negligence in implementing section 732(k). Thus, a yacht or shipbroker is negligent with respect to his or her client when he or she fails to exercise the knowledge, skill and care ordinarily possessed and employed by brokers in good standing. Similarly, a salesperson is negligent with respect to his or her client when he or she fails to exercise the knowledge, skill and care ordinarily possessed and employed by salespersons in good standing.

General California case law on negligence also holds that the degree of care and skill required

to fulfill a professional duty of care is a question of fact that usually requires the opinion of other professionals in the field. Thus, the Department will require the expertise of brokers or salespersons in investigating complaints of negligence under the Act.

C. Incompetence

New section 732(k) authorizes the Department to discipline a licensee for either "negligence or incompetence." It was modeled after Business and Professions Codes section 10177(g) (Real Estate Law), which authorizes the Department of Real Estate ("DRE") to discipline a real estate broker for "negligence or incompetence in performing any act for which he or she is required to hold a license." As stated above, in determining legislative intent, we first look at the words of the statute, giving them their usual and ordinary meaning. Black's Law Dictionary defines incompetence as "lack of ability, knowledge, legal qualification or fitness to discharge the required duty or professional obligation." (Black's Law Dict. rev. 6th ed. (1990), p. 765.) California cases addressing a variety of factual contexts has defined the term similarly to mean "an absence of qualification, ability or fitness to perform a prescribed duty or function." One court has held that this general definition is consistent with objectives of consumer protection in professional licensing statutes. (*Pollack v. Kinder* (1978) 85 Cal.App.3d 833, 837.)

However, it has also been held that a licensing body may not simply enforce this general definition of incompetence without detailing the exact duty or function that is prescribed. (*Wheeler v. State Board of Forestry* (1983) 144 Cal.App.3d 522, 526.)⁴ To do otherwise risks violating the due process rights of the alleged violator to notice of the standards by which conduct is to be measured. (See *Button v. Board of Administration* (1981) 122 Cal.App.3d 730, 738-739.) This right is reflected in the Administrative Procedure Act, which requires that an accusation specify "the statutes and rules which the respondent is alleged to have violated." (Gov. Code sec. 11503.)

The Department commonly receives complaints of negligence (i.e. failure to exercise the knowledge, skill and care ordinarily possessed and employed by brokers in good standing), because most complaints are triggered by a certain act or failure to act on the part of a broker or salesperson. Will the Department ever have the occasion to discipline for incompetence where it does not also discipline for negligence? The Department has spoken with the Attorney General's Office on this issue, at which time they indicated that the charge of incompetence does not occur frequently and usually comes up in the context of a charge of negligence.

The Department of Real Estate ("DRE") likewise has not had the occasion to bring charges

⁴ The Court of Appeal held that Board of Forestry could not enforce a violation against forester for "gross incompetence" under Public Resources Code section 778(b), where it did not define the required standard through statute, rule, regulation or other evidence.

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of incompetence separate from negligence against real estate brokers. Again, this is simply because complaints to the DRE allege specific acts of negligence. Thus, DRE has not enacted a definitional regulation for incompetence and instead has equated it with negligence in its enforcement program.

Thus, from a practical standpoint, it is likely adequate from an enforcement standpoint to equate negligence and incompetence under section 732(k). This is reasonable given that a failure to exercise required qualifications also implies the failure to possess such qualifications.

D. Reasonable Supervision

New subsection 732(l) was modeled on Business and Professions Code section 10177(h) (Real Estate Law), which authorizes the Department of Real Estate ("DRE") to suspend or revoke the license of a real estate broker who:

failed to exercise reasonable supervision over the activities of his or her salespersons, or, as the officer designated by a corporate broker licensee, failed to exercise reasonable supervision and control of the activities of the corporation for which a real estate license is required.

As discussed above, the usual and ordinary meaning of a word in statute may be discerned from the dictionary, which in this case defines "supervise" as "to have general oversight over, to superintend or inspect." (Blacks Law. Dict. rev. 6th ed. (1990), p. 1438.) Thus, subsection 732(l) imposes a duty on the part of the yacht and ship broker to take affirmative steps to ensure that salespersons and corporate employees engaging in activities for which a license is required comply with the Act.

Real estate case law interpreting Business and Professions Code section 10177(h) supports this definition of supervision. In *Grand v. Griesinger*, (1958) 160 Cal.App.2d 397, the court examined the relationship between a sponsoring broker and his or her salesperson in the context of Business and Professions Code section 10177(h) and stated:

It is evident that brokers and salesmen belong in distinctly different categories and that the broker, because of his superior knowledge, experience and proven stability is authorized to deal with the public, contract with its members and collect money from them. The salesman, on the other hand, is strictly the agent of the broker. He cannot contract in his own name [citations], nor accept compensation from any person other than the broker under whom he is licensed.

(*Id.*, at 406.) The court concluded that the entire scheme of the Real Estate Law, including section 10177(h), "requires the broker actively to conduct his brokerage business and to supervise the activities of his salesmen." (*Id.*) Thus, the court indicated that the relationship between broker and salesperson requires the designated real estate broker to be reasonably charged with the brokerage's

responsibility to comply with the Real Estate Law.

These principles were set forth again in *Norman v. Department of Real Estate*, (1979) 93 Cal.App.3d 768, in the context of licensed broker who was the designated broker by the

corporate broker licensee:

Where a corporation is licensed by the Commissioner as a real estate broker, it is required that it appoint a similarly licensed individual as its "designated real estate broker." [citations]... Such a designated real estate broker must reasonably be charged with responsibility for the corporate compliance with the Real Estate Law, for otherwise with no such fixed responsibility, the statutory purpose would be frustrated.

(*Id.*, at 777.) Because the Act was modeled on the Real Estate Law due to the similarity in structure of the two industries, the Department may draw on these two cases to conclude that subsection 732(l) requires a yacht broker to take active measures to reasonably ensure the brokerage's compliance with the Act.

Therefore, in order for the broker to comply with Section 732(l), the broker should establish policies, rules, procedures and systems to review, oversee, inspect and manage:

- (a) Transactions requiring a Yacht and Ship Broker.
- (b) Documents which may have a material effect upon the rights or obligations of a party to the transaction.
- (c) Filing, storage and maintenance of such documents.
- (d) The handling of trust funds.
- (e) Advertising of any service for which a license is required.
- (f) Familiarizing salespersons with the requirements of federal and state laws relating to the prohibition of discrimination.
- (g) Regular and consistent reports of licensed activities of salespersons.

A broker may use the services of brokers and salespersons to assist in administering the provisions of this section so long as the broker does not relinquish overall responsibility for supervision of the acts of salespersons licensed to the broker.

General Documents Requested During an Inspection:

1. Licenses (i.e. broker, sales staff)
2. Broker-salesman relationship agreements
3. Written authorizations to sell
4. Written authorizations to purchase
5. Closing statements

- 6 . Trust Account (i.e. ledger, monthly bank statements, bank receipts, blank checks)

Inspection Results:

Recently, the Department has been conducting routine inspections throughout the State. We have discovered a pattern of mistakes that we believe warrants a reminder to the brokerage industry. Listed below are the discrepancies we have discovered:

- A. Failure to affix a licensee's signature to the closing statement(s) provided to the buyer and seller for the purchase of a vessel.

Section 715 of the Act states:

***After closing of transaction, duties.** Within one month after the closing of a transaction in which title to a yacht is conveyed from a seller to a purchaser through a licensed broker, the licensee shall provide, or cause to be provided to the seller and purchaser, a closing statement in writing of the selling price thereof, including all charges and credits which shall be itemized, and in the event an exchange of yachts is involved, the information shall include a description of the yachts and amount of added money consideration, if any. The licensee shall affix his or her signature to the closing statement to attest to the facts provided in the closing statement. If the transaction is closed through escrow and the escrow holder renders a closing statement which reveals the information, that shall be deemed compliance with this section on the part of the licensed broker.*

- B. Failure to provide an official number and home port of the vessel on the authorization to sell (listing agreement) and the offer to purchase if the vessel was documented with a federal agency.

Section 716(a) and (b) of the Act state:

***Transactions, written authorization required and copies.** (a) No broker shall engage in any transaction for which a license is required under this article without first obtaining a signed written authorization to do so from the broker's principal. An authorization to sell shall contain a description of the vessel, including the undocumented vessel's registration number or the name, official number, and home port if the vessel is documented with a federal agency. The written authorization shall also state the type of listing, the gross listing price, the agreed upon commission or other compensation of the broker, and any repairs authorized to be made.*

....(b) An offer to purchase shall contain the description of the yacht, including the undocumented vessel's registration number or the name, official number and home port if the vessel is documented with a federal agency. The written authorization to purchase

shall also state the amount of the deposit, terms of the sale, and any contingencies or conditions under which the deposit shall not be returned if the sale is not completed.

Recently, many have inquired as to the definition of “home port”. The home port of the vessel is where the documentation process of the vessel took place and where the records are kept. Prior to October 1995, there were several federal field offices located throughout the state that documented vessels. The “Certificate of Documentation” that the federal

agency provided to the owner prior to October 1995 specifically stated the “Home port” in the upper right hand corner of the document. However, after this date the federal agency consolidated their documentation offices into one office, which is currently known as the “National Vessel Documentation Center”, located in Falling Waters, West Virginia. Because all vessels have the same homeport as Falling Waters, West Virginia, so long as the vessel was documented on or about October 1995 to present, the “Certificate of Documentation” no longer lists the homeport. Instead it was replaced with the “Hailing port”, which is listed on the stern of the vessel underneath the vessel name. However, this procedural change by the federal agency does not exempt California brokers from the requirement to list the “home port” on the authorizations to sell or purchase.

Furthermore, if the broker lists the abbreviations for the National Vessel Documentation Center, “NVDC” as the home port of the vessel instead of Falling Waters, West Virginia, the Department will accept this as complying with Section 716(a) and (b) of the Act.

One final comment concerning Sections 716(a) and (b) (failure to provide a homeport). There have been concerns about how the Department has enforced these sections. The Department does not have the discretion to selectively choose which codes it wishes to enforce or “look the other way” when a licensee has failed to perform. The Department is mandated to enforce all sections of the Code. However, the Department does have the discretion in determining the severity of disciplinary action. We often hear violations of the Act described as “technical violations.” While there is no category of “technical” violations, as opposed to others, we view activities which might constitute a breach of fiduciary duty as substantive in nature, certainly more severe than errors or omissions on listing agreements.

- C. Failing to put a gross listing price on the authorization to sell (listing agreement). Instead, several brokers are listing the “Net to Owner” price on the authorization to sell. Please refer to Section 716(a) above to ensure compliance.

New Facsimile Number:

The Yacht and Ship Brokers Unit has a new facsimile number! If you choose to send documents related to your license to the Yacht and Ship Brokers Unit by facsimile, you must now dial (916) 263-1908.

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Please share this information with your staff and remember if you have misplaced any of the previously issued information letters, you can now get a copy via Internet at www.dbw.ca.gov