LORMAN®

Just Not Enough:

Court Deems Zillow's Co-Marketing Program to be Consistent with Real Estate Settlement Procedures Act of 1974

Prepared by:
Amir Shachmurove and Jason E. Manning
Troutman Sanders

Just Not Enough: Court Deems Zillow's Co-Marketing Program to be Consistent with Real Estate Settlement Procedures Act of 1974

By Amir Shachmurove & Jason E. Manning on November 5, 2018

In a recent decision dismissing a purported class action against Zillow Group, Inc., launched by disgruntled purchasers of the company's securities, the United States District Court for the Western District of Washington provided a remarkably thorough—and an eminently useful—distillation of the federal judiciary's emergent application of the Real Estate Settlement Procedures Act of 1974 ("RESPA") to today's increasingly popular co-marketing programs. To the many defendants potentially subject to this statute, this opinion offers a roadmap for minimizing their legal exposure and defeating liability.

Background

Program at Issue

To this day, Zillow generates the majority of its revenue through advertising sales to real estate professionals. With $150 million in cash in the winter of 2013, Zillow launched a new advertising product, a then-unique co-marketing program (herein referred to as "the Program"). This Program allows participating mortgage lenders to pay a percentage of a real estate agent's advertising costs directly to Zillow in exchange for appearing on the agent's listings and receiving some of the agent's leads. ("Leads" are created whenever a user views an agent's listing on Zillow and decides to send their contact information to the agent directly.) In return for this payment, the participating lenders appear on the co-marketing agent's listings as "preferred lenders," their picture and contact information appended. When a user chooses to provide an agent with their contact information, Zillow automatically dispatches their personal information to the co-marketing lender, unless the user affirmatively opts out. “Because users are able to opt out of sending their contact information,” the Court explained, “lenders receive, on average, 40% of the leads received by their co-marketing agents.”

Prior to 2017, an individual lender could pay up to 50% of a co-marketing agent’s advertising costs, and up to five lenders could collectively pay 90%. If a single lender co-marketed with an agent, that lender appeared on all of the agent’s listings. But when multiple lenders co-marketed with a single agent, each lender appeared randomly on the agent’s listings based on that lender’s pro-rata share of the agent’s overall advertising spend.

Relevant Law

RESPA focuses on consumers in the market for real estate “settlement services,” defined as encompassing “any service provided in connection with a real estate settlement, including, but not limited to” title searches, title insurance, attorney services, document preparation, credit reports, appraisals, property surveys, loan processing and underwriting, and the like. This statute aims to curtail the cost of real estate transactions by promoting the disclosure of “greater and more timely information on the nature and costs of the settlement process” and by protecting consumers from “unnecessarily high . . . charges caused by certain abusive practices.”

RESPA’s eighth section focuses on the elimination of kickbacks and unearned fees. Dealing with “business referrals,” Section 8(a), as codified in 12 U.S.C. § 2607(a), prohibits giving or accepting “any fee, kickback, or thing of value pursuant to any agreement or understanding, oral or otherwise, that business incident to or a part of a real estate settlement service involving a federally related mortgage loan shall be referred to any person.” Courts commonly find a violation of Section 8 when all of the following elements are present: (1) a payment or thing of value was exchanged, (2) pursuant to an agreement to refer settlement business, and (3) there was an actual referral. Section 8(b) further cabins liability under this provision: “No person shall give and no person shall accept any portion, split, or percentage of any charge made or received for the rendering of a real estate settlement service in connection with a transaction involving a federally related mortgage loan other than for services actually performed." This part of RESPA concludes with a safe harbor permitting "[a] payment to any person of a bona fide salary or compensation or other payment for goods or facilities actually furnished or for services actually performed."

Instant Case

Plaintiffs' Relevant Claims

In their amended complaint, Plaintiffs attacked the Program for violating RESPA's Section 8 in "two overarching ways." ***First***, they characterized the co-marketing program as an impermissible "vehicle to allow real estate agents to make illegal referrals to lenders in exchange for the lenders paying a portion of the agents' advertising costs to Zillow." As Plaintiffs' alleged, "Defendants created the co-marketing program to allow real estate agents to steer prospective home buyers to mortgage lenders, in exchange for the lenders paying a portion of the agent's advertising costs to Zillow." ***Second***, the Program, they insisted, "allow[ed] lenders to pay a portion of their agents' advertising costs that was in excess of the fair market value for the advertising services they actually receive." Either theory, if accepted, would have left Zillow exposed to liability under RESPA.

Court's Opinion

In trenchant prose, the Court found neither basis to be sufficiently pled under the heightened standard applicable to fraud claims.

The Court discerned no iota of legal or factual viability in Plaintiffs' first theory: "that the co-marketing program is per se illegal because it allowed agents to make referrals in exchange for lenders paying a portion of their advertising costs." Although Plaintiffs rested much of this theory on *PHH Corp. v. Consumer Fin. Prot. Bureau*, 839 F.3d 1 (D.C. Cir. 2016), the Court noted its rejection of the broad theory of RESPA liability espoused by the Consumer Financial Protection Bureau. Instead, as the Court stressed, the D.C. Circuit had "held that RESPA's safe harbor allows mortgage lenders to make referrals to third parties on the condition that they purchase services from the lender's affiliate, so long as the third party receives the services at a 'reasonable market value,'" an approach pioneered by the Ninth Circuit's *Geraci v. Homestreet Bank*, 347 F.3d 749 (9th Cir. 2003).

Under this precedent, the Complaint failed for three reasons. *First*, the Program, as depicted by Plaintiffs themselves, only "allows agents and lenders to jointly advertise their services without requiring agents to refer business to lenders." Because it does not "*explicitly* involve … the referral of mortgage insurance business in exchange for the purchase of re-insurance from the referring business," it falls beyond RESPA's purview. *Second*, the Complaint utterly lacked enough "particularized facts demonstrating that co-marketing agents were actually providing unlawful referrals to lenders. *Third*, even if "co-marketing agents were making mortgage referrals, such referrals would fall under the Section 8(c) safe harbor because lenders received advertising services in exchange for paying a portion of their agent's advertising costs."

Rather than a trio, one reason alone doomed Plaintiffs' second theory. To wit, despite "explain[ing] in detail how the . . . [P]rogram is structured," Plaintiffs had failed to allege, with the requisite specificity, that "specific co-marketing lenders were paying more than fair market value for the advertising services they received from participating in the program." As one example, the Court pointed to Plaintiffs' failure to allege that one co-marketing agent provided a mortgage referral to a specific lender in exchange for that lender paying an amount to Zillow that was above the market value of the advertising services it received. That some lenders refused to pay more than 31% of an agent's advertising costs, it pointed out, did not render that percentage equivalent to the relevant service's fair market value. Some more definite and precise allegations, entirely missing from the complaint, were necessary.

Potential Impact

The Decision holds a distinct promise for defendants in RESPA actions based on co-marketing programs similar to Zillow's own.

Specifically, it shows how potent RESPA Section 8's safe harbor, as previously construed by the D.C. Circuit in *PHH Corp.* and the Ninth Circuit in *Geraci*, can be at the pleading stage. Within this growing line of caselaw, this provision has been read to authorize lenders to pay a portion of their agents' advertising costs, so long as those payments reflect the fair market value for the advertising services they actually receive. A plaintiff's failure to allege, with specificity, how precisely a lender’s payment exceeds the market value could thus readily set their complaint up for prompt dismissal.

In short, in the wake of Zillow’s victory, well- and carefully-designed co-marketing programs today stand on firmer legal ground.