

AGENT SELF DEALING – BEWARE

One of the side effects of the recent great recession has been real estate agents' exposure to many real estate owners in dire financial circumstances. These owners are typically not knowledgeable about real estate and are highly vulnerable. Unfortunately, some agents have used these situations to acquire real estate at a steeply discounted price or otherwise profit from people in distress. Unfortunately, the brokers associated with these unscrupulous agents can, under certain circumstances, be held liable for their agents' transgressions. A recent Ohio case demonstrates how easily a broker can fall into this situation. *Auer v Paliath*, 986 NE2d 1052 (Ohio App, 2013).

In this Ohio case, a real estate brokerage firm (the "Firm") and a salesperson associated with the Firm (the "Agent") were sued by a buyer (the "Buyer") for fraudulently inducing her to purchase a number of properties. The Agent had become associated with the Firm through an independent contractor agreement dated August 17, 2006. The independent contractor agreement contained terms with which most REALTORS® would be acquainted. The independent contractor agreement provided, for example, that the Agent could determine her own business hours and choose her own target clients, marketing techniques and sales methods. Further, the Agent would be responsible for payment of her own taxes, insurance, licensing fees and any other expenses she might incur as a salesperson. The Agent was compensated by the Firm solely from commissions on transactions in which the Firm represented a client as a buyer or seller. All commissions had to be disbursed through the Firm, as required under Ohio law

(as would be the case in Michigan). Under the independent contractor agreement, the Agent was to receive 70% of earned commissions and the Firm was to receive 30%.

In September 2007, the Buyer, a California resident, contacted the Agent to express her interest in a duplex in Dayton, Ohio which the Buyer had seen on an internet website. The Buyer advised the Agent that she was interested in purchasing income properties in order to provide income to herself and her children.

The duplex in Dayton Ohio proved too expensive for the Buyer. However, the Buyer traveled to Ohio to see several other properties. These properties included the following:

- 929-931 Harvard Blvd. (a duplex) (“Harvard Property”);
- 117 Belton Street (a single family home) (“Belton Property”);
- 2259 Emerson Avenue (12 units) (“Emerson Property”); and
- 1111, 1115 and 1119 Richmond Avenue (each having 4 units) (“Richmond Property”).

The Buyer inspected one-half of the Harvard Property and was shown a photograph of the inside of the Belton Property. The Buyer did not see the inside of any of the Richmond Properties.

In September 2007, the Buyer agreed to purchase the Harvard Property for \$40,000 and the Belton Property for \$20,000. At trial, the Buyer contended that she made those purchases based on representations from the Agent that the properties were worth twice those prices. At closing, the Firm received a commission of \$665 for the sale of the Harvard Property and \$180 for the sale of the Belton Property. The Buyer contracted with A-1 Property Management

to manage the Harvard Property and Belton Property. A-1 Property Management had been created by the Agent.

The Buyer and the Agent then together created the “Gem City Investment Group” which bought the Emerson Property for \$73,000. The Gem City Investment Group then entered into a contract with Miami Valley Home Improvements, LLC to rehabilitate the Emerson Property for \$103,000. The Miami Valley Home Improvements, LLC was a company created by the Agent.

In November 2007, a company created by the Buyer, “Rapid Realty Solutions,” agreed to purchase 1111 and 1115 Richmond for \$40,000 each. The Agent had represented to the Buyer that there was a list of people waiting to rent these units and that the properties could be rehabilitated by January 2008. The Agent also allegedly represented that the properties could quickly be resold for \$90,000 each. The sale of these properties closed on December 14, 2007, with the Agent being the only real estate salesperson involved, and the Firm receiving commissions from the sales. The Buyer again contracted with Miami Valley Home Improvements, the Agent’s company, to rehabilitate the two Richmond Properties for \$23,500 each. The rehabilitation was to be completed by January 30, 2008.

At approximately the same time, the Buyer, through Rapid Realty Solutions, agreed to purchase 1119 Richmond for \$60,000. The seller of this property was Miami Valley Custom Homes, Inc., the Agent’s company. Miami Valley Custom Homes had purchased 1119 Richmond for \$8,500 shortly before selling the property to the Buyer on December 19, 2007. The Firm was the broker for this transaction and received a commission of \$3,600.

The Firm returned the Agent's salespersons' license to the State of Ohio on December 7, 2007. The Agent continued as a real estate salesperson under her own company with another individual acting as her broker. The Agent operated a real estate management and rehabilitation company from the same office.

The Agent managed the Buyer's properties until October 2008 and the Agent's rehabilitation company spent the money the Buyer had provided for the rehabilitation of the Emerson Property and two of the Richmond Properties. By August 2008, only one out of the 27 total units that the Buyer had purchased was rented. In October 2008, the Buyer visited each of the properties to determine what work needed to be done and the current condition of the properties. The Buyer found that all of the properties were in disrepair and needed a substantial amount of work.

When the lawsuit began, the Firm immediately took the position that the Agent was an independent contractor and thus, the Firm was not responsible for any of her actions with respect to the Buyer, including the Agent's property management and rehabilitation services.

There appears to have been two primary arguments to support the Firm's position. First, the independent contractor agreement established an independent contractor relationship between the Firm and the Agent. Second, Ohio case law recognized that under Ohio law, a real estate broker and a salesperson could maintain an independent contractor relationship. While the trial court appeared to acknowledge the independent contractor relationship between the Firm and the Agent, it ultimately permitted the case to go to a jury with an instruction that if the jury found that the Agent had fraudulently induced the Buyer to enter into the agreements to purchase the

various properties, the Firm would be vicariously liable for the acts of the Agent. The jury returned a verdict of \$135,200 against the Agent and the Firm.

On appeal, the Ohio Court of Appeals agreed with the Firm that under Ohio law, a real estate brokerage firm and a salesperson may establish an independent contractor relationship. Further, the Court also acknowledged that in this case, there had been an independent contractor relationship between the Firm and the Agent. However, the Court of Appeals found that while under Ohio law there can be an independent contractor relationship between a real estate brokerage firm and its salespersons, as to third parties, a firm will be liable for the acts of a salesperson if the salesperson carried out those acts within the scope of his or her activities for the real estate brokerage firm. The Ohio Court stated:

Because a real estate salesperson is required to be under the supervision of a licensed real estate broker in all of his or her activities relating to real estate transactions, we have held that a real estate broker cannot insulate him or herself from liability for intentional torts committed within a real estate salesperson's scope of employment.

In its decision, the Ohio Court of Appeals referred to Ohio law which, like Michigan law, requires that all listings be through a real estate brokerage firm. Further, it referred to Ohio law which requires that commissions may be paid only to a real estate brokerage firm and that a salesperson may only receive commissions from a licensed real estate firm (the same as in Michigan). The Ohio Court of Appeals then determined that the Firm's receipt of a commission from each of the purchases by the Buyer established that the Agent's activities were within the scope of her activities performed on behalf of the Firm.

It would appear under Michigan case law, the Firm could have been held liable for the misrepresentations made by the Agent regarding the values of the various properties, the current condition of the properties, the costs necessary to rehabilitate the properties and the resale value. Real estate brokers should keep in mind that their responsibility to supervise their agents is not simply in order to comply with the Occupational Code, but also to try and make certain that unscrupulous activities are not being done in the name of the firm. Brokers should also be concerned when salespersons expand into related businesses which may or may not be viewed as being within the scope of the salesperson's activities performed on behalf of the firm. It is not clear whether under Michigan law, the Firm also would have been found liable for the Agent's misdeeds through her own property management company and rehabilitation company. Brokers may wish to consider adopting a policy and/or amending their independent contractor agreements to specifically prohibit "moonlighting" activities in which clients of the firm are provided other services. While there is no Michigan case on point, Michigan brokers may want to be in a position to demonstrate that they prohibited their agents from engaging in these activities. Alternatively, brokers may want to require that the agents who do have side businesses take steps to make certain that their clients are aware and acknowledge that the other businesses are not affiliated with the brokerage firm.