



Legal Issues Update 2007

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DESIGNATED AGENCY – A REFRESHER

I. INTRODUCTION

The Legislation permitting a designated agency relationship was adopted in 2000. Since that time, many firms across the state have adopted the designated agency model; while others have continued to operate under the traditional agency model. While we prepared various instructional materials and articles on designated agency when the law was first enacted, we felt that enough time had passed that a refresher course could be helpful – not only for those of you practicing designated agency, but also for those of you that work with designated agents in other firms.

II. DISCUSSION

A. Background

Under traditional agency law, a client automatically has an agency relationship with every licensee in the firm. Designated agency is a model by which the firm can limit a client’s agency relationship to just a few named individuals within the firm. The practice of designated agency by a REALTOR® is totally optional. However, if a brokerage firm decides that its members will practice designated agency, it is absolutely critical that all members of the firm practice designated agency at all times and with all clients. If one member of a firm practicing designated agency fails to create a designated agency relationship with a firm client, at best the firm will just lose the benefits of designated agency and, at worst, the firm could be put in a very difficult legal position.

It continues to be common practice among many REALTORS® to act as a buyer’s agent without a written buyer’s agency agreement. It is **impossible** to create a designated agency relationship in Michigan without a written buyer’s agency agreement. There is nothing that anyone can say or do under the designated agency legislation to create a designated agency relationship unless it is in writing and signed by a buyer or a seller. The written agreement must name the designated agent and the supervising broker for the designated agent.

MAR has developed both a Designated Agency Addendum to Listing Contract (Form B-DA) and a Designated Agency Addendum to Buyer’s Broker Contract (Form J-DA). These forms are attached as Exhibit A and Exhibit B hereto. If you don’t want to use an addendum, you can modify your listing contract and buyer broker contract forms to include the appropriate language. The part of a service provision agreement relating to designated agency can be as simple as follows:

For Buyers:

REALTOR®/Brokerage Firm and Buyer hereby designate _____ as the Client’s designated agent.
For purposes of this Addendum, Client shall have an agency relationship with ONLY the REALTOR®/Brokerage Firm, the designated agent(s) named above and the following supervisory broker(s): _____.

For Sellers:

REALTOR®/Brokerage Firm and Seller hereby designate _____ as the Seller’s designated agent.
For purposes of this Addendum, Seller shall have an agency relationship with ONLY the REALTOR®/Brokerage Firm, the designated agent(s) named above and the following supervisory broker(s): _____.

There has been some confusion as to who may be named as a supervising broker in the agreement. We are well aware of the fact that many brokerage firms have experienced salespersons acting “as managers” for one of their offices. However, salespersons cannot be named as the supervisory broker in the agreement. If an office is being managed by a

salesperson, presumably the supervisory broker named in the agreement will be the associate broker who is situated within twenty-five (25) miles of the office managed by the salesperson, as required by law.

A firm may wish to consider naming more than one person as a supervisory broker in a designated agency agreement so that there is a high probability that one supervisory broker will always be available. Likewise, there can be more than one designated agent working with a particular client so long as they are expressly named.

In the event a supervisory broker or designated agent cannot carry out their respective roles for a client of the firm, the firm and the client can agree to designate another supervisory broker or designated agent. MAR has prepared a relatively simple form to accomplish this change if it becomes necessary (Form W, a copy of which is attached as Exhibit C).

B. Common Questions and Answers on Designated Agency.

1. Can you use the agency disclosure form to create a designated agency relationship with a buyer?

No. If you are working with a buyer as a client and do not have a written agency contract with a buyer that establishes a designated agency relationship and names the designated agent and the supervising broker, then your buyer has an agency relationship with everyone in the firm. It is not enough to simply declare that your firm is a “designated agency firm.”

2. Can I disclose a client’s confidential information to other members of my firm?

Only if your firm uses the traditional agency model. If your firm is a designated agency firm, then you may only disclose a client’s confidential information to persons named in the designated agency contract (*i.e.*, the designated agent(s) and supervising broker(s)). A REALTOR® acting as a designated agent must treat all other members of the firm as if they were members of other competing firms when it comes to the disclosure of a client’s confidential information.

3. If my firm is practicing designated agency, do I still need to be concerned about dual agency?

Two designated agents who are affiliated licensees may each represent a different party in the same transaction and are not considered dual agents. The statute provides that in this situation, the broker and all supervisory brokers are automatically **consensual** dual agents and requires only that the agents notify their clients that their broker represents both the seller and buyer before an offer to purchase is made or presented. Legally, this can be done orally, although of course it is always difficult after the fact to prove that an oral statement was made. A traditional dual agency situation requiring written disclosure and consent arises if the same designated agent represents both sides of the transaction.

4. How does designated agency change the relationship between members of two firms who are cooperating on a transaction?

The answer to this question is simple – designated agency does not cause any change in the relationships between members of different firms who are cooperating on a transaction. The designated agency law does not prevent a listing firm from offering subagency to other REALTOR® firms.

5. What happens when an agent within a firm is working with a buyer as a customer, and the buyer becomes interested in one of the firm’s listings which is represented by another salesperson as a designated agent?

On an in-house sale, the agent working with a buyer as a customer can act as a transaction coordinator. Remember that under Michigan law, a transaction coordinator acts solely as a “middleman” and does not provide any professional advice to either side of the transaction. Alternatively, the agent can check “none of the above.” Our concern with the “none of the above” selection on the agency disclosure form is that it does very little to advise the buyer as to the broker’s role in the transaction. An agent who selects “none of the above” may want to note on the form that she is “working with buyer as customer.” On in-house transactions, the compensation to the cooperating agent need not be through the MLS, rather the compensation can be set via in-house policy.

III. CONCLUSION

Perhaps the most important rule to remember with designated agency is that it simply does not work if there are members of the firm that continue to operate as buyer's agents without a written buyer's agency agreement. Those agents automatically create an agency relationship between their buyer clients and every other agent in the firm. This situation could easily lead to an undisclosed dual agency situation. In an undisclosed dual agency situation, if challenged, both agents will likely be deemed to have forfeited their right to a commission – regardless of whether there was any actual damage suffered by any party to the transaction.

SELLER DISCLOSURE ACT – AN UPDATE

I. INTRODUCTION

The Seller Disclosure Act (“SDA”) is now over 10 years old. When it was passed in 1994, many people were quite concerned about the potential impact of the legislation. Some critics feared that the legislation would result in increased liability for sellers and REALTORS®. These critics felt that the SDA had radically changed the common law, and that for the first time, sellers would be required to make certain warranties about the condition of their homes. Other critics had just the opposite concern – *i.e.*, that the SDA would be deemed to have wholly eliminated a home seller’s liability for fraudulent statements. Fortunately, as has been made clear by case law that has developed over the last 10+ years, the passage of the SDA has had neither such result. This article will look at the SDA cases that have come out over the last 13 years and discuss the impact of the SDA on existing law.

II. DISCUSSION

A. No Separate Cause of Action Under the SDA

Under the SDA, if the seller fails to provide the buyer with an accurate, complete seller’s disclosure statement, the buyer has the right to terminate the purchase agreement at any time up until the actual closing. MCL 565.954(3). Once the sale has closed, however, the sale may not be rescinded on the basis that there were untruthful statements contained in the seller’s disclosure statement. It has been consistently held that after closing, there is no separate cause of action under the SDA, rather, a buyer must look to traditional common law theories of recovery. (*See, for example*, the unpublished decisions of the Michigan Court of Appeals in *Pena v Ellis* (2006), *Vettese v Zehr* (2005), and *Timmons v DeVoll* (2004).)

B. SDA Did Not Eliminate a Seller’s Liability for Fraud and Misrepresentation – Common Law Causes of Action Still Exist.

1. Traditional Common Law Principles.

Before discussing the impact of the SDA, we want to briefly summarize Michigan law as it relates to the responsibility of home sellers.

It has traditionally been the law in Michigan that home sellers are liable for false statements that they knew were false. One crucial element of a fraud claim is that the buyer must have relied on the false statement and that the buyer’s reliance must have been reasonable.

It has also traditionally been the law in Michigan that a seller can be held liable for even an innocent misrepresentation. Again, however, the buyer’s reliance on the false statement must have been reasonable.

Where the buyer has purchased the home “as is,” a seller cannot be held liable for an innocent misrepresentation, but can still be held liable for a knowingly false statement.

Finally, traditionally sellers have no general obligation to volunteer information about their home. Sellers can be liable for “silent fraud” ONLY if the buyer made a specific inquiry and the sellers failed to fully respond to that inquiry by disclosing all information they knew about the specific problem.

2. How Has The SDA Changed The Common Law?

First and foremost, under the SDA, sellers are now required to volunteer certain information about the property – *i.e.*, sellers are required to answer the specific questions set forth in the seller’s disclosure statement. It has been suggested that the SDA imposes not only a duty to simply answer the specific questions in the seller’s disclosure statement, but also to volunteer any other relevant information. In *Fritz v Tapke*, an unpublished 2001 decision of the Court of Appeals, the Court suggested that the SDA imposes a legal duty to report “known conditions affecting the property,” even if not prompted by a specific question on the disclosure form. Specifically, the Court said:

. . . The statutory form reads: “Instructions to Seller: (1) Answer ALL questions.
(2) Report known conditions affecting the property.” If a seller is only required to

report conditions listed in the questions, the second instruction would be mere surplusage. Therefore, the instructions require more from the seller than simply answering the questions. The “good faith” required by the statute extends not just to answering specific questions asked by the form, but in honestly reporting the condition of the property. . . .

An examination of the specific facts of the *Fritz v Tapke* decision, however, reveals that in that case, the trial court had found that the sellers had made knowingly false statements in the seller’s disclosure statement. For example, the sellers had told the buyers that the septic system was “ok” when in fact the sellers had needed to pump the system continuously so it would function. The trial court had also made a determination that the seller’s statements in the disclosure statement that the roof did not leak were false. (The sellers had argued that the leaks were actually coming from the water around the windows near the roof – so that their statement that the roof did not leak was technically accurate.) Thus, while there is language in the *Fritz* decision that suggests the Court was expanding the disclosure duties of sellers under the SDA, the actual holding in the case simply held the seller liable for a knowingly false statement in their seller’s disclosure statement.

A second change to the common law as a result of the SDA has to do with a seller’s liability for innocent misrepresentations. It has been held that with respect to false statements in a seller’s disclosure statement, a seller can only be liable if it is shown that the seller knew that the statements were false – *i.e.*, that a seller cannot be liable for an innocent misrepresentation in a seller’s disclosure statement. This rule is best perhaps illustrated by a 1994 case involving a significant leaking problem in the roof of a glass-paned sunroom. *Bergen v Baker*, 264 Mich App 376 (2004). While the buyer admitted that the seller’s disclosure statement had indicated that there were roof leaks, the buyer argued that the sellers should be liable because they failed to disclose the extent of the problem. The trial court had dismissed the case in favor of the sellers and the buyers appealed. In discussing the seller’s potential liability for fraudulent statements in the seller’s disclosure statement, the Court of Appeals held:

Reviewing collectively the language of the relevant statutes that comprise the SDA, it is evident that the Legislature intended to allow for seller liability in a civil action alleging fraud or violation of the act brought by a purchaser on the basis of misrepresentations or omissions in a disclosure statement, but with some limitations. Liability is precluded for errors, inaccuracies, or omissions in a seller disclosure statement that existed when the statement was delivered, where the seller lacked personal knowledge and would not have had personal knowledge by the exercise of ordinary care . . . and thus proceeds in good faith to deliver the disclosure statement to the buyer.

In its interpretation of the SDA, the Court in *Bergen* noted that the statute specifically provides that the seller is not liable if he does not know of the problem and could only have discovered the problem through the inspection of inaccessible portions of the home and/or an inspection by a person with expertise in a science or trade beyond the knowledge of the seller. The sellers in this case had answered affirmatively to the question as to whether the “roof leaks,” but had added: “complete tear-off & replacement June 1998.” Noting that reasonable minds could conclude that this response indicated that there had been a past problem but that it had been corrected, the Court of Appeals sent the case back to the trial court to determine whether the statement was in fact false and whether the seller knew it was false when it was made.

C. Reasonable Reliance Requirement is Not a Change to the Common Law.

Several unreported decisions discussing the SDA have dismissed a fraud claim on the basis of the court’s finding that the buyers had not reasonably relied upon the seller’s allegedly false statements in the disclosure statement. In *Timmons v DeVoll* (2004), for example, the buyers allegedly found numerous defects in the home after they moved in, including alleged defects with the electrical, plumbing and HVAC systems. The Court of Appeals noted that the buyers had had the home inspected, that the buyers had relied upon that inspection, and, moreover, that the defects had not been concealed and would have been discovered by a reasonably competent inspector. The Court noted that there was a long-established rule of law in Michigan (dating long before the SDA was enacted) holding that, “there can be no fraud where

a person has the means to determine that a representation is not true.” In *Timmons*, the court concluded, the buyers could not have reasonably relied on the alleged misrepresentation in the seller’s disclosure statement:

. . . because before closing on the property [the buyers] opted to have the closing contingent upon an adequate inspection of the home “in order to determine if there were faults” in the home; and pursuant to [the buyers’] inspection, [the buyers] requested certain repairs and corrections be made before proceeding to closing; [the buyers] had constructive knowledge that certain building permits were not pulled for the “structural modifications, alterations or repairs made” on the home; and all of the evidence demonstrates that the alleged misrepresentations could have easily been identified by a competent home inspector. Therefore . . . [the buyers] had “the means” to determine whether the [seller’s disclosure statement] contained true statements. . . .

D. Completing the Form

REALTORS® should be aware of issues that have arisen concerning several specific questions on the seller’s disclosure statement.

Previous disputes often arose over the “Appliance” section of the seller’s disclosure statement. A typical example was where a seller had excluded the refrigerator from the listing, but had nonetheless completed the seller’s disclosure statement indicating that the refrigerator is working. The buyer often claimed that he had relied on the seller’s disclosure statement and assumed that the refrigerator was included. In order to clarify this issue, MAR obtained an amendment to this section which now provides:

Appliances/Systems/Services: The items below are in working order. (The items below are included in the sale of the property only if the purchase agreement so provides):

A current problem arises under Question 8 under “other items,” which provides:
Farm or farm operation in the vicinity; or proximity to a landfill, airport, shooting range, etc.?

unknown _____ yes _____ no _____

There is no definition of either “the vicinity” or “proximity,” so we have no idea whether it means within 100 feet or within 10 miles. In one recent unpublished case, the sellers claimed that a shooting range located 6/10 of a mile away from their home was not “in the proximity.” *Pena v Ellis* (2006). The trial court dismissed the case in favor of the seller and the buyer appealed. The Court of Appeals reversed the decision, holding that because reasonable minds could differ on the question of whether 6/10 of a mile is in the “proximity” of the sellers’ home, this is a question of fact (and thus to be decided by the jury). Based upon this decision, sellers should simply be told that there is no definitive answer to this question. A seller should answer “yes” if a condition exists nearby which impacts his property, e.g., a nearby landfill causes a stink on the seller’s property. Also, a careful seller would simply state, for example, “city airport approximately one mile away.”

Finally, while there are several questions on the form which ask about the current condition of the property (e.g. “Roof: Leaks?”); other questions are not so limited (e.g., “Has there been evidence of water?”). As to the second type of question, we are often asked whether there is any limitation on the time period of the inquiry. Based also upon the decision in *Pena v Ellis* (2006), the answer to that question appears to be “no.” (Court held that SDA required sellers to disclose the fact that basement had flooded 26 years ago.)

E. Duty to Amend Disclosure Form

It has been consistently recognized that it is not a violation of the SDA if something occurs after the seller’s disclosure statement is completed but before the closing that renders the statement inaccurate. MCL 565.956. However,

if such inaccuracy relates to “structural/mechanical/appliance systems,” then the seller has a duty to update the seller’s disclosure statement. Of course, once the disclosure form is amended, the purchase agreement once again becomes subject to revocation by the buyer. A failure to amend, where required, will give rise to a cause of action for a silent fraud. *Pena v Ellis* (2006). Interestingly, however, the Court of Appeals has indicated that the duty to amend does not apply to all questions in the seller’s disclosure statement, but only “structural/mechanical/appliance system” changes. In the unpublished decision in *Huhtasaari v Stockemer* (2005), for example, the Court found that there was no evidence that an attic mold condition, which had been remediated by the sellers, resulted in a “structural/mechanical/appliance system” change necessitating an amended disclosure statement.

We often get calls from buyers’ agents who have demanded an amended seller’s disclosure statement so their buyer can rescind the transaction. It is unlikely that the buyer’s right to rescind will depend on whether the seller can be “tricked” into providing a new form. A court would likely find that if an amendment is required, the buyer has a right to rescind, even if the seller refuses to actually amend the form. The buyer’s right to rescind will more likely turn on whether the seller actually had an obligation to amend the form.

Logically, it would seem that the seller’s obligation to amend the form will depend on the type of occurrence. For example, Question 1 under “property conditions” states, “Has there been any evidence of water?” Once there is a leak, the answer to that question is “yes,” even if the seller has the basement repaired. On the other hand, the question about the furnace, asks simply if the furnace “is in working order.” If the furnace breaks down after the disclosure form is provided to the buyer, but is subsequently repaired by the seller, the answer to this question is still “yes,” so presumably a seller would not need to amend the form in this instance. If the buyer has the home inspected and discovers various defects which the buyer disclosed to the seller, does the seller need to amend the seller’s disclosure statement? Logically, it would NOT seem necessary to amend the form for the buyer that had the inspection performed.

The seller’s disclosure statement is intended to tell the buyer what the seller knows about the property, it is not a representation as to the condition of the property. Thus, presumably, the seller would have no obligation to amend the form to tell a buyer what *that* buyer’s inspector discovered about the property.

What if the buyer that performed the inspection backs out of the deal – for example, because the buyer’s inspector found evidence of prior termite infestation? Does the seller have to amend the seller’s disclosure statement before providing it to future potential buyers? We believe the answer to this question is in most cases “yes.” The seller now has knowledge that there may be termites and cannot in good faith answer that question the same way. A seller who takes issue with an inspector’s findings can either investigate further or qualify his answer – *i.e.*, “one inspector believes that there may have been a termite problem in the past, seller has no actual knowledge of any problem.”

III. CONCLUSION

The SDA has not radically changed the law to the benefit of either buyers or sellers. While not a perfect statute by any means, it does require sellers to answer certain questions about the condition of their home and provide a written record as to what the buyers were told. Sellers should be advised to complete the seller’s disclosure statement carefully and completely; buyers should be advised to review the form carefully and follow up on any issues raised.

RESPA HOT TIPS

1. Where the purchaser is paying for the title insurance (*e.g.*, the lender's policy), the seller may not require the buyer to use a particular title company.
2. It is probably a RESPA violation if a title company or mortgage broker sponsors a lunch or other type of function for a REALTOR® firm but does not display marketing materials or make a presentation at the function.
3. A title company or mortgage broker may only pay a REALTOR® firm "fair market value rent" for a desk, copy machine, phone line or conference room in the REALTOR'S® office.
4. A REALTOR® firm cannot give its sales agents money or other incentives for referrals of business to the REALTOR® firm's affiliated title company.
5. If a REALTOR® firm wants to set up an affiliated title company, that title company must provide "core title services." The REALTOR'S® title company must have its own qualified employee(s) who understand title insurance and provide actual title services. This employee cannot simply forward orders/inquiries on to a title insurance company.
6. Under RESPA, a real estate broker's relationship with a home warranty company is analyzed the same way as its relationship with a title company or mortgage company.
7. If a group of REALTORS® own a title company, the REALTORS'® respective ownership interests in that title company cannot be adjusted from time to time based upon the quantity of business each of them has referred to that title company.
8. Payment to a REALTOR® for completing an application form for a mortgage company or home warranty company is likely to be viewed as an impermissible referral fee if the amount of the payment is tied to loan amount or premium amount.
9. HUD officials have recently opined that, if a REALTOR® rebates part of his commission back to the seller or purchaser, that rebate must be shown on the HUD-1.
10. HUD's position is that where a REALTOR® and a title company share advertising, the cost of that advertising must be split pro rata.
11. HUD has challenged reinsurance arrangements in which builders had set up title reinsurance companies which collected premiums from title companies. Noting that the purpose of reinsurance is to spread the risk on large claims, HUD's view was that there really isn't any need for title reinsurance on a single family residence, "especially from an entity or an affiliate of an entity that is in the business to refer business to a title insurance company."
12. Mortgage brokerage firms and some lenders are offering to pay referral fees, wages or commissions to real estate agents or their firms. It is suggested that payments made under this arrangement are RESPA compliant if the real estate agent is licensed as a mortgage broker or is employed by the mortgage broker as a loan officer and fills out minimal paperwork. Most of these arrangements are not RESPA compliant. These arrangements must be reviewed to make certain they meet specific HUD criteria.

FREQUENTLY ASKED QUESTIONS: FORECLOSURE & SHORT SALES

Unfortunately, over the past several months, Michigan has been experiencing an increasing number of foreclosures. In fact, the number of foreclosures has become so great that a typical REALTOR[®] firm would have to close its doors to avoid dealing in some way with foreclosed properties. During recent months, we have fielded hundreds of questions regarding the foreclosure and short sale process over the MAR Legal Hotline, in the course of providing legal updates, and in providing services to our REALTOR[®] clients. Hopefully, the following questions and answers will provide REALTOR[®] offices with some assistance in dealing with foreclosed properties.

The questions discussed below are all based upon the following hypothetical scenario: Bob and Mary Brown appear at Acme Realty on May 1, 2007. They meet with Salesperson Smith. The Browns advise Salesperson Smith that they purchased 123 Elm Street a few years ago. While the Browns love living at 123 Elm Street, they have been unable to make their mortgage payments since Bob lost his job. The Browns believe they have some equity in their house and would like Salesperson Smith to list and sell their home for them.

Q: The Browns have mentioned that they have missed some mortgage payments and that Bob has lost his job. Is it legally permissible for Salesperson Smith to ask the Browns if the bank has threatened foreclosure or has in fact started foreclosure proceedings?

A: It is perfectly permissible for Salesperson Smith to ask the Browns about foreclosure. It is not an invasion of their privacy. In fact, it is critical for Salesperson Smith and Acme Realty to have this information to fully carry out their fiduciary duties in the event that Salesperson Smith agrees to list the Browns' property.

Q: In response to Salesperson Smith's question about foreclosure, the Browns reply that they have received a letter from their bank mentioning foreclosure, and that someone has posted a document entitled "Notice of Foreclosure" on their home. What does this mean?

A: It would appear that the bank has accelerated the debt owed it by the Browns (*i.e.*, declared the entire loan amount due and owing) and has at least begun foreclosure proceedings. When a lender starts the foreclosure process, it must have a notice of foreclosure posted on the owners' property, and the notice of foreclosure must be published for four (4) weeks in a county-wide newspaper.

Q: The Browns indicate that they have brought the Notice of Foreclosure with them and can provide a copy to Salesperson Smith. Is there any information in the Notice of Foreclosure that would be helpful to Salesperson Smith in deciding whether to list the Browns' property?

A: Yes. There are at least three (3) very important pieces of information in the Notice of Foreclosure which will be helpful to Salesperson Smith in deciding whether to list and try to sell the Browns' property. These items include: (1) the name of the lender and the amount the lender claims is owed on the property – in this case, the Notice of Foreclosure indicates that the lender is Ace Bank, who is owed \$120,000; (2) the date of the foreclosure sale – in this case, the foreclosure sale was to be held on April 1, 2007; and (3) the term of the redemption period – in this case, the Notice of Foreclosure indicates that the redemption period shall end on October 1, 2007.

Q: Why is the amount claimed owed by Ace Bank, \$120,000, important to Salesperson Smith?

A: The amount claimed by Ace Bank, \$120,000, indicates a starting point for Salesperson Smith in her analysis of whether it is feasible to sell this property. Salesperson Smith, in doing her market analysis, will need to be able to determine whether a willing buyer will pay at least \$120,000, plus amounts equal to transfer tax, commissions, and other seller closing costs.

Q: Why is the date of the foreclosure sale in the Notice of Foreclosure important to Salesperson Smith?

A: The date of the foreclosure sale is important because under Michigan law, it is the date that triggers the beginning of the redemption period. It is also important to know, if a foreclosure sale has occurred, if there was any issue regarding

abandonment of the property (which will be discussed in later questions).

Q: Why is the date of the expiration of the redemption period important to Salesperson Smith?

A: The date of the expiration of the redemption period is critical to Salesperson Smith, inasmuch as it defines how much time she will have to list and sell the property. In this case, Salesperson Smith determines that she has five (5) months to list the property, find a buyer, and close the sale.

Q: Why is the name of the lender in the Notice of Foreclosure important to Salesperson Smith?

A: There are a multitude of lenders, both in state and out of state, foreclosing mortgages in the State of Michigan. Each lender is different as far as its willingness or ability to approve short sales, or in fact, whether it will entertain any type of negotiations after the foreclosure sale. If Salesperson Smith is not acquainted with the policies and practices of Ace Bank on these issues, she should consider asking other persons in the office or colleagues in the business about the policies of Ace Bank. If Salesperson Smith determines that it will not be possible to sell the property without Ace Bank agreeing to take less than \$120,000, it is important that she find out whether, in fact, it is likely that Ace Bank will even consider such a deal. Some lenders simply will not accept anything other than the full amount owed. If that is the case with Ace Bank, then Salesperson Smith may opt not to take the listing.

Q: Does Salesperson Smith now have enough information in her possession to undertake her market analysis and determine whether she has a reasonable likelihood of success in finding a buyer and closing the sale of the Browns' home?

A: Absolutely not. At this stage, Salesperson Smith has no notion whether \$120,000 would be enough to satisfy all liens against the Browns' home. If there are junior mortgages or other liens on the Browns' home, the amount of those mortgages and liens would have to be added to the amount Salesperson Smith will need to raise through the sales price for the Browns' home to close the deal.

Q: Salesperson Smith asks the Browns whether there are any other mortgages on their property. The Browns indicate there are no other mortgages. Is Salesperson Smith now ready to proceed forward with a market analysis?

A: Unfortunately, no. Many sellers in deep financial distress have not been making payments to any lender for months. They simply forget that they granted a second mortgage and perhaps a third mortgage to other lenders. Salesperson Smith should obtain a "pre-commitment" or an "informational title commitment" from a title agency. This document should reflect any other mortgages and/or other liens against the property.

Q: Salesperson Smith obtains a pre-commitment which shows that the Browns granted a second mortgage in the amount of \$30,000 to Risk Bank, and a third mortgage in the amount of \$10,000 to FBN Mortgage. How do the second and third mortgages impact Salesperson Smith's likelihood of success in selling the Browns' home?

A: The second and third mortgages simply raise the ante on how much Salesperson Smith will have to obtain in a sale to fully pay off all lenders. In addition to the \$120,000 owed to Ace Bank, another \$40,000 would now need to be raised to pay off the second and third mortgages. Salesperson Brown now determines that she would need to obtain a sales price of \$180,000 to make certain all of the lenders, commissions and closing costs can be paid.

Q: Salesperson Smith undertakes her market analysis and determines that if she is to find a buyer for the Browns' property within the five-month redemption period, the sales price would most likely be in the range of \$160,000 to \$170,000. Should Salesperson Smith list the property?

A: Salesperson Smith should only undertake listing the Browns' property if she is confident that she has the skills and the energy to pursue a short sale (*i.e.*, a sale in which the first, second and/or third lenders will have to be induced to take something less than the full amounts owed on their mortgages). Further, Salesperson Smith will need to make

certain that the Browns understand that it is highly likely they will not receive a single dollar at closing. Further, Salesperson Smith may wish to advise the Browns that in the event of a short sale, they should check with an accountant as to any possible tax consequences involved in the forgiveness of debt by a bank (*e.g.*, Ace Bank accepting \$105,000 of \$120,000 owed it, and forgiving the remaining \$15,000).

Q: If Salesperson Smith lists the Browns' property, can she put an offer of cooperation and compensation in the MLS?

A: Yes. Salesperson Smith can place the Browns' property in the MLS offering cooperation and compensation to other REALTORS®. However, Salesperson Smith must be mindful of the fact that if she offers, for example, three percent of the sales price as compensation to a cooperating REALTOR®, she is legally bound to pay that amount at closing. If there are insufficient proceeds at closing to pay the offered split, Salesperson Smith will either have to induce the cooperating broker to take less or face potential arbitration for the full amount.

Q: Is there anything Salesperson Smith can do to protect herself from claims by cooperating REALTORS® in the event of a short sale?

A: Technically, there is no way for Salesperson Smith to offer three percent compensation to cooperating REALTORS® through the MLS contingent upon "net proceeds" being available to pay the three percent. If Salesperson Smith indicates in the "Remarks" section of the MLS that there is a possibility of a short sale or a likely short sale, then cooperating REALTORS® will at least be aware of the risk that they will not be paid in full at closing. This issue will need to be addressed contractually as offers are presented and the shortfall amount is determined. Listing REALTORS® should notify cooperating brokers as soon as they become aware that there will be a shortfall.

Q: Salesperson Smith decides she will proceed forward with listing the Browns' property. The Browns are delighted. They advise her that they are moving to North Carolina next week and will provide her with a forwarding address. Does the Browns moving to North Carolina have any potential impact on Salesperson Smith marketing the property?

A: The Browns moving out of the property could severely impact Salesperson Smith's ability to sell the Browns' property. Ace Bank could deem the property abandoned, which would, in turn, dramatically shorten the redemption period (*i.e.*, the time Salesperson Smith has to market and close the sale of the Browns' property).

Q: What is the concept of "abandonment"?

A: A lender may make a personal inspection of the Browns' property and find that neither the Browns nor anyone claiming under the Browns are presently occupying the Browns' property or will occupy the Browns' property. If the lender makes that determination, it can post a notice on the Browns' property at the time of the personal inspection and mail the notice by certified mail, return receipt requested, to the Browns at their last known address. The notice will tell the Browns that the lender considers the Browns' property to be abandoned, and the Browns will lose all rights of ownership 30 days after the foreclosure sale. If a foreclosure sale has already occurred, the notice will provide that the Browns will lose all rights of ownership within 15 days after the lender mails the notice to the Browns unless, within the 15-day period, the Browns provide written notice to the lender by first class mail that the Browns have not abandoned their property. Salesperson Smith should advise the Browns that if they receive a letter from any of their three lenders, they should open it immediately. If the letter is a notice of abandonment, then the Browns must respond to the lender within 15 days by first class mail and state that they have not abandoned their property.

Q: Can a lender declare a property "abandoned" if there are tenants in the property?

A: No. The statute indicates that a property is not abandoned if there are persons in possession of it who are claiming under the owner. In our case, if the Browns rented the property, the tenants would be occupying the property under the Browns.

Q: Can a lender declare a property “abandoned” after the foreclosure sale?

A: Yes. The lender can declare the property abandoned at any time during the foreclosure process.

Q: When listing properties in the foreclosure process, should REALTORS® always inquire as to whether the sellers or someone claiming under them is occupying the property?

A: Yes. If REALTORS® are going to list unoccupied property during the foreclosure process, they should make certain that the lender has not already deemed the property “abandoned.” Obviously, if the property has already been abandoned, there will be no time to list, market and close a sale of the property.

Q: Salesperson Smith has listed the Browns’ property and is fairly certain there is going to be a short sale. What, if anything, should she do next?

A: Salesperson Smith should immediately contact representatives of the first, second and third lenders. Each of these lenders may have differing procedures and information they require to consider a short sale. Unfortunately, most lenders are not well-organized to respond to proposals for short sales. Salesperson Smith will need to gather the necessary information from the Browns as soon as possible and begin the process with each lender.

Q: Salesperson Smith contacts Ace Bank to determine what sale price for the Browns’ property would be agreeable to Ace Bank (i.e., how much of a haircut Ace Bank is willing to take to get a portion of its indebtedness paid at a closing). Ace Bank will not give Salesperson Smith a straight answer. Instead, Ace Bank’s representative says they will consider any offer at the time it is made. Salesperson Smith wants to know whether there is any law that requires Ace Bank to agree in advance to a short sales price.

A: There is no law that requires any lender to agree in advance to how much debt they will forgive on a short sale. As a practical matter, most lenders will not commit in advance to a specific price for a short sale, inasmuch as they wish the REALTOR® to use her best efforts to obtain the maximum amount for the property.

Q: On July 25, 2007, Salesperson Smith receives an offer on the property for \$165,000. The Browns accept this offer contingent upon approval of the sale by their three (3) lenders. While Salesperson Smith gets affirmative responses from Risk Bank and FBN Mortgage, she cannot seem to get a response from Ace Bank for five (5) weeks. Is there any law requiring Ace Bank to respond to the offer in a reasonable period of time?

A: No. There is no law or regulatory requirement that Ace Bank respond to the offer made on the Browns’ property in a reasonable period of time. Legally, Ace Bank could choose NEVER to respond.

Q: After five weeks of waiting, Salesperson Smith is advised by the buyers’ agent that unless Ace Bank approves their offer within seven (7) days, the buyers are going to revoke their offer and look at other properties. If Salesperson Smith puts Ace Bank on notice that its failure to approve the offer will cost the Browns a buyer for their property, could the Browns then make a claim against the bank for damages suffered by them?

A: No. Again, Ace Bank has no legal obligation to timely consider the offer on the Browns’ property.

Q: On August 25, 2007, Salesperson Smith now has all of the stars in alignment and all of the lenders have signed off on the offer to sell the Browns’ property. However, it appears to Salesperson Smith that a closing may not be completed by October 1, 2007, the end date for the redemption period. Is there a legal mechanism by which the Browns can obtain an extension of the redemption period?

A: Absolutely not. There is no statutory mechanism for extending a redemption period.

Q: If Salesperson Smith cannot get the sale of the property closed by October 1, 2007, can the Sellers still sell the property to the buyers?

A: No. Upon expiration of the redemption period, the Browns have no legal title or other rights in the property. They simply have nothing to sell.

Q: Upon expiration of the redemption period, can the buyers of the Browns' property make the bank sell the property to them pursuant to the terms of their agreement with the Browns?

A: Absolutely not. After the redemption period expires, the buyers will have no agreement with the then legal titleholder of the property, *i.e.*, Ace Bank.

Q: Assume that at the time of the end of the redemption period, Salesperson Smith has no pending purchase agreement for the Browns' property, but has three buyers who have expressed substantial interest in purchasing the property. Can Salesperson Smith require Ace Bank to pay her firm in the event one of these three buyers purchases the former Browns' property?

A: No. Ace Bank has no legal obligation to pay any commission to Salesperson Smith. (In most instances, a lender will not be in a position to immediately begin marketing a foreclosed property, regardless of how economically beneficial that may be to the lender. In most instances, the lender will take weeks or months to undertake control of the property and prepare it for sale. In the meantime, the interested buyers will go elsewhere.)

Q: Assume that Salesperson Smith has the Browns' property listed with four months to go on the redemption period. An agent of the lender approaches the Browns and offers to pay them cash if they will give up the keys to the property and grant a deed in lieu of foreclosure. Are the Browns contractually bound to Salesperson Smith under the listing agreement, or can they give up the keys for the cash from the lender?

A: Legally, the Browns are obligated to Salesperson Smith and her firm under the terms of the listing agreement. However, as a practical matter, there is little Salesperson Smith or her firm could do to stop the Browns from making this deal with the bank. While technically, there would be a breach of the listing agreement, it is highly unlikely that the Browns would be worth pursuing – they are, of course, losing their home in foreclosure.

Q: Assume that Salesperson Smith has listed the Browns' property and has three months remaining in the redemption period. A REALTOR[®] who represents the lender approaches the Browns and offers them cash in return for the keys to the property and a deed in lieu of foreclosure. Can the REALTOR[®] for the lender approach the Browns without going through Salesperson Smith?

A: The actions of the REALTOR[®] representing the lender could easily be construed as a violation of Article 16 of NAR's Code of Ethics. The REALTOR[®] acting on behalf of the lender is, as a practical matter, seeking to cause the Browns to breach their listing agreement with Salesperson Smith. This action would be inconsistent with Salesperson Smith and her firm's exclusive representation of the Browns.

Q: Assume that Salesperson Smith has listed the Browns' property and has three months to go until the end of the redemption period. The Browns are contacted by an agent of the lender, who offers them a payment of money in consideration for the Browns providing them with a deed in lieu of foreclosure and the keys to the property. The Browns ask Salesperson Smith, "What is a deed in lieu of foreclosure?"

A: A deed in lieu of foreclosure is an instrument by which the Browns would convey their interest in their property to the lender without the need for a foreclosure proceeding. Typically, in consideration for giving up their redemption rights and possession of the property during the redemption period, the Browns are discharged from their indebtedness to the bank.

Q: What happens to the second and third mortgages in the event of a deed in lieu of foreclosure?

A: Unless the banks holding the second and third mortgages voluntarily agree to discharge their mortgages, even with a deed in lieu of foreclosure, Ace Bank will need to proceed with foreclosure proceedings in order to eliminate the second and third mortgages.

Q: Assume that Salesperson Smith has listed the Browns' property and has four months to go in the redemption period. An agent of the lender has approached the Browns offering a cash payment in consideration for a deed in lieu of foreclosure and the keys to the property. The Browns ask Salesperson Smith whether they should take the offer from the bank or whether Salesperson Smith can successfully close the sale of the property prior to the end of the redemption period at a sales price that will result in some cash payment to the Browns.

A: Salesperson Smith would have to be very careful in responding to this question. She would need to provide the Browns with any underlying information upon which she would base any response (*i.e.*, on average, homes in the Browns' price range are selling within "X" number of days on the market). However, Salesperson Smith will have to be very careful to make certain that she makes no guarantees. In all events, Salesperson Smith should direct the Browns to an attorney for legal advice.

Q: On September 3, 2007, Salesperson Green receives a call from Ace Bank advising her that the Browns' property had been through foreclosure and requesting her to secure the Browns' property and prepare it for relisting and marketing. Salesperson Green travels to the Browns' property and sees Salesperson Smith's sign in the yard and a keybox. Salesperson Green carefully removes Salesperson Smith's sign and keybox and has the locks changed on the Browns' property. Are Salesperson Green's actions legally appropriate?

A: Salesperson Green's actions are legally inappropriate and could have onerous consequences for herself and Ace Bank. The redemption period on the Browns property does not end until October 1, 2007. Neither Ace Bank nor its agent, Salesperson Green, had any right to be on the Browns' property, let alone change the locks. Salesperson Green engaged in what is normally known as breaking and entering.

Q: If Salesperson Green simply changed the locks when she entered onto the Browns' property on September 3, 2007, other than a technical violation of the law, what damages could be claimed against Salesperson Green?

A: Salesperson Green has opened herself up to a claim by the Browns that items of property which were in the home on the date Salesperson Green had the locks changed were no longer in the home when they regained possession of their house. The Browns could claim that jewelry, furs, appliances, big screen televisions and other items disappeared when Salesperson Green wrongfully entered their property.

Q: What should Salesperson Green have done when she received the call from Ace Bank on September 3, 2007, in order to avoid any problems with the Browns?

A: When contacted by Ace Bank, Salesperson Green should have requested some evidence from Ace Bank or their agent in Michigan (*i.e.*, their foreclosure attorneys) that the redemption period had expired on the property. This evidence could be provided in the form of a copy of the sheriff's deed. In all events, Salesperson Green should have retreated from the Browns' property when she saw Salesperson Smith's sign and keybox, until she could determine whether the redemption period had ended. Remember that foreclosure sales can be, and often are, extended from week to week.

Q: On October 2, 2007, Salesperson Green, on behalf of Ace Bank, travels to the Browns' property to secure it by changing the locks and begin preparation for marketing. When Salesperson Green arrives at the Browns' property on October 2, 2007, there are two cars in the driveway and at least two adults in the Brown house. What can or should Salesperson Green do?

A: Salesperson Green can do nothing to forcibly require the persons in the Browns' house to vacate the property. She can politely ask them to leave. If they refuse to do so, her only recourse is to return to her office and contact Ace Bank. If the persons within the Browns' house continue to refuse to voluntarily leave the property, Ace Bank will have to initiate proceedings to evict them. Under no circumstances should Salesperson Green use self-help to remove any persons or property from the Browns' house.

Q: Salesperson Green has listed the Browns' house for Ace Bank. Does Ace Bank have to do any type of seller's disclosure?

A: Ace Bank is exempted from providing a seller's disclosure statement both at the time of the foreclosure sale and upon resale of the property to a third party. Ace Bank is also exempted from lead-based paint disclosure at the time of the foreclosure sale. However, HUD regulations do not exempt Ace Bank from lead-based paint disclosure upon resale to a third party. Many banks mistakenly believe that they are exempt from lead-based paint disclosure upon resale of the property to a third party.

INDEPENDENT CONTRACTOR STATUS

I. INTRODUCTION

Legal responsibilities vary greatly depending upon the status of the relationship between a broker and a salesperson. The potential economic consequences are enormous for brokers and salespersons who think they are operating in an independent contractor relationship but are later determined by law to be in an employer/employee relationship. As an example, if salespersons are employees, a REALTOR® broker is responsible for federal and state income tax withholding, social security and Medicare taxes, unemployment taxes and workers' compensation insurance.

If salespersons affiliated with the REALTOR® broker are independent contractors, the responsibility for these items is borne by the salespersons. REALTORS® must keep in mind that simply because a broker and a salesperson label their affiliation as an independent contractor relation does not mean that a court or regulatory agency cannot later decide that the salesperson was actually an employee.

As will be discussed below, generally the law applies a very complicated and very subjective test in determining whether someone is an employee or an independent contractor. The test is not definitive, but instead involves weighing a number of different factors (similar to the method for determining whether a REALTOR® is the "procuring cause" for a transaction).

Fortunately for REALTORS®, there is a short, simple safe harbor rule which if you follow, you can avoid the uncertainties of the "totality of the circumstances" test.

II. DISCUSSION

A. The Safe Harbor

The Occupational Code includes the following definition of an independent contractor relationship:

(g) "Independent contractor relationship" means a relationship between a real estate broker and an associate broker or real estate salesperson that satisfies both of the following conditions:

- (i) **A written agreement exists** in which the real estate broker does not consider the associate broker or real estate salesperson as an employee for federal and state income tax purposes.
- (ii) Not less than 75% of the annual compensation paid by the real estate broker to the associate broker or real estate salesperson is from commissions from the sale of real estate. [MCL 339.2501.]

Similar to the Occupational Code, Michigan worker's compensation law excludes real estate salespersons from its purview under certain conditions. Specifically, the Worker's Disability Compensation Act, 1969 PA 317, was amended by 1985 PA 103 in order to provide that:

A person who is licensed as a real estate salesperson or associate real estate broker under article 25 of Act No. 299 of the Public Acts of 1980 [the Occupational Code] . . . shall not be considered an employee for the purposes of this act if both of the following conditions have been met:

- (a) Not less than 75% of the remuneration of the salesperson or associate real estate broker is directly related to the volume of sales of real estate and not to the number of hours worked.

- (b) The salesperson or associate real estate broker has a written agreement with the real estate broker who employs the salesperson or associate real estate broker, which states that the salesperson or associate real estate broker, as applicable, is not considered an employee for tax purposes. [MCL 418.119.]

Likewise, real estate salespersons are excluded from the term “employment” for purposes of the Michigan Employment Security Act (“MESA”). Specifically, under the MESA, the term “employment” shall not include “[s]ervice performed by real estate salespersons, sales representatives of investment companies, and agents or solicitors of insurance companies who are compensated principally or wholly on a commission basis.” MCL 421.43(h).

Finally, the Internal Revenue Code also excludes real estate salespersons as employees under certain conditions. Specifically, “in the case of services performed as a qualified real estate agent . . . the individual performing such services shall not be treated as an employee . . .” 26 USC 3508(a)(1). “Qualified real estate agent” is defined as: . . . any individual who is a salesperson if –

- (A) such individual is a licensed real estate agent,
- (B) substantially all of the remuneration (whether or not paid in cash) for the services performed by such individual as a real estate agent is directly related to sales or other output (including the performance of services) rather than to the number of hours worked, and
- (C) the services performed by the individual are performed pursuant to a **written contract** between such individual and the person for whom the services are performed and such contract provides that the individual will not be treated as an employee with respect to such services for Federal tax purposes. [26 USC 3308(b)(1).]

In sum, these statutory provisions create a “safe harbor” whereby a real estate broker and salesperson can definitively establish an independent contractor relationship. As you can see, however, it is absolutely critical that the broker and the salesperson enter into a written independent contractor agreement. A sample of such an agreement is attached as Exhibit A.

B. The “Totality of the Circumstances” Test

If the salesperson does not fit within the “safe harbor” for independent contractors, then regardless of what the broker and salesperson call their relationship, the courts of this state will look at “the totality of the circumstances surrounding the employment relationship.”

Specifically, a non-inclusive list of the facts a court will look at is as follows:

1. The person was required to complete training classes;
2. The person was required to attend regularly scheduled meetings with other persons also providing services to the hiring entity;
3. The person’s work was evaluated by the hiring entity;
4. The person was required to maintain certain office hours (even if only for two or three days per week);

5. The person was required to perform his or her services in a particular manner or particular sequence;
6. The person was required to perform her work during particular hours;
7. The person was required to submit reports;
8. The person was required to perform his or her work at the location designated by the hiring entity;
9. The person received his or her wages at fixed intervals;
10. The person was reimbursed for business and travel expenses;
11. The person was provided materials/ equipment by the hiring entity for use in performing services;
12. The person, while providing services for the hiring entity, was precluded from simultaneously providing services to other entities or persons;
13. The person was required to wear certain clothing when providing services;
14. The person was provided with a specific desk and/or work area at the hiring entity's location;
15. The hiring entity provided the person with business cards;
16. The person had to record and/or report his/her hours worked to the hiring entity;
17. The person was required to meet certain sales quotas;
18. The person was required to schedule their vacations with the hiring entity;
20. The person was subject to disciplinary action such as written reprimands for sub-standard work;
21. The hiring entity had established rules and/or disciplinary guidelines, which applied to the person.

As indicated, this is not an all-inclusive list. Courts may look to other facts to determine the issue of employee versus independent contractor if such facts are present. However, where many of these facts are present, a court, the IRS, the Department of Labor, the Michigan Employment Security Commission, etc. may likely find an employer/employee relationship.

C. Independent Contractor Agreement

REALTORS® should not view these contracts simply as “boilerplate” necessary to fall within the safe harbor rule. The substance of the contract is important, as it governs the relationship between the parties. The contract should include a detailed discussion of commissions – *i.e.*, how they will be set, how they will be divided, and how they will be handled in the event the salesperson leaves the broker before a transaction closes. The contract should specify in detail how expenses will be allocated between the broker and the salesperson. The contract should also spell out any rules that the broker has regarding the salesperson’s advertising, including any listings on websites.

In any month, the MAR Hotline gets a number of calls asking about a departing salesperson’s right to a commission on pending sales and pending listings. REALTORS® are advised that there is no rule of law on this question; rather, a court will look to the specific contract between the parties. If there is no written contract, or if the parties’ contract is silent on the issue, then the court will try to discern the parties’ intent by listening to the testimony of the parties. Obviously, it is preferable to have a written agreement as to how the commissions of departing salespersons will be handled. The sample contract in attached Exhibit A contains a number of choices; however, the list is not all-inclusive, and REALTOR® firms should modify these provisions to reflect their particular policies.

III. CONCLUSION

The only REALTORS® who can afford to operate without a written Independent Contractor Agreement are those who consciously determine that all salespersons should be affiliated with the firm as employees. In any other situation, operating without a written Independent Contractor Agreement almost assures future legal difficulties with various Departments of the State of Michigan or the Internal Revenue Service. As an example, if a salesperson is injured while performing her duties, and it is ultimately determined that she was an employee and not an independent contractor, in the absence of workers’ compensation insurance coverage, the broker could be personally liable for the salesperson’s workers’ compensation claim. Unless salespersons are employees of the firm, no firm file regarding a salesperson’s affiliation with the firm should be complete without an executed Independent Contractor Agreement.

A sample Independent Contractor Agreement is attached to this article as Exhibit A. Obviously, each REALTOR® will need to make certain that the terms of their written Independent Contractor Agreement are legally satisfactory to the REALTOR® and to his or her legal counsel.

EXHIBIT A

(NAME OF BROKER)

BROKER-SALESPERSON CONTRACT

INDEPENDENT CONTRACTOR

THIS AGREEMENT, made this ____ day of _____, 20____, by and between _____ (“Broker”), and _____ (“Salesperson”);

WITNESSETH:

WHEREAS, Broker is now and has for many years been engaged in business as a general real estate broker in the City of _____, County of _____, State of _____, and is qualified to and does operate a general real estate business and is fully qualified to and does procure the listings of real estate for sale, lease or rental to prospective purchasers, lessees and renters of real estate, and has and does enjoy the goodwill of, and a reputation for, fair dealing with the public; and

WHEREAS, Broker maintains an office in _____ (City or County) equipped with furnishings and other equipment necessary and incidental to the proper operation of the business, and staffed with employees, suitable to serving the public as a real estate broker; and

WHEREAS, Salesperson is now, and has been, engaged in business as a real estate salesperson, and has enjoyed and does enjoy a good reputation for fair and honest dealing with the public as such; and

WHEREAS, it is deemed to be to the mutual advantage of Broker and Salesperson to form an association under the terms and conditions of this Agreement;

NOW, THEREFORE, in consideration of the promises and mutual covenants hereinafter contained, it is mutually agreed as follows:

1. Broker agrees to make available to Salesperson all current listings of the office, except such as the Broker for valid and usual business reasons may place exclusively in the temporary possession of some other salesperson, and agrees, upon request, to assist the Salesperson in his/her work by advice and instruction, and agrees to provide full cooperation in every way possible.

2. Broker agrees that the Salesperson may share with other salespeople all the facilities of the office now operated by Broker in connection with the subject matter of this contract, which office is now maintained at _____ (location of office).

3. Salesperson agrees to work diligently and with his/her best efforts to sell, lease or rent any and all real estate listed with the Broker, to solicit additional listings and customers of Broker, and otherwise promote the business of serving the public in real estate transactions to the end that each of the parties may derive the greatest profit possible.

4. Salesperson agrees to conduct his/her business and regulate his/her habits so as to maintain and to increase the goodwill and reputation of the Broker and the Salesperson, and the parties agree to conform to and abide by all laws, rules and regulations, and codes of ethics that are binding upon or applicable to real estate brokers and real estate salespeople.

5. Broker shall have sole control over the manner in which its listings of real estate are advertised. All advertisements of listings shall prominently display the Broker's name. Salesperson may not display, or authorize any third party to display, Broker's listings on any website without Broker's prior written consent. Salesperson shall comply with all of Broker's rules and regulations governing internet advertising activities as the same may be imposed by Broker from time to time.

6. It is expressly agreed and understood between the parties that the Salesperson or Broker, in the performance of his or her services hereunder, is not to be treated or otherwise considered as an employee of the Broker with respect to such services for federal tax purposes, or for any other tax purposes. It is further agreed and understood between the parties that the Broker will not withhold or pay over on behalf of the Salesperson or Broker any amounts relating to federal, state and local income taxes, unemployment compensation, workers' compensation or any other employer liability or responsibility. The Salesperson or Broker agrees and understands that he or she is totally responsible for the timely reporting and payment of all income taxes and other governmental liabilities resulting from the performance of his or her services hereunder, which responsibility is not borne nor shared by the Broker in any manner whatsoever.

7. The commissions to be charged for any services performed hereunder shall be those determined by the Broker. The Broker shall advise the Salesperson of any special contract relating to any particular transaction that he/she undertakes to handle. When the Salesperson shall perform any service hereunder whereby a commission is earned, the commission shall, when collected, be divided between the Broker and the Salesperson, in which division the Salesperson shall receive a proportionate share as set out in the rider attached headed "Commission Schedule," and the Broker shall receive the balance. In the event of special arrangements with any client of the Broker or the Salesperson on property listed with the Broker or controlled by the Salesperson, a special division of commission may apply, such rate of division to be agreed upon in advance by the Broker and the Salesperson. In the event that two or more salespeople participate in such a service, or claim to have done so, the amount of the commission over that accruing to the Broker shall be divided among the participating salespeople according to agreement among them or by arbitration under the rules and regulations of the National Association of REALTORS[®], as amended to conform with Michigan law. Any decision rendered in an arbitration may be enforced through entry of a judgment by a court of competent jurisdiction. In no case shall the Broker be personally liable to the Salesperson for any commission, nor shall Salesperson be personally liable to Broker for any commissions, but when the commission shall have been collected from the party or parties for whom the service was performed, Broker shall hold it in trust for Salesperson and himself, to be divided according to the terms of this Agreement.

8. The division and distribution of the earned commissions as set out in paragraph 6, which may be paid to or collected by either party shall take place as soon as practicable after collection of such commissions from the party or parties for whom the services have been performed.

9. The Broker shall not be liable to the Salesperson for any expenses incurred by him/her, or for any of his/her acts, nor shall the Salesperson be liable to the Broker for office help or expense, and the Salesperson shall have no authority to bind the Broker by any promise or representation, unless specifically authorized in a particular transaction; but the expense of attorneys' fees, costs, revenue stamps, title abstracts and the like which must, by reason of some necessity, be paid from the commission, or are incurred in the collection of, or the attempt to collect the commission, shall be paid by the parties in the same proportion as provided for herein in the division of the commissions. Suits for commissions shall be maintained only in the name of the Broker, and the Salesperson shall be construed to be a subagent only, with respect to the clients and customers for whom services shall be performed.

10. Salesperson shall furnish an automobile at his/her sole expense when one is necessary to carry out the duties of the Salesperson under the terms of this Agreement. Salesperson shall at all times carry liability insurance on his or her automobile in a form and provided by an insurer acceptable to the Broker, with such insurance having minimum limits of \$_____ for each person and \$_____ for each accident, with a property damage limit of not less than \$_____. The minimum amounts of insurance required under the terms of this paragraph may be adjusted by the Broker as is reasonably necessary. Salesperson shall, upon Broker's request, have the Broker listed as an additional insured under any such insurance policy or policies, and shall cause any such insurer to agree to provide Broker with thirty (30) days prior notice of any proposed cancellation of any such policies. Salesperson agrees, upon reasonable request, to furnish Broker with a certificate or other documentation acceptable to Broker evidencing that all

insurance required under this paragraph has been obtained by the Salesperson and is then presently effective. Salesperson agrees to indemnify and hold Broker harmless from any claim for damages asserted against the Broker by reason of any act or omission by Salesperson in the use of their automobile, such indemnification to include reasonable attorneys' fees, costs and expenses incurred by Broker in defense of any such claim.

11. This contract and the association created hereby may be terminated by either party, with or without cause, at any time, upon _____ days notice given to the other. The rights of the parties to any commission, which accrued prior to notice of termination, shall not be divested by the termination of this contract. Broker and Salesperson agree that the notice provided under this paragraph constitutes reasonable notice to the Salesperson to derive the potential economic benefit to the Salesperson of any listings or customers solicited for the Broker.

12. The Salesperson shall not, after the termination of this contract, use to his own advantage, or the advantage of any other person or corporation, any information gained for or from the files or business of the Broker.

13. In the event this Agreement is terminated for any reason, Salesperson shall immediately deliver all files to Broker, including active files.

a. Pending Listings. For listings procured by Salesperson that are pending at the time of termination (select/modify as appropriate):

- Salesperson shall not be entitled to a commission on any sales that close after termination, unless this Agreement is terminated by Broker, in which case Salesperson shall receive all commissions earned prior to termination, which are actually received by Broker. For purposes hereof, "earned" shall refer to transactions with a binding purchase agreement in place at the time of termination.*
- As to commissions actually received by Broker pursuant to binding purchase agreements in place prior to termination of this Agreement, Salesperson shall receive _____ percent of the commission to which he/she would have otherwise been entitled if the Agreement was still in place.*
- As to commissions actually received by Broker pursuant to purchase agreements signed after the termination of this Agreement, Salesperson shall receive _____ percent of the commission to which he/she would have otherwise been entitled if the Agreement was still in place. Salesperson shall not be entitled to any compensation in connection with purchase agreements signed during extensions to any such listings or on any re-listings.*

b. Pending Cooperating Sales. For cooperating sales procured by Salesperson, which are pending at the time of termination (select/modify as appropriate):

- Salesperson shall not be entitled to a commission on any sales, which close after termination, unless this Agreement is terminated by Broker, in which case Salesperson shall receive all commissions earned prior to termination, which are actually received by Broker. For purposes hereof, "earned" shall refer to transactions with a binding purchase agreement in place at the time of termination.*

- *As to commissions actually received by Broker pursuant to binding purchase agreements in place prior to termination of this Agreement, Salesperson shall be entitled to _____ percent of the commission to which he/she would have otherwise been entitled if the Agreement was still in place.*

14. This Agreement shall be construed in accordance with the laws of the State of Michigan.

IN WITNESS WHEREOF, the parties hereto have signed or caused to be signed these presents this _____ day of _____, 20_____.

Broker

Salesperson

THE COMPANY WITHIN THE COMPANY

It is generally believed that salespersons can obtain real tax benefits by forming their own corporate entity to receive income from their real estate activities. It is widely believed that the Internal Revenue Service is less likely to question business expenses which are deducted from the operation of a corporate entity, as opposed to business deductions claimed on an individual salesperson's tax return. Whether these tax benefits really exist is beside the point.

The belief that the benefits do exist is causing many salespersons to establish a corporate entity. However, unless certain steps are taken, these salespersons and their brokers may find themselves in violation of various provisions of the Michigan Real Estate License Law and the Internal Revenue Code.

Typically, a salesperson will visit with a lawyer who will file articles of organization with the State of Michigan to establish a limited liability company in which the salesperson is the sole member (the "LLC"). The salesperson will then ask her broker to thereafter pay all commissions owed to her to her LLC. The broker then begins paying the salesperson through checks made payable to the LLC. The LLC, in turn, pays the salesperson. Is this arrangement legally permissible? The answer is absolutely not, for at least two reasons.

First, real estate brokers are prohibited under the Real Estate License Law from paying a fee, commission or other valuable consideration to an unlicensed person or entity. In this arrangement, the real estate broker is paying commissions to the LLC. The LLC is not licensed. Thus, such payments by the real estate broker violate the Real Estate License Law. MCL 339.2512(h).

Second, the LLC is, in essence, turning around and paying commissions received from the real estate broker to the salesperson. The Real Estate License Law specifically prohibits a real estate salesperson from accepting a commission or valuable consideration for licensed activity from anyone other than the broker with whom the salesperson is affiliated. MCL 339.2510.

One frequently suggested solution to comply with the law is to have the LLC be directly licensed with the real estate broker and receive payment of commissions based upon the efforts of the salesperson affiliated with or employed by the LLC. Unfortunately, this solution is not technically possible. Rule 339.22201 provides that associate broker and salesperson licenses may only be issued to individuals. There is, however, another arrangement which is legally permissible assuming a few mandatory steps are carried out by the salesperson.

First, the salesperson would cause the organization of the LLC. Then the salesperson would file an application with the Department of Labor & Economic Growth ("DLEG") to obtain a real estate broker's license for the LLC.

Second, in order for the LLC to obtain a broker's license, the salesperson would have to file an application to obtain an associate broker's license with the LLC. This, of course, assumes that the salesperson can meet the requisite qualifications for an associate broker's license, as set forth in the Real Estate License Law.

Third, the salesperson would also have to apply and become an associate broker with the real estate brokerage firm with whom she is presently affiliated. In the end, the former salesperson would be an associate broker both for the real estate brokerage firm where she has worked and for her newly formed LLC. She cannot remain as a salesperson with her present real estate brokerage firm, as a salesperson can only receive commissions from her broker. As a salesperson with the real estate brokerage firm, she could not receive commissions from the LLC.

Finally, as an associate broker of the real estate brokerage firm, the licensee would carry out her business as an identified agent of the real estate brokerage firm. The licensee's LLC is simply assigned the right to receive the licensee's commissions from the real estate brokerage firm. In other words, the associate broker does NOT conduct business in the name of her LLC, but in her individual name as an associate broker with the real estate brokerage firm. The real estate brokerage firm can now lawfully pay commissions to the LLC.

It should be understood that the former salesperson (now associate broker), by acting as an identified agent of the real estate brokerage firm, will not have the protection of the "corporate shield" which would normally be available to a person operating through a limited liability company. This would be the case, as the public would not even be aware of the existence of the LLC. However, if at all times the former salesperson (now associate broker) carries out her business as an associate broker of the real estate brokerage firm, she should be covered by that firm's errors and omissions insurer. For what it is worth, DLEG has advised that it considers the arrangement described above to be permissible under Michigan law. If a REALTOR® is considering some form of arrangement which differs from the arrangement described above, he or she should seek legal advice prior to doing so.

The above-described arrangement could previously be carried out by a salesperson through the formation of a corporation under the Michigan Business Corporation Act, MCL 450.1101 *et seq.* (the "BCA"). However, at the time of preparation of this article, DLEG has advised that in the future, it will not permit real estate brokerage firms to be

organized under the BCA. DLEG has reached this conclusion as a result of a decision by the Michigan Court of Appeals in *Miller v Allstate Insurance Company*, Court of Appeals Docket No. 259992. Instead, DLEG has indicated that a real estate brokerage firm, if it wishes to incorporate, must incorporate under the Professional Service Corporation Act, MCL 450.221 *et seq.* (the “PSCA”). Any REALTOR® considering forming a real estate brokerage firm under the PSCA or as a limited liability company should obtain legal advice prior to making a decision. There are substantial legal differences between a limited liability company and a corporation formed under the PSCA. For example, if a REALTOR® wished to start a real estate brokerage firm and family members wished to invest in the business, the REALTOR® would be required to opt for an LLC, as anyone can invest in a real estate brokerage firm acting as an LLC. If the real estate brokerage firm is incorporated under the PSCA, its only investors can be persons licensed under the Real Estate License Law. As another example, as indicated above, a limited liability company usually provides a corporate shield against personal liability. A corporation organized under the PSCA offers no corporate shield or other protection against personal liability for acts of the corporation.

In sum, it is possible for salespersons to obtain the perceived benefits of having payments made to their own corporate entity. Just make sure that all of the steps outlined above are completed.