



2008-2009 Legal Update

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BROKERAGE FIRM ORGANIZATIONAL ISSUES

INTRODUCTION

This article will attempt to clear up what appears to be widespread confusion as to the ability of licensees to operate within a corporate structure.

DISCUSSION

A. The Company within the Company

This portion of the article was included in last year's legal update. It is essentially being reprinted and included in this year's legal update based on the volume of calls that the MAR Legal Hotline continues to receive on this subject, *i.e.*, the establishment of corporations and limited liability companies by salespersons or associate brokers.

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 that 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 pay all future 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 the arrangement discussed above, 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 that differs from the arrangement described above, he or she should seek legal advice prior to doing so.

B. Business Corporation vs Professional Service Corporation

Real estate brokerage firms in Michigan have always been able to choose to operate their business as a corporation formed under the Michigan Business Corporation Act, MCL 450.1101, *et seq* (the “BCA”) and its predecessor statutes. Until recently, there was never any question that real estate brokerage firms could lawfully incorporate under the BCA. Unfortunately, this well-established rule was disturbed by the Michigan Court of Appeals in *Miller v Allstate Ins Co* on remand, 275 Mich App 649, 739 NW2d 675 (2007) (the “Miller Decision”), a case which

involved physical therapists, but which held far-reaching consequences for other types of licensees, including real estate licensees.

As a result of the Miller Decision, the Department of Labor and Economic Growth (“DLEG”) determined that real estate brokers and salespersons could not be properly incorporated under the BCA. The DLEG made the same decision with respect to real estate appraisers. The DLEG took the position that real estate brokers, salespersons, and appraisers must be incorporated under the Professional Services Corporation Act, MCL 450.221, *et seq* (the “PSCA”). This action by DLEG created great difficulties for both existing and planned real estate brokerage firms.

There are substantial legal differences between a corporation formed under the BCA and a corporation formed under the PSCA. For example, if a REALTOR® wishes to start a real estate brokerage firm and family members wish to invest in the business, the REALTOR® could not incorporate under the PSCA. If a 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, in most instances a corporation organized under the BCA provides a corporate shield against personal liability for its shareholders. A corporation organized under the PSCA offers no corporate shield or other protection against personal liability for its shareholders.

MAR, through its legal counsel, advised its members that real estate brokerage firms previously incorporated under the BCA were generally not exposed to liability from third parties. However, many REALTORS® who were investors in existing real estate brokerage firms incorporated under the BCA expressed grave concerns about their ability to sell or bequest their interest in their corporate entities to third parties. MAR then sought legislation to cure the problem.

On July 2, 2008, the Michigan Supreme Court took care of the problem. The Supreme Court vacated the Miller Decision of the Court of Appeals and determined that only the Attorney General has standing under MCL 450.1221 to challenge the lawfulness of the incorporation of any entity in the State of Michigan. *Miller v Allstate Ins Co*, 481 Mich 601, 751 NW2d 463 (2008). In a footnote on page 13 of its decision, the Supreme Court states:

We emphasize that in no way are we passing judgment on the lawfulness of plaintiff’s incorporation. Because a court cannot entertain an individual’s challenge to corporate status under MCL 450.1221, plaintiff must be presumed lawfully formed until its incorporation has been successfully challenged by the Attorney General.

After the Supreme Court’s decision, there is no longer any judicial precedent supporting DLEG’s decision preventing real estate brokerage firms from lawfully incorporating under the BCA. Thus, there is no basis for rejecting articles of incorporation filed by entities licensed as real estate brokerage firms. As important, existing real estate brokerage firms are irrefutably presumed to be lawfully organized under the BCA, subject only to a successful challenge by the Attorney General.

Finally, based on the Michigan Supreme Court decision, the DLEG resumed its long-standing practice of requiring only corporations that provide services in a “learned profession” to

perform as professional corporations under the PSCA. These “learned professions” generally include doctors, lawyers, and the like. It does not include real estate brokerage firms. Thus, approximately thirteen months of chaos ended with a full lap around the track back to the starting point. Real estate brokerage firms may again choose to incorporate under the BCA or form as a limited liability company under the Michigan Limited Liability Company Act. Any real estate brokerage firm that formed during this period under the PSCA should strongly consider converting to a corporation under the BCA. Incorporating under the BCA provides greater protection from personal liability and permits non-licensees to invest in the real estate brokerage firm.

CONCLUSION

In sum, it is possible for salespersons to obtain the perceived benefits of having payments made to their own corporate entity, either as a corporation or a limited liability company. They just need to make sure that all steps outlined above are completed.

BUYER'S AGENCY – CURRENT LIABILITY ISSUES

INTRODUCTION

The seemingly constant decline in property values, at least as portrayed by the media, has caused new issues to become prominent with respect to buyer agency. Most of these issues are just starting to make their way through the trial courts. REALTORS® need to focus on them now in order to avoid becoming part of that process.

DISCUSSION

a. Claims of Overpayment by Buyers

Back in the early 1990's, when buyer representation in Michigan was just beginning, a series of seminars was held to discuss potential liability issues. One of the issues that drew a few chuckles was a potential claim by a buyer against a buyer's agent, based upon an alleged failure to keep the buyer from paying too much for a parcel of property. The chuckles were justified in a real estate environment where market values increased incrementally from year to year. However, in a market of declining values, unfortunately this potential claim is now a real possibility.

In a recent California case, the buyers sued their buyer's agent after they purchased a home in a subdivision. The buyers contended that the buyer's agent did not show them two (2) comparables which would have demonstrated that they were paying in excess of \$100,000 over the fair market value of the home. The buyers contended that the buyer's agent had breached his fiduciary duty owed to them by concealing these comparables from them. In addition, the buyers contended that the buyer's agent had a duty to determine the appropriate purchase price for the home. Fortunately, at trial, the REALTOR® and his lawyer proved that the REALTOR® had not concealed any meaningful comparables from the buyers and that the buyers had paid the approximate fair market value at the time they purchased their home.

REALTORS® in Michigan should not take too much comfort in the fact that this case occurred in California. There have already been similar threats of litigation in Michigan. These threats arise in part from the fact that buyer's agents in Michigan typically gather comparables and provide an analysis to buyers which helps the buyers reach their own conclusion as to what they are willing to pay for a specific piece of property. While REALTORS® need not stop this practice all together, they should take care to make certain that they are not held to the valuation standards of an appraiser.

The primary method to defeat this claim in Michigan is through the use of a disclaimer in a written buyer's agency agreement. A disclaimer indicating that the REALTOR® will not be acting as an appraiser should head off any ambitions a buyer's lawyer may have to establish this type of claim in Michigan. In the absence of a written disclaimer, the issue of whether buyer's agents have a duty to properly value properties for their buyer-clients will be left up to the courts.

Typical disclaimer language in a buyer agency agreement would be as follows:

Broker's services shall include, but not be limited to, consulting with Client regarding the desirability of particular properties and the availability of financing; formulating acquisition strategies; and negotiating purchase agreements. Client acknowledges that Broker is not acting as an attorney, tax advisor, surveyor, appraiser, environmental expert or structural or mechanical engineer, and that Client should contact professionals on these matters.

b. Conflict of Interest among Buyers

Any REALTOR[®] firm practicing traditional agency that represents buyers is in constant peril that it may be found to have breached its fiduciary duties to multiple buyers. The following is a scenario under which a written agency agreement containing a conflict of interest disclaimer is absolutely critical. Assume that REALTOR[®] Smith of Acme Real Estate represents Buyer 1.

Assume further that REALTOR[®] Jones of Acme Real Estate represents Buyer 2. Buyers 1 and 2 make offers on the same property. When Buyer 2 is successful in obtaining the property, Buyer 1 claims that either information about her offer was improperly disclosed to Buyer 2, who changed his offer accordingly or, alternatively, that she was not advised of the terms of Buyer 2's offer and that if she had been so advised, she would have changed her offer. In any event, Buyer 1 claims that Acme Real Estate and REALTOR[®] Smith breached fiduciary duties owed to her.

Without an appropriate disclaimer, it will be extremely difficult to defend Acme Real Estate against a claim of breach of fiduciary duty in this situation. As a matter of common law, Acme Real Estate had a duty of complete disclosure and complete confidentiality to Buyer 2. Thus, Buyer 2 was entitled to know the terms of Buyer 1's offer. Further, the terms of Buyer 2's offer could not be disclosed to Buyer 1, as Acme Real Estate also had a duty of complete confidentiality to Buyer 2. Of course, the same duties applied with respect to Acme Real Estate and Buyer 1. Acting as the agent of Buyer 1, in order to carry out its fiduciary duties owed to Buyer 1, Acme Real Estate would have told Buyer 1 about the terms of Buyer 2's offer, but not told Buyer 2 about the terms of Buyer 1's offer. Obviously it is impossible for a firm to satisfy these conflicting duties.

If a REALTOR[®] firm regularly represents buyers, then it is strongly recommended that a disclaimer be placed in the buyer's agency form indicating that every one of the firm's buyer-clients agree that the firm may represent multiple buyers interested in the same property.

Suggested language would be as follows:

Client acknowledges that Broker may represent other clients desirous of purchasing property similar to the Desired Property. Client acknowledges and agrees that Broker may show more than one client the same property, and may prepare offers on the same property for more than one client. Broker shall preserve any

confidential information disclosed by any buyer-client and shall not disclose the existence of, or the terms of, any offer prepared on behalf of one client to another client. In the event Broker works for two competing buyer-clients in connection with any specific property, Broker will be working equally for both buyer-clients and without the full range of fiduciary duties owed by a buyer's agent to a buyer. In this situation, the competing buyer-clients are giving up their rights to undivided loyalty and will be owed only limited duties of disclosure, obedience and confidentiality.

Buyer-agency contracts, like listing contracts, should also include a dual agency provision. The MAR buyer's agency form contains the following dual agency provision:

CONFLICT OF INTEREST (SELLERS). In the event Client elects to make a bona fide offer on real property listed by Broker (check as applicable):

(a) _____ This Agreement shall automatically terminate only with regard to that real property (but shall continue as to all other real property) and Broker shall continue the agency relationship with the owner of the real property listed by Broker. Any fees previously paid to Broker by Client pursuant to this Agreement shall be returned to Client at closing where the agency relationship was terminated pursuant to this paragraph.

(b) _____ Broker shall act as disclosed dual agent of both Client and the owner of the real property listed by Broker pursuant to a written agreement in the form attached hereto between Broker, Client and the owner of the real property listed. In such event, Broker shall be entitled to any fees owed by Client pursuant to this Agreement.

(c) _____ Broker shall act as a transaction coordinator to facilitate the transaction, and not as an agent for either the Client or the owner of the real property listed by the Broker. In such event, Broker shall be entitled to any fees owed by Client pursuant to this Agreement.

c. Physical Condition and Environmental Risk

It would appear that claims against buyer's agents based upon the physical condition or environmental risks involved in a property are increasing as more buyers buy distressed and foreclosed properties. Typically, lenders selling foreclosed properties require a buyer to sign documents that make it manifestly clear that the lender-seller is making no representations and is offering no warranties with respect to the condition of the property. When a buyer purchases such property and immediately thereafter has problems with the physical condition of the property or discovers environmental risks, *e.g.*, lead-based paint, the buyer looks around for someone to help him bear the cost of curing the problem. It is critically important that the buyer's agent have a disclaimer in a written agency agreement, such as the disclaimer quoted above, in order to protect himself from these types of claims.

A pending case illustrates the importance of the use of such a disclaimer in a buyer's agency agreement. In this case, the buyers purchased a home in Genesee County in November 2004. The buyers financed their purchase of the home through an FHA loan and were represented by a buyer's agent. The buyers contend that FHA regulations required that the well on the property be tested for contamination, including arsenic levels, prior to any sale.

Unfortunately, the buyers have suffered serious health problems. One buyer has been diagnosed with liver cancer, and a child has been diagnosed with lymphoma. Further, the then-seller of the home has recently been diagnosed with ovarian cancer. The buyers have sued both the listing agent and their buyer's agent. The buyers claim that the buyer's agent failed to disclose the existence of a nearby Superfund waste site prior to closing. Further, they claim that the buyer's agent was in possession of a well inspection report that demonstrated that there was arsenic in the well and intentionally withheld the inspection report from them.

The buyer's agent in this case never had an inspection report of any kind in its possession. Further, the buyer's agent in this case had used the MAR form of Exclusive Buyer Agency Agreement. Thus, the REALTOR® will, in part, rely upon the disclaimer contained within that form with respect to environmental matters.

d. Competing with Buyer-Clients

As most REALTORS® are aware, it is extremely difficult for a REALTOR® to purchase for himself a property that was once pursued by a buyer-client. Since a REALTOR® owes fiduciary duties to his buyer-clients, which include a duty of complete loyalty, it is extremely difficult for a REALTOR® to defend his purchase of a property that, at one time, was being pursued by a buyer-client. It would appear that there are three (3) scenarios under which these types of claims arise.

First, in some instances a buyer simply cannot timely meet his obligations under a purchase agreement. The REALTOR®, in a total act of loyalty, arranges to purchase the property with every intent of reselling it to the buyer. Thereafter, buyer, for whatever reason, cannot purchase the property from the REALTOR®. The buyer then contends that the REALTOR® breached his fiduciary duty by buying property that the buyer intended to

purchase. The buyer will have a hundred reasons why he could have purchased the property but for the acts or omissions of his REALTOR® agent. There is an easy solution to this scenario. The REALTOR® needs to enter into a written agreement with his buyer-client stating that the REALTOR® is purchasing the property for the account of his client. The agreement should also set forth the terms under which the buyer will buy the property from the REALTOR®, *i.e.*, the price and the time period during which the purchase will be made.

In the second scenario, a REALTOR® has worked very hard with a buyer-client to attempt to purchase a parcel of property. The client's efforts have failed and it appears the client has no further interest in the property. The REALTOR®, recognizing a good deal, purchases the property. The buyer-client then contends that he was still interested in the property, was about to obtain the necessary financing to purchase the property and cannot do so because of the breach of the fiduciary duty by the buyer's agent. Again, this situation can be easily addressed in a written agreement. Prior to purchasing the property, the REALTOR® should obtain a written agreement from his buyer-client stating that the buyer-client has no further interest in, or the capability of purchasing, the property.

Third, there is the situation where a REALTOR® becomes aware of an extremely good investment opportunity while showing properties to a buyer-client. When the client expresses an interest in this property, the REALTOR® actively discourages any interest through the provision of false information. The REALTOR® then submits his own offer and purchases the property. There is no solution to this situation, as the REALTOR® has breached his fiduciary duty owed to his client.

In sum, whenever for whatever reason a REALTOR® seeks to purchase property that has been the subject of interest of a buyer-client, the REALTOR® needs to make certain that she not only obtains her client's consent, but also that she can document the fact that buyer consented.

e. Agency Responsibility Act Issues

At the time this article was prepared, there were two primary issues being raised by buyer's agents with respect to the provisions of the new Michigan Agency Responsibility Act (the "ARA").

First, a portion of the ARA lists five (5) services, three of which can be waived by a client. One of the non-waivable services is:

For a broker or associate broker who is involved at the closing of a real estate or business opportunity transaction furnishing, or causing to be furnished, to the buyer and seller, a complete and detailed closing statement signed by the broker or associate broker showing each party all receipts and disbursements affecting that party. MCL 339.2512d(3)(e).

This provision of the ARA has been construed by some as indirectly amending the rules previously promulgated by the Department of Labor & Economic Growth with respect to closings. Some persons have indicated to buyer's agents that they must appear at closing and provide a closing statement to a seller and buyer, along, apparently, with the closing statement provided by the listing broker. This is simply not the case.

Rule 311(4) specifies that in a cooperative transaction, it is the final responsibility of the listing broker or associate broker to close the sale and furnish signed closing statements to both the buyer and the seller. The ARA does not change that requirement, but simply speaks to the "broker involved at the closing of a . . . transaction." While some legislation does at times result in ridiculous, unintended consequences, this is not the case with the ARA. Again, buyer's agents are not required to provide duplicative closing statements to sellers and buyers who are already being provided those closing statements by the listing broker.

A second area of confusion involves the statutory form to be used when a REALTOR® is providing limited services to a seller or buyer, *i.e.*, the seller or buyer is agreeing to waive one or more of the three waivable services. Some REALTORS® have used the new statutory form as a limited services agreement. This is not sufficient. The new "statutory form" is not a form at all, but a number of separate provisions **to be included in, or used in conjunction with**, a limited services agreement. The statutory limited services provisions alone do not contain all of the necessary provisions that must be included in any listing agreement – *e.g.*, commission amount, expiration date, anti-discrimination language. Limited services agents will need to develop their own contracts that include the new statutory language, but that also contain all of the other provisions necessary to establish an agency relationship.

CONCLUSION

For many years, we have urged REALTORS® representing buyers to use written agency agreements. Unfortunately, for many years, the most common "agency agreement" with buyers has been the agency disclosure form. Obviously, this form does not constitute any type of agreement with a buyer. It is absolutely critical that all REALTORS® use written buyer's agency agreements containing the necessary disclaimers. This requirement is even more important for REALTORS® providing limited services as this simply cannot be done legally without the appropriate written form.

DUAL AGENCY – A REFRESHER

In the 1980s, REALTORS® throughout the nation were beset by claims of dual agency, *i.e.*, claims that the REALTOR® represented both the seller and buyer without the informed consent of both parties. Fortunately, Michigan REALTORS® were able to successfully fend off many dual agency claims during that period of time. Further, a set of procedures and forms were developed to make certain that dual agency claims did not become common in Michigan. However, in this very difficult real estate market, some REALTORS® are beginning to cut corners simply in an effort to survive. Unfortunately, cutting corners will ultimately result in the opposite result. Thus, we offer a brief refresher on dual agency and the procedures to handle it.

Under Michigan law, if a dual agency situation arises without the full knowledge and consent of the parties, the contract negotiated by the agent is voidable at the option of either buyer or seller who did not have knowledge of the dual agency. Almost 100-year old Michigan case law stands for the proposition, “a broker cannot act as the agent of both parties where their interests are conflicting.” Further, it is not even necessary for a party seeking to void a contract based on non-disclosed dual agency to show that any improper advantage has been gained or damage has been suffered by him. A party may repudiate the contract irrespective of any proof of active fraud. Further, a broker who has acted for both buyer and seller without the full knowledge of both is not allowed to recover compensation from either. Dual agency without informed consent is, among other things, a breach of an agent’s duty of good faith.

The Occupational Code also contains statutory prohibitions against undisclosed dual agency. In particular, MCL 339.2512(1) specifies that it is a violation of the Occupational Code when a licensee acts for more than one party in a transaction without the knowledge of the parties. The statutory provision subjects a licensee to various penalties for acting for more than one party in a transaction without the knowledge of the parties. A violation of this section subjects the licensee to the penalties listed in Article 6 of the Occupational Code, including: suspension of a license; denial of a license; denial of renewal of a license; revocation of a license; a civil fine not to exceed Ten Thousand Dollars (\$10,000.00); censure; probation and/or a requirement that restitution be made. These statutory penalties are in addition to and cumulative with any or whatever legal remedies are available to the buyer or the seller.

If a REALTOR® firm does not practice designated agency, but is also in the practice of representing buyers, then the firm’s listing agreement must have a provision dealing with dual agency. The provision would set forth the understanding and agreement of the seller that the REALTOR® represents buyers, and one or more of those buyers may become interested in buying the seller’s property. Further, this provision will also provide that the REALTOR® will preserve any confidential information learned during the agency relationship with the buyer and, further, that the REALTOR®’s failure to disclose the confidential information to the seller will not constitute a breach of fiduciary duty.

The MAR listing form contains the following dual agency provision:

SHOWING PROPERTY/DUAL AGENCY: Seller understands and agrees that REALTOR®/Broker can show Seller's property to, and obtain offers from, all prospective buyers, including buyers with whom REALTOR®/Broker has an agency relationship. In the event a buyer which REALTOR®/Broker has an agency relationship shall become interested in the Property, REALTOR®/Broker shall notify both the Seller and the buyer of its intention to represent both and obtain both parties' written consent to the dual agency. *REALTOR®/Broker will preserve any confidential information obtained during an agency relationship with a buyer and will not use such confidential information to the detriment of that buyer. Seller acknowledges and agrees that the preservation of this confidential information shall not constitute a breach of any fiduciary duty owed by REALTOR®/Broker to Seller.* Seller also understands and agrees that as part of marketing the Property, REALTOR®/Broker will show potential buyers properties other than Seller's and provide such buyers with information on the selling prices in the area.

The inclusion of this dual agency provision in the listing agreement is required for both a practical and a legal reason. As a practical matter, if a REALTOR® firm represents sellers and buyers, it is not likely that the REALTOR® firm will be able to obtain a separate, side agreement with the seller prior to the time that one of the firm's agents shows the seller's home to a buyer represented by the firm. Thus, obtaining the seller's consent to dual agency prior to it occurring is necessary. This of course does not eliminate the need to ultimately enter into a dual agency agreement or dual agency addendum once a buyer represented by the firm wishes to make an offer on the seller's listing.

The legal reason for including the dual agency provision in a listing agreement is to avoid breaching the respective fiduciary duties owed to both the seller and the buyer when the firm represents both parties. As an example, under common law, both the seller and the buyer are entitled to have all of their material information held completely confidential and to have all other material information disclosed to them. Thus, under the common law, the seller would be entitled to know any material information known by the REALTOR® firm about the buyer, but the REALTOR® firm in turn would have an obligation to the buyer to keep that information confidential. The only way to address this possible source of liability is through a dual agency provision in the listing agreement (and the buyer's agency agreement).

In a designated agency firm, the law in Michigan provides that it is not a dual agency situation where two different designated agents in the firm represent the buyer and seller. This does not mean that a dual agency situation can never arise in a designated agency firm. Where the buyer and seller are represented by the same designated agent, or have the same supervisory broker, those individuals are dual agents and the same conflicting fiduciary duties arise. Although it is less likely that a dual agency situation will arise in a designated agency office, the possibility certainly exists. For this reason, designated agency firms are also encouraged to include dual agency consent language in their listing agreements. A sample of a dual agency provision from a designated agency listing agreement is:

DUAL AGENCY: In the event a buyer who has an agency relationship with any of the designated agent(s) and/or supervisory broker(s) named above shall become interested in the Property, Seller consents to the dual agency status of such designated agent(s) and/or supervisory broker(s). *In this event, the dual agent(s) will preserve any confidential information obtained during the agency relationship with the buyer and will not use such confidential information to the detriment of that buyer. Seller acknowledges and agrees that the preservation of this confidential information shall not constitute a breach of any fiduciary duty owed to Seller.* Seller also understands and agrees that as part of marketing the Property, Seller's designated agent(s) may show potential buyers properties other than Seller's and provide such buyers with information on the selling prices in the area.

Remember that under the law, you do not have a designated agency arrangement with your seller unless the listing agreement expressly states that it is a designated agency listing. It is impossible to create a designated agency relationship without an agreement signed by the seller designating specific persons as the seller's agents.

Are All the Forms Necessary?

We are often asked why it is necessary for REALTORS® to have a separate dual agency agreement signed at the time the dual agency situation arises. If the REALTOR® simply relies upon the sellers' and buyers' consent at the beginning of their agency relationship, it could be argued that the seller or buyer did not fully understand that to which they were consenting, *i.e.*, limited representation. Moreover, buyers and/or sellers could argue that they were not only entitled to notice that a dual agency situation COULD arise, but also that a dual agency HAD ARISEN.

Certainly, an agency disclosure form, signed at the time the dual agency situation arises provides an opportunity to demonstrate that the seller and buyer were fully informed. However, MAR has always recommended a “belt and suspenders” approach to make certain that neither the sellers nor buyers can claim that they did not provide timely and fully informed consent to the dual agency situation. The use of a dual agency agreement signed at the time the dual agency situation actually arises that identifies real live buyers and sellers virtually eliminates any potential claim that the seller or buyer did not provide their full, informed consent to dual agency.

The clauses and the procedures described in this article are battle-tested. There is no reason not to use them.

FORECLOSURES & SHORT SALES: SELECTED ISSUES

INTRODUCTION

Over the past 18 months, MAR has produced voluminous information on the subject of foreclosure and short sales. There are at least two white papers and a three-part series of articles in the Michigan REALTOR® magazine on this subject. All of these materials can be accessed on MAR's website. This article addresses certain select issues based on calls to the MAR Legal Hotline that appear to be very prevalent at this time.

In preparing this article, it is assumed that the reader has at least reviewed the three-part series on foreclosures and short sales in the Michigan REALTOR® magazine. Otherwise, some of the discussion may be difficult to follow. Further, readers are reminded that the foreclosures discussed in this article are foreclosures by advertisement of single family homes, *i.e.*, residential properties of four units or less or on less than three acres of land. The information provided in this article may not be applicable to foreclosures of other types of properties.

DISCUSSION

f. Abandonment

Lenders are increasingly using the “abandonment” process to obtain quick possession of the home they are foreclosing. The abandonment process starts with a lender making an inspection of the property to find out if the owner/debtor is presently occupying the property or someone authorized by the owner/debtor is occupying the property. If the property is vacant, the lender will also make a determination as to whether the owner/debtor intends to occupy the property in the future. If the lender makes the determination that the property is vacant and the owner/debtor does not intend to occupy the property in the future, the lender can post a notice on the property at the time of the inspection and send the notice by certified mail, return receipt requested, to the owner/debtor at his last known address. The notice will alert the owner/debtor that the lender considers the property abandoned, and that the owner/debtor will lose all rights of ownership thirty days after the foreclosure sale. If the foreclosure sale has already occurred, the notice will provide that the owner/debtor will lose all rights of ownership within fifteen days after the lender mails the notice to the owner/debtor unless, within that 15-day period, the owner/debtor provides written notice to the lender by first class mail that the owner/debtor has not abandoned the property.

An issue that is frequently raised is whether a lender may deem a property abandoned if a tenant occupies the property. The quick answer is that a lender may not declare a property abandoned if it is occupied by a tenant. The statute indicates that property is not abandoned if there are persons in possession of it who are claiming under the owner, *i.e.*, are authorized by the owner to occupy the property.

Another issue that also arises is whether a lender can declare a property to be abandoned after the foreclosure sale. Again, there is a quick answer to this question. A lender most certainly can declare a property abandoned at any time during the foreclosure process, including after the foreclosure sale. Thus, when listing properties that are in the foreclosure process, REALTORS® should always inquire as to whether the sellers or someone claiming under them is occupying the property.

Finally, an issue that constantly arises is whether a lender may declare a property abandoned if the property is vacant but is listed by a REALTOR®. In other words, the property is listed in the MLS, the REALTOR®'s sign is in the front yard, and a key box is on the property. Typically, the lender has gone through the abandonment process and has not received a response from the owners/debtors indicating that they are declaring the property abandoned. The REALTOR® listing the property appears at the property and finds that their sign has been removed, along with the key box. While a strong legal argument could be made that the owners/debtors certainly have not abandoned the property, inasmuch as they have listed it with a REALTOR®, the practical answer is that very little can be done in this situation. Even if the property is deemed by a court not to be "abandoned," the "standard" redemption period will have run long before that decision is made. In addition, typically a foreclosed owner/debtor will hardly have the funds or the inclination to hire an attorney to obtain an injunction and challenge the lender's determination of abandonment.

g. Deficiencies

Many sellers spend many sleepless nights worrying about whether their lender will sue them for a deficiency after a foreclosure sale. Their concern is premised on the notion that if there was a \$200,000 mortgage on the property and after foreclosure the lender resells the property for \$160,000, then the sellers will be responsible for a \$40,000 deficiency. In most instances (probably 99 percent of the time with residential mortgages), these worries by the sellers are misplaced and based on a misunderstanding of the law and the foreclosure process.

Assume that 123 Elm Street is owned by the Browns and is subject to a mortgage granted to Ace Bank in the amount of \$200,000. Unfortunately, the Browns default on their loan and Ace Bank forecloses its mortgage. At the foreclosure sale on May 1, Ace Bank bids \$200,000. The Browns attempt to sell the property during the six-month redemption period, but are unsuccessful in doing so. Four months after the end of the redemption period, Ace Bank resells the property for \$175,000. Can Ace Bank now pursue the Browns for \$25,000? Absolutely not, under Michigan law. Michigan follows the so-called "full credit bid" rule. If the credit bid of the lender is equal to the unpaid principal and interest on the mortgage, plus the costs of foreclosure, it is known as a "full credit bid." When a lender makes a full credit bid, the mortgage debt is satisfied and the mortgage is extinguished. If subsequent to the foreclosure sale the lender discovers that the property is worth less than the amount it bid at the sale, under the full credit bid rule, the lender has no recourse against the seller or anyone else for its loss. This result was recently reaffirmed in an unpublished decision of the Court of Appeals, in *New*

Freedom Mortgage Corp v Globe Mortgage Corp, unpublished opinion per curiam of the Court of Appeals, issued August 5, 2008 (Docket No. 274864); 2008 WL 3013400.

h. Short Sale Service Providers

Many REALTORS® have expressed frustration with respect to the time involved and the uncertainty of closing short sales. In response to REALTORS®' frustrations and needs, entities have begun providing short sale services to REALTORS®. It may well be that some of these entities can facilitate short sales for the positive benefit of REALTORS® and their clients. However, REALTORS® and their clients must review the form and structure of the services that will be provided by the short sale provider to make certain that they will not work to their detriment.

Assume that REALTOR® Brown has taken a listing which he has determined can potentially fetch a purchase price of \$190,000. Unfortunately, the owners have granted first mortgage in the amount of \$150,000 and a second mortgage in the amount of \$50,000. REALTOR® Brown has not previously attempted to close a short sale. Thus, he and his clients engage the services of a short sale services provider to facilitate the sale of the property.

Assume further that Ace Short Sale Services has a program by which it eliminates the need for a buyer to wait on the lender's approval of a proposed short sale. Ace Short Sale Services immediately obtains a straw buyer for the property for \$170,000. This offer is submitted to the lender and the short sale process begins. In the meantime, REALTOR® Brown continues to market the property at a sale price of \$200,000. Ultimately, Ace Short Sale Services obtains the lender's approval of the straw buyer for the price of \$170,000. Both lenders are willing to take the necessary reductions in their indebtedness to permit the transaction to close. Thereafter, REALTOR® Brown finds an actual buyer for the property in the amount of \$185,000. The seller then accepts the actual buyer's offer without conditioning it upon approval from the lenders, as Ace Short Sale Services has already obtained the agreement of the lenders to accept \$170,000.

A closing is held with the straw buyer for \$170,000, at which time mortgage discharges are obtained from the two lenders. Immediately following that closing, the closing with the actual buyer occurs, netting an additional \$15,000 in proceeds. The proceeds from the second closing are used to pay closing costs, including Ace Short Sale Services' fees.

There may be legal difficulties attendant to this transaction. If the lenders are never advised that the first buyer was a straw buyer and that the property would actually sell for an additional \$15,000, a claim could be made that fraud incurred in inducing the lenders to accept lesser funds in consideration for the discharges of their mortgages. If representations were made to the lenders that the property had a market value of \$170,000 and an actual offer was procured to substantiate that fact, a claim could be made that these representations violate federal law, which prohibits false statements to induce a lender to attach a specific value to a property.

i. Title Insurance Issues

REALTORS® representing buyers who are purchasing foreclosed properties from lenders need to be particularly aware of some title insurance products that are being offered to their buyers. As REALTORS® are aware, Rule 339.22309 provides as follows:

A licensee who is involved at the time of execution of an offer to purchase in a real estate transaction shall recommend to the purchaser that a fee title policy in the amount of the purchase price be furnished to the purchaser by the seller, issued or certified to the approximate date of the closing of the real estate transaction.

Some lenders offer to provide the buyers with only a title search from the date of foreclosure through the date of closing. A title search provides absolutely no title insurance protection. Further, a title search would not even disclose any liens that arose prior to the foreclosure sale but which were not extinguished by the foreclosure sale, *e.g.*, a second mortgage was foreclosed but the first mortgage still exists.

In response to receipt of these title searches and in compliance with Rule 339.22309, REALTORS® have demanded on behalf of their buyers that the lender provide them with a title commitment. The lender dutifully provides a title commitment. The title commitment should be carefully reviewed to determine if it really does provide title insurance. This author has reviewed title commitments which except matters of record and not of record from their coverage, *i.e.*, they cover nothing. If there is any doubt with respect to the provisions of a title commitment, the REALTOR® should direct the buyers to an attorney who is knowledgeable in matters of title insurance.

j. Second and Third Mortgages

At the beginning of the foreclosure crisis some eighteen months ago, there was some uncertainty as to the effect of the foreclosure of a first mortgage on second and third mortgages on the property. There was a belief by some that the occurrence of the foreclosure sale of the first mortgage extinguished the second and third mortgages, for which there would never be a possible return. Thus, in listing and dealing with a foreclosed property, a REALTOR® would only have to worry about satisfying the first mortgage in order to close the transaction. Obviously, this information was completely incorrect.

Upon the foreclosure of a first mortgage, the second and third mortgages are not yet fully extinguished. The second and third mortgages will only be extinguished if the redemption period runs and the property is not redeemed. If the short sale is completed and the first lender is paid off (*i.e.*, the property is redeemed), then the second and third mortgages will NOT be extinguished. They will remain as liens on the title to the property. Thus, when purchasing property from an owner/debtor (rather than a lender), all three mortgages must be discharged.

k. Multiple Offers to Lenders

No one questions the fact that in pursuing a short sale, REALTORS® must move as swiftly as possible in obtaining and forwarding offers to lenders for approval. Thus, a practice has developed in situations in which REALTORS® are receiving multiple offers for a property in the foreclosure process. Some REALTORS® are having each of these offers signed and accepted by the seller and thereafter forwarded to the lender. Each offer that is accepted by the seller is expressly made subject to the lender's approval. Is there a potential difficulty with this practice? Upon the seller's acceptance of an offer subject to the lender's approval, should the property be deemed "pending" in the MLS?

With regard to the second question, a very strong argument can be made that a binding purchase agreement is in place when the seller accepts an offer subject to the seller's approval. It cannot be argued that an offer by a buyer that is accepted by a seller and contains a financing contingency for the buyer is not a binding purchase agreement. If this is the case, then it is difficult to argue otherwise when the seller accepts, also contingent upon her lender's approval.

The concern about having two (or more) accepted offers forwarded to a lender subject to the lender's approval is a practical one. If the lender indicates its approval of both offers, then the seller will have sold the property twice. In this case, typically one buyer gets the property and the other buyer gets a check.

l. Rights of Owners during the Redemption Period

A most basic issue continues to arise with respect to the owner's rights to possess the home after the foreclosure sale and during the redemption period. This should be a non-issue. Under Michigan law, an owner remains in full possession and control of his property until the end of the redemption period.

A recent decision of the Michigan Court of Appeals involved a situation where there were two houses on the property, both subject to the lender's mortgage. The lender entered one of the houses in order to take action to preserve the vacant property. Upon taking those actions, the lender padlocked all of the doors and blocked any ways of entry into the structure. The Court of Appeals determined that the lender had a right to enter the property to take actions to preserve the property based on a provision in its mortgage that granted it that right. However, the Court of Appeals also determined that the sellers could proceed with a claim for trespass based upon the lender's locking them out during the redemption period.

m. REO Compliance Fees

The issue of so-called "REO compliance fees" generally comes up under a scenario in which a REALTOR® submits an offer for a property that is listed by another REALTOR® for a bank that has obtained title to the property through the foreclosure process. The REALTOR® representing the buyer submits the offer to the listing broker. The REALTOR® representing the buyer then receives an addendum to the proposed purchase agreement from the listing broker.

The addendum calls for the buyer to pay the listing broker a fee (*e.g.*, \$400) as an “REO compliance fee” and as a condition of submission of the offer to the bank. The issue is whether the listing broker can impose the REO compliance fee on the buyer as a condition of presenting the offer.

The answer depends upon who is imposing the condition in the first place. If the bank is requiring the listing broker to collect the REO compliance fee as a condition to its entertaining offers from buyers, then the REO compliance fee would be a lawful condition imposed by a seller with respect to the sale of the seller’s property. If, on the other hand, the bank is not requiring the REO compliance fee and has not imposed it as a condition of receiving offers from buyers, then the listing broker’s failure to present the buyer’s offer to the bank within a reasonable period of time could well be construed as a violation of Michigan license law.

CONCLUSION

Readers of this article are again referred to MAR’s website for more comprehensive materials on foreclosures and short sales. This article is not intended to be a comprehensive article, but simply attempts to address certain select issues that frequently arise.

LEASES WITH OPTIONS

I. INTRODUCTION

Sellers who are unable to sell their home may elect to offer to lease it with an option to purchase. The sellers may hope that this arrangement will give them a stream of income during the term of lease that is sufficient to cover their mortgage payment as well as the property taxes and insurance expenses. There are, however, a number of issues that should be considered prior to entering into a lease/option arrangement.

II. DISCUSSION

A. Crafting a Proper Option to Purchase

An option to purchase gives the holder the right to elect to purchase a property at a particular price. In other words, an option is an irrevocable offer to sell a property for a particular period of time. If the option is exercised, it must be executed prior to its stated expiration date. Unlike time deadlines in other contracts, traditionally Michigan courts have strictly enforced time deadlines in option contracts. This is true for the other terms of an option contract as well. So, for example, if an option provides that you must exercise the option by hand delivering written notice to the seller, do not attempt to exercise your option via email.

An option should be effective upon its exercise. It should not require parties to execute a separate purchase agreement. Because of this, an option contract should spell out the essential terms of the purchase – *e.g.*, title insurance requirements, commission obligations, inspection requirements, tax proration methods, etc. Without these provisions, the option may be difficult to enforce. If, for example, I have an option to buy your home for \$200,000, but we have not agreed upon the other essential terms of purchase, then rather than attempt to draft these additional terms on our behalf, a court may simply find the agreement to be unenforceable. A sample form of option clause for a lease agreement is attached as Exhibit A.

It is typical, but not necessary, for some portion of the rental payments received during the term of the lease to be applied toward the purchase price in the event the option is exercised. Option fees are typically forfeited in the event the option is not exercised. Again, however, this is a matter subject to negotiation.

In order to encourage a tenant to make timely rental payments during the term of the lease, a seller may wish to consider including a clause that provides that the tenant's purchase rights will automatically terminate in the event of a default (or a series of defaults) under the lease.

B. Memorandums/Recording

To protect their rights in a home as against subsequent purchasers, persons holding an option to purchase will want to have an interest of record with the appropriate register of deeds. While the option itself may be recorded, oftentimes parties prefer to record a memorandum which simply acknowledges the existence of the option, but does not make the terms of such contract a matter of public record. A sample memorandum of option is attached as Exhibit B. A party may wish to omit notary blocks from the option agreement itself in order to prevent the other party from later recording the instrument.

C. Due-on-Sale Issues

Most, if not all, residential mortgages contain a due-on-sale clause which requires that a mortgage be paid off if there is a change in ownership. Federal law specifically provides that due-on-sale clauses are enforceable by federally regulated lenders. Other lenders are governed by the somewhat more complicated Michigan statute. As a general rule, REALTORS® should assume that a mortgage contains a due-on-sale clause and that it is enforceable.

A typical due-on-sale clause provides something like this:

If all or any part of the property is transferred without the lender's prior written consent, the lender may require all sums secured thereby immediately due and payable.

Whether a due-on-sale clause is triggered by a lease/option may depend on the specific language of the due-on-sale clause and/or the terms of the lease/option itself. Many mortgages expressly provide that specific types of leases and/or leases/options will trigger the due-on-sale clause. Others provide generally that the clause applies in the event of a transfer of *any interest* in the property.

Commentators often point out that there are no federal or state statutes that make it a crime to violate a due-on-sale clause. It is simply a contractual obligation pursuant to which if the lender discovers the transfer, it may choose to call the loan. While this is certainly true, REALTORS® should never advise a client as to whether a particular due-on-sale clause covers lease options or whether it is likely that the lender will discover the transfer and call the loan. While it is not against the law to violate a due-on-sale clause, it is against the law for a person who is licensed to do business in this state to knowingly assist a person in evading the enforcement of a due-on-sale clause. MCL 445.1628(2). A real estate licensee can be fined up to \$5,000 for each offense and be subject to revocation of his license for a violation of this law. Sellers should be advised that it is almost certain that their mortgage contains such a clause and that they should discuss this matter with an attorney before proceeding forward with a lease/option agreement.

D. Principal Residence Exemption and Other Property Tax Issues

A home that is leased does not qualify for the principal residence exemption (previously known as a “homestead exemption”). As a result, a homeowner who leases his home may experience a significant property tax increase.

Moreover, a lease option will be a transfer subject to the “pop up” tax if the lease is for more than 35 years (including all renewal options) or if the option price is not more than 80% of the property’s projected value at the end of the lease.

If the tenant defaults and the lease is terminated, the homeowner will not be able to resurrect his homestead exemption. Once the home is leased, the homestead exemption is forever lost unless a homeowner moves back into his home and reestablishes it as his principal residence. Returning to the home will not, however, help a homeowner whose taxable value has been adjusted as a result of a lease/option. A homeowner who moves back into his house after suffering through a bad tenant may, with time, be able to reestablish his homestead exemption, but will not be able to reestablish the taxable value as the value that was in place prior to the lease/option.

E. Local Rental Ordinance Issues/Restrictions

Persons who wish to rent their homes should check with their local government to determine whether there are any required permits, licenses, inspections or fees. There may also be applicable subdivision or condominium restrictions of record that prohibit or restrict rentals. And there may be unique issues depending upon the location of the property. For example, the City of East Lansing has an ordinance pursuant to which rentals are prohibited in certain areas within the City. Over the years, the City of East Lansing has also settled many code violation matters by imposing a “consensual” deed restriction which prohibits any future rentals of that particular home. The only way to know about leasing restrictions is to contact the municipality and also to obtain a title search.

F. Insurance Issues

Many insurance policies require continued owner occupancy. While obviously there are policies available for leased homes, the premium is typically higher. Homeowners should discuss this issue with their insurance agent before they lease the home. A seller who does not address this issue who suffers a fire or other casualty may end up with a denied claim. While the cost of insurance may be passed onto a tenant, the homeowner will want to make sure that he is protected by obtaining the coverage himself and collecting reimbursement from this tenant.

G. Financial Risks to Owners and Tenants

A tenant with an option to purchase will want to make certain that the homeowner does not owe more on his house than the option price. Similarly, if the homeowner/landowner is responsible for paying taxes and insurance, the tenant will want to make certain that these items are current. These concerns are particularly important where the tenant will have a significant investment in the property by the time the option is exercised.

The homeowner, on the other hand, will want to take steps to protect his investment should the tenant be unwilling or unable to exercise the option to purchase. A homeowner typically will want control over the extent and nature of any renovations made to the home before the home is actually sold. Likewise, the homeowner will want control over sublets and assignments of the lease/option rights.

III. CONCLUSION

The purpose of this article is not to encourage REALTORS[®] to begin drafting lease option agreements or to offer legal advice as to advisability of such a course of action. Rather, the purpose of this article is to familiarize REALTORS[®] with various issues that may arise with lease/options. Clients should always be strongly encouraged to seek the assistance of counsel when considering lease/options.

EXHIBIT A

SAMPLE OPTION CLAUSE FOR INSERTION IN LEASE

Landlord hereby grants Tenant the option to purchase the Property (the “Option to Purchase”) for a total purchase price of _____ (\$_____) (the “Purchase Price”) by providing notice of the exercise of the Option to Purchase during the term of this Lease (the “Option Period”). The terms of the Option to Purchase shall be as follows:

a. Within fourteen (14) days of the Commencement Date, Tenant shall obtain a commitment for an owner’s policy of title insurance with standard exceptions for the amount of the Purchase Price. Upon receipt of the commitment, Tenant shall notify Landlord of any objections to the condition of the title, including any conditions reflected in the commitment which render title unmarketable, within fourteen (14) days of receipt, and thereafter, Landlord shall have thirty (30) days to cure any such defects. If Tenant’s objections to the condition of the title are not timely cured, Tenant may either: (i) terminate the Lease and receive a refund of the Earnest Money; or (ii) waive his objections. In the event the Option to Purchase is exercised, Landlord shall provide, at its expense a policy of title insurance in the amount of the Purchase Price pursuant to the commitment approved by Tenant pursuant to this Section. If Tenant exercises its Option to Purchase, any objection to condition of title, including any conditions reflected in the commitment which may render title unmarketable, shall be deemed waived by Tenant.

b. Tenant may exercise the Option by delivering to Landlord written notice of its intent to exercise the Option to Purchase during the term hereof.

c. Upon exercise of the Option to Purchase, Landlord and Tenant shall close the transaction within _____ days thereafter.

d. Upon closing of the sale of the Property, Landlord shall convey fee simple title to Tenant by a warranty deed in recordable form.

e. Upon closing of the sale of the Property, Landlord shall pay all county and state transfer taxes associated with the conveyance. Tenant shall pay the cost of recording the warranty deed. Landlord and Tenant will share equally the title company’s closing costs.

f. One hundred (100%) percent of the divisions available under Section 108 of the Land Division Act are to be transferred by Landlord to Tenant upon closing after Tenant’s exercise of the Option to Purchase. Landlord makes no representations as to the number of divisions available.

g. Tenant shall have no right to exercise its Option to Purchase if it is in default under the terms of this Lease during the period of time permitted for exercise of the Option to Purchase until it cures any such default during the period for exercise of its Option to Purchase.

h. Tenant shall not have the right to assign its interest in the Option to Purchase without the Landlord’s prior written consent.

i. Landlord agrees that at the request of Tenant, it shall execute a Memorandum of Option Agreement which shall evidence Tenant’s Option to Purchase, which shall be in recordable form and may be recorded by Tenant with the Register of Deeds for the County of _____.

EXHIBIT B

MEMORANDUM OF OPTION AGREEMENT

THIS MEMORANDUM OF OPTION is made and entered into as of the _____ day of _____ 200__, between _____, a Michigan _____, whose address is _____ (“Optionor”), and _____, a Michigan _____, the address of which is _____ (“Optionee”).

WITNESSETH:

For valuable consideration, Optionor has granted to Optionee an option, commencing on the date hereof (the “Commencement Date”) and expiring on _____ (the “Expiration Date”), to purchase a certain parcel of land situated in the Township of _____, _____ County, Michigan, more specifically described in Exhibit 1 attached hereto (the “Property”), pursuant to the terms of a certain option agreement dated this date between the parties hereto (the “Option Agreement”).

This instrument is executed for the purpose of giving public record of the fact of the execution of the Option Agreement and all the terms and conditions of the Option Agreement are incorporated herein by reference, and any reference to the Option Agreement may be made by referring to the Liber and Page in which this Memorandum of Option Agreement is recorded in the office of the Register of Deeds of _____ County, Michigan.

IN WITNESS WHEREOF, the parties hereto have executed this Memorandum of Option Agreement as of the day and year first above written.

OPTIONOR:

By: _____
Its: _____

STATE OF MICHIGAN)
)ss
COUNTY OF _____)

The foregoing instrument was acknowledged before me, a Notary Public, this _____ day of _____ 200__, by _____, the _____ of _____

EXHIBIT 1

Legal Description for Property

RECENT CHANGES IN REAL PROPERTY TAX LAW

I. INTRODUCTION

In the past couple of years there have been a couple of significant changes in the law as it relates to real property taxes. The first two changes that we will discuss below were made intentionally through actions by the legislature. The final “change” was actually an interpretation of existing law made earlier this year by the Michigan Supreme Court. This article will discuss these recent changes.

II. DISCUSSION

H. Property Tax Appeals

In 2006, the legislature made several changes to the filing requirements for property tax appeals. For property classified as “commercial,” “industrial” or “developmental,” a property owner can now appeal directly to the Michigan Tax Tribunal (“MTT”) without filing first with the local board of review. Remember that a property’s “classification” for tax purposes is not necessarily its current use. The law requires assessors to classify each parcel of property annually. A parcel is assigned to a category based upon the current or “probable future use” of the parcel, or in some cases, the physical characteristics of the parcel.

Under the new law, for “commercial,” “industrial” and “developmental” property, the petition must be filed with the MTT on or before May 31st of the tax year involved. This new deadline applies whether or not a challenge was filed with the local board of review.

This same legislation extended the MTT filing deadline for property classified as “residential,” “agricultural” or “timber-cutover” property until July 31st. As before, an owner of this type of property cannot appeal to the MTT unless he first went to the local board of review.

Finally, the legislation made clear that a petition is deemed “filed” within the time deadline if it is hand-delivered or postmarked on or before the expiration of the filing deadline. A petition required to be filed on a day in which the MTT offices are closed must be filed by the next business day.

I. Principal Residence (Homestead) Exemption

As REALTORS® are well aware, owner occupied homes (now known as “principal residences”) are exempt from school operating taxes. Until recently, a person could only claim one principal residence for this exemption.

Earlier this year the law was amended so that a person who purchases a new home but has not yet sold his prior home can claim an exemption on both homes. In this scenario, the prior home receives what is called a “conditional recission.” In order to qualify for a conditional recission on his prior home, a person must claim a principal residence exemption on his new residence. A person who is currently renting a home or who has moved outside of the State will not qualify for an exemption on his prior unsold residence. Perhaps the easiest way to understand this rule is to keep in mind that the purpose of the legislation was to hopefully rejuvenate the real estate market by creating an incentive for people to purchase homes in Michigan.

In order to qualify for an exemption, the prior home must be unoccupied, for sale, not leased and not used for any business or commercial purpose. The prior home must have previously qualified for an exemption – *i.e.*, the prior home must have been the owner’s principal residence.

If the prior unsold home qualifies, it can receive a conditional principal residence exemption for up to three (3) years. If the prior home is leased, it no longer qualifies for the exemption. Once the property is leased, the exemption is lost forever. A homeowner cannot reactivate the exemption on this home if the tenant vacates the property. Moreover, the disqualification relates back to December 31 of the year immediately preceding the year in which the home is leased.

In order to qualify, the owner must submit the form “Conditional Recission of Principal Residence Exemption” (Form 4640) to the local assessor on or before May 1st of the first year of the claim. A copy of this form is attached as Exhibit A. Thereafter, the owner must submit Form 4640 on or before December 31st of each year to verify to the assessor that the property is still not occupied, for sale and not leased, and not used for any business or commercial purpose.

J. Toll Northville Ltd v Township of Northville

After Proposal A, the assessed value of property is frozen until the property is “transferred” (other than for inflationary adjustments). Even if there has been no “transfer” of the property, a property’s taxable value may be adjusted if there have been any “additions” which is defined to include “new construction” which, in turn, is defined to mean “property not in existence on the immediately preceding tax day and not replacement construction.” MCL 211.34d(1)(b).

Since the enactment of Proposal A, developers of residential subdivisions and site condominium projects have struggled with these provisions. Consider the hypothetical in which a developer takes 10 acres that he owns and a 20-lot subdivision. Can an assessor increase the taxable value on this property or is the original taxable value on the 20-acre parcel simply apportioned among the individual lots?

On one side of this issue, developers have pointed to the fact that the statute explicitly states that an “addition” does not include an increase of value attributable to “platting, splits or combinations.” MCL 211.34d(1)(c). Assessors, on the other hand, have argued that the statute specifically states that an “addition” does constitute “new construction” and that accordingly, the value of the property must be increased to reflect the value of the infrastructure construction – *i.e.*, the value of the roads, utilities and the like, that the developer has “added” to the previously unimproved land. Some assessors have taken the position that the increased value is reflected in the advertised sale price of the lots and have in fact increased the taxable value to match those prices.

Fortunately this argument was addressed earlier this year in *Toll Northville Ltd v Township of Northville*, 480 Mich 6; 745 NW2d 902 (2008), in which the Michigan Supreme Court affirmed an earlier decision of the Michigan Court of Appeals. The stated issue in the *Toll Northville* case was whether a municipality could increase a developer’s property tax assessment on land it was developing as a subdivision solely because the developer had installed public utilities. The Court of Appeals had held that the assessed value could not be increased in this instance and the Supreme Court agreed, stating:

The Court of Appeals correctly concluded that the mere installation of public-service improvements on public property or on utility easements does not constitute a taxable “addition” – as that term was understood when the public adopted Proposal A. In this instance, involving infrastructure improvements made to land destined to become a residential subdivision.

The Supreme Court went on to opine that in this scenario, the increased value due to the availability of the utilities could be incorporated into the taxable value of each individual home “at the time it is built or sold.”

Obviously, on its face, the *Toll Northville* decision is extremely beneficial to all of those developers in today’s market who are holding unsold lots. Unfortunately, even after this decision, there appears to be no relief available if the taxable values on the developer’s lots were increased in a prior year and the developer did not protest the increases at that time. There are two decisions of the Court of Appeals that hold that an owner can neither protest nor obtain a refund where the increase in taxable value was in a prior year that the taxpayer did not protest or appeal. *Leahy v Orion Twp*, 269 Mich App 527; 711 NW 2d 438 (2006); *Springhill Assoc v Twp of Shelby*, unpublished opinion per curiam of the Court of Appeals, issued December 11, 2003 (Docket No. 247100); 2003 WL 22928911. As a result, if a developer goes to the board of review next year to protest the taxable value based upon an improper increase in the prior year, the board will likely reject the developer’s claim.

III. CONCLUSION

While it is true that a person does not need to be a licensed attorney in order to represent someone before a local board of review or the MTT, REALTORS® are cautioned that the rules for the “pop up” tax are extremely complicated and that the filing deadlines are strictly enforced. A property owner who misses a deadline will have delayed his tax relief for at least a year and, depending on the basis for the relief sought, perhaps forever.

EXHIBIT A

Michigan Department of Treasury
4640 (Rev. 07-08)

Conditional Rescission of Principal Residence Exemption (PRE)

Issued under authority of Public Act 206 of 1893.

Read the instructions before completing the form. This form must be filed with the assessor for the city or township where the property is located on or before May 1 of the first year the exemption is being claimed. For 2008 only, if the May 1, 2008 deadline was missed, the property owner may file an appeal with the 2008 July Board of Review or the 2008 December Board of Review to claim a conditional rescission for the 2008 tax year. In addition, this form must be submitted to the assessor annually on or before December 31 to verify the property still complies with the conditional rescission requirements in order to receive the exemption for the following year. This conditional rescission may only be effective beginning with the 2008 tax year. Use a separate form for each property tax identification number.

PART 1: CONDITIONAL RESCISSION TYPE			
Check the box that corresponds to your conditional rescission (check one box only)			Applicable Tax Year (yyyy)
<input type="checkbox"/> Initial Request	<input type="checkbox"/> Second Year Annual Verification	<input type="checkbox"/> Third Year Annual Verification	
PART 2: PROPERTY INFORMATION			
Property Tax Identification Number		ZIP Code	
Street Address of Property		Name of Township or City	County
		<input type="checkbox"/> Township	<input type="checkbox"/> City
Owner's First and Middle Names	Owner's Last Name	Owner's Social Security Number	Owner's Daytime Telephone Number
Co-Owner's First and Middle Names	Co-Owner's Last Name	Co-Owner's Social Security Number	Co-Owner's Daytime Telephone Number
PART 3: REQUIREMENTS			
PRIOR PRINCIPAL RESIDENCE IN PART 2			
When did the owner(s) of the property in Part 2 relocate? (mm/dd/yyyy)		When was the property listed for sale? (mm/dd/yyyy)	
Is the property currently for sale? <input type="checkbox"/> Yes <input type="checkbox"/> No		Does anyone currently occupy/live in the home located on the property? <input type="checkbox"/> Yes <input type="checkbox"/> No	
If yes, enter an MLS listing or provide other proof that the property is currently for sale.		Is the property currently leased? <input type="checkbox"/> Yes <input type="checkbox"/> No	
		Is the property used for any business or commercial purpose? <input type="checkbox"/> Yes <input type="checkbox"/> No	
CURRENT PRINCIPAL RESIDENCE			
Where did the owner(s) move to? (provide complete address)		County	
		Property Tax Identification Number	
Attach a current tax bill and a PRE Affidavit (Form 2368) for the current principal residence.			
PART 4: OWNER CERTIFICATION			
<i>I (we) certify under penalty of perjury the information provided on this document is true and correct to the best of my (our) knowledge.</i>			
Owner's Signature		Date	
Co-Owner's Signature		Date	
Owner's Current Mailing Address	City	State	ZIP Code

Mail the completed form and necessary documentation to the assessor for the city or township in which the property is located. This address may be on the most recent tax bill or assessment notice. Do not send this form directly to the Department of Treasury. If you have any questions, visit our Web site at www.michigan.gov/treasury or call (517) 373-1950.

Instructions for Form 4640

Conditional Rescission of a Principal Residence Exemption (PRE)

This form enables a person who has established a new principal residence to retain a Principal Residence Exemption (PRE) on property previously exempt as the owner's principal residence. The conditional rescission allows an owner to receive a PRE on his or her current Michigan property and on previously exempted property simultaneously if certain criteria are met. An owner may receive the PRE on the previous principal residence for up to three years if that property is not occupied, is for sale, is not leased, and is not used for any business or commercial purpose.

PART 1: CONDITIONAL RESCISSION TYPE

To initially qualify for a conditional rescission, this form must be filed with the assessor for the city or township on or before May 1 of the year of the claim. For 2008 only, if the May 1, 2008 deadline was missed, the property owner may file an appeal with the 2008 July Board of Review or the 2008 December Board of Review to claim a conditional rescission for the 2008 tax year. The owner must annually submit this form on or before December 31 to verify to the assessor that the property for which the PRE is retained is not occupied, is for sale, is not leased, and is not used for any business or commercial purpose. Submit a separate Form 4640 for each exemption being conditionally rescinded.

- Check the "Initial Request" box if this is the first year of the conditional rescission (on or before May 1 of the year of the claim).
- Check the "Second Year Annual Verification" box if verifying the property still complies with the conditional rescission requirements for the second year (on or before December 31 of the year prior to the second year).
- Check the "Third Year Verification" box if verifying the property still complies with the conditional requirements for the third year (on or before December 31 of the year prior to the third year).
- Provide the applicable tax year of the conditional rescission.

For example, if it is April 21, 2008, and it is your initial request for a conditional rescission, you would check the "Initial Request" box and enter tax year 2008. In the same example, to retain a PRE for a second year, you must submit this form again by December 31, 2008, check the "Second Year Annual Verification" box, enter tax year 2009 and verify the conditional requirements are met for the second year. You must submit this form again by December 31, 2009, to retain a PRE for a third year, check the "Third Year Annual Verification" box, enter tax year 2010 and verify the conditional requirements are met for the third year.

If the owner does not annually verify to the assessor, or the assessor finds the property does not meet these conditional requirements, the assessor shall deny the PRE on that property. If the property is found to be leased, the assessor shall deny the conditional rescission, and the denial will be retroactive and effective on December 31 of the year immediately preceding the year in which the property was leased. If the property was receiving a partial exemption, the partial exemption will be maintained during the conditional rescission.

PART 2: PROPERTY INFORMATION

All of the information in Part 2 must be provided to the assessor to process your conditional rescission.

- Property is identified with a property tax identification number. This number will be found on your tax bill and on your property tax assessment notice. Enter this number in the space indicated. If you cannot find this number, call your township or city assessor. Your property number is vital; without it, your township or city cannot adjust your property taxes accurately.
- Enter the complete property address of the exemption you are rescinding.
- Enter the name of the township or city in which the property is located and check the appropriate box for city or township. If you live in a village, list the township in which the property is located.
- Enter the owner and co-owner's complete name. Do not include information for a co-owner who did not occupy the property.
- Enter the Social Security Number(s) of the legal owner(s). The request for the Social Security Number is authorized under section 42 USC 405 (c) (2) (C) (i). It is used by the Department of Treasury to verify tax exemption claims and to deter fraudulent filings. Any use of the number by closing agents or local units of government is illegal and subject to penalty.
- Enter the daytime phone number of the owner(s). This number is important because the assessor may need to contact the owner(s) to verify information in order to process the conditional rescission.

PART 3: REQUIREMENTS

The questions listed in Part 3 are very important in determining eligibility for the conditional rescission. These questions must be answered truthfully and to the best of the owners' knowledge. Failure to answer these questions may result in processing delays of the conditional rescission and/or result in a subsequent denial.

PART 4: CERTIFICATION

The form must be signed and dated by the owners listed in Part 2. Provide the owner's current and complete mailing address.

INTEREST AND PENALTY

If it is determined that the claimed property was not the owner's principal residence, or the conditional requirements are not met, the owner(s) may be subject to additional tax plus penalty and interest as determined under the General Property Tax Act.

STATE TRANSFER TAX ISSUES

INTRODUCTION

In 1993, the State provided tax relief to homeowners in the form of an exemption from local school operating taxes – or what was then known as a “homestead exemption.” At that time, one of the things that was done to make up for lost revenues was the implementation of the state real estate transfer tax (“SRETT”), which is imposed on all recorded instruments (unless expressly exempted under the statute). The state transfer tax rate is .0075 (or \$7.50 per each \$1,000). A complete list of the statutory exemptions to the SRETT is attached to this article as Exhibit A. (This list is similar, but not identical, to the exemptions from the county transfer tax.) This article will discuss several current issues in connection with a couple of these SRETT exemptions.

DISCUSSION

n. State Transfer Tax Relief for Houses with Declining Values

Until recently, few people were aware of the following exemption from the SRETT:

- (t) A written instrument conveying an interest in property for which an exemption is claimed under section 7cc of the general property tax act, 1893 PA 206, MCL 211.7cc [this applies to a “principal residence”], if the state equalized valuation of that property is equal to or lesser than the state equalized valuation on the date of purchase or on the date of acquisition by the seller or transferor for that same interest in property.

* * * MCL 207.526(t)

The intent of this legislation was to provide tax relief to persons selling their houses when the market value has fallen. While this exemption has been in place since the state transfer tax was first imposed in 1993, the exemption was rarely if ever used for the first decade after the tax was imposed. Unfortunately, recent housing market conditions in a number of areas throughout the State have resulted in a recent widespread discovery of this exemption.

In order for this exemption to apply:

- (1) the property must be a principal residence (*e.g.*, have a “homestead exemption”);
- (2) the property’s SEV in the year of sale must be less than or equal to the SEV for the year in which property was purchased; and
- (3) the sale price of the property cannot exceed the property’s true cash value in the year of closing.

What if a sale occurs early in the year before the assessor has definitively established the SEV and the true cost value of the home? When asked this question, the Attorney General has recommended that the parties use the tentative values set by the assessor in March, and if such tentative values have not yet been established, then the values from the preceding year. OAG, 2008, No 7214, (April 3, 2008).

If a REALTOR® represents a seller who did not claim an exemption and has later determined that the finalized SEV and true cash value would justify such a claim, there are simple procedures available to obtain a refund from the Michigan Department of Treasury. A copy of the appropriate form entitled “Application for State Real Estate Transfer Tax (SRETT) Refund” is attached as Exhibit B. A claim can be made up to four (4) years after the tax is paid.

If a seller claims an exemption to which he is NOT entitled, he will be subject to a penalty equal to 20% of the SRETT amount.

Finally, remember that this is an exemption from the STATE transfer tax only. There is NO such exemption from COUNTY transfer tax.

C. The \$100 Exemption

The state transfer tax (like the county transfer tax) is calculated based upon the total value of the property being transferred. Transfer taxes are not calculated on the amount of the consideration paid. If there is not an applicable exemption, then the SRETT is based on the value of the property being conveyed.

The common misconception *B i.e.*, that transfer taxes are calculated based on the consideration paid *B* likely stems from the fact that there is an exemption for transfers where the consideration paid is less than \$100. The correct analysis is as follows: if the consideration paid is less than \$100, then the value of the property is irrelevant. But if the consideration paid is, for example, \$101, then the state transfer tax is calculated based on the actual value of the property and not on the \$101 actually paid. The statute provides that the value of the property means the current or fair market worth. MCL 207.522.

It must be remembered that in determining whether there has been consideration paid, the state will look at the underlying transaction and not just the funds exchanged in connection with the conveyance. It is Treasury’s position, for example, the calculation of consideration paid would include the balance on any mortgage or land contract assumed by the buyer. Likewise, it is Treasury’s position that where two tenants in common partition a parcel and each take half, the consideration in each transaction would be the value of the interest being conveyed. Similarly, the Michigan Tax Tribunal has ruled that when a limited liability company distributed four parcels of land to its four individual members, the consideration paid in connection with those deeds was equal to the capital contribution paid by the respective members. *Hanson Plaza v Treasury*, MTT Docket No. 263743 (2001).

D. Lake Forest decision

In *Lake Forest Partners II, Inc v Treasury*, 271 Mich App 244 (2006), the transaction involved one entity and one purchase agreement which provided the terms for both the sale of the unimproved lot and the terms of the agreement for building a home on that lot. The purchase agreement provided that the property would be deeded to the buyer after the home was completed and a certificate of occupancy had been issued. The Michigan Tax Tribunal held that the value for purposes of calculating the tax included the value of the newly constructed home.

The builder appealed the Michigan Tax Tribunal's decision. The issue faced by the Court of Appeals in *Lake Forest* was whether the time of transfer for purposes of calculating the value of the property was the time the purchase agreement was signed or the time the deed was recorded after the house was built. The Court of Appeals noted that Section 207.523 provides that:

- (1) There is imposed, in addition to all other taxes, a tax upon the following written instruments executed within this state when the instrument is recorded:
 - (a) contracts for the sale or exchange of property or any interest in property * * *
 - (b) deeds or instruments of conveyance of property or any interest in property for consideration.

The Court of Appeals concluded that, although the purchase agreements were not recorded, they were nonetheless contracts for the sale or exchange of property under MCL 207.523(1)(a).

The Court reversed the decision of the Michigan Tax Tribunal and concluded:

Because the transfer tax may be imposed on purchase agreements, we conclude that upon the execution of the purchase agreement, some interest in the property has been transferred under SRETTA We therefore conclude that the transfer is assessed based on the value of property when the purchase agreement is executed.

Unfortunately, the Michigan Supreme Court has summarily REVERSED the Court of Appeals' decision. In its one paragraph decision, the Supreme Court stated:

The State Real Estate Transfer Tax Act . . . taxes recorded instruments In this case, the only recorded instrument was the deed. The "value" exchanged for that deed included both the cost of the lot and the home; thus, the tax tribunal correctly held that the value was the proper measure for taxation.

Under the decision of the Michigan Supreme Court in *Lake Forest*, the builder was required to pay transfer tax on the combined value of the lot and the newly constructed home.

The transaction in the *Lake Forest* case involved a single contract between a builder entity and a homeowner that included one price for the lot and another price for the construction of a home.

As a matter of law, the Supreme Court's holding should be limited to that particular scenario. Given the broad language of the Supreme Court's opinion, however, we think it likely that some assessors will attempt to apply this decision to any situation where the deed is not given until the house is constructed. Assessors may decide, for example, that the ruling applies where there is one entity selling the lot and another entity building the house, each of whom has a separate contract with the homeowner. While that situation is certainly legally distinguishable from the one involved in the *Lake Forest* case, you should be aware that this is a battle that has not yet been won.

A related issue that needs clarification involves the situation where a builder requires a lot owner to convey the lot to the builder during construction so as to protect the builder in the event of nonpayment. This transaction should fall squarely within Section 6(d) of SRETT, which exempts an instrument given as security as well as the instrument used to discharge as security interest. Yet, the following question Q & A appears on Treasury's web site:

- Q. A person owns a lot and wants to begin construction of a home. The builder requires the lot to be put in the building company's name (quit claim deed). After the house is built, the builder deeds the lot and the house back to the original owner. Is either conveyance subject to SRETT?
- A. Both transactions, the quit claim deed to the builder, and the transfer back to the homeowner, are taxable.¹

It is not clear whether in this Q & A, Treasury even considered that a deed given in this instance would be for security purposes within the meaning of Section 6(d) of SRETTA.

CONCLUSION

SRETT is a tax on all recorded instruments, not just on deeds. A homeowner who pays his neighbor for an easement, for example, will be subject to the tax unless one of the statutory exemptions is applicable. REALTORS® should generally familiarize themselves with the exemptions, but should avoid rendering any advice as to the applicability of a particular exemption. While the statute provides that the seller is ultimately responsible for this tax, this obligation can be shifted contractually. Remember that a document cannot be recorded unless and until the transfer taxes are paid. Persons who assume the responsibility of recording the instrument – for example, land contract vendees who pay off their contract and receive a deed and grantees who pay for easements – should make certain that the appropriate funds are collected from the grantor. If not, then the grantee may be required to pay for the transfer tax himself in order to get his instrument recorded.

EXHIBIT A

**STATE REAL ESTATE TRANSFER TAX ACT (EXCERPT)
Act 330 of 1993**

207.526 Written instruments and transfers of property exempt from tax.

Sec. 6.

The following written instruments and transfers of property are exempt from the tax imposed by this act:

- (a) A written instrument in which the value of the consideration for the property is less than \$100.00.
- (b) A written instrument evidencing a contract or transfer that is not to be performed wholly within this state only to the extent the written instrument includes land lying outside of this state.
- (c) A written instrument that this state is prohibited from taxing under the United States constitution or federal statutes.
- (d) A written instrument given as security or an assignment or discharge of the security interest.
- (e) A written instrument evidencing a lease, including an oil and gas lease, or a transfer of a leasehold interest.
- (f) A written instrument evidencing an interest that is assessable as personal property.
- (g) A written instrument evidencing the transfer of a right and interest for underground gas storage purposes.
- (h) Any of the following written instruments:
 - (i) A written instrument in which the grantor is the United States, this state, a political subdivision or municipality of this state, or an officer of the United States or of this state, or a political subdivision or municipality of this state, acting in his or her official capacity.
 - (ii) A written instrument given in foreclosure or in lieu of foreclosure of a loan made, guaranteed, or insured by the United States, this state, a political subdivision or municipality of this state, or an officer of the United States or of this state, or a political subdivision or municipality of this state, acting in his or her official capacity.
 - (iii) A written instrument given to the United States, this state, or 1 of their officers acting in an official capacity as grantee, pursuant to the terms or guarantee or insurance of a loan guaranteed or insured by the grantee.

- (i) A conveyance from a husband or wife or husband and wife creating or disjoining a tenancy by the entireties in the grantors or the grantor and his or her spouse.
- (j) A conveyance from an individual to that individual's child, stepchild, or adopted child.
- (k) A conveyance from an individual to that individual's grandchild, step-grandchild, or adopted grandchild.
- (l) A judgment or order of a court of record making or ordering a transfer, unless a specific monetary consideration is specified or ordered by the court for the transfer.
- (m) A written instrument used to straighten boundary lines if no monetary consideration is given.
- (n) A written instrument to confirm title already vested in a grantee, including a quitclaim deed to correct a flaw in title.
- (o) A land contract in which the legal title does not pass to the grantee until the total consideration specified in the contract has been paid.
- (p) A written instrument evidencing the transfer of mineral rights and interests.
- (q) A written instrument creating a joint tenancy between 2 or more persons if at least 1 of the persons already owns the property.
- (r) A transfer made pursuant to a bona fide sales agreement made before the date the tax is imposed under sections 3 and 4, if the sales agreement cannot be withdrawn or altered, or contains a fixed price not subject to change or modification. However, a sales agreement for residential construction may be adjusted up to 15% to reflect changes in construction specifications.
- (s) A written instrument evidencing a contract or transfer of property to a person sufficiently related to the transferor to be considered a single employer with the transferor under section 414(b) or (c) of the internal revenue code of 1986, 26 U.S.C. 414.
- (t) A written instrument conveying an interest in property for which an exemption is claimed under section 7cc of the general property tax act, 1893 PA 206, MCL 211.7cc, if the state equalized valuation of that property is equal to or lesser than the state equalized valuation on the date of purchase or on the date of acquisition by the seller or transferor for that same interest in property. If after an exemption is claimed under this subsection, the sale or transfer of property is found by the treasurer to be at a value other than the true cash value, then a penalty equal to 20% of the tax shall be assessed in addition to the tax due under this act to the seller or transferor.
- (u) A written instrument transferring an interest in property pursuant to a foreclosure of a mortgage including a written instrument given in lieu of foreclosure of a mortgage. This exemption does not apply to a subsequent transfer of the foreclosed property by the entity that foreclosed on the mortgage.

(v) A written instrument conveying an interest from a religious society in property exempt from the collection of taxes under section 7s of the general property tax act, 1893 PA 206, MCL 211.7s, to a religious society if that property continues to be exempt from the collection of taxes under section 7s of the general property tax act, 1893 PA 206, MCL 211.7s.

History: 1993, Act 330, Eff. Apr. 1, 1994 ;-- Am. 1994, Act 3, Eff. Mar. 30, 1994 ;-- Am. 1994, Act 255, Imd. Eff. July 5, 1994 ;-- Am. 2000, Act 203, Imd. Eff. June 27, 2000 ;-- Am. 2003, Act 128, Eff. Jan. 1, 2004

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Michigan Compiled Laws Complete Through PA 268 of 2008

Courtesy of www.legislature.mi.gov

EXHIBIT B

Application for State Real Estate Transfer Tax (SRETT) Refund

Issued under authority of P.A. 330 of 1993.

When a seller pays the SRETT to the Register of Deeds, and later determines that the sale (transfer) of the real property was exempt from the SRETT, the Michigan Department of Treasury will process an application for a refund of the SRETT. Once the application information is verified, Treasury will issue a check payable to the seller for the amount of the SRETT. This form must be filed within four years from the date the tax was paid.

Questions can be directed to the Customer Contact Division at 517-636-4700. Deaf, hearing- or speech-impaired persons may call 517-636-4999 (TTY).

Type or print in blue or black ink.

PART 1: IDENTIFICATION

Name(s) of Seller (Refund check will be made payable in this manner)	Social Security or Federal Employer ID Number(s)
Address Where Refund Should be Mailed	
City and State	ZIP Code

PART 2: EXEMPTION

State Exemption Being Claimed Under PA 330 of 1993, as Amended (see page 2 for list of exemptions)
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PART 3: DEED

Attach a copy of the deed with the transfer tax stamp showing the tax was paid.

A Michigan SRETT was paid on the deed recorded on (MM/DD/YY)	Liber Number	Page Number	County Name
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PART 4: DESCRIPTION

Legal description of property or Property Identification Number on the above deed (attach additional sheets if more space is needed). If legal description is shown on attached documentation, write "see attached"

PART 5: SELLER'S CERTIFICATION

<i>I declare under penalty of perjury that the information on this form and attachments is true and complete to the best of my knowledge.</i>	
Seller's Signature	Date

MAILING INSTRUCTIONS: Attach a copy of the sales agreement or any other documents that support this exemption claim. Mail this application and supporting documents to:

**Michigan Department of Treasury
Customer Contact Division
Lansing, MI 48922**

Form 2796

Exemptions to State Real Estate Transfer Tax (SRETT)

Under Section 6 of P.A. 330 of 1993, you may claim an exemption from the SRETT for one of the reasons listed below. Enter the section number for the exemption you are claiming in Part 2 of Form 2796.

- (a) A written instrument in which the value of the consideration for the property is less than \$100.00.
- (b) A written instrument evidencing a contract or transfer that is not to be performed wholly within this state only to the extent the written instrument includes land lying outside this state.
- (c) A written instrument that this state is prohibited from taxing under the United States Constitution or federal statutes.
- (d) A written instrument given as security or an assignment or discharge of the security interest.
- (e) A written instrument evidencing a lease, including an oil and gas lease, or transfer of a leasehold interest.
- (f) A written instrument evidencing an interest that is assessable as a personal property.
- (g) A written instrument evidencing the transfer of a right and interest for underground gas storage purposes
- (h) Any of the following written instruments:
 - (i) A written instrument in which the grantor is the United States, this state, a political subdivision or municipality of this state, or an officer of the United States or this state, or a political subdivision or municipality of this state, acting in his or her official capacity.
 - (ii) A written instrument given in foreclosure or in lieu of foreclosure of a loan made, guaranteed, or insured by the United States, this state, a political subdivision or municipality of this state, or an officer of the United States or this state, or a political subdivision or municipality of this state, acting in his or her official capacity.
 - (iii) A written instrument given to the United States, this state, or 1 of their officers acting in an official capacity as grantee, pursuant to the terms or guarantee or insurance of loan guaranteed or insured by the grantee.
- (i) A conveyance from a husband or wife or husband and wife creating or disjoining a tenancy by the entireties in the grantors or the grantor and his or her spouse.
- (j) A conveyance from a mother or father to a son or daughter or stepchild or adopted child.
- (k) A conveyance from a grandmother or grandfather to a grandchild or step-grandchild or adopted grandchild.
- (l) A judgement or order of a court of record making or ordering a transfer, unless a specific monetary consideration is specified or ordered by the court for the transfer.
- (m) A written instrument used to straighten boundary lines if no monetary consideration is given.
- (n) A written instrument to confirm title already vested in a grantee, including a quitclaim deed to correct a flaw in title.
- (o) A land contract in which the legal title does not pass to the grantee until the total consideration specified in the contract has been paid.
- (p) A written instrument evidencing the transfer of mineral rights and interests.
- (q) A written instrument creating a joint tenancy between 2 or more persons if at least 1 of the persons already owns the property.
- (r) A transfer made pursuant to a bona fide sales agreement made before the date the tax is imposed under sections 3 and 4, if the sales agreement cannot be withdrawn or altered, or contains a fixed price not subject to change or modification. However, a sales agreement for residential construction may be adjusted up to 15% to reflect changes in construction specifications.
- (s) A written instrument evidencing a contract or transfer of property to a person sufficiently related to the transferor to be considered a single employer with the transferor under Section 414(b) or (c) of the Internal Revenue Code of 1986, 26 U.S.C. 414.
- (t) A written instrument conveying an interest in homestead property for which a homestead exemption is claimed under either the School Code, P.A. 451 of 1976, being sections 380.1 to 380.1852 of the Michigan Compiled Laws or the State Education Tax Act, P.A. 331 of 1993, being sections 211.901 to 211.906 of the Michigan Compiled Laws, if the State Equalized Valuation of that homestead property is equal to or lesser than the State Equalized Valuation on the date of purchase or on the date of acquisition by the seller or transferor for the same interest in property. If after an exemption is claimed under this subsection, the sale or transfer of homestead property is found by the Treasurer to be at a value other than the true cash value, then a penalty equal to 20% of the tax shall be assessed in addition to the tax due under this act to the seller or transferor.
- (u) A written instrument transferring an interest in property pursuant to a foreclosure of a mortgage including a written instrument given in lieu of foreclosure of a mortgage. This exemption does not apply to a subsequent transfer of the foreclosed property by the entity that foreclosed on the mortgage.
- (v) A written instrument conveying an interest from a religious society in property exempt from the collection of taxes under Section 7s of the General Property Tax Act, PA 206 of 1893, MCL 211.7s, to a religious society if that property continues to be exempt from the collection of taxes under section 7s of the General Property Tax Act, PA 206 of 1893, MCL 211.7s.

DEPARTING AGENTS – CURRENT LISTINGS AND PENDING SALES

I. INTRODUCTION

Whenever a salesperson leaves a firm to join another firm or set up a new firm, it is almost certain that there will be hard feelings on both sides. Much of the controversy is likely to involve the status of pending sales, pending listing contracts and pending buyer's agency relationships. The salesperson will point out that he or she is the only member of the firm that has had any contract with the client. The broker will point out that as a matter of law, the client's contractual relationship is with the firm, not the individual agent. Because both of these statements are true, it is difficult, if not impossible, to move forward without cooperation on both sides. As will be discussed below, in this situation there are a number of different things that CANNOT be done – because they are prohibited legally and/or by the Code of Ethics. Armed with this information, REALTORS® should be better prepared to decide how they wish to resolve their differences.

II. DISCUSSION

K. Provisions for Departure in Independent Contractor Agreements

When trying to determine the rights and obligations of a departing agent, the first thing to do is to check the agent's independent contractor agreement. Ideally, the parties have worked out in advance many of the details as to how departures will be handled. A sample independent contractor agreement is attached as Exhibit A. Paragraph 13 of this sample agreement contains several different methods for handling both pending listings and pending sales.

There are no statutes that govern how this issue will be handled. Further, there is no court precedent to provide guidance. Therefore, if there is no independent contractor agreement, or if the independent contractor agreement does not contain provisions governing departures, there is no fallback position in the law. Rather, a court must try and determine the parties' unwritten agreement – *i.e.*, whether the parties had a general understanding as to how these matters will be handled. If forced to decide the issue, it is likely the court will consider the testimony of the parties as to how the firm had handled these matters in the past and whether there had been any discussions between these particular parties as to how the matter will be handled should it arise. As you might imagine, typically the parties remember these discussions differently, which is why it is always better to have a written agreement. More importantly, by the time a court makes a decision for the parties, the sellers and buyers will probably be long gone.

L. Termination of Pending Listings

When an agent departs, their broker typically receives a call from one or more sellers asking that their current listing agreement be terminated so that the seller is free to list with the departing agent's new company. REALTORS® should keep in mind that the sellers can always terminate the listing contract – the issue is whether by doing so, the sellers have breached their contract. That is, a court will never require the sellers to work with a company they do not wish to work with, however, a court could determine that the early termination of a contract was a breach of that contract and the seller owes damages to the old listing company. Put another way, a listing broker must honor a seller's decision to terminate a listing contract – he does not need to provide the seller with a release of liability.

When can a seller terminate a listing agreement without penalty? It has long been the law in Michigan that most listing agreements can be revoked by a seller at any time during the listing period prior to the broker producing a ready, willing and able buyer. The two exceptions to this rule are 1) when the revocation is made in bad faith or with the intent to deprive the broker of a commission; or 2) if the broker has provided valuable consideration to the seller. *Schostak v First Liquidating Corp*, 320 Mich 406 (1948); *Seelye v Broad*, 379 Mich 289 (1967).

The question of what constitutes sufficient consideration to make a listing agreement irrevocable must be answered on a case by case basis. It has been held that showing the property to ten customers is insufficient to make the agreement irrevocable. *Stoffer v Friedman*, 11 Mich App 532 (1968). However, where a broker paid for the preparation and mailing of a promotional brochure about the property, there was sufficient consideration to prohibit the seller from revoking the listing agreement for a reasonable period of time. *Ladd v Teichman*, 359 Mich 587 (1960). Similarly, where a broker spent over \$5,000 promoting and advertising the seller's property, it was entitled to a commission upon the owner's cancellation of the exclusive listing agreement. *H M Sheldon Co v Carson*, 11 Mich App 613 (1968). Thus, while it is true that the "listing belongs" to the broker, it is also true that the seller can terminate the listing contract at will. If the broker wants to pursue the seller for compensation as a result of that termination, he will need to persuade the court either that the contract was already substantially performed or that the broker gave "consideration" in furtherance of this contract. Departing salespersons should understand that different courts view "consideration" requirements differently and should never advise a client that the listing contract can be terminated without any risk of liability. First as a matter of law, this is not true and second, as will be discussed below, such statements are likely a violation of the Code of Ethics.

M. Code of Ethics

Article 16 of the Code of Ethics generally prohibits a REALTOR® from interfering with another REALTOR®'s agency relationship. Standard of Practice 16-20 provides:

REALTORS®, prior to or after terminating their relationship with their current firm, shall not induce clients of their current firm to cancel exclusive contractual agreements between the client and that firm. This does not preclude REALTORS® (principals) from establishing agreements with their associated licensees governing assignability of exclusive agreements.

Thus while a seller is free to terminate the listing agreement with the old company, a REALTOR® is not free to assist or encourage a seller to do so.

Sometimes salespersons shorten listings prior to their departure so that the expiration date closely approximates the planned departure date. Certainly it can be argued that such activity interferes with the broker's agency relationship in violation of Article 16 of the Code of Ethics.

N. Multiple Listing Service Issues

Unfortunately, any conflict between a broker and a departing salesperson can in many instances cause conflict with the multiple listing service which serves both the broker and the departing agent's new firm. The conflict typically arises when the seller provides notice to the broker that they have terminated their listing with the broker's firm. The broker, believing that the termination was both a breach of contract and involved possible unethical conduct by the departing salesperson, refuses to acknowledge the termination of the listing by the seller. Alternatively, the broker demands some payment from the seller or the departing salesperson as a condition to acknowledging the termination of the listing agreement by the seller. The broker will take no action to remove the listing from the MLS. In the meantime, the departing agent submits a new listing with the seller to the MLS. The MLS obviously does not carry competing listings for the same piece of property and cannot accept the new listing. The seller then becomes angry because their new listing is not in the MLS and their home cannot be effectively marketed by anyone. The angry seller sends a letter to the MLS stating that they have terminated the listing with the original broker and want that listing removed from the MLS.

In this situation, the MLS is in a no-win position. The MLS does not act as a facilitator, mediator or referee. It has neither the authority nor the resources to determine who is in the right and who is in the wrong. The MLS is faced with a situation where there is a listing in the MLS where the original broker is offering cooperation and compensation. However, rightfully or wrongfully, no agency relationship or listing agreement now exists between the seller and the original broker. If a participant in the MLS procures a buyer and submits an offer to the original broker, the broker has no listing agreement with the seller from which she can pay compensation to the participant who procured the buyer. Many MLS's, in this situation, remove the terminated

listing and accept the new listing of the departing agent. This policy does not involve any determination by the MLS that the listing agreement was properly or improperly terminated by the seller. It is simply a reflection of reality, *i.e.*, the listing currently in the MLS has been terminated and the seller has a new listing with the firm of the departed agent.

O. Tortious Interference with Listing Agreements or Prospective Buyers

The law also prohibits someone from wrongfully interfering with someone else's contract or business relationship. Keep in mind that the law does not prohibit any interference, rather the law prohibits "improper" interference – defined loosely as conduct that was "illegal, unethical or fraudulent." As a general matter, conduct that is deemed "improper" for this legal analysis is not well-defined. One leading legal authority has stated that in these types of cases, "the real question is whether the actor's conduct was fair and reasonable under the circumstances."

One of the key factors in determining whether the interference was "improper," is the parties' relationship with one another. That is, a court is more likely to find that the conduct was "improper" if at the time of the conduct in question, the person interfering has an existing business relationship with the person who's contract is being disrupted.

Even though acting as an independent contractor, a salesperson or associate broker working for a firm owes certain responsibilities to that firm. While associated with a particular firm, a salesperson or associate broker should not take any actions designed to hurt the business of that firm. While there are no definitive rules, we think most would agree that terminating the current firm's existing contracts with clients and/or facilitating contracts with other firms would be "improper" for purposes of establishing a claim for tortious interference.

III. CONCLUSION

It is never a good idea to drag clients and customers into the middle of a business "divorce." At a minimum, it reflects badly on the industry and can even rise to the level of a breach of fiduciary duty if the battle interferes with the client's sale or purchase of a home. The best course of action is for the broker and the salesperson to sit down and decide how these matters will be handled in a calm and professional manner. The best time – and realistically, maybe the only time – that this can be done is at the beginning of the relationship when both parties can hardly imagine that such a day will come.

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.

I.

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 which 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 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 7 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 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 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

LEGAL LIABILITY UPDATE

INTRODUCTION

Historically, the annual legal summary has included a legal liability update discussing recent real estate cases from around the country. Though many of these cases are distinguishable or the result might be different in Michigan, a discussion of these scenarios is instructive for understanding liability trends. This article is not a comprehensive listing of every real estate case. Instead, cases are selected for the lessons they provide.

This article discusses buyer's agents' duties, listing agents' duties, and other conduct (in the "odds and ends" section) and provides lessons on what not to do.

Recent Cases Addressing Buyer's Agents' Duties

Buyer's agency is a relatively new concept in real estate law. Historically, the listing broker would have a contractual relationship with the seller and earn a commission upon sale. If another agent produced the buyer in response to an offer of cooperation and compensation on a multiple listing service, that agent always acted as a subagent of the seller. In many instances, this seller's subagent would have few duties, if any, to their buyer. Thus, a market developed for buyer's agency. As buyer's agency is in its infancy in the grand scheme of things, the duties of buyer's agents and legal ramifications of their breach continue to evolve.

For example, a Louisiana broker listed a home in 1999 at 1,846 square feet. Five years later, that brokerage represented buyers in a 2004 purchase of the same home. In 2004, the home was listed by the listing agent as containing 2,132 square feet. The buyers did not discover the discrepancy until after purchase and sued their broker (the former listing broker) for negligence and breach of duty in failing to catch the discrepancy.²

The buyers were home flippers. They did not have the house appraised at purchase. When they had it appraised prior to re-listing it, the appraisal revealed the error. This forced them to lower their sales price, and they sued their agent to recover the difference.

In Louisiana, a broker's duties are governed by an occupational statute and common law (*i.e.*, judicially created) duties based on "customs and practices" of the trade. These duties include a duty not to make false representations.

Here, the defendant buyer's agent simply took the MLS square footage listing as "the gospel." Though the court did not state whether a buyer's agent's duties required them to search the MLS for prior listings of the home (to see if listing data had changed), the court indicated that if there was such a duty, it was breached here.

² *Tres Chic in a Week, LLC v Home Realty Store*, 2008 WL 2765289 (LA App, July 17, 2008) (unpublished). Unpublished opinions are not legally binding on other courts. However, because they are widely available through internet sources and are frequently cited by attorneys, courts may rely on their reasoning. They also provide a window on the courts' general approach to a subject's address. Further, nothing prevents REALTORS® from learning from these examples.

However, the broker escaped liability. The court stressed language in the MLS listing, that is similar to Michigan MLS listings, which indicated that MLS information is “reliable but was not guaranteed.” Further, the purchase agreement indicated that measurements and room dimensions “made by the real estate brokers” were not subject to any warranty and were not “assumed to be accurate.” The purchase agreement also indicated that the buyers were purchasing the property “as seen” and included a waiver of “any and all inconsistencies in such measurements . . . or square footage by brokers.” Further, the purchase agreement allowed for inspection “for verification of square footage” within ten days of execution. As a result, the court found that the plaintiffs were not reasonable in relying on the MLS statement for square footage. Therefore, the trial court properly dismissed the claim against the buyers’ agent.

MAR has consistently taken the position that representations concerning square footage are not actionable, based on similar theories. The buyer always has the ability to determine square footage. Further, there are different methods employed to measure square footage. Some brokers measure from the outside corners of the building, which will yield a different result from measuring rooms individually. Some brokers include closets, while others do not. FHA inspectors typically use sonar-like devices that electronically compute square footage, and these devices have foibles of their own. However, to the extent this case suggests that a diligent buyer’s agent should search previous MLS listings for a property that their client is interested in, the lesson should be well taken.

If an agent arms their client with all information that is reasonably available, there should be no fear of liability based on a failure to do so.

In another recent case, a New York state appellate court clarified the extent of a buyer’s agent’s duties where a brokerage represents multiple parties who are interested in the same property.³ In *Rivkin*, a would-be purchaser sued their agent for a breach of fiduciary duty, claiming that the agent breached the duty of loyalty by failing to disclose that the brokerage represented competing purchasers for the same property.

Here, a prospective purchaser of a summer home contacted defendant Century 21 Teran Realty. Century 21 Teran had 16 salespeople and 4 associate brokers. The buyer contacted one of the associate brokers, who advised the buyer about a lakeside property that was listed by another Century 21 office. The associate broker provided MLS access to the prospective buyer. Based on the MLS, the prospective buyer directed their agent to verbally offer the listing broker \$75,000, which he did. After viewing the property, the prospective buyer’s interest in the property increased.

The buyer asked his agent whether there had been other offers on the property. The agent indicated that there had been, but that he did not know the amount. The agent also indicated that the \$75,000 offer was a “fair offer,” and that a counter-offer was likely.

The same day he saw the property, the prospective buyer made a written offer for \$75,000, which his agent forwarded to the listing broker. The buyer also provided \$1,500 in earnest money and signed an acknowledgment that he received his agent’s agency disclosure form. The disclosure form indicated that the “buyer’s agent acts solely on behalf of the buyer” and recited the fiduciary duties of reasonable care, “undivided loyalty,” “full disclosure,” and other duties.

³ *Rivkin v Century 21 Teran Realty, LLC*, 887 NE 2d 1113 (NY App, 2008).

At about the same time, a competing buyer contacted another associate broker at Century 21 Teran, expressing an interest in the same property. The listing broker advised the Teran associate broker that there was already an offer on the property (presumably, the offer from plaintiff). The competing purchaser viewed the property and offered the full listing price. After a few days, the plaintiff learned of the full price offer and also discovered that this offer came from another broker at Century 21 Teran. Plaintiff sued Century 21 Teran for breach of the duties of loyalty and disclosure.

In pre-litigation correspondence, the associate brokers who owned Century 21 Teran acknowledged that they had no system in place to track whether its buyer's agents were representing multiple buyers bidding on the same property. They also indicated that it was common practice in New York for buyer's agents associated with one brokerage to assist a buyer, while another agent in the same brokerage assisted another buyer who was competing for the same property.

The court held that one brokerage may assist competing buyers for the same property without breaching its loyalty and disclosure duties. In so doing, the court basically approved of a form of common law designated agency. The court based its reasoning in part on prior court decisions that held that a listing agent who acts as a dual agent (*i.e.*, also produces a prospective buyer for a listing) does not owe the seller a duty to refrain from showing other properties to the potential purchaser. In other terms, if a broker takes a listing on a three-bedroom ranch, they are not precluded from listing other competing three-bedroom ranches in the same area. Following that reasoning, the court made distinctions between an individual agent, who cannot represent competing buyers for a single property, and that agent's brokerage, which apparently can. The court reasoned that an individual buyer's agent, who has "multiple clients bidding on the same property," cannot negotiate the best purchase price for each of them. Because the buyers' interests are in conflict, "the agent's representation is inevitably compromised." But where two buyer's agents in the same brokerage are acting on behalf of different, competing buyers, bidding does not present "comparable risks." This is because "there is no incentive for these agents to represent their clients less than zealously." The incentive for commission ensures the individual agent's loyalty to their client.

The court also relied on the state REALTOR® association's brief, which indicated that would-be buyers are well aware that they are competing with other potential buyers, including those represented by other agents affiliated with their agent. The REALTORS® also noted that there are several brokerages with hundreds of salespersons, and a handful of mega-brokerages with over a thousand. Allowing one buyer to effectively preclude the entire brokerage from representing a competing buyer is simply unworkable. The court agreed, but made it clear that "an *individual agent*, however, may *not* represent multiple buyers bidding on the same property without making disclosure and obtaining consent."

The outcome in Michigan would likely be different, in the absence of a designated agency agreement. Even though the arguments raised in New York could apply here, the better practice is to disclose the potential for competition under the designated agency framework.

Another interesting case involves a California buyer who thinks she overpaid for her house. The New York Times and Wall Street Journal have reported on this case, *Ummel v Little*,⁴ and it has received significant treatment in real estate blogs and other real estate broker websites. Plaintiffs, the Ummels, began searching for a San Diego home in 2004. They retained defendant as a buyer's agent and purchased a \$1.2 million home. Shortly after they moved in, the Ummels learned that one similar neighboring home sold for approximately \$1.1 million and had a pool. Another similar house sold for about \$1 million, nearly \$200,000 less than the Ummels paid. The Ummels also appear to raise issues regarding their agent's activities as a mortgage broker and allege that he pushed them into paying too much for this house. Though newspapers do not specify this, the case surely alleged negligence and breaches of a buyer's agent's duties to the buyer plaintiffs.

After several days of trial and two hours of deliberation, the jury returned a verdict on behalf of the buyer's agent. Popular media and real estate blogs indicate that this jury was simply not sympathetic to a buyer who purchased a \$1.2 million home on a golf course and, at the peak of the housing bubble, presented evidence of comparable properties that eventually sold for less merely because she later regretted the decision.

There have been no other reports of similar claims against buyer's agents. It is possible that the publicity surrounding the Ummel case would discourage such claims. On the other hand, the case may encourage similar suits. Further still, sagging prices are putting stress on bubble purchasers. Though buyer's agents often provide their opinion as to a good price, many value components are subjective. Thus, it seems unlikely that a buyer's agent could face liability in Michigan based on their client's perception that they entered into a bad deal. To minimize this risk, however, buyer's agents should avoid pronouncements to the effect that "all homes rise in value" or that a buyer is getting a "great deal." Buyer's agents should use a written buyer agency agreement which defines and limits their duties to a buyer.

⁴ *Ummel v Little* is a California trial court case. These opinions are not published and, in most instances, are not binding on other courts. However, the media attention and the novel legal theory involved make this case noteworthy.

Recent Cases Addressing Seller's Agents' Duties

The duties of listing agents, by comparison, appear to be more firmly established. That said, however, professional duties continue to expand in some areas and be narrowed in others.

For instance, a Massachusetts appellate court recently held that a listing broker had no duty to buyers – either under a contract theory or the state's deceptive trade practices act (similar to Michigan's Consumer Protection Act) – to correctly determine the zoning of the property they listed.⁵

The Massachusetts Unfair and Deceptive Trade Practices Act applies to real estate licensees. This act requires licensee disclosure of all material facts at the time of a given transaction. This duty can run from a listing broker to the buyer. The Massachusetts act ordinarily requires some form of intent by the real estate agent to defraud. However, if a real estate licensee is negligent or careless in ascertaining the truth about a property, they may be sued for a violation of the act.

Here, a property owner purchased a three-unit apartment home and sought a zoning variance to convert the home to four units. In the course of doing so, he discovered that a variance had previously been granted allowing the home to be used as a three-unit home. However, the variance allowed only one unit on the second floor. Even though the apartment had two upper units and was technically non-conforming, the city licensed the property as a rental and taxed it as a multi-unit for several years. When the owner chose to sell, he listed it with the defendant.

In connection with taking the listing, the defendant broker inspected the property, noted that the house was being used as a three-family residence, obtained property tax records (indicating that the property had been taxed as a multi-family residence), and advertised the house as a three-family residence. Plaintiffs bought it as such and operated it as a three-family residence for several years. When plaintiffs decided to sell the property, a prospective purchaser's investigation revealed that the configuration of the home did not meet applicable zoning, as it had two upper units, in violation of the variance provided for the property. The plaintiffs sold the home as a two-family residence, for less money, and sought to reclaim the loss from the listing agent, who advertised the house as a three-family home.

In many states, including Michigan, a listing agent has no duties to a prospective purchaser, as their relationship is commercially antagonistic. The listing agent's duties are to the seller. However, the Massachusetts Unfair Trade Practices Act creates a duty in the listing agent to the buyer. The listing agent in this case, however, was found not to violate the statute. The court believed that she did all that would be expected of a seller's agent under the circumstances. She inspected the property, researched comparable properties to help ascertain a listing price, and reviewed property tax documentation indicating, at least, that the property was being taxed as a multi-family building. Under the circumstances, this agent had no duty to procure the public records of a 20-year old variance to ensure that the house had the authorized number of units on each level. In simple terms, the aggrieved plaintiff purchaser was asking way too much of the listing agent.

This scenario would not likely arise in Michigan, as listing agents typically do not owe any duty to the buyer. Further, Michigan's Consumer Protection Act does not apply to real estate

⁵ *Quinlan v Clasby*, 879 NE2d 703 (Mass Ct App, 2008).

licensees engaged in activities that are regulated under their license. The lesson, however, is to try to avoid making express representations concerning the zoning or lawful uses of a property unless you are absolutely certain that the use conforms with applicable zoning.

The Indiana Supreme Court recently found that a listing broker breached their fiduciary duty to the seller when the broker failed to disclose to the seller that the broker was loaning the buyer part of the down payment money.⁶

In 1998, a bar owner listed her bar property with a real estate broker. She wanted \$300,000 for the establishment, but the broker suggested that the price should be around \$250,000. The listing agreement gave the broker the exclusive right to sell the establishment for a minimum of \$245,000, at a 10 percent commission. The broker showed the property to one potential buyer, who offered \$225,000 but was unable to pay the full price in cash. The buyer offered to make payments on a promissory note. The broker recommended that the seller accept this seller-financed offer, and the seller relied on the broker's judgment and expertise in agreeing to sell under these terms.

The transaction was structured with a stock purchase agreement (to buy the corporation that owned the bar), with \$25,000 cash down and five years of installment payments on the balance. The buyer agreed that the buyer would pay the commission to the listing broker, and the purchase price would be discounted by that amount. Though the buyer had trouble paying off the balance on the note, he eventually did so with financial assistance of the listing broker. That transaction resulted in the bar being re-sold to an entity owned by the listing broker and an employee of that broker. The broker eventually acquired a 95 percent ownership stake of the bar-purchasing entity, which later raised the prospect that the broker was seeking to buy the bar himself the entire time.

In the course of operating the bar, the entity owned by the broker learned that the parking lot adjacent to the bar was owned by the original seller, his former client, personally, and that it did not transfer with the bar. The entity owned by the broker sued the former bar owner, alleging that she had failed to convey the parking lot along with the bar. During the course of this litigation, the seller learned that the listing broker had loaned the first purchaser \$15,000 of the \$25,000 down payment; agreed to defer payment of the \$22,500 in commission; provided funds to the first purchaser to operate the bar; funded the payoff on the purchase note; and now owned and operated the bar. Upon learning this, the seller began charging rent for the use of the parking lot, and the broker dismissed the parking-lot related lawsuit.

The seller brought a separate suit, alleging that the listing broker used a "straw man" to obtain control of the bar and that the listing broker breached his fiduciary duties to her by failing to disclose his loans to the purchaser. Because the transaction was seller-financed, the buyer's creditworthiness was material to the transaction.

The listing broker defended on grounds that he only entered the transaction to gain control of the bar after the bar was failing (*i.e.*, after the purchase) and that he created the eventual owning entity in hopes of turning the business around. This would avoid foreclosure and repossession by his former client, the seller, and would give him a chance to recover his loans and his commission from the first purchaser. The listing broker also argued that the seller knew of his involvement, which made him a disclosed dual agent.

⁶ *Nichols v Minnick*, 885 NE 2d 1 (IN, 2008).

Indiana statutes require a real estate broker representing a seller to disclose all “adverse material facts or risks actually known by the broker concerning the real estate transaction.” Indiana law reflects that a buyer’s creditworthiness is material to a real estate transaction – especially where the transaction is seller-financed – thus, a broker must disclose to the seller any loans the broker makes to a buyer to finance a purchase. Based on these opinions, the court swept aside the broker’s argument that he was a disclosed dual agent. The court reasoned that even if the seller knew there was a dual agency, knowledge of that dual agency is quite different from knowledge that the broker actually loaned the buyer the bulk of the down payment in this seller-financed transaction. The seller was legally entitled to all of the information the listing broker had about the creditworthiness of the buyer under these circumstances – especially where the broker convinced her, in large part, to accept a low, non-cash offer.

The court held in favor of the seller and against the broker and awarded her damages in the amount of the commission. Disgorgement of commission is a historically popular common law remedy for an agent’s breach of a fiduciary duty. This ensures that the agent does not benefit from the transaction. It is noteworthy in this case that the seller did not appear to press the obvious issues concerning the broker purchasing the property through a straw man, or the broker suggesting to her that she list the property for significantly less than she believed it was worth, or the broker urging her to accept a low price offer that was seller-financed. If she had, undisclosed broker self-dealing of this sort would surely amount to a breach of fiduciary duty owed to the seller. The result would be the same in Michigan.

The New York State Court of Appeals recently held that real estate brokers have no duty to prospective buyers in connection with making the house safe for showings.⁷ Here, the listing agent was showing the house to the plaintiff, who slipped and fell on a hardwood floor that was apparently wet. The plaintiff argued that the seller’s agent exacerbated the slippery floor situation by asking people to remove their shoes prior to entering the house. The court found that any apparent danger due to the smoothness of a new, prefinished wood floor was inherent in such a floor and would have been apparent to anybody who entered the property. Thus, the listing agent was not liable. This case also follows the general New York rule that a listing agent has no duty to make the property safe.

Odds & Ends: Broker Transactions, Foreign Check Scandals and Other Misdeeds

If real estate deals proposed by Nigerian investors sound too good to be true, they likely are. The United States Court of Appeals for the Sixth Circuit – which includes Michigan, Ohio, Kentucky and Tennessee – recently affirmed the criminal conviction of a real estate broker for knowingly depositing bogus overseas checks and continuing to draw against them.⁸ As it turns out, those emails from Nigerian real estate investors are most likely a scam.

⁷ *Eichelbaum v Douglas Elliman, LLC*, 859 NYS 2d 145 (NY App, 2008).

⁸ Ordinarily, a full case name and citation would be provided. However, the author chooses to let this Ohio broker remain anonymous.

Here's the story. A residential and commercial real estate broker from a neighboring state, with 20 years in the business, attended the NAR Convention. He met a woman there, "Didi," who offered to gather \$12.5 million for this broker's proposed low-income housing projects, some of it from Nigerian partners. This investor quickly produced a \$90,000 check, which the broker deposited and received \$5,000 back from the teller. Days later, he withdrew another \$8,000 for personal use. When the check proved to be counterfeit, the investor claimed that her contacts were no longer interested in investing in the United States after the events of 9/11.

Not long after, this broker was contacted by another woman, also named "Didi," who claimed to represent Canadian investors who were interested in his low-income housing project. These investors sent a check for \$350,000, drawn on the account of a Chicago car dealer. The broker called the car dealership to find out where the money was coming from, and the car dealership indicated that the check was counterfeit. A few days later, Didi II sent the broker a \$5,000 cashier's check, which the broker deposited. The broker believed the money was sent from his new investor for the purposes of opening an offshore account to facilitate the upcoming overseas payments. This check also proved to be counterfeit. Fortunately, the broker had not drawn against it. The broker advised bank investigators that the checks were from Nigerian real estate investors. The bank advised that this was likely a scam.

After some time had passed, Didi II contacted the broker and agreed to make more investments in the broker's housing project via wire transfers. Shortly thereafter, the broker's bank received a United States Treasury check for \$700,000, payable to the broker. The bank deposited the check, and the broker moved the funds around to various broker-owned business and investment accounts. This check proved to be counterfeit as well.

Shortly thereafter, U.S. Secret Service agents came to the broker's office and advised that they were investigating Nigerian counterfeit check scams and that they believed the broker was a victim. The broker disclosed everything. Several hours into the interview, however, he discovered that he was the subject of the investigation. By that time, he admitted that he suspected a scam but told agents that he wanted to "get the best of" the scammers before they "got the best of" him.

The broker was convicted on two counts of bank fraud and sentenced to more than three years in prison with four years of supervised release. The broker was convicted on the fraud principle of "deliberate ignorance." Under criminal bank fraud law (and related laws), one cannot "avoid responsibility for a crime by deliberately ignoring the obvious." A broker cannot deliberately ignore the high probability that checks or deposits received from business associates would be counterfeit or otherwise fraudulent. Carelessness, simple negligence, or "foolishness" is not sufficient to convict; it must be obvious that a scam is afoot. One would think that after the broker cashed the counterfeit checks from Didi I and her Nigerian investors, the broker would start to figure out that Didi II and her offshore investors were not legitimate business people.

In other odds and ends, a federal bankruptcy court in Florida recently entered an opinion in a bankruptcy matter filed by a Florida real estate broker.⁹ Here, the real estate broker was sued for breach of contract for a marina purchase the broker made. Apparently, this broker discovered that a marina that was for sale was subject to a deed restriction in its chain of title that prohibited the sale of alcoholic beverages on the property. The marina operator was not aware of the deed restriction. The broker sought to purchase the marina and prepared sale contract documents for the property that required the sellers to convey the marina by warranty deed, free and clear of all encumbrances. The sellers, who were not represented by a broker, did not know that Florida brokers typically use form agreements that have standard transfer exceptions for “easements, reservations and restrictions of record.” In other words, title is transferred subject to all encumbrances “of record.” Thus, when the broker entered into the contract, he knew the marina would be in breach due to the deed restriction. The broker took possession of the property, but he refused to pay the balance due based upon the deed restriction. The marina owner successfully sued for breach of contract (*i.e.*, failure to pay) and was awarded a judgment in state court.

The broker filed for bankruptcy and sought to discharge the debt. The marina owners filed an action within the broker’s bankruptcy matter (an “adversary proceeding”), arguing that the broker could not discharge (*i.e.*, walk away from) the debt, as debts that are incurred through fraud or deceit are generally not discharged in bankruptcy.

The bankruptcy court found that because the broker was a party to the contract, he had no direct fiduciary duty to the seller. The court did, however, rely on the Florida statute, which creates duties in real estate brokers to all parties, regardless of whether a brokerage relationship has been established. Thereunder, a real estate broker owes a potential seller or buyer the duties of honest and fair dealing, and disclosure of all known material facts, even where the licensee does not have a brokerage relationship with the parties.

Here, the bankruptcy court found that the broker breached the duty to act honestly and fairly in the transaction but did not find that he acted fraudulently. Thus, he could discharge the debt incurred in the lawsuit.

Though the real estate broker avoided paying the judgment, this discharge came at the end of 17 years of dispute and litigation between these parties. This case illustrates the difficulty or potential pitfalls of entering into a real estate transaction for the simple purpose of trying to manufacture a breach by the other side.

⁹ *Barley v Paletti (In re Paletti)*, 2008 WL 1745561 (Bank ND Fl, 2008). This case has been described by a trial court judge as a “dog fight of deceit and dirty dealing,” where no party was “constrained by truthfulness.”

CONCLUSION

Buyer's agents' duties continue to evolve. Further, as buyer's agency becomes more popular, new wrinkles can be expected to develop. Though listing agents' duties remain somewhat more predictable, cases still arise under the classic fiduciary duty of full disclosure and general prohibitions against undisclosed self-dealing by a listing agent. Furthermore, whether representing buyers, sellers, or as a party to a transaction, exercise caution and healthy skepticism when dealing with overseas "investors" who express interest in your pet projects. Willful ignorance of the obvious may land you in court.

RISK REDUCTION ISSUES

INTRODUCTION

The Michigan Association of REALTORS®, both through its Public Policy Committee and its Legal Action Committee, is constantly striving to reduce sources of risk for REALTORS®. While it may not seem to be the case, the sources of risk for REALTORS® have been steadily reduced over the years. However, most specific types of risk can be avoided only if REALTORS® are proactive. As an example, the seller's disclosure act substantially reduces the risk of fraud claims against REALTORS®, but only so long as REALTORS® and their clients properly use the seller's disclosure form.

This article will review various tools available to REALTORS® to reduce the risk of claims against them. It is not possible to cover every technique for risk reduction in a single article or in a single class. Other matters of risk reduction are covered in different topics which are part of this legal update. Nonetheless in this article we will discuss a number of major risk reduction techniques.

DISCUSSION

a. The Beginning – Independent Contractor Agreements

There are two major sources of potential conflict which exist from the day an agent joins her first brokerage firm. One major source of conflict is with the government. Is the agent an independent contractor or an employee for purposes of workers compensation, withholding taxes, unemployment insurance, and claims of negligence by third parties? Are the commissions earned by associate brokers or salespersons part of the broker's "gross receipts" under the Michigan Business Tax? The other major source of conflict occurs when and if the agent decides to move to another brokerage firm (which is a fact of life). Both of these issues can be addressed in an independent contractor agreement. Specific provisions regarding departing salespersons are covered under another topic as part of this legal update. In this article, we will focus on the regulatory provisions.

A broker and an agent can effectively eliminate any controversy with the state and federal government with respect to the agent's status by simply utilizing an independent contractor agreement. In the absence of an independent contractor agreement, the government will consider numerous factors in determining whether a person is acting as an employee or an independent contractor of the brokerage firm. The tests focus generally on the amount of control the brokerage firm is exercising over the agent. The tests applied by the Internal Revenue Service and other governmental agencies are so subjective that it is almost impossible to predict in advance whether an agent would be treated as an independent contractor or employee.

Fortunately, both NAR and MAR have obtained legislation which permits brokers and agents to eliminate any uncertainty as to the status of the agent as an independent contractor.

NAR obtained legislation that created a “safe harbor” for purposes of federal income taxation. 26 U.S.C. § 3508. MAR obtained an amendment to the Occupational Code and other state laws by which brokers and agents can conclusively establish an independent contractor relationship for various state law purposes. Under both laws, an independent contractor status exists between a broker and salesperson if: (1) a written agreement exists in which the real estate broker states that he does not consider the associate broker or salesperson as an employee for federal and state income tax purposes; AND (2) not less than 75 percent of the annual compensation paid by the real estate broker to the associate broker or salesperson is from commissions from the sale of real estate.

To eliminate any controversy over the status of salespersons as independent contractors, it is an absolute requirement that the broker and salesperson have a written independent contractor agreement in place. While brokers and salespersons are certainly free to develop their own form of independent contractor agreement, it is highly recommended that the “taxation” provisions of the MAR form of independent contractor agreement be included in any customized independent contractor agreement. The “taxation” provisions of the MAR form have been reviewed and accepted by the Internal Revenue Service.

If a brokerage firm and salesperson do not have a written independent contractor agreement in place, but nonetheless treat the salesperson as an independent contractor, then the consequences could be catastrophic. If, for example, a brokerage firm failed to pay unemployment taxes on a salesperson who was later deemed to be an employee, the Michigan Employment Security Act would require the brokerage firm to not only pay all contributions owed, but also allow the Michigan Employment Security Commission to assess penalties up to 50 percent of the amount owed and interest up to 50 percent of the amount owed. Similarly, if the Internal Revenue Service ultimately determined that the salesperson was an employee and not an independent contractor, then the brokerage firm could be required to pay significant penalties to the IRS for failing to comply with withholding requirements.

b. Indemnification Clauses in Listing Agreements

Listing agreements should contain a provision addressing liability for injuries which occur on or to the property while it is listed. There is one scenario under which REALTORS[®] presently have liability for potentially dangerous conditions and another area in which there is a movement to create liability.

In 1997, the Michigan Court of Appeals considered the issue of whether a REALTOR[®] could be liable for conditions at an open house in Michigan. *Anderson v Weingand*, 223 Mich App 549; 567 NW2d 452 (1997). In this case, a homeowner and a REALTOR[®] were sued by a person who slipped and fell on ice. The snow had fallen the day before the open house, and the owners had cleared the driveway and sidewalk of the snow. The owners then left to visit relatives, as their REALTOR[®] did not want them present during the open house.

On the following day, a Sunday, the sun was shining in the morning and it was relatively warm. However, as the day went on the temperature dropped. Unfortunately, a residue of snow left on the sidewalk had melted in the morning but then froze again into black ice in the afternoon. A person who fell on the black ice while walking up to attend the open house sued both the sellers and the listing REALTOR®.

The Michigan Court of Appeals upheld the trial court's decision to dismiss the case against the homeowners. The Court found that a homeowner is not required to go back and re-examine a sidewalk on an hourly basis to determine if ice has formed on the sidewalk. Instead, homeowners are only required to take reasonable measures within a reasonable time after a snowfall to reduce the hazard of injury to persons like the plaintiff in this case.

Unfortunately, the Court of Appeals did not rule in favor of the REALTOR®. The Court found that the homeowners had granted temporary possession and control of the property to the REALTOR® for purposes of holding the open house. Since the REALTOR® was in possession and control of the property at the time of the fall, the Court found that the REALTOR® could be liable for any injuries suffered by the plaintiff. Further, since the plaintiff was an invitee to the property (as opposed to a licensee), the REALTOR® was required to take reasonable steps within a reasonable time to diminish the risk of injury on the ice.

Since this case was decided in 1997, Michigan case law has developed which protects property owners and REALTORS® from some of these types of claims. In more recent years, Michigan courts have generally determined that when there is a danger which would be open and obvious to a reasonable person, a property owner is not liable for damages suffered by someone who is injured by reason of the condition. Michigan courts have held that a "condition is open and obvious if it is reasonable to expect an average person of ordinary intelligence to discover the danger upon casual inspection." In general, there is no duty to warn someone of an open and obvious danger.

In *Dyer v Russell*, unpublished opinion per curiam of the Michigan Court of Appeals, issued December 18, 2007 (Docket No. 273574); 2007 WL 4415467, the Court considered a case in which the plaintiff, a licensed assistant to a REALTOR®, went to the defendant's home for the purpose of showing the house to potential buyers. The licensed assistant slipped and fell down the basement stairs. The REALTOR®'s licensed assistant sued the sellers, arguing that they were liable to her for premises liability. The trial court granted sellers' motion for summary disposition finding that the poor condition of the basement stairs was open and obvious.

The REALTOR®'s licensed assistant in this case contended that despite the fact that the condition of the basement stairs was open and obvious, the sellers should nonetheless be liable because the basement stairs did not comply with the Michigan Residential Building Code as adopted by the City of Lansing. It was contended that the basement stairs were narrow, steep, and did not have handrails or walls on either side. The Court of Appeals determined that there was no authority in Michigan to demonstrate that private owners of residential real estate can be liable for a building code violation under the circumstances of that case.

It should be noted that under Michigan law, generally, a property owner can still be responsible for an open and obvious danger on their property if “special aspects” exist in the case. Typically, a “special aspect” is a condition that makes the open and obvious danger unavoidable to a person. In this particular case, the plaintiff contended that her status as a licensed assistant to a REALTOR® was in fact a “special aspect.” She claimed that the stairs were effectively unavoidable because she had some obligation to the property owners to descend the basement stairs. The trial court and the Court of Appeals rejected this argument, finding that the Plaintiff’s status as a licensed assistant for a REALTOR® did not constitute a “special aspect.”

A second line of potential liability is presently being pursued against REALTORS®. This potential liability arises from damage allegedly caused to a residence by the REALTOR®, a cooperating REALTOR®, or a prospective buyer. For example, if a prospective buyer on visiting the seller’s residence turns on and leaves on a gas burner which ultimately results in a fire, the insurance company of the seller may seek reimbursement from either the listing REALTOR® or the cooperating REALTOR® who was showing the residence to the prospective buyer. It should be noted that the attempted assertion of this type of liability is being resisted, and we are presently unaware of any case finding a listing or cooperating REALTOR® liable for this type of damage claim.

Both of these types of liability can be handled by including appropriate indemnification language in the listing agreement. Under this type of indemnification provision, the sellers would indemnify the listing and cooperating REALTORS® for these types of claims. Language similar to the following provision is suggested:

INDEMNIFICATION: Seller shall indemnify and hold harmless Broker, Broker’s agents and cooperating agents, from any and all liability for any reason as a result of injury to person(s) or damage or loss to property arising out of the marketing of Seller’s home pursuant to this listing.

c. Contractual Reduction of the Period of Liability to a Seller or Buyer

More than one REALTOR® has been faced with the situation where he has been sued by an unhappy buyer or seller almost three (3) years after he last had any dealings with the seller or buyer. Such claims are typically based on a claim of breach of fiduciary duty and/or alleged misrepresentation. Unfortunately, agents involved in the transaction are no longer with the brokerage firm and are not to be found. Further, the witnesses that are still with the brokerage firm have a very vague recollection of the transaction or circumstances which formed the basis for the claim. These practical problems arise from the fact that most claims which can be asserted against REALTORS® are subject to a three-year statute of limitations, and other claims, such as breach of contract, are subject to a six-year statute of limitations. In other words, the seller or buyer has between three and six years to timely sue the REALTOR®.

In 2005, the Michigan Court of Appeals considered the validity of a provision in an employment application which shortened the time frame in which an employee of DaimlerChrysler Corp. had to file a civil rights suit against his employer. *Clark v Daimler-Chrysler Corp*, 268 Mich App 138; 706 NW2d 471 (2005). The ordinary statute of limitations for a civil rights claim is three years. This case involved an employment application in which the employee agreed that he would bring any civil rights suit within six (6) months from the date of the occurrence of the facts which provided the basis for the suit. The Court of Appeals held that such a provision was enforceable.

After the *Daimler-Chrysler* decision, it was not certain whether a court would uphold the validity of a similar contractual shortening of the statute of limitations as between REALTORS® and buyers and sellers. However, a subsequent Court of Appeals decision demonstrated that such a provision would be upheld. *Dean v Haman*, unpublished opinion per curiam of the Michigan Court of Appeals, issued May 16, 2006 (Docket No. 259120); 2006 WL 1330325. In this case, a buyer sued a home inspector for allegedly missing defects in the home. The buyer sued the home inspector approximately nine months after the inspection. The contract between the buyer and the home inspector had indicated that any claims must be brought against the home inspector within six (6) months from the date of the inspection. The trial court dismissed the action against the home inspector based on the six-month contractual limitation. The Michigan Court of Appeals affirmed the decision of the trial court. The Court determined that six (6) months was a reasonable period of time for the buyers to discover any defects which may have been missed by the home inspector. Obviously, if the Court of Appeals determined that any defects missed by a home inspector could reasonably be discovered within six (6) months of the inspection, it follows that the Court would also find that any defects allegedly concealed by a REALTOR® could also be discovered within six (6) months from the date of closing.

The last revisions to MAR's Buy and Sell Agreement, Exclusive Listing Contract, and Exclusive Buyer's Agency Agreement all contain a paragraph entitled "LIMITATION," which sets forth a six-month contractual limitation for a buyer or seller, as applicable, to file claims against the REALTOR® arising out of the transaction. For example, MAR's Exclusive Listing Contract provides:

LIMITATION: Seller and Broker agree that any and all claims or lawsuits between the parties relating to this Agreement must be filed no more than six (6) months after the date of termination of this Agreement. The parties waive any statute of limitations to the contrary.

REALTORS® wishing to incorporate a limitation provision into their various agreements may use the wording set forth in the MAR forms.

d. Agency Disclosure Forms

REALTORS® have been required to comply with Michigan's Agency Disclosure Law for over ten years. Some REALTORS® complain that it is sometimes difficult to comply with the agency disclosure requirements. All REALTORS® should be aware of the fact that the Michigan Agency Disclosure Law has provided substantial protections to all REALTORS® in at least two scenarios.

First, many REALTORS® continue to engage in buyer representation without the benefit of a buyer's agency agreement. Claims are sometimes asserted by sellers that a cooperating REALTOR® has improperly failed to make disclosures of material facts about the buyers to the sellers or to the listing REALTOR®. Fortunately, in most instances the cooperating REALTOR® has made an appropriate agency disclosure and can demonstrate that all parties were aware that she was representing the buyers, as evidenced by the agency disclosure form.

Second, courts have found that agency disclosure by a listing REALTOR® shields the listing REALTOR® from certain types of claims asserted by buyers. In the typical scenario, a listing REALTOR® receives offers from more than one unrepresented buyer (*i.e.*, the listing REALTOR® is working with several buyers as customers). The offers are then submitted to the seller with a recommendation by the listing REALTOR® that the seller accept one of the offers for reasons specific to the seller.

When the second, losing buyer finds out that the seller accepted the other offer based upon the REALTOR®'s recommendation, the losing buyer has tried to sue the listing REALTOR®, contending that he breached a fiduciary duty owed to that buyer. In these instances, the listing REALTOR® has prevailed based on the fact that he made the appropriate agency disclosure to both buyers indicating that he was representing the seller.

e. Seller's Disclosure Form

The Michigan Seller's Disclosure Act (the "SDA") has been in effect since January 1, 1994. The correct use of the seller's disclosure form has served not only to protect sellers, but also to protect REALTORS®. The correct use requires that sellers, NOT THEIR AGENT, complete the form. Correct use requires that the sellers complete the form honestly and completely. It should be noted that at the time the SDA went into effect, many commentators thought that the seller's disclosure form would be the cause of new claims against sellers and their agents. These commentators worried that the SDA would be used as a sword against sellers and their agents, as opposed to a shield. Recent Michigan Court of Appeals decisions demonstrate that these commentators were wrong.

In *Sterrett v Theisen*, unpublished opinion per curiam of the Michigan Court of Appeals, issued September 20, 2005 (Docket No. 262226); 2005 WL 2292677, the Sterretts bought a house and some adjoining real property in rural Clinton County from the Theisens. The Theisens' home was listed by a REALTOR® firm. The Theisens had indicated on the seller's disclosure statement that they were not aware of any encroachments, easements, zoning violations or non-conforming uses, or of any settling, flooding, drainage, structural or grading problems on their property.

After closing, the Sterretts hired a contractor to build a large pond on an area in the middle of the property in front of their house. Unfortunately, during the excavation, the excavator struck a large underground drain. The drain was about 15 inches in diameter and ran through the middle of the property. According to the Sterretts, despite the expenditure of large sums of money to fix the drain and fill in the land, their property flooded each time it rains.

The Sterretts sued the Theisens, the listing agent and the listing brokerage firm. The Sterretts claimed that all of these defendants made misrepresentations and violated the Michigan Consumer Protection Act.

It should be noted that the listing agent testified that in the Spring of 2003, he heard some concerns from another potential buyer of the Theisens' property regarding an easement through the property. A prior title search did not turn up any easements. However, the listing agent contacted a title insurer and requested that it further research the title. The title company then determined that no easement had been recorded with the register of deeds; however, "an easement for drain purposes vested in the Clinton County Drain Office" was disclosed to the title company. This information had been provided to the Sterretts prior to closing.

The Sterretts' claims against the Theisens and their REALTOR® were based in part upon the alleged misrepresentation made by the Theisens in the seller's disclosure statement that they were unaware of easements on their property. The trial court summarily dismissed this claim, and the Court of Appeals affirmed the dismissal by the trial court.

Both the trial court and the Court of Appeals determined that the Sterretts' reliance upon the representation in the seller's disclosure statement was unreasonable. First, the Court noted that the seller's disclosure statement is simply a representation to the Sterretts that the Theisens were unaware of any easements on the property. The Sterretts could provide no evidence to show that the Theisens knew this representation was false when they made it. Further, the Sterretts were provided with a revised title commitment from their title insurer which disclosed the existence of a drain easement on the property prior to closing. Thus, the Sterretts were in possession of facts that would lead a reasonable person to make further inquiries into the extent of the easement.

The result in this case conforms exactly with the intent and purpose of the SDA. In their seller's disclosure form, the Theisens disclosed exactly what they knew about the property from their having lived on the property. There was no reason for them to know, nor could the buyers demonstrate that the Theisens were aware, of a pipe buried deep beneath the soil.

In the second case, *Vettese v Zehr*, unpublished opinion per curiam of the Michigan Court of Appeals, issued December 15, 2005 (Docket No. 255919); 2005 WL 3439788, Vettese purchased a home from the Zehrs. After closing, Vettese discovered serious problems with the foundation of the home. Vettese sued the Zehrs, making multiple claims against them, including an alleged violation of the SDA.

Vettese claimed that the Zehrs violated the SDA when they provided a disclosure statement which was substantially blank. Presumably, the disclosure statement was substantially blank because the Zehrs had never lived in the house that they sold to Vettese. The trial court dismissed Vettese's claim based on the SDA, and the Court of Appeals affirmed that dismissal.

The Court of Appeals reviewed the primary purpose and requirements of the SDA. The Court of Appeals found that the SDA mandates that the seller disclose to a purchaser, via the statutorily required disclosure statement, certain information concerning the condition of the premises. The Court also further determined that liability for errors and omissions in a seller's disclosure statement is limited by the terms of the SDA. The Court found that the SDA permits a buyer to terminate a binding purchase agreement where a disclosure statement is not timely

delivered, although this power of termination expires upon the conveyance of the property at issue. The Court of Appeals held, “By its terms, the SDA provides no other remedies.” The Court went on to find that based upon the SDA’s plain terms, any remedy available under the SDA was extinguished upon the closing of Vettese’s purchase of the property from the Zehrs.

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 opinion per curiam of the Michigan Court of Appeals, issued August 3, 2001 (Docket No. 2221954); 2001 WL 879012, Court of Appeals 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* 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 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. *Roberts v Saffell*, 2008 WL 3876309 (Mich App). 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; 691 NW2d 770 (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.

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*, unpublished opinion per curiam of the Michigan Court of Appeals, issued February 24, 2004 (Docket No. 241507, 249015); 2004 WL 345495, 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 that 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 "[s]tructural 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

When MAR drafted the SDA, it was specifically designed so as not to create any new claims against sellers or their agents. Case law in the almost 15 years since the law was enacted has proven this to be true. However, in order to take advantage of the protections afforded by the SDA, REALTORS® need to make certain that a seller's disclosure form is used correctly for each residential property listed by them.

f. Merger and Integration Clauses in Purchase Agreements

In December of 2002, we advised REALTOR® that there appeared to be a revival occurring in the courts with respect to enforcement of so-called "merger" clauses in contracts. Since that time, we have strongly recommended that every purchase agreement include a merger clause.

To refresh your memory, the decision in 1992 involved a buyer who had sued a seller claiming that the seller had misrepresented the condition of the building which the buyer had purchased from the seller. *Indiana Lumbermen's Mut Ins Co v County of Luce*, unpublished opinion per curiam of the Michigan Court of Appeals, issued June 7, 2002 (Docket No. 236082); 2002 WL 1277026. The case against the seller was dismissed because the contract contained an "integration" clause (also called a "merger" clause) which indicated that all of the terms of the sale were contained within the four corners of the buy-sell agreement. The court held that because discussions between buyer and seller concerning the condition of the property were not reduced to writing in the buy-sell agreement, the buyer could not successfully sue the seller for alleged misrepresentations regarding the condition of the building which were made prior to the time the buy-sell agreement was signed. The court concluded that where a buy-sell agreement contains a "merger" or "integration" clause (these terms are used interchangeably by Michigan courts), neither the buyer nor the seller can maintain a lawsuit based on the failure of any condition, contingency or representation that is not written into the buy-sell agreement.

The Michigan Supreme Court frequently looks to Black's Law Dictionary as a reference source. Black's Law Dictionary defines an "integrated contract" as a "contract which contains within its four corners the entire agreement of the parties." In other words, an "integrated contract" is a writing adopted by the parties as the final and complete expression of their agreement. As a general rule, courts will not accept into evidence oral testimony or other

documents that contradict the terms of an integrated contract. Under Michigan law, an integration clause conclusively establishes the completeness of a written agreement. Generally, where a contract states on its face that it embodies the entire agreement between the parties, the meaning of that contract may only be determined from the document itself. Everything outside the document, including letters, notes and testimony about what one party thought the agreement meant is “parol” evidence and is not admissible.

Obviously, REALTORS® are bound by NAR’s Code of Ethics and should not make misrepresentations with respect to the condition of real estate or otherwise. We are not suggesting that merger or integration clauses should be included in all REALTORS®’ purchase agreements in order to permit them to safely make misrepresentations prior to the buyer and seller entering into a buy-sell agreement. That being said, REALTORS® are also aware of the fact that disappointed buyers often bring lawsuits where they mistakenly allege that a seller or listing REALTOR® made misrepresentations, when in fact the seller or listing REALTOR® never made any such representations. The presence of a merger clause in the purchase agreement simply allows REALTORS® to dispose of these claims against them in a more summary and less expensive manner. Assuming courts continue to enforce merger and integration clauses, then presumably the presence of such clauses will actually act as a deterrent to the commencement of litigation.

g. Waiver Clauses in Purchase Agreements

Michigan courts are generally willing to enforce waiver provisions set forth in purchase agreements. For example, in *McKind v Palms Investments, LLC*, unpublished opinion per curiam of the Michigan Court of Appeals, issued May 8, 2007 (Docket No. 273138); 2007 WL 1342557, Palm Investments (“PI”) had purchased an apartment building at 1001 E. Jefferson in Detroit in 2003 for \$1.25 million. The deed setting forth that purchase price was recorded in February 2004. In May 2004, McKind agreed to purchase the apartment building from PI for \$2.3 million. The purchase agreement provided that McKind had an opportunity to enter the property to make inspections and investigations. The following waiver provision was included in the purchase agreement:

***Waiver.** Purchaser acknowledges that Purchaser has made or has had an adequate opportunity to enter upon the property and to make all inspections and investigations of the records relating to the Property and ... of the physical condition of the Property, which Purchaser has deemed necessary. Purchaser acknowledges that Purchaser is completely satisfied with the review of all books and records relating to the Property . . . and the physical condition of the Property, and Purchaser is not relying on any information, documents, representations or warranties which may have been provided or made by the Seller or any of its shareholders, officers, directors or agents*

In the three months following the signing of the purchase agreement, McKind made non-refundable earnest money deposits totaling \$75,000. In July 2004, the property was appraised for \$2.31 million. A rent roll dated July 14, 2004, which was attached to the appraisal report, indicated that 34 of 69 of the rental units were occupied. There were additional addenda and a second agreement to purchase the property for \$2 million, at which time McKind made another non-refundable deposit. Ultimately, McKind made non-refundable deposits totaling \$200,000.

According to McKind, he made his first “tour” of the interior of the apartment building in December of 2004 – almost eight months after the purchase agreement was signed. McKind was accompanied by a representative of PI and a representative of a lender. During the tour, McKind was told by PI’s representative that some units could not be viewed because they were occupied. The lender’s representative nevertheless opened the door of one such unit, and McKind observed that the unit was unoccupied. He also observed that the ceiling was caved in, exposing a hole in the ceiling through which water was leaking down from the allegedly renovated roof.

McKind sued PI for fraud. He claimed that PI had indicated that it had invested large sums of money in renovating the building. He further alleged that the rent roll PI had provided was false. McKind also asserted that even if PI had not engaged in intentional fraud, it certainly had made innocent misrepresentations entitling him to the return of his earnest money deposits.

Both the trial court and the Court of Appeals ruled against McKind. The waiver was enforced against McKind. In addition, the Court found that there was a merger clause in the purchase agreement which eliminated any claims based on innocent misrepresentations.

h. “As Is” Clauses in Purchase Agreements

There is no question that the use of “as is” clauses in purchase agreements provides certain protections to sellers and their agents. However, used alone as a risk reduction technique, the protections offered by an “as is” clause are highly overrated. An “as is” clause alone will not defeat a buyer’s claim that the seller fraudulently concealed a defect or that the seller made fraudulent representations that were relied upon by the buyer in entering into a binding buy-sell agreement.

It is now well settled in Michigan that an “as is” clause will defeat a buyer’s claim for a defect that should have been discovered by a reasonably competent inspector. As an example, if a seller represents that a roof is in excellent condition, and a buyer feels rain while standing in the middle of the living room, the buyer cannot later recover from the seller based upon the seller’s misrepresentation regarding the roof. Obviously, the buyer was not entitled to rely upon such an obvious lie. On the other hand, the Michigan Court of Appeals has consistently held that even if an “as is” clause is included in a buy-sell agreement, a seller still has a duty to disclose any concealed conditions known to the seller. Michigan courts will not treat a condition as “concealed” if “a competent inspector should reasonably have been expected to discover evidence of the defect.”

REALTORS® representing buyers should strongly recommend that the buyers have inspections performed prior to purchasing a residence. Seller's agents should willingly provide the opportunity for an inspection. If a buyer declines to have an inspection after being offered an opportunity for an inspection, the buyer will not be able to prevail on a claim against a seller for alleged concealed defects, if evidence of those defects would have been discovered by a reasonably competent inspector.

The danger to buyers who do not undertake inspections or do not hire competent inspectors is demonstrated by an unreported Court of Appeals decision in *Miner v Teasel*, unpublished opinion per curiam of the Michigan Court of Appeals, issued April 10, 1998 (Docket No. 197225, 199165, and 199892). In this case, the buy-sell agreement contained an "as is" clause. In addition, the buyers' purchase of the property was made contingent upon an inspection. The buyers never had a complete inspection done for the property but, instead, waived the inspection contingency after a casual walk-through inspection. After closing, the buyers claimed to have discovered defects that cost more than \$74,000 to correct. The buyers sued both the seller and also the buyers' agent. The trial court summarily dismissed the buyers' claims as being frivolous and awarded sanctions to the seller and the buyers' agent.

The Court of Appeals affirmed the trial court, finding that where there is an "as is" clause, the buyers could only recover for concealed defects. The Court again found that where a defect reasonably should have been discovered by a competent inspector, the defects are not concealed and the buyers cannot recover anything.

It should also be noted that in this case, the buyers claimed that the buyers' broker had breached her fiduciary duty by advising them to waive the inspection contingency. The Court of Appeals found that even if the buyers' claim was true, *i.e.*, that the buyer's agent advised them to waive the contingency, the buyers could not recover because they did not rely on her advice, and had in fact conducted an admittedly incomplete inspection. The Court attributed the buyers' damages to their own ineffective inspection and dismissed the claims against the buyer's agent. Obviously, REALTORS® representing buyers should make certain that they can document, either in their buyer agency agreement, the purchase agreement, or some other document, that they recommended that the buyers have an inspection performed on the property.

i. Release Forms

The potential use of a release clause to limit liability was included in a risk reduction article prepared for MAR's 1998 Legal Update. MAR urged that REALTORS® consider using release forms based upon a decision rendered by the Court of Appeals in *Brook v Holmes*, 163 Mich App 143, 145; 413 NW2d 688 (1987), which at that time was still good law. That case involved the release clause contained in the Greater Lansing Board of REALTORS® form which provided:

And, we hereby release _____ and _____ Broker(s) in this transaction, their respective agents, employees, attorneys, and representatives with respect to all claims arising out of the performance of such Buy and Sell Agreement and Addendum and counteroffers thereto, all claims arising by virtue of any purported representations to us as to the condition of the property, and all claims arising from the existence of any special assessments and/or utility bills, which have been, or may in the future be, levied against such property.

The court held that this release was valid unless a buyer could demonstrate that it was obtained through duress, a misrepresentation by the REALTOR® as to the nature of the release clause, or fraudulent or overreaching conduct by the REALTOR® in securing the release.

Several years later, MAR's Legal Action Committee authorized MAR's participation in an appeal in *Hall v Small*, unpublished opinion per curiam of the Michigan Court of Appeals, issued May 12, 2005 (Docket No. 252814). In that case, the Court of Appeals issued an opinion affirming the enforcement of the release clause involved in that case. The use of the release clause had enabled both the listing and cooperating REALTORS® to have all claims dismissed against them. On December 27, 2005, the Michigan Supreme Court denied the buyers' application for leave to appeal, thereby affirming the opinion of the Court of Appeals as to the enforceability of the release clause.

Later that same year, there was yet another case involving the issue of enforceability of release clauses. *Huhtasaari v Stockemer*, unpublished opinion per curiam of the Michigan Court of Appeals, issued December 20, 2005 (Docket No. 256926); 2005 WL 3481429. In that case, the Stockemers had originally purchased their residence in July 1978. On May 6, 2002, in anticipation of the sale of their home, the Stockemers completed a seller's disclosure statement in which they specifically indicated that the home's roof was approximately three years old and that it did not leak.

Within two weeks of listing the property, the listing REALTOR® obtained prospective buyers for the Stockemers' home. The prospective buyers submitted an offer to purchase which resulted in an inspection in mid-May 2002. The home inspector terminated the inspection upon finding mold in the Stockemers' attic. The home inspector allegedly told the listing agent's son,

who was present during the inspection, that “there was black mold in the attic.” The prospective purchasers withdrew their offer, and the listing REALTOR® advised the Stockemers to take their home off the market. The Stockemers took their REALTOR®’s advice and removed it from the market on June 12, 2002.

The Stockemers’ home was re-listed on July 31, 2002. The Stockemers reported to their listing REALTOR® that they had soda-blasting performed in the attic and they had been advised that the mold in the attic was harmless and not black mold. The listing REALTOR® advised the Stockemers to revise their seller’s disclosure statement to indicate the prior mold problem in the attic, but the Stockemers refused to do so.

In August 2002, the Huhtasaaris then submitted an offer to purchase through their agent. The seller’s disclosure statement that was provided to the Huhtasaaris was the same form that was submitted to the prospective buyers who submitted an offer in May 2002. The seller’s disclosure form contained no reference to the prior mold problem in the attic.

The closing on the Huhtasaaris’ purchase of the Stockemers’ home was conducted in early September 2002. Shortly after closing the Huhtasaaris undertook renovations of the home, mold was discovered behind the wallpaper in the kitchen. The mold was also observed by a drywall contractor. The Huhtasaaris then had testing done on the home. Their environmental engineer issued a report indicating that “the mold growth and related structural damage” in the kitchen was “a direct result of long-term water leakage from the flashing area between the lower roof and the house wall.” The Huhtasaaris then sued the Stockemers, the listing agent and the buyers’ agent for fraudulent concealment, misrepresentation, and failure to disclose known defective conditions of the property, in violation of the Michigan Consumer Protection Act.

The trial court granted the listing agent summary disposition based upon the following language in the purchase agreement:

WE FURTHER HOLD CENTURY 21 MECK AND ITS COOPERATING OFFICE AND THEIR SALESPERSONS, BROKERS, AND EMPLOYEES, RESPECTIVELY HARMLESS AND DO HEREBY INDEMNIFY THEM AGAINST ALL CLAIMS, ACTIONS, OR SUITES [SIC] FOR DAMAGE OF ANY NATURE WHATSOEVER, ARISING FROM THEIR ACTIONS LEADING TO THIS SALE AND FROM OUR DECISION NOT TO AVAIL OURSELVES OF ANY OR ALL OF THE INSPECTIONS.

The Huhtasaaris claimed that this release provision was invalid because of the fraudulent misrepresentations and disclosures of the Stockemers. The Court of Appeals rejected this argument, noting that in signing the purchase contract, the Huhtasaaris had acknowledged that “no representations, promises, guaranties, or warranties of any kind, including, but not limited to, representations as to the condition of the premises were made by the Broker, his/her salespersons, other cooperating salespersons or persons associated with Broker.” The Court of Appeals found that this language in the purchase agreement barred the Huhtasaaris from asserting that their execution of the release in the purchase agreement was in reliance upon representations made by either REALTOR® with regard to the condition of the property.

The Huhtasaaris also attempted to invalidate the release by claiming there was a lack of consideration. The Court of Appeals, as in prior decisions, rejected this claim, finding that the release was incorporated into the closing documents for the sale of the house and did not comprise a separate or distinct transaction requiring separate and distinct consideration.

Prior release cases decided by the Court of Appeals generally involved releases obtained from sellers and buyers at closing. This *Huhtasaari* case is important inasmuch as the trial court and the Court of Appeals chose to enforce a release obtained at the time of execution of the purchase agreement. REALTORS® should seriously consider incorporating release provisions both into their purchase agreements and into their closing documents.

REALTORS® should be aware of the case of *Stout v Withrow*, unpublished opinion per curiam of the Michigan Court of Appeals, issued February 14, 2008 (Docket No. 271632); 2008 WL 400675, a decision for which the REALTORS® are presently seeking leave to appeal to the Michigan Supreme Court. MAR's Legal Action Committee authorized MAR's participation in this case both before the Court of Appeals and the Supreme Court. This case provides proof of the old legal bromide that "bad facts can make for bad law."

In this case, it was alleged that the REALTOR® conspired, in essence, with the seller to conceal a completely defective septic system. The buyer was a recently divorced woman of very modest means. The defective septic system resulted in the backup of human waste into the bathroom sink and tub, which rendered the home uninhabitable.

In this case, the REALTOR®'s attorney, on at least three (3) occasions, sought to have the case dismissed based on the fact that the buyer had executed a release. The REALTOR®'s attorney contended that the release provided by the buyer was enforceable, as it was not procured by fraud, duress, or overreaching by the REALTOR®. The trial court refused to grant the dismissal. The Court of Appeals, in a published decision, affirmed the decision of the trial court. The Court of Appeals appeared incensed at the alleged conduct of the REALTOR®. The Court of Appeals found that the alleged fraud of the REALTOR® in concealing the defects in the septic system and presenting that the property was like new resulted in the buyer not obtaining an inspection. In turn, the lack of the inspection left the buyer uninformed as to the true condition of the property. Thus, the alleged fraud of the REALTOR® with respect to the condition of the property was deemed to be fraud used in obtaining the release.

The decision in *Stout v Withrow* runs counter to all previous decisions enforcing releases obtained, at least in part, by MAR. While REALTORS® should continue to use releases, their attorneys should be mindful of this case.

j. Attorney Fees Provisions

When REALTORS® are wrongly sued in a transaction, one of the first questions asked is "can we recover our attorneys fees?" Unfortunately, under the common law, winners of litigation are not entitled to reimbursement for their attorney fees and costs. The only time winners can recover their attorney fees is when there is an applicable statute that expressly authorizes reimbursement of attorney fees and costs, and those types of statutes are few and far between.

There has always been a question as to whether a contractual agreement requiring a loser to pay the attorney fees of a winner would be enforceable in the context of a real estate transaction. In its *Boyd v Burke*, unpublished opinion per curiam of the Michigan Court of Appeals, issued May 17, 2007 (Docket No. 275313); 2007 WL 1452516, the Michigan Court of Appeals provided an answer. In this case, Paul Burke (“Burke”) became interested in purchasing the house of Curtis and Eulanda Boyd (the “Boyd”). RE/MAX Gaylord acted as a dual agent for both Burke and the Boyds. It should be noted that there was no dispute that RE/MAX Gaylord acted as a dual agent by agreement of both parties and after all “relevant and legally required disclosures.”

The purchase agreement called for Burke to purchase the Boyds’ property in a furnished state. A dispute arose as to what was going to be included in the furnishings. Ultimately, the transaction ended with Burke refusing to close and rescinding the transaction. Burke contended that the purchase agreement was not enforceable because it did not completely set forth the items which were to be included as furnishings with the home.

The Boyds sued Burke and RE/MAX Gaylord. The Burkes contended that RE/MAX Gaylord was negligent in preparing the purchase agreement. The trial court ruled in favor of RE/MAX Gaylord. The Court of Appeals found that there was no ambiguity in the purchase agreement; thus, it would have been enforceable. The trial court awarded attorney fees to RE/MAX Gaylord. On appeal, the Boyds contended that RE/MAX Gaylord should not have been awarded attorney fees.

The Court of Appeals found that there was no dispute that the basis for the attorney fees award was a contractual provision in the purchase agreement. The purchase agreement provided:

In any action or proceeding arising out of this agreement, the prevailing party, [sic] shall be entitled to actual and reasonable attorneys fees and costs. This shall also be applicable to any Realtor(s) who become a party to such action or proceeding which Realtors shall be considered a third party beneficiary to this contract.

REALTORS® may wish to include an “attorney fees provision” in purchase agreements, listing agreements, and buyer agency agreements. The theory is that a seller, buyer or other party may think twice before suing if they face the prospect of paying the REALTOR®’s attorney fees. Of course, it should be kept in mind that this sword has two edges. If an attorney fees provision is included, for example, in a listing agreement and a REALTOR® loses in ensuing litigation, the REALTOR® could be stuck paying the other party’s attorney fees. Typically, payment of attorney fees does not fall within coverage of an errors and omissions insurance policy.

k. Home Warranty Programs

Home warranty programs are an effective way to limit risk. Obviously, when a necessary repair is covered by a home warranty program, the parties can avoid a lawsuit. REALTORS® who provide information to sellers and buyers about a particular home warranty program should make certain that the company is reputable and has a good record for handling claims. Moreover, as with inspectors, REALTORS® are cautioned against putting themselves in a position where a party can argue that the REALTOR® should be responsible if the warranty company fails to perform as required under the contract. At a minimum, REALTORS® should make certain that a seller (or buyer) understands that the home warranty company is a separate company not affiliated with the broker. Moreover, a REALTOR® is well advised to present the seller (or buyer) with information on a number of different home warranty programs and let the seller (or buyer) choose one.

l. MCPA Defense

It is assumed that by now all REALTORS® are aware of the fact that in June of 2007, the Michigan Supreme Court rendered a decision which exempts REALTORS® from liability under the Michigan Consumer Protection Act (the "MCPA") if the claims alleged against them are based on their daily activities, *i.e.*, claims arising from a real estate transaction. It should not be assumed, however, that all attorneys are aware of the decision by the Michigan Supreme Court.

If REALTORS® are sued under the MCPA, their attorney must assert the exemption from the MCPA as an affirmative defense at the start of the case. While it is not difficult to assert this affirmative defense, it is fatal if it is not asserted by the REALTOR®'s attorney. The following is a sample affirmative defense to an MCPA claim against a REALTOR®:

The claims set forth in the Complaint for violation of the Michigan Consumer Protection Act are barred for the reason that Defendant is exempt.

The Michigan Association of REALTORS® spent in excess of \$100,000 in pursuing and obtaining an exemption for REALTORS® from liability under the MCPA. A REALTOR® should not lose the benefit of this hard-won victory simply by reason of their attorney's failure to include a two-line affirmative defense in the answer to the complaint.

CONCLUSION

The adoption of any or all of the risk reduction techniques discussed in this article will not provide an absolute shield against litigation for at least two reasons. First, REALTORS® are human and, like all people, will on occasion make mistakes. Second, as REALTORS® are more than aware, anyone with a filing fee can bring a lawsuit against another party. However, adoption of the risk reduction techniques described in this article can deter litigation when a buyer or seller consults with a competent lawyer prior to initiating litigation, or in the event litigation is in fact filed against a REALTOR®, can assist that REALTOR®'s attorney in obtaining summary disposition of the case.