



Beware the Unscrupulous Real Estate Broker

By Geoff Gold

A broker is, by definition, a fiduciary – one who owes the highest duties of care, disclosure and loyalty. What might compel a real estate broker to skirt his ethical and legal obligations?

Unscrupulous Behavior

A broker's behavior might be driven by the contingency fee compensation typical to the industry. Traditionally, the listing (seller's) agent splits the fee with the buyer's broker. Since the listing agent is motivated to close quickly to collect a fee, obtaining the highest price may be of secondary concern. The longer the deal takes, the more work the broker is forced to do, with a diminishing chance of success.

Another conflict may arise when a broker steers the sale of a property to a related party or favored friend without listing it on the Multiple Listing Service. While the broker may convince the seller that a buyer prepared to close quickly has many benefits, the seller loses the chance to ascertain true market value, and potentially a higher price via multiple offers.

How can a seller protect himself from unscrupulous brokers? In Jorgensen v. Beach 'N' Bay Realty, Jorgensen, a home-seller, sued her listing broker and the two agents who had handled the transaction ("BNR"), alleging fraud, misrepresentation, breach of fiduciary duty and negligence. Although Jorgensen was informed that the BNR agents also represented the buyers, she was not informed that the buyers were investors and that the BNR agents had substantial personal stakes in striking a bargain for the buyers. Jorgensen also was led to believe that the buyers would be residing in the home, when in fact it was almost immediately resold at a substantially higher price.

The Court of Appeal, reversing the trial court, found that Jorgensen had valid claims against the defendant-agents for negligently or intentionally setting the price too low. A broker cannot keep from his client or misrepresent what he knows to be the real worth of the property.

In Roberts v. Lomanto, defendant broker Lomanto became the exclusive leasing agent for plaintiff Roberts, who was the trustee of a trust that owned a shopping center. During the listing, Lomanto submitted several letters of intent from third parties. None resulted in a sale. When the listing expired, Lomanto herself offered to buy the shopping center. Roberts accepted, but later, discovered that Lomanto was just buying the property to flip it to someone else, thereby earning a \$1.2 million secret "assignment" fee in

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Strategies for Unsecured Creditors in Bankruptcy

By Duane Kumagai

Creditors' rights in bankruptcy? To trade suppliers, service providers, and other (typically) unsecured creditors, this phrase can seem a contradiction in terms. Considering automatic stay, senior debt, and preference claims, unsecured creditors can feel defeated from the start. It's an unfortunate truth that unsecured claims usually wind up being worthless in a bankruptcy.

With the crisis in the global credit markets threatening to unleash a lasting wave of business insolvencies, creditors, no matter how financially solid, are likely to be affected. Creditors need to be aware of the strategies available to them – and that can be used against them – in bankruptcy court. Two strategies that a creditor can initiate *against* a debtor, involuntary bankruptcy and exception to discharge, are discussed below.

Involuntary Bankruptcy

Bankruptcy Code Section 303 allows creditors to *put a debtor into bankruptcy* by filing an involuntary petition. Such a filing triggers the automatic stay (barring all collection activity against the debtor), and places the debtor under the jurisdiction of the bankruptcy court. Used properly, involuntary bankruptcy can be a powerful and effective weapon for frustrated creditors.

Procedure. The involuntary petition may be filed under chapter 7 or 11 of the Bankruptcy Code. In a typical case, the involuntary petition must be signed by three or more creditors with aggregate, undisputed, unsecured claims of at least \$13,475.

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A debtor served with an involuntary petition has three options: (1) submit to the involuntary proceeding as filed; (2) convert the case from chapter 7 to chapter 11, or vice versa, and proceed accordingly; or (3) contest the petition at trial on procedural or substantive grounds, including whether the debtor is truly “insolvent” under the standard set forth in the Code.

Strategic Considerations. Involuntary bankruptcy has been called the “World’s Worst Collection Strategy,” and not without reason. First, as in any bankruptcy, all creditors receive notice of the case and are entitled to participate *pro rata* in any distribution of the debtor’s assets. In other words, the bankruptcy could **dilute** the potential recovery for the petitioning creditors. Second, if the debtor successfully contests the petition, it may be able to turn the tables and obtain tort damages from the petitioning creditors for injury to the debtor’s business.

So why would a creditor ever sign an involuntary petition? Situations in which involuntary bankruptcy can be the best, or only, effective strategy available to creditors include:

- The debtor has engaged in preferential or fraudulent transfers that a chapter 7 trustee may be able to recover;
- The debtor’s management has demonstrated incompetence or bad faith in the handling of the debtor’s affairs;
- The debtor is a partnership paralyzed by dissension among its general partners; or
- A receiver has taken over the debtor’s assets, and creditors would prefer that a bankruptcy trustee administer the assets.

Exception to Discharge

The chief benefit of bankruptcy for an individual debtor is a discharge of all of the debtor’s debts under Bankruptcy Code Section 727. The discharge is fundamental to the policy that an honest debtor should receive a “fresh start” upon the conclusion of his case.

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addition to an \$110,000 commission on the sale.

Astoundingly, the trial court ruled that Lomanto did nothing improper. Lomanto persuaded the trial court that, when her leasing listing expired, she was free to profit by deciding to buy the property on her own account, and then to assign the property for additional compensation. Thankfully, the Court of Appeal reversed, reasoning that the agent is charged with the duty of fullest disclosure of all material facts that might affect the principal’s decision. The Court held that a real estate agent who has undertaken to represent the principal does not cease to owe his client fiduciary duties just because the agent enters the transaction subsequently as a principal in her own right.

Protective Measures

Lawsuits often follow where (a) people are not represented by brokers, or (b) both buyer and seller are represented by the same brokerage. Buyers and sellers would be wrong to conclude that they are better off without brokers just because some brokers are unscrupulous. Knowledgeable real estate investors know that brokers can provide valuable professional services, including the means to market the property, negotiate a good deal and close a challenging transaction. The key is making sure your broker is responsible and trustworthy.

The best way to ensure that the broker complies with his fiduciary obligations may be, at the outset, to refuse to allow the broker to act as a dual agent. This may be hard to achieve since many brokers insert dubious, overly-broad conflict waivers into their listing agreements. Buyers and sellers should scrutinize listing agreements and attempt to negotiate any objectionable terms.

Next, a seller should seek a written plan from the broker before the broker is hired. The plan should include marketing methods and the basis for the proposed listing price. The broker should commit to, and then faithfully execute, the advertised marketing plan. The seller should not be compelled to accept offers until the plan is completed and all possible parties are vetted and given fair opportunity to bid. In a multiple offer situation, the broker should be required to assure an equal playing field for all bidders.

Negotiate

It is important to remember that everything is negotiable with a broker. A party to a real estate transaction should pose written questions to the brokers in the deal. If any broker provides insufficient answers, that should sound an alarm. While a buyer or seller may have legal recourse for a broker failing to disclose or prevaricating, the availability of future lawsuits is no substitute for acting cautiously before hiring a broker.

Geoff is a trial lawyer specializing in business and real estate matters. He has litigated to successful conclusion cases involving a wide variety of corporate and business issues as well as commercial and real estate transactions. Geoff also acts as outside general counsel to many developing businesses and assists his individual and corporate clients with their everyday legal affairs (ggold@rutterhobbs.com).