BEFORE THE STATE OF ALASKA OFFICE OF ADMINISTRATIVE HEARINGS

ON REFERRAL FROM THE REAL ESTATE COMMISSION

In the Matter of the Surety Fund Claim of:

BOB BUYER

Claimant,

And

LARRY LICENSEE

Respondent.)
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DECISION AND ORDER

I. Introduction

This case is a claim against the Real Estate Surety Fund arising from a failed purchase of a fifty-plex for $4.4M. The transaction was initiated by Larry Licensee, then a licensed real estate salesman working under the supervision of a licensed broker. MR. LICENSEE filled the roles of listing broker, selling broker, and potential co-investor. The buyer was BOB BUYER, a first-time investor of modest means. Although the transaction never closed, BOB BUYER eventually lost most or all of his net worth in dealings with MR. LICENSEE in connection with the transaction. He seeks to recover the maximum available from the Surety Fund, alleging "fraud" and "intentional misrepresentation."

The Executive Administrator of the Real Estate Commission notified Mr. MR. LICENSEE and his broker of Mr. BOB BUYER's Surety Fund claim, and both participated in the initial case planning conference (The broker through counsel and Mr. MR. LICENSEE on his own behalf). Neither MR. LICENSEE nor The Broker attended the hearing to take evidence on the claim. Mr. BOB BUYER has demonstrated systematic and pervasive deception on MR. LICENSEE's part in connection with the transaction, resulting in losses to him exceeding the $15,000 maximum that The Surety Fund may disburse.

II. Facts

The record on which this decision is based consists of testimony from BOB BUYER, Exhibits A-P admitted at the hearing, and the Surety Fund claim file submitted by the Executive Director. [1] Because there was only one witness, citations to witness testimony have generally been omitted from the factual findings below; only documentary sources are cited.

A. BOB BUYER

In the spring of 2006, BOB BUYER was in his mid-thirties, married, and raising two daughters. An hourly employee of the Alaska Railroad in the capacity of conductor and brakeman, he earned $110,000 to $120,000 per year but achieved this income only by working extensive overtime; overtime accounted for 60 percent of his earnings. He hoped to find a less time-intensive way to earn a living so that he could spend more time with his family. BOB BUYER had observed that some of his co-workers had been able to achieve a positive cash flow from four-plexes, and he hoped to purchase one as a beginning real estate investment. Apart from retirement savings of about

$150,000 and educational savings for his daughters, he had less than $10,000 on hand, and so he hoped to use equity from his home to generate funds for the investment. He lived in a home he had built himself, on which he owed about $215,000. Based on comparable sales in the neighborhood, he believed the home to be worth about twice that amount.

B. Agreement to Purchase Creekside Terrace Apartments

On the recommendation of a co-worker, BOB BUYER contacted Larry Licensee, who was then a licensed real estate salesman with a local brokerage. After two or three meetings with BOB BUYER, MR. LICENSEE began to encourage BOB BUYER to consider a larger investment, explaining that bigger is better because one can better insulate oneself from vacancies if they are spread across a large volume of units. He proposed to BOB BUYER that he consider investing in a 50-plex property, the Creekside Terrace Apartments at 573 East Dowling Road in Anchorage, which he said had just become available. MR. LICENSEE said he had cold-called the owner and told the owner he had a potential buyer, and the owner had shown an interest in selling.

On May 31, 2006, BOB BUYER and MR. LICENSEE met to prepare an offer for the property. Troy Stafford of BMC Capital was also present at MR. LICENSEE's invitation. MR. LICENSEE filled out a Purchase and Sale agreement under which " BOB BUYER and/or assigns" would purchase the 50-plex for $4.4M. MR. LICENSEE was listed as both listing and selling broker, "assisting both the Buyer and Seller as a Neutral Licensee. BOB BUYER, who may have seen the property from the road but otherwise had not inspected it, signed the agreement as an offer to purchase. The May 31 offer required the seller to provide financial and leasing information about the property within seven days. The offer contained a contingencies for physical inspection by a professional (by June 10) and for approval of conventional financing (by August 1). Closing was to occur by August 4. The document recorded the deposit of $10,000 in earnest money to be "held in trust" by the selling broker. BOB BUYER did not in fact deposit $10,000 in earnest money; instead, he wrote a check for $5000 to the brokerage for that purpose. These funds were deposited on June 1, 2006 in the broker's trust account. The discrepancy in earnest money amounts reflects an understanding between MR. LICENSEE and BOB BUYER that MR. LICENSEE would find an additional investor or investors, including MR. LICENSEE himself if need be, to form a viable group to complete the purchase. The remainder of the $10,000 was to come from these unnamed additional participants. The Purchase and Sale Agreement, however, made no reference to these additional investors apart from the mention of possible "assigns" on the line for "Buyer(s)."

The sellers made a counteroffer on June 1 accepting most terms, including the $4.4M purchase price, but making some technical changes and adjusting some dates. The closing date was adjusted to August 31 with the sellers having a right to unilaterally extend for 30 days thereafter. BOB BUYER accepted the counteroffer on June 1, 2006. On the same date, BOB BUYER submitted a partly-completed application for financing to BMC Capital. BOB BUYER apparently never heard from BMC Capital again.

C. Loss of Down Payment Funds

During the ensuing six months, MR. LICENSEE and BOB BUYER communicated every week or two. MR. LICENSEE assured BOB BUYER the deal was still on track to close but that "a project of this kind takes time." He showed BOB BUYER financial projections that he said were drawn from financial data provided by the sellers. He told BOB BUYER that an inspection had been conducted but the inspector was still writing up his report. In the meantime, without BOB BUYER's knowledge, MR. LICENSEE served as both listing and selling licensee in a second transaction involving the same property.

On July 28, 2006, he represented the sellers and buyers in connection with an offer by Titus and Glenn Hermann to purchase the Creekside Terrace Apartments for $4.4M BOB BUYER was not a part of this offer and his still pending contract with the sellers was not mentioned in it. The sellers appear to have entered into a contract with the

Hensons, because several months later Land Title Company of Alaska, Inc. issued a Preliminary Commitment for Title Insurance to the Hensons in connection with a $4.4M purchase of the same property. In 2008, during the investigation of this matter by BOB BUYER's counsel, the sellers provided a "Termination of Agreement to Purchase" relating to the BOB BUYER contract. The termination is undated, but it carries a fax imprint indicating that it was transmitted on August 11, 2006 from another brokerage (where MR. LICENSEE was working by August of 2006). The termination bears signatures of the sellers and MR. LICENSEE; it also has a signature for Mr. BOB BUYER that, so far as one can tell from a faxed copy, is almost identical to one of the signatures BOB BUYER had written on the May 31 offer. The preponderance of the evidence in this proceeding indicates that BOB BUYER's signature on the tem1ination was forged. *(Using a ruler, one can determine that the relative proportions of some of the elements are not consistent. Therefore, the later signature is not a photographic copy of the earlier one.)* BOB BUYER so testified and his testimony was credible. His subsequent documented conduct that was reviewed and is consistent only with an understanding that the purchase remained pending, That conduct includes the procuring of cash for closing the Creekside Terrace Apartments purchase in the amount required to supply half the down payment just as he had supplied half the supposed earnest money. Moreover, the termination document itself is unconvincing in several respects. It bears a date substantially after the property was placed under a second contract with different buyers. It indicates forfeiture of 100% of the earnest money to the sellers. Putting aside whether BOB BUYER would plausibly have agreed to such a forfeiture under the circumstances, it is notable that the brokerage, the holder of the earnest money, did not disburse the earnest money according to the purported termination agreement. Instead, they continued to hold the portion of the earnest money that was in its trust account and eventually refunded that remainder to BOB BUYER.

In October of 2006 MR. LICENSEE told BOB BUYER that they were "getting close" to closing the Creekside Terrace Apartments purchase and that BOB BUYER needed to draw down the equity in his home to generate his portion of the down payment. Based on discussions with MR. LICENSEE, BOB BUYER understood that he needed to supply $440,000 of an $880,000 (20 percent) down payment and that when the transaction was consummated, BOB BUYER would be a 50% owner of the complex. MR. LICENSEE arranged an appraiser for BOB BUYER's home, Rich & Associates, who appraised it at $660,000, $438,750 more than the balance owing on the first deed of trust on the home. MR. LICENSEE arranged for BOB BUYER to apply for a second deed of trust with Brian Burns of Pacific Mortgage.

On November 30, 2006, BOB BUYER, working through Burns, closed a loan with Residential Mortgage LLC in the principal amount of$436,000. The loan was secured to his house. It carried an interest rate of 8.525% and required payments of $3360.19 per month. Settlement charges of $9179.32 were paid from the loan proceeds, leaving a net disbursement to BOB BUYER of $426,820.68. MR. LICENSEE suggested that BOB BUYER enter into a "VOD loan" to recover his closing costs. MR. LICENSEE described this kind of loan as a standard practice in the real estate industry. The loan was arranged in the offices of Land Title Company of Alaska. BOB BUYER placed his funds into an escrow account there, where the money supplied required funds for a verification of deposit in connection with a transaction involving a real estate investor named Brad Johns. BOB BUYER was paid $8500 for this service. His principal was returned to him on December 12, 2006. MR. LICENSEE told BOB BUYER the closing on the 50-plex was still close but that inspections were taking more time than expected. He also said that the appraisal of the property had come back at only $4.0M and that he was finding an additional investor to put in the extra down payment cash that would therefore be required to complete the purchase at $4.4 million. Ostensibly because BOB BUYER had made clear that the money he had collected for the down payment needed to be self-sustaining, MR. LICENSEE proposed another loan to make that possible. He introduced BOB BUYER to Andy Smith, his brother in law, and drew up loan documents whereby BOB BUYER would loan Smith $444,064.24 to be repaid in monthly installments of $3360.19, exactly the amount BOB BUYER had to pay on his second deed of trust. The loan could be called on 30 days' notice. The first six months of payments were prepaid by deducting them from the amount disbursed, and there also seems to have been an $8700 "origination fee" deducted, so that the amount disbursed to

Smith was $415,195. Buyer and Smith executed the documents for this loan on December 6, 2006, while the "VOD loan" to Johnson was still outstanding. For reasons that are unclear, MR. LICENSEE countersigned one of the documents. The loan to Smith was ostensibly secured to a home Smith was building on the Anchorage hillside. BOB BUYER did not know about (and did not know enough about real estate to inquire about) a prior deed of trust on the same property. In any event, BOB BUYER's deed of trust was not notarized and was not recorded at the time he disbursed the $415,195.95 to Mr. Smith. BOB BUYER disbursed $415,195.95 to Smith on December 12, 2006, the same day his money was returned from the "VOD loan." After facilitating the payment to Andy Smith, Mr. MR. LICENSEE became extremely difficult to reach and stopped returning Mr. BOB BUYER's telephone calls. The Creekside Terrace Apartments purchase that was the subject of the May 31-June 1, 2006 Purchase and Sale Agreement did not close.

In May of 2007, Smith defaulted on the note to BOB BUYER, having never repaid any of the $415,195.95. The preponderance of evidence in this proceeding indicates that there is no realistic prospect of recovering any of the principal or interest owing. Mr. BOB BUYER now owes substantially more on his own home than its assessed value. His payments on his two mortgages exceed his monthly take-home pay. Because his wife has been able to begin working, the couple has avoided foreclosure. Their net worth, which exceeded $350,000 when they began working with Mr. MR. LICENSEE, is largely or entirely gone.

Many months later, after Smith had defaulted, Smith recorded the note and deed of trust. A notary signed a notarization purporting to attest that the principals signed before her on December 6, 2006. Some alterations were made to the document prior to notarization and recording.
According to BOB BUYER, the hillside property is in foreclosure and is not expected to yield any funds beyond the amount of the first deed of trust. Official notice is taken that Smith has recently been the subject of multiple collection actions in Alaska courts and that court dockets published on the Alaska Trial Courts website show that a writ of execution was recently returned without funds. [A party objecting to the taking of official notice of this fact may file an objection and submit evidence or authority to refute the officially noticed fact. Any such filing should be made prior to the date set in this case for submission of proposals for action under AS 44.64.060(e), and should be submitted separately from any proposal for action filed under that provision.]

III. Discussion

This case falls under the Surety Fund statutes in place prior to substantial amendments that will become effective March I, 2010. To recover from the Surety Fund under the law in effect before that date, an individual must show a loss in a real estate transaction resulting from a licensee's fraud, misrepresentation, or deceit, or a licensee's conversion of trust funds or community association accounts. The maximum recovery from the fund is $15,000 per transaction.

A. Fraud, Misrepresentation, and Deceit

The four bases listed above on which the Real Estate Commission can authorize reimbursement from the Surety Fund fall in two categories. The first category is fraud, misrepresentation, or deceit, concepts that encompass similar and largely overlapping types of conduct discussed more fully below. The terms "fraud, misrepresentation and deceit" are frequently tied together in Alaska licensing statutes. The Alaska Supreme Court likewise uses the three terms essentially interchangeably, requiring for a claim of "fraud," "knowing misrepresentation," or "deceit" proof of: (I) a false representation of fact (2) knowledge that the representation was false (or lack of confidence in the representation, or knowledge that the basis for the representation was not as stated or implied), (3) intention that the other person rely on the representation; (4) justifiable reliance on the representation; and (5) damage as a result of the reliance. "Deceit" has not been separately defined under Alaska law. "The term "deceit" generally means a fraudulent and deceptive misrepresentation used by one or more persons to deceive and trick another person who is

unaware of the true facts and is damaged as a result of the deceitful conduct. Fraud, misrepresentation, or deceit can be found on the basis of nondisclosure in some circumstances, such as when conduct is induced through a "literally true statement that omits additional qualifying information likely to affect the listener's conduct." To support a recovery from the Surety Fund, however, any misstatement or nondisclosure must be "wrongful"; an innocent misrepresentation or nondisclosure is not enough. This case presents a number of instances of wrongful misrepresentation and nondisclosure. Most significantly, after he had brought about the Henson contract on July 28, 2006 and after he had generated a purported termination of the BOB BUYER purchase, Mr. MR. LICENSEE continued to assure Mr. BOB BUYER that BOB BUYER's transaction was moving forward. With these assurances, he induced Mr. BOB BUYER to draw more than $400,000 in purported equity from his own home and to place virtually all of that money at the disposal of MR. LICENSEE's brother-in-law in an inadequately secured loan. After July 28, 2006, MR. LICENSEE knew that his assurances to BOB BUYER were false. The assurances were a proximate cause of BOB BUYER's loss of the $415,195.95 he disbursed to MR. LICENSEE's relative. Viewed from another angle, the fraudulent assurances were a proximate cause of BOB BUYER incurring interest costs at the rate of 8.525% on his down payment funds, costs that began when the $436,000 Residential Mortgage loan closed and that continue to the present. These costs exceed $3000 per month or $36,000 per year.

B. Conversion of Trust Funds

The original Surety Fund complaint in this matter might be construed as a claim regarding both Mr. MR. LICENSEE and The Broker. The cover page of the claim lists both of them after the phrase "1/we hereby make a claim against the surety fund for losses suffered in a real estate transaction involving the following licensees." The factual record developed in this proceeding indicates that the brokerage took $5000 into its trust account on June 1, 2006 solely as earnest money in connection with the May 31, 2006 offer to purchase 573 Dowling Road. When Mr. BOB BUYER requested return of the earnest money, only $2500 remained in the account. The Brokerage allegedly declined to account to Mr. BOB BUYER for the discrepancy. An account record obtained by the Executive Administrator and submitted with the referral of this case suggests that the brokerage disbursed the funds to BMC Capital to cover an appraisal fee and a loan commitment fee. Nothing in the documents the brokerage presented to the Executive Administrator and nothing in the present record of this case would sustain a contention that this could be an appropriate basis to withdraw the earnest money under the documents setting up the escrow, nor that it was a withdrawal authorized by either principal. Mr. BOB BUYER suggests, plausibly, that these circumstances arguably could represent a "conversion of trust funds" by Northern Trust within the meaning of the Surety Fund statute. The most common form of conversion is "an unauthorized transfer or disposal" of another person's goods or funds. A conversion can occur without any intent to steal or defraud. Nonetheless, recovery from the Surety Fund cannot be sustained in this case on the basis of conversion because the Surety Fund claim did not allege conversion of trust funds. Had the claim included that allegation, The Broker, who was offered party status in this case but elected not to participate in the hearing, might have made a different decision about whether it needed to make a defense beyond the mere furnishing of documents from the brokerage's file. It would not be fair to The Broker or the brokerage to resolve the conversion issue in this proceeding.

IV. Conclusion

Because fraud and knowing misrepresentations on the part of licensed real estate salesman Larry Licensee resulted in a loss to BOB BUYER exceeding $15,000, the claim of BOB BUYER against the Real Estate Surety Fund is sustained. Claim S-28-008 is granted in the amount of $15,000.