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MONROE MCDONOUGH BRENT & MORALES, PLLC
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Welcome to the MMB&M Newsletter

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SOUTHERN ARIZONA'S REAL ESTATE LAW FIRM

Are your Agents Employees or Contractors? (And What Does it Matter?)

By: Heidi Rib Brent
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The current federal administration has been on a campaign to classify workers as employees rather than independent contractors for additional tax revenue and so that more workers will qualify for mandated employment benefits. This has resulted in an onslaught of federal and state employment audits, investigations and class action law suits, which now have included the real estate industry – once a safe haven for agents as independent contractors. As a result of this new initiative, brokers should be aware of the relevant factors for classification and review the company handbooks, policies and practices to evaluate if their agents and other workers are properly classified.

Independent contractors, as opposed to employees, are people or companies that are contracted to perform a specific trade or business by the job or project for which they already have the qualifications to perform. They set their own hours and work location, possess their own tools and equipment and arrange for their own insurance. Independent contractors are paid by the contract for the job or project and, if unincorporated, must be provided an IRS Form 1099 for Miscellaneous Income for more than $600.00 in a year.

Employees, on the other hand, take training and direction from their employer. The employers determine the time, place and manner of the employees' performance, as well as provide the tools and equipment and insurance. Employees are protected by federal and state wage and hour laws and must be paid by the hour for every portion of an hour they are permitted to work, (unless they satisfy the federal criteria as salaried employees, which is limited to executive, administrative, professional, outside sales and employees in certain computer-related occupations with certain minimum income levels). Employers must provide worker's compensation, unemployment insurance, and health insurance as required by the Affordable Care Act and must withhold federal and

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Public Private Partnerships – The Way to Bring Much-Needed Infrastructure to Arizona

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Just last month, the Arizona Department of Transportation ("ADOT") finalized its first highway Public Private Partnership ("P3") Agreement with Connect 202 Partners for the construction of Loop 202 South Mountain Freeway in Maricopa County, Arizona. According to ADOT, the partnership will enable the freeway to be delivered three years earlier than expected and at a savings of over $100 million. ADOT has plans for additional P3 projects in the near future.

So what is a P3? According to the National Council for Public-Private Partnerships a P3 "is a contractual arrangement between a public agency (federal, state or local) and a private sector entity. Through this agreement, the skills and assets of each sector (public and private) are shared in delivering a service or facility for the use of the general public. In addition to the sharing of resources, each party shares in the risks and rewards potential in the delivery of the service and/or facility" (www.ncpp.org/ppp-basics/7-keys/).

P3s are being created throughout the United States in order to address the continuing reduction in government funds available for financing much-needed infrastructure, and the efforts by federal and state governments to have the private sector help meet the need. On the federal level, President Barack Obama issued a Memorandum on July 17, 2014 entitled "Expanding Public-Private Collaboration on Infrastructure Development and Financing" which launched the Build America Investment Initiative. Further evidence of federal support for P3s includes the Federal Highway Administration's Model Public-Private Partnership Core Toll Concessions Contract Guide (https://www.fhwa.dot.gov/ipd/pdfs/p3/model_p3_core_toll_concessions.pdf); the Department of the Treasury, Office of Economic Policy's September 2014 booklet "Expanding our Nation's Infrastructure through Innovative Financing;" and the Internal Revenue Service's improved tax treatment for P3s found in the October 26, 2015 amended General Allocation and Accounting Regulations Under Section 141(REG-140379.02;REG-142599-02) (http://federalregister.gov/a/2015-27328.)

The Loop 202 P3 project described above was created under the authorization of Arizona's "Public Private Partnerships in Transportation Act," (Arizona Revised Statutes, Title 28, Chapter 22) (the "Act"). Under the Act, ADOT is granted authority to enter into P3s for a wide variety of projects such as highways, bridges, tunnels, railways, airports, etc. as well as facilities ancillary to such projects, i.e. administration buildings, parking, rest areas, vehicles, energy systems, etc. See A.R.S. §28-7701(2). It is anticipated that additional Arizona legislation will be adopted expanding the use of P3s beyond ADOT.

So, if you are, or work with, a business or entity that has not traditionally been involved in government projects, but provides services that are directly or indirectly related to the construction or maintenance of any public projects (i.e. restaurants, landscapers, builders, contractors, architects, etc.), P3s could prove to be a profitable new source of business. As government funds become increasingly scarce and Arizona's aging infrastructure continues to deteriorate, P3s may well be the wave of the future that you should catch if, and when, it comes.

What's Happening in Tucson

Rise of the Sheik – Gaslight Theatre – 7010 E. Broadway – March 31 through June 5

Fourth Avenue Street Fair - Fourth Avenue Area - April 1 - 3

Marana Bluegrass Festival - 13251 N. Lon Adams, Tucson - April 8 – 10

Cyclovia Tucson - Spring Event- 2700 S. 8th Avenue - April 10

Pima County Fair - Pima County Fairgrounds - April 14 - 24

5th Annual Great Paper Airplane Fly-Off - Pima Air & Space Museum - April 16

Tucson International Mariachi Conference - Casino Del Sol Resort - April 20 - 23

Anti-Trust Refresher

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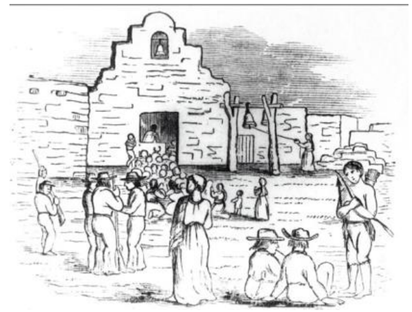
Real estate companies must ever be mindful of the federal and state anti-trust prohibitions and how the prohibitions relate to their industry. Dating back to the Industrial Revolution in the United States, the government became concerned about certain companies becoming too powerful and eliminating their competitors. The Sherman Anti-Trust Act of 1890, still effective and the enforcement tool of our time, prohibits "contracts, combinations or conspiracies by two or more persons in restraint of trade." It is enforced by the United States Department of Justice and the Federal Trade Commission, as well as the State Attorney General. Costs of defense run high and any damages are tripled, plus an assessment for the governments' attorneys' fees.

An anti-trust violation is defined as any agreement or conspiracy in restraint of trade and there is no need for the government to prove "anti-competitive effect." Price-fixing and boycotting are automatic violations. In real estate industry terms, price-fixing is an agreement between two or more competing brokerages to establish standard commissions; not just between the two brokerages for their commission sharing, but for their deals with other brokers as well. Boycotting is an agreement between two or more competing brokerages to drive a competitor out of the industry. Allegations of boycotting were rampant with the appearance of discount brokers and virtual office websites. Moreover, two or more competing real estate brokers or agents denigrating the business practices of another brokerage to discourage other agents from affiliation also could be prosecuted as an anti-trust violation. Other potential anti-trust violations include agreements between competing brokerages to allocate customers by territory, price range or otherwise.

The law does not prohibit a brokerage from establishing its own standard commissions and other terms for its agents; it just prohibits the agreement amongst competing companies. However, a broker can be held liable for the anti-competitive actions of its agents even if the broker was unaware of the agent's actions.

While anti-trust actions have focused on the real estate industry, the law applies equally to other industries, as well. Although trade associations and industry conferences can be beneficial, participants are cautioned not to participate in any conduct that can be construed as anti-competitive.



Attorney Anne Terry Morales takes a break from the 2016 Rodeo Parade and celebrates her family's deep roots in the Tucson community dating way back to 1775.

Arizona Appellate Court Upholds HOA's Redemption Rights to Judicial Foreclosure

By: Anne Morales
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On March 17, 2016, in the case of *The Bank of New York Mellon Trust Company, National Association v. Arizona HOA Acceptance LLC*, the Arizona Court of Appeals ruled that Arizona's redemption laws granted the holder of an HOA assessment lien the right to redeem residential real property following a judicial foreclosure sale of that property. In that case the borrower bought a property with funds from The Bank of New York Mellon Trust Company, National Association (the "Bank") secured by a recorded Deed of Trust. The property also was subject to the existing recorded Declaration of Covenants, Conditions and Restrictions ("CC&Rs") of the Vista View Homeowners' Association ("HOA"). The CC&Rs required the owner to pay assessments and stated that such assessments were a continuing lien on the property as authorized by A.R.S. §33-1807. The borrower defaulted on the Bank loan and the assessments. The Bank then sued the borrower for breach of contract and to foreclose. During the course of the lawsuit, the HOA stipulated that any lien it had on the property was junior to the Bank's deed of trust lien. The Bank obtained a $199,642.52 default judgment against the borrower. In addition, the court declared the Bank's lien valid and superior to all other liens and authorized the Bank to purchase the property by credit bid at a Sheriff's sale. Thereafter, the Bank purchased the property for a credit bid of $22,000.

About a month later, Arizona HOA Acceptance, LLC (Arizona HOA"), as assignee of the HOA's rights to enforce a $2,000 assessment lien, recorded a "Notice of Intent to Redeem" in connection with the property. The Bank filed a motion to prevent the redemption, claiming that A.R.S. §12-1281(2) limited redemption rights to those creditors "having a lien by judgment or mortgage on the property sold…subsequent to that on which the property was sold." Arizona HOA argued that another provision controlled, A.R.S. §12-1283(B), which grants any creditor having a lien on the property sold "subsequent to the lien so foreclosed" the right to redeem the property. The Arizona Appellate court agreed with Arizona HOA and ruled that A.R.S. §12-1283(B) does in fact govern redemption following a judicial foreclosure and confirmed Arizona HOA's right, as a creditor having a lien, to redeem the property.

So what does *Bank of New York v. Arizona HOA* mean in practice? First, in a judicial foreclosure all creditors with subsequent liens now have redemption rights. Second, lenders should determine the amounts owed to each subsequent lien creditor and consider increasing their credit bid to an amount higher than subsequent creditors would be willing to bid. Third, HOAs should ensure that their CC&Rs declare assessments to be a continuing lien on the property.

Are Your Agents Employees or Contractors? *(Continued from Page 1)*

state taxes. Employees are also protected by non-discrimination laws and are entitled to equal treatment for other employee benefits, such as pension, vacation and sick leave.

Historically, in the United States, real estate agents have been treated as independent contractors. Agents fulfill their own educational requirements and are licensed directly by the State. The IRS 3-factor test to determine that agents are independent contractors and that the broker need not collect withholdings from the agents' income is as follows:

1. The agent is a licensed real estate professional;
2. The agent's payment is directly related to sales or output rather than hours worked; and
3. The agent and broker have a written contract stating that the agent is not an employee for federal tax purposes.

However, the written contract is not definitive. The Department of Labor is spending millions of dollars to reclassify workers to extend them employee protections and benefits and to capture billions of dollars of tax revenue. The federal government looks at the "economic realities" to determine if the workers are in business for themselves or if they are economically dependent on the employer. The focus is on the employer's right to control the "manner and means" of employment. Rather than a set formula, the agent's status is ultimately determined by the totality of the circumstances; however, to provide guidance, the IRS has developed its "simplified" eleven factor "IRS Independent Contractor Test", grouped into three categories. The factors include:

Behavioral control factors

1. The extent and type of instructions given to the worker – directions for time, place and manner of performance
2. The training given to the worker

Financial control

3. The extent the worker has unreimbursed business expenses
4. The extent the worker has a financial investment in performing services
5. Whether the worker makes his or her services available to others in the relevant market
6. How the worker is paid
7. Whether the worker can realize a profit or risks a loss

Relationship factors

8. Whether there is a written contract describing the relationship between the business and the worker
9. Whether the worker receives employee-type benefits, such as insurance, pension plan, vacation pay or sick leave
10. The permanency of the relationship
11. The extent the services the worker performs is a key aspect of the regular business of the company.

IRS Publication 15-A (2016). Clear as mud, right?!

In recent court cases in other industries:

- **Fed Ex** drivers in California settled in June 2015 for $228,000,000, after the 9th Circuit Court of Appeals ruled that the drivers were independent contractors in name only. The drivers were required to use branded uniforms, trucks, scanners and company fuel, maintenance, insurance. Once the Court found the workers to be employees, the only remaining issue was the damages for the class of 2300 drivers.

- **Uber** drivers filed suit under a California statute that requires employers to reimburse employees for business expenses. The trial is scheduled for June 2016. Uber recently won in Florida on a similar issue but with different state statutes.
- **Lyft** drivers in California settled with the company for $12.5 million in January 2016; also a compromised settlement.

As for real estate cases, the one that garnered the most attention nationally was ***Bararsani v. Coldwell Banker*** in California. California has a statute which provides that real estate brokers and agents may contract as to whether the agents shall be independent contractors or employees. Although contracted as independent contractors, the Coldwell Banker agents alleged that their broker exercised significant control over factors such as designated work locations, mandatory training, and they were precluded from working for any other company or broker; however they had no employee benefits – wages, overtime pay, payroll tax withholding, or reimbursement of business expenses. The covered period for the action was November 2008 to May 2014. Coldwell Banker argued in defense that it met the IRS 3-factor test, which also applies in California. However, when the California Court held that it would apply the IRS 11-factor test instead, Coldwell Banker limited its exposure by offering arbitration to agents, thereby reducing the size of the class in the action, and then mediated a settlement. Coldwell Banker settled for $4.5 million, with $1.5 million designated as attorneys' fees, $25,000.00 for expenses, $5,000.00 to Bararsani as the named plaintiff and the 5600 agents in the class received only $535.00 each.

Another highly publicized case regarding real estate agents is ***Monell v. Boston Pads, LLC,*** in Massachusetts. The agents alleged that their broker exercised significant control in mandatory training, front desk hours, mandatory office hours, dress codes, cell phone requirements, specific daily planners, and productivity goals. Nevertheless, the Court ruled that the real estate statute is specific in permitting agents as independent contractors and controls over general statute for independent contractor status and, therefore, the real estate agents may contract to be independent contractors.

So how does this apply to Arizona? We have no specific exemption statute like Massachusetts or an option statute like California. The only statute mentioning the status of real estate agents relates to worker's compensation and applies the same IRS 3-factor test. A.R.S. §23-617(14). The Department of Revenue statute on withholding taxes provides that if a worker is exempt under federal law, then the worker is exempt for Arizona purposes as well. A.R.S. §43-104(A). The Department of Economic Security requires independent contractors to have a written contract signed by both parties and, *unless otherwise provided by law*, requires that the business:

"1. Does not require the independent contractor to perform work exclusively for the business. This paragraph shall not be construed as conclusive evidence that an individual who performs services primarily or exclusively for another person is an employee of that person.
2. Does not provide the independent contractor with any business registrations or licenses required to perform the specific services set forth in the contract.
3. Does not pay the independent contractor a salary or hourly rate instead of an amount fixed by contract.
4. Will not terminate the independent contractor before the expiration of the contract period, unless the independent contractor breaches the contract or violates the laws of this state.
5. Does not provide tools to the independent contractor.
6. Does not dictate the time of performance.
7. Pays the independent contractor in the name appearing on the written agreement.
8. Will not combine business operations with the person performing the services rather than maintaining these operations separately." A.R.S. §23-902.

However, the Arizona real estate statutes and regulations ***do*** "*otherwise provide by law*." A.R.S. §32-2101 defines brokers as employing salespersons and that salespersons must be employed by a broker to be active. A.R.S. §32-2151 defines brokers' record keeping requirements for their salespersons. Then Arizona regulations require brokers to exercise reasonable supervision and control over brokers, salespersons and others in their employ, including providing policies, procedures and systems (R4-28-1103(A)), and require brokers to be responsible for acts of all associate brokers, salespersons and other employees acting within the scope of employment. (R4-28-1103(D)). So it is unclear how the 8 factors above would be applied to real estate agents in litigation. However, under Arizona case law, for liability purposes, despite any written contract, the objective nature of a relationship or "totality of facts and circumstance" will determine if a broker will be liable for the negligence of their agents and, therefore, the broker is frequently held responsible.

The bottom line is that the determination of whether real estate agents in Arizona are independent contractors will be subject to the "sniff" test based on the degree of control. I recommend that ***all*** brokers (yes, even for small companies) maintain and update written independent contractor agreements and written policy and procedures manuals. The Arizona Department of Real Estate website has recommended topics for all manuals to address. Brokers are cautioned to modify their language such that specific training and meetings, etc. are ***not*** mandatory, but rather "recommended" or "best practices." The independent contractor agreement should include conflict resolution language to be separately initialed or signed to require mediation and/or arbitration, prohibit class actions and confidentiality of the conflict resolution. And finally, since Arizona law requires brokers to supervise agents, yet mandatory training and procedures may convert agents into employees, brokers should carefully consider their relationship with agents who do not engage in appropriate professional business practices.

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