

Commonwealth Of Kentucky

Court of Appeals

NO. 2002-CA-000455-MR

KENTUCKY REAL ESTATE COMMISSION

APPELLANTS

v. APPEAL FROM HARDIN CIRCUIT COURT
HONORABLE KELLY MARK EASTON, JUDGE
ACTION NO. 01-CI-00954

CLAYTON E. COOK, II

APPELLEES

AND

NO. 2002-CA-000588-MR

CLAYTON E. COOK, II

CROSS-APPELLANT

v. CROSS-APPEAL FROM HARDIN CIRCUIT COURT
HONORABLE KELLY MARK EASTON, JUDGE
ACTION NO. 01-CI-00954

KENTUCKY REAL ESTATE COMMISSION

CROSS-APPELLEE

OPINION
AFFIRMING ON CROSS-APPEAL
AND REVERSING AND REMANDING ON APPEAL

** ** * * *

BEFORE: COMBS, GUIDUGLI, AND SCHRODER, JUDGES.

SCHRODER, JUDGE. This is an appeal and cross-appeal from a judgment of the Hardin Circuit Court reversing a decision of the Kentucky Real Estate Commission ("KREC") denying appellee's/cross-appellant's recovery under the Kentucky Real Estate Education, Research and Recovery Fund, for fraud committed by a licensee in the purchase of a business from appellee/cross-appellant. The sole issue on appeal is whether the buyer of the business was acting as a real estate licensee when he purchased the business. We deem that the circuit court erred in overturning the finding of the KREC that the buyer was not acting as a licensee when he purchased the business. Hence, we reverse and remand for further proceedings consistent with this opinion. As to the cross-appeal, we affirm the circuit court's denial of a motion to compel discovery from the KREC regarding its review process.

On June 5, 1996, appellee/cross-appellant, Clayton Cook, and real estate licensee Robert Lee entered into a listing agreement for the sale of Cook's Pasquale's Pizza restaurant located in Elizabethtown. The listing agreement was titled "Exclusive Authorization to Sell" and designated a listing price of \$62,000. At that time, Lee's license was held by principal broker T.W. Shortt Better Homes & Gardens real estate firm. Approximately three weeks later, Cook and Lee executed an amendment to the listing agreement lowering the requested price

of the restaurant to \$45,000. At some point thereafter during the listing period, Lee expressed a desire to purchase the business himself. On September 3, 1996, Lee and Cook entered into a purchase contract, which was not on a Board of Realtors® contract form, whereby Lee would purchase the business for \$45,000, which included assuming the lease of the restaurant property. Under the purchase contract, Cook agreed to finance the purchase and Lee agreed to make monthly installment payments to Cook. In entering into the purchase contract, Lee made no earnest money deposit and the listing agreement, which was to expire on November 5, 1996, by its own terms, was never expressly terminated by the parties. Further, neither Lee nor Shortt received any commission on the sale of the business.

Subsequent to purchasing the business, it is undisputed that Lee did a poor job with the business. Lee began gutting the interior and selling or trading away inventory and equipment. After making only one installment payment and failing to assume the lease, Lee defaulted on the purchase in October of 1996. Consequently, Lee was thereafter terminated from Shortt's real estate firm and left town.

In January of 1997, Cook filed a civil suit against Lee and Shortt, alleging fraud and breach of contract as to Lee and negligent failure to supervise as to Shortt. The KREC was not a party to this civil suit. The action proceeded to trial

resulting in a verdict of fraud against Lee and a comparative negligence verdict against Shortt. Lee never answered or defended the claim, and Cook was ultimately unable to collect on the judgment against Lee.

During the pendency of the civil suit, Cook also filed an administrative complaint with the KREC against Lee and Shortt. In this action, Cook requested restitution from the Kentucky Real Estate Education, Research and Recovery Fund, (hereinafter, the "Recovery Fund"), pursuant to KRS 324.410 which allows recovery of up to \$20,000 for fraudulent violations of KRS 324.160 by licensees. The administrative case was held in abeyance until after the civil suit was resolved.

On January 26, 2001, a full evidentiary hearing on the administrative complaint against Lee was held before a hearing officer. Cook's administrative claim against Shortt was settled prior to the hearing. Other than a brief letter to the KREC, Lee failed to defend the administrative charges against him. On March 26, 2001, the hearing officer issued his findings of fact, conclusions of law, and recommended order determining that Lee made fraudulent representations to Cook "in his capacity both as a real estate agent and as a prospective purchaser" which Cook relied upon in selling his business to Lee. Accordingly, the hearing officer recommended that Cook receive the maximum award of \$20,000 from the Recovery Fund.

The KREC filed exceptions to the hearing officer's findings and recommended order. On May 30, 2001, the KREC issued its final order disagreeing with the hearing officer on the issue of whether Lee was acting in his capacity as a licensee when he purchased the business from Cook, stating:

The Commission finds that, once Respondent Robert Lee agreed to purchase the property, Complainant Clayton Cook took over as his own representative. The Purchase Contract entered into between Complainant Clayton Cook and Respondent Robert Lee is a legal document that was drafted between Lee and Cook as individual businessmen. The agreement was not on a Board of Realtors® contract.

In its order, the KREC explicitly rejected the hearing officer's finding that Lee was acting in his capacity as both a real estate agent and prospective buyer when he made the fraudulent representations to Cook. Accordingly, the KREC denied Cook any restitution from the Recovery Fund.

Cook then appealed to the Hardin Circuit Court. In the course of this appeal, Cook made a motion for formal discovery into the process utilized by the KREC in reviewing the evidentiary record prior to rejecting the hearing officer's recommended order. The motion was based on the fact that Cook's counsel purportedly learned from the KREC's counsel that the KREC had not reviewed the videotape of the evidentiary hearing prior to entering its final order on the matter. The KREC

refused to answer Cook's discovery request, arguing that it was outside the scope of the record on appeal. Cook then filed a motion to compel discovery. On February 8, 2002, the circuit court entered its opinion and order reversing the KREC's ruling denying Cook recovery under the Fund, and denying the motion for discovery on the basis that it was moot due to the reversal of the KREC's decision. From this judgment, the KREC now appeals the reversal of its ruling denying recovery under the Fund, and Cook cross-appeals the denial of his motion for discovery.

KRS 324.410(1) provides in pertinent part:

If a licensee, acting in the capacity of a licensee, has been duly found guilty of fraud in the violation of one (1) or more of the provisions of KRS 324.160, and upon the conclusion of a final order entered by the commission, or by the courts, if appealed, the commission may pay to the aggrieved person or persons an aggregate amount not to exceed twenty thousand dollars (\$ 20,000) per claimant. . . .

It is essentially undisputed that Lee made fraudulent misrepresentations in purchasing the business from Cook in violation of KRS 324.160(4)(c). The only issue to be resolved in determining whether Cook was entitled to monies under the Recovery Fund was whether Lee was acting as a licensee when he made those misrepresentations.

Judicial review of an administrative action is limited to a determination of whether the agency's action was arbitrary.

Bobinchuck v. Levitch, Ky., 380 S.W.2d 233 (1964). An administrative decision is not arbitrary and will be upheld on appeal if it is supported by substantial evidence. Taylor v. Coblin, Ky., 461 S.W.2d 78 (1970); KRS 13B.150(2). Substantial evidence sufficient to support an administrative decision is evidence of substance and relevant consequence, having the fitness to induce conviction in the minds of reasonable persons. Aubrey v. Office of the Attorney General, Ky. App., 994 S.W.2d 516 (1998).

The KREC maintains that its finding that Lee was not acting as a licensee when he purchased the business from Cook was supported by substantial evidence and, thus, the circuit court erred in overturning its final decision. Conversely, Cook maintains that the circuit court was correct in agreeing with the hearing officer and determining that the evidence compelled a finding that Lee was acting as a licensee when he bought the business.

Under KRS 324.170(2), the duties of a hearing officer appointed by the KREC are to "preside at the hearing and to prepare a recommended order to be submitted to the commission." The hearing is to be conducted in accordance with KRS Chapter 13B. The KREC is not bound to accept the hearing officer's findings and recommendations. KRS 13B.120(2); see Secretary of Labor v. Boston Gear, Inc., Ky., 25 S.W.3d 130 (2000). Pursuant

to KRS 13B.120(2), the agency "may reject or modify, in whole or in part, the recommended order" of the hearing officer.

The hearing officer and the circuit court placed great weight on the fact that the listing agreement between Cook and Lee had not been expressly terminated at the time the purchase contract was executed. However, we do not believe this fact is controlling on the issue of whether Lee was acting as a licensee when he bought the business. By its very nature, a listing agreement is an agreement to pay a certain sum (commission) to the licensee/broker if the subject property is sold according to the terms dictated in the agreement. Additionally, the definition of "real estate brokerage" in KRS 324.010(1) includes the fact that broker receives a "fee, compensation, or other valuable consideration" for his services. Here, it is undisputed that neither Lee nor Shortt received any fee pursuant to the listing agreement. Cook explains away this fact by pointing to the testimony of Shortt that he allowed all of his agents one sale a year without a commission. However, this does not conclusively establish that this was the reason why no commission was paid in this case, and the KREC was not required to accept this explanation. As further noted by the KREC, a standard Board of Realtors® contract was not used for the purchase, and there was evidence that Lee would have ordinarily

used the standard form in a transaction in which he was a licensee.

Nor can Shortt's testimony be ignored that he believed Lee was acting as an individual when he purchased the business and that his real estate firm was in no way involved in the transaction. In his brief, Cook submits "that the testimony of Mr. Shortt regarding Lee's actions with regard to the purchase of Appellee's business were properly given very little weight by the Hearing Officer and the Circuit Court." However, it is not the function of the reviewing court to give weight to the evidence. Johnson v. Galen Health Care, Inc., Ky. App., 39 S.W.3d 828 (2001). That function is left to the ultimate finder of fact in the administrative matter, in this case, the KREC.

Cook also asserts that some of the misrepresentations made by Lee to induce Cook to sell (his real estate selling experience) were directly related to Lee's occupation as a real estate licensee. However, at the time these misrepresentations were made, Cook knew that Lee was purchasing the business for himself. We agree with the KREC that at that point, Cook knew that any such representations were for the purpose of Lee purchasing the business individually and not for the purpose of selling the business pursuant to the listing agreement. Furthermore, simply because representations were made regarding the buyer's experience as a real estate licensee does not

automatically mean that the buyer is acting as a licensee in that particular transaction.

In Leishman v. Goodlett, Ky. App., 608 S.W.2d 377 (1980), a real estate licensee seeking funds to finance a home he was building defrauded the appellee of \$10,000 by giving her a personal note secured by property in which the licensee failed to disclose he had an interest. The appellee sought restitution from the Recovery Fund which was denied by the KREC. Our Court agreed with the KREC that the lender was not entitled to recovery under the Fund because, although the transaction was related to the development of real estate, the licensee was not acting as a licensee when he fraudulently obtained the funds. Rather, he was acting as a private builder-developer of real estate. The Court went on to state:

A literal reading of the statute would subject the fund to potential liability for any substantial misrepresentation or any other improper, fraudulent or dishonest conduct of a licensee whether or not such conduct was in his capacity as a broker or salesman. . . .

We cannot give the statute such an interpretation because the result in our view leads to an absurdity. . . . The obvious intent is to protect the public from unscrupulous acts committed by realtors in their capacity as brokers and salesmen, not in their private capacity.

Id. at 378. The Court in Leishman did note that the licensee was not buying, selling, leasing or renting property when he

defrauded the lender. However, the fact remains that even if the licensee is purchasing property, if he is not doing so as a licensee, there would be no entitlement under the Recovery Fund. KRS 324.410(1).

In sum, we believe there was substantial evidence to support the KREC's finding that Lee was not acting as a real estate licensee when he made the misrepresentations and purchased the business from Cook. Hence, we reverse the circuit court's determination to the contrary and remand the matter for further proceedings consistent with this opinion.

We now turn to Cook's cross-appeal. Cook asserts that the circuit court erred in refusing to grant his motion to compel discovery from the KREC regarding the procedure followed in reviewing his case. Cook maintains that because of *ex parte* information he received alleging irregularities in the process (that the KREC did not review the videotape of the hearing), he was entitled to the requested discovery under KRS 13B.150(1) which provides in pertinent part:

Review of a final order shall be conducted by the court without a jury and shall be confined to the record, unless there is fraud or misconduct involving a party engaged in administration of this chapter.

In our view, the above statute would not authorize discovery from the fact finding body itself into its review procedures. In fact, we are unaware of any authority allowing

discovery into the review processes utilized by judicial/quasi-judicial bodies. KRS 61.810(1)(j) specifically exempts deliberations of judicial or quasi-judicial bodies regarding individual adjudications from the Open Meetings Act. Likewise, KRS 61.878(1)(j) exempts preliminary recommendations or memoranda in which opinions are expressed from the Open Records Act. In any event, there is a presumption that the administrative body considered the evidence before it.

Kannapell v. Dulworth, Ky., 497 S.W.2d 718 (1973). In reviewing the final order of the KREC, we do not see any indication that it did not have full knowledge of the facts and evidence contained in the record. The KREC made a reasoned decision based on the evidence in the record and complied with the required provisions of KRS 13B.120(3) when its final order differed from the hearing officer's recommended order. Accordingly, we cannot say the circuit court erred in denying the requested discovery.

For the reasons stated above, the judgment of the Hardin Circuit Court is affirmed on cross-appeal and reversed on appeal and the matter remanded for further proceedings consistent with this opinion.

COMBS, JUDGE, CONCURS.

GUIDUGLI, JUDGE, CONCURS IN PART, DISSENTS IN PART,
AND FILES SEPARATE OPINION.

GUIDUGLI, JUDGE, CONCURRING IN PART AND DISSENTING IN PART. I respectfully dissent from the majority opinion as to reversing the circuit court's order finding that Cook was entitled to recover the maximum award of \$20,000 from the Recovery Fund. I believe the circuit court correctly found that one could not separate Lee's action as an individual purchaser from that of a real estate licensee. I believe that since Lee's relationship with Cook began as a real estate agent that Cook continued to rely upon the relationship to his detriment. I further believe KREC is responsible to insure that such trust created by its association and members is not broken, but if it is, that KREC is responsible for the resulting damage. As such, I would affirm the circuit court's order on this matter and award Cook the \$20,000 to which he is entitled. I would also affirm the trial court as to the discovery in that the issue is moot.

BRIEF FOR APPELLANT/CROSS-
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BRIEF FOR APPELLEE/CROSS-
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