AVOIDING INNOCENT MISTAKES

Unexpected liability problems for right of way professional firms

BY PETER CHRISTENSEN, JD

Lawsuits could affect any firm involved in right of way work, whether the work involves acquisition agents, relocation agents, appraisers or surveyors. Take this appraiser (we'll call him "Bob") for example. Bob concentrates on condemnation work and operates a small firm. Despite not having performed an appraisal for any lender or for any loan in over a decade, he found himself in a lawsuit filed by the Federal Deposit Insurance Corporation (FDIC). Not long after that, he was sued by one of his former staff members.

None of Bob's legal problems had anything to do with the quality of his professional work. So how could a right of way appraisal firm owner end up being sued by the FDIC? Bob's problems arose from fairly innocent business mistakes, which are easily avoided. In fact, the two situations that led to these liability problems are common occurrences that I see with firms of all sizes and in all practice areas.

An Informal Arrangement

For 15 years, Bob's valuation practice focused on providing valuation and expert witness services to government agencies for condemnation. Bob operated his firm as a simple sole proprietorship; it was not an LLC or corporation. For most of those 15 years, the staff of his firm consisted of a part-time research assistant and an office manager/bookkeeper—with a few notable exceptions. One such exception was for a brief period in 2006 and 2007, when Bob and his firm had an informal arrangement with another appraiser located about 100 miles away. The other appraiser (we'll call him "Junior") was eager to pickup condemnation assignments from Bob because he wanted to diversify away from his regular commercial lending work. Bob felt that the arrangement would open up new client possibilities.

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After a few months, they decided to make their ties a little closer and from the outside, it may have begun to look like they were the same firm with multiple offices. Junior began using an email address associated with the domain name for Bob's firm. He also shared the firm's access to property data services and certain software, and when reports were created, they went out under the DBA used by Bob's firm. Bob's firm also began to take care of billing for Junior—even for his separate non-condemnation work. The invoices used Bob's firm name because that was how the firm's billing software was set up. When payment was received for work by Junior, Bob's firm would keep a small percentage of the billing for the office services and the bulk of the payment would be passed to Junior. If Bob originated the work, he kept a bigger share.

Bob did not consider Junior to be a partner, co-owner or any sort of employee or contractor. They both shared this view. As such, they continued to maintain separate professional liability insurance and also filed separate tax returns based on operating separately owned businesses.

Who's Liable?

The two appraisers ceased their informal business arrangement in 2007 when Junior decided to take a government job. But in 2012, a process server knocked on each appraiser's door to serve a summons and complaint. A bank had failed and the FDIC had "stepped into its shoes" as a receiver. In that capacity, the FDIC was suing both appraisers for professional negligence relating to an appraisal that Junior had performed for a lender in 2006. The loan had defaulted, and the FDIC alleged that the appraisal was negligently inflated and that the failed bank would never have made the loan if the appraisal had been accurate. The FDIC thus sought to hold the appraisers and Bob's firm financially liable for the full sum of unpaid principal, interest, late charges and other damages, which amounted to nearly $300,000. To make matters worse, it was discovered that there were serious deficiencies in Junior's appraisal.

Only Junior had worked on and signed the appraisal, while Bob hadn't done any lending work in over a decade. So why was Bob being sued? The FDIC contended that Bob and his firm's arrangement with Junior amounted to a partnership or other business joint venture. Accordingly, the FDIC contended that Bob was fully liable for the appraisal work performed by the "partnership." Though shaken by being served with the lawsuit, Bob initially thought it wouldn't be a major problem since Junior's E&O insurance provider would surely defend the lawsuit. Unfortunately, Junior soon revealed that he had no insurance coverage. He had cancelled his E&O policy when he went to work for the government. He also told Bob that he was essentially insolvent and could not pay for attorneys to fight the case. As a result, Bob's insurer ended up paying to defend Bob and his firm (as well as Junior) after Bob paid a sizeable $10,000 deductible. Whether or not actual liability existed for Bob and his firm was a legal toss up, and there was a real risk he'd lose if it went to trial. He and his insurer thus ended up agreeing to a settlement in the range of $100,000. Junior never contributed a thing.

Business Mistakes

The foundation to the FDIC's lawsuit against Bob was a collection of facts that they used to paint Bob's affiliation with Junior as some form of a partnership. Bob would have been wiser to avoid the following business practices:

- Permitting Junior to use the firm domain address for his email.
- Allowing Junior to use the firm's software and data services.
- Generating invoices with the firm's name on them.
- Collecting payments made out to the firm.

Bob's operation of his firm as a sole proprietorship also put him at personal risk. An appraiser is always going to have potential personal liability for his or her own professional errors, regardless of how he or she organizes a business. However, a limited liability business entity (such as a corporation or LLC) would likely insulate Bob from personal liability for the mistakes of employee-appraisers or other actual or alleged partners in the business. As a sole proprietor, however, Bob had full personal liability for all of the potential liabilities of his small firm and was thus made an individual defendant to the lawsuit.

Overtime Lawsuits

Bob eventually put the sour taste of the FDIC lawsuit behind him. Within a couple years, his condemnation work was booming. He added two new staff members: an experienced appraiser and a trainee appraiser. Because the workload of the firm was so busy, Bob and his new staff appraisers often worked into the evenings and on weekends as well, putting in 50+ hour workweeks. As the new kid on the block, the trainee sometimes toiled even longer than her supervisors.

Eventually the trainee appraiser decided that the field wasn't for her and left the firm. The trainee must have had an attorney friend or family member who knew something about employment law because another process server was soon at Bob's door handing him a lawsuit complaint. This time, the lawsuit was by his former trainee who sought compensation and penalties under the federal Fair Labor Standards Act (FLSA). This is the law that entitles non-exempt employees to overtime. Under the law, employees in most types of businesses are required to be paid overtime at 1.5 times their regular hourly rate if they work more than 40 hours in a seven-day workweek, unless they are properly classified as "exempt." Recent cases show that this law presents a genuine liability risk to firms of all sizes. The risk is that an employee who is misclassified as "exempt" and not paid overtime will later file a legal action alleging that he or she worked more than 40 hours in a workweek—perhaps for a period of years—and will demand all of the unpaid overtime, penalty damages, interest and attorney fees.

Exemption Analysis

Overtime lawsuits by appraisers, relocation agents, right of way agents and others involved in the land services field have been a growing trend. To many firm owners and managers—and also to employees themselves—it may be shocking to think that such professional-type employees may have to be paid overtime. Aren't they exempt as professionals? Recent cases underscore that it's not that simple and firms need to carefully analyze whether their right of way professional employees are truly exempt for purposes of the FLSA.

Unfortunately, this question cannot be answered categorically for the job positions normally associated with right of way firms. Under the FLSA, it's a two-part analysis to determine whether an employee is exempt. The first part is straightforward: Is the employee paid on a salary basis and does that salary exceed $455 per week? If the answer is no, then the employee is not exempt and must be paid overtime if he or she works more than 40 hours in a seven-day workweek.

The second part of the exemption analysis is more difficult and involves determining whether the employee actually performs exempt-type work duties. This is where the test gets fuzzy. For non-supervisory employees working for right of way firms, the second part of the analysis is primarily going to come down to whether the employee is determined to perform either "professional work" or "administrative work." Under the FLSA, if the employee satisfies the salary requirement and performs either professional or administrative work, then the employee would be exempt from overtime. Professional work generally means performing duties which are predominantly intellectual and require specialized, high-level education, as well as the use of discretion and judgment. Administrative work generally means performing duties that would be thought of as managerial—like managing human resources or performing financial accounting—and involve independent decision-making about significant issues. (For employees who actually supervise at least two other full time employees, there is also a supervisory exemption.)

When looking over Bob's situation, the facts were against him successfully defending the claim. By definition, a trainee's work must be supervised. A trainee cannot sign appraisal reports without a supervisor and does not exercise independent judgment. In Bob's case, the trial court had no problem concluding that the trainee was not engaged in exempt work duties. In the end, the court awarded her approximately $25,000 in unpaid overtime and penalties, plus her attorneys' fees and costs which amounted to over $50,000.

In Summary

Overtime compensation in the right of way field is an issue that all firm owners and managers should carefully consider at this time. Overtime lawsuits are currently affecting a large number of firms providing valuation and right of way services. When taking on staff members to perform such services, firm owners and managers are advised to carefully consider whether the employee can properly be considered "exempt" from overtime as a professional or administrative employee. For very junior, trainee level employees, it can be difficult to support exempt status, putting the firm at risk for litigation or state regulatory action. For employees with higher levels of knowledge, education and responsibility, the determination will be more complicated and firms are advised to seek competent legal counsel from an experienced employment lawyer in their state. ✪

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