FILED
APR - 7 2008
DEPARTMENT OF REAL ESTATE

BEFORE THE DEPARTMENT OF REAL ESTATE

STATE OF CALIFORNIA

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In the Matter of the Accusation of JEFFREY OWEN BLACK and DANA LYNN POTTER, Respondent(s).	No. H-34255 LA L-2007090482

DECISION

The Proposed Decision dated February 29, 2008, of the Administrative Law Judge of the Office of Administrative Hearings, is hereby adopted as the Decision of the Real Estate Commissioner in the above-entitled matter.

Pursuant to Section 11517(c)(2) of the Government Code, the following correction is made to the Proposed Decision:

Page 10, Footnote 6, "The one-day" is amended to read "The one-year".

This Decision shall become effective at 12 o'clock noon on APR 28 2008.

IT IS SO ORDERED 4-3-08.

JEFF DAVI
Real Estate Commissioner

BY: Barbara J. Bigby
Chief Deputy Commissioner

BEFORE THE
DEPARTMENT OF REAL ESTATE
STATE OF CALIFORNIA

In the Matter of the Accusation of: **JEFFREY OWEN BLACK and DANA LYNN POTTER,** **Respondents.**	**Case No. H-34255 LA** **OAH No. L2007090482**

PROPOSED DECISION

This matter came on regularly for hearing on December 19 and 20, 2007, in Los Angeles, California, before H. Stuart Waxman, Administrative Law Judge, Office of Administrative Hearings, State of California.

Robin Trujillo (Complainant) was represented by Martha J. Rosett, Staff Counsel.

Jeffrey Owen Black (Mr. Black) and Dana Lynn Potter (Mr. Potter) (collectively Respondents) were present and were represented by Stephen A. Diguiseppe, Attorney at Law.

Oral and documentary evidence was received. The record was held open through February 8, 2008, for the parties to submit closing briefs in accordance with a specified briefing schedule. The briefs were timely received. "Complainant's Closing Argument" was marked as Complainant's Exhibit 17 for identification. "Respondents' Closing Argument" was marked as Respondents' Exhibit R28 for identification. "Respondents' Exhibit 'A' to Closing Argument" was marked as Respondents' Exhibit R29 for identification. "Complainant's Reply to Respondents' Closing" was marked as Complainant's Exhibit 18 for identification.

On February 8, 2008, the record was closed, and the matter was deemed submitted for decision.

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In this case, Complainant alleges that Respondents, and/or each of them, violated certain statutes relating to the practice of real estate in California (1) by claiming or receiving illegal fees in connection with a Participation Agreement to provide title reinsurance on title insurance policies written for their real estate clients, (2) by taking secret or undisclosed compensation, commission or profit through their failure to disclose to their clients their relationship with the carriers for which they were providing reinsurance, and (3) by creating a corporation to circumvent the real estate laws and hide illegal compensation. Specifically, Complainant alleges violations of Business and Professions Code sections 10176, subdivision (g), 10177, subdivisions (d), (g) and (j), and 10177.4.

FACTUAL FINDINGS

The Administrative Law Judge makes the following Factual Findings:

1. The Accusation was made by Robin Trujillo, who is a Deputy Real Estate Commissioner of the State of California, acting in her official capacity.

2. On December 13, 1985, the Department of Real Estate (Department) issued a corporate real estate broker license to Pinnacle Estate Properties, Inc. (Pinnacle). The license was in full force and effect at all relevant times.

3. In 1979, the Department issued a real estate salesperson license to Respondent Black. Mr. Black was licensed by the Department as a real estate broker in approximately July 1986. Since 1986, Mr. Black has also been licensed by the Department as the broker-officer of Pinnacle. He was so licensed at all relevant times. Mr. Black's real estate broker license will expire on July 10, 2010, unless renewed. His officer license will expire on December 12, 2009, unless renewed.

4. In 1993, Mr. Black's broker and officer licenses were suspended for five days. The suspension was stayed subject to various terms and conditions. Neither the terms and conditions nor the reason(s) for the suspension was disclosed by the evidence.

5. In approximately December 1977, the Department issued a real estate salesperson license to Respondent Potter. The license was in full force and effect at all relevant times. It will expire on June 12, 2010, unless renewed.

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6. Respondents are, and have been, the sole owners of Pinnacle, having founded it in 1985. Pinnacle now has seven locations and employs 628 salespersons. In 2006, Pinnacle's gross income was approximately $28,000,000. Respondents also own two escrow companies, which are licensed by the California Department of Corporations. One of those companies (Pinnacle Escrow) is a division of Pinnacle and serves only Pinnacle's clients. The other company, Ridgegate Escrow, is an independent company and is not so limited.

7. At all relevant times, Respondents carefully divided their labor. As responsible broker and Chief Financial Officer, Mr. Black oversaw sales, escrow operations and contracts, as well as certain legal aspects of the businesses. Mr. Potter operated a training program involving over 40 classes, set up office meetings for each of the seven offices, and motivated and worked with the agents. Since they operate two escrow companies in addition to their real estate company, both Mr. Black and Mr. Potter are, and have been, very much aware of their obligations regarding disclosures to clients. Mr. Potter teaches a disclosure class to their employees.

8. Respondents' companies have done, and continue to do, business with a number of title insurance companies. One of the largest of those companies is Fidelity National Financial, Inc. (Fidelity). Fidelity operates several subsidiaries including Fidelity National Title, Chicago Title, TICOR Title, American Title Company, Security Union Title, Security Title, Alamo Title, National Title Insurance Company of New York, Inc., Fidelity National Information Services, and AIS Fidelity Information Services.

9. In approximately April 2004, Rod Gordy, Fidelity's sales director for Los Angeles County and part of Orange County, and another individual from Fidelity, approached Mr. Black with a proposal that Respondents (more specifically, one or more of Respondents' companies) act as reinsurers for title insurance policies written by Fidelity for Respondents' clients. In August 2004, Fidelity presented a Power Point demonstration to Respondents which explained the details of the proposed reinsurance plan. The Power Point demonstration referred to program participants generally, and did not specifically target Respondents.

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10. According to that Power Point demonstration, the objective of the plan was to "generate an ancillary revenue stream by the formation of a Sponsored Captive Reinsurance Company (SCRC)." The plan contemplated that, when Fidelity or any of its subsidiaries issued a title insurance policy to one of Pinnacle's clients, FNF Title Reinsurance Company (FNF), another Fidelity subsidiary, would execute reinsurance treaties with Respondents who would assume a percentage of the risk in return for an equal percentage of the premium. Under the plan, FNF would create a separate account, referred to as a "protected cell," which would insulate Respondents from losses incurred by other participating reinsurers. Those reinsurers would each have their own protected cells. To participate in the program, Respondents would have to pay Fidelity an annual Participant Fee of $10,000, and they would be required to post an irrevocable letter of credit in the sum of $25,000 to secure their obligations to Fidelity. In addition, Fidelity would deduct a $350 administration fee from Respondents' share of the premium on each issued policy. In the Power Point demonstration, FNF represented that its overall claims history for 2003 was 4.73 percent of the premium. FNF also recommended that participants obtain an "outside legal opinion about the Initiative and whatever consumer disclosures may be required." According to the Power Point demonstration, FNF was licensed and in good standing with the Vermont Department of Insurance. FNF also represented that an SCRC was a "RESPA[1] compliant vehicle created to allow participation in the profit or loss generated by reinsuring a portion of the title risks from transactions the participant has produced."

11. Consistent with the division of labor Respondents had utilized through the years, Mr. Potter had little to do with the dealings involving Fidelity's reinsurance offer. Mr. Black performed the vast majority of the work in that regard. Because of Fidelity's size, stability and position in the industry, Mr. Black believed the program would be a safe one that would suit Respondents' purposes of supplementing their companies' income by branching into a related field. Neither Mr. Black nor Mr. Potter considered Fidelity's reinsurance program to be a sham designed to provide illegal rebates or kickbacks.

12. Fidelity prepared a Participation Agreement and sent it to Respondents who, in turn, forwarded it to their attorney. On August 29, 2004, the attorney wrote to Mr. Black approving the Participation Agreement and opining as follows: "It is my assessment that the terms of the agreement adequately share the loss and benefits in an acceptable manner as between the parties and it is acceptable for execution."

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[1] RESPA is the Real Estate Settlement Procedures Act, a federal Housing and Urban Development consumer protection statute which requires certain disclosures to clients and prohibits kickbacks that tend to increase settlement services costs to homebuyers.

13. On August 31, 2004, Respondents signed articles of incorporation for a new company, Southern California Title Solutions (SCTS).[2] The sole purpose of SCTS was to handle all reinsurance matters related to the Participation Agreement with Fidelity as well as any other reinsurance agreements into which Respondents might enter. Respondents were the only shareholders in SCTS. They formed the corporation because they were concerned that any loss for which they might become liable under the Participation Agreement could be a large one which could detrimentally affect Pinnacle's financial well-being. Rather than take that risk, they chose to funnel all reinsurance-related assets and liabilities through the new company.

14. On September 1, 2004, Respondents signed the Participation Agreement according to which they agreed to accept 15 percent of the liability for all claims on policies subject to the agreement in exchange for receipt of 15 percent of the premiums on those policies. The Participation Agreement contained the following provisions which are germane to the issues in this case:

> **Section 4.** **Funding of and Charges to the Protected Cell.** On a monthly basis or such other basis as determined by the Company in its discretion, but no less frequently than annually, the Company will: (i) allocate an amount equal to the Assumed Premium allocable to the Risk to the Participant's Protected Cell, and (ii) pay Losses, Participant Expenses and the Participation Fee from the funds held in such Protected Cell.
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> [¶] . . . [¶]
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> **Section 7.** **Distribution to Participants.** Subject to the prior approval of the Commissioner [of the Vermont Department of Banking, Insurance, Securities and Health Care Administration], the Company will distribute assets from the Participant's Protected Cell to the Participant from time to time, but at least annually, as consideration for the Participant's indemnity obligations under Section 2 and duty to maintain reserves under Section 8. The Company will have complete discretion in the timing and amount of such distributions, but in no event will a distribution cause the value of the assets in the participant's Protected Cell to fall below the Protected Cell's required Reserves. Any distribution pursuant to this Section 7 will reduce the balance of assets allocated to the Participant's Protected Cell by the amount of such distribution.
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> [¶] . . . [¶]

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[2] SCTS was not, and was not required to be, licensed by the Department of Real Estate.

Section 10. **Regulatory Requirements.** The Participant hereby acknowledges and agrees to the following regulatory requirements:

[¶] . . . [¶]

(e) The Participant shall provide a satisfactory Affiliated Business Arrangement & Reinsurance disclosure statement to any consumer and/or purchaser for any transaction subject to this Agreement and the reinsurance arrangement described herein; and

(f) Participant shall make all consumer disclosures to those involved in the Sale as may be required under federal or state law.

15. Upon their execution of the Reinstatement Agreement, Respondents paid the first $10,000 Participant Fee, and they obtained the required letter of credit, which was issued on October 1, 2004. FNF then began performing on the contract. When Respondents used Fidelity or any of its subsidiaries as the source of a title insurance policy, SCTS provided FNF with records concerning the transaction, and FNF credited SCTS with 15 percent of the policy's premium minus the $350 administration fee. However, Respondents failed to disclose the reinsurance relationships between Pinnacle and SCTS, and between SCTS and FNF to any of their clients who received title insurance policies from Fidelity or any of its subsidiaries.

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16. According to Mr. Black's testimony at the administrative hearing, he

appropriate language for the disclosures that were to be made to Respondents' clients, but that Fidelity failed to do so. Mr. Black further testified that Respondents did not intend for the Reinsurance Agreement to go into effect until they received that information and were then able to make the proper disclosures. Mr. Potter testified in a similar manner. Respondents' testimony in that regard was not credible for the following reasons: (1) No writing or other corroborative evidence was offered to show that Mr. Black made such a request. (2) No writing or other corroborative evidence was offered to show that Mr. Black informed FNF that he did not want to commence performance on the Participant Agreement until he had obtained the necessary disclosure language. (3) FNF was not obligated in any way to provide such language. In fact, the language of section 10, subsection (e) of the Participation Agreement made it clear that it was the participant (i.e., SCTS) that was to provide the disclosure language. (4) According to the Power Point demonstration, each participant was urged to contact private counsel regarding the disclosures to be made. (5) Mr. Black had already paid the $10,000 Participant Fee, applied for the $25,000 letter of credit, and formed SCTS by the time he and Mr. Potter signed the Participation Agreement. Once Respondents signed it, nothing was left for FNF to do before commencing performance under the contract. (6) Respondents continued to use Fidelity and its subsidiaries for their title insurance needs after they executed the Participant Agreement. Had they desired to avoid commencement of the agreement, they could have used any of the several other title insurance companies they had regularly used for their title insurance needs.[3] (7) From the time the Participation Agreement was signed, SCTS provided FNF with records of the policies written by Fidelity and its subsidiaries. Although Mr. Black testified that he never sent FNF a billing statement or any type of request for compensation, it was unnecessary for him to do so. FNF performed its own bookkeeping and disbursed payments in accordance with the provisions of section 7 of the Participation Agreement. (8) The Participation Agreement is dated September 1, 2004. Nothing in that agreement or in any other document indicates a different commencement date, or that Mr. Black requested a different commencement date.

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[3] Mr. Black testified that, in 2004, Respondents did business with approximately two dozen title companies, most of which were underwritten by the two large companies, Fidelity and First American.

17. On November 22, 2004, Barton M. London, Senior Vice President and Assistant General Counsel of FNF, wrote to Mr. Black. According to that letter, Mr. London had received "inquiry letters" from agencies in Colorado, Washington and California which regulated the insurance industry in those states regarding "title insurer practices related to reinsurance covering one to four-family residential properties." Mr. London enclosed the three letters and wrote: "The purpose of this correspondence is to help keep you apprised of certain regulatory developments that could affect the reinsurance arrangement(s) between the FNF brands and your company."

18. At the administrative hearing, Mr. Black testified that, upon receipt of Mr. London's November 22, 2004 letter, he orally notified Rod Gordy that SCTS no longer wished to participate in Fidelity's title reinsurance program. However, Mr. Black did not issue any writing to that effect. In the absence of any corroborative evidence (i.e., a writing or Mr. Gordy's testimony[4]), Mr. Black's testimony in that regard is of questionable credibility. In any event, Mr. Black failed to comply with the provisions of Section 9 of the Participation Agreement which set forth the procedure by which either party could terminate the agreement. Among other things, section 9 required notice of termination to be in writing. Thus, the Participation Agreement remained in full force and effect.

19. In December 2004, Mr. Black received a cashier's check in the sum of $8,059.49, made payable to Southern California Title Solutions, from FNF, as a cash distribution.[5] Mr. Black did not negotiate the check. Instead, he returned it to Mr. Gordy. Mr. Black testified that he returned the check to Mr. Gordy within a couple of days of receiving it, and that he made no writing concerning the check. His credibility in that regard is questionable in that the amount of the check was not credited back to FNF's account until August 9, 2006.

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[4] Mr. Black testified on the second day of the hearing that he had spoken with Mr. Gordy only the day before (December 19, 2007), and that he believed Mr. Gordy still managed the sales force for Los Angeles and Orange Counties, California. To the extent that Mr. Gordy was within the State's subpoena power, Respondents' failure to call him as a witness results in Mr. Black's testimony being viewed with distrust. (Evid. Code § 412.)

[5] Mr. Black testified that, at the time he received the cashier's check, he did not know its purpose. We now know that it was a cash disbursement from FNF, based on Complainant's Exhibit 9H, a document received from Fidelity in response to a subpoena. The document is entitled "FNF Title Reinsurance Company Broker Premium Assumed and Distributed Since Inception As of September 12, 2005." Although Respondents emphasized that Complainant's witness, Robin Trujillo, testified that she was unable to determine the document's meaning with certainty, the document is self-explanatory as to this issue. It indicates that a distribution of $8,059.49 was made by check to "So. Cal Title."

20. On February 4, 2005, Fidelity's Vice-Chairman and Director, Frank P. Willey, wrote to Respondents advising them that Fidelity was terminating the Participation Agreement. Mr. Willey's letter stated in part:

> As you are probably aware, captive title reinsurance agreements are being heavily criticized by many state insurance regulators as constituting illegal rebates. That appears to be the developing position of the National Association of Insurance Commissioner's Title Issues Working Group. Moreover, we have been advised by one state that it intends to impose fines on the parties to such captive reinsurance agreements, while another state has told us that in the near future it will be issuing cease and desist orders forbidding such agreements. We believe that there is regulatory exposure to FNF and to you which warrants the termination of such captive reinsurance agreements along with any ancillary agreements where applicable, such as participation agreements relating to sponsored reinsurance arrangements.
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> Consequently, please accept this letter as formal notice of termination of the Participation Agreement between FNF Title Reinsurance Company and Southern California Title Solutions dated September 1, 2004, pursuant to Section 9.2(a) of that agreement. The Reinsurance Agreement between the FNF Title Brands and FNF Reinsurance Company will also be terminated. Because the foregoing agreements provide for a 90 day notice of termination, the effective date of the termination is May 12, 2005. However, the agreement may also be terminated immediately with your consent. We believe that is in our best interest to do so and request your consent to terminate the agreement immediately. We will be contacting you shortly to discuss this matter.

21. On February 28, 2005, Mr. Willey signed a Termination Agreement according to which all reinsurance agreements were terminated as of February 18, 2005, and all participation agreements were terminated as of May 12, 2005.

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