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IN THIS ISSUE

CASE UPDATE: LENDER THAT ACTS AS LOAN BROKER HAS FIDUCIARY DUTIES

By Fredric W. Trester

In *Tanya Smith vs. Home Loan Funding, Inc.* (2011) 192, Cal.App.4th 1331, a borrower applied for a home equity line of credit ("HELOC") but was unable to qualify. She procured a loan through defendant Home Loan Funding, Inc. Unhappy that the loan had a pre-payment penalty and a high "margin" she sued the lender for the differential in interest she had to pay for 30 years. Plaintiff's expert testified that the margin should have been 2.2% instead of the 3.85% she obtained. She recovered the interest differential for 30 years of the loan.

On appeal, the lender claimed it should not have been liable for breach of fiduciary duty and misrepresentation. While the Court agreed that a lender has no fiduciary duty to a borrower, it found here the lender also acted as a mortgage broker and thus owed fiduciary duties to the borrower. The evidence demonstrating the brokerage activities were essentially that the loan officer "shopped the loan" and represented that he would "get the best loan" for the borrower.

Key points to take from this case are: 1) the Court found it was proper to award the interest differential over the full 30 year life of the loan despite evidence that most borrowers do not keep a home for more than 10 years; and 2) the Court awarded plaintiff attorney's fees based on an oral brokerage agreement that the lender representative would shop the loan for the buyer, and based on loan documents which contained an attorney's fees provision. The Court felt this was justified because "they were all part of the same transaction", citing Civil Code §1642 which states, "Several contracts relating to the same matters, between the same parties . . . are to be taken together."

The problem with the attorney's fees award is that by the same logic one could always claim that an oral brokerage agreement should be merged with a Purchase and Sale Agreement or even loan documents to find attorney's fees against a real estate broker.

The moral of the story is that a lender must specifically define its duties when they are acting as lenders and perhaps have a separate affiliated company act as a loan brokerage.

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REAL ESTATE BROKER'S BREACH OF FIDUCIARY DUTY SUBJECT TO FOUR YEAR STATUTE OF LIMITATIONS?

By Candace E. Kallberg

In cases alleging breach of fiduciary by real estate brokers or agents, defendants typically argue that the gravamen of the allegations are actually based upon professional negligence, e.g., a failure to properly inspect or to confirm square footage, which has a two year statute of limitations under California Code of Civil Procedure §339. Thus claims for breach of contract, breach of fiduciary duty and negligent misrepresentation have each been barred by the two year statute, based upon the reasoning of *Hydro-Mill Co., Inc. v. Hayward, Tilton & Rolapp Ins. Associates, Inc*. (2004) 115 Cal. App. 4th 1145, 1159-1160.

If the breach of fiduciary duty alleges fraud, then the three year statute of limitations of Code of Civil Procedure §338(d) generally sets the outside time frame for bringing the action.

However, the recent case of *Thomson v. Canyon* (2011) 198 Cal. App. 4th 594 applied a four

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year statute of limitations to a breach of fiduciary duty claim on its facts. When a seller's home was sold to a buyer, it was alleged by the seller that her real estate broker failed to properly document a separate oral reconveyance agreement. The buyer purchased the property, refused the seller's demand for reconveyance, and sold it to a third party. The seller brought claims for negligence and breach of fiduciary duty against her broker.

The court found the negligence claim subject to the two year statute of limitations of C.C.P. § 339. Without mentioning *Hydro-Mill* case the court went on to hold that breach of fiduciary duty is a distinct tort from professional negligence and that since the Code of Civil Procedure does not specify a statute of limitations for breach of fiduciary duty, it is subject to the residual four year statute of limitations of Section 343 governing "[a]n action for relief not hereinbefore provided for" in the code. While noting that in certain circumstances, the gravamen of the cause of action is determinative, such as when breach of fiduciary duty amounting to fraud is alleged, the court found the failure to draft documents necessary to the transaction was not fraud, nor was it negligence, but it was a distinct claim for breach of the fiduciary duty to "obey the instructions of the client, and to provide diligent and faithful service." The court also found the cause of action accrued not at the close of escrow, but at the time of sale to the third party causing the seller's damage, loss of her home.

Thus, while in most cases where the claim arises from failure to properly notify, disclose or follow instructions in the real estate purchase or sales transaction, the claim will be negligence, subject to the two year statute, or fraud, subject to the three year statute, this case allows a longer statute of limitations when the claim is the failure to perform a fiduciary duty as identified here.

Query why this alleged breach - "failure to perform a duty when preparing transactional documents"- is any different from that which is usually considered professional negligence? It would certainly seem that *Hydro-Mill* could have been applied to bar this claim as well. However, this case may be found to undercut *Hydro-Mill* in real estate fiduciary duty cases, since *Hydro-Mill* itself involved an insurance broker. We can expect plaintiffs' counsel to be citing this case in the future on breach of fiduciary duty claims, while defendants will argue it should be limited to its facts.

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COURT OF APPEAL CASE MAY PROVIDE AMMUNITION AGAINST CLIENTS WHO FAIL TO CAREFULLY READ TRANSACTION DOCUMENTS.

By Peter B. Rustin

Attorneys defending real estate brokers are frequently faced with a claim that a client did not carefully review documents, but signed them. This claim is generally made in an effort to avoid the effect of the document, which are, often, significant disclosures. In *Desert Outdoor Advertising v. Superior Court* (2011) 196 Cal. App. 4th 866 this issue was addressed by the Court of Appeal. In *Desert Outdoor Advertising*, a lawyer's client signed a fee agreement which did not include an arbitration clause. Subsequently, the attorney informed the client that he was moving his practice to a new law firm, which necessitated that the client sign a new fee agreement. This fee agreement, however, contained an arbitration clause.

The litigation for which the attorney was retained resolved adversely to the client. The clients then filed a complaint, in Superior Court, against the attorneys, alleging professional negligence and breach of fiduciary duties. In response, the attorneys and petitioned to compel the arbitration. The clients opposed the petition, arguing that the arbitration clause was "buried in the last paragraph" of one portion of the fee agreement. They also argued that the lawyer committed constructive fraud by breaching fiduciary duties, because he did not separately disclose that there was an arbitration in the fee agreement or there had not been one in the earlier fee agreement. The clients admitted that they did not carefully read the second fee agreement, with the arbitration clause, claiming that they had no idea that there were any changes in their arrangement with their attorney. The trial court granted the petition to compel arbitration, holding that California law embodied a clear public policy in favor of the enforceability of arbitration provisions within contracts. The clients appealed.

The Court of Appeal affirmed the trial court's ruling. In so holding, the court emphasized that "a cardinal rule of contract law is that a party's failure to read a contract, or to carefully read a contract, before signing it is no defense to the contract's enforcement." The court further noted that it is "not reasonable to fail to read a contract, ... even if the plaintiff relied on the defendant's assertion that it was not necessary to read the contract" On these grounds alone, the court held that the clients were bound by the fee agreement because they signed it, regardless of whether they failed to read it carefully or not.

The clients also tried to argue that these general principles should be discarded, based upon a theory of constructive fraud, stemming from an alleged violation by the attorney of his fiduciary duty to personally explain the new agreement. The

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court rejected this argument as well, noting that the scope of a fiduciary's obligations depends on the specific facts of the case. Factors such as the sophistication and experience of the vulnerable party will be pertinent to this analysis. In *Desert Outdoor Advertising*, one client was the president of a prominent corporation in the industry; the other client was a sophisticated businessman. Because both clients were sent the new fee agreement, were urged to read it, and were encouraged to seek the advice of their own counsel before executing it, the court rejected the clients' arguments, noting that "these were not unsophisticated people unschooled in the ways of litigation." The court also found that the scope of the attorney's fiduciary duties did not include separately explaining the new retainer agreement to the clients. This was based upon a finding that a cover letter made clear that there was, indeed, a new retainer agreement. The court declined to hold that an attorney's fiduciary duties were so broad that it excused the clients from reading the retainer agreement.

Although rendered in the context of an attorney-client relationship, we will cite this case to future courts, to apply these precepts to real estate brokers, who also have fiduciary duties to their clients. The *Desert Outdoor Advertising* case provides further ammunition against claims in which clients sign documents without reading them, especially where those clients can be shown to be both educated and sophisticated.

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SUSPENDING OR REVOKING A BROKER'S LICENSE IS NOT AUTOMATIC EVEN WHEN THE BROKER IS FOUND LIABLE FOR A FRAUD JUDGMENT

By Rinat Kleir-Erlich

In *The Grubb Co., Inc. v. Department of Real Estate* (2011) 194 Cal. App. 4th 1494 the Court of Appeals found that obtaining a fraud judgment against a broker was not sufficient for purpose of revoking the broker's license, if the Real Estate Commissioner did not make a finding of fraud under a higher standard of proof.

The underlying facts of the case involved a representation by The Grubb Company, Inc., through its agent, of both buyers and sellers, in negotiating a sale of a single family residence. The sale fell through once the buyers discovered a discrepancy in the square footage of the property disclosed by their appraiser. The property was built in the 30s and expanded in the 50s to a lower level area, but the city records were vague as to whether the expansion was permitted. Grubb's agent represented the property as having 5,000 square foot, but a prior listing represented it as having 4,200 square foot. Other documents suggested the property was only 2,900 square foot.

The sellers refused to return the deposit to the buyers hence, the buyers filed a lawsuit. After losing the trial but before punitive damages were decided, the sellers settled with the buyers. The sellers were assigned the buyers' claims and proceeded against Grubb. Thereafter, the jury found that Grubb's agent negligently, and also either knowingly or recklessly, made a false representation of an important fact to the buyers and breached his fiduciary duty to them.

As requested in a civil lawsuit, the finding was made based on a burden of proof called 'preponderance of the evidence' (more likely than not, or 51%). For purpose of seeking punitive damages however, the standard is higher ('clear and convincing evidence' of malice, which has been compared to 75%). The buyers/sellers did not meet their burden of proof of 'clear and convincing evidence' and no punitive damages were awarded against Grubb or its agent.

Thereafter, the California Real Estate Commissioner initiated administrative disciplinary proceedings against Grubb and its agent, under Business and Professions Code section 10177.5, which authorizes discipline based upon a civil judgment against a real estate licensee who was found liable for misrepresentation, fraud, or deceit in connection with a transaction for which a license is required

A deputy commissioner presided over the hearing. The deputy reviewed portions of the trial court record in the underlying litigation, as well as additional evidence presented at the administrative hearing. The deputy found that the trial evidence had only one reading and the jury's decision against Grubb's agent must have been that he knowingly misrepresented the square footage of the house to the buyers. Grubb's license could then be revoked as well, based on vicarious liability. (*California Real Estate Loans, Inc. v. Wallace* (1993) 18 Cal.App.4th 1575, 1581–1584). However, due to mitigating circumstances, the deputy decided not to suspend Grubb's license.

The Commissioner reviewed the deputy's decision and found, under *Richards v. Gordon* (1967) 254 Cal.App.2d 735, that while the deputy had erred by guessing what was the basis of the jury's finding (the jury's finding was that the conduct was done either knowingly or recklessly), the civil judgment itself constituted an adequate basis for disciplinary action. The

Commissioner's decision acknowledged that discipline against a professional licensee must be based on 'clear and convincing evidence,' but concluded that under section 10177.5, the only fact that must be proven by 'clear and convincing evidence' is the existence of a judgment based on fraud. Noting that this had been proven, the Commissioner suspended Grubb's licenses for 30 days. Grubb sought review of the Commissioner's decision and when the court denied its petition Grubb appealed.

The Court of Appeal held that under the California Constitution, the suspension or revocation of a professional license must be based on misconduct proven by 'clear and convincing evidence.' *Hughes v. Board of Architectural Examiners* (1998) 17 Cal.4th 763, 788–789 & fn. 9. In this case, the jury's finding of fraud was based on 'preponderance of the evidence.' Hence, when the Commissioner imposed discipline merely on the basis of the 'existence' of a fraud judgment it violated Grubb's due process right to proof by clear and convincing evidence. This was based on a prior Supreme Court case of *Liodas v. Sahadi* (1977) 19 Cal.3d 278, 286–293 holding that professional licensees' due process rights require that proof of misconduct be by clear and convincing evidence.

The Commissioner argued that when an accusation of misconduct by a licensed real estate broker is based on section 10177.5, "the express language of the statute makes the judgment itself the operative fact upon which the disciplinary action is imposed, not the acts or omissions of the licensee which led to that judgment. Thus, if the elements of fraud have been proved in the civil action, collateral estoppel principles bar the licensee from attempting to relitigate those facts at the administrative proceeding. [Citations.]" *Loans, Inc. v. Wallace* (1993) 18 Cal.App.4th 1575, 1581–1584. In other words, once fraud is found by a judgment, the licensee is estopped from arguing and proving otherwise. The Court of Appeal did not address the estoppel argument but noted that in *Loans, Inc*, the prior fraud judgment against the realtor was proven by 'clear and convincing evidence,' in that the jury also awarded punitive damages against the licensee in that case.

Further, the Court of Appeals noted that in attorney licensing cases, a finding made by 'preponderance of the evidence' in civil case cannot be given binding effect, because clear and convincing evidence is required. *Maltaman v. State Bar* (1987) 43 Cal.3d 924, 947. There was no reason to have a different rule when the license involved was a real estate broker. Accordingly, the suspension of Grubb's license-- to the benefit of all brokers who can find themselves in similar situations--was set aside.

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