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REAL ESTATE LEGAL UPDATE

SUMMER 2015

A CREATIVE DEFENSE TO A REAL ESTATE NONDISCLOSURE CLAIM THAT DIDN'T WORK

By Fredric W. Trester

Photo: A Sonoma County vineyard, Wiki Commons

In the recent case of *Ram's Gate Winery LLC v. Roche*, buyer Ram's Gate purchased a winery in Sonoma County, which was underlain by an earthquake fault, from sellers Roche. In the Purchase Agreement the Roches agreed to the disclosure of any soils information or geotechnical reports that "may have a material effect on the value…or use of the property." After the close of escrow, Ram's Gate discovered the fault line, which increased its development costs. They sued the Roches for breach of contract for failing to disclose the earthquake fault.

The Roches, coming up with a creative defense, used the "Doctrine of Merger" to claim that any representations in the Purchase Contract were merged into the deed and therefore did not survive the close of escrow. The trial court bought this argument and dismissed the case.

The appellate court, not surprisingly, reversed the trial court's decision.

ALSO IN THIS ISSUE

FIRM NEWS

Rinat B. Klier-Erlich at CLM's 2015 Professional Liability Conference

Los Angeles Manning & Kass partner **Rinat B. Klier-Erlich** served as a panel speaker at the Claims and Litigation Management (CLM) Alliance's 2015 PROFESSIONAL LIABILITY CONFERENCE.

Peter Catalanotti Named Co-Chair

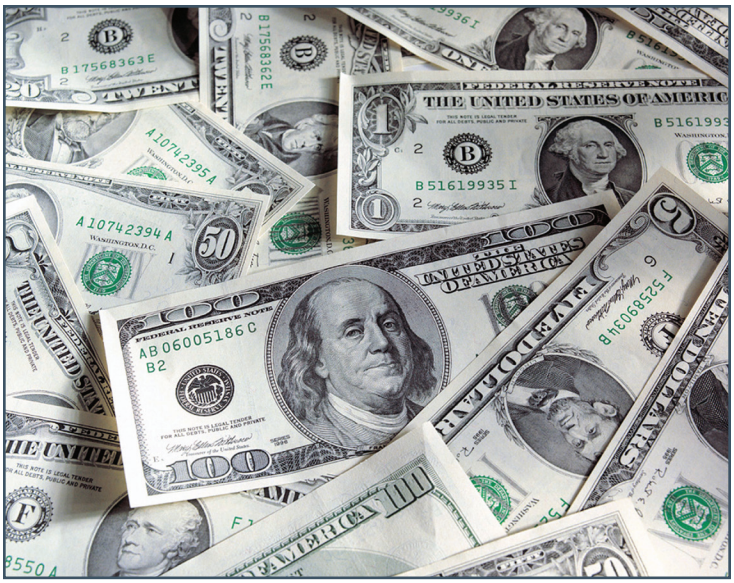
San Francisco Manning & Kass office partner Peter Catalanotti has been named co-chair of the California Bar Association Real Property Law Section, Real Estate Sales and Brokerage Subsection.

The appellate court noted that the Doctrine of Merger provides that "where a deed is executed…all prior proposals and stipulations are merged, and the deed is deemed to express the final and entire contract between the parties." However, the court explained that this doctrine applies only where the contractual terms are inconsistent with the deed or where the parties intended to have all contractual obligations subsumed by the recitals in the deed. In most real estate transactions, this would rarely happen, as deeds typically only set forth conveyance language and a description of the property. While the Roches argued that the intent of the parties demonstrated that the "disclosure warranty" would not survive the close of escrow, because other provisions in the contract had survival language (i.e. that they would survive the close of escrow), the court found this unpersuasive. The court essentially found that there was no conflict between the purchase agreement and the deed to support a merger.

The appellate court reversed the trial court's decision for another reason as well. The court found that the breach of the "disclosure warranty" in the contract occurred before the close of escrow, because Ram's Gate's claim accrued when the Roches failed to disclose the documents relating to the earthquake fault, which occurred prior to the close of escrow. While the Roches argued that the claim did not accrue prior to the close of escrow because no damages had been incurred, the court dismissed this argument stating that if the breach occurred the claim accrued. Logically however, one could argue that damages did accrue at the date escrow closed, because the measure of damages for fraud in the sale of real estate is the difference between what the buyer paid and the value of what they received. In turn, if they received property which had an undisclosed earthquake fault, they could have argued that it diminished in value as of the date they contracted to purchase it. In other words, it was worth less than they paid.

It is not clear what impact this case will have. Conceivably, the seller's attorneys may want to include clear language in the purchase agreement that specific warranties or other obligations in the contract do not survive the close of escrow. Buyer's attorneys will want the exact opposite. Alternatively, language can be added to the deed which specifically states that certain obligations are merged. The latter seems like a more difficult approach in that most buyers and sellers do not consider a deed anything other than a conveyance instrument.

As a result of this case, the parties must be clear as to the claims arising from the purchase agreement obligations they want to survive the close of escrow as the default rule will be that any obligations, such as the obligation to disclose material facts, (which is in the current CAR Residential Purchase Agreement) will survive.



THRESHOLD TO BECOMING A COMMON INTEREST DEVELOPMENT AND AN INTERESTING OUTCOME REGARDING ATTORNEY'S FEES PROVISIONS

By Rinat Klier-Erlich

People live in common interest developments and they may even have governing documents or agreements among them. However, governing documents or agreements do not mean that a living arrangement is a common interest development, as defined by the Davis-Sterling Common Interest

Development Act. A common interest development for purposes of the Act requires a project with a common area. It also requires the common interest to exist pursuant to a valid recorded declaration.

In *Tract 19051 Homeowners Association v. Kemp* (2015) 2015 S.O.S. 1293, decided by the Supreme Court in April, 2015, the homeowner association filed a claim against a homeowner, Kemp, claiming that he violated the association rules by his ongoing and extensive remodeling.

When plaintiffs' Tract 19051 was subdivided in 1958, the developer recorded the declaration of restrictions. However, the original declaration, by its own terms, expired on January 1, 2000, and contained no provision for extending that date. A declaration of restrictions may be extended only by the unanimous vote of 100 percent of the property owners or by a vote of a lesser number of owners as provided in the declaration of restrictions. (See 8 Miller & Starr, Cal. Real Estate (3d ed. 2011) § 24:41, pp. 24-137 to 24-138 & fn. 9). Since there was no vote to extend the declaration and the declaration had expired on its own terms, the trial court found that plaintiffs failed to establish that Tract 19051 constituted a common interest development within the meaning of the Act, and rendered judgment in favor of defendant Kemp. However, the court awarded attorney's fees to Kemp, because had the declaration been enforceable, the prevailing party would have been entitled to attorney's fees. The Court of Appeal reversed the attorney's fees order.

The Court of Appeal relied on *Mount Olympus Property Owners Assn. v. Shpirt* (1997) 59 Cal.App.4th 885 which held that a plaintiff who sought attorney fees under the attorney fee provision of the Act was not entitled to an award of attorney fees when the plaintiff failed to establish that the tract was a common interest development. The Supreme Court however, disagreed with the lower court's reading of *Mount Olympus*. The Supreme Court found that the Mount Olympus case was not authority for denying a defendant against whom an action to enforce the governing documents was brought. It was only authority to denying the plaintiff's fees.

Hence, the Supreme Court concluded that the Court of Appeal erred in reversing the attorney's fee award in favor of defendants. It found that the trial court's award of attorney fees was supported by the language of the statute. The underlying lawsuit was an action to enforce the governing documents of a common interest development, and defendants were the prevailing party in the action. Because plaintiffs would have been entitled to an award under the statute had they prevailed (in proving that the homeowner violated the governing documents). Not awarding fees to the prevailing party would violate the reciprocal nature of the statute and defeat the legislative intent.

California generally follows the American Rule, which provides that each party to a lawsuit must ordinarily pay his or her own attorney fees. (See, e.g., *Trope v. Katz* (1995) 11 Cal.4th 274, 278.). In Code of Civil Procedure section 1021, the Legislature has established a variety of exceptions to the American Rule, which includes statutes. Former Civil Code section 1354(c) is one of those statutes. It reads: "In an action to enforce the governing documents [of a common interest development], the prevailing party shall be awarded reasonable attorney's fees and costs."

Plaintiffs argued that since Tract 19051 was not a common interest development, the statute did not apply. Defendants argued in response that because the statute referred to "the prevailing party," the recovery was based on "prevailing," and not on whether a court ultimately determined that a subdivision was a common interest development.

The Supreme Court agreed with defendants and explained that when a lawsuit is brought to enforce the governing documents, that is the character of the action that has been brought, even if the plaintiffs are ultimately unable to prove that the documents are enforceable.

The Court further looked at two real estate contract cases, *Hsu v. Abbara* (1995) 9 Cal.4th 863 and *Santisas v. Goodin* (1998) 17 Cal.4th 599. In *Hsu*, prospective purchasers of real property brought a lawsuit against the owners, alleging that the defendants had breached a real estate sales contract that contained an attorney fee provision. The trial

court found in favor of the defendants, concluding that the plaintiffs' purported acceptance of the defendants' offer was actually a counteroffer and that no contract had been formed. The trial court denied the request for attorney's fees but the Supreme Court reversed. It stated that, "a party is entitled to attorney fees under section 1717, even when the party prevails on grounds the contract is inapplicable, invalid, unenforceable or nonexistent, if the other party would have been entitled to attorney's fees had it prevailed." Santisas reached the same conclusion.

Moving to an example that does not involve a real estate purchase contract, the Supreme Court discussed *Mechanical Wholesale Corp. v. Fuji Bank, Ltd.* (1996) 42 Cal.App.4th 1647 and explained that the action was against a construction lender on a bonded stop notice in which the lender was the prevailing party. Even though the court found that plaintiff did not have a legal right to claim the benefit of the stop notice provisions (which would have included attorney's fees) it was irrelevant.

Based on this reasoning the Court reversed on the attorney's fees award for the homeowner to recover attorney's fees.

COURT OF APPEALS ALLOWS REAL ESTATE AGENTS TO SHARE COMMISSIONS BASED ON ORAL AGREEMENT

By Melissa M. Palozola

Under California law, there are certain statutory requirements that govern the payment of compensation between brokers and agents in the sale of real estate transactions. Specifically, Business and Professions Code section 10137 regulates the payment of compensation of licensed real estate agents in real property transactions.

In the recent decision in *Sanowicz v. Bacal,* the Court of Appeals for the State of California addressed whether a licensed real estate agent may agree to share a commission with another agent. This was an issue of first impression for the Court as no case directly addressed the application of section 10137 to the sharing of commissions among real estate agents. Plaintiff Sanowicz alleged that he had entered into a joint venture with Defendant Bacal to share various commissions on the sale of certain properties and that Defendant owed him commissions for the sale of the same. Both parties worked at two separate licensed California real estate agencies when the properties at issue were ultimately sold. Plaintiff argued that the section 10137 does not bar commission sharing agreements once the broker has already received the commission. Defendant Bacal argued that it is unlawful for a real estate agent to accept compensation from any person other than the real estate broker under whom he or she is licensed and that therefore these commission sharing arrangements were illegal and thus invalid.

The Court ultimately found Plaintiff's argument more persuasive and held that a licensed real estate agent may agree to share commissions with another licensed real estate agent. The Court reasoned that in enacting section 10137, the legislature limited the manner of payment requiring that any payments be made "through the broker under whom he or she is at the time licensed." However, the legislature did not forbid commission sharing arrangements between the agents themselves after the broker was already paid. This decision now makes it clear that licensed real estate agents can enter into contracts to share commissions for the sale of real property.

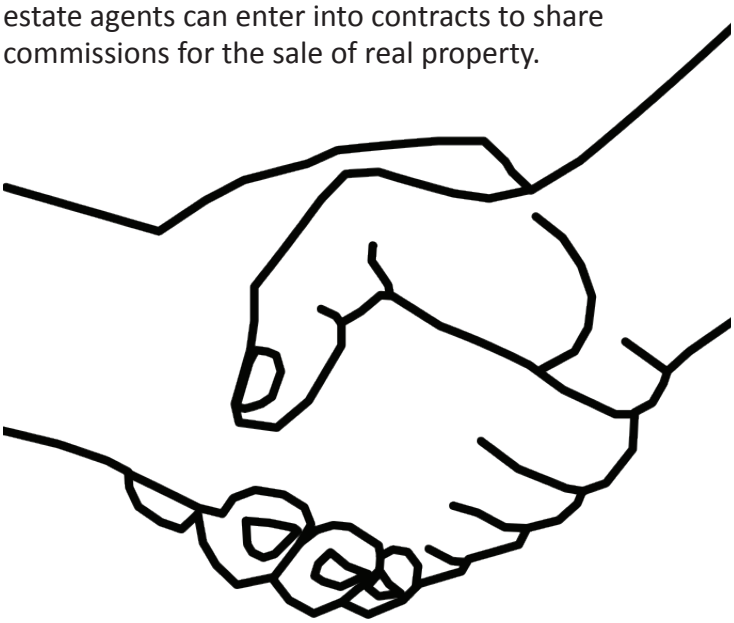


Photo: Handshake, Wiki Commons

CHANGES TO REQUIRED LENDER FORMS JUST AROUND THE CORNER IN 2015

By Victor Rocha

As of August 1, 2015 lenders will be required to give their borrowers two entirely new forms, called the "Loan Estimate" and the "Closing Disclosure," which are intended to give the consumer all material terms of their loan in an easy to understand format. The two new forms will replace the Good Faith Estimate and HUD-1, the initial and final Truth in Lending forms which were also originally intended to apprise the borrower of all material terms of their loan. These forms will be required on most real property loans except for HELOCs, reverse mortgages, and mobile homes.

The first new form to be discussed is the Loan Estimate, which will include all information that was within the Good Faith Disclosure and the initial Truth in Lending form and must be given to the borrower no later than three business days after the borrower submits a mortgage loan application. The term "business days" is defined to include any and all days that the lender's office is open to the public. If the lender is open seven days a week, all days of the week are considered "business days" for purposes of delivering the Loan Estimate. The Loan Estimate is considered delivered the day it is hand delivered or the day sent by mail. The new forms are required on loan applications that are submitted on or after August 1, 2015. So you will not see these forms until after August 1, 2015.

A sample Loan Estimate can be found by going to the Consumer Financial Protection Bureau website (www.consumerfinance.gov) and typing "Loan Estimate" in the website's internal search engine. The first page of the form prominently displays material information of the proposed loan including, but not limited to, loan amount, whether the loan is fixed or variable, interest rate, estimated monthly payments, estimated closing costs, and estimated total cash necessary to close. The first page further informs the borrower whether their loan has a prepayment penalty and/or a balloon payment. The second page itemizes all the closing costs and includes a list of settlement services for which the borrower can shop. The third page states the total sum of all payments after paying the loan for five years, the APR, whether assumption of the loan is allowed, and what constitutes a late payment. This page also identifies who will service the loan along with other helpful information. The lender is generally bound by the terms outlined in the Loan Estimate, unless expressly authorized by law which includes any number of "changed circumstances" relating to the loan. In those cases, the lender is allowed to give the borrower a revised Loan Estimate. The Loan Estimate satisfies the Truth in Lending Act and the Real Estate Settlement Procedures Act by informing the borrower of key terms of the loan and by identifying the nature and cost of all settlement services.

The second new form to be discussed is the Closing Disclosure which will also further the disclosure purposes behind the Truth in Lending Act and Real Estate Settlement Procedures Act. The Closing Disclosure consists of five pages and has all the information found in the Loan Disclosure with more detail and with other information as well. The lender must give the borrower the Closing Disclosure no later than three business days prior to closing the loan. As to the Closing Disclosure, "business days" means all calendar days except Sundays and federally recognized holidays. It should be noted that the term "business days" is not the same for the Loan Estimate and the Closing Disclosure. A loan cannot legally close until the borrower has had the Closing Disclosure for a full three business days prior to closing on the loan. The lender can either hand deliver the Closing Disclosure to the borrower at least three business days prior to closing, or must mail the Closing Disclosure to the borrower at least seven business days prior to closing. If the borrower does not have this three business day period prior to closing, the loan cannot lawfully close.

The purpose for the three business day rule is to give the borrower time to read and understand the terms of the loan and otherwise give the borrower an opportunity to walk away. If the Closing Disclosure contains terms that differ from the actual loan being offered such as an A.P.R. increase greater than 1/8 of a percent, the addition of a prepayment penalty, or the change of a loan product, then the lender must

give the borrower a Closing Disclosure and restart the three business day waiting period. In cases of a "bona fide personal financial emergency," the borrower may waive the three business day waiting period by giving the lender a dated and signed written statement showing the bona fide personal financial emergency. What constitutes a bona fide personal financial emergency will depend on the facts surrounding individual situations but avoiding a foreclosure of the borrower's home is one such circumstance. All real estate professionals should pay special attention to this three business day waiting period, as it is expected to cause problems and delays in some transactions. The best course of conduct would be to alter all parties of this three business day waiting period so that the parties can plan ahead and make arrangements in case the escrow does not close on time. The parties do not want to expect escrow to close on a certain date only to find out that they have to wait an additional three days. Even this minor delay may cause significant harm to the parties. The best practice is to apprise all parties of this new rule and make plans accordingly.

If you would like more information please consult an attorney or go to the Consumer Financial Protection Bureau website (www.consumerfinance.gov) and type TILA-RESPA integrated disclosure in the website's internal search engine.

Photo: House for Sale, Courtesy Wiki Commons