

The Morrison Law Journal

October 2010

Volume V, Edition 10

A New Duty To Disclose? Court Of Appeal Rules That Residential Real Estate Broker, Acting As Seller's Agent, May Have Affirmative Duty To Disclose Amount Of Secured Debt On Property Where Creditors Have Not Agreed To Accept Short Sale Or Compromise

By: Edward F. Morrison, Jr., Esq.
Larry A. Schwartz, Esq.

In this era of falling real estate values, and with "short" sales being common, real property is often marketed in Southern California at an amount which is well less than the amount of secured encumbrances on the property. A question that has arisen is whether a residential real estate broker, acting as the seller's agent only, has an affirmative duty to disclose that a property is being offered for sale at an amount which is significantly less than the total of the secured notes on the property.

That question has now been largely answered based on the October 6, 2010 decision from the California Court of Appeal, Fourth District in the case of Holmes v. Summer (2010) D.A.R. 15614 ("Holmes Case"). In that decision, the California Court of Appeal ruled that a residential real estate broker, acting as the seller's agent in a residential real estate transaction, had an affirmative duty to disclose to a purchaser that the property was significantly over encumbered and that those encumbrances may impede or prevent the close of escrow. The Court of Appeal acknowledged that the seller's agent was not in privity with the purchaser and that the purchaser could have engaged in a title search to determine the existence of the secured notes on the property, but ruled that the selling agent's failure to disclose the extent of over encumbrances may have breached affirmative duties of care, honesty, good faith, fair dealing and disclosure as reflected in Civil Code section 2079.16 as well as such other nonfiduciary duties as are otherwise imposed by law.

The facts of the Holmes Case are common enough. The case concerned a single family residence located in Huntington Beach, California. The sellers retained Sieglinde Summer and Beneficial Services, Inc. (which operated a Re/Max office in Huntington Beach) as their residential broker. The property was listed at between \$749,000.00 and \$799,000.00. The listing made no mention of any encumbrances that might affect the sellers' ability to sell the property at the advertised price.

At the time that the property was marketed, the property was subject to a first deed of trust in the amount of \$695,000.00, a second deed of trust in the amount of \$196,000.00, and a third deed of trust in the amount of \$250,000.00, for a total debt of \$1,141,000.00. Also, the lenders had not agreed to accept less than the amounts due under the loans in order to release their deeds of trust.

After substantial negotiations, the purchasers, Phil and Jenelle Holmes, entered into a contract to purchase the property for \$749,000.00 with a 30 day escrow. The buyers allegedly sold their home, but could not close on the property in Huntington Beach as the sellers were unable to reach agreements with their lenders.

Thereafter, the Holmes sued the sellers' real estate brokers on the basis that the brokers had an affirmative obligation to disclose the fact that the property was over encumbered and that the lenders had not agreed to accept less than the amounts due under the loans. After filing suit, the sellers' real estate brokers filed a demurrer arguing that the lawsuit was a disguised effort to require them to guarantee the sellers' performance. They also asserted that if the sellers decided to sell the property at a loss, such that they would have to come up with cash to close the transaction, but then changed their mind, a business decision was being made by the sellers for which the brokers could not be liable for. The trial court sustained the demurrer without leave the amend.

On appeal, the Court of Appeal ruled that, while Civil Code section 2079.16 did not specify any fiduciary duty being owed by the sellers' real estate broker to the purchasers, the sellers' real estate brokers still owed the purchasers affirmative duties of care, honesty, good faith, fair dealing and disclosure which included, but were not limited to, disclosing whether the property was so encumbered that it could not be sold in the event that the purchasers went into contract. In its ruling, the Court of Appeal specifically found, citing Lingsch v. Savage (1963) 213 Cal.App.2nd 729, 735, that the sellers' brokers' nondisclosure amounted to a representation of the nonexistence of facts which the sellers' brokers were required to disclose. In its ruling, the Court of Appeal commented that while the purchasers could research encumbrances on the property, the title search would only divulge the existence of recorded deeds of trust and would not likely have disclosed the current balances. The Court of Appeal further held that the current amount of debt secured by deeds of trust on the property did not constitute confidential information which the sellers' broker would be required to withhold.

The Holmes Case is important in that it provides guidance to a residential real estate broker as to what information will need to be disclosed in the event the secured debt on the property exceeds the asking price. However, the Holmes Case should be considered to be most relevant to residential real estate matters and may not apply to commercial transactions where information as to secured debt on the property is generally more available.

About the Authors: Edward F. Morrison, Jr. is the founding partner and Larry Schwartz is Of Counsel with The Morrison Law Group, a professional corporation. Their biographies can be viewed at the website www.morrisonlawgroup.com.

Publication Note: The Morrison Law Group wishes to disseminate this publication to all clients and colleagues of the Firm who wish to receive it. Should any recipient desire to be removed from the distribution list, or wishes to have a colleague added, please contact Jim Van Dusen at The Morrison Law Group at 213 356-5504 or vandusen@morrisonlawgroup.com.

Disclaimer Note: The legal article presented above is intended to provide general information which may be of interest or use to clients and colleagues of The Morrison Law Group and should not be construed as legal advice on any matter.