

FAILURE TO DISCLOSE MATERIAL FACTS

A Case Example of a Residential Property Dispute

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Mediation of disputes between sellers and buyers of residential real estate can be especially challenging. Both parties have significant financial interests and emotional investments at stake. Conflicts of interests arise and loyalties are tested when the parties are represented by realtors. (Matters get more complex when both the seller and the buyer have been represented by a single real estate agent in a "dual agency.") Seller and buyer will have relied extensively on their realtors. In many cases, the parties have never met face-to-face until the mediation. Let's explore an example of a mediation concerning an alleged "failure to disclose material facts."

Sellers, a couple in their 70s, lived in their rural San Diego County home for 30 years. Sellers listed the property for sale with their realtor. Buyers were a couple in their late 30s with two teenagers. When the Buyers looked at the house with their realtor, they liked it and its location and offered to purchase it. With the assistance of their realtor, Sellers made disclosures about the condition of the home. Sellers told their realtor there was nothing wrong with the property and nothing else to disclose. During Buyer's pre-closing investigation of the property, Sellers provided a "well report" to Buyers. There was no professional home inspection prior to the closing.



The sale closed, and the Buyers and their two children moved in. On the first night, the family experienced many problems with hot water, electrical systems as well as mold in the walls in their "new" home. Three days after moving in, even more problems arose in the home making the Buyers second guess their purchase. Buyers contacted their realtor, who contacted the Sellers' realtor to discuss the recent events at the house. Sellers' realtor talked to Sellers and reported back to Buyer's realtor that Sellers had nothing to say: everything worked fine when they closed escrow and they would not contribute any money toward repairs.

Over the next few months, Buyers spent \$90,000 in repair costs to fix the problems throughout the house and then demanded mediation with Sellers to discuss this issue. Both realtors agreed to attend, but without counsel. (The parties had initialed the arbitration clause in the standard CAR purchase agreement).

The mediator met alone with Buyer's and Seller's counsel before the mediation began. Seller's counsel stated that Sellers are resolute that their disclosures were accurate, they did not misrepresent the condition of the house as of the close of escrow, and they diligently followed their realtor's instructions in completing the disclosure documents. They had never had a water problem with the home except for one time two summers ago, and everything had been working fine for the previous 18 months. Buyers' counsel recounted the recent events and that the Buyers believed that Sellers were aware of the inadequacies in the home that could lead to potential

problems. Buyers felt that those deficiencies were material matters that Sellers failed to disclose before they sold the house.



Although there was understandably palpable hostility between the Sellers and Buyers, the mediator began a joint session with the parties and their realtors. The Buyers needed to vent their frustration over their nightmarish experiences, and the Sellers needed to gain an understanding of the extent of the Buyers' problems. The Sellers needed to tell their story and establish credibility with the Buyers, despite their disagreements. The mediator used the joint session to give the parties the opportunity

to exchange relevant information, and so the mediator could evaluate how entrenched each of the parties were, and determine the willingness of the realtors to contribute to a possible settlement.

During the joint session, relevant facts emerged about the Seller's historical use of the property. It became apparent that in the last several years, the property had not been burdened with the demands of a growing family, particularly one with two teenagers. During the joint session, the realtors made a few comments, but were guarded in their participation.

Following the joint session, the mediator met with each party, their counsel, and their realtor separate from the other party, counsel and realtor. The mediator believed that the realtors would help diffuse some of their clients' animosity. In each private caucus, the mediator explored the strengths and weaknesses of that party's case, discussed the expenses that would likely be incurred if the case proceeded to arbitration, and the uncertainty of the arbitration outcome. The mediator also met separately with each of the realtors.

In caucus with the Sellers and their realtor, the mediator discussed the materiality of the historical problems that occurred in the home, and the significance of the Sellers' failure to disclose those facts to Buyers. In a private meeting with the mediator, Sellers' realtor admitted that she could have done more regarding the disclosures.

After diligent efforts over a 4-hour period, the parties agreed to settle on terms calling for the Buyers to be paid \$50,000.00. Recognizing that they should have disclosed the problems that occurred in the home two years earlier, the Sellers agreed to pay \$35,000 toward the repair costs. Each of the realtors agreed to contribute \$7,500 based on their roles in the disclosure process. (Each realtor told the mediator in confidence that there was a \$5,000 deductible on their liability insurance policies, and that they were willing to contribute a portion of their earned commission.)



This is a good example of a case where the parties needed to tell the other and hear from each other about how the situation affected them, and they needed to clear up any assumptions they had about the other through direct information exchange, and where all of the parties took personal responsibility for the role they played in the situation. The realtors were wise to

contribute to the settlement as a means to ensure that the case was resolved and didn't go to an arbitration or litigation. The sellers and buyers both achieved a favorable outcome through mediation. This case was very fact-driven, but either side could have won at trial. The settlement avoided the biggest pitfall of litigation: uncertainty.