A Sellers' Market: Anticipated Legal Challenges

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The current residential sales market is experiencing historic escalating sales prices which this author has not seen in over forty-six years as a practicing real estate litigator, and now as a full-time mediator for West Coast Resolution Group in San Diego, California. During those four plus decades of practice, I represented buyers, sellers, and real estate agents and brokers (collectively "agents") in more than 600 cases before the Superior Court, in arbitration, in many cases defending agents before an administrative law judge in license revocation and other disciplinary proceedings, and in both residential and commercial transactions. The potential for litigation, including arbitrations, arising out of the frenzied sellers' market cannot be underestimated. This article discusses some of the potential yet foreseeable disputes that sellers, buyers, agents, attorneys, and mediators can expect.

Many sellers are joyful over the buying frenzy of residential real estate, receiving offers containing prices far exceeding their wildest expectations. Offers in excess of listing prices are common. Multiple and backup offers for a residence are typical. Inventory of homes for sale is inadequate to meet the demand. One pundit noted that there are more real estate agents than homes for sale. As a result, buyers often abandon reason in making offers. So, from a seller's perspective, what is the problem?

Sellers often focus on price only. Their disclosure obligations are often ignored or downplayed. The concern is that these sellers may think that robust disclosures about their properties are somehow less important than required. However, the seller's duties to disclose are statutory, and a seller's market provides no exception to these obligations. See Civil Code section 1102.1, et seq. The Real Estate Transfer Disclosure Statement ("TDS") must be filled out and signed by the seller. The seller's statements are representations based on the sellers' awareness about the condition of the property. Unless there are statutory exceptions from providing the TDS, such as a probate sale, foreclosure sales, sales requiring a public report and others pursuant to California Civil Code Section 1102.2, the seller must complete the form and provide explanations as to responses which are checked in the affirmative. Both the TDS and the Seller Property Questionnaire ("SPQ") ask for information of which the seller is aware.

Selling residential real property "as-is" provides no exception to a seller's obligations of disclosing known material facts affecting the property. Some agents in this market are advertising that if sellers list their property with them, they will be able to sell "as-is", as if that is a unique concept in California, or creating the impression that selling "as-is" somehow lessens or eliminates the seller's statutory duties of disclosure. It does not.

The most-often used agreement in residential sales in California is the California Association of Realtors' Residential Purchase Agreement and Joint Escrow Instructions ("RPA"). It states in no uncertain terms that "Unless otherwise agreed in writing: (1) the Property is sold (a) "As-Is" in its PRESENT CONDITION as of the date of ACCEPTANCE..." subject to the buyer's rights of inspection and investigation, AND subject to seller's obligations to disclose material facts about the property. Those seller's disclosures are made in, among others, the legislatively mandated TDS and the RPA's contractually required SPQ.

The importance of sellers making complete and robust disclosures in these and other forms cannot be overestimated. If you have ever tried a case alleging seller non-disclosure, you know that these completed forms are often blown up to the size of a billboard for the "benefit" of the judge and/or jury. Cross examination of the seller who has made incomplete or inaccurate disclosures in the TDS and/or SPQ can be painful from the defense counsel's perspective.

In this market, sellers are faced with buyers who are so excited about buying residential real estate that they are often making offers which also include their removal/waiver of all contingencies, including but not limited to their rights to inspect the property, among others. Buyers do so to make their offer the most attractive out of the many competing offers. Although these kinds of offers may lead to a seller's acceptance, they may also lead to a buyer discovering material defects to the property after close of escrow (COE), and hence to lawsuits against sellers and the agents. Typically, sellers do not have insurance to pay for cost of defense or indemnity. In short, this market does not relieve a seller from making critical disclosures to the buyer, nor should it result in a buyer's lack of due diligence. Sellers should consider requiring buyers to conduct their due diligence and not encourage buyers to avoid it.

From a buyer's perspective, the current market challenges can be daunting. If the over-list price offer is contingent upon loan approval, the comparable sales prices ("comps") in the neighborhood may not support the loan. The property may not appraise at the sales price. In addition, an offer containing a loan contingency may often result in rejection of the offer, in favor of an all-cash offer for a greater or even a lesser sales price.

We also have a hornet's nest of competing offers given the limited inventory of homes for sale. The author has observed sellers mistakenly accept more than one offer on the same property, or where buyers making back-up offers convince a seller to abandon the first accepted offer with Buyer 1, breach with Buyer 1 by accepting a back-up offer with Buyer 2 because Buyer 2's offer was for substantially more money. So now we have Buyer 1 potentially suing Buyer 2, the agents, and, of course, the seller, for every conceivable cause of action. If Buyer 1 is suing for specific performance, a lis pendens will most likely be recorded against title to the property, thus tying up that property during the pendency of the action.

The above scenario is a potential recipe for chaos and lengthy and costly litigation. The action is typically not simply confined to a buyer suing a seller. Cross-complaints fly like scud missiles; sellers cross-complain against the agents, the agents cross-complain against each other and the principals. The author has access to a service

which publishes all lawsuits filed daily with the San Diego Superior Court. One of the suits recently filed was by a disgruntled buyer who lost his purchase to a subsequent buyer offering more money for the property.

The current market also puts the agents front and center in representing buyers and sellers. The agent, representing his or her principal, owes that principal the utmost duty of loyalty, care, honesty, and skill. They are fiduciaries of their principals. An agent representing a buyer who removes contingencies with the offer is at risk to an unhappy buyer post close of escrow. If the buyer insists on making the contingency-free offer, then the agent for that buyer is encouraged to advise the buyer to include all appropriate contingencies, and then immediately confirm that advice in writing.

An agent who represents a seller is at risk if that seller does not understand the seller's duty to disclose all known material facts about the property. The disclosure forms require the sellers to explain boxes checked in the affirmative. As an attorney and expert witness, the author can attest that the seller's explanations are often not made. Both sellers and their agents need to work together to make certain all forms are thoroughly completed. Buyers' agents also need to be involved in reviewing the seller's disclosures to make certain their buyers get all the information required by these forms and by law.

In addition to other duties, both buyers' and sellers' agents have a duty to perform a reasonably diligent visual inspection of the subject property and to disclose their findings accordingly. See the TDS, paragraphs III and IV. See also CAR's form AVID, in which the agent may report his or her findings from the visual inspection. Again, there is no exception to the agents' duties to their principals in a seller's frenzied market.

Another phenomenon highlighted by the sellers' market is what is called the "pocket listing" or "office exclusive listing" where the seller's listing is not entered into the multiple listing service ("MLS"). There are legitimate reasons to enter into a pocket listing, for example, where the seller for privacy reasons does not want the public to view information, including photos, about her home. There are some critics who have argued that a pocket listing may be used by some agents to increase the likelihood that they will receive "both sides" of the commission. Dual agency, with appropriate disclosures, is accepted throughout the industry and beyond. Some critics challenge the dual agent's ability to obtain the highest price for the seller, and the lowest price for the buyer. Pocket listings have advantages and disadvantages. Some believe it is in the seller's best interest to expose the property to the most potential buyers, i.e., through the public facing website of the MLS and to encourage competition. Many arguments can be made, both in favor of and against pocket listings, which are one product of the low inventory of homes for sale.

Finally, attorneys representing buyers or sellers in a sales transaction, before close of escrow, are faced with many of the same concerns discussed above. Buyers' all-cash offers may be accepted, but, for example, without an appraisal contingency, in which case buyers may argue post COE that they paid too much for the property. Buyers waiving contingencies with the presentation of their offers may have their offers accepted, only to become disgruntled after COE. Counsel's advice should be documented for the benefit of the client as well as counsel. Attorneys representing

sellers pre-COE should make certain that their sellers are making complete and thorough disclosures, regardless of the attractiveness of an above-listing price offer. In addition, sellers are finding after COE that they are having extreme difficulty in acquiring a residence within their price range, given the rapidly escalating prices of residences, both single family and attached. Sellers are now often negotiating post-COE rent backs, to afford them time to find their down-stream next abode. See the RPA, paragraph 9.C., titled "Seller remaining in possession after close of escrow."

Attorneys and agents representing sellers pre-COE should also make certain that the buyers provide contingency removals, proof of funds, and other required information within the time requirements of the RPA. If the offer is contingent upon appraisal and loan approval, the buyer must provide the requisite proof within the time set forth in the agreement. If the RPA is used, and the buyer does not perform within the time required, then the protocol under the agreement requires the seller to provide the buyer with a Notice to Perform, the NBP, as a predicate to cancellation. This buying frenzy and above list price offers will not go on forever. If a seller is not diligent in cancelling under the agreement, the seller may lose her opportunity to take advantage of this market. If that opportunity is lost because of an agent's or counsel's failure to pay attention to the time requirements under the agreement, a seller's claim against the professionals is foreseeable.

There are a multitude of considerations to make in representing buyers and sellers as agents and attorneys in this market. There is little doubt that lawsuits, arbitrations and mediations will increase. As touched upon above, the RPA requires an effort to mediate by the parties pre-litigation or pre- arbitration. If, for example, a buyer files a lawsuit or makes a demand to arbitrate without first demanding the seller mediate the dispute, the buyer will lose all rights to receive his attorneys' fees in the action. Conversely, if the seller refuses to mediate following the buyer's demand, the seller will lose her rights to attorney's fees and costs. (See Paragraph 22A. of the RPA: "The Parties agree to mediate any dispute or claim arising between them out of this Agreement, or any resulting transaction, before resorting to arbitration or court action…If any Party commences an action without first attempting to resolve the matter through mediation, or…before commencement of an action, refuses to mediate after a request has been made, than that Party shall not be entitled to recover attorney fees…") The reader may consider this provision in the RPA to be draconian. But it is in the agreement, and failure to make the demand to mediate or agree to mediate once a demand therefor is made will have potentially disastrous consequences to the prevailing buyer or seller.

This article is by no means all-inclusive as to the risks inherent in this seller's market. It is intended to bring to the reader's attention some of the pitfalls and challenges of this frenzied sellers' market. Sellers, buyers, agents, attorneys beware. Sellers should be discouraged from making less than full disclosures. Buyers should be advised to conduct thorough due diligence and understand the ramifications of removing contingencies with written offers. Mediators and attorneys who become involved in post-COE residential real property disputes, fasten your seat belts -- it is going to be a bumpy and contentious ride.