EXTRA! EXTRA! EXTRA!

RECENT CASE LAW UPDATE

California Courts of Appeal issued three decisions recently after the accompanying issue of *Common Interests* went to press. The rulings are summarized below.

*1. **Realtor's Obligation to Disclose Common Area Defects or Defect Litigation***.

A California Court of Appeal has ruled that a real estate agent participating in a buy-sell transaction for a residence located in a planned development does not have a duty to ask the association whether (a) construction defects exist in the common area, or (b) there is pending or proposed construction defect litigation.

Padgett v. Phariss, 97 Daily Journal D.A.R. 5949 (1997), involved the purchase of a home in a planned development. Neither the seller, the seller's real estate agent nor the buyers' real estate agent disclosed pending construction defect litigation regarding the common areas. The buyers did not learn of the common area construction defect litigation until after escrow closed. Buyers sued the seller, the seller's agent and their own agent. Buyers' claims against the agents were that they either knew or should have discovered the existence of the pending litigation. The agents argued they had no duty to investigate the potential existence of pending common area construction defect litigation, and the trial court awarded them summary judgment.

The Court of Appeal affirmed, noting that California Civil Code Section 2079.3 provides that the inspection a real estate agent is required to make "does not include or involve an inspection of areas that are reasonably and normally inaccessible to such an inspection, *nor an affirmative inspection of areas off the site of the subject property or public records or permits concerning the title or use of the property*. . . ." (emphasis added) The section further provides that if the subject property is a separate interest in a common interest development, the inspection need not extend beyond the separate interest, so long as the seller or broker complies with the requirements of Civil Code Section 1368 (requiring the seller of a separate interest to provide his prospective purchaser with copies of the governing documents and certain association financial information). Even though the italicized language above was added to Section 2079.3 after the close of escrow in the *Padgett* case, the Court of Appeal noted that the legislative history regarding the added language stated that the new language was intended to clarify, and not to change, any existing duty of a real estate licensee.

The Court of Appeal also ruled that the buyers had no common law claims against the real estate agents for misrepresentation, negligence, breach of fiduciary duty or fraud.

It is important to remember that the ruling in this case only applies to pending construction defect litigation regarding common areas that are not a part of the separate interest being purchased. Presumably, a real estate licensee would have to disclose the existence of defects affecting the subject separate interest, even if the defect involves an element of the common area (e.g., a leaky roof).

When combined with last year's ruling in *Kovich v. Paseo Del Mar Homeowners' Association*, 41 Cal. App. 4th 863 (1996), that an association has no duty to disclose the existence of construction defects or construction defect litigation to a prospective purchaser, the *Padgett* case makes it fairly clear that the obligation to disclose the existence of defects and/or pending defect litigation lies with the seller of real property.

2. Community Association Ability to Record Notice of Noncompliance.

In a setback for community association efforts to secure compliance with their CC&R's, a California Court of Appeal has ruled that an association may not record a notice of noncompliance against a homeowner's property in the county recorder's office. *Ward v. Superior Court*, 97 Daily Journal D.A.R. 6456 (1997), involved homeowners who obtained architectural approval to repaint their home, but then allegedly painted the home with colors other than those that had been approved. When they refused the association's demands to paint the house with the approved colors, the association recorded a notice of noncompliance, as authorized by the CC&R's.

The homeowners learned of the notice of noncompliance when they attempted to refinance their home. In order to complete the refinance, they posted a $10,000 bond. The association sued to get the homeowners to repaint the house. The homeowners asked the trial court to expunge (i.e., release) the notice of noncompliance. That request was denied, and the homeowners appealed.

The Court of Appeal ruled that, since recordation of a notice of noncompliance is not specifically authorized by statute, such recordation is not permitted, and ordered the trial court to expunge the notice of noncompliance. The Court of Appeal noted that, if the inability of an association to record a notice of noncompliance would hamper its ability to enforce its CC&R's, the state legislature can make appropriate statutory amendments to address this issue.

The *Ward* decision deprives community associations of low cost means of persuading homeowners to comply with CC&R's. Because a recorded notice of noncompliance clouds an owner's title, it provides an incentive to owners who wish to sell or, as in the *Ward* case, refinance their property, to abide by the CC&R's. With this enforcement tool eliminated, associations will have to resort to other means (e.g., alternative dispute resolution pursuant to Civil Code Section 1354, litigation) to secure compliance with their CC&R's.

3. Recovery of Costs and Attorneys' Fees in Civil Code Section 1356 Proceedings.

A California Court of Appeal has ruled that the successful party in a contested proceeding to amend a community association's declaration through Civil Code Section 1356 is not entitled to recover attorneys' fees and costs.

In *Blue Lagoon Community Association v. Mitchell*, 97 Daily Journal D.A.R. 6975 (1997), the CC&R's required approval of seventy-five percent of the Association's voting power to amend. Two controversial proposals received seventy-one percent and sixty-nine percent approval, respectively. The Association petitioned the Superior Court for an order approving the amendments pursuant to Civic Code Section 1356, which authorizes such a petition if the CC&R's contain a supermajority amendment requirement and the proposed amendments are approved by at least a bare majority, but less than the required supermajority, of the voting power.

Several homeowners opposed the petition. The superior court did not grant the petition, so the amendment failed. The opposing homeowners claimed they were entitled to reimbursement of attorneys' fees and costs from the association because their opposition was successful.

The Court of Appeal rejected those claims, noting that, because Section 1356 is a "safety valve" that enables an association to amend its governing documents when member apathy or other reasons prevent an association from securing necessary supermajority approvals, a Section 1356 proceeding is not adversarial. Homeowners who oppose the petition are therefore not enforcing the governing documents, and are consequently not entitled to recover attorneys' fees and costs.

The Court of Appeal also noted that, if it ruled in favor of the homeowners who successfully opposed the petition, it would follow that an association that prevails in a contested Section 1356 petition would be entitled to recover its costs and attorneys' fees from the unsuccessful opposition. Because the possibility of having to reimburse an association for those expenses would discourage homeowners who oppose a proposed amendment from filing an opposition, the Court of Appeal felt that ruling in favor of the homeowners in *Blue Lagoon* would be bad public policy.

The bottom line, as a result of this ruling, is that each side in a Section 1356 proceeding bears its own costs and fees.

If you have questions regarding either of these cases, or any other matter covered in the accompanying issue of *Common Interests*, please call Harle, Janics & Kannen at (714) 756-2170.