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To Disclose or Not Disclose?

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Real estate brokers and their agents (collectively, "agents") owe disclosure duties to prospective buyers of residential property. Buyers' agents must disclose all material information that might affect their clients' willingness to enter into or complete a real estate transaction. Conversely, sellers' agents only need to disclose information affecting the value or desirability of a property that a "reasonably competent and diligent *visual* inspection" would reveal. Cal. Civ. Code § 2079 (emphasis added). A discussion of agents' disclosure duties in California follows.

California Real Estate Agents' Disclosure Duties

In California, both buyers' and sellers' agents owe disclosure duties to prospective buyers. The duty of buyers' agents is based in common law.

> The [buyer's] broker as a fiduciary has a duty to learn the material facts that may affect the principal's decision. He is hired for his professional knowledge and skill; *he is expected to perform the necessary research and investigation in order to know those important matters that will affect the principal's decision*, and he has a duty to counsel and advise the principal regarding the propriety and ramifications of the decision. The agent's duty to disclose material information to the principal includes the duty to disclose reasonably obtainable material information. [¶] . . . [¶] *The facts that a broker must learn, and the advice and counsel required of the broker, depend on the facts of each transaction, the knowledge and the experience of the principal, the questions asked by the principal, and the nature of the property and the terms of sale.* The broker must place himself in the position of the principal and ask himself the type of information required for the principal to make a well-informed decision. This obligation requires investigation of facts not known to the agent and disclosure of all material facts that might reasonably be discovered.

Field v. Century 21 Klowden-Forness Realty, 63 Cal. App. 4th 18, 25-26 (1998) (emphasis added).

When a sellers' agent knows that the debt on a property substantially exceeds the sales price, such that a transaction involving the property has a considerable risk of failure, he or she must disclose those circumstances to prospective buyers.

Thus, buyers' agents must disclose any information they receive about the property from sellers and others, such as home inspectors. Sellers' agents have no such duty. Rather, they have a limited statutory disclosure duty, Cal. Civ. Code § 2079, and only need to disclose to prospective buyers that which a visual inspection would reveal. Once these disclosures are made, "it is incumbent upon the potential purchasers to investigate and make an informed decision" on whether or not to go through with purchasing the property.

Pagano v. Krohn, 60 Cal. App. 4th 1, 5 (1997) provides a cautionary example of buyers' obligation to conduct further investigation after sellers' agents satisfy their statutory disclosure duty. In *Pagano*, the buyers sued the sellers' agent for failing to disclose water intrusion problems. The sellers' agent had disclosed to the buyers that other units in the condominium complex had experienced moisture intrusion and forwarded a letter from the homeowners' association regarding a lawsuit against the developer for the water intrusion problems, which the buyers' agent read to them. Nonetheless, the buyers argued that the sellers' agent had breached her statutory disclosure duty because she should have disclosed ["the following specific facts within her knowledge prior to the purchase . . . : (1) as a homeowner in [the complex] she received 31 documents such as newsletters and minutes of Association's meetings chronicling the progression of the water intrusion problems . . . ; (2) she was aware of severe water intrusion problems experienced by the owners of three particular units; and (3) she had read the Association's complaint against the developer."]

The court rejected the buyers' argument, stating: ["Disclosure of these additional facts would have served only as elaboration on the basic disclosed fact that there was a water intrusion problem in the development affecting some of the units and resulting in a lawsuit against the developer."] The sellers' agent was neither required to disclose more than the "essential facts about the water intrusion problem" nor "duty bound [by her statutory disclosure duty] to elaborate on those facts by providing further details regarding the various manifestations of water intrusion throughout the development." After the sellers' agent disclosed the essential facts regarding the water intrusion, the additional facts the buyers faulted the seller's agent for not disclosing were within the buyers' "own diligent attention." Notably, those additional facts were beyond the disclosure required by Cal. Civ. Code § 2079.

In *Padgett v. Phariss*, 54 Cal. App. 4th 1270 (1997), buyers argued that the seller's agent, who was involved in the sale of a residence in a planned unit development, had a duty to confirm with the homeowners' association whether: (1) construction defects existed in the property's common areas; and, (2) there was pending or proposed litigation concerning those defects. The court rejected this attempt to expand the disclosure duty of the seller's agent beyond that which a reasonable and diligent visual inspection would reveal. In doing so, the court noted that the sellers had not disclosed to their agent any pending litigation or known common area defects. Accordingly, there was "no justifiable basis for imposing on the agents a duty of inquiry of the homeowners' association" as requested by the buyers. Nor did the statutory disclosure duty require the sellers' agent to search public records.

Foreclosures and Short Sales

Although the "Great Recession" ended in June 2009, many homeowners still owe more on their mortgages than their properties' actual value. Some have been foreclosed upon. Rather than waiting for the bank to pursue them after they fail to make mortgage payments, others have opted for a short sale. A short sale is a real estate transaction in which the seller's lender(s) agree to allow the property owner to sell the property for less than the amount of the loan(s) secured by the property.

Short sales are so prevalent that the California Association of Realtors (CAR) released a Short Sale Information Advisory in November 2010. But short sales are plagued with fraud. Indeed, the California Department of Real Estate has issued several notices and advisories regarding one of the more prevalent forms of short sale fraud — illegal short sale flipping.

Courts have responded to the endemic foreclosures and short sales. For example, a California court of appeal recently expanded the limited, statutory disclosure duty of sellers' agents to sometimes require disclosure of sellers' debts encumbering the property for sale. *Holmes v. Summer*, 188 Cal. App. 4th 1510 (2010).

The Expansion of the Disclosure Duty for Sellers' Agents

The *Holmes* court held that the sellers' agent was liable for not disclosing to the buyers before they signed the purchase agreement that the sellers' debt on the property substantially exceeded the property's sales price. The court announced:

> [W]hen a real estate agent or broker is aware that the amount of existing monetary liens and encumbrances exceeds the sales price of a residential property, so as to require either the cooperation of the lender in a short sale or the ability of the seller to put a substantial amount of cash into the escrow in order to obtain the release of the

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Recent Court Rulings

Accountants

Accountants Owed Employees No Duty to Verify Information Provided by Employer in Preparing W-2 Forms

***Giacometti v. Aulla, LLC,* 187 Cal. App. 4th 1133 (2010)**

The California Court of Appeal for the Second District held that plaintiff restaurant employees could not maintain a professional negligence action against defendant accountants hired by defendant, employer to prepare W-2 forms based on a lack of duty to the employees to verify the information provided by the employer. *Giacometti v. Aulla, LLC*, 187 Cal. App. 4th 1133 (2010).

The accountants were hired by the employer, a restaurant, to prepare year-end financial documents, including W-2 forms. The accountants used information on the employees' income provided by the employer to prepare the financial documents. The employees later claimed that the W-2 forms over-reported their income by as much as $30,000 per employee because tip money taken by the restaurant managers was improperly attributed as income to the employees, thereby subjecting them to investigation by the Internal Revenue Service (IRS) and, in one case, to audit and litigation.

The employees sued the restaurant, its managers, the accounting firm, and the individual accountants, alleging negligence, conspiracy, and intentional infliction of emotional distress because of the over-reported income on the W-2 forms. The claims against the accountants were dismissed and the employees appealed only the order dismissing their action against the accountants for professional negligence.

In affirming the dismissal of the professional negligence claim, the court of appeal held that the employees had failed to show the existence of a duty of care by the accountants in favor of the employees under a general negligence theory. The employees argued unsuccessfully that the court should find a duty because there was a foreseeable risk of injury to third parties, relying on a line of cases under the Restatement (Second) of Torts, Section 552, that allowed "intended beneficiaries" to recover under a negligent misrepresentation theory.

The court rejected the foreseeability argument, citing *Richard B. LeVine, Inc. v. Higashi*, 131 Cal. App. 4th 566 (2005), where the court had held that an accountant hired by a partnership to prepare K-1 forms allocating profits based on the partnership's instructions owed no duty to the individual partner who disagreed with his allocation. The *LeVine* Court concluded that a duty should not be imposed because it was not foreseeable to the accountant that the partner would be harmed because the partnership had simply hired the accountant to make allocations per its instructions and there was no evidence of any miscalculation.

The court found that the employees' claim that it was foreseeable that incorrect information on a W-2 form would harm them did not alone create the existence of a legal duty. Like the accountant in *LeVine*, there was no allegation that the accountants were the sources of the inaccurate numbers or that they had an obligation to ascertain the accuracy of the income reported for each employee by their employer. The restaurant's intention in hiring the accounting firm was not to benefit the employees, but to fulfill a legal obligation to furnish pay information to the IRS. Whatever error occurred, the court concluded, was the result of wrong information furnished to the accountants by the employer.

The court here rejected the employees' attempts to extend liability for professional negligence to third parties based a line of cases that allowed "intended beneficiaries" of a transaction to recover under a theory of negligent misrepresentation. Fortunately for the accountants, such allegations were not made, presumably because of the limited services performed by the accountants.

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Architects & Engineers

Illinois Supreme Court Confirms That Engineer's Standard of Care Governed by Scope of Professional Services Contract

***Thompson v. Gordon*, 2011 WL 190290 (Ill. Jan. 21, 2011)**

The Illinois Supreme Court earlier this year issued an opinion and ruling in favor of a highway engineer who was a named defendant in a wrongful death lawsuit. The case stemmed from a fatal auto accident that occurred when a car hit a low median separating traffic on a highway overpass bridge and vaulted over it into oncoming traffic. The engineer had been retained as part of a redevelopment project of the area surrounding and including the bridge. The engineer's contractually stated "scope of services" included "improvements" to the roadways and "replacement" of the structural design of the bridge deck. The bridge deck was at issue in the litigation. With the support of expert testimony, plaintiffs maintained that the bridge deck design prepared by the engineer should have included a Jersey barrier. The engineer countered that it was not contractually obligated to provide median barrier analysis or design; its scope of services was limited to replacement of the existing bridge deck design.

The trial court granted summary judgment in favor of the engineer, holding that the engineer's requisite duty of care was set by the agreed-upon scope of engineering services, not expert testimony introduced during the malpractice case. The court relied on *Ferentchak v. Village of Frankfort* 105 Ill.2d 474 (1985), in which the Illinois Supreme Court held that a civil engineer was not required to establish minimum foundation grade levels on subdivision lots "absent a specific contractual commitment."

The appellate court reversed. It acknowledged that the engineer's duties were defined in part by its contractual scope of services, but held that the engineer also owed a duty to perform its contractual undertaking using the degree of skill and diligence normally employed by professional engineers. In so holding, the court distinguished *Ferentchak*, reasoning that the engineer in that case had no knowledge of the alleged foundation grade level defect because it was not given information regarding the type of structures that would be erected. On the other hand, the engineer in the instant case knew all relevant aspects of the allegedly defective design. Thus, introduction of expert testimony as to whether an engineer acting within the standard of care would have considered and designed an improved median barrier was proper.

The Illinois Supreme Court reversed the appellate court's decision. Relying on *Ferentchak*, the Court held that an engineer's standard of care is limited to the scope of duties defined in the professional services contract. The scope of those duties cannot be expanded by the introduction of expert testimony to elevate the standard of care to become a jury question. Thus, the "standard of care was limited to the degree of skill and diligence normally employed by professional engineers performing the same or similar services, namely, replacing the bridge deck – [and] replacing the bridge deck did not include improving the bridge deck or considering or adding a Jersey barrier."

This very important decision provides guidance to both attorneys and design professionals. Specifically, in litigation, it establishes a firm rule that expert testimony cannot be used to create a fact question on the issue of duty, which can be determined as a matter of law by reference and interpretation of the design agreement. In their practice, design professionals (and those who counsel them) should pay close attention to their contract provisions defining the scope of their services and the appropriate standard of care for the work because, as this case illustrates, those provisions may serve as a strong shield in later litigation.

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Architects & Engineers

Insurer Must Defend Surveyor for Alleged Failure to Warn of Subsequently Discovered Error

***Landmark American Insurance Company v. Soutex Surveyors, Inc.*, 2010 WL 5692073 (E.D. Tex. Dec. 22, 2010)**

A land surveyor's professional liability (PL) insurer sought a declaratory judgment that it had no duty to defend and indemnify the insured surveyor. The insurer made the novel argument that the policy's coverage for "professional services rendered in the course of surveying and civil engineering" did not include the surveyor's "alleged failures to warn of dangers attributable to subsequently-discovered surveying elevation errors." The carrier argued that a failure to warn of a later-discovered error was really "an alleged breach of a clerical or ministerial duty." It further contended that regardless of professional education or training, a duty to disclose information that makes an earlier statement untrue or misleading is simply a nonprofessional (i.e., general liability) theory of fault. The court concluded that "reason and common sense" will cause Texas courts to regard a failure to warn of a subsequently discovered error as a failure to render a professional service "when discovery of such errors is premised on knowledge obtained from surveying experience and when surveying expertise underlines the alleged liability for failure to warn."

This case illustrates that a professional's skill, knowledge and expertise are often integral to his or her work. Thus, even a simple oversight can trigger PL coverage where, as here, it could only have been caught by person with the requisite ability to spot the error or omission.

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Case Summaries & Conclusions

Accountants

Recovery Against Accountant for "Holder" Claims Requires Direct Communications With Accountant

***Grant Thornton LLP v. Prospect High Income Fund*, 314 S.W.3d 913 (2010)**

The Texas Supreme Court issued an opinion setting forth the conditions under which an accountant can be held liable to a nonclient for an audit under Section 552 of the Restatement of Torts. The Court stated that for liability to attach, the accountant must have been aware of the nonclient and intended it to rely on the audit. Such liability does not extend to all members of a limited class of potential investors and "holder" claims require direct communications between the plaintiff and the defendant accountant.

Plaintiffs were several bond and hedge funds which had purchased Securities Exchange Commission (SEC)-registered bonds from a timeshare vacation property operator. The bonds were sold on the open market and were governed by an indenture and escrow agreement with a trust company, which required that the timeshare operator maintain sufficient funds in an escrow account to cover $8.45 million in semi-annual interest payments to the bondholders. Crucial to the timeshare operator's viability was a credit arrangement with an insurer whereby it loaned the timeshare operator $2 million per week against its receivables. In March, 2000, the timeshare operator retained defendant auditor to audit its 1999 financial statements and review its statements for the first three quarters of 2000. The auditor discovered that the escrow account was not properly operated or funded, but failed to mention that in its audit report issued in April 2000 (the 1999 audit report). In December 2000, the insurer decided not to renew the credit arrangement. Despite this information, the funds continued to buy the timeshare operator's bonds.

The auditor issued its 2000 audit report on April 17, 2001, reiterating that the timeshare operator was maintaining the required funds in the escrow. The timeshare operator defaulted on June 15, 2001, when it failed to make the scheduled interest payment to the bond holders. The funds continued to purchase more bonds until July 2001, when they forced the timeshare operator into bankruptcy. The funds continued to buy the timeshare operator's bonds for the next three years.

The funds sued the auditor for fraud, negligent misrepresentation, negligence, breach of contract on a third-party beneficiary theory, conspiracy to commit fraud, and aiding and abetting fraud. The principal allegation was that the 1999 audit report misrepresented the status of the escrow account, which led the funds to purchase additional bonds, dissuaded them from conducting their own investigation on the escrow account, and thus forced the timeshare operator into an earlier bankruptcy and induced them to refrain from selling their bonds.

The Texas Supreme Court granted judgment in favor of the auditor. It cited *McCamish, Martin, Brown & Loeffler v. F.E. Appling Interests*, 991 S.W. 2d (Tex. 1999), where the Court had adopted Section 552 of the Restatement (Second) of Torts and held that a cause of action by nonclients against a professional information provider is available only when information is transferred to a known party for a known purpose. The Court stated that in the instant case, liability was limited to situations where the professional who provides the information is "aware of the nonclient and intends that the non-client rely on the information."

The Court found no evidence of any direct contacts between the funds and the auditor. The audit reports were disclosed in public filings. One of the funds had not even purchased bonds before issuance of the 1999 audit report. Although the bonds were sold on the open market, there were only a few potential purchasers for this type of bond. The Court held that the auditor's liability did not extend to the nonpurchaser because there was no awareness by the auditor of this fund as prospective purchaser.

In finding no liability on the fraud-related claims, the Court held that there was no evidence that the existing bondholders actually or justifiably relied on the 1999 audit report because the funds had continued to purchase the bonds even after they learned of the nonrenewal of the insurer's credit arrangement, which cut off the timeshare operator's "lifeblood."

As a matter of first impression, the Court held that "holder" claims must be based on direct communications between the plaintiff and the defendant accountant. The funds claimed that they had refrained from selling their bonds or forcing the timeshare operator into bankruptcy at an earlier time based on the alleged misrepresentation in the 1999 audit report. After pointing out that federal law does not allow for recovery of such claims and that many state courts have imposed heightened standards in order to recover, the Court stated that to the extent these funds' "holder" claims were viable, they had to be based on direct communications between the funds and the auditor. The Court again found no liability in the instant case because the funds relied, if at all, on information that was contained in public documents and not on direct communications with the auditor.

This complex decision reflects a conservative approach to interpretation of accountant liability to nonclients for audit reports under Section 552. The Supreme Court declined to follow decisions from other jurisdictions that have expanded liability to all persons, including potential investors, whom the accountant "reasonably expects" to receive and rely on the information at the time it is published.

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Real Estate

California Court Clarifies Term "Prevailing Party" in Contractual Attorneys' Fee Provisions

***de la Cuesta v. Benham*, 2011 WL 1126585 (Cal. Ct. App. Mar. 29, 2011)**

Many real estate-related contracts—including listing agreements, residential purchase agreements and lease agreements—contain a provision whereby the prevailing party on a contract is entitled to its attorneys' fees and costs. *See, e.g.*, California Association of REALTORS®, Residential Listing Agreement ¶ 15 (RLA Rev. 4/06). Cal. Civ. Code § 1717 authorizes a trial court to determine the prevailing party on a contract, but defines "prevailing party" as the "party who recovered a greater relief in the action on the contract." Helpfully, *de la Cuesta v. Benham* provides guidance on what circumstances justify a trial court's finding of "prevailing party" for the purposes of awarding attorneys' fees and costs pursuant to a contractual attorneys' fee provision.

In *de la Cuesta*, a landlord sued its tenant for unlawful detainer (to regain possession of the leased premises), unpaid rent and common area maintenance fees. The tenant argued that he owed nothing because of water and sewage leaks. The day before trial, the tenant left the premises. Following trial, the court awarded the landlord nearly $70,000, which was approximately 70 percent of the damages claimed by the landlord in his amended trial brief. The court nonetheless denied the landlord's subsequent motion for about $42,000 in attorneys' fees, noting that there was no prevailing party. The court of appeal reversed, stating: "The result was so lopsided that, even under an abuse of discretion standard, it was unreasonable to say the landlord was not the prevailing party."

Cal. Civ. Code § 1717, the court found, "*expressly* contemplates *some* sort of comparison of respective results: Otherwise the Legislature would not have defined 'prevailing party' as the party obtaining 'a greater relief' (italics added)—a comparative term." The court went on to state, "[b]ecause the statute allows such discretion, it must be presumed the trial court has also been empowered to identify the party obtaining 'a greater relief' by examining the results of the action in relative terms: the general term 'greater' includes '[l]arger in size than others of the same kind' as well as 'principal' and '[s]uperior in quality.'" Accordingly, the court held that the landlord was the prevailing party because it had recovered most of what he sought from the tenant. Further, an obvious goal of the landlord in initiating an unlawful detainer proceeding was repossession of the premises, which the landlord achieved when the tenant moved out the day before trial was scheduled to begin. In comparison, the tenant, who contended that he owed nothing, was assessed a nearly $70,000 judgment, had all of his fraud claims rejected, and obtained only an offset of 20 percent of the back rent for the leaks. The appellate court held that although the landlord did not have an unqualified victory, in comparison with the tenant, it had greater relief under the contract.

The court's opinion demonstrates that a complete, unqualified victory is not necessary for a trial court to find one party to be the prevailing party; as long as that party came out ahead of the other, it can be deemed the prevailing party and awarded its attorneys' fees and costs under the contract. Putting this in context, a listing agent that sues a former client for commissions may be deemed the prevailing party, even if it ultimately does not recover the entire commission claimed in its complaint.

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To Disclose or Not Disclose?

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> monetary liens and encumbrances affecting title, the agent or broker has a duty to disclose this state of affairs to the buyer, so that the buyer can inquire further and evaluate whether to risk entering into a transaction with a substantial risk of failure.

The court thereby adopted a protective stance that arguably frustrates the limited disclosure duty under Cal. Civ. Code § 2079, drastically expanding the scope of the disclosure duty of sellers' agents.

In *Holmes*, the buyers accepted a counteroffer of $749,000 with a 30-day escrow for the property. When the sellers' agent showed the property, she did not mention that the sellers had three deeds of trust against the property amounting to a total debt of $1,141,000. The counteroffer, which was prepared by the sellers' agent, also did not mention that title could transfer free and clear of liens and encumbrances only if the lenders agreed to a short sale (discounting the debts on the property by at least $392,000) or the sellers deposited $392,000 into escrow.

In reliance on the counteroffer, which did not mention the sellers' debts, and in preparation for closing escrow, the buyers sold their house to finance their purchase of the property. Meanwhile, the lenders refused to agree to a short sale and the sellers lacked the funds to deposit $392,000 into escrow. As a result, escrow never closed. After the sale fell through, the buyers sued the sellers' agent for: (1) deceit based on misrepresentation; (2) deceit based on failure to disclose; (3) negligent misrepresentation; and (4) negligence.

Generally, an agent must disclose all material information that he or she is aware of that affects the property's value or desirability. The sellers' agent argued that this rule does not require agents to disclose "financing" matters, such as the amount of debt on the property. The *Holmes* court disagreed, stating:

> Despite the absence of privity of contract, a real estate agent is clearly under a duty to exercise reasonable care to protect those persons whom the agent is attempting to induce into entering a real estate transaction for the purpose of earning a commission.

Under this duty to exercise reasonable care, the court held that the sellers' agent was required to "disclose information alerting the buyers that the sale was at high risk of failure" before the buyers made an offer. In so doing, the court rejected an argument that if the buyers had conducted their own investigation, acting on their duty to exercise reasonable care to protect themselves, they would have discovered the debts in deeds of trust in the public record. The court found that: (1) a title search may have revealed the deeds of trust, but not the current balances on the debts secured by those deeds; and (2) it was not typical for buyers to do title searches before making offers.

The sellers' agent also argued that imposing a duty on sellers' agents to disclose the excess debt on their clients' property would violate their duty of confidentiality under California law and the National Association of Realtors (NAR) Code of Ethics. The court agreed that California law prohibits the disclosure of confidential information that does not involve the duties listed in Cal. Civ. Code § 2079.16. However, it found that the circumstances implicated the sellers' agent's "duty of honest and fair dealing and good faith"—that is, the duty to treat each party to the transaction honestly and fairly, including, possibly, the duty to disclose known matters affecting the desirability of entering into the transaction. The court explained that the sellers' agent violated the duty of fairness when signing the buyers up for a real estate purchase that she had reason to know was a "highly risky proposition." It added, "fairness under the circumstances dictated disclosing that either lender approval or a substantial seller payment was required to close escrow."

As for the NAR Code of Ethics, the court noted that the preamble to the code stated: "While the Code of Ethics establishes obligations that may be higher than those mandated by law, in any instance where the Code of Ethics and the law conflict, the obligations of the law must take precedence." Finding that the circumstances at issue in the case presented such a conflict, the court held that California's duty of fairness trumped any duty of confidentiality in the NAR Code of Ethics, and required disclosure of the sellers' excess debt.

The Court recommended that sellers' agents, representing clients who have substantial debt exceeding the sales price, should obtain the sellers' permission to disclose their confidential financial information to prospective buyers. Where the seller refuses to grant permission to disclose, the court suggested that the sellers' agents withdraw from representation.

Although *Holmes* does not create a fiduciary duty between sellers' agents and prospective buyers, it effectively expands the scope of the disclosure duty of sellers' agents by requiring such agents to disclose that a property's debts significantly exceed the advertised sales price. It also expands the disclosure duty in time by requiring such disclosure *before* buyers sign the purchase agreement.

In conclusion, the court held that agents have a "duty to disclose to . . . buyers the existence of the deeds of trust of record, of which the [agents] allegedly were aware." That is, when a sellers' agent knows that the debt on a property substantially exceeds the sales price, such that a transaction involving the property has a considerable risk of failure, he or she must disclose those circumstances to prospective buyers. In so holding, the court noted that it did ["not convert the seller's fiduciary into the buyer's fiduciary. . . . Although the seller's agent does not generally owe a fiduciary duty to the buyer, he or she nonetheless owes the buyer the affirmative duties of care, honesty, good faith, fair dealing and disclosure, as reflected in Civil Code section 2079.16, as well as other nonfiduciary duties as are otherwise imposed by law."]

The unprecedented recognition of this expanded disclosure duty is likely to bring about judicial opinions or legislation to reconcile discrepancies in *Holmes* and address unanswered questions. Notably, the court specifically referenced Cal. Civ. Code § 2079.16 as a basis for expanding the disclosure duty. However, the court's review of that section ignored the provision in Cal. Civ. Code § 2079 explicitly limiting the disclosure duty of sellers' agents to that which would be revealed by a reasonable and diligent visual inspection.

Moreover, the court's rejection of the argument regarding the buyers' duty to investigate is contrary to prior case law excluding matters of public record from the scope of the disclosure duty of a sellers' agent. *See, e.g., Assilzadeh v. Cal. Fed. Bank*, 82 Cal. App. 4th 399 (2000); *Pagano*, 60 Cal. App. 4th at 5; *see Padgett*, 54 Cal. App. 4th at 1282 (noting agents not required to disclose matters of public record); *see also* Cal. Civ. Code § 2079.5. The court's reliance on *Alfaro v. Community Housing Improvement System & Planning Ass'n, Inc.*, 171 Cal. App. 4th 1356 (2009) for the proposition that "when a buyer is on constructive notice of matters of record, that does not necessarily mean a cause of action in tort arising out of failure to disclose will not lie" is questionable because that case did not involve the limited statutory duties of sellers' agents to prospective buyers.

Holmes also left many questions unanswered. For example, must agents disclose all short sales or only those where the property's debt significantly exceeds the listing price? Further, at what point does a property's debt significantly exceed the listing price? In *Holmes*, the debt exceeded the sale price by nearly $400,000. What if the debt only exceeded the listing price by $100,000? $50,000? $25,000?

Although *Holmes* made clear what must be disclosed (debt significantly exceeds listing price) and when (before prospective buyers sign the purchase agreement), it also left unanswered the form in which the disclosure must be made. Is it sufficient to check the short sale box when entering an MLS listing? Do agents need to provide a verbal disclosure when showing the property to prospective buyers? Do the disclosures need to be made in writing, adding yet another item to the inches of written disclosures already required?

What is clear is that some agents will err on the side of caution by checking the short sale box when submitting the MLS listing, and disclosing verbally and in writing any amount of debt on the property exceeding the listing price. Whether such extremes are necessary is uncertain. However, it is often better to be safe than sorry.

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