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Real Estate Broker Discipline**THIS ISSUE**

What level of proof is required before a real estate broker can be disciplined for his fraudulent conduct in acting as a broker? And what is the process for agent and broker discipline?

BACKGROUND

California's Business and Professions Code section 10177.5 authorizes the California Real Estate Commissioner to impose administrative discipline against a broker who has a judgment against him for misrepresentation, fraud, or deceit in connection with a real estate transaction.

In one recent case, a jury found the real estate broker (and the agent working for the broker) liable for misrepresentation in connection with a real estate transaction based on a “preponderance of the evidence.” The jury expressly declined, however, to find clear and convincing evidence that the broker and agent were guilty of malice, oppression, or fraud in connection with the conduct for which the jury found them liable.

The Real Estate Commissioner brought a disciplinary action against the broker based on the judgment, and, against the recommendations of an administrative law judge who heard the matter, imposed disciplinary sanctions against the broker based on the judgment. The broker claimed that the imposition of disciplinary sanctions under these circumstances violated due process of law. The trial court refused to disturb the Commissioner's sanction, but the First Appellate District Court reversed, holding that a fraud judgment obtained based on a preponderance of the evidence does not support a disciplinary finding against a real estate licensee¹

¹ *Grubb Company, Inc. v. Department of Real Estate* Cite as 11 C.D.O.S. 5374 (May 4, 2011).

IN BRIEF

Factual Background

It is important to know how the broker and agent found themselves on the wrong side of a fraud judgment to begin with.

Real estate Sellers owned a home in Piedmont, built in the 1930s, and expanded on the lower level in the 1950s. The expansion work was apparently done in accordance with permits issued by the City, but the City's records were not entirely clear on this point. In 1998, Sellers listed the house for sale, but their effort to sell it was not successful.

When the house was listed for sale in 1998, it was described in the multiple listing service as having 4,200 square feet of living space, consistent with an appraisal done at that time that did not include an enclosed patio on the lower level as part of the living space. In March 2002, however, an inspector from the Seller's insurance carrier gave them a replacement cost report showing that the living area of the house measured 5,234 square feet.

In May 2002, Sellers decided to try again to sell the house. They retained an agent at Grubb as their listing agent. The agent told Sellers that Metroscan showed that the house had only 2,800 square feet, as compared with the 4,200 square feet shown on the 1998 listing. The Sellers told the agent about the insurance report. The agent then represented on a flyer that the house had a living area of approximately 5,000 square feet, and Sellers did not take issue with this representation.

Buyers were interested in the house, and looked at it several times. The agent explained to Buyers that the square footage shown on the Metroscan report apparently did not include the expanded lower level, and that the 5,000 square foot living area described on the listing was based on documentation provided by Sellers. The agent also gave Buyers the permit file, Sellers' disclosure statement, and other documents relating to the house.

Buyers asked the agent to represent them, knowing that in doing so, she would be a dual agent for both parties. Buyers and Sellers entered into a contract for the sale of the house at a price of \$1.16 million, and Buyers paid a \$35,000 deposit into escrow. After the contract was signed, however, a conflict developed over pest control inspections and repairs. When the parties were unable to resolve their disputes, Buyers requested that they be released from the contract and that their deposit be returned. Sellers declined.

After some further negotiation, Buyers and Sellers agreed on an addendum to the contract. But another problem developed when the Buyers' appraisal indicated that the living area was only 2,974 square feet; the appraiser was not convinced of the legality of the lower level expansion, and therefore did not include it. Nevertheless, the appraiser did value the house at the sales price, irrespective of this.

Buyers sent a notice of rescission. Sellers responded that the notice of rescission was untimely, that they expected Buyers to perform, and would not return the deposit. Buyers declined to consummate the sale, and Sellers did not release the deposit.

Buyers Sued the Agent, Broker and Sellers

Buyers filed a civil complaint against Sellers, Grubb, and the agent, alleging, among other things, that Sellers and the Grubb defendants knowingly misrepresented that the house contained approximately 5,000 square feet of living space, including the lower level expansion, even though the lower level expansion had been built without permits and could not legally be used for residential purposes.

In special verdicts, the jury found that the agent and Grubb negligently, and also either knowingly or recklessly, made a false representation of an important fact to Buyers, and that they breached their fiduciary duty to Buyers. The jury expressly declined, however, to find clear and convincing evidence that the agent and Grubb were guilty of malice, oppression, or fraud in connection with the conduct for which the jury found them liable.

Department of Real Estate Proceedings

A deputy real estate commissioner filed an accusation against Grubb and its agent based on the facts in the underlying litigation, and later amended it after the judgment was entered in the underlying litigation. The Deputy Commissioner alleged that there was a judgment against Grubb and its agent based "upon grounds of fraud, misrepresentation, or deceit with reference to a transaction for which a [real estate broker's] license is required...", and that the existence of this judgment was grounds for suspension or revocation of Grubb's and the agent's licenses.

The matter was assigned to an administrative law judge, who held evidentiary hearings and later issued a proposed decision. The judge concluded that the jury's verdict against the agent for misrepresentation and breach of fiduciary duty could only have been based on a finding that she recklessly, but not knowingly, misrepresented the square footage of the house to Buyers. The judge also concluded that the verdict against Grubb for misrepresentation could only have been based on its vicarious liability for misconduct by its agent. After considering their backgrounds and lack of any prior history of misconduct, the judge concluded that cause existed to suspend their licenses due to the judgment against them for misrepresentation, but due to mitigating factors, suspension of their licenses was not warranted.

But the Commissioner did not adopt the judge's decision, opining that the judgment itself constituted an adequate basis for disciplinary action; the facts about the acts or omissions giving rise to the judgment were therefore irrelevant.

The Commissioner's decision acknowledged that discipline against a professional licensee must be based on clear and convincing evidence, but concluded that under section 10177.5, the only fact that must be proven by clear and convincing evidence is the existence of a judgment based on fraud, misrepresentation, or deceit in reference to

a transaction for which a license is required. Finding that this had been proved, the Commissioner suspended Grubb's and its agent's real estate licenses and licensing rights for 30 days.

RULING ON APPEAL

The statute under which Grubb was disciplined, section 10177.5, provides: "When a final judgment is obtained in a civil action against any real estate licensee upon grounds of fraud, misrepresentation, or deceit with reference to any transaction for which a license is required under this division, the commissioner may ... suspend or revoke the license of such real estate licensee." By its terms, section 10177.5 permits the Commissioner to discipline a real estate licensee based solely on the entry of a judgment against the licensee for fraud, misrepresentation, or deceit in a real estate transaction, without reference to the facts underlying that judgment.

The main legal issue presented on appeal was whether the application of section 10177.5 to the particular circumstances of this case violates the principle that, under the California Constitution, the suspension or revocation of a professional license must be based on misconduct proven by *clear and convincing* evidence.

Different Evidentiary Standards

A jury verdict finding fraud or misrepresentation — even knowing misrepresentation — need not be based on clear and convincing evidence, but only on a preponderance of the evidence. But what does that mean? A preponderance of the evidence is customarily explained to be "more likely than not." That is, where a jury is not certain one way or another, but the evidence points to a likely result, by something more than a 50% probability, the jury can act on a preponderance of the evidence.

Clear and convincing evidence, on the other hand, is a higher standard. It is not as high as that required in a criminal court — beyond a reasonable doubt. But it is more than a mere "greater likelihood."

Clear and convincing evidence is described in the California Civil Jury Instructions as meaning that “the party must persuade you that it is highly probable that the fact is true.”

Grubb argued that the imposition of discipline based on section 10177.5 violated Grubb's due process right to proof by clear and convincing evidence. Grubb noted that the jury found fraud by a preponderance of the evidence, while expressly declining to find by clear and convincing evidence that Grubb acted with malice, fraud, or oppression.

The court of appeal agreed with Grubb that a court decision is not binding in a later administrative hearing if the findings were arrived at based on a lower standard of proof than the one required in the subsequent proceeding.

The Commissioner argued that “the express language of the statute makes the judgment itself the operative fact upon which the disciplinary action is imposed, not the acts or omissions of the licensee which led to that judgment.” Thus, if the elements of fraud have been proved in the civil action, and judgment entered, the licensee cannot relitigate those facts at the administrative proceeding.

The court of appeal disagreed, holding that the Commissioner’s position did not answer the due process question Grubb raised. The real question was whether the Legislature can constitutionally authorize the imposition of professional discipline based only on clear and convincing evidence that a civil judgment has been entered against the professional for license-related misconduct, without requiring that the judgment itself have been based on clear and convincing evidence.

The court held that the underlying judgment must have been entered based upon proof by clear and convincing evidence before it could be used in a later proceeding at which the licensee’s license was put at risk. Any other ruling would not satisfy the due process required under the California Constitution.

CONCLUSION

The Real Estate Commissioner’s suspension of Grubb’s (and its agent’s) license was reversed. And while that is good for Grubb, it still left Grubb liable in the underlying litigation for the damages proved by the plaintiffs.

When faced with the decision whether to disclose a report or not, an agent or broker should keep this story in mind. Full disclosure requires disclosure of all facts known, even if they seem to be mitigated by other facts. Recall that our last issue dealt with the issue of disclosing that the existing secured liens against a home might preclude its being sold because they exceeded the sales price. In both cases, the brokers were held liable for non-disclosure.

NEXT ISSUE

Two new cases discuss condominium owners association maintenance obligations, and liability for breach of those obligations.

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