

CASE STUDY PREPARED FROM ORIGINAL PUBLISHED OPINION

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RSB Vineyards, LLC v Orsi 9/29/17

Real Estate; Fraud; Failure to Disclose; Imputing Knowledge of Construction Professional to Principal

This action grows out of Plaintiff RSB Vineyards, LLC (RSB)'s August 2011 purchase from defendants of a vineyard and building located in Healdsburg. Following the purchase, RSB discovered structural and other problems with the building that were not disclosed by defendants at the time of the sale. RSB's complaint (complaint), filed in September 2013, contains causes of action for breach of contract, intentional misrepresentation, negligent misrepresentation, fraud, and negligence.

Barely seven months after the filing of the complaint, defendants moved for summary judgment, arguing RSB's claims failed because RSB could not demonstrate defendants had actual knowledge of the building's flaws or made false representations. The motion was supported by declarations from each of the four defendants and excerpts from the deposition testimony of Robin Black, designated by RSB as its person most knowledgeable.

According to the evidence submitted in support of the motion, the four defendants, members of two families engaged in the business of viticulture and wine-making, purchased the real property in 2009. At the time, the main building on the property was a single family home, and defendants planned to convert it into a commercial wine tasting room. They also considered building a winery. Following the purchase, defendants hired an architect to design a remodel of the home and applied for a commercial use permit, which issued in April 2010 for a winery and tasting room. Once the use permit issued, defendants submitted the architect's plans to the County of Sonoma (county),

which approved the plans after requiring some changes. Defendants, none of whom is a construction professional or possesses the skills of such a person, relied on their architect and county officials to insure the plans conformed to applicable building codes, and they had no reason to believe the plans were non-conforming.

The construction work was performed by a licensed contractor, in consultation with a structural engineering firm, and entailed, among other projects, tearing down an addition to the home, new framing and exterior work, replacing windows, renovating bathrooms, reinforcing the floor above the basement, installing new sewage disposal, plumbing, and electrical systems, repairing dry rot, and creating a parking lot. The work was inspected and approved by county officials, and a final certificate of occupancy for a “winery/tasting room” was eventually issued. Defendants began to conduct business in the tasting room upon issuance of a temporary occupancy permit in September 2010.

Soon after commencing business, the four defendants “decided that operating a joint tasting room was not to our liking so we decided to sell the property.” During the sales process, they continued to conduct business. By August 2011, they had listed the property with a licensed real estate broker, who prepared an offering memorandum and placed an ad in a local paper. The offering memorandum stated that the property had a “vineyard-vested winery permit” and an “active tasting room” and attached a table describing the various permits issued for the property. The ad described the parcel as “exceptional 19 acre vineyard parcel with operating tasting room, vested 20,000 case winery permit and 12 acres planted to vineyard.” RSB submitted a proposed purchase agreement soon after, which defendants accepted subject to a counter-offer. Defendants provided to RSB a termite addendum, buyer’s and seller’s advisories, and other disclosures and documents, and they gave RSB the names of their architect, general contractor, and structural engineer. **RSB waived all contingencies and inspection rights, and the sale closed the following month.**

Each of the declarations submitted by defendants contained essentially the same affirmation. As two of the declarations stated, “at no time before the sale to plaintiff did any person connected to the County or any of our own professionals

ever inform me that the finished construction did not comply with any building codes or standards, that the plans or work were substandard or deficient in any regard, or not to code, or even just to the level of good construction practices, or that the building was in any way unsuitable or unsafe for use as a tasting room, nor did I have any such knowledge from any other source, including my own observations." All declarants believed the work "met all applicable codes and standards." Each defendant specifically denied any knowledge, at the time of the sale to RSB, of the defects in the property alleged in the complaint and claimed no knowledge of any material defects in the property, either from personal observation or on information by others.

In her deposition, Black stated that RSB had no information to suggest that any of the defendants had actual knowledge of the deficiencies in the property cited in the complaint. She also could not recall any false representations made to her by defendants in connection with the property.

RSB's opposition to the summary judgment motion was supported by the declaration of Larry Miyano, a civil engineer familiar with the property, and excerpts from several depositions. According to Miyano, he was retained by RSB to evaluate a leaking deck on the renovated residence. Miyano concluded that the deck was not properly built and did not meet "live load requirements" for its intended use. This deficiency led him to investigate the building further. Miyano found the floor structure "insufficient" to support the required load. When he prepared an analysis of the work necessary properly to engineer the floor, the expense was found to be more than the cost of demolition and construction of a new building. Miyano also found the plans prepared by defendants' architect to be "unclear and substandard" and decided to inspect the building during the process of demolition. Based on that inspection, Miyano found deficiencies in the "shear path," the building's resistance to wind and seismic activity, weakening of a wall due to improper construction of a stairway, inadequate roof support, "cut down" and improperly spaced floor joists, dry rot that had been plastered over without repair, insufficient steel reinforcement of the foundation, and improper construction of a bathroom ceiling. Miyano expressed the opinion "that each of these deficiencies was substandard for commercial construction and . . . should have been known by an engineer,

contractor and architect who holds him or herself out as qualified to engage in commercial construction.”

In a detailed written decision, the trial court granted the motion for summary judgment. The court reasoned that RSB was required to provide evidence creating a triable issue of fact regarding defendants’ actual knowledge of the alleged defects in the property and failed to do so. The court rejected RSB’s claim that knowledge of the defects could be imputed to defendants from the presumed knowledge of their construction professionals, concluding that an agent’s knowledge cannot be imputed when actual knowledge is required. The court found a number of other arguments unavailing.

Following the grant of summary judgment, the trial court granted defendants’ motion for contractual attorney’s fees, awarding defendants the full amount of fees and expenses requested, \$262,400 and \$4,868, respectively, without further explanation.

The First District Court of Appeal began by addressing RSB’s primary theory of recovery, that defendants knew or possessed **constructive knowledge** of the various defects uncovered by Miyano and failed to disclose those defects while under a duty to do so.

“ **‘The elements of a cause of action for fraud based on concealment are: (1) the defendant must have concealed or suppressed a material fact, (2) the defendant must have been under a duty to disclose the fact to the plaintiff, (3) the defendant must have intentionally concealed or suppressed the fact with the intent to defraud the plaintiff, (4) the plaintiff must have been unaware of the fact and would not have acted as he did if he had known of the concealed or suppressed fact, and (5) as a result of the concealment or suppression of the fact, the plaintiff must have sustained damage.’ ” ” ” (Bank of America Corp. v. Superior Court (2011) 198 Cal.App.4th 862, 870)**

“A real estate seller has both a common law and statutory duty of disclosure. . . . ‘In the context of a real estate transaction, “it is now settled in California that where the seller knows of facts materially affecting the value or desirability of the property . . . and also knows that such facts are not known

to, or within the reach of the diligent attention and observation of the buyer, the seller is under a duty to disclose them to the buyer. " Undisclosed facts are material if they would have a significant and measurable effect on market value'. . . . Where a seller fails to disclose a material fact, he may be subject to liability 'for mere nondisclosure since his conduct in the transaction amounts to a representation of the nonexistence of the facts which he has failed to disclose.'" (*Calemine v. Samuelson* (2009) 171 Cal.App.4th 153, 160)

The Justices observed there seems little doubt that defendants were under a duty to disclose the deficiencies mentioned in Miyano's declaration, since they affected "the value or desirability of the property" and were not necessarily apparent to a diligent buyer. **The obligation to disclose, however, only arose if defendants had actual or constructive knowledge of the deficiencies.** (*Shapiro v. Sutherland* (1998) 64 Cal.App.4th 1534, 1544-1545.)

Defendants carried their initial burden of demonstrating that RSB could not prevail on a theory of intentional nondisclosure by submitting evidence that they did not know about any of the defects alleged by RSB. Black's deposition testimony confirmed that RSB lacked any evidence to controvert defendants' claims of ignorance. While this evidence was not conclusive in establishing defendants' ignorance of the alleged defects (*Yuzon v. Collins* (2004) 116 Cal.App.4th 149, 163), it sufficed to shift the burden to RSB to provide sufficient evidence of knowledge to create a triable issue of fact.

RSB did not provide any direct evidence of defendants' knowledge, but this is not unusual. (*Blanchard v. DIRECTV, Inc.* (2004) 123 Cal.App.4th 903, 922) Actual knowledge can, and often is, shown by inference from circumstantial evidence. (*Ortega v. Kmart Corp.* (2001) 26 Cal.4th 1200, 1206.) In that case, however, " 'actual knowledge can be inferred from the circumstances only if, in the light of the evidence, such inference is not based on speculation or conjecture. Only where the circumstances are such that the defendant "must have known" and not "should have known" will an inference of actual knowledge be permitted.' " (*Yuzon*, at p. 163; see also *Martinez v. Bank of America* (2000) 82 Cal.App.4th 883, 890-891.)

RSB's sole evidence of knowledge was Miyano's declaration, but the statements in that declaration are not sufficient to create a triable issue of fact regarding defendants' actual knowledge of the deficiencies. With the exception of the first two defects cited, the deck and floor structure, the deficiencies were discovered only during the process of demolition. There is no reason to think defendants would have known of them. Further, Miyano does not suggest that any of the defects would have been apparent to a non-professional. By Miyano's own concession, the defects he cited would have been apparent only to a professional who was familiar with structural engineering and commercial building code requirements. Even as to such professionals, he stated only that they "should" have known of the deficiencies, not that they "must" have known. Accordingly, Miyano's declaration does not provide circumstantial evidence sufficient to create a triable issue of fact that defendants either did or must have known of the defects in the property.

RSB argues that the "sheer number and severity" of the structural defects "could well give rise to an inference that Defendants knew that there were multiple defects with the Property." The Justices commented, that **in order to create an inference of actual knowledge, circumstantial evidence must suggest that the defendant must have known of the matter to be disclosed.** (*Yuzon*, at p. 163.) While Miyano discovered a wide range of problems, all of them are technical matters that would not be apparent to a person unskilled in construction or structural engineering, and most of them became visible only upon demolition. With the exception of a leaky deck, none of the defects cited by Miyano are claimed to have created perceptible problems—such as, for example, a sagging or creaking floor. In the absence of some evidence that defendants had reason to know of the defects, their sheer numerosity does not allow an inference of knowledge. In short, RSB failed to create a triable issue of fact as to defendants' actual knowledge of the deficiencies cited by Miyano.

Next RSB argues that it was not required to demonstrate defendants' actual knowledge of the defects because the construction professionals defendants employed knew of some or all of the defects and, because the professionals were defendants' agents, their knowledge is imputed to defendants. As discussed below, a principal is charged only with the knowledge of an agent acquired while the agent was acting in that role and within the scope of his or her

authority as an agent. Because there is no evidence to suggest that defendants' construction professionals would have acquired information about the residence while acting as defendants' agents, RSB failed to create a triable issue of fact regarding the imputation of the professionals' knowledge.

RSB contends that "knowledge possessed by the professionals hired by a principal is imputed to the principal," citing *Trane Co. v. Gilbert* (1968) 267 Cal.App.2d 720, but the case hardly stands for such a broad proposition of law. In *Trane*, the defendant developer retained an architect, who in turn retained a mechanical engineer to design an air conditioning system. After approximately three years, a motor in the system malfunctioned, and the developer refused to pay for the replacement motor. The engineer's knowledge of the motor warranty was imputed to the developer under the "well established rule in California that the principal is chargeable with, and is bound by the knowledge of, or notice to, his agent, received while the agent is acting within the scope of his authority, and which is in reference to a matter over which his authority extends."

However, California case law and statutes place important and significant limitations concerning the circumstances under which a principal is chargeable with and bound by the knowledge of his agent. While defendants had a contractual relationship with their construction professionals for the provision of services, "not all relationships in which one person provides services to another satisfy the definition of agency." (Rest.3d Agency, § 1.01, comment c.) Rather, Civil Code section 2295 defines an agent as "one who represents another . . . in dealings with third persons." (See also, Rest.3d Agency, § 1.01, comment (c); *Huong Que, Inc. v. Luu* (2007) 150 Cal.App.4th 400, 410-411.) The Restatement comment captures the essential character of this requirement of representation: "It has been said that a relationship of agency always 'contemplates three parties—the principal, the agent, and the third party with whom the agent is to deal.' It is important to define the concept of 'dealing' broadly rather than narrowly. For example, a principal might employ an agent who acquires information from third parties on the principal's behalf but does not 'deal' in the sense of entering into transactions on the principal's account. In contrast, if a service provider simply furnishes advice and does not interact with third parties as the representative of the recipient of the advice, the service provider is not acting as an agent." (Rest.3d Agency, § 1.01, comment (c), p. 19) *Trane*

recognized this same element when it noted that “an architect, as far as the preparation of plans and specifications is concerned, acts as an independent contractor; but so far as the performance of his supervisory functions with respect to a building under construction is concerned, he ordinarily acts as an agent and representative of the person for whom the work is being done.” (*Trane*, at p. 726.) RSB contends that a professional acts as an agent if he or she merely acts “for the benefit” of the purported principal, but that definition is unacceptably broad. One hopes, after all, that every retained professional acts for the benefit of the person retaining him or her. Instead, as section 2295 makes clear, an agent must act for the benefit of another “in dealings with third persons.”

Any knowledge acquired by defendants’ construction professionals about the renovated residence is not imputed to defendants because there is no evidence to suggest those professionals were acting in the role of agent when they acquired that knowledge. While it might be inferred that defendants’ architect, at least, acted on behalf of defendants in dealing with local planning officials during the process of renovation, and therefore might have performed as an agent when acting in that role, there was no actual evidence of such representation with respect to any particular professional. Thus, the record fails to support an inference as to which, if any, of the professionals might have qualified as agents for this purpose. More important, even assuming one or more construction professionals served in this role, the information that underlies RSB’s claim of failure to disclose would not have been gained by these professionals in the course of their work as agents. It would have been gained while the professionals were planning or carrying out the work of renovating the residence. And, as *Trane* noted, when an architect is acting in his or her role as a designer, the architect is not working as an agent. The same is true for the other construction professionals employed by defendants, a general contractor and a structural engineer. Because the professionals’ knowledge of the building’s structure would have been acquired while acting in this role, rather than while acting as defendants’ agents, it is not imputed to defendants.

The distinction is illustrated in the Supreme Court’s ruling in *Herzog v. Capital Co.* (1945) 27 Cal.2d 349, on which RSB relies. In *Herzog*, the plaintiff purchased a defective building from the defendants, which the defendants’ real

estate agent had represented as in “ ‘sound condition’ ” and “ ‘perfectly intact.’ ” In fact, as it later emerged, the agent had been told by the prior owner of the house that it leaked in heavy rain and saw the leaks for himself. By the time the plaintiff toured the house prior to purchase, the agent had caused the water marks on the plaster to be painted over, and the agent told the plaintiff “that there had been some leaks but that the house had been repaired and was “ ‘in perfect condition in all respects.’ ” In holding that the defendants could be held liable for the agent’s fraud, the court held, “it is clear that the agent knew of the defective condition of the house and that he was acting within the scope of his authority when he caused it to be refinished and newly painted, thereby effectually concealing the structural defects. The knowledge of an agent, which he is under a duty to disclose to his principal, is to be imputed to the principal, and, accordingly, defendants are charged with the agent’s knowledge. Under these circumstances they had a duty to reveal the hidden and material facts concealed by their agent and of which they had knowledge, and their failure to disclose them constituted fraud.”

As is clear from the foregoing description, the knowledge gained by the agent in *Herzog* was gained while acting as the defendants’ representative and within the scope of that representation. For that reason, the agent had a fiduciary duty to reveal his knowledge to the defendants, and the defendants, in turn, had a duty to reveal it to the buyers of the home. In contrast, on the record before us, any information gained by defendants’ construction professionals about the structure of the residence would have been gained while they were acting in the role of designers and builders, not as agents. Accordingly, any knowledge of the construction professionals regarding the defects in the structure was not imputed to defendants.

Because RSB’s fraud and deceit and negligence claims are similarly based on the duty of disclosure, summary adjudication of these claims was appropriate under the same rationale.

To the extent RSB contends defendants made affirmative misrepresentations about the property, they have identified only the statements made in the offering memorandum that the property had a “vineyard-vested winery permit” and an “active tasting room.” However, RSB has failed to

adduce competent evidence to support its contention that these representation are false. To the contrary, defendants' evidence establishes both that they had secured a winery permit and were actively operating a wine tasting room at the time of the sale. RSB's evidence did not raise a triable issue of fact as to the truth of this evidence. Accordingly, summary adjudication was appropriate for RSB's claims of intentional and negligent misrepresentation.

RSB treats these statements as constituting a representation that the property was suitable for use as a commercial tasting room. We find no basis for such a reading. Both are simple statements of fact about (1) an on-going activity at the property and (2) the issuance of a regulatory permit by the county. Neither statement constitutes a warranty about the propriety of the activities on the site. That a property is being used for a particular activity does not necessarily imply that the property satisfies all regulatory requirements for the activity. In any event, a cause of action for misrepresentation requires an affirmative statement, not an implied assertion. (*Apollo Capital Fund LLC v. Roth Capital Partners, LLC* (2007) 158 Cal.App.4th 226, 243.)

RSB's claim for breach of contract is based on the contract of sale for the property. The primary contractual provisions underlying RSB's claim for breach of contract are those concerning disclosure, such as the provision requiring defendants to disclose "known material facts and defects" and make "other disclosures required by law." Because there is no triable issue of law regarding a failure to disclose by defendants, there is similarly no triable issue regarding a breach of such provisions.

RSB also claims defendants breached a provision of the contract requiring them to provide a Seller Property Questionnaire (SPQ), a standard-form disclosure document. The SPQ requires disclosure of a number of specific potential problems of which the seller is "aware," such as chemical contamination and insurance claims, material repairs to the property, structural and other defects, mold, boundary disputes, and other matters of concern. The record contains a blank SPQ form drawn up for the property, which was apparently never completed and submitted.

This claim fails because RSB cannot demonstrate a causal connection between the alleged breach and its claimed damages. (*Amelco Electric v. City of Thousand Oaks* (2002) 27 Cal.4th 228, 244; *Daniels v. Select Portfolio Servicing, Inc.* (2016) 246 Cal.App.4th 1150, 1173) RSB argues “had Defendants completed and returned the SPQ . . . , they would have disclosed most, if not all, of the challenged defects.” The SPQ requires disclosure only of “known” problems. If defendants were unaware of the various deficiencies claimed by RSB, they were not required to disclose them in the SPQ, and, in any event, would have been unable to do so. Accordingly, the failure to provide an SPQ would not have prevented RSB’s loss.

In any event, **RSB waived defendants’ provision of a SPQ when it removed the sale contingencies prior to being provided with the SPQ.** The two contingency removal forms executed by RSB include a number of specific contingencies to be removed by the seller, including “reports/disclosures.” In executing a form on August 31, 2011, RSB stated it was removing “ALL Buyer contingencies,” except “Acceptance of survey north line of property by Adobe Associates.” A later contingency removal form, executed by RSB on September 7, 2011, “removes any and all buyer contingencies.” Necessarily, once RSB released a contingency for reports and disclosures, it waived defendants’ obligation to provide the SPQ.

RSB analogizes the contingency removal form to a prohibited “exculpatory clause,” a contractual provision that purports to exempt a person from “liability for fraud or deceit based on intentional misrepresentation.” (*Manderville v. PCG&S Group, Inc.* (2007) 146 Cal.App.4th 1486, 1499-1500; Civ. Code, § 1668.) The contingency removal form, however, does not exempt defendants from any liability for misrepresentation. It simply waives their obligation to provide any further disclosures that would otherwise be required under the contract. Had they made any affirmative misrepresentations, they would remain liable for those.

The remainder of the full opinion, attached, is dedicated to a discussion of the successful claim for attorney fees.

The appeal from the judgment, filed October 8, 2014, is dismissed. The amended judgment, filed April 13, 2015, is affirmed. Defendants are awarded costs on appeal.

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