

**“Seller Cancels Escrow - Buyer Sues”
by Dale Alberstone, Esq.**

Readers may recall the articles I have written over the years concerning the right of a buyer to sue a seller of an apartment building when the seller unjustifiably cancels the escrow. As I have discussed, a seller’s breach gives rise to two general causes of action, to wit: an action for damages and an action for specific performance. In addition, I have explained the adverse implications for a seller when the buyer records a notice of pendency of action (i.e. lis pendens) with the county recorder of the county in which the apartment complex is located.

Another cause of action, although one which I have not previously discussed but may sometimes exist, is “Breach of the Warranty of Authority.”

This month’s column will review the traditional causes of action, comment on the effect of a recorded lis pendens, and expand into the cause of action for Breach of Warranty of Authority.

Damages

The simplest remedy a buyer has against a breaching seller is an action for money damages. Civil Code §3306 provides this remedy. If the seller refuses to perform his contract, the buyer is entitled to recover from the seller the difference between the market value of the property at the time the seller breaches (such as when the seller cancels the escrow) minus the purchase price the buyer agreed to pay under the contract.

What that means is that if the market value of the property is substantially higher than the contract price, the buyer may recover the difference. Market value is usually determined by the testimony of a qualified appraiser.

If the market value on the date of the breach is equal to or less than the contract price, then the buyer is, for the most part, not monetarily damaged. I should qualify that statement by mentioning that in a suit for damages, the buyer may additionally recover from the breaching seller the money the buyer paid to examine the title and prepare the necessary documents, plus certain consequential damages, even if the market value does not exceed the contract price.

Specific Performance

The primary result a buyer usually wants is an order by the court directing the seller to obey the contract and convey the property to the buyer. This form of remedy is available in an action for specific performance. There, the buyer files suit to ask the court to order the seller to complete the terms of the contract by conveying the property to the buyer. Of course, the buyer would have to pay the purchase price to the seller as a condition of the court’s order to convey the property.

Another aspect for the court to consider is whether there was any change to the interest rate the buyer will have to pay the lender as a result of the delay of the sale. If the interest on the buyer’s proposed financing increases during the course of the litigation, the court has the power to adjust or credit the purchase price to compensate the buyer for the additional interest expense he will have to pay over the projected life of the loan. This is particularly true where the buyer has applied for a fixed, rather than an adjustable, interest rate. Obviously, if the fixed interest which the buyer might have obtained at the scheduled close of escrow was 6% per annum, but at the conclusion of the litigation it has risen to 7.5%, the additional cost to the buyer during the term of the loan will be substantial. The court may fashion a judgment to adjust the consideration to be paid by the buyer to offset the cost of the increased interest. (Lawyers wishing to research this accounting issue should read Hutton v. Gliksberg, 128 Cal.App. 3d 240.)

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In order to obtain specific performance, the buyer must prove that at the time the contract was signed, the price and terms were fair to the seller. In other words, if the contract purchase price was \$2,000,000, but at the time the contract was signed the market value was \$4,000,000, the court is likely to determine that the price was not fair and deny specific performance. (See Yackey v. Pacifica Development Co., 99 Cal.App. 3d 776, 783.)

However, in such a case, the court could still award the buyer monetary damages equal to the difference between the market value (\$4,000,000) and the contract price (\$2,000,000), yielding a judgment in favor of the buyer for \$2,000,000. Unfairness of the price or the terms of the contract are not a defense to the buyer's action for damages, even though they are a defense to a cause of action for specific performance.

Thus, even if the court finds that the price was unfair and refuses to grant specific performance, it may nevertheless award damages as discussed above.

Another element the buyer must prove to obtain specific performance is that prior to the close of escrow, the buyer would have been able to obtain the financing to pay the purchase price or, alternatively, he had the financial wherewithal and willingness to deposit the full purchase price into escrow if the lender did not approve the financing. (Lawyers wishing a further discussion of the financing requirements should review: C. Robert Mattress v. CIDCO, 184 Cal.App. 3d 55, and Am.-Cal Investment Co. v. Sharlyn, 255 Cal.App. 2d 526.)

Impact of a Lis Pendens

After (but not before) a buyer files a lawsuit against the seller, the buyer may record a Notice of Pendency of Action. That document, alternatively know as a lis pendens, imposes an encumbrance against the seller's property, which, for all practical purposes, makes the seller's title unmarketable to any other purchaser and unfinanceable by a lender. The recordation of the instrument with the county recorder of the county in which the apartment tenement is located largely eliminates the seller's ability to transfer or otherwise alienate his property.

The Superior Court has the power to expunge (i.e. remove) the lis pendens from the records of the County Recorder. However, that removal is discretionary with the judge (based upon a number of factors), and if the judge refuses to remove it, title to the seller's property is encumbered throughout the 1 to 1 ½ years during which the litigation proceeds.

The huge risk to the seller is that if the market value of the property increases over the next 12 to 18 months, and if the buyer prevails at trial, the buyer will be able to acquire the apartment building based on the original contract price without having to pay for the market appreciation. Such a risk often induces a seller to settle with the buyer early in the litigation.

Breach of Warranty of Authority

Another cause of action which a buyer would have under appropriate facts is a claim for Breach of Warranty of Authority.

Occasionally, a co-owner of property will sign a purchase agreement on behalf of the other co-owner, such as a husband signing for himself and his wife. If the spouse or other co-owner who is on record title thereafter refuses to sell the property to the buyer, the buyer may be precluded from obtaining specific performance or damages (discussed above) on the basis that the contract is not valid or it is otherwise unenforceable. However, the buyer may have a separate and independent cause of action against the single-signing owner for Breach of Warranty of Authority.

California follows a doctrine known as the "Equal Dignities Rule." That rule provides that if a contract is required to be in writing, which is the case with the sale of an apartment building, then any representative or agent who signs the contract on behalf of one or more of the owners, must have written authority from the non-signing owner(s) to do so. If the representative executes the contract without having that written authority, the agent may be liable to the buyer for compensatory damages and,

perhaps, punitive damages for the breach of a warranty of authority. (Lawyers wishing to further research this cause of action should review the annotations to Civil Code Section 3318.)

Conclusion

With the explosion of property values during the past several years, we have seen a significant rise in the number of transactions where a seller cancels the escrow or otherwise refuses to convey the property without a legal basis to do so. Because of the serious legal consequences to a seller who repudiates his contract or escrow, the seller should definitely consult with his attorney before canceling to analyze whether there is a legal basis for the termination. Conversely, a buyer who encounters a seller who refuses to perform, may avail himself to judicial process to encumber the property and compel that sale.

Dale Alberstone is a prominent real estate attorney who has practiced real property and business law for the past 30 years. He has been appointed to periodically serve as a judge pro tem of the Los Angeles Superior Court and is a former arbitrator for the American Arbitration Association. He also testifies as an expert witness for and against other attorneys who have been accused of legal malpractice.

*Mr. Alberstone has been awarded an **AV** rating from Mardindale-Hubbell. An **AV** rating, registered through Reed Elsevier, reflects an attorney who has reached the heights of professional excellence and is recognized for the highest levels of skill and integrity.*

The foregoing discussion is intended as a general overview of the law and may not apply to the reader's particular case. Readers are cautioned to consult an advisor of their own selection with respect to any particular situation.

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