

9th Cir Rejects Foreclosure Buyer's Effort to Rescind Foreclosure Sale

The U.S. Court of Appeals for the Ninth Circuit recently held that, under California law, a two year delay in failing to investigate the facts entitling a party to rescind a foreclosure sale transaction barred that equitable remedy, even though there was a genuine issue of material fact as to whether the plaintiff foreclosure buyer could have discovered material defects before the foreclosure sale.

A copy of the opinion is available at: [Link to Opinion](#)

A mortgagee ("Lender") initiated a non-judicial foreclosure of residential real estate in California, and sold that property at a foreclosure sale to a third party ("Buyer"). At the time of sale, the residential property lacked a certificate of occupancy and a residential easement to provide electrical utilities to the newly constructed home. Buyer discovered the utility easement issue soon after purchasing the property. Two years later, Buyer brought an action seeking to rescind the transaction on the basis of the Lender's failure to disclose the defect.

The District Court granted summary judgment in favor of the Lender against the Buyer holding that the Buyer was not entitled to the equitable remedy of rescission. The U.S. Court of Appeals for the Ninth Circuit affirmed the district court's decision to grant summary judgment in favor of Lender.

The Ninth Circuit noted that one issue was whether the Buyer could have discovered the defect prior to the foreclosure sale. *Karoutas v. HomeFed Bank*, 232 Cal. App. 3d 767, 771 (1991). Under that inquiry, the Court found that there was a genuine issue of material fact as to whether the Buyer could have discovered the defects because 1) their due diligence exceeded industry standards; and 2) it was reasonable not to seek an occupancy certificate because the residence appeared to be constructed before 2007 and the City did not require occupancy certificates until 2010.

However, **the Court relied on the language of Cal. Civ. Code s. 1691 that a party seeking rescission must do so "promptly upon discovering the facts upon discovering the facts entitling him to rescind". Cal. Civ. Code § 1691.** The Buyer paid \$624,000 for a residential property and shortly thereafter discovered that it could not be supplied with electricity (absent the purchase of an additional easement). The Court referred to the cases *Bancroft v. Woodward*, 183 Cal. 99, 108 (1920) and *Jolly v. Eli Lilly & Co.*,

44 Cal. 3d 1103, 1112 (1988) **to find that a reasonable person would have been put on inquiry of the wrongdoing, and therefore the Buyer would have a duty to investigate the facts supporting their equitable right to rescind.**

The Ninth Circuit reasoned that the Buyer could have discovered the electricity defect early on, and therefore, there was no genuine issue of material fact that the Buyer was put on inquiry notice of wrongdoing. The Buyer was deemed to know all facts that could be discovered from a reasonable investigation under Fox v. Ethicon Endo-Surgery, Inc., 35 Cal. 4th 797, 808-09 (2005).

The Court noted that, under Karoutas, as a foreclosing mortgagee, the Lender had the same duty to disclose defects regarding property as any other seller. The Lender presented evidence that the foreclosed borrower informed the Buyer of the defects at the time of sale. Thus, the Ninth Circuit held that, because the Buyer did not present any evidence that it would not have been able to discover facts supporting its right to rescind at the time it discovered the defects, there was no question of material fact on that issue.

Moreover, the Ninth Circuit noted, instead of pursuing its claims, the Buyer took actions inconsistent with unwinding the contract such as encumbering the property, building improvements, and attempting to sell. Therefore, the Court held that the Buyer affirmed the transaction and lost its equitable right to rescind.

Because there was no genuine issue of material fact as to whether the delay deprived the Buyer of the equitable right to rescind under California law, the Ninth Circuit held that the Lender was entitled to summary judgment on that issue.