Los Angeles County Bar Association

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Message from the Editor:

Dear *Real Property Section Review* Readers:

This edition contains summary updates of the most recent, relevant cases that affect our everyday practice. There is also an article relating to 1031 exchanges. Hope you find the summaries and article useful.

Dan Goodkin, Esq. of Goodkin & Lynch LLP

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2009: DEVELOPMENTS IN CALIFORNIA DESIGN & CONSTRUCTION LAW

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I. ATERNATIVE DISPUTE RESOLUTION: ARBITRATION

1. Burlage v. Superior Court (Spencer), 178 Cal. App. 4th (2d Dist. Oct. 2009)

Following the close of escrow, homeowners discovered that the adjacent country club's pool and fence encroached upon their property, and alleged that the seller improperly failed to disclose the encroachment. The parties agreed to arbitrate the dispute before a retired judge affiliated with JAMS. Prior to arbitration, the title company paid the country club for a lot-line adjustment, giving the purchasers clean title, but purchasers continued to seek damages for diminution in value of their property. The arbitrator granted purchasers' motion to exclude evidence regarding the financial effect of the lot-line adjustment, and awarded purchasers approximately $1.5 million in compensatory and punitive damages. The seller moved to vacate the award pursuant to section 1286.2(a)(5) of the Code of Civil Procedure on the grounds that its rights were substantially prejudiced by the arbitrator's refusal to hear material evidence. The trial court vacated the award and the appellate court denied purchasers' petition for writ of mandate, noting that the JAMS rules themselves require arbitrators to give all parties the chance to present material evidence.

II. DESIGN AND CONSTRUCTION DEFECTS LITIGATION

1. Pine Terrace Apartments, L.P. v. Windscape, LLC, 170 Cal. App. 4th 1 (5th Dist. Jan. 2009)

In a suit against the developer and seller of an apartment complex alleging latent construction defects, summary judgment for cross-defendant subcontractors is reversed where: 1) the exemption from the

10-year statute of limitations for "actions based on willful misconduct" applied to cross-complaints for indemnity; and 2) a willful misconduct claim could be made in a cross-complaint by incorporating by reference allegations contained in the complaint.

2. Creekridge Townhome Owners Association, Inc. vs. Whitten, 177 Cal. App. 4th 251 (3d. Dist. 2009).

In 1997, a townhome association consisting of 11 separate buildings and 61 units undertook a reroofing project. A few months after the project was completed, one homeowner submitted a written complaint to the townhome association regarding moisture entering around one window of her townhome. No other complaints were made until six years later, when numerous leaks occurred and an investigation uncovered numerous causes of the leaks. In 2004, seven years after the reroofing project was completed, the townhome association filed a construction defect case against those involved in the project. The defendants obtained summary judgment on statute of limitations grounds, arguing alternatively that the alleged defect was patent and the lawsuit was filed more than four years after substantial completion of the reroofing project or that the leak was a latent condition about which the plaintiff had inquiry notice more than three years before the lawsuit was filed.

On appeal the townhome association argued that the single complaint in 1997 did not, as a matter of law, mean the roof defects were patent. Nor did that single complaint put the association on notice of the need to investigate what was wrong with the roofs. The Court of Appeal agreed. Given the size of the townhome complex, the limited nature of the original complaint, and the expert declaration that there were many causes of leaks that could not be readily appreciated by laypersons, the Court of Appeal concluded that as a matter of law the single complaint of a leak did not create a patent defect for purposes of the four-year statute of limitations in Code of Civil Procedure section 337.1. The Court of Appeal also concluded that there was a triable issue as to whether the single complaint was sufficient to put the townhome association on notice of a latent defect and trigger the three-year statute of limitations for injury to real property in Code of Civil Procedure section 338. It was unwilling to make a ruling that would force owners to perform extensive, expensive investigations in response to minor complaints.

3. Gundogdu v. King Mai, Inc., 171 Cal. App. 4th 310 (1st Dist. 2009)

The defendant was a developer that built a home and recorded a notice of completion for it in 1995. Two years later, the defendant sold the home to the plaintiff. Nine years after purchasing the home (and eleven years after it was completed), the plaintiff filed a construction defect suit against the defendant alleging claims for negligence and breach of implied warranty. The plaintiff attempted to avoid the bar of the ten-year statute of

"…the defendant's ownership of the home for two years after its completion precluded the defendant from being a builder eligible for the protection of the statute of repose…"

repose in Code of Civil Procedure section 337.15 with two arguments: (1) the defendant's ownership of the home for two years after its completion precluded the defendant from being a builder eligible for the protection of the statute of repose; and (2) the ten-year period of the statute of repose was tolled during the two-year interval between the home's completion and plaintiff's purchase of it. Both the trial and appellate courts rejected plaintiff's arguments. There was no evidence that the builder's actions following completion created the problems about which plaintiff was complaining. All of the issues arose out of the actual construction of the home. In addition, plaintiff could cite no authority for the proposition that the date a developer sells a home triggers the running of the ten-year period rather than the date of substantial completion of the improvement, as section 337.15 expressly states.

4. San Diego Unified School District v. County of San Diego, 170 Cal. App. 4th 228 (4th Dist. 2009)

In the 1960's, the County of San Diego operated a landfill on property it leased from the San Diego Unified School District. After the landfill was closed, the School District built a junior high school on the property in 1968. More than thirty years later, the County and the School District entered into a cost sharing agreement to address costs of complying with groundwater clean-up and methane gas monitoring requirements imposed by several regulatory authorities. In 2004, the District filed suit against the County for, among other things, breach of the cost sharing agreement as well as breach of a hold harmless clause in the original lease.

The County succeeded in obtaining summary judgment as to the entire action, arguing that all claims arose out of an alleged latent defect in the construction of the landfill, the landfill was substantially completed by 1967, and the lawsuit filed in 2004 was well beyond the 10-year statute of repose in Code of Civil Procedure section 337.15. The trial court relied on case law establishing that a landfill is a "work of improvement" under section 337.15 (Gaggero v. County of San Diego, 124 Cal. App. 4th 609 (2009)) and that the 10-year statute of repose does not contain an exception for pollution claims (Chevron U.S.A. Inc. v. Superior Court, 44 Cal. App. 4th 1009 (1994)).

The Court of Appeal reversed. In analyzing whether claims are time-barred under section 337.15, the nature of the injury or loss governs, not the label associated with the cause of action. The Court of Appeal concluded that the School District's lawsuit was not seeking to enforce its primary right to have the landfill constructed in accordance with the applicable standard of care and thus the lawsuit was not subject to the 10-year statute

of repose. Instead, the District was suing to enforce its contractual rights under the cost sharing agreement and the original lease, as well as to require the County to shoulder its responsibilities as a landfill operator under environmental laws.

5. Standard Pacific Corporation v. Superior Court (Garlow), 176 Cal. App. 4th 828 (4th Dist. 2009)

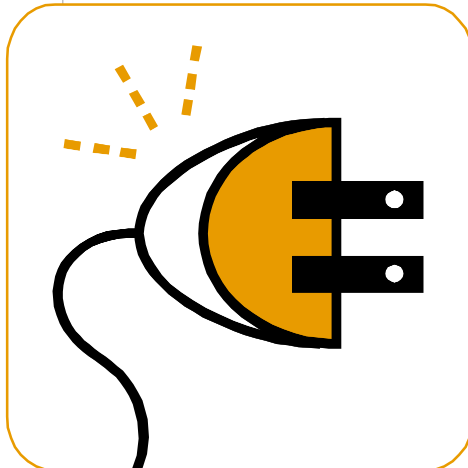
In 2002, the California Legislature enacted a "Fix-It" law (Civil Code section 910 et seq.) that created a series of prelitigation procedures designed to give a home builder an opportunity to repair defects before a home buyer can file suit. The initial steps under the "Fix-It" law are for the buyer to give the builder written notice of its claims (Civil Code section 910) and for the builder to disclose certain information to the buyer within a specified time (Civil Code section 912). A builder who fails to comply with the prelitigation procedures forfeits the protections afforded by the statutes. Civil Code section 912.

In Standard Pacific, the plaintiff home buyer filed a construction defect suit without first giving the builder the required written notice of claims and opportunity to repair the defects. As allowed by the statute, the builder filed a motion to stay the lawsuit until the plaintiff complied with statutory prelitigation procedures. The trial court denied the motion to stay, agreeing with plaintiff that it was the builder's burden to show it had complied with the statutory procedures before it could seek a stay. The Court of Appeal reversed and rejected the buyer's contention that it had the discretion to "opt-in" to the procedures. The Court of Appeal instead held that the buyer bears the burden of showing that it is excused from complying with the prelitigation procedures by affirmatively showing that the builder had failed to comply with its obligations under the "Fix-It" law.

6. Calemine v. Samuelson, 171 Cal. App. 4th 153 (2d Dist. 2009)

The plaintiff bought a condominium that the defendant seller had owned for nearly 20 years. During that time the condominium complex had experienced repeated incidents of water intrusion and flooding on the lower level. The homeowner's association filed two lawsuits because of water intrusion, first against the developer, then against the contractor that performed repairs. Prior to the sale, the seller disclosed the facts of the water intrusion and repairs, and recommended that the buyer hire its own inspector. But the seller did not disclose the fact of the two lawsuits.

After purchasing the unit and experiencing flooding, plaintiff filed suit against the seller alleging the seller breached his common law duty of disclosure. The trial court granted summary judgment in favor of the seller, stating that by disclosing the facts surrounding the water intrusion and flooding, the seller had made a sufficient disclosure of the defects. The Court of Appeal reversed. While the seller had made an adequate disclosure of the fact of the water intrusion itself (and plaintiff's own inspector found ample evidence of the water intrusion and damage), the seller did not disclose the existence of either lawsuit. The buyer thus was not able to evaluate his purchase with the benefit of information from the lawsuits, including with respect to the length of time the problems had existed, the ineffective rounds of repairs, and the limited budget for performing repairs. The Court of Appeal concluded there was at least a triable issue of material fact as to whether the seller was obligated to disclose the lawsuits as material facts affecting the value and desirability of the condominium.



III. DESIGN AND CONSTRUCTION DEFECTS LITIGATION

1. AB 370, Amending Business & Professions Code Sections 7028 and 7028.6

Increases penalties for contracting without a license for those who perform home improvement valued at $500 or more for labor and materials. Also includes that a person who uses the services of an unlicensed contractor is considered a crime victim and eligible for restitution, regardless of whether that person knew the contractor did not have a license.

2. Fifth Day, LLC v. Bolotin, 172 Cal. App. 4th 939 (2d Dist. March 2009)

Plaintiff entered into what was called a "Development Management Agreement" with an owner to assist in the development of a property. The agreement stated that its purpose was to provide professional development and construction management services to the owner. Owner also hired a general contractor to perform the construction. After the project was completed and the building sold, the CM sued the owner, contending it had not been paid out of sales of the building in accordance with the agreement. The trial court granted the owner's motion for summary judgment on the basis that the plaintiff CM lacked a general contractor's license. The Court of Appeal reversed, observing that the contractors state license law does not identify construction managers as workers requiring licensure, and that the CM did not perform any of the activities identified in section 7026 of the Business and Professions Code. Further, the court noted that under section 4525(e) of the Government Code, construction managers on public works projects must be licensed, but there is no parallel law for private work projects. Therefore, the court held that a CM on a private work of improvement who does not undertake actual construction work directly or through subcontractors is not required to have a contractors license.

3. Sanders Construction, Co., Inc. v. Cerda, 175 Cal. App. 4th 430 (4th Dist. June 2009)

A drywall subcontractor, Humberto, was retained by Sanders Construction Co., the general contractor on a hotel project. Humberto's license had expired prior to work beginning, and Sanders at some point discovered that fact, but continued to work with Humberto. Humberto did not pay its workers, who filed wage claims against Sanders with the State Labor Commissioner. The hearing officer cited the holding in Hunts Building Corp. v. Bernick, 79 Cal. App. 4th 213, 220 (2000) "Labor Code § 2750.5 operates to conclusively determine that a general contractor is the employer

of not only its unlicensed subcontractors but also those employed by the unlicensed subcontractors." On that basis, the hearing officer determined that Sanders was the statutory employer of the workers employed by the unlicensed subcontractor, entitling them to recover wages and interest from Sanders. The Appellate Court affirmed, holding that a general contractor may be liable for the unpaid wages of workers hired by an unlicensed subcontractor. As a corollary, the Court noted that although the employees were not themselves licensed, section 7031 of the Business and Professions Code requiring a license to sue for compensation does not apply to a person who receives wages as his sole compensation who does not engage in independent business and who cannot control how the work is performed.

4. <u>Ocguera v. Cohen, 172 Cal. App. 4th 783 (2nd Dist. March 2009)</u>

A general partnership consisted of three partners. Only Mr. Golen, the RME, was licensed. Golen executed a disassociation notice in accordance with section 7076(c) of the Business & Professions Code which provides that "a partnership license shall be canceled upon the disassociation of a general partner or upon the dissolution of the partnership . . . The remaining general partner or partners may request a continuance of the license to complete projects contracted for or in progress prior to the date of disassociation or dissolution for a reasonable length of time . . . " After Golen filed his disassociation notice, the partnership entered into a residential construction project. Following completion, the homeowner sued the partnership for defective construction. In addition to seeking damages for repair of the defective work, she also sought disgorgement of the $32,000 paid to the partnership, pursuant to section 7031(b) of the Business & Professions Code. The issue on appeal was limited to whether the trial court erred in entering a judgment in favor of the owner on the refund of payment. The Court of Appeal affirmed, finding that the substantial compliance doctrine did not apply because Golen's association with the partnership ended on May 24, 2003, and neither remaining partner was licensed before entering into the June 2003 contract. In contrast, the partnership was licensed at one time and so did meet the first prong of the substantial compliance doctrine. However, it did not meet the remaining requirement: both partners knew that they were not licensed and that the RME had executed a disassociation, but they did not act with prompt good faith efforts to secure a license.

5. <u>White v. Cridlebaugh, 175 Cal. App. 4th 1479 (5th Dist. Oct. 2009)</u>

The Whites retained Cridlebaugh and JC Master Builders, Inc. (collectively, the "contractor") to build a

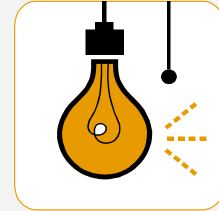
log cabin. Due to various concerns, the Whites terminated the construction contract. The parties filed complaints against one another, the contractor to foreclose on its mechanic's lien, among other things, and the homeowners to recover disgorgement of amounts paid, among other things. On appeal, the court considered, among other things, "whether the Whites properly brought a claim for reimbursement under section 7031(b)." The appellate court concluded that the contractor was not qualified to be licensed because the responsible managing officer was not actively engaged in the business and had appointed another (unlicensed) individual to oversee the "dealings and daily work" of the contractor. Therefore, its license was suspended by operation of law and disgorgement under section 7031(b) was authorized. The court further considered whether "the recovery of compensation authorized by section 7031(b) [may] be reduced by offsets for materials and service provided or by claims for indemnity and contribution?" The court concluded that it may not, and that under the express terms of the statute, "unlicensed contractors are required to return all compensation received without reductions or offsets for the value of the materials or serviced provided."

6. Cal. Groundwater Assn. v. Semitropic Water Storage Dist., 178 Cal. App. 4th 1460 (5th Dist. Nov. 2009)

A water district was sued for declaratory relief alleging that it was performing well drilling services without a C-57 water well contractor's license in violation of Water Code section 13750.5, which requires all persons working on wells to hold such license. The District contended that the Water Code provision did not apply to it based on statutory exceptions enumerated in Business & Professions Code sections 7000, *et seq.*, and its demurrer was sustained. The court of appeal reversed, holding that the Water Code statute governed the licensing requirement because it was created to protect the public health and welfare from water contamination, which is broader than the licensing laws codified in the Business & Professions Code whose sole purpose is consumer protection. The court held that the Water Code mandates a license without exception, and observed that the statute would be satisfied if the District's supervisor of construction were licensed.

7. Davis Moreno Constr., Inv. V. Frontier Steel Bldg., 2009 U.S. Dist. LEXIS 104167 (E.D. Cal. Nov. 2009) (not published)

At issue on a motion to dismiss and for change of venue or transfer was the question of whether Frontier could avoid California's contractor licensing requirement because the construction contract for a California public work of improvement provided that Colorado law applied. The district court denied the motion, declining to enforce the choice-of-law provision on the ground that the interests of the forum



"…unlicensed contractors are required to return all compensation received without reductions or offsets for the value of the materials or services provided…"

state (California) were materially greater than the interests of the chosen state: "California's interests in protecting the public from unlicensed contractors would be more seriously impaired if the choice-of-law provision were enforced." The court also rejected Frontier's argument that the work it performed did not require a contractor's license because it was fabricating a pre-engineered metal building pursuant to plans and specifications.

IV. MECHANIC'S LIENS, LIS PENDENS AND BONDS

A. Mechanic's Liens

1. AB 457, Amending Civil Code Sections 3084 and 3146 (eff. 1/11/11)

To date, mechanic's lien filing procedures have not included a requirement that property owners be notified when a lien is placed against their property. Therefore, many liens have not been pursued and have become void and unenforceable by operation of law, clouding the title of the property on which they were filed. Consequently, consumers have been left with the responsibility of addressing the lien before engaging in financial transactions involving the property. With this new law, claimants intending to file mechanic's liens will be required to notify owners that a mechanic's lien is being recorded against their property by serving owner with a notice of lien, along with a copy of the actual lien; otherwise, the lien will be unenforceable. Additionally, it will also be mandatory that a lis pendens be recorded within 20 days of filing a foreclosure action. Although the law grew out of concern for homeowners by the CSLB, as presently written, it will affect commercial projects as well as residential.

2. United Rentals Northwest, Inc. v. Snider Lumber Prods., Inc., 174 Cal. App. 4th 1479 (5th Dist. June 2009)

A lumber company owned a saw mill which included several lumber-drying kilns. The kilns were bolted to a concrete slab constructed with steel frames and aluminum walls, and were supplied with electricity and sprinklers. When the kilns were originally installed, they were deemed improvements of the land for property tax purposes. The lumber company retained a contractor to remove the kilns through a series of subcontracts. United Rentals Northwest, Inc. rented equipment for use in removing the kilns. United Rentals was not paid for the equipment and recorded a mechanic's lien against the saw mill. The lumber company argued that removal of the kilns was not a work of improvement subject to a mechanic's lien, but rather constituted personal property. In a case of first impression, the court held that removal of the kilns fell within the description of a work of improvement set forth in section 3106 of the Civil Code, which includes the demolition and the removal of buildings. The court observed that the kilns were metal structures that

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were two-stories tall, were attached to concrete foundations, enclosed thousands of square feet of space, had windows and doors, included staircases and places for people to work, were supplied with electricity, stood for between eight and 21 years, and that the cost of removing them was nearly $300,000. Although the court found no published California cases applying the mechanic's lien statutes to facts involving only the demolition or removal of a building, it also observed that section 3106 is not ambiguous in referring to "the demolition of buildings, and the removal of buildings." Therefore, the mechanic's lien law applied to this work.

3. <u>Congrove v. Western Mesquite Mines, Inc., 2009 U.S. District LEXIS 15584 (S.D. Cal. Feb. 2009) (not published)</u>

A construction manager entered into a Construction Management Agreement in connection with improvements to an open pit mine. The agreement included such services as obtaining construction permits, reviewing plans and drawings, furnishing corrections and design change proposals, value engineering, interfacing with the architect and engineers, participating in design change meetings, soliciting bids, determining the scope of work to be bid by various trades, developing purchase orders, determining methods of cost-savings, supervising, managing, directing and scheduling construction, monitoring and inspecting the work, scheduling and interfacing with building inspectors, preparing and tracking budgets and costs, providing safety meetings and training, preparing progress and safety reports, and attending progress and safety meetings. The owner terminated the construction management contract and the construction manager recorded a mechanic's lien and initiated a foreclosure action. Owner moved to dismiss the foreclosure claim on the basis that, as a construction manager, plaintiff was not among the class of persons entitled to assert a mechanic's lien under Civil Code section 3110. The District Court concluded that the allegations pleaded were sufficient to withstand challenge, observing that although plaintiff's primary role appeared to be supervisorial, it also included services that bestowed skill or other necessary services to be used in the construction of a building, rendering it among the class of persons entitled to assert a mechanic's lien.

B. <u>Lis Pendens</u>

1. <u>Manhattan Loft, LLC v. Mercury Liquors, Inc., 173 Cal. App. 4th 1040 (2d Dist. May 2009)</u>

The parties arbitrated an easement dispute pursuant to the requirements of a lease. The holder of the easements recorded a lis pendens, and the owner filed an action for slander of title. The trial court held that the recording was privileged under the anti-SLAPP statute, Code of Civil Procedure section 425.16. The appellate court reversed. Code of Civil Procedure

section 405.20 states that "[a] party *to an action*" may record a notice of pendency of action. Thus, under the plain language of the statute, a lis pendens can be recorded only when a court action is pending.

C. Payment Bonds

1. First National Ins. Co. v. Cam Painting, Inc., 173 Cal. App. 4th 1355 (2d Dist. May 2009)

First National Insurance Company issued a payment and performance bond for the prime contractor, Cam Painting, and also issued a similar bond to Cam's subcontractor, SABCO Electrique. Both Cam and SABCO signed indemnity agreements in favor of surety. SABCO failed to pay one of its suppliers, which subsequently commenced a lawsuit asserting a cause of action against Cam and the surety on Cam's payment bond. In response, CAM cross-complained, asserting a cause of action against the surety on the SABCO performance bond. Thereafter, SABCO cross-complained against the surety on the Cam bond. The surety paid the supplier's claim, allocated half of the payment to each bond, and filed a cross-complaint seeking indemnity from each of the principals. The trial court ruled that surety was entitled to so allocate the loss to both bonds. The appellate court reversed, holding that the surety must pay the supplier's claim entirely from the bond of the principal with whom the supplier was in privity, i.e., SABCO. It observed that the purpose of the subcontractor payment bond was to pay subcontractor debts so that the prime contractor would not have to enter into a dispute with its subcontractor. The court also held that Cam should not have been charged with attorneys' fees incurred by the surety; indeed, the surety was liable to Cam for its attorneys' fees.

2. Oldcastle Precast, Inc. v. Lumbermens Mutual Casualty Co., 170 Cal. App. 4th 554 (4th Dist. Jan. 2009)

A concrete piling supplier made a claim on a public works payment bond and a stop notice release bond, and filed a lawsuit to enforce said claims. The trial court granted the supplier summary judgment on the grounds that the supplier had established the elements of its claims whereas the sureties failed to meet their burden regarding affirmative defenses thereto. Indeed, the sureties' separate statements did not even identify affirmative defenses, let alone advance proposed material facts or proffer admissible evidence in support of any affirmative defenses. The trial court denied sureties' request to continue the hearing in order to give them an opportunity to revise their separate statements as sureties failed to submit an affidavit making a good faith showing as to why a continuance was needed in order to obtain essential facts, as required under Code of Civil Procedure section 437c. The appellate court affirmed, finding that the deficiencies in sureties' separate statements were substantive and not merely a "curable procedural defect."

V. PROMPT PAYMENT

1. Martin Brothers Construction, Inc. v. Thompson Pacific

Construction, Inc., 179 Cal. App. 4th 1401 (3d Dist. Dec. 2009)

At completion of a public work of improvement, the general contractor withheld retention as a result of a dispute over additional work claims and also because the subcontractor failed to provide conditional lien releases as was contractually required for payment. The subcontractor sued for penalties under the prompt payment statutes, specifically section 7107 of the Public Contract Code (governing payment of retention) and section 7108.5 of the Business & Professions Code (relating to progress payments). The trial court agreed that the general contractor was entitled to withhold retention in view of the dispute and the failure to furnish lien releases, and therefore had not violated the prompt payment statutes. In affirming the judgment, the appellate court held that the unambiguous language of Public Contract Code section 7107 allows the withholding of retention for *any* good faith dispute between a general contractor and a subcontractor. The appellate court also held that the parties' contractual agreement that "payment is not due until Subcontractor has furnished . . . applicable releases pursuant to Civil Code section 3262" altered the timing, and constituted a waiver, of the payment requirements of section 7108.5.

VI. PUBLIC WORKS OF IMPROVEMENT

A. Design-Build

1. Public Contract Code Section 20133

The statute authorizing counties to use the design-build contracting method was amended to require any county that elects to proceed under the statute to pay a fee to the Department of Industrial Relations ("DIR") to defray the DIR's costs of monitoring compliance with and enforcing prevailing wage requirements for the project.

2. Legislative Analyst's Office Report on Public Contract Code Section 20133

Analyst's Office ("LAO") recently published its report regarding the effectiveness of design-build contracting based on information gathered from counties that had used the method. This report is required by Public Contract Code section 20133, which is set to expire in January 2011. The LAO received information on 15 projects, only 5 of which have been completed. Based on the limited sample and the lack of parallel projects using the traditional design-bid-build method that could be used for comparison purposes, the LAO was hesitant to draw conclusions about the effectiveness of the design-build legislation. Despite the inconclusive results, the report recommends that the design-build legislation be renewed and that all of the current design-build statutes scattered throughout the Government, Education, and Public Contract Codes be consolidated into a single, uniform, design-build statute.

B. MBE, WBE, and DVBE Goals

1. AB 21, amending Public Contract Code Section 10115.2

Under prior law, state contracts could be awarded to the lowest responsible bidder that either met the statewide goals for minority business enterprises, women business enterprises, and disabled veteran business enterprises contained in the State Contract Act or demonstrated making good faith efforts toward meeting the goals. AB 21 eliminates good faith efforts as an alternative to actually meeting the goals. Under the new law, state contracts must be awarded to the lowest responsible bidder that actually meets the 15% MBE, 5% WBE, and 3% DVBE goals set in Public Contract Code section 10115(c).

C. **Design Immunity**

1. Alvis v. County of Ventura, 100 Cal. Rptr. 3d 494 (2d Dist. 2009)

Family members of those who were injured or died during the January 2005 landslide at the beach community of La Conchita sued Ventura County claiming that a retaining wall designed and constructed by the County at the base of a steep cliff created a dangerous condition that caused the landslide to overwhelm several homes. The County moved for summary judgment on the ground that the claims were barred by the design immunity afforded by Government Code section 830.6. The trial court granted the motion, and the Court of Appeal affirmed the judgment.

The appellate decision focused on two issues. First, the plaintiffs opposed the motion with an expert's declaration that the County-designed retaining wall failed, causing the cliff above it to collapse. A few years earlier, however, the same expert had submitted a report to an insurance company stating that the landslide was initiated toward the top of the cliff and rapidly flowed downward. Both the trial and appellate courts concluded that the unexplained contradictions between the expert's declaration and his prior statements prevented the declaration from constituting evidence of the wall causing the failure sufficient to create a triable issue of material fact

Second, the plaintiffs attempted to demonstrate the County lost its design immunity when the retaining wall design became dangerous because of changed physical conditions after the wall was constructed. Plaintiffs claimed that the retaining wall in actual operation failed to allow water to drain properly, causing pressure to build behind the wall, and ultimately causing the wall to fail during a heavy rainstorm. Both courts rejected these arguments. The County engineers who designed the wall had considered and provided for water drainage in their wall design. Thus the "changed condition" cited by plaintiffs was simply one of the factors considered as part of the original design. The courts were unwilling to allow the plaintiffs to second-guess the original design decisions by characterizing design considerations (such as the build-up of water pressure and the need for drainage) as "changed conditions."

D. <u>California High-Speed Rail</u>

1. <u>Opinions of the Attorney General, No. 07-1002 (February 27, 2009)</u>

The California High-Speed Rail Authority ("HSRA"), which was created by the California High-Speed Rail Act of 1996 for the purpose of developing a plan for the financing, construction, and operation of a statewide, intercity high-speed passenger rail system, is authorized to exercise the powers set forth in Public Utilities Code section 185036. These include the authority to acquire rights-of-way, enter into design and construction contracts, and issue debt secured by pledges of state funds, federal grants, or project revenues. HSRA received partial authority to implement section 185036 through 2002 legislation, and full authority by the California voters' approval, in the November 2008 general election, of the Safe, Reliable High-Speed Passenger Train Bond Act for the 21st Century. The ballot measure approved the sale of up to $9.95 billion in bonds to finance the project.

VII. PREVAILING WAGE/EMPLOYMENT LAW

1. <u>State Building and Construction Trades Council of California, AFL-CIO vs. City of Vista, 173 Cal. App. 4th 567 (4th Dist. 2009), *review granted,* August 19, 2009</u>

In its 2004 decision <u>City of Long Beach v. Division of Industrial Relations, 34 Cal. 4th 942</u>, the California Supreme Court explicitly left unresolved the questions whether the prevailing wage laws in the Labor Code (§ § 1720 – 1780) were a matter of statewide concern and whether a public works project undertaken by a charter city is a municipal affair exempt from prevailing wage laws. Following the <u>City of Long Beach</u> decision, the California Legislature issued a resolution aimed at eliminating the resulting uncertainty by stating that payment of prevailing wages on public projects is a matter of statewide concern and its intent is for prevailing wage laws to apply to charter cities.

In anticipation of several large capital projects that could be constructed for less money if it was exempt from paying prevailing wages, the City of Vista in 2007 asked voters to approve a ballot measure establishing the city as a charter city. After becoming a charter city, Vista prepared design-build contract documents for two of the upcoming projects that did not require payment of prevailing wages. Trade unions filed a peremptory writ of mandate asking that Vista be required to comply with the state's prevailing wage laws.

The Fourth District Court of Appeal answered both of the questions left unresolved by the <u>City of Long Beach</u> case and produced a decision completely at odds with the Legislature's resolution. Citing the facts that many construction projects in California (namely,

"The ballot measure approved the sale of up to $9.95 billion in bonds to finance the project."

all private projects) are exempt from prevailing wage laws altogether and that numerous projects with some element of public funding or support are also exempt (such as projects receiving certain types of tax credits), the Court of Appeal concluded that the state's prevailing wage laws are not a matter of statewide concern. It also concluded that Vista's interest in controlling how it spends its own local tax dollars on its public works projects was a municipal affair that trumped the application of the prevailing wage laws.

The case is currently under review by the California Supreme Court, which will now decide the questions left open by the City of Long Beach decision.

VIII. INSURANCE

1. AB 2738, Amending Civil Code Sections 2782, 2782.9, 2782.95 and 2782.96

This legislation affects wrap-up policies in residential, commercial and public works construction, and also restricts indemnity clauses in residential projects. Among other things, the statutes place restrictions on self-insured retentions, require disclosure of certain policy terms, and make unenforceable clauses requiring subcontractors to reimburse insurance or defense costs for claims unrelated to their scope of work.

2. State of California v. Continental Insurance Company, 169 Cal. App. 4th 1114 (4th Dist. Jan. 2009), *review granted*, 91 Cal. Rptr. 3d 106 (March 2009)

Although not arising out of a construction dispute, this case involves key insurance decisions which are relevant to the building industry. Commencing in 1955, the State commenced using a site in the desert called Stringfellow for industrial waste disposal on the mistaken assumption that impermeable rock underlay the site. Because the underlying rock was, in fact, permeable, the site suffered severe groundwater contamination and was ultimately closed. In 1998, the State was found liable for negligence and for all past and future remediation costs of approximately $700 million. The State sought indemnity from its liability insurers, and went to trial against six excess liability insurers, each of whose policies covered a two or three year period and obligated them to pay the State for losses arising out of injury to, or destruction of, property on a per-occurrence basis. Occurrence was defined as "an accident or a continuous or repeated exposure to conditions which result in . . . damage to property during the policy period . . . " The court engaged in a thorough discussion of progressive property damage insurance law, and the holdings were as follows:

i. Where progressive property damage spans several policy periods, the "all sums" rule applies, i.e., one insurer is liable to the insured for the entirety of the damage, and that insurer, in turn, may

seek contribution from other insurers on the risk.

ii. Where progressive property damage spans several policy periods, the insured can "stack" limits of successive liability policies triggered by the continuous loss.

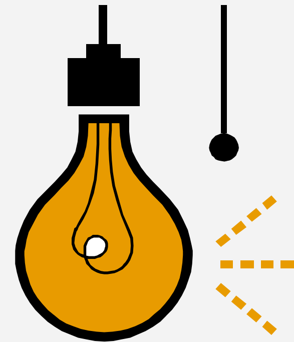
iii. When an insured is covered under a third-party liability policy for the cost of mitigating a covered loss, the insured's failure to mitigate the loss does not diminish the insurer's coverage obligation.

3. Bernard Freedman v. State Farm Insurance Company, 173 Cal. App. 4th 957 (2d Dist. May 2009)

Homeowners had a bathroom remodeled, during which time unbeknownst to them, a nail was driven through a pipe. Over time, corrosion around the nail caused a leak and extensive water damage. The homeowners filed a claim with their insurer which claim was denied on the ground the damage was an excluded loss. The homeowners' policy provided all risk coverage for the dwelling, but excluded loss arising out of corrosion and rust; loss arising out of continuous or repeated seepage or leakage of water from a plumbing system; and loss arising out of third-party negligence in workmanship or construction. The trial court granted summary judgment for the insurer, on the ground that the claim was excluded as a loss not insured. The appellate court affirmed.

4. Griffin Dewatering Corporation v. Northern Insurance Company of New York, 176 Cal. App. 4th 172 (4th Dist. July 2009)

A water district hired Griffin to construct a sewer bypass, which then backed up and caused damage to a residence. After the district paid the homeowners' claim, it sued Griffin for reimbursement. Griffin's CGL insurer refused to defend based on a "total pollution exclusion" in the policy, and the reasonableness of its position was supported by existing case law. However, Griffin's excess insurer provided a defense. Moreover, after the insured filed a bad faith lawsuit against the CGL insurer, the latter changed its mind and settled the lawsuit without the insured suffering any loss. Griffin continued to proceed with its bad faith lawsuit, during which time, the Supreme Court issued its decision in MacKinnon v. Truck Ins. Exchange, 31 Cal. 4th 635 (2003), which interpreted the total pollution exclusion. The jury ultimately awarded the insured $1 million to compensate the insured for its costs "to collect the benefits due under the contract" and $10 million in punitive damages. In considering whether the insurer's denial of a defense was reasonable, the appellate court reversed the judgment. The court engaged in a thorough discussion of the defense obligation, including the "potentiality rule" (where there is any potential for the insured's liability based on the facts alleged in the complaint and facts known to the insurer at the time of the



coverage decision, there is an obligation to defend), and application of the objectively reasonable standard (wherein the reasonableness of the insurer's position is a question of law for the bench to decide).

5. North American Capacity Insurance Company v. Claremont Liability Insurance Company, 177 Cal. App. 4th 272 (4th Dist. Aug. 2009)

This was an equitable contribution action between two insurers of a general contractor. A homeowner sued the contractor for defective work, including conditions that did or would result in water damage. The contractor tendered its defense to Claremont, which had issued a primary CGL policy and excess/umbrella policy both effective in the year 2001, and also tendered to North American which had issued a CGL policy for the year 2002. Both insurers agreed to defend under the CGL policies, subject to reservations of rights. A settlement was reached to which Claremont and North American contributed unequal sums. North American sued Claremont on the ground that it did not contribute its equitable share. The Claremont policies both contained contractors warranty endorsements as conditions of coverage, i.e., providing that coverage would not apply to operations performed by subcontractors unless the insured obtain an indemnity agreement and a certificate of insurance from them. In this case, the insured obtained these from some, but not all of its subcontractors. The trial court concluded that this endorsement was enforceable in both Claremont policies and that the insured's failure to comply precluded coverage for operations performed by subcontractors from whom the agreement and certificate were not obtained, and precluded the right of North American to obtain contribution from Claremont for such operations under either policy. The appellate court agreed. The trial court also concluded that the contract completion date for triggering completed operations coverage, i.e., the date when the residence was "put to its intended use," was the date when the notice of completion was recorded and not the much earlier date when the owner moved into the home. The appellate court agreed, observing that "a residence might be partially inhabited prior to the date of completion, and not yet be put to its 'intended use' because the owner does not have full use of the facilities."

IX. SAFETY/PERSONAL INJURY

1. Zaragoza vs. Ibarra, 174 Cal. App. 4th 1012 (4th Dist. 2009)

A homeowner hired an unlicensed contractor to perform remodeling work. On his second day of work, an employee of the contractor was injured while working on a ladder. The worker sued the homeowner for negligence. In rejecting the homeowner's contention that the worker's exclusive remedy was through the workers' compensation system, the Court of Appeal recognized the well

settled law that a worker hired by an unlicensed contractor who in turn was hired by a homeowner does not come within the workers' compensation system unless the worker has worked 52 hours in the 90 days preceding the injury. Labor Code section 3351(d). Because the worker had not met the minimum hour requirement by the time he was injured, the homeowner was not insulated from an ordinary negligence claim by the workers' compensation laws. The Court of Appeal, however, affirmed the trial court's summary judgment in favor of the homeowner on the negligence claim. The Court concluded that the undisputed evidence revealed no negligence on the part of the homeowner. Instead, it was the worker who placed, adjusted, and climbed the ladder and who chose to perform a risky maneuver from a height of nine feet that ultimately caused his injury.

2. Cortez vs. Abich, 177 Cal. App. 4th 261 (2d Dist. 2009), *review granted,* December 2, 2009

Homeowners hired an unlicensed contractor to replace the roof on their home. On his first day of work, an employee of the contractor fell through the roof and was seriously injured. The injured worker sued the homeowners, alleging that because the contractor was unlicensed, the homeowners were the worker's employer. And as an employer, the homeowners had a duty to maintain a safe work environment in accordance with OSHA regulations, as well as a duty to warn of the dangerous condition of the roof.

The Court of Appeal concluded that under Labor Code section 2750.3, which provides a rebuttable presumption that a person who performs services for which a license is required is an employee rather than an independent contractor, the worker was the employee of the homeowners with respect to potential tort liability. But the Court concluded that the re-roofing project was exempted from the safe workplace regulations of OSHA. Labor Code section 6303(b) excludes "household domestic service" from the definition of employment. The Court determined that the safe workplace regulatory scheme was not intended to apply to homeowners who hire workers to perform re-roofing or other remodeling work.

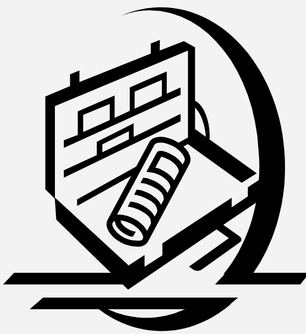
3. Suarez v. Pacific Northstar Mechanical, Inc., A121349, Cal App. 4th (1st Dist., December 18, 2009)

Two employees of a general contractor on a tenant improvement project were seriously injured by an ungrounded light fixture. They filed a negligence lawsuit against a subcontractor working on the same project. Although the subcontractor did not create the dangerous condition, one of its employees had encountered it a few weeks earlier, but the subcontractor had failed to report the condition to the general contractor or anyone else. The trial court granted the subcontractor's motion for summary judgment, but the Court of Appeal reversed. The appellate court agreed that the subcontractor on a multiemployer project did not have a common law duty to protect the employees of others. But the

	court concluded the subcontractor could have faced citation by Cal-OSHA under Labor Code section 6400 and Cal-OSHA's regulation 336.11. Relying on the California Supreme Court's decision in Elsner v. Uveges, 34 Cal. 4th 915 (2004), the appellate court held that plaintiffs can rely on Cal-OSHA provisions to establish the existence of a duty of care, regardless of whether the plaintiff is an employee or not. Thus the court ruled that a subcontractor whose own employees are exposed to a dangerous condition at a multiemployer site has a duty to protect the employees of other contractors working at the site.

TOP TEN REAL ESTATE CASES OF 2008

Written by Sheri A. Ghatak, *Morgan, Lewis & Bockius LLP*



1. Landlord Tripped Up by Defaulting Tenant *(Stone v. Center Trust Retail Properties, Inc.* (2008) 163 Cal. App. 4th 608)

Upon hearing the news that its landlord had obtained a writ of possession, rather than pack its bags, the tenant, Gumboz Creole Cajon Restaurant, elected to host an after-hours dance club. A good time was had by all until a guest slipped on a wet dance floor, which was attributed in part to a water leak. The tenant sued the landlord and won a substantial amount of money. Although the landlord did not have possession of the premises at the time due to the failure of the sheriff to actually serve the writ, nevertheless, the Court found that once the landlord obtained a judgment of possession, it had an affirmative duty to inspect the premises for defective conditions, which would have led to discovery of the leak.

Generally, landlords are not liable to a tenant's guests for dangerous conditions appearing on the property once the tenant is in possession. The Court reasoned that an exception to this general rule is appropriate on the basis that the landlord was aware of the possibility that defaulting tenants tend to neglect property and that the restaurant was in violation of its lease by operating a dance club.

The *Stone* decision is one of ten cases that the speakers O'Malley Miller and Brian R. Hochleutner of the LACBA-sponsored presentation on Hot Topics in California Real Estate Law: The Top Ten Cases of 2008 discussed as the most significant of 2008. While this case serves as a forewarning to landlords to inspect their property periodically in the event of tenant eviction proceedings or face liability for unknown dangerous conditions that may exist on the property, it is another thing to put this into practice, as a defaulting tenant still in possession of property is not likely to grant the landlord access for inspection. As Miller pointed out, just because a landlord has a judgment of possession, does not necessarily mean that the landlord will be able to enforce it, as the wait for the sheriff to enforce such a judgment may be up to one month and in the meantime, the landlord may be denied access. Hochleutner cautioned that the reasoning of this decision could be extended to include circumstances where the tenant is merely in default.

2. The Hatfields and McCoys Take Their Feud Over Easements to Court *(Gray v. McCormick* (2008) 167 Cal. App. 4th 1019)

In *Gray*, two neighbors, the Grays and McCormicks, were locked in a dispute over access to an easement area. Based on a declaration of covenants, conditions and restrictions, the Grays had an exclusive access easement over the McCormicks' property measuring 16 feet by 90 feet. The Grays, desiring to develop the unimproved easement area with a driveway,

perimeter walls and landscaping, found the McCormicks' use of the easement area in this upscale gated community repugnant and sued for declaratory judgment to deny the McCormicks access to the easement area for passage of their horses and for hauling trash, and horse feed and manure, arguing that the provision excluding all others from the easement area included the owner of the servient tenement.

The Appellate Court agreed with the Grays and held that exclusive use means that the owner of the dominant tenement may use the easement area to the exclusion of everyone, including the owner of the servient tenement! The holding of this case is contrary to the rule that an exclusive easement precludes everyone from accessing the easement, save the owner of the servient tenement, who is entitled to use the easement in any manner not inconsistent with the exclusive use by the owner of the dominant tenement. The Court based its holding on the intent conveyed in the instrument creating the easement, which is shown by the absence of any language expressly reserving the easement area in favor of the owner of the servient tenement and the presence of language requiring the owner of the dominant tenenment to maintain and improve the easement area and to indemnify the owner of the servient estate. Thus, under *Gray*, an exclusive easement that entitles only the owner of the dominant tenement access is enforceable in California.

Hochleutner pointed out that this case does not address how such an easement would be treated under the California Subdivision Map Act. The Attorney General has opined that an agreement granting exclusive rights to possession of real property, even if described as a "permit," triggers the Map Act's subdivision requirements. See 57 Ops. Cal. Atty. Gen. 556 (1974). Such reasoning could be applied to an exclusive easement, but the issue was not addressed in *Gray*.

3. <u>California Supreme Court Barely Upholds 1979 Pruneyard Decision in Extending Free Speech Designed to Disrupt a Tenant's Business to Private Shopping Malls</u> *(Fashion Valley Mall, LLC v. National Labor Relations Board (NLRB)* (2007) 42 Cal. 4th 850)

The 1979 *Pruneyard* Decision (*Robins v. Shopping Center* (1979) 23 Cal.3d 899) held that free speech rights under Article 1, Section 2 of the California Constitution are broader than those granted under federal law and that such rights extend to private shopping malls, which the Court characterized as public forums. In *Pruneyard*, the Court held that the solicitation at a shopping center of signatures for a petition to the government is an activity protected by the California Constitution, subject to reasonable time, place and manner restrictions.

The current case stems from the owners of Fashion Valley Mall in San Diego, refusing to allow the employees (the "Union") of a newspaper, who were

engaged in a dispute over its collective bargaining agreement, to distribute leaflets urging customers to boycott one of the stores in the Mall because it advertises in the newspaper, which mistreats its employees according to the Union. Pursuant to the Mall's rules, any person desiring to engage in expressive activity at the Mall was required to apply for a permit and agree to abide by the Mall's rules, including the rule that prohibits "urging, or encouraging in any manner, customers not to purchase the merchandise or services offered by any one or more of the stores or merchants in the shopping center" (the "Rule").

In a close decision, the Court held that the Mall could not enforce its Rule against the Union, reasoning that the Rule prohibiting all speech that advocates a boycott is content-based and, thus, subject to strict scrutiny and must show that it is "necessary to serve a compelling state interest, and …narrowly drawn to achieve that end (*Arkansas Writers' Project, Inc. v. Ragland* (1987) 481 U.S. 221, 231). The Court found that the Mall's purpose to maximize profits for its merchants was not compelling compared to the Union's right to free expression.

The dissent argued that *Pruneyard's* extension of public free speech rights to private property was erroneous and has been overwhelmingly rejected around the country. Moreover, the dissent contends that the *Fashion Valley* Court expanded *Pruneyard* by allowing activity that was designed to interfere with the purpose of the Mall's existence, which was rejected in *Pruneyard*. The dissent also pointed out that the majority improperly applied the strict scrutiny test to action by private landowners involving their own property in reaching its decision (as such test should only apply to government action) and that if action by a private property owner were subject to the strict scrutiny test, the Court would have reached a different conclusion, as "[f]urthering business on its private property is not only a compelling interest, it is the property owner's primary concern; doing business is the reason that shopping center exists."

The presenters pointed out that in light of the dissent, *Pruneyard* could be overruled in the future with a change in the Court's composition. In fact, the dissent of the opinion cites a New York Court's criticism of the *Pruneyard* decision as "dictated by the 'accident of a change of personalities in the Judges of [the] court'" (*SHAD Alliance v. Smith Haven Mall* (1985) 66 N.Y.2d 496, 498). The presenters also noted that California courts have consistently refused to expand *Pruneyard* to stand-alone "big-box" stores and that reasonable time, place, and manner restrictions that do not restrict speech based on its content should remain enforceable.

4. Misrepresentation Claim Prevails for Landlord's Misstatement Regarding the Size of Rented Space *(McClain v. Octagon Plaza, LLC* (2008) 159 Cal. App. 4th 784)

Landlord leased commercial space in a shopping center to Tenant using a Standard Industrial/Commercial Multi-Tenant Lease-Net form drafted by the American Industrial Real Estate Association ("AIR"). The lease provided that the statement of space size is approximate, "which the Parties agree is reasonable and any payments based thereon are not subject to revision whether or not the actual size is more or less." The lease contained a disclaimer that Tenant was responsible for any inaccuracies in the statement of size. A dispute arose regarding Tenant's share of the common area expenses and Tenant sued for, among other claims, negligent or intentional misrepresentation regarding the size of the space.

In spite of the lease's broad disclaimer language, the Court held that Tenant had stated a claim for intentional or negligent misrepresentation. The Court based its conclusion on the Tenant's assertions that it attempted to confirm the size of the space before executing the lease, but that landlord, purportedly offended by tenant's inquires, claimed that measuring the space would be costly due to the space's unusual angles and insisted that tenant could rely on their representations, as they had intimate knowledge of the space. The Court found that landlord knew or had reason to know that the representations were materially false based on an application for earthquake insurance, which disclosed the actual size of the shopping center (the incorrect shopping center calculation was used in determining Tenant's share of common area expenses) and tenant's discovery of a 186 square foot discrepancy regarding the size of her unit, both of which resulted in an overcharge of more than $90,000 over the term of the lease.

The Court further found that §1668 of the California Civil Code ("CC") prohibited landlord from absolving its misrepresentation by a disclaimer contained in the lease. The Court responded to landlord's claims that the lease clearly stated that the measurement was approximate and that the parties agreed that such measurement was reasonable by finding that "a stipulation intended to bar a party's fraud claims does not bind the party, and, thus the insertion of language agreeing that a material misrepresentation is 'reasonable' is of no effect." Further, the lease provision that the rent was not subject to modification regardless of actual size was thwarted by the Court, characterizing Landlord's attempt to insulate itself from liability for any discrepancy as tantamount to an "as is" clause, which has been consistently rejected by California courts "as ineffective in insulating a contracting party from fraud claims regarding nonobvious defects in goods."

The presenters predicted that the holding of this case will impact how leases are drafted, noting that landlords should use caution in making statements about the size of the premises, both during negotiations and in the lease and should provide tenants the opportunity to measure the space. In fact, the AIR has revised its lease forms as a result of this case. The lease forms

contain an assertion by landlord that base rent is not tied to square footage of the space and tenant is encouraged to inspect and measure the premises. AIR advises landlords to avoid any references that rent is based on a calculation of a certain amount of dollars per square foot.

5. California's Anti-Deficiency Law Statute Does Not Apply to Guarantors *(Talbot v. Hustwit* (2008) 164 Cal. App. 4th 148)

Borrower, an investment trust, whose loan was secured by a deed of trust against real property and guaranteed by two individuals ("Hustwits"), defaulted on its loan obligations. The lender foreclosed through a nonjudicial sale under a power of sale provision in the deed of trust and then sued the guarantors for the difference between the purchase bid and unpaid balance of the loan. The court found in favor of the lender, and the guarantors appealed, arguing that (1) the trial court should have applied §580a of the California Code of Civil Procedure ("CCP") (California's anti-deficiency statute), which requires an appraisal of the real property security, before issuing the deficiency judgment, as they contend that the property's fair market value exceeded the total amount owed to the lender; (2) California's policy against excess recovery by creditors following the foreclosure of real property applies to guarantors, as well as principal debtors; and alternatively, the guarantors argued that (3) they were not true guarantors, as they were closely related to the Borrower as settlors and beneficiaries of the trust.

The Court of Appeal concluded that on the basis of well-established precedent, which the Hustwits did not dispute, §580a CCP does not apply to guarantors and that any changes to such law would have to be initiated by the Legislature. Regarding the question as to whether the Hustwits were true guarantors, the Court looked at whether the Borrower was anything more than an instrumentality used by the individuals who guaranteed the Borrower's obligation and whether such instrumentality removed the individuals from their obligations as debtors. In concluding that the Borrower was separate from the guarantor, the Court cited that the Hustwits were secondary rather than primary beneficiaries and that they were not trustees of the trust, but rather, they used a limited liability company as trustee, thereby limiting their personal liability for the trust's obligations. Therefore, the trust structure removed them from any obligations as a principal obligor on the loan.

Hochleutner maintains that this case lays the foundation for the notion that guarantors of loans secured by a deed of trust on California real estate may be liable for the entire amount of debt not covered through a nonjudicial foreclosure, even if the deficiency is determined without an appraisal.

The concurring opinion disputed the majority's reading of the law, citing §2809 CC, which provides that guarantors do not assume any obligation

more burdensome than that assumed by the principal obligors to a loan. The concurring justice cautions that lenders will circumvent anti-deficiency protections that a borrower may have by using the holding of this case and asserts that the Legislature could rectify this undue reading of the statute by clarifying that the protections conferred to guarantors under §2809 CC do apply in the context of anti-deficiency protections. However, Miller points out that Borrower's are typically asked to waive the protections of §2809 CC and that any requirement that guarantors waive such protections would likely be enforceable.

6. <u>No Duty By Tenant Broker to Disclose Negative Financial Information Following Execution of Lease</u> *(Blickman Turkus LP v. MF Downtow Sunnyvale, LLC* (2008) 162 Cal. App. 4th 858)

This case centers around the question whether a tenant's broker ("Blickman"), who is the third party beneficiary of a commission agreement between a landlord ("Mozart") and its listing broker, has a duty to inform the landlord subsequent to execution of the lease, but prior to tenant ("Handspring") taking possession of the premises, that Handspring's ability to perform under the lease was at risk due to its deteriorating financial circumstances.

Blickman was scheduled to be paid one-half of its commission upon execution of the lease and the other half on the effective lease date. In the interim, during the time that Mozart was constructing the premises to Handspring's specifications, Handspring informed Blickman that it was experiencing financial difficulties and was "considering possible exit strategies," including terminating the lease. However, Mozart was not aware of tenant's declining financial condition until nearly a year later. Mozart and Handspring eventually negotiated a termination of the lease. Blickman sued Mozart for the second half of its commission and Mozart counterclaimed, alleging that Blickman violated a duty to inform landlord of tenant's financial circumstances, which resulted in landlord sustaining damages. The trial court rejected the claims of both parties; neither side received damages and both appealed the decision.

The Court found that Blickman did not owe Mozart a duty to disclose tenant's precarious financial circumstances, reasoning that Mozart did not meet one of the four possible situations under which a duty to disclose may arise: (1) by statute or other law; (2) by contract; (3) by a relationship between the parties; or (4) by conduct by the broker that would render silence wrongful.The Court found no statutory basis for requiring disclosure and no contractual obligation requiring Blickman to advise Mozart of tenant's financial circumstances. Mozart asserted Blickman had a duty to disclose on the basis of relationship and by its conduct on the following grounds: (a) as the agent for Handspring; (b) hypothetically, as an agent for Mozart; or (c) by virtue of statements made by Blickman that

obligated it to correct the record when such facts were no longer accurate.

The Court found that the precedent did not support Mozart's contention that Blickman owed a duty to Mozart as agent for Handspring. Only one of the cases cited by Mozart imposed a duty of disclosure on one who was not the plaintiff's agent at the time of concealment of the information and the Court found that the holding stood for the notion that broker is liable where seller's broker is in possession of facts materially affecting the value or the desirability of the property offered for sale. Here, Mozart was not a buyer, but the seller (landlord), the transaction involved commercial, not residential property and the issue is about facts Blickman learned after execution of the lease, not the value of the property. According to Hochleutner, the Court found that it was not reasonable for Mozart to believe that Blickman represented Mozart's interests or that Blickman would disclose any information about tenant to Mozart in the absence of tenant's authorization. Therefore, the Court found that Blickman's role as agent was not sufficient to create liability arising from any duty to disclose. The Court cited several cases where the duty to disclose resulted from conduct by the broker and distinguished this case, substantiating its holding that Blickman had no duty to correct earlier statements about tenant's financial circumstances prior to execution of the lease when the broker had no knowledge of tenant's financial problems.

Blickman stands for the premise that tenant's broker is not obligated by law to reveal to a landlord any negative information broker may discover following execution of the lease about tenant's failing financial circumstances that could affect its ability to perform under the lease.

7. Expanded Judicial Review in Arbitration Decisions Possible (*Cable Connection, Inc. v. DirecTV, Inc.* (2008) 44 Cal. 4th 1334)

This case stems from an arbitration provision contained in an agreement between DirecTV, as a television service provider, with retail dealers, to provide customers with equipment for satellite signals, which reads in part: "[t]he arbitrators shall not have the power to commit errors of law or legal reasoning, and the award may be vacated or corrected on appeal to a court of competent jurisdiction for any such error." The contract did not provide for classwide arbitration. In 2001, dealers from four states sued DirecTV for allegedly withholding commissions and assessing improper charges. DirecTV moved to compel arbitration.

The majority of arbitrators determined that although the contract was silent on the issue, arbitration was authorized under case law. DirecTV moved to vacate the award granted to the dealers on the grounds that the majority had exceeded its authority by allowing classwide arbitration although such intent was not manifest in the agreements, the

majority had ignored extrinsic evidence regarding such intent, and even if the majority had not exceeded general arbitrator authority, the award reflected errors in law, which rendered the decision subject to judicial review. The trial court agreed with DirecTV. The Court of Appeal, relying on precedent, reversed, and the California Supreme Court overturned the Court of Appeal, holding that parties may agree to an expanded judicial review of private arbitration awards beyond the limited basis for review set forth in the California Arbitration Act.

This case opens the door to allowing parties to contract for an expanded judicial review of arbitration decisions, including on the basis of legal mistakes made by arbitrators. This decision overturns three prior decisions by the Court of Appeal rejecting such review, including the pivotal 1992 California Supreme Court decision, *Moncharsh v. Heily & Blase*, which limited judicial review of arbitration decisions to a very narrow set of circumstances set forth in the California Arbitration Act, involving corruption, fraud, or arbitrator misconduct.

Miller contends that this expanded review could potentially increase the cost of arbitration, but could safeguard the parties against a clearly flawed decision. The intent that legal errors are reviewable by the courts should be clearly spelled out in the arbitration agreement. The presenters point out that this decision is in opposition to a recent U.S. Supreme Court *Hall Street* case that was decided five months previously, which may preempt expanded judicial review in cases where federal law, rather than California law, applies to an arbitration agreement.

8. Recorded CC&Rs May Not Eclipse Right to Jury Trial Under Code of Civil Procedure §638 *(Treo @Kettner Homeowners Association v. Superior Court* (2008) 166 Cal. App. 4th 1055)

The homeowners association of a San Diego condominium project (the "Association") sued the project's developer ("Intergulf") for construction defects. Intergulf petitioned the trial court to transfer the case to a judicial referee on the basis that the Association's CC&Rs required that all disputes between it and Intergulf be decided by a general judicial reference pursuant to §638 CCP. The trial court granted Intergulf's motion, and the Association asked the court to set aside the order on the basis that the CC&Rs, unilaterally recorded by Intergulf prior to the execution of any purchase agreements with individual owners, did not constitute a contract and, therefore, could not serve as the basis for a contractual waiver of the Association's right to trial by jury as required by §638 CCP. Alternatively, even if it was deemed a contract, the judicial reference provision was unconscionable and unenforceable.

In analyzing §638 CCP, the Court of Appeal considered whether the Legislature intended equitable servitudes

created by the CC&Rs of common interest communities to constitute a written contract, in which case the right to a trial by jury could be waived. The Court concluded that such was not the intent of the Legislature. The Court reasoned that as reflected in precedent, the right to a trial by jury is a fundamental right, based on California's Constitution, and while it may be waived, such waiver would require "actual notice and meaningful reflection." Case law supports the notion that the Legislature intended that an affirmative mutual agreement is required to waive such inviolable right. The Court further concluded that the CC&Rs are adhesive in nature, as the Association had no opportunity to negotiate its provisions. Therefore, the Court of Appeal concluded that CC&Rs do not constitute a "written contract" as contemplated by §638 CCP and cannot serve as the basis that the Association waived its right to trial by jury.

The presenters assert that the *Treo* holding may be limited to judicial reference provisions contained in CC&Rs, as the decision does not address the enforceability of jury trial waivers in other written agreements, such as purchase and sale contracts. Moreover, it is unclear whether *Treo* conclusively resolved the enforceability of jury trial waivers in CC&Rs, as the holding conflicts with the Court of Appeal conclusion (likely considered dicta, as the holding was based on the unconscionability of the agreement) of *Villa Milano Homeowners Association v. Il Davorge* (2000) 84 Cal.App.4th 819, that CC&Rs do constitute a written contract through which jury trial rights may be waived under the California Arbitration Act ("CAA"). *Treo* distinguished *Villa Milano* on the basis that *Villa Milano* concerned the CAA rather than §638 CCP, but the possible inconsistency between these two cases may result in the issue being ultimately decided by the California Supreme Court.

9. <u>Development Agreement is Not a Valid Means to Create an Exemption to Zoning Ordinance</u> *(Neighbors in Support of Appropriate Land Use v. County of Tuolumne* (2007) 157 Cal. App. 4th 997)

Property owners residing in an "exclusive agricultural" zone applied to Tuolumne County for a permit to host wedding events on their property. Despite the prohibition on commercial zoning and the County's recent rejection of a proposal to amend the zoning ordinance to permit commercial use, the County authorized adoption of a development agreement, granting the property owners an exception to the zoning ordinance and allowing commercial functions to take place on the property. The County also issued a Conditional Use Permit ("CUP"), along with a negative declaration to comply with the California Environmental Quality Act. Claiming that the County's actions violated the zoning

ordinance, Neighbors in Support of Appropriate Land Use sued to reverse the County's commercial use approval. The trial court agreed, and the County appealed.

The Court concluded that the County's attempt to use a development agreement and CUP to create an exemption from zoning ordinances violates §65852 of the California Government Code, which states that zoning regulations must be "uniform for each class or kind of building or use of land throughout each zone, but the regulation in one type of zone may differ from those in other types of zones." The Court reasoned that if the Legislature had intended to create an exception to the uniformity requirement, it would have expressly provided for such exception. The purpose of a development agreement is to assure developers that they may proceed with their projects in accordance with existing policies, rules and regulations, not to fashion exemptions from such regulations. Further, the County's issuance of a CUP was improper because the zoning ordinance did not allow the use at issue as conditional use.

The County could have permissibly transformed the use of the property by taking one of the following actions: (1) rezone the property to a district allowing such use and revise the zoning map, (2) amend the text of the zoning ordinance to allow the use in the existing district, or (3) issue a conditional use permit consistent with the zoning ordinance. Typically, counties also have a fourth option, which is to grant a variance, although such action may not have been appropriate in this particular case, as a variance cannot grant permission to engage in a use prohibited by a zoning ordinance. Rather, it may provide relief from regulations such as those governing setbacks, heights, square footage, and density, where strict application of the zoning ordinance would deprive such property of privileges enjoyed by other property in the vicinity under the same zoning classification. According to Hochleutner, the holding of *Neighbors* may not have broad application, but is instructive in illustrating how a county may permissibly circumvent zoning restrictions.

10. Agencies Must Comply with CEQA Prior to Committing to Development Projects *(Save Tara v. City of West Hollywood* (2008) 45 Cal. 4th 116)

City of West Hollywood residents, opposing an affordable housing development project known as Tara, petitioned for a writ of mandate to negate the City's approval of a loan to, and conditional agreement with, a developer on the basis that City had violated the California Environmental Quality Act ("CEQA") by failing to prepare an Environmental Impact Report ("EIR") before committing to the project. The trial court found in favor of the City on the basis that the City had not given final approval, which was expressly conditioned on

compliance with CEQA. This decision was reversed by the Court of Appeal, concluding that the EIR review process should be part of the decision-making process and not an after-thought and deemed the agreement invalid, ordering a new EIR before the project could proceed. The City appealed.

During the appeal process, the City approved the final EIR for the project and the Supreme Court considered whether such approval rendered the appeal moot. The Supreme Court agreed with the plaintiffs that the appeal was not moot, as no permanent construction occurred on the project site during the appeal process and, therefore, turned to the substantive question, which was whether the City was required to prepare an EIR before conditionally approving the project and, if so, whether the City's actions constituted "approval" of the project. Regarding the first question, the Supreme Court concluded that if an agency, for all practical purposes, has committed to proceed with a proposed development project, even if final approval is contingent on subsequent CEQA compliance, then the project will be deemed "approved," thus requiring prior EIR review.

Hochleutner describes the factors that the Supreme Court considered in finding that the City's actions constituted approval of the project prior to EIR, including: (1) the language in the City's agreement with the developer, making it clear that the City intended to cause the reuse and development of the property as housing; (2) pre-EIR statements from City officials that the City was "obligated" to move forward with the Project and that alternatives had been ruled out; (3) pre-EIR commitment of extensive City resources and funds to the Project; (4) commencement of tenant relocation prior to EIR; and (5) failure of pre-EIR approval documents to state that the City could decline to go forward based on result of the EIR. On the basis of its conclusion, the Supreme Court ordered the City to declare void its approval of the conditional agreement with the Hochleutner maintains that *Tara* will make it more difficult for agencies to involve developers in a project prior to environmental review under CEQA or to enter into binding commitments early in the process. Further, agencies will need to be cautious about publicly expressing commitment to a project prior to the completion of environmental review or relying on agreements that make such agencies' obligations contingent on CEQA compliance. Miller contends that *Tara* will lead to "backroom" agreements, as developers seek agency commitment necessary to obtain financing for development projects.

NEW SAFE HARBOR FOR LIKE-KIND 1031 EXCHANGES

Written By Pedram Ben-Cohen, Attorney & CPA of Ben-Cohen Law Firm, PLC

The IRS has recently issued Revenue Procedure 2010-14, which provides long-awaited relief for taxpayers whose deferred like-kind exchange of relinquished property would be non-taxable under Section 1031 but for the failure of a qualified intermediary (QI) to acquire and transfer replacement property, because the QI has entered into bankruptcy or receivership proceedings. This article provides a general background on Section 1031 and summarizes the key highlights of Revenue Procedure 2010-14.

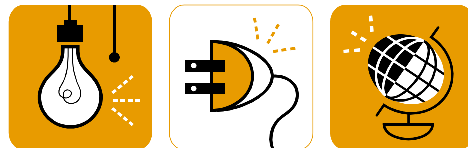
BACKGROUND

In general, no gain or loss is recognized if property held for investment or for use in a trade or business is exchanged for property of a like-kind which is also held either for investment or for use in a trade or business. To qualify for a like-kind exchange, the taxpayer must (1) identify replacement property within 45 days of the transfer of the relinquished property, and (2) acquire the replacement property within the sooner of (a) 180 days of the transfer of relinquished property, and (b) the due date of the tax return (including extensions) for the year of the transfer.

Taxpayers may use a QI to facilitate a 1031 like-kind exchange. If a taxpayer uses a QI, the taxpayer transfers the relinquished property to the QI and the QI sells the relinquished property to a buyer. Next, the QI takes the proceeds from the sale of the relinquished property and buys the replacement property. Finally, the QI transfers the replacement property to the taxpayer.

REVENUE PROCEDURE 2010-14

Recently, Taxpayers have initiated like-kind exchanges by transferring relinquished property to a QI and were unable to complete these exchanges due to the failure of the QI to acquire and transfer replacement property to the taxpayer. In many of these cases, the QI enters bankruptcy or receivership proceedings, thus preventing the taxpayer from obtaining the proceeds from the sale of the relinquished property. Absent some type of relief, this could have caused taxpayers to flunk tax-free treatment under Section 1031 and instead, treat the relinquished property

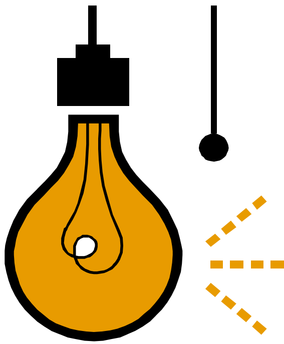


as having been disposed of in a taxable sale. According to Revenue Procedure 2010-14, the IRS believes that a taxpayer who in good faith sought to complete an exchange using a QI, but who failed to do so because the QI became subject to bankruptcy or receivership proceedings, should not be required to recognize gain from the failed exchange until the taxpayer receives a payment attributable to the relinquished property.

WHO IS ENTITLED TO RELIEF?

Revenue Procedure 2010-14 applies to taxpayers who:

- transferred relinquished property to a QI in accordance with Treasury Regulations under Code Section 1031;
- properly identified replacement property within the identification period;
- did not complete the like-kind exchange solely because of a QI that becomes subject to a bankruptcy or receivership proceeding, and
- did not receive the proceeds from the



disposition of the relinquished property prior to the time the QI entered bankruptcy or receivership.

RELIEF PROVISIONS

A taxpayer meeting the above conditions recognizes gain on the disposition of the relinquished property only as required under the safe harbor gross profit ratio method, and only as the taxpayer receives payments attributable to that property.

Under the safe harbor gross profit ratio method, the portion of any payment attributable to the relinquished property that is recognized as gain is determined by multiplying the payment by a fraction, the numerator of which is the gross profit, and the denominator of which is the contract price.

A payment attributable to the relinquished property generally means a payment of proceeds, damages, or other amounts attributable to the disposition of the relinquished property, whether paid by the QI, the bankruptcy or receivership estate of the QI, the QI's insurer or bonding company, or any other person. Gross profit means generally the selling price of the relinquished property, minus the taxpayer's adjusted basis in the relinquished property.

The selling price of the relinquished property is generally the amount realized on its sale, without reduction for selling expenses. The contract price is the selling price of the relinquished property minus the amount of any satisfied indebtedness not in excess of the property's adjusted basis. Satisfied indebtedness means any mortgage or encumbrance on the relinquished property that was assumed or taken subject to by the buyer or satisfied in connection with the transfer of the relinquished property.

A Code Section 165 loss deduction may be claimed for the amount, if any, by which the adjusted basis of the relinquished property exceeds the sum of (1) the payments attributable to the relinquished property (including satisfied indebtedness in excess of basis), plus (2) the amount of any satisfied indebtedness not in excess of basis.

CONCLUSION

Revenue Procedure 2010-14 provides guidance for taxpayers who in good faith sought to complete a deferred like-kind exchange using a QI but who failed to complete the exchange because the QI became subject to a bankruptcy or receivership proceeding. In general, Revenue Procedure 2010-14 provides that certain qualifying taxpayers should not recognize gain from a failed like-kind exchange until the taxable year in which the taxpayer receives a payment attributable to the relinquished property.