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HIGHLIGHTS

ARTICLE: POLICY CONSIDERATIONS TRUMP STATUTORY CONSTRUCTION, GIVING STOP NOTICE CLAIMANTS A BIG ADVANTAGE OVER CONSTRUCTION LENDERS

By Lewis J. Soffer

NEW FEDERAL LAW / POST-FORECLOSURE EVICTION

The Protecting Tenants at Foreclosure Act, Pub. Law 111-22, §§701 to 704 (11th Cong. 1st. Sess.), effective May 20, 2009

New federal law restricts post-foreclosure eviction of residential tenants.

TITLE INSURANCE

First American Title Ins. Co. v. XWarehouse Lending Corp., 177 Cal. App. 4th 106, 98 Cal. Rptr. 3d 801 (1st Dist. 2009)

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California Environmental Quality Act does not require a public agency to complete and consider an environmental impact report commenced before it disapproves a project.

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ARTICLE

POLICY CONSIDERATIONS TRUMP STATUTORY CONSTRUCTION, GIVING STOP NOTICE CLAIMANTS A BIG ADVANTAGE OVER CONSTRUCTION LENDERS

By Lewis J. Soffer*

A development project stalls, and the construction lender forecloses, "wiping out" all junior liens, including mechanic's liens recorded by unpaid subcontractors and material suppliers. Some of those "mechanics," however, also had served bonded stop notices, and others do so after the foreclosure, but within the time allowed after cessation of work. The lender responds that there is no more money left in the till, the entire construction loan fund having been exhausted before the lender received the stop notices. If the stop notice claimants are on their toes, they may still be able to force the bank to pay them.

In a 1989 court of appeal decision that has never since been cited in a published case, the Fourth District Court of Appeal afforded stop notice claimants the ability to "draw back" into the construction loan, as funds available to satisfy their claims, all payments and disbursements made by the construction lender for its own benefit, including earned fees and points, and interest from pre-allocated funds in an interest reserve, even though (a) those disbursements were entirely consistent with, and required by the loan documents, and (b) the disbursements occurred *before* service of any bonded stop notice. As a result, the bank had to pay to the stop notice claimant money that the bank considered was coming "out of its own pocket," in that it consisted of "preallocated loan expenses including interest, loan fees, document preparation fees, and general administrative expenses" that the bank had earned and disbursed to itself before receiving the stop notice.

The published portion of *Familian Corp. v. Imperial Bank* ("*Familian*"),[1] begins with a short paragraph referring to Civil Code section 3166 as "the focus of this appeal," and ends with a short paragraph referring to that statute. Between those bookends is a lengthy exposition on the public policies favoring mechanic's lien and stop notice claimants, with citations to numerous cases, *none* of which holds that section 3166 allows a stop

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notice claimant to reach loan funds that were earned by, and disbursed to the construction lender before service of the bonded stop notice.

Ten years later, in *Steiny and Co., Inc. v. Citicorp Real Estate* ("*Steiny*"),[2] the First Appellate District disagreed with *Familian*, and recognized a distinction between on one hand a construction lender's establishing a reserve fund and thereby segregating a portion of construction loan funds for *later* disbursement to itself of *as yet unearned* interest and fees, and on the other hand a lender's disbursing loan funds to pay itself fees and interest *as those amounts were actually earned*. That court in part agreed with *Familian*, and held that a "pre-allocation" of construction loan funds by way of a contractual agreement between lender and borrower was the functional equivalent of a statutorily prohibited assignment of construction loan funds, and would not be honored to defeat stop notice claims based on notices served before the lender had earned and received the fees and interest; but it then parted company with *Familian*, and held that sums already earned by and disbursed to the lender before receipt of a bonded stop notice could not be drawn back into the loan account for the benefit of the stop notice claimant.

Initially the state supreme court, recognizing the conflict between the two cases, and the public policy implications of the issue, granted review of the *Steiny* decision. The court then reversed field, withdrew its grant of review, and ordered the *Steiny* decision de-published.[3] As a result, *Familian* is the only citable authority on this issue, and is controlling authority as to all superior courts in the state. Contractors and suppliers who understand its implications are in a position to recover from construction lenders millions of dollars, after the lenders believe that they have already earned those dollars and "booked" them as income.

This article addresses the reasoning of both *Familian* and *Steiny*, and concludes that a policy preference for protecting laborers and materialmen has to date outweighed conformity with principles of statutory construction and legal reasoning. This is not to say that *Familian* should or will be disregarded or overruled, but rather that in the present economic climate the rule enunciated in *Familian* is ripe for challenge in other district courts, and perhaps the state supreme court. The recent failure of large real estate projects, leaving contractors unpaid and lenders under-secured, has given rise to numerous situations in which enough money is at stake to warrant the expense of forcing reconsideration of the issue by the appellate courts, and it seems likely that the next case presenting the *Familian* issue is now somewhere in the legal pipeline.

How Stop Notices Function

A stop notice is a written demand served by a contractor, subcontractor or materialman ("mechanic") on whoever is holding construction funds, requiring that person to withhold the sums claimed by the mechanic from the moneys due to the general contractor.[4] Most commonly, the holder of the funds is the construction lender. Although a general contractor may not serve a stop notice on the owner, it may serve one on the construction lender.[5] If the claimant properly served a preliminary notice, and properly serves the stop notice together with a bond protecting the owner, contractor or lender against any losses caused if the stop notice turns out to have been improper,[6] the holder of construction funds is required to withhold the amount claimed, and not to disburse those funds to the owner, the general contractor, or anyone else who claims the funds.[7] Service of the stop notice operates as an equitable garnishment or equitable assignment of the construction funds, giving the claimant a lien on those funds.[8] If after receiving service of a bonded stop notice the lender disburses loan funds to anyone other than the stop notice claimant, except a creditor of the contractor that had previously garnished funds due to the contractor,[9] and thereafter the funds remaining in the construction loan account are insufficient to satisfy the stop notice claim, the lender that disbursed the funds is personally liable to the claimant to the extent of the improperly-disbursed funds.[10]

If the construction lender forecloses, any mechanic's liens that are junior in priority to the construction loan deed of trust are invalidated.[11] Even absent such a foreclosure, if there is no equity in a project above the construction loan balance, junior mechanic's liens have no practical effect. On public projects, mechanic's liens are not allowed.[12] For all these reasons, an enforceable stop notice may be the only means of collection available to a mechanic that provided labor or materials to what has turned out to be a failed project. If at the end of the day there are no funds remaining in the construction loan account, even the stop notice will be unavailing—unless the claimant can force the construction lender to pay with money out of the lender's own pocket. *Familian* creates an opportunity for the claimant to do just that.

The Reasoning of *Familian*, and the *Steiny* Critique

As noted above, the keystone for the *Familian* decision is Civil Code section 3166:

> "No assignment by the owner or contractor of construction loan funds, whether made before or after a stop notice or bonded stop notice is given to a construction lender, shall be held to take priority over the stop notice or bonded stop notice, and such assign-

ment shall have no effect insofar as the rights of claimants who give the stop notice or bonded stop notice are concerned."

Familian and *Steiny* agree that no private contract between an owner and a construction lender, including a recorded deed of trust or loan agreement, can establish the lender's right to pay itself interest, fees or obligations accrued *after* service of a bonded stop notice, since no matter what the mechanism is called (preallocation, interest reserve, etc.), it operates as an assignment of construction loan funds to the construction lender, to the detriment of the claimant. The question is whether section 3166 requires the same result where the obligations to the lender accrue and are paid *before* service of the stop notice. The *Familian* decision held that it does, on the basis that the statute "expressly provides that any assignments made before or after receipt of stop notices are subordinate to preferred [stop notice] claims of laborers and materialmen," and that allowing a construction lender to reverse the statutorily-mandated priority of such liens on construction funds by paying itself interest or fees would "engraft a loophole into section 3166."[13]

Steiny took issue with that analysis, pointing out that the ordinary meaning of "assignment" is "a transfer of a right to do something that has not yet become property in possession."[14] While somewhat opaque, this definition of assignment is consistent with the commonly understood meaning of the word, namely the transfer of a right from one person to another, in this case a transfer by the borrower to the construction lender of the right to receive loan proceeds at prescribed times and for prescribed purposes (e.g., payment of fees and interest). *Steiny* asserted that *Familian* offers no explanation for its extension of the definition of "assignment" to include payments already earned and made, and in a footnote, *Steiny* distinguished the cases relied upon by *Familian* on this point.

This article elaborates somewhat on *Steiny's* observation that the *Familian* court made entirely new law, and concludes that the *Familian* court's explanation for doing so amounts to an admission that policy considerations outweighed conformity with legal precedent.

Familian's Reliance on Inapplicable Authority

The earliest case cited by *Familian* for the proposition that a construction lender cannot achieve priority over stop notice claimants by "depositing *unexpended* loan funds into either a general fund or a separate escrow account for pro rata distribution,"[15] is *Calhoun v. Huntington Park First Sav. & Loan Ass'n*.[16] In *Calhoun*, *after* the lender received service of a bonded stop notice, it transferred all remaining construction loan funds to an escrow holder, to be disbursed to trustees for the benefit of the borrower's creditors. The lender contended that the stop notice had "caught nothing," because under the construction loan documents, upon the borrower's default it was entitled to withdraw all remaining loan funds and credit that amount to the obligations secured by its deed of trust.[17] The *Calhoun* court actually emphasized that there was no evidence the lender ever credited the segregated funds to the borrower's indebtedness, as allowed by the loan documents,[18] as though by doing so even *after* receipt of a bonded stop notice the lender could have enforced a contractual right to accelerate and collect the mortgage debt. *Calhoun* did rely upon Code Civ. Proc., section 1190.1, the predecessor to current section 3166, but not as prohibiting a lender from retaining funds earned and disbursed to itself *before* receipt of a bonded stop notice. As *Familian* acknowledged, *Calhoun* held that once a bonded stop notice is served, "the holder of construction funds may not invalidate the effect of a notice and bond given pursuant to the statutory provisions by *thereafter* transferring those funds to other creditors or using them to advance its own interests."[19]

Familian describes *Rossman Mill & Lumber Co. v. Fullerton Sav. & Loan Ass'n* ("*Rossman*")[20] as holding that the stop notice statutes are remedial, having been designed to protect mechanics and materialmen who furnish labor and materials that go to enhance the value of the owner's property, thereby increasing the lender's security, and "must be liberally construed to effect [their] objects and promote justice."[21] *Rossman* held that lenders cannot avoid section 3166 priority by private agreement.[22] In *Rossman*, the lender ignored service of a stop notice and bond, and at the end of the loan term applied the sum remaining in the building loan fund to reduce the balance due on the borrower's note.[23] That lender argued that the claimant's notice to withhold funds was subordinate to its building and loan agreement with the borrower, and (leading with its chin) that the latter acted as an assignment of loan funds to retire the borrower's debt.[24] Not surprisingly, the *Rossman* court held that any such assignment would violate section 1190.1, the predecessor to 3166, and rejected the lender's argument. *Rossman* did not consider the situation where fees and interest are earned and disbursed under a loan agreement before service of a stop notice.

Without evidencing any appreciation of the irony involved, the *Familian* court cited *McBain v. Santa Clara Sav. & Loan Ass'n* ("*McBain*")[25] and *Doud Lumber Co. v. Guaranty S&L Ass'n* ("*Doud*")[26] in order to quote from those cases language to the effect that a construction lender, by taking precautions in disbursing progress payments, can protect itself against claims by unpaid contractors and materialmen.[27] The holdings of *McBain* and *Doud* were that mechanic's lien claimants whose liens had been wiped out by a foreclosure nonetheless were entitled to equitable liens on the construction loan funds, because the construction lender's act of establishing a system for progress payments induced those persons to contribute to the construction.[28] As *Familian* acknowledges, however, the equitable lien theory that had been incorporated into the stop notice statute was thereafter abolished by amendment, effectively "overruling" *McBain* and *Doud*.[29] *McBain*'s discussion of stop notice law was restricted to requiring strict compliance with the stop notice statutes as a condition to enforcement of any stop notice, and *rejecting* the stop notice claim asserted by the only claimant that had served a stop notice, because he failed to deliver with it a bond. *Familian* is correct in stating that the observation by *McBain* and *Doud* that a construction lender can protect itself can be used to support a pro-contractor result in cases not involving equitable liens, but *Familian* does not acknowledge that those same cases explicitly rejected attempts by unpaid mechanics to extend the stop notice statutes beyond what their express terms allow.

As authority for the proposition that "the construction lender cannot defeat the rights of a stop notice claimant by a transfer to itself… or by overpayment of the fund,"[30] *Familian* quotes from *Idaco Lumber Co. v. Northwestern S&L Ass'n*. ("*Idaco*"),[31] a case in which *after* the borrower defaulted, and *after* the plaintiff had perfected its stop notice claim, the lender transferred all unexpended loan funds into its general fund, and paid on a pro rata basis all the *other* creditors of the borrower, none of whom had served a bonded stop notice, leaving nothing for the plaintiff.[32] The actual holding of *Idaco* was that by perfecting its stop notice claim the plaintiff created a lien on the loan account, and that the lender could not *then* invalidate that claim by transferring the remaining loan funds into its own general fund, and then making payments to other creditors.[33] Neither the question of preallocation of loan funds nor the distinction between such preallocation and actual disbursement of earned fees and interest was considered.

Familian correctly cites *A-1 Door & Materials Co. v. Fresno Guar. Sav. & Loan Ass'n* ("*A-1 Door*")[34] and *Miller v. Mountain View Sav. & Loan Ass'n* ("*Miller*")[35] as holding that even if a construction loan agreement expressly allows the lender to apply undisbursed loan funds to reduce the borrower's debt, or to complete the construction after receipt of a stop notice, the statute proscribes its doing so.[36] Neither of those cases considered whether fees and interest earned by and disbursed to the lender prior to receipt of a stop notice could be drawn back into the loan fund to satisfy the stop notice claimant.

The holding in *Miller* was that although the only stop notice claimant failed to serve a bond with its notice to withhold, and therefore was not entitled to the benefit conferred by statute,[37] there was sufficient evidence in the record to support the trial court's finding that the claimant had relied upon the existence of the loan in providing labor and materials to the project, and so was entitled to an equitable lien on the loan funds.[38] As mentioned above, a subsequent amendment to the stop notice statutes clarified that the equitable lien theory may not be applied to circumvent the bonding requirement.[39] *Miller*'s one-paragraph conclusion, that in order to gain priority a stop notice claim must be accompanied by a bond, appears at the end of a seven-page discussion of the policy underlying the stop notice statutes.[40]

Familian cites *Miller* as holding that section 3166's "blanket proscription" against private agreements that would deprive stop notice claimants of their priority "applies whether the construction loan agreement allows the lender to apply the undisbursed fund to reduce the borrower's debt or to complete the building either before or after receipt of the stop notice.[41] This reading of *Miller* is dubious for two reasons. First, *Miller*'s discussion of this point appears as part of the court's policy discussion, and is arguably dictum. Second, that discussion does not support *Familian*'s characterization of it. Citing *Rossman* and *A-1 Door*, *Miller* states that, "The statutory provisions invalidate as to a claimant *an assignment* whether made before or after a verified claim is filed."[42] Thus, regardless of the timing of an *assignment* of loan funds benefitting the lender, it will not be enforced to deprive a bonded stop notice claimant of priority. That is not to say that costs incurred and actually paid prior to receipt of a bonded stop notice must be disregarded in determining what balance remains in the building loan fund when the notice is received.

Interestingly, *Miller*'s policy discussion contains something for everyone. *Miller* points to "strong reasons of public policy to require commercial lenders to police the speculative building industry by penalizing the lender if the project fails," and to the fact that a construction lender can protect itself by requiring the borrower to provide a completion bond,[43] and by employing proper procedures when it disburses loan funds, such as inspecting physical progress, requiring receipted bills from subcontractors, and employing joint checks.[44] However, in balancing the interests of the construction lender and stop notice claimants, *Miller* observes that, "[T]he fund available to the stop-notice claimants against a loan fund would be the difference between *the sums properly advanced and paid put of the loan account*, and the total value of the work and material furnished toward the improvement...."[45] Any loan funds then remaining should be credited against the indebtedness, because the stop notice claimants "should not at the end of the race receive a bonus insofar as sums are paid out and charged against the property in excess of the difference between the total value of the work furnished, and the sums properly paid out on the loan."[46] Thus, under *Miller* the sum available for satisfaction of stop notice claims should be computed by determining the value of the work of improvement in its state of completion when the bonded stop notice was received, and deducting "the sums properly paid out on the loan" as of that date. Could not a rule requiring the construction lender to restore to the loan fund and make available to the stop notice claimants payments it had actually earned and received before service of any stop notice be characterized an unfair bonus to the stop notice claimants? Of course, the *Miller* court was not actually facing the question whether loan fees and interest taken out of the loan fund before receipt of stop notices should be treated as "funds properly paid out on the loan," but if such charges are to be so treated, then the logic of *Miller* undercuts the result in *Familian*.

The *Familian* court anticipated this observation, and revealed the true basis for its extension of section 3166, when it rejected the lender's argument that a stop notice claimant's priority applies only to unexpended or undisbursed loan funds, and that the lender's fees, points and interest were costs incurred before Familian even commenced work on the project."[47] This is where the *Familian* court characterized the lender's interpretation of the statute as "engraft[ing] a loophole," and observed, "A construction lender would need only to deduct its profits at the inception of the loan to assure a double recovery at the expense of those who enhance the value of the property by supplying labor and materials."[48]

No doubt the "protective policy" serving the needs of the construction industry to which *Familian* then refers would be violated if construction lenders could circumvent section 3166 by paying themselves outlandish fees and prepaid interest at loan closing, or in accord with a disbursement schedule unrelated to accrual of interest or the delivery by that lender of loan-related services or other real consideration. However, while *Familian's* across-the-board and automatic requirement of restitution by the lender of all consideration received by it from the inception of the construction loan, earned or not, serves the short-term purposes of the construction industry, and is easier of application than a more customized rule, the effect of *Familian* is to discourage lenders from making *any* construction loans out of fear that they will receive no return on their loans, and will in effect have *negative profits* because they are compelled to absorb the cost of funds loaned and to disgorge all interest and fees.

If the intent truly is to protect stop notice claimants from rapacious and deceitful lenders, then a more tailored approach is necessary to prevent unfairness to lenders who do not cheat. The remedy for a lender's attempt to circumvent the stop notice law, for example prepayment to itself of unearned interest or fees, could be to declare that such unearned prepayments, *if proved as a matter of fact*, do not qualify as sums earned and paid before receipt of the bonded stop notice, and do not reduce the fund available to the stop notice claimant. Any concern that contractors and subcontractors would not have the financial means to conduct the necessary discovery and make such a showing could be addressed by shifting the burden to the lender to show, as part of a recognized unavailability of funds affirmative defense to the stop notice claim, that any payments it received from the loan account were actually earned and paid before service of the stop notice. Surely this is a more appropriate and intellectually honest solution than *Familian's* unfortunate manipulation of statutory language.

Lender's Issuance of a Letter of Credit or Other Support for Performance Bonds—An Issue Unresolved by *Familian*

Assuming that *Familian* remains unchallenged, the holding of that case leaves unresolved a practical problem of real significance to construction lenders. Often, as a condition to issuance of governmental approvals for a development project, the local jurisdiction will require that the developer provide a performance and/or completion bond, assuring that necessary infrastructure and other desired public improvements will be constructed, whether or not the project reaches fruition. The surety issuing the bond will usually require collateral to assure itself 100% indemnity if it is ever called upon to pay for completion of the bonded work. The developer/ borrower will ordinarily be unable to post the collateral, so the construction lender is asked to do so, often in the form of a letter of credit or set-aside letter. If the project fails, the city makes demand on the bonding entity, and that entity demands payment under the set-aside letter, the construction lender must pay. But what if bonded stop notices are served on the lender, before or after the demand is received for payment under the set-aside letter?

Is payment under the set-aside letter properly treated as disbursement of construction loan funds to a third-party creditor, or should it be viewed as the lender's satisfying its own contractual obligation? If the bonded stop notices precede the demand under the letter of credit, then the foregoing remains an issue; but if payment under the letter of credit comes before the stop notices are received, then an additional quandary arises. Can the lender treat the set-aside funds as restricted for the purpose of paying for the cost of constructing the bonded improvements, or is this an improper "assignment" of the construction funds to pay for future work which is ineffective when the stop notice claimant asserts a claim to the undisbursed loan proceeds? Presuming that payment under the set-aside letter is viewed as a construction loan disbursement, are the stop notice claimants entitled to treat payment to the surety as an improper disbursement under *Familian*, and to force the lender to pay the stop notice claims regardless of the fact that the remaining loan fund is exhausted?

For the moment, these questions are unanswerable, and as a practical matter there is little or nothing that a construction lender can do to ameliorate the risk.

Conclusion

The *Familian* decision affords unpaid contractors and materialmen a powerful tool for collecting sums due for work performed on a development that has failed and gone into foreclosure. If a timely bonded stop notice is served upon the construction lender, the stop notice claimant can force the lender to restore to the loan fund points, fees and interest earned and received by the construction lender from the inception of the loan, even before service of the stop notice.

Whether the *Familian* rule is founded upon solid legal precedent is questionable, but the policy supporting that rule, solicitude for the practical needs of contractors and materialmen, is well entrenched. In such circumstances, and given the current state of the real estate market, the courts may soon have occasion to revisit the issue.

NOTES

1. *Familian Corp. v. Imperial Bank*, 213 Cal. App. 3d 681, 683, 262 Cal. Rptr. 101 (4th Dist. 1989)
2. *Steiny & Co., Inc. v. Citicorp Real Estate, Inc.*, 85 Cal. Rptr. 2d 38 (App. 1st Dist. 1999), as modified on denial of reh'g, (June 17, 1999) and review granted and opinion superseded, 88 Cal. Rptr. 2d 282, 982 P.2d 153 (Cal. 1999) and review dismissed, cause remanded, 109 Cal. Rptr. 2d 301, 26 P.3d 1039 (Cal. 2001) (unpublished/nonciteable). As explained in the article, initially the state supreme court, recognizing the conflict between this case and *Familian*, granted review, but then withdrew its grant of review, and ordered the *Steiny* decision de-published. See cite below.
3. *Steiny and Co. Inc. v. Citicorp Real Estate Inc.*, 109 Cal. Rptr. 2d 301, 26 P.3d 1039 (Cal. 2001) (opinion ordered unpublished/nonciteable).
4. *Flintkote Co. v. Presley of Northern California*, 154 Cal. App. 3d 458, 462, 201 Cal. Rptr. 262 (1st Dist. 1984).
5. *Barker Bros. v. Coates*, 211 Cal. 756, 759, 297 P. 8 (1931).
6. Civ. Code, § 3083; *Miller v. Mountain View Sav. & Loan Ass'n*, 238 Cal. App. 2d 644, 658, 48 Cal. Rptr. 278 (1st Dist. 1965). On service of an unbonded stop notice, the construction lender may withhold the amount claimed from disbursements otherwise due, but is not required to do so. Civ. Code, §§ 3161, 3162.
7. Civ. Code, §§ 3159, subd. (a)(1), 3162, subd. (a)(1). There is, however, an alternative by which the holder of construction funds can "bond around" the stop notice and continue making disbursements. Civ. Code, § 3171.
8. See, e.g., *Connolly Development, Inc. v. Superior Court*, 17 Cal. 3d 803, 813, 132 Cal. Rptr. 477, 553 P.2d 637 (1976); *Theisen v. Los Angeles County*, 54 Cal. 2d 170, 178, 5 Cal. Rptr. 161, 352 P.2d 529 (1960). In some circumstances, if the construction contract and a sufficient bond were recorded before the stop notice was received, the lender need not withhold, but the details are beyond the scope of this article. Civ. Code §§ 3159, subd. (a)(1), (2), 3162, subd. (a)(1), (2).

9 Code Civ. Proc., §§ 488.455, 488.470, 488.610, subd. (b)(3).

10 Civ. Code, § 3162; *Connolly Development, Inc. v. Superior Court*, 17 Cal. 3d 803, 809, 132 Cal. Rptr. 477, 553 P.2d 637 (1976); *Building Profit Corp. v. Mortgage & Realty Trust*, 36 Cal. App. 4th 683, 688-690, 42 Cal. Rptr. 2d 533 (4th Dist. 1995).

11. See *Connolly Development, Inc. v. Superior Court*, 17 Cal. 3d 803, 809, 132 Cal. Rptr. 477, 553 P.2d 637 (1976).
12. *Sunlight Elec. Supply Co. v. McKee*, 226 Cal. App. 2d 47, 49, 37 Cal. Rptr. 782 (4th Dist. 1964).
13. *Familian, supra,* 213 Cal. App. 3d 681, 687.
14. For this definition, *Steiny* cited 7 Cal. Jur. 3d, Assignments, § 1 (1989) p. 7, and *In re Beffa's Estate*, 54 Cal. App. 186, 189-190, 201 P. 616 (3d Dist. 1921).
15. *Familian*, *supra*, 213 Cal. App. 3d 681, 686.
16. *Calhoun v. Huntington Park First Sav. and Loan Ass'n*, 186 Cal. App. 2d 451, 454, 9 Cal. Rptr. 479 (4th Dist. 1960) (italics added).
17. *Id*. at p. 458.
18. *Ibid*.
19. *Familian*, *supra*, 213 Cal. App. 3d 681, 684, quoting from *Calhoun*, *supra*, 186 Cal. App. 2d 451, 459-460, italics added.
20. *Rossman Mill & Lumber Co. v. Fullerton Sav. & Loan Ass'n*, 221 Cal. App. 2d 705, 34 Cal. Rptr. 644 (4th Dist. 1963).
21. *Familian*, *supra*, 213 Cal. App. 3d 681, 685.
22. *Id*. at p. 686.
23. *Rossman*, *supra*, 221 Cal. App. 2d 705, 708.
24. *Id* at pp. 708-709.
25. *McBain v. Santa Clara Sav. & Loan Ass'n*, 241 Cal. App. 2d 829, 51 Cal. Rptr. 78 (1st Dist. 1966).
26. *Doud Lumber Co. v. Guaranty Sav. & Loan Ass'n*, 254 Cal. App. 2d 585, 60 Cal. Rptr. 94 (1st Dist. 1967).
27. *Familian*, *supra*, 213 Cal. App. 3d 681, 685-686.
28. *McBain*, *supra*, 241 Cal. App. 2d 829, 841-846, citing *Smith v. Anglo-California Trust Co.*, 205 Cal. 496, 502-503, 271 P. 898 (1928); *Pacific Ready Cut Homes v. Title Ins. & Trust Co.*, 216 Cal. 447, 450-452, 14 P.2d 510 (1932); *A-1 Door*, *supra*, 61 Cal. 2d 728, 732; *Miller*, *supra*, 238 Cal. App. 2d 644, 660-662; *Doud*, *supra*, 254 Cal. App. 2d 585, 588-592.
29. Civ. Code, § 3264, enacted 1967; see *Familian*, *supra*, at p. 685. See *Boyd & Lovesee Lumber Co. v. Western Pacific Financial Corp.*, 44 Cal. App. 3d 460, 118 Cal. Rptr. 699 (4th Dist. 1975), holding mechanic cannot recover from construction lender under theory of "negligent disbursement" of loan funds, and observing (at p. 464): "Most writers feel that under [section 3264] the equitable lien is entirely dead." Cf. *Nibbi Brothers, Inc. v. Home Federal Sav. & Loan Assn.*, 205 Cal. App. 3d 1415, 1419-1426, 253 Cal. Rptr. 289 (1st Dist. 1988), suggesting that despite the 1967 amendment to Civil Code § 3264, eliminating the equitable lien theory as an alternative to stop notice rights, a mechanic might still obtain recovery from a construction lender under the doctrine of unjust enrichment, or based on fraud, but ultimate holding that no cause of action was stated.
30. *Familian*, *supra,* at p. 686, quoting from *Idaco Lumber Co. v. Northwestern Sav. & Loan Ass'n*, 265 Cal. App. 2d 490, 496, 71 Cal. Rptr. 422 (1st Dist. 1968).
31. *Idaco Lumber Co. v. Northwestern Sav. & Loan Ass'n*, 265 Cal. App. 2d 490, 71 Cal. Rptr. 422 (1st Dist. 1968).
32. *Id.* at p. 493. After thus exhausting the available loan funds, the lender "voluntarily paid from its general funds to the stop notice claimants, except [plaintiff, i.e., to claimants who had not perfected their claims], and to three mechanics lien claimants who had not filed stop notices, the balance of their claims so that each claimant except [plaintiff] received 100 percent of its stop notice claim or lien claim. The record is silent as to [lender's] reason for not including [plaintiff] when it voluntarily made payments in full to other claimants." (*Id*. at p. 494.) A cynic might surmise that the lender wanted to keep the other contractors happy so that it could finish the project after foreclosure, but that it chose to make an example of the one contractor who rejected the offer of a pro rata payment.
33. *Id*. at p. 499.

34. *A-1 Door & Materials Co. v. Fresno Guarantee Sav. & Loan Ass'n*, 61 Cal. 2d 728, 734-735, 40 Cal. Rptr. 85, 394 P.2d 829 (1964).
35. *Miller v. Mountain View Sav. & Loan Ass'n*, 238 Cal. App. 2d 644, 656, 48 Cal. Rptr. 278 (1st Dist. 1965).
36. *Familian*, *supra*, 213 Cal. App. 3d 681, 686.
37. *Miller, supra*, 238 Cal. App. 2d 644, 650, 661.
38. *Id.* at p. 663.
39. *Id.* at p. 661.
40. *Id.* at pp. 655-661.
41. *Familian, supra*, 213 Cal. App. 3d 681, 686.
42. *Miller, supra,* 238 Cal. App. 2d 644, 657, italics added.
43. *Id.* at pp. 658-659.
44. *Ibid*.
45. *Id. at* p. 660, italics added.
46. *Ibid*.
47. *Familian, supra*, 213 Cal. App. 3d 681, 687. The court does not explain why the crucial date should be fixed by commencement of work, and not by service of a bonded stop notice.
48. *Ibid.*

NEW LAWS

LANDLORD AND TENANT

New Federal Law Restricts Post-Foreclosure Eviction of Residential Tenants

The Protecting Tenants at Foreclosure Act, Pub. Law 111-22, §§701-704 (11th Cong. 1st. Sess.), effective May 20, 2009, requires any immediate successor-in-interest of a property through foreclosure (whether by trustee's sale or deed in lieu of foreclosure) to assume its interest in the property subject to two requirements: (a) any "bona fide tenant" must be given at least 90 days prior written notice to vacate the property, and (b) the tenant is permitted to occupy the premises until the end of the remaining term of the lease, *unless* the purchaser in foreclosure or some other person to whom the purchaser in foreclosure sells the property will occupy the unit as their primary residence, in which case the tenant still has the full 90 days to vacate. (*Id*., §702(a)(2)(A)). Even if the lease is terminable at will under state law or the tenant does not have a written lease, the tenant automatically is entitled to remain in possession until 90 days after the required written notice. By its terms, the statute expires on December 31, 2012, at which time it is automatically repealed (Pub. Law 111-22, §704).

The federal law applies to *any property* containing a dwelling or constituting residential real property; the protections apply "in the case of any foreclosure on a federally-related mortgage loan *or* on any dwelling or residential real property after the date of enactment of this title." (emphasis added.) An interesting question is posed by the term "or," which seems to imply that the restriction on eviction applies *whether or not* the foreclosure occurs under a "federally-related mortgage loan." Usually, a federally-related mortgage loan involves a loan other than a construction loan that is secured by a first lien on residential property designed primarily for occupancy by one to four families which is made by a lender whose accounts or deposits are insured by an agency of the federal government, or by an agency regulated, guaranteed, supplemented or assisted by the federal government, or intended to be sold by the originating lender to FNMA, GNMA, FHLMC, or another financial institution for resale to one of these entities and made by a lender who originates more than $1 million per year (with additional requirements). See Real Estate Settlement Procedures Act of 1974, §3 (12 U.S.C. 2602), also referred to in Pub. Law 111-22, §701(c). The word "or" suggests that the Protecting Tenants at Foreclosure Act is not restricted to foreclosures under federally related loans.

✦ **Comment:** The California eviction law was amended in 2008 to prohibit eviction of a tenant or subtenant in possession of rental housing at the time the property was sold in foreclosure for a period of 60 days following written notice to quit, unless the person in possession is a "party to the note." (Code Civ. Proc., §1161, subd. (b), added by 2008 Stats, Ch. 69 (SB 1137), §6, effective July 8, 2008). The federal statute provides for a longer period, and more explicitly provides that only the purchaser in foreclosure can give the notice (i.e., the eviction is only effective after a full 90 days following foreclosure). Like the federal statute, the state statute expires as of January 1, 2013.

» *See Miller & Starr, California Real Estate 3d, Ch. 19, Landlord and Tenant, §19:86.*

NEW CASES

ALTERNATIVE DISPUTE RESOLUTION

Functus officio doctrine applies to interim arbitral awards, but only if they are deemed final.

Arbitration Between Bosack v. Soward, 573 F.3d 891 (9th Cir. 2009)

Deciding an issue of first impression, the Ninth Circuit Court of Appeals held that the *functus officio* doctrine, codified in Rule 46 of the Commercial Arbitration Rules of the American Arbitration Association, may be applied to an *interim* arbitration award in some cases. Rule 46 provides that "[t]he arbitrator is not empowered to *redetermine* the merits of any claim already decided." [Emphasis added.] In this case, due to the complexity of issues involving a partnership dispute, the parties agreed to arbitrate their dispute in stages, resulting in a series of five interim awards and then one final award. Following the arbitration, the limited partners (owed substantial sums of money to the general partner, including punitive damages totaling approximately $20 million) claimed that interim awards 4 and 5, and a portion of the final award, had to be vacated because they violated the *functus officio* doctrine. In concluding that the doctrine may be applied to an interim award, the court adopted the criteria used by the Eighth Circuit in *Legion Ins. Co. v. VCW, Inc.*, 198 F.3d 718, 720 (8th Cir. 1999). This case holds that an interim award may be deemed final for purposes of the doctrine if the award states that it is final, and if the arbitrator intended the award to be final. Here, only interim award 3 satisfied these criteria. Furthermore, the limited partners mischaracterized the scope of that interim award, which was limited to determining the general partner's interest in the partnership. The arbitration panel did *not* redetermine the merits of award 3 in any of the remaining arbitrations, concluded the court of appeals. Accordingly, the doctrine did not apply.

The court of appeals further held that the arbitration award was neither a manifest disregard of California law, nor completely irrational, which would have constituted grounds for vacating the award. See 9 U.S.C.A. §10(a)(4). The court of appeals explained that in order to demonstrate a manifest disregard of the law a party must show that the arbitrator understood and correctly stated the law but proceeded to disregard it. See *Collins v. D.R. Horton, Inc.*, 505 F.3d 874, 879, 26 I.E.R. Cas. (BNA) 961, 155 Lab. Cas. (CCH) P 60494 (9th Cir. 2007), cert. denied, 128 S. Ct. 1739, 170 L. Ed. 2d 539, 27 I.E.R. Cas. (BNA) 608 (2008). There was no such showing here concerning a manifest disregard of conversion law, nor the law concerning punitive damages. As for the limited partners' claim that awards 4 and 5 should be vacated because they were *irrational*, the court explained that the standard is extremely narrow. It is only established where the arbitration decision fails to draw its essence from the agreement. *Comedy Club, Inc. v. Improv West Associates*, 553 F.3d 1277, 1284, 2009-1 Trade Cas. (CCH) ¶76482 (9th Cir. 2009), cert. denied, 2009 WL 1648924 (U.S. 2009). Here, the limited partners failed to meet the standard. They claimed that the arbitration panel's findings of fact in the various awards were inconsistent, not that the award was irrational with respect to the contract. Their claim that the panel's finding that the general partner was entitled to an accounting and distribution was not founded in the agreement also failed. The panel's conclusions concerning an accounting were based on *Delaware law*—not the agreement.

» *See Miller & Starr, California Real Estate 3d, Ch. 35, Alternative Dispute Resolution, §35:89.*

Contractual arbitration award had to be vacated where the arbitrator excluded material evidence, resulting in substantial prejudice to one of the parties.

Burlage v. Superior Court, 177 Cal. App. 4th 166, 99 Cal. Rptr. 3d 142 (2d Dist. 2009)

After purchasing a home, the buyers discovered that their swimming pool and a fence encroached on property owned by a neighboring country club. Based on an arbitration provision in their purchase agreement, the parties agreed to submit their dispute concerning the seller's nondisclosure of this information to determination by a JAMS arbitrator. Before the arbitration was held, the buyers' title insurance company paid the country club $10,950 in exchange for a lot line adjustment, so there was no longer an encroachment problem. The arbitrator granted the buyers' motion to exclude evidence concerning the effect the lot-line adjustment on damages, on the grounds that the damages were fixed at the time escrow closed. The arbitrator later found in favor of the buyers, awarding them $552,750 in compensatory damages, $250,000 in punitive damages, and $732,570 in attorney's fees and costs. The trial court vacated the award, concluding that the seller was "substantially prejudiced" by the arbitrator's refusal to hear "evidence material to the controversy" within the meaning of Code Civ. Proc., §1286.2.

The Court of Appeal for the First Appellate District affirmed, holding that the arbitration award had to be vacated because of the substantial prejudice resulting from the arbitrator's refusal to hear evidence material to the controversy. In rendering its decision, the court acknowledged that judicial review of contractual arbitration is very limited, and that an award will not be overturned merely because the arbitrator reached an erroneous conclusion on a contested issue of law. This is what the parties bargain for in agreeing to submit a controversy to arbitration. The court went on to explain, however, that "tolerance for fallibility has its limits." Here, the arbitrator excluded evidence that the title company paid the cost of a lot line adjustment. According to the court:

> The question whether the arbitrator was right or wrong about the proper date from which to measure damages arguably is not subject to judicial review. But it is self-evident that his ruling disallowing evidence that the title company solved the problem through a modest payment to the country club was more than a mere erroneous evidentiary ruling. The ruling substantially prejudiced Spencer [the seller] and undermined the fundamental principle embodied in section 1286.2, subdivision (a)(5) that an arbitrator must consider material evidence.

According to the court, without this crucial evidence, experts for the buyers were able to testify, unopposed, about the cost to move a pool and fence *even though neither had to be moved.* The court of appeal cautioned that not every evidentiary ruling by the arbitrator should be reviewed by the court. However, a strict rule that courts *never* review an arbitrator's evidentiary rulings would effectively delete subdivision (a)(5) from the statute. The court noted that even the JAMS rules state that an arbitrator *must afford* all parties the opportunity to present material and relevant evidence.

Justice Perren dissented, expressing that an arbitration award should not be vacated based on the arbitrator's error of law.

» *See Miller & Starr, California Real Estate 3d, Ch. 35, Alternative Dispute Resolution, §§35:94, 35:101.*

Under the Federal Arbitration Act, enforceability of an agreement to arbitrate was for the court, not the arbitrator to decide.

Jackson v. Rent-A-Center West, Inc., 107 Fair Empl. Prac. Cas. (BNA) 254, 2009 WL 2871247 (9th Cir. 2009)

As explained by the Ninth Circuit Court of Appeals, generally, when a party challenges the validity of arbitration provisions within a larger contract subject to the Federal Arbitration Act, the court—not the arbitrator—decides the issue of enforceability of this provision. See *Buckeye Check Cashing, Inc. v. Cardegna*, 546 U.S. 440, 446, 126 S. Ct. 1204, 163 L. Ed. 2d 1038 (2006). In the present case involving a claim of race discrimination in violation of federal laws, the district court erred in concluding that the *arbitrator* should decide the issue of whether an arbitration provision in the parties' employment agreement was unconscionable so unenforceable. The court of appeals noted that it was confronted with a similar situation, involving a dispute based on federal law rather than arising out of the contract, in *Davis v. O'Melveny & Myers*, 485 F.3d 1066, 12 Wage & Hour Cas. 2d (BNA) 966, 154 Lab. Cas. (CCH) P 60413 (9th Cir. 2007), cert. dismissed, 128 S. Ct. 1117, 169 L. Ed. 2d 845 (2008). There, as here, the court held that the issue of unconscionability was for the court to decide.

The court of appeals rejected the employer's claim that a court should look at the words of the contract alone in determining whether the parties manifested a clear intent to have the arbitrator decide the issue. In this case, the arbitration agreement provided that, "The Arbitrator, and not any federal, state, or local court or agency, shall have exclusive authority to resolve any dispute relating to the interpretation, applicability, enforceability or formation of this Agreement…." According to the court of appeals:

> The Employer urges us to consider only that Jackson signed the Agreement, which contains language consigning the arbitrability question to the arbitrator. However, the FAA was enacted in part "to place arbitration agreements 'upon the same footing as other contracts.' [citations omitted.] To engage in an artificially contracted review of what the parties agreed to here would contravene this principle and violate the proper role of cooperative federalism. Rather, we hold that where, as here, a party challenges an arbitration agreement as unconscionable, and thus asserts that he could not meaningfully assent to the agreement, the threshold question of unconscionability is for the court.

The court found distinguishable cases from other circuits relied upon by the employer.

Finally, applying Nevada law, the court of appeals held that the district court did not err in determining that a cost provision in the parties' agreement was not substantively unconscionable. However, the district court failed to address the employee's remaining arguments about substantive unconscionability.

Circuit Judge Hall dissented, expressing that the agreement plainly stated that the arbitrator had the exclusive authority to resolve the issue of the enforceability of the agreement. Furthermore, the claims of unconscionability were weak. According to Judge Hall, the majority's opinion ran counter to the general rule favoring arbitration because it will force a mini-trial in this and future cases based on the bare allegations of unconscionability.

» *See Miller & Starr, California Real Estate 3d, Ch. 35, Alternative Dispute Resolution, §§35:37, 35:49.*

Trial court was statutorily required to confirm arbitration award in attorney/client fee dispute after denying a petition to correct it.

Law Offices of David S. Karton v. Segreto, 176 Cal. App. 4th 1, 97 Cal. Rptr. 3d 329 (2d Dist. 2009), as modified on denial of reh'g, (Aug. 19, 2009) and review denied, (Oct. 14, 2009)

A provision of the Code of Civil Procedure governing the enforcement of arbitration awards provides that when a petition is filed, the court "*shall* confirm the award... unless...it corrects the award and confirms it as corrected, vacates the award or dismisses the proceeding." (Emphasis added.) See Code Civ. Proc., §1286. The issues on appeal in this case arose when the trial court took none of these actions after an attorney filed a petition to correct an arbitrator's award following arbitration of a fee dispute with his client. The attorney sought to include an award of prejudgment interest in the fee award of over $42,000. With the requested amendment falling outside the scope of statutorily permitted corrections, the trial court verbally told the attorney to go back to the arbitrator to seek a correction instead of confirming the award, which would have rendered it appealable. After the arbitration became binding (becomes binding 30 days after the arbitration award), the arbitrator corrected the award. The attorney returned to the trial court to confirm the award. Now dissatisfied, the client filed a motion to have a trial *de novo*, which the trial court granted. The attorney unsuccessfully claimed that the correction to the award did not restart the 30-days period before the arbitration award became binding.

Reversing the trial court, the Court of Appeal for the Second Appellate District expressed that Code Civ. Proc., §1286 means what it says. Per the statute, when the trial court initially denied the petition to correct the original award (and it was neither vacated, nor the petition dismissed), the court was required to confirm the initial award. The use of the word "shall" in the statute rendered the provision mandatory. The attorney would have then had the sole remedy of appealing from the trial court's judgment confirming the award. According to the court of appeal:

> While Attorney Karton's petition to confirm the amended award raised novel issues, it is clear that the petition...never would have been filed, and the award never amended, had the trial court complied with Code of Civil Procedure section 1286 when it denied Attorney Karton's earlier petition to correct the initial arbitration award. Upon denying that petition, the trial court should have entered an order confirming the initial arbitration award. Attorney Karton would then have been barred from seeking an amended award under even the lenient standard of *Delaney*, *supra*, 99 Cal.App.4th at p. 659, 121 Cal.Rptr.2d 663, as no amendments can be sought *after* the trial court confirms the award.

The court further held that the trial court did not err in denying the attorney's initial petition to correct the award pursuant to Code Civ. Proc., §1286.6. That section allows corrections for "an evident miscalculation of figures." An amendment to add over $4,000 in prejudgment interest clearly fell outside the scope of the statute.

The order denying the petition to confirm the amended award was vacated and remanded with directions for the trial court to enter a new order confirming the initial arbitration.

» *See Miller & Starr, California Real Estate 3d, Ch. 35, Alternative Dispute Resolution, §§35:87, 35:90, 35:91, 35:92.*

Where a party to an arbitration files an untimely response to a petition to vacate, allegations of the petition are deemed valid, but the court is not required to vacate the arbitration.

Taheri Law Group, A.P.C. v. Sorokurs, 176 Cal. App. 4th 956, 98 Cal. Rptr. 3d 634 (2d Dist. 2009)

Following an unsuccessful outcome in an arbitration of an attorney fee dispute, the attorney filed a petition to vacate the meager $34,196.60 award (he sought over $600,000 in fees), citing all the statutory grounds for vacation set forth in Code Civ. Proc., §1286.2. The client failed to respond to the petition within the 10-day deadline. See Code Civ. Proc., §1290.6. Nearly a month later, the client filed a petition to confirm the award, which the court granted. In so doing, the court rejected the attorney's claim that because the client missed the 10-day deadline, the petition to vacate the award had to be granted.

The Court of Appeal for the Second Appellate District affirmed the trial court, holding that the failure to respond to a petition to vacate an arbitration award does not require that the petition be granted. In so holding, the court examined the words of Code Civ. Proc., §1290.6, which provides only that if the response is not filed within the deadline the "allegations of a petition are deemed to be admitted." The court refused to read into this language that the petition must be granted. In so holding, the court referred to Black's Law dictionary, which defines "allegation" as something declared or asserted as *a matter of fact*, which the court found distinguishable from a conclusion of law. Examining case law, the court found support for this distinction. See *Evans Products Co. v. Millmen's Union No. 550*, 159 Cal. App. 3d 815, 817, 205 Cal. Rptr. 731, 101 Lab. Cas. (CCH) P 11211 (1st Dist. 1984) (union's failure to respond to allegations which were deemed admitted, but this did not automatically require the court to grant the petition to vacate). Thus, while the statute requires the court to accept the *facts* as true, it still must engage in its own legal analysis before determining whether an award must be vacated, concluded the court. The court summarized its holding as follows:

> [W]e conclude that under the plain language of section 1290, the allegations "deemed admitted," when a petition to vacate is not timely opposed, are only the factual allegations of the petition, not the legal conclusions pleaded. The admission of factual allegations does not require courts to grant an unopposed petition. Rather, courts still have the power and duty to draw their own legal conclusions and confirm, correct, or vacate the award, or dismiss the petition, as appropriate (§1286).

The court of appeal next turned to the petition to vacate the arbitration award in this case, engaged in its only legal analysis, and concluded that the attorney failed to satisfy any of the grounds for vacating the award listed in §1286.2.

» *See Miller & Starr, California Real Estate 3d, Ch. 35, Alternative Dispute Resolution, §§35:93, 35:94.*

Party who prevailed in an unsuccessful action to stay arbitration was entitled to an award of contractual attorney fees and did not have to wait until resolution by the arbitrator of the underlying dispute.

Turner v. Schultz, 175 Cal. App. 4th 974, 96 Cal. Rptr. 3d 659 (1st Dist. 2009)

Deciding an issue of apparent first impression, the Court of Appeal for the First Appellate District held that defendants who prevailed in an unsuccessful action brought by a party to *stay* arbitration were entitled to an award of contractual attorney fees by the trial court even before resolution by the arbitrator of the underlying dispute. The parties disputed the terms of a buy-sell agreement related to the amount necessary to buy out a shareholder's interest in the company. While two of the shareholders demanded arbitration under a provision contained in the agreement, the party being bought out (Turner), refused to participate. Instead, he filed an action in Contra Costa County alleging that the other parties made false representations to induce him to enter into the agreement, so the agreement was void *ab initio*. As relevant to the appeal in this case, he also filed suit in San Francisco, seeking an injunction requiring the arbitrators to stay arbitration until the defendants obtained an order compelling arbitration. After the court granted the defendants' motion to compel arbitration in the Contra Costa action, the court in the San Francisco action concluded that because the order had been issued in the other forum, any order on its part would have no practical effect, with appeals dismissed as moot. The trial court in the San Francisco action granted the defendants' motion for a judgment on the pleadings, and also awarded them $82,281 in contractual attorney fees. Turner appealed.

The court of appeal affirmed the award of attorney fees, holding that the defendants could be awarded contractual attorney fees by the trial court in this discreet legal action before final resolution of the underlying dispute by the arbitrator. The court of appeal observed that there were two attorney fee provisions in the agreement. The first (paragraph 19) authorized an award of attorney fees to the prevailing party in the event of proceeding as a result of claims or controversies *arising out* of the agreement. In awarding the attorney fees, however, the trial court had relied on the second attorney fee provision (paragraph 13), which authorized an award of fees to the prevailing party in *any action* on the contract, *i.e.,* for *any legal action or arbitration* of any kind or character *to enforce* the provisions of the agreement. The court rejected Turner's claim that the action to stay arbitration was not "on the contract," explaining that courts have construed this term liberally. Essentially, as long as an action involves a contract, it is "on the contract" within the meaning of Civ. Code §1717, expressed the court. Here, Turner sought declaratory and injunctive relief to avoid enforcement of the agreement's arbitration provision. Thus, there was a "contract" for purposes of the contractual attorney fee award pursuant to §1717.

The court also found without merit Turner's claim that the trial court should not have awarded attorney fees because there was not yet a prevailing party in the underlying dispute. The court of appeal agreed with the trial court that paragraph 13 of the agreement contemplated such an award in the event of *any legal action* or arbitration commenced of any kind or character to enforce the provisions of the agreement. There appeared to be no reported decisions presenting the precise legal posture at issue here (contractual attorney fees in an action to *stay* arbitration), but there were analogous cases concerning an award of fees after the court has ruled on a petition to *compel* arbitration. See *Acosta v. Kerrigan*, 150 Cal. App. 4th 1124, 58 Cal. Rptr. 3d 865 (2d Dist. 2007), and *Otay River Constructors v. San Diego Expressway*, 158 Cal. App. 4th 796, 70 Cal. Rptr. 3d 434 (4th Dist. 2008). According to the court of appeal:

> [I]t appears that defendants' entitlement to attorney fees in this legal action is independent of the outcome of the arbitration of the merits of the underlying dispute, and like the court in *Acosta*, we see no reason that an award of fees may not be made now.... Despite the existence of a contrary line of cases, the court found the more recent cases which supported its holding more persuasive. Irrespective of who becomes the prevailing party in the subsequent arbitration, there was a prevailing party for purposes of section 1717 in this discrete proceeding on the contract, and the trial court could properly award attorney fees.

» *See Miller & Starr, California Real Estate 3d, Ch. 35, Alternative Dispute Resolution, §35:48.*

BROKER'S COMPENSATION

Realtors did not violate antitrust laws by illegally tying commissions with regard to the sale of developed lots to the sale of undeveloped lots.

Blough v. Holland Realty, Inc., 574 F.3d 1084, 2009-2 Trade Cas. (CCH) ¶ 76689 (9th Cir. 2009)

For a summary of this case see REGULATION OF THE REAL ESTATE INDUSTRY.

» *See Miller & Starr, California Real Estate 3d, Ch. 5, Broker's Compensation, §5:20; Ch. 4, Regulation of the Real Estate Industry, §4:29.*

For purposes of entitlement to a real estate commission, it did not matter that the deal never closed because, pursuant to the terms of the parties' agreement, the broker earned the commission when the buyer entered into the contract.

RC Royal Development and Realty Corp. v. Standard Pacific Corp., 2009 WL 3087251 (Cal. App. 2d Dist. 2009)

In a dispute over entitlement to a real estate commission on a $116 million deal, the Court of Appeal for the Second Appellate District reversed the trial court, holding that, pursuant to the parties' agreement, the broker earned the commission even though the transaction never closed. In this case, after the buyer, Standard Pacific Corporation, paid $1 million at the opening of escrow and an additional $5 million in earnest money that became nonrefundable at the end of the contingency period, the parties entered into a termination agreement when Standard Pacific determined that the deal was no longer economically feasible. The purchase agreement conditioned the buyer's obligation to purchase the property on the issuance of a temporary certificate of occupancy, which had not occurred at the time the parties entered into the termination agreement. Relying on its agency agreement with the buyer, the broker claimed that it was still entitled to the 1.5% commission. In reversing the trial court, the court of appeal examined the language of the agency agreement, which provided that the broker was entitled to a commission when the property was "purchased." That term was defined to include "any and all acquisitions of any direct or indirect *beneficial interest* in the Property.... [emphasis added.]"

Addressing the issue of when a beneficial interest is acquired, the court explained that in the context of real estate transactions, a purchaser acquires a conditional, equitable title to property on the execution of the agreement. See *Osborn v. Osborn*, 42 Cal. 2d 358, 267 P.2d 333 (1954). Surveying additional cases, the court concluded as follows:

> [E]quitable title is a "beneficial interest," as it is one stick in the bundle of full legal rights to real property. Once Standard Pacific [the buyer] entered into the buy-sell contract containing all of the essential terms of purchase, it obtained equitable title. With equitable title,... [the buyer] had a "beneficial interest" in the property and RC [the broker] earned its commission.

The court of appeal further reasoned that its conclusion was bolstered by the other actions taken by the buyer after execution of the agreement, including: payment of the $1 million with the opening of escrow, and $5 million as earnest money; waiving its right to terminate the purchase agreement at the end of the review period; and entering into contracts with prospective buyers of condominium units to be developed on the property. According to the court, because the buyer partially performed under the terms of the purchase agreement, it not only obtained equitable title, but also a clear advantage resulting from the contract and hence a "beneficial interest."

The court of appeal found without merit the buyer's claim that the statement in the agency agreement that the commission was to be paid "through escrow at closing" was a condition precedent to payment. According to the buyer, since escrow did not close, no commission was due. This similar argument was rejected in *Steve Schmidt & Co. v. Berry*, 183 Cal. App. 3d 1299, 228 Cal. Rptr. 689 (5th Dist. 1986), with the court of appeal holding that the language did not set forth the condition for entitlement to a commission but a limitation on the time of payment. Thus, unlike the first portion of the agency agreement concerning entitlement to commission, this second part merely fixed the time and manner in which the buyer was to be paid. Thus, the trial court erred in granting the buyer's motion for summary adjudication of the broker's breach of contract cause of action.

> ✦ **Comment:** The agency agreement at issue in this case was between a *buyer* and the buyer's broker, whereas in the *Steve Schmidt & Co.* case, the issue was between the *seller* and a cooperating broker who claimed a commission as a procuring cause of a sale when the listing broker refused to pursue the claims. The decision in the current case does not recognize the distinction between a listing agreement that provides a commission is earned when a ready, willing and able purchaser offers to purchase at the listing price, as in *Steve Schmidt*, and a buyer's agreement to pay a commission when a purchase is completed.

» *See Miller & Starr, California Real Estate 3d, Ch. 5, Broker's Compensation, §5:43.*

CEQA

School district complied with CEQA in certifying environmental impact report for project to construct a high school.

City of Long Beach v. Los Angeles Unified School Dist., 176 Cal. App. 4th 889, 98 Cal. Rptr. 3d 137, 247 Ed. Law Rep. 799 (2d Dist. 2009)

The Los Angeles Unified School District prepared an environmental impact report in connection with the planned construction of a new high school to alleviate overcrowding in existing schools. After the EIR was certified, the City of Long Beach (where the proposed school would be located) filed a petition for administrative mandamus, claiming that the District violated the California Environmental Quality Act (CEQA). The trial court denied the writ petition, concluding that the evidence supported the District's decision that the EIR complied with CEQA.

The Court of Appeal for the Second Appellate District affirmed the trial court, holding that the EIR was sufficient as an informational document. The court first addressed the City's claims concerning the project's health impacts. Specifically, the City asserted that the EIR failed to explain the causal relationship between two mitigation measures and a reduction to acceptable levels of carcinogenic risk. The court disagreed with this claim. The mitigation measures—an enhanced heating and ventilation system and the installation of a 70-foot setback at the southern boundary of the site—were adopted at the recommendation of the District's Office of Environmental Health and Safety. A second environmental consultant concluded that, with the mitigation measures, the risk fell below the established level of significance. The relevant studies, contained in the appendix to the EIR, contained sufficient information to enable the public to discern the analytic route that the District took from evidence to action, concluded the court.

The court also disagreed with the City's claim that the response to its comment concerning the mitigation measures amounted to an improper "scavenger hunt" because it referred to an appendix with no further explanation. In fact, the response was more detailed, with each document cited in the comment either in a Health Risk Assessment (HRA), Appendix J or in a portion of the EIR entitled Response to Comments. The court of appeal admonished that courts have not looked for perfection but for adequacy. Here, the detail concerning the mitigation measures was adequate.

Next, the court of appeal *rejected* all of the City's claims concerning the EIR's analysis of truck traffic and air quality. Contrary to the City's claim, the HRA took into account not only truck traffic and diesel emissions, but *all sources of emissions*. It also analyzed a nearby freeway, even though it was located more than a quarter of a mile away. While it was true that there was no analysis of the impacts on specific streets, the traffic counts conducted for the traffic analysis *were adjusted upward* to reflect the concentration of truck activity in the area. Furthermore, at the direction of the City of Long Beach and a nearby city, the District applied a two per year growth factor to account for overall growth. The District's responses to comments made concerning this issue were adequate to comply with the CEQA guidelines §15088, subd. (c), held the Court.

As for the cumulative impacts analysis, the court explained that the purpose of an EIR is to identify significant effects on the environment, *not* the impact of the environment on the project. While the City had raised an issue concerning the selection of the assessment area, the court explained the rule that this process is left to the agencies' expertise and, absent a showing of an arbitrary action, a court should assume that the agency has exercised its discretion appropriately. *Ebbetts Pass Forest Watch v. Department of Forestry and Fire Protection*, 123 Cal. App. 4th 1331, 1351, 20 Cal. Rptr. 3d 808, 34 Envtl. L. Rep. 20135 (3d Dist. 2004). Here, the methodology used by the City—projects in a 3-mile radius that had related impacts—seemed reasonable. The section of the EIR devoted specifically to air quality covered an even broader area. The court concluded that the EIR contained a reasonable explanation for the geographic limitation used and its determination that the project would not cause an incremental effect. Thus, the District did not abuse its discretion in defining the geographic scope of the cumulative impact area for air quality.

Likewise, because the District provided a reasonable explanation for the geographical limitation concerning the scope of the cumulative impact area, it did not abuse its discretion in concluding that the project would not cause an incremental effect with respect to the impacts. See CEQA Guidelines §15125, subd. (a).

The court of appeal further rejected the City's claim that the District omitted closely related *past* projects from its cumulative impacts section and its responses to comments. The court explained that an EIR only needs to include information concerning past projects to the extent that it is relevant to the understanding of the environmental impacts of the present project considered cumulatively with other pending and possible future projects. The court of appeal also rejected the City's claim that the District's reliance on the one-fourth mile radius in its cumulative impact analysis was erroneous. Although Public Resources Code §21151.8 requires specified findings and a particular scope of review when a school district acquires property for a school, the court explained, this section only refers to project-specific impacts, and not cumulative impacts. In this case, the EIR, in fact, considered different geographic areas for each impact discussed.

The court of appeal also found without merit the City's claim that the EIR impermissibly failed to include an analysis of the land uses and omitted a discussion of the project's consistency with its General Plan. As it was permitted to do by Gov. Code §53904, subd. (b), the District had passed a resolution declaring itself *exempt* from the City's zoning ordinance. Also, the City's claims concerning the requirement that the District analyze General Plan consistency was simply a misstatement of the law. Such an analysis is only required to evaluate *inconsistencies* with the General Plan. According to the court of appeal:

> [B]ecause LAUSD explained how the proposed school would *not* conflict with the Long Beach General Plan, and because the school district exercised its exemption power with respect to any possible conflict with Long Beach's Zoning Code, no inconsistencies exist and *so the FEIR is not required to provide additional analysis.* [citations omitted] Notwithstanding the lack of any obligation to discuss inconsistencies, the FEIR actually contains a seven-paragraph discussion about the Long Beach and Carson general plans and zoning ordinances in section 5.1, entitled "Environmental Effects Found Not to be Significant."

The court of appeal further rejected the City's myriad of contentions concerning the EIR's alleged failure to undertake a meaningful analysis of project alternatives. In asserting that the EIR did not evaluate a reasonable range of alternatives, the City appeared to claim that the EIR's "no project alternative" and "continuation of existing use" alternatives were the same. Even if this was the case, expressed the court, the EIR contained a wider range of alternatives than those two cited by the City. The court further rejected the City's claim that the alternatives analysis was conclusory and lacking in supporting evidence. According to the court:

> In our view, the FEIR's analysis of alternatives is sufficiently informative to satisfy CEQA. LAUSD made an objective, good-faith effort to provide a meaningful analysis of the project's alternatives. It compared and contrasted the several project alternatives to allow meaningful evaluation, analysis and comparison. Chapter 4 contains 29 pages of discussion and analysis of alternatives, and includes a 9-page matrix. In addition to the analysis contained in the FEIR, LAUSD's response to comments added detailed information explaining the basis for its conclusion that the site chosen was the best alternative. CEQA requires neither that the EIR be perfect, nor that the analysis be exhaustive.

The court of appeal noted that Long Beach's criticism was essentially that six of the alternatives rejected were in the nearby City of Carson, which the new school would primarily serve. According to the court of appeal, "courts do not 'pass upon the correctness of the EIR's environmental conclusions, but only upon its sufficiency as an informative document. (Citations omitted).'"

The court of appeal additionally rejected the following claims made by the City concerning the alleged deficiencies in the EIR:

(a) The EIR failed to meaningfully analyze the risks from a rail line located 30 feet from the eastern edge of the project, which *may* ship hazardous materials (the line occasionally shipped *empty* trains; based on the assumption of possible hazardous substances, a mitigation measure was adopted to incorporate a setback of 128 feet in case of derailment);

(b) The EIR failed to analyze each chemical the trains might theoretically carry (engaging in such an analysis would be speculative and infeasible, so not required);

(c) The EIR failed to adequately analyze or mitigate project related student traffic, drop-off, and pedestrian safety (because of the important issue of pedestrian safety, the EIR included a separate subchapter; the recommended pedestrian routes do not take the students to the industrial areas around the schools);

(d) The District erroneously calculated the pedestrian traffic (after receiving a comment concerning the error, the consultants recalculated and came to the same conclusion concerning impacts on safety);

(e) The mitigation measures pertaining to pedestrian safety were impermissibly deferred (the City provided no explanation or analysis as to why the mitigation measures were impermissibly deferred; rather, the mitigation measures were specific and provided identifiable timelines); and

(f) There was no arrangement for student parking even though there was an estimated demand for 402 student spaces (the EIR adequately analyzed the parking impacts; the project contemplated spaces to drop off students and staff; consultants estimated that 1,000 spaces would be available in adjacent neighborhoods at any given time; also, the District planned to promote alternate transportation modes. In short, the analysis provided substantial evidence to support the District's conclusion that there would be no significant parking impacts).

✦ **Comment:** As explained by the court of appeal, "CEQA contains special provisions for environmental review of the acquisition or construction of a school. Section 21151.8 sets out the scope of the review as well as findings a school district must have." Likewise, Government Code section 53094, subd. (b) authorizes the governing board of a school district to exempt itself from a city or county zoning ordinances under prescribed circumstances.

» *See Miller & Starr, California Real Estate 3d, Ch. 25A, California Environmental Quality Act (CEQA), §§25A:14, 25A:16, 25A:17.*

California Environmental Quality Act does not require a public agency to complete and consider an environmental impact report commenced before it disapproves a project.

Las Lomas Land Co., LLC v. City of Los Angeles, 177 Cal. App.4th 837, 99 Cal. Rptr. 3d 503 (2d Dist. 2009)

Las Lomas Land Company proposed to develop a 555-acre site, consisting of approximately 5,800 dwelling units, 2.3 million square feet of office space, 250,000 feet of retail space, a hotel, and other facilities, in an unincorporated area that the City of Los Angeles intended to annex. In connection with the proposed development, the City's planning department declared itself the lead agency, and began the process of preparing an Environmental Impact Report. Over a period of years after filing the initial application for the project, the developer met with numerous agencies, provided all requested information, modified the project (including reducing the number of dwellings), paid all funds requested by the City for environmental review, and expended millions of dollars to consultants and others to prepare environmental studies. However, after opposition to the project arose, including by a Councilmember, the City Council voted to cease work on the proposed project, not to assume the role of the lead agency, and not to process the EIR. The developer then filed a combined petition for a writ and mandate and complaint for damages, alleging violation of CEQA, denial of procedural and substantive due process and related causes of action. The trial court sustained the City's demurrer on all counts, stating in the minute order that CEQA "does not require a public agency to prepare and consider an EIR before it disapproves a project."

The Court of Appeal for the Second Appellate District affirmed the judgment, holding that CEQA did not mandate completion of the EIR before the City could reject the project. In so holding, the court of appeal noted, among other things, the following:

> CEQA applies only to projects that a public agency proposes to carry out or approve, and does not apply to projects that the agency rejects or disapproves. (Pub. Resources Code, §§21080, subds. (a), (b)(5).) Section 21080, subdivision (a) states, "this division shall apply to discretionary projects proposed to be carried out or approved by public agencies." Subdivision (b)(5) states that CEQA does not apply to "[p]rojects which a public agency rejects or disapproves." Moreover, the specific requirement to prepare an EIR expressly applies only to projects that public agencies "propose to carry out or approve" (*id.*, §21100, subd. (a)) or "intend to carry out or approve" (*id.*, §21151, subd. (a)).

The fact that the City began initiating environmental review before it rejected the project, did not change the outcome of the case. The Guidelines section relied upon by the developer to make this contention did not expressly state that a public agency that has initiated environmental review must complete and certify the EIR before rejecting the project. CEQA guidelines §15270. While the case relied on by the developer did not definitively address the issue (see *Main San Gabriel Basin Watermaster v. State Water Resources Control Bd.*, 12 Cal. App. 4th 1371, 16 Cal. Rptr. 2d 288 (2d Dist. 1993)), the court of appeal was satisfied with its own conclusions.

The court of appeal also held that the pleading failed to adequately allege due process and equal protection violations. As for procedural due process under the U.S. Constitution, the court explained the rule that a land use application invokes procedural due process only if the owner has a legitimate claim of entitlement to the approval. According to the court:

> The city's decisions whether to seek to annex the site, enter into a development agreement, and adopt the proposed specific plan were discretionary decisions. Las Lomas can assert no claim of entitlement to the annexation, development agreement, specific plan, and development entitlements that it seeks. The city's denial of those benefits and decision not to proceed with the project therefore was not a deprivation of property for purposes of procedural due process under the Fourteenth Amendment.

Likewise, there was no denial of due process under the California Constitution. The court explained that only property interests or benefits that are conferred by statute are protected by California's due process clause. Here, the court had already concluded that the City had no mandatory duty under CEQA to complete the EIR before rejecting the project. As for the denial of substantive due process, even if the conduct that the developer asserted concerning the Councilmember's actions were proven to be true, it still did not rise to the level of outrageous or egregious conduct supporting such a cause of action. See *Galland v. City of Clovis*, 24 Cal. 4th 1003, 103 Cal. Rptr. 2d 711, 16 P.3d 130 (2001), as modified, (Mar. 21, 2001). Finally, the court explained that for equal protection claims the rational basis test is extremely deferential and does not allow inquiry into the wisdom of government action. See *Lindquist v. City of Pasadena, Tex.*, 525 F.3d 383, 387 (5th Cir. 2008). Turning to the facts of this case, the court of appeal expressed the following:

> [T]he allegations concerning a city council member's efforts to defeat the proposed project and alleged procedural errors in connection with the city council vote cannot establish a factual basis to conclude that the decision to reject the project was wholly irrational. We therefore conclude that the complaint fails to adequately allege a "class of one" equal protection violation.

» *See Miller & Starr, California Real Estate 3d, Ch. 25A, California Environmental Quality Act (CEQA), §§25A:4, 25A:7, Ch. 25, Subdivisions, Land Use Planning, and Approvals, §25:68.*

Where a planning commission reviewed a draft EIR and provided recommendations, the city council was not required

to seek renewed planning commission review following an amendment to the EIR with no changes to the project.

Tracy First v. City of Tracy, 177 Cal. App. 4th 1, 99 Cal. Rptr. 3d 621 (3d Dist. 2009)

The City of Tracy prepared an environmental impact report in connection with general plan and specific plan amendments, and a conditional use permit for the construction of a grocery store. After the planning commission approved the CUP and recommended that the City Council certify the EIR and amend the general and specific plans, an organization known as Tracy First sent a letter to the City appealing the approval of the CUP. Following a City Council meeting in which Tracy First made several objections to the EIR, the City Council decided to obtain further information on the EIR before taking action. The EIR was amended, re-circulated, and later certified by the City Council. Tracy First filed a petition for a writ of mandate, claiming, among other things, that the City was required to obtain renewed planning commission review before certifying the amended EIR. The trial court denied the writ petition.

The Court of Appeal for the Third Appellate District affirmed the trial court, holding that the City did not fail to proceed in a manner required by law. In this case, the City's municipal ordinance required the planning commission to review zoning decisions, and make recommendations before the City Council could act. Further, §15025 of the CEQA Guidelines required the planning commission to "review and consider the EIR...in draft or final form." As explained below, the court concluded that the City complied with this guideline even though the planning commission did not have the amendments to the EIR when it made its recommendations to the City Council.

As an initial matter, the parties disputed the nature of the procedure at the end of the hearing which led the City to amend the EIR. The court agreed with the project applicant that it was a *continuance* of the Council hearing to obtain further information—not the grant of an appeal of the planning commission decision, as was urged by Tracy First. The minutes from the hearing supported this conclusion, and the court found unpersuasive Tracy First's contentions to the contrary.

The court of appeal further concluded that the City Council was not required to remand the matter to the Commission before further action by the Council because the final EIR considered by the Council was merely a different draft, not a different EIR. Also, there is no express requirement that the project application be remanded to the planning commission when the City amends the EIR before it is certified by the city council and used in granting the project application. The court of appeal pointed out that the CEQA Guidelines require review of the EIR by the planning commission in "draft *or* final form." (CEQA Guidelines, §15025.) In this case, the EIR was in draft form. There is no statute or guideline requiring a council to remand the project application to the planning commission when amendments are made to the EIR and *not the project* (e.g., general plan and specific plan amendments and zoning changes could require remand to the commission). In this case, while the EIR was amended, there was no modification of the project. According to the court of appeal:

> The difference between modifying a project and modifying the EIR is substantial. A modification in the project application effects changes in the ultimate land use, while a modification of the EIR does not change the end result sought by the project application.

The court concluded that the requirements of §15025 of the CEQA Guidelines were satisfied when the Commission reviewed the draft EIR and provided recommendations to the City Council.

The court of appeal also held that Tracy First had not exhausted its administrative remedies concerning its claim that the EIR failed to include alternatives that reduced the environmental impacts of the project. Because this issue was not raised in the earlier administrative proceedings, it could not now be raised. The court of appeal found that Tracy First had not failed to exhaust its administrative remedies because it had argued to the City that the EIR failed to include a reduced store alternative in its alternatives analysis. These written comments were submitted during the same hearing at which the EIR was certified. According to the court, "[a]lthough it appears the city council did not actually consider the reduced-size alternative arguments, that does not prevent Tracy First from raising the issue on appeal." The court went on to hold, however, that the EIR was not inadequate for failure to include a reduced store alternative. There was no showing that this alternative would diminish the significant impacts on air quality and traffic identified in the EIR. Although Tracy First also asserted that this alternative would reduce potential store closures and energy consumption, these were not identified as significant impacts in the EIR, so they did not require mitigation and the court did not need to address them.

The court of appeal further held that the City did not fail to proceed in a manner required by law when it relied on California Building Energy Efficiency Standards in concluding that the project would have no significant *energy* impacts. While Tracy First claimed that reliance on these standards was not enough, it failed to show what more the EIR could have done. Tracy First's additional claim that the EIR failed to include a northern parcel in its energy analysis was simply not true. While the analysis did not contain the same level of specificity as that of the southern parcel, the analysis was adequate. The court pointed out that no application had yet been submitted to build on that parcel. Thus, this was not a case of the City chopping the project into smaller units in order to avoid consideration of the entire project. The court rejected Tracy First's additional contentions with respect to the energy analysis as without merit.

Finally, the court of appeal held that, even though the EIR found that the project would substantially impact two intersections, the City was not required to provide funding for improvements as mitigation for those impacts. These intersections were outside the control of the City and there was no existing plan for the County to improve the intersections. According to the court, "[w]ithout jurisdiction and without a county plan in place, the City cannot insure that mitigation measures will be implemented even if funding is required by CEQA." The court of appeal also found misplaced Tracy First's reliance on *City of Marina v. Board of Trustees of the California State University*, 39 Cal. 4th 341, 359, 46 Cal. Rptr. 3d 355, 138 P.3d 692, 210 Ed. Law Rep. 1186, 36 Envtl. L. Rep. 20149 (2006). In that case, unlike here, the Fort Ord Reuse Authority had a statutory obligation and a plan to make the intersection improvements over a period of years.

» *See Miller & Starr, California Real Estate 3d, Ch. 25A, California Environmental Quality Act (CEQA), §§25A:15, 25A:16, 25A:17.*

COMMON INTEREST DEVELOPMENTS

Common interest development association's practice of requiring homeowners to repair storm water drainage channel crossing over individual lots tended to show that the homeowner, not the association, was responsible for such maintenance even though a contrary interpretation of the CC&Rs was plausible.

Starlight Ridge South Homeowners Ass'n v. Hunter-Bloor, 177 Cal. App. 4th 440, 99 Cal. Rptr. 3d 20 (4th Dist. 2009)

For a summary of this case see COVENANTS, CONDITIONS, AND RESTRICTIONS.

» *See Miller & Starr, California Real Estate 3d, Ch. 25B, Common Interest Developments, §§25B:99, 25B:101, Ch. 24, Covenants, Conditions, and Restrictions, §§24:16, 24:17.*

Construction defects suit was not time-barred because

discovery of moisture problems in only one of the 61 units was insufficient to put the homeowner's association on notice of the defects.

Creekridge Townhome Owners Ass'n, Inc. v. C. Scott Whitten, Inc., 177 Cal. App. 4th 251, 99 Cal. Rptr. 3d 258 (3d Dist. 2009)

For a summary of this case see DEFECTIVE CONSTRUCTION.

» *See Miller & Starr, California Real Estate 3d, Ch. 25B, Common Interest Developments, §25B:110, Ch. 29, Defective Construction, §§29:69, 29:72.*

Trails in common area of common interest development were not a "public accommodation" under either state or federal disability laws, despite association's failure to prevent all public use.

Carolyn v. Orange Park Community Ass'n, 177 Cal. App. 4th 1090, 99 Cal. Rptr. 3d 699 (4th Dist. 2009)

For a summary of this case see DISCRIMINATION.

» *See Miller & Starr, California Real Estate 3d, Ch. 20, Discrimination, §§20:3, 20:28, Ch. 25B, Common Interest Developments, §25B:72.*

CONSTRUCTION CONTRACTS

Administrative Law Judge correctly applied the preponderance of evidence standard in a hearing concerning a contractor's alleged violations of state contractor's law.

Owen v. Sands, 176 Cal. App. 4th 985, 98 Cal. Rptr. 3d 167 (1st Dist. 2009), review filed, (Sept. 18, 2009)

A contractor, cited for six violations of state contractor's law, challenged the citation, but it was upheld after a hearing before an administrative law judge. The contractor then filed a petition for administrative mandamus, claiming that the ALJ should have applied the clear and convincing standard instead of the preponderance of evidence standard. The trial court denied the petition, and the contractor appealed.

The Court of Appeal for the First Appellate District affirmed the trial court, holding that the ALJ applied the correct standard of proof. Citing case law, the court acknowledged that the proper standard of proof required in all professional or vocational license disciplinary proceedings is clear and convincing. *Ettinger v. Board of Medical Quality Assurance*, 135 Cal. App. 3d 853, 856, 185 Cal. Rptr. 601 (2d Dist. 1982). However, this was a citation proceeding, not a disciplinary hearing. In this context the preponderance standard was appropriate because the only potential sanctions were orders of correction and civil penalties, expressed the court. While it found no case law directly addressing the correct standard in this context, the court found support for this conclusion by examining case law in the context of a disciplinary hearing.

Ettinger v. Board of Medical Quality Assurance, 135 Cal. App. 3d 853, 856, 185 Cal. Rptr. 601 (2d Dist. 1982). The court noted that courts have often recognized that a person who obtains a license has a fundamental vested right to engage in the licensed activity, and revocation or suspension of that right requires certain procedural protections, including the requirement that a regulatory board or agency apply a heightened standard of review. The court also analyzed cases considering the appropriate standard in the trial court context. See *Hughes v. Board of Architectural Examiners*, 17 Cal. 4th 763, 788-789, 72 Cal. Rptr. 2d 624, 952 P.2d 641 (1998). In those cases, the standard to be applied depended upon the nature of the fundamental vested property right at issue in a licensee disciplinary case (e.g., fine versus revocation). The court summarized as follows:

> We conclude that, because the citation hearing on review could only result in civil penalties or correction orders, and could not have resulted in orders suspending, limiting, or revoking Owen's license, the preponderance of the evidence rather than the clear and convincing evidence standard of proof applied.

The court of appeal rejected the contractor's claim that a citation hearing was a "disciplinary" hearing requiring the heightened standard of review. The court acknowledged that the statutes in the pertinent portion of the state contractor's law used the term "disciplinary action" to include both citations and suspension (or revocation) of the license. However, whether the proceeding was "disciplinary" was not determinative. Rather, the necessary procedural safeguards are determined by a balancing test, which includes an assessment of the weight of the private interest involved, expressed the court. The court reiterated that a contractor cited for a violation and subject only to sanctions is *not* entitled to the same procedural safeguards afforded contractors who face restriction, suspension or revocation of their license. The fact that a contractor could be subject to license suspension if he or she later failed to pay the fines and penalties did not change the outcome of the case.

The court of appeal further rejected the contractor's claim that the ALJ effectively convicted him of two misdemeanors when it found that he violated two provisions of the state contractor's law. The court of appeal pointed out that the Code expressly authorizes the Registrar to cite individuals for violating these statutory prohibitions.

» *See Miller & Starr, California Real Estate 3d, Ch. 27, Construction Contracts, §27:63.*

CONTRACTS

Delivery of a quitclaim deed four years after payment of apparent consideration for purchase of real property constituted executed contract validly transferring interest in real property, rendering the statute of frauds inapplicable.

Lee v. Lee, 175 Cal. App. 4th 1553, 97 Cal. Rptr. 3d 516 (5th Dist. 2009)

Family members who owned a 50% interest in property received $50,000 after telling their mother, the co-owner, that they wanted to sell the property. The money was received from the mother and a brother named Vah. However, no deed was executed evidencing the purported sale (the family wanted the son, George, to keep his name on the property because he was educated and fluent in English). Four years later, George, who was then facing a lawsuit, executed a quitclaim deed conveying the property to Vah's child, Fue Sue. Before the deed was recorded, and without Fue Sue's knowledge, someone added Ge Lee and Vong Lee as additional grantees. In 2005, George had Fue Sue execute a deed conveying the property back to himself and his wife. A dispute arose concerning ownership of the property, with the son and his wife claiming that the $50,000 they received was not consideration for the sale of the property, but a no-interest loan. In a lawsuit concerning who owned the property, and related causes of action, the court held that the 2002 deed was *not* invalid under the statute of frauds, as claimed by the son. The court further held that, although altered, the 2002 deed was valid as to Fue Sue (but not the later added grantees).

The Court of Appeal for the Fifth Appellate District affirmed the trial court, holding that the property was validly conveyed to Fue Sue. The court of appeal acknowledged that under the statute of frauds, a contract for the sale of real property is invalid unless it, or some note or memorandum of it, is in writing and subscribed by the party to be charged. Civ. Code, §1624. However, the statute of frauds *does not apply to an executed contract*. *Kirkpatrick v. Tapo Oil Co.*, 144 Cal. App. 2d 404, 414, 301 P.2d 274 (2d Dist. 1956). Furthermore, a valid deed delivered to the grantee constitutes an executed contract. See Civ. Code, §§1040, 1054. In this case, it was undisputed that the son executed the 2002 quitclaim deed and delivered it to Fue Sue with the intent to transfer their interest in the property. Thus, there was no statute of frauds issue.

The court of appeal rejected the son's claim that, because the two names were later added to the quitclaim deed after delivery without his consent, it was completely void as to all of the grantees. The court of appeal agreed with the trial court that only the names of the two additional grantees should be struck, but it was still a valid conveyance to Fue Sue. While the court of appeal could find no California case addressing the precise issue at hand, it found support for its holding in analogous situations. For example, in the context of an executed contract, it has been held that a third party's alteration of the contract does not void the contract in its entirety. See *Walsh v. Hunt*, 120 Cal. 46, 53, 52 P. 115 (1898). The court of appeal further reasoned that other jurisdictions have adopted this rule. The court of appeal summarized its holding as follows:

> In sum, the trial court correctly ruled that the alterations to the deed that were made after it was delivered to Fue Sue did not divest Fue Sue of title. The deed is void only as to the individuals who were added as grantees after delivery, i.e., Ge and Vong Lee.

Finally, the court of appeal held that the trial court did not abuse its discretion in admitting promissory notes into evidence even though they were produced only five days before trial.

» *See Miller & Starr, California Real Estate 3d, Ch. 1, Contracts, §1:75, Ch. 8, Deeds, §8:54.*

COVENANTS, CONDITIONS, AND RESTRICTIONS

Common interest development association's practice of requiring homeowners to repair storm water drainage channel crossing over individual lots tended to show that the homeowner, not the association, was responsible for such maintenance even though a contrary interpretation of the CC&Rs was plausible.

Starlight Ridge South Homeowners Ass'n v. Hunter-Bloor, 177 Cal. App. 4th 440, 99 Cal. Rptr. 3d 20 (4th Dist. 2009)

Interpreting provisions of Covenants, Conditions and Restrictions for a common interest development, the Court of Appeal for the Fourth Appellate District reversed a grant of summary judgment in favor of a homeowner. The court of appeal held that, pursuant to the relevant provisions of the CC&Rs, the homeowner, not the association, was obligated to maintain and repair a V-ditch (a facility for storm water runoff drainage) running across the owner's property. It was true that the V-ditch was within the bounds of a designated landscape maintenance area, and the CC&Rs generally obligated the association to maintain "improvements" or "structures" within that area. Nevertheless, the CC&Rs assigned to each owner the duty to "maintain, repair, and replace, and keep free from debris or obstructions the drainage system and devices, if any, located on his [or her] Lot." The court of appeal agreed with the association that the drainage maintenance provision pertaining to the owner's obligations was the more specific provision, which controlled over the provision that, *generally*, the association was to maintain the landscape maintenance areas. See Code Civ. Proc., §1859 (where two provisions appear to cover the same matter, and are not inconsistent, the more specific provision controls).

The homeowner countered that the provision assigning the responsibility for maintaining the landscape maintenance areas was, in fact, the more specific provision. The court acknowledged that this interpretation was plausible. It then expressed that to reconcile the conflict, a court may take into account the intentions of the parties—looking not only at the intentions at the time the instrument was written, but *the acts and conduct of the parties after the contract was executed*. (See *Jones v. P.S. Development Co., Inc.*, 166 Cal. App. 4th 707, 720, 82 Cal. Rptr. 3d 882 (2d Dist. 2008), review denied, (Dec. 10, 2008).) In this case, the conduct of the parties over the last 20 years was consistent with assigning responsibility for maintenance of the V-ditch to the individual property owners. The evidence on this point was undisputed. Historical practices concerning the assignment of responsibility for the maintenance of native open space to the individual homeowners also supported this construction.

The homeowner argued that general principles concerning the obligation of benefited parties to maintain easements should lead to a conclusion that *all* of the homeowners, as owners of the dominant tenement of the drainage easement in this case, had an obligation to maintain the V-ditch. In rejecting this argument, the court acknowledged that the owner of the dominant tenement generally has the responsibility to maintain an easement. The court found this general principle to be inconsistent with the terms of the recorded CC&Rs in this case:

> The CC&Rs provisions on which the homeowner relies establish that the *CC&Rs*—not merely the drainage easement—apply to all the lots within the development "as a servitude for the benefit of each and every lot within the development, as the dominant tenement." The CC&Rs themselves, however, expressly specify that the responsibility to maintain the drainage facilities lies with any lot owner upon whose lot the facility exists.

The court also rejected the homeowner's claim that the association contributed to or caused the damage to the V-ditch by failing to properly maintain the landscape maintenance area. The issues in this case, as pled, concerned who had the maintenance responsibility in the first instance. The homeowner never filed a cross-action to recoup costs from the association for indemnity or contribution.

» *See Miller & Starr, California Real Estate 3d, Ch. 24, Covenants, Conditions, and Restrictions, §§24:16, 24:17, Ch. 25B, Common Interest Developments, §§25B:99, 25B:101.*

DEEDS

Delivery of a quitclaim deed four years after payment of apparent consideration for purchase of real property constituted executed contract validly transferring interest in property, rendering the statute of frauds inapplicable.

Lee v. Lee, 175 Cal. App. 4th 1553, 97 Cal. Rptr. 3d 516 (5th Dist. 2009)

For a summary of this case see CONTRACTS.

» *See Miller & Starr, California Real Estate 3d, Ch. 8, Deeds, §8:54, Ch. 1, Contracts, §1:75.*

DEEDS OF TRUST

County recorder's statutory obligation to "stamp and record" a full reconveyance within two business days of receipt does not include *indexing*.

Ricketts v. McCormack, 177 Cal. App. 4th 1324, 99 Cal. Rptr. 3d 817 (2d Dist. 2009)

In order to promptly clear title to property after a secured real estate transaction is fully satisfied, Civ. Code §2941, subd. (c), requires the county record to "stamp and record" the reconveyance within two business days from the day of receipt. This section provides for a penalty of $500 per violation. Ricketts and Rosenberg filed class action lawsuits against the County of Los Angeles and its Registrar-Recorder, claiming that "stamp and record" also includes *indexing*. (Initially Ricketts had filed the suit but when it was alleged that she failed to comply with the government claims requirement, Rosenberg filed an action in intervention). In the first trial, the county counsel "inexplicably" conceded that "stamp and record" included indexing. After the trial court granted the plaintiffs' motion for summary judgment, the county associated in new counsel, and the court granted a new trial. Following a bench trial, the trial court rejected the plaintiffs' interpretation of the statute, and entered judgment in favor of the county.

The Court of Appeal for the Second Appellate District affirmed the trial court, holding that the words to "stamp and record" in Civ. Code §2941, subd. (c) could not be reasonably interpreted to include indexing. On its face, the statute was clear. The court also found support for its conclusion by examining the use of the terms in the portion of the Government Code detailing the duties of a recorder. While recording is addressed in §27320, there is no mention of indexing. Rather, that duty is separately specified in §27324. According to the court of appeal:

> Because the Legislature clearly structured these duties into two separate functions with respect to other aspects of the recorder's responsibilities, there is simply no reason to distort the commonsense meaning of the word "record" and construe it to mean "record and index" when used in section 2941, subdivision (c).

Contrary to the plaintiffs' contention, the court's interpretation did not render the word "record" surplusage. As aptly explained by the trial court, "stamping" is satisfied when the recorder endorses on a reconveyance the order of receipt, the day and the time of receipt, and the amount of fees paid. The reconveyance is "recorded" when the recorder has confirmed the document meets all requirements, created an entry for the document in the ERA (Enterprise Recording Archive) system, calculated and confirmed payment of the required fees, and generated a lead sheet. The fact that courts have consistently held that a reconveyance will not provide *constructive notice* of the transaction unless it is properly indexed (see *Dyer v. Martinez*, 147 Cal. App. 4th 1240, 1243-1245, 54 Cal. Rptr. 3d 907 (4th Dist. 2007), review denied, (June 13, 2007)) did not change the outcome of the case. The court again agreed with the trial court that these cases "do not conflate recording and indexing of documents." Even though the clear statutory language obviated the need for the court to examine legislative history, the court's review of legislative history also supported its holding.

» *See Miller & Starr, California Real Estate 3d, Ch. 10, Deeds of Trust, §10:111, Ch. 11, Recording and Priorities, §§11:20, 11:21.*

State interest rate laws not completely preempted by National Bank Act.

Thomas v. U.S. Bank Nat. Ass'n ND, 575 F.3d 794 (8th Cir. 2009)

For a summary of this case see USURY.

» *See Miller and Starr, California Real Estate 3d, Ch. 10, Deeds of Trust, §10:7, Ch. 21, Usury, §§21:2, 21:33, Ch. 36, Lender's Liability, §36:2.*

DEFECTIVE CONSTRUCTION

Construction defects suit was not time-barred because discovery of moisture problems in only one of 61 units was insufficient to put the homeowner's association on notice of the defects.

Creekridge Townhome Owners Ass'n, Inc. v. C. Scott Whitten, Inc., 177 Cal. App. 4th 251, 99 Cal. Rptr. 3d 258 (3d Dist. 2009)

In a construction defects suit concerning a reroofing project, the

Court of Appeal for the Third Appellate District reversed a grant of summary judgment in favor of the defendants on statute of limitations grounds. The trial court had erroneously concluded that because the homeowners association for a 61-unit townhome community consisting of 11 buildings had notice of a water moisture problem inside the window of a single unit as a result of the new roof, the statute of limitations began to run. In rejecting this conclusion, the court of appeal found that triable issues of material fact remained concerning whether the four-year statute of limitations for patent construction defects or the 10-year statute of limitations for latent construction defects barred the action.

The court held first that, based on the evidence, it could not conclude, as a matter of law, that the alleged reroofing defects fit within the definition of a *patent* defect. See Code Civ. Proc., §337.1. The court explained that this type of determination is based on an objective test that asks whether the average consumer, during the course of a reasonable inspection, would discover the defect. Here, the only evidence supporting the summary judgment motion consisted of a 1997 letter written by the unit owner to the association (concerning a moisture problem and also broken roof tiles), which was discussed during an open meeting. The plaintiff, on the other hand, provided the declaration from a roofing consultant hired in 2003 after the complex suffered numerous leaks earlier that year. The consultant stated that he found a number of defects regarding the 1997 reroofing that would *not* be readily apparent to a lay person. According to the court, the evidence in this case "pale[d] in comparison to the situations involving obvious defects in the context of common experience, in which a patent defect has been found as a matter of law." Thus, is could not say as a matter of law that the alleged defects were patent defects. Thus, on this basis, the court could not grant summary judgment.

The court next addressed whether the statute of limitations for *latent* construction defects barred the action. See Code Civ. Proc., §§337, 338. The court explained that the limitations period for latent defects starts to run upon "discovery," which occurs when the plaintiff suspects or reasonably should suspect that someone has done something wrong to the plaintiff, causing the injury. Again, the court could not say, as a matter of law, that the moisture problem in the unit was enough to put a reasonable person on notice. While the trial court found persuasive *Landale-Cameron Court, Inc. v. Ahonen*, 155 Cal. App. 4th 1401, 66 Cal. Rptr. 3d 776 (2d Dist. 2007), review denied, (Jan. 3, 2008), in making its determination that discovery occurred in 1997 (when the association was apprised of a moisture problem in one of the units), the court of found the facts of that case distinguishable. According to the court of appeal:

> [A]t least half of the units in the *Landale* complex were leaking, and repair attempts had been observed by the homeowner association board president. This stands in stark contrast to the evidence presented here: One of 61 units had a window "water moisture problem" as a result of the tile roofs; the owner of that unit reported several broken concrete roof tiles; and no repairs had been observed.

The court further reasoned that to hold otherwise would force property owner associations to conduct investigations for possible defects based on any report of a small problem, which would be costly and burdensome.

» *See Miller & Starr, California Real Estate 3d, Ch. 25B, Common Interest Developments, §25B:110, Ch. 29, Defective Construction, §§29:69, 29:72.*

Insurer was not responsible for payment of damages caused by subcontractors where insured failed to obtain agreements and certificates from subcontractors as was required under the policy.

North American Capacity Ins. Co. v. Claremont Liability Ins. Co., 177 Cal. App. 4th 272, 99 Cal. Rptr. 3d 225 (2d Dist. 2009)

Following a $1.1 million settlement in a construction defect suit, one of the general contractor's insurers, North American Capacity Insurance Company, filed suit against the another insurer, Claremont Liability Insurance Company, claiming that it did not contribute its equitable share of the settlement under their respective policies of insurance. The Claremont commercial general liability and umbrella policy was effective from January 9, 2001 to January 9, 2002 and the North American commercial general liability policy was effective from January 9, 2002 to January 31, 2003.

The court found that approximately $900,000 of the $1.1 million settlement was covered *solely* under North American's policy, based largely on contractor's warranty endorsements in Claremont's policy. The endorsements required the insured to obtain hold harmless agreements and certificates of insurance from independent contractors working on the project as a precondition to coverage. As later explained by the court of appeal:

> *In practical effect,* this endorsement shifted damages caused by the independent contractor to the contractor and its carrier, rather than JDG [the general contractor] and Claremont, and placed the risk of the contractor's defective performance upon the contractor and its carrier. In the present instance,

> the court found that JDG retained a number of independent contractors who were responsible for $909,574 in damages but, because JDG had failed to comply with the contractors warranty endorsement for those contractors [by not obtaining hold harmless agreements from the independent contractors, and obtaining certificates of insurance showing they were insured], Claremont was not responsible to pay for those damages.

The trial court concluded that $200,000 in damages was covered under both policies. Allocating based on the insurers' proportionate "time on the risk," the court calculated North American was responsible for about $150,000 of this amount, with Claremont responsible for the remainder.

While the insurers had agreed to the "time on risk" apportionment method, they hotly contested the date of completion of a home for purposes of the calculation. The trial court had concluded that the home was completed within the meaning of the policies when a notice of completion was recorded instead of four months earlier when the family moved into the home while construction was still ongoing. Ultimately, the trial court denied any recovery on North American's complaint for equitable contribution because it had only paid a total of $800,000 in the settlement of the underlying suit—less than what it was responsible for paying. North American timely appealed.

The Court of Appeal for the Second Appellate District affirmed, holding that trial court properly determined the contract completion date for purposes of apportionment under the policies. The court of appeal agreed with Claremont that the extent to which the home was complete was a question of fact to which the substantial evidence standard applied. The court found it logical that the trial court could find that the home was not put it its "intended use" within the meaning of the policy even when the homeowners moved in because the they still did not have full use of the facilities. Testimony by a city inspector and others supported the reasonable conclusion that the homeowners moved into the home when it was still not completed.

The court of appeal further held that the contractor's warranty endorsements in the Claremont policy, which led the trial court to hold that $900,000 was covered solely under the North American policy, were enforceable. Citing a case in which the court upheld nearly identical endorsements, the court rejected North American's claim that they were ambiguous. *Scottsdale Ins. Co. v. Essex Ins. Co.*, 98 Cal. App. 4th 86, 119 Cal. Rptr. 2d 62 (4th Dist. 2002). The court of appeal further rejected North American's claim that the conditions in the endorsements were not spelled out conspicuously, plainly or clearly in the policy. According to the court, they could not have been more conspicuously or clearly spelled out. The court found equally without merit North American's claim that to enforce the endorsements would violate fundamental principles of California law. According to the court:

> As in *Scottsdale,* JDG [the general contractor] knew, or is presumed to have known, of this precondition prior to acceptance of the Claremont policies. JDG could have protected itself by obtaining from its independent contractors agreements for indemnity and certificates of insurance before entering into the policy or by seeking modification of this policy term, e.g., by paying a larger premium.

The court of appeal rejected North American's claim that the contractor was only required to comply with the preconditions to coverage with respect to subcontracts it entered into *after* the inception of the Claremont policy. A similar argument was rejected in *Scottsdale.* The terms "will receive" and "will obtain" in the endorsement had no temporal reference and simply meant that the insured had to satisfy the preconditions to coverage.

The court of appeal also found without merit North American's alternate contention that the umbrella policy "dropped down" to provide coverage that is excluded in the primary policy. The court explained, inter alia, that under the California rule of "horizontal exhaustion," all primary insurance must be exhausted before an excess insurer must "drop down" to defend and insured. See *Padilla Const. Co., Inc. v. Transportation Ins. Co.*, 150 Cal. App. 4th 984, 987, 58 Cal. Rptr. 3d 807 (4th Dist. 2007).

Finally, the court of appeal held that sufficient evidence supported the trial court's findings on equitable contribution.

» *See Miller & Starr, California Real Estate 3d, Ch. 29, Defective Construction, §29:12.*

A homeowner has the burden of establishing that the builder did not comply with the requirements of SB 800 in order to sue the builder for construction defects without first following the "notice and opportunity to repair" procedures set forth in the Act.

Standard Pacific Corp. v. Superior Court, 176 Cal. App. 4th 828, 98 Cal. Rptr. 3d 295 (4th Dist. 2009)

Civil Code, §910, part of SB 800, prescribes certain pre-litigation procedures that homeowners must follow before suing a builder (i.e., the homeowner must give notice and provide the developer with an opportunity to repair or correct the defect before filing suit). In turn, §912 provides that builders who fail to comply with the requirements of SB 800 are *not* entitled to its protections, and if the developer fails to comply with the repair obligation, the homeowner can proceed with suing the builder. As expressed by the Court of Appeal for the Fourth Appellate District, this case presented the following issue:

> [W]hether a plaintiff who does not follow the procedures set out in section 910 must first establish the builder's noncompliance with section 912, or whether a plaintiff is free to file suit and need not step back to perform the "notice and opportunity to repair" position until the builder affirmatively establishes that it has complied with its own obligations.

Examining the language of the statute, the court of appeal concluded that nothing in Civ. Code §912 suggested that it was optional (the introductory clause provides that the builder "*shall* do all of the following...."). Given the purpose of the law (an opportunity to avoid expensive litigation), the court of appeal saw no apparent reason for a builder to not want to be covered. Since the homeowner's obligation to follow the pre-litigation procedures is "the norm," the court of appeal expressed that it had "no difficulty" concluding that the *homeowner* bears the burden of showing that he or she did not follow the pre-litigation procedures. In this case, the homeowner plaintiffs sued the builder for construction defects, but did not allege that they had complied with the fix-it law by giving the builder an opportunity to repair the defects. Reluctant to require a potentially unfair result, however, the court of appeal directed the trial court to set a new date for hearing and grant the builder's motion to stay the case unless the homeowners could present sufficient evidence to carry their burden of showing the builders' noncompliance with §912.

» *See Miller & Starr, California Real Estate 3d, Ch. 29, Defective Construction, §29:2.*

DISCRIMINATION

Trails in common area of common interest development were not a "public accommodation" under either state or federal disability laws, despite association's failure to prevent all public use.

Carolyn v. Orange Park Community Ass'n, 177 Cal. App. 4th 1090, 99 Cal. Rptr. 3d 699 (4th Dist. 2009)

The Court of Appeal for the Fourth Appellate District addressed whether a recreational common area in a common interest development, in this case a trail that connected to a larger privately and publicly owned trail system, is a public accommodation for purposes of a disability discrimination lawsuit alleging violations of federal and state laws. Concerned about safety on its portion of the trail system, the association installed barriers to its trail entry points to prevent vehicles from utilizing the trails. In the subsequent lawsuit, the plaintiff, who suffered from physical disabilities, claimed that he was prevented from using a horse drawn carriage on the trail system because of the barriers. Affirming the trial court, the court of appeal concluded that the common area trail system was *not* a public accommodation so summary judgment was proper. In rendering its decision, the court of appeal was careful to note that it was not deciding the issue of whether disability discrimination occurred, only whether the common area in this case was a *public accommodation*, a necessary element to causes of action for disability discrimination in violation of the federal Americans with Disabilities Act, the California Disabled Persons Act and related state disability laws (see comment below).

As an initial matter, the court of appeal dispensed with the association's reliance on the fact that the plaintiff did not own property within the common interest development. The court acknowledged that because the trails were on privately owned land, it was clear that the association could bar the general public from all use of the trails. However, the record reflected that the association did not intend to effectively prevent all public use by non-residents of the project. If the association trails were a public accommodation due to some use of the public's use of them, the association could not discriminate against disabled trail users regardless of whether they were residents within the confines of the common interest development, expressed the court.

The court next surveyed relevant law and noted that purely residential areas of a common interest development are clearly not public accommodations. See *Coronado v. Cobblestone Village Community Rentals*, 163 Cal. App. 4th 831, 77 Cal. Rptr. 3d 883 (5th Dist. 2008), review denied, (Aug. 27, 2008). Conversely, a commercial property open to the public qualifies as a public accommodation, even if it has a residential component. *Baltimore Neighborhoods, Inc. v. Rommel Builders, Inc.*, 40 F. Supp. 2d 700, 705-706 (D. Md. 1999). Examining additional cases and other authorities, the court of appeal held as follows:

> We conclude OPCA's [the Association] trails are not public accommodations under either the ADA or California law. We agree with the premise that recreational common areas within common interest developments can be classified as public accommodations in appropriate circumstances. But we think it clear OPCA's trails would not be a public ac-

> commodation if OPCA actively excluded the general public from using the trails. Moreover, we do not think OPCA's private trails transform into public accommodations merely because OPCA does not actively exclude members of the public from using the trails.

The court of appeal reasoned that the list of public accommodations in the ADA (zoos, golf courses, health spas, bowling alleys or amusement parks, etc.) and that of California's Health and Safety Code (auditoriums, theatres, restaurants, etc.) illustrated "a broader concept that places of public accommodation are places designed and intended to provide services, goods privileges, and advantages to members of the public, usually in exchange for payment." Here, there was no evidence that the trails were built for anyone other than its members, that the association encouraged use by members of the public, or that the association charged a fee for them.

The court went on to disagree with *Birke v. Oakwood Worldwide*, 169 Cal. App. 4th 1540, 87 Cal. Rptr. 3d 602 (2d Dist. 2009), review denied, (Apr. 15, 2009) (plaintiff claimed that the association violated the ADA by failing to limit secondhand smoke in the outdoor common areas at the residential complex) to the extent that it suggested that there was a bright line rule protecting residential complexes from all liability for structural access violations in violation of the ADA. According to the court of appeal, it was only holding that a private property owner who fails to actively deny the public access to the recreational property does not convert the property into a public accommodation. The court of appeal went on to caution, however, that residential areas, including those owned by associations, may still be subject to federal and state fair housing law restrictions without being "public accommodations." See, for example, Cal. Code Regs., tit. 24, §§1101A.1 et seq. (housing accessibility standards applicable to multifamily dwelling units and common areas).

Finally, the court of appeal noted the following possible result if it had held otherwise:

> It would be unfortunate if property owners (including but not limited to homeowners' associations) presently inclined toward nonenforcement of their right to exclude the public from recreational areas changed their outlook because of fears of civil litigation conducted by individuals without an ownership stake in the recreational area at issue. Indeed, the most likely explanation for OPCA's neglect of its members' property rights is the cost and hassle associated with excluding nonmembers and includ-

ing members. It is possible a decision contrary to that reached here could lead a previously apathetic association (or individual landowner) to invest in fences, security, access technology, and other means of excluding the public from privately owned recreational areas.

✦ **Comment:** Because the plaintiff did not argue otherwise, the court assumed without deciding that a state Unruh Civil Rights Act claim can only proceed if the trails are deemed a public accommodation.

» *See Miller & Starr, California Real Estate 3d, Ch. 20, Discrimination, §§20:3, 20:28, Ch. 25B, Common Interest Developments, §25B:72.*

Disabled visitor to mobilehome park who failed to register and pay fee for use of the pool as a guest lacked standing to bring a Disabled Persons Act action for monetary damages.

Reycraft v. Lee, 177 Cal. App. 4th 1211, 99 Cal. Rptr. 3d 746 (4th Dist. 2009)

The physically disabled sister-in-law of a tenant at the Tamarisk Mobile Home and RV Park filed a lawsuit against owners of the park, seeking *damages* based on alleged violations of California's Disabled Persons Act. See Civ. Code, §54.3. As relevant to this case, a violation of the right of an individual under the Federal Americans with Disabilities Act constitutes a violation of the DPA. The park management had a policy of allowing a guest to use the pool if the tenant registered the guest and paid a $10 fee. Allegedly the plaintiff (partially paralyzed on the left side), who was *not* registered and did not pay the $10 fee, attempted to use the pool but could not because there was no pool lift. In her complaint, the plaintiff claimed that the pool and restroom did not comply with ADA Accessibility Guidelines.

The trial court granted summary judgment in favor of the Park after concluding that the plaintiff lacked standing under the DPA because she did not register and pay the guest fee. The plaintiff appealed claiming that the trial court should have relied on the federal ADA in deciding the issue of standing. According to her, the federal Act gave her standing without engaging in such a "futile gesture" because she had actual knowledge that the business violated ADA accessibility standards. The park, on the other hand, relied on federal case law to argue that the pool was not a place of public accommodation within the meaning of the federal Act.

The Court of Appeal for the Fourth Appellate District affirmed the trial court, holding that the plaintiff-visitor lacked standing to bring an action for monetary damages under the DPA. The court of appeal was careful to reject the park's claim that the pool was not a public accommodation, observing that it appeared that the pool, open to the general public as long as they paid the fee and followed the rules, was a *public accommodation* under the DPA. In other words, the park would *not* fall outside of the Act simply because an individual did not pay the fees or follow the rules. "However, any such facts could be relevant to determining whether and to what extent a particular disabled individual suffered recoverable *damages*..." under the Act [emphasis added].

In rendering its decision, the court of appeal found misplaced both parties' reliance on *federal* law as being relevant to the issue of standing to maintain an action for money damages under §54.3 of the DPA. The plaintiff's cause of action was brought under the DPA, not the ADA; pursuant to the plain meaning of the applicable statutes, the standing requirements for *monetary recovery* under the federal and state statutes were different. The court of appeal next explained that the DPA provides the following two distinct private causes of action: one for injunctive relief, and one for damages. Significantly, unlike the ADA (and an injunction under the DPA), a disabled person has standing under the DPA if he or she is a*ctually denied equal access* to a public place. Surveying California law, the court explained that a plaintiff has standing if he or she can allege some invasion of a legally protected interest. See *Angelucci v. Century Supper Club*, 41 Cal. 4th 160, 175, 59 Cal. Rptr. 3d 142, 158 P.3d 718 (2007). As relevant to the plaintiff's disability discrimination case, the court concluded that a claim for damages under the DPA (unlike a claim for injunctive relief or an ADA claim) required more than a reasonable belief about the existence of a discriminatory condition. The plaintiff must suffer an *actual denial of equal access* before any suit for damages can be brought under the DPA. (See *Urhausen v. Longs Drug Stores California, Inc.*, 155 Cal. App. 4th 254, 262, 65 Cal. Rptr. 3d 838 (1st Dist. 2007), review denied, (Dec. 12, 2007).) The court of appeal ultimately reached the following conclusion:

> [S]tanding under section 54.3 of the DPA is established where a disabled plaintiff can show he or she actually presented himself or herself to a business or public place with the intent of purchasing its products or utilizing its services in the manner in which those products and/or services are typically offered to the public and was actually denied equal access on a particular occasion. If, as in *Angelucci [v. Century Supper Club*, 41 Cal. 4th 160, 175 (2007)], the business or public place *does not allow admittance without a fee*, *a disabled plaintiff would need to show he or she presented himself or herself to the business or public place intending to patronize it and to pay the admission*

> *fee* to gain admittance to the business or public place as any other customer would do but was actually denied equal access. [Emphasis added.]

Thus, because the plaintiff failed to register and pay the fee, she lacked standing to bring a suit for damages under §54.3. She was unable to show she actually presented herself to the business (in this case the mobilehome park), as any other customer or guest would do, with the intent of paying the guest fee in order to gain admittance to the Park and/or to use the pool. The court of appeal reasoned that if it held otherwise there would be no difference between a cause of action for injunctive relief under §55 or the ADA and one for monetary damages under §54.3.

» *See Miller & Starr, California Real Estate 3d, Ch. 20, Discrimination, §20:7, Ch. 22, Landowners' Liability, §22:75.*

ESCHEAT

State is not required to pay prospective and retroactive interest to owners when returning property held pursuant to California's Unclaimed Property Law.

Suever v. Connell, 579 F.3d 1047 (9th Cir. 2009)

Various parties sued the State of California claiming that the State violated California's Unclaimed Property Law. The parties sought, among other things, interest on property held by the State. While a prior version of the UPL allowed for payments of interest in prescribed situations, the statute was amended in 2003 to now provide that "[n]o interest shall be payable on any claim paid under this chapter." See Code Civ. Proc., §1540, subd. (c). Guided by intervening precedent, the Court of Appeals for the Ninth Circuit, in consolidated appeals, held as follows concerning the State's obligations under UPL:

> (a) *Prospective interest.* Because the State is not constitutionally required to pay *any* interest under the UPL (see *Turnacliff v. Westly,* 546 F.3d 1113, 1119-20 (9th Cir. 2008)), there is no need to determine whether California's alternative borrowing rate is the appropriate rate that the State must pay when returning property. An order by the district court requiring prospective payment of interest, or payment of interest on any claims for unclaimed property that escheated under the current version of UPL had to be reversed.
>
> (b) *Retroactive interest.* As held by *Turnacliff v. Westly*, 546 F.3d 1113, 1119-20 (9th Cir. 2008), the Eleventh amendment bars plaintiffs from seeking retroactive interest under the pre-amendment version of the UPL. The court found unpersuasive attempts at distinguishing *Tur-*

nacliff. For example, the plaintiffs claimed that, unlike *Turnacliff,* their claims involved illegitimately seized property. The court pointed out, however, that the district court expressly found to the contrary. Also, the plaintiffs misread the relevant cases. While the Eleventh Amendment does not bar return of a party's *own* property, no case has held that a party is entitled to *more* than the property that the State took into its possession (e.g., interest).

(c) *Retroactive restitution*. The plaintiffs claimed that they were entitled to recover the "value" of non-cash property taken into the Controller's possession without regard to the actual sums the Controller obtained in liquidating them. Again, expressed the court, case law holds that plaintiffs are not entitled to *more* than the actual property the State took. See *Taylor v. Westly,* 402 F.3d 924, 932 (9th Cir. 2005). The court flatly rejected the plaintiffs' assertion that they were only seeking private money and not state funds. The court of appeals explained, among other things:

> [E]ven if there were [private property worth] $5.3 billion in the Unclaimed Property Fund, the Controller could not lawfully use it to pay Plaintiffs the difference between the proceeds of the sale of their escheated property and what they claim that property is worth now; to do so, the Controller would by definition have to use money belonging to other owners of unclaimed property.

Finally, the court affirmed the district court's dismissal of the former Controller as a defendant in his individual capacity.

» *See Miller & Starr, California Real Estate 3d, Ch. 18, Escheat, §18:3.*

HOLDING TITLE

Under the neutral principles of law analysis, a local church did not have the authority to amend its governing documents to disaffiliate from the national denomination.

Classis of Central California v. Miraloma Community Church, 177 Cal. App. 4th 750, 99 Cal. Rptr. 3d 449 (1st Dist. 2009)

In a dispute over whether a subordinate church within a hierarchical denomination could amend its articles of incorporation and bylaws to sever its denominational ties to the larger church, the Court of Appeal for the First Appellate District determined that it could not. The Reformed Church in America, the oldest continuous evangelical Protestant church in the country, is organized into the following governmental units: the consistory, the classis, the regional synod, and the

General Synod, with the latter at the top of the hierarchy. After the classis notified Miraloma Community Church, a consistory (the lowest level), that it was considering *superseding* Miraloma due to long-term decline in membership (allows it to replace the administrative body with its own), Miraloma purported to amend its articles of incorporation and bylaws to disaffiliate, and thus retain control of the church (and its property). In a subsequent lawsuit brought by the higher church, the trial court, applying the neutral principles of law analysis as recently approved the California Supreme Court (described below), held that the attempts of disaffiliation were ineffective.

The Court of Appeal for the First Appellate District affirmed the trial court, holding first that Miraloma was a subordinate church within the hierarchical denomination. The court of appeal explained that under the "neutral principles" analysis, the court must defer to the position of the highest ecclesiastical authority on points of religious doctrine. However, to the extent the court can resolve the dispute without referring to church doctrine, as was the case here, the court may consider sources such as the local church's articles of incorporation, the general church's constitution, canons, and rules, and relevant statutes. See *In re Episcopal Church Cases*, 45 Cal. 4th 467, 478, 87 Cal. Rptr. 3d 275, 198 P.3d 66 (2009), as modified, (Feb. 25, 2009) and cert. denied, 2009 WL 1806665 (U.S. 2009). In concluding that Miraloma was a subordinate church, the court noted, *inter alia*, that the corporate documents declared the local church's faithfulness and subordination to the higher church, and through the years Miraloma acted consistently, and in conformity with, the hierarchical nature of the larger church. The court of appeal found without merit Miraloma's claim that the Reformed Church of America was not a hierarchical church, so a different analysis should apply. The court responded as follows:

> While it is true that in the RCA structure laypersons and clergy exercise authority in a representative capacity at the various governance levels within the denomination, the structure nonetheless follows a tiered model of superintendence and appellate supervisory powers, from the local consistory up to the General Synod. It is this tiered structure, with each ascending tier exercising superintendence and appellant supervisory power over the acts, proceedings, judgments and decisions of the lower tier that brings it within the general category of a hierarchical as opposed to a congregational church organization.

The court of appeal next held that Miraloma's attempts to disaffiliate were ineffective. Here, the trial court found that the *bylaws* expressly prevented the church from amending its corporate documents to avoid the requirement that the higher church consent to the change in form. Relying on principles of corporate law (articles of incorporation control over conflicting provisions of a corporation's bylaws), Miraloma asserted that nothing in its *articles* required the consent of the higher church to disaffiliate, so amendment of both was proper and effective. The court acknowledged that this general principle was true, but under the neutral principles analysis the court was not restrained to look only at corporations law. Rather, it could look at the national church's constitution, canons and the like. The court found support for its conclusion by examining case law. See *Guardian Angel Polish Nat. Catholic Church of Los Angeles, Inc. v. Grotnik*, 118 Cal. App. 4th 919, 13 Cal. Rptr. 3d 552 (2d Dist. 2004), as modified, (May 18, 2004). Turning to the facts of the case before it, the court of appeal noted, that "[s]ignificantly, the articles...pledge fealty to the RCA...." The bylaws similarly stated that Miraloma was a member of the RCA. The court also noted Miraloma's actions over the years, and the sequence of events which led Miraloma to attempt to amend its corporate documents to disaffiliate. The court of appeal noted that the contrary case of *California-Nevada Annual Conference of United Methodist Church v. St. Luke's United Methodist Church*, 121 Cal. App. 4th 754, 17 Cal. Rptr. 3d 442 (5th Dist. 2004) (disapproved of by, In re Episcopal Church Cases, 45 Cal. 4th 467, 87 Cal. Rptr. 3d 275, 198 P.3d 66 (2009)), relied upon by Miraloma, is no longer good law in light of the neutral principles approach enunciated in the *Episcopal Church Cases* as well as for other reasons.

The court of appeal further rejected Miraloma's claim that the courts were serving as "enforcers" of the will of denominational religious hierarchies. The court explained again that courts do not decide questions of religious doctrine. Instead, they resolved property and governance disputes by applying neutral principles of law.

Finally, the court of appeal held that the classis was entitled to supersede Miraloma. According to the court of appeal:

> The trial court correctly determined that the RCA was a hierarchical church. Therefore, the Classis' decision to institute the supersedure process, and its vote to supersede, were precisely the kind of ecclesiastical judgments to which we defer. [citation omitted] Moreover, procedurally the Classis followed the dictates of the Book of Church Order.

The court of appeal found without merit Miraloma's claim that the supersedure violated the Corporations Code because it impermissibly delegated the functions of the board of directors to the trustees. The court found inapposite the case relied upon by Miraloma. *Communist Party v. 522 Valencia, Inc.*, 35 Cal. App. 4th 980, 995, 41 Cal. Rptr. 2d 618 (1st Dist. 1995). Here, there was no secret agreement on the part of the trustees to manage the affairs of the Church. The court rejected Miraloma's remaining contentions as without merit.

» *See Miller & Starr, California Real Estate 3d, Ch. 12, Holding Title, §12:68.*

Wife's community property interest in the proceeds from the sale of property was properly applied to satisfy restitution order pursuant to the Mandatory Victim Restitution Act against husband in connection with his conviction for fraud.

U.S. v. Berger, 574 F.3d 1202 (9th Cir. 2009)

An innocent spouse's community property interest in the proceeds of the sale of property was held to be available to satisfy a $3.14 million restitution judgment against her husband pursuant to the Mandatory Victim Restitution Act in connection with the husband's criminal conviction for fraud. The Ninth Circuit Court of Appeals affirmed the judgment of the lower court, which had rejected the wife's claim that case law governing criminal forfeiture controlled. Here, the district court ordered *restitution*, not criminal forfeiture. Furthermore, the wife cited no authority suggesting that a MVRA restitution case should be analyzed under forfeiture laws.

Turning to the central issue before it, the court of appeals applied *state law* and held as follows:

> In the ordinary case, "the community estate is liable for a debt incurred by either spouse before or during marriage, regardless of which spouse has the management and control of the property and regardless of whether one or both spouses are parties to the debt or to a judgment for the debt." Cal. Fam.Code §910(a). Thus, even though Richard is the only spouse who is a party to the judgment for the debt at issue here, under the MVRA and California law the...community property status [of the sales proceeds] makes Cornella liable for that debt. *See* 18 U.S.C.A. §§3613, 3664(m); Cal. Fam. Code §910(a).

The court noted that prior case law supported its holding (*In re Soderling*, 998 F.2d 730, 734 (9th Cir. 1993), and found unpersuasive an unpublished district court case relied on by the wife. The court also rejected the wife's claim that it would be unjust to punish an innocent spouse, expressing that "it has long been true in community property jurisdictions that both spouses assume the risks—and benefits—of that legal system."

» *See Miller & Starr, California Real Estate 3d, Ch. 12, Holding Title, §12:63.*

HOMESTEADS

Judgment creditor could not bypass statutory homestead procedures by having a receiver appointed to sell the residence.

Wells Fargo Financial Leasing, Inc. v. D & M Cabinets, 177 Cal. App. 4th 59, 99 Cal. Rptr. 3d 97 (3d Dist. 2009)

Wells Fargo Home Mortgage filed a motion for an order appointing a receiver to sell residential property subject to a judgment lien pursuant to Code Civ. Proc., §708.620 and also to avoid homestead procedures set forth in Code Civ. Proc., §704.740. Under this latter section, a person entitled to a homestead exemption receives specified protections, including a hearing in which the court determines the amount of the exemption, the fair market value of the dwelling, and the priority of liens, among other things. The homeowner, now divorced from the debtor husband but still subject to the lien, did not object to the appointment of the receiver. She asserted that since she was entitled to a homestead exemption, the creditor could not bypass the homestead procedures set forth in §704.740. The creditor claimed that this section should be read only to apply to a sheriff's sale and not to a sale by a receiver. The trial court agreed, holding that the court could protect the homeowner's rights in the sale of the home by the receiver. The homeowner appealed.

The Court of Appeal for the Third Appellate District reversed the trial court, holding that because the only purpose for appointing the receiver to sell the property was to circumvent the requirements of §704.740, the order had to be reversed. According to the court:

> Section 704.740...unambiguously states that a dwelling subject to a homestead exemption "may not be sold under this division [Enforcement of Money Judgments or EJL] to enforce a money judgment except pursuant to a court order for sale obtained under this article [Homestead Exemption]." The statute thus clearly and unambiguously makes a section 704.740 order a requirement for sale of a dwelling subject to a homestead exemption, without differentiation between a sale by a sheriff and a sale by a receiver.

The court of appeal found additional support for its holding by examining other provisions of the Enforcement of Judgment Law. For example, the EJL chapter on exemptions expressly states that exemptions "apply to all procedures for enforcement of a money judgment" except as otherwise provided by statute. (§703.010.) Additionally, the EJL's chapter on Execution (Chapter 3, §§699.010 et seq.) authorizes the court to appoint a receiver *or* order the levying officer to sell property in specified circumstances, with the manner of the sale and the distribution of proceeds to be accomplished pursuant to the same statutory provisions governing execution. (§699.070.)

While it is true that under a judicially supervised receiver sale, the court has broad discretion to fashion the appropriate sale, the court could not avoid plain language of the statute, expressed the court of appeal. It clearly and unambiguously makes a §704.740 order a requirement for sale of a dwelling subject to a homestead exemption without differentiating between a sale by a sheriff or a receiver.

The court of appeal also found without merit the creditor's policy arguments for allowing the receiver's sale to bypass §704.740 (e.g., claiming that the debtors has even more protections through the appointment of a receiver). Again, none of the arguments could justify the court's deviation from the plain meaning of the statute. The creditor's claim that this section should not be read literally, but should instead be "harmonized" with the rest of EJL was equally unavailing. According to the court, there was nothing to harmonize. The procedure allowing for appointment of a receiver was not inconsistent with the procedure for handling a homestead exemption. Furthermore, if there were a need to harmonize, the court would still hold that §704.740 applied to receivers. According to the court, "homestead law is not designed to protect creditors and should be liberally construed 'to promote the beneficial purposes of the homestead legislation to benefit the debtor [and his family] [citation omitted]." The court found unpersuasive the cases relied upon by the creditor.

Finally, the court held that its holding was not altered by a forbearance agreement between the creditor and debtors granting the creditor a contractual right to the appointment of a receiver in the case of default by the debtors. The agreement said nothing about the homestead exemption, and in the absence of a waiver (the enforceability of which the court noted was not then before it), it remained subject to §704.740.

» *See Miller & Starr, California Real Estate 3d, Ch. 13, Homesteads, §13:43, Ch. 33, Receivers, §§33:2, 33:13.*

JUDICIAL REMEDIES

Losing party in a lawsuit who successfully defended an appeal denying the other party's motion for an award of attorney's fees was not the

prevailing party in the appeal for purposes of an award of contractual attorney's fees.

Wood v. Santa Monica Escrow Co., 176 Cal. App. 4th 802, 97 Cal. Rptr. 3d 909 (2d Dist. 2009)

A personal representative of an estate sued various parties, claiming that they fraudulently induced an elderly woman to obtain a loan secured by her home and then they pocketed the money. Two years after filing the original complaint, Wood, the personal representative, dismissed the complaint with prejudice as to the escrow company involved in the transaction. The escrow company then unsuccessfully filed a motion for attorney's fees. It had relied on the attorney's fees provision in the parties' escrow instructions for an award of fees as the prevailing party. See Civ. Code, §1717. However, the court concluded that, pursuant to Welfare and Institutions Code, §15657.5, subd. (a), only a *prevailing plaintiff* is entitled to attorney's fees in elder abuse cases. To award fees under §1717 would frustrate legislative policy, expressed the court. This holding was affirmed on appeal. See *Wood v. Santa Monica Escrow Co.*, 151 Cal. App. 4th 1186, 60 Cal. Rptr. 3d 597 (2d Dist. 2007), review denied, (Aug. 29, 2007). Wood, also relying on the attorney's fees provision in the escrow instructions, then filed a motion for attorney's fees as the prevailing party on the appeal. The trial court denied the motion, concluding that overall the escrow company was the prevailing party in the action.

The Court of Appeal for the Second Appellate District affirmed the trial court, holding that Wood was not entitled to attorney fees as the prevailing party. The court found without merit Wood's claim that the trial and the appeal could be viewed as two separate proceedings. The prevailing party must be determined by who prevails in the overall lawsuit, held the court. Wood could find no authority for the proposition that a party who prevails on appeal is, solely on that basis, entitled to a contractual fee award if no further proceedings are required.

The court went on to hold that California Rules of the Court, rule 8.278(a)(2) (defines the prevailing party on appeal as the respondent if the court affirms the judgment without modification) did not compel a different outcome. This rule pertains to the award of *costs* on appeal, not attorney's fees.

Finally, the court found "absurd" Wood's claim that §1717 mandated a fee award, and because the escrow company was not entitled to its fees, he should be awarded his fees. Again, expressed the court, the cases relied upon Wood actually held that a party is entitled to fees as the prevailing party in the overall lawsuit, not on the appeal.

» *See Miller & Starr, California Real Estate 3d, Ch. 34, Judicial Remedies, §§34:66, 34:73.*

Suit arising out of dispute over a landlord tenant settlement agreement was not a strategic lawsuit against public participation, so not subject to dismissal pursuant to California's anti-SLAPP statute.

Delois v. Barrett Block Partners, 177 Cal. App. 4th 940, 99 Cal. Rptr. 3d 609 (1st Dist. 2009), as modified, (Sept. 11, 2009)

For a summary of this case see LANDLORD AND TENANT.

» *See Miller & Starr, California Real Estate 3d, Ch. 34, Judicial Remedies, §34:146, Ch. 19, Landlord and Tenant, §19:241.*

LANDLORD AND TENANT

Suit arising out of dispute over a landlord tenant settlement agreement was not a strategic lawsuit against public participation, so not subject to dismissal pursuant to California's anti-SLAPP statute.

Delois v. Barrett Block Partners, 177 Cal. App. 4th 940, 99 Cal. Rptr. 3d 609 (1st Dist. 2009), as modified, (Sept. 11, 2009)

In a lawsuit brought by a tenant against his former landlord stemming from the landlord's alleged failure to honor the terms of a tenancy termination agreement, the Court of Appeal for the First Appellate District reversed the trial court. The trial court had erroneously concluded that the tenant's ten causes of action satisfied the first of two prongs of California's anti-SLAPP statute (strategic lawsuit against public participation). Under this prong, the court must decide whether the defendant has made a threshold showing that the challenged cause of action is one arising out of a protected activity. Here, the trial court had concluded that because the termination agreement was a settlement entered into to avoid litigation, the landlord had demonstrated that the first prong of the test was satisfied. According to the trial court:

> Defendants correctly state that settlement agreements, being a part of the litigation process, are protected activity under CCP section 425.16. That includes 'communications preparatory or in anticipation of bringing an action' [Citations.] The Court finds that defendants have met the first prong of Section 425.16.

This was not a correct statement of the law, expressed the court of appeal, because it ran contrary to authority concerning lawsuits designed to enforce agreements generally, and recent authority regarding the application of the SLAPP statute to landlord-tenant disputes. As explained by the court of appeal in *Applied Business Software, Inc. v. Pacific Mortg. Exchange, Inc.*, 164 Cal. App. 4th 1108, 79 Cal. Rptr. 3d 849 (2d Dist. 2008):

> Under the explanatory provisions in subdivision (e) of

> section 425.16, defendant's entering into the settlement agreement during the pendency of the...case was indeed a protected activity, but defendant's subsequent alleged breach of the settlement agreement after the... case was concluded is not protected activity *because it cannot be said that the alleged breaching activity was undertaken by defendant in furtherance of defendant's right of petition or free speech, as those rights are defined in section 425.16. Thus, the instant suit is based on alleged conduct of defendant that is not protected activity.*

According to the court of appeal, these same principles applied to drafting and execution of an agreement even *before* litigation commences.

The court of appeal then surveyed a number of recent anti-SLAPP cases in the context of landlord-tenant disputes. The court found persuasive the analysis articulated in *Clark v. Mazgani*, 170 Cal. App. 4th 1281, 1289, 89 Cal. Rptr. 3d 24 (2d Dist. 2009), review denied, (Apr. 29, 2009). According to that court, the pivotal distinction is whether an actual or contemplated unlawful detainer action by a landlord merely preceded or "triggered" the tenant's lawsuit, or whether it was instead the basis or cause of that suit. If the protected activity is the *basis* of the suit, then it is subject to a special motion to strike. Turning to the facts of this case, the court of appeal expressed the following:

> [P]laintiff's action here did not challenge any "communications preparatory to or in anticipation of" a lawsuit. Rather, it challenged defendants' actions in allegedly breaching the Tenancy Termination Agreement the parties had entered into after plaintiff would not meet their new rental demands, demands allegedly made because of defendants' desire to convert their property into condominiums. It was also based on the landlords' failure to return plaintiff's rental deposit and other promised refunds, because he was a "couple of days" late in moving out of his unit and had not left it "broom clean"—apparently because of material still in the unit belonging to the landlords, their contractor, and an earlier tenant.

Having concluded that the facts and pleadings of the case did not satisfy the first prong of the anti-SLAPP statute because the causes of action stemmed from breach of the settlement agreement, not protected activity, the court of appeal reversed the trial court's order.

» *See Miller & Starr, California Real Estate 3d, Ch. 19, Landlord and Tenant, §19:241, Ch. 34, Judicial Remedies, §34:146.*

LANDOWNERS' LIABILITY

Cal-OSHA work safety requirements did not apply to homeowner's remodeling project for purposes of finding the homeowner negligent per se for injuries sustained by a laborer working for an unlicensed contractor.

Cortez v. Abich, 177 Cal. App. 4th 261, 98 Cal. Rptr. 3d 830 (2d Dist. 2009)

A laborer hired by an unlicensed contractor to work on a residential remodeling project fell through the homeowners' roof on his first day of work and fractured his spine. The injured laborer brought a negligence action against the homeowners. He asserted that because the homeowners failed to hire a licensed contractor, they were his employer. See Labor Code, §2750.5 (provides a rebuttable presumption that a person who performs services for which a license is required is an employee). As such, they had a duty to maintain a safe working environment as required by OSHA (the California Occupational Safety and Health Act), claimed the laborer. Significantly, if the homeowners were found to be subject to and to have violated OSHA regulations, they would be deemed negligent *as a matter of law.* They also would be barred from asserting assumption of risk or contributory negligence defenses. The laborer alternatively claimed that the homeowners had a duty to warn of a concealed danger. The trial court granted summary judgment in favor of the homeowners. The court concluded, as a matter of law, that the homeowners were not subject to OSHA because the laborer was not an employee of the homeowners. As for the concealed danger theory, the court concluded that the homeowners had no duty to inspect the roof for soft spots.

The Court of Appeal for the Second Appellate District affirmed the trial court, but on different grounds with respect to the OSHA claim. The court explained that the trial court correctly concluded that the homeowners were not the laborer's employer. Labor Code, §3352, subd. (h), bars a party from being the employer when he or she works less than 52 hours in a 90 day period. However, this is for purposes of *workers' compensation*. The court erred in reaching the same conclusion with respect to a negligence suit against them. See *Rosas v. Dishong*, 67 Cal. App. 4th 815, 79 Cal. Rptr. 2d 339, 63 Cal. Comp. Cas. (MB) 1376 (4th Dist. 1998). The court went on to conclude, however, that the homeowners were not subject to OSHA regulations based on the facts of the case. A similar argument was rejected by the California Supreme Court in *Fernandez v. Lawson*, 31 Cal. 4th 31, 1 Cal. Rptr. 3d 422, 71 P.3d 779, 68 Cal. Comp. Cas. (MB) 1021, 20 O.S.H. Cas. (BNA) 1249 (2003). In that case the Court concluded that an exception from the OSHA statutes for "household domestic service" should apply. According to the Court, "overwhelming public policy and practical considerations make it unlikely the Legislature intended the complex regulatory scheme that is OSHA to apply to a homeowner hiring a worker to perform tree trimming...." The court of appeal acknowledged that demolishing a roof was not the same as removing a portion of a tree, but it nevertheless accepted the rationale in that case. According to the court of appeal:

> While we do not suggest that every project undertaken by a homeowner is exempt from the application of the OSHA regulations, we conclude the remodel at issue is exempt because its purpose was personal—to enhance the owners' enjoyment of their residence. We believe our conclusion tracks the goal of OSHA in that it directs its regulatory effect toward the intended target—business employers.

The court of appeal further reasoned that it would be unfair to impute OSHA liability to a homeowner where the he or she hires a professional, reasonably assuming that the professional will understand the safety issues involved.

Finally, the court of appeal agreed with the trial court that the roof did not present a concealed danger, but an open and obvious one. Accordingly, there was no duty on the part of the homeowners to warn of the obvious danger. See *Krongos v. Pacific Gas & Electric Co.*, 7 Cal. App. 4th 387, 393, 9 Cal. Rptr. 2d 124 (1st Dist. 1992).

» *See Miller & Starr, California Real Estate 3d, Ch. 22, Landowners' Liability, §§22:44, 22:58.*

Cattle ranchers who accommodated a social guest's request to ride a horse did not increase the risk of riding to defeat the doctrine of primary assumption of risk by failing to warn of the horse's special training.

Levinson v. Owens, 176 Cal. App. 4th 1534, 98 Cal. Rptr. 3d 779 (3d Dist. 2009), as modified on denial of reh'g, (Sept. 25, 2009)

As expressed by the court of appeal in *Guido v. Koopman*, 1 Cal. App. 4th 837, 842, 2 Cal. Rptr. 2d 437 (1st Dist. 1991), "being thrown off a horse [i]s an inherent risk of horseback riding, [indeed]...it is one of the most obvious risks of that activity, and readily apparent to anyone about to climb a horse." Thus, in that case, the primary assumption of risk doctrine barred a suit by an injured rider against the owner of the horse.

In this latest case involving the guest of cattle ranchers thrown from a specially trained horse, the court of appeal considered whether the ranchers did anything to increase the inherent risks of riding to defeat the doctrine. Trigger (the horse) had uncharacteristically galloped from the field to the corral, with the rider reacting by letting go of the reins and instead holding onto the saddle horn. The horse abruptly cut to the left, with the rider flying from the horse, slamming into a fence and ending up in a feed bunk (her hip was shattered and her face cut by the barbed wire at the top of the fence).

Affirming a grant of summary judgment in favor of the ranchers, the Court of Appeal for the Third Appellate District held that the primary assumption of risk doctrine applied to completely bar the suit. Under this doctrine, a participant in a sporting activity generally is considered to assume the risks inherent in the sport itself. The other persons involved in the activity have only a duty not to make the activity more dangerous than it inherently is, but owe no duty to protect the other person from the inherent risks of the sport. In this case, the court concluded that the defendants did not do anything to increase the inherent risks in riding the horse.

In rendering its decision the court of appeal explained that, depending on the *role* played by a particular person, duties with respect to the same risk may vary. In this case, the defendants were not commercial operators whose services and horses were for hire. Rather, they were cattle ranchers who accommodated a request made, ironically, by their attorney who was invited over for a barbeque to celebrate a victory in a lawsuit. She had claimed that the ranchers had a duty to select a horse that was right for her, but again, the accommodation was made at her request. In allowing her to ride the horse, the ranchers were entitled to rely on her claims made, more than once, that she had ridden horses before. The horse also had no prior history as a dangerous horse. Further, a specially trained horse for cattle ranching purposes was exactly the type of horse a person should expect to encounter on a cattle ranch, expressed the court.

The fact that the rider was told not to pull back on the reins when she originally mounted the horse, did not change the outcome of the case. This admonition was made in response to her pulling the reins when the defendant was adjusting the stirrups, resulting in the horse rearing back and moving around. According to the court, even a person with minimal experience would not interpret this to mean never pull back on the reins. The court also rejected the attorney's further claim that the ranchers should have given her instructions on how to control the horse. Again, expressed the court, the defendants were entitled to believe her assertions that she had ridden horses before.

✦ **Comment:** Operators of commercial guest ranches and riding stables whose horses are available for hire have a greater duty than a private, non-commercial rancher who makes a horse available to a social guest. The opinion in *Levinson* discusses several prior court of appeal discussions which distinguish among the different roles played by riding instructors, including stables and trail ride proprietors whose duty to safeguard the public may require greater care in matching horse to rider than a social host owes to a guest who claims some riding experience.

» *See Miller & Starr, California Real Estate 3d, Ch. 22, Landowners' Liability, §22:78.*

Disabled visitor to mobilehome park who failed to register and pay fee for use of the pool as a guest lacked standing to bring a Disabled Persons Act action for *monetary damages*.

Reycraft v. Lee, 177 Cal. App. 4th 1211, 99 Cal. Rptr. 3d 746 (4th Dist. 2009)

For a summary of this case see DISCRIMINATION.

» *See Miller & Starr, California Real Estate 3d, Ch. 22, Landowners' Liability, §22:75, Ch. 20, Discrimination, §20:7.*

LENDERS' LIABILITY

State interest rate laws not completely preempted by National Bank Act.

Thomas v. U.S. Bank Nat. Ass'n ND, 575 F.3d 794 (8th Cir. 2009)

For a summary of this case see USURY.

» *See Miller and Starr, California Real Estate 3d, Ch. 36, Lender's Liability, §36:29, Ch. 10, Deeds of Trust, §10:71, Ch. 21, Usury, §21:33, §21:25.*

MOBILEHOMES

State statute within the provisions of the Subdivision Map Act which regulated the conversion of mobile home park from rental to residential ownership preempted a local ordinance purporting to implement the requirements set forth in the statute.

Sequoia Park Associates v. County of Sonoma, 176 Cal. App. 4th 1270, 98 Cal. Rptr. 3d 669 (1st Dist. 2009), review filed, (Sept. 30, 2009)

For a summary of this case see SUBDIVISIONS.

» *See Miller & Starr, California Real Estate 3d, Ch. 31, Mobilehomes, §31:41, Ch. 25, Subdivisions, Land Use Planning and Approvals, §§25:2, 25:19.*

RECEIVERS

In enforcing a judgment lien, creditor could not bypass statutory homestead procedures by having a receiver appointed to sell the residence.

Wells Fargo Financial Leasing, Inc. v. D & M Cabinets, 177 Cal. App. 4th 59, 99 Cal. Rptr. 3d 97 (3d Dist. 2009)

For a summary of this case see HOMESTEADS.

» *See Miller & Starr, California Real Estate 3d, Ch. 33, Receivers, §33:2, Ch. 13, Homesteads, §13:43.*

RECORDING AND PRIORITIES

County recorder's statutory obligation to "stamp and record" a full reconveyance within two business days of receipt does not include *indexing*.

Ricketts v. McCormack, 177 Cal. App. 4th 1324, 99 Cal. Rptr. 3d 817 (2d Dist. 2009)

For a summary of this case see DEEDS OF TRUST.

» *See Miller & Starr, California Real Estate 3d, Ch. 11, Recording and Priorities, §§11:20, 11:21, Ch. 10, Deeds of Trust, §10:111.*

REGULATION OF THE REAL ESTATE INDUSTRY

Realtors did not violate antitrust laws by illegally tying commissions charged for the sale of developed lots to the listing and referral fees for sale of undeveloped lots.

Blough v. Holland Realty, Inc., 574 F.3d 1084 (9th Cir. 2009)

Buyers of newly constructed homes filed a class action lawsuit against real estate agents ("Realtors") who represented subdivision developers. In each case, the developer agreed to pay the realtor a commission on sale of a developed lot that included both a commission on the undeveloped lot and a fee based on the cost of the home to be constructed by the developer on the lot. The buyers claimed that the realtors violated anti-trust laws by tying the sale of undeveloped lots to services and commissions for developed lots with newly-constructed homes. As described by the court of appeal, essentially, the following occurred:

> Buyers entered into agreements with homebuilders to purchase developed lots (an undeveloped lot with a newly-constructed home) in different subdivisions in the Boise, Idaho area. Realtors represented the developers of the subdivisions in allocating lots to the homebuilders. The price of the developed lot that Buyers paid to the homebuilders included a commission (or referral fee) for Realtors, typically calculated as a percentage of the total price of the developed lot. It is apparently the custom in Idaho for the seller, rather than the buyer, to pay the commission owed to the listing agent and to the selling agent (the agent assisting the buyer's search for a property) when a transaction closes. Buyers claim the Realtors engaged in a *per se* unlawful tying arrangement when they tied the sale of undeveloped lots (the tying product) to

> their services and commissions on the sale of developed lots (the tied product).

The district court granted summary judgment in favor of the realtors, finding no anti-trust law violations.

The Ninth Circuit Court of Appeals affirmed, holding that the alleged tying arrangement did not violate the Sherman Anti-Trust Act. The court explained that a tying arrangement is a *per se* violation of the Sherman Act if the plaintiff establishes the following three elements: (1) the defendant tied together the sale of two distinct products or services; (2) the defendant possesses enough economic power in the tying product market to coerce its customers into purchasing the tied product; and (3) *the tying arrangement affects a "not insubstantial* volume of commerce" in the *tied product market*. In this case, the court of appeal agreed with the district court that, under the doctrine of "zero foreclosure" the third prong could not be satisfied and, therefore, there was no anti-trust violation. Under the zero foreclosure doctrine, where the tied product is completely unwanted by the buyer, "there is no unlawful tying arrangement because there is no adverse effect on competition in the tied product market." When a seller of one product forces a buyer to purchase another product he otherwise would not have purchased, there is no foreclosure of competition because the buyer would not otherwise participate in the tied market. *See Reifert v. South Cent. Wisconsin MLS Corp.*, 450 F.3d 312, 317-18 (7th Cir. 2006), cert. denied, 549 U.S. 1265, 127 S. Ct. 1494, 167 L. Ed. 2d 228 (2007). In the present case, the Ninth Circuit Court of Appeals found there was no market for the alleged tied product, so there could be no *per se* unlawful tying arrangement because there was "zero foreclosure" of competition. According to the court of appeals:

> While Buyers may well believe the bottom line was too high (something on which we express no opinion), the reality is that they purchased a lot and finished home from the homebuilder for a total price set by the homebuilder. The homebuilder's price no doubt reflected its costs--nuts, bolts, labor, as well as fees, commissions and the like--together with profit. Thus, what Buyers call the tied product boils down to an additional cost to build on a lot in the subdivision of the Buyers' choice. It is undisputed that none of the Buyers wanted (or needed) the tied product on matters relating to building the house. This is understandable, for purchasers of developed lots are not typically in the market to purchase referral and listing services.

» *See Miller & Starr, California Real Estate 3d, Ch. 4, Regulation of the Real*

Estate Industry, §4:29, Ch. 5, Broker's Compensation, §5:20.

SUBDIVISIONS, LAND USE PLANNING, AND APPROVALS

California Environmental Quality Act does not require a public agency to prepare and consider an environmental impact report before it disapproves a project.

Las Lomas Land Co., LLC v. City of Los Angeles, 177 Cal. App. 4th 837, 99 Cal. Rptr. 3d 503 (2d Dist. 2009)

For a summary of this case see CEQA.

» *See Miller & Starr, California Real Estate 3d, Ch. 25, Subdivisions, Land Use Planning, and Approvals, §25:68, Ch. 25A, California Environmental Quality Act (CEQA), §§25A:4, 25A:7.*

State statute within the provisions of the Subdivision Map Act which regulated the conversion of mobile home park from rental to residential ownership preempted a local ordinance purporting to implement the requirements set forth in the statute.

Sequoia Park Associates v. County of Sonoma, 176 Cal. App. 4th 1270, 98 Cal. Rptr. 3d 669 (1st Dist. 2009), review filed, (Sept. 30, 2009)

Part of the Subdivision Map Act (Gov. Code, §§66410 et seq.) regulates the conversion of mobilehome parks from rental to residential ownership. Section 66427.5 of the Act sets forth certain steps that must be completed before a conversion application can be approved. The County of Sonoma enacted an ordinance with the aim of "implementing" the requirements set forth in the conversion statute. The local ordinance imposed conditions not contained in the state statute and required these criteria to be satisfied before the application would be considered "bona fide" and be approved. Sequoia Park Associates, the owner of a mobilehome park, sought to have the ordinance overturned on the grounds that the state law preempted the local ordinance, preventing the County from imposing additional requirements of the ordinance as a condition of approving the conversion.

Government Code §66427.5 requires the subdivider to avoid economic displacement of non-purchasing residents in the proposed mobile home park conversion by mandating that the subdivider offer each tenant an option to purchase the unit created upon conversation or to continue residency as a tenant. The subdivider is required to file a report and to obtain a survey of support of tenants, containing specified information, and provide the survey to the local agency as part of the process for considering approval of the subdivision map. Under subdivision (e) of §66427.5, the local agency must conduct a hearing "limited to the issue of compliance to this section," which includes the requirement that the subdivider avoid economic displacement of all non-purchasing residents by offering them specified monthly rental rights as continuing tenants in the project.

As described by the court of appeal, however, the Sonoma County ordinance added a number of additional requirements and standards, the most significant of which was an elaborate description of application materials, including a specified voting procedure and mechanism for conducting the "survey," a more detailed specification of the contents of the required report, including the identification of all spaces and rental rates, the identification of tenant households which could be expected to purchase their homes within four years, and the number of persons who would wish to continue renting, as well as an engineer's report on common area facilities, a budget and other application and survey requirements. Among other things, the ordinance required that the survey must demonstrate that a majority of the residents support conversion; otherwise the subdivider had the burden of demonstrating "that the proposed conversion is a bone fide resident conversion." The ordinance also required a conclusion that if 20% or fewer of the residents support the to conversion, it is presumed not to be a bona fide resident conversion. (In effect, the ordinance required an election or referendum on the conversion by the existing residents, and gave the existing residents a practical veto power over the conversion). The ordinance also imposed a number of other requirements and conditions, none of which are expressly contained in the state statute.

The trial court denied the relief sought by the park owner, concluding that the ordinance merely gave effect to the requirements in §66427.5.

The Court of Appeal for the First Appellate District reversed the trial court, holding that the conversion ordinance was preempted by state law. After recounting the prior decision in *El Dorado Palm Springs, Ltd. v. City of Palm Springs*, 96 Cal. App. 4th 1153, 118 Cal. Rptr. 2d 15 (4th Dist. 2002), in which an earlier version of §66427.5 was held by the Fourth District Court of Appeal to preempt a conflicting local ordinance, and rejecting the claim that conversion could be restricted by an ordinance requiring at least 50% residents support of the conversion was preempted by the statute, the court of appeal in *Sequoia Park* found that subsequent amendments to §66427.5 reinforced this conclusion. Dismissing the argument that the Sonoma County ordinance merely "implemented" the requirements of §66427.5, the court of appeal held that the ordinance was impliedly preempted as a whole and that §66427.5 solely governs the determinations to be made by the local agency in considering a conversion application. According to the court:

> [W]e conclude that the ordinance is expressly preempt-

> ed because section 66427.5 states that the "scope of the hearing" for approval of the conversion application "shall be limited to the issue of compliance *with this section*." We further conclude that the ordinance is impliedly preempted because the Legislature, which has established a dominant role for the state in regulating mobilehomes, has indicated its intent to forestall local intrusion into the particular terrain of mobilehome conversions, declining to expand section 66427.5 in ways that would authorize local government to impose additional conditions or requirements for conversion approval. Moreover, the County's ordinance duplicates several features of state law, a redundancy that is an established litmus test for preemption. [Emphasis added.]

The court reversed the trial court's order, directing entry of a new order declaring the ordinance *invalid*.

» *See Miller & Starr, California Real Estate 3d, Ch. 25, Subdivisions, Land Use Planning and Approvals, §§25:2, 25:19, Ch. 31, Mobilehomes, §31:41.*

TITLE INSURANCE

Title insurer had no duty to defend or indemnify a mortgage broker's loan facilitator because the loan facilitator did not fit within the definition of "insured" under the broker's loan policies.

First American Title Ins. Co. v. XWarehouse Lending Corp., 177 Cal. App. 4th 106, 98 Cal. Rptr. 3d 801 (1st Dist. 2009)

This case arose out of a typical "mortgage warehousing" arrangement between the "originator" (CHL Mortgage Group, Inc., a mortgage broker) and its "facilitator" or warehouse lender (Access Lending Corporation (now operating as XWarehouse Lending Corporation)). Access had agreed, pursuant to a master repurchase agreement, to purchase loans from CHL and CHL was later obligated to repurchase the loans within a certain period of time for sale and delivery to predesignated investors. However, the notes and deeds of trusts purchased by Access had been forged by CHL. The money Access wired to the escrow was disbursed to CHL, who was supposed to use the funds to refinance the named borrower's existing loans.

After being sued for its role in the fraudulent scheme, Access tendered defense of the claim to First American Title Insurance Company, who had issued title insurance, insuring the loss originated by CHL. In connection with the purported loans to borrowers secured by deeds of trust, First American had issued title insurance policies with *CHL* named as the insured under the policies. Left with worthless notes and subject to the lawsuits, Access claimed that it fit within the definition of "insured" under the policies as either an assignee or a successor in interest.

Because it concluded that Access was not an insured under the policies, First American declined to defend Access in the lawsuits. In a declaratory relief action, the trial court agreed with First American.

The Court of Appeal for the First Appellate District affirmed the trial court, concluding that First American had no duty under CHL's loan policies to defend or indemnify Access.

First, the court addressed Access' argument that it was the holder of "indebtedness" within the meaning of the policy. As relevant to the case, the policies define the insured as "the owner of the indebtedness secured by the insured mortgage and each successor in ownership of the indebtedness...." Access asserted that the term "indebtedness" was ambiguous because it was not defined in the policy, so should be broadly construed as referring to the act of money changing hands. The court disagreed, explaining that just because a term is not defined does *not* make it ambiguous. Rather than being read in isolation, the word had to be construed in light of the surrounding words, namely, "the owner of the indebtedness secured by the insured mortgage," or "the successor in ownership of the indebtedness" as well as other parts of the policy. According to the court of appeal:

> Each policy's Schedule A, describes the "insured mortgage" as a deed of trust from the named borrower...to CHL executed and recorded on specific dates to secure an indebtedness from the named borrower to CHL in a specific amount. Thus, the indebtedness referred to in the definition of an insured can only be reasonably read as referring to the indebtedness between the named borrower...and CHL, and not the transfer of funds by Access through the escrows to CHL.

Second, the court of appeal concluded that in order for an entity to satisfy the definition of insured under by the policies, there must be *an existing indebtedness* between the named borrower and named lender. For the insurer to be liable to a successor owner to the indebtedness, there must have been a valid underlying indebtedness to begin with. (See (*McClellan Realty Corp. v. Institutional Investors Trust*, 714 F. Supp. 733, 735-736, (M.D. Pa. 1988), judgment aff'd, 879 F.2d 858 (3d Cir. 1989).) In this case, CHL obtained the notes and deeds of trusts by fraud (signatures forged). Because no transfer of funds occurred between the purported borrowers and CHL (or Access) that created an indebtedness secured by the insured mortgage, Access could not meet the definition of insured under the policies. The strained construction advocated by Access (merely transferring funds giving rise to "indebtedness" under the policy) would result in imposing a liability on the insurer which it has not assumed.

The court also rejected the claim that it was the defects in the lien instruments that gave rise to coverage and not the forged promissory notes. The court reasoned that even if the title had been perfect, and the liens existed as they should have been insured by the policies, Access would be in the same position that it currently stood. The liens would not be subject to foreclosure because no indebtedness existed. Alternatively, if the named borrowers had actually received the benefit of the loans, the deeds of trust would have been enforceable. The losses suffered were as a result of the forgery of the notes—not the invalidity or unenforceability of the lien of the insured mortgage upon the title.

The court's determination of no coverage was based on two premises. First, mortgage liens and mortgage debts are different legal concepts. Second, the reasonable expectations of the parties would not support a finding of coverage. The lender would be in a better position than the title insurer to assure itself of the validity of the *debt*. The court of appeal concluded as follows:

> As applicable to Access's position as a purchaser of the purported loans originated by CHL, we conclude that it would not be reasonable for Access to expect that a title insurance policy issued to CHL would insure against a loss caused by CHL's failure to perform its obligations to disburse Access's funds either directly to the named borrowers or for the benefit of the named borrowers. (Citation omitted.) Access apparently recognized the risks inherent in its agreement with CHL, and took precautions to protect itself.

The court was not swayed by the argument made by the California Bankers Association that its holding would have an adverse effect on the secondary mortgage market. It had to base its holding on the language of the policies, not public policy considerations.

✦ **Comment:** This is one of a very few reported decisions concerning the scope of coverage under an ALTA lender's policy of title insurance, and highlights an important limitation on the coverage afforded by such policies. California law *permits* a domestic title insurer to insure "the identity, due execution and validity of any note or bond secured by mortgage (Insurance Code §12390, subd. (a)), but the policy language in this case insured against only the "invalidity or unenforceability of the *lien* of the insured mortgage upon title," which the court distinguished from the validity of the *indebtedness*, holding that the lender bears the risk of validity of the debt in the absence of express coverage of it.

This decision also highlights the important distinction between the responsibilities of a title insurer under a title policy and the responsibility of an escrow agent. The lender who funds a loan through an escrow with a note and deed of trust to be executed in escrow and who requires title insurance generally can assume that either the title insurer or escrow agent is responsible for a forgery or a diversion of funds. An uninsured third party who funds into an escrow for disbursement to a party to the escrow generally is not a party to the escrow and, as this case demonstrates, is not in a position to assert policy claims arising out of a forgery in the escrow. Access could not assert escrow claims against First American because First American acted only as a title insurer and not as an escrow agent in the underlying transactions (the escrows were handled by other title companies). If Access had funded with an express instruction to the escrow agent requiring that it obtain an assignee's policy of title insurance insuring validity of the mortgage as a condition of funding, then it might have had a claim against the escrow agent but it still may not have had coverage under the policy. As the court of appeal pointed out, the statutory *authority* of title insurers to insure "identity, due execution and validity of any note or bond secured by a mortgage" (Ins. Code §12390) is not reflected in the policy language at issue in the case, which only insured validity of the *mortgage*, not the validity of the *note*.

» *See Miller & Starr, California Real Estate 3d, Ch. 7, Title Insurance, §§7:36, 7:45, 7:53, 7:106, Ch. 10, Deeds of Trust, §10:10.*

Title insurer liable for loss resulting from recorded restriction containing a right of first refusal that was not "expressly excepted" from coverage within the meaning of Paragraph 1(b)(2) of the standard ALTA 9 endorsement to a lender's title insurance policy.

Nationwide Life Ins. Co. v. Commonwealth Land Title Ins. Co., 579 F.3d 304 (3d Cir. 2009)

The "ALTA 9 endorsement" is issued as part of virtually all American Land Title Association (ALTA) policies of title insurance issued around the country. In this case, the Third Circuit Court of Appeals interpreted the standard language of the ALTA 9 endorsement to determine whether an insured lender's loss resulting from a provision in a recorded instrument was excluded from coverage under the policy where the language of the exclusion did not specifically mention the particular provision of the recorded instrument causing the loss.

Section 1(b) of the ALTA 9 endorsement (which is identical to the CLTA 100.2 endorsement in California) provides that

> "unless *expressly excepted* in Schedule B [of the policy]," the title company "insures the owner of the indebtedness secured by the insured mortgage against loss or damage sustained by reason of...any instrument referred to in Schedule B as containing covenants, conditions or restrictions on the land, which, in addition,... (iv) provides for an option to purchase, a right of first refusal or the prior approval of a future purchaser or occupant." (Emphasis added.)

In this case, PMI Associates had purchased property subject to a declaration of restrictions that vested the seller, Liberty Mills, with a right to refuse a subsequent purchaser and granted Liberty Mills an option to repurchase the property under certain circumstances. PMI later borrowed $3.5 million from Nationwide, using the property as collateral. There was no dispute that the recorded restrictions containing the right of approval and right of first option were specifically excepted in Schedule B of the ALTA loan policy issued to Nationwide by Commonwealth Land Title Insurance Company. However, Schedule B merely referred to the recorded restrictions by document title and recording information, and did not call out the specific fact that the restrictions contained a right of first refusal or right of first option to purchase. Therefore, this case directly posed the question of whether the ALTA 9 endorsement covered a loss resulting from these rights of first refusal because they were not "expressly excepted" in the policy's schedule of exceptions.

The District Court had granted Commonwealth's motion to dismiss, stating that the general listing of the declaration of restrictions under the heading "exceptions from coverage" in Schedule B of the policy "unambiguously eliminated coverage for loss stemming from the rights of first refusal." It did so despite the claim by the insured, Nationwide, that title industry custom and practice uniformly requires a specific description of rights of first refusal or options to purchase as an exception to coverage and does not rely solely upon a reference to the recorded document containing such rights in Schedule B, Part 1 of the standard ALTA loan policy.

The Third Circuit Court of Appeals reversed the District Court, reviewing the dismissal of the action de novo under Federal Rule of Civil

Procedure section 12(b)(6), and interpreting the insurance policy as a question of law over which the Court of Appeals exercises "plenary review." In doing so, the Court of Appeals noted that, under applicable Pennsylvania law (which is similar to California law on these issues, see Miller & Starr, California Real Estate 3d, Chapter 7, Title Insurance, §7:35), the intent of the parties would be determined by reading the policy as a whole, giving unambiguous terms their plain meaning, and taking into account evidence of industry custom and practice, which under Pennsylvania law is "always relevant and admissible in construing commercial contracts and does not depend on any obvious ambiguity in the words of the contract."

The Court of Appeals reviewed the language of the ALTA 9 endorsement, and focused specifically on the lead-in language of Paragraph 1(b)(2) of the endorsement which states "unless expressly excepted in Schedule B" the policy covers loss from "any instrument referred to in Schedule B as containing covenants, conditions or restrictions on the land which, in addition,... (iv) provides for an option to purchase, a right of first refusal or the prior approval of a prior purchaser of a future purchaser or occupant." The Court concluded that merely referring to a recorded restriction did not constitute an "express exception" of the particular option to purchase, right of first refusal or right of prior approval contained in the recorded restriction within the meaning of the endorsement language. The Court reached this conclusion in light of (a) the text of the language, (b) the purpose of the language, and (c) custom and practice in the title industry. With respect to the text of the endorsement, the Court concluded that the policy and the endorsement, read together, clearly required the title insurer to specially call out an option, right of first refusal or right of first purchase contained in a restriction of record, and not merely to reference the recorded document and leave it up to the lender or owner to read the document to determine whether the particular type of restriction was included in the recorded document. With respect to the purpose of the endorsement, the Court noted that since Schedule B of the policy already excludes coverage for the recorded exceptions listed in Schedule B, a lender would normally procure the ALTA 9 endorsement specifically to assure that, unless additionally excepted from coverage, the matters referred to in Paragraph 1(b)(iv) of the ALTA 9 endorsement were insured against, and that requiring the lender to actually read the recorded document to determine whether such provisions existed in it, as argued by the title insurer, defeated the purpose of the endorsement. Finally, with respect to custom and practice, the Court noted that internal underwriting memoranda of the title company, expert testimony and secondary authorities published by the title industry demonstrated that title insurers uniformly instruct their employees to expressly except the rights within an instrument to assure that they are excepted from ALTA 9 endorsement coverage, and normally do not rely upon the recorded instrument appearing in Schedule B, Part 1 of the policy itself as excluding coverage of rights of first refusal or options to purchase contained in a recorded document, as was argued by the title insurer in this case.

The Court also addressed, and rejected, the District Court's finding that the insured, rather than the insurer "bore the burden of completing proper due diligence" to ensure that the declaration did not contain restrictions harmful to its interest in the property. The Court reviewed language in a LandAmerica article cited by Nationwide that described Paragraph 1(b)(2) of the ALTA 9 endorsement which made it clear that (1) an insurer must "fully describe the features of a document" to except loss arising from those features, and (2) a full description of any excepted "feature" ensures that "the Insured will not be misled." The Court of Appeals, noting that this industry text supported its determination of the effect of Paragraph 1(b)(2) of the endorsement, found that the District Court had misread the passage in concluding that a failure by the insured to read the restriction and identify matters not specifically contained in Schedule B subjected the insured to the risk of loss from that failure to review the instrument. The Court observed:

> Since the first land title insurance company opened in 1876, one of the big talking points for title insurance is that it relieves the investor from title work, examinations and worry therefrom, as well as affording protection.... Title insurers also advertise their ability to review titles accurately and efficiently through use of their title records... The District Court's contention that a lender or buyer paying for title insurance bears the burden of completing proper due diligence accordingly robs title insurance of one of its primary reasons to exist. [Internal quotations and citations omitted.]

» *See Miller & Starr, California Real Estate 3d, Chapter 7, Title Insurance, §§7:79, 7:105, 7:107, 7:118, 7:125.*

USURY

State interest rate laws not completely preempted by National Bank Act.

Thomas v. U.S. Bank Nat. Ass'n ND, 575 F.3d 794 (8th Cir. 2009)

Under the Federal Depository Institutions Deregulation and Monetary Control Act (DIDA), 12 U.S.C.A.

§1831d, certain federally insured lenders are prohibited from charging rates in excess of a specified maximum amount for certain "high loan to value" residential mortgages. The statute includes a special provision allowing a state chartered banking institution that is federally insured to charge a floor interest rate of one percent in excess of the discount rate on 90 day commercial paper if this minimum rate would exceed the rate that could be charged by the institution under applicable state law. The purpose of this provision is to prevent discrimination against state chartered federally insured depository institutions if the federally imposed maximum rate for such high value loans is greater than the rate that state law would otherwise permit.

In *Thomas v. U.S. Bank National Association N.D.*, the United States Court of Appeals for the Eighth District, considered the application of §1831d(a) to a loan originated by a state chartered bank that had violated certain restrictions of Missouri law by charging borrowers nonrefundable finders' fees or brokers' fees in excess of the fees allowed by Missouri law and by "marking up" third party closing costs charged to borrowers under the loan. Despite these violations, however, the loans bore a stated interest rate, according to the court, that did not exceed the maximum interest rate allowed on second mortgage loans under state law, and this rate in turn did not exceed the rate allowed by federal law under DIDA.

The question in the case was whether DIDA or other federal laws preempted the application of the *remedies* provided under Missouri law for the overcharges by the lender, including the recovery of some of the interest charged to the borrowers, when these loans, in turn, were transferred to a national bank.

The Eighth Circuit Court of Appeals decided two related preemption issues that arose from this set of facts.

First, the national bank holder of the notes claimed that federal law entirely preempted state law because, under §§85 and 86 of the National Banking Act, national banks are exempt from local interest rate restrictions if the loan interest rate would be legal under the laws of the state in which the federal institution is located or under the laws of the United States, whichever is higher. The court held, however, that national banks who do not originate loans but rather are assignee banks that purchase the loans from state chartered institutions cannot assert federal preemption under the National Banking Act of state law restrictions governing high loan to value loans. Pursuant to 15 U.S.C.A. §1641(d), any person who purchases or is otherwise assigned a mortgage created in violation of applicable law is subject to all claims and defenses with respect to that mortgage which the consumer could assert against the original lender. As the court stated, "to hold otherwise would allow an originating bank to cleanse an otherwise illegal loan merely by assigning it to a national bank."

The more difficult question was whether the preemption language of DIDA (15 U.S.C.A. §1831d) preempted the application of Missouri fee restrictions and fee markup restrictions on loans if the interest rate fell within the federal rate allowed by DIDA. With respect to this issue, the court of appeals noted that complete preemption did not exist because the language of DIDA did not reflect Congress' intent to provide the exclusive cause of action for a usury claim against a federally insured state chartered bank; to the contrary, Congress clearly intended the preemptive scope of DIDA to be limited to particular circumstances where the applicable rate described in DIDA exceeds the rate that the state bank would be permitted to charge in the absence of DIDA. In this case, the interest rate provision of the state statute allowed the interest rate to be charged, and therefore, the federal statute, allowing the federally-mandated rate to be imposed if the contract rate would exceed the rate otherwise permitted by state law was applicable *only* if the interest rate violated the interest rate restrictions of state law. In this case, under Missouri law, the interest rate allowed for second mortgages was either as high as 20.4% or *unlimited* at all times, and well in excess of the rate allowed by DIDA (1% over the rate on 90 day commercial paper) for the period of time in question, and therefore the federal statute did not apply. Further, the federal remedy for excess interest charges (recovery of the interest by the borrower) applied only if the federal rate exceeded the rate allowed by state law, which also was not the case here.

The Eighth Circuit Court of Appeal noted that its decision was supported by its prior decision in *Firstsouth, F.A. v. Lawson Square, Inc.*, (*In re Lawson Square, Inc.*,) 816 F.2d 1236 (8th Cir. 1987) involving the similar wording of §1730g(a) of DIDA, which applies to federally insured savings and loan associations rather than federally insured, state chartered banks as did the section involved in this case. Noting the operative statutory language was identical, the court found its decision consistent with the decision in *Lawson Square*. On the other hand, in *Discover Bank v. Vaden*, 489 F.3d 594 (4th Cir. 2007), cert. granted, 128 S. Ct. 1651, 170 L. Ed. 2d 352 (2008) and rev'd and remanded on other grounds, 129 S. Ct. 1262, 173 L. Ed. 2d 206 (2009) the Fourth Circuit Court of Appeals held that DIDA, like the National Banking Act, completely preempts state law usury claims against federally insured, state chartered banks. The Eighth Circuit found that the Fourth Circuit decision gave a strained and inaccurate reading of the statutory language of §1831d(a), and refused to follow that decision.

✦ **Comment:** Under California law, national banks are, per se, exempt from the usury law limitations of California law. See California Constitution, Article 13. However, the decision in *Thomas v. U.S Bank National Association* suggests that a state law remedy for violations of other state laws affecting the charges imposed on a borrower may still be asserted against the holder of the indebtedness, even if that holder is a national bank.

» *See Miller and Starr, California Real Estate 3d, Ch. 21, Usury, §§21:33, 21:25, Ch. 10, Deeds of Trust, §10:71, Ch. 36, Lender's Liability, §36:29.*

PROPERTY TAX DEVELOPMENTS

Sean Flavin

Editor's Note: The Property Tax Developments column appears in each issue of the *Newsalert*.

A First Since the Great Depression—California Assessment Roll Goes Negative

The State Board of Equalization reports that the combined state and locally assessed property tax rolls, measured as of the lien date January 1, 2009, were *2.4% less* than the previous January 1 – believed to be the first time this has happened since the 1930s. Hardest hit was Merced County with a 13.4% loss, followed by Riverside, San Joaquin, Solano and Stanislaus in the 10% range. Leading a small plus group was San Francisco with a 7.1% increase, followed by Marin at 1.9%, and other coastal counties, such as San Mateo, Santa Barbara and Santa Clara, in the 0.5% range. Los Angeles County, with almost a fourth of the total roll, showed a modest decline of 0.6%.

These declines reflect the collapse of the housing market, particularly in some of the interior counties. The impact of the recession on commercial real estate is yet to be reflected in the totals for the assessment rolls, measured as of the beginning of 2009.

General Validation Procedures, Including Newspaper Publication, Do Not Apply to Actions Contesting Special Assessments under Municipal Improvement Act

Bonander v. Town of Tiburon, 46 Cal. 4th 646, 94 Cal. Rptr. 3d 403, 208 P.3d 146 (2009)

In 2003, pursuant to the Municipal Improvement Act of 1913, the Town of Tiburon, in Marin County, created the Del Mar Valley Utility Underground Assessment District, imposing assessments on 221 parcels, ranging from $7,200 to $31,200 per parcel. Two couples, the Bonanders and the Mulbergs, objected to the assessment on their properties, and filed a petition for writ of mandate and declaration relief. The plaintiffs served the Town, but did not publish notice of the proceedings within the 60 days specified in Code of Civil Procedure sections 861 and 863. The trial court granted the Town's motion to dismiss, which was affirmed by the court of appeal.

The Supreme Court granted review and reversed the decision of the court below, ruling that actions *contesting* special assessments under the Municipal Improvement Act do not require newspaper publication. The court makes an extensive review of the history of procedures for both validating and contesting special assessments, including early case law and the legislative histories of the Improvement Acts of 1911 and 1913.

The court focuses on the general validation provisions of the 1913 Act (Sts. & Hy. Code § 10601) and concludes that it was the legislative intent in amending that section in 1961 to limit its application to actions to validate an assessment. Actions to contest an assessment are governed by the provisions of § 10400 of that law, and since private law actions contesting an assessment are binding only on the parties, notice by publication is not necessary.

> ✦ **Comment:** While the issue in the case was the manner of service of the complaint, the decision contains useful history of case law and statutory revisions of validation proceedings for special assessments.

» *See Ehrman & Flavin Taxing California Property 4th, § 2:39.*

Transfer of Trust Income Beneficiary's Interest to Succeeding Income Beneficiaries Triggers Reassessment of the Beneficiary's Fractional Interest in Trust Property

Phelps v. Orange County Assessment Appeals Bd. No. 1, 96 Cal. Rptr. 3d 306 (Cal. App. 4th Dist. 2009), as modified on denial of reh'g, (June 24, 2009) and review granted and opinion superseded, 2009 WL 3109849 (Cal. 2009) and unpublished/noncitable

John Wilson Phelps created a trust which became irrevocable on his death in 1947. The trust provided for its continuance during the lifetimes of his widow, his children and grandchildren living at the time of his death. Initially the trust income was to be divided among his widow and three children, including a son, Wilson, and on the death of a child, the trust continued for the benefit of child's issue, and if a child died without issue, the income of that child's share was to be divided among the other children. Wilson died in 2002 and his one-third share of the income passed to his four children.

Included among the assets of the trust was a shopping mall in Fullerton with Montgomery Ward & Co as the initial core tenant, followed by Target, after Montgomery Ward's bankruptcy. The master lease provided for the tenant to construct improvements at its own expense, to be surrendered to the trust on termination of the lease. Sublessees constructed retail and restaurant improvements at their own expense, which were also to be surrendered to the trust on conclusion of the lease.

On Wilson's death the assessor reassessed the one-third share of the property, the income from which passed to Wilson's four children. The reassessment was upheld by the AAB and both the trial court and the court of appeal.

Plaintiff's principal contention was that because the trust did not own the improvements, the assessor was not entitled to reassess them. The court rejects this argument, relying on *Auerbach v. Assessment Appeals Bd. No. 1 for County of Los Angeles*, 39 Cal. 4th 153, 45 Cal. Rptr. 3d 774, 137 P.3d 951 (2006) (reported in September 2006 *Newsalert* at page 39), where the California Supreme Court ruled that a trust had the requisite *present interest* in leased property where the tenant owned the improvements until termination of the lease. Phelps sought unsuccessfully to distinguish *Auerbach* on the grounds that here the trust had no right to sell the property, and was not entitled to insurance proceed or proceeds from a taking by eminent domain. Both arguments were deemed oversimplification of complex lease provisions, which under certain circumstances permitted or required the lessee to share proceeds with the trust.

Also rejected is the plaintiff's argument that Wilson did not have a *beneficial use* of the property because the trust held the legal title. Here the court looks to *Reilly v. City and County of San Francisco*, 142 Cal. App. 4th 480, 48 Cal. Rptr. 3d 291 (1st Dist. 2006) (reported in November 2006 *Newsalert* at p. 114), where the court distinguishes between legal title and beneficial interest, concluding that receipt of income constitutes "beneficial use" for change in ownership purposes.

Finally, the court rejects the plaintiff's contention that Wilson's lifetime income interest was not equivalent to the fee, relying on the decision by the same division of the court in *Leckie v. County of Orange*, 65 Cal. App. 4th 334, 76 Cal. Rptr. 2d 426 (4th Dist. 1998), as modified, (July 23, 1998), the creation of a life estate, other than one reserved by the transferor or in a third party, constitutes a reassessable change in ownership because the life tenant has the dominant or primary interest under the "value equivalence" test.

» *Ehrman & Flavin Taxing California Property 4th §§2:14, 2:16, 217*

Retention of Beneficial Interest in LLC Managed by New Owner Does Not Avoid Change in Ownership Reassesment

Fashion Valley Mall, LLC v. County of San Diego, 176 Cal. App. 4th 871, 98 Cal. Rptr. 3d 327 (4th Dist. 2009)

Equitable Life Insurance Company of the United States (Equitable) owned the Fashion Valley Shopping Mall in San Diego (the Mall).To effect a transfer of that ownership Equitable and Simon Property Group, L.P. (Simon) formed a Delaware limited liability company (FVM) as a holding company, with Equitable and Simon each holding a 50% interest. Simultaneously, a wholly owned subsidiary of FVM was formed (Mallco) to act as manager and leasing and development agent for FVM. As their initial capital contributions to FVM, Equitable contributed the Mall and Simon $165 million. A grant deed was recorded transferring record title to the Mall from Equitable to Mallco, but an off-record agreement provided that that the deed would be deemed to be a contribution by Equitable of the Mall to FVM, resulting FVM holding title to the Mall in Mallco. At closing FVM was to make a distribution to Equitable equivalent to Simon's capital contribution of $165 million, and Simon was designated as the managing member of FVM.

In August 2002 the assessor determined that this transaction constituted a 100% change in ownership of the Mall and increased the assessed value from $247 million to $360 million. While Mallco's appeal to the San Diego AAB was pending, Equitable, Simon, FV M and Malloc signed an "Agreement to Rescind, Restructure and Reform" the earlier contribution agreement to document for property tax purposes that there was a change in ownership of only 50% of the Mall by providing that Equitable transferred one-half of its ownership interest in the Mall to Simon in exchange for Simon's capital contribution and thereafter requiring Equitable and Simon to transfer their 50% interests to FVM.

The AAB ruled against Mallco, concluding that there was a 100% change in ownership and that the Reformation Agreement was ineffective to change the property tax effects of the transaction. In Malco's following refund action the superior court upheld the AAB decision, and the court of appeal affirms the decision below.

First off, the court discards the Reformation Agreement as a sham transaction, ineffective to change the terms of the transaction for property tax purposes. Citing federal income tax cases, it rules that the Reformation Agreement is "nothing more than a paper transaction and a transaction artifice that exist for the purpose of seeking to avoid tax liability."

The court agrees with the County that under Revenue & Taxation Code section 61(j) there was a change in ownership in that Equitable transferred 100% of its interest in the Mall to FVM. Looking to Section 60, Mallco contended that Equitable retained a 50% interest because it held a 50% membership interest in FVM, giving it a 50% interest in the ultimate economic benefit of the Mall. The court characterizes as overly broad Mallco's definition of beneficial interest as the *ultimate economic benefit*.

The court rejects Mallco's reliance on *Pacific Southwest Realty Co. v. County of Los Angeles*, 1 Cal. 4th 155, 2 Cal. Rptr. 2d 536, 820 P.2d 1046 (1991) and *Reilly v. City and County of San Francisco*, 142 Cal. App. 4th 480, 48 Cal. Rptr. 3d 291 (1st Dist. 2006), finding that "Mallco has identified no case law outside of the context of a fiduciary situation—and we are aware of none—in which one party was found to enjoy beneficial use for the purposes of section 60, while another party held legal title." As no fiduciary situation existed here, the court concludes that the entity holding the beneficial interest in the Mall is the same entity that holds legal title, namely Mallco.

Nor does Equitable hold a beneficial interest in the Mall through its membership in FVM. As such a member, Equitable does not hold an interest in real property of that entity, but only a personal property interest in its membership interest. Citing *Munkdale v. Giannini*, 35 Cal. App. 4th 1104, 41 Cal. Rptr. 2d 805 (1st Dist. 1995). Noting the numerous restrictions on Equitable's ability to make use of the Mall, the court concludes that the Mall is owned and managed by FVM, through Mallco, and it is Simon, not Equitable, who is the general manager. Thus, for property tax purposes Equitable does not own a *beneficial interest* in the Mall.

» *Ehrman & Flavin Taxing California Property 4th §2:11, 2:14, 2:15.*

✦ **Comment:** The effort to restructure the transaction after the fact exclusively for property tax purposes, while audacious, was clearly bound to fail.

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