

CONTRA COSTA LAWYER

Volume 24, Number 3 | May 2011

THE REAL ESTATE CRISES:

Challenges and Opportunities

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DWELLERS:** Violating
Sherman's Trust or
Assisting Sallie Mae?

**SELF-STUDY MCLE:
USING RECEIVERS
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**GOVERNOR BROWN'S PLAN
FOR CALIFORNIA'S
REDEVELOPMENT
AGENCIES**

LAND USE DUE DILIGENCE

**1031 FORECLOSURES
NOL TAX REFUNDS
STIFFING THE SECOND**

**STRATEGIES FOR SETTLING
FEES-DRIVEN CASES**





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The **Contra Costa Lawyer** (ISSN 1063-4444) is published 12 times a year (6 times in print; 6 times online-only) by the Contra Costa County Bar Association (CCCBA), 704 Main Street, Martinez, CA 94553. Annual subscription of \$25 is included in the membership dues. Second-class postage paid at Martinez, CA. POSTMASTER: send address change to the **Contra Costa Lawyer**, 704 Main Street, Martinez, CA 94553. The Lawyer welcomes and encourages articles and letters from readers. Please send them to: Kerstin Firmin at kfirmin@cccba.org. The CCCBA reserves the right to edit articles and letters sent in for publication. All editorial material, including editorial comment, appearing herein represents the views of the respective authors and does not necessarily carry the endorsement of the CCCBA or the Board of Directors. Likewise, the publication of any advertisement is not to be construed as an endorsement of the product or service offered unless it is specifically stated in the ad that there is such approval or endorsement.

CONTRA COSTA LAWYER

Volume 24 Number 3 | May 2011

The official publication of the Contra Costa County
BAR ASSOCIATION

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Craig Nevin



Gil Berkeley

There is no doubt about it: these are challenging economic times. This is especially true with respect to real estate. Last summer, from within the eye of the storm, Craig and his partner, Alan Ramos, facilitated a presentation to the Real Estate and Litigation Sections titled, *"What Really Happened in the Real Estate Mortgage Industry: How did we get here and where are we going?"* By the end of the presentation, all in attendance recognized two things. First, the residential real estate adjustment probably wasn't close to being over. Second, challenges were already facing the commercial real estate (CRE) sector.

The causes of the residential real estate adjustment included questionable (defenders would say "novel") lending innovations, namely the advent of "Mortgage Backed Securities". These transactions caused a break-down of the traditional lending model: Risk was no longer tied to reward in the same way because lenders had securitized the loans. While there is no end in sight for the residential real estate melt-down, it may seem overly pessimistic to also look at the challenges facing CRE. On the other hand, what good ever comes from not discussing something? Maybe (much like "Y2K") the recession's effect on the CRE sector will be a non-event. But on the other hand, maybe not.

As many readers may already know, the same "innovation" was used in commercial real estate lending where these derivative products are referred to as Commercial Mortgage Backed Securities (CMBS's). The effects of CMBS's have already been seen in CRE transactions, bankruptcies and litigation. Many continue to predict the likelihood of an even larger problem hitting the commercial real estate sector, and point to statistics like the following:

"Issuance of commercial mortgage-backed securities, or CMBS, peaked in 2007 at \$230 billion, having more than doubled from a total of less than \$100 billion in 2004."

Statement of Sandra Thompson, Director, Division of Supervision and Consumer Protection, FDIC, before the Congressional Oversight Panel, Washington, DC, February 4, 2011, at <http://www.fdic.gov/news/news/speeches/chairman/spfebo411.html>

As the recession continues, additional businesses may close resulting in increases in commercial vacancy rates.

Of course, higher vacancy rates will drive down CRE rental rates further. This will not only impair the owner's ability to make payments to the lender, but it may also make it impossible to refinance the properties when loans become due.

"Over the next five years, about \$1.4 trillion in commercial real estate loans will reach the end of their terms and require new financing. Nearly half are 'underwater,' meaning the borrower owes more than the property is worth. Commercial property values have fallen more than 40 percent nationally since their 2007 peak. Vacancy rates are up and rents are down, further driving down the value of these properties."

Nasiripour, S. (2011, February 11). *Elizabeth Warren Warns About Commercial Real Estate Crisis, 'Downward Spiral' For Small Businesses, Local Banks*. The Huffington Post.

Some predict that widespread foreclosures of commercial property will occur. In a recent speech, Dennis Lockhart, president of the Federal Reserve Bank of Atlanta pointed to the, "...potential of a self-reinforcing negative feedback loop..." which will affect commercial lending, small business employment, and commercial real estate values. Some analysts state that CRE values have already declined 42% from their peak in early 2007 to their lowest point in early 2010. (Sources: Real Capital Analytics; Moody's/REAL CPPI National Aggregate Index.) Many predict that local and community banks will be the hardest hit. Unfortunately, loans from local and community banks are often more closely associated with the creation of new jobs. As a result, some predict that we are likely to see an even greater impact on the overall economy caused by an adjustment in the CRE sector than from the residential market adjustment.

However, there are some who disagree. To be sure, there are signs that with respect to CRE perhaps the worst may be behind us. Deals of all types are getting done and some studies give a picture of CRE prices on the upswing. Some point to factors that may buffer a CRE downward spiral and some point to activity in the CRE market and upcoming events (such as preparations for the America's Cup) that could result in a rapid CRE recovery.

One buffer is the liquidity that exists in the national equity market. There are trillions of dollars which will be invested in CRE in 2011. Unfortunately, the specific figure is a fraction of the trillions of equity dollars which were invested in CRE in previous years. Additionally, there are signs that lenders may approach defaulting CRE loans in a different way than how lenders approached defaults on

residential property. Residential loan modifications that reduce the principal balance, though often talked about, occur very rarely. On the other hand, CRE lenders may be more likely to see a rationale for this type of loan modification. This may occur so that a lender can comply with banking regulations. This may also occur because the commercial lender recognizes that cash flow will be maximized by allowing the current owner to continue operating the commercial property—especially when compared to incurring the costs and delay in payments during a foreclosure and/or a bankruptcy. Regardless of why loan modifications could be more palatable to lenders in the CRE sector, it may be one of the factors that slows a downward spiral. The hopeful say that we have already seen the bottoming out of values and that there is sufficient equity in the CRE investment pool to stop values from declining any further.

In order to deal with these and other issues, we bring you this year's Real Estate Issue, "The Real Estate Crises: Challenges and Opportunities". In our first article, Tom Nagle attempts to predict how the recession may affect California's Redevelopment Agencies. Jerry Hunt and Chris Hunter discuss the potential role of a Receiver, appointed by the Court, to assist working through the many issues that arise when a project has only been partially completed. Scott Haislet's article delves into tax implications, and strategies, for moving through this down-market, while Michael Durkee and Thomas Tunny's article addresses the need for land use due diligence when buying real estate in a volatile market. Lastly, perhaps the nature of these times is best

exemplified by our final article by Amanda Bevins which discusses what happens before and during the foreclosure auctions held on the steps of the courthouse.

There is no doubt that these are challenging times. It is our hope that this issue will assist you in navigating some of the challenges and pointing to some opportunities. We look forward to seeing you—after the storm has passed. ♦

(Parts of the above were originally published in the Spring 2011 NRS Law eNews Electronic Newsletter.)

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GOVERNOR BROWN'S PLAN FOR CALIFORNIA'S REDEVELOPMENT AGENCIES

by Thomas C. Nagle



Jerry Brown, a significantly mellower governor in 2011 than he ever was back in 1975, has once more taken the reins of government in Sacramento with the stated goal of reducing the deficit. One of his most controversial cost-cutting strategies is to eliminate all redevelopment agencies statewide. This strategy would purportedly allow \$1.7 billion in tax revenues to flow directly to cash-starved cities and counties, rather than letting those funds “bank” with the more than 400 redevelopment agencies for the purpose of addressing “blight” at some future time.

Redevelopment agencies and their development partners are deeply concerned about Governor Brown’s idea, as precious little real estate lies outside the sphere of influence of these agencies. Redevelopment agencies are very powerful and each is permitted to target what it may deem as “blight” anywhere in its jurisdiction.

While the mayor for the City of Oakland (1999-2007), Brown successfully created low-cost housing projects with the able assistance of the Oakland Redevelopment Agency. Absent the assistance of such an agency, many of these projects would not have been completed. Why? Because few developers and even fewer lenders are willing to accept the risk inherent in the typical redevelopment project, which comes with other “requirements” such as new headquarters for the agency, as well as multiplex movie theaters to complement the required 20% affordable housing.

To find the riches produced by an active redevelopment agency, one need look no further than the adjoining City of Emeryville. Emeryville, once a map of brown fields and abandoned or underutilized industrial space, is now a hub for live/work space, shopping and commerce. Emeryville is solvent, an oddity among city governments these day.

Emeryville has aggressively used the redevelopment process for the last twenty years to turn itself around. How may we attribute this success to the city? Let’s return to the issue of the power of the local redevelopment agency. A line could be, and probably has been, drawn around the entire City of Emeryville, including all of its real property within an area of blight (excepting those properties already redeveloped.) There is not much real estate left outside of this area and the center of the agency’s energy today remains litigation to get reimbursed for the redevelopment it has accomplished to date.

Along with the ominous strength of the local redevelopment agency comes an even more powerful arrow in its quiver, the “Polanco Act.” This piece of legislation allows a highly contaminated city to clean itself at the expense of owners and any identifiable polluters. In practice, the agency requires whoever owns the contaminated property to clean the property pursuant to current California clean air and water environmental standards. Few individuals can afford this level of remediation. The owner of a property (that was polluted many years ago by a major concern) is on the hook for the removal of the contamination, the restoration with clean material and the prohibition against allowing ground water to become contaminated.

Add to the above formula the added impact that the same innocent owner

(with exclusions in all insurance policies) must pay not only his own team of experts in an attempt to defend but also related expenses from the redevelopment agency. In the foregoing example, the innocent owner must sell his property to the city for a number that deducts the cost of the cleanup by the agency and the city's attorney fees. Recently, a \$5 million property became worth less than \$1 million overnight and the only winner was the City of Emeryville and its legal counsel. The blight is gone, the tax base for the City is swollen and the former owner has paid in excess of \$4 million for this project. Can you imagine any injustice close to this scenario without the power of a redevelopment agency? The City of Emeryville would have never seen its PIXAR and IKEA. It would have continued with its reputation as the city on the bay with the spare tire artworks at low tide, and who knows, the schools and public services may well have been the winners.

Is the Redevelopment Agency, armed with a license to steal, necessary to the orderly development of California cities and counties? Perhaps, if the lobby for the agencies is not able to stop the Governor with his plan, we shall find out. You may recall an attempt to eliminate the California Department of Transportation when Mr. Brown ran for office the first time twenty-eight years ago. I recall colloquy about the wisdom of building Interstate 5 when State Hwy 99 was adequate. You might recall improvements to the highway system, affectionately termed Caltrans by the governor, were pretty much eliminated for the following 8 years. Is redevelopment next? ♦

- Thomas C. Nagle is a Walnut Creek attorney who has been practicing in the field of eminent domain from graduation of law school in 1965 to the present. He worked with the State Department of Transportation for 24 years for both Jerry Brown and Pat Brown.

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MAKING LEMONADE FROM LEMONS: USING RECEIVERS FOR PARTIALLY COMPLETED PROJECTS

By Jerry Hunt and Chris Hunter

Many real estate development projects have stalled in the downturn, leaving lenders with difficult decisions and limited options. A partially completed project is considered one of the most "toxic" assets in a lender's portfolio. Some lenders simply foreclose on the property or sell the note, frequently incurring substantial losses along the way. However, many banks are bypassing foreclosure or note sales on large, troubled real-estate developments by installing court-appointed receivers to take over the property, complete the construction and in the process limit or eliminate losses on the loan.



RISKS TO LENDERS ON PARTIALLY COMPLETED PROJECTS

A partially completed project presents an extremely difficult challenge for a lender and many lenders elect not to foreclose except as a last resort after other alternatives have failed. The first issue is timing. A lender will generally want to obtain immediate control of the project. In many cases, the lender may feel that the borrower has misman-

aged the construction and may not want to have the borrower remain in control of the project. The risks of leaving a partially completed project exposed to the elements for any period of time are substantial. In order to gain control of the project, the lender may either attempt to enforce its rights under the loan documents to require the borrower to satisfactorily manage the project or it can foreclose. Each of these approaches present substantial risks to the lender.

Lenders have broad discretion to protect their collateral in most loan documents, but a lender can incur liability under a variety of theories if it attempts to control the borrower or the project itself without first appointing a receiver. A lender needs to avoid being deemed a "mortgagee in possession," which can be found if the lender is deemed to control the actions of the borrower. A mortgagee in possession must account to the borrower for management of the property and is liable for failing to act reasonably and in a businesslike manner in handling the real property and the rents collected¹. A mortgagee in possession is not entitled to compensation for its management efforts² and is responsible for any losses caused by its

negligence³. For these reasons, lenders are extremely cautious about taking any action which could give rise to an allegation that they are a mortgagee in possession. Even an allegation that the lender is a mortgagee in possession can ensnare the lender in litigation. These cases are complex and time-consuming to defend and even a successful defense can take years and cost hundreds of thousands of dollars.

Foreclosure will take months, if not years, before the lender is able to control the project. A nonjudicial foreclosure takes a minimum of four months to complete. A judicial foreclosure requires the lender to first obtain a judgment against the borrower and a borrower has a one-year right of redemption after the foreclosure to repurchase the property, so as a practical matter it is difficult to sell a property in the year after a judicial foreclosure. If the borrower files bankruptcy, these time periods can be extended for months.

Further, if a lender forecloses on a partially completed project to take control of it, the lender becomes exposed to potential liabilities simply by virtue of being in the chain of title. A lender can be subject to claims for environmental issues from the moment it acquires the property. In addition, there are usually pending or threatened mechanic's liens to be addressed which may or may not have been extinguished by the foreclosure. Civil Code Section 3134

provides that mechanic's liens have priority over any other lien or encumbrance which is recorded after the commencement of the work of improvement. This raises a factual issue of whether a single claimant commenced its work before the recordation of the lender's deed of trust, which if proven will mean that all mechanic's lien claimants will have priority over the deed of trust – not just the single claimant whose work predated the recordation of the deed of trust. Regardless, if the lender wants to proceed with the original contractor, it will often need to compensate the contractor for unpaid amounts even if the contractor's mechanic's lien was extinguished by the foreclosure.

Additionally, the lender faces substantial risk if it elects to complete a residential project itself after the foreclosure. Under Civil Code Section 911, a "builder" is strictly liable for construction defects in residential projects. A builder is defined as "any entity or individual, including but not limited to a builder, developer, general contractor, contractor or original seller, who at the time of sale, was also in the business of selling residential units to the public for the property that is the subject of the homeowner's claim or was in the business of building, developing, or constructing residential units for public purchase for the property that is the subject of the homeowner's claim." If a lender meets the requirements of a

"builder" under Civil Code Section 911, it will be held strictly liable for construction defects in a residential project. Similarly, a lender can face claims for construction defects in commercial projects under a variety of legal theories.



RECEIVERS - BENEFITS TO LENDERS

Lenders seek to appoint a receiver on partially completed projects for three primary reasons. First, the appointment provides the lender with immediate third party control of the project. While a receiver is an officer of the court and is not directed by the lender, the receiver will provide hands-on management and clear reporting to all parties. Second, the appointment of the receiver shields the lender from the risks and liabilities described above. Third, and an issue of central importance to lenders with partially completed projects, the appointment of a receiver can dramatically limit the losses the lender might otherwise incur if it foreclosed and sold the partially completed project to a third party.

The appointment of a receiver does not make the lender a mortgagee in possession⁴ and the lender is not generally liable for any misconduct by the receiver⁵. This concept was codified in California Civil Code Section 2938(e), which

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MAKING LEMONADE, cont. from page 11

provides that the appointment of a receiver to enforce an assignment of rents provision and the subsequent collection, distribution, or application of rents, issues, or profits shall not make the lender a mortgagee in possession of the property, does not constitute an action, render the obligation unenforceable, violate Section 726 of the Code of Civil Procedure, or be deemed to create a bar to a deficiency judgment.



APPOINTMENT PROCESS

Civil Code Section 564 sets forth the requirements for the appointment of a receiver. Civil Code Section 564(b)(2) is the most common basis for a lender seeking the appointment of a receiver after a borrower's default on a partially completed project⁶ and states that a receiver may be appointed:

"In an action by a secured lender for the foreclosure of a deed of trust or mortgage and sale of property upon which there is a lien under a deed of trust or mortgage, where it appears that the property is in danger of being lost, removed, or materially injured, or that the condition of the deed of trust or mortgage has not been performed, and that the property is probably insufficient to discharge the deed of trust or mortgage debt."

Receivers are neutral third parties that are appointed by the court to take control and manage the property for the purpose of preserving the collateral. Receivers are not the owners of the assets, but rather, earn fees for their work - protecting the value of the asset that serves as collateral for the defaulted loan. Income generated by the property goes into a receivership estate that

the borrower cannot access.

Receivers are not required to be licensed and may be individuals such as real estate developers, property managers, attorneys or others with hands-on property experience. They are often recommended to the court by the lender. A receiver can be viewed as a caretaker for the property to maintain it and protect the asset until the property is foreclosed by the bank or sold to a third party.

Receivers can also play an important role in helping move a stalled development project forward. Complex ownership and lending structures can also lead to the use of receivers with more diverse experience in real estate finance.

This trend in receivership as an interim step to solving complex, troubled property loans has opened up opportunity for highly experienced real estate professionals, and offers a peek into how properties may be 'unwound' from underwater loans.



RECEIVERSHIP COSTS

Most people in the real estate industry are familiar with the typical "rents and profits" receivership, where a receiver takes over a completed project and uses the rents generated by the property to pay the costs of managing the property and the receiver's fees. A partially completed project presents more challenges, as there is usually no income to pay for the management of the property. In addition, the project almost always has significant unpaid bills, mechanic's liens and other claims.

In these cases, the funds for the management of the property generally come from the foreclosing lender. While this can be expensive for the lender, the lender must balance the projected costs for the re-

ceivership against the substantial discount it will generally be forced to accept if it elects to sell the loan or foreclose and sell the project in a partially completed state.



RECEIVERSHIP ESSENTIALS

Receivers take on the role of the owner/operator but do not hold title, and a bond of insurance is put in place to protect the receiver and the property during this period of interim administration.

Receivers collect rent and any other amounts owing to the owners such as CAM charges, maintain the property, secure the grounds where needed, and generally operate the property in the best interest of maintaining its value.

Receivers often take steps beyond the caretaker role, such as in hiring brokers to lease available space in the property, or reviewing leases and local tax requirements to make sure the asset maintains, if not enhances, its value.



CHALLENGING PROJECTS INCREASE THE NEED FOR RECEIVERSHIPS

The appointment of a receiver for challenging and complex projects, and particularly for a partially completed project, can bring substantial benefits to a lender. A receiver can help more effectively deal with many of the problems and opportunities presented in these cases:

INSURANCE. The order appointing receiver should specifically authorize the receiver to enter into new insurance contracts and to renew existing contracts, whose lapse could endanger the project or raise its ongoing cost basis.

ENTITLEMENTS. In a partially

completed project, there are many factors which can jeopardize the existing entitlements and approvals, including the fact that the borrower has defaulted on the loan, the existence of mechanic's liens, the failure to meet construction timelines and the possible change in ownership by the foreclosure. A receiver can be empowered to negotiate with cities, counties and governmental agencies to preserve entitlements. Frequently, cities and other government agencies are receptive to reasonable modifications to entitlements, as they have no more interest in a stalled project in their jurisdiction than any of the other parties. From the lender's perspective, it can be extremely difficult to find a buyer for a project where the entitlements are no longer valid.

WEATHERIZATION. Stalled construction projects are exposed to the elements, and receivers can enter into contracts to weatherize the project during the winter to preserve the value of the work completed to date.

MECHANIC'S LIENS. Most partially completed projects have pending or threatened mechanic's liens claims. A receiver can be authorized to negotiate with the contractors and suppliers to resolve these claims.

CONSTRUCTION DEFECT CLAIMS.

A good example of the value of a receiver arises in the case of construction defect litigation and the decisions concerning the scope of repair. Such decisions can involve huge sums and have long term implications for the property. A receiver can preserve the value of the collateral by working to resolve these claims and working with the claimants, the borrower's insurer and the lender to prevent these problems from escalating.

SALE OF PROPERTY. In certain circumstances, a receiver can sell the project before the lender forecloses. This benefits the lender as it never enters the chain of title. A receiver can make many important operational decisions and obtain court approval for substantive decisions, protecting the property's value while maintaining the lender's insulation from liability. With a highly experienced but 'disinterested' 3rd-party receiver in place, and the court overseeing the receiver's recommendation, these operational decisions keep the property from losing value and, in many cases, help move it forward. Beyond the legal and procedural requirements, a receiver's appointment can also provide a "fresh start" for all of

the parties, from contractors with mechanic's lien claims to buyers seeking to acquire the asset. Often third parties will be more cooperative with a receiver under court appointment versus a lender that may have legacy issues in dealing with the property, or may not have necessary expertise or staffing levels for such matters. ♦

¹ *Davis v. Stewart* (1944) 67 Cal.App. 2d 415.

² *Earp v. Earp* (1991) 231 Cal. App. 3d 1008.

³ *Murdock v. Clarke* (1891) 90 Cal. 427.

⁴ *Bank of America v. Bank of Amador County* (1933) 135 Cal.App. 714

⁵ *Tourney v. Bryan* (1924) 66 Cal.App.426.

⁶ Receivers can also be appointed pursuant to Civil Code Section 564(b)(11) to specifically enforce an assignment of rents provision. However, most partially completed projects do not have tenants and cash flow.

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1031 FORECLOSURES,
NOL TAX REFUNDS &
STIFFING THE SECOND



by G. Scott Haislet

1 1031 EXCHANGES OF FORECLOSED PROPERTIES

Tax code §1031 provides generally that no gain is recognized on exchange of like kind business or investment property. However, taxpayers sometimes lose 1031-qualifying properties to foreclosure, a short sale, or a deed-in-lieu of foreclosure. Though the lost property might lack equity, disposition might trigger taxable gain.

How can there be gain? Consider the following: Purchased for \$100,000 in 2000, a property ballooned to a \$700,000 value in 2006 at which time the taxpayer took a \$500,000 loan against it. When the foreclosure occurred in 2010, the lender reported the property was worth \$320,000 and that the loan balance was \$500,000. The taxpayer had taken \$30,000 in depreciation

from inception of the ownership of the property.

At the foreclosure, the taxpayer has a \$250,000 tax gain (\$320,000 value minus \$100,000 original purchase price, plus \$30,000 depreciation recapture). Under §1031, if the taxpayer buys another property worth \$320,000, the tax on the \$250,000 gain will be avoided. In order to obtain §1031 treatment, however, taxpayers must establish an exchange agreement with a "qualified intermediary" (also known as an exchange "accommodator"), bearing in mind the special challenges of the "sale" of the foreclosed relinquished property.

In this scenario, the taxpayer may buy the replacement property with no money down, with no loan, or part loan-part cash. To avoid tax on all the gain, the taxpayer must buy at a purchase price of \$320,000 or more. The taxpayer may get partial relief - if the replacement property purchase price is less than \$320,000.

For example, a replacement property purchase price of \$280,000 would result in taxable gain of \$40,000 (\$320,000 "price" of foreclosed property minus \$280,000 purchase price of replacement property: the gain being net debt relief of \$40,000 is commonly known as "boot").

Under these facts, the taxpayer has \$180,000 "cancellation of debt income" ("CODI"), either with or without the §1031 exchange (\$180,000 CODI equals the \$500,000 loan balance at foreclosure minus the \$320,000 value). The CODI is in addition to the gain shown above; and, CODI is ordinary taxable income. Tax code §1031 does not shield CODI; tax code §108 provides that CODI is excluded from taxable income in certain situations (for example, debt cancelled in bankruptcy is not taxable). However, a full discussion of §108 is beyond the scope of this article.

Additionally, if the taxpayer seeks a §1031 exchange upon foreclosure,

a higher value of the foreclosed property will reduce CODI and will allow greater relief under §1031. For example, assume the same facts as above, except the foreclosed property was worth \$420,000. If this was the case, then the CODI would be only \$80,000 (\$500,000 loan balance at foreclosure minus \$420,000 value). If the taxpayer can reasonably demonstrate a higher value for the foreclosed property, he may get greater relief in a §1031 exchange (this is not an absolute rule; in some cases, a lower value might save more tax). Also, be aware that a Lender will likely issue an IRS Form 1099-C or 1099-A stating the foreclosed property's value. The IRS form is not conclusive and a taxpayer does not have to use the 1099 value - if another value can be demonstrated, for example, by comparative sales.

Yet, with the taxpayer's credit score being negatively affected by the foreclosure, one might ask how does the taxpayer qualify to buy a §1031 replacement property? In certain circumstances, the taxpayer might consider taking over another property subject to the existing loan (thus, there would be no qualifying). In this author's opinion, there are plenty of pre-foreclosure properties available for a buyer. Additionally, a no-money-down purchase will meet the §1031 requirement, provided proper closing procedures occur.

2 TAX REFUNDS FROM NOL CARRYBACKS

Many upper-income individuals used their home equity lines of credit to buy investment properties when values were escalating. These taxpayers sought to increase their wealth through their leverage. However, they were unable to reap the tax benefits of over-leveraged real estate due to tax code §469.



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This section generally denies losses from rental real estate for taxpayers having adjusted gross income over \$150,000. Such §469 losses are called "passive activity losses" or "PALs". Thus, those taxpayers who accumulated significant negative cash flows on properties (in the quest for wealth through appreciation), but could not deduct those PALs currently against wages and other income. Under §469, the PALs are not lost forever, but rather, are merely suspended for future use upon sale of the property or net income or gain from similar properties.

PALs, however, are triggered upon a foreclosure of those investment properties. As a result, all of the suspended PALs from prior years are recognized against wages and other ordinary income in the year of the foreclosure(s). Triggered PALs and losses on foreclosure sometimes create a current year "net operating loss" ("NOL"), pursuant to tax code §172. A NOL is negative taxable income with some adjustments. A taxpayer may apply a NOL to a prior year. This is known as a "carryback". The NOL carryback reduces income in a prior year as if the NOL occurred in that year. Under §172, a 2010 NOL is carried back to 2008. This means that the taxpayer can re-figure his 2008 tax return as if the 2010 NOL was a deduction on his 2008 tax return. Example: a taxpayer has 2010 NOL of \$200,000; and had \$200,000 taxable income in 2008 and paid \$50,000 in federal income taxes. Then, the 2010 NOL is applied to 2008, and the taxpayer can get an immediate refund of the \$50,000 taxes they paid in 2008. To get the refund, the taxpayer must file a claim (i.e., amended tax return) with IRS.

Additionally, NOLs exceeding a prior year's income can be carried to other years. Example: taxpayer 2010 NOL of \$200,000 is carried back to 2008. Only \$150,000 of the NOL

is absorbed in 2008, and the other \$50,000 is applied to 2009. For NOLs occurring in 2008 and 2009, an election allowed carryback for up to five years. While federal tax law generally specifies a 2-year NOL carryback, the tax code allows an election to carry over NOL to future years without having to carry back. California does not permit NOL carrybacks, but allows NOL carryovers.

3 STIFFING THE SECOND

In situations of "negative-equity", the second deed of trust lender faces poor remedies when the loan balances exceed the value of the property. If the borrower continues to pay the first loan, the taxes, and insurance, defaulting on the second loan may encourage a settlement with the second lender. Upon default, the second lender can either implement a non-judicial foreclosure or sue (judicial foreclosure). The non-judicial foreclosure leaves the second lender with the property subject to the first loan, and with no deficiency judgment by law ("one-action" rule).

On the other hand, a judicial foreclosure may yield a deficiency judgment, but the lender may face court delays, attorney fees, borrower's redemption rights, an uncertain deficiency sum, and potential borrower bankruptcy. These issues often discourage such action. Consider the following example a second lender may face: a property is worth \$300,000, with a first loan balance of \$280,000 and a second loan balance of \$100,000. The deficiency is \$80,000 (value minus combined loan balances). If the owner defaults on the second loan, the second lender might be smart to take the owner's offer to pay \$10,000 in full settlement instead of seeking its poor choice of foreclosure remedies.

After settlement, the second lender

will issue IRS Form 1099-C reporting the cancelled debt as income ("CODI").

However, the debt forgiveness (\$90,000 in the example) far outweighs income tax on the CODI. In addition, tax code §108 might exclude all or part of the CODI from taxable income. However, negotiating a settlement with an institutional second lender requires patience and hard work. Because laws vary by state, the lender may not understand its poor California remedies. A letter from counsel should explain the second lender's poor remedy choices, with the offer to discount. Still, experience shows that the lender will not respond quickly or easily (if at all) to the offer. The lender will likely ask for financial information from the borrower. Resist the temptation! The lender could use the information later in a suit against the borrower if the plan goes awry.

These are just a few of the challenges and opportunities in these times for clients and their counsel to identify and tackle. ♦

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BETTER A DISTRESSED PROPERTY THAN A DISTRESSED CLIENT: AN OVERVIEW OF LAND USE DUE DILIGENCE

by Michael Patrick Durkee
and Thomas Tunny

I. INTRODUCTION

No one wants to buy property for a particular intended use, only to discover later that it is planned for another use, that it violates the local code, that it cannot be served with public services or facilities, or that it may become “public open space” in the next election. Land use due diligence can help you keep such “surprises” from wrecking your client’s deal.

For example, a major European bank was seeking to purchase a significant commercial office building in the San Francisco financial district. During the course of land use due diligence, it was discovered that the building, unbeknownst to everyone involved – the seller, the seller’s attorneys, the brokers, the city – straddled a lot line. This violated the City Code, Building Code, etc., and would have prevented the buyer from securing tenant improvement building permits (the life blood of the new tenant and hence of the building) until the issue was cured. Because the issue was discovered prior to the purchase, the parties were able to devise a lot line adjustment strategy that involved the City, resolved the issue, and allowed the client to close on its purchase (with appropriate holdbacks and contingencies).

Another example: Based in part on the results of approximately \$25,000 of land use due diligence on a high-profile property in the Bay Area, a potential purchaser opted not to go ahead with the transaction. Later, the potential purchaser was able to recoup the costs of the due diligence - and make a profit - when he sold the land use due diligence to another prospective buyer for \$50,000. As you can see, land use due diligence can create value for your clients in very unusual ways!

In today’s volatile real estate market, where uncertainties are rampant, it will be critical for your client to understand whether a purchase opportunity presents a great buy at a very attractive price, or whether the offering price reflects serious challenges because of underlying land use issues. Worse yet, your client could find itself having celebrated its winning bid in a hotly contested foreclosure purchase and then find out several months later that its plans to rejuvenate the property is facing substantial constraints due to land use restrictions or issues.

With these types of challenges in mind, this article provides an overview of the land use regulatory framework in California and a beginning “check list” to guide your land use due diligence efforts to assure that your client will be making a fully informed decision when it considers acquisition of distressed real estate in California.

II. DISCUSSION

A. CITY, COUNTY, OTHER PUBLIC AGENCIES

Identifying which jurisdiction (city and/or county) has land use authority over your property is imperative. Only cities and counties are “land use” jurisdictions in California.

If the property is in the county’s jurisdiction, but within an adjacent city’s “Sphere of Influence,” certain Local Agency Formation Commission (LAFCO) issues may apply. LAFCO is the independent body that acts on all annexation, detachment and incorporation requests by the public agencies within its jurisdiction.

If the property is within a city’s jurisdiction (or will need to be annexed to a city to develop), then one needs to determine whether the city is a “general law” city (most cities) or a “charter” city. Charter cities (a few counties are also charter) follow their local charter instead of California statute on matters, such as zoning, determined to be a “municipal affair.”

B. GENERAL PLAN

The General Plan is a city’s or county’s primary planning document. It has been described as the “constitution” for all future development. *Leshar Communications, Inc. v. City of Walnut Creek* (1990) 52 Cal.3d 531, 540. It provides the template for development throughout the community. The Plan must address all aspects of development, including housing, traffic, open space, safety, land uses and public facilities. (Gov. Code § 65302.)

DUE DILIGENCE QUESTIONS:

- 1 Is the city or county General Plan in compliance with State law?
- 2 What is the “land use designation” for the property?
- 3 What “uses” are allowed and what are the goals, policies and development standards within that land use designation?
- 4 Will the client’s development plans require a General Plan Amendment?

C. SPECIFIC PLANS

A Specific Plan is an elective entitlement; it is not required by state law. If locally adopted, a specific plan is the next level of planning below the General Plan in the land use approval hierarchy, and is used for the systematic implementation of the General Plan for particular areas. (Gov. Code § 65450). A specific plan must be consistent with the General Plan. Thereafter, zoning, subdivision, public works projects and development agree-

ments all must be consistent with the adopted specific plan. (Gov. Code §§ 65454, 65455).

DUE DILIGENCE QUESTIONS:

- 1 Has a specific plan been adopted (required) that includes the property?
- 2 Is the specific plan consistent with the General Plan?
- 3 Is there a specific plan EIR (already certified or being prepared) that can be used for the proposed development?
- 4 What zoning-level development regulations are in the specific plan?

D. ZONING

Zoning is the “granddaddy” of modern land use regulations and puts “plumbing-level” detail to the General Plan’s (and any applicable specific plan’s) “policy-level” mandates. Generally, zoning is the division of a city or county into “districts” or “zones” and the application of particular regulations to each zone. Zoning regulations can be divided into two classes: those that regulate structures (height, bulk, design, floor area ratio, etc.) and those that dictate the “use” to which the property may be put.

DUE DILIGENCE QUESTIONS:

- 1 What is the applicable zoning district?
- 2 Is it consistent with the General Plan?
- 3 Is it a traditional or is it a planned development type of zone? If a planned development zone, what sub-entitlements does it require (e.g., master plan, general development plan, precise development plan, etc.)?
- 4 What are its regulations relative to: use, density, lot size, floor area ratio, height, parking, infrastructure, services, processing, and growth?

E. SUBDIVISION MAPS

Before any parcel of property may be sold, leased or financed, it must comply with the Subdivision Map Act. (Gov. Code § 66499.30). New parcels generally are created through the approval and recording of a subdivision map. As conditions to a map approval (parcel map or tentative map), a local government may require the dedication/improvement of public infrastructure, fee payments and many other matters reasonably required to promote the public’s health, safety and welfare.

SUBDIVISION MAPS
DUE DILIGENCE QUESTIONS:

- ❶ Has a tentative map, parcel map, or tentative parcel map been approved? If so, is it a "vested" map?
- ❷ If a tentative map or tentative parcel map, when does it expire? Were extensions granted? What extensions are still available?
- ❸ Any conditions of approval still applicable to the property?
- ❹ Has a parcel or final map been filed or recorded?

improvements and construction, for the duration of the agreement, are those in effect when the agreement is executed. (Gov. Code § 65866). Development agreements also regularly provide for unique obligations of the developer.

DUE DILIGENCE QUESTIONS:

- ❶ Is there a development agreement applicable to the property?
- ❷ What is its "life" or "term"?
- ❸ What does it "vest" and what does it not vest?
- ❹ What are its other terms and conditions and have they been satisfied?

F. DEVELOPMENT AGREEMENTS

Development Agreements (Gov. Code § 65864 et seq.) between a developer and a local government control the power of that government to apply newly enacted ordinances to ongoing developments. Unless otherwise provided in the agreement, the rules, regulations and official policies governing permitted uses, density, design,

G. CEQA

Under the California Environmental Quality Act (CEQA) (Pub. Res. Code § 21000 et seq.), "projects" that may have a significant environmental effect require the preparation of an environmental impact report (EIR). (Pub. Res. Code § 21080). CEQA also provides certain "exemptions" from this EIR requirement and allows abbreviated compliance documents (negative declarations, supplemental EIRs, addenda, etc.). A "project" is any activity undertaken, supported or authorized by a public




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agency that may cause a direct physical change in the environment, or a reasonably foreseeable indirect physical change, including activities involving the issuance of permits and entitlements. (Pub. Res. Code § 21065).

DUE DILIGENCE QUESTIONS:

- 1 What prior CEQA work has been done to date for this property and can you use it for your project?
- 2 If so, what are the mitigation measures and which have been satisfied?
- 3 If not, is any environmental review needed (EIR, etc.)?
- 4 Is there anyone in the public who would challenge your CEQA work?

H. DEVELOPMENT FEES

More and more, cities and counties are defraying the costs of public improvements through the imposition of development ("impact") fees. (Gov. Code § 66000 et seq.)

DUE DILIGENCE QUESTIONS:

- 1 What development fees currently exist?
- 2 Are any new fees proposed?
- 3 Have vested rights been secured that affect the applicability of fees, and if not, are such vested rights available?

I. INFRASTRUCTURE

The General Plan, Capital Improvement Plans, Public Facilities Plans, Infrastructure Management Plans and other policy-level regulations of cities and counties address infrastructure needs, expansion, cost, responsibility and timing.

Such plans and regulations should be reviewed to answer the following questions concerning water, wastewater/sewer, drainage, and traffic:

- (1) Is there adequate supply and/or capacity available to your property and project?
- (2) Is the necessary infrastructure in place? If not, what responsibilities might you have towards the construction of such infrastructure?

J. BALLOT MEASURES

Legislative action by the electorate continues to grow and evolve in California. Initiatives (enacting new laws) and referenda (seeking to undo laws enacted by the lo-

cal entity) can drastically effect the land use regulations applicable to your property.

DUE DILIGENCE QUESTIONS:

- 1 Are there any planning and zoning regulations that have been enacted by initiative?
- 2 Are there any pending initiatives or referenda affecting the property? If so, what effect would they have if passed?

K. OTHER ISSUES

(1) Is the property within the Coastal Zone? The Coastal Act established, among other things, state policies and regulations for public access and development on the coast. (Pub. Res. Code § 30000 et seq.) The Coastal Commission's jurisdiction includes generally the area extending from a line 3 miles offshore to a line 1,000 yards shoreward of the mean high tide of the Pacific Ocean, from Oregon to Mexico.

(2) Is this property within the ALUC's Airport Land Use Plan area? If so, what restrictions apply? Every county (except Los Angeles County) with airports served by scheduled airlines must establish an Airport Land Use Commission (ALUC). (Public Utilities Code § 21670). The purpose of the ALUC is to ensure the orderly growth of each public airport and compatibility with the area surrounding the airport through the adoption of an Airport Land Use Plan (ALUP). If a General Plan or specific plan is not compatible with the ALUP, the ALUC must notify the local entity so that they may reconsider their General Plan or specific plan. The ALUP can be overruled by a two-thirds vote of the legislative body of the local entity (as long as it is determined that its own plan adequately protects the public health, safety, and welfare).

(3) Are there local regulations regarding historic structures? If so, do they apply here? If so, what do they require? Many different regulations (federal, state, local) can apply to buildings and neighborhoods designated as having "historic" significance. Often, local regulations control the owner's ability to expand, remodel or demolish structures that have been designated as "historic" in character, and/or structures that are located in a "historic district." ♦

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COURTHOUSE STEP DWELLERS: Violating Sherman's Trust or Assisting Sallie Mae?

By Amanda Bevins

What are those people doing on the steps of the Wakefield Taylor courthouse in Martinez?

What most of them are doing is bidding on bank-owned properties that homeowners have had the misfortune to lose through foreclosure to assist Sallie Mae or Large Bank USA recoup some of their losses. What some of them may be doing is engaging in "bid rigging," which is considered an illegal restraint on trade and competition in violation of the Sherman Antitrust Act of 1890.

For years, as I have climbed the rust-colored brick steps of the Wakefield Taylor courthouse, going to or coming from juvenile court (usually with a heavy heart because of the nature of representing the very young accused of very serious crimes), I have seen men and women assembled on the steps, cell phones and laptops at the ready. As they call out unintelligible addresses and prices, communicating in a language of gestures and glances, I've often wondered what they were doing. When a girlfriend of mine got notice that the house she was renting was being foreclosed upon and would be sold at public auction at the courthouse, I finally put it together: These people on the courthouse steps were participating in a public foreclosure auction.

As a criminal defense attorney, I deal with most substantive issues in an actual courtroom. It seemed odd to me that these auctions would take place without supervision on the courthouse steps. Wouldn't these extrajudicial auctions be susceptible to some unfair practices? Might it not be difficult for someone like my friend, who was naive to the auction lingo, to actually bid on a property? As it turns out, and as this article will discuss, the Government does believe that there has been some unfair practices and collusion in these extrajudicial public auctions. After the property bust and the foreclosure crisis caused in large part by financial institutions offering homebuyers sub-prime mortgages on properties they couldn't possibly afford, the Government, looking

for a scapegoat more easily prosecuted than Sallie Mae or Large Bank USA, has put the spotlight on the mostly small-time real estate professionals who participate in these public auctions. In the wake of the economic meltdown, many of those "courthouse steps" participants are now being investigated by the Government for "bid rigging." A caveat: I'm a criminal defense lawyer, not a real estate specialist. This article is not intended to be a primer on foreclosures, but will focus on the prosecution and defense of bid rigging and the associated criminal penalties.

So what is bid rigging? As you real estate mavens know, a foreclosure is the process by which a bank or other secured creditor sells or repossess real property after the owner has failed to comply with terms of the mortgage by defaulting on the promissory note secured by a lien on the property. The foreclosed property then goes to public auction. In theory, the property is auctioned off by the bank's trustee at a price set by the bank to a consumer who may be the owner, a real estate broker or investor, or any Dick or Jane looking for a good deal. Typically, the property must be purchased at auction at a price no lower than the minimum bid set by the bank, by a cashier's check and sold as is. The trustee then recovers some of the debt owed to the bank and someone acquires below-market-value property to live in, refurbish, invest in or sell and we all go off to the seashore. This is how it's supposed to work.

Bid rigging, by contrast, involves a situation where bidders at the public auction agree not to compete against each other at the auction, usually in return for some consideration. The designated person then bids on the property, and if that person is the successful bidder, sometimes that person and those who had agreed not to bid hold a second round auction. At this auction, the property goes to the highest bidder. The difference between the purchase price at the trustee auction and the second auction is then paid by the ultimate winning bidder to the other persons in the group as a premium

for agreeing not to bid on the property at the first auction.

Does it seem odd that the Government is concentrating on prosecuting these people who, for the most part, may have simply devised a way to breathe new life into the scores of properties that have been lost to foreclosure rather than the banks that put them there? Ironically, these banks that caused the foreclosures by offering "fairytale" mortgages recover part of their losses from these auctions, regardless of whether the bid comes at a first- or second- round auction. So what is the government's motivation in targeting the small guy instead of the money-hungry lenders? The concern does not appear to be to avenge the homeowners or the mom-and-pop real estate brokers and investors, who were shut out of the private second round auction. In fact, the prosecution may have nothing to do with protecting victims because at law it is irrelevant whether anyone is harmed or victimized by the bid rigging. This is because the alleged bid rigging practice is being prosecuted as a per se violation of the Sherman Antitrust Act (15 USC §1.). Therefore, the Government can prosecute these "bid riggers" without showing any harm to anyone and reap large fines and penalties.

When the first of these "bid rigging" cases came our way, my intellectual dander was up when I learned they were being prosecuted pursuant to the Sherman Antitrust Act. The Sherman Antitrust Act was enacted in 1890 to protect against unfair competition. As the Su-

preme Court said in *Spectrum Sports v. McQuillan*:

"The purpose of the [Sherman] Act is not to protect businesses from the working of the market; it is to protect the public from the failure of the market. The law directs itself not against conduct which is competitive, even severely so, but against conduct which unfairly tends to destroy competition itself."

This was the law used by President Taft to break up the American Tobacco Company and unjustly used by President Cleveland to stop the Pullman Strike led by Eugene Debs. It's not often that I get to defend against such a stately and dignified law. It certainly has a more rarified origin than Three Strikes or Megan's Law. So, the crux of the criminal violation is that the "bid rigging," regardless of whether anyone is harmed, is a per se violation of the Sherman Antitrust Act in that it suppresses and restrains competition and creates an unreasonable restraint on interstate trade. These cases are being investigated by the FBI and prosecuted jointly by the United States Attorney and the Antitrust Division of the U.S. Department of Justice. If convicted of a single violation of the Sherman Act, one faces up to 10 years in federal prison and a \$1 million fine. Violators are also subject to the federal alternative fines provision, which authorizes fines up to twice the gross financial loss or gain from the violation. Under these alternative fines provisions, individuals have been fined more than \$10 million. In addition to Sherman Act violations, bid riggers have been prosecut-

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COURT HOUSE STEPS,
cont. from page 25

ed for violations of mail and wire fraud and making false statements to a government agency, leading to decades of additional time in federal prison and increased fines.

These cases are complicated to defend. All the Government needs to prove is that there was an agreement to not bid on a particular property regardless of whether the foreclosing bank received less than it would have had there not been such an agreement, and regardless of whether secondary profit was made from this agreement. This is particularly troublesome, as it is a common practice of "courthouse steps" dwellers to refrain from bidding on a property in a certain area that he or she knows has caught the interest of another bidder. Is that "bid rigging" or professional courtesy?

Moreover, since it may be difficult to tell from the auction results themselves whether anything untoward occurred, the Government relies upon cooperation from those involved to turn on others and provide information. Of course, this method of evidence gathering is rife with problems since those trying to defer scrutiny from themselves are more likely to exaggerate or embellish the dealings of others. And often, overzealous prosecutors will catch a dolphin or two in the tuna net and investigate a person who, for example, had no knowledge of the bid rigging activities of fellow investors or may have had no idea that a second round of bidding was illegal.

So the answer to the question, "What are those guys doing on the courthouse steps?" is complicated and depends on who is asking the question. They may be legitimately participating in a non-judicial fore-

closure auction to purchase cheap, as-is investment or personal real estate. They might be trying desperately to buy back their own home. Or, as the Government believes, they could be conspiring together and participating in secret second auctions to violate the rarified and dignified Sherman Antitrust Act of 1890. ♦

- Amanda Bevins is a shareholder at Gagen, McCoy, McMahon & Armstrong in Danville. She has been practicing criminal defense and juvenile defense law for the past 18 years in Contra Costa, Alameda, Solano and Napa Counties and is on the board of directors of the Contra Costa Bar Association and on the Napa County Juvenile Justice Commission. Amanda is also a member of California Attorneys for Criminal Justice; Women Defenders, and the National Association of Criminal Defense Attorneys.

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THE TAIL WAGGING THE DOG

Strategies for Settling Fees-Driven Cases

by Malcolm Sher

How many times has a defense attorney declared litigation to be “unsettle-able” because plaintiff attorney fees have far exceeded the value of the case? How many times has a plaintiff lawyer responded that the “defense tactics” were the cause of the unreasonable fees? Using the context of a landlord-tenant “habitability” dispute, this article examines how statutes and behavior can lead to the problem and some proposed strategies for minimizing the impacts of these litigation realities.

In this economic climate, people have lost their homes to foreclosure. Families are renting, squeezed into smaller, unfamiliar quarters. In an apartment, children have reduced room to play. Wear and tear increases. Tenants complain about broken screen doors, malfunctioning appliances, insufficient heat or hot water, roof or plumbing leaks. They may claim that a child’s asthma has been exacerbated by toxic mold. The response of landlords and management companies are perceived as untimely or inadequate. Frustrated tenants with limited resources, unfamiliar with their right to “repair and deduct”, or not fluent enough in English to properly document their complaints, stop paying rent. Landlords institute unlawful detainer actions. Courts evict tenants, finding their “non-habitability” defense unpersuasive.

Landlords and property management companies are then sued for violations of habitability and retaliation provisions under Section 1941 et seq. of the Civil Code. Management companies tender their defense to landlords whose insurer

reluctantly defends both of them.

Lawyers and insurers need to recognize some fundamental truths about such cases. First, they are emotionally charged. Second, they become attorney-fee driven, especially when discovery battles ensue with defense counsel objecting to plaintiff’s perceived “fishing expeditions” for documents relating to other tenants or to the landlord’s other rental properties. Discovery motions and countless hours of depositions are typical.

If a rental agreement provides for attorney fees to the prevailing party in an action on the contract and the tenant sues for breach of the express or implied warranty of habitability, attorney fees are governed by Civil Code, Section 1717. Even where the clause appears to benefit only the landlord, Section 1717 will make it bilateral. However, because these cases usually rely on “public policy” statutes, the prevailing plaintiff, but not the prevailing defendant, is entitled to recover fees under Section 1174.²¹ of the Code of Civil Procedure, which provides that a tenant prevailing in a Section 1942 claim

“shall” be entitled to attorney fees. Counsel must be familiar with these fee-shifting statutes because even where liability may be reasonably clear but damages are minimal, plaintiff counsel’s fees may soon exceed the real value of the case. *Herman v City & County of San Francisco* (2008) 158 Cal. App. 4th, 407, 427 states that “[a trial court] does not under California law abuse its discretion simply by awarding fees in an amount higher, even very much higher, than the damages awarded, where successful litigation causes ‘conduct which the [fee-shifting statute] was enacted to deter [to be] exposed and corrected’” (emphasis added).

Since most tenants under the above scenario may be unable to afford legal representation, plaintiff counsel usually prosecute “habitability” cases on a contingency fee basis. Often less-experienced practitioners associate attorneys with specialized knowledge and a track record to co-counsel the case.

Regardless of whether the case is settled or tried, plaintiff counsel will demand full compensation for

all their time, using the two-step "lodestar adjustment" method requiring a calculation of the "lodestar" figure - actual hours reasonably expended multiplied by reasonable hourly rates. They may also seek an "enhancement" or "multiplier", arguing that the unadorned lodestar does not compensate for contingent risk, extraordinary skill and other fair market factors. Associating counsel may increase "firepower" and also justify a lodestar enhancement. Further, fees incurred for fee motions are compensable to a prevailing plaintiff counsel. Fees in most "public policy" cases typically belong to the attorney. This adds incentive to both generate and fight for them. It seems like a no-win situation for defendants and their insurers.

One strategy for avoiding runaway fees is to explore early settlement with a mediator experienced in this field, who will hold pre-mediation meetings to arrange for informal exchange of information. This includes photographs, video or reports from contractors or code-compliance experts depicting or describing allegedly "untenantable" conditions. Consider jointly hiring a well-credentialed expert, neutral to the outcome, to inspect the premises and opine on whether the requirements of Civil Code Section 1941.1 are met and if not, how bad the conditions are and what evidence suggests they are of long duration. This might alter the landlord's belief that the tenant couldn't afford the rent and deliberately damaged the property in order to force a rent reduction or create a habitability claim. Disclose any tenant records evidencing writing to or telephoning the landlord or manager to complain. Any "me too" statements from other tenants which may bolster plaintiff's position and will stand up to cross-examination, might influence the defendants or insurer to settle and should be offered, not hidden.

Tenants whose standard of living has been impacted by economic conditions may label landlords as "slumlords", not appreciating that the same economy may have im-

pacted the landlord's ability to properly maintain the premises and also service the mortgage. Defense counsel may consider voluntarily providing records of responses to complaints, including work orders and payment confirmation. While they may confirm the poor condition and even an inadequate response, it is better to gain this knowledge sooner rather than later. To a tenant who is still occupying, some rent reduction or free rent may afford an adequate remedy. An apology with reasonable compensation to a tenant who has been evicted or voluntarily vacated may still be possible before emotions get out of control. Such overtures may also diffuse "motivated reasoning" (each side seeing the other's, but not their own reasoning as nefariously motivated and therefore suspect). Engaging in a dialogue with a mediator willing to be "evaluative", peeling back perceptions and emphasizing the need not to render the case un-settle-able because of escalating fees may achieve a wider overlap of understanding. The object is to ferret out whether the case has real value and is being prosecuted on its merits or merely to run up fees on the notion that, "what we lose on the roundabouts, we shall make up on the swings". If mediation does not settle the case, a Civil Code, Section 998 offer, to include attorney fees and costs, may pave the way to successfully argue at the inevitable fee motion that the offer was reasonable and influence the court's approach to the lodestar or any enhancement analysis.

The settlement of "habitability" and other "public policy" cases is also impacted by insurance coverage. In California, insurers will not cover punitive damages and Insurance Code Section 533 provides that an insurer has no duty to indemnify a loss caused by the insured's willful act. Insurers also routinely balk at covering emotional distress damages where there is no evidence of "bodily injury". Reservations of rights letters typically address these two issues. Further complications arise when plaintiffs allege illness from expo-

sure to "toxic mold" contamination without scientific proof of its existence and causation. Injury from "pathogenic organisms" is usually excluded from coverage. Before filing pleadings counsel should obtain expert confirmation of toxic mold contamination and a medical opinion that it is the cause of asthma or other illness. Often, some black "stuff" on the grout of bathroom tiles or on windowsills is nothing more than mildew caused by inadequate cleaning or humidity build-up through lack of adequate ventilation. Insurers in habitability cases become skeptical of mold allegations and knowledgeable counsel will weigh the risk of pleading a plaintiff out of insurance coverage and the prospect of settlement.

There is also the risk that an insurer may reserve rights to seek reimbursement for all defense fees allocable to non-covered claims and to not pay the attorney fees portion of any judgment. See *State Farm General Insurance Company v. Mintarish* (2009). Landlords or property managers found liable under Section 1941 et seq., for non-covered injuries, or an intentional failure to maintain premises may find themselves funding not only their own defense, but also plaintiff's fees, not to mention uninsurable damages, including punitive damages.

The anticipated increase in landlord-tenant habitability litigation provides strategy lessons for both plaintiffs and defendants and their counsel. Engaging in early mediation or even paying more than the case may appear to be worth can avoid the risk of catastrophic and perhaps uninsured damages and fees. ♦

This article was first published in the San Francisco and Los Angeles Daily Journals on February 9, 2011

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the door

southern asian cuisine

Restaurant review by Gary M. Lepper

We now know that, for a forest, fire is a kind of overheated cleanser. While fire is not regarded as having a similar commercial advantage, that may not be true for The Door, which has replaced the Walnut Creek's tasty but incinerated Zheng Long. In October of 2009, after an 18-month absence, owner Steven Chen unveiled a complete change: décor, staff, chef and cuisine.

The Door presents itself as serving "Modern Asian Cuisine". Executive chef Daniel Sudar, formerly of Betelnut (San Francisco) and Red Lantern (Redwood City), has devised an eclectic blend of dishes from his native Indonesia, Thailand, Vietnam, Singapore, southern China, the Philippines and even a bit of Japan.

You can begin with the green papaya salad (prawns, pomegranate, herbs and a sweet lime garlic dressing) or my favorite, the Korean apple salad (a delectable mixture, in a mildly spicy vinaigrette, which proves that the whole really is more than the sum of its parts). They certainly are not recreational salads where one picks out some or all of the usual smattering of radish and cucumber slices, carrots and other "salad" garnishes from amid disparate leaves of lettuce. Even better, the size – like all of The Door's portions – is so generous that it can be shared easily.

Beginning this summer, the number of large main plates will decrease and small plates will increase, together with an expanded number of new dishes which will emphasize raw fish and sauces. Notable small plates include the poke

Ahi tuna (with Fosaka seaweed, sweet onions, cashew nuts and won ton chips), mustard shrimp (wok-tossed in a creamy mustard sauce with walnuts) and the lemon grass pork short ribs (glazed with Kaffir lime soy sauce). With one exception, the fifteen small plate prices range from \$6.00-\$9.00.

If you are hungrier or if you like what you like and want it all to yourself, try a large plate, like Mongolian filet mignon (with onions, crispy noodles and Szechwan pepper sauce), caramelized prawns (with mushrooms, tomato, onions, pineapple and lime Mirin soy sauce), Korean port barbeque (with cucumber and jicama salad) – or Chef Sudar's personal favorite, the lamb shanks in spicy curry (from a secret recipe of his family). Again,

What makes The Door particularly special is the covered wooden deck poised above the creek in the rear. - It is an ideal spot for alfresco dining.

there are fifteen selections between \$12.00-\$17.00 (with the \$19.00 exception of the lamb shanks). (As an aside, Mr. Chen is reevaluating the present and annoying, practice of having to separately order rice at dinner.)

Lunch likewise has a broad menu of generous servings, accompanied by soup or salad. The price is a very economical \$8.00-\$10.00, with separate salads and noodle dishes at \$6.00-\$9.00.

Beverages are abundant – but those who need scotch or a Cosmopolitan will be disappointed by the absence of a liquor license (little is more rare than a newly-issued liquor license in Walnut Creek). Instead, you can be lured by one of twelve different soju (like vodka... really) or four different sake cocktails, eleven selected stand-alone sakes and two flights of three sakes. All cocktails are \$7.00; the select

sakes range from \$6.00-\$12.00; the two flights are \$16.00 and \$18.00. For the more pedestrian drinkers (like me), there are fifteen white wines (\$8.00-\$12.00) by the glass, twelve red (\$9.00-\$12.00) and nine kinds of beer (all \$5.00). Corkage is \$15.00. (Oddly, beverage service is a bit slow, whereas food arrives quickly.)

The Door's "Happy Hour" is inventive and extensive. Between 3-6 p.m. (12-6 p.m. on Saturdays and Sundays), you can choose among approximately twenty small-portion "Street Bites," about half of which do not appear on the regular menu.

The dark hardwood floor and tables create an elegant tone in the dining room (which also has four spacious booths and a long, elevated table where a glass top has been raised three inches above two antique Shanghai doors). An auxiliary dining room (32 people) is sepa-

rated, when necessary, by wood-and-glass partitions and another (25 people) is situated on the opposite side of the entry foyer; both can be reserved privately.

What makes The Door particularly special is the covered wooden deck poised above the creek in the rear. The tables, like those inside, are separated enough that you do not have to share your conversation (or meal) with the table next to you. It is an ideal spot for alfresco dining.

The Door – located at 1448 South Main Street, Walnut Creek 94596 (925-930-8088) -- accepts reservations and take-out orders.

Jim Morrison of the Doors (appropriately) once asked, "Do you love her madly, do you love her as she's walkin' out The Door?" Be it with her or him, you now have the chance to find out. ♦



What do you think would have to change for the real estate market to turn around or stabilize?



There are four primary events that are needed for a recovery in the real estate market:

1. Increased participation by lenders in real estate lending.
2. Significant reduction in foreclosure inventories.
3. Reduction in unemployment to below 6%.
4. Regulatory reform of government guarantees on real estate loans.

David W. Ginn

Law Offices of David W. Ginn



For a turnaround of the market, purchasers must "believe" it is a good investment and they must have the ability to enter the market. [...] In order to thaw the mar-

ket, the government needs to slowly reduce their purchasing of home loans thereby encouraging investors to enter the market while also being a conservative purchaser of loans i.e. only guaranteeing loans with 20% down and which can be paid off in this lifetime. The purchaser and lender need to have skin in the game and it must be consistent. The US government needs to set the base line on home loans, not the extremes such as interest only or 3% down. The real estate market will come back, but we still have at least 3-5 more years to clear out all of problems.

Joan Grimes

Law Office of Joan Grimes

It will take time, a lot of it. Over that time distressed inventory will be reduced, underwriting standards will be relaxed, the employment picture will improve and, in some places, the population will grow. But if interest rates go up it as is quite possible, it will take much longer. And if the deductibility of mortgages is substantially curtailed, it could drive prices down, possibly triggering a lot more defaults as owners see they have no equity to preserve or no chance of realizing equity for a very long time. The mortgage deduction was a terrible idea. It just drove prices up, not really helping affordability. Now we are stuck with it.

David W. Baer

John A. Hartog, Inc.



For residential real estate, the market will not stabilize until existing mortgage defaults are worked out or foreclosed, and the foreclosed houses sold. Once that hap-

pens values will be re-set, and there might be demand for new construction.

Robert Seeds

Greenan, Peffer, Sallander & Lally, LLP

More jobs. More jobs. More jobs.

David L. Roth

Real Estate Law Offices of David L. Roth

More QuestionMan responses can be found online, at <http://cclawyer.cccba.org>

New FHA loan requirements for condos have become nearly impossible to meet (that Homeowners Associations have no delinquencies, high reserves, and units be mostly owner-occupied). Lack of loans at this bottom end of the market means only those with all-cash can buy. This drastically drives down the number of possible buyers, and prices, putting more people underwater, delinquent and unable to move up. The pendulum needs to swing to the middle and lenders find ways to finance a buyer with at least the traditional 20% down. As long as people think the market might go down more, they have little reason to buy or lend. But the market can turn on a dime. A few months of rising prices or rising rates can make people feel that they will miss this unusual opportunity to buy at a price and rate that beats renting. That will happen (if the price of gas doesn't kill employment and choke off the ability to save a down payment) ... by next year. But a drastically austere federal or state budget could cause mass layoffs, an economic tailspin, and continually falling prices, as it is in the UK. In that case, the demographic problem of aging baby-boomers no longer in need of family homes would not be offset by young immigrants coming into the State for jobs, and lead to a long downward spiral like Japan.

Michael S. Strimling

Bramson, Plutzik, Mahler & Birkhaeuser, LLP



by **Matt Guichard**

So the idea was to replace "Civil Jury Verdicts" with "Bar Soap". Not going to happen. We still get reports on jury verdicts, so occasionally let's have a stand-alone verdicts column. Okay? Otherwise, as with this one, we will combine the columns.

Lots of rumors and some facts about lawyers on the move. It seems these hard economic times in the legal business are causing many lawyers to branch out on their own by leaving firms and partners. I need to confirm some of the moves, so you will have to wait until next time. Keeps you all in a state of anticipation.

Having nothing to do with hard economic times, we are pleased to report **Cecily Barday, Matt Gray, Stephen Kostka, Geoff Robinson and Barbara Schussman** have joined Perkins Coie's Environment, Energy & Resources practice, in the San Francisco office. Reportedly they will add 110 plus years of experience to the firm. I really didn't think Geoff was that old.

Andy Schwartz of Casper Meadows Schwartz & Cook has received an AV rating from Martindale Hubbell. Did you know that only two percent of all lawyers in the world are rated AV through Martindale Hubbell? An AV rating is preeminent status with the highest ethical rating. Congratulations Andy. I also understand Andy is fairly recent member of ABOTA. Another very impressive by invitation only legal organization.

Speaking of good stories, I have been meaning to write an article about **Maurice Moyal**. As you know he passed away some time ago. I handled many cases with Maurice on the other side when I was a DA. The two Frenchmen as he liked to say. I thought I knew him well, but learned much about him at the celebration of his life. Isn't that always the way? It takes someone's passing for us to appreciate who that person really was. I last saw him at his retirement party. He was in a wheel chair and obviously in poor health. He brightened when I spoke with him, and we shared some funny stories from days gone by.

Maurice Moyal was born into a Jewish family in Morocco. He fled his home as a teenager and traveled to Paris. He fled Paris when the Nazis entered Paris. He came to the United States speaking Arabic and French. In short order he learned English. He joined the military. He rose through the ranks and retired not so many years ago as a colonel. All the while he continued a quite remarkable career on the civilian side. He earned a degree at Cal, then a masters and a Phd in accounting. He was one of the "Originals" at JFK Law School, class of 1970, and was named Alumni of the Year in 2007.

A truly remarkable man and quite a local character in our legal community. His life is a story of great perseverance, hard work and success.

Steven Cavalli provided an interesting jury verdict out of Yolo County. You know Yolo, Woodland is the county seat, and UC Davis is also there. The case entitled **Jacobs v Pacific Transportation et al**, No. PM06-1710 was tried before the Honorable David Reed. Steven Cavalli of Oakland tried the case for the Plaintiff. Richard Alley of Sacramento and Robert Salley of Sherman Oaks represented the respective Defendants.

The case involved a motor vehicle accident. The defense admitted liability for the accident, but contested the nature and extent of the injuries. A CCP 998 demand was made for the balance of the policy limits of \$924,500. An offer of \$250,000 was made. The jury returned a verdict of \$1,503,476.84. It is reportedly the largest personal injury verdict in Yolo County history. Interestingly the case settled after verdict for \$1,750,000.

Keep those cards and letters coming, and be sure to report your jury verdicts, wherever they might be. ♦

— *Matthew P. Guichard is a principal in Guichard, Teng & Portello, APC. Please send case information to: 1800 Sutter Street, Suite 730, Concord, CA 94520 or contact him at 925.459.8440 or mguichard@gtplawyers.com*

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Email: ropatel42@gmail.com.

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CALL FOR BOARD NOMINATIONS!

Do you want to be a leader within our legal community as a Director on the Contra Costa County Bar Association Board?

The Board seeks candidates who agree to meet the following expectations:

- To possess or acquire a basic understanding of the Contra Costa County Bar Association (CCCBA) and its activities.
- To commit to the mission and values of the Association.
- To represent the CCCBA in a manner consistent with Board decisions.
- To prepare for and regularly attend monthly Board meetings.
- To attend additional meetings and bar-sponsored events as needed.
- To participate on at least one committee or taskforce.
- To participate in the annual Board Orientation and Training program.

Directors are selected for their experience and personal attributes. Active participation on a CCCBA committee or section leadership is a plus.

Nomination Process: To be eligible, nominees must be active attorney members of the Association. Any attorney member of the Association may self-nominate by June 30, 2011 for consideration by the Directors' Nominating Committee at the regular October Board meeting, for approval by the Board. The Board may accept or reject any or all of the Committee's nominations. The Board's decision on the candidates for election as Directors may be supplemented by additional nominations made in writing by any member and seconded by four members of the Association, with the concurrence of the nominee, by September 30, 2011.

If you are interested in serving on the 2012 Board of Directors (or to fill an existing vacancy), please submit your written nomination to:

Lisa Reep, Executive Director
704 Main Street, Martinez, CA 94553
lgreep@cccba.org

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