Los Angeles lawyer Bryan C. Jackson discusses the legal and financial challenges facing the construction industry.

**Page 30**

**Challenges to Land Use Decisions**

**Page 39**

**Bankruptcy Remote Structures**

**Page 12**

**Financing Low-Income Housing**

**Page 23**

**Prevailing Wage Doctrine**

**Page 46**
Incorporating your clients just got easier and more affordable.

Document Filings...
It's what we do!™

- Corporations
- Limited Liability Companies (LLCs)
- Nonprofit Corporations
- S-Corporation Elections
- Foreign Qualifications
- Amendments
- Conversions
- Dissolutions
- Certificates of Good Standing
- Document Retrieval Services
- IRS Forms & Filings
- Name Availability Checks
- Name Reservations
- Registered Agent Services
- Corporate Kits & Supplies

Incorporate a Business in ANY STATE in 24 to 48 hours!

For as little as $99
Plus state filing fees

$25 Discount!
for Los Angeles Bar Association Members
Enter coupon code: LBAR-25D when ordering at our website.

MyCorporation.com is a document filing service and does not offer legal or financial advice.

Call for more information: 1-888-692-3614
Visit our website: www.mycorporation.com
Other lawyers say you’re a maverick. Maybe they have you figured right: You go your own way, make your own decisions — blaze your own law practice. lexisONE® likes your style. It’s why we offer LexisNexis™ research priced by the day, week or month for solos. With our research packages, you’re free to access the LexisNexis research tools and materials you need, for the times you need them.

Access:

• LexisNexis™ Enhanced Case Law
• Annotated Rules and Statutes
• Shepard’s® Citations Service
• Public Records
• Administrative Materials
• Journals and Law Reviews
• News
• Matthew Bender® Analytic Content
• Expert Witness Directories
• Verdicts and Settlements

The price won’t hold you back. Research packages from lexisONE include free printing and unlimited searching, and access to the LexisNexis™ Total Research System — to help you stay ahead of the pack. LexisNexis research from lexisONE. You can go your own way. lexisONE. Let’s Solo.

www.lexisone.com/solo
We've Been Going Home With Lawyers for 50 Years.

You might call us easy. Our clients certainly do. Attorneys, realtors and bankers rely on North American Title for smooth, efficient handling of complex real-estate transactions. We’ve been writing title insurance policies for half a century, with offices coast-to-coast, a wealth of resources and no closing arguments. That’s how we make it easy.

www.nat.com
Bryan C. Jackson, a partner at Allen Matkins Leck Gamble & Mallory LLP and cochair of the firm’s Construction Law Practice Group, practices construction law exclusively. He is also vice chair of the Association’s Real Property Section. In “Under Construction,” he analyzes the impact of recent state legislation on the construction industry. His article begins on page 30.

Cover photo: Tom Keller

19th Annual Real Estate Law Issue

30 Under Construction
The legislature needs to go back to the drawing board in its efforts to provide relief for the construction industry
By Bryan C. Jackson

39 In a Class of Their Own
Recent interpretations of civil rights laws have provided federal courts with potential jurisdiction over virtually any local land use decision
By David Pettit and Michael Schafler

Plus: Earn MCLE credit. MCLE Test No. 122, sponsored by CourtCall LLC, appears on page 43.

46 Fair Pay
Recent determinations under California’s prevailing wage doctrine are affecting projects formerly considered to be “private work”
By Teresa Buchheit Klinkner
EMPLOYMENT DISPUTE MEDIATION CENTER

Let experienced employment law litigator
ROBERT D. COVIELLO
assist you in the resolution of your employment dispute.

SERVICES PROVIDED:

FLAT FEE
• All day mediation
• No charge for additional time on same day

OUR CENTRAL ORANGE COUNTY OFFICE OR YOURS
• Will travel within the state at no additional fee

LIBERAL CANCELLATION POLICY
• No charge if cancelled within 72 hours of session

EXPERIENCE
• Knowledgeable in all areas of employment law; has litigated hundreds of employment matters representing both Plaintiffs and Defendants
• No need to expend time educating the mediator

OPINIONS BASED ON EXPERIENCE
• The value, strengths, weaknesses and risks involved in a case
• Full analysis of law, facts and defenses
• Jury appeal/probability of a favorable outcome

ROBERT D. COVIELLO
Mr. Coviello has been actively practicing in Orange County for over 22 years. He has personally tried over 50 jury trials and has been lead counsel in several hundred arbitrations and mediations in employment related matters. He is an Arbitrator on the Employment Panel of AAA and the most recent past Chair of the O.C. Bar’s Labor and Employment Law Section.

EMPLOYMENT DISPUTE MEDIATION CENTER
(714) 557-7500
www.coviello-law.com

Los Angeles Lawyer

VISIT US ON THE INTERNET AT www.lacba.org/lalawyer
E-MAIL CAN BE SENT TO lalawyer@lacba.org

EDITORIAL BOARD
Chair
JERROLD ABELES
Articles Coordinator
GARY RASKIN

ANN M. AGUILAR
DANIEL L. ALEXANDER
HONEY KESSLER AMADO
ETHEL W. BENNETT
R. J. COMER
CHAD C. COOMBS
KEITH E. COOPER
ANGELA J. DAVIS
HEATHER DAVIS
KERRY A. DOLAN
GORDON ENG
DANIEL A. FIORE
JOSEPH S. FOGEL
MICHAEL E. FOX
STUART R. FRAENKEL
MICHAEL A. GEIBELSON
TED HANDEL
DEAN HANSELL
STEVEN HECHT
KATHERINE M. HIKIDA
JOHN-P. LECKRONE
HYACINTH E. LEUS
PAUL MARKS
ELIZABETH MUNSOGLU
RICHARD H. NAKAMURA JR.
KAREN NOBACKOTO
DENNIS PEREZ
GERALD F. PHILLIPS
EDWARD POLL
THADDBUS M. POPE
JACQUELINE M. REAL-SALAS
NINA RES
SUE CAROL ROKAW
KURT L. SCHMALZ
JACOB STEIN
CARMELA TAN
R. BRUCE TEPPER JR.
PATRIC VERRONE
JOEL B. WEINBERG

STAFF
Publisher and Editor
SAMUEL LIPSMAN
Senior Editor
LAUREN MILICOV
Associate Editor
ERIC HOWARD
Art Director
LES SECHLER
Director of Design and Production
PATRICE HUGHES
Advertising Director
LINDA LONERO
Account Executive
MARK MOCKELS
Advertising Coordinator
WILMA TRACY NADEAU
Administrative Coordinator
NATTY JALLON BABY

LOS ANGELES LAWYER (ISSN 0162-2900) is published monthly, except for a combined issue in July/August, by the Los Angeles County Bar Association, 261 S. Figueroa St., Suite 300, Los Angeles, CA 90012, (213) 896-6503. Periodicals postage paid at Los Angeles, CA, and additional mailing offices. Annual subscription price of $14 included in the Association membership dues. Nonmember subscriptions: $28 annually; single copy price: $3 plus handling. Address changes must be submitted six weeks in advance of next issue date. POSTMASTER: ADDRESS SERVICE REQUESTED. Send address changes to Los Angeles Lawyer, P.O. Box 55020, Los Angeles CA 90055.

Copyright ©2004 by the Los Angeles County Bar Association. All rights reserved. Reproduction in whole or in part without permission is prohibited. Printed by Banta Publications Group, Liberty, MO. Member Business Publications Audit of Circulation (BPA).

The opinions and positions stated in signed material are those of the authors and not by the fact of publication necessarily those of the Association or its members. All manuscripts are carefully considered by the Editorial Board. Letters to the editor are subject to editing.
The combined leverage, experience and resources of the Los Angeles County Bar Association and Aon are the surest way to get reasonable professional liability coverage. Many underwriters have fully or partially quit the business because of a reduction in surplus capital. Consequently, law firms face higher premiums for significantly reduced coverage...or no coverage at all, forcing them to go out of business!

The solution is

Aon, one of the largest providers of professional liability insurance for attorneys around the country, will survey the rates of a select group of highly rated underwriters and locate the best malpractice protection available to meet your special needs and budget. Contact us today for a no-obligation quotation of rates.
COMPETENT REAL ESTATE BROKERAGE

- Specializing in helping attorneys and their clients buy and sell real estate in bankruptcy, probate, family, and real estate law
- Experienced negotiator with legal background
- Licensed broker, California Department of Real Estate
- Call for LACBA member discount

Office: (818) 905-7111 Ext. 251
Office: (310) 820-2229
Facsimile: (818) 905-7299
Email: ToddR@realtor.com

PACIFIC CREST BANK WANTS TO BE YOUR BUSINESS BANKING PARTNER

As your local bank, Pacific Crest provides quality service—personalized to fit the special requirements of law professionals.

Since 1974, Pacific Crest Bank has been putting clients first by delivering the customized products and service that businesses, entrepreneurs, and depositors expect. With a comfortable “sit-down” atmosphere, we consistently exceed our clients’ expectations with a winning combination of technology and personalized service. As “Your Financial Services Company,” our goal is to serve you, making your business and personal banking faster, easier, and more convenient.

Call us today!
17656 Ventura Blvd.
Encino, CA 91316 800-631-1572
9320 Wilshire Blvd., Suite 105
Beverly Hills, CA 90212 800-889-1572
www.pacificcrestbank.com

LOSA ME LA WY EA R IS THE OFFICIAL PUBLICATION OF THE LOS ANGELES COUNTY BAR ASSOCIATION
261 S. Figueroa Street, Suite 300, Los Angeles, CA 90012-2503
Telephone 213/627-2727
Visit us on the Internet at www.lacba.org

ASSOCIATION OFFICERS:
President
ROBIN MEADOW
President-Elect
JOHN J. COLLINS
Senior Vice President
EDITH R. MATTHAI
Vice President/Treasurer
CHARLES E. MICHAELS
Assistant Vice President
BERNARD E. LESAGE
Assistant Vice President
DANETTE E. MEYERS
Assistant Vice President
GRETCHEN M. NELSON
Executive Director
RICHARD WALCH
Associate Executive Director/General Counsel
W. CLARK BROWN

BOARD OF TRUSTEES
DAVID B. BABBE
LINDA D. BARKER
SCOTT W. CARLSON
LUCILE L. CHUN
KATESSA CHARLES DAVIS
KERRY J. DOCKSTADER
GARY A. FARWELL
DEBRA S. FRANK
RICHARD B. GOETZ
CRISTINA E. PEREZ GONZALEZ
RITA GUNASEKARAN
STEPHEN T. HOLZER
BRUCE G. IWASAKI
SAMANTHA PHILLIPS JESSNER
HERBERT KATZ
JEFF KICHAVEN
DENA A. KLEEMAN
JOEL W. H. KLEINBERG
PHILIP H. LAM
LAWRENCE E. LEONE
ELAINE W. MANDEL
JAMES C. MARTIN
JUDITH SEEDS MILLER
JENNIFER F. NOVAK
CYNTHIA F. PASTERNAK
AMY M. PELLMAN
WINSTON A. PETERS
MARGARET P. STEVENS
KIYOKO TATSUI
KATHLEEN J. TUTTLE
SCOTT E. WHEELER

AFFILIATED BAR ASSOCIATIONS
BEVERLY HILLS BAR ASSOCIATION
BLACK WOMEN LAWYERS ASSOCIATION OF LOS ANGELES, INC.
CENTURY CITY BAR ASSOCIATION
CONSUMER ATTORNEYS ASSOCIATION OF LOS ANGELES
CULVERMIRAMA BAR ASSOCIATION
EASTERN BAR ASSOCIATION OF LOS ANGELES COUNTY
GLENDALE BAR ASSOCIATION
ITALIAN AMERICAN LAWYERS ASSOCIATION
JAPANESE AMERICAN BAR ASSOCIATION OF GREATER LOS ANGELES
JOHN M. LANGSTON BAR ASSOCIATION
KOREAN AMERICAN BAR ASSOCIATION OF SOUTHERN CALIFORNIA
LAWYERS’ CLUB OF LOS ANGELES COUNTY
LESBIAN AND GAY LAWYERS ASSOCIATION OF LOS ANGELES
LONG BEACH BAR ASSOCIATION
MEXICAN AMERICAN BAR ASSOCIATION
PASADENA BAR ASSOCIATION
SAN FERNANDO VALLEY BAR ASSOCIATION
SAN GABRIEL VALLEY BAR ASSOCIATION
SANTA MONICA BAR ASSOCIATION
SOUTH ASIAN BAR ASSOCIATION OF SOUTHERN CALIFORNIA
SOUTH BAY BAR ASSOCIATION OF LOS ANGELES COUNTY, INC.
SOUTHEAST DISTRICT BAR ASSOCIATION
SOUTHERN CALIFORNIA CHINESE LAWYERS ASSOCIATION
WHITTIER BAR ASSOCIATION
WOMEN LAWYERS ASSOCIATION OF LOS ANGELES
Is A Malpractice Insurance Crisis Looming In Your Horizon? Are You Ready?

Over 15 carriers have withdrawn from the California market. Will your carrier be next?

The changes in the marketplace are troubling. It is an unknown future.

Non-renewals are commonplace. Some carriers can’t secure sufficient reinsurance to operate their professional liability programs.

A major carrier was recently declared insolvent. Other carriers have been downgraded by A.M. Best. Severe underwriting restrictions are now being imposed. Rates are not certain. It’s all very unsettling.

Be prepared. Be informed.
Lawyers’ Mutual Policyholders are . . .

. . . and have been for the past 25 years

Secure Your Future.

Insure With Lawyers’ Mutual.

Investigate Lawyers’ Mutual.

Call us directly at (800) 252-2045.

Find us at www.lawyersmutual.com

Email us at lmic@lawyersmutual.com
Upon the sacredness of property civilization itself depends,” opined Andrew Carnegie in 1889. Although property as a sacrament of wealth may seem awfully civilized, modern notions of real property may be traced to far baser practices, such as the territoriality of lower primates and dogs. Dogs, primates, and many other nonhuman mammals declare ownership of territory by marking it and occupying it. So did our human ancestors, who hung forbidding symbols in trees and later built fences, then castles, then tract homes. Current practices of recording deeds and subdivision maps are simply modern and more sanitary versions of stinking up a tree on the edge of one’s hunting ground.

Skeptical? We refer you to more learned thinkers than ourselves. Richard Pipes, in Property and Freedom (1999), traces the etymology of words regarding possession of property in several languages. Pipes concludes that from the German *besitzen* to the Latin *possidere*, sitting or settling upon the property asserts claims to land no different than the actions of primates. In their essay, “Metaphysics of Real Estate” (2001), Barry Smith and Leo Zaibert accept Pipes’s premise but proceed to distinguish between the certainty of one possessing a chattel, such as a hat or a shirt, and the geographic indefiniteness of possessing real property without a system of marking and enforcing exact boundaries, which is a relatively recent innovation.

In short, only a king’s buttocks are grand enough to sit upon the whole of his lands. Thus the real in real estate, according to Meyer Melnikoff, derives not only from its tangible nature but also from the French and Spanish words for royal. In pre-Christian England, the king was first wed to the land itself, to the Mother Earth. His marriage to a merely mortal queen was considered secondary.

Other than the realm of monarchs, how is it that we have come as a society to respect the legal ownership of land, of real estate? How have we evolved from marking trees to recording deeds?

Dirt lawyers, give yourself a round of applause here. You are half of the equation that made real estate the stuff of civilization—at least Western civilization. The equation comes from Jean-Jacques Rousseau, who declared: “The first person who, having fenced a plot of ground, took it into his head to say this is mine and found people simple enough to believe him, was the true founder of civil society.”

Rousseau’s fence-building, forward-thinking landlord is the first half of the equation. But the landlord’s oh-so-savvy solicitor who devised the mechanisms for convincing everyone else to respect the rights of the landlord is the second half—the primordial real estate lawyer who made civilization itself possible.

Every real estate attorney living today may trace his or her professional ancestry to that one great founding member of modern civilization. We are the inheritors of what Smith and Zaibert label “collective intentionality,” the process of making people (and county recorders) believe that our clients really do own their lands.

Perhaps now that Los Angeles knows the crucial role real estate lawyers played as cofounders of Western civilization, our practice group will be featured on prime time television shows. Perhaps now those grandstanding litigators will share some of the glory with dirt lawyers. Perhaps now beer commercials saluting the great and small of America’s work force will offer kudos to the real estate attorneys—the ones today and the pioneers who documented those early deals humanity made with destiny.

With pride in the heritage of our practice area, we are pleased to present Los Angeles Lawyer’s 19th annual Real Estate Law issue. We deeply thank our contributors for making this issue an engaging collection of articles.
LexisNexis and the Los Angeles County Bar Association Working Together To Support the Legal Profession

The LexisNexis™ Bar Association Member Benefit Program is designed with many offerings to fit the customized needs of Los Angeles County Bar Association members.

From the new attorney building a practice to the established attorney who wants expanded research offerings, LexisNexis™ provides unique solutions as business needs change. Choose from quality legal research sources including Shepard’s®, Michie™, Mealey’s, and Matthew Bender®, exclusively on the LexisNexis™ Total Research System at www.lexis.com.

Find the exclusive benefits that are right for you!
Call For Details: 866-836-8116
Mention code 202370 when calling.
Life at a Small Law Firm

Working at a small firm has many advantages to counteract the lure of large firms

Fairly recently, I joined a smaller law firm, and three particular aspects of my new situation reassure me that I made a good decision. The most attractive aspect of practicing at a small law firm is the flexible lifestyle it affords. You control your schedule at a small firm to a much greater extent than you do at a large firm—subject, of course, to the demands of your clients, and, if you are a litigator, to pleading deadlines and court hearings. Partners do not necessarily expect you to be at their beck and call unless there is a pressing, time-sensitive need. Nor are you burdened with the overwhelming billable hours requirements of large firms. At a smaller firm, you have time for family, friends, bar activities, or simply yourself.

In addition to having a life outside the office, the beginning lawyer at a small firm has the significant advantage of gaining useful experience from the start. At a smaller firm, lawyers are quickly thrown into the fire. In my case, after joining a smaller firm, I feel that I am actually practicing law for the first time in my six-year career.

At large law firms, associates are fed slices of a large case, and they are deprived of the benefit of the bird’s-eye view of the case. It may be several years before you are given primary case responsibility at a large law firm. So if you want to truly practice law sooner rather than later, and if you want direct client contact early in your career, then make the move to a small law firm. You will learn more—and more quickly—and you will be more invested in your work.

The third advantage to working at a small firm that I most appreciate is how I am treated. The difference between associates and partners at a small law firm is not as pronounced as it is at a large firm. At large firms, associates are spoiled not just in terms of salary. If you bring a client to the firm, for example, you are actually given credit rather than an ambiguously promised “due consideration” in your year-end bonus. Partners are genuinely interested in your improvement, and not just for the purpose of obtaining better work. They care about your professional development more than at a larger firm, and they are more willing to provide guidance and counsel.

The Disadvantages

At large and small law firms, the dynamics of personal relationships with partners, fellow associates, and staff can make or break your experience. At a small firm, fewer people generally mean closer contact, and the dynamics of this situation play an especially significant role, for better and for worse. At a small firm, another person’s bad day may become your bad day, another person’s problems may become your problems, and someone else’s bad mood may become your bad mood. If a partner is being unreasonably difficult with a particular secretary, for example, that unreasonableness may get passed along, and you can guess who the recipient will be. Stay focused on your work and avoid the people who are being unreasonable that day.

At a small law firm, a bad relationship can make your life difficult—and this is especially true for an associate. The key ingredient to positive relationships with anyone is always respect. Never underestimate the power of showing respect for colleagues and staff. Perceive everyone as part of a continuum, not a hierarchy, and you will avoid having the majority of your waking hours be a bad experience resulting from bad relationships. Add a dash of humor, and you should thrive.

Another limitation of employment with a smaller firm is compensation. If you want a big salary and expect reimbursement for most expenses, you should work for the large firms. If you are willing to take a pay cut in exchange for a better life and for more rewarding on-the-job experiences, the small firm is where you belong. At smaller firms, what you do not make in salary is made up to you in other ways.

At large firms, associates are spoiled not just in terms of salary. Their cages are gilded with secretaries, copy rooms and staff, paralegals, and numerous other resources. At a small law firm, in contrast, the staff will certainly strive to help when they can, but on days when they are overburdened, you will be on your own. One day while working at a small firm, for example, I approached one of the secretaries and asked for something to be faxed. After an awkward silence of roughly three seconds, I was politely told to go fax it myself.

There may be days when you will spend hours doing your own administrative and support work—whether it be faxing, typing letters, preparing discovery, or making copies. None of this is billable. In addition, do not expect staff members to work overtime for your project, even if they do so on a partner’s project. Although the hours you work at a large firm may be more demanding, at a small one you can still expect to work at the office well into the night hours or during weekends, without support. At times you will need to finish a project well in advance, just in case it is delayed by its low rank in the pecking order. The solution to this problem may lie in being respectfully pushy at times and, at other times, simply doing it yourself.

I have become a better practitioner in a shorter time as a result of working at a small law firm. I enjoy my work more and take increased meaningful interest in the outcome of the firm’s cases. Practicing at a small law firm is enjoyable and is recommended if you can cope with the financial and logistical disadvantages. The advantages are quite rewarding—personally and professionally.
Commercial real estate transactions have one thing in common... they are *all* different.

Companies of the Old Republic Title Insurance Group, the nation's highest rated title insurer, have been insuring commercial real estate transactions across the country for over 95 years.

We offer our commercial customers:

**Title Insurance**

Our nationwide network of direct operations, subsidiaries and independent policy-issuing agents provide innovative commercial title insurance products and services that meet the unique needs and circumstances that commercial transactions often require. Call (800) 228-4833.

**1031 Exchanges**

Old Republic Exchange Facilitator Company, OREXCO, has a team of experts throughout the country, who assist customers in structuring transactions from the simple delayed or simultaneous exchanges to complicated reverse, built-to-suit, or multiple-site exchanges. Call (888) 903-1031.

When it comes to commercial real estate transactions, we're ready to expedite them wherever they are, whatever their size or financial scope and will provide you with expert advice and outstanding service.

*Call us or visit our websites today!*

www.ortc.com

www.orexco1031.com
writing concerns that lenders have regarding a borrower and entities that are related to that borrower. In the context of a real estate finance transaction, a special purpose entity is an independent legal entity formed for the sole purpose of owning and managing the real estate that serves as collateral for the lender’s loan. A special purpose entity becomes bankruptcy remote when its assets are sufficiently insulated from the effects of a bankruptcy of a related entity so that the special purpose entity itself is not likely to become a debtor as a result of the related entity’s bankruptcy.

Regardless of whether the loan is intended to be securitized, lenders generally require the borrower to be a special purpose bankruptcy remote entity. Further, lenders dictate most aspects of the borrower’s form, structure, and organization in an attempt to be consistent with the prevailing standards of rating agencies. Understandably, borrowers want to know what these new terms and requirements mean, why lenders need them, and how they will affect their businesses.

The phrase “special purpose bankruptcy remote entity” comprises two terms, “special purpose” and “bankruptcy remote,” that are distinct concepts. In practice the concepts collectively address certain credit and underwriting concerns that lenders have regarding a borrower and entities that are related to that borrower. In the context of a real estate finance transaction, a special purpose entity is an independent legal entity formed for the sole purpose of owning and managing the real estate that serves as collateral for the lender’s loan. A special purpose entity becomes bankruptcy remote when its assets are sufficiently insulated from the effects of a bankruptcy of a related entity so that the special purpose entity itself is not likely to become a debtor as a result of the related entity’s bankruptcy.

In any securitized financing, the driving force that requires parties to address these bankruptcy-related risks is the rating agencies’ evaluation of the borrower and the debt to be securitized. In larger securitized loan transactions, lenders also will require that the borrower’s counsel provide a legal opinion (a so-called nonconsolidation opinion) that, subject to certain qualifications, a bankruptcy by an entity related to the borrower will not cause the substantive consolidation of the borrower (and its assets) with the bankrupt entity.

Lenders’ Concerns

For lenders, the threshold concern is the severe implications of the effect of a borrower’s bankruptcy. The real estate securing the securitized mortgage would become part of the bankruptcy estate, leaving the mortgage vulnerable to the automatic stay provisions under the

Adam B. Weissburg is a partner and John Matthew Trott is an associate in the Los Angeles office of Cox, Castle & Nicholson LLP, where they represent parties in real estate secured transactions.
Bankruptcy Code.7 The automatic stay is an injunction that arises by operation of law immediately upon the filing of a bankruptcy petition. It bars creditors from initiating or continuing with efforts to collect secured or unsecured debts, or to enforce claims against estate property.8 From the lender’s perspective, this result would present a veritable parade of horribles.

For example, absent relief from the court, the automatic stay would prevent the lender from taking action to obtain possession of or exercise control over its collateral,9 while the borrower might be entitled to continue to use, lease, or sell the real property collateral in the ordinary course of its business.10 Further, notwithstanding the opposition of creditors, the confirmation of a plan of reorganization by a bankruptcy court could allow the borrower to force these creditors to accept less than the amount of the borrower’s indebtedness. In the jargon of bankruptcy attorneys, this process is aptly referred to as a cram down.11

Certainly, taking structural steps to reduce the chances that a borrower can or will file a bankruptcy addresses some of the lender’s concerns. However, substantive consolidation is a powerful weapon that can undermine even the most thoughtful efforts to insulate the borrower. Substantive consolidation is an equitable doctrine used by bankruptcy courts if it appears that two related entities are perceived by creditors as a single entity and the equities of the creditors’ interests are best served by treating those entities as if they were a single entity.12 In evaluating whether to order a substantive consolidation, courts look for evidence of a “substantial identity” between the entities and whether substantive consolidation will avoid some harm or promote some benefit to the party seeking the substantive consolidation order.13

In the case of a substantive consolidation of a borrower following a bankruptcy by an entity related to the borrower, the borrower’s assets and liabilities are merged with the assets and liabilities of the bankrupt related entity to create a single fund and single body of creditors. In a sense, the related party bankruptcy creates the same disastrous prospects that lenders face in the case of their borrower’s bankruptcy, but with substantive consolidation the source of the lender’s grief comes from outside of the lender/borrower relationship.

The growth and development of the secured real estate financing market is directly attributable to the ability of the lending and rating agency communities to adequately address the risks of borrower bankruptcy and substantive consolidation.14 Managing these bankruptcy risks is a matter of 1) limiting the borrower’s ability to file a voluntary bankruptcy petition, 2) restricting the borrower from engaging in activities that might lead to additional indebtedness or other liabilities, 3) requiring the borrower to conduct its business in a way that reduces the risk of substantive consolidation, and 4) assuring that entities related to the borrower do not have a property interest in the collateral for the loan.10 While it will never be possible to bankruptcy-proof a borrower,15 the use of special purpose bankruptcy remote entities in secured financings has become the method of choice for attempting to achieve these four goals.

**Entity Requirements**

To avoid the risk that preexisting liabilities could cause the bankruptcy of the borrower, in most cases the lender will require that the borrower be a newly formed entity. This newly formed entity may be a corporation, limited liability company, or limited partnership, although for loans secured by real estate, limited liability companies formed in Delaware are the most common organizational form. In part the choice to form in Delaware is a result of lenders’ greater familiarity with Delaware corporate law and the extensive Delaware case law adjudicating corporate disputes. Additionally, certain provisions of the Delaware Limited Liability Company Act provide a borrower with greater flexibility as to its management structure17 while also providing some assurance to the lender that a borrower that is a limited liability company will not dissolve upon the dissolution or bankruptcy of its sole member.18 The organizational documents for the newly formed entity will need to include special purpose bankruptcy remote provisions. (In some limited circumstances a new entity will not need to be formed, but in those cases the organizational documents for the existing entity will still need to be modified to incorporate the special purpose bankruptcy remote provisions.)

If the borrower is a limited partnership or a limited liability company, its general partner or managing member also must be a special purpose entity. Its special (that is, sole) purpose is to serve as the general partner or managing member of the borrower.

Once formed, the newly formed entity will take title to the real property that serves as collateral for the loan. Transferring the real property collateral to the newly formed entity accomplishes the goal of separating the real property collateral from the bankruptcy risks of its prior owner. In cases in which the original owner has significant control over the newly formed entity (and as a result the degree of separateness between these entities is determined to be inadequate), or when mezzanine financing is contemplated in addition to mortgage financing, the transfer of the real property should be undertaken in multiple steps. That is, the original owner transfers the real property to a first-tier special purpose bankruptcy remote entity that in turn transfers the real property to a second-tier special purpose bankruptcy remote entity. Such a multi-tier transfer not only provides greater protection from the bankruptcy risks of the original owner but also allows the first-tier special purpose bankruptcy entity to obtain mezzanine financing or to provide credit enhancement to the second-tier special purpose bankruptcy remote entity.19

Organizational issues are only part of the process of structuring a bankruptcy remote entity. While an absolute prohibition on the borrower’s ability to file a voluntary bankruptcy petition is impermissible,20 commentators generally agree that the risk of a voluntary petition can be reduced if there is a requirement that the borrower have at least one independent director (or independent managing member if the borrower is a limited liability company) and that any such voluntary petition be approved by the unanimous consent of the directors of the borrower.21 The requirement that the borrower have one or more independent directors or managers also may bolster the separateness argument and avoid substantive consolidation by preventing the borrower from having identical directors or managers with its related entities.22

To be considered an independent director or manager, rating agencies typically require that the director or manager must not 1) have a direct or indirect legal or beneficial interest in the borrower or any of its related entities, 2) be a substantial creditor, customer, supplier, employee, or other person that derives any of its purchases or revenues from the borrower or its related entities, 3) be a member of the immediate family of any member, manager, creditor, customer, supplier, employee or other person that derives any of its purchases or revenues from the borrower or its related entities, or 4) be a person or entity controlling or under common control of anyone referred to in items 1 through 3.23 A cottage industry now exists comprising companies offering to provide “professional” independent directors for a fee.24

The role of independent directors in the future management of the borrower’s business and the fiduciary duties of these independent directors are important for the borrower to understand. Independent directors are not involved in the day-to-day operations of the borrower’s business. Their involvement is required only for a decision by the
Call in the EXPERTS.

Bringing quality experts into the 21st Century.

Pro/Consul, Inc.
Technical & Medical Experts

12,000 DISTINGUISHED EXPERTS IN MULTIPLE DISCIPLINES.

“Pro/Consul’s ability to locate appropriate expert witnesses is unsurpassed.”

1-(800) 392-1119

Listed and recommended by the A.M. Best Company

- Rigorous standards
- Tailored service
- Prompt turnaround
- Free initial consultations
- Free resume book
- Reasonable rates

LOCAL OFFICE
Pro/Consul Inc.
1945 Palo Verde Avenue, Suite 206
Long Beach, CA 90815-3443
(562) 799-0116 • Fax (562) 799-8821
eexperts@msn.com • ExpertInfo.com

A.D.R. Division
1-877-ARBITER
Retired Judges • Attorneys
Medical Doctors • Technical Experts
borrower to file for bankruptcy or for other major decisions that could implicate the other bankruptcy remote provisions of the borrower's organizational documents. Directors, whether independent or not, normally owe the borrower and its interest holders fiduciary duties of care and undivided loyalty, but prior to insolvency, the directors owe only a contractual duty to the creditors.

Once the borrower is in the “vicinity of insolvency,” however, or after the borrower is actually insolvent, the independent director also owes a fiduciary duty to the creditors of the borrower. This potential for conflict between the competing fiduciary duties of directors (including independent directors) has been a topic of numerous commentators. It is important to note that an independent director may or may not vote in favor of the filing of a voluntary petition, and that as a result the borrower’s ability to file a voluntary petition may be restricted by the independent director.

Impact on the Borrower’s Structure and Business

A lender’s requirement that a borrower must be a special purpose bankruptcy remote entity not only affects the organizational structure of the borrower but also places limitations on how the borrower can operate its business. The special purpose bankruptcy remote requirements will appear as provisions in the borrower’s organizational documents and in the loan documents to which the borrower is subject. It is critical for the borrower to understand the effects of various categories of provisions.

Special purpose requirements. The borrower, whether newly formed or not, will need to limit its business purpose and activities to owning and managing the mortgaged property, borrowing the subject loan, performing its obligations under the loan, and activities that are incidental to accomplish these and only these purposes. The special purpose requirements, by narrowing the purpose and activities of the borrower, limit the universe of creditors that could have claims against the borrower and thereby reduce the potential for an involuntary petition to be filed against the borrower. If the borrower engages in other activities, they cannot be performed by the special purpose bankruptcy remote entity.

Separateness covenants. To reduce the risk that the bankruptcy remote structure is defeated by substantive consolidation, the borrower will need to maintain “separateness” from related entities. There is a laundry list of provisions designed to achieve this goal, but typically they require the borrower to maintain its own separate accounts, books,
records, resolutions, and agreements and file its own separate tax returns. The borrower also will need to pay its own liabilities and expenses, including the salaries of its own employees, out of its own funds and assets. The borrower’s assets must be held in its own name, and the borrower’s funds must not be commingled with the funds of any other entity. To the extent any overhead costs are shared with related entities (for example, if there is shared office space with related entities or there are services performed by those entities), the costs must be allocated fairly and reasonably. The borrower also will need to have separate letterhead and often a separate telephone number, and otherwise make clear in all communications its separate identity. In fact, the borrower typically must include in its documents a covenant to correct any known misunderstandings regarding its separate identity. A guaranty of the borrower’s obligations to the lender and others by entities related to the borrower can pose a threat to the separateness of the borrower, and any such guaranty will be carefully considered by the lender in light of the risks of substantive consolidation.32

Restricting the debt of the borrower. By restricting the debt of the borrower to debt related to the subject loan and to the ongoing business operations of the borrower, the risk that an involuntary bankruptcy petition will be filed against the borrower can be reduced. Such provisions are often coupled with a covenant that the borrower will maintain adequate capital for the normal obligations of a business of its type. The purpose of requiring that adequate capital be maintained reduces the risk that an involuntary petition will be filed against the borrower and may also reaffirm the separateness of the borrower. By analogy to the corporate law of alter ego and piercing the corporate veil, if the borrower was inadequately capitalized, it may be more likely to be viewed as a shell of a related entity rather than a true separate entity.33

Restricting additional liens on the collateral. As is the case with restricting the debt of the borrower, by limiting the ability of the borrower to subject the collateral to additional voluntary liens, the risk that an involuntary bankruptcy petition will be filed against the borrower can be reduced.

Prohibiting the borrower from becoming a guarantor or surety. Under this common requirement in securitized loans, the borrower cannot assume or become obligated for the debts of another person or entity, or hold out its credit as being available to satisfy the debts of another person or entity. This provision accomplishes the goals of limiting the future liabilities of the borrower (and thereby reducing the likelihood that an
involuntary petition will be filed against the borrower) as well as helping to ensure the separateness of the borrower and related entities for which it might otherwise provide such guaranties.

By offering the advantage of relatively inexpensive capital, securitized lending will continue as a prevalent form of commercial real estate financing. Real estate practitioners should therefore be familiar with lenders’ requirements for securitized lending, in particular the required use of special purpose bankruptcy remote entities and the impact this particular requirement will have on a borrower’s business.

1 Securitization is “the structured process whereby interests in loans and other receivables are packaged, underwritten and sold in the form of ‘asset-backed’ securities.” COMPTROLLER OF THE CURRENCY ADMINISTRATION OF NATIONAL BANKS, ASSET SECURITIZATION: COMPTROLLER’S HANDBOOK 2 (Nov. 1997).

2 Ratings of the assessment of credit risk by one or more of the nationally recognized rating agencies are invariably required in connection with securitized loans. One of the fundamental requirements of such rating agencies is that the borrower must be a special purpose bankruptcy remote entity. See Committee on Bankruptcy and Corporate Reorganization of the Association of the Bar of the City of New York, Structured Financing Techniques, 50 BUS. LAW. 527, 535 (1995) [hereinafter Structured Financing Techniques]. The four major ratings agencies are Duff & Phelps Credit Rating Co., Fitch Investor Service, Moody’s Investor Service, and Standard & Poor’s Rating Group. For a comprehensive discussion of the criteria used by Standard & Poor’s in evaluating securitized loans, see STANDARD & POOR’S, U.S. CMBS LEGAL AND STRUCTURED FINANCE CRITERIA (2003).


5 Each lender will establish its own criteria of when nonconsolidation opinions will be required. Typically, nonconsolidation opinions are required for transactions ranging from $20 million to $25 million or more. Certain lenders will require the opinions for smaller transactions.


8 Id.


“Advance restrictions against the filing of a voluntary bankruptcy case pursuant to an agreement between a debtor and a creditor have been held to be void against public policy.” See Structured Financing Techniques, supra note 2, at 556.


18 Del. Code Ann. tit. 6, §18-304 (2000). While this section provides that the bankruptcy of a borrower’s sole member would cause the dissolution of the borrower, by its terms the section can be superceded by the terms of the borrower’s operating agreement.


21 See, e.g., White, supra note 12, at AA-23, and Lahny, supra note 19, at 836.

22 See White, supra note 12, at AA-23.

23 Id. at AA-22-23.

24 Two such companies are CT Corporate Staffing, Inc. and Entity Services, L.L.P.


30 Although substantive consolidation in bankruptcy law is a different concept than piercing the corporate veil in corporate law, many of the separateness covenants required in connection with a securitized loan are exactly the sort of corporate formalities that a court will investigate in determining whether a corporation is an alter ego of its shareholders.

31 The items on this laundry list have evolved over time to address concerns that bankruptcy courts have had in determining whether to apply the remedy of substantive consolidation in particular cases. See In re Augie/Restivo Baking Co., Ltd., 860 F. 2d 515, 518 (2d Cir. 1988). See also In re Auto-Train Corp., 810 F. 2d 270, 276 (D.C. Cir. 1987) and In re Eastgroup Props., 935 F. 2d 245, 249 (11th Cir. 1991). Because substantive consolidation is an equitable remedy that is applied at a court’s discretion, no list should be considered all-inclusive, and lenders may expand the list to address specific concerns raised by a particular transaction.

32 In re Vecco Constr., 4 B.R. 407, 410 (1980) (describing the existence of parent and intercompany guarantees as one of the criteria to be evaluated in determining whether substantive consolidation is appropriate). See also In re Eastgroup Properties, 935 F. 2d 245, 249 (11th Cir. 1991).

33 For a discussion of inadequate capital as a basis for piercing the corporate veil, see Automotriz del Golfo de Calif. v. Resnick, 47 Cal. 2d 792 (1957) (“It is coming to be recognized as the policy of the law that shareholders should in good faith put at the risk of the business unencumbered capital reasonably adequate for prospective liabilities. If the capital is illusory or trifling compared with the business to be done and the risks of loss, this is a ground for denying the separate identity privilege.”).
Constitutional Challenges to the Mechanic’s Lien Law

The California Legislature may update this law with due process safeguards

The due process revolution of the late 1960s and early 1970s worked a fundamental realignment of the rights of debtors and creditors in California. Before the phrase “notice and an opportunity to be heard” found its way into the legal lexicon, creditors’ lawyers in California and elsewhere could obtain prejudgment remedies—such as the seizure of property and assets belonging to an alleged debtor—with very little difficulty, usually without opposition, and often without prior notice to the debtor. By contemporary standards, the property and assets of an alleged debtor were there for the taking.

In those days, creditors in California could obtain a prejudgment writ of attachment to seize any property of an alleged debtor or simply by filing a lawsuit, submitting a declaration confirming the alleged debt, and filing an undertaking equaling half the debt. The creditor’s lawyer did not need to worry that a meddlesome judge or court commissioner might question the validity—let alone the existence—of the debt.

Rather, the path to the sheriff’s office included only a quick detour to the clerk of the court, who was empowered to issue a writ of attachment based on the court filings.

Once issued by the clerk, the writ of attachment could reach any property of the alleged debtor—even a consumer debtor’s necessities of life—and once seized, the property was typically beyond the use and enjoyment of its owner, at least until the collection lawsuit was finally resolved. The same was true for a worker’s salary, which was subject to wage garnishment without notice or hearing, as well as personal property in the possession of an alleged debtor, which was subject to replevin without prior notice and an opportunity to be heard. In short, the period before the late 1960s marked the golden era of permissive, and sometimes abusive, collection practices in California.

This era ended with the 1969 decision of the U.S. Supreme Court in Sniadach v. Family Finance Corporation, which invalidated Wisconsin’s prejudgment wage garnishment statute because it did not provide for notice and hearing prior to the taking of the debtor’s property. In short order, the California Supreme Court invalidated virtually the entire panoply of prejudgment remedies available to California creditors. To quote the California court: “The force of the constitutional principles underlying the Sniadach decision has brought the validity of many of our state’s summary prejudgment remedies into serious question.” Following Sniadach, California’s attachment, wage garnishment, and claim and delivery statutes were all struck down. In subsequent years they were revived and amended to provide predeprivation notice and an opportunity for the alleged debtor to have his or her case heard by a judge.

One important prejudgment remedy, however, managed to survive this constitutional sea change: California’s mechanic’s lien law, which gives contractors, material suppliers, and others the right to place a lien on any “work of improvement” to which they have devoted labor or materials. Notwithstanding that a mechanic’s lien may be placed on the alleged debtor’s property without notice and an opportunity to be heard, in 1976 the California Supreme Court ruled in Connelly Development v. Superior Court that the lien law “conforms to the requirements of procedural due process.”

Recent developments have called into question the continuing vitality of this holding. As the California Legislature considers a major overhaul of the mechanic’s lien law, now may be an appropriate time to take a fresh look at whether the lien law provides adequate due process protection for those whose property may be encumbered by it.

California’s Mechanic’s Lien Law

Generally speaking, a mechanic’s lien is available under California law to any provider of labor or materials to a construction project. The typical beneficiaries of the law are contractors, subcontractors, and vendors. When these parties believe they have not been fully paid for their work on a construction project, they can record mechanic’s liens that will have the effect of encumbering the owner’s real property. The amount of the lien is supposed to be either the unpaid contract price or the reasonable value of the labor or materials provided, whichever is less.

The mechanic’s lien remedy is enshrined in the California Constitution and was long ago implemented by the legislature. According to statute, a preliminary notice must be given by potential lien claimants who are not in privity of contract with the owner. This requirement lets the owner know of the existence of a party that is providing labor or materials and that the party may file a lien in the future. In contrast, those in privity of contract with the owner—for example, a general contractor—need not give any notice that the property may be subject to a lien. Regardless of whether preliminary notice must be given, all liens must be filed within 90 days of completion of the project or the lien right is lost.

Nothing prevents a lien claimant from recording a mechanic’s lien immediately after the claimant’s work on the project has begun. However, as a practical matter, there is usually no benefit in doing so, and there are important disincentives. First, the law mandates that each lien claimant has 90 days from recording to perfect the lien by filing...
a lawsuit. Early filers therefore must be prepared to spend money on lawyers soon after the filing of the lien. Moreover, early recordation of a mechanic’s lien does not bestow on the early claimant any priority over later mechanic’s lien claimants. California follows the so-called first shoveling rule, in which all mechanic’s liens on a project are given equal priority and are deemed recorded on the date work began on the project. Consequently, since there is usually no benefit to filing early, it is common for liens to be recorded in rapid succession toward the end of a project, when contractors and suppliers start getting nervous about being paid.

The amount of the lien is mandated by statute as the lesser of the unpaid contract price or reasonable value. The precise amount often proves to be a moving target. Consider the predication of the homeowners in Lambert v. Superior Court,22 who hired a contractor to do major remodeling work on their home. The total agreed-to contract price was $327,765, with work to be completed within one year. Two years and $361,000 later, the homeowners terminated the contractor but soon found their property encumbered by a mechanic’s lien in the amount of $117,338.05. Most of this amount—$89,000—was what the contractor termed “delay/interest damages.”24

Thus, the homeowners in Lambert found their home substantially encumbered by a contractor who had already been paid more than the contract price and whose claim had not been reviewed. Other such examples abound. California’s otherwise extensive mechanic’s lien law provides no specific mechanism for judicial prereview (or speedy post facto review) of the probable validity of liens such as the one imposed on the homeowners in Lambert. The only judicial review specifically contemplated by the statute is a full trial, proceeding at the relaxed pace of ordinary civil litigation.

These potential constitutional failings were analyzed by the Connolly court in 1976. In upholding the statute, the court initially relied on the merits, proceeding at the relaxed pace of ordinary civil litigation.

in holding, the Connolly court noted that the owner had other alternatives: He or she could sue to enjoin a pending or threatened lien and could obtain a prelien hearing under the temporary restraining order mechanism set forth in the Code of Civil Procedure.25 The owner could also file a declaratory relief action, which would be entitled to priority on a civil court’s calendar.26 Given these provisions of California law, the court found the lack of “prior judicial scrutiny” in the mechanic’s lien statute to be “of little significance.”27

Finally, the court weighed the competing interests of property owners and those protected by the lien statute. The court expressed particular concern for laborers and providers of material, because they are often “in a…vulnerable position” on a construction project.28

Without the protection of the lien statute, the court feared that “the improvement may be completed, the loan funds disbursed, and the land sold before the claimant can obtain an adjudication on the merits….”29 In contrast, the court deemed the interests of the property owners to be not as great, since a mechanic’s lien typically inflicts only a “minimal deprivation of property.”30

The dissent in Connolly took issue with each of these points. The dissent argued that Sniadach and other recent due process decisions mandated a predeprivation hearing (or, at least, an immediate postdeprivation hearing) presided over by a judicial officer.31 Since California’s mechanic’s lien law did not specifically provide for a hearing, the statute should be struck down, just as California’s attachment, wage garnishment, and claim and delivery statutes had been.32 In particular, the dissent established that the earlier cases “did not attempt to ‘read into’ the statutes a procedure for a probable cause type of hearing.”33

Thus, California’s mechanic’s lien statute narrowly avoided the fate of many other pre-judgment remedies that were reviewed by the California Supreme Court for due process violations. But in a post-Connolly world, what is to become of property owners like the Lamberts? The Lamberts paid their contractor the full contract price and then some, only to find their house encumbered by a lien for “delay/interest damages” without any judicial participation. Or, to cite a more vexing problem of recent concern in the industry, what is to become of the homeowner who pays the general contractor in full, only to have an unhappy subcontractor slap a lien on the home because the general contractor did not pay the subcontractor? Are property owners in this situation left only with the statutorily approved method of bonding around the lien, thereby removing the lien but in the process placing at risk the liquid assets that collateralize the bond? Or, alternatively, must they pursue the unwieldy course that is endorsed in Connolly of filing a separate action for declaratory relief and an injunction?

Lambert provides counsel for homeowners with an interesting answer. The Lamberts, defending against the contractor’s suit to foreclose the mechanic’s lien, brought a motion to remove the lien. The trial court, invoking Connolly, held that no such motion existed, and that the homeowners were limited to the statutory remedy of bonding around the lien.34 The court of appeal reversed, holding that a motion to remove a mechanic’s lien qualified as one of the measures that were approved in Connolly by which the homeowner “can protect…against the impact of such a lien.”35 The court noted that Connolly “is premised on the availability of speedy remedies,”36 and that once the lien claimant files a foreclosure action, a motion brought in that action would be speedier than the separate declaratory relief and injunction actions envisioned by the Connolly court.37

At first blush, it might appear that the Lambert court, in following Connolly, did precisely what the Connolly dissent had warned against: reading into the statute a procedure—a motion to remove a mechanic’s lien—that simply is not there, in order to preserve the statute’s constitutionality. But on closer analysis, Lambert says little about the constitutionality of the mechanic’s lien law. The judicial creation of a motion to remove the lien, to be brought as part of a lien foreclosure action, surely would not have satisfied the Connolly dissenters as an adequate protection of the owner’s due process rights. Such a motion would not guarantee a speedy judicial determination on the probable validity of the underlying claim, as the motion could not be filed until after the lien foreclosure action was initiated, and that may not happen for up to three months after the recordation of the lien. Indeed, circumstances could easily delay the availability of the motion until more than three months have passed.38

In addition, attorneys representing homeowners are still guessing about the standards for a Lambert-type motion to remove a mechanic’s lien. The statute is silent on the existence of any such procedure, and the Lambert court provided little guidance. Which party should bear the burden of proof? Must admissible evidence be presented with the motion, or can hearsay be introduced? Must the showing be by a preponderance of the evidence, by clear and convincing evidence, or by some other standard? Is the timing of the motion governed by Code of Civil Procedure Section 1005, or can the motion be brought ex parte? Or, because it is an important motion, must a longer notice period be allowed?
In the realm of other prejudgment remedies, these and other related questions are answered by reference to the detailed statutory schemes that were enacted with a view toward satisfying the due process rights of debtors. Not so with California’s mechanic’s lien law. One secondary source suggests that the procedure for a Lambert-type motion should be similar to the petition to remove a mechanic’s lien that is discussed in Civil Code Section 3154. This provision permits a mechanic’s lien to be expunged if a foreclosure action has not been filed within 90 days of lien recordation. Unfortunately, Section 3154 answers few important procedural questions. Rather, the section envisions a hearing that takes place within 30 days of the filing of the petition (and with as little as 10 days’ notice to the lien claimant). The section sets the principal issue as one of timing—i.e., whether a lawsuit to foreclose on the lien was filed within 90 days of recordation. No guidance is given on how a court should assess the validity of the claim underlying the lien. Another secondary source avoids discussion of the standards for a Lambert-type motion to remove an improper mechanic’s lien, undoubtedly recognizing that Section 3154 sheds no light on the subject.43

Finally, from a due process standpoint, it must be remembered that a Lambert-type motion is not available to the property owner during the time between the filing of the mechanic’s lien and the filing of the lien claimant’s foreclosure lawsuit. During that time, the owner will have suffered a taking of property for which there would appear to be no expeditious judicial relief available.

**Connolly Revisited**

In April 2003, the Rhode Island Superior Court sent minor tremors throughout the construction industry by declaring the mechanic’s lien law of that state unconstitutional as a violation of the property owner’s due process rights.44 For practical purposes, Rhode Island’s lien statute is identical to California’s. It permits lien claimants to encumber the owner’s property based solely on the claimant’s sworn affidavit, without review by a judicial officer until a full trial on the merits. The only statutory method for avoiding the impact of the Rhode Island lien would be to post a bond to cover the lien or deposit cash in the amount of the lien into the court registry.

The decision striking down the Rhode Island law could have been written by the Connolly dissenters. The due process arguments rejected by the Rhode Island court found support in a recent decision by the U.S. Supreme Court. In 1991, the Court added to its Sniadach progeny with Connecticut v...
Doehr. In this case, the Court voided a Connecticut statute that permitted the prejudgment attachment of real property, noting that “even the temporary or partial impairments to property rights that attachments, liens, and similar encumbrances entail are sufficient to merit due process protection.”

Significantly, the Doehr court limited the scope of Speilman-Fond v. Hanson’s, Inc., one of the primary cases on which the Connolly majority relied in upholding the California lien statute:

Our summary affirmance in Speilman-Fond...does not control. In Speilman-Fond, the District Court held that the filing of a mechanic’s lien did not amount to the taking of a significant property interest....A summary disposition does not enjoy the full predecent value of a case argued on the merits and disposed of by a written opinion....The facts of Speilman-Fond presented an alternative basis for affirmance in any event. Unlike the case before us, the mechanic’s lien statute in Speilman-Fond required the creditor to have a pre-existing interest in the property at issue....[A] heightened plaintiff interest in certain circumstances can provide a ground for upholding procedures that are otherwise suspect....

Soon after Doehr, the First Circuit struck down a federal statutory lien that could be imposed on real property under federal environmental law, without notice or hearing. Had Doehr and Reardon been available to the Connolly dissenters, California’s mechanic’s lien statute may not have survived the due process challenge in 1976.

In response to the invalidation of Rhode Island’s mechanic’s lien law, the Rhode Island General Assembly passed an amended statute providing for a due process hearing before an owner’s property can be encumbered. Other states already have such procedures on the books, including Maryland, where the property owner is given notice and a right to a prompt hearing.

Once the dust generated by recent political events in California settles, the legislature will undoubtedly continue to propose and consider amendments to California’s mechanic’s lien law. In doing so, the legislature should look not only to recent court activity that calls the constitutionality of the law into question but also to statutes in other states that have enacted due process protections that balance the rights of lien claimants and property owners.

1 Randone v. Appellate Dept., 5 Cal. 3d 536, 544 (1971).
2 Id. at 541.
Leveraging the Low-Income Housing Tax Credits Program

Ted M. Handel is of counsel to Loeb & Loeb, LLP, where he leads the firm’s Affordable Housing Practice Group. David C. Nahas is president of Veloce Partners in San Juan Capistrano.

By Ted M Handel and David C. Nahas

Affordable housing project financing requires creative mixing of federal and local sources

Seventeen years after it was enacted into law as part of the Tax Reform Act of 1986, the federal low-income housing tax credit (LIHTC) program is generating $6 billion in housing investments and creating more than 115,000 affordable rental housing units nationwide each year for low-income families, seniors, the homeless, and persons with special needs. LIHTCs are part of an overall sophisticated financial structure for developing decent, safe, affordable rental housing and related amenities. This structure includes raising equity through partnerships with tax credit investors, leveraging private and public funds to cover gaps in construction and permanent financing, and obtaining loans and grants to create child care facilities and community rooms.

Access by developers to LIHTCs and other financial resources is essential in meeting the critical shortage of affordable housing both locally and nationwide. In Los Angeles, Mayor James Hahn’s advisory committee noted, “Los Angeles has far too few housing units, those that do exist are often overcrowded and riddled with substandard conditions, and rents vastly exceed the earning capabilities of a significant percentage of the city’s population.”

This demand creates significant business opportunities for developers and owners of rental properties. Many properties are ripe for financial restructuring as rehabilitation is needed, market conditions change, or owners seek to reposition portfolios and address tax concerns. Developers and owners can use a variety of specialized financing programs to achieve their financial goals while responding to this essential public need.

In enacting IRC Section 42, Congress created the LIHTC program to tie “affordable housing syndication and tax benefits...to the income of those units is comparable to that of the low-income units.” The eligible basis is determined at the end of the first year of the credit period (subject to reduction for federal subsidies). Only building costs are included, not land costs. Building costs include related structures, such as recreational and parking facilities, if provided to all tenants at no cost. Eligible costs also generally include those incurred to design and construct the improvements—including construction loan interest and local government fees—while costs for permanent financing and reserve funds are ineligible. In addition, the basis can include developer’s fee for the for-profit or nonprofit entity creating the housing.

For acquisitions, only depreciable property is included in the basis. Projects involving substantial rehabilitation may include only expenditures within a 24-month period that can be capitalized. “Substantial rehabilitation” means that rehabilitation expenses must either equal at least 10 percent of the building’s adjusted basis at the beginning of the 24-month period or cost at least $3,000 per low-income unit, whichever is greater. For new construction, only costs that can be capitalized are included. Also, the eligible basis may be increased to 130 percent for new construction in areas of difficult development or high-cost adjustment.

The building’s qualified basis is then calculated as the portion of the eligible basis that is used for low-income tenants, based on the percentage of total units or the number of low-income units in the building.
floor space, whichever is less. The initial qualified basis is determined on the last day of the first year the building is placed in service or, at the owner’s election, on the last day of the following year. The owner must maintain the initial qualified basis throughout the 15-year compliance period.

In exchange for receiving LIHTCs, a project must truly be affordable to its tenants. Gross rents are limited to 30 percent of the qualifying-income standard applicable to the unit, adjusted for family size. Gross rents include a utility allowance and the cost of any services that tenants are required to pay. The building must also be used on a nontransient basis; that is, initial leases must usually have a six-month term.

A property must be restricted for rental to households that satisfy one of two set-aside tests—either 20 percent of the units must qualify at or below 50 percent of the Area Median Income (AMI) established by HUD, or 40 percent must qualify at or below 60 percent of AMI. AMI is determined annually according to small geographic regions, such as a county or Metropolitan Statistical Area. The AMI for a family of four in Los Angeles is $56,400. Once a project is placed in service, the project owner must make an irrevocable election as to which set-aside test will be applied to the project.

**Allocating Tax Credits**

After the LIHTCs have been calculated and a pro forma financial statement has been prepared that shows that, based on applicable rent restrictions, the project is financially feasible, the project must actually qualify for an allocation of 9 percent credits. This is far from automatic. First, Congress imposes a limit on the number of 9 percent credits that are available nationwide, and they are allocated on a per capita basis among the states. In fiscal year 2000, Congress increased the per capita amount from $1.25 to $1.50 for 2001, to $1.75 for 2002, and indexed the rate for inflation beginning in 2003. Applying this formula, California was allocated approximately $61 million in LIHTCs in 2003.

Each state is delegated the responsibility for allocating its share of LIHTCs. In 1987, the California Tax Credit Allocation Committee (TCAC) was established in the state treasurer’s office. The TCAC comprises three voting members (the state treasurer, the state controller, and the governor or his or her finance director department or director) and four advisory members (the California Housing Finance Agency executive director, the Housing and Community Development Department director, and two local government representatives).

Each state is required to adopt a Qualified Allocation Plan (QAP) to administer the allocation process. A QAP must give preference to projects serving the lowest income tenants and those whose affordability is restricted for the longest period, as well as those located in qualified census tracts. Project selection criteria require that consideration be given to project location, housing needs, the characteristics of the project and its developer, the requirements of persons with special housing needs and individuals with children, and public housing waiting lists.

The TCAC has adopted a QAP that goes beyond the federal requirement that 10 percent of the LIHTCs be set aside for projects developed by qualified nonprofit organizations. The California QAP also mandates that a percentage of the state’s allocation be made available for certain types of housing projects, such as those in rural areas and ones serving persons with special needs, such as the homeless.

The TCAC estimates that the demand for LIHTCs exceeds the credits available for allocation by a factor of 4 to 1 and therefore uses a competitive allocation process. The committee employs a point scoring system, and experienced developers file applications that are assured of qualifying for the maximum number of points. The TCAC then uses a series of tiebreakers that change periodically in response to state housing policy, to make the final allocations. Recent tiebreakers have emphasized large family developments with 3 or 4 bedrooms over senior and special needs projects with 1 and 2 bedrooms.

Once a project receives an allocation, the developer raises project equity by marketing the LIHTCs to prospective investors. While the developer may use the credits itself, this is uncommon because nonprofit developers generally do not pay federal income taxes, and for-profit developers usually do not have income tax liabilities equal to the credits they receive.

Instead, developers typically form a limited partnership or limited liability company to own the project and allow the LIHTCs to flow through to investors. Developers usually retain a .01 percent interest in the project during the compliance period and the investor receives a 99.99 percent limited partnership interest in exchange for making its capital contributions.

In the program’s early years, LIHTCs were not in wide demand as investments because of sunset provisions contained in the original statute and the perceived risk of developing and managing an affordable housing project. Because corporations showed little interest in the tax credits, syndication funds were created and used public offerings to attract individual investors. When the LIHTC program was made permanent in 1993, corporations began acquiring the credits directly and through syndication funds. Corporations now constitute virtually the entire market of LIHTC investors and include banks and insurance companies as well as Fannie Mae and Freddie Mac. Banks not only receive the credits and other tax benefits but use these investments to meet federal Community Reinvestment Act obligations.

Over time, the LIHTC market stabilized in California and elsewhere. Initially, developers received as little as 40 or 50 cents for each dollar of LIHTCs, and investors were rewarded with significantly high returns. Today, LIHTCs are generally priced in California at 80 to 84 cents on the dollar, and developers continue to seek higher prices. While investors’ returns have declined correspondingly, this has been offset by the acknowledgment that low-income housing is not generally a risky venture. If anything, the

**Calculating the Value of Tax Credits**

The following scenario describes the value of 9 percent tax credits in the development of an affordable housing project. The scenario assumes that all units are used for qualified low-income tenants.—T.M.H. & D.C.N.

<table>
<thead>
<tr>
<th>Calculation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total development costs</td>
<td>$10,000,000</td>
</tr>
<tr>
<td>Less ineligible costs</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Eligible basis</td>
<td>$8,000,000</td>
</tr>
<tr>
<td>Percentage of low-income tenants</td>
<td>100</td>
</tr>
<tr>
<td>Qualified basis</td>
<td>$8,000,000</td>
</tr>
<tr>
<td>Assumed current 9% credit</td>
<td>Factor 7.75%</td>
</tr>
<tr>
<td>Annual credit available</td>
<td>$620,000</td>
</tr>
<tr>
<td>Total value of 10-year credit</td>
<td>$6,200,000</td>
</tr>
<tr>
<td>Typical value ratio to an investor</td>
<td>$0.80/$1.00</td>
</tr>
<tr>
<td>Potential equity to developer</td>
<td>$4,960,000</td>
</tr>
<tr>
<td>Required loans or subsidies</td>
<td>$5,040,000</td>
</tr>
</tbody>
</table>
opposite is true: A 2002 study found that the foreclosure rate for low-income housing was 0.14 percent, or 100 times less than the rate for commercial properties.36

Managing a LIHTC Project

When a tax credit investor enters into a partnership with a developer, a comprehensive partnership agreement is negotiated. Under the agreement, the developer/general partner must achieve certain benchmarks before the investor will make capital contributions. These benchmarks often involve achieving, by a mutually agreed-upon deadline, certain levels of construction completion and occupancy. Investors usually require developers to cover project cost overruns and to guarantee that the investor will actually receive the LIHTCs applied for or else face a reduced capital contribution. Agreements also regulate distribution of project cash flow, allocate profits and losses, and tax benefits, and provide for project disposition at the end of the 15-year compliance period.

Developers put projects out for bid and receive offers from prospective investors. The successful investor is not necessarily the one who offers the highest price but often the one whose guarantee and tax credit adjusts are the least onerous from the developer’s perspective. Developers also consider the investors’ asset management requirements, including the deadlines for submitting financial and asset management reports and the penalties for noncompliance.

A developer must satisfy certain tax requirements after receiving an allocation. The first is the carryover allocation—that is, 10 percent of the anticipated project costs must be spent by the later of six months from when the allocation was made or the end of the calendar year in which the allocation was received.37 This 10 percent test is critical and involves technical issues over whether an expense has been incurred. Owners retain accountants to prepare 10 percent test letters to provide to allocation agencies. The project owner must also generally place buildings in service by the end of the second year after the year in which the allocation was made.38

A cost certification must be submitted to the state allocating agency confirming the actual project costs.39 The agency then uses this certification to determine the actual LIHTCs for the project and issues an IRS Form 8609 which the developer attaches to its annual partnership tax return. In addition, project owners must enter into a long-term regulatory agreement,40 annually certify tenant incomes to ensure compliance with rental restrictions, and keep appropriate financial records.41 LIHTCs are subject to recapture in whole or in part under certain circumstances. Full recapture can occur if the owner fails to meet the applicable set-aside test that it has elected.42 Partial recapture can happen if the qualified basis amount decreases from the prior year or the percentage of units occupied by low-income tenants falls below the designated percentage.43

Tax-exempt bonds provide an alternative means of financing a housing project. In California, a developer must receive approval from the California Debt Limit Allocation Committee (CDLAC) in the state treasurer’s office. Like the process followed by TCAC for LIHTC allocations, CDLAC employs a competitive bond allocation process for housing. This is because of congressional limitations on the amount of private activity bonds that each state may issue annually.

Projects financed by qualified private-activity, tax-exempt bonds can receive 4 percent tax credits for new construction or rehabilitation costs. These credits are not awarded competitively and are available to any project that receives approval for the bond issuance.44 However, at least 50 percent of the project’s development costs must be financed with tax-exempt bonds to qualify the entire project for these tax credits.

The tax-exempt bond process requires a housing developer to agree to rental restrictions similar to those used for 9 percent credits. Further, the bonds must be issued by a public agency authorized by state law to serve as a housing bond issuer. Most cities, counties, housing authorities, and redevelopment agencies can perform this role. The California Housing Finance Authority (CalHFA) and several joint-powers authorities serve as bond issuers on a statewide or regional basis.

Developers obtain two benefits from tax-exempt bond financing: access to long-term financing at attractive tax-exempt interest rates and avoidance of the often keen competition for 9 percent credits.

Leveraging Public Funding

While LIHTCs and/or tax-exempt bonds may cover a significant portion of the cost of constructing or rehabilitilitating an affordable housing project, they almost never provide sufficient funds to finance an entire project. Developers must qualify for and obtain a permanent first mortgage. However, lenders will limit the loan to the amount they determine the project can reasonably support based on applicable rent restrictions. This requires finding other public sources to subsidize a project and make it economically feasible.

Several federal programs provide direct financial assistance for housing development. Generally, this consists of either rental assistance for owners and tenants or subsidized loans and grants for property development. Most programs originate within HUD but are often administered at the state or local level.

Section 8 of the United States Housing Act of 193745 is the most well-known rental assistance program. Historically, Section 8 provided owners with project-based rental assistance if they agreed to enter into long-term contracts (often 10 to 20 years) with HUD or a local housing authority. Under these agreements, tenants paid monthly rent equal to 30 percent of their household income, and HUD paid a monthly subsidy directly to the landlord. The subsidy amount is the difference between the tenant’s rent payment and a HUD-determined fair market rent that reflects market conditions and any unique project operating costs.

HUD is now increasingly shifting its focus from project-based to tenant-based rental assistance. Accordingly, under the current Section 8 program, HUD issues rental vouchers directly to income-qualified tenants rather than enter into long-term rental assistance contracts. Tenants then use these vouchers at any property of their choice, and landlords must compete to attract and retain qualified tenants.

Many properties with Section 8 project-based subsidies were financed through HUD-insured loan programs that imposed a rent regulatory agreement. As project-based subsidies expire and loans become eligible for prepayment, current owners can terminate the rent restrictions and subsidies and convert properties to market rate projects. The affordable housing community refers to these projects as “at risk” and is making an intense effort to preserve their affordability. At-risk properties are attractive to affordable housing developers because they often meet the 10-year hold requirement for acquisition LIHTCs and transactions can be readily completed without the delays associated with new construction.

Annual appropriations under the Community Development Block Grant (CDBG) and HOME Investment Partnerships Act programs are another funding source. These programs provide direct financing subsidies to cities, counties, and states based on a per capita allocation formula. Public agencies can use CDBG and HOME funds for community development, infrastructure, and housing.46 Developers often receive loans funded by HOME or CDBG proceeds to fill in their financing gaps. These subordinate loans are long term, typically bear a low interest rate, and are repaid only from residual receipts (i.e., project cash flow remaining after pay-
ment of the first mortgage and operating expenses).

The state of California has long been another public source of housing development funds. The Housing and Community Development Department (HCD) administers most state funding programs; however, CalHFA also offers loan programs to developers and local public agencies. Certain HCD programs involve distribution of Federal HOME and other specialized program funds. Others are funded by voter approved bond measures like the Multifamily Housing Program (MHP) created by Proposition 46 in November 2002. MHP funds are available for new construction or acquisition and rehabilitation of projects not using 9 percent credits. The program helps fill the gap that occurs because equity from 4 percent credits is approximately half the amount available from 9 percent credits.

HCD uses a competitive application process to qualify projects for MHP loans. To ensure that projects remain affordable, developers must comply with long-term rental restrictions. Loans are made for 55 years at 3 percent interest and repaid primarily from residual receipts. Project owners must provide a high percentage of units of three or more bedrooms to serve large families or provide specialized social service programs to serve residents with special disability needs.

Los Angeles has also been a leader in the effort to fund affordable housing. The city recently established an Affordable Housing Trust Fund to accrue funds from a broad range of sources (HOME, CDBG, local general fund appropriations, and specialized energy conservation funds) and distribute them to developers through a single application process.

Inclusionary zoning and “in-lieu” fees are an additional source for creating housing or raising funds. Inclusionary zoning ordinances require developers of new market rate projects (i.e., apartments or single-family home subdivisions) to construct a certain percentage of rent-restricted units based on the overall size of the market rate project. Some programs allow developers to pay a fee in-lieu of building the affordable units, and these fees are then made available to develop affordable housing throughout a community.

City redevelopment agencies may be a subsidy source. California law allows redevelopment agencies to be formed to improve blighted communities. These agencies designate redevelopment plan areas, which are neighborhoods meeting certain blight criteria. Once established, a plan area normally exists for 20 to 30 years. At the outset of a redevelopment plan, property tax assess-
ments are fixed at a presumed low level due to the area’s depressed economic state. As improvements take place over time and assessed values and property tax revenues rise, the agency retains the tax revenue above the initial base rate (known as the “tax increment”) to fund redevelopment efforts. California law requires that 20 percent of the tax increment be used strictly for affordable housing—an appropriation referred to as “housing set-aside” funds. Remaining funds are used for agency operating costs and redevelopment of commercial properties. In this way, redevelopment agencies are usually financially self-sufficient and do not rely on funding from general tax revenues.

A successful housing project involves more than making the units affordable. It also means providing tenants with access to essential services. The competitive application processes used by TCAC, CDLAC, HCD, and Los Angeles each take these into consideration. When developers apply for LIHTCs, a bond allocation, or a loan, a detailed description of on- and off-site amenities must be provided. TCAC, for example, awards points for projects located within certain distances of schools, public transportation, parks, and shops. Developers also often set aside project space for child care facilities and community rooms to gain additional points.

Putting the Programs into Action

Affordable housing developers may be motivated by one or more goals, including serving an important social need, earning reasonable development fees and future cash flow, and participating in complex development projects with a more modest equity investment than market rate developments require.

Developers, however, face several challenges in today’s strong real estate market. Vacant land with appropriate entitlements is scarce, competition has driven land costs upward to record highs, and neighborhood opposition to increased growth continues to mount. Most developments also involve a variety of complex financing programs whose application processes, restrictions, and availability are not well coordinated nor provide quick approvals.

On the other side are property owners who hold difficult-to-develop vacant parcels or older multifamily properties needing financial restructuring or rehabilitation. When properties are located in modest rental markets where the spread between market and restricted “affordable” rents is small, transitioning to affordable housing may present a good opportunity for both parties.

Property sellers frequently face significant tax implications associated with sales of

---

**DAVID OSTROVE**

- Expert Witness — 43 years
- Lawyer/Accountant Malpractice
- Forensic Accounting
- Tax Matters
- Business Valuation
- Value of Services
- Computation of Damages
- Mediator, Arbitrator

Tel 310-255-6114 Fax 310-391-4042 Email am@ffslaw.com

3415 S. Sepulveda Blvd, Los Angeles CA 90034

---

**REAL ESTATE ARBITRATOR**

- Over 30 years experience as a real estate lawyer dealing with industrial, commercial, office and shopping centers including purchases, sales, leasing, ground leasing, financing, development, joint ventures, construction, brokerage, title insurance, easements and protective covenants.
- 18 years as counsel to the forms committee of the American Industrial Real Estate Association, publishers of the AIR lease and purchase forms.
- Real estate law and ADR lecturer on CA State Bar sponsored programs, the extension divisions of UCLA, UCI, UCSB and various educational and realty organizations.
- AAA Commercial Panel Member.

---

Jean’s been at the helm since the first day you became counsel to the company.

You have always counted on each other to get things done.

Now, Jean is facing personal workplace challenges and needs an attorney. She’s counting on you for a “great referral.”

Doesn’t Jean deserve an attorney who specializes in executive matters?

One who has represented over 500 senior executives?

---

The Senior Executive is our only Client!

Severance Packages Release Agreements Employment Contracts Crisis Representation

To learn more about us, please visit our website at www.execlaw.com.

Executive Law Group, Inc.

888.920.EXEC (3932)
While no magic solution exists for each tax problem, several beneficial techniques are available in the affordable housing arena beyond the traditional Section 1031 tax-deferred exchange. The Internal Revenue Code provides an extended exchange period of up to 24 months for properties sold under threat of condemnation. Many public agencies can accommodate a seller by making the required condemnation findings in the context of a proposed affordable housing transaction. If so, a seller who meets this criteria can obtain additional time to find an appropriate replacement property, something particularly useful in markets where quality properties are scarce and asking prices are at a premium.

Sellers can also convert equity to a tax-exempt investment by providing seller financing for a portion of the property sale price. If permitted by the issuer in a tax-exempt-bond financed transaction, the seller may receive carryback financing in the form of a subordinate tax-exempt bond that bears interest at an above-market rate. Such loans may also be eligible for installment sale tax treatment or structured with interest-only payments to maximize tax deferral.

If a property can be appraised at a value exceeding the agreed purchase price and the buyer is a nonprofit entity, the seller may receive a charitable-donation tax deduction for the difference in value. When historic properties are involved, a charitable donation deduction may also be claimed for the value of granting a "façade easement." These easements preclude future changes in the façade of a historic structure and are based on the diminution in value resulting from foregoing alternative development.

Mutually beneficial negotiations between buyer and seller can achieve the simplest benefits. Cooperative sellers can receive an above market price for a property in exchange for allowing the buyer an extended escrow closing period in which to obtain necessary zoning and financing approvals.

Structuring an affordable housing deal today is a sophisticated undertaking, especially in California. In-depth familiarity with federal and state LIHTC requirements, the ability to leverage public and private financing sources, and persistence are each essential to this task. However, as the 17-year history of the LIHTC program demonstrates, when this is achieved, developers and investors gain financially, and the community benefits through the availability of more affordable housing.

1 Affordable housing is defined by the U.S. Housing and Urban Development Department as any dwelling where tenants pay 30% or less of their income in rent.
The exact percentage varies as interest rates change and is currently below 8% for 9% credits and 3.5% for 4% credits.

The building must also have been acquired by purchase from an unrelated person or party and must not have been placed in service or substantially rehabilitated within 10 years of the acquisition. The rehabilitation will be capitalized separately to keep track of the respective 4% and 9% credits for the property.

For capitalization of costs generally, see I.R.C. §263A.


Use of CDBG and HOME funds does not constitute a federal subsidy for purposes of the LIHTC program, provided, with regard to HOME funds, 40% of the units are targeted at 50% or below of AMI.


See I.R.C. §42(h)(4).


Use of CDBG and HOME funds does not constitute a federal subsidy for purposes of the LIHTC program, provided, with regard to HOME funds, 40% of the units are targeted at 50% or below of AMI. See §§42(i)(2)(D) and (i)(2)(E).


I.R.C. §1033(a).

CAL. CODE REGS. tit. 4, §10325(c)(12) (2003). TCAC Executive Director Jeanne Peterson announced on November 5, 2003, that she anticipates changes in the tiebreakers as part of the 2004 QAP and TCAC regulations.


Health & Safety Code §33131(a).

CAL. CODE REGS. tit. 4, §10331(a).

CAL. CODE REGS. tit. 4, §10334.2(a).


I.R.C. §1033(a).
California's construction industry perceives itself as besieged by three significant legal developments that are raising lending costs, liability risks, fees, and emergency costs. First, owners must now secure their payments to contractors under Civil Code Section 3110.5. Second, Senate Bill 800, the California Legislature's mechanism to discourage construction defect litigation, may not succeed, despite its lofty intentions. Third, developers who unknowingly fail to obtain contractor's licenses are in some instances facing the possibility of having to disgorge all their fees under recent amendments to Business and Professions Code Section 7031(b). In addition to these legislative changes, owners, contractors, and developers must address increasing risks to their projects from natural disasters and acts of violence by implementing effective and comprehensive crisis management plans.

**Civil Code Section 3110.5**

Civil Code Section 3110.5 became effective January 1, 2002. For decades, contractors used “pay-if-paid” clauses to forestall paying their subcontractors until the owner paid the contractor. In 1997, two courts held that pay-if-paid clauses constituted unconstitutional waivers of the subcontractors’ mechanics’ lien rights. The courts argued that if contractors were never paid by the owner, the subcontractors’ lien rights would never ripen. The most obvious solution to this alleged waiver of lien rights would have been to allow subcontractors the right to record their liens on an owner’s property once the owner’s undisputed payment to the contractor was more than 30 days late, even if a pay-if-paid clause was present in the subcontract. However, when the courts struck down the pay-if-paid clause, they unknowingly placed contractors in the role of financial guarantors who might be required to pay their subcontractors prior to receiving payment from the owners.

Seeking to relieve contractors from this alleged guarantor role and instead of strengthening traditional remedies for nonpayment...
Section 3110.5 defines “escrow accounts” with the most detail. The escrow holder must be licensed or exempt from licensing under the Escrow Law contained in the Financial Code. The escrow account must be located in California. Also, the owner must establish that the contractor has “a perfected, first priority security interest” in the escrow account. Priority may be established by written opinion of counsel, although this may increase transaction costs and malpractice risks when using escrow accounts.

Under the terms of the statute, and by implication, the bonds, LOCs, or escrow accounts should be limited to the financial obligations of the owner to make timely payments of undisputed amounts under the contract.

Under Section 3110.5, owners have only 10 days to post security after a contractor’s demand, or the contractor can stop all work. Because Section 3110.5 cannot be waived, owner’s counsel should search for possible exemptions. For example, majority owners of the contractor are exempt from posting security. Also, owners that are companies with “investment grade” nonsubordinated debt securities traded on the New York, American, or NASDAQ stock exchanges are deemed “qualified” and also are exempt. If a qualified company’s stock is downgraded below investment grade, the company will no longer be exempt from Section 3110.5. Also, an owner is excluded if it is a wholly owned subsidiary of a qualified company, provided the parent guarantees “the obligations of the subsidiary under the construction contract.” Further, “qualified private companies” with “net worths” in excess of $50,000,000 are exempt. The net worth must be calculated according to generally accepted accounting principles. The statute is silent as to how that net worth must be demonstrated—whether by letter, certificate, affidavit or declaration under penalty of perjury, or unqualified or qualified opinion—or by whom.

These exemptions, based on financial strength, are prejudicial to smaller owners and often unrelated to the alleged purpose of securing timely payment. Smaller owners with excellent payment histories will be burdened with additional costs, while qualified owners with bad payment histories can avoid Section 3110.5’s compliance costs. An owner’s good payment history, coupled with the traditional remedies, worked well for decades before Section 3110.5 became law.

Also, the vagueness of Section 3110.5 raises ambiguities that can only be resolved by courts or legislative revisions. For example, Section 3110.5 exempts the single-family residence, which the section defines as a “dwelling unit for one family.” But many condominiums are now detached single-family units. Counsel for detached single-family condominium projects should determine whether their clients’ interests are best served by arguing for Section 3110.5 application or not. Moreover, the statute does not seem to prevent the owner who lacks sufficient bonding capacity from requiring a bond guarantee from the contractor. However, such an arrangement arguably would constitute an impermissible waiver of the statute. Further, the bond language requires payment if the owner is 30 days late, while there is no similar requirement for LOCs or escrow accounts. Perhaps this is an oversight that should be remedied by legislative amendment.

Owner’s counsel have several options for dealing with Section 3110.5. First, owners can claim they are qualified companies. Second, owners can obtain guarantees from qualified parent companies. The third, and most common option, is for owners to do nothing, because the statute does not provide a penalty for noncompliance.

Noncompliance, however, is risky. Once the contractor serves a demand for security, it can stop all work if the security is not posted in 10 days. In addition, if a construction loan is obtained, ignoring Section 3110.5 may violate the lender’s standard requirement that the borrower comply with all laws. Counsel for lenders and borrowers should negotiate a “stand by” bond, LOC, or escrow account that can be implemented within 10 days of a contractor’s demand.

**Senate Bill 800**

Section 3110.5’s attempt to provide a reliable mechanism for prompt payment to contractors may not be the remedy the construction industry hoped for, but its deficiencies probably will not, by themselves, stop owners and contractors from continuing to build projects in California. Indeed, payment issues are only one concern. Construction defect litigation, with its alarming scope and frequency, arguably eclipses payment issues as one of the greatest risks facing California’s construction industry. The devastating costs of defect litigation puts a severe strain on the parties’ resources, and they are among the reasons, along with the resulting repairs and insurance payouts, for the escalating prices and scarcity of new housing. In fact, construction defect litigation has severely limited the choices and options for construction insurance programs.

Hours before the close of the 2002 legislative session, the plaintiff’s bar, contractors, developers, and lawmakers attempted to
address these problems as well as their varying interests by enacting a measure aimed to reduce construction defect litigation. SB 800 sets forth the first statewide statutory scheme detailing what constitutes construction defects, warranties, repair obligations, and "prelitigation procedures" (further described as "nonadversarial" procedures)—all in an effort to settle defect disputes without litigation. Moreover, SB 800 attempts to provide flexibility so that builders arguably can modify the prelitigation procedures or warranty obligations and disclose these modifications to the buyers of a residential unit. In SB 800, the term "builder" does not include the contractor, subcontractors, and suppliers but, instead, is defined as the "builder, developer or original seller" of a residential unit.3

Prior to the enactment of SB 800, construction defect litigation was often initiated by counsel who first hired experts to find defects that allegedly caused economic losses to the project, then filed suit on behalf of homeowners under a strict liability theory and on a contingency fee basis. Typically, plaintiffs settled with the insurance companies for the value of the alleged defects, and from this amount the lawyer’s contingent fee was paid. This common scenario sometimes left less money for repairs than was needed.

SB 800 provides a process for homeowners to receive either repairs or compensation for deficiencies in the construction, design, surveying, planning, supervision, or testing of their residential dwelling. First, SB 800 attempts to set standards for "every function or component of a structure" for which the builder, subcontractors, suppliers, manufacturers and designers can be found liable.6 These standards, commonly called functional standards, address water barrier systems, structural systems, soil issues, fire protection systems, plumbing systems, electrical systems, manufactured items, hardscape, noise transmission, irrigation systems, untreated wood posts, untreated steel fences, paints, stains, landscaping, tiles, dryer ducts, structural safety, HVAC systems, fireplaces, chimneys, mechanical systems, retaining walls, stucco, exterior siding, shower and bath enclosures, foundations, decks, roofs, windows, doors, flashings, trim, and code compliance—and include a catch-all provision for all other unlisted components that cause damages.8 The builder must provide a one year "fit and finish" warranty and has the option of increasing the length and scope of the warranty by providing an "enhanced protection agreement" to homeowners at the time of sale.10

If a homeowner believes any functional standards were violated by the builder, the homeowner may assert claims under the warranty, enhanced protection agreement, or Chapter 4 of SB 800.11 To assert a claim under Chapter 4, the homeowner must comply with certain nonadversarial prelitigation procedures before commencing any construction defect litigation.12 The builder must cooperate during the prelitigation procedures by, among other things, providing timely acknowledgment of the claims, and providing access to relevant plans, specifications, and other documents.13 The builder may elect to inspect the claims and make offers to repair or provide compensation for the alleged defects.14 The offer to repair must include an offer to mediate the claim. If the homeowner elects to mediate and the mediation proves unsuccessful in settling the claim, the homeowner must allow the builder to carry out the offered repair.15 If the builder fails to timely comply with any prelitigation procedure, or if the prelitigation procedures fail to settle the claim, subsequent litigation may still occur.16

SB 800 attempts to forestall litigation pending the prelitigation procedures. Although the builder must deal directly with the claimant, the claimant’s counsel must be copied on all communications.17 The prelitigation procedures require the builder to acknowledge the claim within 14 days and, if the builder elects to conduct an inspection, it must complete the inspection within 14 days after acknowledgment. If the builder deems that a second inspection is reasonably necessary, then a second inspection may be conducted within an additional 40 days. Within 30 days after the inspections are completed, the builder may offer to repair the problem and to pay certain limited damages to the claimant. Builder’s counsel should ensure that the offer to repair contains the specific

---

**SB 800 Statutes of Limitations and Deadlines**

SB 800 provides a series of statutes of limitations that run from three possible dates: 1) the date the residential unit at issue is transferred to the homeowner; 2) the date of substantial completion; or 3) the date of occupancy of an adjacent unit when attached structures are involved.1 The length of the limitations period depends on which of the functional standards are at issue. Most of the shorter statutes of limitations affecting claims by individual homeowners run from the date of the close of escrow, which could, in large projects, occur long after the date of substantial completion of the structure in which the unit is located. The functional standards contain numerous individual statutes of limitations ranging from one to 10 years for various building categories. Since many construction contracts have warranties that expire one year after substantial completion, many project builders—SB 800 uses the term “builder” to identify the “builder, developer or original seller” of a residential unit—may find themselves making repairs long after the warranties received from contractors, suppliers, and subcontractors have expired.

The statute of limitations period is extended during the SB 800 repair and mediation process. Once the process is completed, the claimant may sue, but the damages for construction defects will be limited if the repair has been performed properly. If the statute of limitations has run during the prelitigation procedures, the statute "is extended from the time of the original claim by the claimant to 100 days after the repair is complete, whether or not the particular violation is the one being repaired."2

If the builder makes an offer to repair, the homeowner has 30 days within which to make an election to accept the offer, to request the names of three alternate contractors to perform the repair, or to request mediation. Mediation must proceed within 14 days after it is requested. The mediator is chosen by and paid for by the builder unless both parties elect to choose and pay for the mediator. The mediation is limited to four hours unless mutually extended by the parties. At the end of the mediation, the parties either agree on a resolution or the claimant must allow the offered repair to be performed. Repairs must proceed with "utmost diligence," must commence within the time periods stated in Civil Code Section 921, and "every effort" must be taken to complete a repair within 120 days of the homeowner’s acceptance of the offer to repair.—B.C.J.

---

1 See Civ. Code §§895(e), 896(e), 896(g)(6), 941.
2 Civ. Code §627.
Contractors must immediately produce a host of information required concerning the scope, timing, and implementation of the proposed repair, including the name of the contractors whom the builder would like to perform the repair. With all its prelitigation procedures, SB 800 does not appear to offer sufficient incentives to settle construction defect claims without subsequent litigation. Also, SB 800 may spur litigation that secures less money than is needed for all the repairs. Indeed, if the SB 800 prelitigation procedures fail, other SB 800 provisions may increase the likelihood of litigation:

- The detailed functional standards make it easier for claimants to allege a list of building deficiencies that are deemed to be construction defects by statute. Prior to SB 800, claimants had the burden of establishing that certain deficiencies in construction rose to the level of a construction defect that violated the standard of care in the industry.
- Once defects are alleged, builders and contractors must immediately produce a host of documents without the expensive and time-consuming discovery procedures common in all other civil litigation. The claimant’s reduced discovery costs and the less time required for the production of documents make litigation a less costly and more attractive option.
- Builders must inspect and provide repairs within nearly impossible time periods, which increases the likelihood of a technical failure to comply with the builder’s prelitigation duties and opens the way for claimants to commence litigation.
- Homeowners are prohibited from releasing their claims in exchange for repairs, which subjects builders to certain litigation.
- Attorney’s fees may be awarded to the claimant if the builder is unsuccessful in staying litigation brought by a claimant who did not complete the prelitigation procedures. This can occur if the builder fails to meet any of its prelitigation duties within the specified time limits, thereby allowing a claimant to bring litigation before exhausting the prelitigation procedures.

However, builders received a few potential benefits under SB 800. The statute of limitations for certain functional standards was reduced from 10 years to shorter periods, although the catch-all provision arguably allows for the full 10-year statute of limitations to apply to all functional standards not specifically listed in SB 800. When the repair is completed, if no prior mediation occurred, mediation must commence before filing an action. A builder can cite repairs as defenses in subsequent litigation. Finally, if a cash settlement is provided, the builder can obtain a release from the homeowners—but a repair on its own cannot result in a release.

The builder also must compensate the claimant for all damages resulting from the repair. Alternatively, the builder may elect to repair some but not all of the alleged defects, allowing the unrepaired alleged defects to be litigated. SB 800 repair damages are limited to the reasonable value of repairing any violation of the functional standards, any damages caused by the repairs, the cost of removing and replacing an improper repair by the builder, reasonable relocation and storage expenses, lost business income if the home is licensed to be used as the principal place of business, reasonable investigative costs, and all other costs or fees recoverable by contract or statute. Under SB 800 the homeowner can pick one of three contractors presented for repairs, which may raise concerns if the original subcontractor is not picked to perform the repairs. Under most form contracts, the original contractor generally has a right to repair defective work for a period of one year after substantial completion or the builder may have waived its claims for breach of warranty against the original contractor.

Builder’s counsel should advise the builder to “buy down” any high contractor or designer insurance deductibles and hire only economically strong subcontractors to facilitate repairs by the original subcontractor or other subcontractor elected by the homeowner. Further, counsel should recommend that the builder offer the homeowner an enhanced protection agreement under SB 800 that can be structured to provide timely repairs of any functional standards for a number of years rather than the one-year warranty for fit and finishes typically provided by builders. Such an enhanced protection agreement should make it easier for the homeowner to seek defect remedies through the enhanced protection agreement rather than by asserting a prelitigation procedure claim followed by litigation. Further, this strategy helps avoid the expensive prelitigation option of the homeowner choosing someone other than the builder and its contractors for carrying out the repairs. However, such enhanced warranty programs “may not limit...or lower” the protections provided in the functional standards or one-year warranty.

To cure the insurance deficiencies and excessive deductibles, counsel may suggest project-specific “wrap” policies that can be designed to provide coverage for worker’s compensation, commercial general liability, professional liability, automotive liability, excess umbrella coverage, builder’s risk, and other types of coverage all controlled by either the owner or the contractor to ensure payment of premiums, claims control, and reasonable rates through greater purchasing power. These wrap policies are often called Owner Controlled Insurance Programs (OCIPs) or Contractor Controlled Insurance Programs (CCIP), depending on who is providing the wrap. In today’s insurance markets, wraps often are the only source of condominium project-specific insurance with adequate levels of coverage, reasonable deductibles, and related terms.

Another vexing issue arises when claimants are homeowner’s associations. Claims from associations are not only subject to SB 800 but also the “Calderon Process.” Under Calderon, the association must serve the builder or contractor with notice of litigation that lists the defects, the extent of the defects, and a summary of any tests. This
notice starts a 180-day dispute resolution period during which documents are produced, case management plans are agreed upon, inspections and testing are conducted, other contractors and designers are joined, insurance carriers are notified, settlement negotiations occur, document depositories are established, and discovery references are appointed. If the claims are not settled during the 180-day period, a complaint may be filed with trial priority. Compliance with Calderon arguably is excused if SB 800 is enforced in a manner substantially similar to Calderon.

However, in some respects, SB 800 and Calderon appear at odds with each other. For example, the Calderon Process takes a minimum of six months before litigation commences, while the SB 800 prelitigation procedures are often completed in half that time. Also, Calderon generally leads to a liquidated settlement amount without repairs, while SB 800 requires repairs, payments, or mediation. Many wonder how a builder is supposed to satisfy these opposing interests. It generally appears advantageous to utilize SB 800 in order to be "excused from performing substantially similar requirements [of Calderon]."

Builder’s counsel should consider opting out of the SB 800 prelitigation procedures by utilizing alternative contractual procedures before any sales take place. If the builder elects to opt out, then the election is binding, even if the alternative contractual procedures are not successful or are held to be unenforceable. If an opt out provision is struck down, the claimant will be able to sue without affording the builder a right to repair or mediate. In opting out, a builder might want to simplify the repair process, impose more control on the selection of the contractor, and modify time periods. However, since there is no safe harbor for opting out of the prelitigation procedures, and since a judge or arbitrator may invalidate the opt out provision and allow the plaintiff to proceed directly to litigation or arbitration, many builders choose not to opt out of the SB 800 prelitigation procedures. Rather than the all-or-nothing crap shoot of opting out, many builders are attempting to avoid utilizing the SB 800 prelitigation procedures by providing an enhanced protection agreement.

After the nonadversarial prelitigation procedures or alternative contractual procedures are completed, SB 800 generally allows the claimant to proceed to litigation. However, Civil Code Section 914(b) also states that “nothing in this title is intended to affect the applicability, viability, or enforceability, if any, of contractual arbitration or judicial reference after a nonadversarial procedure or provision has been completed.”

Thus some builders are requiring arbitration or judicial reference in lieu of litigation after the nonadversarial prelitigation procedures are completed. However, mindful of the recent case of Pardee Construction Company v. Superior Court (Rodriguez), builders requiring arbitration or judicial reference must do so in strict accordance with other statutory requirements in order to avoid claims of unconscionability, duress, and adhesion. Further, Code of Civil Procedure Section 1298.7 precludes binding arbitration in real estate contracts involving construction defects. However, the recent appellate case of Basura v. United States Home Corporation found that the Federal Arbitration Act preempted Section 1298.7 and upheld the arbitration clause as “valid, irrevocable and enforceable, save upon ground such as exists at law or in equity for the revocation of any contract.” Therefore, under Basura, “generally applicable contract defenses, such as fraud, duress, or unconscionability, may be applied to invalidate arbitration agreements.”

With Pardee and Basura in mind, builder’s counsel hoping to utilize arbitration or judicial reference after the prelitigation procedures of SB 800 must carefully follow the procedures outlined in Section 1298.7. Builders may avoid arguments of adhesion and unconscionability by offering the purchaser the choice of arbitration, judicial reference, or litigation along with a detailed description of the pros and cons of each choice in lay terms. Such choices should avoid a waiver of punitive damages or the right to a jury trial, since those types of waivers also were found to be unconscionable in Pardee. Finally, counsel might suggest that the builder pay for all arbitration or judicial reference procedures, thereby countering the Pardee argument that the homeowners did not understand the economic burdens of judicial reference or arbitration.

Contractor License Law Compliance

If SB 800 and Section 3110.5 were not enough for counsel to master, many owner’s counsel are unknowingly allowing their clients to violate California’s contractor license laws. The license laws require those who perform any aspect of construction work—including owners—to be properly licensed as contractors at all times, or else they cannot “bring or maintain” an action for payment. Specifically, unlicensed owners are in danger of losing all compensation for developing their property for third-party purchasers. Owner’s counsel

When you need an effective mediator...

Robert S. Mann, Esq.
Business and Construction Disputes

One of California’s Leading Construction/Business Litigators With 26 Years of Experience

2029 Century Park East
19th Floor
Los Angeles, California 90067

Telephone 310.556.1500
Facsimile 310.556.1577
www.constructionmediation.com
must carefully review the structure of each project to avoid such license law violations. For example, unlicensed owners often are retained to not only sell their property to a buyer but also construct a building on the property that meets the buyer’s specifications. In such a “build-to-suit” scenario, the owner is providing contracting and construction oversight for the buyer, and this requires a contractor’s license—even if a licensed contractor is hired by the owner to perform all the construction work.41 If the owner is developing the project for its own portfolio and has no current intention of selling the project (as evidenced by the owner holding the project without intention to sell for at least a year), then the owner may take advantage of the “owner/builder” exemption to the contractor license laws.42 Without an exemption, even well after the project is sold, the buyer may sue the developer for disgorgement of its build-to-suit fees because the owner failed to obtain a contractor’s license.43

Crisis Management Plans

In addition to Section 3110.5, SB 800, and contractor licensing requirements, counsel should advise their construction industry clients regarding other possible threats to their projects, including terrorism, environmental activism, and natural disaster. Recently, several upscale houses and an apartment complex in the San Diego area were destroyed by fires allegedly set by environmental activists.44 The damages were estimated at $50 million. 45 Also, late last year arson allegedly started the most destructive fire season in California history, resulting in the loss of over 3,500 homes, more than 20 lives,46 and $3 billion in damages. 47 These and other catastrophic events should alert owners and contractors to establish a crisis plan as a means to protect their investments and reputations. The overall objective of the crisis plan should be to save lives, save property, assist public rescue forces, disseminate information to the press and the public, and streamline the process of getting a project back on track as quickly as possible.

Crisis plans often fail because they do not envision all the potential risks that might impact a project. At a minimum, counsel should start with the foreseeable risk and then involve consultants and members of the company to edit, augment, and adapt the list of risks to a particular project. Counsel should evaluate sources of supplies, equipment and fuel, and vulnerable supply routes. For example, owners and contractors should consider choosing a supplier or subcontractor that has its own secure yard with materials, fuel, and equipment instead of...
relying on suppliers or subcontractors who obtain these items from sources or supply routes that may be interrupted by civil wars or terrorism. Further, counsel should negotiate contractual arrangements with local supply sources to reserve local stocks for their projects instead of other projects, even if a premium is charged for such arrangements.

The list of typical risks should include: 1) terrorism, 2) war, 3) violence, 4) vandalism, 5) labor unrest, 6) fire, 7) explosion, 8) extreme weather, including high winds, electrical storms, or flooding, 9) earthquake, 10) slope failures, 11) structural collapse, 12) drought, 13) equipment accidents, and 14) environmental activism.

When death or injury takes place on a project, litigation counsel should be retained immediately. OSHA must investigate all injuries or deaths. Counsel should retain independent consultants to preserve evidence and evaluate the causes of various injuries or damages. Expert reports can be kept confidential, if necessary, under the attorney work-product doctrine if the experts are retained by counsel.

Quickly gathering and disseminating information is critical for successful crisis management. Public relations personnel should coordinate with counsel to disseminate meaningful information in a professional way that also protects the clients’ interests. Drafts of prepared text should be included in the crisis plan so that the designated spokespersons can have a ready framework for organizing information and communicating effectively in times of extreme stress. These drafts help avoid inadvertent and inaccurate admissions of liability.

Placing the project back on track is the final task. Counsel should obtain photographs, videos, and reports by reliable experts in order to pursue insurance and public agency funds. Consultants may be necessary to evaluate site safety, security breaches, and related measures before construction resumes.

The construction industry faces numerous challenges adapting to Civil Code Section 3110.5, SB 800, and contractor licensing requirements. During the current challenging economy, the added cost and necessity of securing the owner’s payment obligations under Section 3110.5 require careful representation and artful negotiations by counsel. Perhaps lawmakers should conduct a careful reevaluation of the traditional remedies that protect contractor payments rather than impose the Section 3110.5 mechanisms. Further, SB 800 has so far failed to persuade insurance companies to lower their construction defect premiums. Despite the pre-litigation procedures in SB 800 to settle defect claims through the repair process, the finan-
cial motivations to litigate these claims remain. Also, owners must obtain contractor’s licenses when necessary to avoid losing all their fees when they knowingly or unknowingly cross the line and provide services that require a contractor’s license.

Counsel must be adept at identifying issues of liability before their clients face indefensible legal exposure. In addition, counsel should help their clients craft crisis management plans that create ways to minimize liability and loss caused by natural disasters and terrorism.


2 Civil Code §3260.2, enacted in 1998, was another legislative response to Safeco. Safeco, 15 Cal. 4th 882. Civil Code §3260.2 allows contractors to stop work upon 10-days’ notice for nonpayment of undisputed amounts by the owner. Essentially, §3260.2 provides stop work remedies similar to §3110.5 without the added teeth of the owner. Essentially, §3260.2 provides stop work remedies similar to §3110.5 without the added teeth of the owner. Essentially, §3110.5 states that the bill was proposed in response to these two 1997 decisions.


4 Civil Code §3260.2, enacted in 1998, was another legislative response to Safeco. Safeco, 15 Cal. 4th 882. Civil Code §3260.2 allows contractors to stop work upon 10-days’ notice for nonpayment of undisputed amounts by the owner. Essentially, §3260.2 provides stop work remedies similar to §3110.5 without the added teeth of the owner. Essentially, §3110.5 states that the bill was proposed in response to these two 1997 decisions. See also Civil Code §910. See also Civil Code §§910-938. See also Civil Code §913. See also Civil Code §§916-917. See also Civil Code §§910, 911. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§919, 928. See also Civil Code §§916-917.

5 Id. See Civil Code §§899-945. 5. See Civil Code §§899-945.5.

6 See Civil Code §911. See also Civil Code §919 (A repair is “to be performed either by the builder, its contractor, or the selected contractor.”) and Civil Code §§1375(g)(2), 1351(g) (A “builder” is defined as the “persons or group of persons who sign the original declaration” setting forth the Covenants Conditions & Restrictions (CC&Rs) for a common interest development.). See Civil Code §§1375 et seq.

7 See Aas v. Superior Court, 24 Cal. 4th 627 (2000), and Jimenez v. Superior Court (T. M. Cobb Co.), 9 Cal. 4th 473 (2002). Essentially, Aas barred recovery for construction defects except when the defects cause “economic losses.” However, Jimenez held that the economic loss doctrine of Aas did not bar the strict products liability imposed on manufacturers of mass-produced items installed in residential projects if those items cause damage to other construction elements in the projects. See also Civ. Code §§897.


9 Id. See Civ. Code §§899-945.5.

10 Id. See Civil Code §§890-906. See also Civil Code §§910-938. See also Civil Code §911. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §919. See also Civil Code §§915. See also Civil Code §§916-917. See also Civil Code §912. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§919, 928.

11 Id. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§919, 928.

12 Id. See Civil Code §§910, 911. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§919, 928. See also Civil Code §§945.5. See also Civil Code §§926, 929.

13 Id. See Civil Code §§919, 928. See also Civil Code §§944. See also Civil Code §§919, 928. See also Civil Code §§944. See also Civil Code §§919, 928. See also Civil Code §§944. See also Civil Code §§919, 928. See also Civil Code §§944. See also Civil Code §§919, 928. See also Civil Code §§944. See also Civil Code §§919, 928. See also Civil Code §§944. See also Civil Code §§919, 928. See also Civil Code §§944.

14 See Civil Code §§912. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917. See also Civil Code §§910-938. See also Civil Code §§916-917.
and use disputes arise in a wide variety of circumstances. Someone’s property is downzoned to a less intensive use. A development is restricted because the property has environmentally sensitive habitat within its acreage. A farmer is denied a grading permit. A developer is unhappy with a consultant’s report that is part of an environmental impact report. A property owner is denied a development permit, a subdivision map, a conditional use permit, a lot line adjustment, or a certificate of compliance.

Historically, the federal system has shied away from resolving these quintessentially local matters. But that may be changing.

Adverse local land use actions or decisions often have led owners or developers to file constitutional claims, principally in state court, alleging that the actions or decisions are regulatory takings. A plaintiff in these cases, after first exhausting various administrative options, must show that the property at issue was essentially rendered valueless by the governmental action or decision. However, as a result of the U.S. Supreme Court’s decision in Village of Willowbrook v. Olech, these claims are now commonly being re-packaged as “class of one” civil rights claims. Without regard to whether an identifiable class of plaintiffs exists or whether the alleged improper treatment by a municipality is related to any previously cognizable protected class, an aggrieved landowner may now bring a federal cause of action. This jurisprudential sea change permits plaintiffs to plead violations of the due process clause, the equal protection clause, the First Amendment, the contracts clause, the supremacy clause, or other federal laws solely on the basis of allegations that local land use authorities acted in an “irrational or wholly arbitrary” manner.

In Olech, the U.S. Supreme Court recognized that equal protection claims can be successful even if they are brought by a “class of one,” if the individual plaintiff alleges intentional and disparate treatment.

By David Pettit and Michael Schafler

Speaking out at a land use forum may be all that a plaintiff needs to do to establish a “class of one” civil rights cause of action.

David Pettit and Michael Schafler are lawyers with Caldwell, Leslie, Newcombe & Pettit in Los Angeles, where they litigate complex business, environmental, and land use matters in state and federal courts. Pettit represented the defendants in Carpinteria Valley Farms, Ltd. v. County of Santa Barbara.
Since Olech, property owners are bringing equal protection and other civil rights claims based on the assertion that they have been treated differently, for reasons that are arbitrary or invidious, from other property owners that are similarly situated.

compared to others similarly situated and that there is no rational basis for the difference in treatment. In a separate concurring opinion, Justice Breyer expressed his concern that the majority opinion would "transform many ordinary violations of city or state law into violations of the Constitution," and attempted to narrow the majority opinion. Breyer explained that the presence in the Olech complaint of allegations of "vindictive action, 'illegitimate animus,' or 'ill will,'" was an "extra factor" necessary to convert "run-of-the-mill zoning cases into cases of constitutional right." Notably, however, the per curiam opinion of the other eight justices expressly declined to incorporate the "theory of subjective ill will." Of course, plaintiffs' counsel would prefer to ignore Breyer's concurrence. By following the dictates of the per curiam opinion, "class of one" plaintiffs could survive a motion to dismiss or even a summary judgment motion simply by alleging that they were treated differently than others and that there is no rational explanation for the difference—without any showing of governmental animus or ill will. Currently, however, most courts that have considered the issue have largely ignored the Supreme Court's statement that it was not reaching the subjective ill will theory and have instead followed Breyer's concurrence. They have held that Olech did not remove the requirement that a plaintiff alleging an equal protection violation based on selective enforcement must show that the governmental action at issue was motivated by animus. Notably, the Supreme Court's post-Olech decision in City of Cuyahoga Falls v. Buckeye Community Hope Foundations resolved an equal protection claim involving a single plaintiff without mentioning Olech.

Taking all this into consideration, because showing animus is often a fact-intensive and inferential exercise that is costly and time-consuming to rebut, in many cases the mere allegation of animus may pave the way toward a jury trial. Consequently, plaintiffs' counsel should plead both unequal treatment and animus if the facts permit.

Under traditional jurisprudence interpreting 42 USC Section 1983 (the civil rights jurisdictional statute), local governments can be found liable for violations of the U.S. Constitution when those constitutional violations represent an abuse of power that "shocks the conscience." It is not sufficient for the violation to simply be a violation. As the Eighth Circuit has held: "A bad faith violation of state law remains only a violation of state law." Olech has changed this landscape, however. Since Olech, property owners are bringing equal protection and other civil rights claims based on the assertion that they have been treated differently, for reasons that are arbitrary or invidious, from other property owners that are similarly situated. One significant benefit is that these plaintiffs do not need to be a member of a protected class or any class at all. Another advantage is that they do not need to show that the challenged action shocks the conscience for their claims to be successful.

Therefore, if Olech is taken to its logical extreme, almost every property rights case could be construed as a civil rights case because a property owner usually can allege that he or she was treated differently, for no good reason, from similarly situated persons in the same jurisdiction. The owner also can claim retaliation for speaking out in public against the decisions of a planning or zoning department. Indeed, property owners can effectively lay the foundation for a civil rights suit by appearing in public and denouncing the local government prior to receiving a determination on a land use application. If afterward they receive an unfavorable outcome, they likely will be able to claim that the result was based upon retaliatory disparate treatment. Plaintiffs filing these suits often will survive a demurrer or motion to dismiss, and their opponents will require expensive discovery to prepare a motion for summary judgment that will ultimately be problematic. Indeed, it would not be a surprise if the plaintiff's claims surmount all procedural hurdles on their way to a jury trial.

Manufacturing Ripeness

For constitutional claims, the ordinary principles of Article III ripeness apply just as they do in other federal actions. The Ninth Circuit has held:

"[J]ust as the case or controversy requirement of Article III prevents a court from hearing an abstract question, the ripeness requirement prevents "the courts...from entangling themselves in abstract disagreements over administrative policies, and also...protect[s] the agencies from judicial interference until an administrative decision has been formalized and its effects felt in a concrete way by challenging parties."

The element of ripeness, together with the requirement in Williamson County Regulatory Planning Commission v. Hamilton Bank that a property owner first resort to available state procedures to obtain both 1) a final determination on a development application and 2) compensation, would appear to preclude "class of one" claims in the land use context unless and until local permit procedures have been completed. Until that occurs, no one knows the nature or extent of any injury. Clearly, a determination of whether, for example, a developer will or will not receive a development permit is the foundation for any future claim by the developer. Recognizing this, the Ninth Circuit has repeatedly stated that equal protection claims arising in land use cases that include regulatory taking claims are unripe unless and until there is a "final determination by the relevant government body." Indeed, in Williamson the U.S. Supreme Court held
COURTCALL® LLC
Telephonic Court Appearances

Lawyers can stop spending their time and their clients’ money traveling to Court by making a CourtCall Appearance.

TOLL FREE 888/882-6878  TEL 310/342-0888  FAX 310/743-1850

COURTCALL APPEARANCES ARE AVAILABLE IN THESE JURISDICTIONS:

CALIFORNIA
Court of Appeal
Sixth Appellate District
Alpine County Superior Court
Amador County Consolidated Courts
Bakersfield Municipal Court
Butte County Consolidated Courts
Calaveras Superior Court
Colusa Superior Court
Contra Costa County Superior Court
Del Norte Superior Court
El Dorado County Superior Court
Fresno Superior Court
Glenn County Superior Court
Humboldt Superior Court
Kern County Superior Court
Kings County Superior Court
Lassen County Superior Court
Los Angeles Superior Court
Beverly Hills
Burbank
Central
Central Civil West
Chatsworth
Citrus/W.Covina
Compton
Culver City
Glendale
Long Beach
Norwalk
Palmdale
Pasadena
Pomona
Redondo Beach
Rio Hondo (El Monte)
San Fernando
San Pedro
Santa Ana
Santa Monica
Torrance
Van Nuys
West Los Angeles
Madera Superior Court
Bass Lake
Marin County Superior Court
Mendocino County Coordinated Courts
Merced Superior Court
Mono County Superior Court
Napa Superior Court
North Kern Municipal Court
Orange County Superior Court
Placer Superior Court
Plumas Superior Court
Riverside Superior Court
Blythe
Hemet
India
Lake Elsinore
Palm Springs
Riverside
Southwest
Sacramento Superior Court
San Benito
San Bernardino Superior Court
Barstow
Big Bear
Central
Joshua Tree
Neodesha
Rancho Cucamonga
Victorville
San Diego Superior Court
Central
East County
North County
South County
San Francisco Superior Court
San Joaquin County Superior Court
San Luis Obispo County Superior Court
Grover Beach
Paso Robles
San Mateo County Superior Court
Santa Barbara Superior Court
Central
Lompoc
Santa Maria
Santa Cruz Superior Court
Santa Cruz
Watsonville
Shasta County Superior Court
Sierra County Superior Court
Solano Superior Court
Sonoma Superior Court
Stanislaus County Superior Court
Tehama Superior Court
Trinity County Superior Court
Tuare County Superior Court
Tuolumne County Superior Court
Yuba County Superior Court
FLORIDA
Fifth Judicial Circuit (Ocala)
First Judicial Circuit (Defuniak Springs, Okaloosa, Santa Rosa Beach)
Twelfth Judicial Circuit
Thirteenth Judicial Circuit (Tampa)
Fifteenth Judicial Circuit (W. Palm Beach)
Nineteenth Judicial Circuit
Twentieth Judicial Circuit (Naples)
GEORGIA
Atlanta Superior Court
INDIANA
Marion County Superior Court
(Indianapolis)
LOUISIANA
Fourth Judicial Dist. (Monroe)
Twenty-Sixth Judicial Dist. (Benton, Minden)
MARYLAND
Second Circuit Court (Centreville)
Talbot County Circuit Court
MICHIGAN
36th District Court (Detroit)*
Washtenaw County Trial Court
18th Judicial Circuit
MISSISSIPPI
4th Circuit Court
NEW JERSEY
Bergen
Burlington
Cumberland
Essex
Gloucester
Hunterdon
Mercer
Middlesex
Monmouth
Morris/Sussex
Passaic
Salem
Somerset
Warren
NEW MEXICO
Dona Ana County (Las Cruces)
First Judicial Circuit (Santa Fe)
TEXAS
22nd District Court (San Marcos)
33rd District Court (Burnet)
79th District Court (Liberia)
105th District Court (Corpus Christi)
133rd District Court (Houston)
219th District Court (McKinney)
238th District Court (Midland)
286th District Court (Levelland)
325th District Court (Ft. Worth)
360th District Court (Ft. Worth)
400th District Court
County Courts
Midland
San Angelo
Tom Green
UTAH
4th District Court (Provo)
WASHINGTON
Spokane County Superior Court
WEST VIRGINIA
Fourth Judicial Circuit
UNITED STATES DISTRICT COURT
Eastern District of California
Fresno
Sacramento
Northern District of California
San Jose
Santa Clara
Southern District of California
San Diego
UNITED STATES BANKRUPTCY COURT
CALIFORNIA
Central District of California
Los Angeles
Riverside
Santa Ana
Woodland Hills
Eastern District of California
Fresno
Modesto
Sacramento
Northern District of California
Oakland
San Francisco
San Jose
HAWAII
ILLINOIS
Northern District of Illinois
Chicago
NEW JERSEY
USDC-New Jersey
Newark
NEW YORK
Southern District of New York
OREGON
District of Oregon
Portland
that the plaintiff’s regulatory taking claim was premature under both the just compensation clause of the Fifth Amendment and the due process clause of the Fourteenth Amendment. 18

Should this well-established rule of ripeness be defeated if, on the same set of facts, the plaintiffs decide to drop their Fifth Amendment taking claim but retain their equal protection claim? For example, in Kinzli v. City of Santa Cruz, 19 the plaintiffs alleged that a local “greenbelt” ordinance was unconstitutional as it applied to them, even though the plaintiffs had not yet applied for a development permit. The Ninth Circuit held that the plaintiffs’ taking claim as well as their equal protection claim were not ripe for adjudication by the district court “until planning authorities and state review entities make a final determination on the status of the property.” 20 Would the court have reached a different result if the plaintiffs had not included a taking claim in their lawsuit? Under that circumstance, no conceptual reason exists for the court to rule contrary to its decision involving both claims.

However, in Carpinteria Valley Farms, Ltd. v. County of Santa Barbara, 21 the Ninth Circuit did just that. In that case, the plaintiffs successfully decoupled their equal protection claims from their potential taking claim and convinced the court that their claims were ripe even though the plaintiffs did not allow the administrative process for the desired land use permits to run its course. The plaintiffs in Carpinteria Valley Farms had applied for 13 development permits from the county. At the time of their lawsuit, they had received 11, withdrawn one, and one was pending. Nonetheless, they sued the county and certain county employees, claiming that they had been treated differently than other applicants because a representative of one of the plaintiffs had criticized county practices at public meetings. The Ninth Circuit held that the claims based on the first 11 permits were time-barred, but the claims based on one application (that was later withdrawn) and one pending permit application were ripe for federal adjudication—regardless of whether the permits were ever issued and what conditions (if any) were attached.

This result is hard to reconcile with Kinzli and appears to announce a significant departure from longstanding Ninth Circuit jurisprudence in land use cases. If traditional ripeness principles are not applied to “class of one” or other civil rights cases arising from the application of local land use regulations, more federal judges and juries will very likely be asked to decide the propriety of everyday decisions regarding planning, zoning, grading, and agricultural issues—and to award damages against local governments and their officials as a result.

To take maximum advantage of the Carpinteria Valley Farms opinion and to sufficiently establish the “certain limited and appropriate circumstances” in which a land use claim under Section 1983 may proceed notwithstanding the fact that the underlying Fifth Amendment taking claim is not yet ripe, 22 a developer’s attorney should allege a concrete act showing a denial of equal protection within the statute of limitations period. 23 The act could be a procedural irregularity, such as excessive delay. If the decision in Carpinteria Valley Farms is correct, a developer’s allegation can be merely that it was treated differently in the development process than similarly situated developers without good reason—and without regard to whether the desired permit ultimately was obtained. The case is strengthened if the developer can allege and prove that there is a nexus between the concrete act and a basis for finding animus: for example, the concrete act is in retaliation for the developer’s public communications criticizing local government officials.

Defense counsel should carefully scrutinize the complaint and should, from the very outset, structure discovery to determine whether statute of limitations issues exist. A developer’s complaint will often contain a long, convoluted story of alleged mistreatment. Much or all of that story will involve actions that took place outside of the statute of limitations period. Some plaintiffs may argue, by analogy to employment cases, that a violation not only occurred but also is continuing, and thus a claim may be brought based on acts that took place outside the usual one- or two-year statute of limitations. However, recent U.S. Supreme Court and Ninth Circuit decisions have placed limits on the continuing violation theory in employment actions, and it is logical that the same rules would apply to land use civil rights cases.

Defense counsel should also consider whether abstention is warranted 24 and whether the doctrine of qualified immunity provides a means to defeat a plaintiff’s lawsuit for some individual defendants. 25 Also, when a developer ultimately accepts a permit but nevertheless sues on equal protection grounds despite this acceptance, defense counsel should consider whether the doctrines of waiver or judicial estoppel would apply.26

Individual defendants may be implicated in “suing the messenger” cases based on reports they prepared on behalf of a governmental agency making a land use decision. A potential defense in these cases, as well as some other land use cases, stems from California’s anti-SLAPP statute, 27 which protects local government and its contractors. 28

This statute also applies in federal diversity cases, although the California anti-SLAPP statute’s special discovery rules do not. 29

However, the anti-SLAPP statute does not apply in cases involving federal questions. 30 Still, it might apply to state law claims that are appended to federal constitutional claims.

A Break from the Past

The decisions in Olech and Carpinteria Valley Farms are hard to reconcile with the historical approach of the federal courts to local land use issues. The U.S. Supreme Court has repeatedly expressed its view that “[t]he power of local governments to zone and control land use is undoubtedly broad and its proper exercise is an essential aspect of achieving a satisfactory quality of life in both urban and rural communities.” 31 In other words, “the Government has considerable latitude in regulating property rights in ways that may adversely affect the owners.” 32 Therefore, the general rule has been that state and local governments have wide discretion in regulating private citizens’ use of their properties when the government is exercising its police powers and acting to promote the public welfare.

Prior to the recent changes largely created first by Olech and now Carpinteria Valley Farms, it was well settled that a land use restriction or decision should stand so long as it 1) served a legitimate interest in promoting the public health, safety, morals, and general welfare of affected citizens, and 2) was not irrational, arbitrary, or capricious. 33 In considering the public’s welfare, the local government was entitled to allow, restrict, or deny a land use request based on a range of factors related to the proposal, such as increased traffic and noise, the effect on property values, the increased demand for city or county services, the preservation of agricultural uses of land, the undesirable side effects of the proposed use, public safety, and even such intangible factors as community pride and aesthetics. 34 While property owners have extensive rights regarding the use and enjoyment of the property they own, restrictions on private property are “properly treated as part of the burden of common citizenship.”35 The U.S. Supreme Court explained that the “burden of common citizenship” is that “all property in this country is held under the implied obligation that the owner’s use of it shall not be injurious to the community.” 36

Until recently, the Supreme Court had not wavered from the principle that the U.S. Constitution does not permit a court to “over-
IN A CLASS OF THEIR OWN
Sponsored by CourtCall LLC

Name ________________________________
Law Firm/Organization ________________________________
Address ________________________________
City ________________________________
State/Zip ________________________________
E-mail ________________________________
Phone ________________________________
State Bar # ________________________________

Instructions for Obtaining MCLE Credits
1. Study the MCLE article in this issue.
2. Answer the test questions opposite by marking the appropriate boxes below. Each question has only one answer. Photocopies of this answer sheet may be submitted; however, this form should not be enlarged or reduced.
3. Mail the answer sheet and the $15 testing fee ($20 for non-LACBA members) to:
   Los Angeles Lawyer
   MCLE Test
   P.O. Box 55020
   Los Angeles, CA 90055

Make checks payable to Los Angeles Lawyer.

4. Within six weeks, Los Angeles Lawyer will return your test with the correct answers, a rationale for the correct answers, and a certificate verifying the MCLE credit you earned through this self-assessment activity.

5. For future reference, please retain the MCLE test materials returned to you.

Answers
Mark your answers to the test by checking the appropriate boxes below. Each question has only one answer.

1. True False
2. True False
3. True False
4. True False
5. True False
6. True False
7. True False
8. True False
9. True False
10. True False
11. True False
12. True False
13. True False
14. True False
15. True False
16. True False
17. True False
18. True False
19. True False
20. True False
turn [a statute that does not burden a suspect class or a fundamental interest] unless the varying treatment of different groups or persons is so unrelated to the achievement of any combination of legitimate purposes that we can only conclude that the legislature’s actions were irrational.\footnote{44}

Under that framework, federal constitutional challenges to a land use rule, such as equal protection and due process claims, were an uphill climb because the state action was only subject to the “rational relationship” test.\footnote{46} Under this test, the plaintiff could only challenge the land use or zoning decision on the basis of whether it is “rationally related to the promotion of the public health, safety or welfare.”\footnote{47}

However, after Olech, landowners’ counsel may convince courts not to take such a deferential view of local land use decisions when there is evidence of disparate treatment and/or animus. When these elements are present, a local land use decision may be subject to a higher level of constitutional scrutiny than the rational relationship test.

**Restrictions on Accessory Uses**

In this new era, property owners or developers are filing “class of one” challenges to the local regulation of accessory uses of property, requiring lengthy and tedious comparisons between a plaintiff’s use of land and the uses by others on other, allegedly similarly situated property. This practice contradicts longstanding state and federal jurisprudence holding that each parcel of land is unique\footnote{48}—a simple and obvious principle that has long justified different treatment even for neighboring properties. The principle now can be transformed into a powerful weapon for unhappy, litigious landowners to attack local regulatory agencies and their staffs. Differential treatment is not an unlikely occurrence. Depending on how Olech and *Carpinteria Valley Farms* are interpreted, local agencies may need to mount defenses to challenges involving the different treatment of properties at least to the summary judgment stage in order to substantiate a valid reason for their actions.

The fact that agencies will have to defend accessory use decisions in this manner represents a change from traditional practices. As one court observed, “In general, land use regulation…specifying some uses and permitting ad hoc determinations of valid accessory uses, is authorized as a common, wide-spread zoning technique.”\footnote{49} However, the court noted that “the validity of such regulation depends on the reasonableness of the definition of accessory use.”\footnote{50} For example, in considering the storage of inoperable or “junk” vehicles on a property zoned for single-family dwellings, courts considered cus-

toms and referred to “our common sense, judicial and personal knowledge of what (single-family) dwellings are customarily and ordinarily used for”—what the ordinary man of the street would consider a one-family dwelling to be.\footnote{51}

Some accessory uses of property—for example, the posting of signs or hosting parties or charitable events—may implicate First Amendment rights of free speech or free association. When that occurs, the government action may be subject to a higher level of scrutiny, regardless of whether an equal protection claim is pleaded. Further, a person’s First Amendment rights are greater when they are exercised on the person’s private property rather than on public property.\footnote{52}

For example, in *Meredith v. Oregon*\footnote{53} the owner of a vacant parcel of property adjacent to Highway 101 erected a sign on his property that was visible to travelers on the highway. The sign advertised a nearby resort. The property owner did not obtain a permit under the state law requiring a permit before posting an outdoor commercial sign visible to the traveling public. The city ordered the property owner to remove the sign or face a fine. The property owner challenged the city ruling. The Ninth Circuit did not reach the merits of the case but implied that the private property owner had at least a potentially viable First Amendment claim against the city.\footnote{54}

While the city ordinance restricts speech, and commercial speech is a category of speech that may be regulated, the law must still survive heightened scrutiny because it implicates a fundamental right.

Other “class of one” attacks can arise if, for example, property owners are being prohibited from raising chickens on their property or from playing recreational polo or softball on their property, and others have not been so restricted. Regardless of whether a use is protected under the First Amendment, these cases become more difficult to defend when the plaintiff alleges retaliatory treatment in response to the plaintiff’s public, anti-gov-ernment speech. Moreover, according to *Carpinteria Valley Farms*, a disputed land use restriction may be rife for federal adjudication whether or not, after the administrative process ends, the restriction still stands.

Before Olech and *Carpinteria Valley Farms*, the history of federal jurisprudence did not contain a hint that inherently local land use disputes are appropriate for federal judicial resolution. However, if the recent result in *Carpinteria Valley Farms* is not overruled, and if Olech continues to be broadly applied, the federal courts may, contrary to their his-
tory of asserting otherwise, indeed become the “Grand Mufti of local zoning boards.”\footnote{55}

---

3. Id. at 565.
4. Id. at 564 (per curiam).
5. Id. at 565 (Breyer, J., concurring).
6. Id. at 565-66.
7. Id. at 565.
10. See also V. Village of Schaumburg, 297 F. 3d 673, 681 (7th Cir. 2002); Bower v. Village of Mt. Sterling, 2002 WL 1752270, at *7 (7th Cir. 2002) (unpublished disposition).
11. City of Cuyahoga Falls v. Buckeye Cnty. Hope Found., 538 U.S. 188, 123 S. Ct. 1389 (2003). The plaintiff in *Cuyahoga Falls* sued a city claiming that a city-sponsored referendum concerning a low-income housing complex was racially discriminatory. Without citing or discussing Olech, the Supreme Court held that “proof of racially discriminatory intent or purpose is required” to show a violation of the equal protection clause. Id. at ___, 123 S. Ct. at 1394.
16. Summary judgment may be even more difficult to obtain in so-called mixed motive cases, in which the defendant claims that it would have taken the challenged action even in the absence of a retaliatory motive against the plaintiff. See, e.g., Ostad v. Oregon Health Sciences Univ., 327 F. 3d 876 (9th Cir. 2003).
22. Kinzli v. City of Santa Cruz, 818 F. 2d 1449 (9th Cir. 1987), as amended, 830 F. 2d 968 (9th Cir. 1987).
23. Petition for Cert. filed at 1455.
25. Id. at 8.
Anita Rae Shapiro
SUPERIOR COURT COMMISSIONER, RET.
PRIVATE DISPUTE RESOLUTION
PROBATE, CIVIL, FAMILY LAW
PROBATE EXPERT WITNESS

WITKIN & EISINGER, LLC
RICHARD G. WITKIN, ESQ. • CAROLE EISINGER

At Witkin & Eisinger we specialize in the Non-Judicial Foreclosure of obligations secured by real property or real and personal property (mixed collateral). When your client needs a foreclosure done professionally and at the lowest possible cost, please call us at:
1-800-950-6522
We have always offered free advice to all attorneys.

The Price Of Progress.
The United States Constitution and California law mandate that a business owner receive just compensation when eminent domain forces the relocation or closure of a business.
The amount of goodwill lost by the business is often a key issue. HML has performed hundreds of loss-of-goodwill appraisals for both business owners and public agencies. The result is progress at a price that is fair.

For More Information Call 213-617-7775
Or visit us on the web at www.hmlinc.com

Higgins Marcus & Lovett
BUSINESS VALUATION • LOSS OF GOODWILL • ECONOMIC DAMAGES • LOST PROFITS
If an otherwise private deal involves any public money, fee waiver, land write-down, or public-private agreement, then the application of prevailing wage laws needs to be analyzed. Careful structuring of a transaction may allow an exemption from prevailing wages to be claimed in some cases, so the issue must be considered at the start of any public-private transaction. Of particular importance are recent court decisions, state legislation, and determinations by the California Department of Industrial Relations (DIR), which indicate that prevailing wages may be required for projects that were considered exempt or subject to safe harbors as recently as a few years ago, otherwise qualify as private work, or are otherwise not governed by the Public Contract Code.¹

When a project becomes known, chances are that the local construction trade union representatives will review it and ask the DIR for a prevailing wage determination. A client that receives a coverage decision from the DIR requiring the payment of prevailing wages when the project budget did not anticipate the additional cost may not be able to proceed as planned. No hard evidence is readily available on the additional cost component because the numbers are very dependent on the project and the location; however, some reports indicate overall costs may increase 15 percent because of prevailing wages.² Given the prominence of the topic in the public-private development community in recent years, every real estate transactions lawyer needs to be familiar with and add segments of the Labor Code to his or her library. In addition to statewide requirements, local city and county ordinances and policies must be reviewed for additional prevailing wage and living wage requirements.

As stated in *Lusardi Construction Company v. Aubry*: [The public policy goal of prevailing wage laws is] to vigorously enforce minimum labor standards in order to ensure employees are not required or permitted to work under substandard unlawful conditions, and to protect employers who comply with the law from those who attempt to gain competitive advantage at the expense of their workers by failing to comply with minimum labor standards....The overall purpose of the prevailing wage law is to protect and benefit employees on public works projects.³

Although the DIR is a quasi-legislative agency that administers and enforces prevailing wages, organized labor is the real watchdog. Any interested party (in particular, a local union representative) is authorized to ask the director of the DIR to make a determination regarding the applicability of prevailing wages to a particular project.¹

*By Teresa Buchheit Klinkner*
California law provides that prevailing wages must be paid on any public works project that is performed under a contract and that costs $1,000 or more, except for work carried out by a public agency with its own forces. Specifically, prevailing wages are the prevailing rate of per diem wages and the prevailing rate for holiday and overtime work to employees employed on public works. The prevailing rate is the basic hourly rate paid on public works to a majority of workers engaged in a particular craft, classification, or type of work.

While DIR determinations primarily focus on hourly wage laborers in the construction business, prevailing wage standards may also apply to salaried administrative, executive, managerial, and professional employees. For example, prevailing wage determinations are available for field surveyors. However, until further notice the DIR appears to be refraining from enforcing prevailing wage obligations on these salaried classifications because it has “neither the prevailing wage determinations nor the personnel resources to establish…or enforce prevailing wage determinations” for the classifications. DIR notices will need to be watched on this topic.

The DIR is required to determine a locality’s prevailing wage rates and to provide the wage rates to an awarding body that requests them. An “awarding body” is defined as the “department, board, authority, officer or agent awarding a contract for public work.” In a traditional public works contract, a city or public agency is the awarding body and obtains from the DIR the different wage rates for each craft, classification, or type of work that is involved in the construction of the project. The awarding body requires contractors who bid on the project to confirm that their bids incorporate the appropriate wage rates.

In 2001, Senate Bill 975 changed the statutory definition of “public works” and thereby changed the landscape of structuring public-private transactions in relation to prevailing wages. The new law confirmed that prevailing wages can be required when the actual construction contract is entirely between private parties, for example a developer and construction general contractor.

If a developer has a contract—such as a disposition and development agreement with a public entity (e.g., a redevelopment agency)—by which the developer acquired the land at a reduced price or received any public funds for the development and use of the property, then the project may be deemed a public work for prevailing wage purposes. In the past, many redevelopment deals were structured without prevailing wage concerns because they were not generally considered to be public works. As a result of recent legislation, however, the practitioner must follow the money, or its equivalent, and carefully analyze how public funds may be involved in what may otherwise seem to be a private deal.

### The Prevailing Wage Analysis

A complete prevailing wage analysis of any project entails review of all documents related to the project, Labor Code Sections 1720 et seq., Title 8 of the California Code of Regulations, local prevailing wage ordinances, and the DIR’s precedent public works decisions (compiled under Government Code Section 11425.60). The statutes and precedents in this area are frequently changing, so the analysis must respond accordingly.

The starting point in the analysis is to understand the definition of “public works.” As amended, Labor Code Section 1720 defines “public works” broadly and provides certain limited exemptions from coverage. Under Labor Code Section 1720(a), a project is a public work if it meets three criteria: 1) the project involves construction, alteration, demolition, installation, or repair work; 2) the work is done under contract, and 3) the work is paid for in whole or in part out of public funds.

California courts tend to be inclusive rather than exclusive in interpreting the meaning of “construction, alteration, demolition, installation, or repair work.” “Construction” includes work performed during the design and preconstruction phase, including inspection and land surveying work. Further, a court recently cited long-held DIR policy to state that for purposes of California’s prevailing wage law, “construction” includes not only the actual building of a structure but also “integritly related activities” such as architectural design, project management, legal services, surveying, and insurance.

Practitioners must be careful to consider an expansive view of construction and not rely on cases that may be challenged. Any research of case precedent must be done with the caveat that the underlying statute has been changing, so only recent cases may be reliable. Therefore, the first step in the analysis should focus on the use of public funds that are in any way related to the construction or development and financing of the land and related improvements and structures.

The second step requires a determination whether there is a contract or agreement with a public entity regarding some aspect of the work. The DIR has consistently taken the position that Labor Code Section 1720 does not require the public entity that pays for the construction to be the awarding entity or even a party to the construction contract. Therefore, any agreement with a public entity that involves public funds may satisfy the contract element if it is at all related to the overall transaction. Moreover, the contract need not require prevailing wages; that requirement is a statutory duty. Therefore, prevailing wages must be considered when the deal at any time includes documents such as a disposition and development agreement, an owner participation agreement, a regulatory agreement, a ground lease, or even a redevelopment loan agreement.

The third, and most expanded, element of the public works analysis involves the definition of “public funds.” Labor Code Section 1720(b) provides that “paid for in whole or in part out of public funds” includes: 1) the payment of money or “the equivalent of money” directly to or on behalf of the public works contractor, subcontractor, or developer, 2) public construction work in execution of the project, 3) transfer of an asset of value for less than fair market price, 4) normal contract fees, costs, rents, insurance or bond premiums, loans, interest rates, or other obligations paid, reduced, charged at less than fair market value, waived, or forgiven, 5) loans to be repaid on a contingent basis, and 6) credits applied against repayment obligations.

The phrase “money or the equivalent of money” means that anything of value from a public entity counts as public funds. However, DIR regulations also provide that public funds include state, local, or federal monies but “do not include money loaned to a private entity where work is to be performed under private contract, and where no portion of the work is supervised, owned, utilized, or managed by an awarding body.” Except for such bona fide loans, virtually the entire arena of redevelopment activity is encompassed within the new definition of “public funds.”

DIR coverage decisions support this inclusive view. Some of the less obvious examples of public funds related to construction include fee waivers, reduced rent on a ground lease, and feasibility study grants and low-interest loans. However, in one recent case, “feasibility gap payments” from a city to a developer in return for a public easement and note at market-rate interest was found by the DIR not to be a public work because no public funds were expended. Practically speaking, however, public funds will be implicated if there is anything of value coming from a public entity in the overall transaction.

### Exemptions

Generally, then, a prevailing wage analysis is likely to find that public-private activities that involve public works will require prevailing wages. After this part of the analysis is complete, the analysis next shifts to determining...
if any exemption is available. There are a few statutory exemptions, including specific residential and affordable housing projects, certain required public improvements without public proprietary interest, DIR-preapproved projects completed with volunteer workers, and de minimis matters.\textsuperscript{33} Drafting is critical for any exemption, and simply using a series of private, nongovernmental third-party agreements to delegate work in hopes of avoiding the application of prevailing wages will not work.\textsuperscript{34}

Labor Code Section 1720(c)(1) provides that private residential projects are not covered by prevailing wages if built on private property unless the projects are built pursuant to an agreement with a state agency, redevelopment agency, or local public housing authority. Also, projects built using a city’s low and moderate income funds may be exempt if only private funds are otherwise involved.\textsuperscript{35} Because most affordable housing projects utilize various funding sources, this exemption may not be so useful unless the other public funding involves certain mortgage revenue bonds or tax credits that were allocated before December 31, 2003.\textsuperscript{36}

However, the use of public funds for rehabilitation or construction of certain privately owned residential projects is exempt from prevailing wage requirements under Labor Code Section 1720(c)(6) if certain conditions are met, including: self-help housing with at least 500 hours of sweat equity; specific emergency, temporary, or transitional housing projects for homeless persons; rehabilitation, mortgage, or down payment assistance on owner-occupied single-family homes; and, below-market interest rate loans on projects in which occupancy of at least 40 percent of the units is restricted for at least 20 years, by deed or regulatory agreement, to individuals or families earning no more than 80 percent of the area median income.\textsuperscript{37}

If carefully structured, payments for certain public improvements that are required for development approvals may be exempt. Labor Code Section 1720(c)(2) provides that if a public entity requires a private developer to perform “construction, alteration, demolition, installation, or repair work” on a public improvement as a condition of regulatory approval of an otherwise private development project, and no money (or its equivalent) is contributed to the overall project than is required to perform the public improvement work, and the public entity maintains no proprietary interest in the overall project, then only the public improvement work shall require prevailing wages. In at least one decision, the DIR recognized this exemption when the developer was careful to account for the project so that net public funds were equal to or less than the net value of the public improvements.\textsuperscript{38} Documents must be mindfully drafted and costs monitored to avoid a situation in which public funds exceed the public improvement value or in which all the project components are so interdependent as to form a single project.\textsuperscript{39}

Projects constructed with volunteer labor may be exempt under Labor Code Section 1720.4 if all the following conditions are met: the work is entirely done by volunteers, the work involves facilities for private nonprofit community organizations, there is no adverse impact on employment, and the work is preapproved by the DIR.\textsuperscript{40} The DIR will ask local employment representatives if there is an adverse impact, so this exemption appears to have some practical limitations.

A de minimis exemption is provided in the statute, although it has yet to be defined. Labor Code Section 1720(c)(3) provides that if a public entity reimburses a private developer for costs that would normally be borne by the public, or provides directly or indirectly a public subsidy to a private development project that is de minimis in the context of the project, the private project will not be covered by prevailing wages. So far, no real guidance has appeared in the precedential decisions, so it is unknown how the DIR will interpret what is de minimis.\textsuperscript{41}

If, after an attorney has completed a thorough prevailing wage analysis, it is still unclear whether an exemption is available, then the attorney may request a coverage determination from the DIR.\textsuperscript{42} Time and patience are needed for this step, as it may take months to receive a response. While hypothetical situations may be provided, a more practical approach is to document the actual proposed transaction, particularly if an exemption determination is sought. Attorneys should include in the request all information and evidence that would be relevant to a fair determination by the DIR. Otherwise, if a proposed transaction involving any public funds does not clearly fall within one of the exemptions provided by Section 1720, then prevailing wages should be factored into the deal and the cost of compliance allocated among the parties.
The awarding body is required to obtain prevailing wage rates, but the contractor bears the primary burden of paying prevailing wages. Except for certain circumstances covered by Senate Bill 966 (which was codified in Labor Code Sections 1726 and 1781), 43 a contractor for a public works project that fails to pay the prevailing rate to its workers is liable for the deficiency and is subject to statutory penalties. 44 The contractor is also responsible for ensuring that the subcontractors pay the appropriate prevailing wage. 45

Under Labor Code Section 1743, contractors and subcontractors bear joint and several liability for wages and penalties. Deficiencies and penalties are to be withheld by the awarding body from the sums that are due under the contract. If the money due a contractor from an awarding body is insufficient to pay penalties and deficiencies, or if there are no payments to the contractor, the Department of Labor Standards Enforcement (DLSE) is authorized to bring an action against the contractor to recover the deficiency due and penalties assessed. 46 The DLSE has broad enforcement powers, including actions on behalf of workers against the awarding body (on a third-party beneficiary theory) and against a surety on a payment bond. 47 If the contractor’s failure to pay was the result of a good faith mistake, then the amount of the penalties may be adjusted, but the underpayment will still need to be paid to the workers. 48

Effects of Senate Bill 966

The statutory responsibility to pay prevailing wages belongs to contractors, but they may not be a party to, or even knowledgeable about, the agreement that creates the prevailing wage responsibility. Often, the parties to the contract that triggers prevailing wages are only the public entity and the developer. Not surprisingly, therefore, Senate Bill 966 was sponsored by the Association of General Contractors. The new law partially shifts the burden of paying prevailing wages onto the public entity that is involved in the transaction. The law allows contractors to make a claim against the public entity for increased costs and penalties if the project is deemed a public work after construction has begun.

Under Senate Bill 966, if a public entity has actual notice that a project is a public work prior to the awarding of the contract and does not inform the contractor, or “affirmatively represents” that the project is not a public work, then the public entity is liable for the increased labor costs, penalties, and the contractor’s attorney’s fees. 49 Further, the law provides that if the public entity receives a determination from the DIR or a court that the project is a public work prior to commencement of construction, then the previous bid or contract is deemed void and the contractor cannot be paid for any nonconstruction work that was performed, unless the body awarding the bid or contract agreed to compensate for the work. 50

The legislation appears to provide for a safe harbor for public entities that make appropriate contractual disclosures, although these disclosures will not appear in any direct contract with a contractor. To avoid liability to the contractor under Labor Code Section 1781(a), public entities must 1) not have a direct contract with the contractor, 2) state in the contract, agreement, ordinance, or other written arrangement by which it undertakes the project that the work was a public work, 3) obligate the party with whom the written arrangement is made to cause the work to be performed as a public work, and 4) fulfill its statutory obligations, if any, to cause a required payment bond to be obtained and maintained. 51

In other words, the public entity may protect itself from the contractor, with whom it has no contract, by including specific provisions, per Senate Bill 966, on prevailing wages in the contract with the developer. Simply relying on a contractual provision that requires the developer to comply with “all applicable laws” is risky for the public entity, because it may be debatable whether the law applies to the developer. Rather, the specific provisions of Senate Bill 966 should be tracked in the contract.

The public entity that is deemed to be the awarding body also may be able to limit liability that may arise from a contractor’s Senate Bill 966 judgment. The entity may accomplish this through additional contractual assurances. The new law provides that if the contractor did not contract directly with the public body that awarded the work, then the contractor’s recovery against the public entity is limited to that portion of the judgment that the contractor is unable to satisfy against the developer. 52 According to the statute, “[A] contractor may not be deemed to be unable to satisfy any portion of a judgment unless, in addition to other collection measures, the contractor has made a good faith attempt to collect that portion of the judgment against a surety bond, guarantee, or some other form of assurance.” 53

Therefore, developers should not be surprised if their public agency partners start becoming more involved in the construction contracting process and require real security assurances (bonds, letters of credit, struc-
tured or retained payments) to ensure that prevailing wages are properly taken into account.

The cumulative effect of recent legislation is that local governments and redevelopment agencies must now be concerned with clearly allocating prevailing wage responsibility as part of the transaction rather than allowing the developer to make its own determination and take the risk. Public entities will likely require indemnification from any prevailing wages liability, because the public entity usually has no relationship with the contractor or subcontractor. In return, public entities may expect that developers will look for the additional funds needed for prevailing wages to come from the public entity. Therefore, paradoxically, public entities will need to use some private contractual mechanism to enforce the payment of prevailing wages by a private party on a project in which the public entity is neither the awarding body nor directly controlling the work of the contractor.

California’s recent gubernatorial change and continuing state and local budget crises may affect state public policy, the policies and staffing of the DIR, and pending prevailing wage decisions. Therefore, statutes, precedents, and determinations should be reviewed anew at the start of any public-private transaction. Practitioners guiding a transaction should complete a prevailing wage analysis and craft an agreement that includes specific provisions that account for recent changes.

4 LAB. CODE §1773.4; CAL. CODE OF REGS. tit. 8, §§16001, 16302.
5 LAB. CODE §1771. Different thresholds may apply under Labor Code §1771.5 if the public entity has a labor compliance program.
6 LAB. CODE §1771.
7 Frequently Asked Questions, WorkItOut, at http://workitout.ca.gov (DIR Web site dedicated to workers’ rights information). The site includes an easily completed worker’s complaint form alerting the DIR to suspected prevailing wage violations.
8 See Precedential Public Works Coverage Determination, Case No. 2002-007, Dokken Engineering/Caltrans Contract 59A0275 (Jan. 23, 2003) [hereinafter Dokken Engineering]; but see exempt status for such employees under Labor Code §515.
9 See http://www.dir.ca.gov/dlsr/PWD/los.xls for Los Angeles County.
10 Dokken Engineering, supra note 8.
11 LAB. CODE §1770.
12 LAB. CODE §1772.
13 See LAB. CODE §1773.2.
14 Labor Code §1720(g) (2002) was added by S.B. 972 to specify that local prevailing wage ordinances are not preempted.
15 See http://www.dir.ca.gov/dlsr/PrecedentialAlpha.htm for precedential decisions.
16 For example, in 2003, the California Legislature passed at least seven bills that affected some aspect of prevailing wages. See A.B. 897, 852, 1418, 1506; S.B. 988 and 906; and S.C.R. No. 49 at http://www.leginfo.ca.gov. At least one attempt to repeal the prevailing wage requirement for redevelopment agencies, A.B. 1421, was defeated in 2002.
17 The term “public works contract” is defined differently for public contract and bidding requirements. See PUB. CONT. CODE §1101; see also specific “public works” definitions under Labor Code §§1720.2 (“public works” includes construction under private contract when greater than 50% of the completed construction work is to be leased to the state or a political subdivision and the lease was entered into prior to construction or construction was performed according to the state or public entity’s specifications), 1720.3 (includes hauling of refuse from a public works site), and 1720.4 (certain volunteer work that receives DIR preapproval).
18 LAB. CODE §1720.
Professional engineers, project managers and clerical staff).

See, e.g., Precedential Public Works Coverage Determination, Case No. 2002-012, California State University, San Marcos Student Housing Project (Oct. 21, 2002) [hereinafter San Marcos Student Housing Project].

See, e.g., Precedential Public Works Coverage Determination, Case No. 2002-012, California State University, San Marcos Student Housing Project [hereinafter San Marcos Student Housing Project].

Precedential Public Works Coverage Determination, Case No. 2001-21, One Harbor Plaza/Suisun City Redevelopment Agency (June 24, 2002) (development and permitting fees, equity participation).

San Marcos Student Housing Project, supra note 25.

Precedential Public Works Coverage Determination, Case No. 2002-008, Redditch Hotel Renovation (Sept. 11, 2002) [hereinafter Redditch Hotel Renovation].

Precedential Public Works Coverage Determination, Case No. 2002-090, Doubletree Hotel Development Project/City of Anaheim (May 13, 2003) (citing Silverado Creek Apartments/Napa Community Redevelopment Agency, PW 099-074 (Sept. 27, 2000)).

See Lab. Code §§1720(e)(1-6) and 17204. Also, charter cities have argued that the prevailing wage laws do not apply to them under the municipal affairs doctrine, which provides that charter cities are sovereign over matters of purely municipal concern and therefore exempt from state requirements. A case on appeal to the California Supreme Court may resolve this issue.

City of Long Beach v. Department of Indus. Relations, 110 Cal. App. 4th 636, 644 (2003), appeal pending, Cal. Sup. Ct. Case No. S118450 (filed Aug. 21, 2003); see also S.C.R. 49, ratified Sept. 11, 2003, to reaffirm the appellate court’s City of Long Beach decision regarding the legislature’s intent that prevailing wages are a matter of statewide concern.

See City of Long Beach, 110 Cal. App. 4th at 649 (cannot avoid prevailing wages by “laundering public funds through a non-governmental third party”).

Lab. Code §1720(e)(4).

See Lab. Code §§1720(d)(1-3) (no bills to extend deadline pending at time of writing). See also Redditch Hotel Renovation, supra note 31.

Lab. Code §1720(e)(6).

Precedential Public Works Coverage Determination, Cases No. PW 2002-099 (Lowes’s Home Improvement Center) and PW 2002-100 (Costco Retail Building) Pacheco Pass Retail Center, City of Gilroy (public improvements including public roads, curbs, gutters, sidewalks, and underground utility lines) (July 10, 2003).

See, e.g., Precedential Public Works Coverage Determination, Case No. 2001-16, Development of River Street Historic District/City of San Jose. See also Lab. Code Regs. tit. 8, §16003.

Precedential Public Works Decision, Case No. 2002-53, Pleasant Hill Schoolyard Redevelopment Project (July 10, 2003), which refers to the $25,000 construction and $15,000 maintenance exemptions in Labor Code §1775.5 applicable to public agencies with labor compliance programs.

See, e.g., Taushinda Park and Trail Project, supra note 28.


Lab. Code §1775; see also Lab. Code §1743 (joint and several liability of contractors and subcontractors for wages and penalties).


See Lab. Code §1781(b).

Id.

S.B. 966 (codified at Lab. Code §1781(a)(3)).

Id.

The California League of Cities was opposed to S.B. 966 due to the likely litigation and increased costs to cities. See Assn. Comm. Analyses (July 8, 2003) and Sen. R. Comm. Rpt. (Sept. 11, 2003).
Weighing Choices in Time and Billing Applications

Small and large firms and different resource needs can be matched to suitable programs

Recording time in an accurate and convenient manner is critical to the business side of lawyering. Time and billing software can help lawyers handle this indispensable administrative task. Indeed, under Rule 4-200 of the Rules of Professional Conduct, accurate timekeeping may be interpreted as an ethical and professional duty of a lawyer to the client. To meet this challenge, some programs offer an integrated suite of time and billing, accounting, contact management, case management, and firm management. Other programs are stand-alone. Sometimes the stand-alone program is a module that can be combined with the vendor’s other modules to create customized suites.

All-in-one solutions may be preferable for an office that does not have, or wishes to convert from, established accounting, calendaring, contact, and case management programs. However, all-in-one solutions tend to be resource hogs. Stand-alone solutions, in turn, may be preferable if the firm wants to mix and match with other programs. With a stand-alone, however, duplication of effort is more likely. For example, someone may need to perform data entry of client information into multiple programs.

Fortunately for consumers, the relatively large number of vendors of time and billing software seems to have generated a fair amount of competition. Most vendors try to make it easy to transition from a competitor’s software to theirs and either have a built-in ability to import the data from another vendor’s program or will provide this service for the user at little or no cost. This service is not always advertised, so it may be worthwhile to ask.

All time and billing programs can capture time, but there are significant variations in how and whether each program takes the data and converts it into the desired format. With most programs, it is difficult to change the preset invoice formats, so a firm should choose a program that already has an acceptable range of formats. Firms can ask the vendor for a trial version of the software. As is typical with software, the vendor’s minimum hardware requirements (e.g., memory and processor speed) are indeed minimum, because when the program runs with others (such as network, word processor, and e-mail) its performance will be affected.

Comparison

In the interest of examining how various programs address these issues of price, performance, and compatibility, I gave a closer look to some of the more popular time and billing programs (in alphabetical order).

Juris. One of the oldest players in this field, Juris has a separate time and billing module that can be coupled with others (financial analysis, accounting, and case management). No demo version is available, but users can arrange an online demo. Juris has a version for small firms and solos, but their target customer is the growing or large firm. This program and Pro Law were the most expensive in the review group. I was not able to run the online demo, but the features for this program appear to be extensive.

PC Law. PC Law version 6 is the program that I use in my office. It has many features, but it is not an all-in-one program. The base program has time and billing as well as accounting, contact management, calendaring, and conflict search features, but it does not have a case management program. Rather, the program links to third-party case management programs.

Editing the reporting and billing templates is a trial-and-error process. Final bills, however, can be exported for editing in a word processor. While many users may not enjoy this duplication of effort, the feature may be the only way to put the bills into a form that is worthy of being sent to clients.

The time entry page allows users to show multiple matters at one time, and the integrated stopwatch can then be moved from one matter to another. Most other programs use a single time slip interface, which can be burdensome when switching between matters or consolidating time for a given matter. Unfortunately, there is no spell check feature built into the time entry program. Overall, PC Law is an inexpensive, multifeatured program suited for a small firm.

Pro Law. Unlike PC Law, Pro Law is an all-in-one solution with a host of features. In addition to time and billing there is a full suite of office support, including accounting, case management, calendaring, and other modules. The software is made for a client-server environment, and so system requirements are high. Firms will need a dedicated server for Pro Law, and they should not even think about using it on Windows 95, 98, or ME (and soon NT). I tried to run the demo, for example, only to discover that I did not have the system resources. This program is intended for a larger firm with newer hardware that is looking for a broad range of features.

QuickBooks Pro 2003. This is an accounting program, with a timekeeper included in the “pro” version, that has a very strong following with small firms. It is a multifeatured program with no case management ability.

The procedures for creating a client, generating bills, and setting up the time unit require a fair amount of consultation with the manual. This program can be more challenging when attempting to implement customized billing arrangements. The base program has a stopwatch timer, which can be run within the program or as a remote module. There does not seem to be a limit on the number of timekeepers. Invoices can be exported into for-
### Time and Billing Software Comparison

<table>
<thead>
<tr>
<th>Package Type</th>
<th>Supported OS</th>
<th>System Requirements</th>
<th>Pricing</th>
<th>Customer Support</th>
<th>Contact Information</th>
</tr>
</thead>
<tbody>
<tr>
<td>Juris</td>
<td>Stand-alone, modules</td>
<td>Win 98/ME/NT/2000/XP</td>
<td>Pentium III with 128 MB RAM; hard drive with 3 MB</td>
<td>$1,700 for 15 timekeepers and 5 concurrent users</td>
<td>3 months free</td>
</tr>
<tr>
<td>PC Law</td>
<td>Suite</td>
<td>Win 98/ME/NT/2000/XP</td>
<td>Pentium 200 MHZ; 32 MB RAM</td>
<td>$195 for 2 timekeepers; $100 for each added timekeeper; network version more</td>
<td>3 or 6 months free, depending on base package</td>
</tr>
<tr>
<td>Pro Law</td>
<td>Suite</td>
<td>Win/NT/2000/XP</td>
<td>Pentium 200 MHZ; hard drive with 175 MB free space; IE 6.0</td>
<td>$299.95, no limit on the number of timekeepers; up to 5 simultaneous users</td>
<td>Included in monthly fee for 15 users or less</td>
</tr>
<tr>
<td>Quick Books</td>
<td>Suite</td>
<td>Win 95/98/ME/2000/NT/4.0/XP</td>
<td>Pentium 200 MHZ; 64 MB RAM; hard drive with 175 MB free space; IE 6.0</td>
<td>$295 for 2 timekeepers on a single computer or $995 for 5 timekeepers on a server</td>
<td>Free installation support</td>
</tr>
<tr>
<td>R.T.G.</td>
<td>Stand-alone</td>
<td>Win 95/98/ME/2000/XP</td>
<td>Pentium 133 MHZ; 32 MB RAM; 20 MB free hard drive space</td>
<td>$75 single computer or network; up to 99 timekeepers; only 10 can access the program at one time; one remote module included</td>
<td>Lifetime e-mail support</td>
</tr>
<tr>
<td>Tabs</td>
<td>Stand-alone</td>
<td>Win 98/ME/2000/NT/XP</td>
<td>Pentium, 64 MB RAM; 20 MB free hard drive space</td>
<td>$295 for 2 timekeepers on a single computer or $995 for 5 timekeepers on a server</td>
<td>60 days free</td>
</tr>
<tr>
<td>Timeslips</td>
<td>Stand-alone</td>
<td>Win 98/ME/2000/NT/XP</td>
<td>Pentium 333 MHZ; 64 MB RAM, 128 MB recommended; 100 to 110 MB free hard drive space</td>
<td>$199.95 for 2 users; network version $399.95 single user; $99.95 for each added user or $499.95 for 5 users</td>
<td>30 days free</td>
</tr>
<tr>
<td>Tussman</td>
<td>Suite</td>
<td>Win 95/98/ME/2000/XP</td>
<td>4 MB free hard drive space</td>
<td>$395 for 3 timekeepers; $50 for each additional timekeeper; network version more</td>
<td>6 months free</td>
</tr>
<tr>
<td>Verdict</td>
<td>Stand-alone</td>
<td>Win 95/98/ME/2000/XP</td>
<td>Pentium 300 MHZ; 32 MB RAM</td>
<td>$1,295 unlimited timekeepers; $1,495 network version allowing 10 simultaneous users</td>
<td>30 days free</td>
</tr>
</tbody>
</table>

mats for word processing. This program comes bundled with an accounting program that is popular with a number of small firms, but it does not have the ease of use and capabilities of some other programs.

**R.T.G. Data Systems.** Version 2.10 is a stand-alone program with a low cost. The program allows users to establish rate tables, which can be assigned by case. This helps the timekeeper to avoid guesswork if the firm uses more than one rate structure. Also, there is a spell checker for the billing descriptions.

The stopwatch method of tracking time is only available with the included remote module. The initial price is the lowest in the test group, but providing the stopwatch feature to all timekeepers adds $15 per head. The overall cost is still likely to be less, however, than that of the other vendors, because they apply the per-seat method of licensing. The software offers no live support. Only support via e-mail is provided, but unlike the other vendors, which charge for support after a brief initial period, RTG claims to offer lifetime support. Overall, this software has the features that a small firm or solo needs, and it is a good value for the price.

**Tabs 3.** Version 11 has a stand-alone time and billing module that can be combined with practice management and accounting modules. Right out of the box, the program asks users for passwords and access rights. Careful attention to the instructions for the setup of this program is essential. This is a feature-rich program, but it is somewhat difficult to set up. For larger firms the access controls are essential, although small firms and solo practitioners may find them burdensome.

This program has a spell checker. On the other hand, navigation to open time slip entries and to open clients and matters is less direct than it is on other programs. Some of the other products are likely to be easier to set up and use, but this program may have strong appeal to firms that want to integrate practice management and accounting features in one package.

**Timeslips.** Version 11 is a stand-alone program that links to many popular case management and accounting programs. The company was recently acquired by the makers of the Peachtree accounting program, so greater integration into Peachtree may follow. The program uses an interface for opening new clients and entering time that requires some practice. A wide variety of billing types and practices are permitted, but adjusting and revising selections can be difficult. Even with a detailed set of tools for formatting bills and modifying the templates, these tasks are not a simple exercise.

This program has been a popular choice over the years, but first-time users will be
Even Los Angeles’ Top Law Firms Need a Consultant at Their Side

CB Richard Ellis Law Firm Practice Group: Delivering Real Estate Solutions in Los Angeles and Around the Globe

<table>
<thead>
<tr>
<th>#</th>
<th>LAW FIRM</th>
<th>ADDRESS</th>
<th># OF ATTORNEYS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Latham &amp; Watkins*</td>
<td>633 West Fifth Street</td>
<td>321</td>
</tr>
<tr>
<td>2</td>
<td>O’Melveny &amp; Myers LLP</td>
<td>400 South Hope Street</td>
<td>299</td>
</tr>
<tr>
<td>3</td>
<td>Lewis Brisbois Bisgaard &amp; Smith LLP</td>
<td>221 North Figueroa Street</td>
<td>205</td>
</tr>
<tr>
<td>4</td>
<td>Gibson Dunn &amp; Crutcher LLP</td>
<td>333 South Grand Avenue</td>
<td>203</td>
</tr>
<tr>
<td>5</td>
<td>Sheppard Mullin Richter &amp; Hampton LLP</td>
<td>333 South Hope Avenue</td>
<td>191</td>
</tr>
<tr>
<td>6</td>
<td>Paul Hastings Janofsky &amp; Walker LLP</td>
<td>515 South Flower Street</td>
<td>170</td>
</tr>
<tr>
<td>7</td>
<td>Sidley Austin Brown &amp; Wood</td>
<td>555 West Fifth Street</td>
<td>154</td>
</tr>
<tr>
<td>8</td>
<td>Jones Day</td>
<td>555 West Fifth Street</td>
<td>140</td>
</tr>
<tr>
<td>9</td>
<td>Quinn Emanuel Urquhart Oliver &amp; Hedges LLP</td>
<td>865 South Figueroa Street</td>
<td>140</td>
</tr>
<tr>
<td>10</td>
<td>Munger Tolles &amp; Olson LLP</td>
<td>355 South Grand Avenue</td>
<td>128</td>
</tr>
<tr>
<td>11</td>
<td>Skadden Arps Slate Meagher &amp; Flom LLP</td>
<td>300 South Grand Avenue</td>
<td>124</td>
</tr>
<tr>
<td>12</td>
<td>Morrison &amp; Foerster LLP</td>
<td>555 West Fifth Street</td>
<td>121</td>
</tr>
<tr>
<td>13</td>
<td>Bingham McCutchen LLP</td>
<td>355 South Grand Avenue</td>
<td>113</td>
</tr>
<tr>
<td>14</td>
<td>Pillsbury Winthrop LLP</td>
<td>725 South Figueroa Street</td>
<td>95</td>
</tr>
<tr>
<td>15</td>
<td>Morgan Lewis &amp; Bockius LLP</td>
<td>300 South Grand Avenue</td>
<td>92</td>
</tr>
<tr>
<td>16</td>
<td>Musick Peeler &amp; Garrett LLP</td>
<td>One Wilshire Boulevard</td>
<td>75</td>
</tr>
<tr>
<td>17</td>
<td>Fulbright &amp; Jaworski LLP</td>
<td>865 South Figueroa Street</td>
<td>74</td>
</tr>
<tr>
<td>18</td>
<td>Howrey Simon Arnold &amp; White LLP</td>
<td>550 South Hope Street</td>
<td>73</td>
</tr>
<tr>
<td>19</td>
<td>Manning &amp; Marder Kass Ellrod Ramirez LLP</td>
<td>660 South Figueroa Street</td>
<td>72</td>
</tr>
<tr>
<td>20</td>
<td>Milbank Tweed Hadley &amp; McCloy LLP</td>
<td>601 South Figueroa Street</td>
<td>71</td>
</tr>
<tr>
<td>21</td>
<td>Arnold &amp; Porter</td>
<td>777 South Figueroa Street</td>
<td>70</td>
</tr>
<tr>
<td>22</td>
<td>Mayer Brown Rowe &amp; Maw LLP</td>
<td>350 South Grand Avenue</td>
<td>70</td>
</tr>
<tr>
<td>23</td>
<td>Sonnenschein Nath &amp; Rosenthal LLP</td>
<td>601 South Figueroa Street</td>
<td>69</td>
</tr>
<tr>
<td>24</td>
<td>Heller Ehrman White &amp; McAuliffe LLP</td>
<td>601 South Figueroa Street</td>
<td>66</td>
</tr>
<tr>
<td>25</td>
<td>Richards Watson &amp; Gershon</td>
<td>355 South Grand Avenue</td>
<td>63</td>
</tr>
</tbody>
</table>

* Represented with the General Services Office at 555 W Fifth Street

Source: Los Angeles Downtown News, November 24, 2003
The Downtown List, Law Firms, Ranked by number of attorneys

CBRE

COMMERCIAL REAL ESTATE SERVICES

For more information, contact Lewis Horne, Executive Managing Director, at 213.613.3305, or visit www.cbre.com
spending some time with the manual in order to use the program with confidence. According to the manufacturer, the latest release (Timeslips 2004) has spell checking.

**Tussman Programs.** Version 7 is a stand-alone that can be combined with other modules, including calendaring, accounting, network use, and remote use. Tussman is promoted as a program written for lawyers by lawyers. The initial setup instructions are easy to follow, which is good because it is important to follow these steps for the program to run properly. Opening clients and matters is simple. New client entries automatically require users to establish matters. The program has a good interface, with a thoughtful layout of information.

One helpful feature is a calculator that can be used to determine elapsed time. This is very helpful for lawyers who track time without using a computer stopwatch. Modifying the template for billing statement formats is a trial-and-error process. After working through numerous options, the result has to be printed before users can see what has been created. This program allows users to retrieve and modify a final bill. Other programs have varying degrees of this ability. Overall, this is one of the better time and billing programs.

**Verdict.** The honor of being the oldest software company in this area may belong to Micro Craft, the maker of Verdict 9.0. It can trace its software back to a time before DOS. Verdict 9.0 is a stand-alone program with modules. Although the base cost of this program is at the high end, Verdict 9.0 does not charge users based on a per-user method. The number of timekeepers is unlimited, although the base network version allows no more than 10 users to post simultaneously. The program has a spell checker, and users can retrieve up to six past months of billing in order to correct entries. A lot of client and account information is displayed in the screens, whereas with other programs users need to generate a report in order to display additional information. Some may consider the ample display confusing, however.

As with other programs, some time with the manual may be needed to get started and to work with the configuration settings that provide flexibility with bills and reports. The program has an appealing pricing format if a firm intends to have more than 10 users, but it has a somewhat steep learning curve.

According to Abraham Lincoln, “A lawyer’s time and advice are his stock in trade.” Lawyers have many choices in time and billing applications, each of which has its appeal for a particular market. Whether the software is part of a suite or stands alone, it plays a vital role in a firm’s practice.
EXPERTS/CONSULTANTS

NEED AN EXPERT WITNESS, legal consultant, arbitrator, mediator, private judge, attorney who outsources, investigator, or evidence specialist? Make your job easier by visiting www.expert4law.org. Sponsored by the Los Angeles County Bar Association, expert4law—the Legal Marketplace is a comprehensive online service for you to find exactly the experts you need.

FOR SALE

FISHING AND DIVING SPORT BOAT. 1994 Proline walk-around twin V8 gas fish finder, radar, color GPS chartplotter, bait tank, outriggers, and stand up head. Sleeps 3. $43,500. (949) 642-3035.

LEGAL SERVICES

PAPER TO CD CONVERSION: PearlMark scans in, stores up to 20,000 pages on one CD and security shreds files for one low price per page. www.pearlmark.com, or call (800) 884-1255 for details. We also scan and convert to Word or WordPerfect formats. End document storage problems. Free sample.

MEDIATION

SEASONED CORPORATE INVESTMENT BANKER now serving as mediator in large and complex financial disputes, transactions, and projects. Take advantage of 25 years of expertise and hands-on deal experience in law and business to help resolve difficult financial issues, work through complicated business disputes, or close tough deals. Paul Bent-Mediator/Attorney/Investment Banker. (562) 432-8700 www.paulbent.com.

OFFICE SPACE

SOUTHERN CALIFORNIA. FREE. Executive Suite Offices Guide. Eighty-page booklet lists over 150 buildings in Los Angeles, Orange, San Diego Counties and the Inland Empire that offer executive suites. Guide includes office prices, amenities offered, photos, maps, and contacts. Mailed the same day ordered. Call 24 hours: (800) 722-5622.


PRACTICE FOR SALE


PLEASE SUPPORT THOSE THAT SUPPORT THE LOS ANGELES COUNTY BAR ASSOCIATION!

NORIEGA CHIROPRACTIC CLINICS, INC.

Is proud to announce the Grand Opening of
SAN FERNANDO HEALTH CENTER
500 S. BRAND BOULEVARD
SAN FERNANDO, CA 91340-4002
(818) 838-1158

Personal Injury and Worker’s Comp cases accepted on lien basis.

*MONTEBELLO HEALTH SERVICES
901 W. Whittier Blvd.
Montebello, CA 90640
(323) 728-8268

*ONTARIO HEALTH SERVICES
334 N. Euclid Ave.
Ontario, CA 91764
(909) 395-5598

*EL MONTE HEALTH CENTER
2163 Durfee Rd.
El Monte, CA 91733
(626) 401-1515

HUNTINGTON PARK HEALTH CENTER
3033 E. Florence Ave.
Huntington Park, CA 90255
(323) 582-8401

POMONA HEALTH CENTER
1180 N. White Ave.
Pomona, CA 91768
(909) 623-0649

VICTORY HEALTH CENTER
6420 Van Nuys Boulevard
Van Nuys, CA 91401
(818) 988-8480

CRENSHAW HEALTH CENTER
4243 S. Crenshaw Blvd.
Los Angeles, CA 90008
(323) 291-5733

HIGHLAND PARK HEALTH CENTER
5421 N. Figueroa St.
(Highland Park Plaza)
Highland Park, CA 90042
(323) 478-9771

SO. CENTRAL HEALTH CENTER
4721 S. Broadway
Los Angeles, CA 90037
(323) 234-3100

WHITTIER HEALTH SERVICES
13019 Bailey Ave., Suite F
Whittier CA 90601
(562) 698-2411

1-800-624-2866

*Medical facilities in Montebello and Ontario only
Important Announcement

Esquire One Publishing is now doing business as Litigation One™

Our name has changed, but we’re still the same attorney-owned company that is committed to providing "first stop" resources for California litigators. Visit our new website to see how our growing book list can help enhance your pre-trial motions, motions in limine, discovery responses, auto cases or trial tactics.

www.litigationone.com

Index to Advertisers

Aon Direct Admin./LACBA Prof. Liability, p. 5
Tel. 800-634-9177 www.attorneys-advantage.com

AT&T Wireless, Inside Back Cover
Tel. 213-253-2400 www.attwireless.com

Law Office of Donald P. Brigham, p. 26
Tel. 949-206-1661 e-mail: db Brigham@earthlink.net

CB Richard Ellis, p. 55
www.cbre.com

Cohen & Associates, Inc., p. 37
Tel. 310-315-5404 www.litigationbusters.com

Cohen Miskei & Mowrey, p. 18
Tel. 818-986-5070 e-mail: cmrn@aol.com

Coldwell Banker, p. 6
Tel. 818-905-7111 e-mail: ToddR@realtor.com

Commerce Escrow Company, p. 52
Tel. 213-484-0855 www.comescrow.com

CourtCall, LLC, p. 41
Tel. 888-882-6878 e-mail: courtcall@aol.com

Law Offices of Robert E. Covello, p. 4
Tel. 310-277-6768 www.covello-law.com

DataChasers, Inc., p. 56
Tel. 909-780-7892 www.datachasersinc.com

Entity Services, LLC, p. 15, 18
Tel. 302-654-7584 www.entityservices.com

Executive Law Group, p. 27
Tel. 888-920-3932 www.execlaw.com

First American Exchange Company, p. 21
Tel. 888-835-3077 www.la1031.com

ForensiGroup, Inc., p. 37
Tel. 626-795-5000 www.forensigroup.com

Samuel K. Freshman, p. 16
Tel. 310-410-2300 www.strdmgmt.com

Gibbs, Giden, Locher & Turner, LLP, p. 37
Tel. 310-552-3400 www.gglt.com

Steven L. Gleitman, Esq., p. 45
Tel. 213-617-7775 www.hlmlinc.com

Hirson Wexler Perl, p. 38
Tel. 323-936-0200 www.hirson.com

Invisible Furniture, p. 8
Tel. 818-757-1444 www.invisiblefurniture.com

Jack Trimmer & Associates Polygraph, Inc., p. 29
Tel. 310-247-2637 e-mail: jtrimarco@aol.com

Jeffrey Kichaven, p. 21
Tel. 310-556-1444 www.jeffkichaven.com

KARS Advanced Materials, Inc., p. 26
Tel.714- 892-8987 www.karslab.com

lawnetinfo.com, p. 58
Tel. 818-727-1723 www.lawnetinfo.com

Lawyers’ Mutual Insurance Co., p. 7
Tel. 800-252-2045 www.lawyersmutual.com

LexisNexis, p. 1, 9
www.lexis.com

The Mann Law Firm, p. 35
Tel. 310-556-1500 e-mail: Mann@silre.com

Arthur Mazriow, p. 27
Tel. 310-255-6114 e-mail: am@ffslaw.com

Laurence D. Merritt, p. 56
Tel. 818-710-3823 www.legalknowit.com

MyCorporation.com, Inside Front Cover
Tel. 888-692-6771 www.mycorporation.com

Nation’s Surety, p. 36
Tel. 877-NAT-SURE www.nations-surety.com

National Properties Group, p. 45
Tel. 310-516-0022

National Registered Agents, Inc., p. 17
Tel. 800-550-6724 e-mail: info@nrai.com

Noriega Clinics, p. 57
Tel. 323-728-8268

North American Title Company, p. 2
Tel. 818-240-4912 www.natic.com

Old Republic Title Co., p. 11
Tel. 818-228-4853 www.ortc.com

One Legal, Inc., p. 26
Tel. 415-491-0606 www.onelegal.com

Ostrove, Kranz & Ostrove, p. 27
Tel. 323-939-3400 www.lawyers.com/ok&olaw

Overland Pacific & Cutler, Inc., p. 50
Tel. 562-304-2000 www.opcservices.com

Pacific Crest Bank, p. 6
Tel. 800-821-1714 www.pacificcrestbank.com

Pacific Health & Safety Consulting, Inc., p. 36
Tel. 949-253-4065 www.phs-web.com

Pro/Consul Technical & Medical Experts, p. 14
Tel. 800-392-1119 www.expertinfo.com

Quo Jure Corporation, p. 28
Tel. 800-843-0660 www.quojure.com

Jan Raymond, p. 8
Tel. 888-676-1947 e-mail: jan@naj.net

Rogers, Sheffield & Campbell, p. 28
Tel. 805-963-9721 www.hugh-techlawyer.com

Sanli Pastore & Hill, Inc., p. 29
Tel. 310-571-3400 www.iph.com

Steven R. Sauer APC, p. 29
Tel. 323-933-6833 e-mail: arbitt@aol.com

Stephen Sears, CPA-Attorney at Law, p. 56
www.searsatty.com

Anita Rae Shapiro, p. 45
Tel. 714-529-0415 www.aars-shapiro.com

ULTIMO Organization, Inc., p. 51
Tel. 714-560-8999 www.geotechnical.com

Vision Sciences Research Corporation, p. 22
Tel. 925-837-2083 www.vsrc.net

Tommy Walker, Inc., p. 17
Tel. 818-760-3355

Law Offices of Alan D. Wallace, p. 22
Tel. 818-501-0606 www.expertwitnessre.com

West Group, Back Cover
Tel. 818-228-4853 www.westlaw.com

White, Zuckerman, Warsavsky, Luna & Wolf, p. 36
Tel. 818-981-4226 www.wzwlw.com

Wirkin & Eisinger, LLC, p. 45
Tel. 310-670-1500

Lillian Wyshak, p. 56
Tel. 310-273-0223

ALL MEMBERS of the Los Angeles County Bar Association receive a FREE COPY of the Southern California Directory of Experts & Consultants, the most comprehensive registry of legal expertise in the region.

The 2004 directory contains more than 2,000 listings! Don’t forget to use it when you are looking for medical, technical, scientific and forensic expert witnesses, litigation consultants, trial support services, alternative dispute resolution service providers, and the Lawyer-to-Lawyer Consultants Network.
**CLE Preview**

### Persuasive Legal Writing

ON SATURDAY, JANUARY 28, the Los Angeles County Bar Association will present a program by noted appellate attorney Daniel U. Smith and Associate Justice Earl Johnson Jr. of the California Court of Appeal. The course will offer instruction on how to write with brevity, simplicity, and clarity—the opposite of what lawyers learn in law school. The speakers will also show how to create compelling briefs through word choice, sentence and paragraph structure, and argument. The course offers key steps for easy drafting and effective editing. Attorneys of all experience levels will benefit from this program, which provides three hours of legal specialization credit in appellate practice. The course will be held at the LACBA/LEXIS Publishing Conference Center, 281 South Figueroa Street, Downtown. Parking at the Figueroa Courtyard Garage will be available for $7 with LACBA validation. On-site registration and the meal and reception will begin at 5:30 P.M., with the program continuing from 6 to 9:15. The registration code number is 7094A28.

- $95—CLE+Plus members
- $165—LACBA members
- $200—all others
- 3.25 CLE hours

### Power Point for Litigators

ON THURSDAY, JANUARY 22, the Los Angeles County Bar Association, in cosponsorship with the Litigation Section, will present “Power Point for Litigators.” Speaker Russell Jackman will show participants how demonstration programs (Microsoft’s Power Point software will be used primarily) can be an integral part of trial and business presentations. Participants are encouraged to bring their laptops for a more interactive experience. Please note that there is limited power access, which will be assigned on a first-come, first-served basis. As a result of the program, participants will be able to create a variety of dynamic, informative, and useful slides and slide shows with Power Point for a number of potential legal scenarios. Also, participants will receive a copy of the NITA’s *Power Point for Litigators*. This program will be held at the LACBA/LEXIS Publishing Conference Center, 281 South Figueroa Street, Downtown. Parking at the Figueroa Courtyard Garage will be available for $7 with LACBA validation. On-site registration and the meal and reception will begin at 5:30 P.M., with the program continuing from 6 to 9:15.

- $150—CLE+Plus members
- $200—Litigation Section members
- $225—members of any other LACBA section
- $300—LACBA members
- $450—all others
- 3.25 CLE hours

---

**Duties of Board Members under Chapter 11**

ON TUESDAY, JANUARY 13 (note the new date), the Bankruptcy Committee of the Commercial Law and Bankruptcy Section as well as the Business and Corporations Law Section will present a program titled “Legal Ethics: Fiduciary Duty and Corporate Governance,” which will examine the duties of boards of directors prior to and after filing chapter 11. Speakers M. Jonathan Hayes and Morton G. Rosen will also discuss the effect of a secured lender on the board. The event will take place at the LACBA/LEXIS Publishing Conference Center, 281 South Figueroa Street, Downtown. On-site registration will begin at 11:45 A.M. and lunch at noon, with the program continuing from 12:30 to 1:30 P.M. The registration code number is 8291 (810LA13). CLE+Plus members may attend for free ($15 meal not included). The prices below include the meal.

- $55—members of either section
- $65—LACBA members
- $75—all others
- 1 CLE ethics hour

---

The Los Angeles County Bar Association is a State Bar of California MCLE approved provider. To register for the programs listed on this page, please call the Member Service Department at (213) 896-6560 or visit the Association Web site at http://forums.lacba.org/calendar.cfm. For a full listing of this month’s Association programs, please consult the January County Bar Update.
The Increased Risk of Slander of Title

A recent appellate decision makes recording a lis pendens a malpractice hazard

There was a time when recording a lis pendens in California was absolutely privileged. That changed in 1993, when the state legislature enacted a new statute that explicitly stripped away this protection. A second piece of legislation passed in 1993 further required the attorney of record in the underlying action to sign any lis pendens before it could be recorded. The combined effect of these two statutory provisions was to impose potential liability for slander of title on any attorney prosecuting a lis pendens case.

That risk of liability changed from theoretical to deadly serious last year with the decision of an appellate court in Palmer v. Zaklama. In Palmer, two physicians, the Zaklamas, lost a residence in a sheriff’s sale. The two doctors then filed an appeal from the judgment that had resulted in the sheriff’s sale and filed for personal bankruptcy as well. Lis pendens that referred to both proceedings were later recorded in official records. In an ensuing lawsuit, the doctors argued that their appeal from the judgment that had resulted in the sheriff’s sale and their personal bankruptcy, each individually, had the potential to reverse the effect of the sheriff’s sale. The court of appeal nonetheless affirmed a jury verdict against them, inter alia, for slander of title based on these two lis pendens. Relying on Civil Code Section 47(b)(4), Palmer held:

If the pleading filed by the claimant in the underlying action does not allege a real property claim, or the alleged claim lacks evidentiary merit, the lis pendens, in addition to being subject to expungement, is not privileged. It follows the lis pendens in that situation may be the basis for an action for slander of title [citations omitted].

Thus, under Palmer, anyone who either records a lis pendens that fails to properly allege a real property claim or who otherwise loses on the merits of a properly alleged real property claim can be sued for slander of title. While many individuals, particularly members of the defense bar, have long argued that the lis pendens is too often used as legal blackmail, under Palmer the erosion of the lis pendens has gone too far. A perfectly plausible lis pendens may eventually be expunged under the preponderance of the evidence standard that is applicable in such matters.

In most situations, the only way a lawyer can be held liable to an adverse party is through the mechanism of a malicious prosecution action. Not only are such malicious prosecution cases disfavored generally, the California Supreme Court has recently confirmed they are also subject to the anti-SLAPP statute. But just when the legal profession received some relief from malicious prosecution exposure, along came Palmer, with its expansive notion of when an attorney’s slander of title liability attaches in lis pendens cases.

After Palmer, why would any sensible lawyer sign a lis pendens and thereby expose himself or herself to slander of title liability to a litigation adversary? With malpractice rates now at historic highs, the last thing any attorney would want to do is something that creates a direct cause of action for an adverse party. Once members of the bar appreciate the impact of Palmer, the use of lis pendens, even in the most meritorious cases, will largely become a thing of the past.

The only solution to this problem is new legislation sharply limiting the holding in Palmer. At a minimum, the provisions of the 1993 law stripping away the absolute privilege must be limited to cases in which the lis pendens in question was published without probable cause—that is, only lis pendens that refer to underlying actions that cannot even arguably be construed as containing a real property claim or real property claims that lack any possible merit would result in liability for the attorney who signed the lis pendens.

When the lis pendens law was revised in 1993, the Real Property Section of the California State Bar did much of the behind-the-scenes work. That law was aimed at carefully reignining perceived abuses of the lis pendens but not eliminating entirely the lis pendens remedy. In contrast, the 1993 law that stripped away the absolute privilege to file a lis pendens was sponsored by State Senator Quentin Kopp, who consulted with nobody. With the holding in Palmer now part of state law, the Kopp bill must be viewed as having fully undermined the State Bar’s bill. In the post-Palmer world, no sensible lawyer is ever likely to record a lis pendens again. This extreme result must not be allowed to stand unchallenged.


Los Angeles Lawyer invites its readers to submit articles for the Closing Argument column. Topics should be of immediate interest to members of the legal profession and should not exceed 850 words in length. Please send submissions to: Closing Argument Editor, Los Angeles Lawyer, 261 South Figueroa Street, Los Angeles, CA 90012-2503.

William McGrane is a partner in the San Francisco office of McGrane, Greenfield, Hannon & Harrington LLP.
When your association membership saves you money on wireless service, it's an easy call to make.

Members of the Los Angeles County Bar Association can save with AT&T Wireless. Choose from a range of already affordable calling plans and get a 5% discount on qualified wireless service charges each month.

TO SIGN UP AND SAVE CALL: 1 800 459-6524

©2003 AT&T Wireless. All Rights Reserved. General requirements: Requires credit approval, $36 Activation Fee, annual contract, $175 cancellation fee and a compatible phone. Subject to service terms and conditions and the calling plan brochure for the specific plan you choose. Service not available for purchase or use in all areas. May not be available with other offers. 5% Discount: Available only to active members of associations participating in the AT&T Wireless Association Program or its predecessor. Discount is activated only when you call the toll-free membership verification number listed above. Discount is only available on select AT&T Wireless digital calling plans and only applies to qualified charges as defined in your association’s AT&T Wireless Services Wireless Association Agreement. It may take up to 90 days for the discount to appear on your account. Other terms, conditions and restrictions apply—contact your association or your local AT&T Wireless Account Representative.
The Miller & Starr series is recognized by attorneys and courts alike as the most extensive and thorough exposition of California real property law. Available in print and online, this series includes a treatise, forms, digest, news alerts, and annotated statutes. It’s the right environment for your practice. Differences that matter.

For more information, call 1-800-762-5272.