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24th annual real estate law issue

Asset Protection Planning Now Can Insulate Your Clients’ Assets From Future Judgments

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Mr. Gleitman has practiced sophisticated estate planning for 26 years, specializing for more than 14 years in offshore asset protection planning. He has had and continues to receive many referrals from major law firms and the Big Four. He has submitted 52 estate planning issues to the IRS for private letter ruling requests; the IRS has granted him favorable rulings on all 52 requests. Twenty-three of those rulings were on sophisticated asset protection planning strategies.

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A simple phrase became a hallmark of a successful White House campaign: “The economy, stupid.” Political strategist James Carville wrote those three words on a sign and hung it in Bill Clinton’s campaign headquarters in 1992. Four presidential campaigns and 17 years later, and despite repeated use by scores of politicians and pundits, the inherent truth of the phrase remains, especially as the U.S. economy has nosedived since 2007.

Paul Krugman, the 2008 Nobel Prize economist, wrote in the New York Times, “We’re in the midst of the worst stock market crash since the Great Depression...unemployment claims are surging, manufacturing production is plunging, interest rates on corporate bonds—which reflect investor fears of default—are soaring....”

Statistics paint an equally bleak picture of the California economy. The state government has an $11.2 billion budget deficit for the current fiscal year. Unemployment was at 8.2 percent near the end of 2008 and is projected to rise to almost 10 percent by mid-2009. Median home prices declined statewide from $424,000 in 2007 to $278,000 a year later, a drop of 34 percent.

While policy makers craft the appropriate financial tools to jump start the economy, the legal process is playing an equally vital role in helping individuals, businesses, and even public agencies through these difficult times. This year’s annual Real Estate Law issue reflects the strong interrelationship between the economy and the law, including the impact that both have on real property.

Foreclosures are one issue. By early September 2008, approximately 2,000 foreclosure notices were being filed in California each business day. Shortly thereafter, after SB 1137 became law, the number leveled off to roughly 500 per day. While this decline is not completely attributable to the new law, lenders have had to delay foreclosures and work with borrowers in default or at risk of becoming so.

Affordable housing is a second. While many can barely afford their mortgage or rent, others find the cost of finding a decent, safe place to live well beyond their means. The legislature enacted SB 1818 in 2004 to provide developers with incentives to build affordable housing. Many local governments struggled to implement the law, and its impact is now only beginning to be seen. The results so far are mixed; for rental housing, it appears to work, while the contrary seems true for for-sale housing.

Real estate partnerships are a third. When times were good, everyone wanted in on the action, and financial investors were no different. Rather than restrict their role to that of lender, many decided to partner with developers and contribute equity. Now that deals have gone south or seem headed in that direction, investors are looking to extricate themselves from these partnerships.

Finally, there is public infrastructure. As the coffers of public agencies dwindle, many are focusing on state laws allowing public and private entities to partner and fund critical repairs to public facilities, such as courthouses.

We hope you find this issue of Los Angeles Lawyer not only topical but also insightful into key legal issues that have arisen or will arise for real estate practitioners in 2009. We express our gratitude to our authors for their invaluable contributions to this issue.

R.J. Comer is a partner at Armbruster & Goldsmith LLP, where he specializes in land use law and municipal advocacy. Ted M. Handel is of counsel at Landmark Law Group, Inc., where he represents clients on affordable housing projects and other transactional real estate matters. Comer and Handel are the coordinating editors of the 24th annual Real Estate Law issue.
**Predictability** – predict’a-bil’i-ty, noun

1.) An alternative for Confidence. ie – Lawyers’ Mutual Insurance Company (LMIC)

2.) The extent to which future states of a system may be predicted based knowledge of current and past states of the system. ie – LMIC

3.) Measured by the variability in achieving cost, performance objectives and the quality of being predictable. – syn: LMIC

**Stability** – sta’bil’i-ty, noun

1.) A stable order. ie – Lawyers’ Mutual Insurance Company (LMIC)

2.) The quality of being enduring and free from change or variation. – syn: LMIC

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Applying the Rules of Multidistrict Litigation

According to the website for the Judicial Panel on Multidistrict Litigation (JPML), there were nearly 300 federal multidistrict litigations (MDLs) pending on October 13, 2008. The subject matter of litigation suitable for MDL is wide-ranging: air disasters, antitrust, common disaster, contract, employment practices, intellectual property, products liability, sales practices, and securities. Each MDL may involve dozens, hundreds, or even thousands of plaintiffs. Lawyers who work on complex litigation may become involved in MDL, so a working knowledge of MDL procedure is important.

Enacted 40 years ago, the MDL statute is intended to provide centralized management for complex litigation filed in multiple federal district courts. MDL is meant to assure “the ‘just and efficient conduct’ of such actions. The... possibility for conflict and duplication in discovery and other pretrial procedures in related cases can be avoided or minimized by such centralized management. To accomplish this objective the bill provides for the transfer of venue for... conducting coordinated pretrial proceedings.”

MDL jurisdiction is limited. MDL can only be used to coordinate cases that are pending in multiple federal district courts into one federal district court; it has no effect on state court cases. Moreover, MDLs are established for pretrial proceedings only.

The JPML usually has seven circuit and district court judges who are appointed by the chief justice, no two of whom may come from the same circuit. The concurrence of four members of the JPML is required for any action. The JPML is based in Washington, D.C., but hearing sessions and oral arguments may be heard in federal courts across the United States. Over the past several years, hearing sessions and oral arguments in front of the JPML have taken place every other month (in January, March, May, July, September, and November).

The JPML’s Test

The function of the JPML is limited to the following questions: 1) Should there be an MDL? 2) If so, where should the MDL be located? and 3) What cases should be transferred into the MDL? When an MDL is contemplated, the JPML will provide notice to the parties to all actions that may be affected. This notice may include an admonition to counsel to limit oral argument to the criteria established in In re “East of the Rockies” Concrete Pipe Antitrust Litigation, which sets forth 20 broad, fact-specific questions that can be asked to determine whether an MDL should be established. The analysis depends on the facts and circumstances of each litigation.

If the JPML decides that centralization is appropriate, its next step is to determine where the MDL should be located. Similar to the determination regarding the establishment of MDL, the location of the MDL is determined according to facts and circumstances. No hard and fast rules apply to the selection of the judge who will preside over the MDL, but considerations include 1) pending constituent actions, 2) experience, and 3) workload and caseload. Some other factors that the JPML may consider include: 1) the location of the evidence, 2) the place of the tortious event, 3) the location of the parties and witnesses, 4) the size of the cases, 5) the nature of the pending cases, 6) coordination with other federal proceedings, 7) coordination with state proceedings, 8) the familiarity of the judge with the issues, 9) the preference of the parties, and 10) the relative advancement of the cases. These factors are exemplary, not exhaustive, and “[t]he Panel has never articulated a ‘formula’ or standard used to balance the various fac-

MDL can only be used to coordinate cases that are pending in multiple federal district courts into one federal district court; it has no effect on state court cases.

Another issue for the JPML to examine is which cases can be transferred. If the JPML determines that centralization is appropriate, the MDL will be established through an initial transfer order that specifies: 1) what pending cases will be transferred, 2) the district court where the cases will be transferred, and 3) which judge will preside over the MDL. Only pending cases in separate districts that were listed in the motion for transfer will be transferred to the MDL at the time the transfer order is issued. Additional, related cases can be transferred to the MDL after it is established. These are called tag-along actions. Attorneys contemplating MDL should review the JPML rules for more details about filing papers, motion practice, oral argument, and tag-along actions.

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**Regulations for Condominium Hotels**

CONDOMINIUM HOTELS are one of the most popular real estate trends in the hospitality industry, proliferating throughout the country and around the world during the past decade. Yet many real estate attorneys, developers’ counsel, and hospitality counsel do not know how to create what are commonly referred to as condo hotels, why they are a popular financing and development model, or how to address the Securities and Exchange Commission implications of these vehicles.

A condominium is an “[o]wnership of a separate interest (the Unit) coupled with a fractional undivided interest in the common areas owned either as tenants in common or through an Association.”1 While a condominium hotel generally looks and operates just like a traditional hotel—with specified hotel rooms, or “units,” owned by individuals—no standard definition of a condominium hotel exists. In fact, the term “condo hotel” is often used indiscriminately to refer to a number of variations on the theme. For example, at some condominium hotel properties, certain rooms are designated for rental to transient hotel guests, while other rooms are designated as condominium units to be owned by individuals who do not participate in any of the services or receive any of the amenities provided to the traditional hotel guests. The most common type of condominium hotels, however, are those in which certain units in a hotel are designated as condominiums to be owned by individuals who participate in all the services of the hotel. And within this type of condominium hotel, individuals might own a unit as a primary residence, benefit from the hotel’s services, and be unable to rent out the unit to transient guests. In others, the condominium owner purchases his or her unit primarily as an investment vehicle or vacation home, renting out the unit during some or all of the year.

In California, creating a condominium hotel requires a subdivision map approved by a local government pursuant to the Subdivision Map Act.2 In addition to local regulations governing construction of the hotel project, each of the condominium units is considered a separate parcel, which must meet local government conditions for design and improvement of the development. These conditions can be extensive, requiring dedications, off-site construction, payment of fees, and preparation of CC&Rs.

In addition, the sale or lease of five or more condominium units also falls under the jurisdiction of the State Department of Real Estate (DRE), pursuant to the Subdivided Lands Law. Subdivisions that fall under DRE jurisdiction cannot be offered for sale or lease until the DRE has confirmed that they meet all statutory requirements—known as affirmative standards—for intended use of the property. The DRE issues a Conditional or Final Public Report detailing information about the project that must be disclosed to all purchasers, including a description of the proposed management of the project. Because a condominium is an interest in property, developers are subject to all normal land use requirements, and purchasers are entitled to the full array of legal protections applicable to the sale of property under California law.

The first condominium hotels were reportedly built in Miami Beach in the early 1980s. However, the popularity of condominium hotels took off in the late 1990s as developers aggressively started selling condominium hotel units, attracted by the potential for up-front fees from condominium purchasers prior to the completion of a hotel project. Through the sale of condominium units, developers could obtain financing for hotel construction or renovation projects even prior to construction. Preselling condominium units also helped

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developers obtain loans because the developer or lender no longer needed to rely solely on the financial projections of incremental profits associated with hotel room rentals traditionally associated with the cyclical hotel industry.

Moreover, condominium hotel units reportedly command a 30 to 40 percent premium over the sale of traditional residential condominiums. The opportunity to realize a quick return on investments even prior to construction caused condominium hotels to sprout up throughout the country, and they have been particularly attractive to buyers in the luxury segment.

In addition, many potential buyers were lured by the attraction of purchasing a condominium hotel unit, often in a luxury hotel or resort destination, as an investment based on the potential for appreciation of the unit and receipt of fees from rental of the unit to transient hotel guests. Indeed, the luxury segment of the condominium hotel industry received another boost when brand management companies and celebrities jumped on the condominium hotel bandwagon, lending their popular names and/or management expertise and track records to condominium hotel projects. For example, George Clooney, Michael Jordan, and others become involved with luxury condominium projects, some of which have been canceled. Hotel management companies, from boutique hotel operators to most of the major hotel brands, have condominium hotels in their pipelines, including Hilton, Hyatt, Ritz-Carlton, Four Seasons, and Starwood. In addition, many potential buyers were lured by the attraction of purchasing a condominium hotel unit, often in a luxury hotel or resort destination, as an investment based on the potential for appreciation of the unit and receipt of fees from rental of the unit to transient hotel guests. Indeed, the luxury segment of the condominium hotel industry received another boost when brand management companies and celebrities jumped on the condominium hotel bandwagon, lending their popular names and/or management expertise and track records to condominium hotel projects. For example, George Clooney, Michael Jordan, and others become involved with luxury condominium projects, some of which have been canceled. Hotel management companies, from boutique hotel operators to most of the major hotel brands, have condominium hotels in their pipelines, including Hilton, Hyatt, Ritz-Carlton, Four Seasons, and Starwood. Finally, from a lifestyle perspective, it is not surprising that condominium hotels have been particularly attractive to buyers in the luxury segment. After all, who has not imagined living in a hotel and partaking in all its amenities, such as valet parking, room service, on-site restaurants, spas, and much more? In contrast to a traditional residential condominium, condominium hotel unit owners also benefit from living in a residence managed by a world-class team, making repairs and providing day-to-day management expertise that might typically be the domain of a condominium association.

**Issues for Owners, Developers, and Managers**

When the increase in condominium hotels became a frenzy in the late 1990s, many industry observers expressed concern about a number of potential issues that might arise. This was because the concept of the condominium hotel is unlike prior trends in the hospitality industry, such as timeshares and fractional ownerships. For example, how would management companies manage properties in which some tenants are transient guests and others are individual unit owners or represented by condominium associations? How would a brand management company enforce its brand standards, and upgrades of those standards, against individual condominium owners? How would a management agreement obtain approvals, if necessary, from each condominium owner? Would owners place a sufficient number of their condominium units into the hotel’s reservation pipeline to maintain the profitability of the hotel for the management company? How would conflicts between management companies and homeowners’ associations be resolved?

Perhaps the inquiry most frequently posed as the sale of a condominium unit is considered a security under federal securities laws is whether the sale of a condominium unit might constitute a sale of a security under federal securities laws. Sale of a condominium hotel unit could be governed by both state DRE and federal SEC regulations. The issue of whether the sale of a condominium unit is governed by federal securities laws is significant because of the potential implications for condominium hotel business practices and the potential liabilities and remedies available to buyers and sellers of condominium hotels. This important issue might soon be resolved as the result of an explosion of recent cases involving condominium hotel transactions. In addition, many potential buyers were lured by the attraction of purchasing a condominium hotel unit, often in a luxury hotel or resort destination, as an investment based on the potential for appreciation of the unit and receipt of fees from rental of the unit to transient hotel guests. Indeed, the luxury segment of the condominium hotel industry received another boost when brand management companies and celebrities jumped on the condominium hotel bandwagon, lending their popular names and/or management expertise and track records to condominium hotel projects. For example, George Clooney, Michael Jordan, and others become involved with luxury condominium projects, some of which have been canceled. Hotel management companies, from boutique hotel operators to most of the major hotel brands, have condominium hotels in their pipelines, including Hilton, Hyatt, Ritz-Carlton, Four Seasons, and Starwood. Finally, from a lifestyle perspective, it is not surprising that condominium hotels have been particularly attractive to buyers in the luxury segment. After all, who has not imagined living in a hotel and partaking in all its amenities, such as valet parking, room service, on-site restaurants, spas, and much more? In contrast to a traditional residential condominium, condominium hotel unit owners also benefit from living in a residence managed by a world-class team, making repairs and providing day-to-day management expertise that might typically be the domain of a condominium association.

The offer for sale of real estate generally does not involve the offer of a security. However, because a condominium hotel unit might be associated with a rental or management program, it can, in certain circumstances, be deemed a security. If so, unless the sale is exempted, the sale must be registered with the SEC and comply with the SEC’s rules and regulations, including its disclosure and antifraud provisions. As a result, if the sale of a condominium hotel unit is deemed to be the sale of a security, the level of disclosure required for condominium hotel promotional materials will likely increase drastically, as the condominium hotel promoter will become an issuer of securities subject to the antifraud provisions promulgated by the SEC. For the condominium hotel unit buyer, the purchase of the unit becomes an investment decision, with the protections afforded under applicable securities laws.

Moreover, if the securities laws apply, and if developers or brokers do not comply with the additional requirements applicable to the sale of securities, they could face serious criminal and civil liabilities. Condominium hotel sellers also could be deemed securities brokers or dealers within the meaning of the Securities Exchange Act and may be required to be registered. Finally, if a condominium sale is considered a security and the sale is not registered, the buyer could void the sales contract.

The definition of a “security,” as developed by the courts, is derived from the economic context of a particular transaction. A security is generally defined as any “investment contract,” which is defined as a “contract, transaction, or scheme of business, which evidences a beneficial interest in a profit-sharing agreement as to a fluctuating market price, with the投资者 receiving some share of the profit or gain or some share of the loss or decline in the fluctuating market price.”
realities test established by the U.S. Supreme Court. In SEC v. W. J. Howey Company,¹¹ the Supreme Court applied what it termed “economic realities” and found that “a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party” is an “investment contract” and, therefore, a security.¹²

The California Supreme Court has established the “risk capital” test¹³ in addition to Howey. Despite the different formulations of Howey and the risk capital test, the U.S. Supreme Court has noted that the risk capital test is an “approach that is virtually identical to the Howey test.”¹⁴ The risk capital test analyzes whether the funds in a given venture will be used to develop or acquire the business or enterprise in which the interest is offered. If that test is satisfied, then the interest is deemed to be a security. The extent of the development of the business at the time the interest is purchased would therefore be an important factor when determining whether the sale of a condominium hotel unit is deemed to be a security.

However, no case law currently exists to definitively answer the question of whether a condominium hotel sale constitutes a security. Most commentators thus have looked to two statements by the SEC for guidance: a 1973 SEC Release and a 2002 “no action” letter.

In 1973, the SEC issued a release to address the “uncertainty about whether offers of condominiums and other types of similar units may be considered to be securities.”¹⁵ The SEC concluded that an offering of securities will arise if the condominiums:

• Are sold with an emphasis on the economic benefits to the purchaser that will derive from the managerial efforts of the promoter or a third party from rental of the units.
• Include participation in a rental pool arrangement.
• Require the purchaser to make the unit available for rental for any part of the year, use an exclusive rental agent, or otherwise materially restrict occupancy or rental of the unit.

Nonetheless, the 1973 release states that “an owner of a condominium unit may, after purchasing his unit, enter into a non-pooled rental arrangement with an agent not designated or required to be used as a condition to the purchase.”

In 2002, the SEC issued a “no action” letter to Intrawest Corporation, a condominium hotel developer in Canada, concerning “the offer and sale of condominium units...coupled with an offer or agreement to perform or arrange certain rental or other services for the purchaser.”¹⁶ Intrawest wanted to institute a

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sales and promotional program for its U.S. developments that would disclose the existence of the rental management programs as one of the services offered. It sought to do this without an SEC registration. To that end, Intrawest represented, among other things, that 1) under no circumstances would prospective purchasers be led to believe that they will profit from unit ownership other than by property value appreciation, 2) representatives of the rental management company would only provide information in response to specific inquiries, 3) Intrawest’s rental management program would be completely voluntary and separate from the Intrawest sales program, 4) sales representatives would not receive additional compensation or other incentives for unit sales tied to rental management agreements, and 5) Intrawest would not discuss the terms of any rental management agreements until a purchase and sale agreement was executed.

Based on the facts presented by Intrawest, the SEC stated that Intrawest’s sales and rental model did not create a security as defined by Howey and the 1973 release because, among other things, the promotion and sale of units did not emphasize any economic benefit to the purchaser derived from managerial efforts or rentals and did not offer participation in a rental pool.17

No court has yet to weigh in on the issue of whether the sale of a condominium hotel unit constitutes a security. However, to avoid being deemed a security, a condominium hotel unit sale must not be tied to any pooling of rents and must be advertised, marketed, and sold as a piece of real estate. Further, the sale must be structured carefully to avoid any association with a management or rental program. While disputes requiring a resolution of this issue may be determined on a case-by-case basis, the manner of an offering and the economic inducements held out to prospective purchasers will be critical to the determination of whether a condominium hotel unit sale constitutes the sale of a security. Dissatisfied buyers have begun the rush to the courthouse to test the theory that condominium hotel unit sales are securities, so promoters of condominium hotels must be scrupulous with their sales efforts.

Indeed, disgruntled condominium hotel owners and investors are relying on federal and state securities laws in an attempt to rescind their purchase agreements and seek damages. A federal district court case in Florida filed by the owners of condominium hotel units at the Clearwater Cay Clubs Resort in Clearwater, Florida, alleges that the resort’s vendors and developers violated federal securities laws and Florida state securities laws by fraudulently inducing them to
invest in condominium hotel units. Specifically, the plaintiffs allege that the defendants promised them "substantial profits" from the investments through guaranteed income from a pool of short-term rental units as well as capital appreciation due to a large-scale conversion/development. Based on the allegation that the sale of a condominium hotel unit constitutes a security, the plaintiffs allege that the units were required to be registered with the SEC. Since they were not, the plaintiffs are seeking damages. Similar lawsuits are being reported with increasing frequency. Plaintiffs are alleging the violation of federal securities law by the sale of condominium hotel units as investments without the units being registered with the SEC. They are seeking monetary damages and the rescission of their purchase agreements.

If the SEC's 1973 release and 2002 "no action" letter are reliable guides, the success of the recent lawsuits alleging violations of securities laws will depend on whether the promotion and sale of the condominium hotel units emphasized any economic benefit to the purchaser derived from managerial rental efforts. If buyers, as alleged in the Clearwater Resort lawsuit, were led to believe that the purchase of a condominium hotel unit would generate guaranteed income from rental arrangements, courts may well find that federal securities laws apply and were violated.

The craze for condominium hotels has led many to question the viability and longevity of this type of real estate vehicle and to ponder the potential implications of federal and state securities laws. The first lawsuits in which unhappy condominium hotel unit buyers allege that they purchased unregistered securities are certain to be closely watched by attorneys, purchasers of condominium hotels, developers, and management companies. A court decision holding that a sale of a condominium hotel unit constitutes a security would be significant and would alter the current practices of those involved in condominium hotels—including, but not limited to, developers and management companies.

1 CIV. CODE §1351(f).
2 GOV'T CODE §66426.
8 See, e.g., SEC v. McCarthy, 322 F. 3d 650, 652-53 (9th Cir. 2003).
9 See id.
10 See id.
12 Id. at 298-99.
14 Reeves v. Ernst & Young, 494 U.S. 56, 64 (1990).
17 Id.
The Pitfalls of Senate Bill 1137’s Foreclosure Prevention Rules

AS MILLIONS OF RESIDENTIAL LOANS across the United States have gone into or are on the verge of going into default and foreclosure, lawmakers have been forced to face a real estate economy more sobering than any since the Great Depression. California has been in the thick of the crisis. On July 8, 2008, Governor Arnold Schwarzenegger approved California Senate Bill 1137, which altered the statutory framework for pre- and postforeclosure procedures applicable to residential loans and properties. Introduced in response to the tremendous increase in defaults and foreclosures of subprime and other mortgages, sponsors described SB 1137 as crucial legislation that would give homeowners “the tools they need to avoid foreclosure when possible because that’s the best outcome for everybody.”5 Supported by a number of consumer advocacy groups, such as the Center for Responsible Lending and Consumers Union,2 the legislation was pushed to protect not only families from the devastation of foreclosure but also neighborhoods and communities, which suffer from the effects of increased vacancies, properties in disrepair, and falling housing values.3

The crisis is not limited to California. In October 2008, Congress passed the Economic Stabilization Act to encourage workouts by lenders and servicers (as applicable) by expanding the HOPE for Homeowners Program (enacted as part of the Housing and Economic Recovery Act of 2008, passed in July 2008) to facilitate loan modifications, such as term extensions, rate reductions, and principal write-downs, including through the use of loan guarantees and credit enhancements.4

Unfortunately, SB 1137 and the federal act, though born of good intent, result in bad law. Both provide broad powers and requirements but not a lot of detail about implementation for lenders and servicers. While there certainly are provisions of SB 1137 and the federal act that will, at least temporarily, fulfill some of their stated goals, both seem unlikely to reduce foreclosures in California significantly. One FDIC official noted that “in a group of 23,000 troubled borrowers, only 1,200 would be eligible for the program.”3 Moreover, in the long run the state and federal legislation may make financing more costly—even for qualified borrowers—and thus may hinder recovery in the residential market.

Encouraging Modifications

An examination of the language of SB 1137 reveals why. For example, it added to Civil Code Section 2923.6 the statement that a loan servicer acts in the “best interests of all parties” if it agrees to or implements a loan modification or workout plan when 1) the loan is in default or where default is reasonably foreseeable, and 2) the anticipated recovery under the loan modification or workout exceeds the anticipated recovery through foreclosure on a net present value basis.6 Under Section 2923.6, servicers should offer a loan modification or workout if a borrower is in foreclosure, or in danger of foreclosure, if such modification or workout would be consistent with the servicer’s contractual or other authority.7 Similarly, the federal act merely directs the Secretary of the Treasury to “encourage the servicers of the underlying mortgages...to take advantage of [various federal foreclosure relief programs] to minimize foreclosures.” The state and federal laws create admonitions against foreclosure without guidance as to implementation of the modifications or assistance for facilitation.8

The California Assembly, in reference to Section 2923.6, described it as a “welcome explanation of the Legislature’s policy and direction concerning what is expected of loan servicers in California related to troubled borrowers.”9 The accompanying legislative analysis cites statistics regarding 1.2 million troubled borrowers who worked out arrangements with their servicers; however, the analysis goes on to state that the majority of the workouts (848,000), “were repayment plans, which are generally not as helpful to borrowers.”10

The California Legislature has limited authority over loan servicers not located in California (even though they may service loans that were originated in California). Thus, the legislature is relegated to issuing legislative findings and expressions of intent. These legislative statements can do more harm than good in the hands of a judiciary that may give the statements more weight than they are due or interpret them as creating judicial authority to fashion “equitable” resolutions to collection and foreclosure actions. The statute does not provide any safe harbor or other protection for a servicer that enters into a modification or workout that it believes is consistent with the new law, which does not provide any protection for the servicer if the borrower declines to participate in a proposed workout.

Despite the explicit limitations found in other sections of SB 1137, Section 2923.6 fails to limit its legislative intent to servicers on residential property. Rather, the section may be read to compel lenders on all types of real property.11 This ambiguity could lead to unnecessary litigation by borrowers on commercial properties that are nonresidential or nonowner occupied, who conceivably could demand their respective servicers to create workout proposals for their commercial debt.

Given the vagaries of this legislative pronouncement, it is understandable that servicers may question what is expected of them. If repayment plans—repayment being what the borrower promised—are “not as helpful to borrowers,” are servicers expected to provide partial or complete debt forgiveness? Does the legislature believe servicers simply should recast all troubled loans with new terms, perhaps regardless of collateral value or the borrower’s income and ability to repay?12

Section 2923.6 also falls short of an express mandate, but taken in its entirety, it could be interpreted as obligating a servicer to offer mortgage reductions or forbearance to the servicer’s economic detriment (and the detriment of the mortgage pool investors to which the

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servicers owe contractual duties) before the servicer is permitted to foreclose. Rather than stating that borrowers and courts should favorably view the attempts of servicers to reach a “loan modification or workout plan,” the legislative analysis casts doubt on what the judiciary may regard as compliant.

### 30-Day Delay of Foreclosure

Civil Code Section 2923.5 requires that before lenders on loans secured by owner-occupied residential mortgages originated from January 1, 2003, through December 31, 2007, may file a notice of default to begin the foreclosure process pursuant to Section 2924, the lender must contact a delinquent borrower in order to “assess the borrower’s financial situation” and to “explore options for the borrower to avoid foreclosure,” and then wait 30 days after contact is made or specified due diligence requirements are satisfied.15 Contact with the borrower (it is unclear how the lender will be able to verify the validity of the borrower contact in order to ensure compliance) must be achieved in person or by telephone, and the lender must advise the borrower during the contact that he or she is entitled to request a subsequent meeting with the lender within 14 days (it is unclear if the request is to be made at or following the meeting). The lender must also provide the borrower with the toll-free number made available by the U.S. Department of Housing and Urban Development to find a HUD-certified counseling agency.16

In the event contact with the borrower is not made, Section 2923.5 provides a laundry list of due diligence requirements. They include: 1) sending a letter by first class mail that includes the toll-free HUD number, 2) after the letter is sent, phoning at least three times at different hours on different days, and 3) if the borrower does not respond within two weeks after the telephone call requirements have been satisfied, sending a certified letter, return receipt requested.17

These requirements need not be satisfied if the borrower has surrendered the property. The surrender must be evidenced by a letter confirming surrender or delivery of the keys to the property to the lender. The requirements also need not be met if the borrower 1) has filed for bankruptcy and the proceedings have not been finalized, or 2) the borrower has contracted with a foreclosure avoidance agent.18 To commence foreclosure, Section 2923.5(b) requires the lender to submit a declaration with its notice of default stating that the lender either has contacted the borrower or tried with due diligence to contact the borrower as required under the section, or that the borrower has surrendered the property to the lender.19 If the lender filed a notice of default prior to enactment of SB 1137, the lender must file a declaration with its notice of sale that either states the lender contacted the borrower to assess his or her financial situation and explore foreclosure avoidance options, or describes the efforts made, if any, to contact the borrower if no direct contact was made.20 These provisions do not contemplate the possibility that the lender may need to declare the diligence provisions inapplicable because the borrower remains in bankruptcy or has contracted with a foreclosure avoidance company.

The extensive due diligence requirements are sure to create not only logistical difficulties for lenders but also opportunities for borrowers to postpone foreclosure. For example, if the borrower hangs up when called, the call arguably would not qualify as contact but only an attempt to contact. The lender that takes the position that hangups or a refusal to discuss satisfies the contact requirement, rather than at that point following the due diligence procedures, runs the risk of its foreclosure being thwarted, perhaps even after a sale.

Another risk is that the statute fails to create any presumption in favor of compliance if the lender provides the proper affidavits, so courts have no direction on what weight to give a lender’s affidavit against a borrower’s denials, thus increasing the chances that questioning affidavits could be used to delay foreclosure in court. Further, the statute creates no standard for substantial compliance, which would allow courts to deal with innocent errors in documenting contact or due diligence. Judges will have little to guide a determination on the issue until the meaning of “substantial compliance” is addressed by legislative amendment or in the appellate courts.

Procedural issues also do not address how lenders are to “assess the borrower’s financial situation and explore options for the borrower to avoid foreclosure” and how courts should decide whether lenders have satisfied this requirement, especially in view of the legislative analysis, which seems to disfavor mere repayment plans. Failure of the lender to offer temporary or permanent reductions in interest or principal certainly could be viewed as failing to satisfy this standard. While SB 1137 does not directly state that reductions in principal and interest must be offered to the borrower, the statute and legislative analysis seem to imply that these options must be explored. Practitioners should advise lender and servicer clients to document not only their contact and due diligence activities as contemporaneously as possible but also their policies and procedures for loan modifications and any analysis, offers, and resolutions with each borrower. Supporting these concerns is a California Reinvestment Coalition survey, cited in the legislative analysis accompanying SB 1137, complaining that servicers “are offering short-term modifications that only postpone borrowers’ day of reckoning.”21

### Maintenance of Property

The new Civil Code Section 2929.3 requires that, in order to preserve the health and welfare of the surrounding community, a legal owner must maintain vacant residential property purchased or acquired through foreclosure or face a fine up to $1,000 per day for failure to do so.22 Failure to maintain includes failing to care for the exterior of the vacant property, failing to prevent trespassing, failing to take action to prevent “mosquito larvae from growing in standing water,” or failing to prevent other public nuisances.23 For conditions not threatening to public health or safety, the governmental agency must allow the legal owner 14 days to begin correction and 30 days to complete correction of the violation. Unlike Section 2923.5, Section 2929.3 is not expressly limited to foreclosed, single family residences—it conceivably could be applied to entire housing tracts or to condominium or apartment properties.

The section’s goal of protecting neighborhoods and communities from foreclosure blight24 certainly is laudable, but as with most of SB 1137, the means do not necessarily accomplish the ends. The statute does not preempt local ordinances, potentially creating compliance issues resulting from nonuniform, possibly conflicting requirements.25 Many cities have ordinances addressing this issue and are increasing enforcement staff; this extra layer of legislation seemingly is unnecessary and potentially will delay and increase the costs of repair and maintenance of foreclosed properties.26

Moreover, the short time frame (approximately two weeks) for compliance could pose problems for the lender who acquires the property and becomes the legal owner through foreclosure, especially if the property is owned on behalf of a group of lenders through syndication or participation of the loan or by a securitization trust with multiple classes of bondholders. The lender must obtain bids and may have an internal approval process for expenditures in excess of certain amounts.

The statute’s lack of foresight puts lenders at significant additional risk simply by complying with repair obligations. First, because the statute provides no limitation on the type of maintenance or repair the lender must provide, it goes beyond simply curing blight; it almost certainly requires lenders to repair damage (at least external, visible damage) that may be the borrower’s fault. These are costs that the lender cannot recover from the
borrower except under extraordinary circumstances, because of California’s antideficiency laws.27 Second, forcing lenders to correct property conditions could expose lenders to construction defect liability claims.

**Notice to Residents**

SB 1137 also added Civil Code Section 2924.8, requiring that a special notice be posted (in various languages) at any residential property when a notice of sale is posted. The lender is also required to mail the notice contemporaneously in an envelope addressed to the “Resident of property subject to foreclosure sale.”28 It is a laudable intent to give tenants extra time to find other accommodations, but this section may have the unintended consequence of discouraging a tenant from continuing to pay rent or maintain the property once he or she becomes aware of an imminent foreclosure, which in turn could reduce the likelihood of a cure or workout for the borrower.

In addition, new Code of Civil Procedure Section 1161b requires that before a purchaser at foreclosure may evict a tenant or subtenant, the tenant or subtenant must be given a 60-day written notice after the foreclosure,29 increasing the 30-day period already provided under Code of Civil Procedure Section 1161a.30 This section, however, does not apply if any party to the loan remains on the property as a tenant, subtenant, or occupant.31

Another potential unintended consequence of SB 1137 is that a tenant who would otherwise be subject to eviction under a three-day notice for nonpayment of rent or breach of other contractual lease provisions may receive a much longer grace period, since the new law applied more detailed regulation. But despite good intentions, the legislature’s failure to articulate the requirements for compliance and the limits on use (and abuse) of the protections offered seems likely to burden servicers, lenders, and courts with unnecessary and potentially frivolous claims. Practitioners will need to advise their lender and servicer clients to be very specific and thorough in the documentation of all contact with borrowers, the due diligence steps undertaken to contact borrowers, the analysis made of each borrower’s situation, and all proposed workout terms contemplated and offered, as well as the steps taken to ensure the maintenance of each property postforeclosure. This detailed documentation may allow lenders and servicers to prove compliance with SB 1137 if challenged. According to at least one news report, lenders and servicers are having trouble reaching borrowers, who do not always respond to letters and other contacts made to discuss workout and modification options.32

**Market Corrections**

Much of the current crisis was stoked by easy financing of increasingly overvalued properties. Many experts believe that in order to reach the end of the crisis and correct the residential market, lenders must be allowed either to determine whether to reach accommodations with existing borrowers or foreclose and sell the properties for what the market will bear, presumably to buyers better able to handle the costs. This suggests that the housing market will recover its health only after the financial market has had an opportunity to reset lending standards and the real estate market has had an opportunity to reset housing values. Allowing unqualified borrowers to remain in their homes may instead divert the resources of lenders away from helping existing and new borrowers and foster the unintended consequence of prolonging the current crisis.

1 Analysis of S.B. 1137, 2007-08 Sess. at 10 (July 1, 2008).
2 Id. at 11.
3 Id. at 10-11.
4 Emergency Economic Stabilization Act, H.R. 1424, 110th Cong. §110 (2d Sess. 2008). Borrowers are only eligible for a potential refinancing if all the following conditions are met: 1) the lender agrees to write down the principal of the mortgage, 2) the borrower agrees to share future equity with the federal government, and 3) the borrower demonstrates the ability to repay the new loan.
6 CIV. CODE §2923.6(a)(2).
7 CIV. CODE §2923.6(b).
8 H.R. 1424 §110.
10 Id. at 8.
11 See CIV. CODE §2923.6 (obligation of “servicers” to “all parties in a loan pool, not any particular parties”).
13 In this article, the term “lender” is used to reference the various sections of S.B. 1137 that define the rights and obligations of a “mortgagor, beneficiary or authorized agent.” The term “servicer” is used as noted in the Senate Bill.
14 S.B. 1137 remains silent as to its effect on judicial foreclosure pursuant to Code of Civil Procedure §726.
15 CIV. CODE §2923.5(a)(2).
16 Id.
17 CIV. CODE §2923.5(g)(1)-(5).
18 CIV. CODE §2923.5(h)(1)-(3).
19 CIV. CODE §2923.5(b).
20 CIV. CODE §2923.5(c)(1)-(2).
22 CIV. CODE §2929.3(a).
23 CIV. CODE §2929.3(b).
25 CIV. CODE §2929.3(f).
28 CIV. CODE §2924.8(a).
29 CIV. CODE. PROC. §1161a.
30 CIV. CODE. PROC. §1161b(a).
31 CIV. CODE. PROC. §1161b(b).
CONFRONTED WITH AGING, inadequate infrastructure and scarce financial resources to pay for construction of new facilities and renovation of existing ones, California has exhibited a renewed interest in public-private partnerships (PPPs). Rather than continue down the traditional path of limiting PPPs to transportation projects, the California Legislature is now exploring ways to tap the resources of the private sector and develop innovative means to finance and deliver a variety of infrastructure improvements.

PPPs are hardly a new concept. In 1652, the Water Works Company of Boston was the first private firm in America created to meet a public need by providing drinking water to the community. Over the past 350 years, private financiers and contractors have invested in and collaborated with government agencies to offer essential public services, including transportation projects. California was once a leader in using PPPs for projects with the Orange County Transportation Corridor Agencies and the San Joaquin Hills Toll Road. Other states soon recognized the value of these partnerships and began implementing different types of PPP projects, including water and wastewater facilities, power generation plants, and schools.

California has ample legal authority permitting the use of PPPs for public projects. Last year, the legislature considered several bills permitting new types of projects to be financed by PPPs as well as those that would have modified existing PPP programs. A new idea has emerged to use PPPs for state courthouse construction and improvements; however, legal and practical challenges need to be resolved to make this a reality.

A PPP has been defined as:

[A] contractual agreement formed between public and private sector partners, which allow more private sector participation than is traditional. The agreements usually involve a government agency contracting with a private company to renovate, construct, operate, maintain, and/or manage a facility or system. While the public sector usually retains ownership in the facility or system, the private party will be given additional decision rights in determining how the project or task
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Privatization, on the other hand, is broadly defined as “the transfer of property or control of assets to deliver goods or services from the public to the private sector.”

Privatization agreements usually fall into two broad categories: 1) operational agreements that involve operations, maintenance, equipment replacement, or management services, and 2) disposition agreements that may involve encumbering or transferring a public asset to the private party and payment of nonoperational revenues (such as transfer or concession fees) to the public agency. Between the two, PPPs require significantly more collaboration between the public agency and the private partner than is customary under the privatization approach, and therefore offer greater flexibility in creating a development model for each project.

**Courthouse Projects**

Nearly 200 state and county court facilities are identified in the State Court Facilities Construction Fund as needing renovation, if not outright replacement. Despite this desperate need, two key factors are working against any attempt to satisfy it. First is the considerable cost to construct or renovate court facilities at a time when the state’s coffers are essentially bare. The other is the current legal framework of court ownership and control that not only inhibits the state from funding new projects (assuming the availability of adequate funds) but also discourages local counties from making needed courthouse improvements.

As an example of the former, the estimated cost to replace the Long Beach courthouse alone is approximately $340 million. Several years ago, Governor Arnold Schwarzenegger attempted to raise money for these and other related projects by proposing a bond issuance of $1.8 billion; however, the legislature failed to support the proposal, and it was not placed on the ballot. Recognizing this problem, the legislature passed a more aggressive bill, SB 1407, in September 2008, creating $5 billion in lease-revenue bonds for construction and renovation of court facilities. The bonds represent about half the estimated cost to bring all court facilities to safe standards and allow for future growth. The new law increases fees for civil filings, criminal convictions; parking violations; courthouse security; and license, registration, and mechanical infractions. A portion of the fees are then deposited into the Immediate and Critical Needs Account of the fund and will go toward construction and renovation of the most pressing projects.

The legal impediments to financing courthouse improvements are exemplified by the interrelationship between the agencies involved in financing, developing, and operating court facilities—the Judicial Council of California and the Administrative Office of the Courts (AOC)—and local county agencies.

As the state judiciary’s policy making body, the Judicial Council designates state court facilities “that may be built with [money] appropriated or otherwise available” from the construction fund. The Judicial Council may use this authority to establish priorities for construction, recommend to the governor and the legislature those projects to be funded, and submit costs of proposed projects to the Department of Finance for inclusion in the governor’s budget. The Judicial Council also has broad latitude to acquire property and create priorities for court construction. It is also responsible for developing performance standards for court facility proposals, including: 1) benchmark criteria for total project life cycle costs, 2) project cost comparisons to traditional delivery and financing options, 3) project risk assessments and allocations, 4) utility and energy conservation requirements (meeting or exceeding state standards), and 5) court security operations cost controls and reduction goals. Finally, the Judicial Council has authority to consider court facility proposals that contemplate PPP arrangements.

The AOC is the staff agency of the Judicial Council and implements projects that the Judicial Council selects. It also supervises court facilities under the control of the Judicial Council, including courthouse operations and general maintenance and repair. The AOC may use the construction fund for any of the following: 1) acquisition, rehabilitation, construction, and financing of court facilities, or 2) rehabilitating one or more existing court facilities together with the construction, acquisition, or financing of one or more new facilities. However, there are several notable restrictions and conditions on its authority. First, all projects are subject to the State Building Construction Act of 1955 and the Property Acquisition Law, imposing stringent building requirements and constraints on the AOC’s ability to acquire land for new courthouses. In addition, the AOC may not use money from the construction fund without prior authorization from the Department of Finance. Finally, 25 percent of all money collected by the fund from a particular county must be designated for trial court projects within that county, thus keeping the AOC accountable to the localities that generate the revenues.

Currently, many trial court facilities are owned and operated by the counties in which they are located. For example, Los Angeles County, with 30 court locations, has some facilities that were built in the 1950s, while most were constructed in the 1960s and 1970s. The county is struggling to cope with the dilapidated condition of its court facilities. The Judicial Council has been authorized to assume responsibility for these courthouses; however, the county must first invest significant time and money into these facilities.

By December 31, 2009, counties are supposed to transfer their courthouses to the Judicial Council. The actual number of facilities transferred pursuant to this mandate will depend on the ability of the Judicial Council to actively enter into agreements with the various counties. Also, it will depend on the counties’ willingness to improve their facilities prior to transfer, because current law prohibits the transfer of facilities in poor condition. Any court facilities found to be deficient cannot be transferred unless the agreement provides for correction of the deficiencies. A court facility is deemed deficient if it 1) constitutes a significant threat to life, safety, or health, 2) has an unacceptable seismic safety rating, or 3) contains other deficiencies that “in their totality are significant to the functionality of the facility.” “[M]ajor structural upgrade[s]” are required to cure the dilapidated conditions in many county courthouses. In the case of seismic safety rating standards and some other statutory requirements, those upgrades can be very costly.

The state legislature has recognized the need to collaborate with local agencies and find innovative ways of financing infrastructure development. If it had been enacted last year, Assembly Bill 2278 would have added Section 65040.15 to the Government Code and required the Office of Planning and Research “to advise and educate local agencies and other interested stakeholders about the role that public-private partnerships can play in planning, studying, designing,
financing, constructing, operating, maintaining, or managing local infrastructure projects.” The Office of Planning and Research would have also assisted in evaluating the feasibility of using a PPP for a particular project or whether a more traditional approach would be a better means of financing a proposed project.  

In conjunction with the state’s efforts to implement PPPs, county offices responsible for court operations are actively investigating the use of PPPs for courthouse projects. Notably, the County of Los Angeles has examined using PPPs for Los Angeles courthouse projects, prior to transferring ownership to the Judicial Council. The AOC has received approval to proceed with a PPP for the Long Beach Courthouse project.

**Long Beach Courthouse**

The decrepit state of the Long Beach courthouse perhaps best illustrates the problem that PPPs can remedy. The courthouse is among the most distressed facilities in the state. In fact, the deficiencies were so severe that the courthouse received a $16 million emergency earthquake safety upgrade to ensure safe evacuation in the event of a major earthquake.  

The AOC’s plans for Long Beach include a new court facility “with at least 31 courtrooms and all court support areas in a building that will comprise approximately 306,500 gross square feet.” In addition—although not explicitly stated in the AOC’s plan—there is a strong indication that one alternative may be to capitalize on the significant value of the courthouse land by transferring ownership of it to a private developer or partner and having the private partner construct the new courthouse elsewhere. All interested parties recognize that the Long Beach courthouse is in such poor condition that further improvements will not adequately address its defects and that a new structure is needed.

The AOC, in collaboration with Los Angeles County, the City of Long Beach, and the Long Beach Redevelopment Agency, intends to use Long Beach to evaluate the effectiveness of PPPs to finance courthouse construction projects. The AOC has already solicited and received proposals and has entered into contract negotiations with a financial consultant and two law firms with regard to Long Beach and potentially other courthouse projects. The next step will involve selecting a private partner and entering into a land transaction that will capitalize on the current facility at 415 Ocean Boulevard. Among the various options that the AOC is considering for completing the Long Beach and other courthouse projects are property transfers, sale/leaseback arrangements, and long-term leases. It is contemplated that legal counsel will work closely with the AOC and its financial consultant to develop the proper legal framework for construction of the new courthouse.

**Other Projects**

In addition to courthouse construction and renovation, the legislature has recognized the value of PPPs for other projects, including transportation and those that generate fees. The use of PPPs is permitted under Streets and Highways Code Section 143. The California Department of Transportation (CALTRANS) and regional transportation agencies are authorized to solicit proposals or accept unsolicited ones and enter into “comprehensive development lease agreements with public or private entities” for transportation projects. Section 143 governs the planning, design, finance, construction, reconstruction, rehabilitation, improvement, acquisition, lease, operation, or maintenance of highway, public streets, rail, or related facilities supplemental to existing facilities. However, this authority is limited to four qualified transportation projects—two in Northern California and two in Southern California.

In selecting private sector partners, Section 143 provides that CALTRANS or a regional agency may use one or more approaches, including: 1) soliciting bid proposals, 2) prequalifying or “short listing” proposers before final evaluation of proposals, 3) final evaluation of proposals using either qualifications, best value, or a combination of the two, 4) negotiating with proposers, and 5) accepting unsolicited proposals while issuing requests for competing proposals. CALTRANS and regional transportation agencies thus have considerable flexibility in choosing a private partner for a transportation project.

Section 143 requires that the partnership agreement set performance standards for the project, such as levels of service, noise mitigation, and pollution control. Each project’s plans and specifications must also comply with the CALTRANS standards applicable to all state transportation projects. In addition, the partnership agreement may permit tolls or user fees to be imposed to cover the cost of constructing the facility, administration, police, and maintenance, while also allowing the private partner to earn a reasonable return on its investment. However, the agreement must provide for a complete reversion of the leased facilities to CALTRANS or a regional agency at the end of the term. Section 143 does not permit conversion of existing non-toll or nonuser fee lanes into toll or user fee lanes with the exception of a high-occupancy vehicle lane “that may be operated as a high-occupancy toll lane for vehicles not otherwise meeting the
requirements for use of that lane.” Finally, Section 143 prohibits CALTRANS or any regional agency from entering into a lease agreement with a public or private entity under the pilot program on or after January 1, 2012.

The South Bay Expressway in San Diego County (State Highway Route 125) is the only project that has proceeded under Section 143. This project was developed pursuant to a franchise agreement between California Transportation Ventures, Inc. (CTV) and the San Diego Association of Governments (SANDAG), the County of San Diego, the City of San Diego, and the City of Chula Vista.4 This agreement provides for up to a 45-year lease (to be extended if agreed to by the parties) and collection of tolls to reimburse SANDAG or CALTRANS for their costs, and CTV for one or all of the following: 1) capital outlay costs for the project, 2) the costs associated with operations, toll collection, and administration of the facility, 3) the costs of maintenance, police, and other services provided by the state, and 4) a reasonable return on investment.33

The South Bay Expressway officially opened on November 19, 2007, and is a 10-mile state-of-the-art toll road, providing four traffic lanes, seven interchanges, and a high-tech toll collection system that allows drivers to pay tolls while maintaining highway speed. The successful completion of the project demonstrates that PPPs can be effectively used for state transportation projects.34

In addition to Section 143, Streets and Highways Code Section 149.3 authorizes CALTRANS, in association with SANDAG, to construct “exclusive and preferential lane” facilities in cooperation with a public or private entity providing mass transit services. The section permits SANDAG to “conduct, administer, and operate a value pricing and transit development demonstration program” on a maximum of two transportation corridors in the County of San Diego.

**Fee-Producing Projects**

Under Government Code Sections 5956 et seq., a government agency may solicit proposals and enter into agreements with private entities for the design, construction, or reconstruction of specified types of fee-producing infrastructure projects, such as water and wastewater facilities.35 The public entity may lease, license, or sell the infrastructure facilities to the private entity for a maximum of 35 years before rights revert to the public entity.

In 2007, Assembly Bill 1261 was introduced to amend this Government Code provision regarding infrastructure financing. According to the bill’s sponsor, Assembly Member Anna Caballero, local agencies and private entities operating under this Government Code section are encountering problems because the statute’s lease/ownership/licensing provision is ambiguous.

If it had been enacted, this legislation would have assisted public-private partnerships on appropriate fee-producing infrastructure projects.36 On April 19, 2007, AB 1261 was amended in the Assembly to accomplish several goals. First, the bill would require that the parties to any agreement for the design, construction, or reconstruction of certain qualifying fee-producing projects (as set forth in Government Code Section 5956.4) have adequate financial resources to perform the agreement. The bill defined “private sector financing” for public works projects broadly to include “cash and cash equivalents, loans, capital investments, in-kind contributions of materials or equipment, construction or equipment financing, carrying of costs during construction, [and] private sector assumption of risk.” Further, the bill required that the agreement provide security for the performance of the agreement and contractual provisions necessary to protect the funding and financial terms of the agreement.

Second, the bill would have extended the maximum term of the lease by the private entity to 99 years. Proponents of the bill argue the current 35-year maximum term does not provide sufficient time for a private entity to recover its substantial capital investment. By extending the term up to 99 years, a private entity would have the time needed to recoup its investment. However, there are concerns that in authorizing a 99-year term, local officials will not be able to anticipate the many contingencies that could arise over the course of a century.

Third, while Section 5956.6 currently authorizes a government agency to impose fees at the level needed to create an adequate revenue stream for a fee-producing infrastructure project, the bill would amend this section to allow for the user fees to be paid either to the government agency or the private entity. In addition, the amendment would have required that fees be used “exclusively to pay the government agency and private entity’s direct and indirect costs for project construction, financing, operations, fee collection, administration, maintenance, a reasonable rate of return to the private entity, and other project related costs.” Finally, the rate of return that the private entity proposed to earn would have been disclosed in the partnership agreement or provided for as part of the costs and fees during the procurement process.

Fourth, Section 5956.4 would have been amended to expand the current list of authorized projects to include sewer systems, power transmission, and power distribution for which a governmental agency could solicit proposals and enter into agreements with private entities.

AB 1261 was amended further in the Senate on August 20, 2007. The Senate amendments modified Section 5956 to include additional items of “private sector financing,” including “debt assumption” and “letters of credit” while omitting “private sector assumption of liability relating to the project.” In addition, the Senate amendments omitted “power transmission and distribution” from the list of authorized projects. In response to concerns over a potential 99-year lease term, the Senate changed this to 50 years. It also amended the ownership and licensing provisions. These amendments also changed the selection criteria for choosing private entities to perform services under the public-private agreements and reverted back to language similar to the existing Section 5956.5, which provides that the demonstrated competence and qualifications of the private entity would be “a primary” selection criteria in choosing a private-sector contractor.37

In addition to courthouse construction, transportation projects, and fee producing infrastructure facilities, several other statutory provisions authorize PPPs for less conventional projects. For example, the legislature mandated that the director of the Office of Emergency Services convene a working group consisting of, among other representatives, private sector experts in technology to evaluate the development of public-private partnerships to “expand an [emergency] alert system.”38 Similarly, Education Code Section 81004 encourages community college districts to create PPPs to construct new education buildings or education centers. In addition, the legislature has declared its intent to promote the development of PPPs for a reuse plan at the California State University at Stanislaus.39

Perhaps the most innovative PPP is the California Fuel Cell Partnership, consisting of seven government agencies, eight automobile manufacturers, four energy supply companies, and two fuel cell technology companies.40 The Fuel Cell Partnership seeks to advance practical environmental transportation solutions with new fuel cell vehicles and hydrogen infrastructure technologies. It is touted as the first PPP to test fuel cell vehicles under real day-to-day driving conditions.

The renewed interest in PPPs is not limited to California. The Federal Highway Administration has developed a comprehensive Web site to inform the nation’s transportation professionals on “new forms of partnerships between the public and private sectors to plan, finance, build and operate the nation’s
transportation infrastructure.” The site provides background information, case studies, and summaries of the enabling legislation for 23 states having significant statutory authority for PPPs on transportation projects. These studies by the highway administration merely underscore the shift toward long-term concession agreements and away from traditional debt and tax financing.

PPPs are not well suited to every public infrastructure project, nor will they single-handedly resolve the dilemma of aging public infrastructure and scarce public funds. However, PPPs may provide a viable alternative to the design-bid-build delivery system and to the traditional financing arrangements used on past public projects. The keys to a successful PPP are enabling legislation, strong public and private partners who are committed to the proposed project, a clear understanding of each partner’s objectives, and the appropriate allocation of risks and rewards in the final agreement.

2 Kamal S. Shihadi, Lessons in Privatization: Considerations for the Arab States (UN Dev. Programme, Jan. 2002).
5 State Administrative Manual §6872, available at http://sam.dgs.ca.gov/TOC/6000/6872.htm. (Lease-revenue bonds are “a variant of revenue bonds used in the state’s capital outlay program. The revenue stream backing the bond is created from lease payments made by the occupying department to the governmental financing entity which constructs the facility.”).
7 See 2008 Cal. Legis. Serv. ch. 311; see also Gov’t Code §70371.5 (The total amount of the bonds may not exceed the amount that can be fully serviced by the fine and fee revenues deposited into the construction fund.).
9 Id.
10 The Judicial Council creates the facilities contracting policies and procedures, subject to consultation and review by the Department of Finance, for the acquisi-
tion and construction of court facilities. See Gov't Code §70374(b).
11 Gov't Code §70391.5 (Performance expectations at all times are to be consistent with current state building practices.). In April 2007, the Judicial Council adopted the Judicial Branch AB 1473 Five-Year Infrastructure Plan for fiscal year 2008-09. The latest version of the plan includes an updated trial court capital outlay plan of 175 new construction, addition, and major renovation projects, as well as a summary of the 2008-09 project funding requests submitted to the Department of Finance. See Judicial Council of California, Judicial Branch AB 1473 Five-Year Infrastructure Plan Fiscal Year 2008-2009, available at http://www.courtinfo.ca.gov/programs/occm/documents/final_to_dof_5yr_plan_fy0809_07_06_01.pdf. See also http://www.courtinfo.ca.gov/programs/occm/5year.htm.

12 See Gov't Code §70391.5.
13 See Gov't Code §70374(c)(e). Section 70374(c)(1) and (2) appear to overlap; however, this apparent redundancy may have been intentional. Construction under §70374(c)(1), as modified by §70374(e), is partially exempt from the State Building Construction Act of 1955, while §70374(c)(2) has no apparent exemption.
14 Gov't Code §§15800 et seq.
15 Id.
17 Gov't Code §§70321 et seq.
18 The Chief Administrative Office for the County of Los Angeles has indicated its ongoing efforts to seek an author for legislation to implement PPPs for courthouse projects, including replacement of the Long Beach Courthouse. See Janssen Memorandum, supra note 4.
19 Gov't Code §70326(b).
20 Id.; see also Gov't Code §70324 (If the transferred building has an acceptable, yet poor, seismic safety rating, the county shall remain responsible for damage and injury related to seismic activity and shall “indemnify, defend, and hold the state harmless” for any related claims.).
21 See Janssen Memorandum, supra note 4.
22 See Gov't Code §70323-70327.
23 A.B. 2278 (as amended Apr. 23, 2008).
24 Id.
25 Id.
28 For planning purposes, it has been assumed that the building will be seven stories tall, including a parking level below ground, in-custody holding cells, a vehicle sally port, surface parking, and landscaping. See RFP Legal Services, supra note 8.
29 Id.
31 See supra note 26.
32 See STS. & HIG.H. COMM. §143.1(a).
33 Id. at §143.1(a)(1)(A)-(D).
36 In addition to A.B. 1261, Assembly Member Caballero introduced A.B. 1756 in order to establish a state clearnigh house to help local agencies set up public-private partnerships for local infrastructure financing. See Press Release, Assembly Member Anna Caballero Calls for Increased Focus on Local Public Private Partnerships (Jan. 8, 2008), available at http://democrats.assembly.ca.gov/members/a28/press/20080109AD28PR02.HTM.
38 See Gov’t Code §5956 et seq.
39 Supra note 3, at 35.
42 The long-term concession agreement is a form of PPP involving a long-term lease or equity interest to the private provider as compensation for construction of the project. Jeffrey N. Buxbaum & Iris N. Ortiz, Protecting the Public Interest: The Role of Long-Term Concession Agreements for Providing Transportation Infrastructure (June 2007), available at http://www.usc.edu/schools/sppd.
DESPITE THE PRECIPITOUS decline in home values over the past year, “affordable housing” remains an oxymoron throughout much of California. For many families, senior citizens, and persons with special needs, the cost of decent, safe housing is barely within their budget, if not actually beyond their means. While many Californians try hard to keep a roof over their heads, state and local officials have had an equally difficult time creating an incentive for developers that, on the one hand, encourages them to build housing that renters and homeowners can realistically afford and, on the other, allows developers to earn a fair rate of return on the investments they make in their projects.

The task of policy makers is further complicated because the perception of affordable housing often does not comport with reality. Contrary to some, it is not housing for the poor; rather, it covers shelter for persons of low to moderate income. It is also not limited to apartments; instead, it also includes for-sale housing units. And, finally, this housing may be a standalone project or a specified venture.

SB 1818 may ultimately provide developers with the incentives they need to build affordable housing.

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number of units within a larger residential development restricted to persons at certain income levels.

While state law mandates that affordable housing units be built within multifamily developments located in Coastal Zones, few local jurisdictions outside these areas have adopted similar policies. Instead, cities and counties have sought to create development incentives, such as density bonuses, to encourage developers to build affordable units. In an attempt to require all local jurisdictions to provide incentives for affordable housing development and create some uniformity with these incentives, the California Legislature enacted SB 1818.2

Since this law went into effect in 2005, many local jurisdictions have struggled with adopting conforming ordinances. Some have left the issue to case-by-case decisions, while others have established extensive menus from which developers can choose the incentives they want to incorporate in their projects or create their own.

SB 1818 has also achieved mixed results depending on the type of affordable housing being built. For developers constructing rental housing in which some or all of the units are income restricted, the law provides them with the opportunity to build more units and incorporate other concessions that can enhance their multifamily projects. In contrast, before the recent financial and credit crisis effectively put a halt to condominium developments, before the recent financial and credit crisis, developers were frequently wary of community opposition to these projects. One reason was the perceived stigma of this housing and the persons who would reside within the units. Another relates to the incentives and concessions that a developer may request for a project. Invariably, these incentives involve changes in height limits, floor area maximums, lot coverage, and design standards—the very issues that often foster public opposition to a project. SB 1818 gives no direction on resolving these conflicts beyond providing that incentives may be rejected if they do not contribute to the affordability of a project or they will have a significant adverse impact on the environment that cannot be mitigated without rendering the project unaffordable.

Certain jurisdictions, such as Pasadena, have chosen to make a case-by-case determination on the issue of incentives.8 The Pasadena Zoning Code simply restates the text of SB 1818 without providing any specific guidance on possible concessions. Rather, Pasadena’s Planning and Housing Divisions will work with an applicant to determine which incentives are appropriate for the specific site location. Others, like the City of Los Angeles, went through an exhaustive administrative and legislative process to put meat on the bones of SB 1818. The result was that Los Angeles did not adopt a conforming ordinance until April 15, 2008.9

The Los Angeles ordinance tracks SB 1818 as it relates to the density bonus granted for allocating a certain percentage of low- and very low-income units within a development. However, the city went beyond SB 1818 by increasing the for-sale housing density bonus for units set aside for persons of moderate incomes. The city’s ordinance provides that if 10 percent of the units are designated for these households, the bonus is 15 percent (as opposed to 5 percent under SB 1818), and if 30 percent of the units are set aside, then the maximum density bonus of 35 percent may be obtained (in contrast to SB 1818, which gives this bonus when there is a 40 percent set-aside).

The ordinance also lists a “menu of incentives” for developers of both rental and for-sale housing. These incentives include:

- An increase in the height limit equal to the percentage of density bonus for which the project is eligible, subject to certain limitations related to whether the project abuts an area zoned for single family homes or the zoning limits the height or number of stories.
- A similar enhancement in a project’s floor area ratio.
- Up to a 20 percent decrease in the required width or depth of any individual yard or setback.
- Up to a 20 percent increase in lot coverage limits.

Density Bonuses

A density bonus allows a developer to build a certain number of additional units in its project beyond the maximum number of residential units otherwise permitted by the applicable local zoning restrictions. The bonus is usually calculated by multiplying a statistically set sliding scale percentage against the number of units that can be built as a matter of right. The drawback of a density bonus is the developer must enter into a long-term covenant—usually from 25 to 40 years—with the local government restricting the rental or sale of those units to persons of very low, low, or moderate income.

Thirty years ago, the first density bonus law was enacted in California. Under the original law, a minimum of units for either 10 percent very low-income households (at 50 percent of area median income, or AMI, as adjusted for family size) or 20 percent lower-income households (at 80 percent of AMI as adjusted for family size) had to be set aside in order to qualify for the density bonus, which was fixed at 25 percent.

Four years ago, the legislature’s enactment of SB 1818 essentially provided developers with a new density bonus law. SB 1818 requires local governments to grant developers density bonuses in exchange for building affordable housing units. The new law made several significant changes to promote the development of affordable housing. The first was establishing a tiered density bonus system that lowered the minimum threshold to qualify for a 20 percent bonus to housing developments with either 5 percent very low- or 10 percent lower-income units. The percentage then increases to a maximum of 35 percent.4 The bonus for for-sale projects is applicable to those of moderate income (i.e., households at 120 percent of AMI as adjusted for family size); a 5 percent density bonus applies for a 10 percent set-aside, and this increases to a 35 percent density bonus if 40 percent is designated for moderate-income units.

The second change was providing developers with the right to request one to three development “incentives and concessions” depending on the percentage of very low- or low- or moderate-income units allocated within a given project.5 However, the statute does not list any specific incentives or concessions except under certain very limited circumstances in which the incentives do not promote the affordability of the project or there will be a “significant adverse impact” on the environment that cannot be mitigated without rendering the project unaffordable.

A third change requires developers to enter into a covenant to protect the affordability of units for 30 years or longer if mandated by any applicable financing or rental subsidy program. With for-sale projects, a local government must also enforce an equity-sharing agreement when a condominium is eventually sold.6 Under the agreement, the seller is allowed to retain the value of any improvements, recover any down payment, and share in any appreciation. In return, the local government may recapture any subsidy that it provided to the homeowner. SB 1818 also includes provisions promoting the establishment of child care facilities and reducing maximum parking requirements.7

Local Government Compliance with SB 1818

While all local jurisdictions, including charter cities and counties, must comply with the SB 1818 mandates, many councilmembers and supervisors have struggled to support ordinances implementing the law. On the one hand, they recognized the need for affordable housing but, at the same time, were
The Los Angeles County Bar Association certifies that this activity has been approved for Minimum Continuing Legal Education credit by the State Bar of California in the amount of 1 hour.

1. Charter cities and counties are exempt from complying with SB 1818.
   - True
   - False

2. SB 1818 mandates that local jurisdictions designate the specific list of incentives and concessions that a developer may select.
   - True
   - False

3. The City of Los Angeles Density Bonus Ordinance allows for a higher density bonus for rental housing projects than the one provided for in SB 1818.
   - True
   - False

4. A developer who receives a density bonus under SB 1818 must restrict the affordable units in its project for at least 30 years.
   - True
   - False

5. SB 1818 does not apply to condominiums or other types of for-sale affordable housing projects.
   - True
   - False

6. Developers may request as a concession: A. A floor area increase. B. Additional building height. C. Reduced building setbacks. D. All of the above.
   - True
   - False

7. A city or county may reject a development concession requested by the developer if it will have a “significant adverse impact” on the environment that cannot be mitigated without rendering the project unaffordable.
   - True
   - False

8. The contribution of an incentive or concession to the affordability of a project is irrelevant for purposes of a local jurisdiction’s decision whether to grant that incentive or concession.
   - True
   - False

9. SB 1818 and the City of Los Angeles Density Bonus Ordinance both grant parking concessions for projects seeking a density bonus.
   - True
   - False

10. The number of people used to calculate the Affordable Housing Cost of a two-bedroom unit is: A. 2. B. 3. C. 4. D. 5.
    - True
    - False

11. In determining the maximum monthly mortgage payment allowed for an affordable family unit, the Affordable Housing Cost set by state law must be reduced by homeowners’ dues, utilities, and property taxes.
    - True
    - False

12. SB 1818 did not modify the density bonus system that existed under prior California law.
    - True
    - False

13. A developer seeking an “off the menu” concession from the City of Los Angeles is required to have a public hearing on the requested concession.
    - True
    - False

14. A moderate-income person who buys a condominium in a project that received a density bonus is required to share any appreciation on the unit with the city or county when the unit is sold.
    - True
    - False

15. State law does not require cities to create affordable housing using a portion of the increased revenues within a redevelopment zone.
    - True
    - False

16. The percentage density bonus granted by SB 1818 is set on a sliding scale based upon the percentage and type (low, very low, or moderate income) of affordable units set aside in the project.
    - True
    - False

17. Very low income, as adjusted for family size, is defined as: A. 30 percent of area median income. B. 40 percent of area median income. C. 50 percent of area median income. D. None of the above.
    - True
    - False

18. Under SB 1818, if a developer sets aside more than the minimum number of very low-income units, the developer will receive—for every 1 percent of very low-income units set aside above the minimum requirement—a 2.5 percent increase in the project density bonus, up to a maximum bonus of 35 percent.
    - True
    - False

19. The development of child care facilities is not one of the purposes for which SB 1818 was enacted.
    - True
    - False

20. Developers of market rate rental housing who designate a certain number of units as affordable are limited to using any density bonus they qualify for to building additional affordable units.
    - True
    - False

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. [ ] A  [ ] B  [ ] C  [ ] D
7. [ ] True  [ ] False
8. [ ] True  [ ] False
9. [ ] True  [ ] False
10. [ ] A  [ ] B  [ ] C  [ ] D
11. [ ] True  [ ] False
12. [ ] True  [ ] False
13. [ ] True  [ ] False
14. [ ] True  [ ] False
15. [ ] True  [ ] False
16. [ ] True  [ ] False
17. [ ] A  [ ] B  [ ] C  [ ] D
18. [ ] True  [ ] False
19. [ ] True  [ ] False
20. [ ] True  [ ] False
• Up to a 20 percent decrease in lot width and open space requirements.

Developers may also request incentives “off the menu.” Consistent with SB 1818, the actual number of incentives that may be received is a function of the affordability restrictions the developer agrees to adopt for its project.

If an incentive is on the menu, the Los Angeles planning director must approve the requisite density bonus and the requested incentives unless one of the two SB 1818 limitations applies. Any initiative that is off the menu is subject to notice and a public hearing and approval by the Los Angeles Planning Commission.

In theory, the density bonuses and other concessions mandated by SB 1818 should encourage developers to build housing that low- and moderate-income persons can actually afford. From the vantage point of a developer of a rental housing project, SB 1818 and the Los Angeles ordinance can be quite beneficial. Certain developers build projects that are intended to be completely affordable; that is, every unit is income restricted. Qualifying for the density bonus is no issue because these projects by definition are structured to be affordable to families, seniors, or persons with special needs whose incomes are at or below the very low-income standard. In addition, the projects are subject to regulatory restrictions that exceed the 30-year minimum of SB 1818.

The practical issue for an affordable rental housing developer is identifying which incentives should be requested. Developers will seek those that optimize their projects by leveraging certain debt financing and tax credit equity, achieving their objective of providing housing to certain income groups, and offering amenities to project residents. Consistent with these goals, the incentives most likely to be sought are changes in height limit, floor area ratios, and setbacks. On the other hand, developers will not be inclined to seek a reduction in open space to avoid creating an overly dense project. The Los Angeles ordinance, like SB 1818, also provides a critical concession with regard to reducing the number of parking spaces that must be provided within a development.

Developers of “market rate” rental housing can also benefit in a similar fashion from these laws. The key difference between these projects and one that is completely affordable is that if the developer agrees to designate a certain percentage of units as affordable, the additional units “earned” by the density bonus do not have to be income restricted.

**For-Sale Housing Projects**

While SB 1818 may benefit rental housing, the opposite seems to hold true for those build-

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**MINIMUM DENSITY BONUS**

<table>
<thead>
<tr>
<th>Project Type</th>
<th>Units</th>
<th>Unit Size (sq. ft.)</th>
<th>Sales Price Per Unit</th>
<th>Cost Per Unit</th>
<th>Total Profit</th>
<th>In Lieu Fee</th>
<th>Net Profit</th>
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<td>1,000</td>
<td>$500,000</td>
<td>$325,000</td>
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<td>10% Moderate Units</td>
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<td>$450,000</td>
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<td>$325,000</td>
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**LOST PROFITS**

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<th>Unit Size (sq. ft.)</th>
<th>Sales Price Per Unit</th>
<th>Cost Per Unit</th>
<th>Total Profit</th>
<th>In Lieu Fee</th>
<th>Net Profit</th>
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<td>No On-site</td>
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**IMPACT OF MARKET DOWNTURN**

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<th>Units</th>
<th>Unit Size (sq. ft.)</th>
<th>Sales Price Per Unit</th>
<th>Cost Per Unit</th>
<th>Total Profit</th>
<th>In Lieu Fee</th>
<th>Net Profit</th>
</tr>
</thead>
<tbody>
<tr>
<td>No On-site</td>
<td>100</td>
<td>1,000</td>
<td>$300,000</td>
<td>$195,000</td>
<td>$10,500,000</td>
<td>$1,500,000</td>
<td>$9,000,000</td>
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<tr>
<td>Affordable Units</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>50% Moderate Units</td>
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<tr>
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<td>$9,975,000</td>
<td>$163,400</td>
<td>$10,138,400</td>
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<tr>
<td>Very Low-Income Units</td>
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<td>$270,000</td>
<td>$195,000</td>
<td>$8,625,000</td>
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<td>Market Units</td>
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<td>$195,000</td>
<td>$677,840</td>
<td>$0</td>
<td>$7,947,160</td>
</tr>
</tbody>
</table>
on a composite of recent actual developments. The unit types and sizes in the example have been standardized. The baseline project has entitlements allowing 100 two-bedroom units of 1,000 square feet each before applying any density bonus. The market rate sales price per square foot for each unit is $500 for projects without low-income units and $450 per square foot for the same project with low-income units on site.10 The cost to construct the project—including land acquisition, soft costs, and carry costs—is $325,000 per unit. As an added incentive to create on-site affordable housing, the project is located in an area with an above average in lieu fee of $15 per square foot. Many jurisdictions offer developers the option of paying an in lieu fee when the revenues are designated to help finance the development of affordable housing rather than have the developer actually build the required affordable units within its project. While many project sites are not located in areas with an affordable housing requirement, this is commonly found in redevelopment areas where state law requires that cities create affordable housing with a portion of the increased revenue from the redevelopment zone.

To compare projects with and without on-site affordable housing, the maximum amount that can be charged per affordable unit must be calculated. The first step is to determine the maximum number of persons allowed in a household. For a two-bedroom unit, state regulations cap the household size at three.11 The calculation applies the applicable county’s specific 2008 income levels12 to the for-sale Affordable Housing Cost caps set forth in the Health and Safety Code.13

For a three-person, moderate-income family in Los Angeles, the maximum monthly Affordable Housing Cost is $1,726. For a three-person, very low-income family in Los Angeles, the maximum Affordable Housing Cost is $672. The total monthly Affordable Housing Cost is then reduced by homeowner’s fees, utility costs, property taxes, insurance costs, and the like to arrive at a maximum mortgage payment amount.

The example involves a series of assumptions: monthly HOA dues of $100, $10 per month mortgage insurance, $100 per month utilities, $50 per month homeowner’s insurance, and property taxes of 1 percent of the purchase price. For moderate-income families, this leaves a maximum mortgage payment of approximately $1,295 per month. For very low-income families, this leaves a maximum mortgage payment of approximately $364 per month. Applying a standard FHA loan—with terms of 3 percent down, 30-year fixed loan with an average interest rate of 6.5 percent—a moderate-income unit can cost a maximum of approximately $211,340, and a very low-income unit can cost a maximum of approximately $59,432. This example shows that projects with the minimum number of either moderate-income or very low-income units to qualify for a density bonus return a smaller profit than smaller market rate projects. (See “Minimum Density Bonus,” page 32.)

However, adding more affordable units to make greater use of the density bonus only serves to increase the lost profits when such a bonus is sought. For moderate-income units, a 1 percent increase in the number of units that can be built is allowed for a corresponding percentage increase in the number of moderate-income units up to a maximum of 40 percent. As a practical matter, this one-to-one ratio means that building more moderate-income units does not result in an increase in the number of market rate units in the project. In this example, there will always be 95 market rate units. If a developer builds the minimum number of moderate units, the result is 95 market rate units (5 percent density bonus yields 105 total units less the required 10 moderate units). If a developer builds the maximum number of moderate units, the result is still only 95 market rate units (35 percent density bonus yields 135 total units less the required 40 moderate units). This means that when moderate-rate units are required to be sold for less than the cost of construction, there is no way to offset the loss on the moderate-income units. In fact, in order for a developer to consider building moderate-income units, those units have to be profitable in their own right. (See “Lost Profits,” page 32.)

A similar, but far less dramatic, increase in lost profits occurs when the density bonus is maximized for very low-income units. For every 1 percent additional very low-income unit, a developer receives a 2.5 percent increase in the project density, up to a maximum bonus of 35 percent.

The data in the example appears to suggest that building the minimum number of on-site moderate-income units is comparable to a market rate project. However, the data ignores two critical items that argue against seeking a density bonus. First, the additional units extend the construction schedule, thereby increasing the project’s carry and interest costs. This will result in a per unit cost that can be significantly higher than the $325,000 per unit calculated in the example. Second, most projects, especially those with Mello-Roos/community facility district charges, may have nonmortgage housing costs that exceed the maximum Affordable Housing Cost before any mortgage payment is taken into consideration. For example, projects in Orange County or Santa Clarita often have HOA dues and Mello-Roos/com-

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munity facility district charges that alone can exceed $900. In this situation, very low-income units would effectively have to be sold for free and then the developer would have to provide some ongoing financial support. As for moderate-income units, the selling price would have to be reduced considerably.

Apart from the economics of a density bonus, developers must also be concerned with whether the requested concessions will be granted, especially since the project will be constrained within the same parameters as a nondensity bonus project. Because the decision to pursue the density bonus has to be made very early in the design process, any denial of concessions would likely require a substantial redesign of the building and inevitably put the project behind schedule, if not over budget. In a significant number of cases this would cause the developer to lose the project by failing to meet processing deadlines in the project financing or by exhausting the funds needed to complete the redesign.

Despite this, the landscape in which SB 1818 will continue to evolve is changing with the recent downturn in the residential and financial markets. Land prices and construction costs have been substantially reduced. Sales prices are slipping and the spread between moderate-income units and market-rate units is shrinking. The effect of a 40 percent drop in the sales price, and an equivalent decrease in the cost per unit, would have a substantial effect on the figures in the example. (See “Impact of Market Downturn,” page 32.)

Will SB 1818 ultimately provide developers with the incentives they need to build affordable housing? The past four years certainly provide no guidance because it has taken that long just for many local jurisdictions to adopt conforming ordinances. For affordable rental housing in the near future, the answer is yes. SB 1818 will most likely lead to the creation of more units and better quality projects for tenants. Regarding for-sale projects, however, the answer is far less certain. The silver lining in today’s worsening economic times and declining property values is that lower land costs could make the inclusion of affordable for-sale units more feasible.

The bigger question will be whether these projects can be entitled, financed, and constructed before the housing market eventually turns around. When that occurs, developers may once again decide that taking advantage of density bonuses and allocating a portion of their for-sale units to persons of low and moderate income may ultimately not be in their best financial interests.

1. Gov’t Code §65590.
2. Gov’t Code §§65915 et seq.
3. The California Department of Housing and Community Development calculates median income annually.
4. Gov’t Code §65915(b); see also the entire density bonus table at Gov’t Code §65915(g)(1), (2).
5. Gov’t Code §65915(d).
6. Gov’t Code §65915(c).
7. Gov’t Code §65915(j); Gov’t Code §65915(p).
8. See PASADENA ZONING CODE §17.43.030.
9. CITY OF LOS ANGELES ORDINANCE No. 119761.
10. The projected sales price of the market rate units in projects with on-site very low-income units is reduced by 10 percent due to the stigma factor; that is, the perceived reluctance of a buyer of a market rate unit to pay many times the price for the same unit as an affordable buyer. The reduction also results from the knowledge that market rate buyers fear that affordable buyers will not maintain their property in the same way as market rate buyers. In actuality, this reduction may not occur after the project is completed, but developers incorporate this factor in their pro forma projections.
11. HEALTH & SAFETY CODE §30852.5(b).
12. 25 CAL. CODE REGS. §6932.
13. HEALTH & SAFETY CODE §§50852.5.
14. Gov’t Code §§55331 et seq.
15. According to a California Association of Realtors September 2008 report, median home prices dropped by 40.9% when compared to September 2007. This decline is largely attributable to the deals that are available to acquire failing or foreclosed projects and the declining cost of construction labor, as contractors are forced to compete for the fewer construction jobs that are now available.
16. The 40% drop in cost per unit is based upon lower land costs for new site acquisitions and the lower construction labor costs caused by the number of out-of-work contractors bidding for each job.
Foreclosures are at their highest rates in years, residential real estate values plummeted in 2008, debt financing is scarce, and consumer confidence is at or near an all-time low. Given these grim realities, it is no surprise that lawyers—and judges—across California are dusting off their old real estate treatises and relearning concepts such as foreclosures, receiverships, and antideficiency legislation. However, this real estate workout cycle most likely will be different from the last major recession in the early 1990s, which resulted in extensive defaults on senior secured loans and nonjudicial foreclosures throughout California. With nearly a full decade of spectacular gains in the real estate market, many capital providers, seeking to share in the appreciation, financed real estate projects by making preferred equity investments rather than, or in addition to, making loans secured by the projects. These investments are made through vehicles such as partnerships, limited liability companies, and other corporate structures that are created for the purpose of developing or managing real estate assets.

As a result, during this downturn, the numbers of equity workouts will increase. These workouts involve providers of capital—as money partners or financial partners—seeking to resolve disputes regarding non-money partners—as deal sponsors or developer partners—who typically located the underlying deal, have less invested capital, if any, and often play a greater role in the day-to-day management of the partnership’s real estate investment.

The structure of this type of real estate venture varies from deal to deal. Nevertheless, these ventures commonly include a project entity—such as a limited liability company or limited partnership—that owns the real estate project. The developer partner typically manages the project entity for a fee subject to the rights of the financial partner to vote upon certain major decisions, such as a sale of the underlying project, certain loan transactions,
and bankruptcy. While the project entity is frequently referred to as a partnership, and its owners are called partners, the legal structure of many of these ventures is a limited liability company, and its owners are members.

In a rising market, this structure enables financial partners and developer partners to benefit from the project’s appreciation while maintaining the financial partner’s limited role in day-to-day project management as well as limited liability. However, in a down market, disputes frequently emerge between the developer partner and the financial partner as the value of the project shrinks, and the partnership labors to satisfy its obligations to lenders, contractors, and other third parties.

As a result of the current downturn, the parties to many a commercial real estate joint venture are now questioning their continued involvement. More and more, the parties to these ventures—the developer partners as well as the financial partners—are beginning to take a close look at the agreement they struck and reread the buy/sell or developer removal provisions of those agreements, hopeful of finding a workable remedy, leverage to negotiate a restructuring of the deal or, in some cases, a way out of their investment.

As many financial partners are now learning the hard way, equity investments are more risky than conventional loans, the rights and remedies of a partner are more difficult and less predictable to enforce than the rights of a secured lender, and exiting from these partnership relationships is tricky, at best. A partner can attempt to minimize the risk and uncertainty that comes with resolving a dispute by anticipating potential problems at the outset when structuring the venture. Partnership and/or operating agreements and applicable law provide various remedies for an aggrieved partner in a real estate venture, and those remedies often include the tools to achieve a fair and just separation.

What is a realistic strategy for managing and financing the partnership? With an established endgame, a strategy must be devised to get there. When a financial partner seeks to remove a developer partner, it is critical that the financial partner consider the practical details of who will be responsible for managing the venture, how decisions will be implemented, and how the venture will be financed.

What resources, including money and time, are available to invest into the partnership? Any strategy for a distressed real estate venture requires the devotion of time and money. Before exercising its remedies, particularly a remedy that removes a developer partner from management, a financial partner should determine how much of its own time and financial resources it will be willing to devote to curing the problems that affect the project and/or the cost of replacing the developer partner.

How will a change in the status quo affect the dealings of the partner or the partnership with third parties, particularly lenders? Frequently partnership loans have provisions that prohibit a change in control absent prior lender consent. Moreover, many loans require a financial partner who has removed a developer partner to guarantee the partnership’s debt.

**Available Remedies**

After considering these questions, the aggrieved partner must consider what remedies are available and which remedy is appropriate under the circumstances. The real estate venture’s governing agreements commonly include buy/sell provisions and forced removal provisions. In the absence of these agreed-upon remedies, California law also provides partners and/or members with additional remedies, such as action rights, dissolution, and partition.

**Buy/sell provisions.** A buy/sell provision is commonly included in partnership and operating agreements to provide a fair, self-executing, and expeditious means of resolving a dispute between partners. Under a typical buy/sell provision, one partner is required to set the price pursuant to which it would either purchase the ownership interest of the other partner or sell its ownership interest to the other partner. The other partner is then required to choose between selling its interest or buying the initiating partner’s interest at the predetermined price.

An important feature of a buy/sell provision is that the partner setting the price does not know whether it will be a buyer or a seller. As a result, a well-crafted buy/sell provision should impose price discipline on the partners and precipitate a fair and just separation. Buy-sell provisions are valid under California law. According to *Ramos v. Estrada*, a buy/sell provision is “valid, favored by courts and enforceable by specific performance.”

As compared to other available remedies, a primary benefit of a buy/sell provision is that it brings about a complete separation between the partners without dissolving the venture. The seller obtains the fair value of its interest and ceases its involvement in the venture. The buyer gets complete ownership and control of the venture, without continuing duties or obligations to the other partner. However, to obtain ownership and control, the buyer usually is forced to purchase the other partner’s interest, which is a difficult decision regarding a troubled real estate project in a declining market.

While a buy/sell provision is intended to be self-executing and expeditious, it frequently results in disputes. A typical buy/sell provision is triggered by the occurrence of certain events that are delineated in the partnership agreement, which may include, among other things, breach of the partnership agreement, misconduct, and/or failures to meet performance thresholds. When a partner believes that its interests are not served by separation, or lacks the ability or desire to be a buyer, disputes arise regarding the triggering events, which are a condition precedent to the exercise of the buy/sell provision. These disputes may be factual and must be resolved by litigation or arbitration. Nevertheless, a buy/sell provision is a powerful remedy to bring about a resolution to a dispute between partners in a real estate venture.

**Removal provisions.** Another powerful remedy in disputes between a financial partner and a developer partner is a forced removal provision, which is commonly contained in partnership and/or operating agreements for real estate ventures. Under a typical partnership or operating agreement, the financial partner is a limited partner or member whose management rights are restricted to the right to vote upon a few designated major decisions. Pursuant to a removal pro-
vision, a financial partner may remove a developer partner from day-to-day management of the partnership and appoint itself or a designee to perform those duties. In effect, the exercise of the removal provision gives the financial partner unilateral control over the venture and converts the development partner into a limited partner or member.

However, in obtaining unilateral control over the venture, the financial partner undertakes greater responsibility to act in the best interests of the partnership. As the general partner of a limited partnership or manager of a limited liability company, the financial partner has fiduciary duties to both the venture and the removed partner. Thus, before undertaking this responsibility and eschewing the benefits of limited liability, the financial partner should consider several factors carefully. Is the value of its interest sufficient to justify the additional risk, as the financial partner is usually the proverbial deep pocket? What goals will be achieved by removal? Are those goals consistent with the interests of the venture? What resources will the financial partner devote to manage and finance the venture? What is a strategy for realizing the financial partner’s goals?

As with a buy/sell provision, the exercise of a removal provision is conditioned upon the occurrence of certain events that are factual and may be arbitrated or litigated. A well-crafted removal provision provides that the removal is effective immediately, so the burden is on the developer partner to obtain an order or award restoring its management rights. However, the developer partner may seek to enjoin removal, arguing that it is seeking to preserve the status quo while the triggering events are adjudicated. Thus it is imperative that the financial partner obtain strong documentary evidence of the occurrence of the triggering event or events before exercising its removal right.

If the operative agreement does not provide express or adequate remedies, an aggrieved partner may be entitled to invoke certain remedies under California law. These include, among others, a statutory buyout right, dissolution, and partition.

Buyout of dissociated partner’s interest.
The Uniform Partnership Act provides for the buyout of a dissociated partner’s interest in the partnership. A partner may dissociate from a partnership upon the occurrence of numerous events, including notice of the partner’s express will to withdraw as a partner. Unlike a buy/sell provision included in a partnership agreement, this statutory remedy does not provide the dissociating partner an opportunity to become the buyer and obtain ownership and control of the partnership. Thus, a partner will only invoke the statutory right to dissociate if its preferred endgame is to withdraw from the investment.

If a partner provides notice of its express will to withdraw, the partnership must cause the dissociated partner’s interest to be purchased for a buyout price determined according to Corporations Code Section 16701. The statutory buyout price is the amount that would have been available for distribution to the dissociating partner upon winding up the partnership business. However, any damages for wrongful dissociation will be offset against the buyout price. When a partnership is for a definite term or a particular undertaking, a partner’s dissociation is wrongful if the partner withdraws by express will before the expiration of the term or the completion of the undertaking. In that case, the partner is only entitled to a deferred payment with security and interest unless the partner establishes to the court that earlier payment will not cause undue hardship to the business. In a down market, this may be difficult to establish, and the dissociating partner may still have to wait until the proj
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member’s interest, the purchasing members may apply to the court to stay the winding up and dissolution proceeding and ascertain the fair market value of the moving party’s interest. Upon application of the purchasing parties to determine the fair market value, the court will issue an order appointing three disinterested appraisers to appraise the fair market value of the moving party’s membership interest. The valuation date is typically the date upon which the action for judicial dissolution was commenced. The determination of the appraisers is final and conclusive upon all parties. The court will then enter a decree ordering the purchasing parties to pay the appraised value to the moving member within a specified time or, in the alternative, at the time of the winding up and dissolution of the company. On receiving payment of the ascertained fair market value, the moving party must immediately transfer its membership interests to the purchasing parties.

Before seeking a court determination of the fair market value, the purchasing members are required to post a bond with sufficient security to pay the estimated reasonable expenses, including attorney’s fees, of the moving party. If the purchasing parties do not make payment for the membership interests within the time specified, the court will enter a judgment against them on the bond for the moving party’s expenses.

Partition. A partner may also seek partition if this action is not prohibited by the partnership or operating agreement. Partition is a procedure for segregating and terminating common interests in the same piece of property. A party may bring an action for partition or the court may determine on its own that partition is a suitable remedy in a proceeding for partnership accounting or dissolution. However, partition is an available remedy only when the rights of the partnership’s unsecured creditors will not be prejudiced.

There are three different ways to accomplish partition: 1) a physical division of the property, 2) a sale of the property and division of proceeds, or 3) a partition by appraisal in which one party acquires the interest of the other party based on a court-ordered and supervised appraisal.

Partition by appraisal is only available by agreement of the parties and when the interests of all parties are not in dispute. The parties must present an agreement to the court for approval that contains the terms and conditions of the partition. The agreement must include 1) a description of the property, 2) the names of the parties in interest, 3) the names of the parties who are willing to acquire the interest, 4) the name or names of an agreed-upon referee or referees, 5) the date on which the interest to be acquired
will be appraised, and 6) any other mutually agreed-upon terms.25

Upon a motion for approval, the court will then appoint a referee (or referees, as the parties’ agreement can provide for up to three referees) to appraise the property and report the valuations to the court. The court will then confirm the report and order the interests transferred to the acquiring party upon payment of the appraised value along with any other amounts that are required by the parties’ agreement.26

If the parties are unable to reach an agreement for partition, and the partnership assets consist of real property, one party may seek to compel a sale rather than partition by a physical division of the property. Because forced sales are generally disfavored, the party seeking the sale must show that either a division of the property into subparcels of equal value is not possible, or a division of the land would substantially impair the value of each party’s interest, so that the value received by one party would be of less value than the moneys received from the sale.27

When determining whether the property is incapable of being divided to support a partition by sale, a court will look at whether the land may be equally divided with regard to value, not whether each subparcel will be identical to the other.28 Courts will use an economic test to determine whether a division of land would substantially diminish the value of the property, and look at whether a partition in kind would result in one party receiving a portion of the land that would be worth materially less than the share of the money that could be obtained through sale of the land as a whole.29

If a court determines that it is equitable to partition the property by sale, the court may order the sale on the terms agreed to by the parties or in a manner determined by the court.30 Usually, the court appoints a referee to sell the property by either a private sale or a public auction.31 Other than the referee appointed by the court or the attorneys for the parties, any person may purchase the property at the sale.32

After the property is sold, the court will hold a hearing to confirm the sale. The court has the power to vacate the sale if 1) the price is substantially less than the value of the property, 2) a new sale would produce a higher price that is at least 10 percent more than the first $10,000 and 5 percent more than the remainder of the price offered, or 3) a different bidder at the confirmation hearing makes a higher bid of at least 10 percent of the first $10,000 and 5 percent of the remainder.33

Statutory expulsion. An aggrieved partner who wishes to continue with the partnership has a limited statutory right to remove a partner through expulsion.34 Expulsion may
occur under several circumstances:

• Pursuant to the terms of the partnership agreement.35

• By unanimous vote of the other partners because of an occurrence under Corporations Code Section 16601(4)(a)-(d). For example, expulsion is appropriate if carrying on the partnership business has become unlawful, all of the partner’s interest has been transferred, or as a result of the dissolution of a partner that was a partnership, limited partnership, or limited liability company.36

• According to a judicial determination for the partner’s expulsion, because the partner engaged in wrongful conduct that adversely affected the business, the partner willfully committed material breaches of the partnership agreement, or engaged in conduct that does not make it practical to carry on business with the partner.37

All limited partners have a statutory right to vote on the removal of a general partner.38 Absent a breach of the partnership agreement or a bad act by a partner, this is not likely to be an efficient remedy.

Before invoking any statutory remedy, a partner should carefully review the partnership or operating agreement. Except as provided in Corporations Code Section 16103(b), the partners are governed by the partnership agreement, and to the extent there is any conflict between the agreement and available statutory remedies, the agreement controls.39 A partnership agreement, however, cannot limit the power of a partner to dissociate or the power of a court to expel a partner for committing a material breach of the partnership agreement or engaging in wrongful conduct that adversely and materially affects partnership business.40 Thus, dissociation and forced removal remain viable remedies to a partner regardless of the terms of the partnership agreement.

Whether a financial partner chooses to invoke a remedy pursuant to the operating agreement or a statutory remedy, the outcome cannot be certain. Indeed, any remedy poses a risk of time-consuming and expensive litigation. The consequences of these additional expenses on the partnership and the value of each partner’s interest are also unclear. Thus it is crucial that before taking any action, a partner should establish a detailed strategy, including an endgame, that will allow the partner to weigh the benefits and risks of each remedy.

2 CORP. CODE §16701.
3 CORP. CODE §16601.
4 CORP. CODE §16701.
5 CORP. CODE §§16602, 16701.
6 CORP. CODE §16602.
7 CORP. CODE §16701(b).
8 CORP. CODE §16701(e).
9 CORP. CODE §16701.
10 CORP. CODE §§16701(h), 16405(b).
11 CORP. CODE §17351(a).
12 CORP. CODE §17351(b)(1).
13 Id.
14 CORP. CODE §17351(b)(2).
15 CORP. CODE §17351(b)(3).
16 CORP. CODE §17351(b)(5).
17 CORP. CODE §17351(b)(4).
18 CORP. CODE §17351(b)(2).
19 CODE CIV. PROC. §872.730.
20 Id. at 366.
21 Id. at 367.
22 CODE CIV. PROC. §§873.010-873.160.
23 CODE CIV. PROC. §§873.690.
24 CORP. CODE §16601.
25 Id. at 366.
26 Id. at 367.
27 CODE CIV. PROC. §873.920.
28 CODE CIV. PROC. §873.960.
30 Id. at 366.
31 Id. at 367.
32 CODE CIV. PROC. §873.910.
33 CODE CIV. PROC. §874.710.
34 CODE CIV. PROC. §§873.910.
35 CODE CIV. PROC. §873.910.
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Suing the Foreign Defendant
ON WEDNESDAY, JANUARY 7, the International Law and Litigation Sections will host a program led by Jeffery J. Daar concerning litigation in which a defendant from another country is sued in California. The issue requires creative strategies to address service of process, jurisdiction, venue, discovery, trial, and enforcement of judgment. The event will take place at the LACBA Conference Center, 281 South Figueroa Street, Downtown. Figueroa Courtyard reduced parking with LACBA validation costs $10. On-site registration will begin at 11:30 A.M. and lunch at noon. The program will continue from 12:30 to 1:30 P.M. The registration code number is 010271. The prices below include the meal.

$35—CLE+Plus members
$55—International Law and Litigation Section members
$65—LACBA members
$75—all others
$85—all at-the-door registrants
1 CLE hour

Persuasive Legal Writing
ON FRIDAY, JANUARY 16, the Association will host a program on persuasive legal writing featuring speaker Daniel U. Smith. Those who attend will learn techniques for brevity, simplicity, and clarity—the opposite of what lawyers learn in law school. The course also offers key steps for easy drafting and effective editing. Attorneys of all experience levels will benefit from this program, which provides 3.25 hours of specialization credit in appellate practice. The event will take place at the LACBA Conference Center, 281 South Figueroa Street, Downtown. Figueroa Courtyard reduced parking with LACBA validation costs $10. On-site registration and the meal will begin at 8:30 A.M., with the program continuing from 9 A.M. to 12:15 P.M. The registration code number is 010264. The prices below include the meal.

$70—CLE+Plus members
$90—Criminal Justice Section members
$125—other LACBA members
$150—all others
$175—all at-the-door registrants
6.5 CLE hours, including 1 hour of ethics
Turbulent Times for Transactional Lawyers

WHETHER OR NOT IT IS TRUE that bad economic times mean more business for litigators, there can be no doubt that lean times are a bad news for deal makers. Those of us who practice transactional law face huge challenges in these times of near record unemployment and collapsing capital markets. Established law firms are going out of business, retrenching, firing associates, and encouraging partners to take “early” retirement. As a result, we may see the 1,143,358 lawyers in the United States decline in number. In 2009, we will see fewer banks lending less, fewer sources of capital and less competition for deals, conservative and cost-conscious clients funding fewer deals, and much more competition among lawyers.

The carnage at many of the so-called Wall Street firms amply demonstrates the perils of over leverage. Armies of highly paid associates who once generated profits for their partners in the millions of dollars are now little more than surplus operating expenses. Interestingly, Main Street firms are selectively hiring a few of these highly qualified associates to complement their low partner-to-associate ratios and charging 20 percent to 30 percent less for the same services these lawyers provided at their former firms. While Main Street firms face intense competitive pressures from their peers, for the vast majority of transactional legal services that lawyers perform, Main Street is now a better value than Wall Street.

In this climate, lawyers at Main Street firms have the benefit of diversity without the perils of large-scale investment in practice areas that no longer exist. As my bankruptcy partners, applying a Vietnam-era lament, are fond of saying, “The light at the end of the tunnel turned out to be an oncoming train, and it’s finally about to hit.” So unless you do bankruptcy work, you must have a plan and execute it, because your professional life depends on it. What should this plan include for you to maintain your business, survive, and even thrive?

If your practice died (think commercial real estate loan securitization, luxury hotel development, or single-family subdivision master-planned communities), you have to grow another practice—otherwise, you may as well give up the practice of law. Finance lawyers are becoming workout lawyers. Real estate development lawyers are exploring affordable housing, becoming “green” lawyers, or dusting off their leasing experience. Look for new angles in your old business. For example, try to represent loan servicers if you once represented originators.

If your personal contacts at your clients’ businesses have lost their jobs, use your own network or your firm’s network to help them find another position. Help them with resumes, references, and referrals. Encourage them, and when they finally get a job, help them get up to speed in areas that might be new to them. It’s rewarding, not only because you sincerely want them to do well but because their debt of gratitude will surely be repaid generously.

Not that you would ever do this, but don’t sit and wait for the phone to ring—because it won’t. Get out of the office, call people whether you represent them or not, do lunches, coffees, dinners, meetings—anything to get yourself out into your communities. Offer insight, referrals, and value however you can to clients, referral sources, and prospects. Be a resource but not a pain. While begging for work is about the least successful way to get it, suggesting that you can provide helpful counsel at the right time may be well received.

Know your clients and their competitors. Read the same trade publications. Attend the same conferences—even if they do not have a legal orientation. Exploit the wider view of the market, trends, and deals that you have obtained from representing multiple clients in the same or similar areas (while being sensitive to client confidentiality). If it makes sense, present possibilities to clients or prospects that they may not have considered before. For example, if your clients are middle market banks and you did not alert them to the intricacies of the Federal Troubled Asset Recovery Program and how it can help their business, worry about all those other lawyers who did.

Recalibrate your approach to the practice of law. In these challenging times, clients—particularly financial institutions, investors, and others who seek to use the law to protect investments and capital interests—can expect more regulation, governmental scrutiny, and potentially harsh treatment in front of juries. Be the first to digest and understand changes in the paradigms and fill a vacuum before people become aware that a vacuum exists. These difficult times also provide a different lens through which to evaluate risks as you advise your clients. Are those material-adverse-change clauses really up to scratch? Do the financing contingencies really work?

Always watch out for the competition and stay ahead of them. Good deal lawyers provide great service to their clients in their chosen area of expertise for a reasonable price. Great deal lawyers do that and adapt to and thrive on change as their clients change, disappear, merge, or change direction.

So what should deal lawyers do in these challenging times? Exactly what they should do in normal times: Be competitive, aggressive, and thoughtful. Work harder than your competitors, and be as creative as you possibly can while treating your clients with the respect and integrity that you would want them to give to you. It’s pretty simple. It just takes a lot of work.

For the vast majority of transactional legal services that lawyers perform, Main Street is now a better value than Wall Street.

Michael A. Williamson is a shareholder with Buchalter Nemer, PC in Los Angeles and the chair of its Real Estate Group.
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