THARPE & HOWELL, LLP

REAL ESTATE LITIGATION NEWSLETTER

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This informational Newsletter is brought to you by Robert Freedman, Chair of Tharpe & Howell's Commercial Litigation and Transactional Practice Group. A special report on water loss and soil movement claims is also attached. Please feel free to contact "Bob" at rfreedman@tharpe-howell.com; or telephone number (818) 205-9955 to discuss any questions or comments you might have.

ORAL CONTRACTS FOR HOME IMPROVEMENTS SOMETIMES VALID

In *Hinerfeld-Ward, Inc. v. Lipian*, the California Court of Appeal recently held that, although *Business and Professions Code* § 7159 requires home improvement contracts to be in writing, a violation of that code does not *automatically* render the contract void.

In this case, the homeowners purchased a single family home intending to undertake a remodel of the property. They retained an architect who began design of the project in early 2000. After the initial design phase, the first general contractor ("GC") was retained, but became frustrated with repeated design changes and left the project in 2004. The architect then recommended that the homeowners retain a 2nd GC.

The homeowners and the 2nd GC never entered into a signed agreement clearly defining the work to be done. Work began, and as negotiations continued, the parties entered into a memorandum of understanding allowing the work to continue. Over the next two years, the 2nd GC submitted 19 payment applications for completed work which were all approved by the architect, who acted as the owners' representative, and paid by the homeowners.

In April 2006, the homeowners disputed certain charges but agreed to a partial payment for subcontractor work. After that, a dispute arose where there was an unpaid $200,000 balance owed to the 2nd GC. The 2nd GC sued the homeowners for breach of oral contract; and the homeowners cross-complained for negligence. At trial, the Jury essentially found in favor of the 2nd GC; and the homeowners appealed.

The California Court of Appeal upheld the Jury's award finding that, although *Business and Professions Code* § 7159 requires home improvement contracts be in writing, a violation of that code section does not *automatically* render the contract void. Rather, non-compliance renders the contract *voidable*, depending on various factors which include: 1) the lack of "serious moral turpitude," 2) available penalties, and 3) unjust enrichment to the homeowners. The Appellate Court found that the homeowners were sophisticated and participated in the design, planning, and negotiation and used an architect throughout the process. Further, the Court found that if the 2nd GC was unable to recover under the oral contract, the homeowners would be unjustly enriched. Accordingly, the Appellate Court found the oral contract to be *enforceable* and affirmed the Judgment against the homeowners, with an award of attorneys' fees.

With respect to the attorney fees, the court went to great lengths to discuss recovery of attorney fees under *California Civil Code* §§ 3260 and 3260.1. *California Civil Code* § 3260 allows for recovery of unpaid retentions, and 3260.1 allow for recovery of unpaid progress payments. The remedies for both are set forth in 3260 (g) which provides a 2% per month penalty on any wrongfully withheld amount, and, attorney fees for prevailing party.

PROHIBITING "COMPANION" DOG MAY BE DISCRIMINATORY PRACTICE

In *Auburn Woods I Homeowners Association v. Fair Employment and Housing Commission*, Ed Elebiaris was permanently disabled after being injured in an accident. Also, both he and his wife Jayne suffered from depression. Sometime after Ed's accident, the couple bought a condo in the Auburn Woods I Homeowner's Association (the "association") which prohibited the housing of dogs. The Elebiaris got a small dog anyway - believing it would help with their depressive states. When the association learned of the dog, it warned the couple they were in violation of the CC&Rs and that fines would be imposed if the dog was not removed.

Jayne asked for permission to keep the dog, and the association requested medical verification. Jayne submitted a letter requesting that the dog prohibition be waived as a reasonable accommodation to her impairment, and enclosed a letter from her doctor which also requested that the accommodation be made. In her letter, Jayne stated she was disabled and needed the companionship of a dog to help alleviate her disability. Shortly thereafter, an advocate for the disabled also submitted a letter on Jayne's behalf.

The association's attorney wrote to Jayne's doctor asking why a cat (allowed under the CC&Rs) would not suffice. The attorney also requested more information about the 'handicap' requiring the companion pet; and asked whether the dog had been prescribed or whether the doctor was stating that the dog was the basis for her improved mental state. The doctor did not know how to respond to these questions and did not reply.

The Elebiaris hired an attorney, but their request to keep the dog was still denied. Jayne even spoke at an association meeting and advised she was allergic to cats which would therefore not be a feasible option. Still, the association's position did not change. It argued a reasonable accommodation **was** made for people (like Jayne) who wanted a companion pet - because it allowed cats, rabbits, hamsters, guinea pigs, and birds. The association stated Jayne's wanting a dog kept her from receiving the companion pet accommodation.

Jayne and Ed filed a claim with the Fair Employment and Housing Commission (the "FEHC") alleging the association discriminated against them by failing to make a reasonable accommodation for their disabilities. The FEHC contacted the treating physicians, who provided additional letters supporting the accommodation request. Before the investigation was complete, however, the couple sold their condo and moved.

After investigation, the FEHC charged the association with disability discrimination. The administrative law judge found that the association had notice of the couple's disabled status and ruled that allowing a companion dog would have been a reasonable accommodation for the association to make.

Eventually, the California Court of Appeal reviewed the matter and also found that unlawful discrimination **had** occurred. When making its ruling, the Appellate Court noted that allowing a companion pet is not **always** required as a reasonable accommodation for an individual with a mental disability (such as depression); and that each accommodation request requires a case-by-case analysis and determination. It found that, given the facts and circumstances in this case, allowing a companion dog would have constituted a reasonable accommodation for the couple's disabilities. [Because the need for a "service animal" was not at issue in this matter, the couple was not required to present evidence that their dog was specially trained to alleviate their disabilities. Rather, it was the innate qualities of the dog, like its **friendliness and ability to interact with humans**, that it made it therapeutic for them here.]

SOMETIMES, SELF-INSURED RETENTIONS MUST BE SATISFIED BY NAMED INSURED

In *Forecast Homes v. Steadfast Insurance Company*, the California Court of Appeal upheld insurance policy language limiting satisfaction of a Self Insured Retention (SIR) to payments made by the Named Insured.

In this case, Forecast Homes ("Forecast") appealed from a judgment entered in favor of Steadfast Insurance ("Steadfast"). Forecast had contractually required its subcontractors to defend and indemnify it for their work performed, and to add it as an additional insured on their GL policies of insurance. Four different Steadfast policies were issued: 98 form, the Rev. form, the 01 form, and the B form. When a claim was brought against Forecast, Forecast tendered it to Steadfast.

Steadfast denied Forecast's tender claiming that only the named insured (subcontractor) could satisfy the per occurrence SIR endorsements and thereby trigger coverage (which the insured subcontractor had not done). Forecast argued it was allowed to satisfy the SIR and that Steadfast's position violated public policy and rendered the coverage illusory. It also argued that revisions in Form-B recognized the ability of an additional insured (like Forecast) to satisfy the SIR retention under Form-A.

The court analyzed the Steadfast policies as two different versions - Form-A (containing the 98 and Rev. form endorsements) and Form-B (containing the 01 and B form endorsements). It found that Form-A to be identical to Form-B except it is an earlier version not containing the clarifying provision. [The primary difference between Form-A and Form-B was that the B form had additional language clarifying the named insured's payment obligation.] After analysis, the court rejected Forecast's position that the revisions in Form-B recognized the ability of an additional insured to satisfy the SIR retention under Form-A. The court pointed out that it is against public policy to view modification of the policy as creating a negative inference on an earlier policy; and agreed with Steadfast's argument that in both Form-A and Form-B, only the named insured (not Forecast) could satisfy the SIR.

The court also rejected Forecast's argument that the coverage was "illusory," noting that the triggering of coverage was not an event under the control of Steadfast, but instead the subcontractor named insured, and that Forecast was protected by its hold harmless and indemnify agreements which held the subcontractors liable regardless of insurance coverage. When rendering its decision, the court noted that because SIRs are equivalent to primary liability insurance, policies subject to SIRs are essentially 'excess policies' which carry no duty to indemnify until the SIR is exhausted; and that other insurance can be purchased to cover the SIR *unless the policy clearly requires* that the named insured pay this amount itself. As a note aside, the court questioned why Forecast never asked the subcontractors to activate their policies by funding the SIR.

Comments:

It is important to note what this case does, and *does not* address. This court's ruling was based on specific policy language that made it clear that only the *named insured* could satisfy the SIR. The court *did not* address (1) Steadfast's ability to assert the failure of the named insured to satisfy an SIR as a defense in a contribution action by another insurer; (2) The *Executive Risk v. Jones* decision, which bound the insurer to a judgment for the amount in excess of an SIR despite the fact the SIR was not satisfied, and; (3) The insurers use of an SIR as an "escape clause" similar to the use of "other insurance" provisions that have been significantly restricted by the courts.

UNLICENSED PROPERTY MANAGER MAY BE ENTITLED TO COMPENSATION

In *MKB Management v. Andre Melikian*, the California Court of Appeal recently held that the absence of a real estate broker's license or a contractor's license does not *necessarily* preclude recovery of payment for those services for which no license is required.

In this action, MKB Management ("the manager") and Andre Melikian ("the owner") [who is also a licensed real estate broker] entered into an Agreement in which the owner granted the manager "the exclusive right to rent, lease, operate and manage" apartment buildings in California. Under the terms of their agreement, the manager had authority to advertise rents; sign, renew, and cancel leases; collect rents and other charges; terminate tenancies and sign notices on behalf of the owner; prosecute unlawful detainer actions; cause repairs and alterations to be made; decorate the premises; purchase supplies; hire and supervise employees to operate and maintain the premises; and contract with others for services on behalf of the owner. The manager agreed to deposit into the owner's bank account all receipts less disbursements; and the owner agreed to pay expenses in excess of the receipts, together with a management fee of $2,000 per month, or 4% of the gross receipts - whichever was greater.

In June of 2008, the manager filed suit against the owner, alleging the owner failed to pay for services rendered and monies advanced. In response, the owner noted the manager was not a licensed broker or contractor, and that such licenses were required in order to render the services described in the parties' agreement. Because the manager was not so licensed, the owner argued the manager could not recover payment for the services provided.

In turn, the manager claimed it was exempt from the real estate license requirement because any services for which such a license was required were exempt under *Business and Professionals Code* section 10131.01(a)(3). It also noted it had provided those services under the supervision and control of the property owner, *a licensed real estate broker*. The manager further alleged it was exempt from the contractor's license requirement under *Business and Professions Code* section 7048 because the charges for any services for which such a license might be required were less than $500 per project.

The owner countered that the exemption in *Business and Professions Code* 10131.01(a)(3) was inapplicable because the manager *was not* an employee of the owner; and the services rendered under the agreement were beyond the scope of those specified in the statute. The owner further held that a contractor's license *was* required for some of the services provided, and that the exemption for projects under $500 was inapplicable. In turn, the manager claimed that some of the services provided did not require either a real estate *or* a contractor's license and argued it was entitled to recover payment for *those* services even if it could not recover payment for other services which did require a license.

The Trial Court determined the parties' agreement was unlawful because its "principal object" was for property management, and the manager admittedly possessed no broker's license. It also concluded any exemptions under the *Business and Professions Code* were inapplicable and therefore ruled on behalf of the owner and dismissed the manager's case. The manager appealed.

The California Court of Appeal held that the absence of a real estate broker's license or a contractor's license does not *necessarily* preclude recovery of payment for those services for which no license is required; and therefore sent the case back to the Trial Court for further determination.

Failure To Participate In Section 8 Housing Program Does Not Violate Law

In *Sabi v. Sterling*, the California Court of Appeal held a landlord's failure to participate in the Section 8 housing program does not violate California's housing and anti-discrimination laws. In this case, Elisheba Sabi rented an apartment from Donald Sterling. When she became eligible for housing assistance from HUD, she asked Mr. Sterling to accept Section 8 funds. Ms. Sabi was an elderly widow, disabled, and on a fixed income.

When Mr. Sterling refused to participate in the Section 8 housing program, the Legal Aid Foundation of Los Angeles (LAFLA) intervened on her behalf. The LAFLA wrote letters to Mr. Sterling asking that he accept the Section 8 as a reasonable accommodation to Ms. Sabi in light of her disabilities and low-income status, but he still refused to do so. Ms. Sabi's family attempted to find other suitable living quarters for her, but concluded it would be best if she did not move. Accordingly, Ms. Sabi continued to pay rent to Mr. Sterling, but decided to sue.

Ms. Sabi argued Mr. Sterling's failure to participate in the Section 8 housing program violated California's state disability and "source of income" anti-discrimination laws. She requested that the Court compel Mr. Sterling to participate in the program, and to accept Section 8 funds toward the rent due. After a full Trial by Jury, a Judgment was entered in favor of Mr. Sterling. Ms. Sabi appealed.

Because the Jury's decision would have wide-spread implications on California landlords and tenants alike, amicus briefs were filed with the Appellate Court by various advocacy groups. Pro-tenant groups argued it was discriminatory, on the basis of source of income, for a landlord to not participate in the Federal Housing Program when a disabled and low-income tenant was involved; while property owners and management firms argued participation in the program was strictly "voluntary" and could not be forced.

After conducting an exhaustive review of California and Federal law on the subject and relative legislative intent, the Court of Appeal found that the Fair Employment and Housing Act, by its plain language, did not compel a property owner (such as Mr. Sterling) to participate in the otherwise voluntary Federal housing program and that refusal to accept such funds did not amount to discrimination based on source of income. Although Ms. Sabi continues to live in the unit, it would appear she pays her monthly rent to Mr. Sterling without Federal support.

Broker's Commission May Be Due Even When Escrow Fails To Close

In *RC Royal Development and Realty Corp. v. Standard Pacific Corp.*, broker RC Royal Development and Realty ("the broker") and Standard Pacific ("the buyer") entered into a written "Confidentiality and Agency Agreement" designating the broker as the buyer's agent (the Agency Agreement), with a 1.5% commission provision. The broker subsequently brought the buyer two parcels of property owned by LPC Union Apartments ("the seller"), located in downtown Los Angeles ("the property").

On August 19, 2005, the buyer entered into a "Real Estate Agreement" with the seller to purchase the property for $116 million ("the buy-sell"). Thereunder, the seller agreed to improve the property by developing two buildings containing 107 and 171 condominium units. On that same date, escrow was opened with the buyer paying a $1 million deposit, with $5 million in earnest money before September 14, 2005.

In the buy-sell, the buyer's obligation to close was subject to the satisfaction or waiver of, inter alia, a "review period" that expired on September 14, 2005. The seller agreed to provide title and construction documents (among other things) for the buyer's evaluation. The buyer could terminate the contract during the review period without forfeiting its earnest money, but its failure to terminate by September 14, 2005 would constitute a waiver of the conditions contained in the review period. The buy-sell also conditioned the buyer's purchase obligation on the issuance of a temporary certificate of occupancy (among other things), and contemplated the transaction would close within five business days of the issuance thereof "but in no event *earlier* than January 4, 2006."

Subsequently, the temporary certificate of occupancy was never issued. During the period of delay, the condo market in Los Angeles declined and the buyer's purchase of the property may have no longer been economically feasible or beneficial. The buyer and the seller entered into a release and settlement agreement terminating the buy-sell and escrow - wherein the buyer forfeited $4 million. In the end, escrow did not close, the buyer did not acquire the property, and the broker's commission was not paid.

The broker sued the buyer for breach of contract and breach of the implied covenant of good faith and fair dealing, arguing its right to the commission had vested and that the buyer was not justified in declining to finalize the property purchase. The Trial Court ruled in favor of the buyer and dismissed the case. The broker appealed.

The Court of Appeal found the broker had earned its commission at the time the buyer entered into the buy-sell contract, and that the close of escrow was **not** a condition precedent to the right to a commission. The Appellant Court therefore determined the Trial Court had erred in its ruling in favor of the buyer. Further, it opined that triable issues of fact exist as to whether the buyer had cause or had acted in bad faith in failing to close escrow. Accordingly, the case was remanded back to the Trial Court for further proceeding.

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This Real Estate Litigation Newsletter has been brought to you by Robert Freedman, a Partner of Tharpe & Howell and Chair of its Commercial Litigation and Transactional Practice Group. Tharpe & Howell has been part of the California, Arizona, Nevada and Utah business communities for more than 34 years, providing clients with experience, judgment, and technical skills. We are committed to delivering and maintaining excellent client service and case personalized attention, and to be an integral member of each client's team.

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For our clients and colleagues exposed to water loss claims, attached to this newsletter is an article about steps you can take to mitigate loss. I hope you enjoy the article, and invite any questions and/or comments you might have. Bob

This publication is designed to provide accurate and authoritative information regarding the subject matter covered. These materials are offered for information purposes only and do not constitute legal advice. Do not act or rely upon any of the resources and information contained herein without seeking professional legal advice.

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WATER LOSS & SOIL MOVEMENT CLAIMS

The recent rains in Southern California have created exposures to a variety of damages that if not timely mitigated and investigated, can lead to expensive and time-consuming claims and litigation. Generally, the losses tend to be primarily property damage, however, depending on the circumstances there can also be personal injury claims.

The ideal situation is for a property owner to identify the *potential* for a water loss claim, and to address the issue prior to a loss. This requires evaluating the likelihood of the exposure of a structure and its contents to water or moisture, and to take actions to prevent damages. An example of this is as simple as fixing the roof, waterproofing, or installing a drain. This type of proactive approach by many property owners in light of the publicity surrounding Southern California's 1997-1998 El Nino rainy season effectively reduced the damages, however, even then there were significant losses resulting therefrom.

The extent of this season's rains was not predicted, and very few people took precautions like they did in the much hyped 1997-1998 El Nino. The situation is further exacerbated by the large amount of major brush fires in Southern California in recent years, including the trend to allow the fires to burn close to the perimeter of populated areas. In addition, population and structure density in urban areas have significantly disrupted natural drainage systems, which in many cases, inadequately designed and constructed surface and sub-surface drainage systems have not fully addressed. The impact of the above is readily observable in the recent reports of mud-slides and soils movement in both rural and urban areas.

Mud slides such as those we have recently experienced, are typically precursors of additional damages and claims to come from water and moisture intrusion. Soils become overly saturated and unstable due to improper drainage and lead to all sorts of landscape and structural damages. In the shorter term, damages to structures and contents from soils and leaking will become quickly apparent. In the longer term, more insidious damages such as mold and dry-rot damages will occur, which can be particularly difficult, and expensive to deal with.

Like all losses, people will be looking for someone to pay for it, and the first place they will look for help is from their insurers. However, over the years, insurance policies have in many cases become more restrictive in the type of water loss claims and damages that are covered, leading to many of the claims being denied, particularly if there is a major loss involved. Whether or not a claim is covered is determined by comparing the facts of the loss with the specific wording in the insurance policy. Care must be taken to act reasonably to mitigate damages by stopping the water intrusion and preventing further damages; notifying the insurer as soon as possible and allow them reasonable access to inspect the property and investigate the claim, and; insure the facts related to both the cause and extent of the damages are properly documented as early as possible.

If there is no first-party insurance, then the primary option is to argue that liability for the loss falls on another party, preferably one who has liability insurance coverage. Examples include a neighboring property for altering drainage, a building owner's failure to keep a structure watertight, or the original builder for defective construction.

Unlike the insurer / insured relationship described above, litigating against another party requires a different and higher level of proof. In a litigation context, there must be evidence to prove that a party being charged had a duty of care to prevent the loss and breached that duty. Typically, that duty arises out of the relationship between the parties and is based on tort or contract theories. Imposing this type of liability on a party typically requires a detailed investigation and preservation of evidence for use at arbitration or trial.

Whether a first-party insurance claim or an action against another party, early and thorough documentation of a water loss claim is important as damages may increase to the point where it becomes difficult, or even impossible to determine the exact source of the water or cause of the intrusion. The earlier a loss is documented, particularly with photographs and videos, the less it will cost later to investigate, and the evidence will be more reliable.

Navigating these minefields may require the help of professionals. This includes having available a reliable contractor that can stop the water intrusion and fix the damages; having a forensic expert available to identify the cause of the water intrusion; and having a lawyer to help determine if there is insurance coverage for the loss, or, if another party is liable.

In the case of homeowner or business property insurance, most insurance policies only afford coverage for a sudden and accidental discharge of water. Long term leakage of water inside or onto an insured property will generally be excluded. Unless special coverage is obtained for floods or earth movement, most policies exclude water losses caused by floods or earth movement. However, in cases of concurring causes, referral to coverage counsel may be indicated to determine if an ensuing loss provision or analysis affords coverage for a sudden discharge of water caused in part by an excluded peril.

Additional coverage issues can arise over the typical exclusions for faulty workmanship or construction, or wear and tear as causes of loss. While many policies exclude coverage for a loss caused by an insured's neglect, case law limits such exclusions to post-loss neglect by an insured to protect the property from further loss or damage after a covered loss has occurred. Such coverage issues can become very complex both with regard to determining the efficient or most important cause of the loss, and analyzing particular coverage provisions and exclusions based on applicable case law. For this reason, a referral to coverage counsel is often important, both for insureds and insurers.

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