Allen Matkins
Breakfast Briefing 2009

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New developments in:

Land Use
Bankruptcy/Workouts
Real Estate
and
Employment Law

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Breakfast Briefing 2009

Presented by:

Michael Patrick Durkee
Partner
Allen Matkins Leck Gamble Mallory & Natsis LLP
200 Pringle Avenue, Suite 300
Walnut Creek, CA 94596
(415) 273-7455
mdurkee@allenmatkins.com
landusenavigators.com

Annette Rittmuller
Senior Counsel
Allen Matkins Leck Gamble Mallory & Natsis LLP
200 Pringle Avenue, Suite 300
Walnut Creek, CA 94596
(415) 273-7486
arittmuller@allenmatkins.com

Lee Gotshall-Maxon
Partner
Allen Matkins Leck Gamble Mallory & Natsis LLP
Three Embarcadero Center, 12th Floor
San Francisco, CA 94111
(415) 273-7423
lgotshallmaxon@allenmatkins.com

Ivan Gold
Of Counsel
Allen Matkins Leck Gamble Mallory & Natsis LLP
Three Embarcadero Center, 12th Floor
San Francisco, CA 94111
(415) 273-7431
igold@allenmatkins.com

William Huckins
Partner
Allen Matkins Leck Gamble Mallory & Natsis LLP
Three Embarcadero Center, 12th Floor
San Francisco, CA 94111
(415) 273-7426
whuckins@allenmatkins.com

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Michael Patrick Durkee
Partner
Allen Matkins Leck Gamble Mallory & Natsis LLP
200 Pringle Avenue, Suite 300
Walnut Creek, CA 94596
(415) 273-7455
mdurkee@allenmatkins.com
landusenavigators.com

I. LAND USE LAW – ITEMS FOR DISCUSSION

A. CEQA

- ***SB 375 (2008).*** This 2008 law: (1) requires the Air Resources Board to provide each region with greenhouse gas emission reduction targets for the automobile and light truck sector; (2) requires a regional transportation plan to include a Sustainable Communities Strategy designed to achieve the targets for greenhouse gas emission reduction; (3) requires the California Transportation Commission to maintain guidelines for travel demand models; (4) requires cities and counties, in general, to revise their housing elements every eight years in conjunction with the regional transportation plan and complete any necessary rezonings within a specific time period; and (5) relaxes CEQA requirements for housing developments that are consistent with a Sustainable Communities Strategy.

- ***AB 1358 (2008).*** Commencing January 1, 2011, requires that the legislative body of a city or county, upon any revision of the circulation element of the general plan, modify the circulation element to plan for a balanced, multimodal transportation network that meets the needs of all for safe and convenient travel in a manner that is suitable to the rural, suburban, or urban context of the general plan. Requires the Governor's Office of Planning and Research (OPR), commencing on January 1 2009, but no later than January 1, 2014, in its next scheduled revision of its guidelines for the preparation of and content of mandatory elements of city and county general plans, to prepare or amend guidelines for a legislative body to accommodate the safe and convenient travel of users of streets, roads, and highways in a manner that is suitable to the rural, suburban, or urban context of the general plan.

- ***California Native Plant Society v. County of El Dorado*, 170 Cal.App.4th 1026 (2009).** The Third District Court of Appeal held that El Dorado County improperly relied upon a fee program to conclude that a project's impacts to endangered plants were sufficiently mitigated and that an environmental impact report (EIR) did not need to be prepared. The court found that the county's reliance was improper because the fee program itself was never subject to CEQA review.

- ***O.W.L. Foundation v. City of Rohnert Park*, 168 Cal.App.4th 568 (2008).** The First District Court of Appeal upheld the City's water supply assessment ("WSA") for a specific plan area. The court held that SB 610 does not mandate that a WSA cover all existing users or a specific methodology for determining the sufficiency of water supply. A WSA is sufficient as long as the methodology and study area applied are not arbitrary, capricious or completely lacking in evidentiary support.

B. MAP ACT / VESTED RIGHTS

- ***AB 333 (2009).*** Signed into law by the Governor on July 15, 2009 (as urgency legislation, it became law when signed). New Map Act section 66452.22 immediately extends the life of tentative and vesting tentative maps that would have otherwise expired before

January 1, 2012 for two additional years. Some may argue that Section 66452.22 allows a local agency to circumvent the "one bite of the apple" rule in Government Code section 65961. We disagree. The new language appears in Section 66452.22(e):

> Section 65961 applies to a tentative subdivision map or parcel map that relies on the 24-month extension pursuant to this section, except for both of the following:
>
> (1) The five-year period described in Section 65961 shall be three years.
>
> (2) Section 65961 does not prohibit a city, county, or city and county from levying a fee or imposing a condition that requires the payment of a fee upon the issuance of a building permit or after the issuance, including, but not limited to, a fee as defined in Section 66000.

Some have interpreted the language in Subsection (e)(2) to mean that a city or county could impose *any* fee as a condition of granting the new 2-year extension. We disagree and interpret Subsection (e)(2) merely to restate existing law, that is, that a city our county could impose a *new* fee that did not exist at the time the subdivision map was approved. Moreover, that fee would be subject to existing applicable law, including constitutional and procedural requirements.

⊡ ***Building Industry Association of Central California v. City of Patterson*, 171 Cal.App.4th 886 (2009).** The Fifth District Court of Appeal held that the City's increase of its affordable housing in-lieu fee was not "reasonably justified" under the terms of the development agreement at issue. The development agreement provided that

> Developer acknowledges that the City is currently preparing an updated analysis of its Affordable Housing fee and hereby agrees to be bound by the revised fee schedule, including indexing as provided by ordinance at the time of adoption of the fee, providing the same is reasonably justified.

The court first concluded that the applicable legal standard for determining whether the fee increase was reasonably justified was the standard established in *San Remo Hotel v. City and County of San Francisco*, 27 Cal.4th 643, 671 (2002): there must be a "reasonable relationship between the amount of the fee, as increased, and the deleterious public impact of the development." Using this test, the court found that the City's fee increase from $734 per residential unit to $20,946 was not reasonably justified.

As many land us practitioners know, there are many ways to address the payment of impact fees and their amounts in a development agreement. Fees can be frozen and enumerated in the agreement itself, the amounts can be left open and paid in whatever amount is applicable at the time of building permit issuance, the fee amount can be set at a certain level for a certain amount of time, say five years, etc. Parties should do their best to avoid nebulous, open-ended language such as the "reasonably justified" provision at issue in *BIA v. Patterson*.

⊡ ***Use Vesting Tentative Maps with Multiple Final Maps.*** Developers that are preparing to apply for subdivision maps for projects should use vesting tentative maps with

multiple (phased) final maps as a strategy for the staying afloat during the downturn. We will discuss different ways in which such a strategy could be executed.

⊡ ***Abernathy Valley, Inc. v. County of Solano*, 173 Cal.App.4th 42 (2009).** The First District Court of Appeal, relying primarily on the *Witt Home Ranch* decision (*Witt Home Ranch, Inc. v. County of Sonoma*, 165 Cal.App.4th 543 (2008)), determined that the Subdivision Map Act's grandfather clause (Gov. Code § 66499.30) did not apply to a 1909 subdivision map. The key issue in *Abernathy* was whether or not the laws in effect at the time the original map was recorded (1909) regulated the "design and improvement" of subdivisions. The court held that those laws did *not* regulate the design and improvement of subdivisions.

C. WILLIAMSON ACT

⊡ ***County of Humboldt v. McKee*, 165 Cal.App.4th 1476 (2008).** The Allen Matkins Walnut Creek land use team represented the petitioner in this important Williamson Act case. The County sued the Plaintiff, contending that Plaintiff's property was out of compliance with the County's new local Williamson Act regulations. Plaintiff counter-complained, arguing that the new local regulations did not apply to his property because they were inconsistent with his existing Williamson Act contract with the County. The Court held for the County, concluding that Williamson Act contracts are "renewed" each year, the parties are assumed to enter a "new" contract every year. All new applicable laws and regulations automatically become part of the "new" contract. We will discuss the radical nature of the court's decision and its potential impact on the Williamson Act.

⊡ ***Governor's budget for 2009-2010.*** Although not yet set in stone, the Governor's 2009-2010 budget would eliminate entirely the state's annual Williamson Act subvention payments to counties. Such an act would make it financially difficult for cities and counties to remain parties to Williamson Act contracts, and the terminate of such contracts could have serious land use implications.

D. INITIATIVES/REFERENDUM

⊡ ***Lin v. City of Pleasanton*, 176 Cal.App.4th 408 (2009).** The First District Court of Appeal reversed the trial court's decision that granted a petition for writ of mandate directing the city clerk to refrain from certifying a referendum petition based on its failure to comply with the "text" requirement of Elections Code section 9238(b). The appellate court determined that the contested Development Plan was not required to be attached to the referendum petition because the challenged ordinance did not include the Development Plan, nor did it incorporate that plan by reference or attach it as an exhibit.

⊡ ***Defend Bayview Hunters Point Committee v. City and County of San Francisco,* 167 Cal.App.4th 846 (2008).** City voters submitted a referendum petition to the city clerk challenging the city's adoption of a redevelopment plan. The city clerk refused to accept the petition because the petition did not include a copy of the redevelopment plan. The Court upheld the clerk's decision because the redevelopment plan was a part of the "text" of the ordinance adopting the plan.

II. LAND USE LAW – ITEMS NOT DISCUSSED

A. CEQA

⊡ ***SB 947 (2008).*** This 2008 law: (1) requires a lead agency, for a project with statewide, regional or area wide significance, to notify relevant transportation agencies and other public agencies about project scoping meetings; and (2) adds overpasses, onramps, and off ramps to the list of transportation facilities where consultation with these agencies is required to better determine the project's impact.

⊡ ***California Native Plant Society v. City of Santa Cruz*, 2009 WL 2581275.** In 1994, the City of Santa Cruz acquired 63 acres of land known as Arana Gulch. In 2003, the city began planning the Arana Gulch Master Plan. In May 2006, the city issued the Final Environmental Impact Report (FEIR) associated with the plan, identifying and analyzing four potential project alternatives. On July 11, the city council approved the Arana Gulch Draft Master Plan, rejecting the alternatives. Under CEQA, a local agency must refrain from approving projects with significant environmental effects if there are feasible alternatives that can avoid those effects. As such, the agency must prepare an EIR that analyzes in sufficient detail a reasonable range of feasible project alternatives. A project with a significant environmental impact may only be approved if the agency finds the alternatives are infeasible and that the impact is acceptable because of overriding social and economic considerations. Assessment of the feasibility of proposed alternatives involves a reasonable balancing of "economic, environmental, social, and technological factors." An alternative that is undesirable from a policy perspective may be rejected as infeasible. In this case, the city properly considered the various competing interests and determined as a matter of policy that the alternatives were infeasible. As such, the city's determination complied with CEQA.

⊡ ***City of Bellflower v. State Water Resources Control Board*, 2009 WL 885964.** The Second District Court of Appeal held that state Water Board amendments of water quality basin plans should be set aside because of a failure to include an alternatives analysis under CEQA. The Water Board acted under the certified regulatory program exemption, but doing so did not excuse the need for an alternatives analysis. The court also found no abuse of discretion by the trial court in voiding the resolutions in the face of argument by the agencies that they should have been given an opportunity to correct the error by preparing an alternatives analysis.

⊡ ***Tracy First v. City of Tracy*, 2009 WL 2623319.** The Third District Court of Appeal held that CEQA did not require the city council to seek renewed planning commission review after city council amended the EIR that planning commission previously recommended the council certify. The amendment to the EIR included modified sections on land use and economics (urban decay), traffic and circulation, and air quality, and a new section on energy conservation. The court reasoned that remand was not necessary because the amendment was only of the EIR, and not of the project itself. The court also held that petitioners failed to exhaust their remedies on a claim concerning alternatives, that the city was not required to consider a reduced project size alternative, and that the city was not required to

provide funding for the improvement of roadway intersections where those intersections were not under the control of the city.

⊡ ***California Oak Foundation v. County of Tehama*, 174 Cal.App.4th 1217 (2009)**. The Third District Court of Appeal held that, under the common interest doctrine, a lead agency's disclosure to a real party-in-interest of privileged documents did not constitute a waiver of the attorney-client privilege. The documents at issue were communications between County staff and the County counsel that the petitioners sought to include in the administrative record of a CEQA case. The court also found that, barring clear intent, a new statute would not constitute an "implied repeal" of an older statute; such a result would require an "unavoidable conflict with the earlier law."

⊡ ***Health First v. March Joint Powers Authority*, 174 Cal.App.4th 1135 (2009).** The Fourth District Court of Appeal found that the Joint Powers Authority's approval of a design plan for an industrial facility was a ministerial act not subject review under CEQA. The Court of Appeal ruled that final project approval is a ministerial act when the agency's review of the proposed development does not involve the exercise of judgment or deliberation and is merely a determination of whether a project conforms with existing design guidelines and land use plans.

⊡ ***Riverwatch v. Olivenhain Municipal Water District*, 170 Cal.App.4th 1186 (2009).** Case involved an a agreement for water district to provide water to landfill. That agreement was part of a broader landfill "project" for purposes of CEQA, and therefore the agreement required environmental review. The court also issued holdings concerning responsible agencies, the meaning of an approval, and necessary parties under CEQA.

⊡ ***Great Oaks Water Co. v. Santa Clara Valley Water Dist.*, 170 Cal.App.4th 956 (2009)**. The Sixth District Court of Appeal holds that a water district's findings pursuant to Public Resources Code section 21080 that its adoption of groundwater rate increases were exempt from CEQA were sufficient. The district minimally satisfied the statute's requirement that it set forth with specificity the basis for the claimed exemption. The appellate court applied a *Topanga* analysis to find that the district exemption findings were adequate.

⊡ ***Save Tara v. City of West Hollywood*, 45 Cal.4th 116 (2008).** City is required to perform environmental review pursuant to CEQA before entering agreement to sell property for redevelopment. This agreement, even with a CEQA compliance condition, put the city in a position of making a loan that would not be repaid unless the project went forward and did not take into account that the proposal might comply with the requirements of CEQA and nonetheless not have benefits that would outweigh immitigable effects.

B. GENERAL PLAN, SPECIFIC PLAN, ZONING, & OTHER LOCAL PLANNING

⊡ ***AB 2280 (2008).*** This 2008 law: (1) removes all language relating to when in the project approval process a developer must request a density bonus and when in the approval process the local government must review density bonus requests and instead restore existing law; (2) specifies that in determining a project's density bonus, if the density allowed

under the jurisdiction's zoning ordinance is inconsistent with the density allowed under the land use element of the general plan, the general plan density shall prevail; (3) clarifies that local governments must comply with density bonus law regardless of whether or not they pass an ordinance specifying how the law will be implemented; and (4) clarifies that a request for the waiver or reduction of development standards does not change the number of incentives or concessions to which the applicant is entitled.

⊡ ***California Nevada Annual Conference of the United Methodist Church v. City and County of San Francisco*, 173 Cal.App.4th 1559 (2009).** The city had no jurisdiction to apply its historic landmark ordinance to a church building that was owned by a religious organization but was no longer being used as a church. The church came within the statutory exemption from historic preservation regulation for "noncommercial" property owned by religious associations.

⊡ ***Farr v. California Coastal Commission*, 173 Cal.App.4th 1474 (2009).** The Coastal Commission properly granted a coastal development permit to add a second story to a home, despite the fact that the addition would partially block the public's view of the sea from a certain location. In the Coastal Act [Pub. Res. Code § 30251 (directing the Commission to consider and protect scenic and visual qualities, and providing that "permitted development shall be sited and designed to protect views")], the Legislature did not intend that permits be denied for all projects that infringed in any way, no matter how minimally, on any view, no matter how limited, for anyone, from any vantage point, no matter the proximity of unlimited and expansive views.

⊡ ***Ste. Marie v. Riverside County Regional Park & Open-Space Dist.*, 46 Cal.App.4th 282 (2009)**. Real property is not deemed "dedicated" for park or open space purposes at the moment of acquisition by a park and open space district (Pub. Res. Code § 5565), but rather is "actually dedicated" only after a district's board of directors adopts a formal resolution for such purposes (Pub. Res. Code § 5540).

C. MAP ACT / VESTED RIGHTS

⊡ ***Friends of Riverside's Hills v. City of Riverside*, 168 Cal.App.4th 743 (2008).** The Fourth District Court of Appeal affirmed the trial court's dismissal of a petition for writ of mandate on statute of limitations grounds. Petitioner failed to serve the summons within 90 days of the decision, thus violating Section 66499.37 of the Subdivision Map Act. Even though the petition also involved CEQA causes of action, the two statutes could be reconciled to require application of the Map Act's 90-day service of summons requirement.

⊡ ***Peak-Las Positas Partners v. Bollag,* 172 Cal.App.4th 101 (2009).** While not a case involving a development agreement, this case involved contractual issues that are very important to negotiating and drafting effective development agreements. The seller had agreed to an amendment of a purchase and sale agreement that provided for future escrow extensions “by mutual consent of Buyer and Seller, which mutual consent shall not be unreasonably withheld or delayed." The court concluded that “ ‘[W]here a contract confers on one party a discretionary power affecting the rights of the other, a duty is imposed to exercise that discretion in good faith and in accordance with fair dealing.’ ” (citing *Locke v. Warner*

Bros., Inc., 57 Cal.App.4th 354, 363 (1997).) "Denying consent solely on the basis of personal taste, convenience or sensibility is not commercially reasonable." (*Id.*, citing *Kendall v. Ernest Pestana, Inc.*, 40 Cal.3d 488, 501 (1985).)

D. INITIATIVES/REFERENDUM

⊡ ***Citizens for Planning Responsibly v. County of San Luis Obispo*, 176 Cal.App.4th 357 (2009)**. Second District Court of Appeal reversed trial court's decision that the State Aeronautics Act (SAA) preempted an initiative that permitted a mixed use development near the County's airport. The appellate court applied the three types of preemption (Legislature completely occupies the field; Legislature delegates exclusive authority to a local governing body; initiative power interferes with essential governmental function) and found that none applied in this case.

E. MISCELLANEOUS

⊡ ***AB 1084 (2009)*.** Before the recession started, demand pressures in the global economic markets resulted in higher costs for the materials needed for public works projects. Some cities and counties raised their exaction fees to cover the higher costs of cement, asphalt, steel, wiring, and pipes. Demand pressures in local real estate markets resulted in escalating prices for the land needed for parks, fire stations, sewer plants, and other public facilities. Now that these prices are starting to fall, builders want to be sure that they can ask local agencies to audit their fees. This new law clarifies that the current opportunities for audits apply to exaction fees for public facilities. The law also clarifies that when costs fall, exaction fees should follow.

⊡ ***AB 1263 (2008)*.** Clarifies the process by which LAFCOs may use fees or service charges to recover their costs, and allowed LAFCOs and cities to use the existing expedited annexation procedures on additional specified county islands.

⊡ ***AB 2484 (2008)*.** Establishes a clear procedure and criteria for a special district to initiate, by resolution, a proposal to a LAFCO to increase, modify, decrease or divest itself of specified services or functions within its district service area.

⊡ ***SB 301 (2008)*.** Eliminates the deadline by which communities must incorporate and cities must annex inhabited land in order to receive additional vehicle license fee funding.

⊡ ***San Bernardino Valley Water Conservation Dist. v. Local Agency Formation Com'n*, 173 Cal.App.4th 190 (2009)**. Second District Court of Appeal affirmed trial court judgment that a water district may not enjoin the processing of an application to consolidate water districts under LAFCO. The courts rejected arguments by the aggrieved water district that a different statutory scheme should be applied, and that Parts 4 and 5 of the LAFCO Act (Gov. Code §§ 56000 *et seq.*) instead apply.

⊡ ***City of Stockton v. Marina Towers LLC*, 171 Cal.App.4th 93 (2009)**. The Stockton City Council adopted resolutions of necessity approving the condemnation of two parcels of land owned by defendants, Marina Towers LLC et al. (Marina), and thereafter, the

City filed an eminent domain action to acquire the property. After obtaining a prejudgment order for possession, Stockton decided to build a parking lot and a baseball field on the property. At trial, the court overruled all Marina's right-to-take objections, and denied Marina any compensation for pre-condemnation activities. On appeal, the court concluded in part, that the project description in the resolutions of necessity was so vague and uncertain that it failed to specify the "public use" for which Stockton acquired the property. The court reversed the judgment with directions to order a conditional dismissal of the action.

Bankruptcy/Workouts Law

Ivan Gold
Of Counsel
Allen Matkins Leck Gamble Mallory & Natsis LLP
Three Embarcadero Center, 12th Floor
San Francisco, CA 94111
(415) 273-7431
igold@allenmatkins.com

William Huckins
Partner
Allen Matkins Leck Gamble Mallory & Natsis LLP
Three Embarcadero Center, 12th Floor
San Francisco, CA 94111
(415) 273-7426
whuckins@allenmatkins.com

BANKRUPTCY/WORKOUTS – ITEMS FOR DISCUSSION

General Growth bankruptcy: bankruptcy remote does not mean bankruptcy proof

The August 11, 2009 decision in *In re General Growth Properties, Inc.*, 409 B.R. 43 (Bankr. S.D. N.Y. 2009), calls into question the core lending principle of separating assets from a parent company's credit risk through "bankruptcy remote" special purpose entities ("SPEs"). The April 16, 2009 bankruptcy petition of General Growth Properties, the nation's second largest shopping center developer and manager, involved 388 entities, including 166 property-level SPEs. The bankruptcy court denied five motions to dismiss that challenged the propriety of the bankruptcy filings of several General Growth subsidiaries alleged to be financially solvent, permitting the healthy SPEs to support, at least in the interim, the restructuring of the larger corporate group and exposing the risks associated with bankruptcy-remote structures employed in the real estate finance industry and securitization markets.

Fire sales rather than reorganizations

The unprecedented weakness in financial markets and sharp decline in consumer demand has resulted in an increase in asset sales in the early stages of a large number of Chapter bankruptcy 11 proceedings, making reorganization the exception rather than the rule. The traditional notions of Chapter 11 – refinancing existing debt, swapping debt for equity, and restructuring operations while under bankruptcy protection – have given way to sales of assets under Section 363 of the Bankruptcy Code, frequently undertaken at breakneck speed that jeopardizes creditors' interests, procedural safeguards and, indeed, due process.

General Motors concluded a sale of substantially all of its assets within 40 days of filing Chapter 11; Chrysler in 42. In a historic collapse, Lehman Brothers filed for bankruptcy on a Sunday and received approval for the sale of its core businesses the following Friday. While these cases are unique, driven by the significant role of the U.S. Treasury in providing support for companies deemed "too big to fail," these "mega-cases" are nevertheless representative of the current state of Chapter 11.

Whether driven by the lack of financing, weakness in consumer demand, or the impact of certain 2005 amendments to the Bankruptcy Code, or a combination thereof, more companies in a variety of industries are liquidating through the sale of assets rather than reorganizing as a going concern. One exception to the current paradigm appears to be a growth in the number of "pre-packaged" plans of reorganization (where the essential terms of restructuring are negotiated and agreed upon prior to bankruptcy). Nevertheless, approval of "pre-pacs" is being sought at an accelerated pace similar to Section 363 asset sales in the current environment.

SINGLE ASSET REAL ESTATE CASES AND THE ADDITIONAL PROTECTIONS AFFORDED SECURED CREDITORS

WHAT IS "SINGLE ASSET REAL ESTATE"?

"Single asset real estate" is defined as real property consisting of a single property or project, other than a residential property with fewer than four units, which generates substantially all of the gross income of a debtor, on which no substantial business is being operated other than operating the real property.

Following the 2005 amendments to the Bankruptcy Code, there are no longer any dollar limits on what is defined as "single asset real estate."

AT THE OUTSET OF A BANKRUPTCY CASE, AN AUTOMATIC STAY IS IMPOSED UNDER BANKRUPTCY CODE § 362(11 U.S.C. § 362).

Bankruptcy Code § 362(a) provides a stay against actions against the debtor, the debtor's property and property of the bankruptcy estate as follows:

§ 362. Automatic stay.

(a) Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of—

(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;

(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;

(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;

(4) any act to create, perfect, or enforce any lien against property of the estate;

(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;

(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;

(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and

(8) the commencement or continuation of a proceeding before the United States Tax Court concerning a corporate debtor's tax liability for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.

THE ADDITIONAL GROUNDS FOR RELIEF FROM THE AUTOMATIC STAY FOR SINGLE ASSET REAL ESTATE CASES:

Bankruptcy Code § 362(d) provides various grounds for a party to obtain relief from the automatic stay to proceed with actions against the debtor, the debtor's property or property of the bankruptcy estate. The most common grounds for relief from the automatic stay provided in Bankruptcy Code §§ 362(d)(1) and (2). Secured creditors of "single asset real estate" are provided with an additional ground for relief under Bankruptcy Code § 362(d)(3).

Bankruptcy Code § 362(d)(1)-(3) provide as follows:

(d) On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay—

(1) for cause, including the lack of adequate protection of an interest in property of such party in interest;

(2) with respect to a stay of an act against property under subsection (a) of this section, if—

(A) the debtor does not have an equity in such property; and

(B) such property is not necessary to an effective reorganization;

(3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period) or 30 days after the court determines that the debtor is subject to this paragraph, whichever is later—

(A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or

(B) the debtor has commenced monthly payments that –

(i) may, in the debtor's sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before, on, or after the date of the commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and

(ii) are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate . . . .

THE PURPOSE OF THE SINGLE ASSET REAL ESTATE PROVISIONS

The purpose of adding Section 362(d)(3) to the Bankruptcy Code was to address perceived abuses and unfairness in single asset real estate cases, in which debtors in chapter 11 cases delayed mortgage foreclosures where there was little, if any, chance of successfully reorganizing and causing additional harm and expense to the secured creditor. *See In re Heather Apartments Ltd. Partnership*, 366 B.R. 45, 49 (Bankr. D. Minn. 2007). The term "single asset case" referred to real estate entities attempting to "cling" to property in a depressed market. *In re CBJ Development, Inc.*, 202 B.R. 467, 471 (9th Cir. BAP 1996) citing *In re Philmont Development Co.*, 181 B.R. 220, 223 (Bankr. E.D. Pa. 1995). Bankruptcy Code § 362(d)(3) provides additional relief to subsections 362(d)(1) or (2) by requiring the court to grant relief from the stay if a reasonable plan of reorganization with a prospect of being confirmed is not filed promptly or payments are not commenced.

APPLICATION OF BANKRUPTCY CODE § 362(d)(3)

Bankruptcy Code § 362(d)(3) provides that relief from the automatic stay in a "single asset real estate" must be granted unless, within the later of (1) 90 days after the petition date, (2) such longer period as the court determines during the initial 90-day period, or (3) 30 days after the court determines that the debtor is subject to the single asset real estate provisions, the debtor:

- files a reorganization plan that has a reasonable possibility of being confirmed within a reasonable time, or
- the debtor has commenced monthly payments equal to interest at the then applicable nondefault contract rate of interest on the value of a consensual lien creditor's interest in the property.

The monthly payments may, in the debtor's sole discretion, be made from rents or other income generated before, on, or after the date of the commencement of the case by or from the property.

Courts generally apply a three-prong test in evaluating whether a particular property or project falls within the definition of "single asset real estate." The criteria are:

> (1) the subject real property must constitute a "single property or project," other than residential real property with fewer than four residential units;
>
> (2) the real property must generate substantially all of the income of the debtor; and
>
> (3) the debtor must not be involved in any substantial business on the real property other than the operation of such property.

See e.g., In re Scotia. Pacific Co., LLC, 508 F.3d 214 (5th Cir. 2007); and *In re Kara Homes, Inc.*, 363 B.R. 399 (Bankr. D.N.J. 2007); *In re Philmont Development Co.*, 181 B.R. 220 (Bankr. E.D. Pa. 1995); *In re Pensignorkay, Inc.*, 204 B.R. 676 (Bankr. E.D. Pa. 1997).

With respect to the first prong, whether multiple parcels constitute a single "project" depends on whether the properties are "linked together in some fashion in a common plan or scheme involving their use." *In re The McGreals*, 201 B.R. 736, 741 (Bankr. E.D. Pa. 1996). *See also*, *In re CBJ Development, Inc.*, 202 B.R. 467 (9th Cir. BAP 1996) (apartment with more than four units was SARE) and *In re Pensignorkay, Inc.*, 204 B.R. 676 (Bankr. E.D. Pa. 1997) (adjacent parcels that were being developed as part of an overall development was found to be single asset real estate).

There are few reported decisions considering the second prong, as the determination of whether a property generates all of the income of the debtor is generally pretty straight forward, though not always.

Litigation generally has focused on the third prong - i.e., whether the debtor is involved in any substantial business on the real property other than the operation of such property. On one hand are cases involving hotels, golf courses and marinas, where the debtors not only own the properties but operate businesses which use the properties. *See e.g.*, *In re CBJ Development, Inc.*, 202 B.R. 467 (9th Cir. BAP 1996); *In re Kkemko*, 181 B.R. 47. (Bankr. S.D. Ohio 1995); *In re Larry Goodwin Golf, Inc.*, 219 B.R. 391 (Bankr. M.D.N.C. 1997); *but see In re Webb Mtn., LLC*, 2008 WL 656271 (Bankr. E.D. Tenn. 2008)(multiple tracts of land with multiple intended businesses developed as a golf resort and spa found to be a single project). On the other hand are cases involving apartment buildings and investment properties in which the debtors are passive owners, merely collecting rents and arranging maintenance. *See e.g.*, *In re Pensignorkay, Inc.*, 204 B.R. 676 (Bankr. E.D. Pa. 1997); and *In re Philmont Development, Corp.*, 181 B.R. 320 (Bankr. E.D. Pa. 1995).

In re General Growth Properties, Inc., 409 B.R. 43 (Bankr. S.D. N.Y. 2009)(Judge Allan L. Gropper); Memorandum of Opinion Denying Motions to Dismiss

Bankruptcy Remote Does Not Mean Bankruptcy Proof

Background

General Growth Properties, Inc. is the parent company for a publicly traded real estate investment trust (REIT) with approximately 750 subsidiaries (collectively, "GGP" or the "GGP Group"). The GGP Group portfolio includes more than 200 regional shopping centers in 44 states, several office properties and five master-planned communities. In the Spring of 2009, General Growth Properties, Inc. and 387 of its affiliates filed for bankruptcy in the United States Bankruptcy Court for the Southern District of New York. Several of the affiliated entities were structured as special (or single) purpose entities (or vehicles) intended to be bankruptcy remote (SPEs) to, among other things, avoid being caught up in a bankruptcy that would prevent/delay enforcement actions against the SPE or its assets, and insulate the SPE from the risk of being substantively consolidated with other insolvent affiliates.

Lenders Move to Dismiss the Bankruptcy Cases of Several of the SPEs

Three Lenders (ING Clarion, as special servicer to certain secured lenders, Helios, as special servicer to other secured lenders, and Metropolitan Life Insurance) moved to dismiss the bankruptcy cases of several of their SPE borrowers on the grounds that their bankruptcies were "bad faith" filings. Specifically, the lenders argued that the SPEs: (1) filed prematurely; (2) were not in financial distress (certainly not at the property level) at the time of the filing; (3) would not be able to confirm a plan of reorganization; and (4) demonstrated bad faith by filing for bankruptcy without first negotiating with the lenders and replacing the independent directors/managers shortly before the filing.

Notably, the motions to dismiss followed contentious proceedings over the GGP Group's use of cash collateral during the case where the Court ultimately allowed the excess cash flow from the SPEs to be used by the GGP Group and its affiliates.

The Bankruptcy Court Rejected the Lenders' Arguments and Denied the Motions to Dismiss

In a lengthy decision, the Bankruptcy Court denied the motions to dismiss that the bankruptcy petitions of the SPEs were filed in "bad faith," finding:

- **the bankruptcy filings were not premature**; there is no requirement to postpone a filing until a debtor is actually insolvent and there was ample uncertainty in the financial markets justifying the filing;
- **the Court was not required to evaluate the financial distress, or lack thereof, of each individual SPE debtor separately**; rather, the Court could examine the collective interests of the GGP Group as a whole;

- **the directors/managers of the SPEs were not limited to only considering the financial condition of the SPEs;** instead, the directors/managers owed fiduciary duties to both the corporation and its shareholders/owners, and could properly consider the interests of the larger GGP Group
- **the alleged inability to confirm a plan of reorganization is not grounds for dismissal at the outset of a case**
- **negotiations between the parties was not a condition precedent to filing**
- **replacement of the independent directors/managers shortly before filing was not "bad faith"**

Notably, while the Court denied the motions to dismiss, it is expressly reserved the issue of whether the SPEs could be substantively consolidated:

- "The salient point for purposes of these motions is that the fundamental protections that the movants negotiated and that the SPE structure represents are still in place and will remain in place during the Chapter 11 cases. This includes protection against the substantive consolidation of the project-level Debtors with any other entities. There is no question that a principal goal of the SPE structure is to guard against substantive consolidation. . . . Nothing in this Opinion implies that the assets and liabilities of the Subject Debtors could properly be substantively consolidated with those of any other entity."

Comments and Observations

- The SPE/bankruptcy remote entity structure and independent director/manager provisions are not guarantees against bankruptcy filings or the ability to remain in bankruptcy.
- While this is just one decision, and may or may not be reflective of other courts facing similar issues, this Court was dismissive of and unsympathetic to the lenders' concerns about the inconvenience occasioned by the bankruptcy filings and the structures developed to isolate borrowers from problems that may plague their affiliates; as a result, the real estate industry may need to reset its expectations on structuring and the ability to insulate a borrower from the infirmities of its affiliates.
- The decision amplifies the well-established rules that insolvency, lack of liquidity, or any degree of financial distress/extremis are required to file for bankruptcy.

THE 2005 AMENDMENTS TO THE TIME LIMITATIONS ON THE ASSUMPTION OR REJECTION OF LEASES IN BANKRUPTCY BEGIN TO HAVE AN IMPACT

On October 17, 2005, significant bankruptcy reform legislation known as The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA") became effective. At the time of its passage in April 2005, most commentators and the media focused on the consumer bankruptcy reforms in the legislation and the role of the credit card industry in its enactment. There were, however, several significant changes in the Bankruptcy Code with respect to the treatment of commercial leases that appear to change the landscape for commercial landlords and their debtor-tenants. Now that four years have passed since the effective date of BAPCPA, the effects of the amendments impacting commercial leases, when combined with the current economic upheaval, are now being better understood.

Under prior law, a debtor-tenant had 60 days from the commencement of its case to assume or reject its non-residential real property leases or such leases would be deemed rejected. Extensions of time were available for "cause" and bankruptcy courts routinely granted multiple extensions of time of the time to assume or reject, frequently extending up until the time of confirmation of a plan, in many cases simply because the debtor asserted that it needed more time to make a decision.

BAPCPA places limits on the bankruptcy court's discretion by extending the initial time for the debtor-tenant to assume or reject from 60 to 120 days but allows for extensions for "cause" of only 90 additional days, absent written consent of the affected landlord, thereby strictly limiting the courts' discretion by setting a maximum time of 210 days to assume or reject. Bankruptcy Code section 365(d)(4) now provides:

> (A) Subject to subparagraph (B), an unexpired lease of non-residential real property under which the debtor is the lessee shall be deemed rejected, and the trustee shall immediately surrender that non-

residential real property to the lessor, if the trustee does not assume or reject the unexpired lease by the earlier of

(i) the date that is 120 days after the date of the order for relief; or

(ii) the date of the entry of an order confirming a plan.

(B) (i) The court may extend the period determined under subparagraph (A), prior to the expiration of the 120-day period, for 90 days on the motion of the trustee or lessor for cause.

(ii) If the court grants an extension under clause (i), the court may grant a subsequent extension only upon prior written consent of the lessor in each instance.

According to the legislative history, "[t]his provision is designed to remove the bankruptcy judge's discretion to grant extensions of time for the retail debtor to decide whether to assume or reject a lease after a maximum possible period of 210 days from the time of entry of the order for relief." H.R. Rep. 109-31(I), 109th Cong., 1st Sess. 2005, p. 153, 2005 U.S.C.C.A.N. 86. The debtor-tenant must still remain current on its post-petition lease obligations (§365(d)(3)) and the landlord may still seek relief during the initial 120-day period if the debtor fails to do so.

In the first reported case on the amended Section 365(d)(4), the bankruptcy court in In re Tubular Technologies, LLC, 362 B.R. 243 (Bankr. D.S.C. 2006), held that the amended statute "plainly requires the Court to enter an order extending the time for Debtor to assume the lease prior to the expiration of the time period set forth in §365(d)(4)(A)." Since the statute is "self executing," the debtor-tenant's failure in Tubular Technologies to timely assume the lease resulted in the subject lease being deemed rejected and the debtor was ordered to immediately surrender the leased premises. While many judges have expressed concern over the potential harshness of the amended Section 365(d)(4), subsequent cases have largely followed this "plain meaning" approach.

The "hard and fast" 210-day deadline to assume or reject unexpired leases under the amended Bankruptcy Code section 365(d)(4) was intended to compel Chapter 11

debtors to make quicker decisions regarding the future of their non-residential real property leases. Multiple extensions of time to await seasonal sales results (e.g., postponing assumption or rejection for one or more Christmas seasons before deciding which leases to assume or reject) or to permit prolonged marketing of a debtor's leases (see, e.g., In re Ernst Home Center, Inc., 209 B.R. 974 (W.D. Wash. 1997) (authorizing 14-month extension to market leases) are a thing of the past. Lease assumption or rejection decisions, frequently combined with negotiations for rent reductions or other lease modifications, now must be part of a debtor's pre-bankruptcy planning. Lease disposition programs (utilizing third party real estate consultants to market a debtor's leases for assignment or through the sale of "designation rights") must be accelerated to accomplish their objectives within seven months, potentially resulting in less success in concluding transactions (as evidenced by several recent Chapter 11 cases) and diminished returns.

Secured lenders and bondholders of bankrupt retailers have taken the position that the 210-period to assume or reject leases really leaves a Chapter 11 debtor with only 120 days to formulate a confirmable a plan of reorganization, since approximately 90 days are required to effectuate an effective inventory liquidation (i.e., a "going out of business sale") in the event it cannot. Given the current lack of liquidity in financial markets (debt or new equity), this posture has contributed to the relative lack of successful retail reorganizations over the last year.

The requirement that landlords give consent to an additional extensions of the time to assume or reject beyond the 210-day period provided by amended Section 365(d)(4) would appear to give landlords additional leverage in responding to extension requests, yet there are certainly circumstances, particularly given the current state of the real estate leasing market, where a landlord might wish to avoid the detriment of a "dark store" or permit the debtor additional time to decide the future of a borderline profitable store under certain conditions. Indeed, in In re Linens Holding Co., U.S. Bankruptcy

Court (D. Del.) Case No. 08-10832, over ninety percent (90%) of the debtor's landlords consented to an extension of time to assume or reject beyond the 210 days period, yet debtor's bondholders concluded a liquidation of Linens 'n Things was preferable to continuing losses while operating under Chapter 11 protection.

Section 365(d)(4) also provides opportunities for negotiation and drafting with respect to consensual extensions of the 210 days. For example, a landlord may consent to an extension of time in exchange for "holiday protection," i.e., the debtor's agreement to keep a store open and operating through the holiday retail season. A gross sales "kick out" provision may be another alternative that accommodates the objectives of both the landlord and debtor-tenant with respect to a consensual extension of time. Last year, some of the Linens 'n Things landlords sought, and received, waivers of prospective liability for preferential transfers (potentially arising from pre-petition late payments of rent made outside the ordinary course of business) in exchange for an extension of the time to assume or reject through the upcoming holiday season.

The parameters of the landlord consent provision (§365(d)(4)(B)(ii)) have not, to date, been tested in reported decisions and there are many unresolved questions. For example, what is "written consent" for purposes of new Section 365(d)(4)(B)(ii)? Would an e-mail from a property manager suffice? In one pending case, In re Movie Gallery, Inc., U.S. Bankruptcy Court (E.D. Va.) Case No. 07-33849, the debtor obtained bankruptcy court approval for a procedure by which notices will be sent to landlords of debtor's intent to extend the time to assume or reject leases beyond the 210 days provided by the amended Bankruptcy Code section 365(d)(4), accompanied by a $100 "Consent Check" that contained the legend "Cashing check is written consent to extend deadline in section 365(d)(4) of Bankruptcy Code."[1] This procedure has not yet been repeated in any major Chapter 11 case.

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[1] The procedures in Movie Gallery allow a landlord to "opt out" of the consent procedures so as to avoid the consequences of an inadvertent acceptance of a "Consent Check." But consider the effect of

If the parties amend their lease in connection with an extension of time to assume or reject, say by adding a new gross sales termination option, is such an arrangement a transaction outside "the ordinary course of business" that requires bankruptcy court approval? Could a landlord go so far as to obtain a "consent fee" from the debtor? The answers to such questions await further case development.

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negotiation of a check sent to a landlord's lock box account and negotiated without a prior affirmative election to be excluded from such consent procedure.

Real Estate Law

Lee Gotshall-Maxon
Partner
Allen Matkins Leck Gamble Mallory & Natsis LLP
Three Embarcadero Center, 12th Floor
San Francisco, CA 94111
(415) 273-7423
lgotshallmaxon@allenmatkins.com

REAL ESTATE LAW

I. SB 800 Issues

1. Basic liability framework

Construction defect litigation is one of the many culprits blamed for the cost and scarcity of new residential housing in California and the lack of affordable construction insurance. In an effort to reduce the cost of such litigation and insurance, while still providing protection to homebuyers, the California legislature enacted SB 800 (California Civil Code Sections 895 et seq.) SB 800 applies to all new residential units sold after January 1, 2003 and establishes forty-five "Functionality Standards" which are intended to address the functions or components of a residential structure. If a new residence does not meet these standards, then the homeowner or, if a common area is involved, the homeowner's association, may commence legal proceedings against the "builder" by following the pre-litigation procedures set forth in the SB 800.

2. Who is/are the builder(s) to whom SB 800 applies?

The term "builder" is any person or entity who, at the time of sale, was in the business of "selling" residential units to the public for the property that is the subject of the claim or who was in the business of "building, developing or constructing" such residential units in the property. Cal. Civil Code Section 911. General contractors are not included in the definition unless they are affiliated with the "builder".

3. Pre-Litigation Procedures.

The SB 800 "pre-litigation" and "nonadversarial" procedures start with a written notice describing, in reasonable detail, the claim against the builder. The builder is to acknowledge the claim within 14 days and, if the builder elects to conduct an inspection, complete an inspection within 14 days after acknowledging receipt of the claim. If the builder deems a second inspection reasonably necessary, then a second inspection may be conducted within an additional 40 days. Within 30 days after the inspections are completed, the builder may offer to repair the problem and to pay certain limited damages to the claimant. The offer to repair is required to contain specific information concerning the scope, timing and implementation of the proposed repair including the name of the contractors whom the builder would like to perform the repair.

4. **Right to Repair vs AIA "correction covenants"**

Unless the builder has custom tailored pre-litigation procedures, SB 800 does not allow the builder to select the contractor who will perform the repairs. The builder may specify the contractor whom the builder would like to perform the repair, but the homeowner can force the repair to be conducted by one of three alternate contractors selected by the builder. If the builder's agreement with the contractor was documented using AIA forms, for example, then the contractor generally has a right to repair defective work for a period of one year after substantial completion of the work. (See American Institute of Architect's General Conditions for the Contract of Construction A 201 1997, Section 12.2.2.1). More importantly, perhaps, is that many such repairs must be completed by the contractor without charge to the builder. If another contractor is selected, then the builder will have to pay the cost of the alternate contractor and then attempt to recover from the original contractor in the teeth of a defense that the builder has waived its rights against the original contractor.

5. Insurance.

An important question is whether the expenses incurred in exercising SB 800's right to repair are insured. The answer, according to some carriers, is that such expenses are not covered since the insurance is only intended to cover damages awarded by a court and the costs incurred in defending against lawsuits brought to recover such damages. This being the case, it is worth considering a discussion with the carrier before undertaking expensive repairs, which may not be covered, (or at least which the carrier may say are not covered) in order to avoid a suit for damages, which may be covered.

6. **Arbitration and Judicial Reference.**

ADR PROVISIONS WILL BE STRICTLY CONSTRUED. In *Thompson v. Toll Dublin, LLC, et al.*, 165 Cal. App. 4th 1360 (2008), the First District of the California Court of Appeal ruled that the alternative dispute resolution ("ADR") provisions in the builder's form of purchase agreement was limited to the types of claims specifically set forth in the ADR provisions, all of which related to construction defects, and that such ADR provisions did not extend to the fraud-related claims filed against the builder.

HOMEOWNER'S ASSOCIATION IS NOT BOUND BY CC&R PROVISIONS WHICH REQUIRE JUDICIAL REFERENCE. A recorded Declaration of Covenants, Conditions and Restrictions ("CC&Rs") cannot be construed as a written contract that is sufficient to waive the right to trial by jury. *Treo @ Kettner Homeowners Assoc. v. Intergulf Constr. Corp,* 166 Cal. App. 4th 1055 (2008). In *Intergulf*, the CC&Rs required that all disputes arising between the Association and the project developer ("Intergulf") were to be resolved by judicial

reference pursuant to Code of Civil Procedure Section 638, rather than by a jury trial. In essence, Section 638 provides that a court referee may be appointed to resolve a dispute arising between parties "upon the motion of a party to a *written contract* if the court finds a reference agreement exists between the parties." On review, the Court determined that, although CC&Rs create sufficient contractual obligations with respect to relatively lesser issues such as the "operation or governance of the association or the relationships between owners and between owners and the association", CC&Rs do not suffice as a contract when the issue is the waiver of the right to trial by jury pursuant to Section 638. In forming its conclusion, the Court stated that the right to trial by jury is "fundamental" and that "it must be 'zealously guarded' in the face of a claimed waiver."

II. <u>Leasing Issues</u>

1. Buy Backs

THE ISSUE: A key measure of the value of a building is the building's ability to generate net operating income ("NOI"). Depending on the cap rate then prevailing in the market, buyers pay between ten and twenty dollars in price for each dollar of NOI. Financial concessions, such as protections against tax increases due to reassessment or caps on operating expenses, decrease NOI and, ultimately, the value of the asset -- sometimes significantly.

SOLUTION: Include a right to buy back the concession from the tenant for an agreed discounted present value. The tenant wins because it gets the equivalent of the present value of the concession. The landlord wins because it has an option to increase NOI with a payment which should be significantly less than the added price the landlord will receive on resale of the building.

DISCUSSION: A building's NOI is a key component for determining value. NOI is the gross income of a building, adjusted for vacancy and credit losses, reduced by operating expenses. NOI divided by the cap rate equals the value of an asset (or at least this is one method, and a very common one, for determining value). The market dictates the range of cap rates being paid in any particular time period. When transactions are few and far between, cap rates rise and buyers are not willing to pay as much for each dollar of NOI being generated by a building. Conversely, when the market is "hot", buyers pay more for NOI and cap rates decline. Cap rates as high as ten percent are not uncommon in the present market. Cap rates as low as five or six percent have occurred in recent memory.

If a financial concession is granted, the effect is to reduce NOI and thus the future value to the landlord on sale of the asset. It is for this reason, among others, that landlords resist such concessions with a vengeance. If

concessions are granted, the landlord should include an option to buy back the concession from the tenant for the discounted value of the concession. Doing so gives the landlord a way to increase NOI and thus the ultimate selling price of the asset and, depending on the formula, gives the tenant cash or a cash equivalent to the concession…it could be a win-win strategy for both the landlord and the tenant

2. Separate Cost Pools

THE ISSUE: Many commercial leases include provisions which charge tenants for increases, over a defined base year, in operating expenses, utility costs, insurance costs and taxes. Including all of these costs in a single pool for calculation purposes is simple and efficient. The landlord simply determines the amount of operating expenses, etc. incurred in the base year and then the landlord determines the total of such operating and other costs in the comparison year and the tenant pays its share of the increase in these costs. But in periods when some of these costs increase and some decrease, sometimes dramatically, there is a distinct advantage to a landlord to draft its standard lease with separate pools and computations for as many different costs as possible. For example, if operating costs increase in a comparison year but taxes decrease in that same comparison year, and if a single pool is used, the tax decrease will not benefit the landlord but will simply reduce the total of the costs included in the pool during the comparison year and thus will reduce the amount which the tenant must pay.

SOLUTION: The landlord should have separate computations for operating expenses, taxes and, depending on conditions in the relevant market, for other pass through expenses as well.

3. Treatment of Refunds

THE ISSUE: What does a landlord do with a refund, such as a tax refund, when computing operating expenses and taxes payable by the tenant or tenants in a building? Should the refund be applied to reduce the expenses in the year the refund is received? If, as is often the case, the refund relates to a prior year, should the refund be applied to reduce the expenses deemed to have been incurred in the prior year, with a resulting refund to the tenants and former tenants who paid increases in the operating expenses in the prior year? If the refund is a one-time refund, should it be considered in computing the expenses considered as having been incurred a the tenant's base year? If the refund is for an expense, such as taxes, which is partially paid by the landlord and partially paid by tenants because of the operation of the base year concept, should the refund first reduce the landlord's costs and then the tenant's cost or should the refund be allocated to both the landlord and to the tenants in proportion to the amount each has contributed toward payment of the item to which the refund relates.

SOLUTION: There are many fair ways to apply refunds. A well drafted lease should address refunds and how they affect the computation of the tenant's share of operating expenses and taxes.

4. **Non-Disturbance Agreements– Lease Amendments May Not Survive Foreclosure.**

GENERAL RULE: JUNIOR INTERESTS ARE TERMINATED. When a deed of trust or mortgage is foreclosed, the foreclosure typically terminates liens and encumbrances, including leases, which are junior to the deed of trust or mortgage. A lease that is junior to a deed of trust is terminated by a foreclosure under that deed of trust unless there is some agreement, such as a Subordination, Non-Disturbance and Attornment Agreement, or perhaps a lease provision, which alters this result and prevents termination of the lease.

EFFECT ON LEASE AMENDMENTS. If a lease is senior to a deed of trust and the lease is amended after the deed of trust has been recorded, then, absent agreement to the contrary, the amendment is terminated by a foreclosure under the deed of trust. *R-Ranch Markets #2 v. Old Stone Bank,* 16 Cal. App. 4th 1323 (1993).

IS IT WORTH GETTING LENDER'S CONSENT TO A LEASE AMENDMENT? Obtaining the lender's consent to a lease amendment may seem like an unnecessary hassle for landlords. But not getting the consent may cause even larger problems for landlords: (i) it may be more difficult for a landlord to work out a loan if the lender believes that foreclosure would terminate lease amendments that the lender believes are not favorable; (ii) failing to obtain consent may violate the terms of the landlord's loan documents; and (iii) if foreclosure terminates a lease amendment, then the bids at the foreclosure sale may reflect a lower value and thus increase potential exposure for payment of a deficiency by the borrower (after a judicial foreclosure) or by any guarantor of the loan.

5. **Security Deposits**

WHAT DO YOU MEAN I HAVE TO GIVE IT BACK? Under Section 1950.7 of the California Civil Code, security deposits in commercial transactions must be returned to the tenant within thirty days after possession is surrendered. The landlord may make claims against the security deposit only for amounts reasonably necessary to remedy tenant defaults in payment, to repair physical damage to the premises or to clean the premises upon termination of the lease. Tenants argue that when the lease is terminated, there is no further rent due, but only damages under 1951.2 of the California Civil Code. Courts have been receptive to this argument and have held that 1950.7 allows landlord to use a security deposit to pay *accrued* rent but it does not allow a landlord to apply a security

deposit to damages it suffers on lease termination. Thus far, efforts to clarify 1950.7 to make it clear that Landlord's should be allowed to use a security deposit to pay damages resulting from the Tenant's Default have not been successful. To avoid the problems caused by 1950.7, well-drafted commercial leases should waive 1950.7.

III. Easements

1. Right to Relocate Easements

MOVE IT OR LOSE IT – THE ABILITY TO DEVELOP THAT IS. If an easement crosses through the middle of an otherwise developable lot, can the owner of the lot move the easement to the side of the lot so that development of the lot can proceed? The answer in most jurisdictions, including California, is still "no" even if the holder of the easement is not adversely affected by the change. In a small number of other jurisdictions, the owner of the burdened lot may move the easement provided that the easement holder is not materially prejudiced by the relocation. Since California has not adopted the more enlightened view, landowners granting easements on their property should consider including a right to relocate the easement so that the land affected by the easement can be more easily developed in the future.

2. Foundations and Tie-Backs

FOUNDATION TIEBACKS ARE A LESS EXPENSIVE WAY TO BUILD FOUNDATIONS AND A VERY EXPENSIVE WAY TO MEET YOUR NEIGHBORS. When buying sites for infill development, remember that the use of tiebacks requires the permission of the neighboring owners. Some jurisdictions, such as the City of Berkeley, are viewing the need for permission as a new revenue source, and the cost is not necessarily nominal. Unhappy neighbors may make it virtually impossible to get tieback rights and, if so, no one will be happy about the cost of redesigning the foundation to avoid use of tiebacks.

IV. Joint Venture Issues

1. Fiduciary Duties

PLAY NICE. Most co-venturers, whether they are partners in a limited or general partnership or members of a limited liability company, have fiduciary duties to each other. Delaware's Revised Uniform Partnership Act, which is the governing authority on the question of the nature and scope of the fiduciary duty applicable to a Delaware limited liability company, states that the only fiduciary duties a partner owes to the partnership and the other partners are the duty of loyalty and

the duty of care. [DRUPA § 15-404] The duty of loyalty requires that there be an accounting for use of partnership property or usurpation of a partnership opportunity, that a partner refrain from treating the partnership as adverse and that a partner refrain from competing with the partnership. The duty of care which governs a fiduciary states that the fiduciary must refrain from engaging in grossly negligent or reckless conduct, intentional misconduct or a knowing violation of law. [DRUPA § 15-404(c)]. A partner does not violate this duty solely because the partner's conduct furthers the partner's own interest. [DRUPA § 15-404(d)].

2. **Implied Covenant of Good Faith and Fair Dealing.**

BE SPECIFIC ABOUT RIGHTS THAT ARE IMPORTANT. The implied covenant of good faith and fair dealing applies to limited liability companies, just as it does to other contracts. [DLLCA §18-1101(c)] Although there are many formulations of what the covenant entails, it is probably safe to say that one cannot take an action under a contract which is inconsistent with the terms that the parties would have included in the agreement if the parties had discussed the issue in question. In other words, the covenant is intended to protect the reasonable expectations of the parties. Carma Developers v. Marathon Development, 2 Cal 4th, 342 (1992). If a contract between commercial parties has a provision which has harsh results but the results were clearly expected and within the contemplation of the parties, it is not a breach of the covenant of good faith and fair dealing to exercise the rights under the provision. Thus when drafting contracts between commercial parties, there are significant benefits to being specific, since it makes it more difficult for a court later to say that the parties "couldn't have expected such a result". Certainly, other principals such as public policy or the limitations on the enforceability of liquidated damage provisions may limit the scope and content of provisions on which the parties may agree. But, within the confines of these policy limitations, the parties should consider being as specific as possible when it is likely that court may be asked to refuse to enforce a provision which results in an outcome which is harsh.

3. **Distributions**

MONEY CHANGES EVERYTHING – SO DO CLAIMS. The members of an LLC must return distributions which are made improperly. It is improper to make a distribution from an LLC if, after the distribution, the LLC would be unable to pay its debts as the mature or if the liabilities of the entity would exceed its assets. Cal. Corp. Code Section 17254. There is a four year statute of limitations applicable to claims under Section 17254 for return of such improper distributions. The comparable period applicable to Delaware LLC's is three years. Del. Corp. Code Section 18-607(c). Once a claim is known and asserted, then it is certain that it must be properly provided for before further distributions may be safely made. If a claim is contingent, then it must still be properly provided for depending on its likelihood and on the likely timing of the claim. *See* Del. Corp.

Code Section 18-804. Procedures for properly providing for contingent future claims for new construction are still evolving.

V. Licensing Issues

1. Broker Licensing

LICENSES ARE REQUIRED MORE OFTEN THAN YOU MIGHT THINK. Under California law, a broker's license must be obtained when a person engages in any of the activities described in Sections 10131, 10131.1, 10131.2, 10131.3, 10131.4 and 10131.6 of the California Business and Professions Code. Section 10131, broadly speaking, requires a broker's license if a person, acting for another person or entity, negotiates or effectuates any of the following for compensation: (i) the purchase, sale, exchange or lease of real property or a business opportunity; (ii) the solicitation of listings; (iii) the collection of rent; or (iv) the solicitation or negotiation of loans secured by real property or by a business opportunity. A person engaged by a broker to do any of the foregoing activities for compensation must have a real estate salesperson's license. Cal. Bus. & Prof. Code Section 10132.

EXEMPTIONS DON'T HELP LLC's, THEIR OFFICERS OR EMPLOYEES. Regular officers or general partners of corporations or general partnerships that engage in activities for which a license would otherwise be required do not need a license where the activities are with respect to property owned or leased by the entity or are to acquire or to lease real property for the entity, provided that the acts are not performed by the officer or partner in expectation of special compensation. Cal. Bus. & Prof. Code § 10133(a)(1). It should be noted that this exemption does not apply to limited liability companies, but only to corporations and partnerships. Limited liability companies cannot be licensed as real estate brokers in the state of California. Cal. Corp. Code § 17375; Ops. Cal. Atty. Gen. No. 04-103 (July 23, 2004).

2. Contractor Licensing

DON'T START WORK WITHOUT A CONTRACTOR'S LICENSE OR YOU WORK FOR FREE. In *MW Erectors, Inc. v. Niederhauser Ornamental and Metal Works Co., Inc.*, 36 Cal. 4th 412 (2005) the California Supreme Court decided a case that involved a contract for a subcontractor's performance of structural steel work and ornamental steel work. The sub did not obtain a structural steel contractor's license until several weeks after it began work under the structural contract. The Court of Appeal held that MW could recover amounts owed for work performed after the license was obtained. The Supreme Court reversed, holding that Business and Professions Code Section 8000 imposes strict guidelines and harsh penalties for those who fail to maintain proper licensure.

Under the law, a contractor cannot maintain an action to recover compensation for the performance of any contract unless he was duly licensed at ALL TIMES during the PERFORMANCE of the act or contract. Exceptions to this harsh rule exist if the contractor can show substantial compliance (i.e. the contractor had been duly licensed as a contractor in this state prior to the performance of the act or contract for which licensure was required). Here, the court found no substantial compliance.

GENERAL RULES TO LIVE BY: The Supreme Court set forth four general rules:

NO LICENSE NO RECOVERY: Where applicable, Section 7031(a) bars a person from suing to recover compensation for any work he or she did under an agreement for services requiring a contractor's license unless proper licensure was in place at all times during such contractual performance.

NO LICENSE FOR PART OF A JOB -- NO RECOVERY FOR ANY OF THE JOB. Section 7031(a) does not allow a contractor who was unlicensed at any time during contractual performance nonetheless to recover compensation for individual acts performed while he or she was duly licensed.

SUBSTANTIAL COMPLIANCE HELPS THOSE WITH LICENSES WHICH HAVE EXPIRED BUT NOT THOSE WHO NEVER HAD A LICENSE. The statutory exception for substantial compliance is not available to a contractor who had not been duly licensed at some time before beginning performance under the contract.

RECOVERY ALLOWED IF THERE IS A LICENSE BEFORE THE CONTRACT IS PERFORMED. If fully licensed at all times during contractual performance, a contractor is not barred from recovering compensation for the work solely because he or she was unlicensed when the contract was executed.

CONSTRUCTION MANAGERS MAY NOT NEED A LICENSE IF SOMEONE ELSE DOES THE WORK. In *Fifth Day, LLC v. Bolotin,* 172 Cal. App. 4th 939 (2009) the court held that a construction manager, which was also an LLC and thus could not have obtained a contractor's license, was not required to have a contractor's license to perform activities which a lively dissent thought were clearly those for which a license would be required (coordination of architects and engineering, advice on administrative and management matters that relate to the coordination of work among and between the contractors, subcontractors, etc., coordination of completion and correction).

VI. Contracts.

1. Contract or Unenforceable Option?

FREE LOOK PERIODS MAY CREATE UNENFORCEABLE OPTIONS. In *Steiner v. Thexton* (2008) 163 Cal. App. 4th 359 the Court of Appeal held that a "Real Estate Purchase Contract" which gave the buyer the right to terminate at any time prior to securing entitlements was not enforceable against the Seller. The court found that the contract created an option for which no consideration had been given and thus the option was not enforceable. This decision, which has been appealed to the California Supreme Court, may undercut the enforceability of the standard real estate purchase agreement which gives the buyer a free look period or an extended period to obtain entitlements.

SOLUTION; Some contracts have separate consideration for the free look or entitlement period. Some are now including affirmative obligations that the Buyer take certain actions so that there is some bargained for performance required before the Buyer is allowed to terminate.

2. Letters of Intent.

KEY QUESTION – BINDING OR NON-BINDING? The key question regarding Letters of Intent is whether the parties intend them to be binding, in whole or in part. If the parties intend to be bound, then courts are receptive to enforcing letters of intent as enforceable contracts. Many Letters of Intent are binding as to some provisions, such as provisions concerning confidentiality, exclusive negotiations, etc.

NECESSARY BOILERPLATE. Strong Disclaimer Language, such as the following, should be included in every letter of intent:

> Except as provided in Paragraphs [40] entitled "Confidentiality"[and Paragraph [39] entitled "Exclusive Negotiating Period"], neither AAA nor BBB shall have any legal obligation or liability to the other with respect to the matters set forth in this letter of intent unless and until a lease document is fully negotiated, executed and delivered by both parties. The parties agree that this letter of intent is non-binding, except as provided in Paragraphs [39] [and [40]], and that any acts or omissions undertaken or any

costs or expenses incurred by AAA or BBB following the execution of this letter of intent are made or incurred at such party's sole risk and expense. Either party may discontinue negotiations with our without cause. BBB hereby acknowledges that, [except as provided in Paragraph [39]], the execution of this letter of intent by AAA does not, in any way, prohibit or limit AAA's right to market the Premises or a portion thereof or to negotiate and/or consummate a lease transaction with third parties with respect to all or a portion of the Premises.

Alternative Disclaimer Language:

Except as described in Paragraph [11] above, this Letter of Intent is intended only as a preliminary outline for discussion purposes and is subject to conclusion of fact gathering by Prospective Tenant and negotiation of other documents by all parties concerned. Either party may discontinue negotiations at any time, with or without cause, and without liability to the other, by giving notice to the other party. Neither you nor Prospective Tenant shall have any obligation in connection with this Letter of Intent, except as set forth in Paragraph [11]. Since this letter is not intended to create any binding obligations, except as set forth in Paragraph [11], you should not take any action or refrain from taking any action in reliance on this non-binding outline or any oral or written statements made in connection herewith.

Similar, but shorter, disclaimer language is suggested for ongoing communications, especially those which deliver drafts of proposed agreements.

THE COPELAND CASE.

CONTRACTUAL OBLIGATION TO NEGOTIATE? *In Copeland v. Baskin Robbins U.S.A.*– the court held that a party can recover reliance damages for breach of an agreement to negotiate. Examples – damages for time spent, expenses incurred and opportunities missed.

FACTS: Copeland wanted to purchase an ice cream plant from Baskin Robbins in the City of Vernon. To afford the plant, Copeland needed a co-packing agreement – an agreement under which Baskin Robbins would agree to purchase ice cream from Copeland. The parties signed a letter which set the agreed price for the manufacturing equipment and stated that the deal was "subject to a separate co-packing agreement and negotiated pricing, to provide [Copeland] a

three year co-packing agreement for 3,000,000 gallons per year…" Copeland signed a statement at the bottom of the letter that the "above terms are acceptable". The parties negotiated for two months, and then Baskin Robbins broke off negotiations with a letter which stated that, due to recent strategic decisions, the Co-Packing Agreement was no longer in alignment with Baskin Robbins' strategy.

AXES AND BEAR HIDES – THE REASONING – "gone are the days when our ancestors sat around a fire and bargained for the exchange of stone axes for bear hides." The days of simple offer and acceptance are over. Contracts result from a flow of events, communications and compromises that evolve into contract terms.

SOLUTION -- USE ANTI-COPELAND CLAUSES. If letters of intent are not intended to be binding they must now state that neither party has agreed to negotiate in good faith. Well drafted clauses now provide that either party may discontinue negotiations with or without cause and that neither party may rely for any purpose on the non-binding letter of intent.

WHAT TO AVOID. Avoid language of offer and acceptance: such as "offer", "acceptance", or "agreed" and avoid terms like "good faith" or "terms to be negotiated". Avoid any communications which leads the other party to a letter of intent to believe that you have a lease or that you will negotiate in good faith.

SELECTED SECTION OF THE CALIFORNIA BUSINESS AND PROFESSIONS CODE

10131. Real estate broker. A real estate broker within the meaning of this part is a person who, for a compensation or in expectation of a compensation, regardless of the form or time of payment, does or negotiates to do one or more of the following acts for another or others:

(a) Sells or offers to sell, buys or offers to buy, solicits prospective sellers or purchasers of, solicits or obtains listings of, or negotiates the purchase, sale or exchange of real property or a business opportunity.

(b) Leases or rents or offers to lease or rent, or places for rent, or solicits listings of places for rent, or solicits for prospective tenants, or negotiates the sale, purchase or exchanges of leases on real property, or on a business opportunity, or collects rents from real property, or improvements thereon, or from business opportunities.

(c) Assists or offers to assist in filing an application for the purchase or lease of, or in locating or entering upon, lands owned by the state or federal government.

(d) Solicits borrowers or lenders for or negotiates loans or collects payments or performs services for borrowers or lenders or note owners in connection with loans secured directly or collaterally by liens on real property or on a business opportunity.

(e) Sells or offers to sell, buys or offers to buy, or exchanges or offers to exchange a real property sales contract, or a promissory note secured directly or collaterally by a lien on real property or on a business opportunity, and performs services for the holders thereof.

10131.1. Real Estate Broker; engaging in business of buying, selling or exchanging real property sales contracts or promissory notes secured by real property, etc.

A real estate broker within the meaning of this part is also a person who engages as a principal in the business of buying from, selling to, or exchanging with the public, real property sales contracts or promissory notes secured directly or collaterally by liens on real property, or who makes agreements with the public for the collection of payments or for the performance of services in connection with real property sales contracts or promissory notes secured directly or collaterally by liens on real property.

As used in this section, "in the business" means any of the following:

(a) The acquisition for resale to the public, and not as an investment, of eight or more real property sales contracts or promissory notes secured directly or collaterally by liens on real property during a calendar year.

(b) The sale to or exchange with the public of eight or more real property sales contracts or promissory notes secured directly or collaterally by liens on real property during a calendar year. However, no transaction negotiated through a real estate licensee shall be considered in determining whether a person is a real estate broker within the meaning of this section.

As used in this section, "sale," "resale," and "exchange" include every disposition of any interest in a real property sales contract or promissory note secured directly or collaterally by a lien on real property, except the original issuance of a promissory note by a borrower or a real property sales contract by a vendor, either of which is to be secured directly by a lien on real property owned by the borrower or vendor.

10131.2. Real estate broker; engaging in business of claiming, demanding, or collecting advance fee in promoting sale or lease of realty or business opportunity.

A real estate broker within the meaning of this part is also a person who engages in the business of claiming, demanding, charging, receiving, collecting or contracting for the collection of an advance fee in connection with any employment undertaken to promote the sale or lease of real property or of a business opportunity by advance fee listing, advertisement or other offering to sell, lease, exchange or rent property or a business opportunity, or to obtain a loan or loans thereon.

10131.3. Real estate broker; engaging in certain securities transactions.

A real estate broker within the meaning of this part is also a person who, for another or others, for compensation or in expectation of compensation, issues or sells, solicits prospective sellers or purchasers of, solicits or obtains listings of, or negotiates the purchase, sale, or exchange of securities as specified in Section 25206 of the Corporations **Code**. The provisions of this section do not apply to a broker-dealer or agent of a broker-dealer licensed by the Commissioner of Corporations under the provisions of the Corporate Securities Law of 1968.

10131.4. Transactions involving mineral, oil, or gas property; acting on behalf of others; compensation.

A real estate broker within the meaning of this part is also a person who acts for another or others for compensation or in expectation of compensation, to do one or more of the following acts:

(a) To sell or offer for sale, buy or offer to buy, solicit prospective sellers or purchasers, solicit or obtain listings, or negotiate the purchase, sale, or exchange of mineral, oil, or gas property.

(b) To solicit borrowers or lenders for or negotiate loans on mineral, oil, or gas property, or collect payments for lenders in connection with these loans.

(c) To lease or offer to lease or negotiate the sale, purchase, or exchange of leases on mineral, oil, or gas property.

(d) To rent or place for rent, mineral, oil, or gas property or to collect rent or royalties from mineral, oil, or gas property or improvements thereon.

(e) Other than as an officer or employee of the state or federal government, to assist or offer to assist another or others in filing an application for the purchase or lease of, or to locate or enter upon mineral, oil, or gas property owned by the state or federal government.

10131.6. Sale of mobilehomes; consumer notice requirements.

(a) Notwithstanding any other provision of law, a person licensed as a real estate broker may sell or offer to sell, buy or offer to buy, solicit prospective purchasers of, solicit or obtain listings of, or negotiate the purchase, sale, or exchange of any mobilehome only if the mobilehome has been registered under Part 2 (commencing with Section 18000) of Division 13 of the Health and Safety Code.

(b) No real estate broker who engages in the activities authorized by this section shall maintain any place of business where two or more mobilehomes are displayed and offered for sale by the person, unless the broker is also licensed as a mobilehome dealer as provided for by Part 2 (commencing with Section 18000) of Division 13 of the Health and Safety Code.

(c) As used in this chapter, "mobilehome" means a structure transportable in one or more sections, designed and equipped to contain not more than two dwelling units to be used with or without a foundation system. "Mobilehome" does not include a recreational vehicle, as defined in Section 18010 of the Health and Safety Code, a commercial coach, as defined in Section 18001.8 of the Health and Safety Code, or factory-built housing, as defined in Section 19971 of the Health and Safety Code.

(d) In order to carry out this section, the commissioner shall prescribe by regulation, after consultation with the Department of Housing and Community Development, methods and procedures to assure compliance with requirements of the Health and Safety Code pertaining to mobilehome registration, collection of sales and use taxes, and transaction documentation.

(e) Nothing in this section increases or decreases, or in any way preempts, consumer notice requirements of the National Manufactured Housing Construction and Safety Standards Act of 1974 and related regulations which are set forth in Section 5414 of Title 42 of the United States Code and Section 3282.255 of Title 24 of the Code of Federal Regulations.

Employment Law

Annette Rittmuller
Senior Counsel
Allen Matkins Leck Gamble Mallory & Natsis LLP
200 Pringle Avenue, Suite 300
Walnut Creek, CA 94596
(415) 273-7455
arittmuller@allenmatkins.com

TO COVER DURING PRESENTATION

I. ECONOMIC DOWNTURN AND LAYOFFS

A. *Layoffs*– Layoffs should be business-related, structural/operational, or economic. They do not provide a "safe harbor" to sweep away problem employees. Layoffs are planned events and must follow a multi-step, time-intensive process, including satisfying WARN requirements, operational & financial decisions, selection of impacted employees, documentation, preparation, severance/outplacement, and aftercare.

1. Practice Tips:

▣ The WARN Notice laws are complex. If you have (or have had) 75+ employees at any time during the past 12 months and you plan to terminate 50 or more employees at once or during a 90-day period (looking backward and forward), consult with legal counsel before taking action.

▣ The selection and documentation stages are important. It is important to build an excel spreadsheet, review for adverse impact (over 40 and other protected categories), and demonstrate that you gave decisions careful thought. Be prepared to justify the company's selections.

▣ Timing is critical. The group of individuals involved in the planning stages should be kept small. Once you decide, act promptly to ensure that you do not lose the wrong people (best employees will leave, but your least marketable employees will stay). Have a plan in place to protect trade secrets.

▣ Layoffs are not a substitute for prior failure to discipline and document. They create more potential litigation risk than a termination for cause. Therefore, managers should be trained to discipline, document, and draft accurate and tough performance reviews.

B. Alternatives To Layoffs:

▣ Reduced work schedules or furloughs. On August 19, 2009, the DLSE changed its stance on partial-week unpaid furloughs for exempt employees. Even with this change, employers must consider the limitations of partial-week unpaid furloughs for exempt employees noted in the federal regulations and DOL opinion letters. Employers are advised to work with counsel when considering furloughs.

▣ Reductions in pay (across-the-board, management and staff).

- With regard to exempt employees, keep in mind that any reduced salary must not fall below the minimum salary rate required for exempt status – currently $2,773.33 per month in California.

II. THE AMERICANS WITH DISABILITIES ACT AMENDMENTS ACT OF 2008

(*Note*: This section addresses the ADA Amendments Act only. California employers must consider the California Fair Employment and Housing Act ("FEHA") and, to the extent the disability involves a leave, federal and state laws governing leaves).

A. How It Affects Employers:

1. The ADA Amendments Act became effective January 1, 2009. Managers and Human Resources cannot rely on prior training regarding disability issues. The ADA Amendments Act changes the text of the statute, invalidates Supreme Court decisions and affects EEOC regulations. The ADA Amendments Act substantively broadens the scope of the ADA and will likely lead to an increase in:

- The number of employees who qualify as disabled.
- The number of disability accommodation requests.
- Disability-related charges and litigation (*i.e.*, failure to accommodate and discrimination claims).
- Less of a focus on threshold issues (does the individual qualify as "disabled" or "regarded as disabled") to liability issues (was the individual discriminated against, harassed, and/or did the company provide reasonable accommodation).
- The cost of disability accommodation and litigation.

B. Summary of Major Changes:

- While the ADA Amendments Act maintains the same definition of "disability," the ADA Amendments Act substantively changes the interpretation of this definition.
- Clarifying that the term "disability" "shall be construed broadly" and that an impairment that is episodic or in remission is a disability if it would substantially limit a major life activity when active. As a consequence, the ADA Amendments Act now covers serious conditions that have disabling flare-ups, such as certain types of epilepsy or multiple sclerosis, and cancers that are in remission.

- Invalidating *Toyota Motor Manufacturing, Kentucky, Inc. v. Williams*, 534 U.S. 184 (2002) which held that:

  - "Substantially" and "major" "need to be interpreted strictly to create a demanding standard for qualifying as disabled."

  - "Substantially limits" means "prevents or severely restricts" activities that are of "central importance to most people's daily lives."

  - "Impairment" must be "permanent or long term."

- Expanding the definition of "major life activity" by providing two non-exhaustive lists. The first list includes activities generally recognized prior to the ADA Amendments Act: caring for oneself, performing manual tasks, seeing, hearing, eating, sleeping, walking, standing, lifting, bending, speaking, breathing, learning, reading, concentrating, thinking, communicating, and working. The second list expands the definition of "major life activities" to include major bodily functions: functions of the immune system, normal cell growth, digestive, bowel, bladder, neurological, brain, respiratory, circulatory, endocrine, and reproductive functions. The effect of this change is that serious diseases such as cancer that were not considered "disabilities" under the ADA because they did not yet substantially affect a major life activity, now qualify as disabilities.

- The determination of whether an impairment substantially limits a major life activity shall be made *without regard to* the ameliorative effects of mitigating measures. For example, an employee who, with medication, exhibits no limitations in major life function can nonetheless qualify as disabled (*e.g.*, muscular dystrophy, diabetes, epilepsy). The only exclusions under the ADA Amendments Act are ordinary eyeglasses and contact lenses. The ADA Amendments Act invalidates *Sutton v. United States Air Lines, Inc.*, 527 U.S. 471 (1999), which held that whether an impairment substantially limits a major life activity is to be determined with reference to the ameliorative effects of mitigating measures. This is a major change in the disability analysis. As a consequence, more people will qualify as disabled.

- Changing the definition of "regarded as" so that it no longer requires a showing that the employer perceived the individual to be substantially limited in a major life activity. As a consequence, it is increasingly important to document the legitimate, non-discriminatory reason(s) for employment decisions.

2. Practice Tips:

- Train Human Resources staff on the ADA Amendments Act.

- Review your policy.

- Assume more employees are protected by the ADA.

- Engage in and document the interactive process.

- Ensure legitimate, nondiscriminatory reasons exist for any adverse employment action.

III. MISCELLANEOUS: RECENT CASES

- Privacy -- *Hernandez v. Hillsides, Inc*. (August 4, 2009) – The California Supreme Court ruled in favor of an employer in a case involving video (no sound) surveillance of a semi-private office space. The court held that an intrusion upon reasonable expectations of privacy had occurred given: (i) the employer's privacy policy did not mention the possibility of video surveillance; (ii) the area in question was enclosed; and (iii) the highly intrusive nature of video surveillance. The Court, however, ultimately reversed the court of appeal and ordered summary judgment for the employer because the employer had not acted in a manner that would be considered "highly offensive to a reasonable person." The Court was influenced by the limited nature of the surveillance (only at night, pointed directly at the computer, conducted for a limited time) and the employer's legitimate business purpose for the surveillance (protecting the children who lived at the residential facility for neglected and abused children). The court rejected plaintiffs' argument that employers are required to prove that they used the least intrusive means to accomplish the legitimate objectives.

- Pregnancy Discrimination – *SASCO Electric v. FEHC* (August 7, 2009) – California Court of Appeal upheld FEHC decision finding that there was substantial evidence of a causal connection between plaintiff's pregnancy and the employer's decision to terminate her employment. Plaintiff's manager told her that she would not have lost her job if she had not been pregnant and admitted he chose to lay her off in part because he was concerned about her being "cavalier" about continuing to work while pregnant. The court held that SASCO's proffered "reduction-in-force" reason for the layoff was pretext because SASCO did not attempt to recall her when it needed additional help and instead hired a less experienced individual.

NOT COVERED DURING PRESENTATION

I. FAMILY MEDICAL LEAVE ACT OF 1993 - NEW REGULATIONS

(*Note*: This section addresses the new FMLA regulations only. Employers must consider FMLA requirements in coordination with requirements under other federal laws, such as the ADA, as well as applicable state laws, including but not limited to, the California Family Rights Act ("CFRA"), California Fair Employment and Housing Act ("FEHA") and California Paid Family Leave ("PFL")).

A. Basics Prior To The New Regulations

1. ***Covered employers – 50 or more employees within 75 miles of worksite.***

2. ***Eligible employees – 1,250 hours of service during 12 months of employment.***

3. ***Covered employers must grant an eligible employee up to a total of 12 workweeks of unpaid leave during any 12-month period for one or more of the following reasons:***

- For the birth and care of the newborn child of the employee;
- For placement with the employee of a son or daughter for adoption or foster care;
- To care for an immediate family member (spouse, child, or parent) with a serious health condition; or
- To take medical leave when the employee is unable to work because of a serious health condition.

B. *DOL Regulations Effective January 16, 2009* - First revision in over a decade. Comprehensive regulations (about 750 pages). Summary of major changes:

1. **"12 months of employment"** ***means 12 months of continuous employment regardless of whether the employee is in service. Employment includes time off for other approved leaves of absence.***

2. **"Serious health condition"** ***has been revised significantly and includes chronic conditions such as asthma, diabetes, and conditions requiring multiple treatments, such as chemotherapy or kidney dialysis. The definition remains convoluted and difficult to apply. Under the new regulations, employees may continue to take FMLA leave on an intermittent basis, with a little or no notice, for alleged "chronic" conditions.***

3. **Light duty** – ***If an employee cannot perform one or more of the essential functions of his or her job, that employee may take FMLA leave even if the employer is willing to provide light duty or a modified job that would allow the employee to continue working. However, if the employee voluntarily does light duty work, the employee is not on FMLA leave.***

4. **Bonus** – ***Where an employee's FMLA leave caused him to fail to qualify for a bonus based on achievement of a*** **specified goal** ***(e.g., hours worked, perfect attendance, safety), the employer need not pay the employee the bonus.***

5. **Perfect attendance awards** – ***Employers can now deny a "perfect attendance" award to an employee who does not have perfect attendance because the employee took FMLA leave (so long as the employer treats employees taking non-FMLA leave the same way).***

6. **Notice obligations** – ***The new regulations impose significant new and enhanced FMLA notice requirements on employers.***

- General notice requirements:
  - Employers with handbooks must inform employees of their FMLA rights in the handbook.
  - Employers that do not have an employee handbook must provide the general FMLA notice to each employee when he or she is hired.
  - Employers must post a general FMLA notice even when they have no FMLA-eligible employees.
  - FMLA notices must be provided in other languages where a workforce is comprised of a significant portion of workers who are not literate in English.
- Specific notice requirements - The individual notice requirements have been separated into two new notice requirements or phases:
  - "Eligibility/Rights and Responsibilities" Notice – Within five business days after an employee requests FMLA leave, or the employer determines that the leave may be FMLA-qualified, the employer must:
    - Covered FMLA Leave: (1) Notify the employee of his or her right to take FMLA leave; and (2) provide the employee with a "Rights and Responsibilities" Notice.
    - Leave not covered by FMLA: (1) Notice must inform the employee that the requested leave is not covered by FMLA and provide at least one reason for the determination; and (2) provide the employee with the "Rights and Responsibilities" Notice.

- "Designation" Notice – Once the employer has obtained sufficient information to determine whether an employee's leave will be protected by the FMLA, the employer must notify the employee within five business days (a change from the current requirement of two business days), that the leave is designated as FMLA leave. The revised regulations permit retroactive notice if the employer fails to provide timely notice and the delay does not cause the employee harm or injury. In all cases, employees and employers can mutually agree that the leave be retroactively designated as FMLA leave.

  - *Employee notice* – The employee-notice provision was previously interpreted to allow employees to give notice of their intent to take FMLA leave up to 2 days after their absence. Under the new regulations, absent unusual circumstances, an employee needing FMLA leave must follow the employer's *usual and customer call-in procedures* for reporting an absence.

  - *Medical certifications* – The DOL has created different forms for employee's own serious health condition and leave to care for a family member. Employees must notify employees in writing of additional information that is necessary to complete the medical certification and allow employees 7 calendar days to provide the additional information.

  - *Additional medical information* – Employers may now follow procedures for requesting medical information under the ADA, paid leave, or workers' compensation programs without violating the FMLA.

  - *Calculation of leave when employee's schedule varies* – When an employee's schedule varies from week-to-week, employers will now use a weekly average over the 12 *months* preceding the leave (rather than just the prior 12 *weeks* previously required).

  - *Substitution of paid leave*- An employee may substitute accrued paid leave for FMLA leave, but the terms and conditions of an employer's paid leave policy must be followed for that substitution. For example, if an employer's paid sick leave policy prohibits use of sick leave in less than full day increments, employees may not use less than a full day of paid sick leave for FMLA leave.

  - *Fitness for duty certification* – Employers may demand more than a "simple statement" of the ability to return to work. Employers may now ask for fitness for duty certifications for intermittent leave if reasonable safety concerns exist.

  - *Settlement of past FMLA claims now permitted* – Employees may voluntarily settle their past FMLA claims without court or DOL approval. However, prospective waivers of FMLA rights will continue to be prohibited.

  - *Qualifying military leaves* - The regulations implement new military family leave entitlements enacted under the National Defense Authorization Act for FY 2008.

- FMLA leave entitlement:

- Qualifying Exigency Leave - Due to a qualifying exigency to enable eligible employees to manage the affairs of family members who are called to active duty in the National Guard or military reserves.

- Military Caregiver Leave - To enable eligible employees to care for covered service members with a serious illness or injury incurred in the line of duty.

"Qualifying Exigency Leave" clarifications:

- Arises from fact that the employee's spouse, son, daughter or parent is on active duty or has been notified of an impending call to active duty.

- Eligible employees allowed to take up to 12 weeks of leave because of "any qualifying exigency."

- Applies only to active or retired Guard or Reserve members, or retired (not active) members of the Regular Armed Forces.

- Qualifying Exigencies are short-notice deployment (7 days or less), military events, childcare & school activities, financial or legal arrangements, counseling (non-medical) for self, service member, or service member's child, rest & recuperation leaves (not to exceed 5 days of leave in each instance), post-deployment activities, and additional activities (if agreed to by employer and employee).

"Military Caregiver Leave" clarifications:

- Eligibility: regular Armed Forces, Guard & Reserve, but not former members (discharged or retired), or members on permanent disability leave.

- Entitled to up to a combined total of 26 work weeks of all types of FMLA leave in a single 12-month period.

- No temporal proximity is required between the date of the injury/illness and the date of leave.

- Individual need not be receiving treatment from a DOD facility.

- "Child" includes those 18+, even if they are capable of self-care.

- "Next of kin" means the blood relative designated in writing by the service member, or the nearest blood relative (other than spouse, parent or child) in this order of priority: relatives granted legal custody by statute or court order; siblings; grandparents; aunts/uncles; and first cousins.

C. Practice Tips:

- Update your FMLA policies and handbooks to meet the new regulations.
- Modify your separation agreements and general releases to include waiver of FMLA claims.
- Update your FMLA posters and notice forms. Sample forms and postings can be found at http://www.dol.gov/esa/whd/fmla/.
- Train management and/or Human Resources on the new regulations.

II. WAGE & HOUR CLASS ACTION UPDATE

A. *Waves Of Class Actions Continue And The Stakes Are High:*

- Red Lobster: $9.5 million for missed meal/rest breaks.
- Olive Garden: $11 million for misclassifying managers as exempt.
- Staples, Inc.: $38 million for misclassifying assistant store managers as exempt.
- Merrill Lynch: $37 million for misclassifying inside sales representatives as exempt.
- State Farm: $135 million for misclassifying claims adjusters as exempt.
- Orange County Register: $36 million for misclassifying newspaper carriers as independent contractors.

B. Major Areas Of Class Action Risk

1. ***Misclassification of employees as "exempt" – The presumption is that employees are non-exempt. Job titles are not determinative, but they can hurt. To be exempt, the job must satisfy the Wage Order's salary rule and duties test.***

- Practice tips: Conduct periodic internal audits of exempt employees to ensure compliance with the salary rule and the duties test. Maintain detailed job descriptions that track the exemption requirements. Create different job levels.

2. ***Meal and rest periods – Violations carry big penalties and add up fast (one hour of "wages" for each missed meal/rest period). Example: 500 employees @ $10/hour assuming 2 missed meal periods per week =***

$10,000 per week + interest + attorneys' fees over 4 years = $2 million. On October 22, 2008, the California Supreme Court granted review of Brinker Restaurant Corp. v. Superior Court (Hohnbaum), which held that employers need only provide employees the opportunity to take meal periods, not ensure that they take them.

▣ Practice tips: To minimize exposure, we recommend the following: detailed written policy distributed to employees and posted at the worksite; meal and rest period training; no automatic 30-minute deductions; no work interruptions during 30 minute meal period; do not require that employees remain on the premises; audit time records and document if the employee voluntarily failed to take a meal period or pay the extra hour of compensation if work prevented the employee from taking the meal period.

3. ***Overtime owed on bonuses – Non-discretionary bonus payments must be factored into the regular rate of pay. In general, non-discretionary bonuses are bonuses due because of a prior agreement or promise. For example, sales bonus, production bonus, sales commissions, store profit bonus. In contrast, discretionary bonuses carry no expectation of payment. For example, holiday bonus and performance bonus (where no set targets and no guarantee that any bonus will be paid).***

▣ Practice tips: Review payroll practices to confirm proper overtime formula.

4. ***"Off-the-clock" claims – This often comes up when employees claim that they worked before or after their shift (walking to particular worksite, putting on required gear, etc.) or outside of their shift over virtual networks/email. In general, employers will be held liable for off-the-clock work if the employer knew or should have known that the employee was working off the clock.***

▣ Practice tips: Policy prohibiting off-the-clock work and requiring accurate timecards from employees. Employee timecard verification. Manager training. Timecard audits.

5. ***Business Expense Reimbursement – <u>All</u> employees (exempt and non-exempt) are entitled to reimbursement for expenses or losses incurred "within the course and scope of employment" (e.g., mileage, cell phone, uniforms, tools, etc.)***

▣ Practice tips: Create and distribute a written policy. If making lump sum payments, periodically audit with employee to ensure accuracy. If covering expenses by paying a higher base salary, portion for expenses must be identifiable.

6. ***Independent Contractors – Practice tips: For every worker classified as an independent contractor, review the EDD Employment Determination Guide and Worksheet on Employment Status.***

http://www.edd.ca.gov/pdf_pub_ctr/de38.pdf If in doubt, treat the individual as an employee.

C. New Legislation

1. Genetic Information Nondiscrimination Act of 2008 ("GINA") - This law prohibits employers and health insurers from discriminating against individuals based on the genetic predisposition toward a disease. Given the complexity of the rules, if you perform pre-hire medical examinations or ask for family medical history on employment application forms, consult an attorney regarding potential risk and revisions to practices and forms.

2. SB 28 "No Texting" Law – Effective January 1, 2009. Expands the 2008 "hands free" cell phone law. Prohibits operating 4,000-lb. vehicle at speeds of 70+ MPH in 5-lane freeway traffic while looking down and thumbing a tiny keyboard. Practice Tips: Revise policies and/or notify employees of either "hands-free" or no cell/text rule. Review your liability coverage.

3. AB 2075 Invalid Waivers for Wages Due – Amended Labor Code 206.5. Prohibits requiring employees to execute a release of wage claims unless payment has been made. Makes it a misdemeanor to require an employee to sign a statement of hours worked that the employer knows is false. Requirement stems from employers withholding wages in order to pressure employees to certify false timesheets without OT or with incomplete OT. Practice Tip: Require that employees certify timesheets, but make sure they are accurate.

4. SB 940 (Labor Code 201.3) Temporary Workers Weekly Pay –Requires that "temporary service employers" are paid weekly or daily if an employee is assigned to a "client" on a day-to-day basis or to a client engaged in a trade dispute. Practice tips: If you use, temporary agencies, ensure that they follow these rules to minimize exposure under joint employer theories.

5. Minimum wage – The minimum wage in California is $8.00/hour. San Francisco's minimum wage is $9.79/hour. As of July 24, 2009, the federal minimum wage is $7.25/hour. Employers must post the federal minimum wage at their place of business. Posters can be found at http://www.dol.gov/esa/whd/regs/compliance/posters/flsa.htm

Allen Matkins Bios

SPEAKER BIOS

Michael Patrick Durkee
Partner

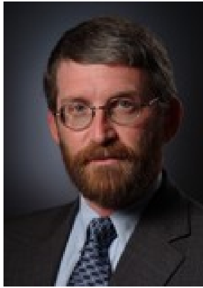
Mike Durkee is Vice Chair of the firm's California Land Use Practice. He is a resident in our Walnut Creek office, where he focuses his practice on land use, elections, and local government law in both administrative and judicial proceedings. Mike represents developers, builders, property owners, cities, counties, special districts, and interest groups in all aspects of California local government, elections, and land use entitlement, review, and approval processes. He has expertise in the laws and processes regarding the California Environmental Quality Act (CEQA), local governance, general plans, specific plans, planning, zoning and development, vested rights (common law, development agreements, vesting maps), exactions (fees/dedications), the Subdivision Map Act, Williamson Act, California Environmental Quality Act (CEQA), and local elections (initiative, referendum, recall).

Mike has been instrumental in the creation, coordination, and implementation of overall entitlement strategy (including defense tactics) for some of California's most controversial development projects, including the San Jose Giants Ballpark Proposal, the Buck Center for Aging and Research, Black Point, Buck Mountain Ranch, and the North Livermore Initiative. He is widely recognized for his expertise in effective negotiation and resolution. Mike has extensive expertise regarding "value-enhancing" entitlements and is considered one of the state's top creative land-use minds. He regularly handles the coordination with city/county staff regarding the planning of the project, the negotiation and drafting of all agency documents for legal compliance and tactical advantage, the coordination of all environmental, planning, and engineering consultants and their reports, and the transition into litigation when necessary.

Mike is a frequent participant in land use seminars conducted for builders' groups, cities and counties, the University of California Extension, and the State Bar of California. He is a co-author of Ballot Box Navigator (Solano Press 2003), and Land-Use Initiatives and Referenda in California (Solano Press 1990, 1991), and the principal author of Map Act Navigator (1997-2009). Mike writes the "Ask the Map Act Expert" column for the quarterly trade journal California Surveyor. He is a former member of the Advisory Board of The California Land Use Law and Policy Reporter, and the State Assembly Local Government Committee's "Subdivision Map Act Advisory Group." Mike is the recipient of the 1992 "Outstanding Instructor" award from the U.C. Davis Extension Land Use Program.

Mr. Durkee received his Bachelors of Science degree from the University of California, Davis in 1981 and was graduated with Distinction from McGeorge School of Law, University of the Pacific, in 1984.

SPEAKER BIOS



Ivan Gold
Of Counsel

Ivan Gold is Of Counsel in Allen Matkins' San Francisco office. Mr. Gold represents clients in all areas of real estate-related litigation in state and federal courts, as well as contested matters and adversary proceedings in bankruptcy court. He has extensive experience in breach of lease and unlawful detainer litigation and pre-litigation counseling and negotiation involving a wide variety of commercial real estate, including neighborhood and regional shopping centers, office buildings, warehouse and industrial properties, restaurants, and hotels. Mr. Gold represents shopping center developers and office landlords in major bankruptcy proceedings throughout the United States. He has utilized alternative dispute resolution in a wide variety of disputes, including arbitration, mediation and private judge proceedings. Mr. Gold is admitted to practice in California, as well as the Central, Eastern and Northern Districts of California and the District of Arizona.

Prior to joining Allen Matkins, Mr. Gold was Senior Counsel at Brobeck, Phleger & Harrison LLP and a partner in the San Francisco law firm of Berg, Ziegler, Anderson & Parker.

Mr. Gold has spoken at continuing education programs sponsored by the State Bar of California and the Bar Association of San Francisco on topics such as landlord-tenant disputes, the treatment of leases in bankruptcy proceedings, alternative dispute resolution and real estate-related litigation.

He is a member of the State Bar of California, the American Bar Association, the Bar Association of San Francisco and the Los Angeles County Bar Association.

Mr. Gold received a Bachelor of Science degree from The American University in 1981 and his J.D. from the University of California, Hastings College of the Law in 1985.

William Huckins
Partner

William W. Huckins is a partner in the firm's San Francisco office, concentrating in the areas bankruptcy, creditor's rights and business litigation. He has extensive experience representing creditors (both secured and unsecured), financial institutions, landlords and developers in a broad range of matters both in bankruptcy, and state and Federal Court, including foreclosures, receiverships, relief from stay, asset sale, contested assignment and plan confirmation litigation. Mr. Huckins also has extensive business, commercial and real estate litigation experience, including business tort litigation, lender liability litigation, fraudulent transfer litigation, corporate and partnership formation disputes, letter of credit disputes, stock disputes, breach of contract claims, and pre and post-judgment enforcement.

Mr. Huckins is admitted to practice in California, Colorado and Hawaii, and is a member of American Bar Association and the Bar Association of San Francisco. Mr. Huckins was also a senior financial consultant for several years with PricewaterhouseCoopers, LLP.

Mr. Huckins received his Juris Doctor degree from the University of Utah in 1994 and his B.S., cum laude, from the University of Colorado in 1981.

SPEAKER BIOS

Lee Gotshall-Maxon
Partner

Lee is a partner in our San Francisco office whose practice focuses on the representation of developers and investors in all phases of real estate acquisition, development, and disposition. His experience includes the formation and management of development joint ventures, limited liability companies, and limited partnerships. Lee's projects have included office, retail, single family, and multifamily developments throughout California and the Southwest.

Lee has also been extensively involved in the representation of landlords and tenants in all aspects of office, retail, industrial leasing, and property management issues. On the landlord side, he has represented institutional property management firms, asset management firms, insurance companies, major hotels, and financial institutions in reviewing, documenting, and negotiating leases and property management agreements. On the tenant side, he has represented both new and established enterprises in negotiating and renegotiating leases, subleases, and lease assignments for premises in California and numerous other states. He has also handled numerous Building and Planning Code and disability access issues.

Lee frequently speaks and writes on real estate issues. He was recently a contributing author to The Lease Negotiation Handbook, published by the American Law Institute/American Bar Association and the Attorneys and Executives in Corporate Real Estate. In early 2005, he presented "Top Ten Lease Negotiating Tips" at the Jones Lang LaSalle Bay Area Quarterly Conference.

Lee is a member of the Urban Land Institute, the International Association of Attorneys and Executives in Corporate Real Estate, the International Bar Association, and the San Francisco Planning and Urban Research Association. He also serves on the Government Affairs Policy Advisory Committee of the Building Owners and Managers Association, and on the Board of Directors of Presidio School of Management. Lee is active in community affairs and has served as President of the Board of the Volunteer Center of Marin, as President of the Board of Central City Hospitality House, and on the Board of Directors of the Legal Aid Society of San Francisco.

Lee graduated cum laude from Dartmouth College in 1975 and received his J.D. from Hastings College of the Law in 1980, where he was awarded the Order of the Coif.

SPEAKER BIOS

Annette M. Rittmuller
Senior Counsel

Annette is senior counsel in our Walnut Creek and San Francisco offices, where she practices employment law.

Annette represents employers in state and federal court, in arbitration, and before administrative agencies on a broad range of employment issues, including discrimination, sexual harassment, retaliation, wrongful discharge, defamation, and wage and hour claims. She represents employers in individual, multi-party and class action employment litigation.

Annette regularly advises employers on various employment issues, including discipline and termination, harassment and discrimination investigations, wage and hour, disability accommodation and leaves of absence, and non-compete/trade secret issues.

Prior to joining Allen Matkins, Annette was an associate at Paul Hastings Janofsky & Walker LLP and Gibson, Dunn & Crutcher LLP.

Annette is co-author of an article titled, "Meal Time: An Expensive Debate is Looming Over the Definition of 'Wages' and 'Penalties'," published in The Recorder (Summer 2004) and "Gender Bias and the Career Parent," which appeared in the ABA's publication, *The Woman Advocate* (Summer/Fall 1999). She is a speaker in programs sponsored by various professional organizations, including Lorman Education Services, where she has addressed topics such as overtime requirements and exemptions.

Annette received her Juris Doctor and her Master of Arts degree in psychology from Duke University in 2000. There she was chosen as a student instructor of legal rights and gender issues and served as co-president of the Asian Law Association and admissions co-chair of the Women Law Students' Association. She also externed for the Honorable Haley Fromholz, California State Superior Court, Los Angeles Division. Annette received her Bachelor of Arts degree in psychology, with high distinction, from University of California, Berkeley in 1996.