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BKCG
BURKHALTER KESSLER CLEMENT & GEORGE LLP

The "Cocktail Napkin" Real Estate Contract

BKCG has been involved in two recent cases where the parties were fighting over whether they had entered into an enforceable contract to buy/sell real estate. In one case, our client agreed to exercise an option, handwritten on a blank sheet of paper, to purchase auto dealership real estate, and the seller tried to back out by arguing that the option, which was only composed of a few handwritten lines, was insufficient to constitute a valid contract. In the other case, our client, who owned a commercial warehouse, met at a coffee shop with a real estate investor who had sent him an unsolicited "proposal" to buy his commercial warehouse. At the end of this introductory meeting, our client was asked to sign what he believed to be a non-binding one page summary, to serve as a reminder of what they had discussed in the event our client's tenant did not renew his lease. The potential investor later used the one page document as the basis for a suit against our client for breach of contract and specific performance. Thankfully, in both of these cases, our client ended up on the winning side of the argument, but not before spending several months in court.

These types of writings are sometimes referred to as "cocktail napkin contracts" after the lore of countless deals allegedly penned on the back on them. In these two illustrative cases, the writings were not much more extensive than if they too had been written on the back of a napkin.

Continued on page 2

Preserving Proposition 13 Benefits For Your Children

Proposition 13 is the law that governs how the County may tax your real estate holdings. Under the law, that was passed in 1978, real estate is taxed at one percent (1%) of the assessed value plus the voted indebtness your City or County has approved. As long as there has been no change in ownership, the County may only increase the assessed value by two percent (2%) per year. Over time, if your property has significantly increased in value, you are very likely paying property taxes based on an assessed value which is much lower than the property's actual fair market value.

To illustrate how this works, assume an individual purchased a home in Southern California in1978 for $50,000. The property taxes would be one percent (1%) of $50,000, or $500 per year. The assessed value may be increased two percent (2%) per year. If this individual owned the same home in 2014, the assessed value would be $98,033 and consequently, the property taxes would be $980. This would be the case even if the house had a current fair market value of $750,000.

Continued on page 2

IN THIS ISSUE

page 1 - 2
- The "Cocktail Napkin" Real Estate Contract
- Preserving Proposition 13 Benefits For Your Children

page 3
- A Rarely Invoked Principle Of Law Helps BKCG Clients Preserve Their Interest In A Classic Local Shopping Center

page 4
- California Co-Owning: The Way You Acquire and Hold Real Property Can Significantly Affect Your Rights and Obligations

page 6
- Not Having Your Lawyer Review Your Commercial AIR Lease Can Cost You A Lot Of Money

page 7
- Don't Be A Loan Shark: Beware Of California Usury Laws

page 8
- Arbitration Clauses - You've Seen One, You Have NOT Seen Them All

The "Cocktail Napkin" Real Estate Contract

Continued from page 1

So, whether you are the buyer or the seller, how do you know when your notes have passed from being mere evidence of ongoing discussions and negotiations, and have now become an enforceable real estate contract?

The general rule is that the Seller has become legally obligated to sell real estate if: 1) he/she has signed the document evidencing the agreement; 2) the writing identifies the parties to the agreement; 3) it contains the price to be paid, the terms and manner of payment; and 4) it contains an adequate description of the property.

In California, the Buyer is not required to sign such a writing in order to claim that the Seller entered into an enforceable agreement. The only signature that matters is that of the Seller. Nor does it matter where the Seller signed—at the top, on one of the side margins, or at the bottom of the writing. As long as the Seller has affixed his signature he can be bound by the writing -- provided the rest of the writing contains enough of the key terms to amount to an enforceable agreement.

In this context, the most vulnerable part of a cocktail napkin contract is the property description. While the law does not require that the writing contain a "legal description" the property must nevertheless be identified in a way that the parties (and the court, if necessary) understand the unique piece of real estate being bought and sold. A street address may suffice. But if the writing only identifies a street and a street number, with no city or state, the court may not have enough information to enforce the writing as a valid contract. For example, if the writing identifies the property as being at 2020 Main Street, the contract is likely unenforceable because there are over 10,000 Main Streets in various towns and cities across the US. However, if the contract identifies a specific address on Zzyzx Road, the court will likely enforce the contract because there is only one such road, located off Interstate 10 in San Bernardino County.

Obviously, the best way to avoid these problems is to retain competent representation, whether it be a real estate broker or agent, or an attorney. In our two cases, the parties failed to confer with a broker or a lawyer before signing their handwritten deal memos. And, these were not small deals. In the instance of the dealership property, the agreed upon price was $2.4 million, and in the case of the warehouse, the amount at issue was $2.6 million. So, resist the urge to sign something until you speak to your advisor.

For additional information, questions or comments on this article, please contact Alton Burkhalter at aburkhalter@bkcglaw.com or 949-975-7500.

Preserving Proposition 13 Benefits For Your Children

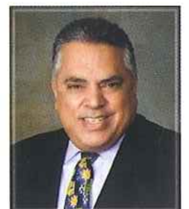
Continued from page 1

The original premise for passing Proposition 13 was that senior citizens were having their property taxes raised frequently and many found they could no longer afford to live in their homes in retirement due to onerous property taxes. In 1986, the law was expanded to provide that real property transfers from parent to child, would not be considered a change in ownership and therefore the transferee child may continue paying the same low property taxes the parent was paying.

This parent/child exclusion can be extremely valuable to a child when a property passes to the child at death or the property is transferred to the child while the parent is alive. In the example above, if the parent homeowner passed away in 2014 and left his or her home to a child, the inheriting child may continue paying the $980 annual property tax instead of the $7,500 property tax that an unrelated buyer would have to pay. Over time, this could result in tens of thousands of dollars in saved property tax payments. The exemption does not happen automatically. If the property is inherited, the claim form must be filed within three years of the death of the parent or before the property is sold, whichever occurs first.

This benefit applies to the taxpayer's primary residence of any value and other real property, up to $1,000,000 of assessed value for a single person and $2,000,000 of assessed value for a married couple. This could result in millions of dollars of real property passing from parents to children with the children being allowed to continue to pay property taxes based on a very low historical assessed value, which could be a fraction of the property's true fair market value.

Clients and children of clients need to be aware of these rules and the benefits that flow from them and to be certain to timely file all forms to take full advantage of a truly significant tax savings.



For additional information, questions or comments on this article, please contact William George at wgeorge@bkcglaw.com or 805-373-1500 extension 11.

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A Rarely Invoked Principle Of Law Helps BKCG Clients Preserve Their Interest In A Classic Local Shopping Center

Recently, some BKCG clients found themselves in the middle of a dispute about the Goldenwest Plaza Shopping Center, a long-standing outdoor retail plaza across from Goldenwest College in Huntington Beach, which the clients owned as a tenancy-in-common with two other groups. The lawsuit concerned a rarely invoked statutory remedy called partition.

In general, partition is a legal process by which a property owner asks the court to force a sale of the property over the wishes of the co-owners. Partition lawsuits often concern properties whose current owners inherited their interest from family members and for which there is no written partnership or operating agreement establishing a protocol for resolving ownership disputes.

The Goldenwest Plaza was just such a property. The BKCG clients inherited their interest in the shopping center from their parents, who, along with the parents of the current majority ownership interest holders, developed the shopping center in the 1960s.

The lawsuit began not long after the majority interest owners fired the third owner, who owned just a 7.5% interest but who had been the property manager for several years. In response, and without notice or negotiation, the minority interest owner filed a lawsuit seeking "partition by sale", a forced sale of the entire shopping center.

Faced with a potential sale of property that had been in their family for 50 years, the clients joined with their majority co-owners and sought a different remedy, "partition in kind", in which a portion of the property representing the value of the dissenting owner's interest is divided from the whole and deeded to the dissenting owner. The remedy sought by the BKCG clients is favored under the law since it does not disturb the existing form of inheritance or compel a person to sell his property against his will.

The burden of proof was on the dissenting minority owner to prove that the shopping center could not be divided in such a way as to give the dissenting owner its fair share of the whole. As the case approached trial, it became very clear that this was a burden that the minority interest owner would not be able to meet. Undisputed expert appraisal testimony established that there were at least four parts of the shopping center, which itself was already divided into multiple parcels on an assessor's map, that easily could be split off and allocated to the dissenting owner.

Faced with a certain loss, the dissenting owner folded on the morning of trial and agreed to sell its interest to the majority interest holder at the exact price established by the majority owners' expert appraiser. The dissenting owner even agreed to a rare settlement term that the BKCG clients and the majority owners each could file a post-settlement motion seeking attorney fees against the dissenting owner for filing the lawsuit in bad faith. BKCG's motion for fees currently is pending before the trial court.

Although BKCG's clients were able to preserve their ownership interest in the Goldenwest Plaza and stand to recover their fees, this case illustrates the risks that come with joint ownership of real property that is not governed by a written agreement. If you co-own real property with friends, family members, or business associates, protect your ownership interest with a formal written agreement that establishes a clear process for resolving the inevitable ownership dispute. BKCG can help you protect your rights and interests.

For additional information, questions or comments on this article,
please contact Michael Oberbeck at moberbeck@bkcglaw.com or 949-975-7500.

California Co-Owning: The Way You Acquire and Hold Real Property Can Significantly Affect Your Rights and Obligations

There are several ways you can co-own property with others in California, all of which give rise to different rights and duties. The nature of these rights and duties can vary depending on the way that you jointly acquire the property with your other co-owners. Because of this, it is very important to understand these differences before you acquire property with someone else.

While co-ownership can be a dense subject matter, even familiarizing yourself with the different forms of co-ownership can help you avoid potentially expensive mistakes for your family and your business.

Tenancies in Common

A tenancy in common is the "default" way to co-own property with others in California, and all other methods of co-owning property are essentially exceptions to this general rule.

To create a tenancy in common, co-owners of a property only need to have the same right to possess the property as their other co-owners (also known as "cotenants" or "tenants in common"). In addition, a corporation or limited liability company can hold title to real property as a tenant in common to the same extent that an individual can.

The following is a list of the general rights of co-owners of a property under a tenancy in common, which apply regardless of their proportionate interest in the property:

- **Use and Occupancy:** Unless otherwise agreed by all the cotenants in writing, tenants in common have the equal right to use and possess the entire property with their other cotenants. Because of this, no cotenant may collect rent from any other co-tenant, nor may any cotenant restrict any other cotenant's right to use and possess the entire property.

- **The Right to Sell or Encumber:** The ownership interests in a cotenancy can be apportioned in any manner, which means there can be multiple cotenants each owning different proportionate interests. Each cotenant has the right to sell his or her own proportionate interest in the property with or without the consent of the other co-tenants. Similarly, each cotenant may encumber (e.g. a mortgage or a deed of trust) his or her own proportionate interest in the property, with or without the consent of other co-tenants.

- **Right to Share Rents, Profits, and Expenses:** Cotenants also have the right to share in rents and profits received as a result of the party according to their percentage of ownership. For example, a cotenant with a 60% ownership interest has a right to 60% of the rents and profits stemming from the property. At the same time, cotenants must share responsibility for the maintenance expenses of the property according to their proportionate interest. However, this does not mean that cotenants can demand that the other cotenants contribute or reimburse them for improvements to the property.

- **The Right to Seek Partition:** Partition is a court procedure that terminates the cotenants' respective interests in a property and divides them equally according to each cotenant's proportionate ownership interest. Each cotenant has the right to seek partition, but this right can be waived.

In addition, the timing in which cotenants take title to a property can also materially affect these rights stated above. Cotenants who take title at the same time through the same written instruments generally owe each other "fiduciary duties." This means that the cotenants stand in a position of trust and confidence to each other, and no single cotenant may gain a personal advantage by acting adversely to his or her fellow cotenants. On the other hand, cotenants that acquire interests in a property at different times through different instruments do not owe each other fiduciary duties.

Continued on next page

California Co-Owning

Continued from page 4

Joint Tenancies

Joint tenancies are similar to tenancies in common, but have several notable exceptions. To create a joint tenancy, a transfer of property to the co-owners must 1) occur at the same time; 2) arise out of the same legal instrument (i.e. a deed, will, etc.), 3) give equal interests in the property to all the tenants for the same duration of time; 4) and give all the tenants the rights to the entire property This is also known as the "Four Unities," and if any one of them is broken or ceases to exist, the joint tenancy reverts back to a tenancy in common. Since joint tenants acquire property at the same time and in the same instrument, they also owe each other fiduciary duties as described above.

Another important distinction between a joint tenancy and a tenancy in common is the right of survivorship. This means that if a joint tenant dies, his interest in the property is transferred to the surviving joint tenants automatically, which can be useful in avoiding probate. On the other hand, there is no right of survivorship among tenants in common. In addition, corporations and limited liability companies may not hold property as joint tenants.

Community Property

Under California law, community property generally is all property acquired by married persons during marriage while they reside in California. This includes real property. By law, each spouse has equal rights of management and control of the property. While joint tenancies and community property share many of the same rights and obligations, they are two different forms of holding property. For example, unlike a property held in joint tenancy, a property is community property whether acquired together by the spouses, or even if acquired by one spouse individually during marriage.

Partnerships

Finally, title to a property may be jointly held by partners in a partnership. In this situation, the property belongs to the partnership itself, and not the individual partners. Property is held as partnership property if it is acquired in the name of the partnership, or by one of the partners if the existence of the partnership is indicated within transferring instrument, or that the person acquiring the property is acting on behalf of the partnership.

While this highlights some of the basic differences between the ways property can be co-owned, it is not an exhaustive list, and many of the default rules described above can be modified by written agreement. Before acquiring property with someone else, make sure to give consideration to the method and manner in which you acquire the property, since it can have far reaching consequences for tax, estate planning, and liability purposes.

Also...

In addition to different legal rights being associated with various methods of owning real property, how you hold title may also affect how capital gains are taxed when a property is sold after the death of one of the owners. If you have implemented a proper estate plan, you have probably created a Revocable Living Trust, and consequently, most, if not of all, of your real estate holdings will be held by the Trust. In those cases, the capital gains issue becomes moot. However, if you insist on owning property outside of a Trust, married couples should own property as Husband and Wife as Community Property, with right of survivorship. This allows property to transfer between spouses automatically at death, and allows the surviving spouse to sell a property and pay zero capital gains taxes, even if the property significantly appreciated during the time both spouses were alive. This does not happen with any other form of joint ownership.

For additional information, questions or comments on this article, please contact Eric Hardeman at ehardeman@bkcglaw.com or 949-975-7500.

Not Having Your Lawyer Review Your Commercial AIR Lease Can Cost You A Lot Of Money

It is increasingly common in Southern California for prospective commercial or industrial tenants to be presented by the landlord with one of several variations of a lease agreement form drafted by the AIR Commercial Real Estate Association, commonly known in the real estate industry as an "AIR" lease. Many tenants, when confronted with these partially customized but largely form-like agreements, mistakenly believe that there is something sacrosanct about them and that the non-customized language is standard "boilerplate" that they don't need to be concerned with. This is simply not true! To the contrary, the fact that these leases are commonly used does not mean that they are necessarily appropriate for any individual tenant's particular arrangements with its landlord. Careful thought should be given to whether significant changes should be made to the leases, or addenda added, to modify default terms in the lease or to address site-specific issues, based upon the tenant's particular needs, market conditions and the tenant's negotiations with the landlord.

The AIR forms are proprietary, subscription-based forms that are customizable, so do not be lulled into thinking that any particular provision in the AIR lease first proposed by the landlord is necessarily "industry standard", or inherently fair or reasonable, as this may simply not be the case. Moreover, as is typical of most commercial lease forms, AIR leases have a distinctly pro-landlord bias.

A couple of examples from the commonly-used *Standard Industrial / Commercial Single Tenant Lease-Net* will illustrate the point. Section 7 is entitled *Maintenance; Repairs; Utility Installations; Trade Fixtures and Alterations* and Section 7.1, entitled *Lessee's Obligations,* spells out what the tenant is responsible to repair and maintain in the leased premises and the building in which the premises are housed. Tenants are often stunned to discover, for the first time, months or even years into their leases, that the default, unmodified Section 7.1 of their lease makes them responsible to repair, maintain and replace, at their own expense, *absolutely everything*: roof, floors, plumbing, roof drainage systems, ceilings, windows, electrical systems, foundations, HVAC, boilers, fire protection systems, retaining walls, parking lots, fences, sidewalks, etc, etc. Obviously, these repair and maintenance costs can be considerable and often tenants fail to budget for them because they never realized that it was their responsibility under the lease to pay for these items.

Another often overlooked or misunderstood provision of the AIR leases, in the section entitled *Assignment and Subletting* makes it an "assignment" of the lease, requiring submission of an application, payment of the landlord's attorneys' fees and possibly providing the landlord with financial statements and other personal information, if an entity tenant, such as an LLC or a corporation, transfers 25% or more of its ownership (as opposed to a far more reasonable 50%). This could result in the landlord having leverage to try to effectively renegotiate the lease, especially if market rents have risen significantly since the lease went into effect, or even finding a way to justify terminating the lease altogether. This assignment clause as written would be triggered, for example, if just one of three 33% co-owners of a business suddenly decided to leave the business for any reason or died.

While there are obviously other provisions of the AIR lease that also could be listed, as the foregoing examples illustrate, seemingly "boilerplate" language in what appears to be a mostly standard form agreement can have expensive and unanticipated consequences for the unwary tenant. It should also be pointed out that, even if a tenant is represented by an experienced commercial leasing broker in the transaction, the broker is typically not a lawyer and is generally not focused on these kinds of issues when reviewing the lease for his or her client.

Commercial tenants can spend hundreds of thousands, or even millions of dollars, during the term of a lease. Overlooked items in the lease, such as the examples provided in this article, can cost a tenant far more money than the relatively modest cost of having an experienced real estate attorney review the lease proposed by the landlord and "redflagging" areas of potential concern that neither a client nor the client's broker may have spotted so that those items can be negotiated. Once the lease is signed, of course, it's too late.

For additional information, questions or comments on this article, or any other transactional real estate matter please contact Greg Clement at gclement@bkcglaw.com or 949-975-7586.

Don't Be A Loan Shark: Beware Of California's Usury Laws

The term usury is an oft misunderstood and disregarded legal concept that is crucial to understand before you enter into any loan transaction. Put simply, usury is the charging of interest in excess of that allowed by law. California's usury laws are further complicated by a multitude of exemptions. Nonetheless, if you find yourself or your company in violation of California's usury laws, the civil penalties are steep which include both (1) forfeiture to the borrower of all interest on the loan (including the non-usurious portion), and (2) the payment of treble damages to the borrower of the interest already collected. Even more severe, a lender who intentionally and knowingly receives interest in violation of the usury laws can be found guilty of loan sharking, a felony punishable by imprisonment for up to five years.

Because of these serious concerns, it is important to understand the usury laws or consult an attorney before making a loan.

Generally, the California Constitution allows parties to contract for interest on a loan primarily for personal, family, or household purposes at an annual rate of no more than 10%. For all other loans, including loans for the purchase, construction, or improvement of real property, the maximum rate of interest is the higher of 10% or 5% over the amount charged by the Federal Reserve Bank of San Francisco on advances to member banks on the twenty-fifth day of the month before origination of the loan. Because the current applicable Federal Reserve Bank rate is .75%, non-exempt loans cannot bear interest at a rate greater than 10%.

These limitations do not, however, apply to most lending institutions such as banks, credit unions, savings and loan association, and pawn brokers. Another common exemption is for commercial transactions in excess of $300,000, or, for transactions in which the borrower has assets of at least $2,000,000. Under these two exemptions, the loan cannot be for personal, family, or household purposes, the borrower cannot be an individual, and the lender must have a pre-existing relationship with the borrower.

One of the most common ways around the usury laws and limitations set forth above is simply to make a loan arranged by a licensed real estate broker that is secured in whole or part by real property. If a licensed real estate broker takes a substantive role in the facilitation of the transaction, then the borrower can be an individual without a minimum net worth.

Because of the harsh penalties imposed by California law upon usurious lenders, and despite the numerous exemptions, private lenders and non-exempt companies should take special heed of the usury laws and proceed with caution before making any loan transactions.

For additional information, questions or comments on this article, please contact Amber Sanchez at asanchez@bkcglaw.com or 949-975-7500.

Arbitration Clauses – You've Seen One, You Have NOT Seen Them All

Many contracts pertaining to real estate, and nearly every standard agreement for the sale of residential real estate, include a provision that requires that all disputes arising out of the agreement must be resolved through binding arbitration. Although such a clause may appear benign to the untrained legal eye, its existence in a contract carries great significance that is often misunderstood until far too late.

Arbitration is a form of dispute resolution in which the parties pay an arbitrator, who is often a retired judge or experienced attorney, to play the roles of both judge and jury to adjudicate a legal dispute. Thus, by entering into a contract that includes an arbitration provision, parties waive their right to have a judge and/or jury resolve their legal dispute, and instead place their legal fate in the hands of a paid decision maker, i.e., the arbitrator.

Arbitration is not necessarily a poor dispute resolution forum, as it can provide some distinct advantages, including the possibility of obtaining quicker results than in court, greater privacy, the potential for more creative solutions, less formality, and the potential ability to select an arbitrator with special expertise. Unfortunately, it also presents some potentially serious drawbacks, including the possibility for much greater expense, limited rights to discovery (i.e., the ability to uncover information and find out the opposing side's evidence prior to the hearing), extremely limited appeal rights, and less assurance the arbitrator will properly apply the law, resulting in less predictable outcomes. Further, at least one scholarly study has confirmed what many attorneys have suspected for years—namely, that in certain types of cases, the claimants, i.e., the arbitration equivalent of plantiffs, win fewer cases than their companions who prosecuted their claims in court, and those claimants who have won in arbitration generally recovered less money than plantiffs have in court (see *An Emprical Study of Employment Arbitration: Case Outcomes and Processes*, published in 2011 by Cornell University [digital copy available at http://digitalcommons.ilr.cornell.edu/cgi/viewcontent.cgi?article=1586&context=articles]).

Fortunately, many of the drawbacks in some cases even eliminated altogether, by consulting with an attorney before you agree to arbitration. Even in circumstances in which agreeing to arbitrate would serve your interests, your attorney can help ensure that you are in the most appropriate arbitration forum. So, before signing any more contracts that include an arbitration provision, please call one of our attorneys to ensure that your rights are protected.

For additional information, questions or comments on this article, please contact Joshua Waldman at jwaldman@bkcglaw.com or 949-975-7500.

BKCG Real Estate Wins

BKCG has had some impressive results with Real Estate legal matters:

- **Mariners Mile Gateway, LLC adv. Thrifty Payless, Inc.** - (Non-suit for BKCG client, plus attorney's fees awarded – $30MM breach of contract)
- **Metropolitan Development and Housing Agency v. Tower Music City II, LLC** - ($30.4 million jury verdict – Eminent Domain)
- **Veronese v. Emadi, et al.** - (Successfully defended action and prevailed on cross-complaint)

The BKCG Bulletin is Published By:

Burkhalter Kessler Clement & George LLP

2020 Main Street
Suite 600
Irvine, CA 92614
Attn: Alton G. Burkhalter
949.975.7500
949.975.7501 fax
www.bkcglaw.com

340 North Westlake Blvd.
Suite 110
Westlake Village, CA 91362
Attn: William C. George
805.373.1500
805.373.1503 fax

Be sure to visit us on LinkedIn

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