Flynn-Law Newsletter

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Welcome to the Flynn-Law Newsletter

By Stephen M. Flynn

Welcome to the inaugural issue of the Flynn-Law Newsletter. The purpose of this newsletter and others which will follow on a monthly basis is to highlight new legal developments as well as existing legal issues which may be of interest to real estate owners, investors and small business owners.

The newsletter will generally focus on four substantive areas of law: (1) real estate law, (2) business law, (3) tax law, and (4) water law. Sometimes we will explore and discuss new laws and cases in these fields. Other times we may delve into existing laws and rules and try to look at them from a fresh, new and relevant perspective. My practice includes both transaction work and litigation work in these fields, so some articles may discuss an aspect of the law from a transactional or

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When is a Lease Default Curable?

A landlord generally has two remedies in the event of default by the tenant – damages and possession. The damages remedy is almost always available. In contrast, just because a tenant has defaulted, it does not mean the landlord is entitled to recover possession of the premises (i.e., evict the tenant through an unlawful detainer proceeding).

Most defaults are "curable", meaning that if the tenant "cures" the default, the landlord can only recover damages (if any), but cannot evict the tenant. The classic example is a default in payment of rent. The landlord can only recover possession after (i) rent is not paid when due, and (ii) rent remains unpaid after the giving of a three-day notice to "pay or quit."

This can create frustration for the landlord. A problem tenant can continually default in payment in performance of other non-monetary obligations under the lease, but can escape eviction by curing the defaults after the landlord services the required three-day notice. Often the defaults may not give rise to damages (e.g., an unauthorized sublease, noise violations, or the unauthorized use of the premises), leaving the landlord with a headache, but no readily available remedy.

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"Most defaults are "curable", meaning that if the tenant "cures" the default, the landlord can only recover damages (if any), but cannot evict the tenant."

Allocation of Recourse Liabilities Under Proposed §752 Regulations

Under §752 of the Internal Revenue Code, a partner's basis is increased by his or her share of partnership liabilities. With respect to recourse liabilities, a partner's share of partnership liabilities equals the portion of the liability for which the partner bears the economic risk of loss (EROL). A partner bears the EROL, for example, if the partner is a general partner, or if the partner has guaranteed partnership debt.

"Under the existing §752 regulations, it is possible for multiple partners to be allocated basis for recourse liabilities which cumulatively exceed the amount of the liability itself… On December 13, 2013, the IRS and Treasury issued proposed regulations under §752 to address this 'problem.'"

Under the existing §752 regulations, it is possible for multiple partners to be allocated basis for recourse liabilities which *cumulatively* exceed the amount of the liability itself. For example, if A and B jointly and severally guaranty a $100 partnership loan, and both have waived rights of contribution, A and B each have $100 in EROL, resulting in a total basis allocation of $200 – $100 A and $100 to B – even though the liability is just $100.

This "artificial" increase in basis was troubling to the IRS because it might allow A and B to deduct losses or receive distributions tax free which might not otherwise have been possible but for the fact A and B were *each* allocated $100 in liabilities.

On December 13, 2013, the IRS and Treasury issued proposed regulations under §752 to address this "problem." The proposed regulations apply if the total EROL exceeds the amount of the partnership liability (e.g., $200 in EROL for a $100 liability). In such an event, the liability is taken into account just once and each partner is allocated liability based on the following formula: Total Liability x (Partner's EROL / All Partner's

Please see *Proposed 752 Regs.* on page 4

Totally unrelated to the law, as an avid cyclist, I've decided to use these pages to showcase some of the highlights of recent bike rides. This photo shows the northern Mt. Vaca mountain rain in the morning sun.

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litigation point of view.

If you are interested in these issues (or know of anyone who may be interested), please visit my website, www.smflynn-law.com. My website has a blog as well as dozens of much more in depth articles on topics in the real estate, business, tax and water law areas. If you have any questions or would like to discuss these or other matters in more detail, please feel free to call or send me an email at smflynn@smflynn-law.com. Enjoy and thank your for reading.

New California Requirements Affecting Mutual Water Companies

AB 240, codified in Corporations Code §§14305-14307, took effect on January 1, 2014 (the "Act"). The Act imposes new requirements on mutual water companies ("MWC's") which operate a *public water system*. (Note – not all MWC's operate public water systems.)

First, the Act imposes new requirements for open meetings similar to the requirements for common interest developments under the Davis-Sterling Act. Amongst other things, the Act requires advance written notice of non-emergency meetings, provides for attendance and speaking rights for any "eligible person", and sets forth actions which may and may not be taken at a regularly noticed meeting. Second, with respect to budgets, the MWC must adopt an annual budget in an open meeting, must contract with a CPA to conduct an annual review of the financial records and reports of the MWC, and must make the annual budget available to any eligible person. Third, the MWC must make records available upon request to an eligible person, including agendas, minutes, budgets, financial reports, and water quality reports.

Lake Curry, now abandoned, was once an integral part of Vallejo's Lakes Water System, as seen from the top of Mt. Vaca (Elev. 2650).

Importantly, the act allows any "eligible person" to bring a civil action for declaratory or equitable relief for any violation of the above. An eligible person who prevails is entitled to attorney's fees and costs; however, if the MWC prevails, it is *not* entitled to fees or costs, unless the action was found to be frivolous. The details of AB 240 will be discussed at this year's board member training course (required under AB 54). Stay tuned for dates.

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There are, however, several instances where a default is non-curable (*see*, Code of Civil Procedure §1161(4)). The most notable examples of non-curable defaults include (1) the maintenance or commission of a "nuisance", and (2) using the premises for an "unlawful purpose." Other, more obvious examples of non-curable defaults include the sale and distribution of controlled substances on the premises, domestic violence and sexual assault against another tenant on the premises, and organized dog fighting.

The "unlawful purpose" exception is narrow. Most leases require the tenant to comply with applicable laws, rules and regulations, but a violation of the law is not necessarily the same as *using* the premises for an "*unlawful purpose*" (such as for the sale or cultivation of drugs or to organize a dog fighting ring).

The nuisance exception is broader, if only by virtue of the ambiguous nature of what constitutes a nuisance. However, rather than leaving the issue to the courts, the key is to define what constitutes a nuisance in the lease. For example, a lease could provide that more than three noise violations create a non-rebuttable presumption of a nuisance (which would give the landlord the right to evict regardless of whether the violation is cured. The lease could define a nuisance to mean the tenant's violation of applicable laws and regulations. The enforceability of clauses may be subject to dispute (at least in the case of a residential lease), but the landlord can help its case by documenting the violations in writing and notifying the tenant in writing of the violation and the consequences of a violation. This at least puts the landlord in a better position in dealing with a true problem tenant.

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Proposed 752 Regs. from page 2

EROL). Thus, in the example above, the $100 liability would be allocated $50 to A and $50 to B (100 x [100/200] = 50).

The proposed regulations also address the allocation of recourse liabilities in tiered partnerships. Under existing regulations, an upper tier partnership is allocated recourse liabilities to the extent the upper tier partnership and any of its partners bears the EROL for the liability. Thus, if A guarantees $100 of the debt of the lower tier partnership, and is a partner in both the lower tier partnership and the upper tier partnership, A would be allocated $200 – $100 directly as a partner in the lower tier partnership, and an additional $100 as a partner in the upper tier partnership – notwithstanding the fact the liability is just $100.

To address this situation, the proposed regulations provide that if a partner in an upper tier partnership is also a partner in the lower tier partnership, the partner is directly allocated 100% of the liability by the lower tier partnership and the upper tier partnership is allocated nothing. Thus, in the example above, A would be allocated $100, but the upper tier partnership would be allocated nothing.

Flynn-Law Press

The *Green Valley Landowners Association v. City of Vallejo* water class action litigation has generated a considerable amount of press in the past few months:

- http://www.thereporter.com/news/ci_24659188/green-valley-water-fight-vallejo-headed-court
- http://www.timesheraldonline.com/news/ci_24659162/water-customers-file-12-million-claim-against-vallejo
- http://www.dailyrepublic.com/news/solanocounty/green-valley-landowners-association-threatens-water-lawsuit/
- http://www.dailyrepublic.com/opinion/localopinioncolumnists/vallejo-must-not-shirk-responsibility-to-water-customers/
- http://www.thereporter.com/news/ci_24983678/green-valley-group-sues-vallejo-over-water-bills
- http://www.dailyrepublic.com/news/solanocounty/rural-water-rate-dispute-prompts-lawsuit/
- http://www.courthousenews.com/2014/01/30/64968.htm
- http://smflynn-law.com/uploads/3/1/4/6/3146267/bloomberg_bna_1.27.14.pdf

Drafting Indemnity Clauses to Include First and Third Party Claims and Damages

It is often lost on both transactional attorneys and litigators that a standard indemnity clause generally only refers to and covers *third party* claims. Thus, in the absence of clear language to the contrary, the court will construe the words "indemnity" and "hold harmless" to obligate the indemnitor to pay only third party claims, and not first party losses (*Zalkind v. Ceradyne, Inc.* (2011) 194 CA4th 1010, 1024).

In order to bring first party (direct liability) losses within the indemnity provision, the drafter needs to expressly state the that indemnity applies not only to third party claims and losses, *but also to direct liability and first party claim and losses*. Only then will the court construe the indemnity clause as covering both situations (*Dream Theater, Inc. v. Dream Theater* (2004) 124 CA4th 547, 555).

Suggested language might provide that: "*Indemnitor will indemnify and hold harmless Indemnitee against all losses, liabilities, damages and expenses, including, without limitation, all third party claims and all first party damages or direct liability losses or claims, incurred by the Indemnitee....*"

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