

# REAL ESTATE LAW

## Products-Completed Operations Coverage v. The Professional Services Exclusion

by Eric J. Rollins, Esq.

Many insurance policies across the construction world contain both products-completed operations coverage, which generally covers claims of property damage for work that has been completed, and a professional services exclusion, which generally excludes damage that results from the rendering of or failure to render professional services. When something goes wrong and damage occurs, a key question for purposes of obtaining coverage is whether the damage occurred because of the construction work or performance (or non-performance) of professional services.

In *North Counties Engineering, Inc. v. State Farm General Insurance Company* (2014) 224 Cal.App.4th 902, North Counties Engineering, Inc. (“NCE”), an engineering company, designed a dam and performed some construction work and labor with respect to certain elements of the dam. The evidence indicated that a separate company, North Counties Development, Inc. (“NCD”), was primarily responsible for the work and labor associated with the dam, while NCE had most of the expertise. After completion, the dam caused damage to third parties, which led to NCE being sued. Despite the fact that NCD performed the majority of the construction work, the underlying complaint alleged that both NCD **and** NCE constructed specific elements of the dam.

NCE tendered its defense to its insurer under a policy that contained both products-completed operations coverage and a professional services exclusion. The insurer denied NCE’s claim multiple times, but years later finally accepted its duty to defend. However, the insurer refused to pay any of NCE’s legal fees for the years between the date of tender and acceptance. Coverage litigation ensued.

The trial court originally sided with the insurer, concluding that no duty to defend existed due to the professional services exclusion. The Court of Appeal reversed in a strongly worded opinion, and ruled that the insurer had a duty to defend NCE



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due in part to the fact that the underlying complaint contained numerous allegations that specified that construction work caused the damage — not NCE’s engineering services. Additionally, the appellate court noted that the insurer’s own claims personnel acknowledged that the complaint contained allegations related to NCE’s construction work. The appellate court reconfirmed that an insurer owes a

broad duty to defend, and found that the trial court erred in “not, as the law requires, looking to determine whether there was any evidence that might support a conclusion that there was a duty to defend, but rather looking only for evidence — indeed, even inferences from evidence — that there was not.” Moreover, the court found that “[t]he ‘professional services’ exclusion is not the panacea State Farm would have it, certainly not when analyzed under the appropriate standard: ‘narrowly against the insurer.’”

The *North Counties Engineering* case is a victory for developers, contractors, and design professionals as it narrows the scope of the professional services exclusion and will force insurers to carefully consider the allegations and extrinsic evidence before denying coverage based on the professional services exclusion.

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# LEASEHOLD TITLE INSURANCE

## Introduction

Buyers of commercial real property in California most often obtain an owner's title insurance policy as a condition to the closing of the purchase of the property. This practice is, in part, the result of California sellers not customarily warranting the status of title to the property and, in part, the relatively modest additional cost for an owner's policy (e.g., a CLTA policy, typically paid for by Sellers) in addition to a loan policy required by providers of purchase money financing to buyers.

Lessees of commercial property in California are not as often inclined to similarly insure their interest by obtaining a leasehold title insurance policy despite many lessees entering into long term leases and intending to make significant and expensive improvements to the property. The reasons stem from avoidance of additional transaction costs to a misunderstanding of the value of leasehold title insurance.

## Why Leasehold Title Insurance

As with an investment in the fee ownership of property, lessees contemplating a significant financial commitment involving a leased property should appreciate knowing with assurance such things as:

**OWNERSHIP** - who is the legal owner of the property? As leasing oftentimes involves intermediaries acting on behalf of the "lessor" (i.e., brokers, property managers and other representatives), knowing who is the property owner, knowing who you are dealing with (relative to the owner) and being able to ascertain if the party executing the lease as "lessor" is authorized, are paramount.

**THIRD PARTY CONSENT** - is third party consent required as a condition to leasing the property? Oftentimes property is subject to liens and encumbrances which require third-party consent to the leasing of the property. Without this consent, the ensuing uncertainty and risk of loss of the leasehold and corresponding financial investment by a lessee would be unacceptable.

**POSSIBILITY OF FORECLOSURE** - do liens and encumbrances exist which may give rise to foreclosure? Liens and encumbrances which provide a foreclosure remedy should be considered as well as considerations of requiring, as a condition to the lease, the subordination of the lien or encumbrance and/or a non-disturbance agreement allowing a lessee continued possession of the property following a foreclosure by the secured party.

**FORESEEABLE CHANGE IN OWNERSHIP** - is the property subject to any purchase or reversionary rights or the subject of any judgments or other liens raising questions concerning the viability of the property owner? Evidence that ownership of the property may be subject to change may be an important factor to consider in leasing the property as any new ownership may not result in the type of relationship enjoyed by the lessee and the property owner at the time of entering into the lease.

**USE RESTRICTIONS; DEVELOPMENT IMPEDIMENTS** - are there any covenants or restrictions of record which limit or prohibit the use of the property or are there any easements or restrictions of record which interfere with or prohibit the intended development of the property? Of equal importance are considerations of the rights of any third-parties (including governmental agencies) prohibiting or restricting specific uses of the property (e.g., uses exclusive to a third party, hours of operation, traffic, outside lighting, noise and dust/odor) or impeding certain improvements or operations at the Property (e.g., prohibitions on improvements interfering with easements governing underground or surface rights or rights to airspace or light over the property).

## Leashold Title Policy

A title search of the property (beginning with a preliminary title report) provides useful information regarding matters affecting the proposed leasehold and a subsequent leasehold title insurance policy provides protection against unknown ownership and against conditions of title to the property. The costs structure of leasehold title insurance is the same as an owner's title insurance policy and the policy form is essentially the same for fee or leasehold, with the notable additional leasehold exceptions being:

- \* the effects of any failure to comply with the term, covenants, conditions and provisions of the lease;
- \* any facts, rights, interests or claims which are not shown by the public records but which could be ascertained by making inquiry of lessors and their successors in interest in the lease; and
- \* any defects in or invalidity of, or other matter relating to the leasehold which would be disclosed by an examination of the unrecorded lease.

Although the first such exception will not be removed by the title insurer, the insurer may be willing to remove the second and/or third exceptions under appropriate circumstances.

## Conclusion

Lessees of real property intent on long term leases or significant leasehold improvements to the property should consider leasehold title insurance for the same reasons buyers of real property would purchase an owner's title insurance policy.



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### Early Collaboration for Greater Protection: Don't Wait to Assemble Your Team

by Josh C. Grushkin and Javier F. Gutierrez, Partners, Stuart Kane LLP

When kicking off negotiations on a real estate transaction, brokers usually lead the charge for their clients. But some principals wait to call their real estate attorney until the letter of intent is signed, and negotiations are beginning on the definitive lease or purchase and sale agreement. But what if an important deal point is missed in the letter of intent that counsel could have raised? Or worse, what if negotiation of the definitive agreement stalls, and a seemingly non-binding letter of intent is found to be an enforceable contract by a court of law? Involving an attorney early in the deal-making process could help to avoid costly oversights, if not simply streamline the transaction.

In *First National Mortgage v. Federal Realty Investment Trust*, 631 F.3d 1058 (2011), sophisticated real estate parties exchanged several proposals for a ground lease with various put and call options. While each “counter proposal” and “revised proposal” included customary “non-binding” language, the “final proposal” executed by the parties only stated that it was subject to approval of the terms and conditions of a formal agreement. Missing an express statement that it was “non-binding,” when the market turned and the parties could not agree on the terms for their formal agreement, the “final proposal” was held by the Ninth Circuit to be a binding contract.

More concerning, recent case law calls into question whether including the words “non-binding” would even solve the potential issue of a letter of intent being held enforceable. The decision in *Riverisland Cold Storage, Inc. v. Fresno-Madera Production Credit Assn.*, 55 Cal. 4th 1169 (2013) overruled 75-year old precedent, with the California Supreme Court holding that a litigant may offer evidence of a prior oral agreement that contradicts a written contract.

Given these types of recent rulings, parties negotiating letters of intent need to consider that documents intended to be non-binding may ultimately be found to be enforceable. And if the party on the other side of the table is litigious, they may be able to win a court battle to invalidate the terms of a written agreement by proving fraud with contradictory prior oral agreements.

Having potential landmines like these in the path of the deal should prompt real estate principals and brokers to involve real estate attorneys early in negotiations. Collaboration on projects helps to quickly address issues, and streamlines the process of negotiating the definitive agreement. Front-loading negotiations with the principal, broker and attorney, yields more efficient use of time and resources. For these reasons, assembling your negotiation team and including real estate counsel at the letter of intent stage is encouraged to ensure all the bases are being covered. If the letter of intent is the key opportunity to mutually agree upon crucial deal points, why wait to raise some of those points until after that opportunity has passed?

Whether the goal is to get the deal done quickly, or to just avoid surprises when a non-binding proposal is held to be enforceable, don't wait to call counsel until after the letter of intent is done. Having real estate attorneys on the full negotiation team assembled at the start of the deal is always going to benefit that party in the negotiation, and help efficiently achieve the best results in the transaction.

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Josh Grushkin is a real estate partner with Stuart Kane LLP. His practice encompasses all aspects of commercial real estate transactions, including land acquisitions and dispositions for commercial and residential developers, homebuilders, investors and corporate users. His expertise also includes lease transactions for office, industrial and retail properties, representing landlords and tenants. Mr. Grushkin also has experience negotiating financing for retail shopping centers, commercial and industrial buildings, as well as for multi-family and residential development.

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# Warning To Property Owners: "Neighborly" Accommodations May Result In Losing Property Rights

by Kenneth R. Styles, Shareholder, Miller Starr Regalia

As the expression goes: "No good deed goes unpunished." In the world of real property law, if a landowner, trying to be a "good neighbor", allows someone to use his or her property, that neighborly accommodation may ripen into a permanent easement-type property interest across the property.

A recent decision from the California Court of Appeal in *Richardson v. Franc* expanded the legal doctrine of "irrevocable licenses" in a situation where one neighbor simply allowed another neighbor to use a portion of a driveway for landscaping and irrigation. Whereas prior cases applying irrevocable licenses arose from the parties' oral agreement, in *Richardson* the parties never communicated to each other. The landowner's knowledge of the use, without assent or objection, was sufficient to create a permanent, easement-like property interest.

Conceptually, a license to use another's real property differs from commonly-known real property doctrines such as "adverse possession" or "prescriptive easement", which may allow others to obtain fee title or easement rights based upon use of the property (e.g., 5-years use that is "open, hostile and continuous"). A well-known method to defeat adverse possession is to grant permission to the user, thus negating the required element of hostility.

In contrast to the hostility requirement for adverse possession, a license is premised upon permission. A license gives the user authority to perform an act or acts on your property. Licenses are commonly seen in commercial transactions to allow specifically-defined use of a property. In those situations, the rights, duties and obligations of the parties are set forth in a written license agreement.

In the absence of a written agreement, a landowner may grant an oral (i.e., "parol") license. Such parol licenses are revocable at any time. The legal doctrine of a parol "irrevocable license" dates back to court decisions in the 1800's. In theory, an irrevocable license derives from an equitable estoppel, in which a landowner agrees to allow use of the property with knowledge that the user will expend significant funds to improve the property. For example, the classic case involves a neighbor asking the landowner for access over the property to a landlocked parcel; the landowner says yes and the neighbor, relying on the landowner's agreement, builds a house on the landlocked parcel – i.e., an equitable estoppel that leads to an irrevocable license.



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The unique fact of the *Richardson* case is that the parties never communicated to each other. Instead, one party – who already benefited from an easement for ingress and egress over a driveway – installed landscaping and an irrigation system beyond the easement boundaries. The landowner was aware of the expanded use, but never communicated with the neighbor. Years later, the new owner of the property objected to the use, filed suit and lost.

The holding in *Richardson* raises some troubling issues for property owners. For example, if a property owner is aware of certain use, but fails to investigate or object, such inaction may result in a permanent, irrevocable license. *Richardson* arguably puts the burden on landowners, as opposed to adverse users, to ensure that any adverse use, even if by mistake, does not ripen into a permanent, irrevocable license. For example, by statute a landowner may prevent a prescriptive easement by either recording permission or posting signs. Arguably, neither of these code sections would prevent an irrevocable license.

So what is a landowner to do, object and risk a prescriptive easement, or assent and risk an irrevocable license? Unfortunately, *Richardson* injects more uncertainty into the ever-evolving world of property use rights (e.g., easements, licenses and leases).

**Kenneth R. Styles**

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