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Rent Escalation Payments Made in Error — Are They Recoverable?

By Maurice H. Sullivan III and Katy Dugan

During negotiation of a lease, parties often pay significant attention to economic terms such as periodic rental increases, rent increases during renewals of the lease term, and the definition and calculation of operating expenses and real estate taxes. Of course, the amounts of operating expenses and real estate taxes in future years are unpredictable at the time the parties enter into a lease. Further, the determination of the amounts of these escalation payments owed by the tenant is often complex, in terms of both characterizing the types of expenses that are reimbursable by the tenant and the other components that may be involved in the calculation, such as consumer price index adjustments, changes in leased space at the property and similar factors. In order to address this unpredictability, commercial real estate leases usually require the landlord to deliver to the tenant escalation payment bills or periodic statements or invoices for amounts owed by the tenant. The tenant is required to pay the stated amount, but may have the right to contest the accuracy of the statement or audit the records supporting the charges within a certain period of time.

Disputes about the amounts due for items that were unascertainable at the time the parties entered into the lease may arise years after such amounts have been paid, or were due but not paid. A number of fairly recent cases demonstrate that, when the parties resort to litigation to resolve these disputes, the outcome of the case turns heavily on the course of conduct established by the parties, equitable concerns and the specific language of the lease.

A less-than-attentive tenant who overpays amounts due under the lease, such as rent or operating expenses and real estate taxes may be prevented from recovering these amounts in future years, particularly if the tenant made the payments consistently over a long period of time, with full knowledge of or the ability to obtain information regarding the basis for the charges. In addition, courts appear to consider significant the parties' degree of sophistication. Courts have applied several different legal concepts to resolve these types of cases, including the voluntary payment doctrine, the statute of limitations, and "mistake of fact."

Under the "voluntary payment doctrine," a party may be deemed to have waived its right to contest inaccurate charges and thus lose the right to recover amounts paid in error. In the absence of fraud or mistake of fact this most commonly occurs when a party pays or collects

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Can Emails Create Binding Contracts?

By Henry Healy and Stefan Lefebvre

Email has become an essential part of personal and business communications. Therefore, it is increasingly important to understand its legal implications. A fundamental question is whether emails can create binding contracts.

While the analysis involves modern technology, it begins with basic principles of contract law. Generally speaking, creating a binding contract requires the following critical elements: identification of the parties, an offer, acceptance of the offer, mutual promises or other valuable consideration, and a statement of the fundamental terms of the agreement setting forth the rights and obligations of the parties. In real estate transactions there is an additional requirement. Under the "statute of frauds" an agreement must be in writing and signed by the party against whom the agreement is to be enforced. Courts that have faced the issue have increasingly rejected the arguments that electronic communications do not constitute "writings" and that a typed name on an email is not a "signature." This is consistent with 19th century decisions finding that a binding contract could be established by telegraph messages. Courts have also been willing to pull together multiple communications between the parties to establish the existence of a contract. Where appellate courts have found that no contract exists, the decision is frequently based on a failure to establish an essential element of a contract, such as the price or the extent of the property to be purchased.

While courts are willing to read long email exchanges as one memorandum of an agreement, the next hurdle is to determine when the negotiations have ended and given rise to a mutual, binding agreement. Correspondence using conditional language can indicate that a true "meeting of the minds" has not occurred. In *Singer v. Adamson*, the Massachusetts court found that the plaintiff's own words barred the formation of a binding contract. After preliminary discussions both in person and by email, the real estate agent for the seller-defendant sent Singer, the buyer-plaintiff, an email stating that "[a]fter careful consideration the seller is willing to accept an offer of $255,000, without the washer and dryer." The agent followed up the next day with an email informing Singer that "[the seller] would like to try to make this work for you and the seller," but that "the best the seller can do is $253,000 including the refrigerator." Singer replied to this email the same day, writing "I think this might be possible. I think you and I and the seller should meet and see if we can get an offer and acceptance." The final email in the exchange came from the broker three days later, who said "[w]e gave your offer to the seller and explained the terms. The seller has asked for time to consider all offers… We would like to see you get the house. It is ultimately the seller's decision." As the *Singer* court noted, the broker's emails never contained "the language of an offer, but rather of continuing dialogue over price," for there were "no words inviting acceptance or any willingness to be bound." For Singer's own part, her use of phrases such as "might be possible" precluded her from arguing that she was accepting an offer, even if there had been a true offer. As a general rule, courts will read qualifiers and other conditional language as clear evidence negating a party's intent to be bound.

Although a series of writings containing the basic elements of a contract would suffice in establishing many types of contracts, as noted above real estate transactions face an additional complication. The statute of frauds requires that real estate transactions be memorialized in a writing signed by the party against whom the agreement is being enforced. This proves problematic when these writings take the form of electronic messages, for emails cannot be "signed" in the traditional sense. Therefore, the next hurdle for email contracts in real estate is determining to what extent an email signature can satisfy the statute of fraud's signed writing requirement.

In 2000, Congress addressed the use of electronic signatures in interstate or foreign commerce by passing the Electronic Signatures in Global National Commerce Act, or E-SIGN. This legislation states that "[a] signature, contract, or other record relating to [interstate or foreign commerce] may not be denied legal effect, validity, or enforceability solely because it is in electronic form." Since then, 47 states have adopted their own versions of the Uniform Electronic Transactions Act, or "UETA," applicable to domestic, intrastate transactions. The UETA was developed by the National Conference of Commissioners on Uniform State Laws and closely mirrors E-SIGN.

Since the passing of E-SIGN and the individual state incarnations of UETA, courts have become increasingly willing to recognize email signatures as satisfying these state statutes (and therefore the writing requirement of the statute of frauds), with a trend towards a broader interpretation of what it means to "sign" a writing. In 2003, prior to the effective date of the Massachusetts version of UETA, the

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New California Limited Liability Company Act

By Edward S. Merrill

California has adopted a new Limited Liability Company Act which took effect Jan. 1, 2014. California's Revised Uniform Limited Liability Company Act (California Corporations Code Sections 17701.01 et. seq., the "New Act") is based substantially on the Revised Uniform Limited Liability Company Act adopted in 2006 by the National Conference of Commissioners on Uniform State Laws (the "Uniform Act"). In some areas, the New Act deviates from the Uniform Act and carries over some of the rules from the old Beverly Killea Limited Liability Company Act (the "Old Act"). Some of the provisions of the New Act resemble corresponding provisions under California's Revised Uniform Partnership Act of 1994 (Corporations Code Sections 16100 et. seq., the "Partnership Act") and the California Uniform Limited Partnership Act of 2008 (Corporations Code Sections 15900 et. seq., the "Limited Partnership Act"). While there are numerous technical and minor changes, the overall thrust of the New Act is similar to that of the Old Act. This discussion is not exhaustive and focuses on the more significant provisions and those which have received comment.

A. DEFAULT OR FILL IN PROVISIONS

The New Act, like the Old Act, contains many provisions which are designed to provide back up operating rules for informal groups operating as limited liability companies and to avoid technical defects in formation which could render the participants generally liable as general partners. However these rules only apply if there is no agreement to the contrary. The key to operating as a limited liability company in the commercial world, whether in California or elsewhere, is a well drafted operating agreement setting out the agreement of the members. The New Act, following a trend started by Delaware some time ago, pays homage to the concept of freedom of contract, notwithstanding that it contains some constraints on that freedom. These few constraints will be discussed in the sections "Constraints on the Operating Agreement" and "Fiduciary Duties," which follow this section regarding the default rules.

1. Default Management Provisions

In the default management provisions, the New Act distinguishes between member-managed and manager-managed LLCs.[1] The New Act establishes a default rule that decisions in the ordinary course of business are decided by majority vote: a majority of the members in a member-managed LLC; and, a majority of the managers in a manager-managed LLC. The default rule is that each member or manager has equal voting rights. For decisions regarding actions outside the ordinary course of business, the default rule is that consent of all members in a member-managed LLC is required. For acts outside the ordinary course of business in a manager-managed LLC, including specifically the sale, lease or exchange of all or substantially all of the LLC's property, the default rule requires the consent of all the members. The Old Act did not make any distinction for ordinary course of business decisions; majority vote was the default rule for all matters and the default for member voting was by share of profits, not the count of members set out in the New Act.

The default rule for fundamental changes, such as an amendment of the operating agreement or merger or conversion, requires the consent of all members. This is consistent with the default rule in the Partnership Act and the Limited Partnership Act. The Old Act required the agreement of a majority of the members, but not less than a majority, to amend the operating agreement. The default rule for election of a manager or removal of the manager is majority vote of the members.

There are extensive default rules for conduct of meetings, notices and the like which are similar to those in the Old Act. Note however that meetings are not required. The section of the New Act, like the Old Act, which provides for the possibility of alter ego liability, provides that where the operating agreement does not require meetings and formalities, the failure to hold meetings or to follow such formalities shall not be a factor in determining alter ego liability.

The New Act provides for the indemnification of the members and managers by the LLC as the default rule.

The New Act also contains specific provisions regarding fiduciary duties which will be the subject of a specific section of this discussion.

2. Default Financial Provisions

The default rule for distributions is that they are made on the basis of the relative value of the contributions to the limited liability company. For this purpose, contributions may be in any form, including services. While services may be valued for determining contributions, the default rule is no compensation

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1 Note the New Act provides that unless stated in the articles or the operating agreement that the LLC is manager-managed it will be member-managed by default. Although some commentators have questioned this default rule, it is of minor consequence because the form California limited liability company articles contain a box to be checked stating whether the LLC is member-managed or manager-managed.

Defaults and Remedies in Commercial Real Estate Joint Ventures

By J. Michael Pickett

The default and remedy terms of a real estate joint venture agreement are naturally often overlooked at the letter of intent stage. The parties are typically more focused on economic and other material terms. This can lead to difficult negotiations later when the developer member receives the equity member's proposed venture agreement and is somewhat surprised by the exhaustive list of defaults, cross defaults, loss of rights and the possibility of the loss of its sacred "promote." This article discusses several of the issues that can arise regarding these provisions and certain lender considerations in exercising agreed upon rights.

For purposes of this article, assume a straight forward joint venture: a special purpose entity limited liability company ("LLC") owns the property being developed; Developer Member owns a 10 percent equity interest and is the managing member under the LLC; Equity Member owns a 90 percent interest. Developer Member is to provide the construction lender the applicable guaranties, including a completion guaranty, a non-recourse carve-out guaranty and possibly a partial repayment guaranty. The LLC is entering into a development and/or construction management agreement and a property management agreement with affiliates of Developer Member (referred to in this article as "Affiliate Contracts"). Developer Member is entitled to additional distributions (often called, the "promote") in the event the project hits certain economic return milestones for Equity Member. Developer Member, as managing member of the LLC, has the authority (and the duty) to act on behalf of the LLC in the implementation of an agreed upon business plan which will include the construction of the project.

Equity Member, as the 90 percent owner, is very concerned that Developer Member perform and execute the plan. It will require that if Developer Member steps out of line in any way, Equity Member will have the ability to replace Developer Member as managing member and to take other actions to protect its investment. Developer Member, arguing that it is the one with the expertise in getting the project completed, believes that it should be given certain lee-way in getting the job done and unless it has done something truly 'bad', Equity Member should let Developer Member do that for which it was hired, and in any event, should Development Member default in its obligations, it's equity stake and "promote" should not be impacted, especially to the extent value has been created as of the time of the default (for example if the Project has become fully entitled or completed prior to the default).

DEFAULTS

Equity Member's form joint venture agreement will contain many different types of defaults, some of which apply to both members, but many of which will pertain solely to Developer Member. While not exhaustive, these defaults can include the following: failure to fund when due required (or other types) of capital; a breach of any term or obligation under the venture agreement (with notice and cure periods as applicable); the commission of a "bad act," including fraud, gross negligence, wilful misconduct, stealing funds, criminal acts, etc.; transfers of interests in violation of the venture agreement; bankruptcy; a default under an Affiliate Contract; defaults under the construction loan caused by a member; failure to obtain consent for a Major Decision; failure of Developer Member to achieve completion on time and on budget (or other project performance thresholds, including in some instances, economic performance); failure of Developer Member's "Key Principals" to maintain control of Developer Member and its applicable affiliates; and failure of Developer Member to obtain and maintain insurance on the project.

Developer Member will try to limit the list as much as possible and to specify that defaults should be project specific. For example, it will argue that a failure to fund capital already has built in remedies (such as member loans and/or punitive dilution) and adding removal remedies unfairly singles out Developer Member. It will also want to be able to cure a bad act by an employee of the Developer Member or an affiliate who is not a-key principal by removing that employee from the project. It will want to expand notice and cure periods, and it will argue that a default under an Affiliate Contract has its own remedy and cross defaulting to the venture is not appropriate. Developer Member should keep in mind that defaults and remedies need to be considered together. For example, if Equity Member is in agreement that there is no loss of promote (or other adverse economic results) for non-bad act defaults, Developer Member may be more inclined to agree to Equity Member's default list.

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Is Conservation Land Tax Exempt?

By Katherine B. Kimball

BACKGROUND

A recent Massachusetts Supreme Judicial Court decision clarified the standard to which charitable conservation organizations will be held in order to qualify for certain local real property tax exemptions relating to their conservation lands. In *New England Forestry Foundation, Inc. vs. Board of Assessors of Hawley*, the New England Forestry Foundation, Inc. (the "Foundation"), a Massachusetts nonprofit organization, applied for a full charitable tax exemption under Massachusetts G.L. c 59 sec. 5, Third ("Clause Third") for a 120-acre parcel of forest land it owns in the town of Hawley, Mass. (the "Hawley Forest"). The Foundation's stated mission includes "providing for the conservation and ecologically sound management of privately owned forestlands in New England." It is one of the largest land-conservation organizations in Massachusetts.

Clause Third provides that the real property of a "charitable organization" is exempt from taxation if the land is occupied by the charitable organization for the purposes for which it was organized. The Board of Assessors of the Town of Hawley denied the Foundation's application for tax exempt status and the Massachusetts Appellate Tax Board (the "Board") upheld that denial. The Board held that the Foundation had failed to carry its burden to show that it occupied the Hawley Forest for a charitable purpose within the meaning of Clause Third since forest management did not qualify as a "traditional charitable purpose." It found that the benefits of the Foundation's activities in the Hawley Forest did not inure to a sufficiently large and fluid class of persons.

DECISION AND REASONING

On May 15, 2014, the Supreme Judicial Court reversed the Board's decision, concluding that the Board erred in denying the Foundation a charitable tax exemption under Clause Third. The court's decision carefully analyzes each part of the two-prong test laid out in the language of Clause Third.

Prong One: Charitable Purpose Requirement

The court cited a number of Massachusetts cases that have defined and clarified the requirements that must be met for an organization to satisfy the charitable purpose requirement under Clause Third. Mere legal status as a charitable corporation or exemption from federal taxation is insufficient. Nevertheless, the Foundation's purposes, according to the court, are "traditionally charitable" within the meaning of the Clause Third.

In particular, the court found that the Foundation's charitable programs and activities, both in Hawley Forest and throughout New England, benefit an indefinite number of people. In past court cases, this "benefit" provided by conservation land was measured primarily by the direct access of the public to land for recreation, scenic views or education. The court's decision expanded the ways conservation land can "benefit" the public, referencing the advancement of the science of conservation, which has made it more apparent that properly preserved and managed land can benefit a community even if few people physically enter the land. The court provided specific examples including that the conservation of large forested blocks of land is an effective means of contributing to "ecosystem resilience in the face of rising temperatures and more severe storms" because the forests naturally absorb carbon and other harmful emissions. These types of benefits appear to extend beyond the parcel of land itself.

In addition, the court noted that the Foundation's work in Hawley Forest, and throughout the Commonwealth, is traditionally charitable because it lessens the burdens of the government. The Massachusetts Constitution provides a right of the people to "clean air and water, freedom from excessive and unnecessary noise, and the natural, scenic, historic, and esthetic qualities of their environment." Under the Massachusetts Constitution, the government's protection of people in their right to the conservation, development and utilization of natural resources is a "public purpose." The Hawley Forest directly abuts a state forest and helps extend a block of forested land preserved by the Commonwealth. The Foundation and other conservation organizations with missions aligned with the conservation goals of the Commonwealth have been identified by the Commonwealth as "essential partners" in conservation efforts.

Prong Two: Occupancy Requirement

The court also held that the Foundation satisfied the "occupancy requirement" prong of the requirements in Clause Third. The court discussed previous Massachusetts cases that explain that occupancy is "something more than

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RENT ESCALATION PAYMENTS MADE IN ERROR, *CONTINUED FROM PAGE 1*

inaccurate charges for a number of years without challenging them. While this doctrine can apply outside the context of real estate leasing, courts have applied the voluntary payment doctrine in a number of cases to prevent tenants from recovering overpaid rent or other lease charges when the tenant consistently and without contest paid the amounts, having full knowledge of, or access to information regarding, the basis for the charges. For example, in a 2010 decision of the New York Appellate Division (1st Department), a major bank claimed that it had been overcharged for rent for nine years due to the landlord's miscalculation of a rent escalation under the lease. The New York court barred the tenant from recovering the overpaid rent because the tenant had acquiesced in making the payments without dispute or even inquiry. Similarly, in a 2006 decision the same court refused to allow a tenant to recover amounts that the tenant overpaid for tax increases based on inaccurate tax bills sent to the tenant. In denying the tenant's claim, the court pointed out that the tenant failed to inquire of the landlord as to the computation made to arrive at the increases. In both of these decisions, the court highlighted the tenant's sophistication and lack of inquiry about the charges.

The statute of limitations, which overlaps with the voluntary payment doctrine in some sense, may also bar a tenant from recovering overpaid amounts. Under New York law, the statute of limitations for overpaid rent is six years. The time commences with the first inaccurate charge and payment made on the basis of that charge. Thus, for example, if a tenant consistently pays rent or other amounts due under a lease based on an incorrect method of calculation by the landlord for six or more years, the tenant will be precluded from recovering any amount paid within that six-year period, or any greater period of time.

In some cases, a tenant may be able to recover overpaid amounts, even though the circumstances support the application of the voluntary payment doctrine or statute of limitations, if the tenant did not have knowledge of factors affecting the amount due, or if the landlord made misrepresentations about relevant facts. The tenant's ability to evaluate information from the landlord regarding amounts due under the lease depends, of course, on the completeness and accuracy of the information available to the tenant. In cases where the landlord provided the tenant with inaccurate or incomplete information, courts characterize the tenant's lack of knowledge or misunderstanding as "mistake of fact," and have permitted tenants to recover amounts paid in error. For example, in one reported case, a landlord billed a tenant for its proportionate share of real estate taxes but failed to give the tenant a credit for tax rebates, abatements and refunds. The tenant paid the invoiced amounts. The court permitted the tenant to recover the overpaid amounts because the tenant had no knowledge or means of knowing about the applicable rebates, abatements, and refunds.

A tenant in another case was able to recover rent it had paid for space that it did not even lease or occupy. The tenant in that case had, at one point, leased multiple units from a landlord, and paid rent to the landlord based on rent invoices itemized by unit. After the tenant vacated a portion of the leased space, the landlord stopped itemizing the rent invoices by unit, and the tenant continued to pay rent for the entire space. The court deemed the tenant's payments negligent, but also said that because the payments were based on mistake of fact, the tenant was entitled to recover the overpaid amounts. The court in that case referenced the doctrine of unjust enrichment as well, indicating that its judgment was based — at least partially — on the rationale that it would be inequitable to allow the landlord to retain overpayments by the tenant based on the tenant's mistake of fact. Equitable principles were particularly appropriate because the landlord had re-let the space vacated by the tenant and received additional benefits as a result.

As noted above, the result in this type of dispute depends heavily on the facts, including the language of the lease and the parties' course of conduct over the years. In a 2012 decision, a tenant, after having consistently for eight years paid rent escalations based on the landlord's calculations, suddenly refused to pay the increased rent going forward. The tenant argued that the applicable lease provision had a different meaning than the one used by the landlord to arrive at the rent increase. The tenant sought to offset the claimed overpayments against the rent now due. The landlord sued the tenant for the past due rent. The court rejected the tenant's position, having determined that the landlord's calculations were correct and were based on unambiguous language in the lease. The court emphasized that, regardless of the clarity of the language in the lease, the tenant's conduct in paying the invoiced amounts without question over the course of eight years comported with the landlord's interpretation of the applicable lease provisions. Thus, even if the language was ambiguous, the parties' conduct was

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RENT ESCALATION PAYMENTS MADE IN ERROR, *CONTINUED FROM PAGE 7*

evidence that the landlord's calculation of the rental increase matched the parties' intent.

The foregoing examples demonstrate that tenants must be attentive to the amounts invoiced by landlords for payments due under the lease, the applicable provisions of the lease, the methods of calculation used by the landlord to determine those amounts, and the collection procedures employed by the landlord. Another recent case reveals that landlords must be equally diligent in adhering to the applicable provisions of the lease, lest they lose the ability to collect amounts rightfully owed by the tenant. In *Mount Sinai Hospital v. 1998 Alexander Karten Annuity Trust*, decided by the New York Appellate Division (1st Department) in August 2013, the landlord was not able to collect back payments of additional rent rightfully owed by the tenant because for twelve years the landlord had failed to send to the tenant invoices as required under the lease. The court held that the landlord's delivery of invoices for the tenant's share of operating costs was a constructive condition precedent to the tenant's obligation to pay the charges. In that case, under the clear language of the lease, the landlord was required to deliver to the tenant a statement of operating expenses for each year following the base year, as soon as reasonably practicable, but in any case within two years after the end of each successive year. The lease further provided that, upon receipt of that statement, the tenant was required to pay the invoiced amounts, but had the right to dispute amounts billed as additional rent within 30 days after receipt of the statement. The lease commenced in 1998, and the landlord failed to deliver any statements of operating expenses to the tenant until March 2011, when the landlord sent a bill the tenant for the entire preceding 12 years of the term. The tenant refused to pay the invoiced amounts, and sought a declaration of the additional amount owed, if any. The tenant claimed that it was not obligated to pay any additional rent for the prior years due to the landlord's failure to deliver timely statements. Ultimately, the court agreed (although the tenant was required to pay additional rent for 2009 and 2010, as these years were within the two-year timeframe set forth in the lease). The court determined that the delivery of a statement of amounts owed by the tenant as additional rent was a constructive condition precedent to the tenant's obligation to pay (and dispute the amounts, if applicable).

After the lease has been signed and the term has commenced, a tenant and landlord may begin to trust and rely on each other and establish a custom and course of dealing with respect to the payments due under the lease that does not actually comply with its provisions. Each party may assume that the other party is paying attention to the specific economic provisions of the lease. In light of the attention a court pays to the vigilance and course of conduct of the parties, however, both the tenant and the landlord should always carefully review the applicable provisions of the lease when dealing with escalation charges and similar lease terms. <

CAN EMAILS CREATE BINDING CONTRACTS?, *CONTINUED FROM PAGE 2*

Singer court described emails as "analogous more closely to telephone calls," positing that parties do not "appreciate that their quickly-composed electronic missives are contractual" and are alternatively "just talking with the help of the internet." In finding that the electronically-signed emails did not satisfy the statute of frauds, the court in *Singer* described the emails as merely being "shot back and forth" without any greater authority placed in this particular form of communication. Half a decade later, courts began taking a noticeably more accepting view of email communication. In 2007, the New York Appellate Division concluded in *Naldi v. Grunberg* that "email is no longer a novelty," and that "the number of people and entities regularly using email" necessitates an expanded view of terms such as "writing" and "subscribed". Six years after *Naldi*, the *Forcelli v. Gelco Corporation* ruling highlighted this same point. There the Appellate Division observed that due to "the now widespread use of email as a form of written communication in both personal and business affairs, it would be unreasonable to conclude that email messages are incapable of conforming to [state signature requirements] simply because they cannot be physically signed in a traditional fashion." In *Forcelli*, "Thanks Brenda Greene" included at the end of the email constituted enough of an intentional "signature" to satisfy the statute of frauds, even though it did not meet the exact standard set out in New York's version of UETA.

One area of e-signature law that remains unsettled is how courts are to determine intent from automatic individual or company names programmed to appear at the end of emails. Some courts previously held that automatic names included in faxes do not demonstrate the required intent necessary to bind the parties. The *Forcelli* decision distinguished automatically generated email names from the "purposefully" typed subscription appearing in the email under consideration by the court. Other courts have found that intent can derive from the fact that automatic signatures were intentionally programmed in at one point in time, and that they current serve as the functional equivalent of written signatures in modern correspondence.

While email contract formation is grounded in basic contract law, the technological developments that change how we interact on a daily basis will continue to influence the inherently subjective effort to determine a party's intent through writings. The unresolved issue of automatic signatures highlights the interplay between traditional legal principles and the social implications of rapidly-evolving technologies—at what point do "new" technologies become the accepted norm in everyday interactions? For the time being, email users should be aware that (i) messages in an email exchange can be pulled together to meet the requirements of contract formation, (ii) conditional language can help negate a claim that there has been a true "meeting of the minds" and (iii) purposely typed email signatures are very likely to satisfy any statute of frauds writing requirement in real estate transactions. <

NEW CALIFORNIA LIMITED LIABILITY COMPANY ACT, *CONTINUED FROM PAGE 3*

to the member for services provided to the LLC other than services in connection with winding up the limited liability company. The New Act allows a person to become a member without a capital contribution and without acquiring a transferable interest, presumably to facilitate compensation incentives.

B. CONSTRAINTS ON THE OPERATING AGREEMENT

Remember that the general rule is based upon freedom of contract and, except as discussed in this section, any of these foregoing default rules can be changed in the operating agreement.[2]

The operating agreement may not eliminate the power of a court to decree judicial dissolution on statutory grounds, which are generally: (i) that it is not reasonably practical to carry on the business in conformity with the operating agreement; (ii) that dissolution is reasonably necessary to protect the interest of the complaining member; (iii) that the business has been abandoned, deadlocked or subject to internal dissention; or (iv) that those in management are guilty of persistent fraud, mismanagement or abuse of authority. Likewise, the operating agreement cannot eliminate the ability to buy out the interest of the complaining member in the judicial dissolution action using the statutory procedure. This procedure is the safety valve from judicial dissolution. This buy out right did not exist in the Old Act.

Consistent with the Old Act, the operating agreement may not restrict the right of a member to approve a merger, conversion or other organic change which would give that member personal liability.

The operating agreement may not restrict a member's right to information and copies of certain records, again, consistent with the Old Act.

An operating agreement may not restrict a member's right to participate in a class action or bring a derivative claim.

Curiously, the New Act's dissenter's rights are not protected from modification by the operating agreement as they were under the Old Act. I understand that this protection will be picked up in technical corrections being proposed for the New Act.

The operating agreement may not eliminate damages for the receipt of a wrongful distribution, for the intentional infliction of emotional harm on the members, or for an intentional criminal act.

Again consistent with the Old Act, the operating agreement may not reduce the vote required to amend the operating agreement to less than a majority.

Before leaving operating agreements, the New Act specifically authorizes the operating agreement to contain a provision giving a third party non member a veto right over modifications of the agreement. I am sure that many lenders will find this to be beneficial.

C. FIDUCIARY DUTIES

Fiduciary duties are frequently a topic of discussion for commentators and a concern for managers. The Old Act had very little regarding fiduciary duties. The Old Act provided that managers had the same duties as partners to the partnership and the other partners and obliquely provided that members in a member-managed LLC had the same duties as managers. This resulted in the incorporation of the fiduciary duties set out in the Partnership Act. The New Act based on the Uniform Act attempts to flesh out those duties more fully but does borrow heavily from the Partnership Act. Similar to the Partnership and the Limited Partnership Acts, the New Act also contains a number of constraints on the modification of the fiduciary duties. The New Act is an improvement, yet as many commentators have noted, it fails to gain ground on Delaware in the "race to the bottom" in that Delaware allows a complete abrogation of duties by management, other than that of good faith and fair dealing.

Consistent with the approach of the California Partnership and Limited Partnership Acts, the New Act makes the statutory statement of fiduciary duties an exclusive statement of those duties. Here California, I think wisely, rejected the Uniform Act approach with its non-exclusive statement of fiduciary duties. It is Interesting that the Uniform Act itself varied from the Uniform Partnership and Limited Partnership acts, which like California, made the statutory statement of fiduciary duties the exclusive statement.

The New Act provides two essential fiduciary duties—the duty of loyalty and the duty of care with some elaboration of specific rules. The New Act also adds to these two essential duties the quasi contractual, quasi fiduciary duty of good

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2 The New Act allows oral operating agreements for informal groups and distinguishes between provisions which may be amended by any operating agreement and those which may be amended only by a written operating agreement. For simplicity, because of the assumed commercial context and the presumed existence of a written operating agreement, this discussion will state only the constraints on written operating agreements.

NEW CALIFORNIA LIMITED LIABILITY COMPANY ACT, *CONTINUED FROM PAGE 10*

faith and fair dealing. The New Act then goes on to specify the manner in which the operating agreement may modify the expression of these duties.

1. Duty Of Loyalty

In the New Act, similar to the Partnership Act and the Limited Partnership Act, the duty of loyalty is comprised of three components: first, a duty to account to the LLC for any property or profit, including a company opportunity, acquired during the conduct or winding up of the LLC's business; second, a duty to refrain from dealing with the LLC during the conduct of its business or wind up as, or on behalf of, a party having an interest adverse to the company; and third, the duty to refrain from competing with the company during the conduct or wind¬up of the company's business.

This duty of loyalty applies to the members in a member-managed LLC and to the managers in a manager-managed LLC but not to the members in a manager-managed LLC.

The New Act, consistent with the Partnership and Limited Partnership Acts, contains a useful statement that members or managers do not violate this duty merely because their conduct furthers their own interests. This statement does not appear in the Uniform Act.

A written operating agreement may vary but not eliminate this duty of loyalty. The operating agreement may identify specific types or categories of acts which do not violate the duty, if the enumeration is not manifestly unreasonable. "Manifestly unreasonable" comes originally from the Uniform Commercial Code (the "UCC") and appears in both the Uniform and California versions of the Partnership and Limited Partnership Acts. The attempts at controlling the definition of manifestly unreasonable contained the Uniform Act were not adopted in California. From the UCC history and limited case law, there are indications that manifest means obvious or egregious and that customary trade practice should be acceptable. From this, I think that common provisions allowing limited violations of the duty of loyalty, like provisions restricting competition within a specified geographic radius of the company business but allowing competition elsewhere or other restrictions on competition based upon categories of business, should be enforceable.

The operating agreement may also identify certain members, like a conflict committee, which, after full disclosure of all material facts, may approve a specific act or transaction which would otherwise violate the duty of loyalty. However, the operating agreement may not eliminate damages for breach of the duty of loyalty nor recoupment of any financial benefit received by the member or manager to which they were not entitled. Any modification of the duty of loyalty requires the informed consent of the members.[3]

Note that the disassociation of a member from the LLC ends that former member's fiduciary duties as to matters arising after the disassociation.

2. Duty Of Care

The duty of care is limited to grossly negligent or reckless conduct, intentional misconduct or knowing violations of law. As with the duty of loyalty the duty of care applies to members in a member-managed LLC and to managers in a manager-managed LLC, but not to members in a manager-managed LLC.

This statement of the duty of care is consistent with that in the Partnership and Limited Partnership Acts. This statement of the duty of care varies from the Uniform Act which adopts an ordinary care standard but subjects the ordinary care standard to the business judgment rule. The fact that the business judgment rule is not specifically mentioned does not mean this judicial rule is not applicable in California in the limited liability company context.

A written operating agreement may not eliminate or unreasonably reduce the duty of care and any modification of the duty requires the informed consent of the members.

3. Duty Of Good Faith And Fair Dealing

The New Act, like the Partnership and the Limited Partnership Acts (and Delaware), requires that a member or manager discharge their duties to the company and the other members, either under the statute or under the operating agreement, in a manner consistent with the obligation of good faith and fair dealing. This obligation is the same as the implied contractual duty of good faith and fair dealing. The case law in this well established area generally does not so much define "good faith" as identify cases of "bad faith."

Unlike the duties of loyalty and care, this good faith and fair dealing obligation applies to everyone: members in both member-managed and manager-managed LLCs and to managers in manager-managed LLCs. Again, the duty of good faith and fair dealing may not be eliminated, but a written

3 The informed consent requirement is a carry-over from the Old Act, which at the time was a compromise with the California plaintiff's bar. The phrase introduces a concept from the medical tort field which has not been well defined in business case law. Presumably it is satisfied if the members know what they are signing. The New Act specifically provides that the deemed assent to the operating agreement on becoming a member is not informed consent. A requirement for informed consent does not appear in either the Partnership Act or the Limited Partnership Act.

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NEW CALIFORNIA LIMITED LIABILITY COMPANY ACT, *CONTINUED FROM PAGE 11*

operating agreement may prescribe standards by which the performance of the obligation of good faith and fair dealing is to be measured, if the standards are not manifestly unreasonable. Any modification of the duty requires the informed consent of the members.

D. MISCELLANEOUS IMPROVEMENTS

The New Act makes a number of less significant modernizing improvements.

For example, operating agreements signed by only one member are specifically validated.

The dissociation concepts from the Partnership and Limited Partnership Acts have been introduced into the New Act to clarify the process of a member leaving a limited liability company and the rules governing that transition.

The New Act continues but refines a creditor's ability to obtain a lien on a member's distributions from a limited liability company (a "charging order"). The scope, applicability and enforcement of charging orders has been improved and clarified. The holder of a charging order may now seek a court foreclosure of the charging order with a showing that distributions will not satisfy the order within a reasonable time.

E. WHEN DOES THE NEW ACT APPLY?

In general, the New Act is applicable to all domestic LLCs and for foreign LLCs registered with the secretary of state after Jan. 1, 2014. The New Act goes on to clarify that the New Act applies only to the acts or transactions by a limited liability company or the managers occurring or contracts entered into after Jan. 1, 2014. It is intended that the limited liability company operating agreement is a contract for this purpose and I understand that a clarification of this issue will be proposed for technical corrections. Therefore existing operating agreements will remain effective as between the parties and continue to be governed by the Old Act.

A question has been raised about the effect of a post-Jan. 1, 2014, amendment to an existing LLC agreement and whether such an amendment automatically causes the LLC agreement to be governed by the New Act. The New Act is currently silent on this issue. I understand that the LLC Committee will propose a rule in technical corrections that amendments will not cause the application of the New Act unless the amendment itself specifically provides for the application of the New Act. In the meantime, if amendments to a pre-Jan. 1, 2014, operating agreement are contemplated, it would be wise to evaluate the amended operating agreement under the New Act.

Questions have also been raised about whether the reference to foreign limited liability companies in the general applicability rule is an effort by California to apply its law to foreign limited liability companies registering in California. This reference is to confirm the applicability of the provisions of New Act which specifically address foreign limited liability companies, not to convert all foreign limited liability companies to California law. The New Act makes it clear that the law of the state under which the foreign limited liability company is formed governs the organization of the limited liability company, its internal affairs and the authority of its members and managers, as well as the liability of a member as a member and a manager as a manager for the debts, obligations and other liabilities of the limited liability company. The internal affairs rule is virtually identical to the rule in the Old Act, the Limited Partnership Act and the provisions in the Partnership Act governing limited liability partnerships. While the scope of the internal affairs rule may be a little fuzzy at the edges, these rules have functioned well in the limited liability company, partnership and limited partnership contexts to date.

Note that one question under the internal affairs rule is the enforceability of series LLC asset divisions. The Uniform Act, in comment, indicates that the series rules are considered to govern the protection of one group of assets of the same limited liability company from the liability incurred with respect to another group of assets and are not therefore included within the phrase referencing the liability of members or managers for debts of the LLC. California has specifically declined to adopt series LLCs and one should not assume a series limitation from a foreign jurisdiction will hold up in California.

The New Act modernizes California LLC law and brings it into closer alignment with the Partnership and Limited Partnership Acts. It does not require any immediate rewrite of existing California LLC operating agreements. It is not perfect, but it was the subject of much thoughtful work and is expected to be the subject of some technical corrections before the end of the year. And, as many commentators have noted, unlike Delaware but like most other states, the New Act does not allow the complete abrogation of duties by management, something investors may actually prefer. The Old Act has been serviceable in California as over 75,000 LLCs were formed in California in 2012 alone. <

DEFAULTS AND REMEDIES, *CONTINUED FROM PAGE 4*

REMEDIES

As with the defaults, the remedies are typically more oriented against the Developer Member. The remedies available to Developer Member for an Equity Member default may be little more than having the right to make a member loan for capital obligations, and/or an offset right for distributions otherwise due and possibly the right initiate an exit (a buy-sell, forced sale or other buyout). On the other hand, Equity Member wants the ability to remove Developer Member from the driver's seat. It also wants to hold Developer Member's feet to the fire in the event Developer Member starts to see that the project is not going to be economically beneficial (and therefore, for example, decides not to fund required capital).

In the first instance, Equity Member will want the ability to remove Developer Member as the managing member of the LLC. It may also want to terminate Affiliate Contracts, terminate Developer Member's exit rights (such as buy-sell, forced sale or put/call) and voting rights, and even remove Developer Member from the venture altogether by purchasing Developer Member's interests (usually at some punitive price or at a price equal to Developer Member's capital contributions). The Equity Member will also want the ability to take away Developer Member's promote (and potentially give it to a replacement manager). Developer Member will try to negotiate several items into these remedies. It will want, for example, to retain certain basic voting rights. It will argue that if it is removed, it needs to be replaced under the loan guaranties. It may also be able to get a special exit arrangement at its election. With respect to the promote, it will argue that to the extent value has been created (i.e., Developer Member is 'in the promote' or perhaps the project has been completed), and especially in the instance where the default at issue was not a 'bad act', it should not lose the benefit of what it has created. Here Developer Member will want to have a process whereby the promote is valued at the time and any promote dollars that would have been paid on that value, accrue to Developer Member.

Both parties should keep in mind that the construction lender has a vested interest in matters such as the removal of the Developer Member and/or the buyout of Developer Member. Often, Developer Member is the sponsor that the lender originally underwrote and there will be loan document provisions that come into play. In addition, to the extent Developer Member is the guarantor on the loan, the construction lender is likely to play a critical role. This is particularly true if Developer Member has won the argument that if it is removed from its position in the venture it should also be replaced as loan guarantor. Here the construction lender will need to be in agreement on a new guarantor. Note also that in the event Developer Member is in default, it is quite likely something is amiss with the project, and equally likely there is a default under the loan, in which event all of the parties will be at the table trying to work things out.

Negotiation of these provisions can become protracted, with each side having vested rights it is motivated to protect. Often these sticking points come up at a time in the deal process where the parties have otherwise agreed on the economic and other material terms and may have overall timing issues in order to close on the deal. Identification of possible issues on these points as early in the process as possible will help alleviate end of the day deadlocks, financing issues, and potentially adverse deal impacts. <

IS CONSERVATION LAND TAX EXEMPT?, *CONTINUED FROM PAGE 5*

that which results from simple ownership and possession. It signifies an active appropriation to the immediate uses of the charitable cause for which the owner was organized." Unlike private ownership of land which typically burdens the government, a charity's ownership of land may benefit the public and lessen the burden of the government.

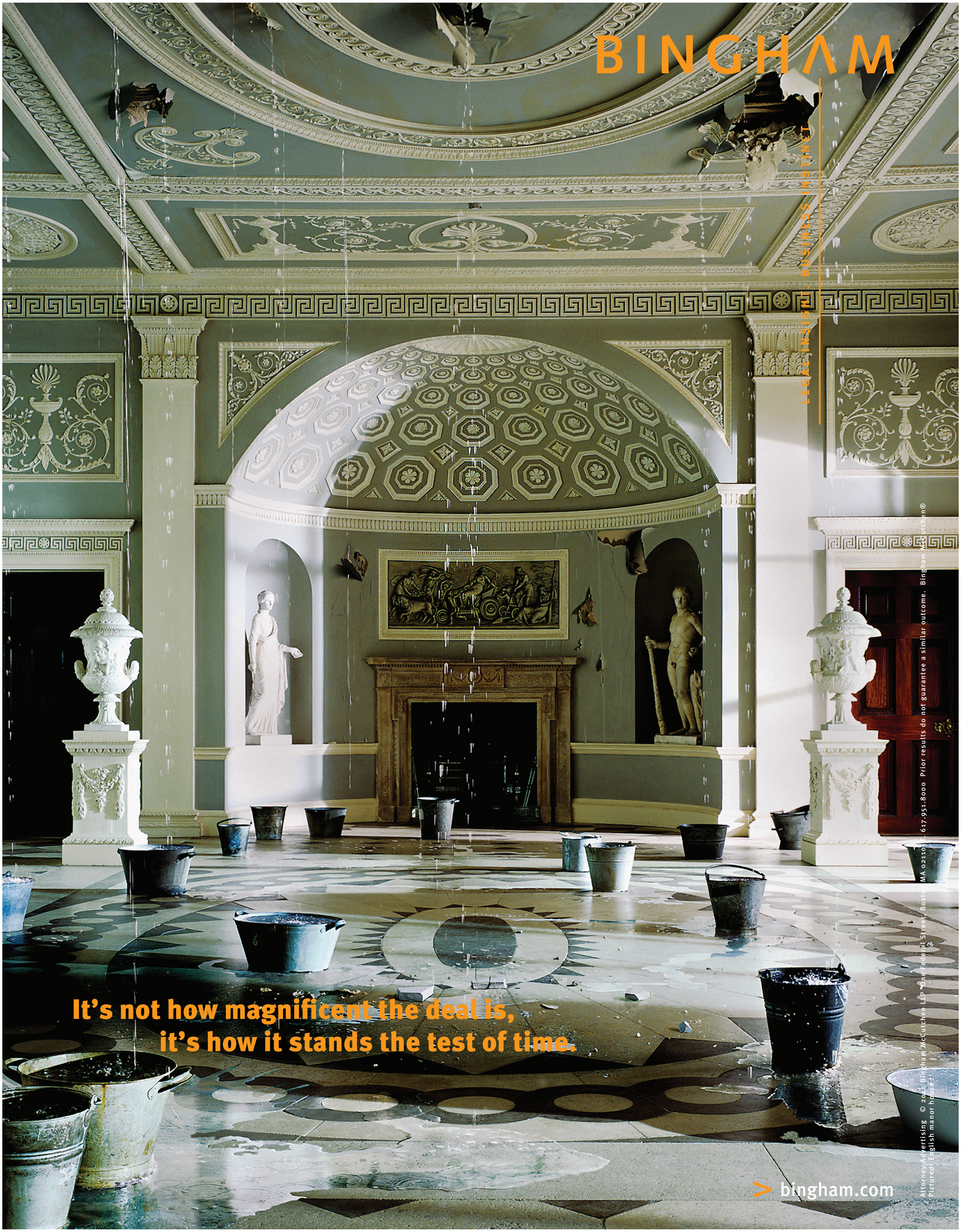
The Board focused its inquiry on the degree of public access the Foundation encouraged and achieved on its property in the Hawley Forest. The Board concluded that the Foundation's proportion of public access was insufficient to satisfy the occupancy component of the test. The court strongly disagreed, stating that the Clause Third does not require imposing an affirmative duty to promote and facilitate public access on conservation lands to satisfy the requirement. The court explained that the promotion of public access is not required to demonstrate occupancy in the Foundation's case as the Foundation was able to achieve its charitable purposes without such public access. The court also pointed out that in certain circumstances, such as in the case of a particularly fragile habitat or ecosystem, public access could even thwart an organization's conservation goals.

The court established certain parameters surrounding this prong of the test. In particular, if a charitable organization affirmatively excludes people from the property (e.g., "no trespassing" signs, physical barriers or actively patrolling the land), a heightened burden would apply. The organization would then need to demonstrate that such exclusion of the public is necessary to the achievement of its charitable purpose. However, the Foundation did not need to meet this heightened burden as it had not actively excluded the public from the Hawley Forest. Rather, it had actively taken steps to encourage public use of the lands.

CONCLUSION

This decision benefits conservation groups and provides charitable organizations with conservation missions a fair degree of deference in determining how to best utilize their conservation lands while maintaining tax exempt status. This is a "win" for conservationists as the court has acknowledged the benefit to the Commonwealth and the general public to having open lands to protect wildlife habitats, filter the air and water supply and absorb carbon emissions even if direct public use of the land in question is not actively promoted.

The decision protects organizations that do beneficial conservation work, but maintains barriers so as not to allow people who own large amounts of private land to abuse the exemption. The court reiterated that exemption statutes are strictly construed, a reminder to all those applying for exemption status that the burden lies with the party seeking an exemption to demonstrate that it qualifies according to the express terms or the necessary implication of a statute providing the exemption. <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