

## LGC Prevails On MSJ In Construction Defect Action

Partner Rich Reese recently prevailed on a Motion for Summary Judgment in a construction defect action on behalf of two clients who developed and constructed a medical office building.

The building consisted of commercial condominium units that were individually owned and common areas that were owned and operated by an owners association. The Notice of Completion for the project was executed in December of 2007. More than 10 years later, in February of 2018, the association filed a lawsuit alleging construction defects in the common areas.

California Code of Civil Procedure Section 337.15 generally bars construction defect actions that are initiated more than 10 years after “substantial completion” of a project. Certain events, such as the recording of a valid Notice of Completion, qualify as “substantial completion” for purposes of the statute, triggering the beginning of the 10-year period.

The 10-year rule is intended to give owners a generous amount of time to discover construction defects and initiate litigation, while also protecting developers and contractors from indefinite liability exposure.

Because the association filed its lawsuit more than 10 years after the Notice of Completion was filed, LGC filed a Motion for Summary Judgment, arguing that Section 337.15 completely barred the owners association’s lawsuit. LGC argued there were no triable issues of material fact related to the statute of limitations, and thus the clients were entitled to judgment as a matter of law.

In opposition to the motion, the owners association questioned the validity of the Notice of Completion and argued that various exceptions to the 10-year rule applied. Plaintiff also claimed that the statutory period was tolled while representatives of the developer sat on the

association’s board of directors after construction. Once the time period of tolling was factored in, Plaintiff argued the suit was timely.

In response, LGC demonstrated that the 10-year statute of limitations is firm and final and that none of the exceptions applied. In particular, LGC noted that while the 10-year statute of limitations could be tolled during the time when the developer controls a homeowner association board for a *residential* project, the rule was inapplicable to *commercial* projects.

Ultimately, the Court agreed with LGC and granted LGC’s Motion for Summary Judgment. Notably, the Court agreed that the statute was not tolled during periods of “developer control” because the project was a commercial project. Judgment will be entered in favor of LGC’s clients, who will be entitled to recover their costs.

Congratulations to Rich on this victory.

### INSIDE THIS ISSUE:

Creative Trusts: Exploring Irrevocable Life Insurance Trusts

LGC Sponsors Beers & Cheers For Autism

New Appellate Decision Affirms CC&R Approval Requirements

## LGC Obtains Dismissal In Development Dispute

Partner Katie Brach and Associate Patrick Klingborg successfully obtained a dismissal of a case against their client in the United States District Court for the District of Arizona after the Court found that Plaintiff repeatedly misrepresented facts to the Court. The Court also awarded LGC’s client nearly \$50,000.00 in attorneys’ fees and costs.

The case was one of two companion cases regarding the same dispute over money for cost overruns and profits allegedly due to Plaintiffs in connection with a real estate

development project in Santa Barbara, California. Plaintiffs filed their first action in Santa Barbara Superior Court, naming LGC’s client individually as a party. The client, however, filed a motion to quash service of the summons based on lack of personal jurisdiction in California. The Santa Barbara Court granted that motion and dismissed LGC’s client from the California action.

(Continued on Page 3)

## Creative Trusts: Exploring Irrevocable Life Insurance Trusts

One creative trust option that is often underutilized is the irrevocable life insurance trust (“ILIT”).

An ILIT is an irrevocable trust that is specifically set up to own a life insurance policy. A person can transfer ownership of an existing policy to the ILIT after it has been formed or the trust can purchase the policy directly. Once the life insurance policy is placed in the trust, the insured person no longer owns the policy, which will be managed by the trustee on behalf of the policy beneficiaries when the insured person dies.

When the insurance benefit is paid after the insured’s death, the trustee collects the funds, makes them available to pay estate taxes and/or other expenses (including debts, legal fees, probate costs, and income taxes that may be due on IRAs and other retirement benefits), and then distributes them to the trust beneficiaries as designated.

Setting up an ILIT gives people more control over their insurance policies and the money that is paid from them. An ILIT also lets people reduce or even eliminate estate taxes so more of their estates can go to their loved ones. And an ILIT provides immediate cash for payment of taxes and

costs and expenses of administration of the estate.

### Tax Benefits

If the proceeds are held in trust for the benefit of a spouse, he or she would receive regular incremental payments rather than the lump sum of proceeds. They would not be taxed as part of his or her eventual estate as they would with a lump sum. This gives control in how the money is applied and potentially saves it for multiple generations.

Even though the estate tax threshold is relatively high (\$11.18 million per estate as of 2018), insurance proceeds are considered in valuing an estate, which may cause people to unknowingly exceed the exemption amount. For example, if a person held a \$5 million life insurance policy along with other property worth more than \$6.18 million at the time of death, the estate would exceed this exemption. The estate—and by extension, the heirs—would owe the estate tax on any value over the \$11.18 million threshold.

On the other hand, if those same insurance proceeds were owned by the ILIT and paid out to the trustee of that ILIT upon

the person’s death, they would not be considered in valuing the estate for estate tax purposes.

### Asset Protection

An ILIT can also be a useful estate planning tool for providing heirs with immediate cash to help pay for any estate taxes or expenses of administration that arise immediately upon death. If the remainder of the assets are tied up, having an ILIT to collect insurance proceeds and direct them to be used to pay for administration of the estate can avoid the need to liquidate other assets.

### Timing Of Setting Up An ILIT

An ILIT can be set up at any time, but it is important to discuss policy options with an experienced broker to confirm insurability at the time the ILIT is set up. Also, there is a three-year waiting period for transfer of existing policies, so if a policyholder transfers an existing policy into an ILIT the policyholder must live for three years after the transfer for it to be valid.

(Continued on Page 3)

## LGC Sponsors Beers & Cheers For Autism



On November 1, LGC proudly sponsored the Autism Society of San Diego’s fifth annual Beers & Cheers for Autism event at Mike Hess Brewing Company.

The event, which raises money for summer recreation programs for adults, teens, and children

with autism, was the Autism Society’s most successful ever. In the end, the Autism Society raised over \$10,000, which is more than double the amount raised in prior years.

The focus of Autism Society of San Diego is to improve the lives of all San Diegans affected by autism by

promoting meaningful participation and self-determination for autistic individuals and their families.

LGC takes pride in its community involvement and looks forward to supporting the Autism Society in future events.

## LGC Obtains Dismissal In Development Dispute

(cont. from page 1)

In light of the dismissal, Plaintiffs then filed the second lawsuit in Arizona, where LGC's client resides.

In the California action, Plaintiffs inadvertently received documents from a bank while a motion to quash a subpoena was pending. The California Court ordered Plaintiffs to destroy the documents and to not use the materials they mistakenly received. Contrary to this order, Plaintiffs subpoenaed records in the Arizona action based on information Plaintiffs had acquired from the errant production of documents in California. LGC promptly brought this violation to the Court's attention.

Meanwhile, during the course of motions filed in Arizona, Plaintiffs' counsel lodged with the Court as evidence inauthentic Articles of Organization in an effort to show a purported ownership interest by one of the Plaintiffs. Ms. Brach noted

suspicious discrepancies in this document as well as a Business Account Application filed by the Plaintiff that (1) was not stamped or otherwise marked as received by the bank and (2) contained redacted signature lines.

In reviewing the issues raised by LGC, the Court noted that Plaintiffs redacted the signature lines but not the social security numbers for the parties on the application. In actuality, Plaintiffs "redacted" a blank space, as the documents Plaintiffs offered were in fact never signed. The Court found that the "redaction itself was a misrepresentation." In addition, the Court found it was clear that the Articles of Organization were fraudulent when compared to the actual Articles of Organization that were readily obtainable from the California Secretary of State.

Based on the misrepresentations

highlighted by LGC, the Court ordered Plaintiffs and their counsel to show cause as to why they should not be sanctioned for making material misrepresentations to the Court.

After considering responsive briefs, the Court found that Plaintiffs materially misrepresented facts with regard to access to the bank account in question. One Plaintiff represented he was still the co-owner and co-signer of the account, but the owner deleted his authorization to sign more than four years ago. While this Plaintiff claimed he had just learned he was unable to access the account, the Court found that this argument "strain[ed] credulity" because there had already been numerous discovery disputes regarding Plaintiffs trying to obtain those very banking documents he claimed he thought he had access to.

(Continued on Page 4)

## Creative Trusts: Exploring Irrevocable Life Insurance Trusts

(cont. from page 2)

### Potential Complications

As noted, if a policyholder dies within three years of transferring a life insurance policy into an ILIT, the IRS will still include the proceeds in the estate for estate tax purposes. A policyholder can avoid this by having the trust purchase the policy and then funding the trust with sufficient money over the years to pay the premiums.

Gift taxes can also be a potential complication because a policyholder is effectively giving the trust the money to pay for the policy (i.e. the premiums) each year, but this is avoidable too. The trustee can simply send the trust's beneficiaries a so-called "Crummey" letter each time money is transferred into the trust. This letter would advise them that they can ask for their share of that money within a

specific period of time. As long as they have an immediate right to the money, the gift tax does not apply.

Of course, the amount being transferred to the trust is negligible compared to the eventual proceeds of the policy, particularly if it is divided among several beneficiaries. If the beneficiaries take the money now, the premiums will go unpaid and the policy would lapse. This is usually sufficient encouragement for the beneficiaries to leave the money with the trust so it can pay for the policy.

For more information about ILITs and other estate planning tools, contact [Darcie Colihan](#) in LGC's San Diego office.

## LGC Obtains Dismissal In Development Dispute

(cont. from page 3)



Katie Brach

As for the errantly produced documents from the California action, the Court not only confirmed that Plaintiffs had in fact misused the documents but also that such use was in bad faith.

The Court went on to note other “shenanigans” that Plaintiffs and their counsel had engaged in over the course of the litigation. The Court found that no lesser sanction short of dismissing the case would suffice, holding that Plaintiffs and their counsel “deliberately and repeatedly tried to mislead the Court and deliberately misused errantly produced information from another case to their advantage in this case, and this is

nothing short of bad faith.”

As a result, the Court entered an order dismissing the Arizona action in its entirety. In addition, the Court awarded LGC’s client nearly \$50,000.00 in attorney’s fees and ordered the clerk to forward a copy of the order to the State Bar of California.

This case highlights the importance of carefully scrutinizing documents produced by other parties. Through careful attention to detail, LGC was able to identify these small inconsistencies that might otherwise have gone unchallenged. Congratulations to Katie and Patrick on their victory.

## New Appellate Decision Affirms CC&R Approval Requirements

In a new decision that may significantly impact construction defect litigation by homeowners associations, a California Court of Appeal ruled that a CC&R provision requiring approval by the majority of owners before initiating a construction defect lawsuit is enforceable and that the failure to comply is fatal to a subsequent lawsuit.

The case, [\*Branches Neighborhood Corporation v. CalAtlantic Group\*](#), involved a condominium development in a master-planned community in Orange County. The homeowners association filed a notice of claim with the developer under SB 800 and, after pre-litigation procedures failed to resolve the claim, the association filed a demand for arbitration with JAMS in January of 2016.

The CC&Rs for the subject development required the association to obtain the vote or written consent of at least 51% of the owners prior to initiating arbitration. The association failed to do so and admitted as much in discovery responses. Instead, months after commencing arbitration, the association held a meeting and purportedly obtained consent from a majority of the owners.

The developer raised the lack of majority approval as an affirmative defense and then moved for summary judgment based on the undisputed facts in the discovery responses. The arbitrator granted the motion and the petition to confirm the arbitrator’s decision was granted.

On appeal, the Court affirmed, finding that the requirement of the CC&Rs was clear and that the plain language controlled. The Court found that the CC&R provision did not run afoul of any other applicable statutes and that the association’s attempt to

obtain approval after the fact was insufficient. The Court also concluded that the provision did not violate public policy.

This decision could have widespread effects in construction defect actions. Many CC&Rs have similar provisions requiring majority consent prior to initiating litigation. However, associations frequently fail take such a step. It is critical for defendants in such actions to evaluate whether the CC&Rs contain such a requirement and, if so, propound necessary discovery to determine whether the association has complied.

For more information about the decision and its potential impact, contact [Chris Schmitthenner](#) in LGC’s San Diego office.

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