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BURKE, WILLIAMS & SORENSEN, LLP

Real Estate and Business Law Update

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ESCROW COMPANIES

Commercial Property Buyer Cannot Hold Escrow Company Fully Liable After Short Delay in Closing Was Stretched Out For Over Year by Bankruptcy, Preventing Buyer From Doing 1031 Exchange

In *Ash v. North American Title Company*, 2014 WL 612988 (Cal.App. 2 Dist., February 18, 2014), plaintiff Ash entered into an agreement to purchase a commercial property from defendant Lerner in order to defer the capital gains tax payable on the sale of another commercial property. Defendant North American was selected to be the escrow company, with escrow scheduled to close on November 21, 2008. Ash had the money from the sale of the other property deposited in a segregated account with LandAmerica, an Internal Revenue Code § 1031 qualified exchange intermediary. On November 21, 2008, Ash was informed that escrow would take a few more days to close. On November 24, 2008, LandAmerica froze its accounts and then filed for bankruptcy. Escrow closed in March 2010 after the bankruptcy court released Ash's funds. Ash was unable to obtain the § 1031 tax deferral. He sued, claiming over $1 million in damages. The jury found that Lerner and North American breached its contract by delaying the timely close of escrow, and that North American was negligent and breached its fiduciary duty.

The appellate court held that contract damages are generally limited to those within the contemplation of the parties when the contract was entered into or at least reasonably foreseeable by them at that time. Consequential damages beyond the expectations of the parties are not recoverable. Here, there was no evidence that the parties to the transaction were concerned that the economy or other institutional failures created a risk to the funds placed in a segregated account with LandAmerica. Also, there was no evidence that Lerner or North American had any knowledge at the time of contracting of the possibility that a bankruptcy judge would not release the money in a segregated account for such a lengthy period of time. The appellate court also held that the trial court failed to instruct the jury on the tort defense of intervening and superseding cause. The bankruptcy events were unusual and not reasonably foreseeable, and the trial court should have instructed the jury on that defense. The court affirmed the judgment as to the liability of Lerner and North American Title for breach of contact. It reversed and remanded the matter as to contract damages regarding Lerner and North American. The court also reversed and remanded as to the tort liability of North American.

EASEMENTS

Waste Disposal Service's Easement for Storage of Garbage Bins Limited to Its Historic Use

In *Rye v. Tahoe Truckee Sierra Disposal Company, Inc.*, 2014 WL 98652 (Cal.App. 3 Dist., Jan 10, 2014), plaintiffs Brian and Dawn Rye had been the owners of a property at Kings Beach, California since 2004. In 1995, Brian Rye's father had purchased the property from the previous owner for use as a tree maintenance and wood supply service known as Bushwhackers. Defendant Tahoe, a garbage disposal business, had been the owner of a recorded easement over a portion of the property since 1981. The servient portion of the property was used for Tahoe's garbage trucks and bins. Tahoe had also entered into a 99-year lease in 1982 with the property's previous owner. The terms of the lease paralleled the area and purpose of the easement. The easement area was paved by Tahoe so that front loader vehicles could turn. In 2000, large areas of Bushwhackers' wood rounds started appearing in the dirt portion of the easement area, which impeded Tahoe's trucks from using the non-paved areas to unload its dumpsters. The

Ryes filed a complaint seeking to bar Tahoe from the use of the area subject to the easement beyond its historic uses. Tahoe filed a cross-complaint claiming the right to use all of the subject property. The trial court ruled that Tahoe had abandoned the lease and that the terms of the written easement were not exclusive. The trial court issued an injunction barring Tahoe from expanding its use beyond the historic area.

The appellate court held that Tahoe's ability to use the easement area for parking and storage was limited to the paved area and a small portion of the unpaved area that was historically used for the parking of trucks and storage of garbage bins. The express easement, which was "for ingress, egress, parking, storage, utilities over a portion of [the Rye's property]," did not contain any clear indication of an intention to extend the parking and storage to all of the area subject to the easement. The expansion of parking and storage to the entire easement area would in effect create an exclusive easement, which would preclude the Ryes from any effective use of the servient part of their property. An exclusive easement could not be inferred from the general language of the easement. The appellate court also held the lease had been abandoned. The fact that a portion of the property was used under color of the easement was not evidence that the property was used under color of the lease. The lease was over 20 years old, Tahoe paid no taxes on the property (as required by the lease) and the company was entirely indifferent as to the lease terms. The appellate court affirmed the trial court's judgment limiting Tahoe to the historic uses of the easement.

SECURITIES

Director of Software Company May Sue Outside Directors of Public Company for Overstating Revenue and Inflating Stock Prices During Merger

In *Hildes v. Arthur Andersen LLP,* 734 F.3d 854 (9th Cir. 2013), plaintiff Hildes was a director of Harbinger Corporation, a provider of software products, and he beneficially owned Harbinger common stock. In early 2000, Peregrine Systems, a publicly traded software company, began merger discussions with Harbinger. On April 5, 2000, the two companies entered into a merger agreement, under which Harbinger would become a wholly-owned subsidiary of Peregrine, and each outstanding share of Harbinger common stock would be exchanged for 0.75 shares of Peregrine common stock. Harbinger's obligations to effect the merger were subject to certain conditions, including acceptance by the SEC of a registration statement. Hildes and certain other Harbinger shareholders executed voting agreements with Peregrine in which each granted Peregrine an irrevocable proxy to vote his or her Harbinger shares in favor of the merger. On May 22, 2000, Peregrine filed its registration statement, which was audited by defendant Arthur Andersen and signed by Peregrine's outside directors. The registration statement allegedly overstated Peregrine's revenue by $120 million and understated its net losses by $190 million. The merger was completed on June 16, 2000. As a result of the alleged fraud, Peregrine's stock price was artificially inflated.

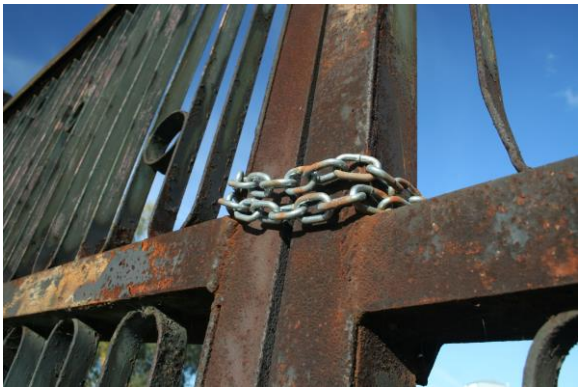
On June 30, 2003, the SEC filed a complaint for financial fraud against Peregrine. Peregrine's shareholders brought a class action for financial statement fraud. Hildes filed his own lawsuit under Section 11 of the Securities Act of 1933 against Arthur Andersen and other defendants regarding the false registration statement. Hildes later sought to add claims against Peregrine's former outside directors. On July 19, 2010, the district court denied Hildes' leave to add these claims on grounds of futility. The court determined that Hildes entered into a binding commitment to exchange his shares for Peregrine's shares as a matter of law when he signed his voting agreement and irrevocable proxy prior to the registration statement's effective date. Any alleged loss was thus not logically to be attributed to misrepresentations in the registration statement.

The appellate court held that Section 11 imposes broad liability without regard to reliance or fraudulent intent for any material misstatements or omissions contained in a registration statement for the first year that the registration statement is available. Although Hildes agreed to have his Harbinger shares voted in favor of the merger with Peregrine, he did not irrevocably commit to exchange those shares for Peregrine shares prior to

the filing of the registration statement. Moreover, Hildes alleged that if Peregrine's registration statement had contained accurate information, the merger would not have taken place, and Hildes' voting agreement and irrevocable proxy would have terminated. Accordingly, Hildes sufficiently alleged that the material misstatements caused his losses. The appellate court thus reversed and remanded the case.

CORPORATIONS

Personal Injury Plaintiff Cannot Rely on California's Survival Statute to Sue Dissolved Delaware Corporation That Had Conducted Business in California



In *Greb v. Diamond Intern. Corp.* (2013) 56 Cal.4th 243, plaintiff Greb filed a complaint in December 2008 for personal injuries against defendant Diamond and several other entities. Greb sought recovery under California Corporations Code § 2011(a)(1)(A) from Diamond's unexhausted liability insurance that covered it during the decades when it did business in California. Diamond demurred to the complaint, alleging that more than three years earlier, in July 2005, the corporation had obtained a corporate dissolution pursuant to the laws of Delaware, its state of incorporation. Diamond argued that it lacked the capacity to be sued under Delaware's three-year survival statute when Greb filed his complaint in December 2008. Greb opposed the motion, arguing his action was permitted under California's own survival statute, Corporations Code § 2010. The trial court ruled that California's survival statute did not apply to foreign corporations, and that Delaware's corresponding statute applied to Diamond. Accordingly, the trial court dismissed Greb's complaint with prejudice. The Court of Appeal affirmed and Greb appealed to the California Supreme Court.

The Supreme Court held that pursuant to California Corporations Code § 2010, a corporation which is dissolved continues to exist for the purpose of winding up its affairs, prosecuting and defending actions, disposing of and conveying its property, and collecting and dividing its assets. The dissolved corporation does not exist for the purpose of continuing business except so far as necessary for its winding up. Corporations Code § 2010 sets no time limitation for suing a dissolved corporation for injuries arising from its pre-dissolution conduct. In contrast, Delaware's three-year survival law precludes suit against a dissolved corporation even when the plaintiff did not know of the injury during that period. After analyzing the legislative background and various appellate court decisions, the Supreme Court concluded that Corporations Code § 2010 does not apply to a dissolved foreign corporation. Further, because of that conclusion, the Supreme Court was not required to perform a choice-of-law analysis in order to determine which state's law applied and governed Diamond's capacity to be sued. The judgment was affirmed.

ABOUT OUR FIRM

For more than eighty years, Burke, Williams & Sorensen, LLP has been providing legal services in the fields of real estate and business law. With nearly one hundred attorneys and eight offices throughout California, the firm can meet the legal needs of all emerging and established businesses. The firm's practice covers a wide range of businesses, including real estate, banking and financial services, and food and grocery services.

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