

Issues & Answers

REAL ESTATE LAW

INSIDE ISSUES

A Caution
for Limited
Partnerships 1

Landowners
Given Economic
Protection for
Undeveloped
Property 2

Three
Engineering
Societies
Join Efforts
to Revamp
Construction
Agreements 3

Arizona
Real Estate
Update 3

Real Estate
Group
Contacts 4

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A Caution for Limited Partnerships



By Ken Lee

Arizona statutes do not provide a mechanism for extinguishing claims of unknown creditors with respect to limited partnerships. Absent the running of the applicable statute of limitations, a partner who receives a distribution from an insolvent partnership faces an open-ended risk that an unknown creditor will assert a claim against the partnership and, if the creditor obtains a judgment, enforce the judgment against the partner's distributions.

The Arizona Court of Appeals ruled against the limited partners of a dissolved limited partnership in a suit that was not initiated until nearly four years after the dissolution of the limited partnership. The court found that the limited partnership was insolvent at the time it made the final distribution of its assets, despite the fact that the creditor's claim was unknown at the time of the limited partnership's dissolution, and required the limited partners to return their final distributions.

The underlying claim against the limited partnership arose out of the sale of the partnership's sole asset – an apartment complex. The partnership sold the apartment complex to an investor in return for cash and a promissory note. Five years after the sale, the investor, having failed to make the required payments to the partnership, sold the apartment complex to an unrelated third party and the partnership accepted a reduced payment on the promissory note. After it received payment from the investor, the partnership distributed all of its assets to its partners and was dissolved.

Just over a year after the partnership dissolved, the investor sued the partnership and its general partner. The partnership and the general partner failed to file an answer and the investor obtained a \$500,000 default judgment. Another two years passed before the investor sued the limited partners seeking to recover against the amount they received as a result of the dissolution of the limited partnership. The investor alleged that the final distribution to the limited partners was a fraudulent transfer because the partnership was insolvent at the time it made its final distribution and the partnership did not receive value for the assets it distributed to the partners. Applying definitions found in the Arizona's Uniform Fraudulent Transfer

Continued on page 2.

Act, the court found that the limited partnership was insolvent at the time of the distribution because a creditor (the investor) had a claim against the partnership at the time of dissolution. The fact that the claim was not raised until over a year after the limited partnership dissolved or that the limited partners had no knowledge of the claim at the time of the dissolution did not make a difference with respect to determining whether the limited partnership was insolvent when it dissolved.

A dissolved partnership is not likely to have the resources to defend against a

claim that may be brought against it years after it has dissolved. One way to help ensure that the dissolved partnership has the resources to defend itself is to have a requirement in the partnership agreement that the partners will recontribute assets to the partnership, to the extent they have received a distribution, to defend claims. In addition, since a judgment creditor can enforce the judgment against a partner to the extent of the distribution wrongfully received by the partner, the partnership agreement should have a contribution agreement among the partners so that if a partner is required to return more than its

pro rata share of the judgment, based on the amount of the partner's interest in the partnership, the partner can look to its fellow partners for reimbursement.

The final word on this matter has not yet been heard. The Arizona Supreme Court accepted for review the Court of Appeals decision in this case. To the extent necessary, Fennemore Craig will update this article after the Supreme Court rules on these issues. For more information, please contact Ken Lee at 602-916-5347. ■

Landowners Given Economic Protection for Undeveloped Property



By Joshua R. Forest

In the recent legislative session, the legislature attempts to provide economic protection to landowners of undeveloped property.

HB 2032 provides protection to these landowners in two separate but related ways: (1) It limits the authority of municipalities and counties to designate private (or state trust) lands in a manner that deprives the land of economic use; and (2) It potentially provides an economically feasible alternative to development.

This bill prohibits municipalities and counties from designating private or state trust lands as open space, recreation, conservation or agriculture unless the landowner consents to the designation or there are provisions in place that allow for one residential dwelling per acre to be placed on the land despite the designation. While this does not provide absolute economic protection to landowners, it at least places some limits on the county or city government's police power, without landowners having to prove that the designation limited the use of their property

as to make the designation a constitutional taking. This legislation establishes a dispute resolution mechanism for landowners wishing to challenge property designations. Additionally, HB 2032 specifies that county plans may not regulate certain activities conducted on five or more contiguous acres.

In addition, HB 2032 provides protection to landowners of undeveloped ranch, agricultural or other historically archeologically significant property by establishing a mechanism for the state to purchase "agricultural easements." The main objective of the agricultural easements is to protect and conserve agricultural land, the local production of food and fiber, open space, native species and their habitat, and large tracts of undeveloped land. This bill also repeals the development rights retirement fund and establishes a sixteen-member "Arizona Agricultural Heritage Commission" charged with awarding grants for the purchase of agricultural easements. The easements must be granted in perpetuity or for a renewable term of at least 25 years. Agricultural easements are to be funded by legislative appropriations, gifts, grants and other monies and may be granted to State agencies, political subdivisions, and qualified non-profit organizations for the following purposes: buffer zones, preserve habitat, sustain the heritage of agricultural and ranching activities, preserve archaeological resources and historic properties, and comply with the requirements of the Endangered Species Act.

In considering which projects should receive funding, various factors must be considered. The most important of which is whether the project will be partially funded by outside sources. These projects will be given priority funding. Additionally, the other factors to be considered in purchasing agricultural easements include: the importance of natural, cultural or public values found on the farm or ranch lands; the possibility of converting the property from traditional use; positive impacts on long term agricultural productivity; landscape and watershed integrity; habitats for native, rare, important and sensitive species; and allowance by the landowner for public access as a part of the easement. While none of these factors is necessary or sufficient, they are important and must be taken into account.

Two other provisions protect the subject landowners: First, even if a landowner grants an agricultural easement, he/she may reserve limited residential developments rights for up to ten percent of the property. Second, the government cannot use the power of eminent domain to acquire agricultural easements.

Overall, HB 2032 appears to establish an economically viable alternative to development for those landowners wishing to maintain their agricultural, ranch or historically significant lands in its present state. ■

Three Engineering Societies Join Efforts to Revamp Construction Agreements



By Scott Hyder

The American Consulting Engineers Council, American Society of Civil Engineers and the National Society of

Professional Engineers have formed a joint committee, Engineering Joint Contract Document Committee (“EJCDC”), to develop and revise form construction and engineering agreements, which are used mainly for horizontal construction projects. The EJCDC documents are very similar to some of the American Institute of Architect (“AIA”) forms, but are not as well-known or widespread as the AIA documents. By standardizing forms, the EJCDC hopes to enhance relationships between builders and subcontractors, improve efficiencies and minimize liability.

EJCDC plans to develop and/or revise numerous forms and agreements, resolving the disputes about some of the substantive provisions of the documents. In addition, the Committee will develop a plan to market the documents, such as providing them in electronic format, similar to the AIA software.

If you have questions about the EJCDC’s activities, please contact Fennemore Craig’s Scott Hyder, an EJCDC member, at 602-916-5388 or shyder@fclaw.com. ■

Arizona Real Estate Update



By Don J. Miner (pictured) & Joshua R. Forest

A Ninth Circuit Court of Appeals Case ruled that officers, designated brokers, and sole

shareholders/owners of a real estate business may be held **individually liable** for compensatory damages for acts of their employees that violate the Fair Housing Act. Holley v. Crank, 258 F.3d 1127 (9th Cir. 2001).

In the Holley case, the plaintiffs sued a real estate agent, the agent’s employer, and the company’s sole owner (in his individual capacity as owner, officer, and designated broker) for racial discrimination in violation of the Fair Housing Act. The trial court dismissed the case against the owner for individual liability stating that any liability could only attach to the company or the person who actually committed the violation of the act. The Ninth Circuit Court of Appeals (which has jurisdiction over Arizona) reversed this holding on appeal.

The Court of Appeals stated that the Fair Housing Act’s purpose is to “eliminate all

traces of discrimination within the housing field,” and the act allows suit against “any person who directs or controls **or has the right to direct or control, the conduct of any person**, with respect to any aspect of the sale” who engages in discriminatory housing practices. The Court held that sole shareholders, sole owners, officers, and designated agents (from a California statute, similar to Arizona Revised Statute § 32-2153, mandating supervision of employees) of a real estate company fit this description and may be held personally liable for damages caused by the acts of their employees even if they had no knowledge of the acts.

The Court emphasized that the duty to obey laws relating to racial discrimination under the Fair Housing Act is non-delegable. The Court also adopted the reasoning of a case in another jurisdiction that held that a sole shareholder could be held personally liable for compensatory damages due to an employee’s violation of the Fair Housing Act even though the “sole shareholder had **specifically instructed the agents not to discriminate**, and had not personally joined in any discriminatory acts.” (see City of Chicago v. Matchmaker Real Estate Sales Center, Inc., 982 F.2d 1086, 1096-1098 (7th Cir. 1992)). The Court concluded that even though its decision varied from general

corporate law shielding officers and shareholders from personal liability, these persons cannot delegate their duty to comply with the Fair Housing Act and they have an affirmative duty to **ensure that their employees follow federal and state anti-discrimination laws**. This holding greatly expands the potential for vicarious liability for violations of the Fair Housing Act in the Ninth Circuit.

Due to the potential liability to owners, sole shareholders, designated brokers, and officers for acts committed by employees, we recommend appropriate precautions be taken regarding the adoption of proper policies and the training, evaluation and supervision of employees working with the general public. The Ninth Circuit Court of Appeals has indicated that taking these steps may not completely shield owners, designated brokers or officers from liability. However, these precautions should be an effective preventative measure and may limit the type and severity of damages a court would be willing to impose. Please contact Don Miner at 602-916-5000 or any other member of Fennemore Craig’s Real Estate Practice Group if you have any further questions regarding this case or any legal matter. ■

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