Los Angeles Lawyers Kenneth C. Gibbs and Barbara Reeves Neal discuss recent restrictions on California’s prompt payment statutes.

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Consider the fundamental conceit of the show. A nebbish accountant, Leo Bloom, convinces erstwhile producer Max Bialystock that he can make more money from a flop than a hit. Bialystock proceeds to con and seduce little old ladies into investing in a show that is eventually oversubscribed countless times over. After reviewing many scripts, Bialystock and Bloom seize on one, Springtime for Hitler, that they are absolutely certain will be a total flop. On opening night, the critics and the audience are repulsed by the awfulness of the show but they cannot stop talking about it, and the buzz they create actually transforms the show into a must-see phenomenon that will run for years. Bialystock, of course, is unable to repay the little old ladies, and he is convicted of fraud and sentenced to Sing Sing.

The scam perpetrated by Bialystock and Bloom is hardly novel. Still, it is tempting to consider if the plot of The Producers in some way foreshadowed the events that would befall the financial and housing markets around the time the musical closed in 2007. Substitute the housing market, for example, for a Broadway show. Apply the Bloom accounting principle by first identifying locations in Southern California and other areas where rising home values would invariably collapse. Then take the Bialystock marketing approach by preaching the relatively recent but now sacrosanct gospel that every American deserves to own a home. Entice people into homeownership by offering loans requiring little or no down payment or even ones in which the principal balance exceeded the home’s appraised value. And for good measure take a liberal attitude toward credit underwriting. Finally, finance these loans by issuing securities backed by these mortgages.

Just like the cash that Bialystock hoarded before Springtime for Hitler opened and that Bloom used to jet to Rio, everyone from loan originators to lenders to investors earned substantial sums based on the simple yet deceptively sophisticated premise that there is a greater and more immediate return to be earned from a flop than a hit. Replace little old ladies with people eager to not only buy their own homes but get their share of equity from rising home values, and it is not that hard to put the Bloom accounting principle into effect in the housing market.

An immutable theory in nature and law holds that for every action there is an equal and opposite reaction. Last year, Congress enacted the Dodd-Frank Act to address certain practices of the mortgage industry. In California, the Department of Real Estate is challenged to use not only its licensing authority but also its broad disciplinary powers over real estate brokers to protect consumers from deceptive practices involving loan modifications, foreclosure rescue, and short sale fraud.

For real estate attorneys, the question is how their practices will be affected in 2011 and the years ahead as the law and the economy strive for an equilibrium between the heated real estate market of the early 2000s and the depressed one of the past several years.

Ten years ago this spring, The Producers opened on Broadway. More than 2,500 performances later, and after winning 12 Tony awards, Mel Brooks’s creation is hailed as one of the biggest hits ever on the Great White Way. Why, however, mark this musical’s anniversary in
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How the LACBF Helps the Immigration Legal Assistance Project

As 2011 begins, the Los Angeles County Bar Foundation enters its 44th year as a nonprofit, charitable organization in Los Angeles. The Foundation, through the work of 44 volunteer board members, distributed over $172,000 in grants in its 2010 fiscal year to projects in Los Angeles that offer low-cost or pro bono legal services. Annually, approximately 75 percent of the Foundation’s grant money goes to four projects that LACBA sponsors: the Domestic Violence Project, the Center for Civic Mediation (formerly DRS), the AIDS Legal Services Project, and the Immigration Legal Assistance Project. The remaining 25 percent of the Foundation’s grants are awarded to approximately 20 other legal service nonprofit organizations throughout Los Angeles.

Ivan Price, the executive director of the Foundation, describes the money allocated by the organization as being primarily raised through “donations, special events including a charity golf tournament and theater night, endowment income, and directed sponsorships.” To make sure that the grants are used effectively, a Foundation committee of 25 volunteers visits the grant applicants. Price says, “Each committee member gets an assignment of a nonprofit that has applied for funding consideration. They review the application, and then conduct a site visit where they talk to that organization’s leadership, be it staff or board members, and also possibly clients, and report back to the committee with a recommendation of the level of giving.” This diligence ensures that the Foundation allocates grants to organizations that can provide as many discounted or pro bono legal services as possible to the clients they serve.

From its office on the third floor of the federal building in downtown Los Angeles, the Immigration Legal Assistance Project offers low-cost consultations, counseling, and advice for issues relating to immigration law. The project offers help with family petitions, conditional residency, naturalizations, lost green cards, travel permits, translations of Spanish language documents, VISA packets, and affidavits of support. While the project lacks the means to take complicated cases, it can guide the parties involved in these cases in the right direction. The project’s primary goal is to keep families together.

Currently, the need for the project is high because legal advice is expensive, complicated, and often confusing for many of the people who need assistance. Furthermore, there has been a surge in “immigration consultants” who operate without a license to practice law—often at a lower cost than lawyers—and who frequently provide incorrect advice. Too many people find out the hard way that poor legal advice can result in a waiver of rights and a forfeiture of access to relief that may have otherwise been available.

Many of the project’s clients come from the U.S. Citizenship and Immigration Services office, which is housed in the same building. Lawyers and law students provide more than 3,000 volunteer hours annually to the project. The regular staff consists of two attorneys, a paralegal, a receptionist, and four or five volunteer attorneys. Los Angeles and its immigrant community benefit enormously, and without the Foundation’s assistance, the Immigration and Legal Assistance Project would be unable to continue supplying the community with a service that is desperately needed.

Marie Williams

Marie Williams is an example of the many who have received help from the project. Born in Liberia, Marie came to the United States from her home country under Temporary Protected Status due to armed conflict in Liberia that began in 1991. Marie came to the Immigration Legal Assistance Project in order to receive help in extending her status after the Department of Homeland Security announced it was terminating the temporary status for all Liberians on October 1, 2007. Two weeks after the DHS’s announcement, President George W. Bush declared that Liberians would be allowed to remain in the United States under a new designation; however, those applying for the new designation only had two weeks to submit their paperwork. Having missed the deadline, and unsure what to do, Marie turned to the Immigration Legal Assistance Project, which in turn helped her file a late application for the new designation, now called Deferred Enforced Departure. With this application, Marie was able to legally remain in the United States for two additional years. Without the existence of inexpensive and pro bono counseling provided by the project, people like Marie would not have the opportunity to navigate the complex laws of our U.S. immigration system.

All those who need affordable or pro bono legal services depend on volunteers and donations. The Foundation is committed to ensuring the availability of these services by supporting exemplary programs. By channeling grant money to other organizations that offer pro bono and discount legal services in Los Angeles, the Foundation offers its donors a unique opportunity to positively affect numerous legal aid programs with a single donation. Donors can be confident that their contribution provides funds for deserving programs that are reviewed annually by leaders in the local legal community. Its efforts improve the lives of many who without the Foundation’s help would be lost in a complex and otherwise prohibitively expensive legal system.

Geoffrey Bowen is an English and philosophy double major at UCLA, and Mary L. Mucha is the directing attorney of the Immigration Legal Assistance Project.
OUTDOOR ADVERTISING is capable of capturing immediate, widespread public attention. As a result, it receives enthusiastic support from advertisers while, at the same time, many people consider it a visual blight. Balancing these disparate interests has long been a difficult task for governments, including the Los Angeles City Council. This task has become more complicated as outdoor advertising has expanded from billboards and bus benches to digital billboards, supergraphics, and mobile message boards. However, a government strikes a balance, interested parties turn to the courts to challenge the law or seek its enforcement. Since 2002, the city of Los Angeles has been involved in a series of legal conflicts over outdoor advertising.

In 2002, the Los Angeles City Council adopted two citywide ordinances regulating billboards. The ordinances ban all billboards and supergraphics except in Hollywood and the area surrounding Staples Center. The city council also allowed sign districts to be created and specific plans to be adopted regulating signs within those areas.

Billboard companies—including Clear Channel, Vista, Regency Outdoor, and CBS Outdoor—immediately challenged the city ordinances on First Amendment grounds and on issues related to imposition of a billboard inspection fee. The city settled with these larger companies over concerns related to the legality of its inspection fees; however, many smaller billboard owners did not do so and proceeded with their lawsuits. In 2007, federal district courts ruled in two decisions—Metro Lights, L.L.C. v. City of Los Angeles and World Wide Rush, LLC v. City of Los Angeles—that the city ordinances were unconstitutional. The district courts concluded in their respective decisions that the ordinances were invalid because advertising was allowed solely on city-owned transit stops, and Hollywood and the Staples Center area were exempted from their proscriptions.

The city appealed these rulings to the Ninth Circuit, which in 2009 overturned the lower court ruling in Metro Lights concerning transit stop signage. A year later, the Ninth Circuit acted similarly in World Wide Rush and reinstated the 2002 ordinance. While appeals were pending, the city council responded in December 2008 to a proliferation of billboards by enacting an interim control ordinance banning all new billboards citywide, including those allowed under the settlement agreements, until a new ordinance could be implemented that complied with the lower court ruling in World Wide Rush. Later, when the interim control ordinance was about to expire, the city council passed an emergency measure banning digital billboards and supergraphics from being erected. In response, the billboard companies initiated additional, unsuccessful litigation.

Between the Ninth Circuit decisions, the city’s temporary control measures, and a vigorous enforcement campaign by the Los Angeles city attorney, developers and billboard companies are left in a quandary as to where, when, and how billboards can be placed, if at all. The answer lies in understanding 1) the types of outdoor advertising subject to the city regulations, 2) the constitutional issues presented by those regulations and why the federal appellate court ultimately upheld them, and 3) the city attorney’s efforts to crack down on billboard companies since the Ninth Circuit rulings. Armed with this knowledge, developers and billboard companies can navigate through the city’s regulations and develop a strategy for gaining city approval of their advertising vehicles.

The 2002 City Ordinance

With the creation of billboards came government efforts to regulate them. The earliest form of billboards, posted bills, appeared 3,000 years ago in Thebes and Egypt. Billboards as a form of advertising appeared in the late 1800s. In 1911 the Missouri Supreme Court decided that St. Louis could use its police power to regulate billboards, as the Ninth Circuit noted in its World Wide Rush opinion. And in 1958, Congress initiated the first comprehensive billboard regulations by enacting the Bonus Act, followed by the Highway Beautification Act in 1965, which limited and controlled billboards along interstate highways. The two acts, however, took divergent approaches toward

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accomplishing the common policy goal. The Bonus Act provided incentives, in the form of bonus transportation funds, to states that regulated outdoor advertising along interstate highways. The Highway Beautification Act took the opposite approach and penalized states (with a 10 percent reduction in federal highway funds) that did not control outdoor advertising along interstate highways. This “stick” resulted in states passing laws regulating billboards.

The city council did very little to regulate billboards before 2002.9 Until then, the city only required a review of the appropriateness of the location for a sign and prohibitions on size, orientation, and other physical characteristics of the signs. Before 2002, outdoor advertising was politically difficult to get approved because of neighborhood opposition, but the code did not contain any blanket prohibitions. With the 2002 ordinances, however, the city council adopted a blanket prohibition on off-site signs and supergraphics except for Hollywood and the Staples Center areas and restricted the creation of new sign districts, to the dismay of developers and billboard companies.

The city regulates every type of sign. For example, the Los Angeles Municipal Code prohibits a nameplate containing the name of a home business on the front of a residence,10 regulates the size of murals on buildings,11 and prohibits mobile billboards.12 More common forms of outdoor advertising—such as traditional billboards, supergraphics, and digital displays—are also regulated.

The Billboard Suits

Billboard companies responded to the city council’s enactment of the 2002 ordinance by filing three lawsuits. Clear Channel and CBS Outdoor filed the first immediately after the ordinance passed.13 The city initially prevailed on the First Amendment issues in that case but settled in January 2007 to avoid losing a dispute over the ordinance’s mandatory inspection fees. The settlement agreement obliged Clear Channel and CBS Outdoor to remove 49 signs, in exchange for which they were permitted to modernize 420 signs, including converting them to digital displays. The settlement also allowed the two billboard companies to select which signs would be removed and which would be modernized.

The second challenge, Metro Lights, raised an “underinclusivity” argument under the First Amendment. The argument was based on the city’s prohibiting most outdoor off-site advertising while allowing a private company to place outdoor off-site advertising on street furniture (i.e., transit shelters and bus benches) at city-owned transit stops. Metro Lights prevailed on this argument at the district court level. However, the Ninth Circuit reversed this decision and upheld the city’s ordinance, applying the U.S. Supreme Court’s holding in Central Hudson Electric & Gas v. Public Service Commission of New York.14 Under Central Hudson, the constitutionality of a restriction on commercial speech rests on a four-prong analysis. The first prong addresses the First Amendment. If the communication is neither misleading nor related to an unlawful activity, then the restriction merits scrutiny under the First Amendment. Second, the governmental entity must assert a substantial interest to be achieved by its restriction. Third, the restriction must directly advance that substantial interest. Fourth, the restriction cannot be more extensive than necessary to achieve the interest that the government is advancing.

In analyzing the 2002 ordinance, the Ninth Circuit panel found that the first two prongs of Central Hudson were essentially nonissues. The parties conceded that the off-site advertising at issue merited First Amendment protection. In addition, the Ninth Circuit found that the city’s stated objective of promoting traffic safety and aesthetics was a valid substantial governmental interest. With little in dispute regarding the first two issues, the decision focused on the latter two prongs. The third prong—advancement of the governmental interest—presented two contentions. One was that the ban had to advance the city’s interest generally and not be directed solely towards Metro Lights. The other was Metro Lights’ underinclusivity argument: A regulation can be found unconstitutional if its exemptions “undermine and counteract” its objectives. Metro Lights argued that the city contradicted its stated goals for enacting the 2002 billboard ordinance by exempting transit stops ads from its off-site advertising ban.

The Ninth Circuit rejected Metro Lights’ contention primarily because it agreed with the city that the ordinance helped remove visual clutter on public streets. In addition, while the exemption for street furniture seemingly was at cross-purposes with the city’s objectives, the court found the city council had a legitimate interest in promoting the city’s receipt of compensation for transit stop advertising and it also retained the right to supervise that advertising.

The Ninth Circuit then disposed of Metro Lights’ argument that the city failed to tailor the billboard ordinance appropriately. The court held that the city’s plan allowed it to focus on a more concentrated supply of off-site signage that promoted its aesthetic interests. In addition, the court also did not accept Metro Lights’ argument that the ordinance was content-based. In the court’s opinion, neither the city nor the vendor that it had selected to install the street furniture and place ads on it had discriminated against advertisers.

In the third case, World Wide Rush, the Ninth Circuit upheld the 2002 ordinances. Multiple billboard companies and building owners challenged the city’s ban on 1) billboards located within 2,000 feet of a freeway, on-ramp, or off-ramp, and 2) supergraphics and off-site advertising. The district court found that the freeway facing sign ban was unconstitutional because it was underinclusive, and that it was underinclusive because it exempted Staples Center area and a sign district along a portion of Santa Monica Boulevard. The district court reasoned that if aesthetics and traffic safety were the city’s stated goals, no reason existed for exempting the Staples Center area and Santa Monica Boulevard sign district, which both face a freeway. The district court also struck down the supergraphics and off-site advertising bans by finding that the exceptions for sign districts gave the city too much discretion in selecting how and what speech could be conducted at a given site.

In May 2010, the Ninth Circuit reversed the district court and upheld the city ordinance. Applying again the Central Hudson test, the Ninth Circuit found in World Wide Rush that the city had a substantial interest in traffic safety and aesthetics that was not undermined by exempting Staples Center and the Santa Monica Boulevard sign district. The Ninth Circuit also found the supergraphics and off-site ban to be a legitimate exercise of the city’s land use authority.

Following the Ninth Circuit decisions, the 2002 ordinances are legally enforceable and, as a result, Los Angeles City Attorney Carmen Trutanich has increased enforcement on outdoor advertising. Metro Lights alone has removed over 200 billboards. The city attorney has also had arrest warrants issued for at least five people accused of violating the supergraphics ban and filed a civil complaint against 27 defendants, including the Howard Hughes Center in Westchester, for violating the off-site sign and supergraphics bans.

Developers and property owners must understand the full import of the city’s billboard regulations. The first step is to know what is actually regulated and restricted. A threshold distinction is whether a sign is an off-site or an on-site sign. Off-site signs include traditional billboards and any type of sign that “displays any message directing attention to a business, product, service, profession, commodity, activity, event, person, institution or any other commercial message, which is generally conducted, sold, manufactured, produced, offered or occurs elsewhere than on the premises where the sign
is located." In contrast, an on-site sign is simply defined as “[a] sign that is other than an off-site sign.” For example, a sign placed on a building advertising a law office is an on-site sign if the firm is located within the building.

On-site signs are not prohibited anywhere in the city. However, the signs are subject to size, orientation, and other restrictions found in the Zoning Code. An on-site sign may not contain strobe lights or emit odors, and if it is a wall sign, it must comply with additional limits.

**Supergraphics and Digital Signs**

Supergraphic signs have become the latest trend in outdoor advertising. Technology has evolved to allow printing onto vinyl and other materials with little regard to size, and signs have grown accordingly. The Los Angeles Code defines supergraphics as:

A sign, consisting of an image projected onto a wall or printed on vinyl, mesh or other material with or without written text, supported and attached to a wall by an adhesive and/or by using stranded cable and eye-bolts and/or other materials or methods, and which does not comply with the following provisions of this Code: Sections 14.4.10; 14.4.16, 14.4.17; 14.4.18; and/or 14.4.20.

A supergraphic sign is any sign—whether on-site or off-site—that exceeds the size, location, and other restrictions for wall signs, temporary signs, off-site signs, and murals. One example of these signs is the three-panel Apple Computer ads that appeared on the wall of the Hotel Figueroa across from Staples Center. Developers should be cautious. A sign may avoid being banned as a supergraphic because it complies with size restrictions for a wall sign, but it may still be prohibited as an off-site sign. These overlapping categories of prohibition can ensnare the uninitiated.

The city council recently added digital displays as a separate sign category by defining them as:

A sign face, building face, and/or any building or structural component that displays still images, scrolling images, moving images, or flashing images, including video and animation, through the use of grid lights, cathode ray projections, light emitting diode displays, plasma screens, liquid crystal displays, fiber optics, or other electronic media or technology that is either independent of or attached to, integrated into, or projected onto a building or structural component, and that may be changed remotely through electronic means.

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Despite this definition, the city has not adopted specific regulations for these signs, and they remain regulated under the applicable sign category. A digital display placed on the side of a building is regulated as a wall sign, and, depending on the advertising content, may also qualify as an off-site sign.

Based on an analysis of these seemingly obtuse definitions and regulations, the following rules can be discerned regarding outdoor advertising: First, on-site signs, including on-site digital displays, are not automatically prohibited if they comply with the general provisions applied to all signs and any specific limitations based on their type of sign. Second, an off-site sign is automatically prohibited unless one of the following exceptions applies: It is permitted by a relocation agreement, part of a legally adopted specific plan, in a supplemental use district, or part of an approved development agreement. Third, supergraphics are automatically prohibited unless they are permitted by a legally adopted specific plan, a supplemental use district, or an approved development agreement.

Given the seeming zeal of the city attorney to pursue alleged violations of the city’s sign ordinance, developers, billboard companies, and building owners are well advised to be careful in approaching new opportunities for outdoor advertising facilities. The clearest and simplest approach is to comply with the law by obtaining a special use district. While applying for a sign district may seem like a daunting task, it is actually relatively straightforward. The only requirements for applying for a sign district are that the property where the sign will be placed must be zoned commercial, industrial, or, in certain cases, R-5 (high-density residential), and the sign district must encompass at least one square block or three acres, whichever is smaller. The applicant for a sign district must be able to demonstrate that the sign district will “enhance the theme or unique qualities of that district.”

Many developers and building owners are proposing a sign district as an integral component of their commercial projects. Without a sign district, they argue that projects are not economically viable. They also contend that a sign district will enhance a community by promoting its revitalization and creating much-needed jobs. Like all land use projects, political considerations are as significant, if not more so, than Zoning Code and other legal requirements. Beyond demonstrating that legal requirements will be satisfied, a developer or building owner ultimately must garner the support of the council member in whose area a sign district will be located if the project and that particular development component will ever become a reality.

1 L.A., Cal., Ordinances 174517, 174547.
2 A sign district is a type of special use district.
4 Metro Lights, L.L.C. v. City of Los Angeles, 551 F. 3d 898 (9th Cir. 2009).
5 World Wide Rush, LLC v. City of Los Angeles, 606 F. 3d 676 (9th Cir. 2010).
6 L.A., Cal., Ordinance 180445.
7 L.A., Cal., Ordinance 180841.
8 23 U.S.C. §§131 et seq.
9 The regulations were a part of Building Code Sections 91.6201 et seq. and now are codified at Sections 14.4 et seq. of the Los Angeles City Zoning Code. The city moved the billboard control sections from the Building Code to the Zoning Code in 2008.
15 L.A., Cal., Code §14.4.2.
16 Id.
18 L.A., Cal., Code §14.4.2.
19 L.A., Cal., Ordinance 180841.
20 L.A., Cal., Code §14.4.2.
The California Supreme Court’s Recent Flood of CEQA Decisions

THE CALIFORNIA ENVIRONMENTAL QUALITY ACT (CEQA), with its mandate on public agencies to lessen or avoid the unwelcome environmental effects of proposed projects, has generated hundreds of lawsuits in the state’s trial courts and intermediate appeals courts over the statute’s 40-year history. Perhaps no other California law matches CEQA in this respect. With so many lawsuits, commentators have noted wryly that it is not difficult to find a CEQA case standing for almost any proposition. Lead agencies and project proponents expend untold millions each year defending or settling those suits and in paying their opponent’s attorney’s fees when public interest plaintiffs prevail under the state’s private attorney general statute. Moreover, these sums do not account for the enormous expenses arising from the delays that can ensue once a project is challenged in court.

While the supply of CEQA cases in the lower courts appears inexhaustible, historically only a minute fraction of those cases have been accepted for review by the California Supreme Court. The relatively few CEQA cases taken by the supreme court each year is not surprising given the court’s discretion to grant review and the narrow circumstances under which it does so. What is surprising, however, is the number of CEQA cases decided by the court in the last four years, and particularly in late 2009 and the first quarter of 2010. The court decided four CEQA cases in as many months—a new record eclipsing by a wide margin the number of CEQA cases decided by the court in previous years.

Why is CEQA drawing so much attention from the court now? Have the supreme court’s actions revealed discernable trends? The answers to these questions may portend the direction of the court’s CEQA jurisprudence and the fate of future cases.

In CEQA cases, like almost all civil cases, the California Supreme Court’s review is discretionary and typically granted in limited circumstances when necessary to settle an important question of law or resolve a conflict in decisions among the state’s six appellate districts. Indeed, of the roughly 7,000 petitions received by the court each year, only 1 to 2 percent are accepted for review. The court has decided about 40 CEQA and CEQA-related cases since the statute was approved by the California Legislature in 1970—an average of one per year. According to Justice Kathryn Werdegar, when a conflict emerges among the appellate districts, the court “almost always grants review” unless 1) the case at issue involves a “maverick opinion” that is nonetheless heading in the right direction, 2) the case is not a good vehicle due to unusual facts or procedural difficulties, 3) recent legislation may solve the problem, or 4) the court wants the issue to “percolate” further among the lower courts.

Enacted to inform decision makers and the public about the potentially significant environmental effects of proposed projects before those projects are approved, CEQA requires lead agencies to prepare an Environmental Impact Report (EIR) whenever the agency finds that a project may have a significant impact on the environment. The EIR, in turn, must evaluate ways to avoid or reduce the environmental effects of the project through changes to the project or the use of feasible alternatives or mitigation measures.

When the lead agency finds that the project will have a less-than-significant effect on the environment, the agency may adopt a negative declaration instead of preparing an EIR. CEQA and its implementing guidelines also provide a series of exceptions or exemptions from CEQA’s environmental review requirements. If any apply, the lead agency need not prepare a negative declaration or an EIR. Once the agency approves the project, it may issue a notice that triggers a short 30- or 35-day statute of limitations period.

The state supreme court first grappled with CEQA just two years after its enactment. Referring to the statute as “EQA” at the time, Justice Stanley Mosk authored the decision in Friends of Mammoth v. Board of Supervisors that answered a simple but fateful question: Does CEQA apply to private activities for which a government permit or other entitlement is needed? The court’s answer is apparent to anyone familiar with the endless stream of litigation involving private projects since that time. In Friends of Mammoth, the court first articulated the oft-cited rule of statutory construction that the Legislature intended CEQA to be interpreted in such manner as to afford the fullest possible protection to the environment.

Following Friends of Mammoth, the court has had occasion to resolve a number of seminal questions under CEQA. For example, in Laurel Heights Improvement Association v. Regents of University of California (Laurel Heights I) the court first held that the “rule of reason” governs the range of project alternatives that the agency must consider in an EIR, as well as the level of detail and analysis that the EIR must include concerning those alternatives.

In Western States Petroleum Association v. Superior Court, the court considered the evidentiary standards that apply in CEQA cases. It set considerable limits on the admissibility of extra-record evidence—that is, evidence that was not before the agency when it made its decision. While the court did not entirely “foreclose” the admissibility of extra-record evidence under “unusual circumstances or for very limited purposes,” the court emphasized that extra-record evidence “can never be admitted merely to contradict the evidence the administrative agency relied on in making a quasi-legislative decision or to raise a question regarding the wisdom of that decision.”

In balancing the earlier rule that CEQA be interpreted in a manner that affords the “fullest possible protection to the environment,” the court held in Napa Valley Wine Train, Inc. v. Public Utilities Commission that this general rule of construction does not apply when “the Legislature has, for reasons of policy, expressly exempted several cat-

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of projects from environmental review.” In those circumstances, the court “does not sit in review of the Legislature’s wisdom in balancing these policies against the goal of environmental protection because, no matter how important its original purpose, CEQA remains a legislative act, subject to legislative limitation and legislative amendment.”

The 2006-2009 CEQA Docket

Six of the seven justices currently seated on the California Supreme Court have been together since January 2006, when Justice Carol Corrigan, the most junior justice, joined the court. Since then, the court has rendered 11 CEQA or CEQA-related decisions, 6 of which have been authored by Justice Werdegar. Of those decisions, all but one were unanimous, and all but two reversed the lower court decisions. The only two lower court decisions to survive review (albeit on separate grounds) arose from the Second Appellate District in Los Angeles. In the 11 decisions issued since 2006, the court has shown no clear preference for plaintiffs or defendants or for environmental groups or public agencies. Indeed, the decisions constitute an almost even split.

Between 2006 and 2009 the court ruled on broad substantive issues of statewide importance. In 2007, for example, the court in Vineyard Area Citizens for Responsible Growth, Inc. v. City of Rancho Cordova held that an EIR for a 22,000-acre, multi-phased development project should have identified and evaluated long-term water supplies for future phases of the project. Within the same year, the court in In re Bay-Delta Programmatic Environmental Impact Report Coordinated Proceedings decided whether the state in its programmatic EIR for the operation and restoration of the Sacramento/San Joaquin Delta should have evaluated an alternative to diverting water to southern California—an alternative that presumably cured an end to years of population growth in California and would have rendered moot years of fierce political battles over the allocation of water between north and south.

Deferring to the public agencies’ discretion to set program objectives, the court decided that the state was not required to evaluate a no-export alternative that conflicted with the program’s overall purpose—to “achieve ecosystem restoration goals and meet current and projected water export demands.”

During the 2006-2009 period, the court also addressed more technical and narrow procedural issues—from the standards for determining when a mitigation measure is “legally infeasible” to what sort of activity does or does not constitute a “project” under CEQA. In City of Marina v. Board of Trustees of the California State University and Save Tara v. City of West Hollywood, the court sided with project opponents and imposed a heightened duty on public agencies to consider mitigation measures more carefully and to conduct environmental review earlier in the project development process.

But in Matzzy Ranch Company v. Solano County Airport Land Use Commission, the court deferred to the state CEQA guidelines and the agency’s decision about whether the action in question—approval of an airport land use plan—fell within the “common-sense” exemption for projects with no possible significant effect on the environment. Taken together, these three cases reveal that the court is willing to parse the language and procedural requirements in CEQA and its guidelines but is not predisposed for or against lead agencies.

Procedural Focus in 2009-2010

The California Supreme Court’s pace in deciding a steady stream of CEQA cases since 2006 has been remarkable—and this past year was unprecedented. Nevertheless, the court’s recent CEQA jurisprudence would not be considered groundbreaking because it does not address the reach of the statute or the momentous environmental issues of our time, like climate change or water supply. Instead, the cases involve day-to-day procedural issues left unresolved by the lower courts—the sort of procedural issues that, as Justice Joyce Kennard quipped at oral argument in Committee for Green Foothills v. Santa Clara County Board of Supervisors, only a “CEQA aficionado” could love. As posited by Justice Werdegar, this recent trend is not due to the composition of the court but

Incoming Chief Justice Cantil Sakauye and CEQA

California Supreme Court Chief Justice Tani Cantil Sakauye—who this month replaces retiring Chief Justice Ronald George—may yet alter the fate of future CEQA cases. Justice Cantil Sakauye is a 20-year veteran of the California courts and has served on the Third Appellate District since 2005. No stranger to CEQA, the justice has authored five CEQA decisions during the last five years—three published and two unpublished—and has concurred in numerous others. Each of those decisions has been unanimous, which evinces her willingness and ability to work with fellow justices rather than assert her independence.

Justice Cantil Sakauye’s record on appeal shows no clear alignment with her political leanings. In her first two published opinions, she ruled against the lead agency on narrow procedural grounds. First, in California Farm Bureau Federation v. California Wildlife Conservation Board, she found that a proposal to purchase and convert farmed land to wetland habitat, while environmentally beneficial, did not qualify for any categorical exemptions under CEQA or its guidelines because the alterations still would have resulted in some adverse impacts. Second, she held in Citizens for Open Government v. City of Lodi that the opponents to a shopping center project had properly exhausted their administrative remedies before filing suit by attending planning commission and city council hearings and objecting to the proposed action at those hearings. The mere fact that the group had not filed a notice of administrative appeal before filing suit, she reasoned, did not defeat their exhaustion claim.

Justice Cantil Sakauye’s third published opinion favored the lead agency and served as precursor to the California Supreme Court’s treatment of an unsettled area in its CEQA jurisprudence. She ruled in Concerned McCloud Citizens v. McCloud Community Services District that an agreement between a water bottling company and a local services district for the sale and purchase of spring water was not an “approval of a project” within the meaning of CEQA because the agreement was expressly conditioned on subsequent compliance with CEQA. Consequently, the district was not required to prepare an EIR before entering the agreement.

At that time, the supreme court in Save Tara v. City of West Hollywood was evaluating the same legal question but later came to the opposite conclusion—that the conditional approval of a low-income housing project did amount to “approval of a project” that first required an EIR. But while reaching an opposite result, the court was careful not to question the correctness of Justice Cantil Sakauye’s opinion. The two cases together mark the dividing line between commitments that amount to “approvals” subject to CEQA and those that do not.

Whether Chief Justice Cantil Sakauye will shift the supreme court or upset its current trends on CEQA cases in any discernable way is an open question. The California Supreme Court does not harbor any severe doctrinal leanings, particularly in CEQA cases. It appears from her record, however, that she may be willing to assert greater leadership in this area than her predecessor. Moreover, her past opinions show a willingness to decide these cases in favor of environmental or citizen plaintiffs. —C.L.M.
rather the number of conflicts and open questions that have emerged among the appellate districts.\(^{10}\)

All of the court’s CEQA decisions in 2009-2010 were unanimous, and all but one reversed the lower court’s decision. Unlike its earlier CEQA cases, however, three of the court’s most recent decisions favored the lead agency. Also, Justice Corrigan, despite having been relatively quiet on CEQA cases and at oral argument early in her tenure on the court, was the most active justice in 2009-2010—authoring two of the four decisions and asking pointed questions from the bench.\(^{31}\)

In *Sunset Sky Ranch Pilots Association v. County of Sacramento*, the court in December 2009 examined whether a county’s decision to deny renewal of a conditional use permit for an existing private airport was shielded from environmental review by CEQA’s statutory exclusion for projects that a public agency “rejects or disapproves.”\(^{32}\) The Third Appellate District had concluded that the county’s denial of the airport’s use permit was a “project” requiring environmental review because it amounted to a “County plan to enforce its zoning code by closing the airport and transferring pilots to other airports.” Thus, the county’s denial of the use permit would have resulted in a number of direct and indirect environmental effects associated with the transfer of airport operations to new or alternative airfields.

The state supreme court disagreed. Writing for a unanimous court, Justice Corrigan explained that while the airstrip had been in operation since 1934, it was a private airstrip seeking a “new approval for its operations.” Consequently, it was not an activity “directly undertaken by [a] public agency” and fell squarely within the statutory exclusion for projects that have been rejected or disapproved.\(^{33}\)

In reaching this conclusion, the court observed that the circumstances surrounding the private airport in *Sunset Sky Ranch* were distinguishable from those involving a public airport. Had the county decided to close a public airport, that would have been an “activity directly undertaken by [a] public agency” and thus subject to environmental review under CEQA. Consequently, public agency decisions to cease their ongoing activities may no longer fit within the statutory exclusion. The court also eschewed a liberal reading of the statute in circumstances where the legislature intended to limit environmental review over projects:

> Although we construe CEQA broadly…we do not balance the policies served by the statutory exemptions against the goal of environmental protection…. [T]he very purpose of the statutory CEQA exemptions is to avoid the burden of the environmental review process for an entire class of projects, even if there might be significant environmental effects.\(^{34}\)

In February 2010, Justice Corrigan again authored a unanimous opinion in *Committee for Green Foothills*.\(^{35}\) The Sixth District had construed CEQA’s short, 30-day statute of limitations to prohibit opponents from filing suit on some claims but not others. CEQA generally requires opponents to file suit within 30 days after the approving agency files a Notice of Determination.\(^{36}\) As in *Sunset Sky Ranch*, the court reversed the lower court’s ruling and affirmed the legislature’s limits on environmental review and legal actions.

In *Green Foothills*, Santa Clara County years earlier had approved a community plan and EIR for the future growth of the Stanford University Campus. The EIR called on Stanford to “dedicate easements for, develop, and maintain the portions of the two trail alignments which cross Stanford lands shown in the 1995 Santa Clara Countywide Trails Master Plan.” To implement that measure, Stanford and the county subsequently negotiated and approved a trails agreement for two separate trail alignments. The county prepared and adopted a supplemental EIR for one trail alignment but decided that the second alignment did not require environmental review because no improvements had been proposed.

The county filed a Notice of Determination of the county’s approval of the trails agreement and the fact that no improvements had been proposed for the second trail alignment. After the 30-day limitations period expired, the Committee for Green Foothills filed suit challenging the county’s approval of the trails agreement, arguing that the approval violated CEQA because it approved the second trail alignment without undertaking further environmental review. The trial court dismissed the case based on the plaintiff’s failure to file its suit within CEQA’s 30-day statute of limitations.

The Sixth District reversed, reasoning that the nature of the underlying claim—that the county approved changes in the community plan without first determining whether those changes would have any significant effect on the environment—was not controlled by the particular notice and statute of limitations relied upon by the county. Thus, the nature of the underlying claim mattered to the Sixth District, and the 30-day limitations period did not apply.

Nevertheless, the California Supreme Court sided with the trial court, holding that the agency’s filing of the notice triggers CEQA’s 30-day statute of limitations for all potential challenges to the decision announced in the notice. The limitations period cannot, as the petitioners had argued, be extended based on the nature of the CEQA violation alleged. Thus, again, the supreme court construed CEQA’s statutory provisions to protect the agency’s decision, and the court limited legal challenges by third parties.

In *Communities for a Better Environment v. South Coast Air Quality Management District*, its third decision of the quarter, the supreme court issued another unanimous opinion, but this time the decision was authored by Justice Werdegar.\(^{12}\) The case involved an application by ConocoPhillips to the South Coast Air Quality Management District (SCAQMD) for a permit to construct a series of improvements at its petroleum refinery in the city of Wilmington. The improvements were intended to allow the refinery to produce ultralow sulfur diesel fuel and would have substantially increased operations at the existing refinery and associated emissions of nitrogen oxide (NOx). The projected increase in NOx emissions, however, were still generally within the levels previously authorized by SCAQMD under ConocoPhillips’s existing permit for the production of gasoline, jet fuel, diesel fuel, and other petroleum products.

Because NOx emissions were not expected to increase substantially above what SCAQMD considered baseline environmental conditions—the previously permitted maximum levels of NOx emissions—SCAQMD concluded that the ultralow sulfur diesel fuel project would not have a significant effect on the environment and approved the permit under a negative declaration rather than an EIR. In so doing, SCAQMD treated the additional NOx emissions as part of the “baseline measurement for environmental review,” rather than as part of the new project.

The statute itself does not define the environmental baseline. The CEQA guidelines, on the other hand, state that the “physical environmental conditions in the vicinity of the project, as they exist at the time the notice of preparation is published, or…at the time environmental analysis is commenced…will normally constitute the baseline physical conditions by which a lead agency determines whether an impact is significant.”\(^{38}\) SCAQMD reasoned that its approach fit within the guidelines because ConocoPhillips could have increased its operations (and hence its NOx emissions) at any time without seeking further approval from the agency.

The court disagreed of SCAQMD’s approach and cited a long line of cases holding that “the impacts of a proposed project are ordinarily to be compared to the actual environmental conditions existing at the time of CEQA analysis, rather than to allowable
conditions defined by a plan or regulatory framework." The maximum operations and emissions levels under ConocoPhillips’s existing permit did not constitute normal operating conditions, and therefore did not represent the existing physical environmental conditions that existed at the time SCAQMD conducted its environmental analysis. Consequently, those maximum emissions levels did not represent the appropriate environmental baseline, and the court sent SCAQMD back to the drawing board.

The court distinguished the circumstance in which existing environmental conditions are temporary in nature and do not fairly represent normal operating conditions. In that situation, a lead agency may use past and ongoing operations as the environmental baseline. Though the court departed from its early pattern of siding with project opponent, it again articulated practical guidelines for project proponents, lead agencies, and lower courts to adhere to in the future.

The supreme court rendered its most recent CEQA decision on April 1, 2010, in Stockton Citizens for Sensible Planning v. City of Stockton.39 Much like the circumstances in Committee for Green Foothills, the court in Stockton Citizens examined CEQA’s statute of limitations. But unlike the prior case, Stockton Citizens addressed whether a Notice of Exemption (not a Notice of Determination) triggered CEQA’s 35-day statute of limitations period if the underlying approval was invalid.

In 2002, the city of Stockton approved a supplemental EIR and an amended master development plan for the Spanos Park West development comprising 138 acres in North Stockton. The development plan envisioned a mix of retail, commercial, office, and residential uses, with zoning that would remain flexible enough to continue to adapt to changing economic conditions. So long as future projects were within the density and intensity of uses already approved, no further environmental review or amendments to the plan would be required.

Although not identified in the amended development plan, Wal-Mart in 2003 began processing entitlements for a 207,000 square-foot Supercenter on 22 acres within the Spanos Park West development area. After Wal-Mart submitted building and site plans to the city’s community development department, the director issued a letter to the project applicant affirming that the Supercenter conformed to the standards in the master development plan and thereafter filed a Notice of Exemption with the county clerk. Typically, the filing of this type of notice starts the 35-day clock on “[a]ny action or proceeding alleging that a public agency has improperly determined that a project is not subject” to CEQA.40

Some months after the notice—and well beyond the 35-day limitations period—the Stockton Citizens for Sensible Planning filed suit challenging the Supercenter under CEQA. The group complained that the director did not have authority to administratively approve the Wal-Mart Supercenter and that the Supercenter should have been reviewed by the city council. The city and the project’s proponents argued on demurrer and at trial that the suit was barred by CEQA’s 35-day statute of limitations.

The trial court, however, ruled that the director’s notice—the only public notice of the project—was invalid. The notice, the judge reasoned, had failed to trigger the statute of limitations because the director’s conformance determination was not an “approval” of a project—a procedural predicate to a valid notice. On appeal, a majority of the Third District agreed, adding that the director’s letter was not a valid approval by a public agency because the director did not follow agency procedures in issuing the letter and he did not have the authority to approve projects that require environmental review under CEQA.

The supreme court reversed, issuing a rebuke of the lower courts’ opinions by stating that it does not matter whether the underlying claims may be meritorious or unmeritorious. If the notice is properly filed and complies in form with the statutory requirements, courts cannot look behind the notice. Instead, they must honor CEQA’s 35-day limitations period without evaluating the validity or correctness of the underlying approval. The supreme court emphasized that the CEQA limitations period, while unusually short, is necessary to “ensure finality and predictability in public land use planning decisions” and to prevent CEQA challenges “from degenerating into a guerrilla war of attrition by which project opponents wear out project proponents.” In line with its earlier decisions in Sunset Sky Ranch and Committee for Green Foothills, the court enforced procedural limits established by the state legislature and found that the group’s claims were barred.41

**Future CEQA Rulings**

On the heels of a record series of CEQA decisions, the California Supreme Court is showing no signs of CEQA fatigue. Just three weeks after issuing its decision in Stockton Citizens, the Court’s seven justices voted unanimously to review a split decision in a case from the Second District—Save the Plastic Bag Coalition v. City of Manhattan Beach.42 The court has been asked to resolve two threshold questions under CEQA: 1) When is an EIR required under the “fair
argument standard,” and 2) under what circumstances do financially motivated opponents have standing to sue under CEQA.

Save the Plastic Bag Coalition involves an ordinance adopted by the city of Manhattan Beach to limit the distribution of plastic bags at the point of sale. The purpose of the measure was to address concerns about ocean pollution and trash in the marine environment. In weighing the feasibility of the ordinance, the city found that any possible increase in the use of paper bags that might result from the new law would have a “minimal or nonexistent” effect on the environment due to a variety of reasons, including the limited scope of the ordinance, the lack of other such ordinances in the region, and the city’s program to replace plastic bags with reusable bags. The city adopted the ordinance based on a negative declaration rather than an EIR.

The Save the Plastic Bag Coalition—an association of plastic bag manufacturers and distributors in the plastic bag industry—sued to compel the city to prepare an EIR to analyze the possible effects that increased paper bag use resulting from the ordinance would have on the environment. The Second District sided with the coalition, concluding that the group had raised enough evidence under CEQA’s fair argument standard to necessitate an EIR.43 Under the fair argument standard, “a public agency must prepare an EIR whenever substantial evidence supports a fair argument that a proposed project ‘may have a significant effect on the environment.’”44

Because the fair argument standard is such a low threshold, it is not uncommon for lead agencies to prepare an EIR to avoid the risks associated with possible legal challenges even when a mitigated negative declaration would suffice.45 Indeed, negative declarations are becoming less common in California for projects with any possible opposition. The supreme court may have granted review in this case to set new boundaries surrounding the fair argument standard and to clarify the evidentiary burden borne by would-be challengers.

Perhaps equally important, this case also marks the first opportunity in years for the court to clarify the rules of standing—a jurisdictional prerequisite to filing suit—and to set a limit on environmental lawsuits brought by financially interested parties. Plastic bag manufacturers, distributors, and other companies in the plastics industry ostensibly formed the Save the Plastic Bag Coalition to “counter misinformation about the effect of plastic bag usage on the environment.” Nonetheless, the coalition made little effort to hide its members’ financial interests in promoting the manufacture and distribution of plastic bags. A ruling adverse to the group that sets a meaningful limit on
standing to sue under CEQA could have important implications on the myriad other groups seeking to challenge projects based on allegedly but not completely altruistic environmental purposes.

Something in the Second District’s decision has caught the supreme court’s attention, and its increasing tendency to reverse lower court decisions and place practical limits on environmental review portends a similar result here. For example, each of the court’s four decisions rendered in late 2009 and early 2010 tended to set parameters for undertaking environmental review or adhering to statutory or regulatory mandates, often in a manner deferential to the lead agency. The court seems poised to view Save the Plastic Bag Coalition in the same light and to provide helpful guidance on when a negative declaration is appropriate and under what circumstances financially interested parties can sue to enforce the state’s environmental laws.

Appellants have also fared well when there has been a dissenting opinion below.46 In Save the Plastic Bag Coalition, an impassioned dissent was issued by Second District Court of Appeal Justice Richard Mosk—son of the late California Supreme Court Justice Stanley Mosk, who authored the court’s first CEQA (or EQA) decision in Friends of Mammoth. The strong voice of Justice Richard Mosk suggests the supreme court’s recent trend may continue, and the Second District’s decision in Save the Plastic Bag Coalition will fall.

Save the Plastic Bag Coalition will not be the last word in the supreme court’s CEQA jurisprudence. Currently at least three petitions for review in CEQA cases await a ruling by the supreme court, and five additional appellate decisions are within the time limit for petitioning for review. CEQA is such a comprehensive statute, applied broadly to almost any development activity in the state, that there will undoubtedly be a host of legal challenges and enough splits in the lower courts to warrant the supreme court’s intervention again and again.

1 The California Environmental Quality Act (CEQA), PUB. RES. CODE §§21000-21178.
2 CODE CIV. PROC. §1021.5; Center For Biological Diversity v. County of San Bernardino, 185 Cal. App. 4th 866, 895-902 (2010) (affirming an award of $265,715.55 to the prevailing plaintiffs in a challenge under CEQA against a waste composting facility).
3 Stockton Citizens for Sensible Planning v. City of Stockton, 48 Cal. 4th 481, 500 (2010). In Stockton Citizens, the time from project approval to a decision in the California Supreme Court spanned over six years.
4 The state supreme court has original jurisdiction over selected civil cases, including CEQA actions filed against the California Public Utilities Commission. PUB. RES. CODE §21168.6. Even in those circumstances, the court’s review is discretionary.
A few of the 34 cases did not directly address CEQA or its regulatory guidelines but nonetheless referenced and interpreted principles of law under CEQA. Those cases are counted here as CEQA-related cases.

8 Justice Werdegar’s Remarks, supra note 6.
9 Id. at 259.
11 Id. at 578-79.
13 Id. at 907 (citing Napa Valley Wine Train, Inc. v. Public Utilities Comm’n, 50 Cal. 3d 370, 376, 381 (1990)).
14 Id. at 908 (citing Pub. Res. Code §21065(a)).
15 Id.
17 Id.
18 Laurel Heights Improvement Ass’n v. Regents of the Univ. of Cal., 6 Cal. 4th 1112, 1123 (1993) (Laurel Heights II); see also Pub. Res. Code §§21080(d), 21082.2(d); CEQA Guidelines §15064(a)(1), (b)(1).
19 See, e.g., KOSTKA & ZISCHKE, PRACTICE UNDER THE CALIFORNIA ENVIRONMENTAL QUALITY ACT §7.3, at 394 (2d ed. 2010).
Obtaining Recovery for Property Damage through Inverse Condemnation

**WHEN A CLIENT’S COMMERCIAL OR RESIDENTIAL** real property has been damaged by landslide, flood, fire, or other natural disaster, the results can be financially and emotionally devastating. While a lawyer may review the client’s potential insurance recovery and tort claims, one additional avenue for recovery that should not be overlooked is a possible action in inverse condemnation against a governmental entity or a public utility.

Under the constitutions of California and United States, a property owner is entitled to payment of “just compensation” for the taking or damaging of private property for “public use.” This is true even when the taking or damaging is the unintended result of the design, construction, maintenance, or operation of a public project.1 Because this right is constitutionally based, the property owner need not prove that the government was negligent or that the incident giving rise to the damage was foreseeable, as might be required in a tort lawsuit. Demonstrating a cause-and-effect relationship between the public project and the incident giving rise to the damages, evaluated under the substantial factor test, may be all that the property owner needs to prevail. Traditional tort defenses, including governmental immunities and comparative negligence, are not available to the government in defense of an inverse condemnation lawsuit. The property owner’s recovery may include the cost of repair, diminution in value, attorney’s fees, expert fees, and other categories of damages.

Unlike an eminent domain case, in which the governmental entity is the plaintiff and seeks an order of condemnation, an inverse condemnation case features the property owner as the plaintiff. In an inverse condemnation case, the property owner seeks to establish that the government—perhaps unintentionally—took or damaged his or her property without formally condemning it, with the result that the government must pay damages if it had deliberately chosen to take the property for public use.2

**Constitutional Bases**

The Fifth Amendment to the U.S. Constitution and the California Constitution, Article I, Section 19 provide the constitutional bases for inverse condemnation law in California. Under these provisions, a citizen is entitled to compensation if his or her property is “taken” or “damaged.” The two terms sometimes are used interchangeably.3 Substantial damage to private property equates to a taking.4 Inverse condemnation is the procedural device for redress when these constitutional provisions are violated.5

The policy principle underlying inverse condemnation law is to ensure that the cost of any loss caused by public improvements—whether or not the loss is intended or foreseeable—will be spread throughout the community rather than imposed disproportionately on one or a few property owners.6 The courts have recognized this policy principle and the distinction between the constitutional basis for inverse condemnation and tort law principles for over 100 years.7

The fundamental justification for inverse condemnation liability is that the public entity, acting in furtherance of public objectives, in constructing or maintaining improvements, is taking a calculated risk that damage to private property may occur.8 Public entities treat uncertain costs or damages as deferred costs of the project when they build an improvement. If unforeseen costs or damages do arise, injuring private property, those costs should be recognized as having been inflicted in the interest of fulfilling the public purpose of the project and thus subject the government to a duty to pay just compensation to the injured property owner.9

**Strict Liability**

With limited exceptions, a strict liability test applies in inverse condemnation cases. The California Supreme Court established the general rule of liability without fault in inverse condemnation cases in the landmark decision of Albers v. County of Los Angeles.10 In that case, a county of Los Angeles road-building activity triggered a landslide that damaged the plaintiffs’ property. The trial court found that although the county was not negligent, it was still liable for inverse condemnation. The California Supreme Court affirmed, holding that any injuries to real property caused by government improvements are compensable under the constitution, whether foreseeable or not.

The Albers opinion used “proximate cause” terminology and eliminated foreseeability as an element of the claim. This caused some confusion. Professor Arvo Van Alstyne suggested in an influential law review article11 that the true measure of proximate cause should be defined as a “substantial cause-and-effect relationship which excludes the probability that other forces alone produced the injury.”12 The cases following Albers adopted this test and established that the element of causation for inverse condemnation liability is satisfied when the public entity’s project, action, or omission is a substantial contributing cause of the damage. If a public entity’s project, act, or omission is one of several substantial causes of damage, the public entity is liable in inverse condemnation. The presence of other concurrent causes is irrelevant.13 Thus, the cases hold that to establish inverse condemnation liability, it is only necessary to show that the defendant public entity’s conduct was one substantial cause, though there may be others, including the property owner’s conduct.14

The strict liability standard of Albers was affirmed but slightly modified in Holtz v. Superior Court,15 which recognized that a public entity might act reasonably, and hence not negligently, in connection with a work of public improvement (in that case, excavation for construction of BART), yet the public entity still would be liable in inverse condemnation to a property owner damaged by the work of improvement. This modified the Albers “proximate cause” aspect of inverse condemnation liability.16 At a later phase of the Holtz case, the California Supreme Court held that recovery in inverse condemnation is based on the constitutional provision requiring just com-

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pensation, not on a theory of tort, to effectuate the policy of protecting property owners from bearing a disproportionate share of the costs of public improvements through unintended collateral damage to their property.17 California law defines “[p]roperty of a public entity” and “public project” to mean “real or personal property owned or controlled by the public entity....”18 On this basis, courts find that the threshold for “a work of public improvement” or a “public project” for inverse condemnation liability is satisfied by inquiring “whether the particular public entity defendant had control, in the sense of power to prevent, remedy or guard against the dangerous condition, whether [its] ownership is a naked title or whether it is coupled with control, and whether a private defendant, having a similar relationship to the property, would be responsible for its safe condition.”19

Official acts of dominion and control can be shown if the public entity performs maintenance or repair work at a property.20 Both the U.S. Supreme Court and the California courts have repeatedly held government agencies liable in inverse condemnation for their substantial participation in projects that cause a taking or damaging of private property.21 When a public improvement has been constructed and private property is proximately damaged in the maintenance or use of it, the fact that the public improvement was built by a private property owner or firm does not necessarily exonerate the public agency from liability. It may be enough that the work has been somehow approved or accepted by the public agency.22 In litigating an inverse condemnation claim, there is a relaxed standard of proof in favor of the property owner. An example of such a standard can be found in California State Automobile Association Inter-Insurance Bureau v. City of Palo Alto.23 One of Palo Alto’s sewer lines became clogged and backed up, causing a sewage spill in a residence. The homeowner’s insurer sued the city of Palo Alto on an inverse condemnation cause of action via subrogation. The trial court found the inability of the plaintiff to prove the specific cause of the sewer line back up to be fatal to the plaintiff’s case. The court of appeal reversed, finding that the defendant was liable despite the plaintiff’s inability to prove the specific mechanism of causation.

The City of Palo Alto court observed that the plaintiff had presented evidence of three possible causes: 1) tree roots in the sewer line, 2) the sewer line’s insufficient slope, and 3) the city’s delayed maintenance and replacement program.24 The court held that the burden of proving with specificity how the sewer backup occurred did not lie with the plaintiff; rather, the city had to prove that forces other than its improvement, acting alone, caused the damage to the home.25 Thus, in line with the policy of ensuring that the costs of governmental actions are borne not by individual property owners but by the community at large, the burden of proof in an inverse condemnation action is more favorable for the property owner than in tort actions.

Inapplicability of Tort Defenses

An important theme in inverse condemnation cases is the distinction between inverse condemnation strict liability principles and negligence law, including the inapplicability of governmental immunity defenses. For example, in Pacific Bell v. City of San Diego,26 a private landowner, Pacific Bell, sued the city of San Diego for inverse condemnation and tort claims for damages related to flooding caused by the bursting of a water pipe that serviced a fire hydrant. In reversing a judgment for the city, the court of appeal held that the ordinary rules of inverse condemnation strict liability, not a reasonableness test, applied.

In Pacific Bell, it was undisputed that the city’s cast-iron water pipes were old and corroding, and that the city did not monitor them but rather had a replace-when-broken policy, to save money. A pipe burst when an automobile struck a fire hydrant, causing an automatic shut-off valve to activate, temporarily spiking the pressure in the pipe. The pipe burst only because it was corroded.

Pacific Bell sued on a multicity count complaint but dismissed all tort claims at trial. The city asserted numerous affirmative defenses, including a defense to liability related to firefighting equipment based on Section 850.4 of the Government Code. The city argued that this barred the inverse condemnation claim. The court of appeal disagreed, holding that government immunities that are applicable to torts do not apply to inverse condemnation claims.27 Likewise, comparative negligence is not a valid defense in an inverse condemnation action. In Blau v. City of Los Angeles,28 the court of appeal reversed the trial court verdict for the government because it was based on an erroneous jury instruction that allowed for a defense based on contributory negligence. The court of appeal held that so long as the governmental project was one substantial cause of the damage, the governmental entity defendant would be held liable, despite the potential contribution of the property owner’s conduct as a cause.29 Since inverse condemnation is constitutionally based and not part of tort law, the government is subject to inverse condemnation liability when a public improvement is a substantial contributing cause of the damage; the public improvement need not be the substantial cause of the damage, nor the sole cause, for the government to be liable.

No published case supports the use of comparative negligence as a defense in an inverse condemnation action—with the possible limited exception of flood control improvement cases, a separate and distinct branch of inverse condemnation law.30 This flows from an exception to the general rule of strict liability in inverse condemnation cases: a situation in which the state had the common law right to inflict the damage (for example by protecting its own land from floodwaters or properly exercising police power).31

An inverse condemnation cause of action may have two other advantages over tort claims against government entities: 1) no prelawsuit claim need be filed by the property owner,32 and 2) the statute of limitations is three years,33 or, under some circumstances, five years,34 possibly extended by tolling until the date of discovery,35 or until the situation stabilizes,36 whereas prelawsuit tort-based claims against government entities for property damage must be filed within one year of the injury,37 and a lawsuit must be filed within six months of the rejection of the claim.38

Categories and Measure of Damages

In inverse condemnation, diminution in value may be one measure of damages.39 This may be calculated as the difference between the fair market value of the property before and after the incident that caused the damage.40 A general rule in tortious injury to property cases, not always followed in inverse condemnation cases, is that the property owner’s recovery is limited to the cost of repair, not to exceed the diminution in value of the property, unless the property owner has a personal reason that would justify spending more than the limiting amount.41 Sometimes in inverse condemnation cases the property owner may seek the cost of repair that exceeds the value of the property based upon the “personal reason” exception.42

The property owner may also be entitled to recovery for loss of use based on the fair rental value of damaged property,43 relocation benefits,44 and reimbursement for costs and the fees of attorneys and experts.45 Emotional distress is not an item of recoverable damages in an inverse condemnation action.37 However, the property owner may be able to join a cause of action for nuisance, or other tort causes of action, to permit recovery of such damages within the same lawsuit, provided that the property owner filed a prelawsuit claim. These causes of action are judged by different standards than the inverse condemnation cause of action and have different procedural requirements. Proceeding on multiple causes of action requires special attention to avoid hindering the property owner’s overall chances of recovery,46 but one advantage is that liability on an inverse condemnation

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cause of action is decided by a judge, while tort liability is decided by a jury (if demanded). Thus, within the same trial, the property owner may have the benefit of two triers of fact. Success with either may be sufficient to obtain substantial recovery.

Inverse condemnation liability has been recognized in a wide variety of situations, including, for example, damage to property caused by construction that undermines lateral support; landslides caused by grading; damage to property caused by flooding from ruptured outdated water mains; brush fires caused by sparks from electrical power transmission lines; loss of value of property due to jet noise, fumes, and vibrations from a neighboring airport; blocking ingress and egress due to street construction; sewer line spills; and escaping sewer gas.

While the situations that give rise to liability are numerous, significant exceptions to the strict liability rule exist, including 1) damages caused by the failure of flood control projects and 2) regulatory takings. With flood control projects, the public agency is liable if its conduct poses an unreasonable risk of harm to the plaintiff, the unreasonable conduct is a substantial cause of the damage to the plaintiff's property, and the plaintiff has taken reasonable measures to protect the property. The rule of strict liability generally followed in inverse condemnation does not apply. Flood control law, also called water law, departs significantly from the general rules applicable to inverse condemnation. The other significant exception is regulatory takings, including land use regulations. These may be governed by very short statutes of limitations and unique claim filing procedures.

In inverse condemnation litigation, practical experience is often a better teacher than research in the law. The merits of each inverse condemnation claim depend on the specific facts, and exceptions to general rules are common. While tort claims may be available, attorneys in cases involving damage to real property proximately caused by the design, construction, maintenance, or operation of a public project should also examine the possibility of an inverse condemnation claim.

2 City of Oakland v. Oakland Raiders, 32 Cal. 3d 60, 67 (1982) (“[C]ondemnation and inverse condemnation...are merely different manifestations of the same governmental power, with correlative duties imposed upon public entities by the same constitutional provisions...”).
4 Id. at 652-54; Tilem v. City of Los Angeles, 142 Cal.
App. 3d 694, 701-02 (1983).
3 Reardon v. City & County of San Francisco, 66 Cal. 492, 505 (1885).
5 Van Alstyne, supra note 8, at 491-92.
6 Albors v. County of Los Angeles, 62 Cal. 2d 250, 263-64 (1965).
7 Van Alstyne, supra note 8, at 431.
8 Id. at 436.
10 Blau, 32 Cal. App. 3d at 84-86.
12 Id. at 304 (“[W]e limited our holding of inverse condemnation liability, absent fault, to ‘physical injuries of real property’ that were ‘proximately caused’ by the improvement as deliberately constructed and planned.”).
13 Holtz, 17 Cal. 3d at 656 n.8.
14 Gov’t Code §830(c).
20 Id. at 483.
21 Id.
23 Id. at 602-3.
25 Id. at 85.
27 Albors v. County of Los Angeles, 62 Cal. 2d 250, 263-64 (1956).
28 Archer v. City of Los Angeles, 19 Cal. 2d 19, 24 (1941); Gray v. Reclamation Dist. No. 1500, 74 Cal. 622 (1917).
29 Gov’t Code §905.1.
30 CODE CIV. PROC. §338(j).
34 Gov’t Code §911.2(a).
35 Gov’t Code §§913, 945.6; CODE CIV. PROC. §342.
40 Kapping v. City of Whittier, 8 Cal. 3d 39, 54 (1972).
41 Gov’t Code §§7260 et seq.
42 CODE CIV. PROC. §1036.
45 People v. Ricciardi, 23 Cal. 2d 390, 402 (1943) (citing Vallejo, etc., R. Co. v. Reed Orchard Co., 169 Cal. 345, 356 (1915)).
51 People v. Ricciardi, 23 Cal. 2d 390, 413 (1943).
56 Gov’t Code §66499.37; Hensler v. City of Glendale, 8 Cal. 4th 1 (1994).

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Appellate courts appear to be limiting the reach of construction prompt payment laws

WITH PRIVATE CONSTRUCTION at its slowest pace in years and public construction wavering as government budgets are cut, contracting parties in the construction industry are learning the importance of how they label payments. A payment may look like a progress payment—which by law is required to be paid within a specified number of days—or it may seem to be a retention—which by law is required to be paid upon completion of work. California has a collection of laws known as the prompt payment statutes that are supposed to guarantee that contractors and subcontractors will be paid promptly for the work they perform. Nevertheless, California courts of appeal have news for contractors: If they do not carefully and precisely name payments and spell out when and under what circumstances payments are due, contractors may not be able to obtain the penalties and interest otherwise available when payments are late.

Payments are always an issue in construction projects, and this is especially so in tough economic times. The speed of the flow of money from lender to owner to contractor becomes slower as the ability to borrow tightens. Profit margins shrink as contractors and subcontractors cut their bids in order to compete for what work is available. Everyone in the payment chain wants to hold on to cash for as long as possible, with the result that many smaller contractors and subcontractors complain that they are being forced to wait longer and longer for payments that should have been made more promptly. They in turn cannot pay their employees or for supplies—and in today’s financial climate, borrowing may not be an option. But recent state appellate decisions have cut back on the protections that the prompt payment statutes were meant to provide.

The current economic downturn in the construction industry is similar to the losses it endured in the 1980s, with smaller contractors and subcontractors bearing the brunt of the pain. The industry had fallen into the practice of slow payments in both public and private construction arenas. Prior to the 1990s contractors and subcontractors had limited remedies at their disposal when progress payments or retentions were withheld. Contractors complained that owners would hold retentions for open-ended periods of time. Subcontractors complained that they did not receive progress payments on time.

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Generally the terms of payment to contractors and subcontractors in California were determined by the contract or subcontract documents. The party with the greatest leverage—generally an owner vis-à-vis a contractor or a contractor vis-à-vis subcontractors—was able to draft contractual provisions providing for slow progress payments and large retentions. During lean times with tight credit, subcontractors were forced to obtain loans in order to manage cash flow, especially when retentions were held for a long time and, as is often the case in depressed markets, when the retention equaled or exceeded their profits. It had become commonplace for owners to withhold money from general contractors and general contractors to withhold money from subcontractors—and then dare the other party to sue.

**Legislative Response**

In 1990, following a period of losses and bankruptcies, the California Legislature took action and passed Senate Bill 2515, the first of a series of prompt payment statutes designed to provide meaningful protection to contractors and subcontractors. The legislative history of Senate Bill 2515 makes clear that the lawmakers recognized a problem in need of a remedy: “Slow payment or nonpayment to subcontractors is one of the more serious problems facing the construction industry.” Senate Bill 2515, codified as Civil Code Section 3260, requires prompt payment of retentions by owners and general contractors on private works construction. Two years later, the legislature established Public Contracts Code Section 7107 to extend the protections of the prompt payment requirements to public works construction. The section requires a public entity to pay retention to the original contractor within 60 days after the date of completion. Further, original contractors must pay subcontractors their retention within seven days from the receipt of funds from a public entity.

The legislature followed these enactments with a number of other statutes:

- **Civil Code Section 3260.1** requires owners to pay prime contractors progress payments within 30 days of a contractor’s request for payment.
- **Business and Professions Code Section 7108.5** requires prime contractors or subcontractors to pay all tiers of subcontractors within 10 days of receipt of funds by contractors for private projects. Public Contract Code Section 10262.5 makes the requirement applicable to contractors and subcontractors in public works construction.
- **Public Contract Code Section 10261.5** requires that state agencies pay the prime contractors within 30 days after a payment request or engineer submittal.
- **Civil Code Section 3320** requires any public entity to pay a design professional within 30 days of the design professional’s demand if it is for a progress payment and within 45 days if retention is due. Civil Code Section 3321 requires a design professional to pay both progress and retention payments to the design professional’s subconsultants within 15 days after receipt from the public agency.
- **Public Contract Code Section 7200** limits the amount of retentions that may be withheld in public works construction.

These prompt payment statutes, among others, prescribe remedies for late payment in the form of penalties in addition to interest in some cases, penalties in lieu of interest in other instances, and often costs of suit and attorney’s fees to the prevailing party. California’s contractors and subcontractors would seem quite well protected when it comes to being paid promptly.

Prompt payment statutes are common around the country. Also, in 1982 Congress passed a federal prompt payment act partly as a result of a General Accounting Office report finding that government agencies were late in paying 30 percent of their bills. All states, with the exception of New Hampshire, have some form of prompt payment legislation applicable to government contracts; many states also have prompt payment laws that apply to private construction. California seems to have more prompt payment statutes in place than any other jurisdiction. However, at a time when contractors and subcontractors need them the most, the protections of these statutes are proving illusory in many cases.

**Recent Appellate Decisions**

The California Legislature enacted prompt payment statutes to ensure that contractors and subcontractors will be paid promptly for the work they perform. Three recent state appellate court decisions, however, have interpreted the prompt payment statutes in a manner that restricts the applicability of their provisions. In each case, the court’s interpretation, while arguably defensible in terms of strict statutory construction without reference to legislative history, is at odds with the original intention of the prompt payment legislation.

In *Martin Brothers Construction, Inc. v. Thompson Pacific Construction, Inc.*, the Third District Court of Appeal dealt a blow to two of the statutory protections encompassed under the prompt payment statutes. First, the court held that the statutory exception allowing a contractor to withhold retention when there is a “bona fide dispute” did not apply only to a bona fide dispute relating to the contract payments. Rather, the court held that a contractor could withhold retention after the subcontractor raised a dispute relating to change orders outside the contract, even though the contractor had no dispute regarding the work performed under the contract. Second, the court affirmed the right of contractors to include language in the subcontract that amounted to a waiver of certain protections of the prompt payment provisions.

In that case, the plaintiff subcontractor, Martin Brothers Construction, brought an action against a general contractor, Thompson Pacific Construction, and against the general contractor’s surety and bonding companies. Martin Brothers sought penalties, interest, and attorney’s fees for late progress and retention payments for work on a public works project. The subcontract provided that Thompson would make monthly progress payments to Martin Brothers, minus a retention. Also, the subcontract contained a provision that neither the progress payments nor the withheld retention would be paid until Martin Brothers had furnished specified documentation, including lien releases, certified payroll, union letters, and proof of insurance. For final payment of the previously withheld contract retention, the subcontract required additional releases.

Martin Brothers did not provide the specified documentation promptly, and Thompson Pacific accordingly did not pay Martin Brothers within the statutory time limits. Moreover, at the conclusion of the project, the contractor withheld the retention amounts—even though it acknowledged that all the contracted work had been performed—based on disputes between the parties involving change orders for additional work. Martin Brothers made claims under both Business and Professions Code Section 7108.5 (progress payments) and Public Contract Code Section 7107 (retention payments).

Under Public Contract Code Section 7107, the failure of a contractor to pay a subcontractor within seven days of a contractor being paid by the public entity allows the subcontractor to receive a penalty payment of 2 percent per month on the amount withheld. The subcontractor also is entitled to attorney’s fees. The section expressly states that any waiver of this requirement is void as against public policy. Nevertheless, Section 7107(e) contains an exception: “The original contractor may withhold from a subcontractor its portion of the retention proceeds if a bona fide dispute exists between the subcontractor and the original contractor. The amount withheld from the retention payment shall not exceed 150 percent of the estimated value of the disputed amount.”

The court in *Martin Brothers Construction* recognized that Section 7107 “serves a remedial purpose: to encourage general contractors to pay timely their subcontractors and to provide the subcontractor...
with a remedy in the event that the contractor violates the statute.” Nonetheless, the court refused to construe Section 7107 liberally in light of this remedial purpose and limit withholding of contract retention proceeds due to a bona fide dispute related to the contract work. The court held instead that the word “dispute” in Section 7107 was not limited to any particular kind of disputes other than those that are bona fide. Accordingly, the court deprived the subcontractor of the right to prompt payment of the contract retention, notwithstanding the fact that the contractor had no dispute regarding the subcontractor’s performance on the contract.

The court also addressed the meaning of the phrase “unless otherwise agreed to in writing” as a qualification to the rule in Business and Professions Code Section 7108.5 requiring prompt payment of progress payments. Section 7108.5 provides that a “prime contractor or subcontractor shall pay to any subcontractor, not later than 10 days of receipt of each progress payment, unless otherwise agreed to in writing, the respective amounts allowed the contractor on account of the work performed by the subcontractors, to the extent of each subcontractor’s interest therein.” The trial court and court of appeal found that Thompson Pacific and Martin Brothers had “otherwise agreed” to a different time of payment. Thus the parties had “opted out” of Section 7108.5 by the provision in the sub-contract that stated, “Subcontractor agrees that payment is not due until Subcontractor has furnished all applicable administrative documentation required by the contract documents and the applicable releases pursuant to Civil Code section 3262.” The court interpreted the language of Section 7108.5 to permit contractors and subcontractors to waive the payment requirements otherwise provided for in that statute, perhaps even indefinitely. It is true that Section 7108.5 permits parties to “otherwise agree[] in writing.” The parties may wish to agree to lump sum payments upon conclusion of certain construction milestones, for example. However, the court of appeal’s holding in Martin Brothers Construction has now opened the door for contractors to incorporate language into sub-contracts under Section 7108.5 that authorizes indefinite delay. Although several of the prompt payment statutes expressly prohibit waiver of the protections as against public policy, Section 7108.5 does not contain such an express prohibition.

**Final Payment or Progress Payment**

In Murray’s Iron Works, Inc. v. Boyce, the Sixth District Court of Appeal dealt with the question of whether a final payment, due at the conclusion of the work, was covered by Civil Code Section 3260.1, which provides for prompt payment of progress payments. According to Section 3260.1(b), “Except as otherwise agreed in writing, the owner shall pay to the contractor, within 30 days following receipt of a demand for payment in accordance with the contract, any progress payment due thereunder as to which there is no good faith dispute between the parties.” Civil Code Section 3260(g) further provides that the remedy for failing to make a progress payment when due is the same remedy as provided under Section 3260 covering retentions—namely, a charge of 2 percent per month on the improperly withheld amount, in lieu of any other interest, as well as attorney’s fees and costs to the prevailing party.

The contract in Murray’s Iron Works provided that payment would be made “50% Deposit/Net upon Satisfactory Completion of Project.” Upon completion, the owner paid less than half of the outstanding amount ($50,000 of $116,222) and raised a claim of breach of contract as a result of the contractor providing decorative ironwork containing imitation gold leaf rather than 22-carat gold leaf. Contending that imitation gold leaf was agreeable to the parties as an acceptable finish, the contractor sued under Civil Code Section 3260.1 for the remainder of the final payment.

In construing Section 3260.1, the court stated, “Since the payment was not due until the project was completed, it is considered a final payment and not a progress payment.” While the term “progress payment” is not defined anywhere in the Civil Code, the Business and Professions Code defines “progress payments” as “any payments, other than the down payment,...made before the project is completed.” Sections 10853(e)(1) and 20104.50 of the Public Contracts Code define “progress payments” as “all payments due contractors, except that portion of the final payment designated by the contract as retention earnings.” From these analogous sources, the court of appeal in Murray’s Iron Works reasoned that at least part of a final payment could be deemed a progress payment.

Nevertheless, the court came to the “logical conclusion” that inasmuch as a final payment is to be made after all work is completed, that payment cannot be a progress payment because “there is nothing left on which to stop work.” The contractor may have thought that its final progress payment was protected under the prompt payment provisions of Section 3260.1, but by failing clearly to name that payment a progress payment, the contractor lost its remedy.

The Second District Court of Appeal also addressed the final payment issue in Yassin v. Solis. Following Murray’s Iron Works, the Yassin court agreed that a final payment was not a progress payment. Moreover, the court held that the final payment also was not a retention payment under Section 3260: “The remedy for the failure to pay a last installment payment upon completion of the services is simply damages for a breach of contract.”
Yassin, a contractor, was hired by the Solises to do improvement work on their home. The contract for $75,000 provided for a down payment and additional payments at various stages of construction, including $15,000 after the final inspection and a final payment of $7,500 due upon the issuance of the certificate of occupancy. The trial court awarded Yassin nothing on his claim and awarded the Solises $50,000 on their cross-complaint for deficient work. In addition, the trial court awarded the Solises attorney’s fees on the theory that they had prevailed on Yassin’s claim for the final $7,500 payment—which the trial court deemed to be a retention under Section 3260. The court of appeal reversed the award of attorney’s fees on the ground that the final payment was not a retention payment, and thus Section 3260 was not applicable.

In reaching this result, the Yassin court reasoned that the last payment did not constitute “retention proceeds withheld from any payment” but was instead merely a final payment. The court stated, “Retention amounts are a form of security generally retained by the owner from prior payments due for work previously performed.” The final payment is just that, a final payment, and not an amount that has been previously withheld, unless the contract specifies that sums were being withheld during the course of the work. The trial court had recognized that the final payment of $7,500 was 10 percent of the total contract price, which is the amount usually withheld by the owner, and had deemed the final payment to be a retention because it was not to be paid until the work was approved. While noting that this position was “tenable,” the court of appeal rejected it, apparently because the contract did not name the final payment a retention.

As if to confirm the confusion and inconsistencies inherent in the collection of prompt payment statutes, the Second District followed its decision in Yassin with another (and rather complicated) analysis of Civil Code Sections 3260 and 3260.1 in Heinefeld-Ward, Inc. v. Lipian. At issue in that case was whether the contractor was entitled to an award of attorney’s fees under Section 3260.1 as a result of the owner’s withholding of progress payments.

The court’s analysis demonstrates the tangled thicket that the prompt payment statutes have become:

As we have seen, section 3260.1, subdivision (b) provides for recovery of the “penalty” specified in section 3260, subdivision (g), but that statute does not use the term “penalty.” In contrast, other prompt pay statutes cited by the parties expressly characterize a monthly charge imposed on withheld amounts as a “penalty.” The characterization of the monthly two percent charge in section 3260, subdivision (g) as “in lieu of interest” rather than as a “penalty” reflects a legislative choice to distinguish that statute from other prompt pay statutes. Had the Legislature employed the term “penalty” in section 3260, subdivision (g) to describe the two percent charge, the statute would not be ambiguous and no resort to other interpretive aids would have been required.

The court despaired of finding clarity in the statutes and turned to legislative history for support for its conclusion that both the 2 percent monthly interest payment and the prevailing party attorney’s fees were intended to be the “penalty” within the meaning of Section 3260.1.

Naming Payments

What is evident from these cases is that judges are reading the prompt payment statutes narrowly and cautiously. Construction disputes traditionally are more apt to find their way into arbitration, and as a result the published case law on payment issues is relatively slim. The court in Martin Brothers Construction refused to take judicial notice of the legislative history that would have explained the purpose of the prompt payment laws, stating that the language of the statutes was clear enough for the court to interpret without the need for outside resources. Likewise the courts in Yassin and Murray’s Iron Works relied upon a careful parsing of the statutory language and compared that to the contract provisions at issue.

For counsel drafting construction contracts, the lessons from these recent cases is the importance of carefully naming payments. This includes not only defining what each payment is but also denoting the preconditions to payment and when payment is due. Progress payments and retention payments have specific statutory protections, but these payments must be clearly specified. If a payment due at the end of construction is one last “progress payment” (albeit at the end of the progress), it should be identified clearly as a “progress payment” or the “final progress payment.” If the final payment is payment of the retention, it should be named “payment of the retention.” Cats may have three names, as T.S. Eliot has written, but payments under construction contracts are better off having only one name—and a very specific one at that.

Owners have the greater bargaining power in the current economic climate, but counsel for contractors should be able to specify and clarify the conditions that must be met before payments are made. If lien releases or other documentation are required, the contract should specify that payments are to be made within a certain number of days after the documentation has been provided, in order to avoid an indefinite delay. With regard to retention against disputes, the contractor should clarify the disputes against which the retention is being withheld. Owners and contractors both benefit from contract terms that are clear and explicit.

California’s prompt payments statutes reflect a legislative determination that contractors and subcontractors should be paid promptly for their work. In scaling back these protections in Martin Brothers Construction, Murray’s Iron Works, and Yassin, the courts of appeal did not dispute this remedial statutory purpose but nonetheless applied rules of strict statutory construction. Assuming that the construction industry believes that prompt payment statutes are still needed, the time is now for all parties involved in the industry to propose that the legislature create a uniform statutory scheme. This would replace the current disparate and inconsistent statutes and directly address the issues presented by the recent appellate opinions as well as future decisions that may further restrict California’s prompt payment remedies.

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5. Id. at 1414.
6. Id. at 1416-17.
7. PUB. CONT. CODE §7107(f).
8. PUB. CONT. CODE §7107(h).
9. PUB. CONT. CODE §7107(e) (emphasis added).
11. Id. at 1415.
13. CIV. CODE §3260(g).
15. BUS. & PROF. CODE §7159.
17. The contractor still has its breach of contract remedy, but it lost the right to collect interest of 2 percent per month plus costs and attorney’s fees.
19. Id. at 6725.
20. Id. at 6723.
23. “The Naming of Cats is a difficult matter. It isn’t just one of your holiday games! You may think at first I’m as mad as a hatter! When I tell you, a cat must have THREE DIFFERENT NAMES.” T.S. Eliot, “The Naming of Cats,” OLD POSSUM’S BOOK OF PRACTICAL CATS (1939).
ROY SNYDER, A TRUCK DRIVER, decided to take out a loan on his mother’s unencumbered home to pay some bills. He wanted to borrow approximately $4,000, and he had his mother’s authorization to use the property as security for the loan. At the time the loan was made, a loan broker’s commission on loans up to $4,999.99 was limited by law. Snyder’s loan officer talked him into borrowing $5,250, thereby avoiding the limit on the broker’s commission. The higher loan amount was achieved by selling credit life insurance and disability insurance to Snyder for $1,117.20, which Snyder was informed he had to buy to receive the loan. The insurance company was owned by one of the loan brokers, his sister, and the sister’s husband. As a commission, the brokers took a second trust deed on Snyder’s mother’s property for $2,500.

In total, Snyder incurred an indebtedness of $7,750 and received $3,874.60, while the brokers amassed $3,875.40. If Snyder’s loan had been under the statutory limit of $4,999.99, the brokers’ maximum commission would have been $750. This fact was never disclosed to Snyder.

The California Department of Real Estate became aware of the brokers’ activities involving Snyder. After an investigation and the required procedures, the DRE revoked the brokers’ real estate licenses, along with the licenses of their salesmen. The DRE did so based on the brokers’ violations of Business and Professions Code provisions addressing misrepresentation, fraud, and dishonest dealing.1

This scenario of self-dealing took place in 1967, when loan money was tight and real estate brokers often resorted to creative ways to earn commissions. Some of those methods were unlawful, as in the case involving Snyder. Now, once again, in another distressed real estate market, the DRE finds itself with a surge of real estate law violations involving many old tricks as well as new ones in the areas of loan modification, foreclosure rescue, and short sale fraud activity. Practitioners representing real estate brokers or parties seeking redress for questionable broker practices need to become aware of the DRE’s mandate, scope, and disciplinary procedures.

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The DRE is a licensing, regulatory, and enforcement agency. Its legislative mandate is to protect the public regarding transactions for the purchase, sale, and lease of real property, business opportunities, common interest developments, timeshares, mobile homes affixed to the land, and loans secured by real property. Those seeking to represent parties in these transactions must obtain a license from the DRE as either a real estate broker or salesperson, except for attorneys rendering services to a client. Engaging in the transactions covered by the DRE's mandate without a real estate license can result in criminal liability. The authority for the DRE's operations is the Real Estate Law, which is codified in the Business and Professions Code, and the Regulations of the Real Estate Commissioner, which are codified in the California Code of Regulations.

Created in 1919, the DRE's purpose has always been to require that brokers and salespeople be honest and trustworthy, as they generally act in a confidential and fiduciary capacity with the public. The DRE achieves this goal not only through licensing but also through disciplinary actions against licensed brokers and salespersons. Conduct that violates the Real Estate Law will result in formal disciplinary action against a licensed real estate broker—whether the broker was acting on behalf of others or as a principal, and whether or not the conduct occurred in the context of a real estate transaction.

In addition to revocation of a real estate license, the types of discipline imposed by the DRE include revocation of the plenary license and issuance of a restricted license; suspension of the license with or without a monetary penalty (up to $10,000); restitution to the victim; educational course completion and ethics testing; trust fund reporting requirements; chargeable audits; criminal arrest reporting requirements; order of debarment “from any position of employment, management, or control”; and desist and refrain orders.

Until a formal pleading is filed against a licensee or applicant, the DRE's investigative review process is completely confidential. When a consumer files a complaint against a real estate broker, only the party who made the complaint and the party against whom the complaint was made will be aware that the DRE is conducting an investigation. Once the department makes a determination that the broker's conduct warrants formal disciplinary action, it files an Accusation against the broker's license and assigns an H number—a case designation that begins with the letter “H.” Filed hearing documents are public records, and H numbers appear on a broker's public records license page on the DRE's Web site.

The DRE's disciplinary procedures are conducted pursuant to the Administrative Procedure Act. Licensees have the right to a hearing before an administrative law judge. The process has its own rules of procedure, discovery, and evidence that differ from rules applicable in criminal prosecutions or civil court actions. Following the hearing, the ALJ issues a Proposed Decision. The California Real Estate Commissioner has the discretion to accept or reject the ALJ's decision, and the commissioner's decision is final and given an effective date. The commissioner's decision may be overturned only by a request for reconsideration made directly to the commissioner or a writ of mandate filed in superior court.

Since violators of the Real Estate Law may be subject to criminal penalties, the DRE coordinates its investigative efforts with other law enforcement agencies. Prosecutions are pursued by county, state, or federal prosecutorial officials depending on the type of violation. If another administrative agency has prosecuted a broker or salesperson before the DRE commences its action, the department's ultimate disciplinary action may include, or be based on, the other agency's findings and results. A licensed real estate broker will be subject to discipline if his or her conduct demonstrates a lack of honesty and integrity—whether that determination has been made by the DRE alone, by some other agency, or by the court.

All real estate broker applicants must provide a fingerprint sample to the DRE so the department can conduct a criminal records background investigation prior to the issuance of a license. Once the license is issued, the fingerprint database remains active. The California Department of Justice notifies the DRE whenever a real estate licensee has been arrested or convicted of a crime. The DRE then will file formal disciplinary proceedings against any licensee who has entered a plea of guilty or no contest, has been found guilty of, or been convicted of, a felony or a crime “substantially related” to the qualifications, functions, or duties of a real estate licensee.

**Revocation after Judgment by Others**

The DRE's formal disciplinary proceedings will arise even when the crimes committed by the licensee do not directly involve real estate. The DRE will examine the conduct at issue to determine whether it substantially relates to the standard of conduct for a real estate licensee.

For example, *Arneson v. Fox* involved a real estate broker who was found guilty in U.S. district court of participating in a scheme to make false land sales to straw buyers or shell corporations. The aim of the scheme was to boost the financial statements of a real estate development company. The broker set up various shell corporations that purchased property from the development company in paper deals devised to appear as if they were arm's-length transactions. In fact, the development company or its officers actually provided the funds for the purchases to increase the company's stock price and thereby create the impression that the development company was extremely profitable. Following the broker's felony conviction, the DRE revoked the broker's real estate license.

The DRE also revoked the license of the real estate broker in *Robbins v. Davi*. In *Robbins*, the real estate broker managed over 20 properties consisting of more than 1,000 residential apartments. He was found guilty of misdemeanor violations of the Los Angeles Municipal Code relating to fire prevention and safety. While the court of appeal held that the broker's criminal conviction alone was insufficient to support the revocation of his real estate license, it noted that the DRE was authorized to look to the underlying circumstances to determine the degree of discipline or to ascertain whether the violations were substantially related to the qualifications, functions, or duties of a real estate licensee.

The broker's conduct in *Robbins* entailed an unlawful act with the intent of conferring a financial or economic benefit upon him or with the intent or threat of doing substantial injury to the person or property of another. This constituted a violation of Business and Professions Code Section 10177(b) and California Code of Regulations Title 10, Section 2910. The DRE's action was based on the broker's conviction of three misdemeanor violations of the fire protection and prevention provisions of the Los Angeles Municipal Code. However, the broker previously was convicted of 50 municipal code violations in the period between 1986 and 1995. In upholding the DRE's revocation of the broker's license, the court of appeal noted that the broker's activities in ignoring fire code laws involved an intent to confer a financial benefit by reducing operating expenditures while simultaneously risking the safety of the apartment tenants.

Real estate brokers frequently hold other professional licenses in addition to a real estate license. Also, real estate brokers engaged in mortgage loan activities often are licensed in more than one state. A broker's real estate license will be subject to suspension or revocation if another licensing agency within California or in any other state suspends or revokes that broker's other license based on acts that would also constitute a violation of the Real Estate Law.

In some cases, the DRE's discipline might be more severe. For example, in *Herrera v. Department of Real Estate* the department
1. When was the California Department of Real Estate established?  
A. 1901.  
B. 1970.  
C. 1999.  
D. None of the above.

2. The action of another state to revoke a real estate broker license in that state is not recognized in California.  
True.  
False.

3. Once a consumer makes a complaint to the DRE about a real estate broker, the consumer forfeits all civil remedies against the broker.  
True.  
False.

4. A person must acquire a real estate license to perform which of the following real estate activities?  
A. Selling the person’s own house.  
B. Handling loans secured by real property.  
C. Asking the person’s lender to modify the person’s mortgage loan.  
D. None of the above.

5. A real estate broker has a duty to exercise reasonable supervision over the real estate corporation for which he or she is the designated officer and over the salespersons in his or her employ.  
True.  
False.

6. The DRE is a:  
A. Regulatory agency.  
B. Licensing agency.  
C. Enforcement agency.  
D. All of the above.

7. The types of disciplinary actions the DRE may take include:  
A. Imposition of jail time.  
B. Seizure of bank assets.  
C. Fines up to $10,000.  
D. None of the above.

8. A real estate broker license only can be revoked if the broker’s misconduct involved the use of the license in a real estate transaction.  
True.  
False.

9. Consumers can discover if the DRE is investigating a real estate broker by searching the broker’s license information page on the DRE Web site.  
True.  
False.

10. The DRE process for imposing discipline against a real estate broker license is governed by:  
A. The Office of Administrative Hearings.  
B. The Administrative Procedure Act.  
D. The California Association of Realtors.

11. A person could be imprisoned for conducting real estate activities without first obtaining a real estate license from the DRE.  
True.  
False.

12. Funds that a real estate broker receives on behalf of another party must immediately be placed into:  
A. A neutral escrow depository.  
B. The hands of the broker’s principal.  
C. The broker’s trust fund account.  
D. Any of the above.

13. A final civil court fraud judgment against a broker is grounds to revoke a real estate broker license regardless of the type of fraud.  
True.  
False.

14. The conviction of a crime is grounds for the revocation of a real estate broker license if the crime involves moral turpitude.  
True.  
False.

15. A licensed California attorney does not need a real estate license to conduct real estate activities in the course of rendering legal services for a client.  
True.  
False.

16. A real estate salesperson can be compensated by any real estate broker.  
True.  
False.

17. Documents on file in a formal disciplinary proceeding to revoke a real estate license are public records.  
True.  
False.

18. In Robbins v. Davi, the court ruled that Robbins’s real estate broker license could not be revoked because he was an attorney.  
True.  
False.

19. The DRE’s mandate is to:  
A. Protect the public.  
B. Issue real estate licenses.  
C. Issue public reports for private interest developments.  
D. Discipline the licenses of real estate brokers who break the law.

20. Business and Professions Code Section 10177 covers discipline for a broker’s misconduct that does not occur in connection with a real estate transaction.  
True.  
False.
revoked the real estate broker license of a lawyer whose law license was merely suspended by the State Bar of California. The State Bar found that Herrera had received client funds without notifying the client and then misappropriated the client’s funds for his own use. As punishment, the State Bar suspended Herrera’s law license for 60 days, with one year of probation. The DRE’s revocation of Herrera’s real estate broker’s license was grounded on the suspension of Herrera’s law license. Indeed, Herrera’s misappropriation of trust funds was conduct that would have warranted the revocation if it had occurred in the context of a real estate transaction. The suspension would have been grounds to deny the issuance of a real estate license if Herrera had applied for a license after the State Bar’s action.

The DRE’s “substantially related” standard also applies to brokers who have incurred civil liability. The DRE will accept the findings of a civil court, even though the civil standard of proof is not as high as the DRE’s administrative standard of proof—which is clear and convincing to a reasonable certainty. A real estate broker’s license will be subject to discipline after a final civil court judgment that is related to a real estate matter and is based on the grounds of fraud, misrepresentation, or deceit. The ground for discipline is the issuance of the judgment, so civil cases, like criminal cases, will not be religitigated in the administrative proceeding.

An illustrative case is *Denny v. Watson*, in which a group of real estate brokers had their licenses revoked following a civil judgment against them for fraud. The court found that the brokers together secured the deed to a motel from one of their clients for no money down. The brokers promised that they would (1) not record the deed until they had sold the property, (2) make the payments on the trust deeds and liens against the property, (3) manage the property, and (4) when they sold it, pay the client $5,500, clear of the debts. Instead, the brokers recorded the deed, failed to make the necessary trust deed payments, permitted the property to be sold under power of sale in one of the trust deeds, and, through a con- federate, purchased the property for themselves at the trustee’s sale for a reduced price. The seller sued the brokers and obtained a civil judgment for fraud. The DRE revoked the brokers’ licenses based on the judgment.

The DRE’s disciplinary actions are completely independent of the civil remedies that a consumer may pursue against a real estate broker based on the same activity. A civil judgment for fraud is only one ground upon which a broker’s activities—conduct that resulted in harm to a consumer—could result in the revocation of that broker’s license.

**Investigations by the Department**

In addition to accepting the findings of other agencies and tribunals, the DRE conducts its own investigations into alleged real estate broker misconduct. A real estate broker’s license will be subject to discipline for violations of the Real Estate Law or state regulations promulgated to address or prevent direct losses to the public as the result of misrepresentation, fraud, dishonest dealing, negligence, unlicensed activity, trust fund mishandling, and lack of broker supervision.

In keeping with the DRE’s mandate to protect the public, a real estate broker’s license will be subject to disciplinary action whether the broker was acting on behalf of a client or as a principal. When a broker’s wrongful conduct occurs during the course of performing licensed real estate activities, Business and Professions Code Section 10176 governs the discipline for that conduct. Section 10177 provides for discipline of a broker’s wrongful conduct that is not strictly within the course and scope of real estate activities.

For example, in *Realty Projects v. Smith*, the case involving overcharged borrower Roy Snyder, the brokers’ licenses were revoked for violations of Sections 10176(a) (making any substantial misrepresentation), 10176(i) (conduct that constitutes fraud or dishonest dealing), 10177(d) (willfully disregarding or violating the Real Estate Law), 10177(j) (conduct that constitutes fraud or dishonest dealing), and 10177(k) (conduct supporting license denial). The disciplinary proceedings against the brokers and their sales agents were based on the Section 10176 requirement of fair and honest dealing while acting as mortgage loan brokers, but Section 10177 was applied to the

In affirming the license revocation, the court reiterated that the object of an administrative proceeding aimed at revoking a license is to protect the public—that is, to determine whether a licensee has exercised his or her privilege in derogation of the public interest, and “to keep the regulated business clean and wholesome.”
constitute a good faith claim to receive payments for property he did not own and could never convey is beyond comprehension. 3.30

In affirming the license revocation, the court reiterated that the object of an administrative proceeding aimed at revoking a license is to protect the public—that is, to determine whether a licensee has exercised his or her privilege in derogation of the public interest, and “to keep the regulated business clean and wholesome.” 3.31 When a real estate broker’s misconduct shows a complete lack of honesty and trustworthiness, it renders that broker unfit to hold the unique position of trust that real estate licensees are given by members of the public.

Unlicensed Activity

Consumers all too frequently suffer losses when they deal with unlicensed representatives in connection with real estate activities. With some exceptions, a real estate license generally is required for 1) buying, selling, or listing real property or a business opportunity, 2) managing rental property, 3) applying for the purchase or lease of government property, 4) handling loans secured directly or collaterally by liens on real property or on a business opportunity, and 5) buying, selling, or exchanging notes secured by real property or a business opportunity for another person. 3.32 Disciplinary issues arise when a licensee compensates an unlicensed person for performing activities that require a real estate license or when a salesperson accepts compensation for real estate activities from someone other than the broker under whom the salesperson is licensed. 3.33 The payment or collection of compensation for unlicensed real estate activity is a crime punishable by a fine up to $20,000, imprisonment up to six months in jail, or both. 3.34

Under the Real Estate Law, a salesperson who is not working under the auspices of a licensed broker is not licensed to conduct real estate activities. In Grand v. Griesinger, 3.35 a real estate salesperson operated a company that listed rental properties. He formed a partnership with a real estate broker for 25 percent of the net profits. The broker had no ownership in the company and no responsibilities. Moreover, the broker did no work for the company except to allow the salesperson to register the name of the company as a fictitious business under the broker’s license. The DRE refers to this type of uninvolved broker as a “rent-a-broker.” The salesperson involved his whole family in the business, including his father and wife, who were also licensed salespersons. The salesperson’s father proceeded to open his own company with his own rent-a-broker. The salesperson licenses of the real estate salesperson, his father, and his wife were all revoked because their real estate activities were conducted without actual supervision by the broker under whom they were licensed at the time or without their being licensed under any broker.

Unlicensed activity is usually uncovered after repeated losses by consumers based on the actions of the unlicensed individuals, who do not have the same training, experience, and responsibility normally attributed to real estate brokers. The Grand court explained that brokers and salespersons belong in distinctly different categories. Brokers are supposed to have superior knowledge, experience, and proven stability, and that is why the state authorizes them to conduct business dealings with the public involving contracts and the collection of money. A salesperson is not presumed to possess that same level of expertise and trustworthiness. 3.36

A recent DRE license revocation of two mortgage loan brokers shows the interplay of trust fund mishandling, in violation of Section 10145, with unlicensed activity causing a direct loss to a consumer. In the case, In the Matter of the Accusation of Charles Louis Tosti, 3.37 a real estate broker operated two mortgage loan companies. The broker’s husband was a real estate salesperson whose license had expired long before. The unlicensed husband solicited a consumer to provide funds to be used as hard money loans secured by real property. In exchange for checks totaling $150,000, which the consumer obtained by taking out equity loans against her home, the consumer was given deeds of trust for two different properties.

The consumer/lender later learned that the deeds of trust were completely false. In one deed of trust, signed by the unlicensed husband as purported “attorney in fact” for the owner, the property was not owned by the person who was named as the owner in the deed of trust. The other deed of trust was for a residential property that the broker and her husband were renting as their home for a few months. The consumer’s checks were deposited in the general bank accounts of the two mortgage loan companies, and the funds were converted by the broker and her husband to their own personal use. Outgoing company checks were signed by the couple’s son, who had no real estate license. Moreover, the designated officer of the company that had received the bulk of the funds was a rent-a-broker living in a nursing home in a remote part of the state.

While a licensed real estate broker may solicit funds for use as loans secured by real property, the funds received must be treated as trust funds. Funds acquired for the benefit of others that are not immediately placed into a neutral escrow depository or into the hands of the broker’s principal must be deposited into a trust fund account.
maintained by the broker in a bank or recognized depository in the state.38 The broker must be a signatory to the trust fund account, with other signatories limited to those who possess a real estate license or fidelity bond coverage.39

For proper trust fund handling, the chronological control record must be reconciled with the separate record and with the bank statement.40 In the DRE license revocation action, one check was written to the consumer/lender as a partial repayment of the loan by one of the mortgage loan companies. The check was signed by the broker’s unlicensed son and was returned by the bank for insufficient funds. If the original funds had been held in trust as required, and properly reconciled, the consumer would not have received a worthless check. The DRE revoked the licenses of the real estate corporations, the broker, and the rent-a-broker for multiple violations of the Real Estate Law, including trust fund mishandling and fraud.

Brokers also may be subject to license discipline for failure to exercise reasonable supervision over their corporation, employees, or salespersons.41 The supervising broker’s responsibility is to secure full compliance with the Real Estate Law and regulations by the corporation for which the broker is the designated officer and by the salespersons licensed under that broker.

While it may never be known whether the broker in the recent DRE license revocation case actually instructed her unlicensed husband to solicit funds from the consumer, the failure of the broker and the rent-a-broker to provide adequate supervision over the husband’s conduct as well as the mortgage loan brokerage activities of the two corporations led to disastrous consequences for the affected consumer/lender and, ultimately, for the brokers’ futures as real estate licensees.

2. BUS. & PROF. CODE §10133(a)(3). While attorneys engaging in real estate activities are exempt from DRE jurisdiction if those activities are part of services on behalf of a client, they may come within the reach of the DRE’s unlicensed activity prohibition if they are acting outside the attorney-client relationship. For example, loan modification is a real estate activity that requires a DRE license. Many attorneys without a real estate license were subject to DRE enforcement actions for collecting advance fees for loan modification from “clients” they had never even met.
3. BUS. & PROF. CODE §§10000-11288.
4. CAL. CODE REGS. tit. 10, ch. 6, §§2705 et seq. (the Regulations of the Real Estate Commissioner).
6. BUS. & PROF. CODE §§10156.3-10156.7.
7. BUS. & PROF. CODE §10087.
8. BUS. & PROF. CODE §10086.
9. GOV’T CODE §11340; CAL. CODE REGS. tit. 1, div. 2, ch. 1, §§10000 et seq.
10. GOV’T CODE §§11500-11522.
11. GOV’T CODE §11521.
12. GOV’T CODE §11523.
13. BUS. & PROF. CODE §§490, 10177(b), 10177(f), 10177.5.
14. BUS. & PROF. CODE §490, 10177(b); CAL. CODE REGS. tit. 10, ch. 6, §2910.
17. BUS. & PROF. CODE §10177(f).
20. BUS. & PROF. CODE §10177.5.
22. BUS. & PROF. CODE §§10176-10177.
23. BUS. & PROF. CODE §10131.
24. BUS. & PROF. CODE §10145.
25. BUS. & PROF. CODE §10139.2, 10177(b); CAL. CODE REGS. tit. 10, ch. 6, §2725.
26. See, e.g., BUS. & PROF. CODE §10177(j).
28. Id. at 210.
30. Id. at 455.
31. Id. at 457.
32. BUS. & PROF. CODE §10131.
33. BUS. & PROF. CODE §10137.
34. BUS. & PROF. CODE §10130.
36. Id. at 406.
38. BUS. & PROF. CODE §10145.
39. BUS. & PROF. CODE §§2832(a), 2834(a-b).
40. CAL. CODE REGS. tit. 10, ch. 6, §§2831.2.
41. BUS. & PROF. CODE §§10159.2, 10177(b).
THE MORTGAGE INDUSTRY has seen tremendous changes since the start of the financial crisis. New laws and regulations are changing the manner in which the industry does business. For example, the Secure and Fair Enforcement for Mortgage Licensing Act (SAFE Act) now mandates a nationwide licensing and registration system for mortgage loan originators and imposes education and testing requirements for state-licensed originators. New rules of the Department of Housing and Urban Development (HUD) that became effective on January 1, 2010, require a new good faith estimate to be given to borrowers. If charges at settlement exceed the charges listed on the good faith estimate, the lender or mortgage broker may be deemed to have violated the Real Estate Settlement Procedures Act (RESPA). Furthermore, the Board of Governors of the Federal Reserve System has issued new rules (that become effective April 2011) that will further restrict lender practices.

Perhaps the most important change, however, is the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act). President Barack Obama signed the act into law on July 21, 2010. This wide-ranging act will change the manner in which mortgage lenders, brokers, appraisers, settlement services providers, and others participating in mortgage lending will conduct business. The act imposes new prohibitions on compensation and steering practices, expands substantive protections and disclosure requirements relating to residential mortgage loans, creates a new agency—the Bureau of Consumer Financial Protection (CFPB)—to enforce fair lending laws, and imposes new requirements relating to the securitization of mortgage loans. The provisions most directly affecting the mortgage industry can be found in Title IX, X, and XIV of the act.

Title XIV
Title XIV—called the Mortgage Reform and Anti-Predatory Lending Act—contains a significant number of the new measures that will directly affect the mortgage industry. Title XIV amends the Truth in Lending Act (TILA) and other existing consumer protection statutes to regulate the origination of residential mortgage loans. Beth S. DeSimone is counsel in the financial institutions practice group of Arnold & Porter LLP in Washington, D.C., and James D. Richman is a partner in the firm’s real estate practice group in Los Angeles. Tengfei (Harry) Wu is an associate in the firm’s financial institutions practice group in Washington, D.C.

The Dodd-Frank Act takes aim at the primary abuses uncovered during the mortgage meltdown
idential mortgages, impose new minimum protection standards for mortgages, expand disclosure requirements relating to residential mortgage loans, place new restrictions on high-cost mortgages, set out new mortgage servicing-related requirements, and enhance oversight of residential loan appraisals.

The provisions of Title XIV apply to most residential mortgage loan originators. Title XIV defines the term “mortgage originator” broadly to include more loan origination participants than before. Specifically, the act defines a mortgage originator as a person who, for pay, performs, or represents to the public that he or she performs, any of the following activities: taking a residential mortgage loan application, assisting a consumer in obtaining or applying to obtain a residential mortgage loan, or offering or negotiating terms of a residential mortgage loan. A person who merely performs clerical tasks for a mortgage originator is not a mortgage originator. Typical mortgage originators include brokers and loan officers.1

The Dodd-Frank Act defines a “residential mortgage loan” as a closed-end consumer loan secured by a mortgage (or other equivalent security interest) on a dwelling (or residential property that includes a dwelling). Importantly, the definition does not include home equity lines of credit (HELOCs).2 Some of the requirements of the act apply to residential mortgage loans, as defined, and open-end loans that include HELOCs.

Not all of the requirements that Title XIV imposes are new. Under the act, a mortgage originator must be qualified and, when required, registered and licensed in accordance with applicable law, including the SAFE Act. In addition, a mortgage originator must include on all loan documents his or her unique identifier issued by the Nationwide Mortgage Licensing System and Registry.3

The act also regulates the compensation that can be paid to a mortgage originator. It prohibits a mortgage originator from receiving any compensation that varies based on the terms of a residential mortgage loan other than the principal amount.4 In addition, a mortgage originator can only be paid an origination fee by the consumer. One exception is that a mortgage originator may receive compensation from a person other than the consumer if 1) the mortgage originator does not receive any compensation directly from the consumer, and 2) the consumer does not make an up-front payment of discount points, origination points, or fees (except for exemptions that the Federal Reserve, or later the CFPB, may provide for by regulation).5 Also, yield spread premiums are prohibited if the total amount of direct and indirect compensation from all sources permitted to a mortgage originator would vary based on the terms of the loan (other than the principal amount).6 The act grants a consumer the right to assert a violation of these provisions as an affirmative defense in a foreclosure action—without regard to the statute of limitations.7

The act also requires regulations to be promulgated in order to reduce “steering” of consumers toward loans with disadvantageous terms.8 This is similar to the Final Rules published by the Federal Reserve on August 16, 2010, which also prohibit steering practices. Under the antisteering provisions of the Final Rules, to determine a violation, one examines whether the alleged steering practices have the effect of maximizing the originator’s compensation from the lender—and thus potentially adverse to the consumer’s interest. By comparison, when reviewing an alleged violation of the antisteering provisions of the Dodd-Frank Act, one must review the terms of the loan to which the consumer is steered to determine whether it has the prohibited disadvantageous features. A loan with disadvantageous terms tends to result in higher compensation to the originator. The antisteering provisions of the Final Rules and those of the Dodd-Frank Act aim for the same consumer protection goal.

Another important change of Title XIV involves new minimum substantive protection standards. These are designed to impose a “suitability-like” standard on lenders and discourage them from making some of the unconventional or hybrid loans that many have cited as a primary reason for the mortgage crisis.

The first substantive protection standard that the Dodd-Frank Act imposes is that no lender may make a residential mortgage loan unless the lender makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the borrower has a reasonable ability to repay the loan and all applicable taxes and insurance over the loan term.9 If the property securing the proposed loan is subject to more than one lien, the lender must make this determination with respect to all the loans secured by liens on that dwelling.10 In determining whether the borrower has the ability to repay, the lender must consider credit history, current income, expected income, current obligations, debt-to-income ratio, employment status, and financial resources other than the house being mortgaged, among other underwriting criteria. With the exception of loans that refinance certain government guaranteed loans, the lender also must verify the borrower’s income or assets. Reverse mortgages are generally exempted from these provisions.11

There also are several specific provisions relating to how a lender must determine the borrower’s ability to repay with respect to certain unconventional loans, including variable rate loans that defer repayment of any principal or interest, interest-only loans, and negative amortization loans. These rules would require the lender to consider higher payments that the borrower would have to make but for the “unconventional” characteristics.12

The act also sets forth factors to consider in determining a borrower’s ability to repay when the lender considers an application for refinancing an existing hybrid loan into a standard loan. Under this provision, if there would be a reduction in monthly payment and the borrower has not been delinquent on any payment on the existing hybrid loan, the lender, in determining the borrower’s ability to repay, may 1) consider the borrower’s good standing on the existing mortgage, 2) consider if the extension of new credit would prevent a likely default should the original mortgage reset, and give these concerns a higher priority, and 3) offer rate discounts and other favorable terms to the borrower that would be available to new customers with high credit ratings. It appears that the Dodd-Frank Act allows the lender to consider the borrower’s ability to repay with a standard loan relative to the borrower’s ability to repay under the existing hybrid loan, although the statutory language does not specifically say so.13

Violation of these rules is an assertable defense for a borrower in a foreclosure action, without regard to the statute of limitations.14 The act provides, however, a safe harbor in which a lender making a “qualified mortgage” loan meets the “ability to repay” requirements. To be a qualified mortgage loan, a loan must generally possess seven characteristics. First, it must not permit negative amortization or, subject to certain exceptions, deferred principal. Two, subject to certain exceptions, it must not require any balloon payment (defined as a scheduled payment that is more than twice as large as the average of earlier scheduled payments). Three, the income and assets relied on to qualify the borrower must be verified and documented. Four, underwriting must be based on full amortization over the loan term. Five, the debt-to-income ratio must not exceed certain guidelines to be set by regulation. Six, total points and fees must not exceed 3 percent of the total loan amount (with certain exceptions allowed for smaller loans in rural areas), and seven, the loan term must not exceed 30 years, subject to certain exceptions.15 Certain mortgages with balloon payments may be considered qualified mortgages in limited circumstances under regulations to be promulgated that are to be otherwise
consistent with these factors.\textsuperscript{16}

The second substantive protection standard imposed by the act prohibits prepayment penalties on any loan that is not a qualified mortgage loan. While prepayment penalties may be imposed on a qualified mortgage, they are subject to limits decreasing over a three-year period from 3 percent of the loan balance to 1 percent of the loan balance. Moreover, a creditor may not offer a residential mortgage loan with a prepayment penalty without also offering one without a prepayment penalty.\textsuperscript{17}

Third, the act provides that no lender may finance, with respect to any residential mortgage loan or any HELOC secured by a consumer’s principal dwelling, credit insurance paid as a lump sum, except for certain credit unemployment insurance sold by unaffiliated third parties.\textsuperscript{18}

Finally, no residential mortgage loan or HELOC loan secured by a consumer’s principal dwelling may include terms requiring arbitration or any other nonjudicial procedure for resolving disputes. However, a consumer may agree to this type of resolution method after a dispute arises.\textsuperscript{19} One provision in the act that favors lenders is that if a borrower has been convicted of obtaining a residential mortgage loan by actual fraud, the lender may not be held liable for violations of TILA for that loan.\textsuperscript{20}

Disclosure Provisions

The act imposes new disclosure requirements for consumer mortgage loans. For example, negative amortization loans secured by a dwelling, whether closed-end or open-end, require additional disclosures about negative amortization.\textsuperscript{21} Additionally, if a residential mortgage loan is protected by state antideficiency laws, as is the case in California, the creditor or mortgage originator must provide notice of this protection, and if a refinancing would cause the borrower to lose antideficiency protection, the creditor or mortgage originator in the refinancing must provide notice of loss of protection.\textsuperscript{22} The Dodd-Frank Act also will require that six months’ notice be given for changing a fixed rate to a floating rate on a hybrid adjustable rate mortgage, and similar notice may be required by regulation for nonhybrid adjustable rate mortgages.\textsuperscript{23}

Furthermore, the act requires new disclosures to be provided at the closing of a mortgage loan, such as: 1) information regarding settlement charges, including the aggregate amount of the charges, and the amount included in the loan and the amount to be paid at the closing, 2) the approximate wholesale rate of funds in connection with the loan, 3) mortgage originator compensation, 4) total interest payments over the loan term as a percentage of the loan principal, and 5) certain monthly payment information for variable rate loans with escrow accounts.\textsuperscript{24}

New information also must be provided on periodic statements for each billing cycle: 1) the amount of the loan principal, 2) the current interest rate, 3) the date on which the interest rate may reset or adjust, 4) any prepayment fee, 5) any late fee, 6) a phone number and an e-mail address the borrower may use to obtain information on the loan, 7) information on credit counseling agencies, and 8) any other information required by regulation.\textsuperscript{25}

Title XIV also expands the applicability of the “high rates, high fees” provisions of the Home Ownership and Equity Protection Act (HOEPA). Currently, HOEPA and the Regulation Z provisions implementing it cover certain “high rates, high fees” loans, but generally, these laws only apply to refinancing and home equity installment loans.\textsuperscript{26} The act will make HOEPA apply to all “high-cost mortgages,” including purchase money mortgages, and add further consumer protections.

Under the act, a high-cost mortgage is redefined to be a loan (whether closed-end or open-end) that is secured by a consumer’s principal dwelling and that fits under one of three categories. The first category is one in which the annual percentage rate (APR) exceeds the average prime offer rate (which will be published by the Federal Reserve and eventually by the CFPB) for a comparable transaction by more than 6.5 percent if the loan is secured by a first mortgage, or by more than 8.5 percent if secured by a second mortgage. The second category is one in which the total points and fees exceed 5 percent of the loan amount if the loan is $20,000 or more; or the lesser of 8 percent of the loan amount or $1,000 if the loan amount is less than $20,000. The third category is one in which the prepayment penalties exceed more than 2 percent of the amount prepaid.\textsuperscript{27}

The Dodd-Frank Act imposes significant restrictions on high-cost mortgages. Among other things, a high-cost loan cannot be subject to any balloon payment (i.e., a scheduled payment that is more than twice as large as the average of earlier scheduled payments).\textsuperscript{28} Also, the act limits the late fees that can be charged and restricts the acceleration of any high-cost mortgage. Points and fees on a high-cost mortgage may not be financed. In addition, certain preloan counseling is required for a high-cost mortgage.\textsuperscript{29}

Mortgage Servicing and Appraisal

Title XIV of the Dodd-Frank Act also imposes additional requirements relating to mortgage servicing, mostly relating to the establishment and maintenance of escrow accounts, which becomes mandatory for many borrowers. Under the act, a lender is required to establish an escrow account for the payment of taxes, insurance premiums, and other required assessments associated with any closed-end loan secured by a first lien on the principal dwelling of a consumer if it is made, guaranteed, or insured by a state or federal governmental lending or insuring agency. The rule also applies if the APR on the loan exceeds the average prime offer rate for a comparable transaction by at least 1.5 percentage points for a loan that does not exceed the applicable conforming loan limit, or by at least 2.5 percentage points for a loan exceeding the applicable conforming loan limit.\textsuperscript{30}

The act allows the Federal Reserve (and presumably eventually the CFPB) to provide for exceptions from this requirement for lenders operating in rural and underserved areas that retain their loans in portfolio. In addition, new or modified requirements may be imposed if the modifications are in the interests of consumers and the public.\textsuperscript{31}

If required, the escrow account generally must be maintained for at least five years after the loan closing, unless 1) the borrower has sufficient equity in the dwelling to no longer be required to maintain private mortgage insurance, 2) the borrower becomes delinquent on the loan, 3) the borrower otherwise has not complied with legal obligations as established by rule, or 4) the mortgage is terminated.\textsuperscript{32} The lender also is required under the act to provide certain disclosures regarding the mandatory escrow account at least three business days before the closing (or as otherwise provided by regulation), including the amount required to be placed in escrow at closing, the amount required for the first year, and the estimated monthly payment into escrow.\textsuperscript{33} When establishment of an escrow account is not mandatory, the lender or servicer must give the borrower disclosures regarding the responsibilities of the borrower and the implications if an escrow account is not maintained.\textsuperscript{34} If an escrow account is established, the repayment schedule must take the monthly escrow payments into account.\textsuperscript{35}

In addition, the act provides that a servicer of a federally related mortgage may not obtain and bill the cost to the borrower hazard insurance unless the borrower fails to comply with the insurance requirements after the servicer has sent two written notices to the borrower.\textsuperscript{36} It requires that escrowed amounts be refunded to the borrower within 20 business days of loan payoff.\textsuperscript{37} The Dodd-Frank Act also requires that servicers generally credit a payment to the consumer’s loan account as of the date of receipt, unless any delay in crediting does not result in any charge to the consumer or the reporting of negative
information to a consumer reporting agency. A lender or servicer of a home loan also must provide an accurate payoff balance within seven business days after receiving a written request.

Finally, Title XIV contains new rules governing the appraisal of residential property securing mortgage loans. The act prohibits lenders from making a “higher risk” (which is a wording change from “subprime”) mortgage loan to any consumer without obtaining a written appraisal made in accordance with a number of requirements. Among other things, the appraisal must be performed by a certified or licensed appraiser who conducts a physical property visit of the interior of the property. Additionally, a second appraisal must be performed if the loan is to finance the purchase of the property from a person who purchased the property at a price lower than the current sale price within the previous 180 days.

A “higher risk” loan is defined as a residential mortgage loan secured by a principal dwelling with an APR that exceeds the average prime offer rate for a comparable transaction by at least 1.5 percentage points in the case of a first lien loan having an original principal amount not exceeding the applicable conforming loan limit, or by at least 2.5 percentage points for a first lien loan exceeding the applicable conforming loan limit, or by at least 3.5 percentage points for a subordinate lien loan.

Certain acts or practices that compromise appraisal independence are prohibited if the appraised property is the principal dwelling of a consumer. For example, a person with an interest in the credit transaction may not compensate or otherwise influence the appraiser to obtain an appraised value that is not solely based on the appraiser’s independent judgment; nor may such a person mischaracterize or induce any mischaracterization of the appraised value of the mortgaged property. Furthermore, an appraiser with an interest in either the mortgaged property or the credit transaction may not be involved in appraising the mortgaged property. The act also prohibits a lender from extending credit on the basis of an appraisal that fails to meet the independence standards. In addition, if a person involved in a consumer credit transaction secured by the principal dwelling of a consumer has a reasonable basis to believe that the appraiser failed to comply with applicable laws or standards, that person must report the failure to the applicable state licensing agency. Persons covered by this provision would include mortgage brokers, lenders, and real estate brokers.

The Federal Reserve issued an interim final rule to implement these appraisal independence provisions in October 2010. The act also regulates appraisal management companies (i.e., companies that oversee more than 15 certified or licensed appraisers in a state or 25 or more nationally in a year), requiring them to be registered and supervised by a state appraiser certifying and licensing agency. An appraisal management company that is a subsidiary of an insured depository institution will be regulated by the federal regulator for the parent institution.

A broker price opinion (i.e., an estimate prepared by a real estate broker, agent, or salesperson that details the probable selling price of a particular piece of real estate property) may not be used as the primary basis to determine the value of a consumer’s principal dwelling for the purpose of originating a residential mortgage loan secured by that dwelling.

Finally, the act amends the Equal Credit Opportunity Act to require that each creditor furnish to an applicant a copy of any written appraisal and valuation developed in connection with the applicant’s application for a loan secured by a first lien on a dwelling promptly upon completion, but no later than three days prior to the loan closing (if the loan does go to closing). Currently, the creditor is required to furnish a copy of the appraisal only at the applicant’s request.

Title X
Title X of the act, which establishes the CFPB, also contains provisions that will affect participants in the mortgage industry. First, Title X will subject a wide range of nondepository entities in the consumer mortgage business to the regulation of the CFPB, including originators, brokers, servicers, and those providing loan modification or foreclosure relief services. The CFPB will conduct regular examinations of these entities and have the authority to take enforcement actions against them. Nondepository consumer mortgage entities are subject to a comparable degree of scrutiny for compliance to consumer protection laws as are depository institutions.

Title X also directs the CFPB to publish a single, integrated model disclosure form for mortgage loan transactions that meets the disclosure requirements of both RESPA and TILA. This new model disclosure form will set forth information regarding settlement costs, loan costs, and any transfer of servicing rights. The Federal Reserve and HUD had been discussing such a model form, and since the enactment of the act, further interagency discussions have been held to implement this requirement within the statutorily mandated one-year period.

In addition, Title X amends the Alternative Mortgage Transaction Parity Act of 1982 (Alternative Mortgage Act) in a manner that could bring about major changes to adjustable rate mortgages. Before the act, a state-chartered entity could make adjustable rate mortgage loans without regard to state laws that prohibited adjustable rate mortgage loans if the entity made the loans according to the regulations of the appropriate federal regulator. And the federal agencies that administered the Alternative Mortgage Act generally interpreted the preemptive scope of the Alternative Mortgage Act broadly. As a result, many state law restrictions were found to be prohibiting alternative mortgage transactions and thus preempted by the Alternative Mortgage Act.

The Dodd-Frank Act amends the Alternative Mortgage Act to clarify that state laws that regulate mortgage transactions in general are not preempted by the Alternative Mortgage Act.
Mortgage Act, and therefore, a state will be able to subject adjustable mortgage loans made by state-chartered entities to various restrictions, such as those on prepayment penalties or late charges, if such restrictions apply to mortgage loans in general. Moreover, under the act, an adjustable rate mortgage loan made by a state-chartered entity will need to comply with the new regulations that the CFPB may issue for federally chartered housing creditors to enjoy any preemptive effect of the Alternative Mortgage Act, and the CFPB may prescribe more stringent terms than those of the existing federal regulations governing such loans.32

The new preemption standard in the Alternative Mortgage Act may appear to deprive state-chartered entities of parity with their federally chartered counterparts with respect to adjustable rate loans, except to the extent that the CFPB’s regulations governing adjustable rate mortgages will be more stringent than any of the state regulations. Other provisions of Title X relating to preemption for federally chartered institutions could be narrowly construed to further reduce these differences, although it is unclear how these provisions will be implemented.

Finally, Title X also strengthens fair lending standards by requiring lenders to collect additional items of information under the Home Mortgage Disclosure Act regarding completed applications, loan originations, and loan purchases.53 For loans that a mortgage lending institution actually originates or purchases, the institution must also compile and report a number of other additional items. Fair lending enforcement will be transferred to the CFPB, which may require institutions to compile and report yet additional items of information. The CFPB must issue regulations regarding the format in which an institution must report the required information, taking into account the privacy interests of the mortgage applicants or mortgagees.54

Title IX

Title IX of the Dodd-Frank Act, which mostly relates to securities regulation, contains credit risk retention requirements that will directly affect mortgage lenders and issuers of mortgage-backed securities and the way these participants originate, sell, and package mortgage loans.

Specifically, an issuer of securities backed by certain mortgage loans, or a person who organizes and initiates the issuance of these securities by selling or transferring certain mortgage loans to the issuer, generally must retain at least 5 percent of the credit risk for the mortgage loans collateralizing the securities. If the issuer purchases the mortgage loans collateralizing the securities from a lender, the risk retention obligation will be allocated between the issuer and the lender according to regulations to be issued by the federal banking agencies and the Securities and Exchange Commission (SEC).55

“Qualified residential mortgages” are directed to be exempt from these risk retention requirements pursuant to joint regulations issued by the federal banking agencies, the SEC, the Secretary of HUD, and the Director of the Federal Housing Finance Agency. In that connection, the agencies must define the term “qualified residential mortgage” in their joint regulations, but the definition may not be broader than the definition of “qualified mortgage” set forth in Title XIV. In addition, in defining the term “qualified residential mortgage,” the agencies must take into account a number of underwriting and product features that historically result in a lower risk of default, such as documentation and verification of income and assets, and certain debt-to-income measures.56

The securitizer in an issuance of asset-backed securities may use the “qualified residential mortgage” exemption from the credit risk retention requirements only if all the assets that collateralize the issuance are qualified residential mortgages. In this connection, the SEC is directed to require each issuer that uses the exemption to certify that the issuer has evaluated the effectiveness of its internal supervisory controls for ensuring that all assets collateralizing the issuance are qualified residential mortgages. In addition, the exemption will not be available for an issuance of asset-backed securities collateralized by tranches of other asset-backed securities, regardless of whether the collateral securities themselves are collateralized solely by qualified residential mortgages.57

The act also states that the credit risk retention requirements do not apply if the assets collateralizing an issuance of asset-backed securities are residential mortgage loans insured or guaranteed by the United States or an agency of the United States. Fannie Mae, Freddie Mac, and the federal home loan banks are not considered an agency of the United States for purposes of this exemption. The only agencies that would appear to qualify for this exemption are the Federal Housing Administration and the Department of Veteran Affairs.58

There is no doubt that the Dodd-Frank Act will materially change the manner in which the mortgage industry conducts business. Certain originator compensation practices will need to be revisited, there will be far fewer interest only or limited or no documentation loans, lenders will need to provide more disclosures to borrowers—the list of changes can go on and on. The extent of the changes will become better known as the
federal regulators, particularly the Federal Reserve and the CFPB, issue new regulations to implement the new statutory requirements, a process that has already begun. To be well positioned for this new regulatory environment, participants in the mortgage industry would be advised to stay nimble and keep themselves informed.

2 Id.
3 Dodd-Frank Act §1402.
4 On August 16, 2010, the Federal Reserve published Final Rules amending Regulation Z (Final Rules). See Board of Governors of the Federal Reserve System, Regulation Z, Truth in Lending (Aug. 16, 2010) (to be codified at 12 C.F.R. pt. 226). The Final Rules also prohibit a loan originator in a residential mortgage loan transaction from being compensated on the basis of loan terms (other than the principal amount) and from receiving payments from a person other than the consumer if the originator is paid directly by the consumer. But the Final Rules do not contain all the restrictions imposed by the Dodd-Frank Act. Specifically, under the Final Rules, the lender may receive origination points from the consumer and pay the originator if the consumer does not pay the originator directly. In contrast, under the Dodd-Frank Act, if the consumer makes an up-front payment of origination points to the lender on a residential mortgage loan, the originator may not receive compensation from the lender on that loan. The Federal Reserve indicated in the preamble to the Final Rules that it would implement the relevant provisions of the Dodd-Frank Act fully in a subsequent rule making.
5 Dodd-Frank Act §1403.
6 Id.
7 Dodd-Frank Act §1413.
8 Dodd-Frank Act §1403.
9 Dodd-Frank Act §1411.
10 Id.
11 Id.
12 Id.
13 Id.
14 Dodd-Frank Act §1413.
15 Dodd-Frank Act §1412.
16 Id.
17 Dodd-Frank Act §1414.
18 Id.
19 Id.
20 Dodd-Frank Act §1417.
21 Dodd-Frank Act §1414.
22 Id.
23 Dodd-Frank Act §1418.
24 Dodd-Frank Act §1419.
25 Dodd-Frank Act §1420.
27 Dodd-Frank Act §1431.
28 Dodd-Frank Act §1432.
29 Dodd-Frank Act §1433.
30 Dodd-Frank Act §1461.
31 Id.
32 Id.
33 Id.
34 Dodd-Frank Act §1462.
35 Dodd-Frank Act §1465.
36 Dodd-Frank Act §1463.
37 Id.
38 Dodd-Frank Act §1464.
39 Id.
40 Dodd-Frank Act §1471.
41 Id.
42 Dodd-Frank Act §1472.
43 Id.
44 Id.
45 Id.
46 Dodd-Frank Act §1473(f).
47 Dodd-Frank Act §1473(c).
48 Dodd-Frank Act §1474.
49 Dodd-Frank Act §1024.
50 Dodd-Frank Act §1098.
51 The regulations that nonfederally chartered banks must comply with are those issued by the Office of the Comptroller of the Currency. Nonfederally chartered credit unions must comply with regulations issued by the National Credit Union Administration. All other nonfederally chartered housing creditors must comply with regulations issued by the Office of Thrift Supervision. 12 U.S.C. §3803.
52 Dodd-Frank Act §1083.
53 The Dodd-Frank Act does not specifically broaden the scope of institutions that are subject to the compilation and reporting requirements of the Home Mortgage Disclosure Act, however.
54 Dodd-Frank Act §1094. Information reported under the Home Mortgage Disclosure Act must be disclosed to the public in some form.
55 Dodd-Frank Act §941. The act directs the Federal Reserve to conduct a study of the effect of the new credit retention requirements. The Federal Reserve issued a report on the findings of the study in October 2010. In addition, the FDIC addressed the credit retention requirements of the act in its September 2010 final rule on safe harbor protection that the Federal Deposit Insurance Corporation, as conservator or receiver, provides for securitizations.
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**Personal Injury 101**

ON SATURDAY, JANUARY 8, the Los Angeles County Bar Association will host a program led by Brad Avritt, John Carpenter, Bruce Fishelman, Candice S. Klein, and Paul Zuckerman that will provide the nuts and bolts of litigating a personal injury case from intake to trial or settlement. Case evaluation and investigation, maintaining a proper file, calendaring, and using various retainer agreements will all be covered, as well as how to draft, file, and serve a lawsuit; how to take and defend a deposition; and how to efficiently propound and respond to written discovery. Court appearances will also be examined. Basic law and motion practice will also be discussed, including demurrers, motions to strike, motions to compel, and summary judgment motions.

Finally, the course will present a thorough overview of how to resolve cases, including presentations on how to write an effective demand letter, how to open an insurance policy, how to handle mediations and arbitrations, how to negotiate medical liens, and how to manage your client’s expectations. This course is an essential overview for new personal injury lawyers and a great refresher for the more experienced attorney. The program will take place at the Los Angeles County Bar Association, 1055 West 7th Street, 27th floor, Downtown. Parking is available at 1055 West 7th and nearby parking lots. On-site registration will begin at 7:30 A.M., with the program continuing from 8 A.M. to 1:30 P.M. This event is also available as a live Webcast. The registration code number is 011163.

- $135—CLE+Plus member
- $150—Small Firm and Solo Practitioner Section member
- $230—all others
- $205-$260—live Webcast
- 5 CLE hours

**Litigation for Business Managers**

ON THURSDAY, JANUARY 13, the Los Angeles County Bar Association will host a program led by James I. Ham and Ellen A. Pansky on how business managers can be more litigation savvy and capable of evaluating whether to resort to the courts. Understanding how to select and work with an attorney and understanding the litigation process is essential to a company’s legal affairs. Failure to understand the manager’s role, the attorney’s role, and the legal process can lead to mistakes, bad decisions, and expensive misunderstandings between client and lawyer. This presentation offers a primer for those who want to better understand the litigation process, what to expect, and how to have a successful relationship with an attorney. It will explore common misconceptions about the litigation process, how long it takes, the discovery process and what it involves, trials versus private mediation or arbitration, settlement approaches, the cost of litigation, and issues related to the attorney-client relationship. The program will take place at the Los Angeles County Bar Association, 1055 West 7th Street, 27th floor, Downtown. Parking is available at 1055 West 7th and nearby parking lots. On-site registration will begin at 4 P.M., with the program continuing from 4:30 to 6:30. This event is also available as a live Webcast. The registration code number is 011135.

- $20—CLE+Plus member
- $55—Small Firm and Solo Practitioner Section member
- $75—LACBA member
- $75—Los Angeles Chamber of Commerce member
- $100-$130—live Webcast
- 2 CLE hours

**ETHICS UPDATE**

ON SATURDAY, JANUARY 29, the Los Angeles County Bar Association, along with the Small Firm and Sole Practitioner Section, will present the seventh annual review of major ethics issues by the leading ethics attorneys in Los Angeles. John W. Amberg, Evan A. Jenness, Diane L. Karpman, Stanley W. Lamport, Clare Pastore, Jon L. Rewinski, and Robert K. Sall will review the important ethics decisions and ethics committee opinions reached in 2010. The discussion will also cover the proposed new Rules of Professional Conduct, what lawyers can and cannot reveal from confidential attorney-client relationships, and when conflicts of interest require leaving a matter. The panelists will also analyze fee and retainer issues, including what to do about fees when the legal relationship ends, motions for withdrawal and returning files, and the ethical and legal implications of social networking, listservs, e-mail, and metadata. The program will take place at the Los Angeles County Bar Association, 1055 West 7th Street, 27th floor, Downtown. Parking is available at 1055 West 7th and nearby parking lots. On-site registration will be available at 8:30 A.M., with the program continuing from 9 A.M. to 1 P.M. The registration code number is 011126.

- $90—CLE+Plus member
- $105—Small Firm and Solo Practitioner Section member
- $125—LACBA member
- $175—all others
- 3.5 hours of CLE credit, including ethics credit

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Mediation is Not a Contact Sport

OVER THE PAST FEW DECADES, MEDIATION has become an increasingly popular alternative to arbitration as a means of resolving disputes short of trial. Indeed, I remember well—not so long ago—when practitioners did not fully appreciate the difference between mediation and arbitration. Unfortunately, in the past several years mediation, too, has been caught up in the incivility crisis that has affected the legal profession.

During 27 years of practice as a civil litigator, plus more than 7 years on the bench and a year and a half in private dispute resolution, I have seen this sad decline in professionalism and civility in the practice of law. My hope—shared by organizations such as the Los Angeles County Bar Association—is that there will be an increasing awareness by practitioners that we enjoy a career in a wonderful profession, not just a job, and with that comes the duty to act as professionals. I commend Rule 7 of the Los Angeles Superior Court Rules regarding the behavior and cooperation of counsel.

This lack of civility is particularly distressing in the context of mediation, because it mitigates against the very advantages that mediated dispute resolution offer. Mediation is the only chance the parties have to create an acceptable resolution short of having someone—a judge or jury—tell them what to do. This is particularly important for a couple of reasons. As Judge Lawrence Waddington used to remind me when I was a trial attorney, “Settlement buys certainty.” That message is one that attorneys should convey to clients, as there is great value in the certainty of resolution and the ability to move on. However, one of the keys to successful mediation is the recognition that one does not “win” a mediation. Rather, the parties are able to engage in a process of evaluation in a nonconfrontational setting that will result in a resolution that is acceptable to all parties.

Another advantage is that a mediated resolution is far more likely to be enforced than a judgment that may be appealed or delayed in compliance. I found this particularly true in family law matters. And, as my colleague Jan Schau says, resolution is “better in the conference room than the courtroom.” The courtroom solution is unpredictable and very costly—not only financially but emotionally as well.

Amy Solomon, past president of the Consumer Attorneys Association of Los Angeles, reminds us that one should not “confuse civility with weakness.” No one who ever litigated against Amy would accuse her of being weak, but civility and professionalism should transcend the gamesmanship and posturing often found in litigation.

All of this points to the principle that mediation should not be treated as a contact sport. First, the parties should engage in the mediation willingly and with reasonable expectations of what constitutes a successful resolution. I believe that most mediations should start with the opposing parties in separate rooms. This tends to reduce the immediate conflict and confrontation that often results when parties who are suing each other share the same space. In close confines, counsel tend to immediately don their gladiator suits and go into litigator mode, with each side trying to convince the other of the strength of its position, while simultaneously reinforcing their clients’ commitment to their own positions, thereby reducing the probability of reasoned negotiation.

After starting with the parties separated and giving each side an opportunity to explain its position in as aggressive a tone as necessary, the mediation can then move toward modification and resolution.

This professionalism and civility in communication, preparation, and presentation can create the atmosphere for meaningful discussion, reasoned compromise, and negotiated resolution that is the real purpose of mediation. This is when civility is most important. Once counsel have shown how willing they are to advocate vigorously for their clients, it is important to remind everyone that mediation has great benefits, reduces the level of conflict, and can result in a resolution that may in fact be more favorable than what a court could ultimately order.

Civility and professionalism are the lodestones by which counsel should prepare their clients to participate meaningfully and to be willing to compromise to obtain resolution. Moreover, counsel must shed the role of gladiator, especially in the presence of clients. This means avoiding name-calling or denigrating the quality of the opposing counsel or his or her position. Practitioners should respect the parties and counsel and acknowledge that there may be some validity to opposing points of view.

Always remember that ex parte communication in mediation is not prohibited. In fact, it is helpful to contact the mediator in advance of the hearing to discuss any special issues of fact, law, or (perhaps most importantly) personality that will be critical in obtaining resolution. And, by all means, talk with opposing counsel before the mediation and discuss your position on settlement, what constitutes a successful resolution from your point of view, and how that can be obtained.

This professionalism and civility in communication, preparation, and presentation can create the atmosphere for meaningful discussion, reasoned compromise, and negotiated resolution that is the real purpose of mediation.
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