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Asset Protection Planning Now Can Insulate Your Clients’ Assets From Future Judgments

Yes, it’s true. By properly restructuring your clients’ estate plan, their assets and the assets they leave to their family will be protected from judgment creditors. Here are some of the situations in which our plan can help protect your clients’ assets:

- Judgments exceeding policy limits or exclusions from policy coverage.
- Judgments not covered by insurance.
- Children suing each other over your client’s estate.
- A current spouse and children from a prior marriage suing each other over your client’s estate.
- A child’s inheritance or the income from that inheritance being awarded to the child’s former spouse.

Mr. Gleitman has practiced sophisticated estate planning for 26 years, specializing for more than 14 years in offshore asset protection planning. He has had and continues to receive many referrals from major law firms and the Big Four. He has submitted 52 estate planning issues to the IRS for private letter ruling requests; the IRS has granted him favorable rulings on all 52 requests. Twenty-three of those rulings were on sophisticated asset protection planning strategies.
usually find myself on the optimistic side of pragmatism. Recent history, however, has led me and others to simply being thankful—for our clients, our jobs, our families, our health. Hopefully the lessons of these troubling times can carry us through the years to come, but I fear that the desire for good news and stability will create amnesia about what we experienced. In such times, it is exceptionally important to safeguard the dignity of our profession.

Fortunately, the Los Angeles legal market appears to be moving forward again. Firms seem more willing to hire. National firms are planting new roots here. The largest firms are scrambling to match each other’s spring bonuses—a feature of employment that, as an associate, I did not know even existed. And legal recruiters are busy leaving voicemails and sending e-mails. (But to my work e-mail address? Really?!)

Loyal readers of my From the Chair columns have recognized that over the past year I have explored ways “to protect the public and to promote respect and confidence in the legal profession.” Rule 1-100, Rules of Professional Conduct. Whether by working with pro bono organizations like the Disability Rights Legal Center (http://www.disabilityrightslegalcenter.org), mentoring a new lawyer, or just being reasonable with opposing counsel and third parties, each of us must find his or her own path to promoting respect and confidence in the profession.

Two ongoing debates deserve greater attention. The first concerns the governance of the State Bar. Too little attention has been given to the legislature’s recent push to do something, anything, to change the way lawyers are governed. Competing proposals have been floated that dramatically reduce the number of lawyers sitting on the Board of Governors and significantly affect how they are elected or appointed. (See http://www.calbarjournal.com/April2011/TopHeadlines/TH5.aspx.)

The duties of the Board of Governors include the formulation of the rules and regulations that govern admission, discipline, fee agreements, advertising, and the like. Thus, how we are to be governed will likely be decided by a legislature that has relatively few lawyers among its members. Given the importance of the issue, the debate has been too quiet—and participation in the debate too light. Let your voice be heard at http://www.calbar.ca.gov/AboutUs/BoardofGovernors/Roster.aspx.

The second debate concerns the training of our next generation of lawyers. While I have written about mentoring (http://www.lacba.org/Files/LAL/Vol33No5/2720.pdf), others have taken aim at the value of law review articles. Historically, participation on law review has been viewed as a hallmark of achievement on a resume. Increasingly, however, scholars are questioning whether the inherent cost of law review articles is justified. (See Karen Sloan, “Legal scholarship carries a high price tag,” available at http://www.law.com.)

While law reviews face an uncertain fate, Los Angeles Lawyer consistently ranks as one of the top reasons for membership in our bar association. The magazine is read widely and deeply. Once again I invite all experienced lawyers to work with young lawyers to submit articles for publication in Los Angeles Lawyer.

As this is my last From the Chair column (for now), I pass the helm of the Editorial Board to Ken Swenson. Ken—the most humorous, irreverent, and tallest trans-transactional lawyer employed by a national bank—will undoubtedly stay the course that the magazine’s 33 years of authors and editors have created. It is up to the rest of us to create the content and curiosity that continue to advance our profession.

Michael A. Geibelson is a business trial lawyer with Robins, Kaplan, Miller & Ciresi L.L.P., where he handles unfair competition, trade secret, and class actions. He is the 2010-11 chair of the Los Angeles Lawyer Editorial Board.
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Understanding the Information Contained in EDGAR Filings

FOR THE PROTECTION OF INVESTORS, the federal government passed the Securities Act of 1933 and the Securities Exchange Act of 1934 to require companies engaged in public trading of their securities to make key information publicly available. These disclosures are available online through the Securities and Exchange Commission’s EDGAR filing system. EDGAR filings are very valuable sources of information for attorneys. Even those whose work is unrelated to investing can use EDGAR to find out about companies and the people who run them.

A company’s first significant public disclosure is usually made through a registration statement filed with the SEC through the EDGAR system. Registration indicates a company’s intention to engage in more widespread trading of its securities. This intent triggers the need for public protection through disclosure.

Generally, there are two types of registrations. The first is the registration of a public offer and sale of securities. This includes what is commonly referred to as an initial public offering or IPO, typically filed on Form S-1. This filing will contain significant disclosures regarding the terms of the IPO, including the number of shares being offered for sale to the public, the price of the shares, the underwriters involved in the offering, and the company’s anticipated use of the proceeds from the sale. This form also calls for extensive disclosures regarding the company, including its history, business, finances (including audited financial statements), capitalization, significant shareholders, assets, and management. Along with these disclosures, the registration statement will also include as exhibits the important (or material) documents related to the company, including its governance documents.

The other type of registration is that of a class of a company’s equity securities. Typically, the registration of an IPO is accompanied by this second type of registration. However, even companies that are not selling securities will need to register a class of their securities if they attain certain asset and share ownership levels and/or they want their shares to trade on an exchange. This type of registration, when made outside of the IPO context, is typically made on Form 10. The form includes information about the company similar to that required on the Form S-1 but does not include any particular sale or offering information, since the filing is not associated with a particular securities transaction.

After a registration statement is filed, the company becomes obligated to file reports publicly on an ongoing basis and becomes what is commonly referred to as a public reporting company. These reports include reports of information, significant events, shareholder actions, and ownership filed by a company’s executive officers, directors, and significant shareholders.

The 10K
One of the most valuable sources of information on a public reporting company is its annual report on Form 10-K. This form, like a registration statement, contains all the basic information about the company, including its business, history, assets, and finances (including audited financial statements). Information about management may also be contained in the Form 10-K, or it may be included in the proxy statement. Certain information included in the annual report on Form 10-K is required to be updated by the filing of a quarterly report on Form 10-Q. These reports are a good place to check what may have changed at a company since the last annual report.

An even more up-to-date source of information is a current report on Form 8-K. This report is generally required to be filed within four business days of the occurrence of certain specified significant events. These events include, among other things, the entering into of material agreements, sales or mergers involving the company, new debt, the issuance of equity securities, the results of shareholder meetings, and certain changes in executive management.

Proxy Statements
Whenever a public reporting company solicits the votes of its shareholders in connection with an annual or special meeting of the company’s shareholders, the company must mail (or in some cases make available on its Web site) a disclosure document, known as a proxy statement, to its shareholders. The proxy statement must also be filed with the SEC on a Schedule 14A. Proxy statements include information related to what actions are to be voted upon at the meeting. Because a common type of shareholder action is the election of directors, these proxy statements often contain significant information about the company’s management. Proxy statements are also used in connection with shareholder approval of other company actions, such as amending corporate governance documents and approving major transactions such as mergers, substantial issuances of stock, and asset sales.

The executive officers, directors, and significant shareholders of public reporting companies are also required to make certain disclosures to the public from time to time. For example, the executive officers and directors of a company, as well as any shareholders owning 10 percent or more of the voting securities of a company, are generally required to make filings about their stock holdings and any acquisitions or dispositions of their stock on a Form 3, 4, or 5. These reports inform the public about the reporting person’s holdings, when securities are purchased or sold, and the price of acquisitions or dispositions. Similarly, any person who acquires more than 5 percent of the voting securities of a public reporting company is generally required to file a report called a Schedule 13D (or under certain circumstances, the abbreviated Schedule 13G). These reports disclose information about the filer, the filer’s holdings of the company’s securities, and the filer’s intentions for the company.

SEC reports provide a wealth of information to the public, and attorneys doing research on companies or the people who own or run them should get to know EDGAR. The forms discussed above are the most common types of public company filings, but they are not the only filings. Other filings for specific situations reveal additional valuable information.

Alison M. Pear is a transactional attorney specializing in securities and mergers and acquisitions at TroyGould PC in Century City.
FOR THE PAST SEVERAL YEARS, the Internal Revenue Service has been waging a fierce battle against taxpayers who fail to report earnings on foreign bank accounts. The IRS is now giving taxpayers who fall into that category until August 31, 2011, to come clean without imposition of criminal penalties and with reduced civil penalties. The reduced penalties apply to taxpayers who comply with the Internal Revenue Service’s Offshore Voluntary Disclosure Initiative (2011 OVDI), but only if they do so before the IRS becomes (or already is) aware of their prior tax-related indiscretions. This is the second IRS initiative focused on undeclared interests in foreign financial accounts. The 2009 IRS Offshore Voluntary Disclosure Program (2009 OVDP) offered a more taxpayer friendly resolution than the 2011 OVDI for taxpayers who contacted the IRS before October 15, 2009.

U.S. citizens and residents are taxable on their worldwide income and are subject to the full jurisdiction of the laws of the United States. Under the Bank Secrecy Act, U.S. citizens, residents, or persons in and doing business in the United States must file an information report with the government if they have a financial account in a foreign country with a value exceeding $10,000 at any time during the calendar year. Taxpayers comply with this law by acknowledging the account on Schedule B of their income tax return and by filing Form TD F 90-22.1, the Report of Foreign Bank and Financial Accounts (FBAR). Having a legal or beneficial interest in a foreign financial account does not violate U.S. law. However, intentionally failing to report the earnings on the account and to file an FBAR with the IRS may be a violation.

Many U.S. taxpayers and their advisers have long been unaware of or have simply ignored the FBAR information reporting requirements. Willfully failing to file an FBAR can subject the taxpayer to both criminal sanctions, including imprisonment, and civil penalties equivalent to the greater of $100,000 or 50 percent of the highest balance in an unreported foreign account per year for each year since 2004 for which an FBAR was not filed. The requirement is addressed in Schedule B of IRS Form 1040. Line 7a asks the taxpayer to mark “yes” or “no” to the question: “At any time during the [tax year], did you have an interest in or a signature or other authority over a financial account in a foreign country, such as a bank account, securities account, or other financial account?” The instructions to Schedule B provide a general description of the FBAR and how to obtain a copy of the form. This question and the corresponding instructions provide the government with what some consider important evidence that a failure to file a FBAR was willful, because taxpayers are deemed to know the information contained in their income tax return.

When IRS Commissioner Douglas H. Shulman announced the 2011 OVDI on February 8, 2011, he stated, “As we continue to amass more information and pursue more people internationally, the risk to individuals hiding assets offshore is increasing. As I’ve said all along, the goal is to get people back into the United States tax system….Combating international tax evasion is a top priority for the IRS. We have additional cases and banks under review. This new disclosure initiative is the last, best chance for people to get back into the system….Tax secrecy continues to erode….We are not letting up on international tax issues, and more is in the works. For those hiding cash or assets offshore, the time to come in is now. The risk of being caught will only increase.”

Under the 2011 OVDI, eligible taxpayers must contact IRS Criminal Investigation (CI) by August 31, 2011, and request participation in the program. Taxpayers must file all original and amended income tax returns (generally including tax years 2003 through 2010) and pay taxes (or make good-faith arrangements to pay taxes), interest, and 20 percent accuracy-related penalties on the income tax deficiencies. If applicable, delinquency penalties for the failure to file returns or pay the tax may also be required. Financial transactions occurring before 2003 are mostly irrelevant for those participating in the 2011 OVDI.

The 2011 OVDI penalty framework requires a 25 percent offshore
penalty equal to the highest value of the financial account and assets between 2003 and 2010. Only a single 25 percent offshore penalty will be applied with respect to voluntary disclosures relating to the same account and assets. Taxpayers with beneficial ownership interests in the account and making the voluntary disclosures may then allocate the offshore penalty in any manner they choose. Potential penalties are limited to those that are specifically stated in the 2011 OVDI.

Preclearance Requests
Taxpayers may seek participation in the program by submitting a preclearance request, including identifying information (name, date of birth, taxpayer identification number, and address) and Power of Attorney (if represented) by fax to the IRS CI Lead Development Center at (215) 861-3050. Taxpayers who are already listed in the CI database—due to an ongoing IRS examination of the taxpayer (or related entity) that already gives the IRS information about the taxpayer’s foreign account—will not be cleared to participate in the 2011 OVDI. As such, a taxpayer would be unwise to submit to the CI any information beyond the taxpayer’s name, date of birth, taxpayer identification number, and address until the CI has made an initial determination that the taxpayer may be eligible to participate.

Following receipt of a request to participate in the 2011 OVDI, CI will notify taxpayers or their representatives via fax whether or not the taxpayer has been cleared to make a voluntary disclosure using the Offshore Voluntary Disclosures Letter. Presently, such notifications are being sent within approximately 10 days after submission of the request to participate. Taxpayers or representatives with questions regarding their 2011 OVDI preclearance request can call (215) 861-3759 or contact the nearest CI office. Preclearance is merely the initial phase and does not guarantee a taxpayer acceptance into the 2011 OVDI.

Within 30 days following notification of preclearance by CI, a taxpayer must submit a completed Offshore Voluntary Disclosures Letter to the IRS Criminal Investigation.

The IRS will review the document and notify the taxpayer or representative by mail whether the voluntary disclosure has been preliminarily accepted or declined. If notified that their voluntary disclosure has been preliminarily accepted, the taxpayer has until August 31, 2011, to submit the remaining information, including payments indicated in the full Voluntary Disclosure Package for all applicable years to the IRS office in Austin, Texas.

In the Offshore Voluntary Disclosures Letter, the taxpayer must identify or provide the following information:

- The reason the offshore account was created or opened.
- The source of deposited funds.
- An estimated annual range of the highest aggregate value for the accounts or assets.
- An estimated potential annual unreported income from the account.
- The foreign financial institutions and foreign advisers relating to the account.
- Other affiliated account holders.
- An explanation of meetings with others regarding the account or assets.

Similar information provided by participants in the expired 2009 OVDP continues to serve the government well in ongoing civil and criminal investigations of foreign financial institutions and advisers. In turn, each new investigation uncovers additional leads to other institutions and advisers who have assisted U.S. taxpayers avoid their reporting obligations. Information provided under the 2009 OVDP and the 2011 OVDI will continue to provide the government with a target-rich environment for many years. Taxpayers who are foreign residents and who were unaware they were U.S. citizens may qualify for a reduced 5 percent offshore penalty instead of the mandatory 20 percent offshore penalty. The 5 percent offshore penalty will also apply to taxpayers who:

1) Did not open or cause the account to be opened (unless the bank required that a new account be opened, rather than allowing a change in ownership of an existing account, upon the death of the original owner of the account).
2) Have exercised only minimal and infrequent contact with the account, for example, solely to request the account balance, or update account holder information such as a change in address, contact person, or e-mail address.
3) Have, except for a withdrawal to effect the closing of the account and transferring the funds to an account in the United States, not withdrawn more than $1,000 from the account in any year covered by the voluntary disclosure.
4) Can establish that all applicable U.S. taxes have been paid on funds deposited to the account, with the result that only account earnings have escaped U.S. taxation. Funds deposited before January 1, 1991, will be presumed to have been appropriately taxed if no information is otherwise available. This presumption might work against taxpayers pursuing the 5 percent reduced offshore penalty for accounts that include post-1990 deposits where information is not available.

If the highest aggregate account balance in each of the years covered by the 2011 OVDI is less than $75,000, the taxpayer will qualify for a 12.5 percent offshore penalty. The highest aggregate account balance includes the fair market value of assets in undisclosed offshore entities and the fair market value of any foreign assets that were either acquired with improperly untaxed funds or yielded improperly untaxed income. IRS examiners will have no authority to negotiate a different offshore penalty.

FBARs for 2010 are due on June 30, 2011, and no extensions are available. Taxpayers who reported and paid taxes on all their taxable income for 2010 but did not file FBARs should not participate in the 2011 OVDI but should merely file the delinquent FBARs with Department of Treasury and attach a statement explaining why the reports are filed late. The IRS will not impose a penalty for the failure to file a delinquent FBAR if there are no underreported tax liabilities and the FBAR is filed by August 31, 2011.

Under the 2011 OVDI, taxpayers are not required to pay a penalty greater than what they would otherwise be liable for under the maximum penalties imposed under existing statutes. A similar provision in the 2009 OVDP has caused considerable frustration among taxpayers and their representatives. The understanding of potentially applicable penalties may differ greatly in the eyes of a taxpayer as compared to an IRS examiner. Anyone considering a 2011 OVDI submission
must carefully examine all potential civil penalties and evaluate the actual risk of criminal prosecution.

**Tactical Considerations**

Criminal prosecutions generally require a voluntary, intentional violation of a known legal duty. For many taxpayers, the actual risk of criminal prosecution might not be high. Many taxpayers with foreign bank accounts are immigrants or descendants of immigrants who are unfamiliar with the filing and reporting requirements. The determination of whether the government might be able to demonstrate a voluntary, intentional violation of a known legal duty to appropriately report an interest in a foreign account or asset must be carefully considered before determining whether to participate in the 2011 OVDI.

Taxpayers and their advisers should ask whether the prospect of a criminal prosecution can be reduced or eliminated merely by filing amended or delinquent returns and FBARs in lieu of a direct participation in the 2011 OVDI.

Potential civil penalties associated with undisclosed interests in foreign accounts and assets can far overshadow the current value of these accounts and assets. This raises several questions: Is there some method of reducing the potentially applicable penalty exposure without participating in the 2011 OVDI? Could filing amended or delinquent returns and FBARs in lieu of a direct participation in the 2011 OVDI reduce these civil penalties?

What would be the potentially applicable penalties upon an examination of such returns and FBARs? In any such examination, would the government exact retribution, since the taxpayer effectively declined participating in the 2011 OVDI? Will the government pursue noncompliant taxpayers through the required judicial process following assessment of an FBAR penalty?

In answering these questions, it is important to consider that the ability of a U.S. taxpayer to maintain an undisclosed, “secret” foreign financial account is fast becoming nonexistent. Information regarding undisclosed interests in foreign financial accounts and assets flows into the government on an almost daily basis. Financial mercenaries (i.e., whistleblowers or informants) are lurking within substantially every foreign institution. Tax treaties and information exchange agreements, information developed through submissions and interviews of 2009 OVDP participants and those who will participate in the 2011 OVDI, information provided by foreign institutions and advisers (whether indicted or not) all continue to generate additional leads to taxpayers and their advisers. Additional information will become available as the Foreign Account Tax Compliance Act (and foreign financial asset reporting) become effective in the next few years.

The 2011 OVDI, by limiting and fixing in place the penalties that can be imposed, eliminates IRS discretion. There are typically no exceptions based on reasonable cause. If taxpayers desire to pursue potentially lesser penalties, they could opt out of the 2011 OVDI and take their chances in the normal IRS administrative process.

The 2011 OVDI specifically includes foreign assets, real estate, foreign entities, and the like in the offshore penalty calculation, especially if assets are acquired with funds subject to U.S. taxation. Contents of foreign safe deposit boxes may be subjected to the offshore penalty together with other foreign assets acquired with funds that were subject to U.S. tax but on which no such tax was paid. The offshore penalty would apply regardless of whether the assets are producing current income. If the assets were acquired with after-tax funds or from funds that were not subject to U.S. taxation and if the assets have not yet produced any income, there has been no U.S. taxable event and no reporting obligation to disclose.

It is not possible to know exactly what will happen to taxpayers who decide not to par-
participate in the 2011 OVDI and to risk detection by the IRS and the imposition of substantial civil penalties, including the civil fraud penalty, numerous foreign information return penalties, and the potential risk of criminal prosecution. Full examinations? For how many tax years? Taxpayer and return preparer interviews? Maximum civil penalties? Criminal investigations? Will Congress later enact a strict-liability death penalty (i.e., one that doesn’t permit a defense of “reasonable cause”) for taxpayers who are non-compliant?

The ability to properly advise a client regarding participation in the 2011 OVDI requires an understanding of the potentially applicable foreign-related penalties for non-participants, the historic IRS and Department of Justice voluntary disclosure practice and policies, and a healthy respect for the ongoing governmental international tax enforcement efforts alone. But each noncompliant taxpayer that the IRS detects will no doubt forever regret missing the opportunity to participate in the “the last, best chance…to get back into the system.”

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1. 26 U.S.C. §§61 et seq.
4. INTERNAL REVENUE MANUAL [IRM] 4.26.16.5.3 (July 1, 2008), specifically provides that the mere fact that a person checked the wrong box, or no box, on a Schedule B is not sufficient, by itself, to establish that the FBAR violation was attributable to willful blindness. However, taxpayers should exercise caution in asserting a lack of willfulness when the wrong box has been checked on Schedule B. All relevant facts and circumstances must be developed and carefully considered.
8. The letter should be addressed to Attn: Offshore Voluntary Disclosure Coordinator, 600 Arch Street, Room 6404, Philadelphia, PA 19106.
10. The mailing address is: IRS, 3651 S. IH 35 Stop 4301 AUSC, Austin, TX 78741. ATTN: 2011 Offshore Voluntary Disclosure Initiative.
11. The 2011 OVDI FAQs, supra note 6, FAQ 52.
12. Id.
13. The 2011 OVDI FAQs, supra note 6, FAQ 53.
14. Mail to: Department of Treasury, Post Office Box 32621, Detroit, MI 48232-0621.
15. The 2011 OVDI FAQs, supra note 6, FAQ 17.
16. The 2011 OVDI FAQs, supra note 6, FAQ 50.
17. The period of limitation on collection of FBAR penalties is found in 31 U.S.C. §5321(b)(2). The government may commence a civil action to recover a civil penalty assessed under subsection (a) at any time before the end of the two-year period beginning on the later of 1) the date the penalty was assessed or 2) the date any judgment becomes final in any criminal action under 31 U.S.C. § 5322 in connection with the same transaction with respect to which the penalty is assessed. The date the FBAR penalty is assessed is the date that the IRS-designated official stamps IRS Form 13448. See IRM 4.26.17.5.5.2 (01-01-2007).
18. 26 U.S.C. §6038D.
Complying with the Identity Theft Red Flags Rule

According to a 2008 report of the President’s Identity Theft Task Force, identity theft—a fraud attempted or committed using identifying information of another person without authority—results in billions of dollars in losses each year to individuals and businesses. 1 In response to the growing problem of identity theft, the Federal Trade Commission in 2007 issued what is commonly known as its Red Flags Rule.2 The rule implements provisions of the Fair and Accurate Credit Transactions Act (FACTA) amendments to the Fair Credit Reporting Act (FCRA).3 To comply with the rule, certain financial institutions and creditors must develop, implement, and maintain a written identity theft prevention program. The rule requires an identity theft prevention program to detect patterns and activities—“red flags,” in the language of the rule—that indicate the possible existence of fraud in connection with transactions on accounts that the organization offers or maintains. The program also must develop effective response mechanisms to prevent this type of fraud and mitigate the harm the fraud may cause.

Most lawyers familiar with the Red Flags Rule know that recently enacted legislation effectively exempts lawyers from the rule’s compliance obligations. (See “Lawyers Not Covered,” page 14.) Nevertheless, lawyers should still be aware of the rule and its consequences for their clients. The rule continues to apply to all financial institutions and “creditors,” as newly defined under the amended legislation, that offer or maintain what the rule deems “covered accounts.” Lawyers should know how to determine if their clients qualify as the type of organization covered by the rule, whether the accounts offered or maintained by their clients constitute covered accounts, and if so what their clients must do to comply with the rule.

The Red Flags Rule was issued jointly by the FTC and federal banking regulators, including the Federal Reserve, the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, the Office of Thrift Supervision, and the National Credit Union Administration. The federal banking regulators’ version of the rule applies to organizations that fall within the regulatory authority of these agencies. The FTC’s rule applies to all other financial institutions and creditors.

The Red Flags Rule went into effect on January 1, 2008. The first compliance deadline for organizations regulated by the federal banking regulators was November 1, 2008. The FTC, however, delayed its implementation of the rule4 as a result of the controversy regarding its initially broad interpretation of the rule. Specifically, the FTC argued that the rule applied to a wide swath of organizations and professionals—including law firms and attorneys—that allow customers to pay for products and services at a later time. The FTC believed that these type of organizations were “creditors” within the meaning of the rule and, therefore, subject to the rule’s requirement to implement an identity theft prevention program.

Some of the affected businesses fought back, arguing that they were not “creditors” within the ordinary meaning of the term because they were not involved in lending. Moreover, they claimed that the FTC’s interpretation would impose a heavy compliance burden on businesses for which identity theft was not a significant risk. The FTC sought to address these concerns by delaying the enforcement of the rule, publishing guidance for those subject to it, and creating a simplified compliance template for low-risk organizations. Nonetheless, several industry groups representing attorneys, accountants, and healthcare providers turned to the federal courts to stop the FTC from enforcing the rule against their members.

Ultimately, Congress sided with the business representatives opposing the broad reach of the rule. It passed the Red Flag Program Clarification Act of 2010, which narrowed the FCRA’s definition of “creditor” and therefore dramatically limited the scope of the rule. The FTC began enforcing the Red Flags Rule on December 31, 2010.

Determining Who Must Comply

A practitioner advising clients about the Red Flags Rule must first determine whether they are a financial institution or creditor within the reach of the rule. For clients who meet the rule’s definition, counsel must then discern whether they offer or maintain accounts that must be covered by an identity theft prevention program. The rule refers to these accounts as “covered accounts.” Only organizations that meet both criteria must develop and implement an identity theft prevention program.

The FTC’s rule applies to two types of organizations: financial institutions and creditors. The financial institutions covered by the FTC’s rule are those that are not regulated by the federal banking regulators, which issued their own versions of the rule. Financial institutions under the FTC’s jurisdiction include insurance companies, state-chartered credit unions, brokers, dealers, investment advisers, and other organizations that hold deposits or accounts from which consumers can make payments or transfers to third parties. These include mutual funds that offer accounts with check writing or debit card privileges.

As a result of the amendment to the FCRA, the creditors that remain subject to the FTC’s Red Flags Rule are organizations that obtain or use consumer reports, directly or indirectly, in connection with a credit transaction; furnish information to consumer reporting agencies in connection with a credit transaction; or advance funds to or on behalf of a person based on the person’s obligation to repay the funds or repayable from property pledged by or on behalf of the person. Organizations whose credit-related activities are limited to providing a product or service and allowing customers to pay for the product or service at a later time generally are no longer subject to the rule’s requirement to implement an identity theft prevention program.

The FTC has the authority to expand the definition of “creditor” through rulemaking. It may still make a determination that a particular type of creditor offers or maintains accounts that are subject to a reasonably foreseeable risk of identity theft fraud. Nevertheless, the

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Financial institutions and creditors must conduct an identity theft prevention program. The program must identify the patterns, practices, and activities—that is, the red flags—that are indicators of possible identity theft fraud in connection with the covered accounts that the organization offers or maintains. These red flags may emerge, for example, as a result of attempts to steal personal information or use stolen personal information to commit fraud. The rule contains a sample list of red flags that organizations may consider. The FTC, however, has specifically cautioned against using its guidance as a substitute for an organization’s own efforts to identify red flags that are most relevant to its business. In addition to the FTC guidance, the organization may identify appropriate red flags from its own experiences with identity theft or from guidance issued by trade organizations.

As for developing methods for detecting and responding to the red flags, organizations will find that the rule offers guidance here as well. The FTC’s guidance may be used to assist organizations in their efforts to design identity theft prevention programs appropriate to their businesses.

An organization may prepare an identity theft prevention program using various formats. One potential format would be a chart divided into three columns. The relevant red flags would be listed in the left column, the steps that designated personnel must take to detect the red flags would be placed in the middle column (such as comparing the data on the driver’s license of an individual opening an account to the individual’s physical characteristics), and the necessary actions for responding to the red flags would appear in the right column (such as not opening an account and contacting the supervisor).

An organization’s board of directors or senior management must give its approval to the initial identity theft prevention program. Following this approval and the implementation of the program, the organization must regularly evaluate the program’s effectiveness and appropriately update the program to reflect its experience with identity theft fraud, changes in the organization’s business, and any new information regarding methods of identity theft.

In addition, the rule requires organizations to assign responsibility for the implementation and administration of the identity theft prevention program. Further, the rule requires organizations to prepare annual reports to evaluate the program’s effectiveness. The rule’s requirement for the periodic revision of the program to incorporate new developments includes the identification of additional covered accounts and pertinent red flags. Finally, the organization must train appropriate personnel to implement the program effectively.

The rule mandates a process rather than a particular result. Therefore, practitioners should advise clients to document the steps they take to determine their obligations under the rule and the actions they take to comply with the rule by developing an identity theft prevention program.

**Service Provider Obligations**

The Red Flags Rule also requires financial institutions and creditors to ensure that their service providers conduct their activities in accordance with reasonable policies and procedures designed to detect, prevent, and mitigate the risk of identity theft fraud. This requirement applies to vendors that provide services in connection with accounts covered by an organization’s identity theft prevention program.

An organization may, for example, contractually require these service providers to maintain policies and procedures to detect any red flags that arise in the course of the func-

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tions performed by the service providers on behalf of the organization. Another contractual provision could require the service providers to either report the red flags to the organization when they are detected or take appropriate steps to prevent and mitigate identity theft.

As a consequence of these requirements, service providers are likely to receive certain requests from their customers who must comply with the rule. The customers may ask the providers to confirm that they maintain appropriate identity theft fraud detection, prevention, and mitigation safeguards. Providers also may be requested to monitor their activities for the emergence of red flags and take appropriate steps to remedy any identity theft that may occur. In connection with annual program reviews, customers also may require service providers to submit to audits of their identity theft fraud policies and procedures.

To mitigate the burden of complying with various customer requirements regarding the Red Flags Rule, service providers should consider developing their own streamlined identity theft prevention program. Alternatively, service providers may choose to request detailed instructions from their customers on detecting and responding to any red flags that might be germane to the tasks performed by the providers.

**Enforcement**

The FTC has indicated that it will focus its enforcement efforts on egregious cases of noncompliance. The federal banking regulators—which have been enforcing their version of the Red Flags Rule since November 1, 2008—have found four main areas of noncompliance among the organizations that they supervise:

- Failure to develop and implement an identity theft prevention program.
- Wrongful exclusion of small business accounts from an identity theft prevention program, even though those accounts may pose a reasonably foreseeable risk of identity theft fraud.
- Failure to train personnel regarding their obligations under an identity theft prevention program.
- Lack of oversight of service providers.

While lawyers may no longer be subject to the Red Flags Rule—for now—many of their clients not only are still subject to the rule’s requirements but also continue to grapple with the problem of identity theft. Practitioners should familiarize themselves with the rule to assist their clients in meeting all of the rule’s compliance obligations.

3 15 U.S.C. §1681m(e).
4 The FTC extended the enforcement deadline from November 1, 2008, to May 1, 2009, to August 1, 2009, to November 1, 2009, to June 1, 2010, and finally to December 31, 2010. The FTC’s continuance of the enforcement deadline did not extend to financial institutions and creditors subject to the jurisdiction of the banking regulators and the National Credit Union Administration. The compliance deadline for financial institutions regulated by the banking agencies, the NCUA, and the Securities and Exchange Commission was November 1, 2008.
7 The rule’s examples of the means for detecting red flags include 1) obtaining identifying information about, and verifying the identity of, the person opening an account, 2) authenticating customers, 3) monitoring transactions, and 4) verifying the validity of requests for changes of address. Sample responses to detected red flags may include 1) not attempting to collect on or not selling a covered account to a debt collector, 2) determining that no response is warranted under the circumstances, 3) providing a response required by statute, 4) monitoring an account for evidence of identity theft, 5) contacting the customer, 6) changing security settings, passwords, or account numbers, 7) closing an account, 8) not opening an account, 9) notifying law enforcement, or 10) other activities designed to prevent and mitigate identity theft.
8 www.northwesternmutual.com
9 www.beerfinancialgroup.com
10 The Beer Financial Group
11 Woodland Hills - Encino
12 Santa Barbara - Bakersfield
13 (818) 887 - 9191
14 www.northwesternmutual.com
15 www.beerfinancialgroup.com
16 05-27-91 The Northwestern Mutual Life Insurance Company, Milwaukee, WI. Northwestern Mutual, Mitchell Craig Beer is a General Agent of Northwestern Mutual Life and disability insurance, annuities and a Registered Representative and Investment Advisor Representative of Northwestern Mutual Investment Services, LLC (member), an affiliate of Northwestern Mutual, broker-dealer, registered investment advisor and member FINRA and SIPC. Certified Financial Planner Board of Standards Inc. owns the CERTIFIED FINANCIAL PLANNER™ mark (CFP®), which it awards to individuals who successfully complete initial and ongoing certification requirements. FORTUNE® magazine, March, 2008.
Clients seeking permanent residency in the United States may be unpleasantly surprised by the legal interpretation of their marital status. When awarding immigration benefits such as permanent residency based on a family or marital relationship, federal immigration authorities generally must defer to state law interpretations of marriage, divorce, and annulment. This deference leads to widely varying immigration rulings that benefit some couples and harm others depending on where they reside. The rule also complicates the job of an attorney representing a client who is facing an immigration hearing, because the client’s marriage history, as interpreted under state law, can result in a denial of permanent residency.

The only exceptions to this rule arise when a federal law specifically supersedes state law. A prime example is the Federal Defense of Marriage Act (DOMA), which limits the definition of marriage—for the purpose of federal benefits eligibility—to a union between a man and a woman. Although California recognizes the gay marriages entered into during the short time when gay marriage was legal here, these marriages are not eligible for federal immigration benefits, because federal law does not recognize homosexual marriages as legally valid. Although President Barack Obama’s administration announced in February that it would no longer defend DOMA’s constitutionality in court, in March the Department of Homeland Security’s Office of General Counsel confirmed that the department’s Citizenship and Immigration Services (CIS) was to adjudicate cases as before, because there had been no change in the law.

DOMA’s restrictions have been successfully challenged, however, in a case in which state law allows marriage between a post-operative transsexual and a person of the opposite sex. In Matter of Lovo-Lara, the Board of Immigration Appeals deferred to North Carolina state courts to determine whether to recognize such a marriage under that state’s laws, and the state court concluded that since one spouse’s state birth cer-

by Heather L. Poole

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tificate reflected a postoperative gender change, the state recognized the marriage, and this, in turn, provided a route to permanent residency (also known as a green card) for one of the spouses.

In addition, provisions in the Immigration and Nationality Act (INA) forbid other types of marriages, even if they are allowed under a state’s or country’s law, from receiving marriage-based immigration benefits. These include polygamous marriages (polygamy is valid in many countries—including Sudan, Myanmar, and India), which are denied immigration benefits under the INA because Congress has deemed them to be in violation of public policy.

Aside from exceptions such as DOMA and polygamy, the general rule holds that in immigration matters state law guides decisions about whether a person is or was married—and as a result, whether one spouse can sponsor the other for permanent residency. For example, an immigrant spouse may be sponsored for residency based on a common law marriage, but only if common law marriage is recognized in the state where the couple resides. In addition, although the CIS will generally not recognize a proxy marriage (at which one spouse is not physically present at the legal ceremony), the marriage will be considered valid for immigration purposes if the spouses can prove it was consummated, which carries its own evidentiary problems. Similarly, taking this extra requirement that immigration law imposes into account, the legitimacy of a proxy marriage that has taken place in a foreign country will depend on the laws of that country. If the marriage was legally valid at the time of inception in that country, then it will be recognized for U.S. federal immigration purposes, assuming it does not violate U.S. public policy.

Although proxy marriage may be recognized in some states and under federal immigration law, it is not recognized in California unless the absent spouse is in the U.S. armed forces, stationed overseas, and serving in a conflict or a war. If these circumstances do not apply, an immigrant spouse who resides and entered into a proxy marriage in California may not petition for a green card based on the marriage.

Valid, Void, and Voidable

While the legal details of a marriage may not seem important to a client on his or her wedding day, they can profoundly affect the client’s fortunes in later immigration proceedings. For example, a spouse who was married in a foreign country and is seeking alimony and a share of marital assets in a divorce may be dismayed to discover that the foreign marriage is invalid under state law. A finding under California law that a foreign marriage is invalid can also upset the federal immigration case of a spouse who obtained permanent residency based on the presumed validity of the marriage. If fraud or bigamy is implicated, the invalid marriage can potentially result in ineligibility for permanent residency, hefty fines, imprisonment, and deportation.

A California marriage that state law characterizes as void (which is not the same as voidable) can also terminate a divorcing spouse’s options and eliminate the likelihood of federal immigration benefits. Void marriages are defined in California Family Code Sections 2200 through 2201. These marriages are invalid from the moment of inception and cannot be cured through a nunc pro tunc order, equitable estoppel, or any other family or common law device to make the marriage legally valid after the fact. A voidable marriage, by contrast, is not necessarily invalid but can be deemed so by a court, at which point the marriage is held to be not legally valid. An immigration lawyer should not expect an adjudicator from the CIS to know the state Family Code and the special mechanisms for legitimating a process or finding. Instead, the attorney should expect an uphill battle and likely appeals when issues arise concerning whether a marriage is valid, void, or voidable.

Divorce

The validity of a client’s marriage may depend not only on the particulars of the marriage but also those of a prior divorce. The validity of a foreign national’s divorce plays a critical role in whether he or she can legally remarry. Making a determination about the validity of a divorce is not as simple as reviewing a foreign divorce decree that appears facially valid. The foreign national’s physical presence in the state of California, as well as the time when the divorce was finalized, are crucial factors in determining the validity of the divorce under California law. A person’s current immigration status is irrelevant for purposes of this analysis, as California can exercise jurisdiction over a foreign national who is illegally residing in the state (without a valid visa, permanent residency, or authorized stay) for purposes of the Family Code.

When trying to preserve or file for U.S. immigration status, many immigrants, whether they reside in California legally or illegally, opt for a so-called quickie divorce in their home country (by proxy or by making a short trip). Many immigrants are ignorant of the California law that allows them to file for divorce in state court even if they have no immigration status. U.S. citizens have also been known to take advantage of foreign quickie divorces, most notably in the Dominican Republic, which since the 1970s has approved divorce based on mutual consent and allowed foreigners to divorce with no imposed residency requirement. Unfortunately for those immigrants who have availed themselves of a quickie foreign divorce before consulting an attorney, these divorces will likely not be recognized in California if California domicile has attached.

A quickie divorce in a foreign country may not be found valid under California law if the foreign national was living, even illegally, in California at any time in the year before the foreign divorce is filed. The California Family Code assumes jurisdiction over the foreign national based on physical domicile in California. A quickie foreign divorce that California does not recognize cannot be used for immigration purposes—including, for example, to demonstrate a legal right to remarry. For the divorce of a foreign national domiciled in California to be valid, the foreign national must file the divorce in California pursuant to the Family Code. Otherwise, any subsequent marriage is void and bigamous, which could severely undermine a subsequent immigration case.

In Matter of Hosseini, the Ninth Circuit was presented with the question of whether a divorce decree obtained in Hungary should be recognized. The spouses in the divorce proceeding lived in California at the time the proceedings commenced and were finalized. The court quoted the Family Code’s residency requirements in holding that the foreign divorce decree was invalid because the spouses were residents of California at the time, and California had jurisdiction over them.

The CIS, which governs benefits—including permanent residency—that are granted to immigrants, has also agreed with the Hosseini decision more recently in a similar case in Florida. In 2008, the CIS Administrative Appeals Office affirmed the Miami CIS district director’s denial of a green card for the spouse of a U.S. citizen because the spouse’s prior Columbian divorce was determined to be invalid. The immigrant could not demonstrate that she or her previous spouse had resided in Colombia for the necessary six months prior to the filing of the divorce petition. They lived in Florida, which obtained jurisdiction under its family code when they became residents.

Other States

These laws are not the same in all states. New Jersey, for example, does recognize absentee divorces obtained by its residents. The Board of Immigration Appeals may therefore recognize a New Jersey marriage in which one party has previously obtained a foreign divorce. As the BIA stated in Matter of Ma, “[W]here one of the parties to a marriage has a prior divorce, we look to the law of the
state where the subsequent marriage was celebrated to determine whether or not that state would recognize the validity of the divorce.\textsuperscript{24} An attorney in California, therefore, should investigate a client's marital and residential history with the Hosseinian decision in mind.

Objections to the Hosseinian court's line of reasoning, and to the constitutional validity of California's residency requirements in recognizing foreign divorces, have been raised based on the full faith and credit clause in the U.S. Constitution and the inherent public interest in recognizing the laws and court decrees of other countries.\textsuperscript{25} But as the Hosseinian court pointed out, the full faith and credit clause does not apply to the recognition of divorces obtained in foreign countries. It only applies to other U.S. states.\textsuperscript{26} For the full faith and credit clause to apply, a divorce must not only be valid under the laws of the jurisdiction that granted the divorce but also be in keeping with public policy. If not, a state or federal immigration authority may decline to recognize the divorce.\textsuperscript{27}

Similarly, if a foreign national who has resided in California for years travels to another state and fraudulently claims to be a resident of that state to obtain a quickie divorce, the CIS may not recognize the divorce. The issue of whether a state court is bound to legally accept another state's divorce decree or order even if it was obtained fraudulently remains to be litigated in federal court.\textsuperscript{28} The U.S. Supreme Court has held that the full faith and credit clause is "exacting," in the United States after having lived here for years. Legal problems may not begin until after the immigrant hires a lawyer to obtain a U.S. divorce or to obtain permanent residency. Immigrants may assume that the first marriage in the home country was not legal because it was not registered. The immigration attorney must turn to the laws of the foreign country where the marriage took place to determine if the first marriage was legal.\textsuperscript{30}

Another common scenario is that an immigrant or a U.S. citizen marries abroad and later fails to tell his or her divorce or immigration attorney about the prior marriage, believing that it will not be recognized in the United States. However, under California law, if someone knows that he or she is not legally divorced and remarries, he or she can be charged with bigamy. The person may likewise be guilty of polygamy under federal law, which is a ground for the immigrant's inadmissibility (legally barring the immigrant from obtaining a green card). A federal conviction of marriage fraud also carries a penalty of five years in prison and/or a fine of $250,000. The state of California also penalizes bigamy with either a prison sentence of up to one year or a fine of up to $10,000.\textsuperscript{31} A bigamous marriage will only be recognized as valid for federal immigration purposes if it is the U.S. citizen spouse who has committed the bigamy and the immigrant spouse can prove that he or she has been abused by the U.S. spouse.\textsuperscript{32}

Thus, the subsequent marriage is voidable, not void.\textsuperscript{34} If no nullity action is ever applied for by a prior spouse or adjudged by a court, then the subsequent marriage may be deemed legally valid despite the absence of a prior divorce decree. The CIS recognizes voidable marriages as valid.\textsuperscript{35} Immigration practitioners trying to guide clients through this Family Code loophole should expect a fight, however, since the last precedent BIA case on this issue for purposes of granting immigration benefits was decided over 30 years ago.\textsuperscript{36}

Immigration lawyers should protect themselves and their clients against unwanted surprises by conducting a thorough inquiry into the marital, citizenship, and residential history of not only the client but also of the client's spouse and all former spouses. A similar thoroughness in the intake inquiry for couples or individuals who are visiting a family lawyer's office for a prenuptial or marital agreement may also help a family or immigration case later.

The complex interplay between state and federal laws leaves many immigration and family law clients confused, frustrated, and looking for someone to blame. Family and immigration lawyers can expose themselves to malpractice liability if they fail to take into account the many factors that can render a marriage void and thus destroy an immigrant's hope for permanent residency. Among these factors is the deference that federal immigration authorities pay to state laws concerning marriage.\textsuperscript{37}

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3 See, e.g., http://www.keennewsservice.com/2011/03
\end{flushright}
5 Id. at 748.
6 Id. at 753.
11 FAM. CODE §420(b).
12 8 U.S.C. §1325(c) (up to five years in prison and/or $250,000 fine for marriage fraud felony conviction); 8 U.S.C. §1227(a)(1)(G) (marriage fraud deportation ground).
13 FAM. CODE §§2200-01.
14 See FAM. CODE §2346(c)-(d) (nunc pro tunc); Mukherjee v. INS, 793 F. 2d 1006 (9th Cir. 1986) (Failure of INS to detect an invalid termination of a prior marriage does not constitute affirmative misconduct for equitable estoppel to attach.); Matter of Morales, 15 I & N Dec. 411 (B.L.A. 1975).
15 FAM. CODE §2210.
17 Dominican Republic, Ley No. 142 (adding ¶IV and V to Art. 28 of Ley No. 1306) (Gaceta Oficial No. 9229, June 1971, amended 2000).
18 See Lopes v. Lopes, No. 081803 (Fla. 5th Dist. Ct. App. 2003) (A foreign divorce that evaded state’s residency requirements is invalid.).
21 Id.
25 U.S. CONST. art. IV, §1.
28 Id. at 386.
33 See, e.g., Matter of G., 9 I & N Dec. 89 (B.L.A. 1960) (recognizing marriages that are merely voidable but not void); See also Matter of Arenas, 15 I & N Dec. 174 (B.L.A. 1975) (Depending on state law, a second marriage, where divorce is not final, may only be voidable, not void.).
34 Id. at 386.
THE ANTI-SLAPP LAW has been an inviting first line of attack for the defense bar—and a nightmare for the plaintiffs’ bar—ever since its passage 19 years ago. Anti-SLAPP motions have spawned over 4,000 published opinions, in which courts repeatedly attempt to clarify the law’s provisions. In 2003, the legislature became concerned enough with the “disturbing abuse” of the anti-SLAPP law to create statutory exemptions for commercial speech and public interest lawsuits.¹ The legislature further limited the anti-SLAPP law in 2005 by addressing the courts’ application of the law to malicious prosecution cases.²

Last year, the California Court of Appeals the California Supreme Court, and the Ninth Circuit continued to interpret and clarify the anti-SLAPP law. The 2010 anti-SLAPP opinions of these courts addressed several procedural issues as well as two categories of issues on the merits: 1) whether the acts in dispute are constitutionally protected within the meaning of the anti-SLAPP law, and 2) whether the plaintiff has met its burden.

In 1992, the California Legislature enacted what is now Code of Civil Procedure Section 425.16 in response to a “disturbing increase in lawsuits brought primarily to chill the valid exercise of the constitutional rights of freedom of speech and petition.”³ The section, which applies to “strategic lawsuits against public participation,” is commonly referred to as the anti-SLAPP law.⁴ An anti-SLAPP motion is a special motion to strike to expedite the early dismissal of unmeritorious causes of action that are aimed at preventing

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citizens from exercising their constitutional rights of petition or free speech in connection with a public issue.5

The motion involves a two-step process. In step one, the moving defendant has the burden of making a prima facie showing that the plaintiff’s cause of action arises from an act “in furtherance of the [defendant’s] right of petition or free speech...in connection with a public issue.”6 If the defendant satisfies step one, the court proceeds to step two to decide if the plaintiff can meet its burden of establishing “a probability that [the] plaintiff will prevail on the claim.” If the defendant fails to meet its threshold burden under step one, the inquiry ends.7

For the defendant to meet its burden in step one, it must establish that the statement or conduct on which the cause of action is based falls within one of the four categories delineated in Section 425.16(e).8 Three of the categories involve written or oral statements made 1) before a judicial proceeding (or other official proceedings),9 2) in connection with an issue under consideration or review by a judicial body (or other official bodies),10 or 3) in a place open to the public or a public forum in connection with an issue of public interest.11 The fourth category involves other conduct in furtherance of the exercise of the right of petition or free speech regarding a public issue or an issue of public interest.12 With limited exceptions, the filing of an anti-SLAPP motion stays all discovery proceedings in the action13 and, if the motion is successful, an award of attorney’s fees to the moving defendant is mandatory.14 The downside to the moving defendant is that if the court denies the motion and determines that the motion was “frivolous or...solely intended to cause unnecessary delay,” the court may award discretionary attorney’s fees to the plaintiff pursuant to Code of Civil Procedure Section 128.5.15 An order granting or denying an anti-SLAPP motion is automatically appealable under Code of Civil Procedure Section 904.1.16

Procedural Issues

In 2010, courts addressed procedural issues that previously were unclear or unresolved. Among these was bifurcating the hearing. If the defendant challenges whether the plaintiff’s claim arises out of the defendant’s constitutionally protected speech or petition activity, courts may find it logical to bifurcate the motion. Since the court need not go to step two (the plaintiff’s probability of success) unless the moving defendant has met its burden in step one (protected activity), the court and one or both parties may prefer to save the time and expense of having to brief both steps and instead focus only on step one. The statute does not provide direct author-

ity for or against bifurcation. It does have a strict timing requirement: The hearing on the motion must be scheduled within 30 days after service of the motion unless the docket conditions of the court require a later hearing.17 Given that statutory deadline, it may seem implausible to bifurcate the hearing on the anti-SLAPP motion into separate hearings on step one and step two and still be able to complete both within 30 days. However, having the hearing on step one within 30 days and continuing the hearing on step two to a future date may be the approach for satisfying the scheduling requirement. In All One God Faith, Inc. v. Organic and Sustainable Industry Standards, Inc.,18 the one decision in 2010 that addressed bifurcation, the trial court had bifurcated the anti-SLAPP motion and permitted briefing and a hearing on step one before doing the same for step two. In its opinion, the court of appeal wrote, “By trial court order, not contained in the record but acknowledged by the parties, briefing and argument on the motion to strike was bifurcated, with the first portion of the hearing limited to the threshold question of whether [the defendant’s] alleged conduct constituted an ‘act in furtherance of a person’s right of petition or free speech....’”19 This statement, without comment, left it unclear whether the bifurcation was a result of the trial court’s own motion or by stipulation of the parties. Nevertheless, it was a cost-saving move, because the motion was denied on step one by the trial court and affirmed on appeal. However, if the court of appeal had reversed, it would not have had the benefit of an analysis of step two for a de novo review. Its only option in that scenario would have been to reverse on the analysis of step one and send the case back to the court below for a full briefing on the motion.

The California Supreme Court in Simpson Strong-Tie Company, Inc. v. Gore20—its only anti-SLAPP opinion in 2010—addressed a procedural issue regarding Code of Civil Procedure Section 425.17’s commercial speech exemption to the anti-SLAPP law. The statute does not expressly address whether the burden is on the moving defendant to establish that the exemption does not apply or whether it is the burden of the plaintiff opposing the motion to establish that the exemption does apply. The supreme court provided a definitive answer.

The Simpson court reviewed the court of appeal’s affirmation of the trial court’s granting of an anti-SLAPP motion on causes of action for defamation, trade libel, false advertising, and unfair business practices by a manufacturer of galvanized screws against an attorney who had placed an advertisement in a newspaper. The advertisement was directed to “Wood Deck Owners,” referenced galvanized screws manufactured by the defendant and others, and stated, “Please call if you would like an attorney to investigate whether you have a potential claim.” The trial court granted the defendant’s anti-SLAPP motion, finding that the defendant had established that 1) the statements were made in furtherance of the right of petition or free speech on an issue of public interest, 2) the plaintiff failed to demonstrate a probability of prevailing on the merits, and 3) the commercial speech exemption did not apply because the advertisement made no statement about a business competitor’s products or services.21 The court of appeal affirmed and assigned the burden of invoking the exemption to the plaintiff, disagreeing with a prior published opinion to the contrary.22

The supreme court affirmed the court of appeal’s ruling. In doing so, the court drew a bright line: “The burden of proof as to the applicability of the commercial speech exemption, therefore, falls on the party seeking the benefit of it—i.e., the plaintiff.”23

Parties involved in anti-SLAPP motions often ask if the award of attorney’s fees can be against not only the opposing party but also the opposing party’s attorney. In Moore v. Kaufman,24 the court of appeal considered that issue in the context of mandatory attorney’s fees to a successful moving defendant. The trial court had ordered the plaintiff’s attorney as well as her client to pay the defendant’s attorney’s fees. After the plaintiff’s attorney was found in contempt for refusing to answer questions at a judgment debtor’s examination, she filed a petition for writ of mandate. The court of appeal granted the petition, finding the judgment against the attorney to be void because the attorney was not a party to the litigation, and Code of Civil Procedure Section 425.16(c)(1) does not authorize an award of attorney’s fees against a party’s attorney.25 The Moore court took note of a comment by the California Supreme Court that the purpose of the mandatory fee award is to discourage SLAPP suits “by imposing the litigation costs on the party” that files a SLAPP suit.26 Thus, counsel’s payment obligations under the attorney’s fee order were stricken.27 In contrast to Moore, a court may award attorney’s fees against a defendant’s attorney who files an unsuccessful anti-SLAPP motion. Code of Civil Procedure Section 425.16(c)(1) allows the court to award attorney’s fees and costs to the plaintiff under Code of Civil Procedure Section 128.5(a) if the court finds that the motion is “frivolous or is solely intended to cause unnecessary delay.” Section 128.5(a) expressly permits trial courts to “order a party, the party’s attorney, or both to pay any reasonable expenses, including attorney’s fees....” Thus,
1. The California Legislature’s concern about the “disturbing abuse” of the anti-SLAPP law led to passage of statutory exemptions for commercial speech and public interest lawsuits.
   - True
   - False

2. The anti-SLAPP statute permits the filing of a special motion to strike to expedite the early dismissal of unmeritorious causes of action aimed at preventing citizens from exercising their constitutional rights of petition or free speech in connection with a public issue.
   - True
   - False

3. In the four-step analysis that courts apply to anti-SLAPP motions, the moving party has the burden in all four steps.
   - True
   - False

4. Even if the moving party cannot meet its burden in step one of the anti-SLAPP motion analysis, the court still must evaluate step two.
   - True
   - False

5. The anti-SLAPP statute expressly provides for bifurcation of the briefing and hearing for a resolution of step one before going further.
   - True
   - False

6. In 2010, the California Supreme Court resolved whether the burden was on the moving defendant or the plaintiff to establish the applicability (or lack thereof) of the commercial speech exemption.
   - True
   - False

7. If a defendant wins an anti-SLAPP motion and is entitled to mandatory attorney’s fees, the court can award those fees against the losing plaintiff and the plaintiff’s attorney.
   - True
   - False

8. If a plaintiff defeats an anti-SLAPP motion and the motion is found by the court to be frivolous or intended to cause unreasonable delay, the court may grant the plaintiff an award of attorney’s fees against the defendant and the defendant’s attorney.
   - True
   - False

9. If a plaintiff defeats an anti-SLAPP motion and is awarded attorney’s fees, the defendant can appeal the denial of the anti-SLAPP motion but cannot appeal the award of attorney’s fees.
   - True
   - False

10. In 2010, published opinions in which anti-SLAPP motions were denied in step one included claims for,
     - A. Legal malpractice.
     - B. City land use guidelines.

   C. Purely business disputes.
   D. Trade association activities.
   E. All of the above.

11. Last year, published opinions in which anti-SLAPP motions were denied in step one focused on the gravamen of the claims not being constitutionally protected within the meaning of the statute.
   - True
   - False

12. A cause of action in 2010 for cyberbullying of a minor by other minors was not subject to an anti-SLAPP motion.
   - True
   - False

13. A defendant dismissed before the hearing on an anti-SLAPP motion may still be entitled to attorney’s fees if the motion is granted.
   - True
   - False

14. Malicious prosecution is one of the causes of action that continued to receive judicial attention in 2010 in the anti-SLAPP motion arena.
   - True
   - False

15. To succeed in an anti-SLAPP motion to strike a cause of action for breach of fiduciary duty alleging more than one act of wrongdoing, every act alleged in the complaint must be constitutionally protected.
   - True
   - False

16. A lawyer’s failure to redact personal information from credit reports filed with the court is not the type of criminal activity that fell under the Flatley v. Mauro exception for criminal acts.
   - True
   - False

17. Subpoenaing mental health records during the mandatory arbitration of an uninsured motorist claim was deemed protected activity subject to an anti-SLAPP motion.
   - True
   - False

18. The anti-SLAPP statute’s automatic stay of discovery does not apply in federal court because it conflicts with federal rules.
   - True
   - False

19. The denial of an anti-SLAPP motion in federal court is appealable under 28 USC Section 1291 and the collateral source doctrine.
   - True
   - False

20. Anti-SLAPP motions are not available in federal court because the anti-SLAPP statute is a California statute.
   - True
   - False
attorneys who file anti-SLAPP motions risk an award of attorney’s fees against them if they lose, but attorneys who oppose anti-SLAPP motions do not face that same risk.

The appealability of attorney’s fee awards was also addressed in 2010. In Baharian-Mehr v. Smith, the plaintiff defeated an anti-SLAPP motion on claims of accounting, injunctive relief, breach of fiduciary duty, constructive fraud, constructive trust, and declaratory relief. The plaintiff did so because the dispute at issue was a business dispute that did not involve protected activity. After the required finding of frivolousness, the plaintiff was awarded attorney’s fees. When the defendant appealed both the order on the anti-SLAPP motion and the order on the attorney’s fees, the plaintiff argued that the attorney’s fees award was reviewable only on appeal from a final judgment.

The court of appeal rejected that argument. It reached this result because “[i]n cases where…the issue of whether the anti-SLAPP motion should have been granted is properly before the appellate court, it would be absurd to defer the issue of attorney fees until a future date, resulting in the probable waste of judicial resources.”

Step One
From the viewpoint of plaintiffs, defeating an anti-SLAPP motion by showing that the allegations against the defendant are not based on protected activity (step one) means that plaintiffs are spared the anxiety of having the court move to step two, in which they bear the burden of proving the probability of success. With a 15-page limitation for oppositions, plaintiffs must carefully allocate sufficient space to step one, yet leave enough pages for the often more fact-intensive step two in which they establish the probability of prevailing.

In 2010, the opinions in which anti-SLAPP motions were denied in step one necessarily focused on the gravamen of the claims not being constitutionally protected within the meaning of the statute. These included claims for, or based on: 1) legal malpractice, 2) city land use guidelines, 3) purely business disputes, 4) trade association activities, 5) hospital peer review activity, and 6) city contracts based on competitive bidding.

The court of appeal in Robles v. Chalipoyd denied an anti-SLAPP motion by an expert witness sued by former clients for conspiring with the clients’ attorney in a prior action to give false deposition testimony and to conceal a business agreement with the attorney. Robles reiterated the established rule in legal malpractice cases regarding lawyer defendants: “It is true that the statute protects litigation-related speech and petitioning activity undertaken on another’s behalf...but the statute should not be used to insulate those statements from recourse by the very client on whose behalf the statement was made.” The Robles court concluded that there was no reason to create an exception for expert witnesses.

The court reached its conclusion by applying the gravamen test. Indeed, in evaluating the defendant’s burden under step one, the court of appeal reiterated that the gravamen test controls:

[I]t is the principle thrust or gravamen of the plaintiff’s cause of action that determines whether the anti-SLAPP statute applies...and when the allegations referring to arguably protected activity are only incidental to a cause of action based essentially on non-protected activity, collateral allusions to protected activity should not subject the cause of action to the anti-SLAPP statute.

In D.C. v. R.R., a case that addressed the emerging issue of cyberbullying by minors, a number of high school students posted offensive and threatening messages on a student’s Web site. The Web site was designed to promote the student’s career as a singer and actor. The postings included statements like: “I want to rip out your ____ heart and feed it to you….I’ve...wanted to kill you. If I ever see you I’m...going to pound your head in with an ice pick.” The student’s parents reported the threats to the police, who suggested that the student withdraw from the school, which he did. The student and his parents then moved to another part of the state. None of the responsible students were suspended or expelled from the school.

The aggrieved student and his parents then sued six of the students who made the Web site postings, and their parents, for defamation and intentional infliction of emotional distress as well as for violating California’s hate crimes laws. One of the defendants responded with an anti-SLAPP motion, arguing that the posted messages were protected speech and, more specifically, constituted written statements or writings made in a public forum in connection with an issue of public interest under Code of Civil Procedure Section 425.16(3)(3). The trial court denied the motion on behalf of the defendant’s father, finding that the plaintiff dentist had met her burden in step two of protecting the public from the school.

Step Two
Surprisingly few published opinions in 2010 involved an anti-SLAPP motion that was denied because the plaintiff met its burden in step two. It would seem that if defendants concluded that an anti-SLAPP motion was likely to end the case early, an adverse ruling would not discourage a follow-up appeal. Moreover, if a defendant filed the motion for delay, an appeal from an adverse ruling would be certain. Perhaps the reason for the scant litigation in this area is that defendants simply are not filing anti-SLAPP motions when they recognize that the plaintiff is likely to meet its burden. If so, the statutory threat of attorney’s fees being awarded to a successful plaintiff may be having its desired effect.

One opinion from 2010 addressing step two was a defamation case, Wong v. Jing, in which a pediatric dentist sued the parents of a minor patient for libel in posting a critical review of her services on the Internet. The defendants’ anti-SLAPP motion was denied by the trial court, and the court of appeal affirmed in part with regard to the defendant father, finding that the plaintiff dentist had met her burden in step two of presenting sufficient evidence that a jury could find in her favor on libel.

However, the court of appeal also remanded and directed that the motion be granted on two other issues. First, the court directed the granting of the motion on behalf of the defendant wife based on the plaintiff’s failure to produce evidence that the wife had anything to do with the Internet posting. Second, the court directed the motion to be granted on the plaintiff’s causes of action for intentional and negligent infliction of emotional distress, because the evidence did not establish the sort of “severe” or “serious” emotional distress necessary to support those causes of action.

The plaintiff had also sued Yelp, the publisher of the Web site. Yelp joined the parents in the anti-SLAPP motion. Before the hearing, the plaintiff voluntarily dismissed Yelp from the lawsuit without prejudice. When Yelp later joined in the appeal from the denial of the parents’ anti-SLAPP motion, the plaintiff challenged Yelp’s standing. The court held that Yelp had standing despite Yelp’s dismissal. It
After the required finding of frivolousness, the plaintiff was awarded attorney’s fees. When the defendant appealed both the order on the anti-SLAPP motion and the order on the attorney’s fees, the plaintiff argued that the attorney’s fees award was reviewable only on appeal from a final judgment. The court of appeal rejected that argument.
image and catchphrase in a birthday card without her permission. The district court dismissed one claim on a motion to dismiss under Rule 12(b)(6) of the Federal Rules of Civil Procedure and declined to dismiss other claims under the rule. The court also denied the defendant’s anti-SLAPP motion filed against one claim. Although most of the opinion addressed the substantive law on the right to publicity, the Ninth Circuit first had to resolve the threshold question of whether it had appellate jurisdiction over the rulings on the various motions decided by the court below. The Ninth Circuit recognized that appellate courts generally only have jurisdiction over final judgments and orders and, in the case before it, the denial of the anti-SLAPP motion was neither. Nevertheless, the court held that it had jurisdiction to review the denial of the anti-SLAPP motion under the “collateral order doctrine,” which applies to the “narrow class of decisions that do not terminate the litigation, but must, in the interest of achieving a healthy legal system…nonetheless be treated as final.”

Later in 2010, the Ninth Circuit relied on Hilton to once again review the denial of an anti-SLAPP motion. Mindy’s Cosmetics, Inc. v. Dakar was a suit by a client against its attorney for claims including legal malpractice and breach of fiduciary duty arising out of the registration of trademarks. The district court denied the defendant’s anti-SLAPP motion. While the Ninth Circuit disagreed with the district court that applying to register trademarks was not protected activity under step one, the Ninth Circuit nonetheless affirmed because it agreed that the plaintiff had nevertheless met its burden under step two of establishing a probability of prevailing on its claims.

Thus, under the 2010 Ninth Circuit anti-SLAPP law cases, the automatic appeal provision of the anti-SLAPP law does not apply. However, the granting and the denial of an anti-SLAPP motion in federal court are both appealable under 28 U.S.C. Section 1291 and the collateral order doctrine.

Despite 19 years of judicial interpretation, the California anti-SLAPP law continues to be a hot topic and the subject of published opinions in state and federal courts. With creative defense counsel seeking to expand the umbrella of the law, and effective plaintiffs’ counsel striving to constrict it, 2011 should be another exciting year for anti-SLAPP jurisprudence.

1 CODE CIV. PROC. §§425.17(b)(1-3) (public interest exception), 425.17(c)(1-2) (commercial speech exception).
2 CODE CIV. PROC. §425.18(a). See Jarrow Formulas, Inc. v. La Marche, 31 Cal. 4th 728 (2003) (anti-SLAPP law held applicable to malicious prosecution cases).
3 CODE CIV. PROC. §425.16(a).
4 CODE CIV. PROC. §425.17(a).
5 Simpson Strong-Tie Co., Inc. v. Gore, 49 Cal. 4th 12, 21 (2010); CODE CIV. PROC. §425.16(b)(1).
6 CODE CIV. PROC. §425.16(b)(1).
9 CODE CIV. PROC. §425.16((b)(1).
10 CODE CIV. PROC. §425.16((b)(1).
11 CODE CIV. PROC. §425.16(e)(1).
12 CODE CIV. PROC. §425.16(e)(2).
13 CODE CIV. PROC. §425.16(e)(3).
14 CODE CIV. PROC. §425.16(e)(4).
15 CODE CIV. PROC. §425.16(e)(3).
16 CODE CIV. PROC. §425.16(e)(4).
17 CODE CIV. PROC. §425.16(g).
19 Id. at 1197.
21 Id. at 20.
22 Id. (disagreeing with Brill Media Co. LLC v. TCW Group, Inc., 132 Cal. App. 4th 324 (2005)).
23 Id. at 26.
25 Id. at 607, 614.
26 Id. at 616-17.
28 Id. at 268, 270.
29 Id. at 275; but see Doe v. Luster, 145 Cal. App. 4th 139 (2006) (If a defendant loses an anti-SLAPP motion and does not appeal and the plaintiff is not awarded attorney’s fees, the plaintiff does not have a right of automatic appeal on the denial of its attorney’s fees motion.).
30 CAL. R. CT. 3.1113(d).
31 Id. at 1199.
32 Id. at 1231; but see dissenting opinion, id. at 1231-61.
33 id. at 1218.
34 id. at 1221, 1223.
35 id. at 1230.
37 id. at 1371-74 (failure to warn and misdiagnosis statements), 1374-75 (use of general anesthesia statements).
38 id. at 1369.
39 id. at 1376-77.
40 id. at 1364-65.
43 Id. at 1555.
44 Id. at 1552.
45 Id. at 1553; but see id. at 1555 (A justice concurs but also dissents with the majority opinion’s ruling that the causes of action must be stricken in their entirety.).
47 Hartley v. Mauro, 39 Cal. 4th 299 (2006) (A defendant is precluded from using the anti-SLAPP statute if the underlying speech or petition activity was illegal; lawyer’s conduct that was extortion as a matter of law was not protected.).
48 G.R., 185 Cal. App. 4th at 610.
49 Id. at 617, 623.
51 Id. at 535 (citing CODE CIV. PROC. §425.16(e)(2)).
53 Id. at 713.
54 Id. at 716-17.
55 Id. at 718.
57 Metabolife Int’l, Inc. v. Wornick, 264 F. 3d 832, 845 (9th Cir. 2001).
58 CODE CIV. PROC. §425.16(g).
59 Metabolife, 264 F. 3d at 845.
60 Price v. Stossel, 620 F. 3d 992 (9th Cir. 2010).
61 Hilton v. Hallmark Cards, 599 F. 3d 894 (9th Cir. 2010).
62 Id. at 900 (citing Digital Equip. Corp. v. Desktop Direct, Inc., 511 U.S. 863, 867 (1994)).
63 Mindy’s Cosmetics, Inc. v. Dakar, 611 F. 3d 590, 595 (9th Cir. 2010).
64 Id. at 598, 600-01.
Collateral MATTERS

Does the power of a receiver to sell real property extend to sales of collateral from a loan?

When prospective receivers seek an assignment from a real property secured lender, they generally highlight their ability to sell loan collateral during the receivership. Receivers will assure the lender that the sale of the loan collateral during the receivership will save the lender the costs and time of foreclosure as well as postforeclosure marketing and sales efforts.

While the Code of Civil Procedure empowers receivers to sell real property, no California statute or case establishes how this generic statutory authority applies when the receivership property in question is California real estate pledged as collateral for a loan. For that situation, the receivership power runs headlong into the formidable set of California laws regulating 1) foreclosure of real estate loan collateral (including the borrower’s rights of reinstatement and redemption), 2) recovery of deficiencies from borrowers (where permitted) and guarantors, and 3) the one-action rule. Moreover, no clear statutory or judicial authority has established whether a receiver’s sale of collateral, even with a court’s blessing, can be equivalent in legal result to a foreclosure sale. Equally uncertain is whether the receiver can sell real estate loan collateral free and clear of liens, as bankruptcy courts are permitted to do.

In fact, the legislature appears to have intended the power of a receiver to sell real property to be purely generic—a one-size-fits-all power available in any of the myriad situations in which receivers may be appointed, such as to manage partnership dissolutions or large litigation settlements. No statute or case law addresses the intersection of receivership powers and other state laws, but intersect they will. When they do, the powers of the receiver must be considered in connection with other applicable state laws as well as the facts surrounding the appointment.

General rules of statutory construction require that more specific statutes take precedence over those that are of more general application. Thus, in a real estate foreclosure in which a receiver has been appointed, the more specific borrower protections built into the foreclosure and collection process will prevail over the general authority of a receiver. A secured lender must take this prospect seriously, because a negative ruling against the powers of the receiver could lead to the receiver’s sale being set aside and the loss of the lender’s security. The court also could eliminate the lender’s ability to recover a deficiency or substantially reduce the value of the collateral.

Therefore, a secured lender that is considering whether to engage the services of a receiver to sell real property loan collateral must carefully address and resolve several principal issues. These include:

• Whether the sale violates the protections afforded to borrowers by the foreclosure laws.

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• Whether the price obtained by the receiver is subject to challenge in later collection activities.
• Whether the sale can be made free and clear of liens—that is, can the court in the proceeding order that any liens against the real property must attach to the proceeds of sale of the property.
• Whether a secured lender’s acceptance of sales proceeds would constitute a violation of the one-action rule.
• Whether the sale would violate any contract obligations of a lender acting as agent bank or lead bank to its syndicate or participant banks acting as co-lenders.

Advance planning during the course of negotiations and document preparation is essential. Doing so should minimize risk and result in the successful use of a receiver to sell real estate loan collateral.

Duty of the Receiver

The appointment of a receiver is a provisional remedy—a measure to preserve the status quo until an ultimate verdict can be reached in the underlying case—and thus must be sought in connection with an action. A lender generally files an action for judicial foreclosure more or less concurrently with the commencement of a nonjudicial proceeding, as the judicial foreclosure action provides the vehicle for seeking the interim remedy of receivership. The lender seeks the appointment of a receiver in the judicial foreclosure complaint or by motion shortly thereafter. In many jurisdictions the lender has the ability to name a desired receiver. In other jurisdictions, the lender may be required to choose from a list of court-approved receivers. The court is always empowered to choose the receiver itself, but by far the most typical result is for the court to permit the lender’s first or at least second choice.

The principal responsibility of the receiver is to protect and preserve the receivership estate. In a real estate collection case, the estate consists of the real property collateral, the rents or other proceeds from the property (such as insurance or condemnation proceeds), and any personal property that is collateral for the loan and maintained on or in connection with the real property.

The receiver’s duty, as an agent of the court, is to the court, not the lender. Nevertheless, in practice the relationships are often blurred, given that lenders usually are permitted to name the receiver. As a result, the receiver may feel beholden to the lender to assure future business. Even when future business is not an issue, the receiver may need the lender to advance funds to pay taxes on or perform work at the property, especially if the property is not producing sufficient income to pay its own expenses. Of course, careful lenders and receivers will avoid any conflict and will ensure that the receiver’s business is carried out in accordance with the receiver’s duty to the court and the receivership estate. In most cases, the lender’s interest in protecting collateral value will coincide with the same interest of the court and the receiver.

For receivership sales, the interplay between the lender and the receiver may have an impact. Receivership sales that appear to be ordered by the lender could lose the protections afforded to court-ordered sales. The more the lender looks like it is directing the action, the more the borrower acting as co-lender may have an impact. Receivership sales that appear to be directed by the lender could lose the protections afforded to court-ordered sales. In such cases, the court may be required to choose from a list of court-approved receivers or to seek court approval of sale procedures prior to conducting an out-of-court auction. By doing so, the court will ensure that the borrower does not have to pay cash up to the amount of its debt but merely sets off its bid against the amount it is owed. Thus every dollar bid reduces the exposure of those liable for deficiencies, including guarantors (who are often either the borrower’s principals or are related to them).

It is often beneficial for a receiver to seek court approval of sale procedures prior to conducting an out-of-court auction. By doing so, the receiver can set the minimum bid—and in the event of a “stalking horse” bidder, a minimum overbid. The receiver in this situation may also set bidding increments, thereby predetermining the borrower’s right to credit bid. No law in California addresses the deficiency liability of a borrower when property is sold by a receiver rather than through a foreclosure sale. Clearly, the law provides that a borrower has no deficiency liability when a property is sold in a California nonjudicial foreclosure sale. A borrower could argue that a receivership sale is an attempt to get around California’s antideficiency laws, although such an argument would appear to be more of a defense against a deficiency claim than an action to nullify the receivership sale itself.

Securing Court Approval of Receivership Sales

A vigorous debate may ensue as to whether a borrower in default, whose property is being managed by a receiver, is realistically in a position to exercise the rights of reinstatement or redemption. Similarly, there is probably no way to clearly determine whether a receivership sale does or does not yield a price at least as good as the one a foreclosure sale would fetch. The risk for lenders and receivers is that courts are inclined to look only to the hypothetical value of the protections for borrowers or junior lienholders—and are more concerned with making sure that these legal protections are observed than with speculation about whether the protections could be exercised or have actual value.

The nature of the receiver’s sale transaction may be a key factor in the assessment of whether or to what extent the borrower lost its legal protections as result of the sale. Receivership sales serve a valuable function when used to finance the ongoing completion of units. These sales may be less valuable when they involve a single, completed, investment asset. In the former case, the receiver’s completion and sale
of units is aligned with the expectations of the borrower and all parties to the transaction. The sale of units benefits the bank by allowing the receiver to complete units with the proceeds from previous sales, without the bank continuously advancing new proceeds. The sale of units even benefits owners who previously purchased other units in the development. The alternative is units remaining unfinished for months or years—an eyesore at best and a nuisance at worst.

With a single investment property, however, a receivership sale could deprive the borrower and other interest holders of their rights and long-term interests without any alignment with their expectations. The property is literally sold out from under them without even the benefit of the time allowed for foreclosure. In this situation, there also seems to be less benefit for the lender, which could just as easily obtain title through an alternative means—such as foreclosure, deed in lieu, or a sale under Bankruptcy Code Section 363—and then sell to the same buyer identified by the receiver.

To avoid these arguments from borrowers and junior lienholders, the lender and the receiver can take several steps. The order appointing the receiver should expressly provide for the ability of the receiver to sell all or a portion of the collateral. Both the order appointing the receiver and the sale order should be approved by the court through hearings on motions noticed to all parties with an interest in the real estate. Notice is more easily accomplished when the receivership appointment is obtained as part of judicial foreclosure proceedings in which all appropriate parties are already named. The noticed hearing gives all parties their day in court, with a chance to raise objections based on foreclosure law protections and price, and makes it harder (although not impossible) for them to sue or appeal later if they do not raise these objections at the hearing.

Lenders and receivers can solidify the court’s approval of the sales price by a variety of actions, including:

- Making sure the receiver’s marketing efforts are professional and sufficiently broad to reach a good cross-section of the market for the type of property in question.
- Confirming the proposed sales price against the bank’s appraisals or other estimates of value.
- Setting overbid procedures, including preapproval of the marketing strategy.
- Securing the borrower’s consent to the sale (and thus eliminating the borrower as an objecting party) in consideration for 1) not having the foreclosure on record, 2) waiving deficiency claims against the borrower, or 3) other consideration as the parties may negotiate, such as guarantor relief for borrowers related to guarantors on the loan.

Questions may remain about the borrower’s liability for a deficiency following a receivership sale versus a nonjudicial foreclosure sale. A lender can control its destiny on this issue by simply choosing not to seek a deficiency judgment following a receivership sale. Lenders should think of the receivership sale as the equivalent of a nonjudicial foreclosure but without the headache of owning and selling the collateral themselves.

Nevertheless, a court-approved receivership sale may have more in common with a judicial foreclosure than a nonjudicial foreclosure, because the receivership court hears motions regarding the sale, all interested parties can raise objections, and the court orders—or at least approves—the sale. Under California law, judicial sales give rise to a borrower’s deficiency liability. Thus it is by no means certain that a deficiency cannot be obtained following a sale of loan collateral by a receiver.

Of course, judicial sales are also subject to postforeclosure fair value hearings to determine whether the sale price was fair in the context of the marketplace. Any right to obtain a deficiency from a borrower following a receivership sale might also carry the risk of a fair value hearing at which a court could determine that the receiver’s sale price was too low. Technically, there is no penalty for selling too low. The only downside is that the amount of the deficiency is increased. However, a lender and a receiver—even if merely to preserve their reputations—might not want to run the risk of a judicial finding that the receiver was not able to get fair value for its sale of collateral.

Sales Free and Clear of Liens

A deed of trust foreclosure sale cleanses title to the foreclosed property of liens and other property interests that were created after the deed of trust was recorded or that were subordinated to the lien of the deed of trust. Similarly, a sale of loan collateral—the assets of the bankruptcy estate—under Bankruptcy Code Section 363 is expressly permitted to be conducted free and clear of liens and other interests if certain conditions are met.

While no state or federal law expressly and clearly allows for a sale free and clear of liens by a receiver, one could argue that such a sale is authorized by the procedures afforded to a levying officer of a judgment creditor. Receivers often rely not only on the absence of a statute prohibiting them from selling property free and clear of liens but also on the broad discretion afforded receivers in conducting sales. A receivership sale is considered equitable because liens and other interests are attached to the proceeds of the sale in their order of priority—which means the secured, senior lender would get paid.
Still, no authority exists to definitively hold whether a receivership sale of collateral can be free and clear of liens in the absence of any specifically permissive statute. Moreover, although junior liens and mechanic’s liens are usually of principal importance to lenders, parties may also find it desirable to cleanse other subordinate property interests, such as leases (without a subordination, nondisturbance, and attornment agreement in place16); covenants, conditions, and restrictions; easements; and licenses. It would be difficult for a court to cause a sale of collateral free and clear of these other interests unless the court can find a way to equitably offset the loss of rights with a mechanism that values and compensates the rights holders from the proceeds of the sale.

Without clear statutory authority for a sale free and clear of liens, and only equitable power providing support, the best course for the lender and the receiver will be to make sure that the court order approving the sale states that 1) the sale is free and clear of liens and other interests, and 2) liens and other interests will attach to the proceeds of sale of the collateral in their order of priority. The phrase “and other interests” would likely encompass nonmonetary encumbrances, but if the lender or the receiver is aware of a specific encumbrance that either or both want to eliminate through the sale, that interest should be specifically identified in the order. Even so, the speculative ability of the court to eliminate nonmonetary interests in a receivership sale suggests that a lender or receiver might be better off in this instance with foreclosure.

A factor of paramount importance is the willingness of the title company to insure title to the buyer. Accordingly, the best approach would be to clear any sale order with the title company prior to its entry—whether or not the order provides for the sale free and clear of junior interests. Enforcing a sale free and clear of liens is similar to avoiding challenges based on the loss of borrower protections. In both instances, the lender and the receiver will find it easier to accomplish their goals if the sale order arises from a fully noticed motion and hearing. All interest holders who will be affected by the sale should receive the notice and have an opportunity to be heard. Indeed, the receivership court is likely to require evidence that any junior interest holder whose lien will not be paid immediately from the sale proceeds was provided with notice and an opportunity to object.

Another problem facing lenders in California potentially comes from the rule variously designated as the “one form of action,” “one action,” “single action,” or the “security first” rule.17 This rule will come into play if the bank accepts proceeds from the receivership sale. According to the one-action rule,
when a loan is secured by California real estate, the lender is limited to foreclosure as its one form of legal action to recover its debt and must proceed against its collateral before taking any other action. The rule has been held to cause the loss of security for lenders that offset unpledged accounts prior to foreclosing on real estate collateral. 18

In Great American Savings v. Bayside Developers, the California Court of Appeal in 1991 applied the rule to a sale of assets by a receiver when the sales proceeds were paid to the lender prior to completion of foreclosure. The court held that proceeds of a receiver’s sale of collateral prior to a foreclosure were not part of the lender’s security interest, and a lender’s acceptance of those proceeds constituted a violation of the one-action rule similar to a setoff of unpledged accounts. 19

Even though the case was depublished and cannot be relied on for legal precedent, a contrary holding has never been published by any California court, and the California legislature took no action to undo or clarify the decision. The Bayside ruling is difficult to follow and largely founded upon lengthy quotes from treatises, including Miller and Starr California Real Estate. 20 However, the court seems to propose its own remedies to its holding.

First, the receivership motion should be brought as part of a judicial foreclosure action, thereby comprising a single action in comformance with the rule. Second, the receiver should be clearly empowered to sell property as well as collect rents. In addition, the assignment of leases and rents, or the grant of a security interest in the real estate, expressly should include sales proceeds of the property. 21 The lender or receiver will have to work with whatever the loan documents give them at the time of enforcement. Third, the court should be asked to approve the sale when first contracted by the receiver and to confirm the sale when completed. A fully noticed hearing on motions of approval and confirmation create the best procedural record to sustain the court’s rulings on these matters.

Fourth, as a way to act with an abundance of caution, the lender should consider electing that the receiver not distribute sales proceeds to the lender prior to completion of the nonjudicial foreclosure sale. The proceeds could be distributed to other creditors with a claim on them or to holders of mechanic’s liens or stop notice claimants with whom the receiver or the lender has reached an agreement on payment. The best approach is the receiver holding the net proceeds pending discharge and final accounting. 22 In the absence of judicial authority to the contrary, Miller and Starr strongly suggests this course of action as being consistent with the goals of the one-action rule.

Ultimately the problem with Bayside, like so much of case law, lies in the particular facts presented to the court. The lender in Bayside sought appointment of the receiver as a “rents and profits” receiver—and this fact alone seems to have created the house of cards that the court easily brought down. Today, lenders and receivers generally are more sophisticated in their approach, from the first engagement of the receiver through to the last stage of discharge. However, practitioners must always be vigilant. With the current crush of foreclosures and receiverships, not every lender workout officer or receiver will have extensive experience in these matters. Moreover, courts may be willing once again to explore the boundaries of California’s borrower protection laws as they affect sales proceeds of collateral.

Lenders also must address the issue of the management of multiple lender syndicates or participations. Most syndicated loan agreements or participation agreements grant member banks or participation purchasers the right to approve sales of collateral. An unapproved sale by a receiver could be deemed to violate this provision and create liability for the agent bank or lead bank. A member bank or participant would need to show damages, and this could be done in a number of ways,
at the very least to survive summary judgment. These parties could make sustainable allegations that the receiver’s price was lower than fair market value, or that completion of property repairs or other improvement post-foreclosure could have increased value.

In theory, a receiver only needs the court’s approval, not the lender’s, to sell collateral under the receiver’s care. However, in practice, the lender usually is advised as the sale process progresses, and the receiver takes the lender’s opinions and perhaps even the lender’s direction into account in determining whether to proceed. If the receiver does sell without lender approval, the issue regarding the agent or lead bank is not relevant.

To avoid syndicate or participant banks from asserting that the agent or lead bank acted in concert with the receiver without proper consent under the loan agreement or participation agreement, the lender should reserve the right to object to any sales proposed by the receiver—and this should be documented in the order appointing the receiver. Prior to the hearing on approval of the sale, the lender should obtain the requisite number or percentage approval of syndicate or participant banks to the proposed sale. If approval cannot be obtained, the lender should try to work with the receiver to postpone or cancel the sale. If this is not possible, the lender may need to appear at the sale hearing and object on the grounds that the creditors have not approved the sale.

Sales of collateral by receivers have become a regular part of the commercial loan workout landscape in the last several years. Lenders and receivers face several risks that can result from selling loan collateral outside of the traditional foreclosure process. However, they can take a series of measures that will make the sales significantly more defensible in the event of a challenge.

1. Code Civ. Proc. §564 (A receiver may be appointed in “an action by a secured lender for the foreclosure of a deed of trust or mortgage and sale of property upon which there is a lien...where it appears the property is in danger” of loss or damage and where other factors apply, including that “the property is probably insufficient to discharge the deed of trust or mortgage debt.”); Code Civ. Proc. §568 ( Receivers may “make transfers” of receivership property.); Code Civ. Proc. §568.5 ( Receivers may, “pursuant to an order of the court, sell real or personal property in the receiver’s possession upon notice” and following the procedures in Code Civ. Proc. §701.310.);
2. Civ. Code §§2924 et seq. (foreclosure procedures). See, e.g., Civ. Code §§2924b and 2924f (establishing procedures for publicly noticing sales), and §2924c (restitution of the loan); Code Civ. Proc. §580a (hearings to establish the fair value of collateral as part of obtaining a deficiency judgment following a judicial foreclosure); Code Civ. Proc. §580b (no deficiency judgment following any type of foreclosure on vendor liens and purchase money mortgages); Code Civ. Proc. §580d (no deficiency judgment against borrowers following nonjudicial foreclosure sales); Code Civ. Proc. §726 (Lender may assert only one form of action in the recovery of debt secured by real property.).
5. Civ. Code §2924b;
(f) The trustee may sell property under subsection (b) or (c) of this section free and clear of any interest in such property of an entity other than the estate, only if—
1. applicable nonbankruptcy law permits sale of such property free and clear of such interest;
2. such entity consents;
3. such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
4. such interest is in bona fide dispute; or
5. such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.
14. Code of Civil Procedure §568.5 allows a receiver to sell real or personal property “upon the notice and in the manner prescribed by Article 6 (commencing with Section 701.310) of Chapter 3 of Division 2 of Title 9 (Enforcement of Judgments).” Code of Civil Procedure §701.630 provides that if “property is sold pursuant to this article, the lien under which it is sold, and any liens subordinate thereto, and any state tax lien (as defined in Section 7162 of the Government Code) on the property sold are extinguished.”
15. People v. Riverside Univ., 35 Cal. App. 3d 572, 584 (1973) (“Consequently, unless regulated by statute, the court has full power to order the receiver to dispose of property...and the advice of the receiver and his opinion in regard to the value of the property, the manner, time and place of its disposition are entitled to great respect and weight.”).
16. See Ken Swenson, Bridging the SNDA Gap between Lenders and Tenants, LOS ANGELES LAWYER, Sept. 2007, at 19.
20. Id., 232 Cal. Rptr. at 200-01.
21. The Bayside court was unimpressed with a grant of a security interest in proceeds. The court determined that “proceeds” constituted merely the rents and profits from the use of the real estate—not the net sales revenue from disposition of the real estate. Id. at 198-99.
22. The Bayside case eventually found its way to federal court. The U.S. district court held that the state trial court had the authority to approve the sales of the real and personal property because the receiver had the authority “to take possession of the property, to conserve and manage it.” Further, the district court held that applying the sales proceeds to the debt before foreclosing the lien did not violate the one-action rule. See Resolution Trust Corp. v. Bayside Developers, 817 F. Supp. 822, 828-29 (N.D. Cal. 1993), 97 F.3d 1230 (9th Cir. 1994, as amended, Jan. 20, 1995).
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Degrees/licenses: JD Southwestern University School of Law, Cum Laude, 1978; Admitted in California since 1978. Also admitted in Central, Eastern, Northern, Southern District and Ninth Circuit.

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Is Mediation Still “Fairly Legal” in California?

IN THE NEW TELEVISION SHOW Fairly Legal, the main character is a mediator who sometimes finds herself mediating street fights, for example between her cab driver and a bicycle rider. Although she is not practicing law, she doles out legal advice with impunity. Here in California, this fictional character’s impunity apparently has a basis in reality, given the recent California Supreme Court decision, Cassel v. Superior Court.1

In Cassel, the plaintiff sued his attorneys for malpractice, alleging he received poor legal advice regarding a claim at a mediation. Before trial, the defendant attorneys moved to exclude all evidence of attorney-client communications leading up to and occurring at the mediation that took place outside the presence of the mediator, claiming that the mediation privilege extended to “anything said...for the purpose of, in the course of, or pursuant to mediation.”2 The court weighed the benefits of confidentiality in mediation against the potential injustice of shielding attorneys from liability for bad advice. The court concluded, particularly in light of the wording of the mediation privilege statute, that the importance of confidentiality prevails over the injustice that may result from the loss of evidence of malpractice. In affirming the trial court’s ruling excluding the evidence, Cassel raises the question of whether mediations are being reduced to mere street fights, without any protection for clients from unscrupulous legal counsel.

Mediations routinely invite a series of difficult conversations between lawyers and clients. When lawyers are initially retained, the case evaluation often leads us to believe that our clients have a winning position. It is often not until preparing for mediation that lawyers are required to reassess the likelihood of success on particular claims and defenses. Also, by the time mediation arrives, clients are generally better apprised of the realistic costs, risks, and challenges of proceeding to trial. A resolution of the dispute demands that lawyer and client engage in sensitive, frank, and honest conversation. That is why courts require the clients to be present during mediation.

A settlement reached during mediation is not the determined outcome of a scientifically applied process but instead is a highly subjective decision based upon advice on myriad factors unique to a particular dispute. For example, is the client likeable and believable? Is the opposing counsel a trial lawyer with a proven track record? Will the dispute capture the jury’s sympathy? Lawyers strive to educate the client, make recommendations about strategies, and engage the mediator in helping to reanalyze a case once offers and demands are being exchanged. A lawyer’s advice is integral to the decisions made during mediation.

Clients participating in mediation certainly expect to be able to rely on the advice of their counsel. At a mediation, the mediator may explain that the process will require careful consideration of the facts and the evidence, together with the likely costs, in an effort to help each side understand the risks and rewards of proceeding. Imagine if the mediator continued, “The process is completely confidential. That means, dear Client, that if your attorney gives you some false advice, or breaches ethical or professional duties toward you, you won’t be able to get me to testify about it, and you won’t be able to testify about it either. Client, beware.” This disclosure would tend to undermine the relationship between attorney and client and discourage mediation.

A recent Ninth Circuit decision illustrates how challenging it is to contest a mediated settlement. In Facebook v. ConnectU, Inc.,3

This disclosure would tend to undermine the relationship between attorney and client and discourage mediation.

ConnectU (or the Winklevosses, as the persons behind ConnectU are collectively addressed in the case) claimed that the settlement agreement releasing the claims against Facebook, which all parties signed, was unenforceable because, the Winklevosses alleged, the agreement was procured by securities fraud. The Winklevosses were not permitted to introduce any evidence of what Facebook said or did not say during the mediation. The Winklevosses could not show that Facebook misled them about the value of its shares and related financial matters. The court noted that all parties had signed a confidentiality agreement in the mediation, which was binding no matter what transpired during the mediation. Without the evidence, their claim of fraud could not be entertained. The court upheld the settlement.

Clients deserve protection against fraud and malpractice in mediation. In the absence of legislation to carve out a statutory exception for malpractice, lawyers should strive to ensure that the mediation process is never misused to shield or insulate attorneys who give unethical or other bad advice. If clients, lawyers, and mediators are to continue to use and not abuse ADR, all must pledge to safeguard the process in the face of cases such as Cassel and Facebook.

If lawyers are free to hide behind the Evidence Code rather than answer for poor representation, the result will be injustice for all disputants. Careful preparation and diligent representation in mediation should ensure that the deals that are struck there are as fair as they are unassailable.

2 Evid. Code §1119.

A neutral specializing in employment and business disputes, Jan Frankel Schau has lectured on matters of ethics and confidentiality in ADR.
Cross-Border Distressed Transactions

On Monday, June 6, the International Law Section and the Corporate Law Departments Section will host a seminar featuring speakers Dominic Kracht, Mauricio Leon de la Barra, Antonio Maldonado, Malcolm S. McNeil, and Malhar S. Pagay. They will address the key legal and tax issues that generally arise in cross-border distressed transactions and provide practical tools to help buyers and sellers (and their business, legal, and tax advisers) achieve successful results. Most transactions involving troubled companies, either in or out of bankruptcy, generally occur on an accelerated schedule and pose challenges additional to those that exist when buying assets from a solvent entity. Those who attend this seminar will gain knowledge and expertise required when a purchase and sale transaction has cross-border or multijurisdictional implications. The seminar 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 6 P.M., with the program continuing until 8. This event is also available as a live Webcast. The registration code number is 011112. The prices below include the meal.

- $25—CLE+PLUS member
- $55—International Law Section member
- $55—Corporate Law Departments Section member
- $65—LACBA member
- $75—all others
- $85—at-the-door registrant
- 2 CLE hours

2011 Dana Latham Awards Luncheon

On Friday, June 3, the Taxation Section will host the 2011 Dana Latham Award Luncheon. This year’s award will be presented to Edwin G. Schuck Jr. in recognition of his outstanding contributions to the community and the legal profession in the field of taxation. The keynote speaker at the luncheon will be Professor Edward Kleinbard from USC Gould School of Law. The luncheon will take place in the Bunker Hill Ballroom of the Omni Los Angeles Hotel, 251 South Olive Street, Downtown, and will begin at 11:30 A.M. The registration code number is 010970. There is no CLE credit.

- $90—individuals with meal
- $1,000—Taxation Section sponsor table of eight

Probate Department View from the Bench

On Thursday, June 30, the Trusts and Estates Section and Fiduciary Trust will host Judges Mitchell L. Beckloff, Marvin M. Lager, Reva G. Goetz, and Michael L. Levanas, who will discuss recent developments in the Probate Department of the Los Angeles Superior Court. In addition, the Arthur K. Marshall Award will be presented. The program will take place at the Omni Los Angeles Hotel, 251 South Olive Street, Downtown. On-site registration will begin at 11:45 A.M., with the program continuing from 12:30 to 1:30 P.M. The registration code number is 011265. The prices below include the meal.

- $45—CLE+PLUS member
- $55—Trusts and Estates Section member
- $70—LACBA member
- $85—all others
- 1 CLE hour, with Estate Planning, Trust, and Probate Law Legal Specialization Credit

The Los Angeles County Bar Association is a State Bar of California MCLE approved provider. To register for the programs listed on this page, please call the Member Service Department at (213) 896-6560 or visit the Association Web site at http://calendar.lacba.org, where you will find a full listing of this month’s Association programs.
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