Los Angeles lawyers Elliot J. Siegel and Julian Burns King discuss the implications of *In re Hyundai and Kia Fuel Economy Litigation*, which is under en banc panel review in the Ninth Circuit Court of Appeals.
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WOMEN LAWYERS ASSOCIATION OF LOS ANGELES
New lawyers are often surprised when I tell them that they will largely be judged as lawyers based upon their clients. I am not sure why this comes as a surprise. We have all seen the news stories lionizing a lawyer representing a high-profile client in an important matter. Fair or not, the general public tends to assume that if a lawyer has been chosen to act for a prominent client in an important matter, that lawyer must be highly competent and qualified.

It is not that hard work, skill, and intelligence don’t matter; it is just that potential clients will often select an attorney based upon that attorney’s representation of important clients, trusting that such past representation was based upon quality lawyering.

How does a new attorney go about getting an important client in the first place? My experience has been that new clients come from two primary sources: 1) referrals from other attorneys, and 2) referrals from existing clients. However, unlike the chicken-and-egg conundrum, it is clear that you need to have a client before you can get a referral from an existing client. This leaves other attorneys as a primary source for getting clients. Attorneys will refer an important client to another attorney for a variety of reasons. For example, they may have a conflict of interest in a particular matter or they may need legal expertise in an area outside their own area of expertise. Typically, they will only make such a referral to an attorney they know and trust. This is particularly true if it is an important client.

How does a new attorney go about getting other attorneys to refer important clients to him or her? There are actually relatively few opportunities for attorneys to directly experience the capabilities of another lawyer if they are not already working together. Such an opportunity most often occurs in an adversarial context, which may not be the most conducive situation to promote friendship and trust. However, there is an old saying that “how you do anything is how you do everything.” A corollary is that people assume that how you handle yourself while doing one thing is how you will handle yourself doing all things. Thus, new attorneys should look for opportunities to interact with other attorneys in a context that allows them to demonstrate that they are capable, responsible, and reliable.

Bar associations are a great way to meet other attorneys. The Los Angeles County Bar Association, the largest bar association in Southern California, represents a fantastic opportunity to meet other attorneys. Moreover, with its many committees, sections, and affiliated bar associations, there are numerous opportunities to become active and engaged. Beyond simply joining a bar association, new attorneys will want to become active and engaged to provide prime opportunities to demonstrate how capable, responsible, and reliable they are. This will lead to the type of friendly and trusting relationships that yield important client referrals.

Los Angeles Lawyer has initiated a new feature called “My LACBA Story.” It provides an opportunity for attorneys to express what LACBA has meant to them and their careers. It is my hope that through involvement in LACBA, you will soon have your own LACBA story to tell.
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LACBA President Brian S. Kabateck presents J. Michael Hennigan with LACBA’s Shattuck-Price Outstanding Lawyer Award.

More than 300 judicial officers, attorneys, government officials, and other dignitaries gathered at the City Club to celebrate the Los Angeles County Bar Association’s 140-year legacy of leadership in the Los Angeles legal community.

Dan O’Connell, husband of the late Hon. Beverly Reid O’Connell, U.S. District Court Judge of the Central District of California, accepts LACBA’s Outstanding Jurist Award on her behalf. In lieu of a physical award, donations were made in Judge Reid O’Connell’s name to the scholarship funds of both Pepperdine University and the Women Lawyers Association of Los Angeles.

LACBA President-Elect Ronald F. Brot, Shattuck-Price Outstanding Lawyer Award co-honoree David J. Pasternak, and LACBA President Brian S. Kabateck.
A Six-Month State of the Association Report

AS WE HIT THE SIX-MONTH MARK of my presidency and administration, it is important to take a step back and see where we are, where we are heading, and to report on the state of the Los Angeles County Bar Association. My time as president is short and within that time to date, our team has worked to accomplish as much as possible. Over the last few years, LACBA membership has dropped tremendously. We have made great strides in regaining membership by developing new benefits and we are working hard to make membership attractive to all lawyers.

Last year, LACBA’s Board of Trustees adopted a section autonomy policy that permits sections to present programs their members want with the requirement that the sections break even annually rather than per program. We have granted section chairs access to financial information and are continuing with an across-the-board policy of complete transparency. Any member has a right to receive nonconfidential LACBA information.

LACBA’s Counsel for Justice has developed and implemented an aggressive plan for fund-raising and building its charitable activities. CFJ is under no false pretenses about its actual cost of operations. In 2018, CFJ broke all prior records for number of clients helped, number of volunteers, total value of pro bono services, and the number of pro bono hours. We encourage CFJ to expand its Domestic Violence Legal Services clinics to other courthouses throughout the county. We also urge the expansion of CFJ’s Veterans Legal Services Project. I am convinced there are more veterans in Los Angeles County than any other county in the country. I recognize that some LACBA members believe it is not our primary focus to deal with these pro bono activities. However, I believe our pro bono projects serve the dual function of giving back to the community and providing our members with a pathway to provide service.

Cost Saving Measures

Earlier this year, I said that LACBA is going to need to do more with less. Under the direction of Executive Director Stan Bissey, LACBA has implemented a hiring freeze for the professional staff. There are plans to sublet the twenty-sixth floor of LACBA’s downtown headquarters, which would allow some employees to work remotely and thus provide a smaller physical footprint in the office space. We are also looking at other cost-cutting measures while continuing to provide the same high level of service to our members.

Stan is excellent and dedicated. I consider him a co-leader with the elected volunteer officers of LACBA. Staff members feel reinvigorated in their jobs and are pleased with Stan’s leadership. Along with his senior staff, we work as a team to improve LACBA every single day. One of Stan’s projects is the LACBA mobile app for smartphones that will allow members to custom design the information they wish to receive from LACBA, get updates on programs of interest, and make suggestions regarding membership benefits.

We are currently executing a program in which lawyers and law firms will have the opportunity to host a continuing legal education event in their offices or at a venue of their choice. Any law firm or lawyer member who wishes to host an event would receive LACBA staff support to promote the event.

We have also implemented the “Bring a Guest” program in which a LACBA member can bring a nonmember to any section event at little or no cost to the nonmember.

LACBA’s Board of Trustees has recently implemented new bylaws and added a new position of vice-president for diversity, inclusion, and outreach. This is an elected position with a two-year term.

Affordable Membership

Another LACBA goal this year was to make membership more affordable. Dues are free to first- and second-year attorneys, and third-year attorneys pay only $50 annually. (Third-year attorneys who do not practice in Orange County or Los Angeles County pay $99 annually.) In addition, law students now are free members of LACBA and the Barristers/Young Attorneys Section. Special rates and discounts also are available for long-term members and those who are not actively practicing law.

The 2018-2019 president of the Los Angeles County Bar Association, Brian S. Kabateck is founder and managing partner of plaintiffs law firm Kabateck LLC in Los Angeles where he practices in the areas of personal injury, insurance bad faith, pharmaceutical litigation, wrongful death, class action, mass torts, and disaster litigation.
In conjunction with the Barristers/Young Attorneys Section, LACBA has launched “Admitted,” a new podcast that assembles experience, tips, and insights from practicing attorneys to help students prepare for their legal careers and successfully transition from law student to legal professional.

Bench and Bar
We continue to work closely with the judges of the Los Angeles Superior Court and the Federal District Court for the Central District of California in providing our members with access to the judiciary. We are hopeful the new governor will take note of the hard work from our bench officers as well as the constant lobbying from LACBA.

We have also developed programs to offer membership discounts as the Los Angeles Superior Court transitions to an electronic format. We have partnered with ACE and One Legal for membership discounts on e-filing.

More to Come
There is a lot that we have accomplished and a lot that we have not. Nonetheless, we continue to fight every day to restore confidence and faith in LACBA. We need to be a bar association that appeals to young and new lawyers, and we need our members to encourage others to join. In the next six months, we will look closely at our fiscal responsibilities to the membership and make determinations so that we will continue to operate for many years to come.

I am distressed by our failure to reach out to all of Los Angeles County. Los Angeles County has more lawyers than any county in the state, and we have a responsibility to make our bar association more vibrant and interesting so that attorneys will feel it is their association.

Leadership Transition
I want to assure that the hard work will continue as LACBA transitions from my leadership to that of President-Elect Ron Brot. We cannot forget the past, but LACBA must be dedicated to both the present and future. Young people in high school and college are considering careers in law, and we must do more to reach out to them and to make sure they want to join the Los Angeles County Bar Association.

Many have gotten us this far, so let’s keep pushing. If you sprint ahead, you run alone, but if you are in it for the long haul, you must run together.

David J. Pasternak has been a Los Angeles County Bar Association member for more than 40 years, serving as president, trustee, and barristers president. He was also the 91st president of the State Bar of California and first member of the State Bar Board of Trustees appointed by the Supreme Court of California. David is a member of Pasternak, Pasternak & Alsbrook and has had a long and distinguished career as a civil litigator, state and federal court receiver, a provisional director, partition referee, special master, and Bankruptcy Court custodian. In a few short words, David shares his LACBA story and the impact that being an active member has had on his career.

This is David’s story:

When I was in junior high school, I chose to pursue a career in the law because I liked to read and believed that becoming a lawyer would enable me to help others. After graduating from Loyola Law School 42 years ago, I joined LACBA and the Barristers Section in 1977.

Both the Barristers and LACBA were instrumental in my success as a lawyer. I started in Barristers by volunteering to serve as a settlement officer (similar to a mediator) in the landlord-tenant court at what is now the Stanley Mosk Courthouse and, shortly afterwards, was asked to chair that program. In addition to making lifelong friends, Barristers offered me my first leadership opportunities and many of my first mentors and role models. LACBA later continued offering me all of those same rewards for no more than the commitment of some of my time.

At a time when new attorneys frequently change jobs, it is more important than ever that they expand their network of friends and professional acquaintances to enable them to have more future professional opportunities. LACBA, and especially Barristers, offer those opportunities while also enabling new attorneys to fulfill their professional responsibilities at a time when it is more important than ever that all attorneys do so. We all need to help provide access to justice to those who are less fortunate, as well as to educate the public about their rights, the importance of the rule of law and independent and impartial courts, and the vital role that our justice system plays in our democracy.

We invite you to explore all the benefits of LACBA and Barristers/Young Attorneys Section membership, which is free to all first- and second-year attorneys. If you have questions about your membership or how to get involved, please contact LACBA Member Services at 213-896-6560.
During my term, we faced a severe civil backlog in the Los Angeles Superior Court. The county and the state legislature were not supportive of additional judgeships or funding. The Los Angeles County Bar Association aggressively led efforts to lobby legislators and educate the public about the needs of the courts and the importance of an independent judiciary.

We initiated litigation in the U.S. District Court to secure adequate funding for the courts. Leading bar members, including at least three presidents of LACBA, created the Coalition for Justice, a broadly based organization intended to educate the public about the need for adequate funding and judicial independence. We opposed efforts in the legislature to defund the courts. We supported efforts of the California Judicial Council for delay reduction and other court reforms, including the merger of the trial courts and statewide funding. Ultimately, our litigation was unsuccessful in the Ninth Circuit, but working with the Judicial Council, the trial court delay reduction program was implemented, the trial courts were merged, and statewide funding was achieved.

It was an exciting time of continued membership growth, implementation of new programs, and enhancement of LACBA’s many existing initiatives. The great strength of LACBA has always been to build upon the tremendous contributions of many former officers and volunteers in professional and community service. This year was no exception. Highlights include the expansion of meaningful pro bono through the Pro Bono Policy and creation of the Pro Bono Council under the leadership of Margaret Morrow, Joe Mandel, and Steve English; support of the Fast Track and the Joint Association Settlement Officer Programs in the Superior Court under the leadership of Rex Heeseman and Rich Davidoff; expanding the scope and quality of Los Angeles Lawyer; implementing LACBA’s litigation guidelines in the U.S. District Court; instituting litigation under the leadership of Richard Chernick to seek adequate judicial positions in the Los Angeles Superior Court and additional court funding; emphasizing our support of the Minorities in the Profession Committee (which was later renamed the Diversity Committee), maintaining the continuity of our lawyers errors and omissions insurance program despite insolvency of one of the insurers; participating in the work of the Christopher Commission and engaging a full-time MCLE director to address the needs created by mandatory CLE.

It was my honor to work with the many talented and committed board members and volunteers in achieving these goals.

Richard Chernick
1992-1993

Patrick Kelly
1990–1991

Hon. Lee Smalley Edmon
1998–1999

I was honored to serve as LACBA’s president from 1998–1999. That bar year we focused on providing better training for new lawyers, improving our courts, raising money for minority applicants to local law schools, providing free legal services to thousands who could not afford to pay a lawyer, creating online services for lawyers, drafting guidelines for disclosures by private judges to parties, and moving the LACBA offices (from the landmark Oviatt Building to Figueroa Street). A major reward of my service to LACBA is the warm and lasting friendships I developed with so many talented, creative lawyers. I was also fortunate to work with the remarkable LACBA staff led by Executive Director Rich Walch, the finest bar executive in the country at the time.
Linda Dishman
President and CEO of the Los Angeles Conservancy

you three major job duties? To advocate for preservation, to direct educational programs, and to make sure we have the necessary funding.

The Conservancy has a staff of 16 people. What is your yearly operating budget? $2.8 million.

The Conservancy has approximately 300 volunteers. What do they do? The largest piece is the walking tour docents. On any given Saturday morning, we have 10 to 20 docents out on the street, showing people the majesty of our city.

Your board of directors has 24 members. Is it a varied group? We have, among others, a couple of lawyers, a couple of architects, some entertainers, an engineer.

Who handles the legal matters? Fortunately, we have been able to use pro bono services. We have also hired attorneys to help us with specific issues.

The Conservancy is a nonprofit with nearly 6,000 members. Who is a typical supporter? Members with lots of different viewpoints. Most love Los Angeles; that’s why they belong. It’s about that yearly support. We have annual memberships for $40.

The Conservancy was founded in 1978 to save the Central Library building. What was the context? Bunker Hill was demolished. We had lost the Atlantic Richfield building. There was unrest, and activists came together.

Who is credited with creating the Conservancy? Our founding president, Margaret Bach. She shepherded the organization at its founding and had emphasis on the future.

Who is credited with creating the Conservancy board? They said you need to form an organization not just to save Central Library but to advocate for threatened historic buildings and also with an educational arm.

How did the Central Library project transpire? It took 13 years. The library building had constraints and required a very complex plan.

What is the most important building you could not save? The Ambassador Hotel, which was built in 1921. In many ways it told the story of the city. It was tourism, entertainment, and politics. It also represented the westward expansion of the city from downtown to the westside. We had done everything we could and gave it our all.

Since 1978, the Conservancy has been located in significant buildings downtown. What is important about your current location? We moved into the PacMutual building about 20 years ago. The Beaux Arts building was constructed in phases from 1908 until 1936. It features one of the most beautiful lobbies in downtown.

Who decides what is historic? The City did a survey and identified five percent of our 880,000 parcels as historic.

What is our report card grade on preservation? A+ for Los Angeles.

Who gets an F? From Agoura Hills to Vernon to Duarte; 47 of the 89 jurisdictions do not have a preservation ordinance.

Approximately 10,000 people take the downtown tours each year. Your favorite? I love the Historic Downtown Tour because it encompasses the Library, Grand Central Market, and the Bradbury Building—the showstoppers.

What outreach do you have for youngsters? Field trip tours for specific schools. It’s interactive, like a scavenger hunt.

The California Environmental Quality Act (CEQA) became law in 1970 to protect the environment. Are buildings part of the environment? Yes. They decided the environment is not just squirrels and creeks.

The Conservancy comments on the draft...
Environmental Impact Reports. How does that work? CEQA says that there’s a process for the approval of projects. Anybody can comment.

What do you look for? We are looking for the process to be followed. Which is?

Has the building been identified as historic? If the developer wants to demolish a historic building, have they done a good job looking for alternatives? The last is if we agree with their conclusions.

Do you usually agree? Sometimes.

Has the work changed at the Conservancy? Developers now come to us earlier in the process. Preservation solutions are often worked out before the project begins its environmental review.

What if it is entirely a private project? If the developers want an entitlement, and there is a discretionary option by the city or the county or the state, they have to go through the process.

What do they usually want? A zoning change.

CEQA operates under a self-executing statute and public agencies are entrusted with compliance. Do they do their job? Most times, the cities have a good faith effort, but it’s not consistent. There is still need for vigilance.

How many lawsuits have you filed in your tenure? Five.

The Mills Act is an incentive program for preservation. How does it work? Basically, it says you need to make the following changes in a building when you invest, and we will lower the property taxes.

A Mills Act contract runs with the land. How does that help sellers? You sign up for 10 years, and on your anniversary it renews for another 10 years. Not many people want to opt out because the property is not necessarily reassessed at the new value when sold.

What is the interplay among local, state, and federal regulations? There are regulations at all three levels of oversight and they are interwoven. I think there is the most power to preserve buildings at the local level—the planning level.

Do designated historic districts face a decline in property values? Anecdotally, we don’t believe so. We have commissioned a study.

What was your best job? This one.

What was your worst job? I haven’t had one. I feel very fortunate.

How do you get your news? Los Angeles Times and different things online.

Which magazine do you pick up at the doctor’s office? Los Angeles Magazine.

What is one app you wish you could work on your iPhone? What I want to do, I do.

Where is your favorite vacation spot? Rome.

Where do you go on a three-day weekend? San Diego—I have relatives there.

Do you answer your e-mail when you travel? Yes.

What is your Starbucks’ order? Iced tea, unsweetened and black.

What is your favorite restaurant and what do you order there? Water Grill—I always have the Mexican Shrimp Salad.

What trait do you like in yourself? Sense of humor.

Is there a trait you’d like to improve upon? Have a better memory.

What are the three most important historic buildings in Los Angeles? City Hall, Union Station, and the Cathedral of St. Vibiana.

What’s the story with St. Vibiana? It’s from 1876. People came together and said we’re going to have the railroad here in a couple of years and we need a big building. It was aspirational.

What happened? It was threatened with demolition in the mid 1990s, and we filed two of our lawsuits. It was the power structure of downtown against the Conservancy.

Do you mean the Catholic Church? Oh, yeah. We stood firm, and the Archdiocese built their cathedral on another piece of property.

What are your two favorite streets in Los Angeles? Broadway—there are 12 theaters there that are just jaw-dropping amazing—and Wilshire Boulevard.

What part of Wilshire Boulevard? All of it.

What is the one word you want written on your tombstone? Resilient.
A Strategy for Success in Disruptive Technologies Litigation

CROWD-SOURCING TECHNOLOGIES like Airbnb, Uber, and Bird have revolutionized travel. However, with their benefits, these innovations also carry a host of perceived threats, to communities and individuals alike, motivating a myriad of lawsuits. By definition, these disruptive technologies have changed the current landscape, requiring regulation—and litigation—to play catch up.

In an era of legal uncertainty, one thing remains certain: The floodgates to these lawsuits have burst and are likely to remain open. Uber, for example, was reportedly sued over 400 times in 2017. Also, lawsuits over scooter-share services like Bird or Lime are gaining traction across the country. These actions are providing litigators a unique opportunity to become innovators themselves. With no settled principles in the case law, company counsel have a chance to forge the path ahead, yet with great power comes great responsibility. One unfavorable result at the forefront of these disputes can set the stage for hundreds or thousands of cases to follow.

Litigating in Uncharted Waters

At this intersection of opportunity and accountability, there are three principles that company counsel must heed:

Develop a Strong Factual Record. Many of the lawsuits brought to date have required a fact-intensive inquiry—particularly when discrimination or personal injury claims are alleged. Developing a strong record regarding the company’s policies and ongoing attempts to self-regulate can have broad implications in the present case and for many other actions to come. At a minimum, a finding of liability and the supporting record can be instructive for future plaintiffs’ lawyers; even worse, the client may be stuck with a binding ruling that can estop them in future precedent for future plaintiffs’ lawyers; even worse, the client may be stuck with a binding ruling that can estop them in future actions.2 These actions are providing litigators a unique opportunity to remain open. Uber, for example, was reportedly sued over 400 times in 2017. Also, lawsuits over scooter-share services like Bird or Lime are gaining traction across the country. These actions are providing litigators a unique opportunity to become innovators themselves. With no settled principles in the case law, company counsel have a chance to forge the path ahead, yet with great power comes great responsibility. One unfavorable result at the forefront of these disputes can set the stage for hundreds or thousands of cases to follow.

Showcase the Benefits of the Technology. Lawsuits over disruptive technologies often attempt to stoke mass hysteria by focusing on the ways that the technology, quite literally, disrupts entire communities. Effective company counsel will play offense and focus on developing the affirmative story.

These new technologies quickly gain in popularity because they are filling a public need—providing more affordable housing options when traveling, safe rides after a night out, and decreased environmental damage. Many of the claims available to plaintiffs—for example, nuisance—require balancing competing interests: the harm caused by the technology versus its social utility. In such instances, expounding on the benefits of the technology bears directly on the claims. The social utility of the technology, however, should be an inextricable part of the affirmative story that is told at all stages of the litigation, even in cases in which it is not directly at issue. The raison d’etre of the technology and the public support for it will often be necessary to frame the dispute for both judge and jury.

Shift Liability to the End User. One of the challenges of plaintiffs’ claims in the crowd-sourcing space is the existence of a third-party actor. Most lawsuits seek to hold the defendant company liable for the actions of a third-party consumer of the technology—whether it be a driver, rider, or renter.

Patchwork of Case Law

A patchwork of case law has developed as courts try to make sense of liability in these untraditional spaces. However, many courts have recognized that the existence of a third-party user affects defendants’ liability. Uber, for example, has litigated whether its drivers are employees or independent contractors for years—an issue which has great impact on whether Uber can be held liable for a driver’s negligence.

Recently, a federal court ruled that UberBLACK drivers could not be considered “employees” under the Fair Labor Standards Act,3 potentially helping Uber avoid future liability. Last year, a federal court sided with Airbnb in a dispute with a landlord over apartment listings in violation of the landlord’s policies. The important distinction made by the court was that “Airbnb hosts—not Airbnb—are responsible for providing the actual listing information.”4

These issues continue to be contentious with far-reaching implications. Nevertheless, shifting liability from the defendant company to the third-party actor should be part of every company counsel’s playbook.

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Construction Defect Liability Coverage in California Post-Ledesma

Construction Companies, like all sensible California businesses, obtain insurance to guard against unforeseen casualty risks. At a minimum, contractors typically purchase Commercial General Liability (CGL) policies to cover liability for slip and fall incidents and similar claims. CGL policies are often invoked to provide coverage for another common event plaguing California contractors: construction defect lawsuits.

Whether coverage for faulty work is afforded depends on whether there has been an “occurrence” under the CGL policy. This issue emerged in the 1990s as a common defense asserted by insurers in response to construction defect claims. Unfortunately, court decisions in this area are varied and difficult to harmonize. Most jurisdictions that have decided the issue have concluded faulty work can constitute an “occurrence,” because the term “accident” within the “occurrence” definition can encompass unintended property damage resulting from intended but negligently performed acts. Other jurisdictions apply a more narrow definition of the term “accident” to preclude coverage by focusing on the insured’s conduct rather than its unintended consequences.

California’s lower courts have likewise been divided on this issue. The California Supreme Court’s 2018 landmark decision in Liberty Surplus Insurance Corporation, et al. v. Ledesma & Meyer Construction Co., Inc., et al. may thus be a welcome relief to California construction industry policyholders trying to obtain insurance coverage against lawsuits alleging faulty work.

Defining “Occurrence”

To trigger coverage, the insuring agreements of post-1986 CGL policy forms drafted by the Insurance Services Office (ISO) require the subject injury or damage be caused by an occurrence. The policies define “occurrence” as “an accident, including continuous or repeated exposure to substantially the same general harmful conditions.” The term “accident” is not defined, leaving its interpretation to the courts. Insurance carriers and construction company policyholders often dispute whether faulty work qualifies as an occurrence under CGL policies, with the main area of contention being whether the event giving rise to the loss was accidental.

California lower court decisions are divided on whether an accident may be found when the damages leading to the litigation were not intended by the insured-defendant, even though the preceding acts—construction activities—were fully intended, and indeed were the object of the construction contract.

One line of cases has denied coverage by refusing to find an accident when the ultimate effect of the insured’s intentional conduct was unanticipated. For example, in Merced Mutual Insurance Co. v. Mendez, an insured sexually assaulted a victim. The insured conceded intentionally engaging in the sexual conduct but urged he intended no injury, claiming he believed the victim had consented to the activity. The “accident” would have been the insured’s misreading of the victim’s mental state. The court focused solely on the insured’s conduct: “[W]here the insured intended all of the acts that resulted in the victim’s injury, the event may not be deemed an ‘accident’ merely because the insured did not intend to cause injury.” The Mendez court concluded there was no accident because “[a]ll of the acts, the manner in which they were done, and the objective accomplished occurred exactly as [the insured] intended,” and there was no “additional, unexpected, independent or unforeseen act” that occurred.

Again, in State Farm General Insurance Co. v. Frake, a lower court concluded there was no accident when the insured did not intend the ultimate consequences of his intentional acts. The insured and the victim were engaging in horseplay when
the insured struck his friend in the groin, resulting in serious injuries. The court ruled there was no accident because the strike itself was intentional: “[T]his is not a case where some ‘unexpected, independent, and unforeseen happening’ in the causal chain produced the resulting harm.” The court emphasized that “[t]he mere fact that [the insured] did not intend to injure [the victim] does not transform his intentional conduct into an accident.”

Another line of cases has found there is coverage—or at least potential coverage triggering the insurer’s duty to defend the lawsuit—by finding an accident when either the cause was unintended or the effect was unanticipated by the insured. For example, in Chu v. Canadian Indemnity Co., the court stated that an accident may be found under liability policies “where the injury is an unexpected or unintended consequence of the insured’s conduct.” There, the court found the insured developer’s (obviously intentional) sale of condominium units could fall under the insurance policy’s definition of “accident,” if the units turned out to contain defective workmanship, and the insured was unaware of the defects at the time of sale.

State Farm Fire and Casualty Company v. Superior Court (Wright), another personal injury case, reaches the opposite result when compared with Frake. There, the insured threw his friend at a swimming pool during horseplay but, sadly for the friend, missed. The victim landed on the pool’s concrete step and sustained serious injuries. The court found this was an accident because the injury was an unintended consequence of the insured’s conduct: “[A]n accident can exist when either the cause is unintended or the effect is unanticipated.” The court emphasized the insured “did not intend or expect” to hurt the victim and concluded there was an accident because “the act directly responsible for [the victim’s] injury, throwing too softly so as to miss the water, was an unforeseen or undesigned happening or consequence and was thus fortuitous.”

**Ledesma**

Almost a decade after last addressing the “occurrence” requirement in liability policies, in June 2018, the California Supreme Court supplied further guidance that may expand coverage for construction companies alleging faulty work constitutes an “occurrence” under CGL policies.

In Liberty Surplus Insurance Corporation v. Ledesma & Meyer Construction Company, Inc., the construction company (L&M) performed work at a middle school. One of L&M’s employees was alleged to have committed sexual abuse against a student. The victim’s family sued, asserting L&M had negligently hired, supervised, and retained the perpetrator.

The carriers for L&M sued L&M in federal court, seeking a declaration that they had no duty to defend or indemnify L&M in the underlying action. The CGL policy contained the standard ISO definition of “occurrence.” The district court granted Liberty’s motion for summary judgment, finding no duty to defend. The court reasoned the alleged injuries were not caused by an accident, refusing to look to whether the insured intended the consequences rather than intending the preceding acts: “[C]ourts have rejected the argument that the insured’s intentional acts of hiring, supervising, and retaining are accidents, simply because the insured did not intend for the injury to occur.” The construction company, L&M, appealed, and the Ninth Circuit Court of Appeals certified the following question to the California Supreme Court: “Whether there is an ‘occurrence’ under an employer’s [CGL] policy when an injured third party brings claims against the employer for the negligent hiring, retention, and supervision of the employee who intentionally injured the third party?” The Ninth Circuit declared: “[R]esolution of this question will extend beyond the employment context, affecting many insured entities and persons” and “[g]iven the ubiquity of insurance policies that cover ‘occurrences’ in California, this certified question presents an issue of significant precedential and public policy importance.”

On June 4, 2018, the California Supreme Court answered the certified question affirmatively, ruling the victim’s injuries “can be considered ‘accidental’” and thus an occurrence under a CGL policy. The court reiterated the term “accident” in CGL policies means “an unexpected, unforeseen, or undesigned happening or consequence from either a known or unknown cause.” The court concluded that, from the perspective of the insured, L&M, “[e]ven though the hiring, retention and supervision of [its employee] may have been ‘deliberate act[s]’ by L&M, the molestation of [the claimant] could be considered an ‘additional, unexpected, independent, and unforeseen happening...that produced the damage.’”

Read broadly, **Ledesma** raises serious doubt about the line of authority holding subjectively unintended consequences flowing from intentional conduct can never qualify as an accident, and thus an occurrence, under CGL policies. The decision thereby further strengthens insureds’ coverage rights under their CGL policies. Moreover, it affirms the broad coverage that was intended to be provided under the standard CGL policy.

As signaled by the Ninth Circuit, **Ledesma**’s implications extend beyond the employment context. The construction industry should also benefit from the opinion, as it suggests faulty work may constitute an occurrence under CGL policies when the insured did not intend the resulting damages.

**Leveraging Ledesma**

Post-**Ledesma**, California construction industry policyholders should be entitled to at least a defense under CGL policies when the damage is not alleged to have been subjectively intended from the insured’s perspective. In California, an insurance company’s duty to defend is broader than its duty to indemnify. An insurer must defend its insured against claims that create a potential for indemnity, and “[a]ny doubt as to whether the facts establish the existence of the defense duty must be resolved in the insured’s favor.” In short, carriers are required to offer a defense unless they are certain that there is no potential coverage for damages sought in the underlying action. In addition, insuring provisions like the “occurrence” requirement are “interpreted broadly so as to afford the greatest possible protection to the insured.”

At a minimum, **Ledesma** creates uncertainty in California insurance law regarding whether faulty work that results in damage not intended from the insured’s perspective qualifies as an occurrence. Since courts construe the “occurrence” requirement broadly in favor of coverage, and resolve uncertainties in favor of the insured, **Ledesma** provides policyholders with additional ammunition to claim carriers must offer a defense against construction defect claims.

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(Kan. 2006); Lerner Corp. v. Assurance Co. of Am., 707 A. 2d 906 (Md. Ct. Spec. App. 1998); Architec
Ass’n v. Scottsdale Ins. Co., 27 So. 3d 1148 (Miss. 2010); Employers Mut. Cas. Co. v. Fisher Builders,
Inc., 371 P. 3d 375 (Mont. 2016); Cypress Point Condo. Ass’n, Inc. v. Adria Towers, L.L.C., 143 A.
N.W. 2d 80 (S.D. 2017); Travelers Indem. Co. of Am. v. Moore & Assoc., Inc., 216 S.W. 3d 302 (Tenn.
2007); Lamar Homes, Inc. v. Mid-Continent Cas. Co., 242 S.W. 3d 1 (Tex. 2007); Yakima Cement Prods.
2001).


6 Id.


8 Id. at 48, 51.

9 Id. at 50.

10 Id.

11 Id.


13 Id. at 310.

14 Id.


16 Id. at 96.

17 Id. at 96-97 (citing Geedles & Smith, Inc. v. St. Paul Mercury Indemn. Co., 334 P. 2d 881 (Cal. 1959)).


19 Id. at 326.

20 Id. at 328-29 (citations omitted; emphasis in original).


2018).

23 Id.


25 Id. at *2.

26 Id. (citing Foremost Ins. Co. v. Eanes, 134 Cal. App. 3d 566, 570-71 (Cal. Ct. App. 1982); Merced
Ins. Co. v. Bay Area Cab Lease, Inc., 756 F. Supp. 1287, 1290 (N.D. Cal. 1991); Delgado, 47 Cal. 4th at
315-316). The district court also found the negligent hiring, retention, and supervision claims were “too
attenuated” from the injury-causing conduct. Ledesma, 2013 WL 12143958, at *3.


28 Id. at 1002.

29 Rephrased slightly as follows by the California Supreme Court: “When a third party sues an employer for the negligent hiring, retention, and supervision of an employee who intentionally injured that third party, does the suit allege an ‘occurrence’ under the employer’s [CGL] policy?” Ledesma, 418 P. 3d at 402.

30 Id.

31 Id. at 403 (quoting Delgado, 47 Cal. 4th at 308).

32 Id., 418 P. 3d at 406, 408. The Supreme Court also rejected the district court’s other line of reasoning, confirming that tort principles govern the causation issue with respect to liability coverage and ruling L&M’s negligence was not “too attenuated” from the injury-causing conduct. Id. at 404-05.

33 The concurring opinion, authored by Justice Goodwin Liu, would have gone further, overruling the analysis in Mendez and explicitly finding intentional acts resulting in unintended consequences may constitute an “accident”. Id. at 409-12. The concurring opinion noted that “in a liability insurance policy, an ‘accident’ does not necessarily refer to the conduct of the insured, rather it is an ‘unexpected, unforeseen, or undesigned happening or consequence…resulting from the conduct of the insured.’” Id. at 410.

34 See, e.g., Philip L. Bruner & Patrick J. O’Connor, Jr., BRUNER & O’CONNOR CONSTRUCTION LAW §11:201 (June 2018).


37 Id. at 1002.

38 See, e.g., Philip L. Bruner & Patrick J. O’Connor, Jr., BRUNER & O’CONNOR CONSTRUCTION LAW §11:201 (June 2018).

39 The concurring opinion, authored by Justice Goodwin Liu, would have gone further, overruling the analysis in Mendez and explicitly finding intentional acts resulting in unintended consequences may constitute an “accident”. Id. at 409-12. The concurring opinion noted that “in a liability insurance policy, an ‘accident’ does not necessarily refer to the conduct of the insured, rather it is an ‘unexpected, unforeseen, or undesigned happening or consequence…resulting from the conduct of the insured.’” Id. at 410.
Pondering Predominance

Clarity regarding the consequences of different state law for predominance analysis is anticipated in the Ninth Circuit en banc panel finding

*In re Hyundai and Kia Fuel Economy Litigation* has the potential to create significant barriers to certification of nationwide settlement classes in the Ninth Circuit. While the decision currently is under consideration by an en banc panel of the Ninth Circuit Court of Appeal, if the full court adopts the panel’s reasoning, objectors can use variations in state law to defeat predominance for a settlement class—potentially resulting in a sea change in how class settlements are currently approved. Until the issue is settled, lawyers should consider thoroughly engaging in choice-of-law analysis when seeking to certify a class.

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Under Rule 23(a) of the Federal Rules of Civil Procedure, four prerequisites must be satisfied before certification of a putative class: 1) numerosity, 2) commonality, 3) typicality, and 4) adequacy. To satisfy Rule 23(a), a plaintiff must prove through a “rigorous analysis” that each particular requirement is met.\(^2\)

Once Rule 23(a) is satisfied, a party must then show either 1) a risk that separate actions would create a risk of prejudice, 2) that injunctive or declaratory relief is appropriate to the class as a whole, or 3) that common questions of law and fact predominate through the class and class adjudication is superior to any other methods of trying the case.\(^3\)

Until the Ninth Circuit panel’s opinion in *Hyundai*, the primary case governing application of the predominance requirement to a nationwide settlement class was *Hanlon v. Chrysler Corporation*.\(^4\) Similarly to *Hyundai*, in *Hanlon*, dozens of class actions, asserting violations of state consumer protection laws, were consolidated through multidistrict litigation (MDL) in which the parties reached a settlement proposing a nationwide settlement class seeking damages under state consumer protection statutes for defective latches in their vehicles. Despite variations in state consumer protection laws, the Ninth Circuit found that common issues predominated because “a common nucleus of facts and potential legal remedies,” including defendant’s awareness of the latch defects, dominated each of the state law claims at issue in the litigation.\(^5\) Potential differences in remedies and variations in state law did not defeat predominance, and the proposed nationwide class was certified for settlement purposes.\(^6\)

**Hyundai in the District Court**

In 2011, a consumer advocacy group complained to the Environmental Protection Agency (EPA) that Hyundai and Kia had overstated the fuel efficiency of certain vehicles in “Monroney stickers,” the disclosures in the window of every new car that provide official vehicle specifications.\(^7\) The EPA launched an investigation and, in late November 2012, confirmed that Hyundai and Kia had used improper procedures to develop the fuel economy information advertised for certain 2011, 2012, and 2013 model year vehicles, resulting in inflated fuel efficiency estimates. At the same time that the EPA announced the results of its investigation, both companies “voluntarily” announced that they would lower the affected vehicles’ fuel economy ratings and implement a lifetime reimbursement program to reimburse customers for fuel costs based on the difference between the affected vehicles’ actual and advertised fuel economy ratings.\(^8\)

While the EPA investigation was pending, numerous plaintiffs filed lawsuits alleging false advertising and unfair competition claims against Hyundai and Kia, based on alleged misstatements in the Monroney stickers and other advertising.\(^9\) One of these cases, *Espinosa v. Hyundai Motors America*, alleged claims under California’s unfair competition law,\(^10\) false advertising law,\(^11\) and the Consumer Legal Remedies Act (CLRA),\(^12\) and sought remedies of damages, rescission, restitution, and injunctive relief in the form of corrective advertising.\(^13\) Following removal to federal court, plaintiffs moved to certify a nationwide class consisting of owners of specified vehicles who purchased or leased vehicles in the United States.\(^14\) Hyundai argued that variations in state consumer protection laws precluded application of California law to non-California consumers, attaching a 34-page chart of purportedly relevant variations between California law and the law of other states.\(^15\) Hyundai claimed that these variations defeated Rule 23(b)(3)’s predominance requirement.\(^16\)

Shortly thereafter, *Espinosa* was consolidated with dozens of other cases in an MDL. The parties reached a voluntary settlement with a nationwide class comprised of all purchasers of certain vehicle makes and model years. In December 2013, plaintiffs moved for class certification and preliminary approval of the nationwide settlement. The district court granted the motion for preliminary approval and certified the nationwide class—acknowledging but ultimately dismissing concerns about differences in substantive state law.\(^17\) In June 2015, the district court entered final approval of a $210 million settlement agreement without engaging in a state-by-state choice of law analysis.\(^18\)

**Order Vacating Settlement Class**

After approval of the final settlement, objectors filed appeals arguing that the approved settlement was not “fair and adequate,” partially on the basis that the district court abused its discretion for failing to undertake a choice of law analysis on the consumer protection claims brought on behalf of the nationwide class.\(^19\) The Ninth Circuit panel agreed, vacating the certification order after finding the failure to undergo any choice-of-law analysis for the settlement class was legal error.

In reaching this conclusion, the panel relied on the Ninth Circuit’s 2012 decision in *Mazza v. American Honda Motor Company*, which held that in order to apply California law to a nationwide class, it must first be shown that sufficient contacts exist between California and class members’ claims for constitutional application of California law.\(^20\) If that is the case, then a three-part governmental interest test is applied asking: 1) if the law of the foreign jurisdictions is similar or different to California law, 2) whether the jurisdiction has an interest in applying its own law over California’s, and 3) which state’s interest in applying its laws would be more impaired if subordinated.\(^21\) If there is a true conflict, the state with the “larger” degree of impairment must have its law applied. Thus, under *Mazza*, in determining whether Rule 23(b)(3) is satisfied, common questions of law and fact do not “predominate,” justifying use of class-wide adjudication, unless the governmental interest test comes out in favor of uniformly applying California law to the class.

This distinction between a litigation and settlement class impermissibly tainted the settlement negotiations because “class counsel confined to settlement negotiations could not use the threat of litigation to press for a better offer, and the court faced a bargain proffered for its approval without benefit of adversarial investigation.”\(^22\) The panel also found it significant that the district court early on had found “material differences” between the California and foreign state laws and that a choice-of-law analysis militated against nationwide certification in accordance with *Mazza*, but approved settlement regardless because the court was not certifying a litigation class.\(^23\) Further, the panel did not believe, as the district court did, that reliance on a fairness hearing would allow the court to ameliorate the choice of law problem.\(^24\) Given that a court’s Rule 23 obligations are “heightened” in the context of settlement certification, the panel found that the district court’s obligation to conduct a “rigorous analysis” of compliance with Rule 23(b) was heightened as well. The panel expressly repudiated the proposition that settlement class certification was subject to a lesser standard than litigation class certification.\(^25\)

**Judge Nguyen’s Dissent**

In a strongly worded dissent, Judge Jacqueline Hong-Ngoc Nguyen rejected the majority’s opinion, which she viewed as dealing “a major blow to multistate class actions.”\(^26\) In her view, the district court validly exercised its discretion in certifying
a settlement class. Observing that “[b]oth [the Ninth Circuit] and our sister circuits have long held that a nationwide class action cannot be decertified simply because there are differences between state consumer protection laws,” Judge Nguyen reiterated that the predominance inquiry “is not a matter of nose-counting...more important questions apt to drive the resolution of the litigation are given more weight in the predominance analysis over individualized questions which are of considerably less significance to the claims of the class.” The district court’s finding that the undisputed common questions—whether fuel economy statements were, in fact, accurate and whether defendants knew their statements were false or misleading—established predominance was a proper application of Ninth Circuit law that was entitled to deference by the appellate court.

More importantly, Judge Nguyen argued that the majority had created an onerous new burden for district courts and class counsel in putative nationwide class actions: the duty to survey state law and affirmatively prove that the forum state’s law applies. Noting that the objectors in Hyundai failed to argue choice of law issues at the district court level, she accused the majority of “reasign[ing]...the burden” on choice-of-law issues to the district court and class counsel, violating the basic mandates of Rule 23 and Erie Railroad Company v. Tompkins, which requires a federal court sitting in diversity jurisdiction to apply the forum state’s choice-of-law rules.

Finally, Judge Nguyen noted, the panel’s ruling unnecessarily created a circuit split. In Sullivan v. DB Investments, Inc., the en banc Third Circuit held that variations in state rights and remedies did not defeat a finding of predominance as to a putative nationwide class. The Sullivan court noted that concerns regarding differences in state law largely go to the manageability of the class action format, which is not at issue for a settlement (as opposed to litigation) class. Similarly, in In re Mexico Money Transfer Litigation, the Seventh Circuit noted that “nationwide classes are certified routinely even though every state” has its own laws. Like the court in Sullivan, the Mexico Money panel found that, “[g]iven the settlement, no one need draw fine lines among state law theories of relief.” Moreover, Judge Frank H. Easterbrook, writing for the panel, expressly rejected the burden-shifting adopted by the panel majority in Hyundai, observing, “Why [class counsel] should have an obligation to find some way to defeat class treatment is a mystery.”

What Is Next?

On July 27, 2018, a majority of the Ninth Circuit’s active judges voted in favor of rehearing en banc, vacating the panel’s order. A panel of 11 judges held a hearing on September 27, 2018. No order has been issued.

Numerous amici curiae, including such unlikely bedfellows as the National Consumer Law Center and the American Tort Reform Association, weighed in and uniformly urged the en banc Court to reverse the panel’s prior order. From the consumer advocates’ perspective, the panel’s order functionally would result in fewer remedies for consumers, a concern that also animated Judge Nguyen’s dissent when she noted that “[e]conomic reality dictates that...consumer lawsuit[s] proceed as a class action or not at all,” and the majority’s opinion “effectively ensures that no one will recover anything.” Moreover, the panel’s order would disrupt what the consumer advocates regard as settled law, upending the scheme endorsed by the Ninth Circuit in Hanlon and the Third and Seventh Circuits over thousands of opinions and more than a decade of litigation.

For their part, the Association of Global Automakers and American Tort Reform Association argued that the panel’s order made it more onerous and expensive to resolve class action litigation, interposing uncertainty, briefing, and attorneys’ fees for counsel in each of the 50 states as additional obstacles to reaching fair and just settlements. This concern echoed the plaintiffs’ petition in support of rehearing en banc, which argued that the panel’s decision “increases the expense and uncertainty of nationwide settlements, which reduces their likelihood, contrary to public policy.”

A third set of amici expressed concern for the already overburdened court system. As the Third and Seventh Circuits observed in Sullivan and Mexican Money, respectively, requiring courts to engage in a substantive comparison between state laws absent any articulated concern by objectors amounts to a wasteful intellectual exercise that unduly burdens the district courts and further slows relief to aggrieved class members. (In seeking en banc review, the Hyundai plaintiffs called this exercise “wasteful make-work for litigants and lower courts when a case will not be tried.”) These amici accused the panel of conflating manageability—which is irrelevant for purposes of settlement certification—with predominance, which courts consider when certifying a settlement class. Each of these concerns is valid and weighs in favor of overturning the panel’s order and restoring Hanlon’s longstanding supremacy. Nevertheless, what are class action litigants to do in the meantime?

Although the Ninth Circuit has vacated the panel’s order, the few district courts and Ninth Circuit panels to consider the panel opinion already have developed theories to blunt its impact. In In re Volkswagen “Clean Diesel” Marketing Sales Practices, and Product Liability Litigation—where, unlike in Hyundai, objectors did raise choice-of-law issues before the district court—a different Ninth Circuit panel found that the settlement was unaffected by the panel’s order because, “[u]nlike in that case, the district court here provided a thorough predominance analysis under Rule 23(b)(3), sufficient under In re Hyundai.” By contrast, the court in In re Anthem, Inc. Data Breach Litigation found that a choice-of-law analysis was not required by Hyundai because, among other concerns, plaintiffs in the data breach litigation conceded that the laws of the 50 states applied to the settlement while Hyundai plaintiffs did not.

Moreover, the district court in Hyundai previously found that state law variations would defeat predominance in the context of a trial class. It is difficult to see why these distinctions matter; the Anthem court’s reasoning is best viewed as an attempt to limit the disruptive scope of the panel opinion’s order.

As the Anthem court observed, the key takeaway from In re Hyundai—should the panel’s order carry the day—is that courts should examine “differences in the underlying state law as part of the predominance analysis.” Presumably, the en banc Ninth Circuit will clarify who, exactly, bears the burden of making this showing. In the meantime, counsel for the settlement class may be best served by providing the district court with the evidence necessary to engage in a predominance analysis and thus earn the deferential standard of review accorded to orders awarding class certification absent errors of law.

1. In re Hyundai & Kia Fuel Econ. Litig., 881 F. 3d 679, 694 (9th Cir. 2018), rel’g en banc granted sub nom. In re Hyundai and Kia Fuel Econ. Litig., 897 F. 3d 1003 (9th Cir. 2018).
3. Fio, R.Civ. P. 23(b).
5. Id. at 1020-21.
6. Id. at 1022-23.
7. In re Hyundai & Kia Fuel Econ. Litig., 881 F. 3d
679, 694 (9th Cir. 2018), reh’g en banc granted sub
nom. In re Hyundai and Kia Fuel Econ. Litig., 897 F. 3d 1003 (9th Cir. 2018).
8 In re Hyundai, 881 F. 3d at 694-95.
10 BUS. & PROF. CODE §§17200–17209.
11 BUS. & PROF. CODE §17500.
12 CIVIL CODE §§1750-1784.
13 In re Hyundai, 881 F. 3d at 695 at n.9.
14 id. at 695.
15 id.
16 id.
17 id. at 700-01.
18 id.
19 id. at 701-02.
21 id. at 590.
22 In re Hyundai, 881 F. 3d at 702-03.
23 id. at 696.
24 id.
25 id.
26 id. at 708 (Nguyen, J., dissenting).
27 id. (citing Hanlon, 150 F. 3d at 1022-23; Torres v. Mercer Canyons Inc., 835 F. 3d 1125, 1134 (9th Cir. 2016)).
28 In re Hyundai, 881 F. 3d at 708-09.
29 id. at 709.
31 In re Hyundai, 881 F. 3d at 709.
32 Sullivan v. DB Investments, Inc., 667 F. 3d 273, 301-302 (3rd Cir. 2011).
33 id. at 297.
34 In re Mexican Money Transfer Litig., 267 F. 3d 743, 747 (7th Cir. 2001).
35 id. at 746-47.
36 id. at 747.
37 In re Hyundai & Kia Fuel Econ. Litig., 897 F. 3d 1003 (9th Cir. 2018).
39 In re Hyundai & Kia Fuel Econ. Litig., 881 F. 3d 679, 707, 718 (9th Cir. 2018) (Nguyen, J., dissenting) (internal citations and quotations omitted).
40 Public Justice Brief, supra note 38, at 4.
42 Plaintiffs’ Petition for Rehearing (en banc), In re Hyundai, No. 15-56014, Dkt. 102-1 at p. 2 (Mar. 8, 2018) [hereinafter Plaintiffs’ Petition].
44 Plaintiffs’ Petition, supra note 43, at 7.
45 Larson & Rosenberg Brief, supra note 44, at 6-7.
46 In re Volkswagen “Clean Diesel” Marketing Sales Practices, and Product Liability Litigation, 895 F.3d 597, 609 (9th Cir. 2018) (“This conclusion is not affected by this court’s recent decision in In re Hyundai & Kia Fuel Economy Litigation.”)
48 Id.
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*Local and state taxes applied when applicable
Court cases that have a profound impact on the entire country and society at large are regularly referred to as landmark decisions. These landmark decisions are so well known that, like our favorite Hollywood stars, we often find ourselves referring to such cases by just one name, e.g., Miranda. Arguably, the same can be said when it comes to criminal tax rulings handed down by the Supreme Court. Cases such as Spies and Cheek come readily to mind. Most recently, the Court has given us Marinello.

On March 21, 2018, the Supreme Court, in Marinello v. United States, issued its much-debated ruling as to the appropriate reach for alleged criminal tax conduct under the Internal Revenue Code’s Omnibus Clause of Section 7212(a), which forbids “corruptly or by force or threats of force...obstruct[ing] or imped[ing], or endeavor[ing] to obstruct or impede, the due administration of [the Internal Revenue Code].” In a 7-2 majority opinion, authored by Justice Stephen Breyer and joined by Justices John Roberts, Anthony Kennedy, Ruth Bader Ginsburg, Sonia Sotomayor, Elena Kagan and Neil Gorsuch, the Court held that, in order to convict a defendant under the Omnibus Clause, the government must show there was a nexus between defendant’s conduct and a particular administrative tax proceeding and also prove that the defendant was aware of the pending tax-related proceeding or could reasonably foresee that such a proceeding would commence.

Resolving a split in the opinions of the circuit courts, the Supreme Court made clear that a broad intent to interfere with, or to impede, the Internal Revenue Service’s everyday obligation and ability to collect taxes and administer the tax laws as set forth by Congress in the Internal Revenue Code was not per se sufficient to sustain a conviction under this statutory provision, often referred to as “the tax obstruction clause.” Rather, the Court read a “proceeding prong” into the text where Congress, in enacting Section 7212(a), simply used the words “due administration of [the Internal Revenue Code].”

Relying in significant part on its prior ruling in United States v. Aguilar when the Court limited the similarly broad statutory language “due administration of justice” in its interpretation of a Title 18 federal obstruction statute by requiring proof of a nexus between the defendant’s obstructive conduct and a particular judicial proceeding, the Court in Marinello held that the Title 26 federal obstruction statute was limited to proceedings before the IRS. However, in issuing its opinion in Marinello v. United States, the Court made clear that a broad intent to interfere with, or to impede, the Internal Revenue Service’s everyday obligation and ability to collect taxes and administer the tax laws as set forth by Congress in the Internal Revenue Code was not per se sufficient to sustain a conviction under this statutory provision, often referred to as “the tax obstruction clause.”

Although Marinello v. United States answered many questions, a wide swathe of uncertainty concerning charges under Section 7212’s Omnibus Clause still exists.

by Sandra R. Brown

U.S. SUPREME COURT

Court cases that have a profound impact on the entire country and society at large are regularly referred to as landmark decisions. These landmark decisions are so well known that, like our favorite Hollywood stars, we often find ourselves referring to such cases by just one name, e.g., Miranda. Arguably, the same can be said when it comes to criminal tax rulings handed down by the Supreme Court. Cases such as Spies and Cheek come readily to mind. Most recently, the Court has given us Marinello.

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Sandra R. Brown is a principal of Hochman Salkin Toscher Perez PC., specializing in criminal and civil tax controversy and litigation. She is a former Chief of the Tax Division (U.S. Department of Justice) and acting U.S. Attorney for the U. S. Attorney’s Office, Central District of California.
ello, the Court decidedly left room to ques-
tion the full extent of those limitations. While the Court signaled to the govern-
ment, albeit in dicta, a conservative ap-
proach to unfettered prosecutorial discre-
ction by its stated unwillingness to leave the interpretation and application of the Omnibus Clause to the sole discretion of the “great power in the hands of the pros-
ecutor,” the Court nonetheless chose not to elimi-
ate such prosecutorial discretion by making equally clear that it was leaving the door ajar to variant interpretations of this statute by expressing that “we need not here exhaustively itemize the types of administrative conduct that fall within the scope of the statute.” Rather, the Court chose to leave such deciphering by all to an analogy to maritime law, specifically, “the proceeding must at least be in the offing.”

How did we go from an expansive inter-
pretation, by the government and the majority of the circuit courts, of the Omnibus Clause of Section 7212(a), which admittedly on its face broadly states “or in any other way corruptly...obstruct or impedes, or endeavors to obstruct or impede, the due administration of this title...” to a decision from the Supreme Court that this broad congressional word-
ing is not entitled to such an expansive interpretation.

Congressional Intent
Section 7212(a) of the Internal Revenue Code states:

Whoever...in any other way corruptly or by force or threats of force (including any threatening letter or communication) obstructs or impedes, or endeavors to obstruct or impede, the due administration of this title, shall, upon conviction thereof, be fined not more than $5,000, or imprisoned not more than 3 years, or both, except that if the offense is committed only by threats of force, the person convicted thereof shall be fined not more than $3,000, or imprisoned not more than 1 year, or both.

The congressional intent in enacting Section 7212(a) was to criminally punish behavior, “where the [IRS] officer is intim-
imated or injured; that is, where corruptly, by force or threat of force, directly or by communication, an attempt is made to impede the administration of the internal-revenue laws.” Nonetheless, in the midst of this legislative history, with its focus on conduct directed at an investigating IRS official, Congress in enacting Section 7212(a) chose words that facially discon-
ected the application of the Omnibus Clause to any official IRS proceeding. Instead, Congress chose, in arguably the broadest wording possible, to connect this portion of the criminal tax violation to “the due administration of this title [26 U.S.C.].”

Perhaps reflecting even more clearly that Congress intended its selection of words to have real consequences is what Congress did in enacting the penalty pro-
visions of Section 7212(a). Notably, while Congress limited the punishment for acts of threats or force directed at a specific IRS official or a member of his or her family to a misdemeanor, Congress ren-
dered corrupt endeavors to obstruct or impede the due administration of the federal tax laws to be sufficiently harmful to be worthy of punishment as a felony.

Prosecutorial Discretion
Faced with this set of mixed signals from Congress, for more than two decades the government did not bring charges for alleged criminal tax conduct under the Omnibus Clause of Section 7212(a). It was in the context of this decades-long void that the Eighth Circuit, in United States v. Williams, considered the first appeal of a defendant convicted of violating the Omnibus Clause of Section 7212(a). As stated by the Eighth Circuit in Williams:

Our research...has disclosed no case brought by the government under the more general ‘omnibus clause’ of section 7212. We note, therefore, that the proper interpretation of this clause presents us with an issue of first impression, and that we proceed cautiously where for over twenty-five years the Government has feared to tread.

Interestingly, the appeal in Williams involved a curious set of facts involving not one but three defendants convicted of violating the Omnibus Clause of Section 7212(a). While the conduct of all three defendants stemmed from allegations that they assisted in the preparation and filing of false W-4 forms, two of the three defend-
ants were also charged with, and con-
victed of violating, Section 7205. The Eighth Circuit, finding that Section 7205, which makes the willful filing of false W-4 forms illegal in its own right, noted that Section 7205’s limiting clause which states that such conviction shall be “in lieu of any other penalty provided by law” could not allow convictions to stand under both Sections 7205 and 7212(a) for acts in connection with the willful filing of false W-4 forms. As such, while affirming the Section 7205 convictions, the Section 7212(a) convictions for these two defend-
ants were reversed. The third defendant was not in the same procedural situation, and thus the court proceeded to consider the meaning of the Omnibus Clause of Section 7212(a). The Eighth Circuit not only looked to the words of Section 7212(a), but also to longstanding Supreme Court criminal tax cases that interpreted various other Title 26 criminal statutes. The Eighth Circuit in upholding the remaining Section 7212(a) conviction held:

[We] agree with the Government that the broad language of section 7212’s omnibus clause demands a correspondingly broad construction. But section 7212 is only one of several general criminal provisions contained in the Internal Revenue Code. In sum, these provisions establish what the Supreme Court described as a system of sanctions which singly or in combination were calculated to induce prompt and forthright ful-
fillment of every duty under the income tax law and to provide a penalty suitable to every degree of delinquency.

Not that many years after the decision in Williams, the government issued a policy as to the appropriateness of bringing charges under the Omnibus Clause. The policy, found at U.S. Department Of Justice (DOJ)/Tax Division Directive No.77 (1989), while setting forth that the Omnibus Clause typically should be applied to conduct occurring after a tax return has been filed, such that the actions are destined to impede or obstruct an audit or criminal tax inves-
tigation, also noted that such charge is not limited to activity after filing tax returns. The policy instead provided prosecutorial discretion—subject to approval by the Tax Division—to consider such charge when, absent sufficient evidence of a conspiracy, a defendant was involved in acts constit-
tuting the continual assistance in filing false tax returns, activity designed to obstruct audits, and other “large scale” violations.

Almost a decade later, and close to two decades after the Eighth Circuit decision in Williams, the Sixth Circuit in United States v. Kassouf, having the benefit of the Supreme Court’s decision in Aguilar, took a more restrained view of the reach of Section 7212(a)’s Omnibus Clause. The Sixth Circuit in Kassouf, relying in large part on the Supreme Court’s decision in Aguilar interpreting 18 U.S.C. Section 1503’s “due administration of justice” to require a nexus to a judicial or grand jury proceeding, held that a defendant must be aware of an ongoing IRS investigation in
The Los Angeles County Bar Association certifies that this activity has been approved for Minimum Continuing Legal Education credit by the State Bar of California in the amount of 1 hour. You may take tests from back issues online at http://www.lacba.org/mcleseltests.

1. The Omnibus Clause of 26 USC Section 7212(a) prohibits corrupt attempts to impede the due administration of the tax laws.
   True.  
   False.  

2. To obtain a conviction for a violation of the Omnibus Clause, the government only has to prove a nexus between a defendant’s conduct and a particular administrative tax proceeding.
   True.  
   False.  

3. The U.S. Supreme Court in *Marinello v. United States* granted certiorari to resolve a split in the opinions of the circuit courts.
   True.  
   False.  

4. Prior to the Supreme Court’s decision in *Marinello* only the Sixth Circuit had ruled that the defendant must be aware of an ongoing Internal Revenue Service investigation in order to be convicted of a violation of the Omnibus Clause.
   True.  
   False.  

5. Section 7212(a) only provides for a felony criminal tax violation.
   True.  
   False.  

6. The legislative history of Section 7212(a) focused on the need to deter threats and intimidation of IRS employees and members of their families.
   True.  
   False.  

7. The Supreme Court in *Marinello* eliminated all prosecutorial discretion in deciding what type of conduct can be charged as a violation of the Omnibus Clause.
   True.  
   False.  

8. 26 USC Section 7205 makes the willful filing of false W-4 forms illegal.
   True.  
   False.  

9. A conviction under Section 7205 does not preclude a conviction under any other statute for acts in connection with the willful filing of false W-4 forms.
   True.  
   False.  

10. A defendant who threatens to harm an IRS employee can be charged with a misdemeanor violation under Section 7212(a).
    True.  
    False.  

11. The Supreme Court in *Marinello* limited the government’s ability to charge a violation of the Omnibus Clause to conduct that involves bodily harm to an IRS employee or his or her family.
    True.  
    False.  

12. The Supreme Court’s rulings in both *Marinello* and *United States v. Aguilar* placed restraints on the reach of federal criminal obstruction statutes.
    True.  
    False.  

13. A conviction for obstructing due administration of justice under 18 USC Section 1503(a) requires proof of a nexus between defendant’s conduct and a particular judicial or grand jury proceeding.
    True.  
    False.  

14. An intentional failure to timely file a tax return, if required to do so, is not a violation of 26 USC Section 7203.
    True.  
    False.  

15. The Omnibus Clause does not include conduct such as routine, day-to-day work carried out in the ordinary course by the IRS, such as the review of tax returns.
    True.  
    False.  

16. Knowingly interfering with an ongoing IRS investigation is a violation of the Omnibus Clause.
    True.  
    False.  

17. Destroying business records related to an IRS audit, after receiving notice of such audit, is conduct that can be charged under the Omnibus Clause.
    True.  
    False.  

18. Knowledge of an ongoing tax proceeding, or at least, the reasonable foreseeability of the commencement of such a proceeding, is a necessary element of a violation of the Omnibus Clause.
    True.  
    False.  

19. The Supreme Court in *Marinello* found that Congress did not intend the Omnibus Clause to be a catchall provision that was applicable to the entire Internal Revenue Code.
    True.  
    False.  

20. The government may not charge pre-nexus corrupt acts, such as the destruction of books and records, as an affirmative willful attempt in violation of Section 7201.
    True.  
    False. 

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Mark your answers to the test by checking the appropriate boxes below. Each question has only one answer.

1.   □ True   □ False  
2.   □ True   □ False  
3.   □ True   □ False  
4.   □ True   □ False  
5.   □ True   □ False  
6.   □ True   □ False  
7.   □ True   □ False  
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13. □ True   □ False  
14. □ True   □ False  
15. □ True   □ False  
16. □ True   □ False  
17. □ True   □ False  
18. □ True   □ False  
19. □ True   □ False  
20. □ True   □ False  

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order to be charged with having violated the Omnibus Clause of Section 7212(a). As such, the Sixth Circuit upheld the district court’s decision to dismiss the charge that the defendant corruptly endeavored to obstruct and impede the due administration of the tax laws in violation of Section 7212(a), which was based on an asserted failure to maintain books and records, thereby making it more difficult to discover and trace defendant’s business activities as well as affirmatively misleading the IRS by filing tax returns that failed to disclose financial transactions. Following the Sixth Circuit’s decision in Kassouf, not a single other court of appeals, including the Sixth Circuit itself, in considering the reach of the Omnibus Clause of Section 7212(a), followed Kassouf’s narrow application of this statute.

Marinello’s Path to the Supreme Court

Almost 60 years after the enactment of Section 7212(a), Carolo J. Marinello II was charged with a violation of eight misdemeanors in violation of Section 7203 for his alleged willful failure to file various federal tax returns, and one felony in violation of Section 7212(a)’s Omnibus Clause. As summarized in the opinion of the Second Circuit, in 1990, Marinello set up, owned, and managed a New York corporation which conducted a freight service business, couriering documents and packages between the United States and Canada. Thereafter, Marinello not only failed to maintain complete documentation of his business’s income or expenses, but to the extent records existed, he shredded or discarded most of it. He paid his employees in cash and did not issue to them, or to himself, forms W-2 or 1099. He used the company’s funds to pay personal expenses, including mortgage payments on his residence (made indirectly through weekly cash contributions to his wife) and monthly payments to his mother’s senior living center.

In 2004, the IRS received an anonymous letter purporting to outline Marinello’s business practices and alleging tax evasion on his part. The IRS began a covert investigation of Marinello’s business. While the IRS’s records established that Marinello had failed to file individual or corporate income tax returns from as far back as 1992, it was unable to determine a sufficient amount of unreported income to justify continuing the investigation. The investigation was closed with no indication that Marinello was ever made aware of the criminal investigation.

In 2009, the IRS decided to investigate Marinello again. On June 1, 2009, during an interview, Marinello told an IRS special agent that he couldn’t recall the last time he had filed a return. Initially maintaining that he did not file returns because he did not think they were required for persons who earned less than $1,000 per year and insisting that his annual earnings had remained below that threshold, Marinello later changed his story and admitted he had earned more than that amount annually, and that he should have paid taxes but “never got around to it.” He conceded he used business income to pay for personal expenses by withdrawing from the business bank account and by cashing checks from the company’s customers and depositing a portion of them into his personal bank account. He further acknowledged that he shredded bank statements and did not keep track of the company’s income or expenses. When asked to explain, he said that is what he had “been doing all along,” adding that he “took the easy way out.”

Marinello was charged in a superseding nine-count indictment filed October 16, 2012.

As noted, Marinello was charged with one count in violation of the Omnibus Clause of Section 7212(a) and eight counts of violating Section 7203 by willfully failing to file individual and corporate tax returns for each of calendar years 2005 through 2008. At trial, defense counsel, while conceding Marinello had not filed the returns at issue, argued that Marinello could not be convicted on the Section 7212(a) count because he lacked the requisite criminal intent. Marinello’s counsel argued that to corruptly obstruct or impede the administration of the code, a defendant should have undertook an affirmative act, such as “file a phony return.” Marinello, as his counsel argued, had simply failed to act. The jury convicted Marinello on all nine counts.

Marinello’s post-conviction motion, which relied in part on the Sixth Circuit’s decision in Kassouf, argued that the phrase “the due administration of this title” of Section 7212(a) refers exclusively to IRS investigation already underway, and thus, a defendant may only be convicted under this statute if he knowingly interferes with an ongoing IRS investigation. The district court denied the motion, concluding that knowledge of a pending IRS investigation “is not an essential element of the crime” and noting that a later panel of the Sixth Circuit had limited Kassouf to its facts and that other courts had rejected the Kassouf court’s reasoning.

Marinello appealed to the Second Circuit. While the Second Circuit had not previously issued an opinion as to the application of the Omnibus Clause of Section 7212(a), faced with a split amongst the other circuit courts, none of which had decided to follow the Sixth Circuit’s decision in Kassouf, the Second Circuit ruled with the majority. In aligning itself with the other courts of appeal, the Second Circuit proceeded to differentiate the text of 18 U.S.C. Section 1503 from the text of 26 U.S.C. Section 7212(a), to negate the Sixth Circuit’s reliance on the Supreme Court’s decision in Aguilar. First, the Second Circuit noted the different purposes of the two provisions as reflected in the differences in the wording of Section 1503(a)’s key phrase “the due administration of justice” versus Section 7212(a)’s key phrase “the due administration of this title.” Next, the Second Circuit pointed to the legislative history of Section 1503(a), which “makes clear that Congress intended ‘the due administration of justice’ to refer only to grand jury or judicial proceedings; however, no comparable legislative history points to interpreting ‘the due administration of this title’ under section 7212(a) in a similar manner.” As such, the Second Circuit concluded that the Omnibus Clause of Section 7212(a) criminalized corrupt interference with any official effort to administer the tax code and that it was not limited to a known IRS investigation.

Marinello’s request for rehearing en banc, was denied by the Second Circuit albeit with a strong dissent that relied upon the Supreme Court’s decision in Aguilar.

Supreme Court Grants Certiorari

Relying on Aguilar and noting two important reasons that Aguilar imposed a nexus requirement in interpreting 18 U.S.C. Section 1503(a) to effectuate the exercise in restraint in assessing the reach of a federal criminal statute: 1) “deference to the prerogatives of Congress” and 2) “concern that a fair warning should be given in language that the common world will understand”—the Supreme Court held such reasons applied equally in interpreting Section 7212(a).

The Court, viewing a congressional intent to bookend the Omnibus Clause with direct acts against an officer of the IRS by its drafting of the statute to begin with “intimidate or impede any officer or employee of the United States acting in an official capacity” and then later defining intimidate or impede as “threats of bodily harm to the officer or employee of the United States or to a member of his family,” construed Section 7212(a) to refer to only “corrupt or forceful actions taken against individual identifiable persons or property.” Therefore, the Omnibus Clause could only
relate to obstructive conduct in that more limited context, rather than as a “catchall” for every violation that interferes with the administration of the Internal Revenue Code.37

As noted by the Supreme Court, both the U.S. House and Senate reports accompanying the original enactment of Section 7212(a) in the 1954 code focused on the need to deter threats against and intimidation of IRS agents, other officers or employees of the United States, or members of their families. The Court found that “nothing in the statute’s history suggests[ed] that Congress intended the Omnibus Clause as a catchall applicable to the entire Code including the routine processing of tax returns, receipt of tax payments, and issuance of tax refunds.”38

While holding that the government must now prove a nexus to an audit or criminal investigation and that such “administrative [tax] proceeding” was at least “reasonably foreseeable” to the defendant, the Court saw no need to “exhaustively itemize the types of administrative conduct that fall within the scope of the statute,” merely observing that conduct covered by the omnibus clause “does not include routine, day-to-day work carried out in the ordinary course by the IRS, such as the review of tax returns.”39 The Supreme Court then remanded for a reversal of Marinello’s Section 7212(a) conviction.

Post-Marinello

From a litigation perspective, the courts and the government have already begun, and will undoubtedly continue, to face an array of pending motions within the spectrum of post-indictment stages, from pre-trial to post-conviction, that raise Marinello issues. Depending on the stage of the litigation, complex and potential corrective measures may or may not remain available, such as filing superseding indictments, striking alleged acts in counts charging violations of the Omnibus Clause of Section 7212(a) that do not fall within the limits of Marinello, corrective jury instructions when trials are already underway, dismissal of charges, reversals, and retrials, or, as in Marinello, at a minimum, reversal and resentencing.

From a policy perspective, the Tax Division of the U.S. Justice Department has updated its Criminal Tax Manual at Chapter 17.00, titled “26 U.S.C. § 7212(a): OMNIBUS CLAUSE,” to include a case alert noting that the Supreme Court, by its decision in Marinello, had resolved the circuit split concerning the scope of Section 7212(a)’s Omnibus Clause and thereafter setting forth both the specific holding of
the Court regarding the need for a nexus between the defendant’s conduct and a pending administrative proceeding, or, at least, that such a proceeding be reasonably foreseeable, e.g., “that the proceeding must at least be in the offing.”

While the Supreme Court’s ruling in *Marinello* has perhaps provided a number of answers in the context of charges under the Omnibus Clause of Section 7212(a), it has also left a number of unanswered questions. When it comes to answering those questions, it may be that what is most important is not how we got here but instead what use will the government and the trial courts have in the future for all of those uncharged but often very colorful and arguably telling, pre-nexus corrupt acts? As history often repeats itself, it may be that the Supreme Court in a decades-old case, known by just one name, has already reasonably forecast the answer to that question, in which case, rather than expecting an abandonment of such corrupt acts, following the very words of the Supreme Court in *Spies*, there will be an uptick in charges brought under Section 7201: By way of illustration, and not by way of limitation, we would think affirmative willful attempt may be inferred from conduct such as keeping a double set of books, making false entries of alterations, or false invoices or documents, destruction of books or records, concealment of assets or covering up sources of income, handling of one’s affairs to avoid making the records usual in transactions of the kind, and any conduct, the likely effect of which would be to mislead or to conceal.40

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5. Id. at *3-11.
6. Id.
10. Id. at *11.
11. Id.
15. Id.
17. Id. at 699.
18. Id. at 700-701.
20. Williams, 644 F. 2d at 700 (internal citation and quotation marks omitted).
24. Id. at 953.
25. See, e.g., United States v. Bowman, 173 F. 3d 595 (6th Cir. 1999); United States v. Massey, 419 F. 3d 1008 (9th Cir. 2005); United States v. Floyd, 740 F. 3d 22 (1st Cir. 2014); United States v. Sorensen, 801 F.3d 1217 (10th Cir. 2015).
27. Id. at 211-12.
28. Id. at 212.
29. Id.
30. It does not appear that the asserted false statements made by Marinello to the IRS special agent during the ongoing IRS investigation, noted in the Second Circuit decision, were included as any of the acts alleged in the Section 7212(a) count as charged in the indictment.
32. Id. at 213-14.
33. Id. at 214.
34. Id. at 220-22.
35. Subsequently, the Fifth Circuit in *United States v. Westbrooks* (858 F. 3d 317 (5th Cir. 2017)), adopted the same legal position as the Second Circuit as to the breadth of the Omnibus Clause of Section 7212(a).
37. Id. at *5.
38. Id. at *6.
39. Id. at *11.
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Distilling real estate financing jargon into everyday plain English is the true sign of expert conversance, i.e., “know your audience”

Perhaps the most challenging aspect of starting as a junior associate in a real estate finance practice is just figuring out what coworkers are saying, as demonstrated in the following mock directive:

E-mail Bernie at RLF and tell him we need the Delaware opinions, a non-con and a UCC perfection opinion for the Westwood deal. Make sure you send him the searches, pairings, good standings and a recycled SPE certificate. After that, call Chatham and tell them we have a Fannie defeasance and our client wants to take the Successor Borrower residual up-front.

Law schools do not teach real estate finance speak, and it is far from intuitive. Much like the “alphabet soup” of federal government agencies, the practice of real estate finance law comes with its own nomenclature of slang and abbreviations. Many lawyers with years of real estate experience still come across unrecognizable terms. This highly specialized, ever-changing vocabulary can leave the unindoctrinated feeling as if they just stepped off a plane in a foreign land and not understanding a word of the local tongue.

Many anachronistic words still remain in today’s form loan documents, despite a total lack of contemporary applicability. For example, two old-school terms still seen in deeds of trust from time to time are “enfeoff,” and “dower and curtsey.” “Enfeoff” is a term dating back to feudal England meaning to give someone—perhaps a fortunate serf on the estate of the local nobleman—land in exchange for pledged service. “Dower and curtsey” also date back to old England, pertaining to the right of a surviving spouse to an interest in real property upon the death of his or her wife or husband. “Dower” generally refers to a widow’s right to property, while “curtsey” refers to a widower’s right to property. A few states and commonwealths, e.g., Arkansas and Kentucky, still have dower laws on the books. California does not (nor does it have serfs or noblemen). Nonetheless, these terms continue to appear in loan documents and thus are worth knowing.

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There are a variety of real property financing options commonly identified by terms that are not as high concept as “acquisition loan” and “construction loan.” One example is a “wraparound mortgage” or “all-inclusive deed of trust,” which is basically the equivalent of subleasing a mortgage loan. Generally appearing in connection with a sale of real property, the buyer/borrower under a wraparound loan agrees to make payments to the seller/original borrower of an underlying conventional loan secured by real property and to abide by the terms of the original borrower’s loan documents. Unlike a “loan assumption,” where upon purchasing the mortgaged property the new borrower steps into the shoes of the original borrower and assumes the original borrower’s obligations pursuant to an agreement with the lender, in a wraparound loan, the agreement is between only the new borrower and original borrower, and may exist without the secured lender’s knowledge. If asked to document a wraparound loan, the first question should be, “Is this being done to circumvent the due on sale clause in the underlying deed of trust?” If the answer is yes, it is best to pass on the opportunity.

Another creative form of real property financing is a “shared appreciation loan,” often evidenced by a “contingent interest promissory note.” Under the terms of a shared appreciation loan the lender agrees to accept as part of its payment for making the loan a portion of the appreciated value of the mortgaged property realized upon its sale or other transfer. Typically, a shared appreciation loan is evidenced by a contingent interest note in a nominal amount (e.g., $5,000) secured by a contingent interest deed of trust. In most cases, a traditional promissory note in the full principal amount of the loan and an accompanying deed of trust are also included among the loan documents, although in many transactions the promissory notes may be combined.

“Hard money” loans may sound like something from the film Goodfellas, but in fact such loans fill an important niche in the world of real estate finance.2 Often, a hard money loan is a “bridge loan,” the function of which is just like it sounds: It is a bridge, and the span being bridged is time. Bridge loans and hard money loans can be a useful form of short-term financing, providing a source of acquisition funds while entitlements are being processed and construction or permanent financing is being arranged. This is also particularly helpful if the closing timeframe under a purchase agreement is shorter than the anticipated due diligence and documentation period for a bank loan that will ultimately finance the property. Hard money loans also provide a source of financing for borrowers who may not be considered sufficiently creditworthy to obtain a traditional loan. Hard money lenders tend to focus on the value of the collateral relative to the loan amount. These lenders are able to move quickly and require less in the way of due diligence and underwriting than traditional lenders. However, convenience has its cost. Hard money loans usually come with interest rates greater than those of traditional alternatives. Additionally, when obtaining financing of this nature, a borrower should always be wary of a “loan to own” play, in which a lender makes or buys a loan with the intention of foreclosing on a distressed property as a means of acquiring it below market value.

Two types of loans commonly referred to interchangeably but actually having distinct characteristics are “syndicated loans” and “loan participations.” Documents for a syndicated loan create a one-to-many relationship among the borrower and multiple lenders. An “administrative agent” or similar lead lender will oversee and manage the loan under the terms of a single loan agreement, but each syndicated lender will likely hold its own promissory note evidencing its portion of the loan. By contrast, a loan participation is a one-to-one-to-many relationship evidenced by loan documents between the borrower and a single lender on the “front end” and on the “back end” by a participation or similar agreement between the originating lender and each of the participating lenders purchasing an interest in the loan. The terms of a syndicated loan governing the relationship among the lenders are included in the loan agreement to which the borrower is a party. The terms of a participated loan governing the relationship among the participating lenders are set forth in a separate agreement to which the borrower is not a party and will likely never see.

**Mezzanine Loans**

A form of real property financing not actually secured by real property is a “mezzanine loan.” To secure a mezzanine loan, the mezzanine lender takes a pledge and grant of security interest in the limited liability company or partnership interests in an entity that owns real property (often called “pledged interests”). This pledge is made by the owner or owners of an entity owning real property, which is usually a mortgage borrower under a separate loan. If a default should occur under the “mezz” loan, the mezz lender forecloses on the pledged interests pursuant to Article 9 (Secured Transactions) of the Uniform Commercial Code (UCC) of the state set forth in the governing law provisions of the pledge agreement.3 Following the UCC foreclosure, assuming the mezzanine lender is the successful bidder, the mezzanine lender steps into the shoes of the former owner or owners of the mortgage borrower, becomes the owner of the mortgage borrower, and as such takes control of the subject real property. However, the real property encumbered by the mortgage loan remains subject to the mortgage loan, which continues in effect after the mezzanine foreclosure. With the mortgage borrower now under the mezzanine lender’s control, the mortgage borrower must continue to pay debt service on the mortgage loan in order to avoid a real property foreclosure like any other mortgage borrower. The interest rate on a mezzanine loan is higher than that of its mortgage loan counterpart because a mezzanine loan is structurally subordinate to a real property mortgage loan; however, as secured financing, it is still superior to equity investments.

For a mental image, one can imagine a Broadway theater in which the orchestra seating is the mortgage loan. The mezzanine loan is the mezzanine level above the orchestra seating but below the balcony where equity investors are seated. This layering of funding sources is called the “capital stack.” Some capital stacks include a “junior mezzanine loan” and “senior mezzanine loan.” Continuing with the analogy, the junior mezzanine loan is the lower balcony, situated above the mezzanine tier and below the upper balcony where the equity investors sit. In order to manage the rights of each of the lenders in the capital stack relative to each other, the mortgage lender and each of the mezzanine lenders enter into an “inter-creditor agreement.” Mortgage and mezzanine borrowers are not parties to the intercreditor agreement and are usually not provided with a copy of the document.

Although a security interest in pledged interests may be perfected through the filing of a Form UCC with the office of the secretary of state for the state in which the property-owning entity is organized (most frequently Delaware), it is now common practice for mezzanine lenders also to require perfection through possession. To achieve this form of perfection of the mezzanine lender’s security interest in pledged interests, the pledged interests must be “certificated” and evidenced by a physical certificate similar to a traditional stock certificate for a corporation. In order to accomplish this, the operating agreement or partnership agreement of the property owner entity whose interests are being pledged must state that it has elected to “opt in” to Article 8 of the UCC, which governs investment securities. A security interest in pledged
interests certificated under Article 8 is perfected by the mezzanine lender taking physical possession of the original certificates evidencing the pledged interests.

Commercial Mortgage-Backed Securities

A practice area practically requiring its own dictionary is that of “Commercial Mortgage-Backed Securities” (CMBS), which covers “Real Estate Mortgage Investment Conduit” (REMIC) or “Conduit” lending. Mortgage-backed securities are bonds for which the payment of principal and interests is secured by a pool of commercial real estate loans. This method of raising capital allows investors to participate in the real estate loan market without having to invest in the overhead required to become an originating lender. It also infuses liquidity into the mortgage loan market, which allows originating lenders to offer lower interest rates. The approach of using a pool of many loans to secure bond payments creates a diversification of risk and guards against the economic failure of any single property securing the bonds.

The process of creating the pool of loans and issuing the mortgage-backed securities is called “securitization,” and the “special purpose vehicle” (entity) formed to hold the pool of loans and issue the securities is called a REMIC. This is why loans destined for securitization are often referred to as “conduit loans.” Residential mortgage loans are similarly securitized through a variety of quasi-government agencies known as government-sponsored enterprises (GSE), including the Federal National Mortgage Association (FNMA or “Fannie Mae”) and the Federal Home Loan Mortgage Corporation (FHLMC or “Freddie Mac”).

Loans bound for securitization include certain characteristics designed to protect the holders of the mortgage-backed securities secured by such loans. One such characteristic is the requirement that each borrower in the pool with a loan amount above a certain dollar threshold engage one or two “independent managers” or “independent directors” per the terms of such borrower’s operating or partnership agreement. To the lender, the sole purpose of an independent manager is to vote “no” on any proposal to file for bankruptcy or to seek similar protections under insolvency laws if such filing is contemplated by the borrower’s members or partners. The borrower’s operating agreement or partnership agreement must include a requirement that any bankruptcy filing or similar action on the part of the borrower be approved by an affirmative vote of the independent party. Despite the use of the terms “manager” and “director,” independent managers and independent directors have no economic interest in the borrower and have no rights or authority other than to vote on insolvency matters. In practice, the members or partners of the borrower never meet their independent counterparts as most are professionals engaged through service providers for an annual fee.

An independent manager in some cases may also serve as a “springing member” and under certain conditions a “special member” of the borrower entity. A springing or special member of a limited liability company exists, e.g., solely for the purpose of satisfying the requirement that a limited liability company always have at least one member. If for some reason all members of the borrower limited liability company withdraw, die, or otherwise cannot serve as members, this member “springs” into place and becomes the special member of the limited liability company, serving as a legal place holder until the real-world people controlling the limited liability company document a new member’s admission. Like an independent manager, a springing member or special member has no economic interest in the borrower entity and no rights or authority under the borrower’s operating agreement.

Another common characteristic of CMBS loans is “cash management.” Since the CMBS bond holders’ goal is to minimize their investment risk to the greatest extent possible, one method of limiting default risk is to have the lender control the revenue generated by the properties securing the loan pool. This prevents the borrower from absconding with property funds and allows the lender to take an active role in ensuring property revenues are being allocated in a manner that maintains the value of the property. Cash management is implemented through the use of a “lockbox.” For typical bank loans not requiring cash management, the borrower receives income from the property in the form of tenant rent payments and can spend it as it wishes, provided it remains current on loan payments and does not otherwise violate the terms of the loan documents. However, if cash management is in place, all revenue from the property securing the loan must be deposited into a designated “lockbox account” with a bank approved by the lender (sometimes called a “cash trap”). If a “soft lockbox” is in place, property revenue is deposited into a lockbox account or “clearing account,” and the borrower may withdraw funds from the account at its discretion until an event of default or other “trigger event” occurs. If a trigger event occurs, e.g., a borrower’s failure to satisfy a periodic financial success test, the borrower’s access to the lockbox account is blocked by the bank holding the account and the lender takes control of the deposited funds. If a “hard lockbox” is in place, upon closing of the loan, tenants of the property are sent a “tenant direction letter” instructing them to make all rent payments directly to the lockbox account and not to the borrower or property manager. Periodically, funds in the lockbox account are “swept” from the lockbox account and transferred to a lender controlled “cash management account.”

Once in the cash management account, property revenue is held until disbursed to the borrower per the terms of a “cash flow waterfall.” Funds from the waterfall are disbursed into “buckets,” each of which corresponds to a category of property costs (e.g., property taxes, insurance, debt service, required reserves, operating expenses, and mezzanine loan debt service, if applicable). Each bucket represents a deposit into an account or a payment to a party entitled to property revenue, such as a mezzanine lender. Any cash left over is either given back to the borrower or held in an “excess cash flow account” as additional collateral for the loan or for future use with the lender’s approval. Sometimes a “springing lockbox” is established, in which case the borrower has the right to receive and use revenue from the property until a trigger event occurs, at which time a lockbox account “springs” into place and cash management is implemented.

In addition to knowing default risk is being managed, CMBS bond holders also want their expected return on investment to continue for the bond’s entire term. This presents a problem for commercial real estate owners needing the flexibility to sell or refinance properties before the terms of the loans encumbering such properties have matured. The issue is addressed with the financial devices of “minimum interest,” “yield maintenance,” and “defeasance.” In each case, if the borrower elects to prepay the loan prior to an established date, the borrower must compensate the lender (and therefor the bond holders) for its lost return on investment. Under the minimum interest approach, the lender calculates the amount of interest it would have earned had the loan not been prepaid prior to the permitted prepayment date, and that is the amount the borrower must pay to the lender when the principal amount of the loan is prepaid. “Yield maintenance” is similar to minimum interest; however, instead of using a set dollar amount, the principal and interest that would have been paid if the loan had remained in place until the permitted prepayment date is calculated based on a discounted cash flow formula set forth in the loan agreement.
A “defeasance” is an alternative to yield maintenance that allows a securitized loan to remain in place even after the real property collateral securing the loan has been sold or refinanced. To “defease” a loan is to exchange a portfolio of government bonds as substitute collateral for the real property collateral securing a securitized loan. A loan is defeased when the borrower wants to sell or refinance the property securing a mortgage loan but under the loan documents is not allowed to pay off the loan until a prepayment date, or at least cannot do so without paying yield maintenance. Working with a defeasance consultant, the borrower and loan servicer enter into a transaction pursuant to which the liens and security interests encumbering the property securing the loan are released, and in exchange the loan becomes secured by a portfolio of low risk bonds, T-bills and Treasury notes. Essentially, the parties swap out the type of collateral securing the loan. The borrower usually buys the securities portfolio with the proceeds from the sale or refinance of the property. The securities portfolio is structured (using a computer model) such that each month the income from the bonds in the portfolio is equal to the amount necessary to pay the monthly debt service on the loan. Upon maturity of the loan, the value of the securities remaining in the portfolio is sufficient to pay off the final balloon payment of outstanding principal. A defeasance allows a loan to continue to exist until maturity, which in turn allows the “trustee” responsible for the loan pool to continue to make payments to the holders of the bonds for the entire anticipated term of their investment. Any funds remaining after the pay-off of the loan is called the “residual” value of the securities portfolio. The residual is usually shared by the original borrower and the defeasance consultant.

Other CMBS Considerations
In order for the defeased loan to remain in place, a “successor borrower” takes the place of the original borrower that owns or owned the real property being released from the lien of the mortgage or deed of trust. The successor borrower assumes the original borrower’s obligations to make payments under the loan documents, thereby allowing for the release of the original borrower from such obligations. The successor borrower is usually formed by the defeasance consultant or loan servicer and serves no purpose other than that of obligor under the defeased loan documents and owner of the securities portfolio purchased at the defeasance closing. A third-party “securities intermediary” holds the bonds in the defeasance portfolio and ensures debt service on the loan is paid from portfolio income.

Unlike a traditional bank loan, the borrower and lender parties to a securitized loan part ways shortly after closing and do not maintain an ongoing relationship through the term of the loan. Responsibility for the day-to-day management and collecting debt service under a securitized loan is that of the “master servicer.” While master servicers handle routine approvals and other ministerial functions under the loan documents, if any material decisions regarding the loan are to be made, the loan will be transferred to a “special servicer.” Special servicers commonly become involved in loan assumptions, loan modifications, and any restructuring of the loan that is done in an attempt to avoid foreclosure, commonly referred to as a “workout.” However, the regulations governing REMIC loans serve to limit the flexibility of the special servicer in any workout negotiations.

When structuring the content of loan documents, one of the primary goals of a CMBS lender is to include effective protections and disincentives against the borrower filing or becoming involved in a bankruptcy proceeding. This is in part because the “single asset real estate” (SARE) rules in the U.S. Bankruptcy Code favor mortgage lenders and in part because fighting it out in bankruptcy court with other secured and unsecured creditors is costly and time-consuming with uncertain results. In the event that a mortgage lender finds itself in bankruptcy court, despite its best efforts to avoid it, the ruling a lender really wants to avoid is “substantive consolidation,” in which the assets and liabilities of the mortgage borrower are pooled with those of one or more of its parent companies or affiliates to create a single bankruptcy case in which the SARE rules may no longer apply.

One way CMBS lenders try to avoid substantive consolidation is to require that the mortgage borrower satisfy the requirements of a “single purpose bankruptcy remote entity.” Such an entity is more commonly known as a “single purpose entity” or “special purpose entity” (SPE). The theory is that a mortgage borrower entity satisfying certain SPE covenants will not be substantively consolidated with an affiliated entity in a bankruptcy proceeding. Typical “SPE covenants” require that the SPE own only one real estate asset and no assets unrelated to that asset, engage in no business unrelated to its one real estate asset, and generally keep its books, records, funds, and business activities separate and distinct from the activities of its parent entities and other affiliates. In some cases, the breach of an SPE covenant by a borrower triggers recourse under a carveout guaranty. If an SPE entity has a business history and is not newly formed immediately prior to the closing of a loan, it is called a “recycled SPE” and must reform its entity operations, certify to certain facts, and make the SPE representations in order to provide comfort to the lender that substantive consolidation based on the borrower’s history would be unlikely.

To create a significant disincentive for mortgage borrowers to file for bankruptcy, CMBS lenders generally require a person or entity with substantial net worth, liquidity, and a direct or indirect ownership interest in the borrower to execute a “non-recourse carveout guaranty” or “carveout guaranty.” For those familiar with CMBS speak, the title is self-evident. It is a guaranty of the financial consequences arising from the exceptions (carveouts) to the non-recourse provisions in the loan documents. Per the terms of a “non-recourse” loan, the lender agrees to look only to the loan collateral for compensation in the event of a loan default and agrees not to pursue any causes of action against the borrower for personal liability. However, in order to place some good faith restrictions on the borrower’s behavior, CMBS loan documents include exceptions to the non-recourse provisions that are triggered if the borrower engages in certain prohibited acts. The most egregious of these borrower transgressions are those that could deprive the lender of its collateral, including the sale of the collateral property without repayment of the loan, a voluntary bankruptcy filing by the borrower, and a variety of other insolvency actions.

Given the risk that any of these events could prevent the lender from foreclosing on its collateral, a violation of any one of these triggers results in the loan’s becoming “full recourse” to the borrower, at which time the borrower becomes personally liable for the entire amount of the loan and all other amounts due under the loan documents. However, since the borrower has no assets other than the property securing the loan, the guarantor parties to the non-recourse carveout guaranty also become liable for such amounts. Trigger events resulting in full recourse to the borrower and guarantor are said to be “below the line.” Due to the negative nature of the acts that trigger borrower recourse, traditionally, non-recourse carveout guaranties have been referred to as “bad boy” guaranties. In these more enlightened times, many in the lending community are now calling them “bad act” guaranties.

Although the origin of the term “the line” may be lost in history, given that there are below the line non-recourse carveouts, logic would dictate there must also be “above the line” non-recourse
carveouts. “Above the line” non-recourse carveouts are acts of the borrower that are clearly in violation of the borrower’s expected behavior under the loan documents but are nonetheless acts that, while they would likely not result in a complete wipe-out or loss of the lender’s collateral, nevertheless have a negative impact on the real property collateral. If any of these above-the-line acts are committed by the borrower, the borrower and guarantor are only liable for any losses the lender may incur as a result of such actions but not the entire amount of the loan. Above the line recourse triggers are also referred to as “losses carveouts.”

In some cases a lender will include non-recourse carveouts that are not at all tied to an illegal, immoral, unethical, or ill-behaved act of the borrower, which may nonetheless result in recourse for events outside of borrower’s control. This approach is called “allocation of risk” and does not necessitate the commission of a bad act to trigger recourse. Thus, it should always be made clear in the term sheet as to whether the recourse triggers in the loan documents will be tied to bad acts or are simply a method of allocating the risk of loss between the borrower and lender.

Legal Opinions Practice

Another area of real estate finance law that comes with its own unique subset of words and phrases is the legal opinions practice. Most legal opinions issued in connection with a mortgage or mezzanine loan are fairly straightforward opinions regarding the enforceability of the loan documents and/or the power and authority of the borrower parties to enter into the loan documents. Subject to some assumptions and qualifications set forth in the opinion letter, the law firm issuing the opinions states that the subject upon which it is opining is in compliance with applicable law and that the loan documents are enforceable in accordance with their terms. However, in some cases the law is sufficiently vague or untested that a solid legal opinion cannot be issued. In these cases, law firms issue “reasoned opinions,” which typically cite innumerable cases and statutes and eventually arrive at a conclusion as to what a court “should” rule if a case is properly presented and competently argued.

The most commonly reasoned opinions in real estate finance law are “substantive non-consolidation” or “non-con” opinions. A non-con opinion is a reasoned opinion concluding that a bankruptcy court would not substantively consolidate the borrower and certain affiliates of the borrower identified in the non-con opinion letter, such as parent entities and guarantors, if the various assumptions set forth in the opinion letter are correct. The matching of the various entities whose assets and liabilities may be consolidated in a bankruptcy proceeding for purposes of a non-con opinion letter is called the “pairings,” which must be provided to the author of the opinion letter before it can be drafted. A non-con opinion letter is intended to provide comfort to the “rating agencies” (e.g., Standard & Poor’s, Moody’s, Fitch, and others) when they are evaluating loans to be included in a CMBS pool.

Additional opinion letters that rating agencies often require as part of a loan evaluation package are the “Delaware opinions.” Because Delaware corporate, limited liability company, partnership, and bankruptcy law is well established and well known, most CMBS lenders require that mortgage and mezzanine borrowers be formed under Delaware law. The two commonly required Delaware opinion letters are the “Delaware law opinion” and the “authority to file opinion.” Under a Delaware law opinion, the law firm issuing the opinion letter opines that under Delaware law the borrower is a separate legal entity and that such entity is not permitted to file for bankruptcy without the affirmative vote of the independent manager(s). A Delaware authority to file opinion is a reasoned opinion under which the law firm issuing the opinion letter opines that Delaware law, and not federal law, would govern the determination of which persons or entities have the authority to file a voluntary bankruptcy petition on behalf of the borrower entity.

“Non-contravention opinions” are statements contained in an opinion letter that are generally grouped with the opinions but in truth are not legal opinions at all. They are factual confirmations made by the law firm issuing the opinion letter. Typical non-contravention opinions state that the execution and delivery of the loan documents will not violate any laws of a specified state, any contracts to which the borrower parties executing the loan documents are a party, or any existing court orders applicable to the borrower parties.

California Law

Whether working on CMBS loans, hard money loans, or typical bank loans, all California real estate finance lawyers should be familiar with the interpretations of a few key statutes that govern the exercise of a lender’s remedies for loans secured by real property. These include the “one-action rule,” the “security first rule” and California’s “anti-deficiency” statutes. The one-action rule is rooted in California Code of Civil Procedures Section 726(a), which states: “There can be but one form of action for the recovery of any debt or the enforcement of any right secured by mortgage [deed of trust] upon real property.” Basically, a mortgage lender is allowed one opportunity to exercise its remedies against a mortgage borrower and its collateral property, and that one action under the security first rule must be foreclosure. A violation results in the loss of the lender’s deed of trust on the real estate collateral. This law is intended to prevent a lender from hammering away on a borrower with multiple lawsuits over one loan. Generally speaking, an “action” under the one-action rule means a judgment or judicial action, but may include other actions by a lender that can result in limiting a borrower’s rights with respect to assets not securing the loan, such as obtaining a prejudgment attachment of assets. For this reason, California lenders tend to be very careful when exercising mortgage loan remedies so as to avoid inadvertently exhausting their one permitted action.

An action does not include a non-judicial or “power of sale” foreclosure under a deed of trust, commonly known as a “trustee’s sale.” However, under the “anti-deficiency laws,” a trustee’s sale precludes the exercise of certain other lender remedies (such as suing for a deficiency following the foreclosure sale). The “security first rule” comes from the judicial interpretation of Section 726, pursuant to which creditors with debts secured by real property must exhaust their security for the loan before otherwise proceeding against their debtors for a monetary judgment.4

In addition to Section 726(a), the California Code of Civil Procedure also provides protection to mortgage borrowers through a series of statutes known as the anti-deficiency laws,6 which prevent or limit a lender’s ability to seek a “deficiency” judgment against a mortgage borrower. Under the circumstances set forth in these statutes, a lender cannot seek a monetary judgment against a borrower for the difference between the amount due to the lender under the loan documents and the value realized by the lender through the exercise of its foreclosure remedies. In the context of commercial real estate lending, Section 580d prevents a lender from seeking a deficiency judgment against a borrower if the lender foreclosed on the real property collateral pursuant to a trustee’s sale. Section 580c protects borrowers against unreasonable costs and fees associated with a judicial foreclosure. Section 580b prevents a lender from seeking a deficiency judgment against a borrower after foreclosure under a real property “pur-
chase-money” loan (commonly known as seller-financing or an initial residential loan obtained in connection with the acquisition of the residence). Finally, Section 580a, often superseded by Section 580d, prevents a lender from seeking a deficiency judgment against a borrower in excess of the difference between the total debt owed and the fair market value of the foreclosed upon property at the time of the sale. This is intended to prevent lenders from selling a property at foreclosure for pennies on the dollar and then suing the borrower for a deficiency greater than that which a fair market sale would have produced. Among the anti-deficiency laws, Section 580d is the most relevant to typical loans secured by nonresidential real property.

Despite the variety of terms used in the legal practice of real estate financing, there are also a few definitions in California law that every real estate lawyer should know. Per Code of Civil Procedure Section 1933, “execution of an instrument” means “subscribing and delivering it, with or without affixing a seal”; therefore, writing “execution and delivery” is redundant. Per Section 9 of the California Civil Code, “[a]ll other days than those mentioned in Section 7 are business days for all purposes.” Section 7 reads: “Holidays within the meaning of this code are every Sunday and such other days as are specified or provided for as holidays in the Government Code of the State of California.” Thus, under California’s Civil Code, Saturday is a “business day.” Per Section 7.1(a), every Saturday is an “optional bank holiday,” but not every lender is a bank. This is why “Business Day” should always be defined in loan documents.

As in any highly specialized profession, mastering the jargon of real estate finance law takes time and a career-long attentiveness to the new lingo of the day. However, even once mastered, one must always keep in mind that effective communication requires an understanding of the language by all parties to a conversation. Accordingly, no matter how familiar one becomes with the language of loans, it is always important to adhere to the “know your audience” rule and be ready to offer a plain-speaking explanation of any terms and phrases that might be unknown or confusing to a client, junior associate, or any other party to a discussion.

1 See, e.g., BLACK’S LAW DICTIONARY (10th ed. 2014).
2 GOODFELLS (Warner Bros. 1990).
3 Article 9 of the UCC is designated Division 9 under the California Commercial Code.
6 See CIV. PROC. CODE §§580a-d.
THE YEAR WAS 1850, and Peter H. Burnett, the newly elected governor of California, which had recently been admitted as the 31st state of the United States, signed the law creating 27 counties, including the county of Los Angeles. In February of that year, a group of leading Angelenos met to select a slate of candidates to run in the county’s first election. The group, referred to as a “secret junta,” included Abel Stearns, Benjamin Hayes, Jonathan Temple, Benjamin Davis Wilson and Agustín Olvera.1 Olvera was an unusual candidate in the newly formed county government. After all, the United States had just defeated Mexico in 1848, and Olvera was part of Alta California’s governing elite, having served as secretary to the departmental assembly2 before the war, a land commissioner for Mexican Governor Alvarado, and a justice of the peace in Los Angeles.3 After the cessation of hostilities with Mexico, Olvera was able to quickly ingratiate himself with the new powers. He had participated in the negotiation of the Treaty of Cahuenga, which ended the war in California, and thereafter the first U.S. Military Governor Bennet Riley appointed Olvera to be a Judge of the First Instance for Los Angeles during the transition in 1849.4

Olvera also had a vested interest in the newly formed government. During his time as a land commissioner, he had acquired extensive land holdings, such as la Misión Vieja, which encompassed present-day Mission Viejo; Cuyamaca Rancho, which includes Julian, Cuyamaca Rancho State Park, Lake Cuyamaca, and Cuyamaca Peak in San Diego County; and part of Rancho Cienega, encompassing present day Baldwin Hills district, Leimert Park, Ladera Heights, and Windsor Hills.5

Agustín Olvera not only participated in the transition of power but also became an important member of the political establishment of Los Angeles. In fact, the meeting of the secret junta of leading Angelenos took place at his home. The slate of candidates put forward by the junta included Olvera for county judge, Benjamin Hayes for county attorney, Benjamin D. Wilson

Among other significant accomplishments, Judge Olvera upheld the 1849 California Constitution by requiring bilingual accommodation in English and Spanish.

Los Angeles County’s First Judge

Among other significant accomplishments, Judge Olvera upheld the 1849 California Constitution by requiring bilingual accommodation in English and Spanish.

Dennis F. Hernandez is a commissioner at the Los Angeles Superior Court and a member of the Los Angeles Lawyer Editorial Board.
for county clerk, and George F. Burrill for county
sheriff. On April 1, 1850, the entire slate won
without opposition, and Olvera was elected as
the first Los Angeles County judge.

Under the 1849 California Constitution, the
county courts had original jurisdiction in cases
of forcible entry and detainer, insolvency, actions
to prevent or abate nuisances, special cases and
proceedings not otherwise provided for,6 and
such criminal jurisdiction in cases arising in justice
and other inferior courts. The county judges
also performed duties as probate judges and
had the power to issue writs of habeas corpus
in their respective counties.7

In the first two years after the formation of
the county, Olvera served as county judge and
as chief executive of the county when the judicial,
legislative, and executive branches of county
government were combined into a court of ses-
sions. The court of sessions was largely a provi-
sional device to govern California counties prior
to the creation of boards of supervisors in 1852.
The duties of the court of sessions included crim-
inal proceedings and civil administration, but the
daily agenda in legislative matters was minimal
at first when the population was small and county
services were few beyond judicial matters.8

On June 24, 1850, the first meeting of the
court of sessions was held with the Honorable
Agustin Olvera as presiding judge, and Jonathan
R. Scott and Luis Robidoux as associate justices.
Associate justices were drawn from among the
county’s six townships. They were responsible
for all criminal cases, impaneling juries (including
grand juries), overseeing probate actions, and
filling vacancies in county offices. They also
approved county expenditures and the bonds
of officeholders, and conducted other admin-
istrative business. As county judge, Olvera was
also responsible for supervising the six county
justices of the peace who were elected along
with him. Each justice hired a constable to serve
warrants and arrest suspects. In addition, George
T. Burrill, who was then county sheriff, was
appointed interpreter for the court—an impor-
tant appointment since Olvera could not speak
English at that time and only one of the associate
justices could speak Spanish.

Under the newly formed government, some
practices that had been established under Mex-
ican law were continued. For instance,
jueces del
campo, or judges of the plains, were ap-
pointed to be present at the annual roundup of cattle
and gathering of horses to give an accurate account
of the stock. These judges were plains riders, and
there were few written rules for guidance.9

The county courts had limited resources to
serve the county, which then included present-
day Los Angeles, San Bernardino, and Orange
counties. Judges were few, and district attorneys
and lawyers had to meet few professional require-
ments to serve in the courts. Court sessions
were often quite chaotic, with judges and lawyers
known to conceal firearms during trials. Some attorneys and judges were seldom sober and some were not very particular about their personal appearance. One judge who was trying to restore order and decorum ordered that “hereafter attorneys while in attendance upon court shall wear a coat of some kind and will not be allowed to rest their feet on the tops of tables or wrinkle or spit tobacco juice on the floor or stove.”

One of the first challenges for the new court was to reconcile the newly enacted California Constitution and laws with the Mexican laws and decrees that had previously governed the territory. The area of law immediately in conflict was land title. After the cessation of hostilities in the Mexican War, Mexico ceded to the United States the territories of Alta California and New Mexico under the terms of the Treaty of Guadalupe Hidalgo. Under Articles VIII and IX of the treaty, the Californios—habitants who remained in the territories—were guaranteed free enjoyment of their liberty, religion, and property without restriction. Californios like Olvera who possessed land grants from the Mexican government believed their interests were protected under the Treaty.

The U.S. Congress, however, had other intentions. In May 1848, Articles VIII and IX were removed from the Treaty of Guadalupe Hidalgo before it was ratified by Congress. Then, in 1851, Congress enacted “An Act to Ascertain and Settle Private Land Claims in the State of California,” which stated that “all land claims in California derived from the Spanish and Mexican governments, were inchoate and imperfect, mere equitable claims.” Congress established a land commission to review the land claims of the Californios and others. While the land commission approved two-thirds of the claims presented, the federal government automatically appealed all successful claims to the federal courts. The appeal process was lengthy—averaging about 17 years to complete—and expensive. Presenting land claims before the commission became quite a lucrative practice for some attorneys, who in some cases charged half of the land as a contingent fee for confirmation of the claim.

The other major challenge for the new court was to establish order and justice in a lawless and racially charged environment. As historian John Mack Faragher documents in his book Eternity Street: Violence and Justice in Frontier Los Angeles, the early years in Los Angeles County were difficult as lawlessness and frontier justice reigned. First of all, enforcement resources were limited. The new sheriff was authorized to hire two deputies, which at the time was the totality of the county’s law enforcement. Killings on the streets of Los Angeles alone were said to have averaged one per day.

In response to the violence, vigilante groups were organized. In 1853, a group of citizens organized the Rangers, a semi-vigilante, quasi-social group to track down and chase criminals. These groups were known to arrange for vigilante trials and quick executions for those accused of crime. Between 1854 and 1855, the Rangers alone arranged for 22 trials and executions. Some of these vigilante groups turned to mob violence. In 1871, in one of the most appalling episodes of collective violence, a mob descended on Los Angeles’ Chinatown and randomly shot, hung, and murdered 22 Chinese.

During this time, nevertheless, Judge Olvera had a reputation of being well respected, helping to maintain order and efficiency in the courts. One historian noted that “Olvera and his cohorts did their best to keep the courts relatively free of rampant racism and bigotry that pervaded the region at this time.”

During his time as county judge, Olvera made an effort to protect the rights of Spanish-speaking Angelenos to have their cases heard in their native language. The California Constitution of 1849 guaranteed that “All laws, decrees, regulations and provisions emanating from any of the three supreme powers of this State, which from their nature require publication, shall be published in English and Spanish.” California statutes also protected the rights of Spanish speakers in some counties. Article V of the statutes governing courts and judicial officers stated: “In the Counties of San Luis Obispo, Santa Barbara, Los Angeles, and San Diego, the proceedings may be in the English or Spanish.” During his tenure, Judge Olvera was able to require that official county business be published in English and Spanish and that Spanish translators be available for county meetings. After his departure from the bench, however, these accommodations were no longer made available.

Olvera served as judge of Los Angeles County until December 31, 1853, when his term expired. Olvera entered private practice in 1855 and, later that year, was elected to serve as a Los Angeles County Supervisor.

Agustin Olvera presided as county judge at a time when Los Angeles was a frontier town. He survived the transition from being a leading member of the Mexican elite in Alta California to becoming a member of the Los Angeles political elite during the early years of statehood, all the while maintaining his Spanish language and California traditions. He died in 1876 at the age of 58. In 1877, the Los Angeles City Council renamed Wine Street, on the north end of the Plaza and the historic center of Mexican Los Angeles, to Olvera Street in his honor. Today, Olvera Street stands as a monument to Agustin Olvera and the bilingual and bicultural foundations that he established for the courts of Los Angeles County.

1 John Mack Faragher, Eternity Street: Violence and Justice in Frontier Los Angeles 213 (2016) [hereinafter Faragher].
2 Alta California was considered a “department” under Mexican law.
4 A Judge of the First Instance was equivalent to a justice of the peace under Mexican and Spanish law. W.W. Robinson, Lawyers of Los Angeles: A History of the Los Angeles Bar Association and of the Bar of Los Angeles County 23 (1899) [hereinafter Robinson].
6 The California Constitution stated: “The County Courts shall have such jurisdiction, in cases arising in Justices Courts, and in special cases, as the Legislature may prescribe, but shall have no original civil jurisdiction, except in such special cases.” Criminal jurisdiction was more limited “as the Legislature shall prescribe.” CAL. CONST. art. VI, §8.
7 There were three levels in the courts at that time. At the lowest level were the alcaldes, or mayor’s courts, headed by justices of the peace, in the townships. These courts presided over petty crimes. At the middle level was the court of sessions. At the next level was the district court. Los Angeles was the First District, which initially encompassed several southern California counties from San Luis Obispo to San Diego. The district courts were renamed as the superior courts in the state Constitution of 1879. Paul R. Spitzzen, On a Case by Case Basis: Ethnicity and Los Angeles Courts 1850-1865, 83 CAL. HIST. 26, 32 (2005).
10 Robinson, supra note 4, at 38.
12 Sitten supra note 6, at 51.
13 Faragher, supra note 1, at 477-78.
14 Id.
16 Id., note 1.
17 Id., note 1.
18 Supervisor Agustin Olvera, supra note 3.
Invisible: The Forgotten Story of the Black Woman Lawyer Who Took Down America’s Most Powerful Mobster

Who knew that the prosecutor who crafted and implemented the successful legal strategy that put Lucky Luciano behind bars in the 1930s was an African American woman? Professor Stephen L. Carter knew because that woman was his grandmother. He tells her remarkable story with grace, affection, and precision in Invisible: The Forgotten Story of the Black Woman Lawyer Who Took Down America’s Most Powerful Mobster.

Invisible is about Eunice Hunton Carter. She was a granddaughter of slaves, the first black woman to pass the New York bar exam, a senior trial lawyer and supervisor in the New York District Attorney’s office, and a leading Republican.

However, the book is about more than Carter. It is about the appointment of a special prosecutor and the building of a criminal case against a Mob boss through creativity and determination. It is about Fiorello La Guardia, Thomas Dewey, and Tammany Hall. It is also about Harlem’s prominence in New York life over two decades. Eunice Hunton Carter’s journey, as told by her grandson, is a journey through history, particularly New York in the 1930s and 1940s, from the vantage point of an exceptionally brilliant woman whom Professor Carter describes as “cultured and mannered,” whose “diction was always precise.” (p. 243)

Professor Carter, the William Nelson Cromwell Professor of Law at Yale, knows much about law and a great deal about writing, having written six novels and eight works of nonfiction, including many best sellers. The reader is the beneficiary of Professor Carter’s many gifts, as Invisible is a brisk and enjoyable read with fascinating legal detail. The 68 pages of endnotes underscore that the book is well-sourced; the deep research by Professor Carter and his team, including his daughter, will impress historians.

Born in Atlanta in 1899, Eunice Hunton Carter was the daughter of a social worker and a senior executive at the YMCA. In 1906, after race riots in Atlanta, the family moved to Brooklyn. Carter graduated from Smith College in 1921 with both a B.A. and an M.A.

After her college graduation, Carter worked as a social worker in Harlem (where she lived most of her adult life), married a dentist, and had a son—Professor Carter’s father. In 1932, she was the first black woman to graduate from Fordham Law School. She completed her legal studies at night, while working and becoming increasingly active in Republican politics. She opened her own law practice in 1933 during the Depression. Carter was an active supporter of La Guardia’s 1933 New York mayoral campaign when he successfully ousted Tammany Hall Democrat John O’Brien from the mayor’s office. La Guardia was New York’s first anti-Tammany mayor. The next year, at age 35, Carter herself was a candidate for office. She ran an impressive campaign for state assembly as a Republican. Although she lost, her intelligence and speaking ability became widely known. Professor Carter writes “Eunice took to politics quite naturally. She enjoyed herself on the stump. Her audiences were enthusiastic. The press called her ‘a convincing speaker—not thunderous, but impressive.’ ” (p. 79)

Carter’s private legal practice grew as did her reputation as a lawyer, but, like many lawyers just starting out, she did not have enough business to keep her fully occupied. She volunteered as a legal assistant in the Women’s Courts, an experience that would be important several years later when she was working on the Luciano case. New York’s Women’s Courts were established around 1908 during the Progressive Era with the idea that the prosecution of women should take place in facilities separate from, and better than, the courts that handled criminal cases against men. Most of the prosecutions in the Women’s Courts were for prostitution, and many of the prosecutors were women.

In 1933, riots broke out in Harlem. Mayor La Guardia appointed Carter and 10 others (all men) to the “Commission on Conditions in Harlem” to study the cause of the riots. The commission held hearings on housing, education, crime, and employment discrimination. In a chapter of the book devoted to the commission, Professor Carter explains that his grandmother’s “service on the commission once again placed her squarely in the public eye.” (p. 98) She parlayed that public moment into the position that would make her famous for the next decade—working for special prosecutor Thomas Dewey, starting in 1935, to take on organized crime in New York and then, starting in 1937, as key lawyer in the district attorney’s office.

History remembers Dewey for his unsuccessful presidential runs, but Professor Carter shines a spotlight on the early years of his career. In 1933, Dewey, then a 31-year-old federal prosecutor, was appointed temporary U.S. Attorney for the Southern District of New York. Two years later, in 1935, the DA appointed Dewey, on a recommendation by New York’s governor, as the special prosecutor to take on organized crime. That is when Dewey first hired Carter.

In 1937, Dewey was elected Manhattan district attorney with help from Carter, who frequently campaigned with him in Harlem. She was featured in his campaign film, “Smashing Crime with Dewey.” She was named deputy assistant district attorney and successfully tried many cases in the Women’s Courts. By 1939, Carter had been promoted to head of Special Sessions, the division in the office that handled the largest number of cases. Dozens of
white male lawyers reported to her. In 1942, Dewey was elected governor and served for 12 years.

Carter’s connection to Dewey began with his role as special prosecutor and the core story told in Invisible is about that time period—1935 to 1936—a period of great accomplishment and increased fame for both Carter and Dewey. Professor Carter devotes five chapters of his 22-chapter book to Dewey’s investigation of organized crime as a special prosecutor. The chapter titles tell the chronology: The Prosecutor, The Premise, The Raiders, The Preparation, The Trial. Many lawyers applied to work for Dewey (one book reported 3,000 applicants), and he hired just 20, all after grueling interviews. Nineteen were white men. One was an African American female—Eunice Hunt Carter. The 20 lawyers on Dewey’s team were supported by over 60 New York police officers and 10 investigators. It is hard not to think of special counsel Robert Mueller’s investigation when reading about how thorough Dewey’s investigation was. Dewey’s autobiography, published 30 years later, was titled Twenty Against the Underworld, referencing the legal team that he chose in 1935.

Dewey’s team took offices at the Woolworth Building at 233 Broadway, and Dewey went on the radio asking the public to help fight the underworld, inviting people with information to visit his staff at the Woolworth Building. Many of those who showed up wanted to complain about prostitution and brothels. Carter was assigned the task of supervising the staff that listened to those complaints.

Carter heard the same story repeatedly. The police raided brothels, but they would be back in business the next day. Corruption seemed likely, but the question was whether a central person controlled all of this. Professor Carter explains how Carter’s view, prostitution was too decentralized to be subject to central control. But Carter and Gurfein persisted over many months. Piece by piece they put together the case. Ultimately, they were able to convince Dewey to authorize raids on all the brothels at the same time. On February 1, 1936, 160 New York police officers raided dozens of brothels. The idea was to arrest as many prostitutes, madams, bookers, bondsmen, and fixers as possible and try to get people to flip on the higher-ups.

Witness interrogations continued for weeks, and the case against Luciano became clear. Luciano was indicted for compulsory prostitution along with 12 others. Three pled out and nine went to trial with Luciano. The trial began May 13, 1936, and ended June 7, 1936, with convictions of Luciano and the other defendants. Dewey tried the case himself, and his key witnesses were three prostitutes, including Florence Brown, also known as Cokey Flo. An admitted heroin addict suffering from withdrawal symptoms, she persuaded the judge to let her drink brandy while testifying to steady her nerves. The drinking during her testimony led to the newspaper headline: “Luciano Named Vice Ring Head by Drug Addict: Florence Brown Testifies, Fortified by Brandy, That He Directed Syndicate.”

Luciano testified in his own defense, and Dewey cross-examined him for four hours. Most of the rest of the defense case was an attack on the credibility of the three prostitutes. Dewey’s closing argument was five-and-a-half hours. Professor Carter writes:

“Oh June 7, the jury found Luciano and his nine co-defendants guilty on nearly all counts. He was, at the time, the most senior organized crime figure ever convicted in an American court. At a press conference after the verdicts were announced, Eunice was one of the handful of assistants Dewey made a point of publicly thanking by name.” (p. 149)

When the defense moved for a new trial based on affidavits from some of the women recanting their testimony, Dewey asked Carter and one other lawyer to appear with him at the hearing. The motion for a new trial was denied. Luciano was sentenced to 30 to 50 years in prison.2

When Dewey was elected Manhattan district attorney in 1937, he named Carter deputy assistant district attorney, the first woman to hold that post. She excelled as a lawyer in the district attorney’s office but also was a sought-after speaker nationally. Professor Carter describes her as “one of the best-known black women in America.” (p. xv) She was appointed head of Special Sessions and was the lead prosecutor on many high-profile cases.

Carter continued to support Dewey politically when he ran for president and governor. Carter hoped and expected to be named a judge, but unfortunately (and unfairly) that never happened. Professor Carter suggests that his grandmother never received a judgeship because of controversies about her younger brother William Alpheaus Carter, Jr., a professor at Howard University who was a member of the Communist Party and whose life story also is told in Invisible. In January 1945, Carter resigned from the district attorney’s office and opened her own office again. She became a prominent leader on the international stage and active in the United Nations. She died in 1970 at the age of 70.

In Invisible is made into a movie (perhaps with Tessa Thompson as the lead), it will be the second time that Eunice Hunton Carter is portrayed on screen. Professor Carter notes in the book’s prelude that in the fall of 2014, the cast of HBO’s Boardwalk Empire included a black female lawyer working for the district attorney investigating organized crime. Professor Carter writes:

“[l]et us watch—there won’t be two black lawyers back then—not black women lawyers, anyway. And certainly there were no black female prosecutors. The casting, the skeptics insisted, was just another example of Hollywood political correctness run amok. But they were wrong. My Nana Eunice was real… and really did prosecute mobsters… and lived a life so remarkable that her story should have been told long ago. I am grateful for the opportunity to tell it now.” (p. xvii)

We can all be grateful that Professor Carter has shared his grandmother’s story. Eunice Hunton Carter is a role model for us all, especially lawyers, on leading a full public life and practicing law with creativity, determination, and integrity.

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1 Dewey ran for president three times: 1940, 1944, and 1948. In 1940, despite a strong campaign, he was not nominated, the Republicans choosing Wendell Willkie instead. In 1944, Dewey was nominated and lost to Franklin D. Roosevelt. In 1948, he lost to Truman. In 1955, after Dewey finished his third and last term as governor, he joined a law firm that then changed its name to Dewey Ballantine, which later became Dewey LeBoeuf.

2 In 1946, Governor Dewey commuted Luciano’s sentence contingent on his agreement to be deported to Italy. The commutation was based on a controversial argument that Luciano had helped the U.S. with the war from prison.
A Call to Revive LACBA Public Service Announcements

WHEN I GRADUATED FROM LAW SCHOOL in 1976, one of the most popular movies was a remake of A Star Is Born. In my first year of law school, 1973 to 1974, the major new stories concerned congressional investigations of an amoral American president who thought he was above the law. Names may change, but history repeats itself, and, unfortunately, we are generally facing issues and events today that are not unique but simply recurring.

Bar associations also face recurring issues. Membership growth, retention of existing members, finances, and technological changes are now at the forefront of LACBA and many other bar associations. LACBA and other bar associations have confronted these issues before and likely will again. LACBA is admirably recognizing and addressing these important challenges while simultaneously maintaining its long tradition of support for its vital voluntary legal services programs. This recognition of lawyers’ professional obligation to help provide equal access to justice is a cornerstone of our profession and our justice system.

Another area of professional responsibility that bar associations are uniquely qualified to fulfill is public civic education. Both former U.S. Supreme Court Justice Sandra Day O’Connor and California Chief Justice Tani Cantil-Sakouye spearheaded civic education efforts after acknowledging the unfortunate lack of such education in our public schools in recent decades. That deficit resulted in at least a generation of citizens and residents who lack an understanding, and perhaps an appreciation, for our system of justice and constitutional rights and safeguards.

At a time when the president of the United States regularly expresses his disdain for constitutional rights such as freedom of press and religion, long-established doctrines such as separation of powers and checks and balances, and other cornerstones of our justice system such as the independence of the judiciary and rule of law, it is critically important that bar associations such as LACBA fulfill lawyers’ professional responsibility to educate the public about their legal rights, our system of justice, and our constitutional and judicial history. LACBA has played a key role in doing so in the past and is uniquely positioned to do so today.

Founded following the tragic events of September 11, 2001, and to honor Constitution Day, LACBA annually presents the Dialogues on Freedom program. With cosponsors the Los Angeles Superior Court and Los Angeles Unified School District, the program brings judges, attorneys, and law school students into Southern California high school classrooms to foster lively debates with students about their constitutional rights and protections.

Now in its 18th year, a recent collaboration with the Constitutional Rights Foundation (CRF) has allowed broadening the reach of the popular program. Volunteers are welcome for this important opportunity to inspire and educate our young people about the law and constitutional freedoms. The 2019 dates are March 15 to 16. Still, more can be done.

In 1987, as part of the bicentennial of the Constitution celebration, a LACBA committee that I cochaired produced a series of 24 public service radio announcements that were sent on cassette tapes to radio stations across the country. Each 60-second tape highlighted a facet of our constitutional history. They were written with the assistance of local law school professors, cosponsored by the CRF, recorded in Hollywood at Capitol Records, and narrated by none other than Gregory Peck, best known for his Academy Award-winning portrayal of attorney Atticus Finch in To Kill a Mockingbird. Peck and Capitol Records both donated their services.

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