POINTS & Authorities®
QUARTERLY NEWSLETTER
BUCHALTER NEMER
FALL 2014

FALL 2014

In This Issue

Legal Considerations for Web Based Start-Ups

Vicki Dallas

Mobile Internet usage is predicted to grow faster in the next few years, making online or web based businesses great opportunities. A leading forecaster found that global mobile internet usage leapt from 14 percent to 25 percent between May 2013 and May 2014. In North America, it jumped from 11 percent to 19 percent and in Europe it jumped from 8 percent to 16 percent during this same period.

What does that mean for you if you are starting an online business? It means access to customers and advertising to sell products, without the hard cash investment of brick and mortar facilities. It also means that social media can quickly accelerate your business without investing thousands of dollars in print or other advertising.

Over 80 percent of mobile owners use devices while watching TV. They web surf, shop and talk to their friends online. The future belongs to the mobile internet. If your business is not getting ready for that future today, your business may be in trouble tomorrow.

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California's Water Anxiety Prompts Landmark Groundwater Legislation

Douglas Wance, Howard Ellman and Kimberly Huangfu

In an effort to balance depleted groundwater supplies amid record drought conditions, Governor Jerry Brown signed three bills on September 17, 2014 designed to regulate groundwater aquifers throughout California. The landmark legislation, as Senator Pavley avers, "embraces the concept that groundwater is best managed locally." This marks the beginning of a critical chapter in the ongoing water saga for the state, in stark contrast to the traditional paradigm that has focused primarily on the management of surface water. Though guardedly optimistic, many still believe that the fate of California's water crisis remains uncertain.

Through a trinity of groundwater legislation, SB 1168, AB 1739, and SB 1319 collectively the Sustainable Groundwater Management Act ("Act"), California enacted a grand framework to regulate and monitor underground basins, a precious resource that provides up to 60 percent of the California's total water supply in dry years. Though highly controversial, the Act has been deemed by some to be a step in the right direction—a remarkable shift away from California's

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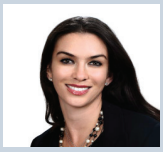

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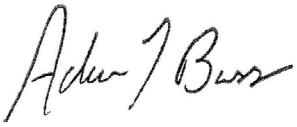
Points from the President

ADAM BASS

I'm pleased to present the Fall 2014 issue of our Points and Authorities. This issue covers a range of topics that impact our clients and their businesses, with articles that cover technology, intellectual property, California water legislation, litigation and insolvency.

Opening this issue, Vicki Dallas raises legal considerations for starting a web-based business in an increasingly mobile world. Next, a topic of concern to all Californians is the state's new groundwater legislation. Doug Wance, Howard Ellman and Kimberly Huangfu explain what that means to California and others impacted by California's ongoing drought. Ben Seigel lists the options for a business whose customer has gone bankrupt and has left outstanding receivables. Sandra Thompson helps technology companies understand the importance of subject matter conflict searches and lays out a step-by-step process for protecting their patent applications. Denise Field and Bob Zadek warn factors not to presume their perfected security interests take priority over a later judgment lien. Finally, Oren Bitan and Jeff Wruble discuss defending against lender liability lawsuits.

As always, we welcome your comments and feedback.



Adam Bass
President and Chief Executive Officer

Factor Beware: A Judgment Lien Creditor in California May Have Priority Over Your Security Interest

Denise H. Field and Robert Zadek

A factor may receive notice from a judgment creditor that the judgment creditor holds a judgment lien on the accounts of the factor's client, and be tempted to ignore the notice, since the judgment lien is later in time than the factor's perfected security interest. However, if the factor continues to advance funds, under California law, it may be at risk of losing its priority on the personal property to the judgment lien creditor.

Although most lien priority issues are resolved by the UCC, priority between the holder of a judgment lien on personal property and a conflicting security interest in the same personal property is determined according to the provisions of California Code of Civil Procedure ("CCP") § 697.590, *not the UCC*. Except as specifically provided therein, conflicting interests in the same personal property are determined by priority at the time of filing or perfection. CCP § 697.590(b)

Under the CCP, the factor which perfects its security interest in personal property prior to the filing of a judgment lien may have priority over the judgment lien in certain circumstances, although it may have limited rights with respect to future advances. The factor with a prior perfected security interest which makes advances after the judgment lien is filed, has priority with respect to those advances only to the extent they are made: (a) within forty-five (45) days after the judgment lien attaches; (b) without knowledge of the judgment lien; or (c) pursuant to a commitment made without knowledge of the judgment lien. CCP § 697.590(f). "Knowledge" of the judgment lien means actual knowledge. UCC § 1202(b). Thus, once the factor receives the notice of judgment lien from the judgment creditor, or actually learns of the judgment lien, the "45 day clock" starts to run, and advances made thereafter are subordinated to the judgment lien (remember that the lien creditor must have filed a Notice of Judgment Lien in the UCC records in order to prime the factor's security interest as to such post-45 day future advances).

The filing and service of the judgment lien are the crucial alerts which should cause the factor to consider whether or not to make future advances. The fact that a judgment is obtained against the debtor is not the critical element in determining priority without the judgment lien creditor taking the steps to file and serve.

How can the factor making advances to the debtor protect itself against a judgment lien creditor? The factor may advance without losing priority within forty-five days after the judgment lien attaches or when it acquires knowledge of the lien. Knowledge of the judgment lien is critical. The factor should always use a service to monitor filings with the Secretary of State against its debtor. If the factor changes its address, it should immediately file a notice of the change of address with the Secretary of State. However, even though a factor files the change of address, under CCP § 697.590(f), a judgment lien creditor may send proper notice by mail to the address provided in the security agreement; if the address has changed, the factor may not receive the notice and not be aware of the 45 day time period running. This "loophole" makes the monitoring of a filing of notice of judgment lien with the Secretary of State even more critical. The factor may also consider an amendment to the security agreement solely to provide its new address. In addition, the factor may also choose to negotiate with the judgment lien creditor and enter into a payment arrangement which specifies priority. Of course, the factor may also choose to wait until the judgment is satisfied before it makes further advances.

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When Your Customer Files Bankruptcy and Your Factor Has not Approved the Orders: Reclamation, Administrative Claims and Other Possibilities for Recovery

Benjamin S. Seigel

Consider the plight of a manufacturer of women's blouses who sells to every major department store and specialty chain in the country. One of her highest volume customers is a 150 store chain of boutiques. Let's call the manufacturer "Better Blouses, Inc." and the boutique chain, "Le Boutique" (both names are fictitious and any resemblance to actual business names is purely coincidental). Better Blouses' New York salesman has taken orders from Le Boutique; $3,000 per store. A nice order totaling $450,000!

When Better Blouses received the order its credit manager advised her factor, who gave tentative approval of the credit. The goods were put into work and the complete order was ready to be shipped when the factor called and advised that credit approval had been withdrawn.

The credit manager called the CFO of Le Boutique and was given assurances that everything was fine; there was a temporary cash flow problem. "Don't worry. Ship the goods and you'll be paid." The credit manager phoned the New York salesman and was told, "They're as good as gold. Everyone's shipping!" Better Blouses' CEO decided to ship the orders without factor approval.

Two days after the goods were shipped the headlines in Women's Wear Daily were "Le Boutique Files Chapter 11." The goods were received by the Le Boutique, distribution center the day before the bankruptcy was filed.

What are Better Blouses options?

Reclamation
Bankruptcy Code Section 546(c) provides for the remedy known as reclamation.The over-used term "a trap for the unwary" is exemplified by the reclamation issues that can arise in a Chapter 11 reorganization case. Since Better Blouses shipped the goods in question two days prior to Le Boutique's Chapter 11 filing, and the presumption of Le Boutique's insolvency exists due to the bankruptcy filing, a reclamation demand letter would appear to be an appropriate course of action.

A Priority Claim
Section 503 (b) (9) of the Bankruptcy Code provides that after notice and a hearing, there shall be allowed as an administrative expense the value of any goods received by the debtor within 20 days before the date of commencement of the case in which the goods have been sold to the debtor in the ordinary course of the debtor's business. That means that a qualifying creditor should get paid before general unsecured creditors as a priority expense. Procedures for asserting these claims are generally established early in the case.

Request for Notice
Although Better Blouses may be one of the 20 largest creditors who are ordinarily included on the list to receive notice of all court filings, the company should consider filing a "Request for Notice." It is a good idea to consult with a bankruptcy attorney to prepare the request in proper form. The request should be served on all of the individuals and entities shown on the master mailing list that the debtor has filed with the court.

Proof of Claim
Even though a reclamation demand has been made, a separate reclamation proof of claim should be prepared and filed with the clerk of the Bankruptcy Court. If money is owed to Better Blouses because of prior unpaid shipments that were not shipped with factor approval, a separate proof of claim should also be filed. The advice and assistance of a bankruptcy attorney is helpful to be certain that all of the required supporting documentation and information is included.

The Creditors' Committee
Service on the "Committee" can be an enlightening experience. The Committee may consult with the debtor concerning the administration of the case to investigate the acts, conduct, assets, liabilities and financial condition of the debtor, Le Boutique; the operation of Le Boutique's business; the desirability of the continuance of such business; and any other matter relevant to the case or to the formulation of a plan of reorganization.

Preferences and Fraudulent Transfers
If Better Blouses received payment from Le Boutiqe on non-factored invoices within the 90 days preceding the commencement of Le Boutique's bankruptcy case, and such payment was for past due amounts, a claim against Better Blouses to recover the preferential amount may available to Le Boutique. A bankruptcy attorney should be consulted so that an appropriate defense can be ready in the event the preference claim is filed.

A fraudulent transfer claim against Better Blouses, although highly unlikely, might also be brought under the appropriate circumstances.

Trademark Protection
If Better Blouses sold Le Boutique pursuant to a distribution or license agreement that provided certain protections for Better Blouses' trademarks, consideration should be given to Le Boutique's intentions regarding the liquidation of its inventory to raise money for operations.

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Hidden Traps: Subject Matter Conflicts of Interest in Patent Prosecution

Sandra P. Thompson, PhD

Attorneys who have been practicing for more than a day are familiar with the process of conflicts of interest searches. A new client comes into the office or firm, the attorney or conflicts team searches a client database for the name of the person or entity. If a potential conflict surfaces, the conflict must be cleared, waived or the client sent elsewhere. As law firms merge and attorneys move from firm to firm, conflict-of-interest searches become important considerations, especially regarding subject matter conflicts with respect to intellectual property.

The issue is not only ensuring that the prospective patent clients don't present conflicts with one another, but also ensuring that their patent applications don't present conflicts. A subject matter conflict search is equally as important as an entity/individual conflict search. This type of additional search is not related to the inventors, assignee or research team, but is directly related to the patent application disclosure. Ignoring these searches can create mountains of problems down the road ranging from allegations of inequitable conduct to patent invalidity.

Competitors

If reviewing subject matter conflicts of interest is new to your or your company, there are several steps you can take to make this new process more efficient and streamlined. First, you need to build a list of competitors and parties interested in your company's technology area. Under the America Invents Act, the United States Patent & Trademark Office established a post-grant opposition procedure. The European Patent Office already has one in place. A list of companies and individuals allows you to set up intellectual property and technology watches that alert you when they file trademarks, patent applications and put out press releases. However, it is important to move quickly under the patent post-grant opposition procedure, because you have to make a decision to pursue, gather the information you will need and file the petition within a few months of allowance.

The best way to develop this list is identify one or two technology leaders at your company and develop the basic list. This first list may be 1-2 companies or 10-20 companies. If you have already sent a list of competitors to your outside counsel, you should calendar to review it with them every six months to ensure that you have provided any new information to them and to ensure that the outside firm understands how important this issue is to your company.

Training

Organize a first basic training for key members of your company, including management, sales and technology/ product development. Initially, it is appropriate to reach out to outside counsel to provide this training. Outside patent counsel is probably better able to develop presentations and accompanying materials, because this information benefits all of their corporate clients. Once the general training materials are developed and utilized, the company may decide to develop additional training materials on their own that are better suited to its specific business.

The training should focus on the basics of subject matter conflicts, why it is important to monitor them and then move into a brainstorming session regarding your competitor list. You should provide your initial list and give the group 10-20 minutes to provide additional competitors and potential competitors, and this is the perfect time to do it, because you have laid out why identification of competitors is important. Finally, provide them with a takeaway form that they can give to their group members, so that if any competitors were missed, you can capture that information. Once you finalize that list, provide it to your outside counsel and ask them to a) run conflicts on the list, and b) add the companies and names on that list to their conflict system as "related parties" or "adverse parties" to your matters.

A complete and two-way training program also involves your company-side team training outside counsel. Ideally, technical and sales teams should review their work with outside counsel quarterly. If outside counsel adds new attorneys to their patent team, those attorneys should be asked to participate in this training as well. This information will inform outside counsel as to how your business operates, how your products or services are advertised, sold and protected. It will also help outside counsel spot issues that might be relevant to your company, such as new initiatives by the USPTO, labor and employment issues, and legal developments with competitors or similar businesses that may be suitable for future training.

How often should training take place? For some groups at the company, such as human resources and management, training may be appropriate once or twice a year. Other groups, such as the technical groups and sales team, should receive regular quarterly training. Written resources should be provided online or as a company intellectual property manual that is provided during hiring and returned to the company, if the employee leaves.

Alerts and Triggering Events

Set up Google alerts (or other similar search spiders) on that list you just developed. As mentioned in an earlier article, a list of companies and individuals allows you to set up intellectual property and technology watches that alert you when they file

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Legal Considerations for Web Based Start-Ups

Vicki Dallas

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Start-Up Considerations

Initially, starting an online business has the same challenges as starting any other new business.

1. Consideration needs to be given to the appropriate legal entity to use for the formation of the business. If the intent is to raise venture or other capital in the near future, a Delaware or California corporation is usually best suited. Angel and venture capital investors favor this approach, as it provides them with state governance laws they are familiar with and allows them to use preferred stock which gives investors added protections.
2. It is very important to get the founders committed to the new venture long-term. This is done with Founders Agreements. Founders Agreements are used to describe the vesting provisions for each founder's shares, and to set forth voting rights and share transfer provisions, among other things.
3. Attracting the right qualified employees is also important for an online business. Stock options can be used to attract employees, consultants, celebrities and others, particularly when a business cannot afford to pay market compensation for these services.
4. The business name and intended URL's need to be searched and secured to be sure there are no potential infringement issues. Trademarks need to be registered and patents, if any, need to be filed. Investors are more willing to invest, and at higher valuations, if the intellectual property is properly protected.
5. Website Development and Hosting Agreements need to be prepared, as well as Website Terms of Sale. The Federal Trade Commission (FTC) regulates e-commerce activities, including the use of commercial emails, online advertising and marketing, and consumer privacy, therefore, the FTC rules must also be addressed.

Dissecting a Typical Term Sheet

Venture capital investment in 2014 hit its highest levels since 2001. Hedge funds and private equity have also joined the party and are investing in online companies. If you are the next online sensation, you may be presented with a Term Sheet. The following are deal points included in a typical Term Sheet:

1. The financing terms will be addressed, including pre-money and post-money valuation. The securities offered will be described, such as preferred stock, convertible debt, etc., setting out the pricing terms. It is important to keep in mind that negotiating valuation is more art than science. It depends on many factors, including:
   - market opportunity
   - strength of the management team
   - intellectual property strength
   - product salability and scalability
2. The rights, preferences, and privileges of "preferred" securities will be described, including dividend provisions, liquidation preferences, redemption rights, anti-dilution provisions, and conversion features.
3. The voting rights of the securities will be described, with certain protective provisions allowing investors veto/blocking rights for certain triggering events such as new financings or a sale of the company.
4. The composition of the board of directors will be addressed.
5. The investors may require the inclusion of certain investor rights provisions, including registration rights in the event of a public offering, rights of first refusal, and co-sale rights.
6. A Stock Purchase Agreement will be required in which the founders will make certain representations and warranties to the investors concerning the company.

Starting any new business has its challenges and certainly starting an online and web-based business presents these same challenges and many more. What is different for an entrepreneur today venturing into an online or web based business are the fantastic growth opportunities presented by mobile internet.

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When Your Customer Files Bankruptcy and Your Factor Has not Approved the Orders: Reclamation, Administrative Claims and Other Possibilities for Recovery

Benjamin S. Seigel

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Disclosure Statement and Plan of Reorganization
At some point in the Chapter 11 case, Le Boutique may prepare and file a Plan of Reorganization. If the plan provides for anything other than full payment to all creditors, a Disclosure Statement must be prepared and court approval of its provisions must be obtained before consents to the Plan can be solicited. The Disclosure Statement must contain sufficient information to enable a creditor to determine whether or not to vote in favor of the Plan.

Better Blouses should await the receipt of the Disclosure Statement and then decide whether to vote in favor of or against the plan.

Conclusion
In spite of what you may hear to the contrary, there are Chapter 11 cases where unsecured creditors receive payment in full. There are other cases in which unsecured creditors receive significant dividends because of the actions of Creditors' Committees. To do everything possible to maximize your recovery, consider the matters discussed in this article.

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Hidden Traps: Subject Matter Conflicts of Interest in Patent Prosecution

Sandra P. Thompson, PhD

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trademarks, patent applications and put out press releases. However, it is important to move quickly under the patent post-grant opposition procedure, because you have to make a decision to pursue, gather the information you will need and file the petition within a few months of allowance. Developing an alert system allows you to monitor this group easily and on a regular basis.

Develop a system for organizing triggering events, such as trade shows, scientific meetings and other public presentations. This list can also include employees who have left the company. This system may be a simple as a spreadsheet or may be as complicated as a docket system, where each event can have a set of reminders and notes added. This system has a lot of advantages, but with respect to subject matter conflicts, it lets your team review with the presenter in advance or right after the event to review whether they saw anything or spoke with anyone who could be a potential competitor or interested party. With respect to employees who have left the company, your company wants to track them to ensure they aren't setting up competing businesses or possibly utilizing trade secrets or proprietary information in their new venture. The regular review of this information will start to develop a culture of intellectual property consideration at your company. Finally, you want to identify someone in your team to stay on top of this information, keep it organized and provide updates at regular meetings. You have a lot of things on your schedule, so the suggestion that you take on this additional work may be unreasonable. However, the goal here is to provide a foundation for the idea that these conflicts are important to your company's bottom line, provide questions and talking points you can use when you discuss these conflicts with your outside counsel, and provide information for your company on how to set up internal systems, so that this process is streamlined and becomes a part of your company's general procedure.

For more information on these types of conflicts and additional systems you can put in place, visit www.buchalter.com

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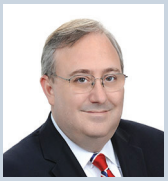

California's Water Anxiety Prompts Landmark Groundwater Legislation

Douglas Wance, Howard Ellman and Kimberly Huangfu

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traditional laissez-faire approach to groundwater management. Regardless of the intentions of the legislation or the state of groundwater management, the practical implications boil down to how the Act will affect the basins, the pumpers, overlying landowners and ultimately the end-users. Most importantly, the extraordinary transfer of management and enforcement authority to local agencies will be watched by all to see how each local agency attempts to judiciously sustain each basin while weighing the allocation of groundwater among competing interests.

A short overview of the Act's key provisions:

- Assembly Bill 1739 ("AB 1739") mandates the local management of groundwater basins with the goal of reaching "sustainable yield" over a 20- to 30-year horizon. The local agencies will be called Groundwater Sustainability Agencies ("GSAs") and have the authority to charge fees to supplement the cost of related groundwater management programs. Further, AB 1739 puts new teeth into the local agencies' enforcement powers, including civil penalties of up to $500 per acre-foot of water pumped in excess of the amount authorized, and penalties of up to $1,000 for violations of any related rule, regulation, ordinance or resolution.

AB 1739 requires that the California Department of Water Resources ("DWR") adopt regulations for the evaluation and assessment of groundwater management plans by June 1, 2016. It also grants authority for the State to intervene if DWR, in consultation with the State Water Resources and Control Board ("Board"), determines a local plan to be inadequately written or implemented.

- Senate Bill 1168 ("SB 1168") establishes minimum standards for sustainable groundwater management and provides GSAs with the authority, technical, and financial wherewithal to manage groundwater sustainably. SB 1168 also establishes the boundaries of groundwater basins, defines a local agency's powers and authorities, develops criteria required in a sustainability plan, and outlines which basins will be required to implement plans, as well as the process through which a local entity can become the GSA for its basin.

DWR is required to prioritize the list of all groundwater basins and to classify each basin as being high, medium, low, or very low priority based on the following considerations: population, extent of public wells, overlying irrigated acreage, reliance on groundwater, any document impact from the basin from overdraft, subsidence, saline intrusion and other water quality degradation, or any other information determined to be relevant, such as adverse impacts on local habitat or local stream flows.

GSAs are then mandated to adopt a groundwater sustainability plan ("Plan") and submit it to DWR by January 31, 2020 for all high or medium priority basins with serious overdraft conditions, or January 31, 2022 for all other high or medium priority basins, unless the basin has been adjudicated or the GSA asserts that the basin is being sustainably managed. Though encouraged, low and medium priority basins are not required to prepare a Plan.

Any local agency or combination of agencies can establish a GSA for the purpose of developing and implementing a Plan. Further, GSAs are granted the power to collect information relevant to groundwater management through the acquisition of land and water to carry out the Plan, including but not limited to spreading, storing, retaining, percolating, transporting, or reclaiming water to recharge the basin or provide water supplies in-lieu of groundwater; the ability to monitor for compliance and impose limits on groundwater extractions; and the assessment, imposition, and enforcement of fees against pumpers to fund the Plan. GSAs additionally can impose extraction allocations, which in turn could limit a pumpers' ability to extract groundwater in accordance with an existing water right.

And finally, to address the concerns of agricultural constituents, Senate Bill 1319 ("SB 1319") delays the State's ability to intervene in certain regions where surface water has been affected by groundwater pumping. SB 1319 provides that the Board may not intervene and establish a plan for a basin due to surface water depletion caused by groundwater extraction prior to January 1, 2025.

While this article does not address all the intricacies of the Act, it is safe to assert that California has not enacted such a vast legislative framework affecting the waters of California since the Water Commission Act became effective in 1914. With competing water demands due to drought conditions in the late 1930s, courts devised a formal adjudication process to "legally" reapportion and effectively reduce existing water rights if the basin was found to be in overdraft.

As codified, the Act's statutory framework appears to circumvent the adjudication process that the courts devised to "equitably" reapportion and effectively manage water rights if a basin was found to be in overdraft.

This steers those with groundwater rights into dangerous terrain given the Act's strong deference to the GSAs. As such, all groundwater pumpers and overlying landowners must proceed with caution and remain vigilant in protecting their respective groundwater rights as the Board and GSAs navigate into unchartered waters. Alternatively, groundwater rights holders, pumpers and overlying landowners may find themselves unwittingly the biggest losers in California's uncertain and perpetual water drama.

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How to Aggressively Defend Against Lender Liability Lawsuits

Oren Bitan and Jeffrey Wruble

Introduction
Following an economic downturn, lenders are inundated with lender liability suits typically based on purported promises to extend the maturity dates of loans, alter the terms of loan agreements, or to forbear from foreclosing on real property collateral. Even if these suits lack merit, lenders are required to spend time and money defending these suits. As a result, it is imperative for lenders to aggressively defend lender liability suits to minimize the time and expense incurred.

As is true for any lawsuit, the most effective tactic is to avoid liability in the first instance. Therefore, lenders are well advised to require that a borrower sign a forbearance agreement before any negotiations occur, meticulously document correspondence with borrowers to avoid any confusion as to the parties' understandings, and provide borrowers with sufficient notice to consider and accept proposed loan extensions or amendments. If a lender liability lawsuit is ultimately filed, a lender has several litigation tools to help "aggressively" defend the lender liability lawsuit, including a rapidly developing tool called a special motion to strike a strategic lawsuit against public participation (or "anti-SLAPP" motion).

Typical Sources of Liability and Potential Defenses
The typical sources of liability in a lender liability complaint (or cross-complaint) are derived from contract or tort principles. Contract-based claims can include a purported breach of oral commitment to lend money or extend the maturity date of a loan, a breach of the terms of the written loan agreement, or a hybrid breach of contract claim based in part on oral representations and based in part on the terms of the written loan agreement.

A typical defense to an allegation of an oral representation is that the borrower is barred from introducing any evidence of an oral representation that preceded or was made in conjunction with the writing that contradicts the writing, which is called the parol evidence rule.[1] This doctrine has its limitations and in the recent case entitled *Riverisland Cold Storage v. Fresno-Madera Prod. Credit Ass'n* (2013) 55 Cal.4th 1169, the California Court of Appeal held that parol evidence can be introduced if a borrower alleges fraud at the inception of the parties' contractual relationship.

Non-contract tort claims typically asserted in a lender liability complaint include fraud, negligence, breach of fiduciary duty, fraudulent concealment or breach of the implied covenant of good faith and fair dealing. The typical crux of each of these tort claims arises from a lender's alleged misrepresentation of a fact to the borrower (i.e. the lender would extend the maturity date of the loan), reasonable reliance by the borrower and damages incurred by the borrower.

A typical defense to such tort-based claims is that such claims are barred under California law, which generally provides that that a lender does not owe its borrower a legal duty of care and that lenders are entitled to exercise their contractual rights under loan documents.[2] The recent decision in *Jolley v. Wells Fargo Bank* (2003) 112 Cal.App.4th 1527 somewhat eroded this general proposition by holding that lenders can be found to have a duty of care to a borrower if the lender steps out of its traditional role of a money lender. A second decision, in *Lueras v. BAC Home Loans Servicing, LP* (2013) 221 Cal.App.4th 49, somewhat narrowed the decision in Jolley and reaffirmed the general proposition that a lender does not typically owe a duty of care to a borrower. Nonetheless, if a lender steps out of its traditional role as a lender of money, it can be found to owe a duty of care to a borrower. At a minimum, if the borrower correctly pleads such a claim, the claim can survive through trial absent a lender's success with another litigation tool, as detailed below.

Other defenses to lender liability claims can include contributory negligence, wherein the lender proves that the borrower was at least partially at fault for any damage it incurred, third party superseding cause, in which the lender proves that a third party such as an architect or contractor is at fault, or a statute of limitations defense, wherein the lender proves that the borrower waited too long to allege its claims.

Pre-Litigation Procedures
To help avoid liability in the first instance, lenders are well served to require that a borrower sign a forbearance agreement before any negotiations occur between the lender and borrower. The forbearance agreement should contain standard releases and waivers by the borrower and an alternative dispute resolution provision requiring that any dispute be first mediated and if not successfully mediated, arbitrated. That way, a borrower will be precluded from filing any action in a court of law and will be precluded from a jury trial. This point is especially important for loan agreements containing a jury trial waiver, which are no longer enforceable in California. Other requirements typically included in forbearance agreements are the production of updated financial statements by the borrower so the lender can effectively determine the borrower's credit worthiness.

Following execution of a forbearance agreement, lenders should document all correspondence with its borrower with the qualification that any correspondence is not binding on the lender until all conditions are met and approval is received by the lender's credit committee. Lenders should not make any verbal offers or assurances. If a lender is considering a note sale, it should do so carefully and analyze the potential for a lender liability suit to arise after the note sale and build that in to the terms of the note sale.

Post-Filing Analysis
Once a lender liability suit is filed, the lender should take immediate steps to help analyze the merits of the claims asserted against the lender. First, the lender should gather facts and documents to preserve evidence, and analyze the potential for an anti-SLAPP motion or cross-complaint. The lender should then issue an internal litigation hold letter to preserve all documents pertaining to the loan and borrower at issue. The lender and its counsel should then analyze whether an arbitration or reference provision exists to have the matter be transferred from a court to an arbitrator or whether there are grounds to remove the lawsuit

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from state to federal court. Finally, the lender should analyze whether mediation is a viable option and whether any potential bankruptcy issues exist.

Litigation Tactics

Aside from filing a demurrer (state court) or motion to dismiss (federal court), which are the most common responses to a lender liability action and which challenge the sufficiency of a borrower's allegations, a lender has additional litigation tools it can use to defend itself from a lender liability complaint. First, the lender should determine whether it has grounds to file a motion to compel arbitration, which would eliminate any potential for a jury trial. Second, a lender can evaluate whether it can remove the action to federal court. Third, and perhaps the most "aggressive" response to a lender liability complaint, a lender and its counsel should evaluate whether an anti-SLAPP motion is an appropriate response to the borrower's complaint.

Anti-SLAPP Summary

A "SLAPP" suit "seeks to chill or punish a party's exercise of constitutional rights to free speech and to petition the government for redress of grievances."[3] Thus, a lawsuit arising from constitutionally protected speech or petitioning activity is a SLAPP suit if it "lacks even minimal merit."[4] SLAPP suits may be disposed of by a special motion to strike under section 425.16, commonly known as an "anti-SLAPP motion," which is "a procedure where the trial court evaluates the merits of the lawsuit using a summary-judgment-like procedure at an early stage of the litigation."[5]

In analyzing an anti-SLAPP motion, the court engages in a two-step process. First, the court decides whether the defendant has made a threshold showing that the challenged cause of action is one arising from protected activity. If the court makes such a finding, it then determines the second prong -- whether the plaintiff has demonstrated a probability of prevailing on the merits of the claim under a standard similar to that used in determining a summary judgment motion.[6]

The anti-SLAPP procedure thus operates "like a … motion for summary judgment in 'reverse'"—the plaintiff bears the ultimate burden of stating and substantiating a legally sufficient claim in response to the special motion to strike.[7]

Anti-SLAPP Motions in Lender Liability Suits

In the context of a lender liability dispute, an anti-SLAPP motion is properly filed in response to a complaint if the borrower seeks to hold the lender liable for actions "arising from" the lender's litigation activity, which includes pre-litigation communications by the lender's lawyers and other communicative conduct such as the filing, funding, and prosecution of a civil action. This protection dovetails with the absolute litigation privilege codified in Section 47(b) of California's Civil Code.

The benefit of filing an anti-SLAPP motion is that, if successful, the Court will strike the improper causes of action without leave to amend and will order that the borrower pay the lender's attorneys' fees incurred in preparing the motion. If the lender is not successful, the order denying the anti-SLAPP motion is immediately appealable and if appealed, will stay the underlying causes of action until the appeal is resolved, which can be as long as 18 months.

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[1] C.C.P. § 1856(a).

[2] C.C.P. § 3434; *Jolley v. Chase Home Finance, LLC* (2013) 213 Cal.App.4th 872, 885; *Jones v. Wells Fargo Bank* (2003) 112 Cal. App. 4th 1527, 1540 at fn. 5 ("there is no fiduciary relationship between a debtor and creditor"); *Chazen v. Centennial Bank* (1998) 61 Cal. App. 4th 532, 537 ("A debt is not a trust and there is not a fiduciary relation between debtor and creditor as such."); *Nymark v. Heart Federal Sav. & Loan Assoc.* (1991) 231 Cal. App. 3d 1089, 1096 ("Under California law, a lender does not owe a borrower or third party any duties beyond those expressed in the loan agreement, excepting those imposed due to special circumstance or a finding that a joint venture exists.").

[3] *Rusheen v. Cohen* (2006) 37 Cal.4th 1048, 1055.

[4] *Navellier v. Sletten* (2002) 29 Cal.4th 82, 89.

[5] *Varian Medical Systems, Inc. v. Delfino* (2005) 35 Cal.4th 180, 192; *Paiva v. Nichols* (2008) 168 Cal.App.4th 1007, 1015-1016; *Kibler v. No. Inyo County Local Hosp. Dist.* (2006) 39 Cal.4th 192, 197.

[6] *Equilon Enterprises, LLC v. Consumer Cause, Inc.* (2002) 29 Cal.4th 53, 67.

[7] *Briggs v. Eden Council for Hope & Opportunity* (1999) 19 Cal.4th 1106, 1123.

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