Daily Journal

Standing Under Scrutiny Again

In Nov. 2004, California voters overwhelmingly passed Proposition 64, which was premised on the notion that the state's unfair competition law was being misused. At the time, "[s]tanding to bring...an action [under the unfair competition law] did not depend on a showing of injury or damage." This "broad grant of standing" encouraged the filing of unfair competition lawsuits as a means to generate attorneys' fees where no client actually had been injured, clogging the courts and causing expense to taxpayers.

Proposition 64 took square aim at this "loophole" that allowed undamaged plaintiffs to bring private actions under the unfair competition law; the measure's language limits standing to those private plaintiffs who suffered actual injury and financial or property loss, seeks to prevent the abuse of "shakedown" lawsuits. The immediate effect of Proposition 64 was to limit and restrict standing in all unfair competition law cases, directly benefiting all defendants facing a prospective claim.

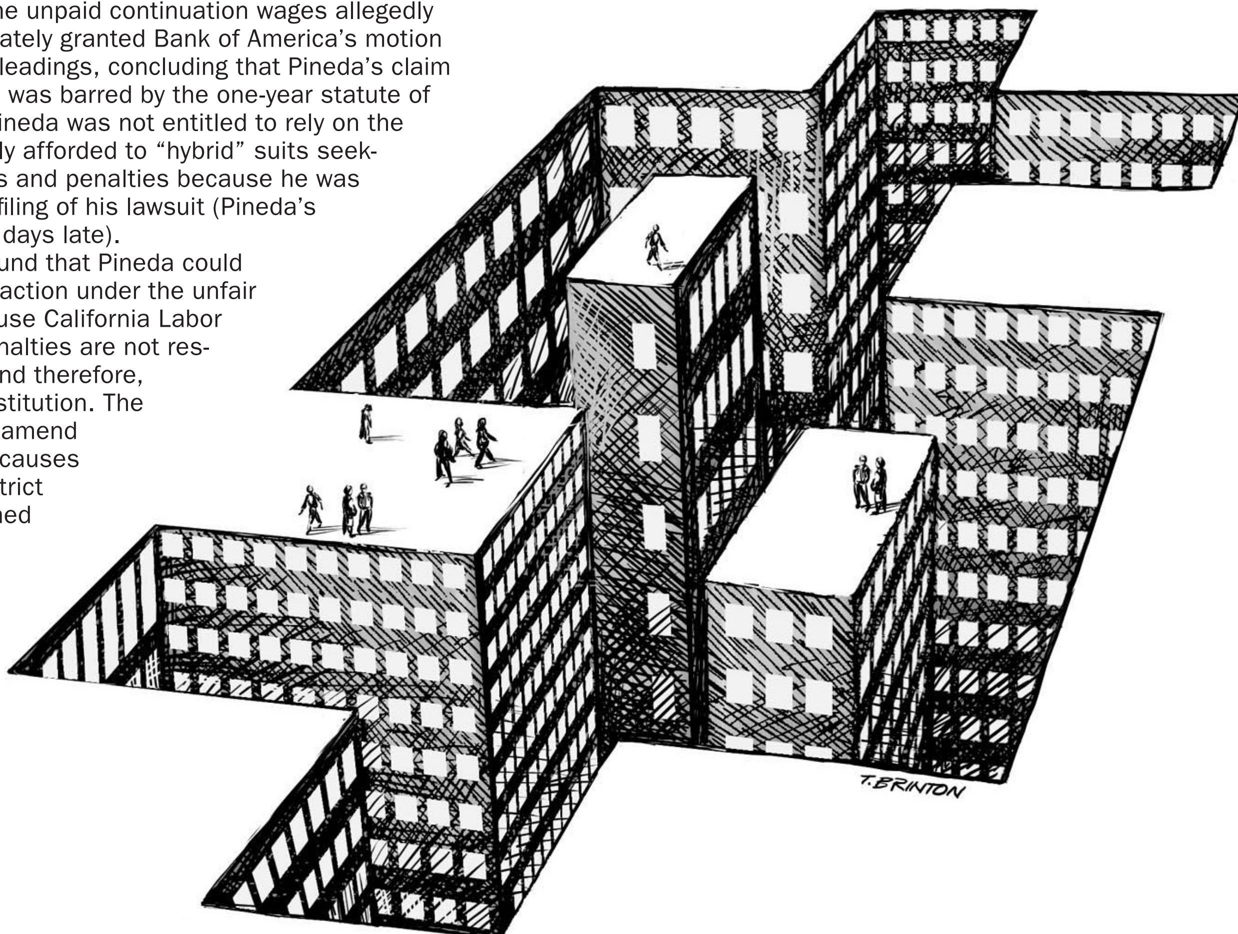
RICHARD S. RUBEN is a trial practice partner at Jones Day, where he practices complex commercial, real estate, employment, and construction litigation. He can be reached at rruben@jonesday.com.

Since Proposition 64's passage, however, California courts have grappled with interpreting and applying the unfair competition law's new standing requirements whether in the employment, consumer protection, or direct competitor arena. Specifically, courts are now faced with the task of reconciling and applying well settled pre-Proposition 64 case law (most notably, *Korea Supply Co. v. Lockheed Martin Co.,*) with emerging case law decided after Proposition 64's passage. This has been especially true with the recent trend of cases relying on the "restitution" standard to establish lost money or property. Courts also have been forced to re-examine under what circumstances a prospective plaintiff has a "vested interest" in lost money or property for unfair competition law standing. In practice, California's lower courts have generally had a difficult time defining exactly what "lost money or property" means, which in turn has spurred review by the state's highest court.

EDWARD S. CHANG is a trial practice associate at Jones Day and practices in all aspects of commercial litigation including class action defense. He can be reached at echang@jonesday.com.

Pineda v. Bank of America is another new case involving the unfair competition law in the employment context, and is currently pending before the California Supreme Court. The case potentially tables two important questions regarding employees' rights under the unfair competition law and how they relate to statutory penalties. First, in cases where only Labor Code Section 203 penalties (penalties for not timely delivering an employee's final check after termination) are sought, can the "waiting time penalties" be recovered as "restitution," to invoke standing under the unfair competition law? Second, whether plaintiffs seeking unfair competition law relief must be afforded the longer four-year statute of limitations period as opposed to the one-year statute of limitations for actions seeking only "penalties" under California Code of Civil Procedure Section 340(a). The prospective resolution of these questions will help shape and settle standing questions for future unfair competition cases (especially in the employment context where statutory penalties abound), as well as shed light on its relationship to other statutory remedies.

Pineda initiated a class action lawsuit against Bank of America for failure to timely pay final wages upon separation from employment, in violation of California Labor Code Section 201 or 202. As a result, Pineda and the class argued they were entitled to waiting time penalties or "continuation wages" under California Labor Code Section 203. Pineda also asserted a second cause of action under the unfair competition law, seeking restitution of all the unpaid continuation wages allegedly owed. The court ultimately granted Bank of America's motion for judgment on the pleadings, concluding that Pineda's claim under the Labor Code was barred by the one-year statute of limitations and that Pineda was not entitled to rely on the longer statute normally afforded to "hybrid" suits seeking both unpaid wages and penalties because he was fully paid prior to the filing of his lawsuit (Pineda's final check was a few days late).



The court further found that Pineda could not allege a cause of action under the unfair competition law because California Labor Code Section 203 penalties are not restitutionary in nature and therefore, not recoverable as restitution. The court denied leave to amend and dismissed those causes of action. The 1st District Court of Appeal affirmed and the Supreme Court granted review on May 22, 2009. The briefing is now complete.

Based on the California Supreme Court's recent trend of reviewing unfair competition law standing cases (as evidenced by its May 2009 decision in the *In re Tobacco II Cases*, and its grant of review in *Kwikset Corp. v. Superior Court*), it is likely that the Supreme Court will utilize *Pineda* as a vehicle to further refine unfair competition law jurisprudence and to clarify the required standing to bring such a suit. That is particularly so because of the Supreme Court's dicta in the *In re Tobacco II Cases*, which put at issue the federal courts' application of the restitutionary standing standard to all unfair competition law cases.

If the Supreme Court did grant review to once again address the unfair competition law, it will probably grapple with the question of whether an employee has a vested legal interest in waiting time penalties such that a former employee, ultimately but untimely paid final wages, will have standing to pursue a unfair competition law claim, as well as determine the applicable limitations period for such a claim. It is also possible that the Supreme Court will deal with the "entitlement to restitution requirement" issue for standing in all unfair competition law cases generally. While the Supreme Court may simply follow existing decisions and affirm the lower courts' determinations that an employee (or any plaintiff, for that matter) does not have a vested legal interest in a statutorily mandated penalty sufficient to invoke unfair competition law standing for restitution purposes, it may not stop there. The Supreme Court may use *Pineda* to "finish what it started" in the *In re Tobacco II Cases* and put to bed the issue of whether a one-size-fits-all approach to unfair competition law standing is appropriate in all cases, regardless of the type of relief sought (restitutionary versus injunctive relief). Such a decision would have far reaching effects beyond the employment context.

On the other hand, the Supreme Court may decide *Pineda* on the isolated statutory interpretation issues of whether the penalty provided under Labor Code Section 203 is governed by Code of Civil Procedure Section 340(a), thus limiting penalty-only lawsuits to a one-year limitations period where former employees have already been paid all "earned" wages, and settle the question of whether a penalty-only lawsuit should be afforded the longer statute of limitations of a suit seeking unpaid wages, even if such a claim is hypothetical in nature because all unpaid wages have been paid prior to the filing of the lawsuit (which, again, is the case in *Pineda*). Much of the briefing in *Pineda* focuses on these narrow statutory interpretation issues.

If the Supreme Court indeed granted review to only deal with these specific statutory interpretation questions, little additional guidance will come from *Pineda* on the standing issues raised in the wake of Proposition 64's passage. Regardless of the reason for review however, *Pineda* should help clarify Proposition 64's ultimate impact on employers and the unfair competition lawsuits they may face from employees seeking statutory penalties.

Mortgage Modifications Made Easier

The Internal Revenue Service has issued highly anticipated guidance that should significantly increase mortgage lenders' and servicers' flexibility to modify certain securitized commercial mortgage loans. The guidance (Revenue Procedure 2009-45), issued on Sept. 15, 2009, applies to securitized loans held by Real Estate Mortgage Investment Conduits or investment trusts. The guidance clarifies and simplifies the conditions under which Real Estate Mortgage Investment Conduits and loan servicers may modify existing loans without compromising favorable tax status.

DAVID KIMPORT is a partner in Nossaman LLP's Real Estate Practice Group, with more than 30 years experience in a variety of transactional matters. He can be reached at dkimport@nossaman.com.

The guidance's major thrust is to allow Real Estate Mortgage Investment Conduits and servicers to consider the current credit crisis in determining whether a borrower is likely to default. More than $200 billion of securitized loans will mature between now and 2013. Given the current economic conditions, however, a significant number of commercial borrowers will not be able to refinance their loans at maturity, putting the loans into default. Even loans that are performing today may be at risk of default at maturity if new loans are not available.

The IRS has taken an important first step toward addressing the potential commercial mortgage crisis by giving conduit lenders and their loan servicers conditions under which they can now comfortably explore loan modifications to reduce the likelihood of default, either at maturity or earlier.

To date, interpretation of tax rules applicable to Real Estate Mortgage Investment Conduits and investment trusts has greatly limited the ability of the conduit lenders or servicers of securitized loans to consider, let alone agree, to modifications that might reduce the likelihood of default. Specifically, IRS regulations permit modifications of securitized loans held by Real Estate Mortgage Investment Conduits s if the change in terms is "occasioned by default or a reasonably foreseeable default." Because of the significant tax penalties imposed on a Real Estate Mortgage Investment Conduit if it were to "vary the composition of its mortgage assets," many conduit lenders and servicers have interpreted the regulations to mean that a loan modification is only "occasioned by default or reasonably foreseeable default" if the loan is not performing or default is imminent, with "imminent" generally thought to be a default likely to occur within three to six months. Borrowers have been unable to discuss loan modification until late in the process, when options may be severely limited or there is inadequate time or opportunity to negotiate a modification to avoid default and foreclosure.

The new guidance is designed to alleviate the conduit lenders' and servicers' concerns about tax penalties so they may negotiate modifications earlier - when such modifications could actually prevent default and foreclosure.

Specifically, the guidance allow modifications if: The loan is not a residential mortgage loan affecting buildings with fewer than five units; the loan is not held by a Real Estate Mortgage Investment Conduit or investment trust which had more than 10 percent of the loans in its mortgage pool already in default when first formed; and the conduit lender or servicer reasonably believes that there is a significant risk of default of the loan upon maturity or at an earlier date based on a diligent contemporaneous determination of the risk.

Then the conduit lender or servicer may make modifications to the loan it reasonably believes will present a substantially reduced risk of default compared to the condition of the loan before the modification.

Note that the guidance modifies the prior understanding: the risk of default need only be deemed "significant," rather than "imminent." The guidance specifically states "there is no maximum period . . . after which default is per se not foreseeable." Moreover, the IRS asserts through the guidance that, based on contemporaneous diligence, "a holder or servicer may reasonably believe that there is a significant risk of default even if the loan is performing," thus permitting the holder or servicer to modify the loan if the prospective default could be due to an inability in the current credit market to refinance a balloon payment required at maturity. Provided the relevant modification is within the scope of the guidance, the IRS will not challenge the tax status of the Real Estate Mortgage Investment Conduit or the investment trust. Modifications may include, but are not limited to, interest rate changes, principal forgiveness, extensions of maturity, and alterations in the timing of changes to an interest rate or to a principal amortization schedule.

The guidance took effect Sept. 16, 2009 for loan modifications made after Jan. 1, 2008. The IRS specified there is no termination date for the guidance.

The guidance could be of great benefit to borrowers whose loans have been securitized. In the regular conventional loan situation, when either a borrower or a lender anticipates problems that may arise in the future that would affect the borrower's ability to perform, borrowers and lenders can start a dialogue immediately and make such modifications to the loan as may be appropriate to reduce the risk of default. For securitized loans, however, conduit lenders and servicers have been reluctant even to begin a dialogue until it is almost too late, notwithstanding that the lenders may have adequate information available to indicate that the loan is reasonably likely to go into default in the future, either at maturity or before. Under the guidance, conduit lenders and servicers should be able to engage in meaningful discussions and modifications earlier without fear of adverse tax consequences, thereby enhancing the possibility that the loan can be salvaged and default and foreclosure can be avoided.

The IRS guidance will by no means resolve all the issues surrounding securitized commercial mortgages. Conduit lenders and servicers are still bound by the terms of their pooling and servicing agreements, which may limit the lender's or servicer's ability to make all potentially desirable modifications, and other business reasons may still preclude some loan modifications. Nevertheless, this guidance should facilitate more open communication earlier, positively affecting the commercial loan picture.

Daily Journal

Charles T. Munger
Chairman of the Board
J.P. Guerin
Vice Chairman of the Board

Gerald L. Salzman
Publisher / Editor-in-Chief
Robert E. Work
Publisher (1950-1986)

David Houston
Editor

Alexia Garamfalvi
San Francisco Editor

Sharon Llang
Legal Editor

Liz Enochs, Associate Editor, *San Francisco*
Pia Sarkar, Associate Editor, *San Francisco*
Christian Berthelsen, Associate Editor, *Los Angeles*
Sarah Garvey, Associate Editor, *Los Angeles*
Evelyn Larrubia, Associate Editor, *Los Angeles*

Aris Davoudian, *Designer*

Los Angeles Staff Writers
Pat Alston, Rebecca U. Cho, Gabe Friedman, Evan George, Sandra Hernandez, Catherine Ho, Greg Katz, Joanna Lin, Ciaran McEvoy, Susan McRae, Jean-Luc Renault

San Francisco Staff Writers
Rebecca Beyer, Laura Ernde, Dhyana Levey, Sara Randazzo, Jill Redhage, John Roemer, Fiona Smith, Amy Yarbrough

Bureau Staff Writers
Craig Anderson, *San Jose*, Jason W. Armstrong, *Riverside,* Matthew Pordum, *Sacramento*, Don J. DeBenedictis, *Santa Ana*, Pat Broderick, *San Diego,* Lawrence Hurley, Robert Iafolla, *Washington D.C.*

Robert Levins, S. Todd Rogers, *Photographers*
Lisa Kestenbaum, *Editorial Assistant*

Rulings Service
Seena Nikravan, *Rulings Editor*
Kenneth Hsu, *Verdicts and Settlements Editor*
Meryl Chambers, Edward Chang *Legal Writers*

Advertising
Audrey L. Miller, *Corporate Display Advertising Director*
Monica Smith, *Los Angeles Account Manager*
Joel Hale, Michelle Kenyon, *San Francisco Account Managers*
Jesse Rios, *Display Advertising Coordinator*
Nikki Delucchi, *San Francisco Administrative Coordinator*

Art Department
Kathy Cullen, *Art Director*

The Daily Journal is a member of the Newspaper Association of America, California Newspaper Publishers Association, National Newspaper Association and Associated Press