POINTS
& authorities®
QUARTERLY NEWSLETTER

BUCHALTER NEMER SUMMER 2011

Summer Strategies

In This Issue

1 Anna Nicole Smith Strips Bankruptcy Court Jurisdiction
The Advent of ".Anything": Journey Into the Unknown

2 New Faces
Points from the President

3 Successful Strategies for Defending Fraud-Based Commercial Lender Liability Claims

4 Buyer Beware: The Arizona Homeowner's Purchaser Dwelling Act

5 Lender Beware: When Real Property Title Issues Arise, Don't Forget Your Escrow Claim

8 Triumph of the Impractical: Treatment of Water Supply Under the California Environmental Quality Act

9 Solving the Puzzle of Community Bank Mergers and Acquisitions

Anna Nicole Smith Strips Bankruptcy Court Jurisdiction

Benjamin S. Seigel

Who is Anna Nicole Smith?

Anna Nicole Smith was born in 1967 and died in 2007. After a troubled childhood, among other activities, she worked as a waitress in a fried chicken restaurant and held jobs at Wal-Mart and Red Lobster. She became a stripper in 1991, was Playmate of the Year in 1993 and a model for Guess Jeans. Little did she know that she would gain notoriety for initiating legal proceedings that would result in what some legal pundits and scholars believe to be a significant change in one aspect of our country's bankruptcy laws. Did her actions strip the Bankruptcy Courts of jurisdiction over matters that they had traditionally decided?

The Litigation History

On June 23, 2011, in a 5/4 decision, the United States Supreme Court decided the case of *Stern, Executor of the Estate of Marshall v. Marshall, Executrix of the Estate of Marshall*, 546 U.S. _____ (2011), or simply, *Stern v. Marshall*. It involved a long running dispute between Vickie Lynn Marshall, better known to the world as Anna Nicole Smith, and her deceased husband's son, Pierce Marshall over a purported trust that Vickie claimed was promised to her by her late billionaire husband, J. Howard Marshall. The marriage took place approximately one year prior to J. Marshall's death.

Continued on page 6

The Advent of ".Anything": Journey Into the Unknown

Farah P. Bhatti and Annie L. Albertson

In June 2011, the Internet Corporation for Assigned Names and Numbers (ICANN), the regulatory body that oversees the Internet's domain name system, approved a plan to expand on generic Top-Level Domain ("gTLD") extensions. The plan will soon allow virtually anyone to apply for their own custom gTLD suffixes. In addition to the current limited number (22, at last count) of defined gTLDs (e.g., .com, .org, .net, .info, .edu, .gov, etc.), the new plan will re-organize the Internet to allow for there to be ".anything." The gTLDs can be as long as 63 characters, and can consist of almost any word in any language.

Clearly, this landmark move signals a watershed moment in the development of the Internet. With the ability to create ".anything" domain names, the organization of the Internet now has the potential to become much more confusing, a fertile breeding ground for increased cybersquatting and trademark infringement. Many commentators believe this new expansion will dramatically change the ways in which web surfers use and approach Internet websites. At the same time, the new ICANN initiative will open up creative branding opportunities for

Continued on page 7

New Faces

PETER BALES
San Francisco
Associate
Litigation
415.227.3655
pbales@buchalter.com

ANTHONY R. CALLOBRE
Los Angeles
Shareholder
Bank and Finance
213.891.5024
acallobre@buchalter.com

JOHN CONNOLLY
San Francisco
Shareholder
Bank and Finance
415.227.3508
jconnolly@buchalter.com

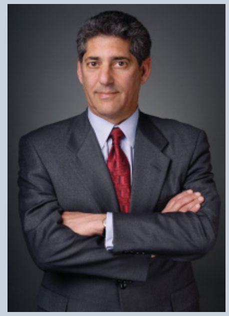
ABI GNANADESIGAN
Los Angeles
Associate
Litigation
213.891.5430
abi.gnanadesigan@buchalter.com

BRADLEY GRUMBLEY
Los Angeles
Associate
Litigation
213.891.5232
bgrumbley@buchalter.com

ALEXANDER ZOLFAGHARI
Scottsdale
Of Counsel
Bank and Finance
480.383.1833
azolfaghari@buchalter.com

Points from the President

RICK COHEN



It's a wrap. Summer is drawing to a close and with it comes our Summer 2011 *Points and Authorities*.

Opening this issue, Ben Seigel entertains and informs us with his analysis of *Stern v. Marshall*: its circuitous path, *twice*, to the United States Supreme Court, and the impact of the High Court's controversial 5-4 decision on the Bankruptcy Court's jurisdiction.

Turning our attention to the IP world, Farah Bhatti and Annie Albertson take us on a journey into the unknown as we watch and wait to see how the launch of .anything unfolds along with its potential impact on businesses. Impending crisis or much ado about nothing?

In a follow-up to his article on California's water issues in our Spring *Points and Authorities*, Howard Ellman returns with an update on this rapidly developing situation.

The remainder of this issue's articles focus on litigation.

Denise Field and Kim Arnone write about a new trend shaped by commercial borrowers bringing lawsuits against their lenders in search of some form of relief as they stave off foreclosure. Their winning strategy: early assessment and collaboration with counsel are key to a successful defense in those cases.

Also writing for lenders in litigation, Jason Goldstein reminds them not to overlook possible escrow claims when title issues arise with respect to loans secured by real property. Escrow claims may allow a lender to recover damages beyond the indemnity amount prescribed in a title insurance policy.

Attorneys Rob Rutila and Ben Gottlieb address the Arizona courts' strict application of legislation passed in response to a crushing wave of construction defect litigation that flooded the Arizona courts in 2002. Dismissal looms for homebuyers who fail to adhere precisely to the steps required by the statute, even where the builder steps in to repair.

We hope you enjoy our Summer reading wind-down.

Rick Cohen
President and Chief Executive Officer

Successful Strategies for Defending Fraud-Based Commercial Lender Liability Claims

Denise H. Field and Kim Y. Arnone

As the economy struggles to stay on track, court dockets continue to be dominated by litigation arising from defaulted loans. Disputes over defaulted loans are being brought not only by lenders seeking to enforce their rights but also by borrowers claiming some form of lender liability. Commercial borrowers are filing these suits as the economic downturn continues to challenge their businesses and real estate developments. Increasingly, claims alleging lender liability include allegations of fraudulent practices.

This article examines this trend in borrower suits and presents strategies to defend against them. A case study is presented that employed these strategies in the successful defense of a lender facing fraud-based claims.

Typical Claims And Remedies Sought

In filing suits against lenders, borrowers are often attempting to plead various fraud-based claims including intentional misrepresentation, fraudulent inducement to contract and Racketeer Influenced Corruption Act ("RICO") causes of action. These claims carry the possibility of punitive damages. Plaintiffs often supplement these fraud-based claims with allegations of breach of contract, unfair competition (California Business and Professions Code section 17200 *et seq*. ("UCL")), negligence, and breach of fiduciary duty, among others. Through these claims, borrowers seek damages from the lender as well as rescission of the loan. Additionally, unstated goals of borrowers may include renegotiation of loan terms, forgiveness of principal, staying foreclosure proceedings, and staying enforcement of guarantees. The wide range of claims, as well as the sheer volume of allegations asserted, may at first, appear to be daunting.

Preparing To Defend

When a lender liability claim is threatened or filed, good practice dictates that the lender:

- assemble all agreements with the borrower,
- assemble all correspondence and notes regarding the transaction at issue,
- identify witnesses, and
- undertake a review of the factual claims.

Collaboration between counsel and the lender to facilitate an early, clear assessment of the allegations is key to determining how to respond to a lender liability claim.

Defending Commercial Lender Liability Claims

Early collaboration between lender and counsel coupled with an in depth analysis of the complaint's factual allegations and legal theories will determine whether the lender should answer the complaint or move to dismiss the complaint for failure to state a claim.

Buchalter Nemer recently defended a lender facing fraud-based claims as well as claims of breach of contract, intentional interference with prospective economic advantage, and negligence. The borrower's claims were alleged in a complaint of more than 300 paragraphs filed in federal court. *Buena Vista, LLC v. New Resource Bank*, 2011 WL 250361 (N. D. Cal. January 26, 2011). In that suit, the borrower did not generate the revenue it had anticipated from a townhome construction project as the real estate market slumped. Facing the sale of its loan to another lender and potential loan default and foreclosure, the borrower alleged various unsubstantiated general misrepresentations. The complaint included, among other claims, RICO mail and wire fraud, breach of contract, fraud-based UCL claims, intentional misrepresentation, and negligence. Ultimately, the district court rejected each of the borrowers' claims and dismissed the entire matter at the pleading stage.

With the fraud-based claims, RICO, misrepresentation and fraudulent UCL claims, the court found that the borrower failed to allege the purportedly fraudulent statements with particularity. As to RICO claims, the deceptive statements made by wire or mail needed to be identified by date and the content alleged and the borrower needed to plead how the alleged fraud was furthered by the particular mailings or telephone calls. *United States v. Blecker*, 657 F.2d 629, 637 (4th Cir. 1981). The borrower was unable to allege any specific mail or interstate telephone communication to support its RICO claim and thus the claim was dismissed along with the misrepresentation and UCL claims.

As to breach of contract claims, the court found that the borrower made general breach allegations related to the lender's promised handling of the loan but failed to identify any provision of the loan agreement that was breached. The loan documents, the court ruled, simply did not provide evidence that the lender made the promises alleged in the complaint. As loan agreements typically include an integration clause indicating that the loan documents are a final expression of the parties' agreement, allegations contradicting the express loan terms cannot support a breach of contract claim. *Continental Airlines, Inc. v. McDonnell Douglas Corp*., 216 Cal.App.3d 388, 418 (1989). As such, borrower's contract claims also failed to survive the dismissal motion.

Negligence or fiduciary duty causes of action are also utilized by borrowers in lender liability actions but such claims cannot be maintained under applicable case law. In *Buena Vista*, the court dismissed borrower's negligence cause of action because a financial institution owes no duty of care to a borrower where the lender does not exceed its role as a lender of money. *Nymark v. Heart of Fed. Savings & Loan Assn*., 231 Cal.App.3d 1089, 1095 (1991). This tenet applies equally to breach of fiduciary duty claims.

In the *Buena Vista* case, after being permitted to amend its pleading once, eventually all of borrowers' lender liability claims were dismissed with prejudice. Early assessment and analysis provided the key to a successful defense.

Denise Field is a Shareholder in the Firm's Litigation Practice Group in San Francisco. She can be reached at 415.227.3547 or dfield@buchalter.com.

Kim Arnone is Senior Counsel in the Firm's Litigation Practice Group in San Francisco. She can be reached at 415.227.3577 or karnone@buchalter.com.

Buyer Beware: The Arizona Homeowner's Purchaser Dwelling Act

Rob Rutila and Ben Gottlieb

In 2002, as a direct response to the wave of construction defect litigation flooding the Arizona courts, the Arizona legislature enacted the Purchaser Dwelling Act (the "Act"), A.R.S. § 12-1361, *et seq*. The purpose of the Act was to reduce traffic within the courts by making it more difficult for homebuyers to file construction defect claims against homebuilders and developers.

This article outlines the processes—and pitfalls—of which a homebuyer must be aware and a homebuilder may take advantage, before any construction defect lawsuit may be filed in Arizona.

Homebuyer's Hurdles to Filing a Lawsuit

Boiled down to its essence, the Act shields homebuilders from being sued for alleged construction defects unless and until the homebuyer takes specific actions laid out in the Act that give the homebuilder an opportunity to repair the defects before suit is filed. Should a homebuyer file suit without first complying with the specific steps laid out by the Legislature, the homebuilder will likely succeed in having that lawsuit dismissed.[1]

First, under the Act, an aggrieved homebuyer *must* provide the homebuilder with notice of any alleged construction defects at least *90 days* notice before filing a lawsuit. The written notice must be given to the builder "by certified mail, return receipt requested," and it must specify, in reasonable detail, the basis of the lawsuit.

Importantly, the Act defines "seller" as "any person, firm, partnership, corporation, association or other organization that is engaged in the business of *designing, constructing* or *selling dwellings*." Thus, as a practical matter, "seller" means developers and homebuilders.[2] (Interestingly enough, the Act precludes "real estate brokers" or "real estate salesperson").

Once the homebuilder receives the written notice of defects, it may inspect the house to determine the nature and cause of the alleged defects. Upon inspection, the contractor is then provided an opportunity to cure and must, within 60 days of receipt of the homebuyer's notice, "send to the purchaser a good faith written response to the purchaser's notice by certified mail, return receipt requested." If the homebuilder does not provide the homebuyer with a response within 60 days of receiving the "notice" letter, the homebuyer can then file a lawsuit without waiting for the 90 days to expire.

However, if the homebuilder does respond, the homebuilder may offer "to repair or replace any alleged defects, to have the alleged defects repaired or replaced at the seller's expense or to provide monetary compensation to the purchaser [homebuyer]."

Once the homebuyer receives the homebuilder's offer, he or she must then either accept or reject the offer and provide a "good faith written response to the seller within 20 days after receiving the seller's offer." The homebuyer's response must also be provided in writing by certified mail, return receipt requested.

Strict Compliance

Arizona courts appear to have eagerly accepted the Arizona Legislature's challenge as they have enforced the Act and its procedural hurdles.

This strict enforcement was illustrated recently in *McMurray v. Dream Catcher USA*, 220 Ariz. 71, 76, 202 P.3d 536, 541 (App. 2009). There, the trial court *dismissed* the homebuyer's lawsuit because the buyer did not strictly comply with the Act's written notice requirements. The facts were simple: After discovering a number of construction defects, the homebuyer filed a complaint with the Arizona Registrar of Contractors. Upon receipt of the written complaint, the homebuilder attempted repairs to the home. Because the homebuyer believed the homebuilder did not repair *all* the defects, the homebuyer eventually filed a lawsuit against the builder in Maricopa County Superior Court.

The trial court *dismissed* the case because the homebuyer failed to properly send the "written notice letter, return receipt required" to the homebuilder as required by the Act. Thus, despite filing an action before the Arizona Registrar of Contractors, and having the homebuilder attempt repairs to the home, the homebuyer's failure to *strictly* abide by the Act's written notice requirements proved fatal to its claims. A lesson learned by the homebuyer the hard way.

As the above demonstrates, it is imperative that an Arizona homebuyer comply with the *specific* procedural requirements of the Purchaser Dwelling Act or face possible dismissal of his or her lawsuit.

Rob Rutila is an Associate in the Litigation Practice Group in Scottsdale. He can be reached at 480.383.1826 or rrutila@buchalter.com.

Ben Gottlieb is an Associate in the Litigation Practice Group in Scottsdale. He can be reached at 480.383.1810 or bgottlieb@buchalter.com.

[1] Note, in a narrow exception, that the Act does not apply to claims for defects involving an immediate threat to the life or safety of a home's occupants or visitors.

[2] The provisions of the Act are not limited to new construction. In the instance of alleged defects to existing construction, the buyer would serve notice on the seller of the property.

Lender Beware: When Real Property Title Issues Arise, Don't Forget Your Escrow Claim

Jason Goldstein

When a lender experiences real property title issues involving a secured loan, the first thought that normally comes to mind is: where is my title insurance policy? While this is a very good initial reaction—and one that cannot be forgotten—what is sometimes overlooked is that the lender may also have an escrow claim based on the instructions it provided to the escrow holder who closed the loan. Accordingly, when title issues arise with respect to loans secured by real property: don't forget your escrow claim!

In other words: welcome to the *escrow claim zone*. It is an area close to, and sometime overlaps, the *title claim zone*. Nevertheless, entrance into both zones always begins the same way. A would-be borrower fills out an application for a loan and compiles supporting documentation. This documentation is either submitted directly to the lender by the borrower or through a broker or a correspondent lender. The would-be lender then reviews the application and supporting documentation and obtains an appraisal to determine whether the value of the proposed real property security is sufficient to justify the proposed loan amount. If the information compiled by the lender satisfies its underwriting guidelines, the proposed loan is approved.

An escrow is then set-up and instructions are provided by the lender to the escrow holder. These instructions are normally in writing, although they do not have to be, and include a request for the issuance of a title insurance policy which insures that title to the real property securing the loan is vested in the borrower and that the deed of trust securing the loan is in a first lien position on the secured property. A closing date is set, the borrower signs the appropriate loan and security documents, and then the loan funds. The deed of trust securing the loan is then recorded with the applicable county recorder and the origination process is complete.

In a perfect world, shortly after the escrow closes the lender receives a title insurance policy with no exceptions that indicates that title to the real property security is vested in its borrower alone. The borrower then begins to make timely payments on the loan and does so until the entire loan balance is satisfied. The lender then happily reconveys its deed of trust and closes the books on what was a perfect loan.

But wait, we are not in a perfect world . . . we have traveled into the *escrow claim zone*! Here, borrowers do not always tell the truth or make payments on time. These borrowers sometimes fall on hard times and are willing to do things that honest people are not willing to do.

Similarly, in the *escrow claim zone*, escrow companies do not always follow the instructions that they are given. The escrow companies also cannot always be relied upon to make sure that the lender is fully apprised of all pertinent facts—of which they have actual knowledge at the most important time—prior to the funding of the loan.

For example, in the *escrow claim zone*, borrowers default on loans secured by properties that they misrepresented that they owned (but didn't) and the title insurance company who issued your policy did not catch this material issue or is part of the borrower's scheme to defraud. This same title insurance company, which gladly took the lender's money to issue a title policy, now refuses to issue the litigation guarantee that the lender needs to provide to the trustee under the deed of trust so that the foreclosure sale can proceed.

In this situation, the lender should of course tender a claim under its title insurance policy. In fact, it is always a best practice, subject to certain exceptions, to try and tender every possible claim that you may have to an insurer. However, title insurance is a policy of indemnity and not a guarantee. Practically speaking, this means that just because the title insurance company screwed up, it does not mean that the title insurer needs to pay the full amount of the policy, which is generally the cap on damages a lender will be able to obtain against a title insurer.

To keep all of the lender's options open, the lender should also consider an escrow claim. An escrow claim is based on the lender's instructions to the escrow holder in conjunction with the closing of the loan.

Since an escrow holder is the agent of all of the parties to the escrow, it has a fiduciary duty to the parties to the escrow. A fiduciary duty is the highest duty of care provided for in the law. As a result, the escrow holder is required to strictly comply with the instructions provided to it and is liable for damages to the lender when it does not do so. Accordingly, unlike a title claim, which is solely contractual in nature, an escrow claim is not so limited.

For example, an escrow claim does form the basis for a breach of contract cause of action. But it can also form the basis for negligence, breach of fiduciary duty and fraud claims. This means that the damages a lender suffers from an escrow claim may not be limited solely to contract—benefit of the bargain principles—but may be governed by common law tort principles which include damages proximately caused as a result of the escrow company's breaches of duty. Under certain circumstances, tort principles can allow a lender to a recover an amount in excess of what is obtainable in indemnity under a title insurance policy.

Accordingly, when real property title issues arise: don't forget the escrow claim.

Jason Goldstein is Senior Counsel in the Litigation Practice Group in Orange County. He can be reached at 949.224.6235 or jgoldstein@buchalter.com.

Anna Nicole Smith Strips Bankruptcy Court Jurisdiction

Benjamin S. Seigel

Continued from page 1

The litigation against Pierce was commenced by Vickie prior to the death of J. Howard at age 90 and worked its way through the State and Federal courts in Louisiana, Texas and California. Two of those courts, a Texas state probate court and the Bankruptcy Court for the Central District of California, reached contrary decisions on the merits. Vicky and Pierce both died in the course of the litigation so the litigation continued between the representatives of their respective estates. *Stern v. Marshall* was the second time that the Supreme Court was faced with adjudicating the rights of Vickie and Pierce.

The issue before the Supreme Court this time was whether a Bankruptcy Court had the authority to enter a final judgment on a counterclaim filed by Vickie against Pierce in Vickie's California bankruptcy case. Pierce had filed a proof of claim in the bankruptcy proceedings, claiming that she had defamed him, and Vickie filed a counterclaim against Pierce for tortious interference with her rights to receive the purported trust. The Bankruptcy Court held that it could hear and decide the counter claim and awarded Vickie a bit under $450 million. The award was reduced to $88 million by a District Court Judge. The 9th Circuit Court of Appeals overruled the District Court reasoning that the federal courts lacked jurisdiction to overrule the Texas state court decision in favor of Pierce. The issue eventually came before the Supreme Court.

What the Supreme Court Decided

In a 38-page opinion the majority held that although the Bankruptcy Court had the statutory authority to enter judgment on Vickie's counterclaim, it lacked the constitutional authority to do so. In a separate 2-page concurring opinion, Justice Scalia stated, "The sheer surfeit of factors that the court was required to consider in this case should arouse the suspicion that something is seriously amiss with our jurisprudence in this area."

In a 17-page dissenting opinion, Justice Breyer, joined by Justices Ginsburg, Sotomayor and Kagan, disagreed with the majority's constitutional interpretation and predicted dire consequences stating, "[A] constutionally required game of ping-pong between the courts would lead to inefficiency, increased cost, delay and needless additional suffering among those faced with bankruptcy."

So What?

So, what's it all about? Well, first of all, Bankruptcy Courts are created under Article I of the constitution, the administrative branch of government. Those courts get their power and authority from the Article 3 courts, or the judicial branch of government. Some matters that come before a bankruptcy court are called "core" matters and are defined in the Bankruptcy Code. If a matter comes before the bankruptcy court that is not a core matter, there are arguments both in favor and against the jurisdiction of the bankruptcy court to decide the matter. In *Stern v. Marshall*, the Supreme Court held that the counterclaim brought by Vicky against Pierce was based on his tortious interference with her right to receive the trust purportedly promised to her by Pierce's father, the late J. Howard Marshall, was not a core proceeding and could not be decided by the bankruptcy court.

Looking at the Law

The law at issue is found in 28 USC §157(b) (2) (C) which states in pertinent part, "Core proceedings include, but are not limited to…counterclaims by the estate against persons filing claims against the estate." The Supreme Court majority opinion held that although the Bankruptcy Court had the statutory authority to enter judgment on Vicky's counterclaim, it lacked the constitutional authority to do so. That decision was supported by a lengthy dissertation on what powers had been given to the Bankruptcy Courts and what powers had not been so granted.

Some Comments

Professor Dan Schechter of Loyola Law School, commenting on the Supreme Court opinion, indicated that the effect of the opinion is to delete §157(b) (2) (C) from the statute and that Bankruptcy courts will still be able to hear and decide counterclaims under another statutory provision, §157(c) (1) by issuing proposed findings and conclusions which will then be routinely rubber-stamped by a district court judge—the only change being the additional paper, expense and time delay. Schechter also raised the long debated issue of whether or not the opinion continued what some believe to be the "…continuing and inexplicable hostility of some judges toward the bankruptcy bench….I think that some federal judges are simply worried about encroachments on their turf."

Adam A. Lewis, Esq., a bankruptcy lawyer with the San Francisco office of Morrison & Forrester commented that the decision did not resolve the compulsory counterclaim issue and how it should be procedurally resolved. He asks, "Does the decision mean that the claim objection remains with the Bankruptcy Court, but that the debtor has to bring her 'compulsory' counterclaim in the District Court? Could the debtor bring the compulsory counterclaim with the claim objection and ask the District Court to withdraw the reference?" (A term used to describe the referral of bankruptcy cases by the District Court to the Bankruptcy Court.)

Conclusion

As is the case with all controversial decisions of our Supreme Court, only time will tell if this decision is much ado about nothing or a true and significant stripping of bankruptcy court jurisdiction.

Benjamin S. Seigel is a Shareholder in the Firm's Insolvency & Financial Solutions Practice Group in Los Angeles. He can be reached at 213.891.5006 or bseigel@buchalter.com.

The Advent of ".Anything": Journey Into the Unknown

Farah P. Bhatti and Annie L. Albertson

Continued from page 1

companies, municipalities and other owners of intellectual property. It is anticipated that many corporations and businesses will apply for gTLDs based on their brands. The ability to use non-Latin characters (such as Cyrillic, Arabic, and Chinese) will also increase the number of new gTLDs. Industry analysts predict this new program will usher in 500-1000 new gTLDs, mostly reflecting the names of companies and products, but also cities and generic names like .bank and .sport.

Overview of the Application Process

Once ICANN opens the formal application period, which is expected to occur on January 12, 2012, companies must submit their applications within a three-month window of time. Applicants will be required to describe in their applications the rights protection mechanism they propose for second-level registrations, but will not be required to own a trademark in the proposed gTLD. Unlike the typical domain name registration process by which anyone can purchase a single or multiple available domain names such as "i-love-domains.com" from an already existing domain name registrar by paying a nominal fee, these new gTLDs will essentially allow an applicant to form and operate a new gTLD registry. For that reason, the initial price to apply for a new gTLD extension is steep—$185,000 for each gTLD extension application. While the application fee itself is quite high, there may also be other costs involved, such as dealing with any third-party objections to one's application, and applicants may also need to outsource many services based on the many legal and technical issues involved in owning and operating a registry. Overall, most experts estimate that the total fees and costs associated with the application and evaluation process, together with operational costs and legal fees, could total as much as $2 million dollars over a one- to two- year period.

ICANN will use a dedicated web-based application interface through which applicants will submit their applications as well as supporting documentation. After the application window closes, the application will be evaluated in several stages, each with its own estimated time duration. The total evaluation process is expected to last eight to eighteen months. In the event that ICANN receives multiple applications for the same or "confusingly similar" gTLD extensions, the pre-selected evaluation panels will be responsible for coming to a final determination based on certain established contention procedures.

After the initial application period closes, which is currently set to be April 12, 2012, ICANN will verify that all of the applications are complete and will then release the list of all gTLD extensions, applicant names, and other application data. This will then start an approximately six-month period of time for third parties to file a formal objection using pre-established dispute resolution procedures. Any such formal objections will be adjudicated by independent dispute resolution service providers, not by ICANN.

Once an application has passed all evaluation and selection procedures, including the public objection process, the application will be deemed approved. This approval is not expected to occur any sooner than November, 2012. An applicant is then required to sign a registry agreement with ICANN and pass technical pre-delegation tests before a new gTLD can be assigned. The new gTLD is expected to be delegated within one year of execution of the registry agreement.

Important Considerations

In theory, the rollout of unlimited generic top-level domains would allow companies to explore branding or re-branding themselves in fresh, innovative ways. The inclusion of non-Latin characters in gTLDs may precipitate a huge increase in the number of Internet users around the world. Thus, the ability to reach a much larger audience could prove to be a major shift for businesses with global brands.

However, critics believe the new program is a disaster waiting to happen, concerned that the expansion of virtually unlimited gTLDs would cause great confusion among average consumers and Internet users. Still others predict that the hype of the new program will outlive its actual implementation if past rollouts of other top-level domains such as .jobs, .museum, and .travel, which have largely been under utilized, are any indication.

Clearly, the process can become very expensive, very quickly. Trademark owners who feel strongly about owning a new gTLD registry and extension would be well served to judiciously consider only applying for the trademarks that are most critical to their businesses.

Companies that cannot make a business justification to own and operate their own gTLDs are not without options to protect their brands and trademark rights under the new gTLD system. Rights owners should remain vigilant in monitoring ICANN's application process, and file formal objections to any gTLD that infringes their rights. ICANN has established four separate grounds for formal objections to gTLD applications, and the most relevant of the four for brand owners is the "legal rights objection." Under this ground, a trademark owner, one who claims that it has rights in a trademark, can object on the basis that an applied-for gTLD takes advantage of the objector's reputation or mark, impairs the distinctive character of the objector's mark, or otherwise creates a likelihood of confusion with the objector's mark. The "legal rights objection" can be based on either registered or common law trademark rights, but ICANN has not yet specifically provided details on how one must prove its trademark rights. The formal objection procedure will be similar in scope and structure to complaints filed under the current Uniform Dispute Resolution Process for existing domain name disputes.

Brand owners can watch ICANN's website (http://www.icann.org/en/topics/new-gtld-program.htm) for future announcements concerning important application and objection dates.

Farah Bhatti is a Shareholder and Chair of the Firm's Intellectual Property Practice Group. She can be reached at 949.224.6291 or fbhatti@buchalter.com.

Annie Albertson is an Associate in the Intellectual Property Practice Group in Los Angeles. She can be reached at 213.891.5102 or aalbertson@buchalter.com.

Triumph of the Impractical: Treatment of Water Supply Under the California Environmental Quality Act

Howard Ellman

Several Court of Appeal opinions have announced the unremarkable conclusion that assessment of water supply in environmental impact reports must start with a realistic baseline supply number.[1] The State Water Project currently consists primarily of the Oroville Dam impounding the waters of the Feather River, delivered by instream flow to the Tracy pumps at the southern end of the Delta and then transported by the California Aqueduct to points south. The planners originally designed the State Water Project to achieve an output of 4.2 million acre feet per year.

The state has never built several of the planned project components essential to achieving that output. Fiscal and environmental considerations render completion of the initially planned facilities highly unlikely. As a result, the Project has rarely been able to deliver more than about half of its initial planned capacity, and the actual yield fluctuates from year to year in response to variations in precipitation.

Nonetheless, the Department of Water Resources ("DWR"), the State operator of the Project, entered into contracts with various downstream water agencies based on an assumed output equal to the original design capacity. In other words, irrigation districts and water agencies south of the Delta hold contracts from DWR purporting to entitle them to roughly twice as much water as DWR can ever hope to deliver.[2]

Despite the historic discrepancy between paper entitlement and wet delivery, many of the water agencies and other parties holding DWR contracts projected supply for purposes of their environmental impact reports at their contract entitlement rather than at the level of actual deliveries. It should come as no great shock that the courts struck down EIRs based on that type of analysis, making little attempt to mask their disdain. After all, CEQA is intended to deal in the real world of actual environmental impact. One cannot determine whether or not adequate water exists to meet the demands of a project when an agency relies on fictitious water as the basis for computing supply, particularly when that approach greatly overstates the quantity of real wet stuff available for developments both public and private.

The Court of Appeal similarly rejected a fiddle with supply numbers in a case not involving the SWP. In *Save Our Peninsula Committee v. Monterey County Board of Supervisors* (2001) 87 Cal.App.4th 99, a project developer sought to establish that his project would not need water in excess of historic agricultural usage. He inflated "historic usage" by dramatically increasing irrigation for alleged agriculture prior to applying for his project approval, then claiming the higher usage as a baseline. The Court had no difficulty rejecting that approach.

Although the foregoing cases undoubtedly reached the correct result under CEQA, they shed little light on the proper approach to addressing the real difficulty inherent in attempting to predict long-term water supply required to sustain a major development. *Vineyard Area Citizens for Responsible Growth v. City of Rancho Cordova* (2007) 40 Cal.4th 412, dealt with that problem. The Specific Plan the County of Sacramento[3] had approved in that case covered an area of 2,600 acres to contain 9,886 residential units as well as a community commercial area with shopping centers, neighborhood parks and schools. Groups opposed to the project challenged the adequacy of the EIR in its treatment of water supply. The Court rejected their arguments for the early stages of the development, but found the EIR inadequate in its treatment of the later stages, *projected for completion roughly twenty years in the future*.

In finding the EIR insufficient in its analysis of long-term supply, the Court stated:

> [The relevant decisions] articulate certain principles for analytical adequacy under CEQA, principles with which we agree. First, CEQA's informational purposes are not satisfied by an EIR that simply ignores or assumes a solution to the problem of supplying water to a proposed land use project. Decision makers must, under the law, be presented with sufficient facts to "evaluate the pros and cons of supplying the amount of water that [the project] will need." 40 Cal.4th *supra* at 430, 431.

That quote, however, set up a straw man, as the EIR in question went much further, identifying a number of possibilities from which water essential to later stages of the project might be supplied, including a mitigation measure requiring that no further increment of the project could be developed without proof of water supply at the time each such increment came up for the approval that would actually initiate physical development. *State law mandates that result in any case*. Water Code §§ 10910-10912; Govt. Code § 66473.7. The EIR sensibly acknowledged the difficulty inherent in trying to formulate a prediction so far into the future in a field clouded by many imponderables.

While claiming that it was not requiring a demonstration of certainty (40 Cal.4th at 438), the Court nonetheless rejected the EIR on grounds that can be construed as transcending the limits of reasonable clairvoyance:

> Factual inconsistencies and lack of clarity in the FEIR leave the reader—and the decision makers—without substantial evidence for concluding that sufficient water is, in fact, likely to be available for the … [project] at full buildout.

Continued on page 10

Solving the Puzzle of Community Bank Mergers and Acquisitions

Dan Wheeler

The merger and acquisition market for community banks as of mid-2011 presents real challenges for participants on either the buy or sell side. The market could be considered a buyer's market because there are probably more interested sellers than buyers and because the anxiety and pressure is generally found on the seller side. But, acquirers also have significant difficulty in finding an opportunity with an attractive price.

The central problem that must be solved is credibility on credit quality. If the buyer and seller don't agree on the true credit quality of the target bank's loan portfolio, a deal cannot happen. If, on the other hand, a seller/target bank can make available a robust database for its entire loan portfolio that could be opened to potential buyers, this would provide enormous comfort and credibility to any buyer doing its due diligence. Such a database would include:

- A spreadsheet summarizing key metrics for each loan with hyperlinks allowing a buyer to drill down and review all loan information;
- Borrower and guarantor financial statements, tax returns, projections and credit scores;
- All loan documents, guaranties, modifications, title reports, title insurance;
- Payment history;
- Appraisals, past and most recent;
- Credit memos and loan approvals; and
- A description of how the loan's status and grade squares with the analysis of auditors and examiners.

The goal is to give a potential buyer complete certainty as to the accuracy of loan portfolio grades and valuation. Each side can then defend to its board of directors and to its shareholders a price that might otherwise have seemed too low or high. Otherwise, the credibility gap on credit quality will almost always prevent a closing because neither side can defend the price. Obviously, robust security procedures and a tough confidentiality agreement are necessary to protect the disclosing bank and its customers.

Next, management at the selling bank should be regularly updating its board and shareholders as to the bank's expected valuation based on (1) the uncompromisingly thorough and frank loan analysis detailed above and (2) the currently modest price-to-book valuations being achieved in the M&A market. Without being conditioned to understand the bank's market valuation, boards and shareholders might reject an offer that actually is in the range of fair market terms and valuations. For example, as of mid-2011, the median price-to-book value is about 107 percent. A deal priced at 125 percent is probably fair for many community banks right now. And, the price likely will be paid entirely or significantly in stock of the acquiring bank. A good market indicator for a particular bank is the pricing it has to offer to attract equity investors. Many times, the tiny premium in an M&A transaction is better for shareholders than the heavily dilutive price at which the bank must issue stock to new investors.

Many small community banks may need to combine with another small bank in order to register any interest with a strategic buyer. This can be an excellent, albeit slightly more complex strategy. The institutions may need to bring in additional capital in order to sell the combination to regulators. Members of the two management teams will need to be re-allocated, but the result can be a win for the individuals as well as the institutions. There is a great deal of talk about the need for mergers to be strategically attractive, and that is true. But, at the level of two small community banks, an excellent strategy and justification for the combination can be as simple as the opportunities flowing from thoughtfully reallocating particular people on the banks' combined teams so as to free more people to develop business and build the combined franchise. For example, instead of two sets of compliance personnel, there can be one and the balance devoted to acquiring core deposits and worthy credits.

In a merger of small banks, the two banks don't have to be geographically close to one another, although proximity is usually important in obtaining regulatory approval. Opus Bank in Irvine, California (the former "Bay Cities Bank") recently succeeded in obtaining approval to buy Cascade Financial Corp. (the holding company for Cascade Bank) in Everett, Washington State. Of course, Opus Bank is sitting on an exceptionally large ($460 million) pool of equity capital raised in 2010, has an approved plan to become a regional bank and could demonstrate its capacity to absorb the liabilities of Cascade Bank.

Dan Wheeler is a Shareholder in the Firm's Bank and Finance Practice Group in San Francisco. He can be reached at 415.227.3530 or dwheeler@buchalter.com.

Continued from page 8

> Most fundamentally, the project FEIR and [a related water-planning document] provide no consistent and coherent description of the future demand for new water due to growth in the [larger area that might require service] or of the amount of new surface water that is potentially available to serve that growth. 40 Cal.4th at 439.

As Justice Baxter pointed out in dissent, this analysis requires the EIR writers to anticipate possible future demand generated by projects not yet entitled and for which no entitlement application has yet been filed—a level of analysis the Court did not require with respect to the initial stages of the Project when such a predictive exercise would have had a much stronger claim to accuracy. 40 Cal.4th *supra* at 452-53.

No one seriously argues that a governing body approving a project should not be required to make a serious effort to determine that adequate water supplies are available to meet project demand. But asking a lead agency to project supplies against hypothetical demand from projects not yet proposed—and not likely to be proposed for ten or twenty years—invites nothing more than speculation, an exercise that CEQA supposedly abjures. The real question, however, is why a mitigation measure requiring proof of adequate supplies as a condition of approval for each increment of development does not serve the desired purpose, against a backdrop of conditions that make accurate projection of water supply almost impossible—and where a tedious, exacting and expensive effort must be deployed even to create the appearance of such an examination.

Moreover, none of the cases cited above dealt with the current sources of uncertainty in any question dealing with water supply in California. They include area-of-origin protection (Water Code §§ 10505.5, 11460 *et seq*.), application of an invigorated public trust doctrine, water required to prevent harm to endangered species under the Endangered Species Act, the flow requirements that will be generated by the Delta protection legislation; and of course, the inevitable variations in precipitation that may deviate in unpredictable way from historic patterns due to climate change. All of these preempt assessments of future supply, *taking priority even over "vested" water rights and supposedly binding supply contracts*.[4]

In the face of these requirements and compound uncertainties, how can lead agencies at any level be expected to generate legally adequate environmental documents? The likely answer: with great effort, expense and scientific input—inevitably opening up vast areas for challenge and litigation. In short, we have added more buckets of glue to an already fraught decisional process at a time when the governing bodies responsible for the integrity of that process lack the financial resources to do their job. Those who cooked up this stew, while undoubtedly well meaning, demonstrate by their efforts a less than vise-like grip on practical reality.

It would be difficult to imagine a legal structure more well calculated to serve the pernicious ends of delay, excessive cost, and as a breeding ground for even more litigation as obstacles to beneficial development both public and private.

Howard Ellman is a Shareholder in the Real Estate Practice Group in San Francisco. He can be reached at 415.296.1610 or hellman@buchalter.com.

[1] *California Oak Foundation v. City of Santa Clarita* (2005) 133 Cal.App.4th 1219, *Santa Clarita Organization for Planning v. County of Los Angeles* (2003) 106 Cal. App.4th 715, *Friends of Santa Clara River v. Castaic Lake Water Agency* (2002) 95 Cal.App.4th 1373, and *Planning and Conservation League v. Dept. of Water Resources* (2000) 83 Cal.App.4th 892 all concerned a fundamental issue related to the State Water Project.

[2] The contracts contain a clause to adjust deliveries to actual water available. The baseline in the contracts, however, was calculated on an assumed yield of 4.2 million acre feet.

[3] The County granted the approval with the property annexing to the newly incorporated City of Rancho Cordova shortly thereafter—which explains why the City is identified as the nominal respondent in the case caption.

[4] The most recent issue of Points and Authorities contained an article in which I elaborated on those sources of serious uncertainty. "The Real Drought Has Just Begun," *Points & Authorities*, p.9 (Spring 2011).

Los Angeles   Orange County   San Francisco   Scottsdale

Providing expert legal services for six decades

Buchalter Nemer Los Angeles Office Building

Points & Authorities

Points & Authorities is published as a service to our clients and friends. Its articles are synopses of particular developments in the law and are not intended to be exhaustive discussions or relied upon as conclusive. The authors are pleased to discuss the information contained in their articles with you in greater detail.

To reprint articles that appear in the *Points & Authorities*, please contact the Marketing Department by email at marketing@ buchalter.com or call (213) 891-0700.

BuchalterNemer
1000 Wilshire Boulevard, Suite 1500
Los Angeles, CA 90017-2457

ADDRESS SERVICE REQUESTED

PRESORTED
STANDARD
U.S. POSTAGE
PAID
PERMIT NO. 1233
GLENDALE, CA

www.buchalter.com