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GUEST COLUMN

What the Richmond plan is — and is *not*

By Robert Hockett

As one of those who has been designing and advocating eminent domain plans for deeply underwater mortgage loans since the outbreak of crisis in 2007-2008, I am continually surprised by much that I hear about what is now underway in Richmond and dozens of other hard-hit cities across the nation. Some such surprise is occasioned by things said by those who support such plans. Much is occasioned by things said by those who do not. It might be in order, then, to say a few things about what eminent domain

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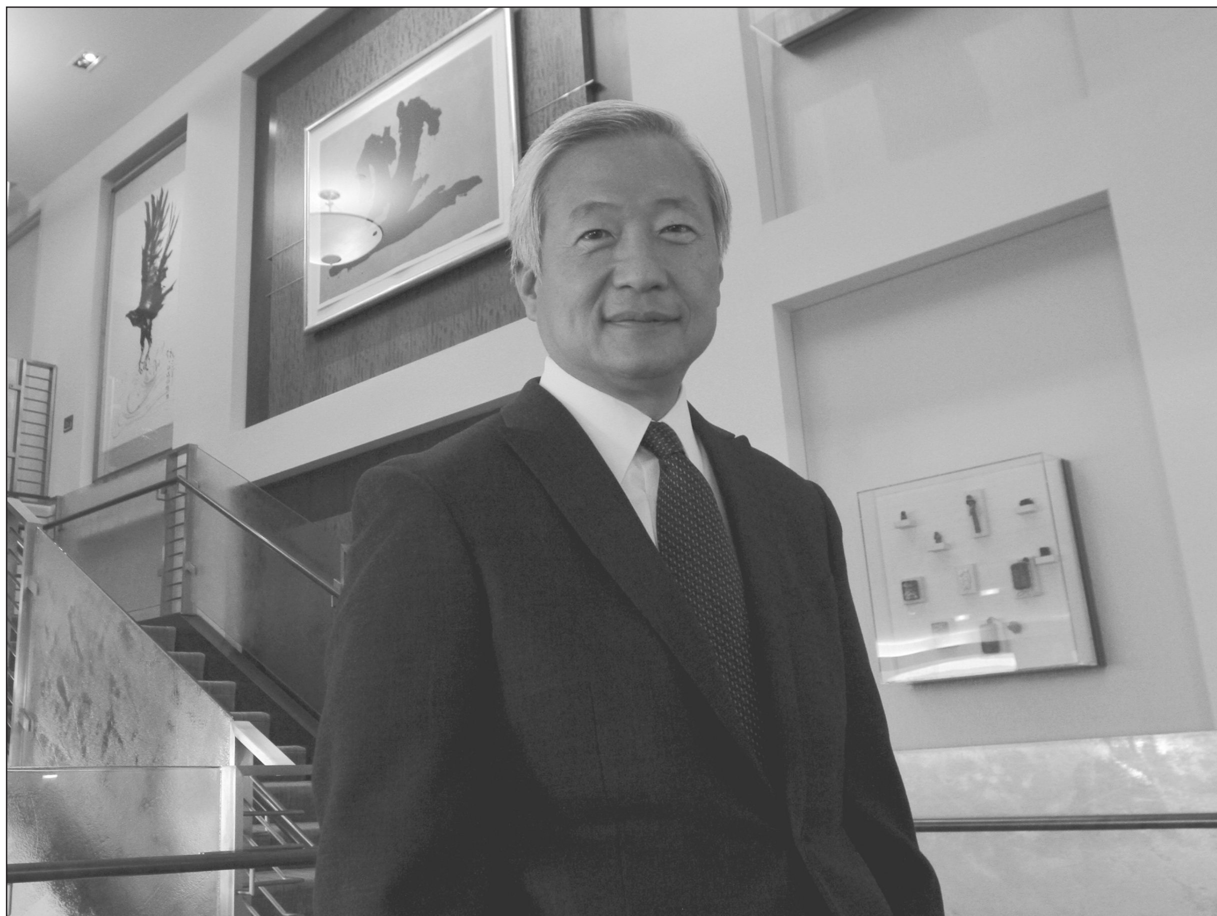

Hugh Williams / Special to the Daily Journal
Squire Sanders partner Thomas T. Liu helped Eva Airways overcome obstacles to opening a new flight school.

Flight school finds smooth air after bumpy legal turbulence

By Andrew McIntyre
Daily Journal Staff Writer

Those concerned with airlines' safety after last month's crash landing of Asiana Airlines Flight 214 might be reassured by one foreign carrier's quest to provide top-level training for its pilots by opening a flight school in the United States. Taiwan's Eva Airways plans to be among the first foreign airlines to accomplish the task by setting up a flagship pilot academy at Sacramento's Mather Airport next year, pending FAA approval.

Eva first conceived of the school in late 2012 as a means to train Taiwanese pilots, but bringing the project to fruition hasn't been easy. First, the U.S. government enacted a rule barring flight schools from accepting foreign students during their first year of operation. Then, across-the-board federal budget cuts known as sequestration threatened to shut down the airport control tower at Eva's first-choice location for the school.

To help address the wide spectrum of issues — including matters of corporate, real estate, environmental, regulatory, immigration and employment law — Eva turned to Thomas T. Liu of Squire Sanders in Los Angeles. Working as the company's "gatekeeper," Liu, who speaks Chinese, connected the company with germane lawyers at the firm.

"To be trained in the U.S., get certified in the U.S., is still considered the gold standard for pilots," Liu said. "If you get trained in the U.S., meet the FAA requirements for pilots, you are considered that much more qualified."

But when the U.S. government barred schools from accepting foreign students during the first year, "that really kind of put a jolt into the whole flight academy plan," Liu said. "They wouldn't be able to train pilots from Asia for the short term."

Still, Eva went ahead with its plans, banking on the prospect of training Taiwanese pilots after the first year. Pilots who fly for Taiwanese airlines must be Taiwan residents and have served in the Taiwanese military.

Construction of training facilities and classrooms has not yet begun, but a spokesman for the airline said in an email to the Daily Journal that it expects an initial class of 16 students next year and hopes to boost the class size to 100 by 2017. The airline will pay for admission and room and board for participants in the three-year program, Liu said.

Eva is not the first foreign airline to set up a school in the United States. The Airline Training Center Arizona Inc. at Phoenix's Goodyear Airport caters exclusively to Lufthansa pilots, the only location outside of Europe where pilots from that airline train.

While the vast majority of U.S. schools — like the storied Pan Am International Flight Academy Inc. in Miami — cater to pilots from all corners of the globe, some, like Redding-based Iasco Flight Training Inc., target students from specific regions. Iasco's trainees include pilots for Chinese airlines who study there thanks to an agreement between Iasco and China's

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Mandatory minimums lose appeal

Congress introduces two bills that would allow judges more discretion

By Hadley Robinson
Daily Journal Staff Writer

Proposals to give judges more discretion when sentencing criminal offenders are suddenly coming from every direction.

In a rare show of bipartisanship, two separate bills have been introduced this year to allow judges to depart from mandatory minimum sentences for certain non-violent offenders involved with drugs, pornography or firearms. A bill set for a hearing in September, the Safety Valve Act of 2013, decries the absolutist approach that requires offenders, no matter what, to minimum prison terms.

In July, a group of 50 former U.S. attorneys, judges and other high-level law enforcement officials from both parties, including several from California, urged Congress to pass the bill.

And on Monday, the country's chief law enforcement officer — Attorney General Eric Holder — will talk about "smarter sentencing" and criminal justice issues in a speech at the American Bar Association annual meeting in San Francisco, according to a spokeswoman.

Though civil rights groups and politicians on the left have long criticized mandatory minimums as discriminatory and ineffective in decreasing recidivism, bipartisanship on this issue is new and the result of a morphing political climate, legal observers say. Certain sectors of the Republican Party are departing from traditional "tough on crime" stances that have been a pillar of the party line since President Ronald Reagan's War on Drugs in the 1980s that initially ushered in mandatory minimum policies.

With the federal prisons at 138 percent capacity, on top of a severely reduced prison budget due to sequestration, some conservative legislators are seeing more reason to ratchet back sentences for nonviolent criminals.

"Politicians used to think of criminal justice as a kind of theological imperative that could not be subject to a cost-benefit analysis," said Stanford Law School professor Robert Weisberg. "Now we see many libertarian conservatives saying law enforcement are government programs; they therefore fall under the general principle that we distrust government programs and want to subject all government programs to rigorous cost-benefit analysis."

Sen. Rand Paul of Kentucky, a rising libertarian-oriented star of the Republican Party, is leading the charge to pass the Safety Valve Act along with Sen. Patrick Leahy, a Vermont Democrat.

"Our country's mandatory minimum laws reflect a Washington-knows-best, one-size-fits-all approach, which undermines the constitutional Separation of Powers, violates our bedrock principle that people should be treated as individuals, and costs the taxpayers money without making them any safer," Paul said in a statement in March when the bill was first introduced.

The reform proposals would not eliminate mandatory minimums altogether, but allow judges to depart from them in certain instances.

Proponents of mandatory minimums argue they remove disparity in sentencing, prevent crime by incarcerating dangerous individuals and deter future criminal behavior.

In the 1980s, Congress established sweeping laws

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Skadden poaches Toyota defense lawyer from Alston & Bird

By Omar Shamout
Daily Journal Staff Writer

Lisa Gilford, who helped Toyota Motor Corp. negotiate its $1.6 billion settlement in a class action lawsuit over sudden unintended acceleration, is leaving Alston & Bird LLP to join the Los Angeles office of Skadden, Arps, Slate, Meagher & Flom LLP & Affiliates.

Gilford worked with Skadden attorneys while serving as lead counsel defending Toyota against product liability claims related to alleged incidents of unintended acceleration since 2009. *In re: Toyota Motor Corp. Unintended Acceleration Marketing, Sales Practices and Products Liability Litigation*, ML10-2151 (C.D. Cal., filed April 12, 2010).

In an interview, Gilford said discussions about her move began as the settlement negotiations wound down and "came together fairly quickly."

As co-chair of Alston & Bird's products liability group, Gilford also represented clients such as DuPont Co. and T-Mobile USA Inc., among others, in connection with consumer class action claims. She said details are still being ironed out with Alston & Bird regarding future representation of those clients.

"All that is a bit unclear at this point," Gilford said. "I hope to continue those relationships."

Gilford said in a statement Friday that her previous experiences partnering with Skadden on the Toyota case have been top notch.

"I am excited about joining such an impressive group of attorneys," she said.

Gilford will continue to represent Toyota in *Dushane v. Toyota*, a case slated for a January trial as part of combined sudden acceleration litigation filed in Los Angeles County Superior Court. *Toyota Motor Cases*, JCCP4621 (Los Angeles County Super Ct., filed Feb. 4, 2010).

Skadden attorneys also heaped praise on their colleague in the statement.

"Lisa is widely regarded as one of the West Coast's leading products and consumer class action defense and trial attorneys," said John H. Beisner, national head of Skadden's mass torts, insurance and consumer litigation group.

The firm's West Coast litigation practice leader Thomas J. Nolan added Gilford makes "an ideal complement to our existing bench of talented litigators and trial lawyers in California and across our national platform."

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GILFORD

DAILY APPELLATE REPORT

CIVIL LAW

Real Property: Borrower may sue bank for wrongful foreclosure where attempted transfer of loan to securitized trust occurred after trust's closing date. *Glaski v. Bank of America*, C.A. 5th, DAR p. 10679

Real Property: Developer prevails in suit against county to subdivide parcel into residential lots, but does not win attorney fees because project was not for low-income housing. *Honchariw v. County of Stanislaus*, C.A. 5th, DAR p. 10647

Torts: Copyright law does not preempt renovator's claim against redevelopment company for use of its architectural plans in application for tax credit. *Civic Partners Stockton LLC v. Youssefi*, C.A. 3rd, DAR p. 10654

Workers' Compensation: WCAB must determine what percentage of employee's hearing loss was caused by occupational factors before awarding total disability. *Acme Steel v. WCAB*, C.A. 1st/1, DAR p. 10693

CRIMINAL LAW

Criminal Law and Procedure: Contractor escapes convictions for impairing fire protection systems because he did not specifically intend to impair systems' effective operation. *People v. Williams*, C.A. 5th, DAR p. 10663

Litigation/Corporate

Public Minded
4th District Court of Appeal Justice Jeffrey King's first love is politics — he served briefly as a mayor before taking the bench.
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Moving Up
Kathleen Philips, Zillow's general counsel, now has new responsibilities as the chief operating officer.
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Perspective

Default corporate form
What type of legal entity should you form for clients? It all depends, of course, but what should be your default? By Robert W. Wood
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Fool's gold
Mining for mortgage modifications through the use of eminent domain could prove more trouble than it's worth. By Laurence E. Platt
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ABA Convention

Lawyers debate Stand Your Ground laws
Amid the national debate over "stand your ground" laws, many Californians would be surprised to know that this state also has a similar provision.
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Women rainmakers share their wisdom
When it comes to breaking into the "old boy's club," women should carry with them a simple tip: men are just people, speakers said during an American Bar Association panel.
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Fool's gold: mining for modifications by seizure

By Laurence E. Platt

Ever since the financial crisis first emerged in 2007, local, state and federal governments have sought to help distressed borrowers avoid home foreclosure. It generally did not matter whether up-front origination issues or subsequent changes in a borrower's circumstances caused a loan default. In either case, influencing loan holders and servicers to offer loan modifications and other loss mitigation options to eligible borrowers has been the goal.

Borrowers who are current on their payments and can afford their loans generally do not qualify for loan modifications. They rely instead on refinancings to reduce their monthly payments. Where home values have fallen below the amount of the outstanding debt, however, these borrowers often are unable to qualify for a refinancing. Why? If the loan-to-value ratio on a refinancing exceeds 100 percent, there is insufficient equity to pay off the noteholder if it subsequently forecloses and sells the home following a default. Special refinancing programs for "underwater" loans are available for loans owned by Fannie Mae or Freddie Mac or insured by the Federal Housing Administration, because they already "own" the risk of loss. Privately owned and insured "underwater" loans often are ineligible for refinancings.

That's where eminent domain comes in. A local government will acquire an underwater loan from the private holder at a discount to the loan's outstanding principal balance. The new holder will permanently write down the loan to something less than the current value of the home. The borrower then may be eligible to refinance into a cheaper loan, the proceeds of which would be used to repay the local government or an interim source of funding.

Of course, that assumes that the holder wants to sell on those terms. Holders that are private securitization trusts may not have the contractual authority to sell the loans at all or at a discount. Eminent domain is designed to force private holders to sell their loans on an involuntary basis.

Unless the refinancing lenders intend to make the new loans with their own money for their own investment, which is highly unlikely, they will have to satisfy the applicable eligibility criteria of potential loan purchasers and mortgage insurers.

Enter the city of Richmond. It recently contacted the owners and servicers of various loans secured by homes located within city limits and offered to buy the loans for less than half of their outstanding principal balances. An undisclosed "independent" appraisal obtained by the city provided the foundation for the offer price. Most of the loans reportedly are current. A not-so-subtle threat accompanied the offer — if the recipients reject the offer, the city may seize the loans for the original offering price through eminent domain.

The legal challenge

Using eminent domain in this manner raises serious legal issues. The threshold question is whether a local government can exercise authority over an "intangible" debt that is secured by a local home, but owned by an entity that holds the evidence of the debt outside of California. Interestingly, neither the ownership nor the enforcement of the loan, even if secured by California real property, constitutes "doing business" in California under Section 191 of California's Corporations Code, and it's questionable whether California has "long arm" jurisdiction over these holders.

Next question is whether the city's use of eminent domain is unconstitutional. Is the seizure a permissible "public use" when the primary purpose is to permit a city resident simply to swap one residential mortgage loan for another? Does the answer change if affordable credit is less available to other city residents as a result of the city's actions? Does a purchase price based on a discount to the home's current market value constitute "just compensation" for a performing loan? These, and other legal challenges, will not be solved quickly by the courts.

The practical impediments

So where does that leave the mortgagors in the meantime? Can the program work as contemplated? Following the money may give us a clue.

Eminent domain in this context is predicated on the sale or securitization of the refinancings that repay the seized loans. The city appears to have no intention to use its own money on other than an interim basis (if at all) to pay "just compensation," however that amount ultimately is determined. Private lenders, not the city, will make the refinancings, and their proceeds will provide the direct or indirect source of funds used by the city to purchase the seized loans. But how will the lenders fund the refinancings?

Unless the refinancing lenders intend to make the new loans with their own money for their own investment, which is highly unlikely, they will have to satisfy the applicable eligibility criteria of potential loan purchasers and mortgage insurers. Perhaps, government-related entities, like Fannie Mae, Freddie Mac or the Federal Housing Administration, simply may refuse to purchase or insure these loans as a matter of principle. But even if there are no such blanket prohibitions, existing eligibility criteria may pose issues.

Any refinancing requires the release of the lien on the home pertaining to the paid off loan. This can occur in only three ways. The original lender voluntarily may release its lien, but why would it do that? The lien may be extinguished by operation of law if a court of competent jurisdiction determines that the eminent domain action is lawful. Or a court can order the release of the prior lien while battles remain regarding the amount and payment of just compensation.

Why must the prior lien be released? To be eligible for sale or insurance, the new security instrument must create a first lien priority security interest on the borrower's home. Litigation challenging the constitutionality of the city's action may well raise questions regarding the survival of the old lien and a "cloud" on the priority of the new lien. For the new loan to be eligible for sale to Fannie Mae or Freddie Mac or pooling to back securities backed by the Government National Mortgage Association under their existing guidelines, the delivered loan package must include a title policy by an approved title insurer insuring the first lien position of the new security instrument, free and clear of conflicting claims. Private purchasers generally have similar requirements. Will title insurance companies issue clean title policies in the face of litigation, and what happens if they do not? Even if the new lender elects to refinance the seized loan without a new title policy, it may be delayed in its ability to sell or securitize the loan if it is not clear that the old lien has been extinguished?

In other words, there may be two different loans secured by the same city home for which the mortgagor is liable until the dust settles. This chaos could leave a borrower wondering to whom loan payments should be made, in what amount, and whom can they call for definitive answers? And who has the authority to enforce the loan documents against the borrower in the event of nonpayment? While this uncertainty and perceived political hostility persists, unnerved lenders may pause before making new loans to other city residents.

If the city and the other California jurisdictions that are actively considering eminent domain truly believe that "there is gold in them thar hills," as the saying goes, they might want to consider the impact of potential title issues. A pan full of gold in the form of immediate principal write-downs and refinancings could prove to be elusive as long as legal challenges to the city's use of eminent domain remain.

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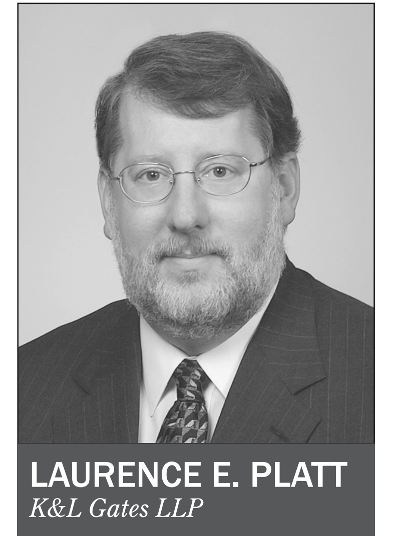

LAURENCE E. PLATT
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What city's mortgage seizure plan will — and *will not* — do

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plans for mortgage loans really do and are for, as well as about what they do not and are *not*.

The first point we must grasp if we are to understand plans of this kind is what prompts them. the key is the difference between the high rates at which bank-held portfolio loans are modified when deep underwater, on the one hand, and the low rates at which securitized such loans are modified when deep underwater, on the other. The remarkable difference between these two rates — and the fact that a quarter of mortgage loans still are deep underwater — is what first got me thinking along eminent domain lines six years ago.

You see, the portfolio loans, which are held in their entireties by the banks that have power to modify them, modify at high rates when they're deep underwater. Why? Because banks recognize that deeply underwater loans default at high rates, meaning in turn that they're worth very much less, as a practical matter, than their face values until written down. Foreclosure, after all, is very expensive, and banks collect nothing from borrowers who default. So banks write down underwater loans in a manner that keeps the loans payable and thereby benefits creditor, debtor, and community alike. It's a "win-win-win" when they do.

Now *securitized* loans are *not* modified at such rates. In fact, they are nearly never written down — even when write-downs would render them payable, increase their values, and thereby aid creditor, debtor, and community alike. Why? The reason is not hard to find. It's not that it is any less value-recouping to write down these loans. It's that their complex securitization arrangements make it impossible — even, again, when creditors would *like* it to happen. The creditors are too scattered to do or to authorize it, and their agents — the trustees and servicers of securitized loans — are contractually prevented from doing it.

The securitization arrangements to which I refer, it's important to note, were developed during a time when many had the foolish idea that home prices generally "only go up." No provision was made, then, in the securitization contracts, for trustees and servicers to modify or sell loans on a large enough scale when literally millions of such loans fall below water after an unanticipated crash.

The eminent domain plan is meant to address that — and only that — problem. Because the securitized loan problem is ultimately a poorly-drafted-contract problem, and because investors in securitized loans are generally too scattered, too anonymous, and too passive to come together to rewrite or override these contracts, we need a way to get past the contracts on behalf of the bondholders. Eminent domain is the one way to do that, the way governments *always* have done that when necessary for the contracting parties and society at large.

The critical point is that this is simply an indirect means by which securitized creditors write down loans in a self-benefiting way, entirely analogous to the way in which portfolio creditors directly do write-downs in a self-benefitting way

In light of the eminent domain plan's origins and purpose as just described, it is easy to see both (1) what kinds of loans should be eligible for inclusion in the plan, and (2) how the plan should be financed. With respect to (1), eligible loans should be all and only those loans whose values can actually be increased by writing them down — for these are the loans whose not already having been written down is both (a) attributable to dysfunctional contracts as described above, and (b) now harming creditors, debtors, and their communities alike. It should be noted that it is also straightforward, as an actuarial matter, to determine which loans these are and by how much they should be written down.

With respect to (2), the plan should be financed, as far as is possible, by the current investors themselves, who should then own the newly modified loans that are left after the plan has been employed.

This last point requires a little elaboration. How does the plan work, mechanically speaking? It works like this: Current investors in pools of securitized loans that include large numbers of underwater loans, supplemented by other investors as necessary, supply the funds used to purchase the underwater loans out of securitization trusts. They do so in partnership with cities, since cities have eminent domain authority. The cities then employ this authority to get past the contracts that currently prevent the relevant loans from being modified or sold. They purchase these loans with the investor-supplied funds, then modify them in a manner that simultaneously lightens the debt loads of underwater homeowners while rendering the loans more valuable because now payable. After modifying the loans, the cities then convey them back to the original investors, who now have more valuable assets than they previously had.

It might ring initially counterintuitive to suggest that the current beneficial owners of loans — that is, the bondholders — "buy the loans from themselves and then repay themselves with those loans" as the eminent domain plan does. But it should not be that difficult to grasp. The critical point is that this is simply an indirect means by which securitized creditors write down loans in a self-benefiting way, entirely analogous to the way in which portfolio creditors directly do write-downs in a self-benefitting way. It simply takes an extra step in the case of the securitized loans, relative to the bank-held portfolio loans, because of the "middle man" that is the securitization trust in these securitization arrangements. An extra link in the chain requires an extra step in the write-down process. That step is the cities' use of eminent domain authority.

And that is it. The eminent domain plan is nothing more, and nothing less, than this. Now note a few implications that flow from the above.

First, since the plan is meant to be win-win-win, there is no reason in principle for it to require disputation or litigation among stakeholders. In theory, all stakeholders — creditors, debtors, and municipalities — should be able to agree to basic principles of loan-selection and -valuation, and then instruct the cities on which loans to purchase and what to pay for them. The eminent domain proceeding would then be a mere formality analogous to a court's formally approving an out-of-court agreement.

Second, again because the plan is win-win-win, none of the putative legal and financial objections now being offered by various trade groups and other special interest lobbies actually apply to the eminent domain plan as originally conceived and here characterized. There is no invidious discrimination between creditor and debtor, for example, if you get an agreed loan-workout among them that all approve and benefit by. Nor is there any "burden" on interstate commerce or the free flow of credit, if all you do is to "get the lead out" of securitization trusts by replacing undervalued underwater loans that cannot be sold or modified with better valued above-water loans that creditor and debtor alike prefer.

Why, then, have Richmond and the two dozen (and still counting) cities now considering various renditions of the eminent domain plan attracted such fuss? I think there is both an innocent and a not-so-innocent explanation. The latter is that some in the securitization industry realize that if the plan works, it proves that (some of) their hurriedly slapped-together, bubble-era securitizations are at the root both of the crisis and of our ongoing troubles ever since. Hence they work to torpedo the plan by spending millions of dollars both to spread disinformation about it and to tie it up in court, thereby frightening even homeowners, bondholders, and cities whom the plan ultimately would *benefit*.

The more innocent explanation is that many nonlawyers, not realizing that eminent domain has always applied to all forms of property — intangible as well as tangible — initially experience the eminent domain plan as some sort of "radical departure" from prior law, hence fear a "slippery slope" that might ultimately lead to less laudable uses of the eminent domain authority. In fact, however, there is no basis for those fears — indeed, mortgages and other financial instruments have *often* been purchased in eminent domain when structural problems like those noted above have harmed multiple constituencies. In fact, *mortgages themselves* were purchased in eminent domain during the Great Depression, precisely in order to end a foreclosure epidemic among small family farms in the "dust bowl."

In sum, then, if all parties would just step back a moment, take a deep breath, and read carefully and in more detail a bit more on what the eminent domain plan is for and how it works, we might end this nation's continuing economic malaise, underwater-loan-caused as it is, at long last. A good place to start, I suggest, is with these two articles, the first brief, the second more detailed: Robert Hockett, "Paying Paul and Robbing No One: An Eminent Domain Plan for Underwater Mortgage Debt," 19(5) Current Issues in Economics and Finance 1 (2013), *available at* http://www.newyorkfed.org/research/current_issues/ci19-5.html; and Robert Hockett, "It Takes a Village: Public-Private Partnerships for Write-Downs of Underwater Mortgage Debt," 18 Stanford Journal of Law, Business, and Finance 121 (2012), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2038029.

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