Los Angeles lawyer Adam K. Treiger warns practitioners of the risks of special appearances.

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Adam K. Treiger, a partner in the Westlake Village firm Stowell, Zeilenga & Ruth, specializes in business and employment litigation and counseling. In “Dangerous Appearances,” he outlines the malpractice risks that may result from making a special appearance on behalf of a colleague or opposing counsel. His article begins on page 20.

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The arrogance of audacity has now doomed Osama bin Laden, his run in Afghanistan, the Taliban regime, and probably the al-Qaida network worldwide. As others have done before, the adversaries of the United States have misjudged the ability of a U.S. president to lead an aroused and angry country. Even if the World Trade Center towers had not collapsed, what response did the terrorists think their attack would evoke? A few more misguided cruise missiles? Hardly.

The work of the U.S. military has been so successful so quickly that one wonders what all the charges over waste, fraud, and abuse were about. The $500 toilet seats seem to be working. Of course, future campaigns will not all be so swift with relatively limited casualties or free from controversy over targets and tactics. The war against terrorism may take some time. But does anyone now doubt the final result?

The brilliance of the government in organizing the war effort illustrates and validates much about our democracy and the political system by which we choose to govern ourselves. In a democracy, competing political parties fundamentally exist not to hold conventions, raise money, incubate ideas, educate voters, or contest and win elections. They exist to form governments after winning an election. Whatever one may feel about President George Bush or the tangled route by which he was chosen, he and his party formed a government of experienced senior officials capable of managing the military and diplomatic responses to September 11. As we know from our law practices, experience matters. Trust and respect among colleagues matters. Civility in disagreement over strategy and tactics matters.

The stunning success of the United States and its allies against the Taliban in Afghanistan is so remarkable when contrasted with the initial failure of the U.S. homeland security effort to reassure the country and protect postal workers in the early days of the anthrax threats. The lack of specificity in terrorist alerts still startles and confuses. What were those warnings all about? Do they remain in effect? If they do or if they are issued again, what are we to do? How do we make judgments in a time of terror? Perhaps the best we can do is to look out the window each morning and check the sky for more than just the weather.

Our work as lawyers has begun. We will have cases to prosecute, clients to defend, victims for whom we need to seek recovery, survivors who need assistance in qualifying for benefits, contracts to draft, and new laws to write and interpret. The courts will soon hear cases with fresh facts and issues. The use of military tribunals and the issue of treason will occupy our time. Legal magazines and journals will publish.

Once again, a national debate about our laws is taking place—this time about how to balance civil liberties with the need for more certainty and security in our lives. Law-centered national dialogues have recurred in a single generation, twice over the impeachment of a president and twice (during the Watergate and Iran-Contra scandals) over the constitutional conduct of a president. The recent angry response of the audience at a California State University commencement to a speaker who raised questions about the government’s responses to terrorism alerts us to the difficult, even risky road ahead for defense counsel.

I am writing this From the Chair column during the 2001 holiday season, and the fear of an uncertain future seems to have dampened. Sadness remains. We all seem to be quietly waiting for the next target of the government’s war against terrorists and those who harbor them. We are also waiting for the next move from the terrorists. We still wait for a general call to serve—for a 2002 Manhattan Project or domestic Marshall Plan. And while we wait, the once wobbly knees of a frightened country have straightened as we feel confidence in our might and in our virtue. Will we soon be guilty of the arrogance of optimism?
A Trial Preparation Checklist

To keep things simple, the tasks of pretrial preparation may be listed by category

Whether new civil litigators are immediately thrown into the fray or slowly assume responsibility, they will eventually be obliged to prepare a case for trial. When that happens, they will need to keep myriad tasks in mind to ensure that they are as fully prepared as time and resources allow. Going to trial involves many strategic considerations, but they can be managed by focusing on a checklist of a few basic questions.

When are the deadlines? Most cases do not result in trial, but trial preparation—including motion and discovery as well as a demonstration of the client’s willingness to expend resources—may expedite a resolution through compromise, dismissal, or judgment. A favorable result for a client is dependent on remembering that a trial date imposes deadlines. Even if no trial date is set, no lawyer should assume that plenty of time is available to prepare the case.

For example, Los Angeles superior courts vary in their calendaring, but it is no longer unusual for them to set matters for trial within 6 to 10 months from a first appearance. If the case file does not reveal if a trial date is set, call the clerk or check at www.lasuperiorcourt.org.
The site also provides information on hearings.

Who’s who? As the case goes to trial, keep in mind who is involved. Before leaping into discovery and law and motion, define the roles of everyone involved; the larger roles get more attention. Keep your client informed by sharing important discovered facts, strategic issues, and professional recommendations. Learn the client’s expectations about trial and settlement. Does the client have unreasonable expectations? Do the client and you have differences of opinion? Will the client limit the amount of time and money invested in the case? Does the client really want to settle? Keep the client’s concerns in mind in all decisions you make as trial counsel.

The question of who’s who extends to you. If you are not the lead attorney, find out what the lead attorney knows about the case and find out to whom he or she reports problems and progress. Identify how informed the trial attorney wants to be of your progress, problems, and developments. Learn what the limits on your decision-making ability are, and learn whether additional human resources—including attorneys, paralegals, law clerks, or investigators—are needed if the case is to continue on schedule. The establishment of a chain of command and communication may help the trial preparation progress more smoothly and efficiently than otherwise.

Do I have the discovery I need? From the beginning of the case to its conclusion, litigators should constantly assess their theories as discovery progresses. At the outset, the complaint states causes of action, each of which has elements of proof and should allege facts supporting these elements. Similarly, any responsive documents may identify a defendant’s theories and supporting facts. From these initial pleadings, an attorney can formulate—and reformulate—a basic discovery plan. At a minimum, propound basic written discovery to clarify the pleadings and identify the facts, witnesses, and documents to support the opposing party’s allegations or defenses.

Attorneys facing trial should also plan to depose the opposing party, which may include the party’s agents and employees. Keep in mind that clients may know facts that would be nearly impossible to obtain through discovery. The client may know what questions to ask during depositions or be able to identify witnesses unknown to the other side. Clients with a technical background or other specialized knowledge may help explain concepts that are basic to the case but outside a lay person’s experience. Discussions with the client are therefore a basic part of discovery. However, it is wise to independently verify the client’s discovery information if possible.

One round of discovery may yield enough information to assess settlement value, draft dispositive motions, or prepare for trial. However, the first round often will result in the need to pursue additional documents, witnesses, and facts that in turn will lead to a reassessment of the case. The discovery may also point to theories or defenses not previously identified in the pleadings. Or discovery responses may be woefully inadequate, thereby meriting a meet and confer or motions to compel. Do not wait until the eve of trial to bring a discovery motion. Even if you prevail, the court is likely to grant the other side a reasonable time to respond.

Some cases involve lengthy discovery battles. Others progress smoothly. Until discovery begins, it may be impossible to predict how long it will take to obtain the information you need, let alone to incorporate it as part of the trial preparation. In the meantime, keep in mind that discovery means more than written interrogatories, document productions, and depositions. For example, discovery may require site inspections, destructive testing, or medical examinations, all of which require a stipulation or a formal demand.

Do I need experts or consultants? Often needed to meet burdens of proof and persuasion at trial and in motions, expert witnesses can also help attorneys save time. An expert brings experience, knowledge, and training to the case that the attorney may not have; thus, an attorney can receive a crash course in that expert’s field or at least learn where to
start an education in that field. If resources allow, it is prudent to have an expert involved earlier rather than later. The expert can help shape case strategy, provide declarations in support of motions, identify issues to address in discovery, perform inspections and testing, and offer opinions on the strength of the case. Experts thus can help attorneys shape a case for trial or even decide whether the case should go to trial.

An important difference exists between a consultant and an expert. Under Code of Civil Procedure Section 2018, any writings that reflect litigation strategy and are based on your thoughts, investigation, research, impressions, or opinions are considered attorney work product, even if the product is based on information gathered by clerks, investigators, or clients. A question also exists if oral evidence reflecting an attorney’s investigation also falls under this doctrine. Therefore, use of a consultant during litigation may fall under the absolute or conditional work product doctrine.

Unlike a consultant, an expert witness must be disclosed to opposing parties under Code of Civil Procedure Section 2034. The other side must have fair warning of the expert’s anticipated testimony to make an informed decision whether to depose that expert. Sandbagging is not recommended; the court may simply preclude the expert from offering testimony on any undisclosed subject matters. More important, opposing parties may demand to review the expert’s entire file, including notes of conversations with and correspondence from the attorney. Keep this in mind if you plan to turn a consultant into an expert or plan to discuss case strategy with an expert.

Even if you do not plan to use an expert during discovery and law and motion, you should still plan for retention fairly far ahead of trial. Under Section 2034, parties may demand disclosure of experts 70 days before the first trial date. If this demand is made, parties must disclose experts 50 days before trial. By this date, therefore, you will need to identify which areas of the case need an expert, provide the expert with the information that will allow him or her to render an opinion, and know what opinion the expert intends to offer at trial. Fifty days before trial often seems far removed from the present, but remember that the expert may need depositions, inspections, and other discovery to formulate opinions.

Should I consider dispositive or other motions? Plaintiff clients may want to amend the complaint to allege new causes of action, and defendant clients may seek to dispose of some or all of the case through a motion for summary judgment or adjudication. The par-
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ties may wish to move to trial. Although it seems elementary, keep in mind that motions require time to prepare and time for hearing. And the sooner that certain motions (like a motion to amend) are filed, the more inclined the court may be to grant them and avoid prejudice to other parties. A motion filed now can save time later.

And what else is there? If all these issues are somewhat in order, it frees the attorney to deal with the details of preparation for trial. The attorney should start thinking about motions in limine (keeping in mind the requirement that the parties meet and confer before filing), serving trial subpoenas, setting last-minute depositions, bringing final discovery motions, and preparing clients and experts for the road ahead.

If you truly find yourself on the road to trial, find out everything you can about your judge. Does the court have any preferences about how attorneys prepare exhibits? Does the courtroom allow attorneys to utilize technology? Do you need to have your demonstrative evidence scanned into a computer, should you make transparencies, and should you rent or borrow such items as an ELMO? How does the court conduct voir dire? Does the court put time limits on argument or questioning? What is the judge’s reputation regarding evidentiary rulings, motions for nonsuit, and leeway during questioning? Will the court actually start the trial on time? Will the court force a series of settlement conferences when you appear?

If you are not able to answer these and similar questions before beginning trial, you may wish, if possible, to take a field trip to observe trials in that courtroom before yours begins. A little research on the judge and room is time well spent. Finally, keep in mind that if the court is engaged on the day your trial begins, you may be asked to wait while the court finds a judge and courtroom with availability and then sends your case there.

This type of reassignment is not common, but it does happen, so be forewarned. Should this occur, it is invaluable to have a network of experienced attorneys to whom you can turn for advice and information on the new judge as you travel from your original judge to your new one.

This checklist is by no means complete but may highlight many of the issues that inevitably arise during litigation. Keeping these basics in mind, you may find it easier to settle, catch opposing counsel off guard with a well-prepared motion, take more complete depositions, or lessen the labor involved in preparing for trial. Keeping focused on the basics can increase your chances of achieving a good result for your client through diligent pretrial preparation.
F or the last several years, California courts have grappled with the question of whether a client who is guilty in a criminal matter should be able to recover damages for negligence against an attorney who failed to obtain an acquittal or failed to negotiate the best possible plea. While restrictions on legal malpractice actions arising out of criminal prosecutions have been in place for some time, the California Supreme Court has finally provided what seems to be a definite answer to the question—and that answer is a resounding no. Recent court decisions appear to have foreclosed any possibility for guilty clients to maintain legal malpractice actions against their prior attorneys.

Traditionally, to support a claim for legal malpractice, a plaintiff must demonstrate that 1) the defendant attorney owed a duty to use reasonable skill, prudence, and diligence, 2) the attorney breached that duty of care, and 3) the breach of that duty proximately caused an actual loss or damage to the plaintiff. In order to support the required elements of causation and damages, a plaintiff is typically required to prove that, but for the attorney’s negligence, a meritorious case was lost or a recovery was diminished.

Applying this standard in criminal matters, malpractice plaintiffs who have been convicted would only have to prove that, had their attorneys acted diligently, reasonable doubt as to their guilt could have been established or their attorneys could have negotiated more favorable pleas. Recent decisions, however, have modified the traditional elements of a malpractice case as applied to criminal actions and have made it virtually impossible for guilty plaintiffs to prevail against their prior attorneys.

In 1998, the California Supreme Court determined in Wiley v. County of San Diego that, in order to sustain a legal malpractice action arising out of a prior criminal prosecution, plaintiffs must plead and prove that they were actually innocent of the underlying charges. The court reasoned that plaintiffs who have in fact engaged in the criminal conduct for which they were accused should bear the full consequences of their acts and that any negligent conduct by their attorneys is superceded by their

Slamming the Door on Malpractice Claims in Criminal Matters

Jonathan B. Cole, David B. Owen, and Michael R. Newhouse are attorneys at the Sherman Oaks firm of Nemecek & Cole, which specializes in professional liability claims defense.
criminal conduct. Therefore, in the absence of proof of actual innocence, it would be against public policy for a legal malpractice suit arising out of a criminal prosecution to proceed. The court reasoned that allowing a guilty convict to recover damages would impermissibly shift responsibility and the punishment for a crime away from the convict to the attorney and thereby diminish the consequences of that conduct.11

With this holding, Wiley created an initial pleading hurdle that requires plaintiffs to affirmatively argue that they were innocent of the underlying charges that had been alleged against them.12 Because California employs a “notice pleading” requirement for civil actions, plaintiffs are not required to plead any facts supporting their assertions of innocence.13 Rather, plaintiffs can easily overcome the pleading hurdle by merely alleging that they were innocent of the underlying charges. Proof of innocence must still be established at trial. However, given that the vast majority of civil cases settle prior to trial, Wiley's actual innocence requirement would have done little to prevent guilty clients from filing suit against their prior attorneys.

Collateral Estoppel

However, in Weiner v. Mitchell, Silverberg & Knupp,14 a case decided prior to Wiley, the court took judicial notice of an underlying criminal conviction and held that the plaintiff was collaterally estopped from asserting innocence in a subsequent legal malpractice action. Relying on a insurance breach-of-contract case, Teitelbaum Furs, Inc. v. Dominion Insurance Co., Ltd.,15 the Weiner court held that the plaintiff could not relitigate any issues that were decided as part of his previous criminal trial.16 The Weiner court concluded that the plaintiff’s own wrongful conduct, rather than his attorney's alleged negligence, was the proximate cause of all damages allegedly sustained by the plaintiff.17 Since proof of actual damage is a necessary element in a legal malpractice action, a finding that the damages were proximately caused by the plaintiff rendered the claim deficient as a matter of law.18

In light of Weiner’s application of collateral estoppel, the pleading hurdle created by Wiley is significantly strengthened because a plaintiff’s claim of innocence can be rebutted by taking judicial notice of the findings made in the underlying prosecution. It is important to note, however, that the plaintiff’s guilt in Weiner was established at trial and following a full presentation of the evidence. Like civil cases, however, the vast majority of criminal cases never go to trial.19 Consequently, neither Weiner nor Wiley addressed whether collateral estoppel applied to a guilty plea, and so that issue remained open.

While a guilty plea is supposed to have the same effect as a conviction,20 in dicta, the Teitelbaum court disagreed and reasoned that a stipulation of guilty reached in a plea agreement should not have the same preclusive effect as a conviction stemming from a trial.21 The Teitelbaum court noted that when a plea is entered, the issues have not been subjected to a full presentation of the evidence and may only reflect a compromise or a belief that a plea is more advantageous than continuing through trial. As such, considerations of fairness and the policy of encouraging plea agreements prohibit the application of collateral estoppel against civil litigants who have pled guilty in a criminal proceeding and then seek to litigate their innocence for the first time in a civil action.22

Contrary to Teitelbaum, however, a majority of other jurisdictions hold that, in the absence of postconviction relief, a guilty plea will collaterally estop a plaintiff from asserting innocence in a later legal malpractice action.23 Recently the California Supreme Court, in Coscia v. McKenna & Cuneo,24 rejected Teitelbaum’s reasoning and adopted the view of the majority of jurisdictions on the application of collateral estoppel to a prior plea agreement.

In Coscia, the plaintiff, after pleading guilty to felony securities fraud, filed suit against his former attorneys, alleging that their negligence led to his pleading to a felony rather than a misdemeanor.25 The trial court, however, took judicial notice of the records from the criminal case and sustained a demurrer to Coscia’s suit on the grounds that, unless he obtained some form of postconviction relief, Coscia was collaterally estopped from relitigating his innocence in the civil malpractice action.26

The court of appeal, however, reversed. Purporting to follow Teitelbaum, the court held that since a conviction stemming from a plea agreement did not derive from a trial on the merits, it was not necessarily an accurate indicator of the plaintiff’s guilt.27 Therefore, it should not have a preclusive effect on a litigant’s efforts to demonstrate actual innocence. In addition to the collateral estoppel issue, the court also reasoned that under the applicable one-year statute of limitations provided by Code of Civil Procedure Section 340.6, most cases would expire prior to any postconviction relief.

The California Supreme Court disagreed with the court of appeal in Coscia and granted review of its decision.28 In reversing the court of appeal, the supreme court recognized all the policy rationales asserted in Wiley and further reasoned that the requirement of exoneration by postconviction relief guards
against the possibility of inconsistent verdicts being reached in the criminal and civil cases, promotes judicial economy, and encourages representation of criminal defendants by reducing the risk of baseless lawsuits. In rejecting the Teitelbaum rule, the court opined that, if only clients who plead guilty can recover for malpractice without obtaining postconviction relief, defense attorneys might be tempted to practice preventive law when faced with the choice of advising a client to plead guilty or to proceed to trial. On this basis the court held that in the absence of some form of postconviction relief, a plaintiff previously convicted of a crime, whether by trial or plea, is collaterally estopped from asserting his or her innocence in a civil action. With this holding the court expressly held that, as a prerequisite to filing a legal malpractice action, previously convicted plaintiffs must first have their convictions reversed or otherwise set aside by obtaining some form of postconviction relief.

The Statute of Limitations

The Coscia court then dealt with the statute of limitations question. The supreme court agreed with the court of appeal and recognized that the one-year statute of limitations for legal malpractice actions would virtually guarantee that most malpractice claims would expire before innocence or guilt could be determined through postconviction relief. As such, the court held that requiring a plaintiff to obtain postconviction relief would inequitably result in barring potentially meritorious claims.

While the court refused to allow a tolling of the statute of limitations, it adopted a two-track approach to ensure fairness to both plaintiffs and defendants in criminal malpractice actions. Under this approach, plaintiffs are required to file malpractice actions within one year of their convictions. Although this action is subject to demurrer or summary judgment while the conviction remains intact, the trial court should stay the malpractice action while the plaintiff is diligently pursuing postconviction remedies in a timely manner.

In light of Wiley’s actual innocence requirement and the prerequisite of obtaining postconviction relief set forth in Coscia, it has now become virtually impossible for a guilty client to prosecute a legal malpractice action successfully. To avoid the application of collateral estoppel from barring a suit, plaintiffs must first secure, in a timely and diligent manner, some form of postconviction relief which reverses the underlying conviction. Then, even after postconviction relief has been obtained, plaintiffs must still plead and
prove that they were actually innocent of the crimes for which they were convicted.

Based on these requirements, clients cannot sue their prior attorneys by merely showing that an acquittal could have been obtained or that some negligence by the attorney resulted in a stiffer sentence than would ordinarily have been imposed. Likewise, guilty plaintiffs who had previously pled guilty cannot base a subsequent malpractice action on the grounds that their attorneys could have negotiated a better deal. Rather, only a truly innocent person who would not have been convicted but for the attorney’s neglect will be able to maintain a claim for legal malpractice. These requirements will not prevent convictions from filing meritless lawsuits against their former attorneys but will make it virtually impossible for the lawsuits to make it beyond the initial pleading stages.

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4 Id. at 535.
5 Id.
6 Id. at 535, 536.
7 Id.
8 Id.
9 Id. at 544.
10 Id. at 537.
11 Id. at 539-544.
12 Id. at 544.
15 Teitelbaum Furs, Inc. v. Dominion Ins. Co., Ltd., 58 Cal. 2d 601 (1962). In Teitelbaum, the president of the plaintiff company had been convicted of charges including attempted grand theft and filing fraudulent insurance claims. The company sued its insurance carrier to recover its losses. After the company admitted that its president was its alter ego, the court refused to allow the company to re-litigate the actual guilt or innocence of the president.
17 Weiner, 114 Cal. App. 3d at 48.
18 Id.
20 See Penal Code §1016.
22 Id.
25 Id.
26 Id.
28 Coscia, 25 Cal. 4th 1194.
29 Id. at 1206.
30 Id. at 1210.
few topics in American law are more controversial than affirmative action. For its supporters, affirmative action is essential to remedying past discrimination and advancing equality. They believe that today, at times, society must be color-conscious if ever there will be a time when it can be color-blind. For opponents, affirmative action equals reverse discrimination. They believe that society should not use race in making decisions either to benefit or to harm racial minorities.

In recent years, substantial restrictions have been imposed on the ability of the government to use race as a factor to benefit minorities. The Supreme Court has held that the equal protection clause of the Constitution requires that the government meet the strict scrutiny standard in order to engage in affirmative action. This means that racial classifications benefiting minorities are allowed only if the government meets the same burden that is required when race is used to disadvantage minorities: The government action must be proven to be necessary to achieve a compelling purpose.

California law, however, goes even further in restricting affirmative action. In 1996, California voters approved Proposition 209—now codified as Article I, Section 31 of the California Constitution. The law prohibits government discrimination or preference based on race or gender in contracts, education, or employment. There is an exception if federal law requires the use of race or gender in decision making; obviously a state law, even in the state constitution, cannot authorize violation of federal mandates.

This makes it difficult for state or local governments to engage in affirmative action. To be upheld, a program has to overcome two hurdles: meeting both the U.S. Constitution and the California Constitution. However, it is incorrect to view either federal or state law as barring all forms of affirmative action in all circumstances. Although there is still uncertainty in the law, some forms of affirmative action remain permissible. Neither federal nor state law prohibits the government from pursuing diversity so long as it uses means that are permissible under both the federal and state constitutions.

What can a state or local government do to advance racial or gender equality without running afoul of either constitution?

Colleges and universities may pursue racial diversity as an objective so long as there are no racial preferences. In Regents of the University of California v. Bakke, five justices on the U.S. Supreme Court said that colleges and universities have a compelling interest in maintaining a diverse student body and that they may use race as one factor in admissions decisions to benefit minorities. Justice Powell, the key fifth justice in the majority, said that “the interest of diversity is compelling in the context of a university’s admissions program.” Ideally, such diversity would occur through race-blind admissions and hiring policies. But if that is not the case (and because of the legacy of discrimination it often will not be), affirmative action can be employed to enhance diversity.

In December 2000, in Smith v. University of Washington, the Ninth Circuit held that Bakke remains the law and that colleges and universities may use race as a factor in admissions decisions to benefit minorities and enhance diversity. Smith involved a challenge to the University of Washington Law School’s affirmative action program. While the case was pending, Washington voters approved Initiative Measure 200, which, like Proposition 209 in California, prohibits the government from using race or gender as a basis for discrimination or preference. The Ninth Circuit ruled that this made the plaintiff’s suit for injunctive and declaratory relief moot but did not eliminate claims for money damages for the prior application of the program.

In the opinion written by Judge Ferdinand Fernandez, the Ninth Circuit ruled that Bakke remains the law, and under it colleges and universities may use race as one consideration among many in admissions decisions to benefit minorities and increase diversity. The court explained that “the attainment of a diverse student body is a constitutionally permissible goal for an institution of higher education. In that regard, ethnic diversity can be one element in a range of factors a university properly may consider in attaining the goal of a heterogeneous student body.”

The Ninth Circuit disagreed with an earlier ruling from the Fifth Circuit, Hopwood v. Texas, which held that Bakke had been implicitly overruled by later cases. The Fifth Circuit ruled that race could not be used as a factor in admissions decisions to benefit minorities. The Ninth Circuit in Smith expressly disagreed with Hopwood and declared: “We, therefore, leave it to the Supreme Court to declare the Bakke rationale regarding university admissions policies has become moribund, if it has. We will not. For now, therefore, it ineluctably follows that the Fourteenth Amendment permits University admissions programs which consider race for other than remedial purposes and educational diversity is a compelling governmental interest that meets the demands of strict scrutiny of race-conscious remedies.” On May 29, 2001, the U.S. Supreme Court denied certiorari in Smith.

Recently, two federal district courts in Michigan have come to opposite conclusions as to whether Bakke remains good law. One decision upheld the University

**Practice Tips**

By Erwin Chemerinsky

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**Broad outreach that includes but is not limited to minorities is acceptable**

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Erwin Chemerinsky is the Sydney M. Irmas professor of public interest law, legal ethics, and political science at the University of Southern California.
well-established doctrines defining what constitutes discrimination or preference, there is no indication in Proposition 209 or its legislative history that it means to deviate from well-established doctrines defining what constitutes discrimination and preferences.

The Supreme Court in interpreting the U.S. Constitution, and the California Supreme Court in interpreting the California Constitution, have identified two alternative ways of proving discrimination or preferences. One is a facial classification by gender or race. If a university admissions committee, for example, uses race or gender as a basis for its decisions, this would be a facial classification. This is prohibited by Proposition 209.

Alternatively, laws that are facially neutral can be found to be discriminatory or to grant preferences in the way they are implemented or administered if there is proof of both a discriminatory purpose and a discriminatory effect. In other words, laws that are facially neutral as to race and gender will be deemed discriminatory or preferenceal only if proof of a discriminatory intent behind the law and a discriminatory effect of the law can be found.

An admissions committee may use criteria that strongly correlate with race or gender so long as the criteria are facially race and gender neutral and so long as the purpose is not to discriminate. The Supreme Court’s decision in Personnel Administrator of Massachusetts v. Feeneyp is instructive. Feeney involved a challenge to a Massachusetts law that gave preference in hiring for state jobs to veterans. At the time of the litigation, over 98 percent of the veterans in the state were male. The result was a substantial discriminatory effect against women in hiring for state jobs. Nonetheless, the Supreme Court held that no gender classification was created by the law because it was facially gender neutral and there was no proof that the state’s purpose in adopting the law was to disadvantage women.

The Court’s explanation is particularly relevant to the ability of colleges and universities to use factors that correlate with race and gender. The Court declared: “Discriminatory purpose,” however, implies more than intent as volition or intent as awareness of consequences. It implies that the decision-maker…selected or reaffirmed a particular course of action at least in part because of, not merely ‘in spite of,’ its adverse effects upon an identifiable group.”

In other words, an admissions committee’s choice to use a criterion is not to be considered to be based on race or gender even if it entirely benefits a particular race or gender and even if the university knew this in deciding to use that factor. Race or gender discrimination or preference exists only if the university chose the factor because of a desire to benefit people of that race or gender.

Indeed, to exclude from consideration those experiences that are predominately based on race or gender would in itself violate Proposition 209. To forbid California universities from using any factor that is disproportionately experienced by a particular racial or gender group would be to discriminate against experiences based on race or gender. Such a choice would be inconsistent with Proposition 209, because allowing a university that is making admissions decisions to consider all aspects of a person’s life except race or gender singles out those factors for exclusionary, discriminatory treatment.

State and Local Governments

State and local governments may pursue diversity in contracting and employment through broad-based outreach. In High-Voltage Wire Works, Inc. v. City of San Jose, the California Supreme Court ruled that Proposition 209 prohibits local governments from engaging in targeted outreach. The case involved San Jose’s policy of requiring contractors bidding on city projects to either show that they made efforts to contact minority-owned businesses or that they have included a sufficient number of minority-owned businesses in their bid.

There is a strong argument that targeted outreach should not be seen as violating Proposition 209, because it does not discriminate or give a preference in the award of contracts. But in High-Voltage Wire Works the California Supreme Court rejected this view. Justice Janice Brown, writing for the court, concluded the “Program [impermissibly] discriminates...against prime contractors that...engage in outreach nor meet the evidentiary presumption, and it grants preferential treatment to those that do.”

However, the court emphasized that it was not disapproving all forms of outreach to enhance diversity and remedy past discrimination. Justice Brown’s majority opinion stated: “Although we find the City’s outreach option unconstitutional under section 31, we acknowledge that outreach may assume many forms, not all of which would be unlawful. Our holding is necessarily limited to the form at issue here....Plainly, the voters intended to preserve outreach efforts to disseminate information about public employment, education, and contracting not predicated on an impermissible classification.”

Specifically, broad-based outreach that includes but is not limited to minorities is permissible. A local government may advertise employment opportunities in newspapers with predominately Latino, Asian, or African American readerships so long as it also places advertisements in other newspapers as well. Nothing in High-Voltage Wire Works or Proposition 209 prohibits state and local governments from seeking to ensure that its jobs and contracts go to a diverse
cross-section of the population; what is forbidden are efforts that reach out only to some.

Indeed, state and local governments must be sure that their hiring and contracting policies do not have a racially discriminatory effect on minorities. If a government agency discovers that few minorities are receiving jobs or contracts, that is a strong indication that discrimination is occurring in some form and that remedial steps are needed. A clearly permissible remedy is broad-based outreach. Also, the agency needs to examine its hiring and contracting process carefully to eliminate any subtle forms of bias.

Recently, the California Court of Appeal ruled that race-based goals for contracting are impermissible. The court found that such goals constitute a racial preference forbidden by equal protection and California’s Proposition 209. However, the court stressed that governmental entities “remain under a duty to eliminate the vestiges of segregation and discrimination. All of the Justices agree that government entities may use race and gender neutral methods of fostering equal opportunity and that, in some instances, even race and gender specific remedies may be employed.” The court expressly said that gathering information based on race and gender in contracting is justified “by…compelling government need.”

State and local governments may use race or gender as a preference if strict scrutiny is met and if it is necessary to meet federal law. In Adarand Constructors, Inc. v. Pena, the Supreme Court said that strict scrutiny is to be used in evaluating equal protection programs, but Justice O’Connor’s majority opinion stressed that this need not always be fatal. Affirmative action programs are permissible if they are proven to be necessary to achieve a compelling government purpose.

For example, in Hunter v. Regents of the University of California, the Ninth Circuit ruled that the laboratory school at the University of California may consider race in its admissions decisions to ensure a diverse student body. The court reasoned that to fulfill its mission as a laboratory school, studying various aspects of education, it must have diversity. The court found that the goal of providing effective education is a compelling interest sufficient to meet the requirements of equal protection.

The U.S. Supreme Court granted review of a case to be heard next term, Adarand Constructors, Inc. v. Slater, as to whether strict scrutiny was met by a federal program that uses race-conscious presumptions designed to favor minority enterprises and other “disadvantaged business enterprises.” On remand from the Supreme Court’s decision in Adarand v. Pena, the Tenth Circuit found
that the race-conscious program was necessary to achieve the compelling goal of remedying discrimination against minority-owned businesses. The Supreme Court will consider whether this is sufficient under the equal protection clause.

To comply with Proposition 209, the government also needs to show that race or gender preferences are necessary to meet the requirements of federal law. For example, under Title VI of the 1964 Civil Rights Act, recipients of federal funds cannot engage in practices that have a racially discriminatory impact. California and virtually all local governments receive federal funds, and they must ensure that their programs do not have a disparate impact against minorities. Federal law requires appropriate remedial steps to be taken if there is such an effect.

Neither the U.S. Constitution nor Proposition 209 limits the ability of private entities to engage in affirmative action programs. The U.S. Constitution, of course, applies only to the government and not to private businesses or other nongovernment entities. Likewise, Proposition 209 applies only to the state of California and local governments in the state. Neither in any way limits the ability of private entities to engage in affirmative action. Thus, private universities may engage in affirmative action to ensure a diverse student body. Similarly, private companies may use race and gender as factors in hiring and contracting decisions to prevent discrimination and ensure fairness.

Over the last decade, significant restrictions have been imposed on the ability of government entities to engage in affirmative action, but none of these limits prevents governments from acting to remedy past discrimination and to ensure diversity—so long as they do so in constitutionally permissible ways. Both the U.S. Constitution and Proposition 209 leave open many ways in which the government may engage in affirmative action to advance racial and gender equality.

3. Id. at 341. Although Powell was writing for himself, without question four other justices agreed with him that colleges and universities have a compelling interest in a diverse student body. Justice Brennan, joined by Justices White, Marshall, and Blackmun, wrote an opinion concurring in the judgment that argued that only intermediate scrutiny need be met by affirmative action programs. These justices were even more willing than Powell to allow affirmative action and thus would also have agreed that his more restrictive standard was met.
5. Id. at 1197.
7. Id. at 1200.
8. Smith, 121 S. Ct. ____.
13. Id. at 270.
14. Id. at 279.
16. Id., 24 Cal. 4th at 562, 101 Cal. Rptr. at 671.
17. Id., 24 Cal. 4th at 565, 101 Cal. Rptr. at 673.
20. Id.
22. Hunter v. Regents of the Univ. of Cal., 190 F. 3d 1061 (9th Cir. 1999).
Two lawyers are representing opposing sides in a litigation matter. The plaintiff’s lawyer calls and asks the defendant’s lawyer to appear for the plaintiff’s lawyer at a hearing—a status conference—in the matter. The plaintiff’s lawyer tells the defendant’s lawyer that she has two other appearances that day in different courts and just cannot appear at the hearing without great difficulty. She tells the defendant’s lawyer that she has tried to obtain a continuance of the hearing or permission to appear telephonically, but the judge has denied these requests.

The defendant’s lawyer is skeptical about the motives of his opposing counsel. The plaintiff’s lawyer tells the defendant’s lawyer that, of course, he should not make any arguments on behalf of the plaintiff; all the defendant’s lawyer needs to do is make a special appearance for the plaintiff’s attorney so that the court will not sanction her. This form of appearance happens all the time, the plaintiff’s lawyer tells her counterpart. She wonders why he is so tentative. Indeed, she has made this type of appearance on numerous occasions. The plaintiff’s attorney further cajoles the defendant’s attorney by saying that all she wants is a small professional courtesy, which she will not forget. What should the defendant’s lawyer do?

If the defendant’s lawyer is inclined to make the appearance, he should notify his malpractice carrier—and so should all lawyers tempted to make a similar decision under similar circumstances. Many lawyers may be surprised by this admonition. After all, judges do not seem to object to these appearances—at least not too often. And most clients do not complain when their lawyers help their counterparts in these instances. Lawyers might argue that members of the bar should perform these harmless little courtesies for each other, especially because these types of appearances have been standard practice in California for a long time. Nevertheless, even though many lawyers have made an appearance for opposing counsel on many occasions in many courts, they should hesitate now.

Adam K. Treiger is a partner with Stowell, Zeilenga & Ruth LLP in Westlake Village, California. His practice emphasizes business and employment litigation and counseling.
The warning also is true for attorneys who would never make any appearance of any kind for their opposing counsel but have made appearances on numerous occasions for their colleagues in the bar, as a favor or for compensation, in cases in which the attorney making the special appearance is not a counsel of record. Attorneys may argue that, in this instance, no conflict of interest exists, because the attorney making the appearance does not represent the opposing party and cannot be held to the same standard as a counsel of record because of one courtesy appearance. But recent case law belies this argument.

According to the California Court of Appeal in Streit v. Covington & Crowe,1 when lawyers specially appear for another attorney in court—even in a seemingly unimportant status conference—they subject themselves to a profound and dangerous conflict of interest if the appearance is for an opposing counsel. Moreover, if the appearance is for nonadverse counsel, lawyers making special appearances undertake all duties that the counsel of record owes to his or her client. Either way, the lawyers making special appearances risk liability for malpractice and breach of fiduciary duty.2

In the underlying case in Streit, Yvonne Streit was a defendant and cross-complainant3 represented by her counsel of record, Weldon Diggs and his associates (referred to by the Streit court as the Diggs defendants). The plaintiffs and cross-defendants in the underlying case brought a summary judgment motion against Streit, but the Diggs defendants, for an undisclosed reason, were unable to attend the hearing on that motion. Therefore, as many attorneys have done in the past (and as some still continue to do), the Diggs defendants asked the law firm of Covington & Crowe to make a special appearance for them at the hearing. The only connection Covington & Crowe had to Streit’s representation “was that, as a professional courtesy to Streit’s attorney of record, the Diggs defendants, Covington & Crowe…‘specially appeared’ for Streit in their stead at [the summary judgment hearing].”4

Although the Streit court was rather terse regarding the facts of the underlying case, Streit presumably did not prevail on the summary judgment motion. As a result, Streit brought a malpractice suit against not only the Diggs defendants but also Covington & Crowe. Streit contended that when Covington & Crowe made its special appearance for the Diggs defendants at the summary judgment hearing, Covington & Crowe formed an attorney-client relationship with Streit, with all of its attendant fiduciary duties, including the duty of care, the duty of loyalty, the duty of competence, the duty of confidentiality, and the duty to represent the client zealously. In the malpractice case, Covington & Crowe brought a summary judgment motion of its own, arguing that, as a matter of law, the firm owed no duty to Streit as a result of its limited special appearance.5

The trial court granted the motion brought by Covington & Crowe, finding as a matter of law that no attorney-client relationship existed between Covington & Crowe and Streit because “Covington & Crowe was not associated as counsel for plaintiff, did not participate in any advice or recommendations to plaintiff, and appeared at the hearing on the motion for summary judgment solely as an accommodation to the Diggs defendants.”6

Streit appealed to the Fourth District Court of Appeal, which reversed the ruling of the trial court. In its opinion, the court of appeal summarized the issue to be decided and stated its resulting decision: “When an attorney makes what is commonly referred to as a ‘special appearance’ for a litigant instead of the litigant’s attorney of record, does that appearance make attorney owe a duty of care to the litigation? Covington & Crowe contends that no attorney-client relationship arises in that situation…The trial court agreed. We do not.”7

**Association of Counsel**

In analyzing the tort of malpractice, the court noted that while an attorney-client relationship is a necessary element of the tort, such a relationship can arise by implication, without any direct dealings between the lawyer and the client.8 The court also noted that when one attorney is associated with another on a particular matter, both attorneys owe a duty of care and a duty of loyalty to the client, notwithstanding whether only one attorney is primarily handling the case.9

In Streit, Covington & Crowe asked the court of appeal “to draw a distinction between an association for an entire case and an association for the purpose of the hearing of a single motion, and hold that there is an attorney-client relationship in the former but not in the latter.”10 In support of its position, Covington & Crowe reasoned that a special appearance is not substantively the same as an association of counsel and, under California agency law, the specially appearing attorney is merely an agent of the counsel of record and not of the client. The court rejected both these arguments.11

First, the court reasoned that only attorneys of record, or those lawyers associated with them, are allowed to be heard on behalf of a litigant in a court: The fact “that the association is limited to a single appearance is a distinction only of degree, not of kind.”12 Moreover, given the rule that “the act of making an appearance on behalf of a party creates a presumption that the attorney is authorized to do so,” it follows that making such an appearance “is strongly presumptive of an attorney-client relationship.”13 Further, the court held that a rule equating a special appearance with a complete association of counsel “is consistent with common sense. By appearing at a hearing in a case in which the attorney has no personal interest, the attorney is obviously representing the interests of someone else, someone who is a party to that action. The client is such a person; the client’s attorney of record is not.”14

The court made short shrift of Covington & Crowe’s argument that agency law protected it from the attorney-client relationship: “[A]lthough an attorney is generally said to be an agent of the client, agency principles are used primarily to indicate the nature and extent of the attorney’s authority. Agency principles are not controlling when determining the existence and scope of an attorney’s duties.”15

In the end, the Streit court held that “by agreeing to ‘specially appear’ in the place of Streit’s attorneys of record, Covington & Crowe undertook a limited association with that firm for the purpose of representing Streit at the hearing on the motion for summary judgment. Covington & Crowe thereby entered into an attorney-client relationship with Streit pursuant to which Covington & Crowe owed Streit a duty of care. The trial court erred by concluding otherwise.”16

Some attorneys may respond to the Streit decision by musing that the Covington & Crowe firm certainly was unlucky. Indeed, they may say that Streit proves the old adage that “no good deed goes long unpunished.” These attorneys may contend that the Streit case ultimately does not have broad implications. They will note that the wrongdoing of Covington & Crowe stemmed from the firm’s agreement to make a courtesy appearance on an all-important and highly adversarial motion for summary judgment. They may argue that if Covington & Crowe had merely made a special appearance at a status conference or a similarly purfatory proceeding, like many members of the bar do every day in California courts, its fate would have been altogether different.

**No Exception for Perfunctory Appearances**

Although Justice Art McKinster, writing for the Streit majority, was silent on this point, Justice James Ward’s concurring opinion offered analysis that goes to the heart of the argument of lawyers who would construe Streit narrowly. Justice Ward’s concurrence
held that special appearances, even on perfunctory matters, subject the appearing attorney to all the attorney-client duties of the counsel of record. Even though Justice Ward agreed with the logic and ruling of the majority opinion, he decided to file a concurring opinion because he believed the court’s holding was “likely to cause substantial concern in the legal community.”17 Therefore, the purpose of Justice Ward’s concurrence was to set forth the assumptions implicit in the majority opinion regarding the practice of law and the function of attorneys who appear in court.18

Justice Ward formulated questions that address the issues at the core of the Streit case: “How do we protect the clients being served by our profession, and how do we assure the public that the attorneys they choose are qualified for the task at hand?”19 In response, Justice Ward wrote that ultimately “we rely on the court system to protect the public after the fact: we allow clients to sue attorneys for negligent performance, but we rely on the court system to protect the public before the fact: we allow clients to choose attorneys who are qualified for the task at hand.”20

Justice Ward was initially sympathetic to this argument. He stated, “With a court system as huge as ours, with branch courts spread across the state and multiple appearances being required in connection with litigation, this is a matter of great concern. I have sympathy for attorneys who work by themselves or out of small firms where they have difficulty in attending numerous court appearances. I am well aware of the practice of sending a friend (or a hired stranger, for that matter) in another town to cover a perfunctory appearance.”21

Still, Justice Ward opined, “[T]hese remedies may prove wholly inadequate, and do not protect clients from harm in the first instance.”22 The only way to protect clients before any harm can befall them is to follow a bright line rule of lawyering: “[W]hen an attorney stands before the court and announces ready for Jones, the world can count on it—that the attorney represents Jones, and that the attorney will be held responsible if he or she commits malpractice or violates rules of professional conduct.”23

A close reading of Justice Ward’s concurring opinion reveals that Covington & Crowe presented an argument that the majority opinion did not address. According to the argument, the logistical demands of modern litigation require the legal system to allow for limited representation, with concomitant limited responsibility, when an attorney merely appears for another attorney as a courtesy or only briefly for a perfunctory matter in a case with which the attorney is unfamiliar.24 Justice Ward was initially sympathetic to this argument. He stated, “With a court system as huge as ours, with branch courts spread across the state and multiple appearances being required in connection with litigation, this is a matter of great concern. I have sympathy for attorneys who work by themselves or out of small firms where they have difficulty in attending numerous court appearances. I am well aware of the practice of sending a friend (or a hired stranger, for that matter) in another town to cover a perfunctory court appearance.”25

Still, Justice Ward, like the Streit majority, found that the rights of clients take precedence over the convenience of attorneys.26 In doing so, Justice Ward noted that perfunctory appearances, such as status conferences, are too numerous in our legal system, and he urged trial courts “to reevaluate the need for some court appearances that are currently required.” He suggested that trial courts use new technology, such as the Internet, to make these appearances more effective with regard to time and cost.27

Notwithstanding this astute suggestion, there does not seem to be any movement afoot to abolish status conferences, either in the courts or the legislature. As a result, the Streit decision places the burden on attorneys to change the requirements regarding court appearances. Unfortunately, attorneys do not have the power to do this, and especially powerless are attorneys in small firms and solo practices who will bear the brunt of the Streit ruling. The courts, as an institution, must make a concerted effort to significantly curtail perfunctory appearances. They should be willing to abolish status conferences altogether or allow telephonic or electronic appearances and short written appearances to accomplish the necessary tasks associated with status conferences and other pretrial hearings. This will minimize the impact on attorneys’ practices of excessive time spent by attorneys traveling to court and potentially lost opportunities to earn fees.

Justice Ward framed another question as a result of Streit. What is a perfunctory appearance?28 In his concurrence, Justice Ward offered a definition. He is fairly certain that “a court appearance which requires no special knowledge of the case and requires only that some person attend, for example, to set a trial date,” is perfunctory.29

Assuming, arguendo, that this definition is adequate, there is still another problem with Covington & Crowe’s argument for an exception for perfunctory appearances. Most important, “we do not know when the ‘no-brainer’ appearance will suddenly transform into the crucial turning point of the case.”30 Justice Ward presented an example of when “the accommodating attorney goes to court to arrange for a continuance of the trial, only to be told by the judge to call his or her first witness.”31 Or perhaps a judge at a status conference takes such an interest in a defense attorney’s argument that his or her client is not the proper party to the action that the court orders the plaintiff’s attorney to show cause why the defendant should not be dismissed immediately from the case.32 In either of these scenarios, the client is not well served by a specially appearing attorney with only limited knowledge of the case.

Justice Ward also took issue with Covington & Crowe’s proposed exception for perfunctory appearances because it “tramples on the court’s right and duty to control the
Along with many litigators, Justice Ward clearly has seen a trial court’s frustration with an attorney making a special appearance who cannot offer any explanation for the delays in a case or for the inability of the parties to reach a settlement, and who cannot enter into any agreements or stipulations with opposing counsel, no matter how reasonable, because he or she does not have authorization from the counsel of record. According to Justice Ward, “If we must choose between a process which encourages inadequate preparation or a process which demands competent performance, there is no real choice—our professional duty demands excellence.”

Justice Ward concluded his concurring opinion by stating that Covington & Crowe’s argument of limited lawyer liability for an appearance on perfunctory matters “is unworkable, unacceptable and unwise,” and “creates more problems than it solves.” If limited liability for a special appearance means a two-tiered approach to what constitutes an attorney-client relationship, the argument still does not provide a standard to determine when the exception for perfunctory appearances will apply. Further, the exception blurs the boundaries of a lawyer’s duty and diminishes the obligation of lawyers to protect the interests of their clients. Moreover, the exception deprives the court of the ability to control its own proceedings.

Professional Courtesy

Whatever attorneys believe about the wisdom, workability, or acceptability of the ubiquitous special appearance, it is certain that its days in California courts are numbered. The next time an attorney is asked by another attorney—friend or foe alike—to appear for the latter at a status conference or at any other courtroom hearing, the former’s response should be clear. The attorney on the receiving end of the request should either answer in the negative or prepare to assume all duties commensurate with the attorney-client relationship, including potential malpractice liability to a client the attorney has never met on a case about which the attorney knows next to nothing.

However, the lesson of the *Streit* case is not that professional courtesy need be disregarded, even if opposing counsel is making the request. For example, a defendant's attorney receiving a request from the plaintiff's attorney in the same matter can find a professional contract attorney (with suitable malpractice insurance and an appropriate understanding of the *Streit* case) to make the appearance. Or the defendant's attorney can participate with his or her opponent in a conference call with the judge or the judge's
clerk to try to arrange for a continuance or telephonic hearing, even if the court first refused this request when it was made unilaterally. The defendant’s attorney can decide that, while not making an appearance for his or her opponent, the defendant’s attorney also will not advocate for sanctions against the plaintiff’s attorney—and will even try to encourage the court toward leniency rather than anger.

Why should attorneys be so considerate to each other, especially in light of the Streit case? The answer is simple. Courtesies between counsel will in no way prejudice their clients and may lead eventually to significant cost savings and even settlement by keeping needless obstreperousness and calumny between counsel to a minimum. ■

3 Streit, 82 Cal. App. 4th at 445.
4 Id.
5 Id. The Diggs defendants also brought a motion for summary judgment, but it was denied based on the existence of disputed issues of material fact. Id. Subsequently, the Diggs defendants settled out of the case and were dismissed. Id. at 444.
6 Id. at 443. 7 Id. at 444. The court then noted that ‘technically, ‘special appearance’ means an appearance for the limited purpose of challenging an assertion of personal jurisdiction over a party.’ Id. at n.2. But the court clarified that this term would be used in the opinion “in its less formal but perhaps more common usage to denote an appearance at a hearing by one attorney at the request and in the place of the attorney of record, whether with or without compensation.” Id.
8 Id. at 444-45.
9 Id. at 445-47.
10 Id. at 445.
11 Id. at 445-46.
12 Id. at 445.
13 Id. at 446.
15 Streit, 82 Cal. App. 4th at 446. The court further rejected Covington & Crowe’s agency-based arguments by holding that, under agency law, an agent is authorized to employ subagents, and subagents and agents owe the same duties to the principal. In Streit, Covington & Crowe was the subagent of the Diggs defendants, and thus, under agency law, Covington & Crowe and the Diggs defendants—Streit’s counsel of record and agent—owed the same duty to Streit. Id. at 446 n.3.
16 Id. at 447.
17 Id. at 447-48 (Ward, J., concurring).
18 Id. at 448. Justice Ward began his concurrence with a recitation of his views concerning the question of “What is a lawyer?” He noted, “Unflattering though it may be, the truth is that lawyers in the American system are officially tangible. Grab a person with a bar card and you can plug that person into any court.”

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often need varying degrees of help to cope with their challenges. So an opportunity to provide help with financial resources should not go to waste. A special needs trust is a frequently used tool to protect the government benefits of disabled people who inherit property, settle claims, or win judgments. When drafting a special needs trust, an attorney can avoid errors by staying informed about how the various government benefit programs apply to a client’s situation and by remembering that standard forms cannot always address the specifics of a disabled person’s life and needs.

In California, the term “special needs trust” generally refers to an irrevocable trust that gives the trustee discretion to supplement, but not supplant, whatever is provided by government programs to the trust’s beneficiary. Counsel’s primary goal in drafting the trust is to enable the disabled beneficiary to benefit from both the trust and the government programs. However, many practitioners rarely attempt to tailor a special needs trust to a specific situation, since they do not understand the nuances of each government program. Even when practitioners attempt to refine a standard form, they often step onto a legal mine field. Too often, special needs trusts are strewn with drafting errors that do not cause trouble until after the drafter is no longer involved and the beneficiary or trustee is left alone to face problems in the administration of the trust.

To avoid drafting errors, counsel should understand the financial criteria for different government programs. Some programs—such as Supplemental Security Income (SSI), In Home Support Services (IHSS), and Medi-Cal—consider certain assets and income of an individual when eligibility is determined. Some, such as certain veterans’ and federally subsidized housing programs, consider only income. Others, such as Social Security Disabled Adult Child (DAC) benefits, consider only earned income.

Eligibility for one program can positively or negatively affect eligibility for another in complex ways. For example, Medi-Cal eligibility is automatic for a recipient of SSI or IHSS, but Medi-Cal may also be separately obtained. When someone obtains any amount of IHSS, the person has an additional advantage of Medi-Cal coverage without a Medi-Cal share of cost. The amount of IHSS may then be reduced, however, if the person uses Medi-Cal to pay for something that supposedly supplants IHSS services, such as an adult day health care center. When someone

**Something Special**

**Just like those who are not disabled, people who have disabilities often need varying degrees of help to cope with their challenges. So an opportunity to provide help with financial resources should not go to waste. A special needs trust is a frequently used tool to protect the government benefits of disabled people who inherit property, settle claims, or win judgments. When drafting a special needs trust, an attorney can avoid errors by staying informed about how the various government benefit programs apply to a client’s situation and by remembering that standard forms cannot always address the specifics of a disabled person’s life and needs.**

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Terry M. Magady is president of the Elder Law Center and a certified elder law attorney.
is eligible for DAC income benefits for two years, the person is eligible for Medicare, but the DAC benefits increase the person’s income and thus may reduce the amount of IHSS or Medi-Cal coverage.11

Counsel should also understand which, if any, government programs affect the quality of a beneficiary’s life. Medi-Cal may be unimportant to adults who live at residential or adult care facilities (which currently are not subsidized by Medi-Cal)12 and who have private insurance or Medicare (which usually provides better reimbursement than Medi-Cal). On the other hand, if an adult requires skilled nursing care at a facility,13 is eligible for a skilled nursing waiver for home care,14 daily attends an adult day health care center to avoid skilled nursing placement,15 or has enormous monthly drug bills,16 Medi-Cal may be critical as one of the few payment sources for these items and services.

Likewise, SSI may be unimportant to an adult who is gainfully employed despite the disability,17 receives DAC income benefits almost equal to the SSI rate, or has a very substantially funded special needs trust. On the other hand, SSI is a lifeline for someone who has no other source of income, has a minimally funded special needs trust, or tries to prevent an eviction by a residential or adult care facility for failure to pay a higher monthly rate than that provided by SSI.18

**Common Drafting Errors**

Lack of knowledge of government-funded programs is not the only factor in the careless use of standard forms to draft special needs trusts. Counsel make four common drafting errors:

1. Inappropriate restrictions on a trustee’s ability to make certain distributions.
2. Lack of attention to California regional center benefits.
4. Failure to adapt standard trust provisions that are unrelated to government benefits to suit the needs of a disabled person.

Special needs trust forms frequently have two restrictions that can have deleterious effects upon a beneficiary’s care and are usually unnecessary to protect government benefits in California. First, some forms provide that the trustee may pay only for “services and items” (a frequently used term that may be understood not to include housing) or that the trustee specifically may not pay for food, clothing, or housing. Second, some forms provide that the trustee cannot do anything that diminishes the beneficiary’s government benefits.19

These restrictions in the standard forms stem from a misunderstanding of the eligibility requirements for Medi-Cal, SSI, and IHSS. Medi-Cal has specific rules regarding trusts and counts an irrevocable trust as a resource if it was established on or after August 11, 1993, for the benefit of the beneficiary with assets of the beneficiary or the beneficiary's spouse, unless it was created by a will.20 Medi-Cal then provides an exception for such an irrevocable trust established with assets of the beneficiary or the beneficiary’s spouse if done so by a court, legal representative, parent, or grandparent for a beneficiary under 65 years old.21 To qualify for this exception, the trust also must provide that, upon the death of the beneficiary or the trust’s termination, the state receive funds remaining in the trust for any Medicaid program expenditures for the beneficiary.22

There is no Medi-Cal requirement prohibiting a trustee from using trust funds for food, clothing, or housing. If a trustee pays in kind for the beneficiary’s food, clothing, housing, or utilities, the Medi-Cal program allots the beneficiary a small maximum amount of monthly income and thus perhaps an increase in the beneficiary’s monthly share of cost.23 Significantly, however, the allotment is made only when any such item is paid in kind in its entirety in the particular month.24 A properly guided beneficiary, therefore, can use a minimal part of the beneficiary’s income toward food, clothing, housing, and utilities and thus avoid even the small increase in the share of cost that results from in-kind trust distributions for these items.

As of January 1, 2000, the SSI and IHSS rules became similar to those of Medi-Cal with the comparable exception for certain trusts established with the assets of the beneficiary or the beneficiary’s spouse for a beneficiary under 65 years old and with a Medicaid payback provision.25 For trusts not established with assets of the beneficiary or the beneficiary’s spouse, SSI rules provide that the trust is not counted as a resource if the beneficiary does not have the legal authority to revoke the trust or direct the use of the trust assets for the beneficiary’s support and maintenance.26 It should be noted that this restriction is on the beneficiary, not the trustee.27 In contrast to Medi-Cal, the SSI and IHSS programs automatically allot a maximum monthly income equal to one-third of the SSI federal benefit rate (or that amount plus $20, depending upon the person’s living arrangements) when any portion (as opposed to the entirety) of a person’s food, clothing, or shelter is paid by another party, including a trust, in a particular month.28

Admittedly, an absolute bar on the trustee’s ability to spend trust funds on food, clothing, or housing or to diminish government benefits offers more reliability that the beneficiary’s government benefits will not be impaired. This prohibition would also cover future events that are unforeseen. For example, the beneficiary may move to a state with more restrictive rules than California’s.29 Even in California, rules may change over time, and a court, administrative hearing officer, or Social Security or county eligibility worker may take a more restrictive approach on benefits.30

The possible benefits, however, of the absolute bar on the trustee’s options are often outweighed by the high personal price of the restriction. For example, assume that the beneficiary is a 30-year-old man with Down Syndrome. He plans to take a step toward independence by moving into an apartment. He has a trust of $300,000 that generates $1,000 per month after expenses—just the amount to provide a rent subsidy that allows him to live in a nice apartment. He already receives DAC income benefits of $600 per month, Medicare as a result of the DAC benefits, SSI of $150, and Medi-Cal as a result of the SSI. While the beneficiary may be eligible for some services at home through IHSS, a California regional center through its supported living services program could supplement whatever services were needed but not provided by IHSS.31 The trust restrictions could serve to help protect SSI, but even if SSI were lost, the worst that would happen would be that the beneficiary would have $150 less each month and simply could apply to Medi-Cal separately.

On the other hand, what the beneficiary needs is a rent subsidy, particularly since a California regional center’s supported living services program could pay for custodial and other care necessary for him to live independently but would not pay rent. However, if the trust prohibits either paying for housing or diminishing public benefits, the beneficiary cannot achieve his goal of living independently. The trustee’s alternative may be to purchase a home, but a significant amount of the trust funds would then need to be placed in a single investment. Moreover, a lease instead of a purchase may provide needed flexibility if a change of residence is foreseeable. Additionally, a home purchase (and possible later sale) would involve significant transaction costs. Thus, the restriction in the trust that protects the $150 per month in SSI costs the beneficiary an important and otherwise achievable personal goal.

**California Regional Centers**

Unfortunately, practitioners who fail to consider a beneficiary’s personal development when drafting special needs trusts often neglect to consider California regional centers as well. These centers offer significant resources for adults in California who are...
developmentally disabled, and practitioners drafting trusts can help beneficiaries take advantage of these resources without creating a financial liability for the trust. Financed with state funds, California regional centers are nonprofit corporations that provide public benefits to any adult in California who is developmentally disabled. Regional centers can pay for services related to long-term care at home or at a residential care facility that are impossible for adults to receive from any other government source in California.

Generally, regional centers do not base services on the financial resources of the disabled person or a trust for the person’s benefit, but the nature of this entitlement may evolve as the state budget tightens. While no case law exists on the subject, some regional centers at administrative hearings have successfully taken the position that the resources of a trust for the person are “possible sources of funding for consumers” which must be sought prior to regional center payment. California Welfare and Institutions Code Section 4659 provides that such “possible sources of funding” may include “entities or programs required to provide or pay the cost of...services...[and] [p]rivate entities, to the maximum extent they are liable for the cost of services, aid, insurances, or medical assistance to the consumer.”

To help a special needs trust fend off an attack by regional centers, practitioners should use specific language that follows the applicable Welfare and Institutions Code sections giving regional centers a mandate to seek other possible sources for their services.

Regional centers also may try to avoid financial responsibility for the trust beneficiary by disputing whether the beneficiary truly is developmentally disabled. The disabling condition must have originated prior to age 18, and, except for certain specifically named disabilities, must be closely related to mental retardation or require treatment similar to that required for individuals with mental retardation. The condition must not be one that is solely physical in nature, solely a psychiatric disorder, or solely a learning disability.

If, at a minimum, practitioners are aware of these issues, they can avoid undercutting the trustee’s regional center eligibility—for example, by mentioning in a court petition or trust recitals that the beneficiary’s condition started after age 18, is chiefly physical or psychiatric, or results in minimal cognitive impairment. On a more proactive basis, practitioners can try to use recitals, allegations in court petitions relating to the trust, and findings in court orders to support a position that the beneficiary is developmentally disabled as defined under the Welfare and Institutions Code. As a first step when an eligibility fight may be in the offing, counsel may consider providing notice to the applicable regional center of the hearing on any petition for the special needs trust with such allegations. This step may be taken even when the disabled person is not yet a regional center consumer.

Payback Provisions

In addition to ignoring regional center eligibility criteria, practitioners drafting special needs trusts often make one of two mistakes with state payback provisions. One mistake is to include a payback provision when it is not required, thus providing the state with reimbursement rights it would not otherwise have. The second is to include, in a required payback provision, language from Probate Code statutes that can cause Medi-Cal ineligibility.

For example, it is an error to include a payback provision as part of a parent’s trust or will for the benefit of a disabled child or as part of one spouse’s will for the benefit of the other, disabled spouse. The payback provision is only required for trusts established with the property of the beneficiary or the beneficiary’s spouse, unless established by will. When a trust is established by a parent with the parent’s own property in a traditional estate plan or is established with one spouse’s property in a testamentary trust, no payback provision is required.

Another drafting error is found in an estate plan that requires a court order. Typically, special needs trusts are established in a court proceeding in connection with a litigation settlement or award for someone under 65 years old who would otherwise require a conservatorship. Special needs trusts are also established in a court proceeding when that person would otherwise receive insurance proceeds or a probate distribution free of trust. In the former and probably the latter case, a payback provision would be required.

Other special needs trusts established in court, however, should not require a payback provision. A cognitively disabled person with assets (for example, someone with dementia) may not yet have provided a special needs trust for an heir in his or her estate plan. In a conservatorship or comparable proceeding for the person with dementia, a court can create a will or trust or amend a revocable
trust to include a special needs trust for the heir.42 In connection with such a proceeding, a court will often require notice to the Department of Health Service, Department of Mental Health, and Department of Developmental Services, and at least one of the departments will take the position that a payback provision is required.43 Unfortunately, uninform counsel often include, without opposition, whatever provisions a department may request.

An irrevocable trust may be modified in a court proceeding to change it into a special needs trust.44 If the property of the trust was not that of the beneficiary, then a payback provision may again be avoided. However, the determination may not be so easy, since certain property rights of the beneficiary under Medi-Cal, SSI, or IHSS rules may have been created once the as yet-unmodified trust was established.

The second type of payback provision error occurs when counsel incorrectly conclude that applicable California Probate Code sections should not affect eligibility for government benefits. Attempts to refine special needs trusts by incorporating these sections into the payback provisions in special needs trusts may render a beneficiary ineligible for Medi-Cal.

Pursuant to the Probate Code, state and local agencies must make claims to a special needs trust within a certain period and, if trust property is insufficient to pay all such claims, the trustee must petition the court for instructions, and the claims will be paid from trust property as the court deems just.45 Medi-Cal rules, on the other hand, provide a trust cannot require the state to submit a claim in order to obtain reimbursement and that states should be paid back for expenditures for Medicaid programs prior to any other claims.46 The Medi-Cal rules even provide that any trust including the requirements described in the Probate Code is counted as a resource of the beneficiary even if it otherwise would have come under the exception for certain trusts established for disabled beneficiaries under age 65.47

Boilerplate Provisions

Even if a special needs trust correctly addresses the myriad issues concerning Medi-Cal and other government benefits, boilerplate trust provisions that are unrelated to government benefits may contain pitfalls. Otherwise standard provisions may create complications as a result of a beneficiary’s disability. The selection or removal of a trustee is one example.

If the disabled beneficiary is young and one or more initially selected trustees are indeed trusted, the practitioner may want to provide in the trust for the ability of the trustee to select a successor. Unlike a typical trust for a child, a parent’s special needs trust for a young beneficiary may function for more than 50 years, long after many individually named trustees are either deceased or too old to serve and many institutional trustees cease to exist. At the time the trust is drafted, siblings, who are often selected as trustees, may not be born or may be too young for a parent to determine how capable they will be. A trust provision for a trustee to select a successor gives the parent an opportunity to make the decision out of the hands of the court and to make the decision one that is less subject to conflict.

If the beneficiary is only physically disabled, has good judgment, and is comfortable with only the initially selected trustee and no others at the time the trust is established, the practitioner may include a provision in the trust that permits a majority of the beneficiaries to select a successor trustee. The trust should then carefully define the term “beneficiary” as appropriate, because “beneficiary” may include contingent beneficiaries.48 A method of providing the beneficiary some control in this regard may be for the trust to give the disabled beneficiary a special power of appointment to select the contingent beneficiaries. Too much control by the beneficiary, however, may also make the trust vulnerable to challenge by a government agency on the grounds that the beneficiary actually can control not only the selection of the trustee but also the expenditure of the trust assets.

When a beneficiary has good judgment or family members are in a position to monitor the trust’s activities, counsel may provide a more liberal standard for the removal of a trustee. Removal typically is based upon egregious conduct, but the instrument may also permit removal if the beneficiary or family members determine that removal of a trustee is in the best interests of the beneficiary.49 To guarantee a safe harbor against disinheritance, the trust may also provide that a petition on such removal is not a contest.50 On the other hand, if the beneficiary is intelligent but because of a mental disability acts in a way that is detrimental to himself or herself, these trustee provisions may be inappropriate. A clause permitting a beneficiary to select a successor trustee may afford the beneficiary too much control. Beneficiaries who cannot be relied upon to act in their own best interest may also be subject to undue influence in connection with the exercise of power of appointment over the contingent beneficiaries.

The drafting of special needs trusts is much more complicated than many lawyers may believe, and standardized forms are not always an appropriate means of addressing the needs of the disabled. Counsel cannot properly do their job simply by inserting new names in a form without considering the lives of the people named. Each special needs trust should be treated as something special.

1 The Probate Code uses the term “special needs trust” but does not define it. See Prob. Code §3604, 3605. The seminal Medi-Cal guide on trusts, Medi-Cal Eligibility Procedures Manual Letter No. 179 (May 15, 1997), provides a sample of a special needs trust but again no definition. A special needs trust should be distinguished from a so-called Medicare set-aside trust used for the narrow purpose of preserving Medicare benefits in workers’ compensation settlements. See Centers for Medicare & Medicaid Services Letter to All Associate Regional Administrators (July 23, 2001).

2 SSI provides income assistance and is one of the few potential government subsidies in California for care at a licensed residential care facility or adult care facility, as opposed to a skilled or intermediate nursing facility. See 42 U.S.C. §§1381 et seq.

3 IHSS can pay vendors for personal care services at home. See Welf. & Inst. Code §§12300 et seq.

4 Medi-Cal, California’s state Medicaid program, can pay for medical treatment, hospital stays, drugs, adult day health care centers, and skilled nursing care typically at a facility but sometimes at home under a waiver program. See Welf. & Inst. Code §§14000 et seq.

5 California veterans’ programs can pay for a variety of benefits, including medical, skilled nursing, and domiciliary care. There are no financial requirements for eligibility for certain veterans’ benefits. See 38 U.S.C. §§1101 et seq.

6 Federal housing programs can subsidize rent at residential units owned privately or by a nonprofit or government agency. See 42 U.S.C. §§1437 et seq.

7 An adult whose disability began prior to age 22 can receive DAC income benefits based upon the work record of a parent of the disabled adult when the parent is disabled, retired, or deceased. See 20 C.F.R. §404.350.


9 Welf. & Inst. Code §12305. A share of cost is the monthly amount an individual must contribute toward medical bills each month, prior to Medi-Cal coverage, in the event the individual receives in excess of a specified level of income each month depending upon family size and living circumstances. Welf. & Inst. Code §§14005.12(c)-(d); Cal. Code Regs. tit. 22, §§50651-50660.

10 For the IHSS mandate to consider alternative resources for supportive services that may be available from other agencies and programs, see California Department of Social Services IHSS Manual Regs. §§30-763.31.


12 In many other states, Medicaid programs do subsidize care at facilities that are comparable to residential and adult care facilities in California. Legislation is regularly introduced in California (but so far has not been enacted) that would enable Medi-Cal to provide some subsidies for residential and adult care facilities. California recently authorized the development of a model program to evaluate such subsidies. See Welf. & Inst. Code §14132.36.

13 See Welf. & Inst. Code §14132(c). Medi-Cal covers custodial care and skilled nursing care at skilled nursing facilities, whereas Medicare and supplemental “Medigap” insurance together cover only skilled nurs-
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<th><strong>Special Needs Trusts</strong></th>
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<td><strong>Provision Language</strong></td>
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<tr>
<td><strong>Regional Centers</strong></td>
<td>Providing that it is irrevocable, that it is intended to support or maintain, and that the beneficiary may not revoke the trust or control, direct, or compel the use of the trust estate for the benefit of the beneficiary. The provision carries some risk that the trust estate may be considered an available resource or income of the beneficiary. However, in the trustee’s sole and absolute discretion, it is in the best interests of the beneficiary for the trustee to do so in light of the goals of this trust.</td>
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<tr>
<td><strong>Liberal Distribution</strong></td>
<td>This provision tracks language from California Welfare and Institutions Code Section 4659 regarding the mandate of regional centers to seek other possible sources of funding. Further recitals in the court order or trust may elaborate upon why the beneficiary is developmentally disabled as defined in this code section. Cognitive disabilities should be emphasized. References to physical, psychiatric, and learning disabilities should be avoided when possible.</td>
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<tr>
<td><strong>Allowing Payments That May Diminish Public Benefits</strong></td>
<td>This distribution provision is comparable to the one contained in Medi-Cal Eligibility Procedures Manual Letter No. 179 (May 15, 1997). Nonetheless, the language should not be considered a safe harbor. Unlike some other forms for distribution standards, the definition of special needs is not limited only to “services” and “items” and thus provides more flexibility to the trustee. However, the terms “support” and “maintenance” are purposely excluded from the definition of special needs.</td>
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Source: 42 C.F.R. §409.20 et seq.

See, e.g., California Welfare Drafting (CEB 2001) §§23.31-1, 23.31-3, 21.331 et al. 816, 817, 822, 823. This form contains a provision that the trustee can only pay for “services and items” and cannot make a payment that makes the beneficiary “ineligible for public benefits otherwise available to the beneficiary.”

See, e.g., California Welfare Drafting (CEB 2001) §§23.31-1, 23.31-3, 21.331 et al. 816, 817, 822, 823. This form contains a provision that the trustee can only pay for “services and items” and cannot make a payment that makes the beneficiary “ineligible for public benefits otherwise available to the beneficiary.”

This provision gives the trustee the flexibility to act in a way that does not place the preservation of public benefits above all other considerations. The cross-referenced goals of the trust should include enhancing the beneficiary’s quality of life as well as supplementing but not supplanting public benefits, so that those benefits can be protected. The term “public benefits” should also be defined.

The provision carries some risk that the trust estate may be considered available for eligibility purposes for a government program. However, that risk must be weighed against the risk that, without such a provision, the trustee could not pay for needs that are critical to the beneficiary’s quality of life.

The trust still should provide that it is irrevocable, that it is intended to supplement but not supplant public benefits, that no part of the trust estate should be considered an available resource or income of any kind to the beneficiary, and that the beneficiary may not revoke the trust or control, direct, or compel the use of the trust estate for the beneficiary’s support or maintenance or any other purpose.

27 Id.

28 For SSI, see 20 C.F.R. §§416.1131, 1140. Shelter includes room, rent, mortgage, payments, real property taxes, heating, fuel, gas, electricity, water, sewage, and garbage collection services. 20 C.F.R. §§416.1130(b).

29 Some states have much more restrictive rules than those of California. See, e.g., OHIO REV. CODE §1339.51(D)(4). On the other hand, other states have relatively liberal safe harbors permitting a trustee to make distributions that diminish public benefits under certain conditions. See, e.g., N.Y. ESTATES, POWERS & TRUSTS §7.1.12(e)(2)(i).

30 California cases have held that the state may have the right to be reimbursed from a “support trust” for the costs of institutionalizing a beneficiary due to mental illness. Estate of Johnson, 198 Cal. App. 2d 503 (1961); Estate of Hinckley, 195 Cal. App. 2d 164 (1961); Estate of Lackmann, 156 Cal. App. 2d 674 (1958). Other courts have found that a trust providing the trustee with discretion to provide certain items, including “maintenance” and “support,” was an available resource for Medicaid eligibility purposes. See, e.g., Metz v. Ohio Dept. of Human Servs., Ohio Ct. App. 8th Cir., No. OT-00-048 (Aug. 17, 2001).

31 CAL. CODE REGS. tit. 17, §§58600 et seq.

32 WELF. & INST. CODE §§4501 et seq.

33 See id. State regulations placed a cap on the cost of independent living services and supports that can be provided to a regional center consumer. Cal. Code Regs. tit. 17, §58617. However, administrative law judges have found these regulations to be void because of their conflict with the enabling statute for the regional centers’ provision for home services. WELF. & INST. CODE §4689.

34 WELF. & INST. CODE §4512(a).

35 See, e.g., OAH Case No. N-9511166 (July 24, 1996).

36 WELF. & INST. CODE §4659. See, e.g., OAH Case No. N-9511166 (July 24, 1996).

37 Id.; see also Prob. Code §§2580 et seq.

38 See notes 21, 22, 23, and 26, supra.

39 PROB. CODE §§3600 et seq.

40 Id.; see also Prob. Code §§2580 et seq.

41 See, e.g., OAH Case No. N-9511166 (July 24, 1996).

42 Id.; see also Prob. Code §§2580 et seq.

43 At least the notice provisions of Probate Code §§3600 et seq. arguably could be interpreted very broadly to apply to all court orders resulting in payment for the benefit of a minor or incompetent person, not only those orders made under Probate Code §§3600 et seq. See reference to “judgment” in Probate Code §3800, references to “judgment” and “order” in Probate Code §3810, and broad definition of “judgment” in Code of Civil Procedure §577.

44 PROB. CODE §§15403, 15404.

45 PROB. CODE §3605(e).


47 Id. See Prob. Code §24(c).


49 See Prob. Code §21306.
One significant factor in many of the recently brought securities fraud cases stemming from the dot-com crash is the well-publicized fact that securities lawyers were often paid with an equity stake in their start-up clients. The news stories of the last few years were tantalizing with their details of partners in law firms forming investment pools with client equities and even compensating associates with a share in those in-house investment funds. This was one of the many hallmarks of the new economy, in which lawyers threw off the shackles of traditional practices in an effort to look and act more like their younger start-up clients. Instead of billing the old-fashioned way, they hitched their success (or failure) to the prospects of their new economy clients.

Those lawyers will certainly look like their former dot-com clients in at least one respect, if the plaintiffs’ bar has its way: diminished assets. Whether and to what extent any claims against dot-com lawyers will survive will be a product of other lawyers’ creative and successful spinning of facts and their ability to fashion new economy claims within the previously established old economy liability framework.

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John W. Cotton is a partner in the law firm Cotton & Gundzik LLP in Los Angeles.
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guidelines of the courts and Congress. The chief focus will be on the role of lawyers in helping new economy clients gain (and keep) access to public equity markets and whether that role was sufficiently flawed to support claims for either statutory or common law liability. The possibility that such claims will survive motions to dismiss or for summary judgment may be greater than generally believed, in part because of lawyers' equity stakes in their clients.

A commonly held but flawed belief is that a lawyer is only a scrivener for the client and not the auditor or guarantor of the correctness of the client’s representations. In reality a lawyer is an integral and irreplaceable gatekeeper to the public fund marketplace when he or she assists in securities offerings and required public filings. Were it otherwise, lawyers would be hard pressed to justify the significant time and cost involved in providing legal services for clients going public. Lawyers are not merely taking dictation from their clients. Considering the complexity and multiplicity of federal and state regulations, and the severe penalties meted out to the public company that fails to follow the maze of regulatory requirements correctly, lawyers have been recognized by many courts as being much more than just scriveners. The more difficult question faced by the courts, however, is when and under what circumstances to hold lawyers responsible for misstatements or material omissions in documents that they draft with their publicly held clients.

Section 10(b) of the Securities and Exchange Act of 1934 provides the basis for most of the federal securities fraud lawsuits filed when publicly traded securities are involved.2 Public market participants who intentionally or recklessly misstate material facts in connection with the raising of equity capital are held liable under Section 10(b) when others have relied on those misstatements in making investment decisions to their economic detriment. When the misstatements are directly attributable to the issuer, or its employees and agents, the claims are said to be “primary” liability claims.

Section 10(b) claims have been made against accountants, underwriters, and lawyers when they assisted their clients in gaining access to the public marketplace. In the past, these claims were brought only infrequently as Section 10(b) primary violations. More often the claims were brought as claims for aiding and abetting and were usually referred to as “secondary” liability claims because the accountants, underwriters, and lawyers were said to be helping primary violators achieve their unlawful ends. The elements of proof for a claim for aiding and abetting are somewhat less stringent than those for a claim of primary liability, particularly with regard to the necessary element of intent.

The ease with which claims could be brought against nonissuer professionals such as accountants, underwriters, and lawyers for aiding and abetting came to an end in 1994, when the U.S. Supreme Court decided Central Bank of Denver v. First Interstate Bank of Denver.3 In Central Bank of Denver, the court held that the text of Section 10(b), as well as the intent of Congress at the time of passage of the antifraud rule, did not support charges for aiding and abetting.4 The plaintiff in the case, a commercial bank, was seeking to make the charge for aiding and abetting under Section 10(b) against another commercial bank, the Central Bank of Denver, which acted as indenture trustee in a public improvement bond financing. Though widely criticized by securities law experts for its very rigid analysis, Central Bank of Denver did not involve accountants or lawyers, and, more important, did not involve any alleged misstatements by the issuer authority in the bond offering documents prepared by the accountants and lawyers. It involved an alleged failure by the defendant trustee, the Central Bank of Denver, to supervise required indenture real estate valuations that ran with the bonds.

The U.S. Supreme Court in Central Bank of Denver determined that Section 10(b) had no implied private right of action for securities violations caused by alleged aiders and abettors. Holding that its job was to look to the clear meaning of the statutory text of Section 10(b) first, and congressional intent in passing Section 10(b) second, the Court found no support for the charge. According to the Court, the language “directly or indirectly” used in the text of Section 10(b) was too broad and imprecise to support the inference of liability for aiding and abetting, because it reached far beyond those who merely give some degree of aid to violators.5 Further, the Court felt that since Congress did not impose liability on aiders and abettors in those sections of the Securities and Exchange Act of 1934 in which it did grant express private causes of action, the Court inferred that Congress did not intend such a cause of action in Section 10(b).6

Central Bank of Denver was immediately hailed by the defense bar as a silver bullet to stop claims against securities professionals such as lawyers and accountants. In actually, the Central Bank of Denver Court recognized specifically that primary violation claims could be brought against securities professionals under Section 10(b), even though its main holding had undermined vicarious or secondary liability claims such as aiding and abetting.7 Central Bank of Denver has forced investors and their lawyers to dig a bit deeper in their pleading bag and bring their claims under the somewhat more onerous five-element framework for primary liability under Section 10(b), instead of the easier-to-plead three-element test for aiding and abetting.8 This result is not really novel, because primary violator claims had been brought (albeit sparingly) against lawyers and accountants before the Central Bank of Denver decision and continue to be filed in its wake.

Lawyers as Primary Violators

The courts have not universally agreed on whether and to what extent lawyers can be held responsible for misstatements in their clients' offering documents. Prior to the decision in Central Bank of Denver, the courts were split on this issue. One line of cases held that Section 10(b) claims against the issuer's or underwriter's law firm were an improper attempt to impose a "duty to correct" false statements that did not exist under either the federal securities laws or ethical guidelines.9 These courts even refused to permit claims against lawyers to survive when the lawyer was actively involved in the drafting process.10

Another line of cases, arising chiefly from decisions in the Sixth Circuit, expressed the judicial belief that when lawyers become involved in the drafting process—depending on how substantial their involvement is—
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they could become primary participants in a misstatement and share equally in their clients’ liability for a primary violation. In order to justify this result, the courts that have upheld the primary violation claim against lawyers have required two evidentiary prerequisites. Courts have required facts supporting charges that 1) the lawyers themselves made the actual representations at issue in the offering documents, and 2) the lawyers have undertaken some responsibility in the due diligence process to verify the information used by their clients in the offering documents.

In Molecular Technology Corporation v. Valentine, the Sixth Circuit held that an attorney drafted a client’s documents, the attorney assumed an affirmative duty to adequately disclose accurate and reliable information that, absent his or her drafting, would have been provided by others. This duty also includes within its scope a duty to correct when later discovery reveals material inaccuracies in the original representations. Even before Central Bank of Denver, courts outside of the Sixth Circuit followed the holding in Molecular Technology, including at least one district court in the Ninth Circuit. In that case, Koehler v. Pulvers, the U.S. District Court for the Southern District of California held that an attorney’s failure to conduct a reasonable investigation of the offering documents he drafted, and his later failure to correct the inaccurate statements he made, could constitute a primary violation under Section 10(b).

After Central Bank of Denver, there have been a handful of cases that have addressed the issue of lawyers assuming primary violator status as a result of their role in the offering document process. One from the Central District of California contains perhaps the strongest acceptance of the theory yet. In Employers Insurance of Wausau v. Musick, Peeler & Garrett, the district court, ruling on a claim made under Section 10(b), held that lawyers who draft offering documents for their clients can be primarily liable for misstatements and omissions in those same documents just as the offeror can be held liable.

In support of this ruling, the district court relied in part on a Ninth Circuit decision that accountants could be held as primary violators under Section 10(b) when they played a “significant role” in the drafting of a letter to the Securities and Exchange Commission that contained material misrepresentations. The district court in Employers Insurance of Wausau saw no theoretical distinction between a misrepresentation in a letter to regulators and a misrepresentation contained in an offering document to a prospective investor. The court also apparently saw no practical distinction between the roles played in the offering document process by accountants and lawyers.

In a similar decision after Central Bank of Denver, a district court in the Third Circuit held that lawyers should not be held liable under Section 10(b) unless the misstatements or omissions actually appear in parts of the offering document they authored or coauthored and their participation in the drafting process was “sufficiently significant.” The only conclusion one can reach from the holdings in the Sixth Circuit and district courts in the Third and Ninth Circuits is that when a lawyer’s role in the drafting process is direct and sufficiently significant, and the misstatement he or she authored or coauthored is an important part of the information offered to the public, the lawyer faces liability as a primary violator under Section 10(b).

State of Mind

It is one thing to find a duty to disclose and correct on the part of the securities professional. The duty alone, though, is not enough to establish liability even when a significant role is played in the drafting process. To be held liable as a primary violator, the lawyer, like any alleged Section 10(b) violator, must also have the requisite intent to violate the securities laws. Courts are split on what constitutes the requisite intent now that Congress has passed the Public Securities Law Reform Act. The PSLRA was enacted by Congress in 1995.

The chief aim of the PSLRA is to restrict the race to the courthouse to file securities class action suits by setting standards for the selection of counsel for the lead plaintiff. The law also sets forth specific pleading requirements for securities fraud actions that allege deception by misstatement or omission of material facts. The PSLRA requires the complaint to specify each statement alleged to be misleading and the reason why it is misleading—and if any allegation is based on “information and belief,” all facts that have formed the belief must be set forth. Moreover, the PSLRA also requires that if proof of “state of mind” is required under the Securities and Exchange Act of 1934, the complaint must state with “particularity” the facts giving rise to an inference the defendant acted with the required state of mind. While at first glance this provision seems to be no more than a reiteration of Rule 9(b) of the Federal Rules of Civil Procedure, some courts have taken a different view.

Prior to the 1995 passage of the PSLRA, courts believed that scienter allegations must lead to a strong inference of fraudulent intent. A plaintiff could accomplish this by alleging facts that either 1) showed the defendant had
violations of Section 10(b) in connection with misstatements in offering documents.
  True.
  False.

6. Unlike attorneys, accountants cannot be liable as primary violators under Section 10(b).
  True.
  False.

7. In 1995, the Public Securities Law Reform Act (PSLRA) eliminated the requirement that plaintiffs allege or prove scienter in claims brought under the Securities and Exchange Act of 1934.
  True.
  False.

8. The Ninth Circuit requires that scienter be pled in great detail, with facts that constitute strong circumstantial evidence of deliberately reckless or conscious misconduct.
  True.
  False.

9. Attorneys who have an equity interest in a client and who have been sued for securities fraud will have a difficult time prevailing on a motion to dismiss because:
   A. The attorneys arguably have a divided loyalty between their client's interests and their own interests.
   B. The judgment of the attorneys has been impaired by their financial interest in the client.
   C. The attorneys have an interest greater than the fee they will earn through representing the client.
   D. All of the above.
  True.
  False.

10. Prior to 1998, a California plaintiff alleging that an attorney acted recklessly could state a claim for aiding and abetting under the Corporations Code.
   True.
   False.

11. Which of the following was not one of the goals of Congress when it enacted the Securities Litigation Uniform Standards Act (SLUSA) in 1998?
    A. The creation of national standards for securities fraud.
    B. Making filing and prevailing in class action securities fraud claims more difficult.
    C. Making state law negligence claims the sole remedy for securities law violations.
    D. Extending the PSLRA's heightened pleading requirements.
   True.
   False.

12. SLUSA only affects claims that require allegations of scienter.
   True.
   False.

13. SLUSA is intended to affect which of the following claims?
    A. Fraud in connection with securities not publicly traded.
    B. Fraud in connection with securities that are exempt from registration under federal law.
    C. Common law negligence claims.
    D. Claims like those under Section 10(b) that require scienter.
   True.
   False.

14. California does not have laws regulating the sale of securities, so complaints must allege violations of federal law.
   True.
   False.

15. Claims against attorneys for aiding and abetting that are based on state law likely cannot survive in light of SLUSA and Central Bank of Denver.
   True.
   False.

16. Central Bank of Denver prohibits the SEC from bringing claims against attorneys for aiding and abetting.
   True.
   False.

17. The SEC can obtain injunctive relief enjoining attorneys from practicing before the SEC if there is a finding that an attorney violated federal securities laws.
   True.
   False.

18. An attorney sued for violation of federal securities laws has no basis to assert a claim for coverage under an attorney malpractice insurance policy.
   True.
   False.

19. The Second, Third, Sixth, and Ninth Circuits are in accord on the pleading requirements for scienter following passage of the PSLRA.
   True.
   False.

20. An attorney can avoid all liability for primary or secondary securities laws violations by reading this month's MCLE article in Los Angeles Lawyer and taking the accompanying MCLE test.
   True.
   False.
In cases finding a common law duty of care to third parties, California courts have not been troubled by the argument that lawyers’ professional duties only extended to the client corporation that issued the documents and not to third parties.

The loftier the value of a lawyer’s equity stake at the time of the alleged violation, the greater will be the claim that it impeded clear judgment, or worse, that it caused the lawyer to act recklessly in the face of known disclosure failures. This claim will be made in spite of the fact that the equity became worthless.

Common Law Negligence

Whatever the final decision is regarding the scope of Section 10(b) liability for lawyers, aggrieved third parties—such as franchisees, limited partners, and investors—also may utilize a simple theory of common law negligence for the drafter of a misleading disclosure document. In a negligence action, Central Bank of Denver likely will have no protective effect and may actually drive investors toward state law claims in jurisdictions hospitable to them. California is a state with strong case law supporting the theory of a lawyer’s duty of care to third parties.

In cases finding a common law duty of care to third parties, California courts have not been troubled by the argument that lawyers’ professional duties only extended to the client corporation that issued the documents and not to third parties. The argument has required that scienter be pled “in great detail, [with] facts that constitute strong circumstantial evidence of deliberately reckless or conscious misconduct.” The Second Circuit articulated this standard, which became known as the Second Circuit standard for scienter, in Press v. Chemical Investment Services Corporation. The PSLRA did not change the fact that negligence is not enough to meet the scienter standard for a violation under Section 10(b).

When the PSLRA was passed, many commentators and several circuit courts concluded that it “elevated” the scienter standard. While the circuits are still split on this view, the Ninth Circuit is an adherent to it and has required that scienter be pled “in great detail, [with] facts that constitute strong circumstantial evidence of deliberately reckless or conscious misconduct.” The Second Circuit still adheres to its pre-PSLRA standard, as do the Third and Sixth Circuits.

The net effect is that, at least in the Ninth Circuit, allegations of motive and opportunity to commit fraud, without more, are not enough to survive a motion to dismiss for failure to state a claim.

Whatever else may be said about the role motive should play in pleading a securities fraud claim, and however the Supreme Court ultimately rules on the scienter issue under the PSLRA, evidence of an equity ownership in a client takes the pleader a long way toward defeating a motion to dismiss, even under the heightened standard enunciated by the Ninth Circuit. Ownership in the client not only implicates such factors as divided loyalty and potentially impaired judgment but gives life to a claim that the lawyer had more at stake than just a professional fee. Considering the public attention that was lavished on the lucrative value of the “equity for fee” portfolios of outside counsel, the issue of lawyers taking an equity interest in a client in lieu of standard fees will clearly become a focal point of shareholder litigation in the right case.

The loftier the value of a lawyer’s equity stake at the time of the alleged violation, the greater will be the claim that it impeded clear judgment, or worse, that it caused the lawyer to act recklessly in the face of known disclosure failures. This claim will be made in spite of the fact that the equity became worthless.
In one recent post-SLUSA case in California, a district court granted a remand motion and sent a negligence-based securities claim back to state court. Thus, while SLUSA does provide protection to lawyers, that protection will not extend to claims similar to those made in Employers of Wausau, in which the lawyer’s duty to investors was breached by a failure to meet a standard of care. Ironically, SLUSA will have a perverse effect on securities claims against lawyers, making claims alleging the lawyer acted as a participant (for example, the lawyer was part of the scheme to defraud investors) harder to plead than those alleging the lawyer acted as a lawyer (for example, the lawyer was the scrivener to the defrauders).

California, like many states, has a statutory scheme involving the regulation of securities and those who offer to sell or actually sell them as well as those assisting the offerees or sellers in reaching their audience. Corporations Code Sections 25504.1 to 25504.2 provide for joint and several liability for those who “materially” assist the offeror in activity constituting a violation of the Corporations Code. Most cases alleging securities claims against lawyers filed in California have also alleged some form of aiding and abetting under the state Corporations Code. Prior to SLUSA, courts allowed aiding and abetting claims under the Corporations Code so long as plaintiffs alleged the statutorily required intent to deceive or defraud. Courts held that recklessness was not sufficient to plead properly under Corporations Code Section 25504.1, and claims based on conduct short of intentional were usually dismissed.

The combined effect of Central Bank of Denver and SLUSA is the likely demise of class action claims against lawyers based on state law for aiding and abetting in the national securities marketplace. To the extent SLUSA federalizes all state claims of covered class action securities fraud, Central Bank of Denver assures that claims against lawyers who aid and abet the issuers of covered securities will be dismissed whether they are brought as implied claims under Section 10(b) or as statutory claims under Corporations Code Section 25504.1. Either way, the claims will fail, leaving as viable claims only the aiding and abetting claims under state law against noncovered securities, negligence claims brought under common law as malpractice actions, and primary federal securities fraud claims (such as those alleged in Molecular Technology).

**Claims by Regulators for Aiding and Abetting**

Central Bank of Denver does not completely end the possibility of claims against lawyers for aiding and abetting under Section 10(b). Those claims may be brought as part of a regulatory action by the SEC or the California Department of Corporations. While not armed with the threat of economic disaster in the form of a massive tort damages award, charges by regulators can seriously disrupt, if not destroy, the careers of lawyers who practice before those agencies.

After Central Bank of Denver, it was believed by regulatory law practitioners that lawyers who previously had been charged by the SEC in its enforcement actions with aiding and abetting would now be free from such entanglements. Not so, according to the Ninth Circuit. In the only case to decide the issue, the Ninth Circuit held that Section 104 of the PSLRA provided that aiding and abetting any violation of Title 15 of the USC Sections 78a through 78kk (Section 10(b) is included within those sections) may be brought by the SEC and that injunctive relief and monetary damages may be sought. According to the Ninth Circuit, while Central Bank of Denver found an absence of congressional intent to support a cause of action for aiding and abetting under federal securities laws, the case did not have any application to another part of the federal regulatory scheme governing securities, for which Congress decided to create a cause of action for aiding and abetting, albeit one limited to the SEC.

While no cases have yet been brought by the SEC under Section 104 of the PSLRA, the statute gives the SEC the authority to seek penalties and enjoin lawyers from practicing before it. The latter remedy is of particular concern to those law firms that assisted dot-com companies in the capital markets. A finding of a violation of any provision of the federal securities laws as a result of Section 104’s provision for aiding and abetting can be a separate basis for an order disallowing the law firm from filing registration statements or other required filings on behalf of publicly held clients. While seldom used, this draconian relief effectively can prevent a firm from engaging in a large part of its corporate practice. For an individual corporate lawyer, the penalty essentially prevents him or her from practicing at all in the lucrative public capital markets.

What is clear from the past 20 years of litigation against lawyers in the securities arena is that the taking of equity positions and board seats with clients carries a measure of exposure to severe economic and professional pain in a market gone sour. The old saw that a rising tide lifts all boats has equal application in reverse and is particularly poignant to securities lawyers today. Once the equity markets began to falter, a lot of professionals became exposed to potential liability. In the world of floundering start-up companies, the lawyers for the companies may meet the plaintiffs’ class action bar, or the SEC, in trying circumstances. Thus lawyers, too, may become casualties of the Internet slowdown, particularly when their activities with their clients lead to the inescapable inference that their judgment was clouded by a motive to enrich themselves all too quickly in the once-booming new economy.
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An abundance of information about companies can be found online, often for free

An attorney often needs to investigate a company’s financial records, corporate structure, and the personal and business affairs of its executives. For example, the company may belong to, or be associated with, an opposing party or a potential or existing client. Before agreeing to represent a corporate client, an attorney needs to conduct a conflict check to ascertain whether he or she ever filed suit against one of the company’s other entities. To accomplish this, an attorney needs to research the company’s structure. An attorney would also be wise to investigate the company’s assets to discover whether the corporate client can pay for the legal work required. Only when armed with adequate information about a potential client or opponent may an attorney make the best decision about such issues as representation, potential conflict of interest, and case evaluation.

In the past, many attorneys hired specialists to search a variety of expensive databases and reference books to investigate a company’s background. This was often referred to as gathering competitive intelligence. Often, the specialist would require what seemed like an inordinate amount of lead time to complete the investigation. Now, however, with so much business and financial information available on the Internet, attorneys and other legal professionals can quickly accomplish the lion’s share of this task on their own by using a variety of free resources or reasonably priced databases that are accessible on the Web. To locate company information on the Internet, take the following steps from the obvious to the not-so-obvious:

- Review the company’s Web site.
- Search company directories.
- Review the SEC filings of the company if it is public.
- Review state business records.
- Obtain news about the company and its executives.
- Ascertain whether any federal or state agency regulates the company and review the information that the agency has about the company and industry.
- Locate opinions, briefs, complaints, and settlements concerning the company.
- Think creatively about where to pursue additional information that lies off the beaten path.

Whether investigating a client company or an opposing company, the best place to begin the investigation is at that company’s Web site. Most companies post a plethora of information about themselves. The site may provide information about the company’s background, its corporate structure, and its executives. The site may also provide links to press releases, stock quotes, and SEC filings. Additionally, some information found on company Web sites may be tantamount to a warranty or an admission that attorneys for the opposing side can use at deposition or at trial. On the other hand, if a company with a possible admission on its site is your client, be sure to know what information is on the site in case any of it could raise questions from an opponent that need to be answered.

Company directory sites compile background information about public and private companies and provide links to SEC filings, news articles, stock quotes, research reports, and financials. Hoovers (www.hoovers.com) provides all these categories of information and thousands of company capsules about both public and private companies, but only some of the data is free. For more detailed information, such as analyst reports, users need to subscribe to Hoovers for $99 per year. One can also link to fee-based credit report sites from Hoovers, such as D&B or Experian. For those investigating initial public offerings, Hoovers also sponsors IPO Central (www.hoovers.com/ipo/0,1334,17,00.html).

For information about the more elusive private companies, Corporate Information (at www.corporateinformation.com) contains 20,000 company profiles on its site and a search engine that links to 300,000 public and private company profiles at other sites. While most company directories are searchable only by company name, Thomas Register is searchable also by product name or brand name (www.thomasregister.com). This can assist the searcher who needs to discover the name of the company that manufactures a certain product or brand name. For detailed analysis on over 20,000 American and foreign companies in English, see Wright Investors’ Service at http://profiles.wis.com. Search by company name or ticker symbol or view a list of foreign companies by industry or by country. One of the most useful aspects of this site is a currency converter that converts the financial information expressed in a foreign currency into any other currency.

Public Companies

To find financial information about public companies, review SEC filings. While most people use the official SEC EDGAR (at www.sec.gov/edgar/searchedgar/webusers.htm) site for free access to all public companies’ filings, it has many shortcomings. For example, publication of filings is delayed by one day, and searching is very limited—there is no full-text searching. For a more robust search engine and access to filings in real time, use 10K Wizard, found at www.tenkwizard.com. There, users may search the full text of all filings by key words and phrases or search by ticker symbol, company name, SIC code, industry, or filing form type. An attorney who needs to know specific information about the compensation...
package of a public company executive would be able to pinpoint this information on 10K Wizard by entering the executive’s name and the phrase “executive compensation” into the search menu. Although 10K Wizard recently became subscription-based at $99.95 per year, its search engine is still available for free. If you search too infrequently to warrant a subscription, use 10K Wizard to search and then take the results to the free SEC EDGAR site to view the relevant filings.

If an attorney needs to discover whether a company is incorporated in a specific state, who its registered agent is, or what the company’s address and phone number are, information from 42 states is available free at the Secretaries of State Web site. For a comprehensive list of links to sites for these states (and for information on how to obtain the information from states, such as Delaware, that do not provide free access), users can visit www.residentagentinfo.com.

**News Sources**

Local business journals, general newspapers, and wires are an excellent source of information regarding companies and executives. CEO Express lists business news sources by subject (www.ceoexpress.com) while Northern Light (www.northernlight.com/news.html) provides a free search engine for real-time news from 56 newswires that can be limited to the past two hours, today, or the past two weeks. The *New York Times* and the *Wall Street Journal* are the best places to find news articles about companies. The *New York Times* archive (www.nytimes.com), which goes back to 1996, can be searched for free; a reprint of an article costs $2.50. The *Wall Street Journal* costs $29 per year for those who also have a print subscription and $59 per year for those with an online subscription only (www.wsj.com).

For Los Angeles lawyers, the *Los Angeles Times* has the best site for researching local companies. The *Times* is searchable back to 1985 for free at the Los Angeles Public Library’s Web site (www.lapl.org), but only those with a library card (which can be applied for online) can perform this search. To access the archives of select business journals from around the country, see http://bizjournals.bcentral.com/search.html.

If a company is part of a publicly regulated industry, the federal or state agencies that regulate the industry may have sites that contain reams of information about the industry and its standards. Additionally, the sites may contain company-specific information, including any legal action taken or investigations made. If researching a merger between Media One Cable Company and AT&T, check the Web site for the Federal Communications Commission.
Commission (www.fcc.gov) to find all the merger-related documents. If you are unsure of which agency regulates an industry, search FirstGov (www.firstgov.gov), which indexes every word of 30 million federal government documents and features links to many state and local sites.

**Searching Delaware**

Since so many companies are incorporated in Delaware, many cutting-edge business suits are filed there. At the Delaware Corporate Clearinghouse (which is located at http://corporate-law.widener.edu/case.htm), users can search the full text of documents for selected opinions, briefs, complaints, settlements, motions, and other documents filed in the Delaware Court of Chancery as far back as March 1999.

These investigative tools are not an Internet searcher’s only resources. For instance, by finding out who is linking to whose Web site, one may discover unofficial connections between companies, products, or executives that do not appear in traditional corporate family trees. To discover such links, go to the Advanced Search page of Lycos at www.lycos.com and click on Link Referrals. Enter the target URL to discover what sites link to it. The links search of Google (www.google.com), found on its Advanced Search page, performs the same function.

To keep an eye on a company site, consider tracking changes by establishing a free alert account at either Mind-it (located at http://mindit.netmind.com) or Northern Light (www.northernlight.com). An e-mail alert will be sent to you every time the company changes its Web site.

To investigate a company’s old pages, where deleted but useful material may still be found, visit the Internet Way Back Machine (www.archive.org), an archive of old Web pages. To find information, rumors, or public opinion about a company, product, or executive, try searching Usenet postings using Google Groups (which has archived 700 million postings since 1981) or Board Reader, which searches 732,456 forum and message boards (www.boardreader.com). Additionally, search Daypop, an index of blogs (personal Web logs), at www.daypop.com.

Attorneys can save time by using various sites to conduct company research, but since no site is perfect, information should be verified by at least two sources. Attorneys seeking solid information can ascertain a site’s credibility by reading the “about us” statement that most sites have. If the site has a bias, it will probably manifest in its statement of purpose. Also note a site’s “last updated” statement when the currency of the information is an issue.
Accepting Percentage of Prospective Profits as Attorney Fees for Preparing and Prosecuting Patent Application

SUMMARY: It is not unethical for a lawyer to accept as fees for preparing and prosecuting a patent application an interest in any proceeds such patent may bring. Moreover, the committee does not regard such a fee agreement as requiring compliance with Rule 3-300 of the California Rules of Professional Conduct (avoiding interests adverse to a client). Nevertheless, in entering into such an agreement, a lawyer should be mindful of Rule 4-200 (unconscionable fees for legal services) and, because a lawyer's fees in such an arrangement are also inherently contingent in nature, must comply with California Business and Professions Code Section 6147 (contingency fee contracts).


Facts and Issues

A new client seeks to retain a lawyer to prepare and prosecute an application for a patent. Instead of an hourly or flat fee, however, the client proposes to pay the lawyer a contingent fee measured by a percentage (in this case 5 percent) of the “net profits” from any licensing of the patent. The lawyer’s interest in such profits will not be secured, the issuance of the patent is by no means certain, and the size of any future profits is unknown at the time the new client seeks to retain the lawyer. May the lawyer accept the proposed engagement on the foregoing terms, and, if so, what must he or she do to comply with the California Rules of Professional Conduct and the applicable sections of the California Business and Professions Code?

Discussion

Except as noted below, “the negotiation of a fee agreement is an arm’s-length transaction.” This inquiry involves the negotiation of a form of contingent fee at the outset of the lawyer-client relationship, which is distinguishable from the negotiation of a new fee arrangement after the formation of that relationship, the latter being governed by different rules. No California statute, case, or ethics rule expressly prohibits the fee arrangement proposed above.

1. Compliance with Rule 3-300 (avoiding interests adverse to a client). Rule 3-300 prohibits a lawyer from entering into a fee agreement by which he or she acquires an ownership, possessory, security, or other pecuniary interest adverse to a client, unless several conditions are met. An interest is considered adverse to a client if, under the circumstances, a lawyer has acquired “the ability to summarily extinguish the client’s interest in property” without judicial intervention. The committee believes that the ethical concern hinges on the summary nature of the means by which the lawyer may extinguish the client’s interest in the property. Thus, in an inquiry considering whether civil rights plaintiffs could give their lawyer a priority lien on their recovery in one case to satisfy the unpaid fees they owed that lawyer in another, this committee noted that Rule 3-300 was inapplicable where the client’s right “would not be summarily extinguished without due process of law.”

Although based on facts distinguishable from those in this inquiry, the State Bar Court in In re Silverton recently considered the case of a lawyer who, as part of his initial retainer agreement, contracted with a client to keep for himself any sums resulting from a compromise of claims from the client’s medical providers. The court concluded that the State Bar’s allegations that the lawyer thus obtained a “pecuniary interest adverse” to the client, if proved, could show “the requisite adverse interest” that invokes the requirements of Rule 3-300. Refusing to say, “as a matter of law, that no violation of rule 3-300 occurred,” the court remanded the case for an evidentiary hearing for “a full understanding of what, if anything, was conveyed by that agreement.”
court cautioned that the lawyer’s arrangement with his client would run afoul of Rule 3-300 to the extent that he acquired an exclusive right to a portion of the settlement attributable to the medical expenses and, upon negotiating a compromise of the medical claims, put himself in a position to extinguish his client’s interest in that property.10

The committee construes the fee agreement in the inquiry as giving the lawyer a contractual right to be paid a contingent fee in the future, the amount of which will be determined based on the proceeds that the client’s patent may later generate. This agreement is not one that assigns the lawyer an ownership interest in the patent or its profits, the rights to which the lawyer could enforce against third parties or to the detriment of the client’s ownership interest in the patent. Therefore, the lawyer does not acquire any ability to summarily extinguish the client’s interest in such proceeds but, rather, obtains only a contractual right to be paid a fee measured by a percentage of such proceeds. To enforce that right, the lawyer would have to pursue a claim for fees in a civil action (or arbitration) if the client fails to pay the fee after it becomes due. As was the case in this committee’s Opinion No. 496, the client here remains “free to oppose the existence, the amount and/or the enforceability of the lawyer’s fee” in the independent action.”

While they may not necessarily trigger the application of Rule 3-300, the committee recommends caution when entering into these types of fee arrangements because of a potential divergence of interests. For example, throughout the preparation and prosecution of a patent application, an attorney retains considerable discretion to determine the breadth of the inventor’s claims. In general, an application with narrowly drafted claims should be easier to prosecute successfully, whereas an application with broader claims, while potentially resulting in the grant of correspondingly broader property rights to the inventor, is often riskier and more challenging to prosecute. Because the lawyer and client may have differing opinions as to how broad the claims should be, the committee believes that, since it is the lawyer who can control how the claims are drafted and/or prosecuted, the lawyer’s pursuit of his own interests under a contingent fee agreement may be detrimental to the client’s.11 The committee does not regard the inherent adversity in such an agreement as constituting an adverse pecuniary interest within the meaning of Rule 3-300 or under the supreme court’s ruling in Hawk.12 However, the lawyer must fulfill other duties to the client, including providing competent representation, providing full disclosure, and allowing the client to make informed ultimate decisions in the matter.

2. Prohibition of Rule 4-200 against Unconscionable Fee Agreements. Under Rule 4-200(A), a lawyer may not enter into an “agreement for, charge or collect an illegal or unconscionable fee.” The term “unconscionable” is unique to California law and has been defined, with respect to attorney fees, as “so exorbitant and wholly disproportionate to the services performed as to shock the conscience.”13 Unless the parties contemplate that the fee will be affected by later events, the conscionability of a fee is determined on the basis of facts and circumstances existing at the time the agreement is made, not when it is sought to be enforced.14

3. Written Contingency Fee Agreement and Compliance with Business and Professions Code Section 6147. A contingency fee agreement must be in writing.15 In order to protect clients and to assure fee agreements are fair and understood by clients, the Legislature enacted numerous statutes specifically delineating the required contents of most attorney fee agreements.16 Though it is not necessarily grounds for discipline, failure to comply with the contingency fee agreement statute “renders the agreement voidable at the option of the plaintiff” (although the lawyer is still entitled to collect “a reasonable fee”).17

Under the fee agreement proposed above, because the lawyer will not receive any payment unless both the patent application succeeds and the invention is commercially exploited—two significant elements of contingency—the fee agreement must comply with all of the statutory requirements set forth in Section 6147(a) of the California Business and Professions Code.18

This opinion is advisory only. The committee acts on specific questions submitted ex parte, and its opinion is based on such facts as are set forth in the inquiry submitted.19

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1 All unspecified references to rules are to the California Rules of Professional Conduct unless otherwise indicated.
2 We observe that the calculation of the “net profits” could well prove to be the source of dispute if that term is left undefined (as it was in the inquiry presented to the committee).
4 See Discussion to Rule 3-300; see also Cal. State Bar Form, Op. 1989-116. Rule 3-300 similarly prohibits a lawyer from entering into a “business transaction” with a client unless the same several conditions are met. Yet this prohibition does not apply to an initial fee agreement, because the Discussion to Rule 3-300 makes it expressly inapplicable to “the agreement by which the member is retained by the client,” unless the agreement otherwise confers on the lawyer an ownership, possessory, security, or other pecuniary interest adverse to the client. Cf. Passante v. McWilliam, 53 Cal. App. 4th 1240, 1248 (4th Dist. 1997) (invoking Rule 3-300 where lawyer engaged in business transaction with client during course of representation).
8 Id. at 7.
9 Id. at 7.
10 Id. at 10.
11 Moreover, from the attorney’s standpoint, the combined uncertainty that the patent will be granted and that it will have any commercial value may render the payment of fees highly speculative. Hence, in the event that the patent is issued and ultimately proves marketable, the attorney may wish to be paid as soon as possible, e.g., from licensing fees. At the same time, the client may have a greater interest in further developing the invention and may be less interested than the attorney in seeking to commercially exploit the invention at the earliest opportunity.
12 The committee also considered the potential application of Rule 3-310(B) (avoiding the representation of adverse interests), which provides in relevant part as follows: “A member shall not accept or continue representation of a client without providing written disclosure to the client where…(4) The member has or had a legal, business, financial, or professional interest in the subject matter of the representation.” Rule 3-310(B). The committee concludes that written disclosure to the client that the lawyer “has a business [or] financial…interest” in the proceeds of a client’s patent is unnecessary because the patent lawyer’s financial interest in this case is obvious to the client and differs little from that of the personal injury lawyer whose fee is calculated based on the value of what, if anything, results from the representation.
14 Rule 4-200(B); Brobeck, Phleger & Harrison v. Telex Corp., 602 F. 2d 866, 875 (9th Cir. 1979) (applying California law); Cetenko v. United Cal. Bank, 30 Cal. 3d 528, 532 (1982). “Unconscionability” and “unreasonable-ableness” are different standards. Although the same factors may be considered in analyzing a fee, California lawyers may not be disciplined simply for charging an “unreasonable” fee; to warrant discipline, the fee must be “unconscionable.”
15 BUS. & PROF. CODE §6147(a).
17 BUS. & PROF. CODE §6147(b).
18 Section 6147(a) of the California Business and Professions Code provides, in pertinent part, as follows: The contract shall be in writing and shall include, but is not limited to, all of the following: (1) A statement of the contingency fee rate that the client and attorney have agreed upon. (2) A statement as to how disbursements and costs incurred in connection with the prosecution or settlement of the claim will affect the contingency fee and the client’s recovery. (3) A statement as to when, if any, the client could be required to pay any compensation to the attorney for related matters that arise out of their relationship not covered by their contingency fee contract. This may include any amounts collected for the plaintiff by the attorney. (4) Unless the claim is subject to the provisions of Section 6146, a statement that the fee is not set by law but is negotiable between attorney and client.
19 BUS. & PROF. CODE §6147(a).
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**Judges’ Program for Attorneys**

On Saturday, February 23, the Los Angeles County Bar Association, the judges of the Los Angeles County Superior Court, and the Los Angeles Daily Journal will present the Los Angeles Superior Court judges’ program for attorneys. The program is designed primarily for attorneys who have been recently admitted to the bar. Among the topics to be presented are ADR and law and motion (including summary judgment, writs and receivers, and discovery). In addition, prominent trial lawyers will present parts of a mock trial based upon a hypothetical medical malpractice case. Attendees will learn successful pretrial and trial techniques and common pitfalls to avoid. The event will take place at the LACBA/LEXIS Publishing Conference Center, 281 South Figueroa Street, Downtown. On-site registration and a continental breakfast will begin at 8 A.M., with the program continuing from 8:30 A.M. to 4 P.M. Breakfast, lunch, beverage breaks, and parking at the Figueroa Courtyard parking garage (with validation) are included in the registration price. Registration code number: 7091B23.

- $45—CLE+PLUS members
- $90—at the door
- $85—all others who have preregistered by noon February 22

6 CLE hours

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**Electronic Transactions and Title Insurance**

On Tuesday, February 19, the Title Insurance Subsection of the Real Property Section will present “Cyber Signatures, Electronic Recording, and E-Commerce in the Title Business,” a discussion of the implications of the Uniform Electronic Transactions Act upon real estate transactions. Speaker Steven Ray Garcia will address how, as more and more commerce is conducted without paper, lawyers need to consider the market and technological forces driving electronic commerce, the UETA’s relation to these advances, and why the law is not quite ready to provide for entirely paperless real estate transactions, particularly regarding the title insurance industry. The presentation will take place at the Los Angeles Athletic Club, 431 West Seventh Street, Downtown. On-site registration will begin at 11:45 A.M. and lunch at noon, with the program continuing from 12:30 to 1:30 P.M. Registration code number: 803LB19. CLE+PLUS members free ($27 meal not included). Prices below include meal.

- $60—Real Property Section members
- $70—other LACBA members
- $80—all others, including at-the-door registrants

1 CLE hour

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The Los Angeles County Bar Association is a State Bar of California MCLE approved provider. To register for the programs listed on this page, please call the Member Service Department at (213) 896-6560 or visit the Association Web site at http://forums.lacba.org/calendar.cfm. For a full listing of this month’s Association programs, please consult the February County Bar Update.
A Patriotic Critique of the PATRIOT Act

The antiterrorism legislation that Congress passed in haste is a threat to civil liberties

In his famous dissent in a wiretap case, Justice Louis Brandeis wrote, “Experience should teach us to be most on guard to protect liberty when the Government’s purposes are beneficent. Men born to freedom are naturally alert to repel invasion of their liberty by evil-minded rulers. The greatest dangers to liberty lurk in insidious encroachment by men of zeal, well-meaning but without understanding.”

Brandeis’s words have special significance today. The U.S. Justice Department, under Attorney General John Ashcroft, is using September 11 as cover for the most aggressive expansion of law enforcement authority in years. To show unity in the fight against terrorism, Congress passed the USA PATRIOT Act. PATRIOT is an acronym for the act’s title, “Providing Appropriate Tools Required to Intercept and Obstruct Terrorism.” Afraid to dissent lest they be viewed as not rallying around the flag, legislators passed the PATRIOT Act with little debate. A full and healthy debate surely would have weeded out those parts of the act that needlessly encroach on civil liberties. Despite its title, the act generally will be employed in cases having little to do with terrorism. Thus it should be judged primarily as a crime control measure.

The PATRIOT Act significantly expands the authority of law enforcement to invade privacy without meaningful judicial oversight. For example, Section 216 of the act allows law enforcement officers to access electronic communications simply by certifying to a federal judge that the records of a person’s electronic communications are “relevant to an ongoing criminal investigation.” The judge then must issue an ex parte order giving law enforcement access to the person’s “dialing, routing, addressing, and signaling information.”

Proponents of the act note that this standard is no more lenient than one needed to trap and trace a list of dialed telephone numbers. But Section 216 permits law enforcement to record and review a list of all the Internet sites a person visits. Accessing a list of Internet sites reveals much more than a list of telephone numbers. Internet sites reveal content. Yet this search of a person’s Web interests permitted under Section 216 is not subject to any kind of judicial review. Nor is it limited to terrorism or national security investigations.

The PATRIOT Act also permits the government to delay notifying the subject of a search that a search has taken place. Under this rule, if a court finds “reasonable cause to believe” that immediate notice would adversely affect the investigation, the government may delay notice for a “reasonable period.” The reasonable-cause-to-believe standard will be easy to satisfy—and easy to abuse. “Sneak and peek” warrants may eventually become the rule rather than the exception, since the new provision applies not just to terrorism investigations but to all crimes. For years, the notification requirement has permitted people to seek timely judicial review of unlawful searches. Now, many of these searches simply will be kept secret during the pendency of investigations, which often drag on for years.

The PATRIOT Act’s expansion of control measures for money laundering also goes too far. Money laundering statutes can be effective tools to combat crime. Congress and prosecutors must be careful, however, not to lump unknowing persons who end up with “dirty money” together with those who perpetuate the unlawful activities that generate it. Even as the U.S. Sentencing Commission has begun to recognize that the penalties for money laundering are often disproportionate to the underlying crimes upon which the laundering charges are predicated, the PATRIOT Act greatly expands not only the unlawful activities within the scope of the money laundering statutes but also the statutes’ foreign jurisdictional reach and the related regulatory reporting requirements.

The act puts much of the onus on banks to root out money laundering at the expense of consumer privacy. For example, the act obligates banks to take greater steps to verify the identification of customers before they open accounts. When the government tried to promulgate a similar requirement in 1999, it backed down after receiving thousands of adverse comments from consumers who did not want their financial privacy invaded. In the wake of September 11, however, this rule passed with little fanfare.

While financial institutions already must comply with extensive requirements to report suspicious activities, the act adds more. The act immunizes financial institutions from liability for overreporting while penalizing them for underreporting. Naturally, financial institutions will err on the side of filing reports and will no doubt report many innocent activities. Persons who have done nothing wrong generally will not know that banks and the government have placed their names and information in suspicious activity files—and these files will follow the blameless parties throughout their lifetimes.

The events of September 11 do not justify changing the balance between government intrusion and civil liberties outside the arena of national security and terrorism. If Congress felt the need to act quickly by passing antiterrorism legislation, it should have tailored the PATRIOT Act more narrowly. This would have alleviated its spillover into general criminal law enforcement and helped avoid unnecessary governmental overreaching.

1 Olmstead v. United States, 277 U.S. 438 (1928).

Gary S. Lincenberg is a partner and Benjamin N. Gluck is an associate with Bird, Marella, Boxer & Wolpert. They specialize in white collar criminal and enforcement matters.
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