Los Angeles lawyer Edward A. Klein explains the process of conducting discovery in the United States for foreign proceedings.

*Discovering America*

Los Angeles Lawyer

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Edward A. Klein specializes in entertainment, securities, and other complex litigation as a partner at O’Neill, Lysaght & Sun LLP in Santa Monica. In “Discovering America,” he describes the rules governing the conduct of discovery in the United States arising out of foreign proceedings. His article begins on page 24.

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ROBERT D. COVIELLO
Mr. Coviello has been actively practicing in Orange County for over 22 years. He has personally tried over 50 jury trials and has been lead counsel in several hundred arbitrations and mediations in employment related matters. He is an Arbitrator on the Employment Panel of AAA and the most recent past Chair of the O.C. Bar’s Labor and Employment Law Section.

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The changes in the marketplace are troubling. It is an unknown future.  
Non-renewals are commonplace. Some carriers can’t secure sufficient reinsurance to operate their professional liability programs.  
A major carrier was recently declared insolvent. Other carriers have been downgraded by A.M. Best. Severe underwriting restrictions are now being imposed. Dramatic rate increases are certain.  

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- **Will your carrier** continue to insure “your type” of practice at your next renewal?  
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Field trips should be fun as well as educational. As kids, visiting the the zoo or the museum or the Wonder Bread factory gave us a little bit of exposure to some new part of the world as we began to add to our life experiences. Continuing to have new experiences throughout our lives will most often enrich us.

Several months ago, Ninth Circuit Court of Appeals Judge Alex Kozinski took a field trip. It was not one that carried the promise of fun and now, as a result of taking the trip, Judge Kozinski is certainly not having any. What he learned from his trip may have a valuable impact on his future judging. But taking this trip may also keep him from any future judging, at least of California death penalty appeals.

In fall 2002, Judge Kozinski went to San Quentin prison with two other Ninth Circuit judges and toured death row. After the other two judges left the prison, Judge Kozinski—with the warden’s permission and accompanied by a prison official—met with a former death row inmate with whom the judge had corresponded during the preceding five years. The inmate is serving a life sentence without parole after his death sentence was overturned on appeal—an appeal that did not involve Judge Kozinski—and a second trial. At their meeting the inmate and the judge “talked about life on death row, writing and correspondence during the preceding five years. The inmate is serving a life sentence without parole after his death sentence was overturned on appeal—an appeal that did not involve Judge Kozinski—and a second trial. At their meeting the inmate and the judge “talked about life on death row, writing and the cases of at least three other inmates.” Two of the cases are still pending. After learning of the visit, in early December 2002 the California attorney general’s office wrote to the California Supreme Court requesting that the presiding judge disqualify the judge from any future judging, at least of California death penalty appeals.

In the end, the California Supreme Court decided not to disqualify Judge Kozinski from judging California death penalty cases. But the decision was not an easy one. The court had to weigh the importance of having a judge with personal knowledge of the case against the possibility of a disqualification effort. The court decided that the judge was not disqualified and that the case would proceed as normal.

The decision was not without its critics. Some people felt that the judge should have been disqualified because of his personal knowledge of the case. Others felt that the judge was allowed to continue judging the case because of his personal knowledge of the case. The decision was a difficult one for the court to make. The court had to consider both the importance of having a judge with personal knowledge of the case and the possibility of a disqualification effort. The court decided that the judge was not disqualified and that the case would proceed as normal.
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Choosing a Career in Public Service

The rewards of practicing law in the public sector outweigh the financial disincentives

Before beginning a term as a law clerk, I considered the stand I was taking on a debate waged in student lounges in law schools across the nation. How could I forego inflated first-year associate salaries and bonuses in exchange for a more modest living in the public sector? Worst of all, I was headed for Los Angeles—a destination geographically and metaphysically distant from my Midwestern ivory tower. Could I settle for a Volkswagen in a city where every other car is a Beemer or a Benz?

This debate was already familiar to me. Before joining the California Attorney General’s Office, I had engaged in public service during and immediately following college. I was aware of the financial disincentives. I did not fully appreciate, however, the opportunity for learning that practice in the public sector would give me.

Like most litigators, I live for the courtroom. For many new attorneys, experience before the bench is an ongoing education. Nothing forces attorneys to develop their skills quite like interaction before the bench. As a deputy attorney general, I was shoved up the courthouse steps to handle writ of mandate proceedings, and I even argued before the late Justice Mildred Lillie at the court of appeal.

At that time, I was merely a little over a year out of law school, and my choice was already beginning to reap benefits. I discovered that public service allowed a less-experienced attorney to gain an invaluable lead on peers who entered private practice. Two years and a jury trial later, I have been fortunate to gain insights into the practice of law that others might only accumulate after five or six years.

A public service post benefits more experienced attorneys as well. Many lawyers are able to use skills accrued in private practice to manage their caseload independently. In the public sector, complex hierarchies of overseers are absent, and fewer cases that are tried by committee. Likewise, client contact is unfiltered—a ring of the phone may bring any public sector attorney in contact with the mayor’s office or the chief counsel for the governor.

Practice areas are as equally diverse as they are in the private sector. Opportunities arise based upon shifts in public policy and the needs of the client. At the state level, for example, the energy crisis has resulted in the formation of the attorney general’s Energy Task Force, which is committed to safeguarding the interests of consumers. Work is also available on issues on the political forefront, such as police accountability and racial profiling. In concert with more traditional work ranging from capital punishment to environmental protection, and from advising the judiciary to dependent advocacy, assignments can be as varied as they are challenging. Whether you are a prosecutor protecting public safety or a defense attorney keeping watch over the public coffers, you have an opportunity to convey a direct benefit to the community.

One of the biggest benefits of public service is the ability to pursue other interests outside the office. In the absence of pressure to achieve minimum billable hours, attorneys are able to contribute to other good works. The public sector is well represented in the administration of local and statewide bar activities. Within the Barristers, for example, several committee chairs and executive committee positions are filled by public sector volunteers who enhance the overall benefit of legal services to the greater Los Angeles community. Many also engage in pro bono programs administered by the bar.

This is not a new phenomenon. Attorneys who find themselves engaged in public service are frequent volunteers. As the legal profession continues to change, law schools are placing greater emphasis on services for low- and middle-income clients (71 and 61 percent of whom, respectively, go without legal representation in civil matters). Meanwhile, major law firms, in part due to increased salaries for first-year associates, are performing less pro bono work than in the past. Recent data indicates that a typical big firm lawyer performs less than 42 hours of pro bono work per year.\(^1\)

Perhaps the most important benefit for a new attorney in public practice is the opportunity to practice law in an open and constructive learning environment. The substantive work provides the basis for evaluation. Assignments are distributed in an equitable manner. Supervisors assist employees experiencing burnout in an attempt to retain talented professionals. This is due in part to the self-motivated nature of the public service attorney, who derives satisfaction from excelling in his or her work, and to the nurturing environment, a primary goal of which is to encourage self-confidence and embolden all employees to succeed in any endeavor. Meritocracy remains a measure of good government, and this axiom is no less applicable to public legal services.

In the legal profession, there are as many different goals and needs as there are lawyers and clients. For some, a career in public service enables advancement toward laudable goals. Moreover, past achievements may give rise to new opportunities and a desire to redefine objectives to suit one’s needs. In the public sector, the objective is to develop practice skills that lead to proficient advocacy—a noble aim for any attorney. ■

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Although it is not illegal to own a credit card issued by an offshore bank, the Internal Revenue Service has suspected for some time that some U.S. citizens might be using offshore credit cards to evade payment of taxes. These individuals divert funds overseas by, for example, claiming false deductions for payments to foreign entities or by using other income diversion schemes. The credit cards then provide relatively easy—many believed untraceable—access to the diverted funds maintained in various “tax haven” countries.

In order to determine the scope of the problem, the IRS turned to a well-established tax enforcement tool, the John Doe summonses, which allows the IRS to obtain information about individuals who may not be in compliance with the tax laws and whose identities are otherwise unknown to the IRS.1 U.S. district courts in Miami and San Francisco have enforced the issuance of John Doe summonses to Mastercard International, American Express, and Visa relating to accounts in approximately 30 foreign countries. The summonses seek information relating to the tax years 1998-2001.2

The IRS also has been authorized by other district courts in Florida and California as well as district courts in Arizona, Georgia, Illinois, Minnesota, Maryland, New Jersey, New York, Ohio, Texas, Virginia, and Washington, to serve John Doe summonses on more than 100 separate businesses, including airlines, hotels, rental car companies, and Internet providers who have accepted the use of offshore cards. Identification of the merchants confirmed IRS suspicions that use of offshore credit cards has “gone retail”—offshore transactions are no longer confined to the super wealthy but instead are conducted by a broad stratum of the population. Information gathered in this process is being used for both civil tax examinations and criminal investigations. IRS fraud referral specialists will likely assist agents in identifying those cases having the greatest criminal investigation potential.

Early returns from these investigations suggest that large numbers of U.S. taxpayers are, at the very least, not fulfilling the reporting requirements for maintaining a foreign bank account: filing Form TD F 90-22.1 (Report of Foreign Bank & Financial Accounts, or FBARs) and checking the appropriate box on Schedule B of their income tax returns. Information provided by Mastercard, which is estimated to have about 30 percent of the offshore credit card market, suggests that as many as one or two million U.S.-based customers may possess debit/credit cards issued by offshore banks. However, in 2000 only 170,000 FBARs, and in 1999 only 117,000 FBARs, were filed.

With the IRS’s increased enforcement activities, taxpayers who have used offshore credit cards or other offshore accounts to evade U.S. taxes are faced with an increased prospect of detection, examination, investigation, and possible criminal prosecution. The stakes of offshore tax evasion schemes have increased, but so have the tools available to practitioners counseling clients in what is admittedly a very difficult matter. A series of recent pronouncements by the IRS have provided some avenues of potential relief. The IRS recently revised and updated its longstanding voluntary disclosure policy and, more recently, the IRS announced the Offshore Voluntary Compliance Initiative, a program designed to allow individuals to step forward and “clear up their tax liabilities.”3

Revised Voluntary Disclosure Policy

A “voluntary disclosure” is the process by which a taxpayer voluntarily reports previously undisclosed income (or false deductions) by filing an amended or delinquent return. Practitioners often are uncertain whether a taxpayer can avoid with certainty a criminal tax investigation by making such a disclosure. It is clear that a taxpayer’s timely, voluntary disclosure of a significant unreported tax liability is an important factor when the IRS considers whether the matter should be referred to the Depart-

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**The IRS’s revised disclosure policy offers a limited amnesty that ends on April 15**

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A voluntary disclosure is also a factor that the Department of Justice considers in deciding whether to prosecute a taxpayer. However, the IRS takes the position that the voluntary disclosure policy creates no substantive or procedural rights for taxpayers. Rather, it merely describes internal IRS practice, provided solely for guidance to IRS personnel. Most federal courts agree with this interpretation—although one district court found that the policy created substantive taxpayer rights. Nor may a criminally charged taxpayer rely on the fact that other similarly situated taxpayers may not have been recommended for criminal prosecution. The taxpayer’s admission of wrongdoing, along with any other available evidence of repentance, is weighed along with all other factors in the investigation in determining whether to recommend criminal prosecution.

Thus, a timely voluntary disclosure will not automatically guarantee immunity from criminal prosecution, but a true voluntary disclosure will normally result in the IRS not even recommending a criminal prosecution to the Department of Justice. In practice, a true voluntary disclosure is a strong deterrent to the IRS from initiating a criminal investigation. From a tax administration point of view, those who make a voluntary disclosure lack jury appeal, and there are more culpable taxpayers to investigate.

The recent publicity surrounding the IRS offshore credit card investigations has called into question whether a taxpayer’s disclosure could now be called truly voluntary. In its recently revised and updated voluntary disclosure policy, the IRS answered that question: The general publicity regarding enforcement and compliance efforts, including the use of offshore credit cards, will not bar a taxpayer from making a voluntary disclosure. In addition, the disclosure policy has been modernized to reduce the uncertainty over what constitutes a timely voluntary disclosure.

A voluntary disclosure must be truthful, timely, and complete, and the taxpayer must demonstrate a willingness to cooperate—and must, in fact, cooperate—with the IRS in determining the correct tax liability. The taxpayer must make good-faith arrangements with the IRS to pay in full the tax, interest, and any penalties determined by the IRS to be applicable. Additionally, the policy only applies to income earned through a legal business—so-called legal source income. A modern-day Al Capone cannot take advantage of the policy.

The recent revisions to the policy clarify the timeliness requirement, an issue long troubling to practitioners. To be timely, the disclosure must now be received before:  

- “The IRS has initiated a civil examination or criminal investigation of the taxpayer, or has notified the taxpayer that it intends to commence such an examination or investigation.”
- “The IRS has received information from a third party (e.g., informant, other governmental agency, or the media) alerting the IRS to the specific taxpayer’s noncompliance.”
- “The IRS has initiated a civil examination or criminal investigation which is directly related to the specific liability of the taxpayer.”
- “The IRS has acquired information directly related to the specific liability of the taxpayer from a criminal enforcement action (e.g., search warrant, grand jury subpoena).”

Any taxpayer who contacts the IRS in person or through a representative regarding a voluntary disclosure will now be directed to IRS Criminal Investigation for an evaluation of the disclosure. IRS Criminal Investigation special agents have been encouraged to consult IRS area counsel for criminal tax matters on issues relating to a voluntary disclosure.

Examples of timely voluntary disclosures include:  

- A letter from an attorney enclosing amended returns from a client that are complete and accurate (reporting legal source income omitted from the original returns) and that offers to pay in full the tax, interest, and any penalties determined by the IRS to be applicable and that meets the timeliness standards.
- A disclosure made by a taxpayer of omitted income that was hidden or disguised through a widely promoted scheme, and, although the IRS has begun a civil compliance project involving the scheme and already obtained information that might eventually lead to an examination of the taxpayer, the IRS has not yet commenced an examination or investigation of the taxpayer or notified the taxpayer of its intent to do so. This still constitutes a voluntary disclosure because the civil compliance project involving the scheme has not yet identified the specific liability of the taxpayer.
- A disclosure made by an individual who has not filed tax returns even after the individual receives a notice stating that the IRS has no record of receiving a return for a particular year and inquiring whether the taxpayer filed a return for that year. The individual must file complete and accurate returns for the years in question and make arrangements with the IRS to pay the tax, interest, and any penalties determined by the IRS to be applicable. This is a voluntary disclosure because the IRS has not yet commenced an examination or investigation of the taxpayer or notified the taxpayer of its intent to do so.
- “A letter from an attorney stating that a client, who wishes to remain anonymous, wants to resolve his or her tax liability. This is not a voluntary disclosure until the identity of the taxpayer is disclosed and all other required elements are satisfied.”
- “A disclosure made by a taxpayer who is under grand jury investigation. This is not a voluntary disclosure because the taxpayer is already under criminal investigation. The conclusion would be the same whether or not the taxpayer knew of the grand jury investigation.”
- “A disclosure made by a taxpayer, who is not currently under examination or investigation, of omitted gross receipts from a partnership, but whose partner is already under investigation for omitted income skimmed from the partnership. This is not a voluntary disclosure because the IRS has already initiated an investigation which is directly related to the specific liability of this taxpayer. The conclusion would be the same whether or not the taxpayer knew of the ongoing investigation.”
- “A disclosure made by a taxpayer, who is not currently under examination or investigation, of omitted constructive dividends received from a corporation which is currently under examination. This is not a voluntary disclosure because the IRS has already initiated an examination which is directly related to the specific liability of this taxpayer. The conclusion would be the same whether or not the taxpayer knew of the ongoing examination.”
- “A disclosure made by a taxpayer after an employee has contacted the IRS regarding the taxpayer’s double set of books. This is not a voluntary disclosure even if no examination or investigation has yet commenced because the IRS has already informed the third party of the specific taxpayer’s noncompliance. The conclusion would be the same whether or not the taxpayer knew of the ongoing investigation.”

Examples of what will not be considered a voluntary disclosure include:  

- “A disclosure made by a taxpayer who has not filed tax returns even after the IRS has acquired information directly related to the specific liability of this taxpayer. The conclusion would be the same whether or not the taxpayer knew of the ongoing investigation.”
- “A disclosure made by a taxpayer who has not filed tax returns even after the IRS has acquired information directly related to the specific liability of this taxpayer. The conclusion would be the same whether or not the taxpayer knew of the ongoing investigation.”

To determine whether the disclosure is truly voluntary, the IRS will review the status of any prior IRS interest in the taxpayer, the taxpayer’s potential knowledge of this interest, and the taxpayer’s fear of a potential trigger that could have alerted the IRS. A voluntary disclosure cannot be made anonymously. Any plan by a taxpayer, or his or her representative, to resolve a tax liability, file a correct return, or offer payment of taxes for an anonymous client will not be considered a voluntary disclosure.

Under the revised policy, a voluntary disclosure does not occur until the IRS has actually been contacted. As such, it is imperative
that the disclosure occur as quickly as possible. Since returns filed pursuant to a timely voluntary disclosure face a relatively high likelihood of being audited, they should be bulletproof—correctly reflecting the taxpayer’s income and expense items.

Due to various information sharing agreements among federal and state agencies, applicable state returns should be contemporaneously filed or amended with the federal returns. Returns for related entities should also be contemporaneously filed or amended. Questions or doubts should generally be resolved in favor of the government. Remember, if a return filed pursuant to a voluntary disclosure is less than accurate, the taxpayer is compounding, not diminishing, the problem.

For long-term tax avoiders, there is a question of how far back the disclosure should go. While there is no firmly established rule on how many returns to file when making a voluntary disclosure, the general consensus is about six tax years, the statute of limitations for most tax-related crimes. That about six tax years, the statute of limitations for voluntary disclosure, the general consensus is how many returns to file when making a voluntary disclosure is less than accurate, the taxpayer is compounding, not diminishing, the problem.

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Other practitioners prefer making the voluntary disclosure in a meeting with the special agent in charge at the local IRS Criminal Investigation office where the investigation would be conducted. At this meeting, counsel can outline the facts in a hypothetical form (probably in writing) and ask whether IRS CI would consider the filing to be a voluntary disclosure and thus avoid recommendation for criminal prosecution. Counsel may also attempt to secure an IRS waiver of all applicable penalties before revealing the taxpayer’s identity. In the event that CI responds affirmatively, counsel could then disclose the client’s identity and taxpayer identification number.

The Offshore Voluntary Compliance Initiative

The revised voluntary disclosure policy plays an important role in the IRS’s recently announced Offshore Voluntary Compliance Initiative. This initiative is designed to bring taxpayers who have used offshore credit cards or other offshore financial arrangements to hide their income and evade taxes into compliance with tax law. It is a bold initiative that offers taxpayers the opportunity to avoid criminal prosecution through application of the voluntary disclosure policy and to settle with finality the civil tax liabilities arising from their use of illegal offshore financial arrangements.

The IRS is attempting to achieve two important goals with the initiative. First, it is attempting to get at the root of the offshore tax evasion problem—the promoters and others who are selling these types of tax avoidance devices to taxpayers. Second, the IRS recognizes it has limited resources and cannot audit and prosecute everybody who was involved in these transactions. The initiative allows taxpayers themselves to correct prior underreporting and allows the IRS to focus on the promoters and taxpayers who do not want to come forward and “pay their fair share.” Taxpayers who want to take advantage of the initiative must, on or before April 15, 2003, send a written request to participate to the National Offshore Voluntary Compliance Initiative Coordinator.

Before doing so, every practitioner must weigh the risks and benefits for taxpayers to come forward. By taking advantage of the initiative, taxpayers who qualify will gain a greater degree of certainty over how they will be treated by the IRS. For voluntarily disclosed unreported income or false deductions claimed in connection with an offshore financial arrangement, the IRS will waive the 75 percent civil fraud penalty, the 75 percent fraudulent failure-to-file penalty, and the penalties for failure to comply with various reporting requirements relating to foreign transactions. The Treasury Department’s Financial Crimes Enforcement Network (known as FinCEN) also will agree not to impose civil penalties for failure to file FBARs in a timely manner.

More importantly, taxpayers qualifying under the initiative receive a high degree of assurance that they will not be subject to criminal prosecution. While the revenue procedure covering the initiative discusses only civil liabilities and is silent about criminal prosecution, the IRS press release states,
“Eligible taxpayers who come forward will also avoid criminal prosecution based upon the revised voluntary disclosure practice.” While this announcement is not a formal grant of immunity, the IRS is now on record as telling taxpayers that voluntary disclosure will not just be a consideration in determining whether it will recommend criminal prosecution, it has publicly stated that qualifying taxpayers will not be prosecuted. While the form of this public pronouncement may not create ironclad constitutional due process protections for a qualifying taxpayer, the practical result is that the IRS will need to stand by what it says, and it is highly unlikely that qualifying taxpayers will be prosecuted. However, the devil is in the details, and each taxpayer who undertakes voluntary disclosure will still face the question of whether he or she qualifies.

Those who qualify still face substantial costs, even taking into account the waiver of fraud penalties. Taxpayers qualifying under the initiative will be required to pay all tax and interest plus the 20 percent accuracy-related penalty and the 25 percent delinquency penalty, or both if the circumstances warrant. While the initiative indicates penalties will be applied only in “appropriate circumstances,” the implication of the IRS announcement is that these penalties will apply in most circumstances. What the taxpayer avoids is the larger, 75 percent civil fraud penalties and the possibility of criminal prosecution.

Taxpayers may possibly gain another benefit because the initiative limits the number of years that the IRS requires a taxpayer to report the correct amount of income and pay the additional tax. As a general matter, the initiative applies to tax years ending after December 31, 1998—for most individuals, the 1999 and subsequent tax years. This could provide a substantial benefit for taxpayers who engaged in illegal offshore tax avoidance for many years. It is likely the IRS drew this administrative line in recognition of the three-year statute of limitations on tax avoidance unless fraud is proven (in which case there is no civil statute of limitations), the difficulty of proving fraud, and the recognition that taxpayers needed to be provided a significant financial inducement to come forward. On the other hand, sound tax administration requires that the inducement not be so great as to cause compliers taxpayers to question whether tax avoidance pays off in the long run.

There is an important caveat regarding pre-1999 tax years not covered by the initiative. The IRS has reserved the right to investigate pre-1999 tax years if information comes to its attention that “substantial tax avoidance” occurred in those years, as long as the statute of limitations remains open. Some taxpayers may thus place themselves at real risk if their tax avoidance is significant and evidence of fraud is present. The IRS seemed to recognize this dilemma by providing in the initiative that if a taxpayer wants to file amended returns for pre-1999 tax years, the IRS will accord those returns the same beneficial treatment as those of later years. The initiative, however, is silent on how the IRS will treat tax avoidance in pre-1999 tax years if it comes to the IRS “attention” without the taxpayer’s disclosure.

Qualifying under the Initiative
There are four conditions a taxpayer must satisfy in order to be eligible for the initiative:

First, the taxpayer has to file the written request to participate before the IRS has 1) initiated a civil examination or criminal investigation of the taxpayer, or has notified the taxpayer of its intent to do so, or has received information from a third party alerting the IRS to the taxpayer’s noncompliance, or 2) initiated a civil examination or criminal investigation that is directly related to the specific liability of the taxpayer, or 3) acquired information directly related to the specific liability of the taxpayer from a criminal enforcement action (e.g., search warrant, grand jury subpoena). This first requirement incorporates, in essence, the new timeliness criteria of the revised voluntary disclosure policy.

Second, the taxpayer must not have promoted, solicited, or in any way facilitated the participation of others (other than members of the taxpayer’s immediate family or individuals from whom the taxpayer did not receive compensation of more than a nominal amount) in arrangements to avoid taxation by using offshore payment cards, offshore financial arrangements, or any other abusive transaction, domestic or offshore.

Third, during the years in which the taxpayer seeks to participate, the taxpayer must not have derived income from illegal sources, such as income from drug trafficking.

Fourth, during the years in which the taxpayer seeks to participate the taxpayer must not have used the offshore payment cards or offshore financial arrangements to support or in any way facilitate illegal activities not related to taxes.

The timeliness issue presents the greatest concern for practitioners, since the IRS may already have initiated a criminal or civil investigation of the taxpayer, and the practitioner or the client may not know about it. This is especially true for criminal grand jury investigations conducted in secrecy. Taxpayers who otherwise would qualify must try to determine whether the criminal investigation has begun, because if it has, the taxpayer may be accelerating his or her criminal indictment rather than avoiding it by applying under the initiative.

After a taxpayer submits a written request to participate in the initiative, the IRS will, within 30 days of receipt, indicate to the taxpayer whether he or she has been “probable” determined to be eligible. That indication, however, will not prevent the IRS from later determining that the taxpayer is not eligible to participate. Within 150 days of receiving the preliminary determination, the taxpayer must provide the IRS with copies of all previously filed returns for tax years ending after December 31, 1998, a detailed description of the offshore payment cards and foreign accounts at issue, and information regarding all direct and indirect beneficial or legal interests in any foreign assets held at any time after December 31, 1998.

Further, the taxpayer must identify the sources of these foreign assets and provide all promotional and transactional materials related to them, complete and accurate amended or delinquent returns for all tax years ending after December 31, 1998, and an explanation of the previously unreported income or incorrectly claimed deductions (even if not related to the offshore financial arrangement). All relevant information must be provided. The taxpayer must also file complete and accurate amended or delinquent information returns and FBARs related to the offshore financial arrangement. The IRS may also request additional documentation and secure consent to extend the statute of limitations on the assessment of additional taxes.

Finally, the taxpayer must fully pay the tax liabilities, including applicable penalties and interest or make “other financial arrangements” acceptable to the IRS for all years covered by the initiative. The taxpayer will also be required to pay or make other financial arrangements for all other unpaid tax liabilities. For purposes of the initiative, the submission of complete financial statements to the IRS with the amended or delinquent returns will satisfy the “other financial arrangements” requirement.

It is unclear whether a taxpayer can make a voluntary disclosure under the initiative simply by filing correct tax returns with the IRS. Prior to the initiative, this was a common and accepted means of making a voluntary disclosure. The benefit is the possible avoidance of the accuracy-related penalties that will in most cases be imposed under the initiative. Under the initiative, this strategy appears risky, especially if done to avoid the 20 percent accuracy-related penalty. While the initiative is silent on the point, the IRS press release notes, “As part of the…Initiative,
the IRS will also be closely monitoring the filing of amended returns. If in order to circumvent this initiative, taxpayers simply file an amended return without complying with the other required provisions, they run the risk of having the civil fraud penalty and other information return penalties applied.29 A taxpayer’s exposure to criminal prosecution might also increase if he or she does not have the benefit of the initiative. Those taxpayers who do not make the April 15, 2003, deadline for applying for qualification under the initiative will, however, not be out of options. But they will then fall under the less generous provisions of the general voluntary disclosure policy, absent the benefits of the initiative.

The recently revised IRS voluntary disclosure policy and the Offshore Voluntary Compliance Initiative provide a greater level of certainty to taxpayers wishing to appropriately respond to their potential tax problems. While everyone qualifying under these avenues of relief will have to bear certain costs, in some cases these avenues could actually become prescriptions for disaster. Counsel must thoroughly review all potentially relevant information before determining whether a voluntary disclosure or an application under the initiative is right for a particular taxpayer.

The IRS is receiving volumes of electronic information about transactions that involve offshore credit cards and other offshore arrangements. Many civil examinations and criminal investigations have already begun or are in the pipeline. The initiative is a recognition that the IRS, on its own, cannot prosecute all the taxpayers who took a chance with an aggressive offshore financial strategy. With the initiative, many taxpayers will now come forward, and the information they provide will make many more promoters the focus of IRS investigations. That, in turn, may implicate more individual taxpayers who adopted the promoters’ schemes. Notwithstanding the fact that these developments will surely increase the odds in favor of detection and punishment, many taxpayers will continue to believe they can escape detection. For these taxpayers, one thing seems clear: Since the IRS has given them a second chance to get into compliance, a third chance is unlikely to be in the cards.

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2 In re Does, No. CV 00-3919 (S.D. Fla. filed Oct. 30, 2000).
3 See United States v. Knottnerus, 139 F. 3d 558 (7th Cir. 1998) (no rights created) and Crystal v. United States, 172 F. 3d 1141 (9th Cir. 1999) (questioning whether enforceable rights exist).
8 See supra note 6.
11 Id. at ¶8.
12 Id. at ¶4.
13 Id. at ¶5.
14 Id. at ¶6.
15 Id. at ¶7.
16 Id. at ¶8.
17 Id. at ¶9.
18 Id. at ¶10.
19 Id. at ¶11.
20 Id. at ¶12.
How *Presley Homes* Has Changed the Duty to Defend

The crux of this debate can be traced back to 1997, when the California Supreme Court announced a “prophylactic” duty to defend uncovered claims in so-called mixed actions. In these suits, some causes of action are covered and some are not. Before the 1997 decision—*Buss v. Superior Court*—policyholders and insurers had different ideas about mixed actions. Policyholders argued that the insurance company had to pay for the defense of all causes of action if any one cause of action was potentially covered under the liability insurance policy. The only way the insurer could avoid paying for the defense of particular causes of action was to produce “undeniable evidence” showing that specific fees and expenses were allocable only to uncovered causes of action. On the other hand, liability insurers argued that the standard of undeniable evidence of allocability applied only in situations in which the insurer had wrongfully denied its duty to defend. If an insurer defended or innocently (but mistakenly) denied a request for defense, then a fair allocation of the fees and expenses between the covered and the uncovered causes of action was to be considered appropriate.

In resolving this debate, the *Buss* decision introduced a new concept to California law: the liability insurer’s prophylactic duty to defend. The *Buss* court concluded that it could not justify imposing an obligation to defend uncovered causes of action in mixed lawsuits that was based on policy language alone. The policy merely obligates the insurer to defend those causes of action that are potentially covered and nothing more. But the *Buss* court also held that the law imposes on insurers a prophylactic duty to defend the entire lawsuit, including causes of action that are not even potentially covered, if the lawsuit includes some covered and some uncovered causes of action. According to *Buss*, the law imposes this prophylactic duty to protect policyholders from the hardship that would result if certain causes of action were not defended at all.

*Buss* emphasized that the prophylactic duty to defend uncovered claims differs substantially from a true contractual duty to defend claims that are in fact potentially covered. The contractual duty to defend is a true duty that exists for all purposes. When a cause of action is potentially covered under a liability insurance policy, the insurer has to fund the insured’s defense against the third party’s claim. In this situation, the insurer is not entitled to reimbursement, even if it turns out that the third party is unable to prove the claim, and even if actual coverage never develops.

In sharp contrast, the prophylactic, or protective, duty to defend can be ephemeral. When necessary to protect against the hardships that would exist if defense attorneys refused to mount any defense to uncovered claims, the insurer with a prophylactic duty to defend must front legal fees and expenses incurred to defend claims that are not potentially covered, as long as at least one cause of action is potentially covered. However, the insurer that provides a prophylactic defense of uncovered causes of action is entitled to seek reimbursement at the conclusion of the litigation. The insurer has to show that certain fees and expenses are solely allocable to uncovered causes of action. The burden of proof for the insurer is merely a preponderance of evidence.

**The Duty to Defend**

*Presley* is important, but only because the decision applies the prophylactic duty to defend as established in *Buss* to additional insured carriers in the construction defect context. Developers who build residential housing typically require the subcontractors who do the construction work to have their own liability insurance policies. The developers and general contractors also usually require subcontractors to make sure that their insurance policies name the developers as additional insureds. Most commonly, developers are added by an endorsement that essentially says that they will be treated as insureds, but only with respect to liability arising from the work performed by the named insured subcontractor.

Since construction defect lawsuits often involve numerous alleged defects, large groups of damages that might be alleged against a developer can have nothing whatsoever to do with issues that have been alleged against a particular subcontractor.
As a result, the additional insured coverage afforded under a particular subcontractor’s policy might provide coverage for only a very small percentage of the overall construction defect lawsuit.

Presley apparently involved an ordinary construction project. American States insured two of the subcontractors that worked on the project. One subcontractor installed concrete foundations, driveways, walkways, and stoops. The other purchased lumber and did rough carpentry work. Both subcontractors had their policies endorsed to make Presley Homes an additional insured. Each policy limited Presley Homes’s coverage to certain liabilities arising out of the named insured subcontractor’s work.11

Presley Homes and American States could not agree on the defense obligation. Presley Homes said American States had an obligation to provide a full and complete defense, but American States argued that it only had a duty to defend claims relating to its named insured subcontractors’ work. American States offered to retain a separate lawyer who would represent Presley Homes with respect to framing issues. American States also talked about the idea of contributing a certain percentage to the overall defense costs. Ultimately, however, Presley Homes and American States could not agree, and Presley Homes filed suit.

On cross motions for summary adjudication, Presley Homes asked the court to rule that American States owed a 100 percent defense obligation. American States asked the court to rule that it did not owe a 100 percent defense obligation. The trial court ruled in favor of American States, finding that its defense obligation was limited.12 The appellate court reversed, holding that Presley Homes “did incur legal expenses in defending against the [construction defect] suit.”13 This sentence shows that Presley Homes was not being fully defended by any other insurer (or group of insurers) when American States was trying to negotiate a partial defense. Since Presley Homes was not being fully defended by anyone else, all the court of appeal had to do was apply Buss—and that is exactly what it did.

Although Presley has generated quite a commotion in construction defect litigation circles, the appellate result represents no great departure from previously existing law. The appellate court in Presley said that it rejected American States’ argument “because an insurer’s duty to defend the entire action is based on public policy, not the terms of the party’s contract.”14 Then the court cited and quoted extensively from Buss, noting: “[T]he delay in providing a defense while the parties attempted to reach a mutually accept-

able percentage, highlights the very reason the Supreme Court requires an insurer to provide a complete defense even where the underlying lawsuit includes both covered and uncovered claims.”15

Although American States could correctly point out that its named insured subcontractors’ work represented a relatively small percentage of the defects that were at issue in the lawsuit against Presley Homes, this was not enough to distinguish Buss. After all, in Buss, the California Supreme Court ruled that Transamerica had a duty to defend the entire lawsuit even though only one of 27 separate causes of action was potentially covered under Transamerica’s policy.16

One Full Defense

The prophylactic duty to defend is not implicated if some other insurer is already providing a full defense. To be sure, neither Buss nor Presley expressly says so; however, the rationale behind the imposition of a prophylactic duty to defend uncovered claims evaporates if some other insurance company is already funding a full defense. The law imposes a prophylactic duty to defend uncovered claims to prevent situations in which an attorney works vigorously to defend the covered causes of action and not at all to defend the remaining uncovered causes of action.

But policyholders are only entitled to one insurer-funded defense, not several. And this is particularly true in construction defect litigation, in which one developer may request a defense from 20 or more different insurance companies. Once a policyholder receives a full defense from a particular insurer, another insurer’s failure to defend is not actionable and has no consequences for the policyholder. For example, in Ceresino v. Fire Insurance Exchange,17 the court drew a distinction between situations in which an insurer’s failure to defend left the policyholder defenseless and situations in which the failure to defend was far less meaningful because some other insurer was already fully defending.

Explaining its reasoning, the court noted: But Ceresino did not face that danger—his representation was undertaken by his other insurance company. Farmers’ failure to defend was of no consequence except to Commercial Union, which requested Farmers pay for half the defense.18

In Ringler Associates, Inc. v. Maryland Casualty Company,19 the court held that it would not have allowed a policyholder to collect damages from the insurer who failed to defend, even if the insurer had a duty to defend. After explaining that the basic measure of damages is the amount required to compensate the policyholder for harm caused by the insurer’s breach of the duty to defend, the court noted:

Ringler suffered no liability in excess of the Policy limits; nor was it compelled to or unable to defend itself. Instead, as Ringler implicitly acknowledged, it was fully protected from having to pay any costs of its own defense by other insurers who were on the risk when Ringler allegedly first slandered the plaintiffs….20

Another case, National Union Fire Insurance Company v. Nationwide Insurance Company,21 involved a dispute between insurers. The appellate court criticized National Union for its “strident references to Nationwide’s ‘bad faith’ failure to defend….22 Citing Ceresino, the court went on to explain: ‘To the contrary, National Union stepped in and fulfilled the very roles for which it received policy premiums. This dispute between insurance carriers is little served by co-opting rhetoric which more aptly applies to insureds who are left without any insurer-provided defense.’”23

A similar point was made more recently in Barratt American, Inc. v. Transcontinental Insurance Company.24 Barratt argued that one of its additional insured carriers had the burden to prove that the costs that Barratt had incurred to repair and upgrade homes that were not involved in litigation were not reasonable and necessary “defense costs.” Barratt argued that traditional burden-of-proof rules were inapplicable because Transcontinental had “breached” its duty to defend. The court rejected Barratt’s argument because Barratt had been defended by a different insurer.

As the court explained, “Transcontinental was never asked to provide additional legal counsel” and Barratt was not “left to mount its own defense.”25 Instead, “Barratt’s direct insurer (Gerling) had accepted the duty to defend….and Barratt was fully represented by legal counsel paid by Gerling.”26 In a footnote the court explained that although there was some evidence that Gerling did not pay all the attorney’s fees and expert bills that Barratt had incurred in a timely manner, there was no evidence showing that Barratt’s “defense was impeded or that if those bills had been paid more promptly the defense would have been improved.”27

As these authorities show, from the standpoint of a developer that is already receiving a fully funded insurance defense, an additional insured carrier’s obligation to defend is largely irrelevant. The developer is entitled to one insurer-funded defense, not several.28 This is why the key fact in Presley was that Presley Homes was not receiving a full defense from any other insurer when...
American States offered to provide a partial defense.

If Presley Homes had been receiving a full defense from its own direct insurer (or some other additional insured carrier, or some combination of insurers) when it asked American States to defend, Presley Homes would have held no rights against American States. Instead, those insurers that were funding the defense would have had the right to request equitable contribution from American States.

**Allocation of Responsibility**

When two or more insurers share an obligation to defend the same policyholder against the same lawsuit, courts allocate responsibility among those insurers based on equitable principles. The “purpose of this rule of equity is to accomplish substantial justice by equalizing a common burden shared by co-insurers, and to prevent one insurer from profiting at the expense of others.” There is no one fixed rule. Formulas that have been used to equitably allocate a shared defense obligation include comparison of policy limits, the amount of “time on the risk,” the premiums paid, and the amounts contributed to a settlement.

Some attorneys have argued that the 100 percent prophylactic duty to defend outlined in Presley means that each insurer owes the same defense obligation. From there, they argue that equitable sharing between insurers must be based on equal shares, with each participating insurer contributing the same amount toward the defense regardless of whether or not other factors would make this approach inequitable.

There are certainly times when equitable allocation based on equal shares makes sense, but this approach is not required just because every insurer with an obligation to defend part of a lawsuit has a prophylactic obligation to defend the entire lawsuit. In fact, decisions after Buss and Presley have continued to endorse other methods of arriving at a fair contribution among insurers who share a common obligation to defend a policyholder. For example, Fireman’s Fund Insurance Company v. Maryland Casualty Company specifically rejected the notion that Buss and the prophylactic duty to defend uncovered claims has anything to do with division of responsibility among insurers who share a common defense obligation. As the court explained: “Unlike Buss, this issue here is not the scope of Nationwide’s duty to defend. It is allocation of costs among several insurers each of which had a duty to defend.” And when it remanded the case for the trial court’s consideration of the equitable contribution issue, the appellate court instructed the trial court to consider all relevant factors, including the scope of coverage afforded by the various policies.

In another post-Buss decision, Centennial Insurance Company v. United States Fire Insurance Company, the court refused to equitably allocate defense fees and expenses among coinsurers based on an equal shares approach. In Centennial, the court concluded: “[The time on the risk method was much more equitable than the equal shares approach.]”

Even after Presley, California courts continue to hold that “[t]here is no single method of allocating defense or indemnity costs among co-insurers.” So the fact that each insurer with a duty to defend has a prophylactic duty to defend uncovered claims does not mean that every insurer will ultimately have the same defense obligation. The prophylactic duty to defend, after all, includes the right to seek reimbursement of fees that are allocable to uncovered claims.

Like Buss, Presley merely reiterates a rule that increases the likelihood that policyholders will be fully defended. If multiple insurers are obligated to defend, however, allocation of defense costs among those insurers will be based on equitable principles that can include an assessment of policy limits, premiums collected, time on the risk, the scope of coverage afforded under the policy, comparative contributions toward settlement, and each insurer’s handling of the claim.

**Presley** is a helpful decision for additional insureds that are not receiving a full defense from an insurer or group of insurers. The case has nothing to say, however, about situations in which a policyholder is already receiving a full defense from one or more of its insurers. Similarly, Presley has little to say about equitable contribution among co-carriers. Although equal shares may be a fair and equitable approach to dividing fees and expenses in some situations, Presley does not mandate that approach.

Considering its modest holding, Presley has received too much attention, and it is probably cited too frequently. Attorneys who deal with construction-defect-related coverage issues might be able to better serve their clients by identifying and citing cases that address the issues they are debating. Presley is not going to do much good if the insured is already receiving an insurer-funded defense or if equitable allocation among co-insurers is involved.
By Scott C. Lascari

Res Judicata and California’s Unfair Competition Law

Section 17200 defendants may face subsequent lawsuits based on the same conduct

Among the bills, letters, and advertisements that clutter residential mailboxes, some people have found documents addressed to them entitled “Notice of a Class Action Settlement.” The notice usually refers to a product, such as a car tire or a computer modem, that the notice recipients have been using for a while without any problem. Despite the recipients’ personal satisfaction with the product, someone else was unhappy with it and sued the manufacturer “on behalf of” all purchasers. The result, as the notice explains, is payment to the named class representatives and their attorneys as well as nominal compensation for the notice recipients. Usually the recipients need not do anything, so they often throw the notice away and, weeks later, receive a coupon that they never use. Case closed.

But what if a person who never bought the product sued the manufacturer “on the public’s behalf” and won an injunction and/or restitution? Could another purchaser nevertheless sue the same manufacturer for his or her personal unhappiness with the product, or would the previous lawsuit protect the manufacturer? Unfortunately for defendants, the law regarding California’s Unfair Competition Law (UCL)—codified in California Business and Professions Code Sections 17200 et seq.—indicates that the second lawsuit might be viable.

The UCL authorizes plaintiffs to sue businesses on the public’s behalf for unfair competition, which the law defines as unlawful, unfair, or fraudulent acts or practices or as deceptive, untrue, or misleading advertising. In effect, plaintiffs can use the UCL to sue businesses for any wrongful business activity. In fact, if a court finds that a company engaged in unfair competition, the court can make whatever orders or judgments are necessary to deter the company from repeating its conduct and to compensate victims of the company’s conduct.

Furthermore, while some statutes expressly forbid individuals to privately prosecute an action if the government has already filed a case, California courts in the past have combined public and private Business and Professions Code Section 17200 actions and allowed them to continue as one case. The courts have even allowed private parties to recover their attorney’s fees in these combined actions, regardless of whether the district attorney or the private party initiated the first case. The UCL further permits courts to make awards favoring absent parties without class certification. Within this legal environment, a question arises: If a plaintiff brings a UCL lawsuit on behalf of the California general public, and the lawsuit is not a class action, will that lawsuit preclude future Section 17200 suits against the same defendant for the same conduct? Recent case precedent indicates that the later action might not be precluded. One starting point for understanding this result is a 1977 California Supreme Court decision, People v. Pacific Land Research Company.

Pacific Land Research Company

In Pacific Land Research Company, the California attorney general and the Kern County district attorney brought suit on the People’s behalf, alleging that the defendant vendors violated various legal provisions—including Business and Professions Code Section 17500, which is the part of the UCL dealing with deceptive advertising—while selling tracts of land to the public. In particular, the complaint alleged that the defendants were landowners who solicited purchasers through false and misleading statements and who created subdivisions without following the relevant subdivision provisions of the Business and Professions Code. The complaint sought a temporary restraining order, preliminary and permanent injunctions, a civil penalty, and restitution for the land purchasers. After the trial court ruled in the People’s favor on the preliminary injunction, the defendants appealed, contending that the inclusion of restitution in the complaint meant that the court had to follow class action procedural safeguards.

The California Supreme Court, however, disagreed with the defendants. The court found that the People’s action was “fundamentally a law enforcement action designed to protect the public and not to benefit private parties.” After all, injunctive relief was intended to prevent parties from continuing to violate the laws and to prevent violators from dissipating illegally obtained funds; civil penalties were meant to punish violators for past illegal conduct. Any requests for restitution were only ancillary to these public remedies, not the primary objective of the public suit. The court added that “an action by the People lacks the fundamental attributes of a consumer class action filed by a private party.”

Furthermore, if the People were required to follow class action procedures, they might be forced to abandon restitution claims whenever immediate injunctive relief was necessary to protect consumers from further illegal acts by the defendants. The court found this result unacceptable, primarily since a key reason for class action safeguards was to allow defendants to assess the resources that they should spend in defending against this type of litigation. In Pacific Land Research Company, since the People sought a $2,500 civil penalty for each of the defendants’ alleged violations, the court believed the defendants had “sufficient incentive to mount a vigorous defense....” In addition, the court mused that, if the People failed to prevail in their action, the odds that other parties
seeking restitution would harass the defendant through litigation was no more than “a remote theoretical possibility.”

**Theory and Reality**

More than 20 years later, theory gave way to reality when a California appellate court faced the preclusion issue head on. In *American International Industries v. Superior Court*, a nonprofit corporation served the California attorney general as well as two hair color product manufacturers and distributors with a notification document. It informed the manufacturers and distributors that they had violated the Toxic Enforcement Act by failing to warn consumers of the lead acetate contained in their products. Six months later, the nonprofit corporation sued the manufacturers and distributors in San Francisco—on the public’s behalf and under the UCL—for exposing consumers to lead acetate. Four months after the San Francisco lawsuit was filed, individual plaintiffs brought a class action in Los Angeles against the same defendants on behalf of themselves and others similarly situated, alleging a UCL violation connected to the lead acetate.

Seven months after the Los Angeles suit, the parties in the San Francisco action settled the case, and the California attorney general signed the settlement, signifying that it was in the general public’s best interest. The settlement agreement provided for a reformulation of the defendants’ products; at least $70,000 in coupons to California consumers; $22,500 in a civil penalty; and $69,000 in restitution and $173,500 as a fee and expense reimbursement of the defendants’ products; at least $70,000 in of the defendants’ products; at least $70,000 in damages. The plaintiffs thereafter appealed. The court of appeal first acknowledged the fundamental difference between public actions and either class actions. Specifically, the court found that, while the ‘general public’ are nonparties to the action, are not given notice of the proceedings, and have no opportunity to be heard. The court therefore found that a triable issue existed as to whether individuals purchasing the defendant’s mutual funds prior to April 13, 1992, were adequately represented in the settled class actions.

Without reference to the supreme court’s *Pacific Land Research Company* decision, the court of appeal concluded that res judicata applied to the Los Angeles action. The court first found that both the San Francisco and the Los Angeles cases involved identical issues and that the San Francisco action involved a final judgment on the merits. The court then determined that the private plaintiffs in the Los Angeles action were in privity with the attorney general, who represents the People’s interests in matters of general concern and who both participated in and signed the settlement agreement. Furthermore, since the San Francisco private plaintiff brought a representative action and since the attorney general participated in it, the Los Angeles plaintiffs’ interests were amply protected with respect to any due process concerns. As a result, the appellate court instructed the trial court to grant the defendants’ motion for judgment on the pleadings. This opinion, however, was ordered depublished.

Two years after the *American International Industries* decision, the court of appeal faced another preclusive effect argument in a UCL action. In *Payne v. National Collection Systems*, the Los Angeles district attorney and the California attorney general sued Trans World Airlines and National Collection Systems in connection with a TWA training course that produced $7.5 million in profits for the defendants. The plaintiffs alleged that TWA did not guarantee jobs to those completing the course (as TWA had originally promised), a majority of the travel industry did not use the reservation system taught during the course, classes were unruly and disorganized, educational materials were rarely used, a majority of the teachers were not accredited, and the fees and expenses for the course were such that successful applicants ultimately earned less than the minimum hourly wage. Two years after filing suit, the district attorney and the attorney general secured separate judgments against the defendants, imposing both injunctive and monetary relief based, in part, on the UCL. The attorney general’s judgment even produced restitution for 63 individuals harmed by the defendants’ conduct.

Three months after the judgments were entered, 23 former job applicants brought a UCL class action against the defendants with regard to the same training course. None of the 63 individuals receiving restitution under the prior judgments were plaintiffs in this second action. Nevertheless, the trial court sustained the defendants’ demurrer to the UCL cause of action on res judicata grounds, prompting the plaintiffs to appeal.

Relying heavily on the *Pacific Land Research Company* decision, the appellate court considered the fundamental differences between public actions and either class actions or other representative litigation. In particular, the court found that public prosecutors fundamentally bring UCL actions both for the public benefit and for law enforcement purposes. Private parties, on the other hand, typically bring suit to make whole the victims of improper business practices. Therefore, since the prior action was brought on the public’s behalf while the present action was brought on behalf of private individuals, and since the 23 private plaintiffs in the present action did not receive restitution in the first case, res judicata did not apply.

The same appellate panel faced another res judicata issue in a UCL case just a few months later. In *Zinzan v. Great Western Bank*, more than 20 individuals sued a financial institution and its subsidiaries, claiming that they conspired to defraud their bank customers by having those customers purchase high risk, noninsured mutual funds. The representative UCL action sought restitution for members of the general public who had bought and sold the questionable mutual funds before April 13, 1992. Months later, a class action (later split into two class actions) was brought against the same defendants on behalf of people who had bought and sold the questionable funds after April 13, 1992, and before April 13, 1995. The latter class actions were eventually settled, and a $17.2 million settlement fund was established for distribution to all members of the class. The settlement agreement also provided for the general release of claims against the defendants that would arise under the UCL. Once settlement was reached in the class actions, the defendants moved for summary judgment on res judicata grounds in the previously filed representative action. The trial court granted the defendants’ motion and dismissed the case. The plaintiffs thereafter appealed.

The court of appeal first acknowledged that the law was unclear “as to whether and when an unfair competition law action by a private litigant seeking injunctive and/or restitutionary relief on behalf of the general public has a res judicata effect.” In fact, due process concerns would “arise because the ‘general public’ are nonparties to the action, are not given notice of the proceedings, and have no opportunity to be heard.” The court therefore found that a triable issue existed as to whether individuals purchasing the defendants’ mutual funds prior to April 13, 1992, were adequately represented in the settled class actions.

Specifically, the court found that, while the settling class plaintiffs had a “personal and substantial financial stake” in the litigation’s outcome, there was no evidence that the general public’s interests were considered during the settlement process. Furthermore, the settlements did not provide for relief to members of the general public or restitution to persons falling outside of the defined class. In addition, injunctive relief was secured on the general public’s behalf. As a result of these triable issues of fact, the appellate court reversed the
summary judgment that had been granted by the lower court in the defendants’ favor.

Just three months after Zinzun, the appellate court handed down another UCL res judicata ruling. In Braco v. Superior Court, an individual brought 23 UCL representative lawsuits against 23 bars in 23 days, with each lawsuit alleging that a particular bar violated the Smoke Free Workplace Act by allowing people to smoke inside. The plaintiff asked for preliminary and permanent injunctive relief, profit disgorgement, customer restitution, and attorney’s fees. The actions were eventually reassigned to a single judge and then consolidated into a single action. The trial court thereafter ruled that the plaintiff was not competent and lacked standing to prosecute the UCL claims.

On appeal, the defendants claimed that allowing the particular plaintiff to prosecute the representative action would be improper because it would preclude later actions by customers and competitors who were actually harmed. The appellate court disagreed. Since the action was a representative action instead of a class action on behalf of customers, competitors, or employees, no one would receive notice of the lawsuit or an opportunity to opt out: “[A]s a result, the judgment in this case would have no res judicata or collateral estoppel effect.” Like Zinzun, however, Braco was not certified for publication.

**Principles and Policies**

Interestingly, only two cases among this group of decisions—Pacific Land Research Company and Payne—are on the books and thus citable in briefs before the courts. Nevertheless, at least one general principle emerges. If the first UCL suit is a public suit, it will not act to bar a later, private UCL action—even if the public suit seeks restitution—because the courts believe that public and private actions fundamentally differ from each other. Public suits have a protective and deterrent effect, while private suits are aimed at individual restitution.

Furthermore, if a private UCL action is followed by another private UCL action, the preclusion question might very well turn on whether due process concerns are satisfied. As the court observed in Pacific Land Research Company:

Failure to require notification of the class before a decision on the merits prevents a binding adjudication against the class because members of the class who were not notified are not barred by the determination in the defendant’s favor since they were not parties. On the other hand, a defendant who loses an action brought by individual class members may be estopped under the doctrine of collateral estoppel to deny the binding effect of the judgment against him in a subsequent action brought by other class members.

Parties defending against or settling unfair competition actions must therefore be alert. With either litigation or settlement, it remains questionable whether res judicata will apply to future actions based on the same conduct, in spite of specific language indicating otherwise in the settlement or judgment.

The issue is further complicated by policy arguments from both sides that have done nothing to resolve the problem. On the one hand, if res judicata applies to later private actions, victims who should receive restitution might be deprived of their due process. After all, they most likely will not receive notice, the opportunity to object or opt out, or other information and safeguards that correspond to class actions. In addition, many plaintiffs bring UCL actions based on their own narrow dispute with a defendant but allege a public interest to expand discovery and increase leverage. Those same plaintiffs might sacrifice the UCL allegations, however, if it means that a quick or beneficial resolution might be obtained. Furthermore, if the current procedures produced finality, “it might be based on who reaches the courthouse door first, or more likely, based on who the defendant settles with first—effectively giving the ‘private attorney general’ selection to the defendants, not the ideal party to make such a decision.”

On the other hand, the denial of res judicata means that plaintiffs who are serving a true private attorney general function and who are attempting to vindicate larger interests cannot offer defendants a final resolution. A perceived lack of finality by defendants would lead them to “delay or avoid publicly advantageous settlements” because they would be subjected “to an unlimited number of lawsuits from future litigants over the same alleged practice.” As a result, defendants could face having to vigorously defend a suit only to find that they must do so over and over again. Or defendants could attempt to settle a lawsuit with no guarantee that the settlement would preclude future actions.

The California Legislature has made attempts to resolve the preclusion issue, to no avail. For example, in February 2002, Assemblyman Robert Pacheco introduced a bill in the state Assembly that, in its amended form, recognized that:

(d) The unfair competition law is being misused by a significant number of private attorneys as a means of generating attorneys’ fees without creating investigation.
a corresponding public benefit in certain situations, including the follow-
ing: (3) Filing repetitive claims on behalf of the general public over issues and activities that have already been resolved by a prior claim on behalf of the general public.46

The bill proposed a new section, Business and Professions Code Section 17300, which would allow for private, representative UCL actions if 1) the plaintiff suffered a distinct and palpable injury due to unfair competition, 2) the plaintiff served the defendant with a copy of a notice of intent to sue 90 days before commencing the action, 3) no public prosecution was initiated against the defendant “alleging substantially similar facts and theories of liability,” and 4) no other private, representative action was initiated against the defendant “alleging substantially similar facts and theories of liability.”47

The bill never made it out of the Assembly Committee on Judiciary, however. Sadly, this was not surprising, for, as the California Supreme Court aptly noted, “[W]henever the Legislature has acted to amend the UCL, it has done so only to expand its scope, never to narrow it.”48

1 BUS. & PROF. CODE §17200.
Recent arrests and trials of suspected terrorists in Bahrain, France, Germany, Indonesia, Jordan, Malaysia, Pakistan, Spain, Yemen, and elsewhere demonstrate the global nature of the antiterrorism campaign being led by the United States. Although these cases are being pursued in foreign jurisdictions, witnesses and other evidence are likely to be located in the United States. As a result, prosecutors and suspects in such cases may invoke 28 USC Section 1782, a little-known federal statute that enables parties to take discovery in the United States for legal proceedings abroad.

Since 1855, U.S. law has provided some degree of assistance to foreign parties seeking evidence in the United States.1 The law evolved over the years, with Congress substantially broadening its scope in 1964. The current version of the statute potentially applies to all foreign civil and criminal matters and is not limited to terrorism or any other category of cases. The statute, which has remained virtually unchanged for almost 40 years, states:

The district court of the district in which a person resides or is found may order him to give his testimony or statement or to produce a document or other thing for use in a proceeding in a foreign or international tribunal, including criminal investigations conducted before formal accusations. The order may be made pursuant to a letter rogatory issued, or request made, by a foreign or international tribunal or upon the application of any interested person and may direct that the testi-

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mony or statement be given, or the document or other thing be produced, before a person appointed by the court. By virtue of his appointment, the person appointed has power to administer any necessary oath and take the testimony or statement. The order may prescribe the practice and procedure, which may be in whole or in part the practice and procedure of the foreign country or the international tribunal, for taking the testimony or statement or producing the document or other thing. To the extent that the order does not prescribe otherwise, the testimony or statement shall be taken, and the document or thing produced in accordance with the Federal Rules of Civil Procedure.

Additionally, “[a] person may not be compelled to give his testimony or statement or to produce a document or other thing in violation of any legally applicable privilege.”3

**Three Questions**

Although the statute appears to be relatively straightforward, it has generated considerable litigation in recent years. That litigation has focused on three questions: What are the statute’s expressed requirements and limitations? Are there any implied requirements? And, if the statute’s requirements are satisfied, what discretion does the district court have in implementing the statute?

Courts have interpreted the statute as imposing three requirements. First, the discovery sought must be for use in a “proceeding in a foreign or international tribunal.” Next, the application must seek discovery from a “person” who “resides or is found” in the district in which the application is filed. Third, the application must be made by a “foreign or international tribunal” or an “interested person.”5

The first requirement has led courts repeatedly to address what constitutes a “proceeding in a foreign or international tribunal” under Section 1782. Traditional lawsuits in courts of law are clearly included. However, it is less clear whether inquiries conducted by administrative bodies and other similar proceedings fall within the terms of the statute. The Ninth Circuit has held that the phrase is “intended to be read broadly to include quasi-judicial and administrative bodies and foreign investigating magistrates.”6 In the Ninth Circuit, any proceeding that is “related to a quasi-judicial or judicial proceeding” qualifies under Section 1782.7 The Second Circuit applies a slightly different analysis. The test there concerns whether the foreign proceeding is “adjudicative in nature.”8 Despite the apparent precision of these tests, the case law suggests they are difficult to apply and the results turn on the particular facts of an individual case.9

Until recently, surprisingly little attention has been paid to the issue of whether a private international arbitration qualifies as a “foreign or international tribunal.” The majority of commentators believe that Section 1782 does apply to private commercial arbitrations,9 and one early district court case so held.10 However, in recent years, the Second and Fifth Circuits have decided that a private international arbitration is not a foreign or international tribunal within the meaning of the statute.11 There does not appear to be any circuit court authority to the contrary.

In future years, courts will likely have to decide whether the International Criminal Court (ICC) constitutes a “foreign or international tribunal” under the statute. The ICC was created in 1998 pursuant to the Rome Statute of the International Criminal Court and came into effect in July 2002. Although the United States initially supported the creation of a permanent international criminal court, this country later renounced the ICC and indicated that the United States would not have any involvement in the court. Thus, although the ICC would likely qualify as an “international tribunal” under Section 1782, the U.S. government’s adverse position may provide litigants with a basis for resisting discovery sought in connection with an ICC proceeding.

The statute’s second requirement is that the discovery be sought from a person who resides or is found in the district. A recent case arising out of the automobile crash in Paris that killed Princess Diana established new law regarding the definition of a “person” under Section 1782. Although both individuals and entities qualify as persons under the statute, until recently no court had decided whether the federal government constitutes a person under Section 1782. In connection with a French investigation of the crash, Mohammed Al Fayed (the father of Dodi Fayed, the other crash victim) sought to subpoena documents from the Central Intelligence Agency. The trial court refused to compel compliance with the subpoena on the ground that “person” did not include the sovereign. Al Fayed appealed, and the D.C. Circuit Court affirmed the lower court. The court noted the statute did not expressly refer to the federal government one way or the other. After analyzing a number of statutes and precedents, and addressing Section 1782’s reference to the Federal Rules of Civil Procedure, the D.C. Circuit Court concluded that the term “person” does not include the federal government or its agencies.12

The statute’s final requirement is that the Section 1782 applicant be either the tribunal itself or an “interested person.” The statute does not define the term “interested person,” but courts have generally held that this encompasses both persons designated as such under foreign law and parties to the foreign proceeding.13 Although parties attempting to resist discovery have challenged Section 1782 applications on the ground that the applicant is not an interested person, there does not appear to be any reported decision denying discovery on this basis.

If an applicant establishes the three requirements necessary to invoke Section 1782, the statute mandates that the court nonetheless deny the application if the discovery would violate “any legally applicable privilege.”14 A party may thus resist discovery under Section 1782 on the ground that such discovery would violate his or her constitutional rights, such as the privilege against self-incrimination or the right to be free from unreasonable searches and seizures.15 Likewise, if the discovery fails to meet the constitutional requirements of due process, it should be prohibited.16

Courts have interpreted the phrase “any legally applicable privilege” to encompass a variety of statutory and common law rights. The Eleventh Circuit, for example, upheld the decision of the U.S. magistrate that refused to disclose grand jury materials, attorney work product, and records of intercepted conversations on statutory and common law grounds.17

The “legally applicable privilege” precluding discovery may also be a privilege under a foreign legal system.18 However, courts have had some difficulty when confronted with such a claim. Indeed, the Second Circuit has suggested that courts should require “authoritative proof” of an alleged foreign privilege before refraining from granting a Section 1782 application based on such claims.19

**Implied Limitations**

Most of the litigation concerning Section 1782 has not focused on the express statutory requirements and limitations but rather on potential implied extrastatutory limitations or conditions. One such issue is whether the foreign proceeding must be “pending” at the time of the Section 1782 application. Until 1964, the statute was expressly limited to “pending” proceedings. That requirement was deleted in the 1964 amendments, and courts have generally recognized that there is no such requirement. Some courts are nonetheless reluctant to accept the elimination of the “pending” requirement. Most notably, the Second Circuit has suggested that the omission of the “pending” require-
ment may have been inadvertent. The Second Circuit has thus substituted an “imminence” requirement in place of the “pending” requirement:

Though we will not insist that a proceeding be “pending,” we think it prudent, in the absence of any indication as to why Congress deleted the word “pending” and in view of the distinct possibility that the deletion might have been inadvertent, to require that the adjudicative proceeding be imminent—very likely to occur and very soon to occur.

It appears that the court was trying to strike a balance between legitimate discovery requests and privacy interests of U.S. citizens:

That [imminence] standard permits foreign governments to obtain judicial assistance from American courts when they are on the verge of instituting adjudicative proceedings in which the uses of disclosed material may be carefully controlled but avoids the risk inherent in making confidential material available to investigative agencies in countries throughout the world at preliminary stages of their inquiries. The latter course poses dangers to legitimate privacy interests of our citizens that we do not believe Congress intended to imperil.

In contrast, the Ninth Circuit has repeatedly refused to recognize either a “pending” or an “imminence” requirement. The Ninth Circuit’s rejection of the Second Circuit position is persuasive:

Focusing on the plain language of the statute…we note that the word “imminent” does not appear. Surely, had Congress wanted to authorize assistance of foreign investigations only when foreign proceedings are imminent, it could have said so. It is also impossible to read an imminence requirement into the statute following the 1996 amendment to [Section] 1782 (authorizing assistance in “criminal investigations conducted before formal accusation”) without leading to an absurd result. Appellant’s insistence on “imminence” would create an untenable Catch-22 for foreign law-enforcement authorities seeking U.S. aid: investigators would be unable to receive such help before proceedings actually become imminent, and yet the proceedings might never become imminent because the investigators would be stymied in collecting evidence necessary to justify the filing of criminal charges.

This dispute has yet to be resolved, and the remaining circuits have taken a variety of positions on this issue. For example, the D.C. Circuit requires that the proceedings in the foreign tribunal be “in reasonable contemplation” when the discovery request is made. The Eleventh Circuit’s position apparently requires only that the evidence will eventually be used in a proceeding.

The Question of Discovery

Perhaps the most widely litigated issue regarding Section 1782 is whether an applicant must make a threshold showing, prior to obtaining discovery, that the information sought in the United States would be subject to discovery in the foreign jurisdiction. The courts have offered three answers to this question: yes, it depends, and no.

In the First and Eleventh Circuits, a request for discovery under Section 1782 will only be granted if the evidence would be discoverable in the foreign jurisdiction. In re Application of Asta Medica, S.A. is the leading proponent of a requirement that the information be discoverable. In that case, the First Circuit held that the history, rationale, and policy considerations of Section 1782 require an applicant to show that the information is discoverable under foreign law before discovery will be ordered in the United States. The court was apparently concerned that a U.S. party involved in litigation in a foreign country with limited pretrial discovery could be disadvantaged against the foreign party:

All the foreign party need do is file a request for assistance under Section 1782 and the floodgates are open for unlimited discovery while the United States party is confined to restrictive discovery in the foreign jurisdiction. Congress did not amend Section 1782 to place United States litigants in a more detrimental position than their opponents when litigating abroad. This result would be contrary to the concept of fair play embodied in United States discovery rules and the notion that “[m]utual knowledge of all relevant facts gathered by both parties is essential in proper litigation.”

The First Circuit was also concerned that, by enabling foreign litigants to obtain information not available in the foreign jurisdiction due to either procedural restrictions or substantive laws, Section 1782 could be used to circumvent those foreign laws and procedures. The court held that “Congress did not seek to place itself on a collision course with foreign tribunals and legislatures, which have carefully chosen the procedures and laws best suited for their concepts of litigation.”
The Fourth and Fifth Circuits also give great weight to concerns regarding circumventing foreign restrictions on discovery and avoiding offense to foreign tribunals. Accordingly, they impose a discoverability requirement when the Section 1782 applicant is a private litigant but not when the discovery request comes from the foreign court itself.23 These courts reason that, since the foreign court is presumably the arbiter of what is discoverable under its own rules, it makes no sense for a U.S. court to double-check the foreign court's request to determine whether the discovery would be available in the foreign jurisdiction.

The Second, Third, and Ninth Circuits have all rejected a discoverability requirement, regardless of whether the applicant is a private litigant or a foreign court.24 Those circuits note that there is nothing in the text of Section 1782 that makes any reference to a foreign discoverability requirement. In Advanced Micro Devices, Inc. v. Intel, for example, the court noted: "The legislative history is equally devoid of any indication that Congress intended to limit the scope of Section 1782 to those situations in which the discovery sought would be discoverable under the law of the foreign jurisdiction."25 Moreover, these circuits have held that a discoverability requirement would not further the statute's purposes of providing efficient means of assistance to foreign courts and encouraging other nations to do the same.22

Courts have generally refused to impose any other extrastatutory limitations or requirements. For example, courts have rejected claims that a witness should not be required to give evidence because that evidence is not admissible in the foreign jurisdiction.23 Appellate courts have been no more receptive to the claim that a district court should not order discovery under Section 1782 until and unless the applicant first seeks that discovery from the foreign tribunal. They have held that a "quasi-exhaustion requirement," which would force litigants to first seek the information through the foreign tribunal before requesting discovery from the district court, finds no support in the plain language of the statute and runs counter to its purposes.24

Courts have likewise rejected the argument that Section 1782 requires that foreign courts have corresponding assistance procedures.25 As the Second Circuit explained, "Congress purposely engineered [Section] 1782 as a one way street. It grants wide assistance to others, but demands nothing in return."26 In practice, many countries have signed bilateral mutual legal assistance treaties with the United States or are party to the Hague Convention on Taking Evidence Abroad in Civil or Commercial Matters, which provide additional avenues for obtaining discovery in foreign countries. However, these agreements are not a prerequisite to obtaining discovery under Section 1782.

### Trial Court Discretion

An applicant that satisfies the statutory requirements, as well as any extrastatutory hurdles, is not home free: The district court has discretion to grant, limit, or deny discovery.27 The court's discretion has been described as "considerable,"28 "wide,"29 and "broad."30

The statute does not provide any guidance as to how the court should exercise such discretion.41 Several courts have stated that "in exercising its discretion under [Section] 1782, the district court should be guided by the statute's twin aims of providing efficient means of assistance to participants in international litigation in our federal courts and encouraging foreign countries by example to provide similar means of assistance to our courts."42 In fact, the Second Circuit has stated that so long as the district court fashion its order in accordance with these twin aims, it acts within its discretion.43 Other courts have suggested a number of relevant factors to consider in the exercise of discretion. These factors include: 1) the nature and attitudes of the government of the country from which the request emanates and the character of the proceedings in that country,44 2) whether the foreign tribunal for which the discovery is sought would take offense to the granting of the application,45 3) discoverability,46 4) reciprocity,47 and 5) whether the application is made in good faith.48 As a practical matter, any reasonable exercise of discretion is likely to be upheld, given the district court's considerable authority in this regard.

In the context of terrorism, national security is likely to be considered as an important factor in a court's exercise of discretion. For example, even if a foreign government or suspected terrorist satisfies the requirements of Section 1782, a district court is likely to give great weight to a plea by the U.S. Department of Justice to deny the discovery request on national security grounds.49 It is also likely that foreign policy concerns could affect Section 1782 litigation regarding a proceeding in the International Criminal Court. For example, the executive branch may support a discovery request from a prosecutor if the defendant is a suspected terrorist but vehemently oppose a similar request if the defendant is a U.S. citizen. Courts will undoubtedly be called upon to address such issues in exercising discretion under the statute.

The district court also has discretion regarding the procedures to be employed in connection with Section 1782. The statute provides that the court's order "may prescribe the practice and procedure, which may be in whole or in part the practice and procedure of the foreign country or the international tribunal, for taking the testimony or statement or producing the document or other thing."50 However, absent an explicit prescription, the discovery process will be guided by the Federal Rules of Civil Procedure, with courts usually deferring to those rules.51

In granting a Section 1782 application, the court may also impose appropriate conditions.52 Such conditions generally take the form of protective orders governing the confidentiality of the discovery materials or the protection of privileged information.53 In some instances, however, the conditions are substantially more significant. For example, in response to a concern that permitting discovery in the United States would alter the balance created by the procedural rules of the foreign tribunal, the Second Circuit has endorsed trial court orders that impose reciprocal discovery obligations on the parties.54 District courts thus have extremely wide discretion regarding virtually all aspects of an application under Section 1782.

Section 1782 can provide an effective means of obtaining evidence in the United States for foreign or international proceedings. The statute has been used sparingly and most often in ordinary civil and criminal matters, but it is likely to be employed with increasing frequency in the future. Moreover, although it will usually be invoked in connection with international commercial disputes and mundane criminal investigations, it will undoubtedly play a role in the campaign against international terrorism.
7 In re the Application of Ishihara Chem. Co., 121 F. Supp. 2d 209, 218 (E.D. N.Y. 2000) (Patent invalidity proceeding before the Japanese patent office is a proceeding in a foreign or international tribunal.); In re Gianoli Albinati, 3 F. 3d 54, 62 (2d Cir. 1993) (Chilean incompetency proceeding in which a court-appointed guardian sought discovery to inventory property is within the statute’s scope.); Advanced Micro Devices, Inc., 292 F. 3d at 666-68 (Investigation being conducted by the Directorate General-Competition of the European Commission qualifies.); In re Letters Rogatory from the Tokyo Dist., Tokyo, Japan, 539 F. 2d 1216, 1219 (9th Cir. 1976) (Investigation being conducted by the Tokyo public prosecutor’s office is a proceeding before a foreign or international tribunal.); In re Request for Int’l Judicial Assistance for the Federative Republic of Braz., 936 F. 2d 702, 705 (2d Cir. 1991) (Investigation conducted by Brazilian police, tax, and currency officials does not qualify.); Letters Issued by the Dir. of Inspection of the Gov’t of India, 385 F. 2d at 1021 (Tax assessment inquiry by an Indian income tax officer unrelated to judicial proceedings does not qualify.); In re Letters of Request to Examine Witnesses from the Court of Queen’s Bench from Manitoba, Can., 488 F. 2d 511, 512 (2d Cir. 1976) (Canadian Commission of Inquiry, whose purpose is to conduct investigations, does not qualify.); Fonseca v. Blumenthal, 630 F. 2d 322, 324 (2d Cir. 1980) (Investigation conducted by the Colombian Superintendent of Exchange Control is not a proceeding in a foreign or international tribunal.).


9 See, e.g, In re Letter of Request from the Boras Dist. Court, Sweden, 153 FRD 31, 34 (E.D. N.Y. 1994) (finding those rights would not be violated by order requiring blood sample). In re Letter Rogatory from the First Court of First Instance in Civil Matters, Caracas, Venez., 42 F. 3d 308, 311 (5th Cir. 1995) (rejecting claim that letter rogatory violated due process); In re Letter of Request from the Local Court of Pforzheim, Div. AV, F.R.G., 132 FRD 366 (W.D. Mich. 1989) (finding that an order compelling witness to provide a blood sample did not violate any due process right). Some courts have suggested that the due process analysis requires federal courts to look beyond the discovery and examine the proceeding in which that discovery is to be used. Surprisingly, courts seem to agree that, before ordering discovery, they may “scrutinize the underlying fairness of foreign proceedings to insure they comply with notions of due process.” John Deere Ltd. v. Sperry Corp., 754 F. 2d 132 n.3 (3d Cir. 1985); accord In re Request for Judicial Assistance from the Seoul Dist. Criminal Court, Seoul, Korea, 555 F. 2d 720, 724 (9th Cir. 1977) (recognizing that an inquiry into the foreign proceedings may be appropriate if “departures from our concepts of fundamental due process and fairness are involved”); In re Letter of Request from the

10 NBC v. Bear Stearns & Co., Inc., 165 F. 3d 184, 185 (2d Cir. 1999); Republic of Kazakhstan, 168 F. 3d at 881-83.


12 See, e.g, In re Request for Judicial Assistance from the Seoul Dist. Criminal Court, Seoul, Korea, 555 F. 2d 720, 724 (9th Cir. 1977) (recognizing that an inquiry into the foreign proceedings may be appropriate if “departures from our concepts of fundamental due process and fairness are involved”); In re Letter of Request from the

13 28 U.S.C. §1782(a) (“[A] person may not be compelled to give...testimony or statement or to produce a document or other thing in violation of any legally applicable privilege.”).

14 See, e.g, In re Request for Judicial Assistance from the Seoul Dist. Criminal Court, Seoul, Korea, 555 F. 2d 720, 724 (9th Cir. 1977) (recognizing that an inquiry into the foreign proceedings may be appropriate if “departures from our concepts of fundamental due process and fairness are involved”); In re Letter of Request from the
Government of France, 139 FRD 588, 592 (S.D. N.Y. 1991) (Federal courts are not to decide the propriety of the use of the evidence obtained under §1782 “absent a showing that a requesting country is manipulating §1782 in a manner offensive to concepts of fundamental due process and fairness.”). For the time being, this issue seems more theoretical than real. There is no reported case of a court denying a request under §1782 on the ground that the foreign proceeding does not comply with due process. This is not surprising in light of the fact that discovery under §1782 is generally sought for use in proceedings in countries that share U.S. concepts of due process. The true test will arise if discovery is sought under the statute for use in a proceeding that offends such principles.

11 United States v. United Kingdom, 238 F. 3d 1312, 1320-22 (11th Cir. 2001); see also Al Fayed v. United States, 210 F. 3d 421, 424-25 (4th Cir. 2000) (refusing to issue subpoena for classified documents).

12 In re Erato, 2 F. 3d 11, 14-15 (2d Cir. 1993); accord In re Request for Assistance from the Ministry of Legal Affairs of Trin. & Tobago, 848 F. 2d 1151, 1156 (11th Cir. 1988).

13 In re Metallgesellschaft A.G., 121 F. 3d 77, 80 (2d Cir. 1997).

14 In re Request for Int'l Judicial Assistance for the Federative Republic of Brazil, 936 F. 2d 702, 705 (2d Cir. 1991); but see In re Letter Request for Assistance from the Crown Prosecution Serv. of the U.K., 870 F. 2d 686, 691 (D.C. Cir. 1989) (“[W]e will not treat Congress' deletion of the word 'pending' as a mistake or mere accident.”).

15 Request for Int'l Judicial Assistance for the Federative Republic of Brazil, 936 F. 2d 706.

16 Advanced Micro Devices, Inc. v. Intel Corp., 292 F. 3d 664, 667 (9th Cir. 2002). (“[N]ot for need the proceeding be imminent, as Congress made clear through the elimination of the requirement that the proceeding be pending.”).

17 United States v. Sealed 1, Letter of Request for Legal Assistance from the Deputy Prosecutor Gen. of the Russian Federation, 235 F. 3d 1200, 1205 (9th Cir. 2001).

18 In re Letter Request from the Crown Prosecution Serv. of the U.K., 870 F. 2d at 687.

19 In re Request for Assistance from the Ministry of Legal Affairs of Trin. & Tobago, 848 F. 2d 1151, 1152 (11th Cir. 1988).

20 In re Application of Asta Medica, S.A., 981 F. 2d 1, 6-7 (1st Cir. 1992); United States v. United Kingdom, 226 F. 3d 1312, 1319 (11th Cir. 2001).

21 Application of Asta Medica, S.A., 981 F. 2d at 5-6.

22 Id. at 6.

23 In re Letter Request of Atsgericht Ingolstadt, F.R.G., 82 F. 3d 590, 592 (4th Cir. 1996); In re Letter Rorgotary from the First Court of First Instance in Civil Matters, Caracas, Venez., 42 F. 3d 308, 310 (5th Cir. 1995).

24 In re Request for Int'l Judicial Assistance for the Federative Republic of Brazil, 936 F. 2d 702 (2d Cir. 1991); In re Bayer A. G., 146 F. 3d 188, 193 (3d Cir. 1998); Advanced Micro Devices, Inc. v. Intel Corp., 292 F. 3d 664, 668-9 (9th Cir. 2002).

25 Advanced Micro Devices, Inc., 292 F. 3d at 669; Bayer A. G., 146 F. 3d at 193.

26 Bayer A. G., 146 F. 3d at 193; In re Metallgesellschaft A.G., 121 F. 3d 77, 79 (2d Cir. 1997).

27 Bayer A. G., 146 F. 3d at 193; In re Request for Assistance from the Ministry of Legal Affairs of Trin. & Tobago, 848 F. 2d 1151, 1156 (11th Cir. 1988); In re Request for Judicial Assistance from the Seoul Criminal Court, Seoul, Korea, 555 F. 2d 720, 723 (9th Cir. 1977).

28 Metallgesellschaft A.G., 121 F. 3d at 79; Application of Malev Hungarian Airlines, 964 F. 2d 97, 100 (2d Cir. 1992).

29 Bayer A. G., 146 F. 3d at 193; Malev Hungarian Airlines, 964 F. 2d at 97.

30 Euromepa, S.A. v. R. Esmerian, Inc., 51 F. 3d 1095, 1097 (2d Cir. 1995).

31 Bayer A. G. v. BetaChem, Inc., 173 F. 3d 188, 191 (3d Cir. 1999); Metallgesellschaft A.G., 121 F. 3d at 79; accord Al Fayed v. United States, 210 F. 3d 421, 424-25 (4th Cir. 2000) (“[T]he statute explicitly permits to the district court's discretion the determination of whether to grant a request for assistance in a foreign tribunal.”); United States v. Sealed 1, Letter of Request for Legal Assistance from the Deputy Prosecutor Gen. of the Russian Federation, 235 F. 3d 1200, 1206 (9th Cir. 2000) (“[T]he fact that §1782 authorizes assistance does not mean that the district court must exercise its discretion to grant such assistance.”).

32 Letter of Request for Legal Assistance from the Deputy Prosecutor Gen. of the Russian Federation, 235 F. 3d at 1205.

33 Al Fayed, 210 F. 3d at 424.

34 Euromepa, S.A., 51 F. 3d at 1102; In re Lo Ka Chun, 858 F. 2d 1564, 1565 (11th Cir. 1988).

35Letter of Request for Legal Assistance from the Deputy Prosecutor Gen. of the Russian Federation, 235 F. 3d at 1205.

36 210 F. 3d at 424.

37 Id., 235 F. 3d at 1205.

38 In re Letter of Request from Atsgericht Ingolstadt, F.R.G., 82 F. 3d 590, 592 (4th Cir. 1996); In re Letter Rorgotary from the First Court of First Instance in Civil Matters, Caracas, Venez., 42 F. 3d 308, 310 (5th Cir. 1995).


42 BetaChem, Inc., 173 F. 3d at 191; In re Gianoli Ablucht, 3 F. 3d 54, 59 (2d Cir. 1993).

43 See, e.g., In re Bayer A. G., 146 F. 3d 188, 196 (3d Cir. 1998) (noting that the trial court could consider appropriate measures to protect the confidentiality of the materials); Euromepa, S.A., 51 F. 3d at 1100 n.4.

44 In re Application of Esses, 101 F. 3d 873, 876 (2d Cir. 1998); accord In re Gianoli Ablucht, 3 F. 3d 54, 61 (2d Cir. 1993) (“[B]ecause the district court's exercise of discretion properly was guided by the purposes of §1782, we hold that the court did not abuse its discretion.”).


46 Bayer A.G., 146 F. 3d at 195; Gianoli Ablucht, 3 F. 3d 54, 59.

47 In re Metallgesellschaft A.G., 121 F. 3d 77, 79 (2d Cir. 1997); Euromepa, S.A., 51 F. 3d at 1098; Gianoli Ablucht, 3 F. 3d at 60.


49 Euromepa, S.A., 51 F. 3d at 1101; accord Letter of Request for Legal Assistance from the Deputy Prosecutor Gen. of the Russian Federation, 235 F. 3d at 1205 (District court has discretion to decline application if request is being used to harass political opponents.).

50 Refusing to allow Terror Suspects to Testify, WASHINGTON POST, Nov. 20, 2002.

51 In re Application of Esses, 101 F. 3d 873, 876 (2d Cir. 1998); accord In re Gianoli Ablucht, 3 F. 3d 54, 61 (2d Cir. 1993).
Issues of loyalty and confidentiality continue to dominate developments in legal ethics

By John W. Amberg and Jon L. Rewinski

Last year, conflicting pressures from within California and outside the state buffeted the field of legal ethics for California lawyers. On the national stage, responding to the public outcry over corporate malfeasance, policymakers sought to enlist lawyers in the enforcement process by making them blow the whistle on their clients. Congress passed the Sarbanes-Oxley Act of 2002, which required the Securities and Exchange Commission to propose regulations imposing new duties on lawyers when they are faced with client wrongdoing. The American Bar Association proposed similar changes to the Model Rules of Professional Conduct. Lawyers and bar groups from throughout the country, including the Los Angeles County Bar Association, have warned that such regulations would alter the attorney-client relationship and threaten confidentiality and trust.

In California, the response by the state supreme court and the governor to recent scandals was to reaffirm the lawyer’s duty to counsel his or her client to avoid wrongdoing while still preserving the confidentiality that makes such advice possible. The supreme court rejected the State Bar’s proposed amendment to Rule 3-600 of the Rules of Professional Conduct that would have provided new protection to whistle-blowing attorneys. The court’s rationale was that the amendment was in conflict with Business and Professions Code Section 6068(e), which requires an attorney “[t]o maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client.” When the state Assembly tried to amend the law, Governor Gray Davis vetoed the legislation, saying that while it was well-intended, the proposed law would erode the relationship that is intended to foster candor between the attorney and client.

Cases decided by California courts last year also reflected this tension between a strict construction of an attorney’s ethical duties and a more pragmatic response to the modern realities of practice. A more long-range view will be provided by the State Bar’s Commission for the Revision of the Rules of Professional Conduct.
Professional Conduct, which held public hearings around California as it proceeded with its multiyear task.

Duty of Loyalty

The two paramount duties owed by a lawyer to a client are the duty of loyalty and the duty of confidentiality. The duty of loyalty was given a ringing affirmation by the Second District Court of Appeal in American Airlines, Inc. v. Shepard, Mullin, Richter & Hampton. The background was a federal lawsuit by ADO Finance A.G. against McDonnell Douglas Corporation over the payload capacity and range of the MD-11 aircraft. Gregory A. Long, a partner in the Shepard, Mullin law firm, was retained by American Airlines to review confidential American-related documents to be produced by McDonnell Douglas in response to an ADO document request, and to oppose their production if necessary. The airline had an interest in protecting the reputation of the airplanes it was flying and its confidential information. After the document review, the airline also asked the partner to respond to a threatened subpoena of American by ADO. Simultaneously, ADO’s lawyers asked him to appear as a witness for ADO under Rule 30(b)(6) of the Federal Rules of Civil Procedure. ADO’s lawyers made this request of him because ADO had no employee who was as knowledgeable as Long. American objected, but after consulting his law firm’s ethics committee, the partner wrote his client that his work for the airline was completed, and he would accept the ADO assignment. During the deposition, the partner refused to answer questions relating to his work for American, and a special master later ruled he was not a proper Rule 30(b)(6) witness.

American Airlines successfully sued Long and Shepard, Mullin for breach of fiduciary duty, and the court of appeal affirmed. On appeal, the partner and the law firm argued that Rule 3-310(C) of the Rules of Professional Conduct, which governs conflicts of interest, did not apply because the partner was acting as a witness for ADO and not as its counsel. However, the court of appeal held that Rule 3-310(C) applied because as ADO’s designated agent, the partner owed a fiduciary duty to answer the deposition questions to the best of his ability, which conflicted with his fiduciary duty to preserve American’s confidences. Furthermore, under the “hot potato rule,” the lawyer could not avoid breaching his duty of loyalty by dropping his present client to accept the new assignment. The court of appeal held that the partner’s characterization of his relationship with American as over was disingenuous and in conscious disregard of the client’s rights.

Long and Shepard, Mullin also argued that Rule 3-310(E) of the Rules of Professional Conduct, which prohibits the use of confidential information against a former client, did not apply because as a nonparty, American Airlines was not adverse to ADO. However, a former client need not be a party to the litigation for a conflict to arise, and the court of appeal noted that American had retained the partner to resist ADO’s discovery and avoid public disparagement of the aircraft. Finally, the lawyers argued that even if the partner possessed material confidential information from his representation of American, there was no danger of disclosure because ADO had agreed he would not be required to disclose confidential information obtained from American and he was in sole control of any disclosure. The court of appeal “categorically rejected” this argument, which it said was “anathema to the Rules of Professional Conduct.” The court explained:

Long’s promise to maintain the confidences of American is entirely dependent on his self-assumed position as arbiter of his own fidelity and what is and is not a privileged communication. That is not a permissible avoidance of his fiduciary duty...Clients always have to trust attorneys to maintain confidences imparted during the course of the attorney-client relationship, but they are not compelled to accept the attorney’s invitation to “trust me” when he undertakes to align himself with a new client whose interests pose a conflict of interest.

Both the duty of loyalty and the duty of confidentiality were considered in City National Bank v. Adams. An attorney who prepared an opinion letter for City National Bank concerning the effect of a restrictive legend on stock pledged as collateral by a borrower was disqualified from representing the same borrower in a subsequent lawsuit by CNB against the borrower. The Second District Court of Appeal affirmed. Quoting a 1932 California Supreme Court case, Wutchumna Water Company v. Bailey, the appellate court noted:

An attorney is forbidden to do either of two things after severing his relationship with a former client. He may not do anything that will injuriously affect his former client in any matter in which he formerly represented him nor may he at any time use against his former client knowledge or information acquired by virtue of the previous relationship.

Therefore, a lawyer who accepts employment in violation of these rules is subject to disqualification.

The trial court found that the prior representation concerned the same matter as the subsequent representation, and the court of appeal agreed. Though the duty of loyalty furnished a sufficient basis for disqualification, the court of appeal also analyzed the lawyer’s duty of confidentiality under Rule 3-310(E). It held that when a substantial relationship exists between a former representation and a current representation, courts will “conclusively presume” that confidences material to the current dispute were exchanged between the lawyer and the former client. In the absence of informed written consent from the clients, the need to protect the first client’s confidential information required the lawyer to be disqualified. A pragmatic exception for those situations when a lawyer can show he or she had no opportunity to obtain confidential information was not available in this case because the lawyer’s clients were on opposite sides in the same matter, and the matter involved the lawyer’s work for the former client.

Duty of Confidentiality

Last year courts of appeal reversed orders disqualifying lawyers in three published cases that considered the duty of confidentiality. In DCH Health Services Corporation v. Waite, two individual plaintiffs associated with plaintiff Downey Community Hospital Foundation moved to disqualify the defendant’s lawyer because he was married to Ana Luna, a former director of the foundation who also happened to be a Los Angeles Superior Court judge. Despite the lawyer’s denial that he had received confidential information from his wife, the trial court concluded that the “unique nature of the marital relationship” created an appearance of impropriety that only disqualification would cure. The Fourth District Court of Appeal reversed, holding that the individual plaintiffs lacked standing because they were never in a confidential relationship with the former director, and that neither the marital relationship nor the desire to avoid an “appearance of impropriety” was sufficient to disqualify the lawyer. The appellate court refused to decide the issue in a rote fashion based merely on the relationship between the lawyers. Indeed, the court offered an admonishment:

Rather, the court should start with the presumption that, unless proven otherwise, lawyers will behave in an ethical manner. Society has entrusted lawyers with confidences, and we should not assume that lawyers will violate these confidences when involved in particular relationships.

The doctrine of imputed knowledge was the subject of another Fourth District Court...
1. The two paramount duties owed by a lawyer to a client are loyalty and confidentiality.
   True. False.
2. Rule 3-310 of the Rules of Professional Conduct, which governs conflicts of interest, is inapplicable when an attorney is not acting as counsel for a client.
   True. False.
3. An attorney can avoid a conflict of interest between an existing client and a new client by resigning from his or her existing engagement.
   True. False.
4. Rule 3-310(E) of the Rules of Professional Conduct, which prohibits the use of a former client’s confidential information, is inapplicable if the former client is not an adverse party in a lawsuit against a new client.
   True. False.
5. Lawyers cannot be the arbiter of their own fidelity and what is and is not a privileged communication in order to avoid breaching their fiduciary duty to a client.
   True. False.
6. After severing a relationship with a client, lawyers may not:
   A. Do anything that will injure the former client in any matter in which they formerly represented the client.
   B. Use against their former client any knowledge or information acquired by virtue of the relationship.
   C. A and B.
7. When a substantial relationship exists between former and current representations, courts will presume that confidences material to the current dispute were exchanged between the lawyer and former client.
   True. False.
8. A lawyer can rebut the presumption that material confidences were shared by showing that he or she had no opportunity to obtain confidential information.
   True. False.
9. To protect a former client’s confidences, a lawyer may be disqualified from a new representation unless the lawyer obtains informed written consent from both the former client and the new client.
   True. False.
10. An appearance of impropriety, without evidence that a lawyer shared confidential information, is sufficient to disqualify the lawyer.
    True. False.
11. A court will not disqualify a lawyer based on double imputation; that is, by imputing knowledge of confidential information from one member of a firm to all of the lawyers in the firm, and from that firm to an entirely different firm.
    True. False.
12. A confidentiality clause in a settlement agreement does not prevent the client from testifying as a percipient witness in another lawsuit brought by the same lawyer who represented the client in the case that led to the settlement agreement.
    True. False.
13. Possession of an adversary’s confidential information by a lawyer automatically disqualifies the lawyer.
    True. False.
14. Business and Professions Code Section 6068(e) states that it is the duty of a lawyer “to maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client.”
    True. False.
15. Business and Professions Code Section 6068(e) has no exceptions.
    True. False.
16. The new ethical rules issued by the SEC pursuant to the Sarbanes-Oxley Act of 2002 allow an attorney to reveal confidential information:
   A. To prevent the issuer of stock from committing a material violation likely to cause substantial financial injury to the issuer or investors.
   B. To prevent the issuer from committing an illegal act.
   C. To rectify the consequences of a material violation or illegal act in which the attorney’s services were used.
   D. All of the above.
   True. False.
17. The SEC rules promulgated under the Sarbanes-Oxley Act of 2002 are inconsistent with Business and Professions Code Section 6068(e).
    True. False.
18. To enforce a fee-sharing agreement, an attorney must comply with Rule 2-200(A)(1) of the Rules of Professional Conduct by disclosing the fee division in writing to the client and obtaining the client’s written consent.
    True. False.
19. An insurance company does not engage in the unauthorized practice of law by employing lawyers to represent its insureds because, absent a conflict of interest, the lawyers represent the insurer’s own rights and interests as well as those of the insureds.
    True. False.
20. There is no fiduciary duty between cocounsel to protect their prospective interests in a contingent fee.
    True. False.
of Appeal case, Frazier v. Superior Court, 18 which involved Cumis counsel for an insured. An insurance company for the defendant retained counsel to represent its interests and also hired an independent lawyer to represent its insured as Cumis counsel. 20 When the Cumis counsel was unavailable, the insurer’s lawyer covered some depositions in his place. Subsequently, the insurer’s law firm discovered it had a conflict of interest because the plaintiffs had contacted another lawyer in the firm about possible representation before filing suit, and it withdrew. The plaintiff moved to disqualify the Cumis counsel on the ground that there was a presumption that the insurer’s lawyers had divulged confidential information to the Cumis counsel. The trial court granted the motion, but the court of appeal vacated the disqualification.

The appellate court held that to affirm the lower court’s order, it would have to impute knowledge of the confidential information not only from one member of the insurer’s counsel’s firm to all the other lawyers in the firm but also from that firm to an entirely different firm, and there was no legal authority for such double imputation. 21

Another attorney disqualification was reversed by the Third District Court of Appeal in McPhearson v. The Michaels Company, 21 an employment discrimination case. The plaintiff’s lawyer had brought discrimination claims against the same employer in an earlier suit on behalf of another employee. When the first suit was settled, the settlement agreement contained a confidentiality clause stating that the plaintiff would keep the terms of the settlement agreement secret and would not disclose any information regarding the agreement to any past, present, or future employee. Later the lawyer sought to introduce the testimony of the first employee into the McPhearson case, and the employer moved to disqualify the lawyer on the ground that the settlement agreement created a conflict of interest. However, the McPhearson court noted that the confidentiality clause did not prevent the first client from testifying as a percipient witness, and that since both clients had executed informed waivers of the conflict, the only party seeking disqualification was a litigation adversary who was not personally interested in the alleged conflict. 22 Expressing skepticism, the appellate court directed the trial court to vacate the order and reinstate the lawyer.

A lawyer is subject to automatic disqualification if his or her representation of a client conflicts with the duty to preserve the confidences of an adverse former client, if the information is material to the new representation and both clients do not consent. 23 But what if the lawyer never represented the opposing party and is exposed to its confidential information? Mere possession of an adversary’s confidential information does not automatically disqualify the lawyer.

The issue was considered in Neal v. Health Net, Inc., 24 a suit for wrongful discharge based on alleged race and gender discrimination by Health Net’s former human resources manager. During the pendency of the suit, the plaintiff’s lawyer agreed to represent another former employee of the defendant, a legal secretary who had been fired after she reviewed the company’s litigation file on the plaintiff that contained privileged communications and reports from outside counsel. The secretary claimed she had looked in the file only to obtain the attorney’s number, but computer records showed that she had accessed the file for two and one-half hours. The lawyer denied receiving any confidential information from the secretary. The defendant had no way to dispute these denials, and there was no direct evidence that its confidential information was shared with the plaintiff’s lawyer, but the trial court concluded that there was a reasonable probability that the secretary had shared confidential information with the lawyer, and disqualified him.

The court of appeal reversed. It reasoned that even if a reasonable inference could be made that confidential information was disclosed, disqualification was inappropriate for mere exposure to such information, especially if the disclosure was in the course of a communication with a new client. 25 Disqualification would not prevent the client from disclosing the information to a new attorney, and it would unfairly penalize the first client by depriving her of her chosen counsel. 26

Whistle-Blowing

Are lawyers permitted, or even required, to be whistle-blowers regarding their clients? Not yet. But the legislative rumblings inside and outside of California during 2002 suggest that the day may soon be coming. For more than a century, the confidentiality of communications between attorney and client has been the bedrock upon which the relationship between the two has been built. Implicit is the belief that an attorney can best represent his or her client only if the client candidly and fully discloses all of the pertinent facts to the attorney. Recognizing the importance of this principle, every jurisdiction extends evidentiary protections to attorney-client communications and imposes ethical rules requiring attorneys to maintain client information in confidence.

Nowhere are the ethical restrictions more stringent than in California, as evidenced by Business and Professions Code Section 6068(e), which requires attorneys to maintain their clients’ confidences and secrets. Section 6068(e) has no exceptions. Thus, under California’s ethical requirements—as opposed to those in virtually every other state—if a client discloses in confidence to his attorney that he intends to kill his spouse, the attorney may not warn the spouse or law enforcement. 27 Rather, in California, the attorney should advise the client against wrongful conduct and, if the client persists, withdraw from the engagement without disclosing confidential information.

In 2001, in the wake of the public allegations by Insurance Department attorney Cindy Ossias about the activities of former Insurance Commissioner Chuck Quackenbush, Assemblyman Darrell Steinberg introduced Assembly Bill 363, “The Public Agency Attorney Accountability Act.” As modified, AB 363 proposed enactment of a new section, Business and Professions Code Section 6068.1, which essentially would have permitted a government agency attorney to refer a concern over misconduct by the agency or its officials to a higher authority within the agency. If the attorney believed this was futile or was not satisfied with the response, the proposed section would have permitted the government agency attorney to disclose the matter to law enforcement. After further amendments, AB 363 was approved by the state Assembly in 2001 and the state Senate in 2002. Governor Davis vetoed AB 363 on September 30, 2002.

As AB 363 was making its way through the California Legislature, on January 26, 2002, the State Bar proposed to amend Rule 3-600 of the California Rules of Professional Conduct, which describes the duties of an attorney with an organization as a client. Rule 3-600 currently provides that if an attorney representing an organization knows that an agent of the organization is or may be committing a violation of law reasonably imputable to the organization, the attorney must comply with Business and Professions Code Section 6068(e). This means that the attorney may urge that the organization reconsider its action and/or refer the issue to the next higher authority in the organization but may not disclose confidential information to anyone outside of the organization, including law enforcement. The State Bar proposed amending the rule to permit disclosure outside of the organization under certain circumstances. The California Supreme Court rejected the proposed amendment on May 10, 2002, reasoning that “the proposed modifications conflict with [Business and Professions] Code section 6068(e).” 28

Thus, attempts to create exceptions to Section 6068(e) were rejected twice in California during 2002. In the meantime, an
ABA Task Force on Corporate Responsibility as well as the Securities and Exchange Commission were also looking into the whistle-blowing issue as a result of sensational revelations of alleged corporate wrongdoing at Enron, WorldCom, Adelphia Communications, and Tyco International, among others. As these scandals were unfolding, on July 16, 2002, the ABA Task Force on Corporate Responsibility issued a preliminary report that recommended modifications to the ABA's Model Rules of Professional Conduct. Although the ABA Model Rules are not binding on members of the California Bar, they are quite influential, particularly in other states.

First, in a manner similar to the California State Bar's ultimately futile attempts to amend Rule 3-600, the task force recommended that Model Rule 1.13—which, like Rule 3-600, generally defines the ethical duties of attorneys representing an organization, as opposed to an individual—be modified 1) to require an attorney to pursue remedial measures for misconduct by reporting it to higher levels of the corporation, and 2) to clarify that this “up the ladder” disclosure does not constitute a breach of the attorney’s duty not to reveal confidential information without client consent. The proposed modification to Model Rule 1.13 is not likely to face significant opposition in California, unless it is interpreted to require an attorney to make a “noisy withdrawal”—that is, to disclose the reasons for withdrawing from the representation. A noisy withdrawal is inconsistent with Rule 3-700 of the California Rules of Professional Conduct and Business and Professions Code Section 6068(e).

Second, the task force recommended that Model Rule 1.6, which generally delineates the duty of attorneys not to reveal confidential information without client consent, be modified 1) to permit disclosure when the attorney believes that client conduct has resulted in or is reasonably certain to result in substantial injury to the financial interests or property of another, and 2) to require disclosure to prevent felonies or other serious crimes, including violations of the federal securities laws, when such conduct is known to the attorney. The Los Angeles County Bar Association, among others, has opposed this proposed modification as weakening the attorney-client relationship, discouraging clients from candidly discussing the facts with counsel, and impeding an attorney’s ability to advise his or her clients to perform responsibly.

Third, the task force recommended that Model Rule 1.2(d) (prohibiting an attorney from counseling a client to engage in, or assist a client, in conduct that the attorney knows is criminal or fraudulent), Model Rule 1.13 (defining and delineating the duties imposed on attorneys representing organizations, including duties arising when the attorney knows that an officer, director, employee or other corporate agent is engaged in wrongful conduct), and Model Rule 4.1 (prohibiting an attorney from knowingly making a false statement of fact or law or failing to disclose a material fact when necessary to avoid assisting the client in engaging in a criminal or fraudulent act) be modified to reach beyond actual knowledge to knowledge the attorney reasonably should have. The Association has opposed these changes as well because they would, in effect, turn the attorney into the client’s watchdog and adversary. The Association also fears that if an attorney is sued by a third party, the attorney may be required to disclose confidential information to defend against the allegation that he or she “should have known” of the client’s conduct.

The task force is expected to finalize its recommendations on modifications to the Model Rules in early 2003.

In the meantime, on July 30, 2002, President George Bush signed the Sarbanes-Oxley Act of 2002, which imposed new ethical obligations on attorneys. Specifically, Section 307 required the SEC to prescribe minimum standards of professional conduct for attorneys appearing and practicing before the SEC for any reason regarding the representation of issuers. On November 21, 2002, the SEC issued its proposed new ethical rules. The SEC requested public comment on its proposed rules by December 18, 2002, and received a barrage of criticism from lawyers and bar groups, including the Association. Drawing the most fire from these critics were the rules requiring lawyers appearing before the SEC to make a noisy withdrawal under certain circumstances. On January 23, 2003, the SEC adopted its new rules, but in substantially modified form, and extended for another 60 days the comment period on the noisy withdrawal and related provisions.

For an attorney who has credible evidence of a material violation of the Securities and Exchange Act of 1934, the SEC’s new rules give two options: 1) report the matter to the issuer’s chief legal counsel (or chief legal counsel and CEO), or 2) report the matter to the issuer’s “qualified legal compliance committee,” if the issuer has one. Doing nothing is not an option. Under the first option, the attorney is also required to report the matter up the corporate ladder if the issuer’s chief legal counsel (and/or CEO) fail to respond appropriately to the evidence.

The SEC’s new rules also allow an attorney for the issuer to reveal confidential information without the client’s consent to the extent the attorney reasonably believes necessary 1) to prevent the issuer from committing a material violation likely to cause substantial financial injury to the financial interests or property of the issuer or investors, 2) to prevent the issuer from committing an illegal act, or 3) to rectify the consequences of a material violation or illegal act in which the attorney’s services were used. Thus the new SEC rules are inconsistent with, and arguably will supersede, California Business and Professions Code Section 6068(e).
Although the new rules will impose additional obligations on attorneys practicing before the SEC, the SEC has made it clear that the new rules do not create a private cause of action. Rather, the SEC will have exclusive authority to enforce compliance with the new rules. The SEC’s new rules will become effective 180 days after publication in the Federal Register.

**Ethics Standards for Arbitrators**

New ethical standards for neutral arbitrators in California became effective on July 1, 2002. The standards, 15 in all, appear in the California Rules of Court.

Among other things, the new regulations require an arbitrator to:

- Decline an appointment if he or she cannot be impartial (Standard 6).
- Disclose information possibly relating to potential biases or conflicts of interest, such as relationships with the parties or attorneys, previous service as an arbitrator for a party or attorney, financial relationships, knowledge of disputed evidentiary facts, and memberships in organizations practicing discrimination (Standard 7).
- Decline future employment from a party or attorney (Standard 10).
- Conduct hearings “fairly, promptly, and diligently and in accordance with the applicable law” (Standard 11).
- Avoid ex parte communications with a party or attorney (Standard 12).
- Refrain from using confidential information or informing a party of the award in advance (Standard 13).
- Disclose in writing to the parties the arbitrator’s compensation (Standard 14).
- Be truthful and accurate in marketing material and refrain from soliciting additional arbitration business during an arbitration (Standard 15).

The new ethics standards have been applauded by consumers and bar groups but criticized by arbitration services as adding costs to the process, creating roadblocks that will make arbitration impractical, exposing arbitration services to lawsuits, and improperly imposing new rules when current rules promulgated by the services adequately address the issue.

**Fee Splitting**

The California Supreme Court spoke decisively on the subject of fee-splitting in Chambers v. Kay and resolved a conflict created when two courts of appeal issued contradictory decisions in 2001. Attorneys Chambers and Kay were cocounsel for the plaintiff in a sexual harassment lawsuit brought by Rena Weeks against the law firm Baker & McKenzie. Kay orally promised to pay Chambers a percentage of the attorney’s fees, but after working together, they had a disagreement and Kay removed Chambers from the case. Kay nevertheless confirmed that Chambers would receive the promised percentage in a letter he copied to the client, but neither lawyer obtained the client’s written consent. Following the sizeable verdict, Kay abrogated the agreement, and Chambers sued.

The supreme court held that Chambers was prohibited from sharing in the fee received by Kay because the two attorneys did not comply with Rule 2-200(A)(1) of the Rules of Professional Conduct, which requires full written disclosure of a fee division to the client and the client’s consent in writing. The court disapproved a contrary decision in Sims v. Charness, which had limited Rule 2-200’s application to “pure referrals” in which a lawyer refers a matter to another lawyer but does no work. Looking strictly at the language of the rule, the court held that unless an attorney is a partner, associate, or shareholder with the other lawyer, he or she must comply with the rule. No exception is allowed for joint ventures among lawyers. Finally, the court affirmed that although Rule 2-200 precluded a claim based on the fee-sharing agreement, Chambers nevertheless could recover in quantum meruit for the reasonable value of his services—but that type of award could not be based on a division of the contingent fee.

**Regulating the Practice of Law**

The somewhat musty concept of the unauthorized practice of law was given new life by the California Supreme Court’s 1998 holding in Birbrower, Montalbano, Condon & Frank, P.C. v. Superior Court. In Birbrower, a New York law firm could not recover fees for legal services that it performed in California in violation of Business and Professions Code Section 6125, which states that no one may practice law in California unless he or she is an active member of the State Bar. The effects of Birbrower are still being felt. On January 1, 2003, a new law doubled the penalty for the unauthorized practice of law: up to one year in county jail or a $1,000 fine, or both.

In Gafcon, Inc. v. Ponsor & Associates, an insured sued its insurer, Travelers Property Casualty Corporation, and its in-house law firm, which is composed of lawyers who are all employees of Travelers. The insured alleged that the insurance company was engaged in the unauthorized practice of law. The superior court granted summary judgment for Travelers, and the court of appeal affirmed. The plaintiff argued that a corporation may not employ lawyers for customers, and that absent qualification of the company as a certified law corporation under the Business and Professions Code, such practice is barred by Section 6125. However, the appellate court rejected the argument that the insurance company’s employing lawyers to represent insureds constitutes the practice of law because, absent a conflict of interest, an attorney represents the insurer’s own rights and interests as well as those of the insured under the tripartite relationship among the insurer, insured, and insurance defense counsel in California. The prohibition against the practice of law by a corporation was intended to avoid interference with the lawyer’s independent judgment and duty of loyalty to the client, but this rule is subject to exceptions. The Gafcon court found the plaintiff had failed to rebut ‘Travelers’ evidence that it did not control or interfere with its staff lawyer’s professional judgment or restrict the lawyer’s ability to represent the insured. Therefore, the insurer was not engaged in the unauthorized practice of law.

In recent years, as law firms consolidated and the business of clients expanded across state lines, the legal profession has considered reforms to loosen the traditional limits on multijurisdictional and multidisciplinary practice. Notwithstanding Section 6125’s prohibition on practice by a nonmember of the State Bar, out-of-state attorneys and in-house counsel often perform legal services within California on a limited or temporary basis. In January 2002, the California Supreme Court Advisory Task Force on Multijurisdictional Practice recommended that out-of-state lawyers and in-house counsel be permitted to perform limited services without admission to the State Bar, in return for registration and compliance with certain regulations. In August 2002, the ABA House of Delegates adopted similar recommendations offered by the ABA Commission on Multijurisdictional Practice. The California Supreme Court appointed a Multijurisdictional Practice Implementation Committee composed of 16 lawyers, judges, and State Bar officials to draft new rules to implement the recommendations of the task force.

A separate report was issued last year by the State Bar Task Force on Multidisciplinary Practice. Multidisciplinary practice is a concept in which lawyers deliver legal services in combination with accountants, physicians, scientists, or other specialists, in a manner similar to the operations of the major accounting firms in recent years. Currently, Rule 1-310 of the Rules of Professional Conduct prohibits a lawyer from forming a partnership
with a nonlawyer if the activity of the partnership includes the practice of law, and Rule 1-320 prohibits sharing legal fees with a nonlawyer. The multidisciplinary practice task force report acknowledged that permitting multidisciplinary practice would require modification of Rule 1-310 and Rule 1-320, and the subject is still undergoing study. In the wake of the corporate and accounting scandals, however, the public demand for independent auditors and securities analysts whose advice is not compromised by institutional conflicts of interest appears to have quelled the desire for allowing multidisciplinary practice, at least for now.

Attorney Indemnification

In two cases released on June 27, 2002, the California Supreme Court analyzed claims between cocounsel arising from their handling of a mutual client’s matter. In Beck v. Wecht,55 the supreme court imposed a bright-line rule that cocounsel cannot sue one another for breach of fiduciary duty. In Musser v. Provencher,56 the supreme court concluded that, depending on the circumstances of the case, cocounsel may sue one another for indemnification for legal malpractice damages. The attorney’s duty of undivided loyalty to the client and client confidentiality figured prominently in both cases.

In Beck, one attorney sued his cocounsel for breach of fiduciary duty because the cocounsel failed to accept a $6 million settlement offer made in the midst of a jury trial in spite of instructions from the client to do so. The jury returned a defense verdict. The attorney claimed that his cocounsel’s failure to follow the client’s instructions deprived him of a significant contingent fee. The issue before the supreme court was whether cocounsel owe each other a fiduciary duty. The courts of appeal were split on this issue.57

The supreme court concluded that it would be contrary to public policy to require these actions among attorneys on the theory that cocounsel have a fiduciary duty to protect one another’s prospective interests in a contingency fee. Such a duty between cocounsel would increase the exposure of attorneys to liability and place them in an untenable position of divided loyalties to their clients and associated counsel.58 Litigation between attorneys could have an adverse impact on attorney-client relationships and “[p]ublic confidence in the legal system may be eroded by the spectacle of lawyers squabbling over the could-have-beens of a concluded lawsuit, even when the client had indicated no dissatisfaction with the outcome.”59 A client’s right of undivided loyalty from his or her attorney must be protected, even when the result of that right is the denial of an attorney’s cause of action against another attorney.60 The supreme court concluded that as a “bright-line rule,” there is no fiduciary duty between cocounsel.61

In Musser, an attorney represented a spouse in divorce proceedings. When the other spouse filed for bankruptcy, the attorney arranged for a bankruptcy specialist to obtain relief from the automatic stay so that the attorney could pursue a petition for spousal and child support. The bankruptcy specialist incorrectly advised the attorney that she could pursue the support petition without relief from the automatic stay. The attorney did so. The bankrupt spouse successfully reversed the support awards for violating the automatic stay. Thereafter, the attorney’s client settled for less than the original support award when faced with the possibility of punitive damages for violating the automatic stay.

The client sued the attorney for legal malpractice, and the client’s ex-spouse also sued the attorney for violating the bankruptcy stay. The attorney filed a cross-complaint against the bankruptcy specialist for indemnification. The trial court entered judgment for the bankruptcy specialist. The supreme court reversed, holding that the attorney was not barred from seeking indemnification from the bankruptcy specialist. The supreme court affirmed.

The supreme court noted that except for one much criticized exception, courts have uniformly barred indemnification claims between predecessor and successor counsel based primarily on two important policy considerations: avoiding conflicts of interest between attorneys and their clients and protecting client confidentiality.62 The Musser case, however, involved an indemnification claim between cocounsel, not between predecessor and successor counsel. The supreme court found this context different. As a result, the supreme court concluded that courts, using the same policy considerations that underlie indemnification between predecessor and successor counsel, must analyze on a case-by-case basis whether cocounsel can assert claims against each other for indemnification.63

This year, lawyers can expect to see further efforts by lawmakers and government agencies to modify the traditional role of lawyers in ways that may create conflicts with California’s ethics rules. Meanwhile, the California Supreme Court is certain to apply the Rules of Professional Conduct and Business and Professions Code Section

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The protections afforded client confidence (that is, the loyalty to the client) and client secrets through Business and Professions Code §6068(e) are broader than the evidentiary protections afforded attorney-client communications through Evidence Code §§954 and 955. The evidentiary protections are subject to various exceptions, such as the crime or fraud exception under Evidence Code §956. Because Business and Professions Code §6068(e) has no exceptions, if an attorney called to the stand to testify is asked questions about communications with a client, a judge may order the attorney to disclose the communications because of an evidentiary exception, such as the crime or fraud exception—but pursuant to §6068(e), the attorney is still not permitted to answer and, in fact, may be subjected to disciplinary proceedings if he or she does. See Mark L. Tuft, For Your Eyes Only, LOS ANGELES LAWYER, Dec. 2002, at 26.

Los Angeles Bar Association, Los Angeles County Bar Association, and Jon L. Rewinski, Chair, LACBA Professional Responsibility and Ethics Committee, to James H. Cheek, Chair, ABA Task Force on Corporate Responsibility (Oct. 30, 2002) (on file with author Rewinski).
30 Id.
31 15 U.S.C. §§7201 et seq.
34 See SEC Press Release, supra note 33.
35 Id.
36 Id.
37 Id.
38 CAL. RULES OF CT., Appendix, Div. VI (effective July 1, 2002).
40 Id. at 142 (2002).
42 Id., 29 Cal. App. 4th at 147.
43 Id. at 151.
44 Id. at 162.
46 Bus. & Prof. Code §6126.
49 See People v. Merchants Protective Corp., 189 Cal. 531 (1922).
51 Gafcon, 98 Cal. App. 4th at 1413.
58 Beck, 28 Cal. 4th at 294 (citing Pollack, 120 Cal. App. 3d at 949 (Johnson dissent)).
59 Id. at 295-96 (citing Mason v. Levy & Van Bourg, 77 Cal. App. 3d 60, 67 (1978)).
60 Id. at 294 (citing Pollack, 120 Cal. App. 3d at 945 (Johnson dissent)).
61 Id. at 298.
62 Musser v. Provencher, 28 Cal. 4th 274, 281 (2002); see also id. at n.3.
63 Id. at 284.
Expert witnesses are more important than ever. Most complicated cases do not settle until after the experts have issued comprehensive reports or had their depositions taken. This trend will increase because education has not kept pace with the continuing increase in knowledge, causing an ever-widening gap between what the average person knows and what specialists know.

Assuming that as part of your representation of your client, after hiring the best expert available, what do you do next to improve your chances for success? You and your expert should outline the analytical procedures to be performed and estimate their cost. You may feel comfortable with a verbal communication, or you may want a brief written confirmation.

Along with this list of procedures to be performed should come a schedule. Experienced litigators ensure that they and their experts understand all deadlines and how these deadlines interact. Identify key records, including those from your opponent. Reach agreement with your experts regarding how much time their analyses will require. Regardless of the reason, however good, for the delay in the receipt of materials, experts cannot produce good work instantaneously after receiving the information they need. This means that you need to anticipate discovery battles for critical records.

Make sure their experts understand how their opinions will fit into the general argument of the case. Communicate the time line of key events in the case and their consequences. In complex litigation, there are often multiple key dates that an expert may need to address. To avoid reworking conclusions and flawed analyses, ensure that your experts are using data that is pertinent to those dates.

Well before your experts reach their final conclusions, meet with them to learn how their work is progressing. These meetings should discuss the good news and the not-so-good news. Be willing to hear the expert explain 1) favorable and unfavorable facts, 2) available testing methods to address potential challenges, 3) false or weak assumptions, or other inadequate work, 4) opinions upon which reasonable experts may differ, and 5) possible “long shots” that might be worth the effort to investigate.

Insist that your experts support their conclusions with analysis, testing, and inspection. Descriptions beginning with phrases such as “I saw,” “I heard,” and “I examined” should constitute the strongest support the conclusions. Judges and juries are less persuaded by summaries beginning with “in my opinion” or “based on my experience” than they are by more positive phrases such as “my analysis indicates,” “the data supports,” or “the market tells us.” Your opponents will usually discredit experts who do not adhere to the analytical rigors of their profession.

Discuss with your expert whether there is government data or studies that corroborate your position. Government information is often highly credible to a judge or jury. So-called learned treatises or academic publications are not as useful. These works are as numerous and varied as the experts who prepare them. If you find a learned treatise that supports your argument, you can probably also find another treatise by an equally qualified author that conflicts with your position.

If you have more than one expert working on the same case, arrange for them to meet with you in a joint conference in which they have an opportunity to discuss their methodology and tentative conclusions with one another. Many litigators avoid this because the meeting is subject to discovery. While unfavorable disclosure is a risk, the greater problem is having your multiple experts impeach one another with inconsistent testimony.

Avoid the ever-present temptation to have experts accept additional responsibility in areas in which they are not truly qualified. Experts who are credited in areas that they are covering as a favor to you will lose credibility in the more important areas of their true expertise.

Your expert’s work is not complete until it is supported with demonstrative charts, graphs, or other visually appealing exhibits. Your expert may have the best conclusion and credentials but may lose in the courtroom to someone who has prepared a presentation that is more intuitive and easier to understand. If you have selected a superior and experienced trial expert, this person should be able to prepare good graphics with little assistance. The advantages of having experts prepare their graphics include:

- It is usually less costly, because the expert already is familiar with the entire effort.
- The graphics will be more faithful to your expert’s methodology.
- The expert will be more confident and convincing because of having been personally involved with the creation of the graphics.

Help your experts avoid accidentally supporting your opponent’s case. The fact that you did not hire an expert to address a particular subject does not prevent your opponent from asking that expert some questions about that subject. Because of your familiarity with the dispute, you may not appreciate the difficulty that your witness may face with these surprise attacks. Forewarn your expert of these matters, including related hypothetical questions.

Finally, remember that your expert is there to support your argument, not to state it. Do not allow your expert to profess your arguments and advocacy. Experts should explain and defend their opinions, and their opinions can certainly favor your client. However, your expert must maintain the attitude and appearance of being an independent servant of the court. If your expert shows unwillingness to acknowledge an obvious favorable point of your opponent or to admit the possibility of a reasonable alternate view, your expert fails the credibility test.

These many concerns highlight the importance of hiring the right expert in the first place. Serving as an expert witness is a difficult job. The attorney’s job is also daunting, but selecting an experienced witness will make that challenging task much easier.

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While marketing is clearly an essential business practice, it is not taught in law school. As more lawyers graduate from law school, the relative size of the client base is decreasing. All too often, however, law firms expect new clients to come to them by word of mouth and do nothing to retain clients. Years ago, many large law firms saw the need for marketing and started investing in it, but others, including mid-sized and smaller firms, resisted this trend. However, the good sense of having a budget and plan for the acquisition and retention of a client base is unassailable. Every law firm should investigate what it is doing to build its own customer database capabili-ties to retain clients. Years ago, many large law firms saw the need for mar-keting and started investing in CRM programs. This practice is not advisable, but personal experiences about the offer are expected to fail (despite what the target's true needs in the cor-porate literature in a prominent place for the reader to see immediately. The offer is the information that gets the target to respond and contact the firm. When a firm has a clear focus on the target, many questions about the offer are answered, but personal experience and marketing knowledge remain important for the creation of the kind of offer that addresses the target's true needs in the correct idiom.

For example, knowledge of a firm's target clients should ex-

**Creating and maintaining a customer database can improve your bottom line**

The five most important elements of a marketing campaign are analysis, list, offer, testing, and follow-up. If a marketing campaign fits these pieces together correctly, new clients will arrive and current clients will stay with the firm.

The first task is to conduct an internal and external analysis of the firm's clients and potential clients and the available means of reaching them. The analysis should uncover potential market niches and provide a road map that is based on true and current information. It should also determine what ABA rules apply and what features a CRM must have for the campaign. For example, if the analysis shows that 80 percent of the firm's target market is best reached online, then online marketing becomes an important medium, and the CRM must have significant online functionality.

The internal analysis should include a firm's product portfolio, technical abilities, management and employee strengths and weaknesses, and financial standing. External analysis includes customer information, the firm's competitive abilities in comparison with other firms, an industry analysis, and consideration of larger influences, such as population demographics and the economy.

**Starting the Analysis**

The analysis will reveal the firm's opportunities, threats, strengths, and weaknesses. The CRM statistics will also raise questions, some of which may uncover previously unnoticed avenues for firm growth. The marketing data will also allow the firm to focus more precisely on its marketing mission and the appropriate strategies for achieving it. With this knowledge, the firm is also in a better position to select an appropriate CRM. The analysis will also uncover the target market. Usually this market is identified by demographic criteria such as income level, industry, and geography.

Once the target is clear, the list must be selected. Without a good list, which is true and current information on the target market, no marketing campaign can succeed. For example, if a law firm were to mail invitations to the executives of major entertainment firms in Hollywood to attend the firm's entertainment law seminar but used a list of executives of local kennel clubs, the firm's campaign can be expected to fail (despite what the firm may have heard about kennel clubs). Lists can be purchased from many sources and cost from 10 to 85 cents per name.

Once an accurate, useful list is compiled, the next question to address is what to offer the people on that list. The offer is placed in the banner of all literature in a prominent place for the reader to see immediately. The offer is the information that gets the target to respond and contact the firm. When a firm has a clear focus on the target, many questions about the offer are answered, but personal experience and marketing knowledge remain important for the creation of the kind of offer that addresses the target's true needs in the correct idiom.

For example, knowledge of a firm's target clients should ex-

**Customer Relationship Management for Law Firms**

By Benjamin Sotelo and James Gillen

Benjamin Sotelo can be reached at benjamin@legalfriendly.com. James Gillen practices personal injury law in Marina del Rey.
tend to personality traits. Most extroverts like bold colors, while introverted clients tend to prefer earth tones. This bit of information can be useful to a firm that is tailoring its offer, for example, to actors or to actuaries. Any advantage that may be available should be included in the CRM database.

Once the CRM database is in operation, the remaining steps of testing and follow-up are continuous. For this reason, a CRM database that allows for various forms of analysis is desirable. Various theories of analysis should be accounted for in the database.

For example, one marketing theory that your marketing effort must keep in mind is the theory of the choice set. The CRM database needs to address the choice set, which is all the firms that a client considers when deciding to employ a firm or lawyer. Usually, the choice set contains no more than five items. If your target’s choice set does not include your firm, you are not yet in the game. For this reason, the CRM database should include data about competitors and their solutions to client needs.

**By the Numbers**

Some of the time-tested rules of marketing rely on easy-to-remember numbers. The rule of 3, for example, states that the target will not remember the firm until the target has been exposed to the firm’s message three times. The rule of 10 indicates that the firm should communicate with the target every 10 days. The firm can use more than one medium for this purpose, including the fax machine, regular mail, e-mail, and the telephone. Next is the rule of 2, which cautions starry-eyed marketing directors to remember that the usual return rate for a communication campaign is only 2 percent. This percentage, or pull rate, can be improved, however, with support from other media (for example, a mail campaign supported by telemarketing). The CRM program is a critical tool for increasing the pull rate.

Then there is the rule of 1. The one-voice campaign helps the target remember the offer by making the offer appear the same no matter which medium communicates it. In other words, the mailed flier, the fax, and the Web page should all look alike and convey the same message. The firm must keep its marketing campaigns specific, with a focus on the target. The firm should find out what the target needs and offer a solution instead of telling the target what it needs. For this reason, even larger firms should concentrate on a specialty. When a firm tries to present itself as all things to all people, its message is bound to be confusing.

The firm’s message should also alleviate the concerns that clients and potential clients

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will always have about risk. A guarantee is one means of lessening apprehensions about spending money but not getting the desired result. For this reason and because client retention is of vital economic importance, a CRM program must address communication from the client as well as to the client. Good work is the start—after that, ask clients for their impressions, find a way to add their information to the database, and ensure that they are aware that you appreciate their business. Ask satisfied clients for referrals.

Finally, one last number to consider is how much a firm should spend on marketing. The CRM program should provide accurate estimates of the following:

- The amount of the firm’s average billing per client.
- The number of billings per year.
- The number of referrals that an average client makes.
- The estimated number of referrals that each client could make.
- The percentage of referrals that become clients.
- The amount of gross billings per year divided by the number of clients per year.
- The value of a return client.
- The value of each referral that becomes a client.
- The lifetime value of a client—the calculation of which includes the number of years a client can do business with the firm.

Using these values, it is possible to surpass guesswork and arrive at accurate estimates of the return on money invested in finding and keeping clients, including referrals. A potential means of calculating a marketing budget is to multiply the fully calculated lifetime value of a client (including referrals and other factors) by 15 percent.

In addition to statistical analysis, the CRM program can be used to sell a firm’s legal products across a customer base—that is, selling a different legal product to clients who have already sought one legal product. The CRM program should also allow users to search for referrals across lists and to track referrals according to various cross-references.

CRM programs are only one piece of a law firm’s marketing strategy. They are only a tool that, properly employed, will allow the firm to use its resources wisely. To that end, each law firm should use its CRM program to test marketing channels and offers. With feedback from the market, the firm can improve its ability to identify and reach its target clients, hone its image, and concentrate on the message that allows the firm’s target clients to remember and contact the firm.

The CRM program is the central mechanism by which this effort is controlled.
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G l e n d o n  T r e m a i n e  S y m p o s i u m  2 0 0 3

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$85—CLE+PLUS members
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$185—Association members
$205—at the door and all others
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The Benjamin S. Crocker Symposium

On Thursday, May 1, the Association’s Real Property Section and USC Law School will jointly present the Benjamin S. Crocker Symposium on Real Estate Law and Business. At this one-day event, major practitioners and real estate industry experts will address key legal and business issues facing this critical area of the economy. Additionally, Edmund G. “Jerry” Brown, mayor of Oakland, will appear as the luncheon keynote speaker. For information, please visit http://lawweb.usc.edu/cle/realestate/pages/registration.html. Registration information is also available by calling (213) 740-2582. The USC Law School will be processing all registrations and CLE credits for this event. The symposium will take place at the Wilshire Grand Hotel, 930 Wilshire Boulevard. On-site registration and continental breakfast will begin at 8:30 A.M., with the program continuing from 8:45 A.M. to 5:15 P.M. The registration code number is 8084D25.

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The Right Business Decision

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It is the right business decision.” I have said these words so many times over the last 12 years that they have become part of a smooth-flowing sales pitch designed to convince my clients to accept sensible settlement offers. Yet this time, the words sound different. This time, I am the client hearing them.

It is a fee dispute case with an ex-client. It begins the same way all cases begin, with tough talk and hard demands followed by a knock at the door. As I look at the summons and complaint and politely sign the process server’s receipt, I feel a visceral, seething, boiling anger welling up. I am overwhelmed as I read the peculiar blend of technical terms, facts, half-truths, fabrications, and conclusions that the complaint comprises. Although I have had to report defendants to the police more than once for threatening me, I never really understood how anyone could be moved to violence by the mere existence of a lawsuit—until now. I rage at my empty office, throwing the papers on the ground and spewing curses. Denial goes hand in hand with anger. I look at the papers over and over to see that they are real. It cannot be happening to me.

My anger recedes and is replaced with my first real pangs of concern when I tell my wife later that day about the lawsuit and she asks if we have to worry about losing our little house with the one bathroom. I wish I could reassure her, but I am a litigator. I know about the risks inherent in litigation, about bad rulings and jury nullification, botched instructions and personalities taking precedence over facts. I know that as a lawyer defendant I will lose the popularity contest. The jurors probably will excuse my client’s shrill accusations and baseless demands; conversely, they will almost certainly punish the clipped harshness of my denials and rejections.

As my professional training and experience kick in, as the first waves of emotion recede, I ask my colleagues for help. My closest professional confidant advises me to settle, even if it means rebating the entire fee. He reminds me that every moment I spend fighting the case is a moment lost with my family or taken from my practice, and that all the energy expended on this battle will take its toll on my soul. All is a moment lost with my family or taken from my practice, and that entire fee. He reminds me that every moment I spend fighting the case.

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Two weeks after I am served, I receive an offer to settle for a rebate of slightly less than half the fees I was paid. I have to accept the offer. It calculatingly leaves me just enough of my fee to make the risks and costs of trial truly unattractive. Yet I am wracked with doubts, especially when everyone I know who is not involved in the practice of law questions whether I settled too readily. Even as I respond that it could have been worse, it only makes me realize that I have agreed to write a big check to a person I loathe.

My emotional ride does not end with the dismissal. Although I accept the result, there is no acceptance. The lawyer in me knows that it is profoundly stupid and self-destructive to blindly allow rational decision-making processes to be held hostage to the angry child inside. I made the right business decision. Even so, I feel betrayed, ashamed for capitulating. I now understand why so many clients on both sides cry bitterly when they make the right business decisions. When I urge settlement I move from champion to diplomat, betraying the client’s emotional investment in the attorney-client relationship. Eventually, my clients who settle their cases feel acceptance. Many even thank me or ask me to take on additional work. Eventually I will reach acceptance, too, and forgive myself for making the right business decision.
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