Los Angeles lawyer June Lehrman analyzes recent Supreme Court decisions on the arbitrability of gateway issues

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June Lehrman is a neutral based in the Los Angeles office of JAMS, where she specializes in complex contract, business torts, employment law, and healthcare law disputes. In “On the Threshold of Arbitration,” she reviews recent U.S. Supreme Court decisions on determining the decision maker for gateway issues in arbitration. Her article begins on page 20.

20 On the Threshold of Arbitration
Recent U.S. Supreme Court decisions attempt to clarify when courts or arbitrators decide gateway issues raised by an arbitration clause
By June Lehrman

29 Unsuitable
An antisuit injunction is a viable alternative to the unpredictability of motions to dismiss for forum non conveniens
By Jeffrey S. Raskin

39 Buy-Sell Buy In
The key to avoiding litigation over buy-sell agreements is to draft the instrument to meet the individualized needs of all shareholders
By B. Keith Martin

47 Special Section
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I didn’t know Steve that well at all. I spoke to him a few times about a case I was handling. Steve was referred to me as a potential expert who could help me with sensitive defense issues. He quickly grasped the difficulties my client faced in the case and provided some cogent thoughts about how to navigate the minefields.

Those discussions occurred several months ago. I never retained Steve, because settlement discussions made his expert testimony moot. Our interactions were so infrequent and dated that I had to think twice when I saw his name as the subject line on an e-mail that I received. The message, addressed to Steve’s “friends” and announcing his sudden death, hit me hard, for reasons that I still cannot explain.

Perhaps it was the circumstances of Steve’s passing that affected me. Steve was traveling for work, 3,000 miles away from his family, when he suffered a migraine and died in his sleep. Steve was, as best as I could tell, only in his mid-forties, and he left a wife and two grade-school-age children.

I, too, have a wife and young children, so I have perhaps projected more from Steve’s death than I have for others who have left us recently. By being away from his family when he died, Steve has revived in me nagging fears of an untimely death that have increased exponentially since the September 11 attacks.

I have taken more than 10 roundtrip flights for business and pleasure during the past 12 months. Every one of those trips, through 11 states and two foreign countries, was preceded by the now ubiquitous security screenings. As much as I hate the hand-wandings and pat-downs by employees of the Transportation Security Administration, I also feel concern when I am not stopped. Why must my shoes be X-rayed in some airports while not in others? Why are the procedures for checked luggage different for each airline, with inconsistent answers to questions about whether the screening equipment will damage film? And why in the world are we not allowed to carry one-inch nail clippers in a carry-on but can walk freely onto an airplane with an umbrella with a four-inch steel tip?

The concern, of course, is that inconsistencies in security measures and protocols can be exploited, which can lead to life-threatening results. As of this writing, we still do not know how a college student was able to carry several box cutters and bottles of bleach onto a Southwest Airlines plane, or, more troubling, why it took several weeks for investigators to find them even after they were told the contraband existed.

I’d like to have faith in the TSA screeners, given the enormous responsibility they bear, but I have as little confidence in them now as I did in their predecessors on September 12, 2001. Like any large organization, consistency is impossible, especially when subjective analysis of fuzzy images on flickering computer screens is required every few seconds by people who expect to go hours or days without finding anything suspicious. The bottom line is that future airborne incidents are practically assured, especially as air traffic returns to 2001 levels and cuts continue to be made in the TSA’s budget. Besides, what is the worst that could happen to a screener who misses something? Were criminal charges brought against any of the screeners who let the 19 terrorists with weapons onto planes two years ago?

For every flight I boarded recently, I thought, mostly only for a moment, that it was going to be my final trip, my final glimpse of family and friends. (Even taking Amtrak to San Diego raises concerns, for there is absolutely no security check prior to boarding—no metal detector, no luggage screening, no cross-referencing of passenger names against a terrorist watchlist.) Given that air travel is a necessary part of the practice of law for many attorneys, the prospect that one of us will not return home—like those who worked for Cantor Fitzgerald, Aon, or the other affected companies in the World Trade Center towers—is ever present.

Steve continues to touch me, even in his death. May his memory be a blessing for his family and friends.

Jerry Abeles is a litigation partner in the Los Angeles office of Friedemann O’Brien Goldberg & Zarian LLP. He is the chair of the 2003-04 Los Angeles Lawyer Editorial Board.

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Regulatory Preemption of Medical Devices

**What is the boundary between federal and state laws that affect medical devices?**

Federal regulatory preemption of medical devices has its genesis in the 1976 Medical Device Amendments (MDA) to the Food, Drug, and Cosmetic Act of 1938 (FDCA). Under the FDCA, the Food and Drug Administration (FDA) was given jurisdiction over medical devices, but it did not provide for the rigorous pre-market approval (PMA) process of medical devices that it did for drugs. In 1976, however, the MDA extended the PMA process to medical devices.

Under Section 360(c) of the MDA, medical devices are categorized into three classes, based upon the degree of risk they pose to the consumer. Class I devices, such as tongue depressors, are subject only to minimal controls by the FDA because of their generally accepted safety standards. Class II devices, such as tampons, are subject to more specialized controls that may include performance standards or specific guidelines. Class III devices, such as pacemakers, must undergo the stringent PMA process because of the central role they play in saving lives. The PMA process requires extensive clinical testing and the disclosure of specifications, intended use, manufacturing methods, and proposed labeling.

Section 360e of the MDA provides two exceptions to the PMA process. The first is a grandfather clause, which applies to medical devices that were on the market by 1976. The second exception applies to devices that are substantially equivalent to Class I, II, or III devices that were already approved by the FDA and were on the market before 1976.

**The 510(k) Process**

A manufacturer of a medical device can obtain an FDA clearance indicating that the device in question is a substantial equivalent. This is accomplished through a notification process commonly known as the 510(k). In contrast to the PMA process, the 510(k) process merely requires the manufacturer to notify the FDA of its intent to market the medical device at least 90 days prior to its introduction to the market and to explain the device’s substantial equivalence to a pre-1976 device (which is known as a predicate device). By this means, a Class III device marketed under the limited review of 510(k) as opposed to the more rigorous PMA process.

**Where Does Preemption Begin?**

In 1996, the U.S. Supreme Court addressed the regulatory preemption of medical devices in the landmark decision of *Medtronic, Inc. v. Lohr.* The Court held that state claims regarding the negligent design of a Class III device marketed under 510(k) were not preempted. Central to the Court’s holding was the fact that the device was marketed under the limited review of 510(k) as opposed to the more rigorous PMA process.

**Barrister's Tips**

By Kevin R. Costello and Christopher Q. Pham

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Kevin R. Costello and Christopher Q. Pham are associates in the products liability group of Sedgwick, Detert, Moran & Arnold LLP, in Los Angeles. They wish to acknowledge the assistance of Ralph Campillo in writing this article.

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In 2002, in *Gilleon v. Medtronic USA, Inc.,* the Ninth Circuit addressed preemption in the context of a Class III stent used for abdominal surgery. The court held, “To the extent plaintiffs’ claims seek to impose liability even though the...device at issue...complies with the design approved by the FDA...and to the extent plaintiffs’ claims are based on alleged failures to warn, or inadequate warnings, arising from the warnings and labeling approved by the FDA, those claims...are preempted.”

Courts that found against preemption have done so on the basis that the PMA process provides no device-specific regulations. In *Lakie v. Smithkline Beecham,* the district court for the District of Columbia held that because the PMA process for denture adhesives does not constitute a “specific federal requirement,” it does not trigger federal preemption. Also, in *Sowell v. Bausch & Lomb, Inc.,* the New York appellate court came to the same conclusion in a ruling that was concerned with extended wear...
contact lenses.6

Additionally (although the issue was not addressed by the Lohr Court), Class II devices have been held to be preempted if device-specific regulations have been promulgated by the FDA. In Papike v. Tambrands, Inc., the Ninth Circuit held that the plaintiff’s state claims were preempted because tampons, although a Class II rather than a Class III device, have been the subject of several specific FDA regulations mandating warnings for toxic shock syndrome.9

Proposition 65

However, in Committee of Dental Amalgam Manufacturers v. Stratton, the Ninth Circuit held that Section 360k did not preempt a claim under Proposition 65, California’s Safe Drinking Water and Toxic Enforcement Act.10 The court found that dental amalgam is both a Class I and II device because of its component parts of mercury and amalgam alloy. Since Proposition 65 is a general law of applicability and it is not specific to any one product, the court held that the warning requirements under Proposition 65 do not constitute a specific requirement.

Based upon a survey of current law, what appears to be the crucial issue is whether the device was marketed under the PMA process or whether the FDA articulated specific requirements. Thus, as a general rule, Class I and II devices with no specific FDA requirements, as well as Class III devices marketed under the 510(k) process, will not be preempted from state actions. Class II devices with attendant FDA special requirements, and Class III devices marketed under the PMA process, will generally be preempted from state regulations. However, since the U.S. Supreme Court has not fully addressed the scope of preemption under the MDA, these issues remain unclear.11

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21 U.S.C. §§360c-d.
21 U.S.C. §§301 et seq.
9 Papike v. Tambrands, 107 F. 3d 737 (9th Cir. 1997).
10 Committee of Dental Amalgam Mfgs. & Distis. v. Stratton, 92 F. 3d 807, 813-14 (9th Cir. 1996).
Protecting Privileged Information in Transactional Negotiations

Use of the common interest doctrine can avoid a waiver of the attorney-client privilege

A company is contemplating whether to enter into a transaction to sell one or more of its lines of business. As is common for any operating business, the company has ongoing litigation, investigations, or other legal issues. Indeed, the company has recently discovered a situation that requires attention from its legal counsel. The company discusses this problem in detail with its attorneys, and these conversations are conducted in a manner that invokes the protective umbrella of the attorney-client privilege.

If the company decides to proceed with the sale, it faces the following dilemma: On the one hand, as the seller, the company must disclose to the buyer all material information relating to the business that the buyer is purchasing. On the other hand, if the company shares this confidential information with the potential buyer, it jeopardizes waiving the attorney-client privilege for the information being shared and, potentially, any other related privileged information. This means that if litigation is pending or is later filed against the seller by a claimant other than the buyer regarding the problem in the scenario, and the claimant requests the confidential information that was shared with the buyer, the seller will be unable to assert that the information is privileged and thus will have to provide the potentially damaging information to the claimant.

Proper handling of this potential Catch-22 is critical to a successful transaction and to avoidance of ongoing exposure. With hesitant buyers already predisposed to finding reasons to back out of transactions, the least desirable outcome for the seller is to disclose material information to the buyer in a manner that waives the attorney-client privilege, only to watch the buyer walk away from the deal. This leaves the seller with the worst of both worlds—not only a failed transaction but also a waiver of the privilege. A seller can potentially lessen its risk of waiving the attorney-client privilege, however, by invoking the “common interest” exception to the attorney-client privilege.

The common interest doctrine expands the application of the attorney-client privilege and is an exception to the general rule that the attorney-client privilege is waived upon disclosure of privileged information to a third party. Courts have held that communications can remain privileged if the disclosing party and the receiving party have a common legal interest, such as when they are “involved in or anticipate joint litigation…the key consideration is that the nature of the legal interest be identical, not similar, and be legal, not solely commercial.”

The facts of Hewlett-Packard

Brette S. Simon and Lawrence M. Braun

By Brette S. Simon and Lawrence M. Braun

Practice Tips
the application of the common interest exception was not satisfied
In the event that a court holds that the
Common Interest with the seller, the seller's and buy-
of the common interest doctrine. Most sellers require a prospective buyer to sign a confidentiality or non-disclosure agreement upon commencement of due diligence in an M&A transaction. The provisions of this agreement should be crafted carefully. For example, does the confidentiality period terminate after a certain number of years? How does it address disclosures required by law? The parties should consider a provision that keeps privileged information confidential in perpetuity, with no expiration date. In addition, the seller should insist that, in the event that the law requires the buyer—pursuant to a subpoena, under SEC disclosure rules, or the like—to disclose the confidential information, the buyer must notify the seller immediately. In the event that applicable law mandates disclosure of the confidential information, the agreement should obligate the buyer to assert the attorney-client privilege and to cooperate with the seller in attempting to seek a protective order or other form of confidential treatment for the information.

Limit access to the privileged information. The parties should agree in writing on the number of people who will be allowed to have access to the privileged information. Obviously, the fewer the better. Further, disclosure should be restricted to the buyer's key senior executives. The seller should limit the number of copies of the confidential documents provided to the buyer, should not provide them electronically, and should clearly and conspicuously stamp them “confidential,” “attorney-client privileged,” and “joint defense privileged.” In the event that the deal is not consummated or the legal matter is resolved, the seller should require that the documents be returned to the seller.

Refrain from disclosing privileged information to accountants and investment bankers. While there is no guarantee that the seller will be able to assert the common interest exception with respect to information shared with a potential buyer, the seller will clearly waive the attorney-client privilege if it widens the pool of people “in the know” to include accountants and investment bankers. While the buyer may or may not be ultimately considered to have a common legal interest with the seller, the seller’s and buyer’s business advisers certainly do not. Thus, these advisers should not participate in any conference calls or meetings during which the privileged information is discussed.

Require the buyer to provide post-closing access to information and employees. In the event that a purchase and sale agreement is entered into between the parties, the seller should require that the agreement allow the seller to have access to the transferred employees of the sold business, as well as the books, records, and other documents relating to the business. In the event that a lawsuit is filed regarding the sold business, the seller will need to call upon its former employees as witnesses and will need access to the books and records of the business it sold to respond to discovery requests and the like.

Consider entering into a joint defense agreement. Entering into a joint defense agreement can provide evidence that the disclosures between the parties were made in the course of formulating a common legal strategy. This showing bolsters the parties’ argument that the common interest exception should apply to the shared information. However, determining whether or not to enter into a joint defense agreement requires careful analysis. Each party and its attorney generally should consider, among other issues:
1) Whether the joint defense agreement could become the subject of a future disclosure request if, for example, either party becomes the subject of a government investigation.
2) The nature of the duties of each party as they are set forth in the joint defense agreement and the potential for breaching those duties.
3) Which party will be responsible for each issue and indemnification after the closing.
4) How much information the seller should share under the terms of the joint defense agreement (and whether the failure to disclose certain items could constitute a material omission).

Use caution in discussing the problem. In the event that a court holds that the common interest exception was not satisfied and the seller waived the attorney-client privilege, the Miranda rule, in essence, will apply: Everything that has been said can and will be used against you. Thus, the parties should be sensitive to the way in which the problem is characterized. Avoid referring to the matter in conversations or correspondence as a “problem,” or using other words with negative connotations.

The best course of action clearly will depend on the facts and circumstances of a particular case. However, these suggestions offer a general guide for the parties on how they can best achieve their mutual goal of sharing information and completing a deal while lessening the likelihood that they will waive the attorney-client privilege.

Suggestions for Preserving the Privilege

There is no black letter law for ensuring the application of the common interest exception. Thus, with any disclosure to a potential buyer, there is always the risk that a court will decide that the seller has waived the attorney-client privilege. However, based on the holdings in Hewlett-Packard and Libbey, a seller—and a prospective buyer as well—can take the following actions to, at a minimum, increase the likelihood that the parties will be able to invoke the common interest exception and preserve the attorney-client privilege.

Execute a confidentiality agreement. Evidence that the parties made an effort to keep the privileged information confidential is essential to satisfying the requirements of the common interest doctrine. Most sellers require a prospective buyer to sign a confidentiality or non-disclosure agreement upon commencement of due diligence in an M&A transaction. The provisions of this agreement should be crafted carefully. For example, does the confidentiality period terminate after a certain number of years? How does it address disclosures required by law? The parties should consider a provision that keeps privileged information confidential in perpetuity, with no expiration date. In addition, the seller should insist that, in the event that the law requires the buyer—pursuant to a subpoena, under SEC disclosure rules, or the like—to disclose the confidential information, the buyer must notify the seller immediately. In the event that applicable law mandates disclosure of the confidential information, the agreement should obligate the buyer to assert the attorney-client privilege and to cooperate with the seller in attempting to seek a protective order or other form of confidential treatment for the information.

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4) How much information the seller should share under the terms of the joint defense agreement (and whether the failure to disclose certain items could constitute a material omission).

Use caution in discussing the problem. In the event that a court holds that the common interest exception was not satisfied and the seller waived the attorney-client privilege, the Miranda rule, in essence, will apply: Everything that has been said can and will be used against you. Thus, the parties should be sensitive to the way in which the problem is characterized. Avoid referring to the matter in conversations or correspondence as a “problem,” or using other words with negative connotations.

The best course of action clearly will depend on the facts and circumstances of a particular case. However, these suggestions offer a general guide for the parties on how they can best achieve their mutual goal of sharing information and completing a deal while lessening the likelihood that they will waive the attorney-client privilege.
34 Years Experience in the Boardroom

- Member, Corporations Committee of the Business Law Section, State Bar of California
- Author, Lecturer, Consultant
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human needs without discrimination.

See also Union Carbide v. Dow Chem., 619 F. Supp. 1036, 1046 (D. Del. 1985);
2 Engaging in willful blindness and adopting a “don’t ask, don’t tell” policy with the buyer risks a fraud claim if the
company sells the business without informing the buyer of the problem. Alternatively, telling the buyer
“I just found out about something bad, but I can’t tell you about it” is not an effective tactic at the negotiating
table.
3 Generally, voluntary disclosure of privileged attorney-client communications to a third party waives the
privilege regarding all other communications on the same subject.
4 Confidential information shared with a potential buyer would not be privileged should a dispute arise between the
seller and the buyer.
5 The common interest doctrine is also often referred to as the community of interest rule or the common
defense doctrine.
6 See note 1 supra.
10 Notably, the court reached its conclusion despite the fact that Bausch & Lomb and GEC did not complete
the sale and did not have to litigate the same factual issues. The court reasoned that the common interest
exception only required that joint litigation be anticipated. Hewlett-Packard, 115 F.R.D. at 310.
11 Id. at 309.
13 Id. at 349.
14 Other courts have handed down rulings contrary to the decisions in Hewlett-Packard and Rayman. See, e.g.,
upon which Salomon [Brothers, Inc.] and Northrop were embarked was a business, not a legal, enterprise.”).
16 For a general discussion of the use of joint defense agreements, see Dan K. Web, et al., CORPORATE
INTERNAL INVESTIGATIONS §5.05 (1993); BUSINESS AND COMMERCIAL LITIGATION IN FEDERAL COURTS §4.10(d)
Navigating the Child Support Services Department at CCW

The bureaucracy at Sixth and Commonwealth need not be intimidating

Central Civil West (CCW), located at Sixth Street and South Commonwealth Avenue near Downtown, is an imposing building covered in reflective silver glass. It can send shivers through the spines of attorneys who approach it to assist clients who have been served with a Child Support Services Department (CSSD) complaint or, worse, a default judgment. With knowledge of some of the intricacies of this court, however, practitioners may approach it with confidence.

Paternity and child support issues were handled by a branch of the district attorney’s office. However, about two years ago, a new agency was created to address those issues. This agency is the CSSD. Although the agency was new, many procedures remained the same, as did the office’s addresses and its preference for finality of judgment over the needs of children or parents involved in the county’s child support collection system. For example, a significant portion of the budget for the CSSD comes from state and federal agencies that link collections with their allocation of revenue to the department. The amounts collected and accounts receivable have an impact on the department’s financial support.

The documents that the CSSD and the CCW court use, and the procedures that they follow, are in many cases unique. Therefore, an understanding of how the process works may yield dramatically improved results for clients. With this in mind, the practitioner may consider the central principle of the application of family law at CCW.

Child support matters addressed at CCW boil down to money: child support, child support arrears, and spousal support if accompanied by a child support issue. Other issues (such as suspensions of driver’s and professional licenses, bank account liens, and wage garnishments) are related to the underlying actions for financial support. At the CCW, this issue guides three common activities: the establishment of a judgment, the setting aside of a default judgment, or the enforcement of a judgment.

When a case to establish child support commences correctly, the respondent—obligor—typically, the presumed father—is properly served with four things: a summons, a complaint, an answer to complaint form, and a proposed judgment. The initial critical question for the respondent client is whether or not to file an answer. If the client desires genetic testing to assist in determining paternity, the answer is yes, file an answer. However, if the client does not desire genetic testing and understands that this may be his only opportunity to obtain genetic testing, there may be a financial advantage to not filing an answer. In a great number of child support cases, the CSSD does not have sufficient or accurate financial information about a respondent when the initial set of documents is prepared and served. This is often apparent from the support amounts indicated on the proposed judgment (which generally turns out to be identical to the later, actual judgment). It may well be the case that your client’s actual income would yield a higher child support amount than that listed on the proposed judgment form. Therefore, filing an answer and providing financial information may result in a higher support order than the one that may result if the proposed judgment is allowed to become final.

The proposed judgment form is a trap for the unwary. A layman who is served with the proposed judgment and believes that he may be the father may erroneously conclude that he is the father and that, therefore, the amount listed in the proposed judgment is the amount he must pay. The man often does not realize that he can contest both paternity and the amount of claimed child support. It would be far better if the forms simply explained that a child support order may be obtained by default without genetic testing results or financial information. This should be enough to inspire respondents to file their answers.

Attorneys and clients need to be aware that sometimes the CSSD may file an amended summons and complaint with actual financial information and a higher child support amount listed on the proposed judgment. Therefore, it is important for clients to remain in close contact with their attorneys and to provide copies of all documents that they receive from the CSSD. Counsel should check frequently to see if a default judgment has been entered. If a default is entered and the amount is higher than what the guidelines recommend according to a client’s actual (rather than supposed) economic circumstances, counsel can seek to set aside the judgment.

Improper Service

Many of the cases tried at CCW relate to setting aside a default judgment, often because the respondent was not aware that a case was filed against him. For example, he may have been improperly served (or not served at all) because: The county relied on an old driver’s license for the address, the service was performed at the claimant’s address, the process server did not actually perform the service, a person having the same name as the client was served in error, the service was performed by substituted service upon a family member at an address different from that of the respondent, or the information used to effect service was simply outdated. In this
situation, an attorney can make a tremendous difference for a client. In fact, an attorney who represents a client who has been improperly served may be able to mount a much better defense than that provided by a public interest organization, paralegal service, or the Court Facilitator’s Office. An attorney can prepare a set-aside motion complete with a detailed declaration and thorough points and authorities, and this may be exactly what a client needs.

One argument that counsel may employ in a motion to set aside a default judgment is jurisdictional: If a respondent was not properly served, the court has no jurisdiction over the respondent and the resulting default judgment is, therefore, void.3 This argument, however, is outside the conceptual box, so to speak, of the CSSD. Instead, the department relies upon Code of Civil Procedure Sections 473 and 473.5 because of their reference to “actual knowledge” of the notice (although actual knowledge of a default judgment is irrelevant if the service was improper).4 Documentary evidence that establishes that the proof of service of the summons and complaint is erroneous, however, may be all the court needs to set aside the judgment.

In some cases, a respondent may make support payments through a wage assignment for some time before hiring counsel and bringing a motion to set aside the default judgment. If you seek to set aside a default judgment that was filed less than six months previously, you can save your client money by simply filing a “Bobb set-aside order” (named after Aviva K. Bobb, the current supervising judge in Department 2 of the Los Angeles Superior Court). The Bobb-set-aside order is a one-page form (obtained on the third floor) that requires only the case number and entry date of the default to be completed. The only required attachment is an answer to the complaint admitting or denying parentage. If the filing of the default judgment took place more than six months previously, a formal noticed motion to set aside the default judgment is required. The forms required for this motion are the Notice of Motion cover page, the Application for Order and Supporting Declaration, the Answer to Complaint, the Points and Authorities (not required but highly recommended), and the Income and Expense Declaration.

When appropriate, you may seek to set aside only the financial terms of a default judgment pursuant to Family Code Section 17432(c), Family Code Section 4071, or both.5 If the default judgment is over six months old and is based upon imputed income (which is specified in a box on the proposed judgment form), and if no monies have been taken from any source for over one year, counsel may argue that the financial terms should be set aside because a substantial difference between imputed and actual income exists or because an extreme financial hardship would result if the default figures remain in effect.6

Other issues related to enforcement of a judgment that are frequently heard at CCW include orders to show cause to release a driver’s license or professional license, reduction of a 50-percent wage assignment, and lien releases on bank accounts. License suspensions, liens, and 50-percent wage assignments are the most common enforcement tools used by the CSSD. Even though there is debate among the judiciary about seeking relief ex parte (rather than through a noticed motion), ex parte motions are often used in advance of a noticed motion to set aside the default judgment. The ex parte motion is treated as a special appearance. A stipulation for this ex parte relief avoids a court appearance and usually consists of a temporary payment plan pending the outcome of the set-aside motion.

Many clients think they are on a payment plan because a computer-generated wage assignment is served on their place of employment. However, the CSSD does not consider this wage assignment to be a payment plan. An actual stipulation filed with the court or an order after hearing is required to limit the amount ordered and to prevent additional enforcement penalties, such as license suspensions, from being imposed.

Another potentially money-saving action that an attorney can take for a respondent-obligor is to request an audit. An audit may find a significant error in the billing statements. It is not unusual for an audit to reveal that the client owes thousands of dollars less than what is reported on the most recent billing statement. Respondents are required to submit self-audits before the CSSD is willing to generate one for them. Be aware, however, that if your client has not paid child sup-

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**Child Support Services: Nitty-Gritty Details**

These pointers may help attorneys who are new to Central Civil West and the Child Support Services Department.

- To avoid waiting (potentially for hours) on the 18th floor, make sure you sign in on the clipboard for attorneys by 8 A.M. The clipboards are posted at 7:30 A.M.
- The civil matters are negotiated on the 18th floor, and the courtrooms are located on the 16th floor. Criminal matters for noncustodial parents with nonpayment histories of greater than 90 days are heard and heard on the 5th floor. The criminal court is a single courtroom, Division 270, and it is rumored that this sole remaining court may be closed because of budgetary problems.
- Cases ending in 00-24 are heard in Dept. 2E, Room 1615; those ending in 25-49 in 2F, Room 1612; those ending in 50-74 in 2G, Room 1609; and those ending in 75-99 in 2H, Room 1608.
- Many of the proofs of service of the Summons and Complaint and the Notice of Entry of Judgment forms contain language that the service address has been redacted. Attorneys can obtain these addresses easily by completing a Request for Release of Address form (available at the Court Facilitator’s Office on the 16th floor) and submitting it at the check-in window on the 18th floor. The results are nearly immediate in most cases. The Court Facilitator’s Office is open from 8 A.M. to noon Monday through Friday and from 1:30 to 4:30 P.M. every afternoon except Thursday.
- Local Rule 14.6 requires your client to bring the following documents to court: 1) payroll records and/or copies of the two most recent payroll stubs showing year-to-date earnings, 2) copies of state and federal income tax returns and all loan applications (whether or not the loan was granted) for the two previous tax years (including but not limited to federal income tax forms, W-2s, 1099s, and 1040s, including any supporting schedules), and 3) any tax schedules that relate to sources of income other than wages.
- Additional information on the workings of the court may be obtained from the members of the Family Law Indigent Paternity Panel. A list of the panel members, with their phone numbers and addresses, is available at the Court Facilitator’s Office and Departments E-H.
- For information about your specific case, call the CSSD and ask for the name and extension of the “digit staff attorney” assigned to your case. These attorneys may be able to provide valuable information about the case that you did not learn from your client as well as helpful documents such as payment histories that list the entirety of payments received by the court trustee.
- To learn how each commissioner operates, visit the courtroom between 10 A.M. and noon or between 2 and 3:30 P.M. This may provide valuable insights regarding how to prepare your motions and how best to proceed on your hearing.—J.L.
port for more than 90 days, the client is exposed to criminal prosecution. Therefore, you may want to appear ex parte and ask the court to waive the self-audit requirement so that the county’s audit can be prepared without having the client first submit a potentially self-incriminating public record. Audits can take a long time to prepare, so the court date should be set at least six weeks from the filing date of the order to show cause requesting an audit and determination of arrears. By doing so, the audit has a better chance of being completed by the hearing date.

In addition to audit requests, the courts at CCW will consider requests on behalf of respondents regarding credit against arrears for custodial time and credit for direct payments to the obligee parent. If a minor child lived with the noncustodial parent for a time, or if the noncustodial parent made payments directly to the custodial parent, the noncustodial parent may receive credit against child support arrears.

Recently, the CSSD initiated two programs to assist in adjusting current child support and child support arrears. First, the Child Support Improvement Program is an internal review program in which cases are set by the CSSD to special departments (namely, 2Y and 2Z). Cases are referred when a noncustodial parent’s child support or child support arrears should be lower than they are. These situations may arise when the noncustodial parents are or have been incarcerated during some or all of the child support arrears period, are no longer employed, or received a judgment by default that was based on presumed income imputed from an actuarial table listing the “average living wage” instead of the current minimum wage. Second, a new state statute, Family Code Section 17550, has prompted what is called the compromise program, which enables respondents, under a particular set of circumstances, to save hundreds or even thousands of dollars on their child support arrears. Counsel may call the CSSD to inquire if a client is able to take advantage of either program.

Court Appearances

The CSSD notice of a court date is confusing. It lists a time to appear and a courtroom on the 16th floor, but the notice does not mention that the respondent should first go to the 18th floor. Clients should sign in at the window on the 18th floor and wait for their name to be called for a pretrial conference. Attorneys must sign their names, clients’ names, case numbers, and arrival times on clipboards at the security desk on the 18th floor waiting room. Attorneys should also note if they are appearing ex parte; doing so may expedite being called. If the issues can
be resolved during the conference, a stipulation and order are drafted. Pro per respondents must then wait for their case to be heard by the court so the court may satisfy itself that the respondents understand the stipulation. Respondents represented by counsel do not have to wait for this step and may leave the courthouse after the stipulation is signed and conformed on the 18th floor. (For additional tips, see “Child Support Services: Nitty-Gritty Details,” page 16.)

If a satisfactory agreement is not reached with the staff attorney on the 18th floor during the pretrial conference, client and attorney are sent to a courtroom on the 16th floor and wait for the file from upstairs to be delivered to court. It is not uncommon for a different staff attorney to be arguing the case in the courtroom. Lead staff attorneys are assigned to each courtroom and handle more routine matters. Cases requiring special handling, in contrast, are usually pursued by one staff attorney. Once in court, counsel will be asked by the bailiff to have the client review and sign a waiver form that allows the commissioner to hear the case. If your client signs the waiver, you may still object to the commissioner who is deciding the case by stating at the commencement of your appearance, “I appear pursuant to Family Code Section 4251(c).” The section indicates: “If any party objects to the commissioner acting as a temporary judge, the commissioner may hear the matter and make findings of fact and a recommended order. Within 10 court days, a judge shall ratify the recommended order unless either party objects to the recommended order, or where a recommended order is in error.” If, when the hearing has ended, you are content that the result is a fair one, you may waive your objection. If you do not believe the result was fair, you may confirm your objection by filing a notice of objection within 10 days of the hearing date. You will be mailed a notice of the hearing date for a trial de novo (which will occur at 111 North Hill Street, Downtown).

Sometimes a commissioner may warn counsel that filing an objection may expose the client and the attorney to sanctions for filing a frivolous lawsuit. This warning may come if the commissioner believes that you are simply attempting to get a second bite of the apple. However, negative consequences for making a Section 4251(c) objection are rare, and a reasonable argument often succeeds in avoiding sanctions even when the commissioner’s decision is ultimately confirmed. Counsel may or may not raise the Section 4251(c) objection at a hearing even if the commissioner has already heard the case on other issues. This is different from regular family law court matters, in which the fail-
ure to object to a commissioner at the outset of the first appearance waives the right to do so on subsequent appearances.

The procedure for ex parte appearances differs from noticed appearances. The CSSD must receive notice before 10 A.M. (by telephone is acceptable) the day before an ex parte appearance. On the day of the appearance, the attorney must check in with the back-office clerks of the appropriate courtroom before 10 A.M. Counsel should proceed to the filing room on the 3rd floor to pay the ex parte appearance fee, then return to the 18th floor to sign in and wait to be called.

All regular rules of evidence apply at CCW. Be especially sure to comply with Local Rule 14.6, which specifies which documents are mandatory for your client to provide at the time of filing the motion or, failing that, at the time of trial. Failure to comply can result in the removal of your case from the calendar or, in the extreme case in which the respondent has brought several similar motions in the recent past, the imposition of sanctions for being a vexatious litigant. For example, a modification of child support requires that the respondent has experienced a material change in circumstances from those in effect at the time of the order (unless the previous order was under guideline). Filing orders to show cause for a downward modification without supporting documentation may result in monetary sanctions and an order precluding the party from bringing another motion for a specified time.

With very few exceptions, the CSSD staff attorneys and the commissioners try to assist the people who come to court. That does not mean that counsel should not ask the court to deviate from the guidelines if special circumstances exist or should not make an appropriate Section 4251(c) objection. For example, counsel may be able to make a persuasive showing—with supporting documentation—that the imposition of the child support guidelines would not allow the respondent to meet the basic necessities of life. This showing may persuade the commissioner to deviate from the guidelines and order an amount that allows the respondent to meet his basic monthly expenses. Basic courtesy goes a long way with the staff attorneys and commissioners, but courtesy should not be confused with obsequiousness, just as advocacy should not be seen as aggression. Therefore, do not hesitate to assert your client’s priorities when necessary.

Practitioners who are familiar with some common issues and procedures related to practicing law at CCW can approach that imposing silver building with confidence. It can be overwhelming for a person to deal with paternity and child support issues at the CSSD; it does not have to be for that person’s attorney as well.

1 For articles detailing the evolution of the Child Support Services Department, see http://www.latimes.com and search headlines for “child support” and Greg Krikorian as the author.
2 Child support software is critical in order to calculate child support: Dissomaster (made by California Family Law Report) is the program of choice for the CSSD, but X-Spouse, Westlaw, and Nolo Press also offer lower-priced packages.
3 In re Marriage of Smith, 135 Cal. App. 3d 543, 553 n.21 (1982).
4 Gray v. Lawler, 151 Cal. 353, 354 (1907).
5 Family Code §17432(c) provides, “The court may set aside the child support order contained in a judgment…if the defendant’s income was substantially different…[from] the income the defendant was presumed to have.” Family Code §4071(a) lists the circumstances evidencing hardship.
6 FAM. CODE §17432(f): “A motion for relief under this section shall be filed within one year of the first collection of money by the local child support agency or the obligee.”
7 See FAM. CODE §4251(c).
8 A low-income client may qualify for a waiver of court costs and fees. Forms for this purpose are available on the third floor and should be submitted before the ex parte appearance date or before the Order to Show Cause/Notice of Motion is filed.

The New Reality: Current Issues in Fact-Based Programming
Thursday, January 29, 2004
4 - 7:30 p.m. Reception to follow.

Legal issues arising out of fact-based programming were once of concern primarily to lawyers representing the news media. Today, those issues cut a far broader swath through the ENTERTAINMENT and MEDIA businesses.

The New Reality will examine current and developing legal issues arising from all kinds of fact-based and scripted programming in three panels composed of leading experts in the field.

Co-Sponsored by the Media Law Resource Center
This event offers 3 hours of CLE credit, including 1 hour of legal ethics.

To register for these events or for more information, contact:
The Donald E. Biederman Entertainment & Media Law Institute
Southwestern University School of Law
853 S. Westmoreland Ave., Los Angeles, CA 90005
Tel: (213) 748-6607
Email: institute@swlaw.edu

Sony v. Universal:
The Betamax Decision Twenty Years Hence
Thursday, March 11, 2004
3:30 - 8 p.m. Reception to follow.

Twenty years ago, Sony v. Universal ushered in the use of revolutionary entertainment technology. Today, as a new revolution unfolds, the case continues to dominate the legal landscape. In three panels, this conference explores the Betamax decision from past, present and future perspectives.

Co-Sponsored by the Los Angeles Copyright Society
This event offers 4 hours of CLE credit.
On the Threshold of Arbitration

Whether a court or arbitrator decides a threshold arbitration issue hinges on whether the issue involves a question of arbitrability

First Options of Chicago, Inc. v. Kaplan, a landmark decision issued in 1995, the U.S. Supreme Court sketched the broad outlines of a methodology to distinguish arbitral from judicial powers over “gateway” or “threshold” issues. Arising at the onset of an arbitration, these issues are not clearly within or outside the contractual grant of power to the arbitrator and may be determinative of whether the arbitration will proceed. In its 2002-03 term, the Court discussed and refined that methodology in three decisions: Howsam v. Dean Witter Reynolds, Inc.; Pacificare Health Systems, Inc. v. Book; and Green Tree Financial Corporation v. Bazzle. While these decisions clarify the division of power between courts and arbitrators at the commencement of an arbitration, they also identify schisms within the Court regarding who should decide certain threshold issues and note areas in which the balance of power between courts and arbitrators has yet to be addressed.

Arbitration involves a contractual trade-off of certain traditional due process rights, such as judicial review, for the benefits of arbitral efficiency, finality, and the selection of the decision maker. Therefore, determining whether or not a dispute will be resolved by arbitration is crucial:

Whether the parties have actually agreed to this trade-off—the “arbitrability” of the dispute—is a question that is profoundly important....This question of agreements to arbitrate has proliferated an extraordinarily complex and nuanced patchwork of doctrine that sometimes seems far removed from reality—the Serbonian bog of arbitration law.

Moreover, just who makes the arbitrability decision is among the more subtle and important issues lurking in the mist.

The arbitral power to decide gateway or threshold issues that may determine the viability of the arbitration itself contains an inherent circularity. Consider the question of who decides defenses to the enforcement of a contract. The arbitrator’s power arises only from the contract. Therefore, if the contract...
is void or unenforceable, the arbitrator arguably should have no power. However, attorneys, courts, and arbitrators are already familiar with the concept of an arbitrator having the power to decide the applicability of defenses to the very contract from which the arbitrator’s power stems. In a 1967 decision, Prima Paint Corporation v. Flood & Conklin Manufacturing Company, the Supreme Court held, under Section 4 of the Federal Arbitration Act, that when the arbitration clause is included in a larger contract, unless a contract defense goes to the unenforceability of the arbitration clause itself, the arbitration can proceed. Moreover, the applicability of fraud and other similar challenges to the main contract will be decided by the arbitrator and not by the court. Under the “separability doctrine” of Prima Paint, the arbitration clause in the contract is “separable” from the rest of the contract and allegiations that address the validity of the contract in general, as opposed to the arbitration clause in particular, will be decided by the arbitrator, not the court.8

The same circularity can be seen when the arbitrator decides whether conditions precedent to an arbitration have been fulfilled. However, the Revised Uniform Arbitration Act of 2000, seeking to “incorporate the holdings of the vast majority of state courts and the law that has developed under the [Federal Arbitration Act],” states that an “arbitrator shall decide whether a condition precedent to arbitrability has been fulfilled.”9 Richard C. Reuben, a professor at the University of Missouri-Columbia School of Law, has noted that: “The separability doctrine is counter-intuitive, and as a result has been difficult for many lower courts to implement, and has simply been rejected by others as bad policy. This has led to massive doctrinal complexity, confusion, and uncertainty; it is one of the thickest areas in the bog [of arbitration law].”10

The developing jurisprudence of First Options and the more recent Supreme Court cases must be understood in the context of Prima Paint and the “doctrinal complexity” of the separability doctrine.11 First Options and its progeny address the question of who—the court or the arbitrator—has the power to decide various precursors to arbitration, including: 1) questions of arbitrability (First Options12), 2) whether contractual statutes of limitations stated as conditions precedent to arbitration have run (Houseman13), 3) the meaning of contractual terms that arguably render a particular claim not subject to arbitration (Book14), and 4) the meaning of contractual terms that determine the availability of arbitral class actions (Bazzle15). Perhaps more important than the particular issues addressed, however, is the emerging methodology for deciding the balance of power over other threshold issues that will arise in the future.

Determining Arbitrability

The claimant in First Options was a company in the business of clearing stock exchange trades. In a dispute arising from debts incurred after the 1987 stock market crash, the claimant sought arbitration against defendant Kaplan, his wife, and Kaplan’s wholly owned investment company. The dispute focused on four documents governing the debt workout. Kaplan’s investment company had signed the only one of the four documents that contained an arbitration clause, but the Kaplans had not personally signed that document and resisted arbitration.16

The arbitrators rejected the Kaplans’ arguments that they did not belong in arbitration, and rendered an award on the merits against them, which the Kaplans moved to vacate. The district court confirmed the award. The Third Circuit agreed with the Kaplans that the dispute against them was not arbitrable, and it reversed the district court’s confirmation of the award. The Supreme Court granted certiorari. The issue addressed by the Supreme Court was who, as between the court and the arbitrator, had the power to decide whether the claimant’s dispute with the Kaplans (who were not signatories to the arbitration clause) was arbitrable.17

As an initial matter, the Court identified the gateway question at issue (whether the nonsignatory Kaplans were subject to arbitral power) as a question of the dispute’s arbitrability.18 Then, the court addressed who—the court or the arbitrator—has the power to decide arbitrability.19 The Court resolved this issue by looking to what the parties intended:

Just as the arbitrability of the merits of a dispute depends on whether the parties agreed to arbitrate that dispute, so the question “who has the primary power to decide arbitrability” turns upon what the parties agreed about that matter. Did the parties agree to submit the arbitrability question itself to arbitration? If, on the other hand, the parties did not agree to submit the arbitrability question itself to arbitration, then the court should decide that question—indeed, independently.20

The parties’ intent should be decided by the state law contract interpretation principles normally used by courts in assessing the intent of contracting parties: “The relevant state law here, for example, would require the court to see whether the parties objectively revealed an intent to submit the arbitrability issue to arbitration.”21 Thus, the Court determined that the parties’ intent, as discerned by application of state law contract interpretation principles, governs who makes the arbitrability determination.

The Court then added a crucial qualification: When assessing whether a party has agreed that arbitrators should decide arbitrability, courts must have “clear and unmistakable” evidence that the party so agreed, and in the absence of such evidence courts should not make that finding.22 This qualification appears to create a rebuttable presumption regarding the parties’ presumed intent about whether courts or arbitrators will decide the arbitrability of the dispute. The presumption favors the courts’ power to decide arbitrability; it can be rebutted only by clear and unmistakable evidence of contrary intent.

The Court acknowledged that this presumption differs from a presumption in its prior cases in favor of finding that a “particular merits-related dispute is arbitrable because it is within the scope of a valid arbitration agreement.”23 Under the earlier Supreme Court jurisprudence, “any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration.”24 First Options explains the disparity between the usual presumption favoring arbitrability of issues and the contrary presumption that arbitrability itself is not arbitrable:

[T]his difference in treatment is understandable. The question [of whether a particular dispute is within the scope of a valid arbitration clause] arises when the parties have a contract that provides for arbitration of some issues…. [G]iven the law’s permissive policies in respect to arbitration, one can understand why the law would insist upon clarity before concluding that the parties did not want to arbitrate a related matter. On the other hand, the…question [of who should decide arbitrability] is rather arcane. A party often might not focus upon the question or the significance of having arbitrators decide the scope of their own powers. And, given the principle that a party can be forced to arbitrate only those issues it specifically has agreed to submit to arbitration, one can understand why courts might hesitate to interpret silence or ambiguity on the “who should decide arbitrability” point as giving the arbitrators that power, for doing so might too often force unwilling parties to arbitrate a matter they reasonably would have thought a judge, not an arbitrator, would decide.25

Thus, First Options creates a rebuttable presumption that parties
would normally and reasonably expect a court to decide arbitrability. This presumption can be rebutted by clear and unmistakable evidence that the parties expected an arbitrator to decide it.

It is important to note that the word “arbitrability” is ambiguous. “Arbitrability” can refer to arbitral jurisdiction over persons, and it was in this context, when a nonsignatory to an arbitration clause was contesting arbitral jurisdiction, that First Options arose. “Arbitrability” can also refer to whether a particular factual or legal issue (for example, a tort related to a contractual breach) falls within the scope of the arbitration clause.

Reuben has observed that:

Unfortunately, the term “arbitrability” has come to embrace—and confuse—a series of similar but analytically distinct issues relating to agreements to arbitrate. The analytical abyss that has inevitably followed does not permit easy synthesis; even simple discussion is often inhibited by the frailty of language in allowing for nuance. As a result, one leading arbitration scholar has mused wistfully that “arbitrability” is a word that might well be banned from our vocabulary entirely—or at least restricted, as in other legal systems, to the notion of what society will permit arbitrators to do.”

First Options found that questions of arbitrability were presumptively to be decided by the court and not the arbitrator. This makes it semantically crucial under First Options whether a particular threshold or gateway issue is or is not defined as a question of arbitrability. But First Options did not define “arbitrability,” and there is much semantic argument by the parties in the later cases as to which side of the arbitrability line the particular threshold or gateway issue addressed in each case falls.

Reasonable Expectations

In the three cases decided in the 2002-03 term, however—Howsam, Book, and Bazzle—the Court appears to be focusing less on whether a particular gateway issue presents a question that could semantically be defined as an arbitrability question under First Options, and more on the core issue of what gateway determinations the parties reasonably would have thought a judge or an arbitrator would decide. Thus, seven years after First Options, the cases decided last term develop the central concept in First Options: When determining who decides gateway questions, the court will assess what, in the absence of express intent, the parties reasonably would have expected.

These cases present for the Court’s examination only a few particular types of threshold determinations out of a potentially vast number of possible issues that could arise at the onset of arbitration that might in turn affect whether the arbitration goes forward. In general, the issues presented so far have not caused significant internal division within the Court. However, one case, Bazzle, resulted in a deep rift. The future delineation of the balance of power between courts and arbitrators most likely will be based on the close cases in which there is a difference of opinion over the parties’ reasonable expectations about arbitral versus judicial powers.

In Howsam, the Court decided that, in the absence of a contrary expression of intent, the parties are presumed to have intended that an arbitrator, not a court, will decide whether a contractual statute of limitations, stated as a condition precedent to arbitration, has run. Howsam cites First Options extensively and expressly relies on what the parties “would likely have expected” a judge, as opposed to an arbitrator, to decide.

Howsam involved a dispute between an investor and a brokerage house that was governed by the National Association of Securities Dealers arbitration rules. The rule at issue contained a contractual statute of limitations, which stated that no dispute “shall be eligible for submission to arbitration…where six…years have elapsed from the occurrence or event giving rise to the…dispute.” When the investor initiated arbitration, the broker sought judicial intervention, asking the court to declare the dispute ineligible for arbitration on the grounds that the dispute was more than six years old. The district court found that the arbitrator, not the court, should interpret and apply the rule. The circuit court, however, disagreed and found that the issue presented a “question of arbitrability” that, under First Options, was for the court to decide, not the arbitrator. Lower courts had for years been deeply divided over whether this gateway or threshold issue in the NASD rules should be decided by courts or arbitrators.

The Supreme Court in Howsam distinguished the case from the circumstances in First Options and held that whether the NASD arbitration was time-barred was a matter to be decided by the arbitrator.

Linguistically speaking, one might call any dispositive gate-
way question a “question of arbitrability,” for its answer will
determine whether the underlying controversy will proceed
to arbitration on the merits. The Court’s case law, however,
makes clear that...the phrase “question of arbitrability” has a
far more limited scope. (Citation omitted.) The Court has
found the phrase applicable in the kinds of narrow circum-
stances where contracting parties would likely have expected
a court to decide the gateway matter, where they are not likely
to have thought that they had agreed that an arbitrator would
do so....

At the same time the Court has found the phrase “ques-
tion of arbitrability” not applicable in other kinds of general
circumstances where parties would likely expect that an
arbitrator would decide the gateway matter.26

Applying the logic of what the contracting parties would likely
have expected a court or an arbitrator to decide, the Court found
that:

[The contractual statute of limitations] is a matter presum-
tively [in the absence of contrary intent expressed by the
parties] for the arbitrator, not the judge. The time limit rule
closely resembles the gateway questions [waiver, delay, and
similar defenses] that this Court has found not to be “ques-
tions of arbitrability.” (Citation omitted.)

Moreover, the NASD arbitrators, comparatively more
expert about the meaning of their own rule, are comparatively
better able to interpret and to apply it. In the absence of any
statement to the contrary in the arbitration agreement, it is
reasonable to infer that the parties intended the agreement
to reflect that understanding. (Citation omitted.) And for

the law to assume an expectation that aligns (1) the decisionmaker
with (2) comparative expertise....

[NASD’s] time limit rule falls within the class of gateway
procedural disputes that do not present what our cases have
called “questions of arbitrability.” And the strong pro-court
presumption as to the parties’ likely intent does not apply.41

Thus, in Howsam, as opposed to First Options, the dispute was
found not to present a question of arbitrability to be decided by
the court but rather to present a gateway procedural question
presumptively for the arbitrator. The distinction rested on the Court’s
assessment of the parties’ likely intent about who would decide the
gateway issue.

Statutory Damages Limitations

Later in the 2002-03 term, the Supreme Court addressed the ques-
tion of who, between the court and the arbitrator, should decide the
meaning of a contractual term that might, depending on its inter-
pretation, render an arbitration clause unenforceable. Book42 arose
in the context of a healthcare dispute between doctors and a man-
aged healthcare organization in which the doctors alleged system-
atic underpayments, stated RICO violations, and sought treble
damages. The contracts at issue contained arbitration clauses with
limitations on damages, including limitations on the recovery of puni-
tive damages in some cases and extracontractual damages in other
cases.43 If this language were construed to prohibit treble damages
under RICO, then a conflict would exist between the arbitration
clauses and the parties’ statutory rights and remedies. In such sit-
uations, the arbitration clauses are unenforceable as written. Courts
will either strike the offensive provision of a clause and permit the
arbitration to go forward without the limitation or find that the
offensive provision is not severable, thus rendering the entire arbi-
tration clause unenforceable. The district court chose the latter
course and denied the defendants’ motion to compel arbitration of
the RICO claims.44 The Eleventh Circuit affirmed.

On appeal to the Supreme Court, the defendants argued that the
issue of enforceability of the clauses in question, with the damages
limitations, was not a question of arbitrability and hence should have
been decided by an arbitrator rather than by a court.45 The Supreme
Court found that that question was premature because, prior to even
addressing the enforceability of an arbitration clause with a damages
limitation that would be offensive to RICO, one first had to interpret

the clause to find whether the limitation on punitive damages or
extracontractual damages did in fact restrict RICO treble damages.
The Court found that this was not a settled question but required
contract interpretation and legal analysis.46 The contracts had
already been interpreted in this case by the district court.

Nevertheless, concluded the Supreme Court, the contracts should
have been interpreted by the arbitrator and not by the district court:
“At this interlocutory stage...it is not established what the arbit-
trators will apply to [the] claims or that [the claimant] will receive
diminished protection as a result.”47

Therefore, the court continued:

[Given the uncertainty surrounding the parties’ intent with
respect to the contractual term “punitive,” the application of
the disputed language to [the claimants'] RICO claims is, to
say the least, in doubt. And Vimar Seguros Y Reaseguros, S.A.
v. M/V Sky Reefer instructs that we should not, on the basis
of “mere speculation” that an arbitrator might interpret these
ambiguous agreements in a manner that casts its enforce-
ability into doubt, take upon ourselves the antecedent ques-
tion of how the ambiguity is to be resolved.48

The Supreme Court that the proper course was to com-
pel arbitration, thereby submitting the contractual analysis to the arbi-
trator for resolution. The Court did not address what was to happen
if the arbitrator should decide that the contractual damages limita-
tions did in fact limit treble RICO damages (which would render the
RICO claims inarbitrable under the clauses as written). Quoting Howsam,
the Court found that the contractual ambiguity itself was
not a “question of arbitrability” that the parties would likely have
expected a court to decide.49

Class Actions

Finally, in Bazzle,50 a plurality of the Court found, similarly to Book,
that a court had erred by making a decision about arbitrability
based upon an ambiguous contract term that the lower court inter-
preted rather than sending the contractual ambiguity in question to
the arbitrator. The case emerged in the context of lending con-
tracts entered into in South Carolina that allegedly violated a state
consumer protection statute. The arbitration clause in the contracts
did not specifically address the question of arbitral class actions but
did say that disputes “shall be resolved...by one arbitrator selected
by us with consent of you.”51 The issue in the case was whether the
arbitration clause was silent on the issue of arbitral class actions—
and what were the consequences of that silence.

The Bazzle case was eagerly awaited, as it was expected to
resolve one or more hotly contested and topical issues—namely
whether Section 4 of the FAA,52 which requires arbitration in “accord-
ance with the terms” of the agreement, permits classwide arbitration
when an arbitration clause provides no guidance on that issue, and
whether Section 4 of the FAA applies in state courts or only in fed-
eral courts. The South Carolina Supreme Court found that the
clause at issue did not address classwide arbitration and, in the face
of contractual silence, class arbitration was permissible.53 The U.S.
Supreme Court granted certiorari.54

Rather than decide the expected issues, a plurality of the Supreme
Court justices in Bazzle found instead that the preliminary question
of the contract’s “silence” was open to interpretation and should have
been resolved by an arbitrator rather than the state court:

[T]he dispute about what the arbitration contract...means (i.e., whether it forbids the use of class arbitration procedures) is a dispute “relating to this contract” [under the language of the arbitration clause]. Hence the parties seem to have agreed that an arbitrator, not a judge, would answer the relevant question.55

The plurality further held that whether the contracts forbid class arbitration is not, under First Options, a “question of arbitrability” that the parties would presumptively and in the absence of clear and unmistakable evidence to the contrary have reasonably expected a court rather than an arbitrator to resolve. Like the contractual statute of limitations question in Housam, the plurality found that:

[The question] concerns contract interpretation and arbitration procedures. Arbitrators are well-suited to answer that question. Given these considerations, along with the arbitration contracts’ sweeping language concerning the scope of the questions committed to arbitration, this matter of contract interpretation should be for the arbitrator, not the courts, to decide.56

Bazzle presents in stark relief the sharp differences of opinion that can arise about the parties’ reasonable expectations. Justices Scalia, Souter, and Ginsberg joined in the plurality decision with Justice Breyer, who wrote the opinion (and who also wrote the plurality decision with Justice Breyer, who concurred in the judgment but on alternate grounds.57 Justices O’Connor and Kennedy joined the vigorous dissenting opinion written by Justice Rehnquist,58 who argued that the decision was one for the courts, not for the arbitrator, and that classwide arbitration in the absence of explicit contractual authorization violates Section 4 of the FAA:

[T]his case is controlled by First Options, and not by our more recent decision in Housam.... I think that the parties’ agreement as to how the arbitrator should be selected is much more akin to the agreement as to what shall be arbitrated, a question for the courts under First Options, than it is to “allegations of waiver, delay, or like defenses to arbitrability,” which are questions for the arbitrator under Housam.59

Further vigorous disagreement will no doubt ensue as other particular gateway or threshold issues—such as contract defenses and conditions to arbitration—are presented for determination either by courts or arbitrators in the face of contractual silence over who the parties expected would decide them.

Unconscionability

There is one crucial issue that has not yet been addressed head on by parties and courts but is clearly implicated by these recent Court of Appeals decisions: whether the applicability of the contract defense of unconscionability ultimately will be found to be for arbitrators, not courts, to decide.60 If, as is typical, an arbitration clause provides that “all disputes arising out of or related to this contract shall be resolved by arbitration” (or words to that effect), should one presume that the parties reasonably would have thought a court or an arbitrator would decide whether the clause was unconscionable? This is the question, as framed in the manner of the questions posed by First Options and Housam. The answer is yet to be determined.

The defense of unconscionability and the question of who decides it is of critical importance in the ongoing public policy debate over mandatory arbitration—that is, arbitration arising from clauses embedded in employment and consumer contracts in which there is a disparity in the bargaining power of the parties and the clause is presented on a take-it-or-leave-it basis. Unconscionability arguments typically have been addressed to courts, especially challenges that focus on the unconscionability of the arbitration clause itself. Extensive case law has developed across the country from challenges to arbitrability based on the defense of unconscionability. Such challenges have been routinely decided by courts, not arbitrators.61

However, in Hawkins v. Aid Association for Lutherans,62 the Seventh Circuit recently found that an unconscionability challenge was for the arbitrator, not the court, to decide. The Hawkins case involved three groups of plaintiffs, who filed putative class actions against Aid Association for Lutherans (AAL)—a fraternal benefit society that provided them with life insurance—alleging that AAL engaged in fraudulent sales practices. Fraternal benefit societies are not regulated by the same laws as commercial insurance companies but rather are governed by a regulatory scheme based on a model fraternal code. Fraternal benefit societies employ “open” contracts that are memorialized by the member’s application, the insurance certificate, and the society’s articles of incorporation and bylaws, which are subject to change. When the plaintiffs purchased their policies, AAL’s bylaws did not prescribe a means for resolving disputes, but they were later amended to include a mandatory arbitration provision. The district court in
Wisconsin granted AAL’s petitions to compel arbitration of the plaintiffs’ claims. The Seventh Circuit consolidated the appeals of the plaintiffs.

The appellants contended that the arbitration provisions were unconscionable on a number of grounds, all of which were rejected by the Seventh Circuit. Invoking Prima Paint in response to the appellants’ arguments that the clause was unconscionable because it limited the remedies available to them, the court notably held:

[C]omplaints about the unavailability of such remedies first must be presented to the arbitrator. In analyzing a motion to compel arbitration, courts must consider only the issues relating to arbitrability. [Citation omitted.] “Once the court determines that an arbitration clause is enforceable, the status of the other contract terms is for the arbitrator to decide.” [Citation omitted.] Because the adequacy of arbitration remedies has nothing to do with whether the parties agreed to arbitrate or if the claims are within the scope of that agreement, these challenges must first be considered by the arbitrator.

If under the Prima Paint doctrine of separability, contractual defenses such as fraud, waiver, estoppel, and laches are arbitrable, what about unconscionability? Under First Options, is unconscionability a “question of arbitrability” that parties “reasonably would have thought a judge, not an arbitrator, would decide”? Or does it, under Howsam, “fall[]” within the class of gateway procedural disputes that do not present what our cases have called ‘questions of arbitrability’?” This issue remains unsettled but will likely be addressed increasingly by lower courts across the country. When and if this unsettled issue reaches the Supreme Court, the justices will likely decide it pursuant to the methodology laid out in First Options and developed in Howsam, Book, and Bazzle.

8 Accordingly, if the claim is fraud in the inducement of the arbitration clause itself—an issue which goes to the ‘making’ of the agreement to arbitrate—the federal
court may proceed to adjudicate it. But the statutory [Federal Arbitration Act] language does not permit the federal court to consider claims of fraud in the inducement of the contract generally." Id. at 403-04. The question as stated by the Court in Prima Paint was "whether the federal court or an arbitrator is to resolve a claim of fraud in the inducement, under a contract governed by the United States Arbitration Act of 1925, where there is no evidence that the contracting parties intended to withhold that issue from arbitration." Id. at 396-97. Justice Black, dissenting in Prima Paint, complained that "[t]he Court holds, what is to me fantastic, that the legal issue of a contract's voidness because of fraud is to be decided by persons designated to arbitrate factual controversies arising out of a valid contract between the parties." Id. at 407 (Black, J. dissenting).

Revised Uniform Arbitration Act §6(c) and comment 2, 7 U.L.A. 12-13 (Supp. 2002).

See Reuben, supra note 5, at 825. For more on the lower federal courts' application of Prima Paint, see id. at 852-55 and accompanying notes. Reuben notes that while "lower federal courts are of course obligated to follow Prima Paint's rule of separability,...[s]tate courts, however, are not similarly bound...." However, in varying forms and to varying degrees, the separability rule has taken hold in a majority of the states. Id. at 852; see also id. at nn.198-207 and accompanying text.

10 "The Court's most recent pronouncement on [separability]...—...Howsam...—...Book—...provides...evidence that a...fundamental shift may be underway within the Court on arbitrability law...." Id. at 825-26.


First Options, 514 U.S. at 940-41.

Id.

Id. at 942.

Id.

Id. at 943 (citations omitted) (emphasis in original).

Id. at 944.

Id.

Id. at 944-45.


First Options, 514 U.S. at 945 (citations omitted) (emphasis added).


First Options, 514 U.S. at 943-45.


Howsam, 537 U.S. 79.

Book, 123 S. Ct. 1531.


Howsam addresses a contractual statute of limitations, stated as a condition precedent to arbitration. 537 U.S. 79. Book considers the enforceability of an arbitration clause containing a statutory damages limitation. 123 S. Ct. 1531. Bazzle presents the question of contractual language permitting or prohibiting arbitral class actions. 123 S. Ct. 2402.

Justice Breyer's opinion in Howsam was joined by six justices, with Justice Thomas concurring. 537 U.S. 79. Justice Scalia's opinion in Book was joined by seven jus-
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tices. 123 S. Ct. 1531.
53 Justice Thomas dissented on other grounds. Thomas
51 Petitioner Green Tree argued before both the South
50 Green Tree Fin. Corp. v. Bazzle, 123 S. Ct. 2402
49 Id.
48 Id.
47 Id.
46 Id.
45 Id.
44 Id.
43 Id.
42 Pacificare Health Sys., Inc. v. Book, 123 S. Ct. 1531
41 Id.
40 Id.
39 Id.
38 Id.
37 Id.
36 Id.
35 Howsam, 537 U.S. 79.
34 See text, infra.
33 Howsam, 537 U.S. 79.
32 Id. at 83-86 (citing First Options of Chicago, Inc. v.
31 Kaplan, 514 U.S. 938, 942, 943-46, 944-45).
30 Id. at 82. Id.
29 Id.
28 Id.
27 Id. at 83-84 (emphasis in original).
26 Id. at 85-86.
25 Pacificare Health Sys., Inc. v. Book, 123 S. Ct. 1531
23 Id. at 1535.
22 Id. at 1534.
21 Id.
20 Id. at 1535-36.
19 Id. at 1534 (quoting Vimar Seguros Y Reaseguros, S.A.
18 v. M/V Sky Reefer, 515 U.S. 528, 540 (1995)).
16 Bazzle, 123 S. Ct. at 2404.
15 Id.
14 Id.
13 Id.
12 Id.
11 Id.
10 Id. at 2408-09 (Stevens, J., concurring).
9 Id.
8 Id. at 2411.
7 Id. at 2409-10 (Rehnquist, C.J., dissenting) (citing
6 Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 84
5 (2002)).
4 See note 9, supra. The Prima Paint separability rule—
based on §4 of the Federal Arbitration Act—applies in
3 federal courts. It is an undecided issue whether it
applies in state courts. Nevertheless, the separability
rule has been adopted (and adapted) by numerous
state courts. See, e.g., Rosenthal v. Great Western Fin.
2 Secs., 14 Cal. 4th 394, 405-08 (1996). There is a complex
1 and bewildering body of law across the country address-
0 of a private arbitration agreement. Id. at 2411.
-180 F. 3d 838, 844 (7th Cir. 1999) (citing Prima Paint
-178 See also K. Gordon & M. Quirk, Fighting Mandatory Arbitration—Uncon-
-176 scionability Arguments after Howsam and Pacificare,
-172 See, e.g., Ting v. AT&T, 319 F. 3d 1126 (9th Cir.
-170 2003); Sarela v. Discover Bank, 97 Cal. App. 4th 1094
-168 (2002); Armendariz v. Foundation Psychcare, 24 Cal.
-166 4th 83 (2000). In these cases, the courts decide the
-164 unconscionability of arbitration clauses, and the argu-
-162 ment is not even raised that this is a matter that should
-160 properly be addressed to the arbitrator.
-158 Hawkins v. Aid Ass'n for Lutherans, 338 F. 3d 801
-154 Id. at 805.
-152 Id.
-150 Id. at 807 (citing We Care Hair Dev., Inc. v. Engen,
-148 180 F. 3d 838, 844 (7th Cir. 1999) (citing Prima Paint
-144 Id.
Litigation seeking to affirm insurance coverage for toxic tort liabilities often extends beyond one state into other states, and even into foreign countries. Corporate policyholders frequently face lawsuits in numerous states as a result of their far-flung operations, the widespread distribution of their products, and the creativity of the plaintiff’s bar. Their insurance policies, in many instances, were purchased from numerous insurance companies operating in many different places and, sometimes, through a number of different brokers who, themselves, might have brokered the policies in various different locations.

For these policyholders, an insurance coverage lawsuit legitimately can be filed in a number of different courts across the country—those located 1) where the policyholder, or its subsidiaries, are headquartered, 2) where the policyholder or its subsidiaries operate, 3) where the toxic tort lawsuits are pending, 4) where the insurance companies operate, or 5) where the insurance contracts were negotiated, brokered, executed, or delivered. Although all courts profess to adhere to choice of law principles intended to curtail forum shopping, the inescapable fact remains that “courts have a natural bias favoring the law of the state in which they sit.” Retention of a party’s chosen forum, therefore, can substantially affect the outcome of a multiparty, multistate insurance coverage lawsuit when the law on particular issues in dispute might differ from state to state.

With that in mind, California continues to be a favorable forum for policyholders to litigate insurance coverage disputes for toxic tort and other significant bodily injury liabilities. California law generally permits the policyholder to secure complete coverage under the maximum number of insurance policies and does not require the policyholder to absorb a portion of its defense costs, or indemnity expenses, corresponding to periods when it was “self-insured” or covered by now-insolvent insurance companies. The insurance companies, however, perceive advantages in the law of other jurisdictions, which they
argue limit the number or the extent of insurance policies that might respond to a loss or otherwise require the policyholder to absorb that portion of its costs and expenses attributable to the time when the policyholder was self-insured. Thus, policyholders with national operations, national liabilities, and insurance policies that were negotiated, or issued, in various places sometimes find that their insurance coverage lawsuits filed in California are met with parallel lawsuits initiated by their insurance companies in less friendly jurisdictions.

The traditional response to parallel litigation regarding the same general subject matter consists of competing motions by policyholders and their insurers to dismiss each other’s lawsuits for forum non conveniens. The doctrine of forum non conveniens generally seeks to ensure that litigation pending in more than one court is adjudicated on its merits by the court with the closest connection to the parties’ dispute. In ruling on such a motion, a court typically is required to balance various “private interest” factors—such as the relative ease of access to evidence, the availability of a compulsory process for the attendance of witnesses, and the cost of obtaining the attendance of witnesses—as well as certain “public interest” factors—such as the burden of imposing jury duty on a community that has no relationship to the litigation, the interest of localities in deciding controversies arising in their jurisdictions, and the avoidance of problems involving the conflict of laws. 

Motions to dismiss for forum non conveniens, however, are unpredictable. One commentator noted that the doctrine has resulted in “a crazy quilt of ad hoc, capricious and inconsistent decisions.” Another stated that “seemingly indistinguishable cases have far too often yielded diametrically opposite results.” An even less charitable observer remarked that it is “deeply unsatisfactory that judges are handling [forum non conveniens] matters instinctively and haphazardly,” that the doctrine is marred by “flawed public policy rationales,” and that, in the end, the doctrine “clearly costs more than it’s worth.” The U.S. Supreme Court itself noted that the discretionary nature of the forum non conveniens doctrine, combined with the “multifariousness of the factors relevant to its application,” makes “uniformity and predictability of outcome almost impossible.”

**Antisuit Injunctions**

Policyholders whose California insurance coverage disputes are threatened by lawsuits filed elsewhere by their insurance companies have, however, another tool to employ in seeking to dispose of out-of-state parallel litigation in favor of their California action: the antisuit injunction. The underlying premise of an antisuit injunction is simple. It is “a legal order barring litigants from instituting or prosecuting the same or similar action in another state.” This simple definition, however, masks the fact that the antisuit injunction can be a powerful tool in complex litigation, which is a label often affixed to multistate, multiparty insurance coverage litigation:

The issuance of an antisuit injunction greatly increases the probability that the issuing court will be the only court to hear a cause of action and dramatically decreases the chance that another court will preempt the jurisdiction of the issuing court by reaching a final judgment first. It avoids the possibility that two virtually identical causes of action will proceed concurrently in parallel courts. From the perspective of the litigants, the issuance of an antisuit injunction may heavily influence the outcome of the cause of action: To the extent that the injunction determines the forum for litigation, it decides choice-of-law rules, and often the substantive law that will govern the case.

Under this analysis, receipt of an antisuit injunction thus not only can ensure that the policyholder maintains its selected forum but also can assist the policyholder in obtaining favorable rulings from its chosen court, given the “natural bias” of judges in favor of home state law. The California Supreme Court held recently that trial courts in California, consistent with principles of judicial restraint and comity, have the power to restrain parties under its jurisdiction from prosecuting parallel lawsuits in other states in certain circumstances.

Last year the California Supreme Court offered guidance regarding antisuit injunctions in its decision in *Advanced Bionics Corporation v. Medtronic, Inc.* The supreme court had granted review in that case “to decide whether the superior court properly enjoined a party to a California lawsuit from taking any action in a Minnesota proceeding involving the same dispute.” Although the *Advanced Bionics* case traveled a procedurally complex route, its pertinent facts are relatively straightforward. Mark Stultz held high-level product management jobs with Medtronic, Inc., a corporation headquartered in Minnesota. While employed by Medtronic, Stultz signed a noncompetition agreement that, among other things, provided that it would be governed by the laws of the state in which Stultz was last employed by Medtronic.

Stultz resigned from Medtronic and went to work for Advanced Bionics Corporation, a Medtronic competitor headquartered in Sylmar, California. Stultz and Advanced Bionics immediately thereafter sued Medtronic for declaratory relief in Los Angeles County Superior Court, alleging that the noncompetition agreement Stultz signed at Medtronic, and its choice of law provision, were void under California Business and Professions Code Section 16600.

After some initial procedural wrangling, Medtronic filed a competing action in Minnesota state court alleging claims for breach of contract against Stultz and tortious interference with contract against Advanced Bionics. Shortly thereafter, Medtronic obtained a temporary restraining order in Minnesota enjoining Advanced Bionics from hiring Stultz in any competitive role and an order barring Advanced Bionics and Stultz from obtaining relief in another court that would effectively limit or stay the Minnesota lawsuit. The TRO ultimately became a preliminary injunction but did not include the provision restraining Advanced Bionics and Stultz from continuing to prosecute their California lawsuit. Nevertheless, after the Los Angeles Superior Court denied Medtronic’s motion to dismiss the lawsuit filed by Advanced Bionics and Stultz, it issued a temporary antisuit injunction against Medtronic:

[Medtronic is enjoined] from taking any action whatsoever, other than in this Court, to enforce [its covenant not to compete] against...Stultz or to otherwise restrain...Stultz from working for Advanced Bionics in California, including but not limited to making any appearance, filing any paper, participating in any proceedings, posting any bond, or taking any other action in the second-filed [Minnesota] lawsuit.

After additional procedural battles in the Minnesota and Los Angeles courts, Medtronic sought relief in the Second District of the California Court of Appeal. The appellate court upheld the issuance of the temporary antisuit injunction because 1) the injunction was necessary to protect the interests of Advanced Bionics and Stultz pending final disposition of the action, 2) the case would be decided under California law, notwithstanding the choice of law provision in the noncompetition agreement, and 3) California courts should decide the dispute because California law would apply and the California action was filed first.

The California Supreme Court reversed the Second District’s decision, but it nevertheless articulated basic principles that should have an impact on the issuance of antisuit injunctions by the trial courts of this state. Justice Chin, writing for the court, first noted that antisuit injunctions have been rec-
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- Plumas Superior Court
- Riverside Superior Court
- Blythe
- Hemet
- Indio
- Lake Elsinore
- Palm Springs
- Riverside
- Sacramento Superior Court
- San Benito
- San Bernardino Superior Court
- Barstow
- Big Bear
- Central
- Rancho Cucamonga
- Victorville
- San Diego Superior Court
- Central
- East County
- North County
- South County
- San Francisco Superior Court
- San Joaquin County Superior Court
- San Luis Obispo County Superior Court
- San Mateo County Superior Court
- Santa Clara County Superior Court
- Santa Cruz Superior Court
- Santa Cruz
- Watsonville
- Shasta County Superior Court
- Sierra County Superior Court
- Solano Superior Court
- Sonoma Superior Court
- Stanislaus County Superior Court
- Tehama Superior Court
- Trinity County Superior Court
- Tulare County Superior Court
- Tuolumne Superior Court
- Yuba County Superior Court

FLORIDA
- Fifth Judicial Circuit (Ocala)
- First Judicial Circuit (Defuniak Springs, Okaloosa, Santa Rosa Beach)

GEORGIA
- Atlanta Superior Court
- Athens-Clarke County Superior Court
- Calhoun County Superior Court
- Cherokee County Superior Court
- Clayton County Superior Court
- Cobb County Superior Court
- Cherokee County Superior Court
- Oconee County Superior Court
- Murray County Superior Court

LOUISIANA
- Fourth Judicial Dist. (Monroe)
- Twenty-Sixth Judicial Dist. (Benton, Minden)

MARYLAND
- Second Circuit Court (Centreville)
- Talbot County Circuit Court

MICHIGAN
- 36th District Court (Detroit)
- Washtenaw County Trial Court
- 18th Judicial Circuit

MISSISSIPPI
- 18th Judicial Circuit
- 36th District Court (Monroe)
- 32nd District Court (Greenwood)

MISOURI
- Jackson County Circuit Court
- Clay County Circuit Court
- Newton County Circuit Court
- Andrew County Circuit Court
-_pi_circuit

NEVADA
- 7th Judicial District
- 5th Judicial District
- 16th Judicial District

NEW JERSEY
- Bergen
- Burlington
- Cumberland
- Essex
- Gloucester
- Hudson
- Hunterdon
- Mercer
- Middlesex
- Monmouth
- Morris/Sussex
- Passaic
- Salem
- Somerset
- Warren

NEW MEXICO
- Dona Ana County (Las Cruces)
- First Judicial Circuit (Santa Fe)

TEXAS
- 22nd District Court (San Marcos)
- 33rd District Court (Burnet)
- 75th District Court (Liberty)
- 105th District Court (Corpus Christi)
- 133rd District Court (Houston)
- 219th District Court (McKinney)
- 238th District Court (Midland)
- 286th District Court (Levelland)

UTAH
- 4th District Court (Provo)

WASHINGTON
- Spokane County Superior Court

WEST VIRGINIA
- 400th District Court
- 360th District Court (Ft. Worth)
- 325th District Court (Ft. Worth)

UNITED STATES DISTRICT COURT
- Eastern District of California
- Northern District of California
- District of Oregon

UNITED STATES BANKRUPTCY COURT
- Central District of California
- Northern District of California
- USDC-New Jersey

BANKRUPTCY COURT

CALIFORNIA
- Los Angeles
- Riverside
- San Diego

NEW YORK
- Southern District of New York
- Eastern District of New York

OREGON
- District of Oregon

HAWAII
- Northern District of Hawaii

ILLINOIS
- Northern District of Illinois
- Chicago

NEW JERSEY
- USDC-New Jersey

NEW YORK
- US District Court for the Southern District of New York

OREGON
- District of Oregon
- Portland
nognized in California since at least the late nineteenth century: “We recognize that this is a case of first impression, but note that nearly 100 years ago, this court observed that ‘[t]he courts of this state have the same power to restrain persons within this state from prosecuting actions in either domestic or foreign jurisdictions which courts of equity have elsewhere.”

Despite a court’s power to restrain parallel litigation, Chin stated further that the “significant principles of judicial restraint and comity inform that we should use this power sparingly.” Although the court agreed with Advanced Bionics and Stultz that the competing Minnesota and Los Angeles actions filed by the parties presented the possibility of conflicting judgments arising in the parallel lawsuits, the court concluded, without much comment, that the Minnesota action nevertheless did not divest California of jurisdiction over the dispute. Further, Chin’s opinion held that the principles of judicial restraint and comity meant that a TRO should not be issued merely because conflicting judgments might ultimately issue in two different lawsuits, filed in two different states, involving the same parties.

Because Chin’s opinion did not adopt a standard of general applicability for the use of antisuit injunctions in the trial courts—other than commenting that antisuit injunctions should only issue in an “exceptional circumstance that outweighs the threat to judicial restraint and comity principles”—Justice Moreno offered a lengthy concurring opinion discussing the approaches taken by various courts in determining the appropriateness of an antisuit injunction and suggesting the standards that should apply in California.

After noting that state courts “employ various different tests to determine whether an antisuit injunction is appropriate,” Moreno observed that “Texas, for example, enjoins foreign suits ‘sparingly, and only in very special circumstances.’” Moreno explained that Texas courts apply a “four-part test” that determines whether an antisuit injunction is warranted: “1) to address a threat to the court’s jurisdiction; 2) to prevent the evasion of important public policy; 3) to prevent a multiplicity of suits; or 4) to protect a party from vexatious or harassing litigation.”

Moreno also discussed certain decisions in other jurisdictions that adopted a more “liberal” approach to granting antisuit injunctions. This approach allows antisuit injunctions merely, for example, to prevent a multiplicity of suits or to protect a party from vexatious and harassing litigation. Moreno stated, however, that he would adopt a more “restrictive” approach and permit antisuit injunctions primarily to protect the jurisdiction of the enjoining court, or to prevent a litigant’s evasion of the important public policies of the forum in which the enjoining court is located. This, according to Moreno, “is clearly more protective of the principles of comity and judicial restraint.”

Moreno thus did not believe that the parallel lawsuit filed by Medtronic in Minnesota threatened the jurisdiction of the California court. The original TRO issued in Minnesota was only “defensive” in nature—that is, it only enjoined the parties from obtaining relief in another court that would “effectively stay or limit [the Minnesota] action.” This order, however, did not become part of the preliminary injunction that the Minnesota court ultimately issued, which solely restricted Stultz’s activities as an Advanced Bionics employee. Moreno contrasted the defensive posture of Medtronic in the Minnesota action with a party in another case that filed a parallel, foreign proceeding that was “solely designed to rob the court [where the case was originally filed] of its jurisdiction.

Similarly, Moreno did not believe that Medtronic filed its Minnesota lawsuit to evade important California public policies. Although California and Minnesota might take opposite approaches to the enforcement of noncompetition agreements, Moreno posited that an actual evasion of important public policies occurs only when a parallel action is filed in a forum to which none of the parties has ties, or when “litigants are both residents of the state in which the injunction is sought, and one resident is seeking to evade the law of the common domicile in order to gain an inequitable advantage over the other.” Thus, because the employment agreement that Stultz signed with Medtronic stated that it would be construed according to the laws of the state in which Stultz was last employed—which, in this case, was Minnesota—Moreno stated, “I cannot conclude that Medtronic filed suit in Minnesota for the purpose of evading California public policy.”

Three Examples from Texas Courts

Although California apparently would reject the more liberal approach to issuing antisuit injunctions, courts in other states nevertheless have issued such orders in complex insurance coverage cases by focusing on the more restrictive standard, which serves to protect their jurisdiction and to prevent the evasion of important public policy. Three cases from Texas—which allows the issuance of antisuit injunctions but only rarely and under extremely circumscribed conditions—are instructive.

In Forum Insurance Company v. Bristol-Myers Squibb Company, Bristol-Myers Squibb
7. A California trial court may issue an antisuit injunction because conflicting judgments might ultimately issue in two different lawsuits, filed in two different states and involving the same parties.
   True.
   False.

8. In his concurring opinion in Advanced Bionics, Justice Moreno commented that Texas permits the issuance of antisuit injunctions only in very special circumstances.
   True.
   False.

9. Which of the following factors is not relevant to the issuance of an antisuit injunction in Texas?
   A. To prevent an evasion of important public policy.
   B. To protect a party from vexatious or harassing litigation.
   C. To ensure that local controversies are decided by local courts.
   D. To prevent a multiplicity of lawsuits.
   D.

10. In his concurring opinion in Advanced Bionics, Moreno stated that the interests of judicial restraint and comity are served by permitting the issuance of antisuit injunctions only to avoid a multiplicity of lawsuits between the parties to an action.
    True.
    False.

11. In Forum Insurance Company v. Bristol-Myers Squibb Company, the Texas court appropriately issued an antisuit injunction for which of the following reasons?
    A. The insurance policies at issue contained “service of suit” clauses.
    B. The policyholders were Texas-based companies.
    C. The parties were in settlement discussions when the insurance companies filed a competing lawsuit in New York.
    D. The competing lawsuit that the insurance companies filed in New York threatened the jurisdiction of the Texas court where an action was originally pending between the parties.
    C.

12. In London Market Insurers v. American Home Assurance Company, the insurance companies argued, among other things, that the lawsuit they filed in New York should be able to proceed because it involved different types of asbestos claims than were at issue in the case that the policyholder filed in Texas.
    True.
    False.

13. The issuance of an antisuit injunction in London Market Insurers was affirmed on appeal because the Lloyd’s insurance policies obligated the underwriters to defend a lawsuit in any court chosen by the policyholder.
    True.
    False.

14. The London Market Insurers court held, among other things, that the policyholder’s lawsuit in Texas encompassed all of the issues concerning its right to insurance coverage for asbestos lawsuits, regardless of how the asbestos lawsuits were labeled.
    True.
    False.

15. An antisuit injunction was issued in London Market Insurers, in part, to avoid difficult choice of law problems regarding New York and Texas law.
    True.
    False.

    True.
    False.

17. The trial court in Triton held that the presence of a “service of suit” clause in an insurance policy prohibited the insurance company from filing a lawsuit against the policyholder in a foreign jurisdiction.
    True.
    False.

18. The antisuit injunction in Triton was affirmed on appeal because, among other things, the “service of suit” clause in the insurance policy issued by the insurer that filed the parallel lawsuit required the insurer to abide by any final decision entered by the court chosen by the policyholder.
    True.
    False.

19. To obtain an antisuit injunction, the policyholder in Triton was not required to demonstrate that the later-filed lawsuit by its insurance company posed an actual threat to the original court’s jurisdiction.
    True.
    False.

20. In California, a “service of suit” clause in an insurance policy favors maintenance of the lawsuit in the forum chosen by the policyholder.
    True.
    False.
Texas court of appeals placed the blame squarely on the insurers for filing parallel litigation in New York in the first instance: “From our perspective, colloquially speaking, the ‘end run’ if any, was made by these ten defendant insurance companies being subject to Texas court jurisdiction, filing a like suit in the State of New York.”

A Texas court of appeals addressed a similar New York end run by the London Market Insurers (Lloyd’s) in London Market Insurers v. American Home Assurance Company, which involved an insurance coverage lawsuit that Asarco, Inc. originally filed in Texas concerning its premises asbestos liabilities. Six months after Asarco filed its Texas lawsuit, Lloyd’s filed suit in New York “to determine insurance coverage for products liability claims allegedly resulting from exposure to products” that Asarco and related entities “introduced into the stream of commerce.”

One month after the New York action was filed, Asarco amended its Texas lawsuit to add the additional entities sued by Lloyd’s in New York and to seek an additional “declaratory judgment to determine insurance coverage for alleged asbestos injuries caused by asserted exposure to asbestos fiber or asbestos-containing materials” in products sold by the entities that Lloyd’s sued in the New York lawsuit. Asarco referred to these new claims as “products claims.” Four months later, the Texas trial court issued an antisuit injunction enjoining Lloyd’s from filing or pursuing coverage litigation in any jurisdiction “that would raise the same issues” as those in the Texas lawsuit. A Texas court of appeals affirmed.

Although the appellate court applied the four-part test later referred to by Moreno in Advanced Bionics, it focused most of its attention on the threat to the Texas court’s jurisdiction posed by Lloyd’s parallel New York lawsuit. In particular, Lloyd’s argued that its New York lawsuit did not threaten the jurisdiction of the Texas court because “the action before the Texas court was limited to premises liability coverage claims at the time the New York suit was filed [and] the New York action...involved only products liability coverage....” According to Lloyd’s, the new asbestos products claims appearing for the first time in Asarco’s amended petition did not

The Texas trial court’s antisuit injunction against the insurance company was affirmed on appeal because, among other reasons, the insurance company sought to evade an important Texas public policy by filing suit in California, and the parallel litigation threatened the Texas court’s jurisdiction over the dispute.

while the stay remained in effect. Following various proceedings in New York that ultimately permitted the New York litigation to proceed, the policyholders sought, and obtained, an antisuit injunction “to prohibit the insurance companies from proceeding with the New York lawsuit, or filing other duplicate lawsuits,”

A Texas court of appeals affirmed the issuance of the antisuit injunction against the insurance companies. While the appellate court noted that principles of comity require “that courts exercise the power to enjoin foreign suits ‘sparingly’ and only in very special circumstances,” the court stated that the Texas and New York lawsuits involved the same “core issue”—the rights of BMS and MEC to insurance coverage for “multiple breast implant claims from multiple insurance companies.” Consequently, an antisuit injunction was appropriate to halt the threat to the Texas court’s jurisdiction over the insurance coverage issues between BMS and MEC and the insurance company defendants.

In rejecting the insurance company defendants’ assertion that the antisuit injunction was an “end run” around the jurisdiction of the New York courts—in this instance New York’s highest tribunal, which was poised to consider an appeal of the reversal of a stay issued in the New York coverage action—a
held that “the Texas court’s jurisdiction was threatened by the New York action involving insurance coverage under the same policies.”51 Indeed, the court concluded, “The generic basis of both the Texas declaratory judgment action and the New York action involved the question of insurance coverage.”52 On this basis alone, the appellate court held that all of the coverage issues “were brought” by Asarco’s original lawsuit, the product claims “were brought in by virtue of the relation-back doctrine” and, as such, “the Texas court obtained original jurisdiction over the entire coverage dispute.”53

Similarly, in *American International Specialty Lines Insurance Company v. Triton Energy Ltd.*,54 the policyholder sued its insurance companies in Texas state court seeking coverage for a malicious prosecution lawsuit in California, including punitive damages. One of the insurance companies thereafter sued the policyholder in California in an attempt to take advantage of the state’s prohibition of the indemnification of punitive damage awards.55 The Texas trial court’s anti-suit injunction against the insurance company was affirmed on appeal because, among other reasons, the insurance company sought to evade an important Texas public policy by filing suit in California, and the parallel litigation threatened the Texas court’s jurisdiction over the dispute.

First, the *Triton* appellate court noted that the insurance company’s policy contained a “service of suit” clause under which the insurance company agreed to submit to the policyholder’s chosen forum and “abide by the final decision of such court or of any appellate court in the event of an appeal.”56 Although the court noted that the provision did not bar the insurance company from filing its own action, or even removing to federal court an action filed by the policyholder, it nevertheless agreed with the trial court that the “terms of the insurance policy were that the insured could file suit in the jurisdiction of his choice, and the insurer agreed to abide by the final decision of that court.”57 The insurance company’s initiation of parallel litigation, after the policyholder first filed in Texas, thus evaded an important Texas public policy of requiring insurance companies to honor their contractual obligations.58

Second, the appellate court agreed that the later-filed action in California threatened the Texas trial court’s jurisdiction because it would enable the parties to “cherry pick” favorable rulings from each court as the litigation progressed, hindering the ability of each to proceed to judgment in its own case.59 The trial court’s concern, in issuing the anti-suit injunction, therefore was not that Texas and California would flout each other’s rulings in violation of comity principles, but that the ultimate resolution of the lawsuits would be difficult to achieve and that the insurance company attempted to evade its “service of suit” agreement to litigate the dispute in the forum chosen first by its policyholder. This was sufficient to constitute the requisite threat to the Texas court’s jurisdiction to justify the issuance of an antisuit injunction. Indeed, an actual deprivation of the Texas court’s jurisdiction was not required.60

**Implications for California**

Assuming that California would adopt a restrictive approach to antisuit injunctions, as suggested by Moreno, the rationale behind the three Texas decisions is instructive regarding the use of the procedure by any California trial court. Although the Texas cases ostensibly considered the entire four-part Texas test quoted in *Advanced Bionics*—including the prevention of a multiplicity of suits and the need to obviate vexatious and harassing litigation—the courts’ discussions of the threat to the trial court’s jurisdiction and the evasion of important public policy posed by the insurance companies’ later-filed lawsuits were far more important to the decisions. Similarly, Moreno would only permit the issuance of an antisuit injunction for the two

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reasons underpinning the Texas decisions.61

As presented in the three Texas cases, these two factors are implicated when a policyholder’s coverage lawsuit is met with parallel litigation initiated by its insurers in a foreign jurisdiction. Particularly when insurance coverage is sought for mass torts, such as in the Forum and London Market Insurers cases, the filing of the initial action establishes that court’s jurisdiction over the parties’ comprehensive dispute. Whether the insurance companies plead their later-filed lawsuit as involving premises claims instead of products claims, toxic tort liabilities instead of products liabilities, or any other imaginable semantical variation of the policyholder’s initial lawsuit, the fact remains that the later-filed action likely would seek rulings under the same insurance policies issued by the same insurance companies to the same policyholders concerning the same basic liabilities placed at issue in the initial action. As the London Market Insurers court recognized, parallel insurance coverage lawsuits “generically” involve questions of “insurance coverage.”62 Thus, it is not difficult to imagine that a later-filed insurance coverage action invariably is intended to circumvent, and ultimately oust, the initial court’s jurisdiction over the parties’ dispute.63

The Triton court’s discussion of the “service of suit” clause is also significant. Similar “service of suit” provisions appear in every insurance policy issued by Lloyd’s and typically appear in insurance policies issued by insurance companies that are not licensed—and thus do not necessarily “do business”—in the state in which the policyholder principally operates, is headquartered, or has substantial operations.

Although insurance companies invariably argue that the “service of suit” clause is not a “forum selection” clause and does not preclude the insurer from filing its own lawsuits in the forum of its choosing, the Triton court held that the provision meant that “the insured could file suit in the jurisdiction of its choice, and the insurer agreed to abide by the final decision of that court.”64 Or, in other words, once a policyholder whose policies contain a “service of suit” clause files the initial lawsuit in the forum of its choice, the provision should prohibit the insurance company from initiating parallel litigation elsewhere. Indeed, in reversing a trial court’s dismissal of an insurance coverage lawsuit for forum non conveniens, the Second District Court of Appeal noted that the “service of suit” clause favored maintenance of a lawsuit in the policyholder’s forum of choice: “Many of the insurance policies involved in this case, issued by defendants INA, Lloyd’s, Lexington, Northbrook and Stonewall, contain a ‘service of suit’ clause...When a policy contains such a clause, the parties’ convenience also weighs in favor of suit in the forum chosen by the plaintiff.”65

This is particularly important for purposes of an antisuit injunction. As the Triton court recognized, when jurisdiction is established over an insurance company that agreed to service of suit in the forum of the policyholder’s choice, that insurance company’s attempt subsequently to resort to the courts of another state is a direct assault on the jurisdiction of the initial court.

Finally, the Advanced Bionics litigation involved three parties and the interpretation of a noncompetition provision in a single employment contract. By contrast, insurance coverage litigation often involves dozens of parties, hundreds of different insurance contracts, and insurance coverage worth hundreds of millions of dollars, if not more. The many insurance policies at issue can contain different language and sometimes bear overlapping or nonconcurrent effective dates. The simultaneous litigation of parallel lawsuits under these circumstances does not merely threaten to result in inconsistent rulings—which, according to Chin in his opinion for the court in Advanced Bionics, was an insufficient justification for the issuance of an anti-
suit injunction—but instead threatens to unleash the type of irreconcilable conflicts and serial cherry picking of favorable rulings that the Triton court thought would hinder the ability of either of the two trial courts handling the parallel litigation in Triton "to proceed in judgment in its own case." The Triton court therefore agreed that this possibility—albeit coupled with the "service of suit" provisions in the insurance company’s policy—threatened the jurisdiction of the Texas court in which the dispute was first filed.

Although the trial court’s issuance of an antisuit injunction was reversed by the California Supreme Court in Advanced Bionics, and the court indicated that such relief should only be granted in exceptional circumstances, the court’s analysis, and that of Justice Moreno, suggest that California courts may issue antisuit injunctions in complex, multiparty insurance coverage litigation initiated by policyholders in California. The antisuit injunction therefore could prove to be a powerful weapon for policyholders to employ—in addition to the more traditional, but inherently unpredictable, motion to dismiss for forum non conveniens—in seeking the early disposition of parallel litigation subsequently initiated by their insurance companies in less friendly jurisdictions.

1 Advanced Bionics Corp. v. Medtronic, Inc., 29 Cal. 4th 697, 709 (2003), modified (Mar. 5, 2003) (Brown, J., concurring op.).
2 Armstrong World Indus., Inc. v. Aetna Cas. & Sur. Co., 45 Cal. App. 4th 1 (1996). In Armstrong, the court held that the “continuous trigger” of coverage applied to asbestos bodily injury lawsuits. This means that coverage exists under all of the insured’s policies in effect between the claimant’s initial exposure to asbestos through manifestation of disease or death. Id. at 43-45, 48. Additionally, the court held that the insured was entitled to obtain complete defense and indemnification from one, or more, of its insurers, with equitable apportionment between the insurers after the policyholder was defended and indemnified in full. Id. at 48-55.
3 Id. at 55-57.
8 Alan Reed, To Be or Not to Be: The Forum Non Conveniens Performance Acted Out on Anglo-American Courtroom Stages, 29 Ga. J. Int’l & Comp. L. 31, 105 (Fall 2000).
11 Id. at 2010.
12 Choice of law principles adopted by the California Supreme Court reflect its own bias in favor of applying California law in California courts. See Washington Mut. Bank, FA v. Superior Court, 24 Cal. 4th 906, 919...
Antisuit injunctions, however, are not available in two instances. First, a state court may not enjoin parties from prosecuting actions in federal court. Donovan v. City of Dallas, 377 U.S. 408, 412-13 (1964) (“[S]tate courts are completely without power to restrain federal-court proceedings in in personam actions...”). Second, the federal Anti-Injunction Act prohibits federal courts from preventing parties from proceeding in state courts unless there is specific congressional authorization to do so. 28 U.S.C. §2283. Federal bankruptcy courts have been given this express power under the Bankruptcy Code. See also Chris Helkaeus Weaver, Binding the World: Full Faith & Credit of State Court Antisuit Injunctions, 36 U.C. DAVIS L. REV. 993, 997-98 (Apr. 2003).


Faith & Credit of State Court Antisuit Injunctions. See also given this express power under the Bankruptcy Code. See also Chris Helkaeus Weaver, Binding the World: Full Faith & Credit of State Court Antisuit Injunctions, 36 U.C. DAVIS L. REV. 993, 997-98 (Apr. 2003).


Id. at 700.

Id. at 700-01.

Id. at 701. Business and Professions Code §16600 states, in pertinent part, that “every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.” Stultz and Advanced Bionics later amended their complaint to assert a claim that Medtronic violated Business and Professions Code §§17200 et seq., which define “unlawful competition” to include “any unlawful, unfair or fraudulent business act or practice.” Advanced Bionics, 29 Cal. 4th at 701 n.2.

Advanced Bionics, 29 Cal. 4th at 701-02.

Id. at 702-05.

Id. at 705-04.

Id. at 704 (quoting Sprechels v. Hawaiian Com. & Sugar Co., 117 Cal. 377, 378 (1897)).

Id. at 705.

Id. at 706.

Id. at 708.

Id. at 709.

Id. at 710.

Id. at 711 (quoting Christensen v. Integrity Ins. Co., 719 S.W. 2d 161, 163 (Tex. 1989)).

Id. at 716 (quoting Laker Airways, 731 F. 2d 909, 931 (D.C. Cir. 1984)).

Id. at 717.

Id. at 718.

Id. at 718 (quoting Laker Airways, 731 F. 2d 909, 931 (D.C. Cir. 1984)).

Id. at 719.

Id. at 719 (quoting Christensen v. Integrity Ins. Co., 719 S.W. 2d 161, 163 (Tex. 1989)).


Id. at 115.

Id. at 117, 118.

Id. at 119-20.

Id. at 120.

Id. at 120.


Triton, 52 S.W. 3d at 341.


Advanced Bionics, 29 Cal. 4th at 706.

Triton, 52 S.W. 3d at 342.

Antisuit injunctions are not only available to policyholders. See First State Ins. Co. v. Minnesota Mining & Mfg. Co., 335 N.W. 2d 684 (Minn. App. 1995). In First State, the insurers obtained an antisuit injunction in Minnesota enjoining their policyholder from prosecuting a later-filed, parallel coverage action in Texas.

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David Hirson and Mitchell L. Wexler are certified by the State Bar of California Board of Legal Specialization as specialists in Immigration and Nationality Law. All matters of California state law are provided by active members and/or under the supervision of active members of the California State Bar.
To avoid wasteful litigation, owners of newly formed corporations should prepare for unusual but foreseeable events that will have a major impact on the ownership, management, control, and participation in their businesses. Working partners who convert an existing partnership into a corporation may not realize the different consequences upon an owner’s death, disability, or disagreement that occur as a result in the change in entity status. Even more problematic is the conversion of an equal partnership, which invites deadlock among equal shareholders or their heirs. Another wrinkle arises when employees receive or purchase stock and thereby become shareholders as well.

In these situations, how can the parties prepare for the triggering event—the death, disability, retirement, or other termination of employment of shareholders? The classic answer to this question has been the buy-sell agreement, extolled by practitioners and recommended in numerous practice books for closely held corporations with multiple shareholders. But buy-sell agreements do not come without their own uncertainties. What rights does a shareholder have after the triggering event—often a traumatic moment for the parties and for the business?

A buy-sell agreement was described by the California Supreme Court in a 1997 case, Stephenson v. Drever, as:

[A] contract by which the stockholders of a closely held corporation...seek to maintain control over the ownership and management of their business by restricting the transfer of its shares. A secondary purpose is to protect the investment of the departing (or the estate of the departed) shareholder by facilitating the valuation and sale of an interest that might otherwise have no ready market.

In the absence of unusual facts or inequitable conduct, the courts will enforce

B. Keith Martin, an attorney with the Santa Barbara firm of Rogers, Sheffield & Campbell LLP, is a specialist and expert witness in corporate securities and high-technology business law.
The End of Mandatory Buyouts?

Buy-sell agreements that require the corporation to repurchase shares at a triggering event were, at press time, dealt a serious blow by the Financial Accounting Standards Board (FASB) when it issued Statement of Accounting Standards No. 150, which requires that the obligation for mandatory buyouts be reflected as a liability on the corporation’s balance sheet. Moreover, the new directive does not permit life insurance intended to fund the obligation to be shown as an offset to the liability. Finally, any increase in the purchase price in a year must be shown as a loss on the income statement for that year.

Under the strictures of SFAS 150, any reasonably successful, growing company could have its equity and earnings devastated by its repurchase liability. Mandatory buyouts may have to be changed to buyouts at the option of the corporation, which eliminates some of the estate and succession planning advantages of buy-sell agreements. Or, practitioners might be able to limit the amount of liability on the balance sheet by providing for the termination of the buy-sell agreement after the death of the first shareholder (in a two-shareholder corporation). However, it is unclear whether this arrangement would result in accruing only half the total obligation as a liability.—B.K.M.
ment decision.” Except for an early case, these holdings are consistent with the principle of Stephenson v. Drewe: A shareholder retains statutory rights until all the terms of the repurchase are defined and conditions are satisfied, but not thereafter.

Even with careful drafting and an otherwise enforceable right on the part of the corporation to repurchase or redeem shares, the buy-sell agreement will not be enforced if the corporation does not satisfy the retained earnings test or balance sheet test under California law.17 These tests are designed to preserve the capital and to limit distributions that might jeopardize creditors and shareholders. Life or disability insurance proceeds in excess of premiums paid, however, are exempt from those tests if used to carry out an obligation to repurchase under an agreement and if the corporation would not become insolvent upon the distribution. A backup option held by other shareholders to purchase the shares, the so-called cross-purchase agreement, can provide another source of funds. Specific performance of the obligation to sell is available, although only one identified California case expressly grants that relief.18 The seller’s remedy at law—the price—is adequate, so equitable redress is not ordinarily available to the seller.

Drafting Buy-Sell Agreements

The consideration of the death or disability of a major shareholder is at the interface of corporate planning and estate planning. Shareholders in a closely held corporation generally communicate well about corporate goals for growth and expansion, financing, and the like, but not nearly so well about their life and family goals. Before adopting a buy-sell agreement (or any other exit strategy), the major stockholders should have intimate conversations regarding their goals and beliefs. One shareholder may desire, upon his or her death or disability, to have a spouse or offspring take over the business and to hold executive positions and ownership in the corporation.19 The other major shareholder may see those beneficiaries as flighty or incompetent and dread running the business with them.

Shareholders recognizing that their beneficiaries are not qualified to run the business may seek to insulate them from the attendant risks and control while still providing them a regular income. If employment of the beneficiaries is an important consideration, not objectionable to the other major shareholders, the beneficiaries should maintain ownership of the inherited shares after the triggering event. Then, a mandatory buy-sell agreement is inappropriate, and an agreement among shareholders20 or an employment agreement can help ensure continued family employment.

The buy-sell agreement should restrict lifetime transfers to avoid circumvention of the plan. For employee-minority shareholders, buy-sell agreements can be drafted to help or hinder an action for specific performance of the agreement. Employer’s counsel should consider reciting in the document that the parties agree that the remedy at law is inadequate and equitable relief is appropriate.

Funding and Pricing

Full funding of a buy-sell agreement, usually not an easy task, reduces the incentive for litigation following the triggering event. Life insurance is usually the first option for funding the repurchase of shares at death, but the cash reserve in an ordinary life policy is also useful for inter vivos repurchase. Life insurance, however, is not always the answer—age or the insurability of shareholders may require prohibitively costly premiums. Uninsured buy-sell agreements typically use leveraged buy-outs: issuing long-term notes to the beneficiaries against ongoing cash flow of the corporation. Using a repurchase price below fair market value will lessen the funding problem but provide a windfall to the surviving shareholder. The founding shareholders can discourage litigation resulting from this windfall by reciting in the agreement that this result is their intent.

Should the agreed or formula price for repurchase after the trigger seek to reflect the full fair market value? On its face that seems fair and equitable, but it is difficult to fund. Moreover, the beneficiaries get a low-risk free ride, while the surviving shareholder assumes all the risks and responsibilities of
running the business without the decedent he or she previously relied on—and minus the capital paid to the beneficiaries. Realistically, a discount for lack of marketability and blockage (typically 15 percent to 30 percent) should be subtracted from the market value. This has the salutary effects of reducing the cost to the business of repurchase, facilitating funding of the agreement, and lowering estate taxes for the decedent.

Most experts, however, abhor the idea that the parties might not periodically amend the repurchase price. Some propose a hybrid approach so that, as a backup, some formula or appraisal comes into effect. But what if the parties do not want to address this issue? One or both shareholders may be reluctant to bring the subject up, being content with the discounted price. Should they be forced into a different valuation scheme because they do not desire periodic revaluation?

The confiscatory “accumulated earnings tax” must also be considered when accumulating liquid reserves in anticipation of funding repurchases. Establishing that these reserves are for the “reasonable needs of the business” can provide immunity to the tax. The IRS holds that accumulation of reserves for the redemption of minority shareholders is a reasonable need, although redemption from majority shareholders is not. An exception applies for accumulations to repurchase shares under IRC Section 303 for death taxes.

For employee-minority shareholders, establishing a fair price is an all-important consideration. The price should be adequate to reward employee-shareholders’ efforts as well as to build loyalty and encourage long-term employment. A forfeiture of shares on termination of employment by employees who have not served a reasonable period of service is expected and generally accepted by new employees as necessary to establish loyalty and long-term employment. Repurchase of shares prior to vesting should be at the employee’s cost basis, if any, and after vesting, at fair market value. In certain transactions, the California commissioner of corporations has jurisdiction to regulate repurchase obligations including repurchase pricing for stock issued to employee-shareholders unless the transaction is exempt from the California Corporate Securities Law of 1968 as a non-public offering.

Methods of fixing the repurchase price include agreement among shareholders, updated annually, for small corporations or a periodic board of directors determination for larger ones. Some shareholders prefer a formula such as a function of sales, earnings, EBITDA, book value, or any combination of them (for commercial, industrial, and service businesses) or of book value only (for financial institutions), subject to non-GAAP adjustments such as marking liquid assets to market. Other choices are arbitration or appraisal, either conducted independently or by the probate referee of the decedent’s estate. Finally, hybrids of these methods can be used.

**Obviating Litigation**

The most important weapon for forestalling litigation is a prior agreement to terminate all shareholder-employee’s rights as a shareholder at the trigger. The Stephenson court’s dictum approves that tactic, but would the courts so if no repurchase price has been fixed? How can the shareholder become a creditor when the amount of the debt is unknown? The agreement should thus provide a means for promptly determining the repurchase price. Payment of interest from the date of termination will further establish the appearance of fairness and thus aid in the enforceability of the agreement. A shareholder’s concern about oppression can be palliated by the corporation’s covenant in the buy-sell agreement to take no action jeopardizing payment for the shares.

To further reduce the potential for litigation after the buy-sell agreement trigger, the agreement should adopt a feature from estate planning practice: the *in terrorem* or “no contest” clause. Any person filing a lawsuit that unsuccessfully challenges a repurchase under a buy-sell agreement would be required to sell the shares back at a heavily discounted price. There appears to be no California case that addresses the enforceability of such a provision in the context of buy-sell or other stock repurchase. Courts would be more likely to favor such a provision if the claimant still gets some compensation, such as the invested basis for the shares, but might not enforce a clause that required complete forfeiture of vested shares.

The buy-sell agreement should also address a frequent cause of litigation: a major increase in the value of the stock if the business is sold after consummation of the repurchase. At the time of repurchase, the corporation should disclose any known or potential future sales, and the parties could then agree to limit the corporation’s liability if the business is sold. One high-technology industry CEO suggested expressing the “exponential decay” of this premium over time as %P = e^{-t/360} (where P = the premium created by the subsequent sale; e = the logarithmic constant 2.718282; t = days elapsed since purchase from the minority shareholder).

This mathematical, objective approach assumes that the value of manipulation or use of inside information at the time of repurchase from the minority shareholder dwindles...
with the passage of time and can easily be determined on a financial calculator. After 180 days the premium payable would be 61 percent of the postclosing premium; after 360 days, 37 percent; and after 540 days, 22 percent.

For example, assume a terminated shareholder sells at $100 per share under a buy-sell agreement. Six months later, the employer is acquired by a third party at $400 per share, a premium of $300. The sold-out shareholder would be entitled to 61 percent of the premium, an additional $183. At 12 months, the entitlement would be only 37 percent, a $111 premium. This approach could prove useful in pure buyout scenarios as well.27

Litigation after the trigger can be avoided by encouraging major shareholders to envision future scenarios and compare objectives. Is repurchase or continued employment of beneficiaries the goal? The buy-sell agreement should then be drafted to support that decision in any ensuing litigation. In terrorem clauses will discourage arguments, as will full or substantial funding, and express acknowledgment that the agreed price is discounted from fair value. The parties should consider and agree whether the seller will share in any premium paid for shares in a later transaction. To ensure that stock ownership will be effective in building employee loyalty and reducing turnover, employers should seek to fix a fair price. Employer’s counsel should consider cutting off shareholders rights immediately upon termination as well as laying the foundation for specific performance. The potential for deadlock should be anticipated upon initial formation and in drafting the buy-sell agreement. This new look may enable the careful business attorney to keep shareholders out of court after the trigger. ■


2 Here, “stock repurchase agreement” means any agreement giving the corporation the duty or option to purchase the shares from the shareholder or giving the shareholder the duty or option to sell them to the corporation. “Buy-sell agreement” means a stock repurchase agreement contemplating consummation in the distant future, sometimes conditioned on continued employment or service to the entity by the shareholder. “Buyout agreement” means a stock repurchase agreement without employment conditions, contemplating prompt consummation.


5 Closely held corporations are corporations without a public market and with fewer shareholders than the normal publicly held corporations. Statutory close corporations are a subset of closely held corporations that have adopted a specific amendment to their articles of incorporation declaring the corporation to be subject to the statutory close corporation rules (such as Corporations Code §300(B)-(L)).

6 See, e.g., BALLANTINE & STERLING, supra note 1, at §63.02.

7 Stephenson, 16 Cal. 4th 1167.

8 Id. at 1173.

9 Id. (citing Gilfillan v. Gilfillan 168 Cal. 23, 31 (1914)); Corp. Code §1600(d).

10 Stephenson, 16 Cal. 4th 1167, 1173 (citing Corp. Code §1600(d)).

11 Id. at 1175 n.5.


15 Smith v. Duff & Phelps, Inc., 91 F. 2d 1567 (11th Cir.
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44 LOS ANGELES LAWYER / DECEMBER 2003
How Firms Can Help Clients Prepare for Electronic Discovery

Although data discovery is like paper discovery, new methods must be developed.

Electronic discovery is an exciting field for computer engineers, but it can seem overwhelming to law firms that still struggle with their word processing software. Law firms practice law, not computer engineering, and what they want to know about this new form of discovery usually has to do with the basic principles upon which they may base a methodology for conducting electronic discovery effectively. First, law firms will need to accept the reality that nearly all intellectual property is now stored electronically and that a large percentage of the data that may prove vital to a legal dispute is stored in message systems such as e-mail, in which unimportant data is abundant. Firms that have learned to deal with being buried in paper must also learn how to deal with being buried in data.

With this in mind, what is an acceptable forensic discovery methodology? Generally, courts agree that electronic discovery should follow the same principles applied to paper evidence.

However, admissibility for electronically discovered information is maintained very differently than it is for paper discovery. In electronic discovery, the primary goal is to produce an exact copy of the original data, and to do so on a medium on which that copy can be stored for a long time. Specialized software is typically used for this task. This specialized electronic discovery software should 1) be able to produce a copy of the original data that can be used repeatedly, 2) have an internal verification mechanism to prove that the copy is exact, 3) not introduce viruses, 4) not damage or corrupt the data, and 5) capture the unallocated space on the original data storage device (where deleted files may still reside). If criteria such as these are ignored, the court may rule that the electronic data is not admissible, and without an admissible copy of the original data, what is discovered there will be valueless.

A dozen major software programs may be used for electronic discovery and forensics. The main function of all these programs is to perform disk imaging (i.e., making a copy of the original source of the data) and data indexing to facilitate searches. Some programs produce an image of a disk or other storage device quickly. This is important if the data is in danger of destruction or if there are very large amounts of data. Other programs are designed to search unallocated disk space or to tabulate the time, date, and creator of the files on a disk. It is likely that several programs will be needed to collect and catalog the data effectively.

Data Sources

The amount of data that can be collected is likely to be daunting. Valuable evidence may be found not only in e-mail, word documents, and spreadsheet files but also in Internet history files, caches, graphic images, databases, calendar and scheduling data, activity logs, PDFs, session folders for chat rooms, all data on portable media (floppies, CDs, etc.), voice mail on computerized telephone systems, backups, files that are deleted but still accessible, and even the files on digital voice recorders (some of which may be installed in automobiles).

Hardware used by forensic experts for accessing all these potential sources range from handheld computers to disk copy devices so large that they must be carried on dollies.

A law firm should create a list of the many possible sources of electronic data and incorporate it into a usable subpoena form. Additionally, attorneys should keep in mind that courts recognize the burden of production and will expect the deposing party to minimize the burden on the producing party. Forensic discovery is evolving as new tools, technologies, and laws are created, but basic evidentiary principles still apply. If electronic evidence is not collected, stored, and accessed correctly, it can become inadmissible, whether or not it is the critical data upon which a case may turn. The evolution of technology is constant, and each new development requires new instruments and methods to ensure the admissibility of the evidence that is discovered.

When dealing with computers and data, knowing what is achievable and what is not often requires an advanced understanding of technology. For this reason, it may be advantageous for an attorney to discuss the process and progress of electronic discovery with an expert. Not only must computer forensic specialists help an attorney make informed choices regarding what can be accomplished through forensics but also they need to be able to stand as credible witnesses under cross-examination. The most important point on which an expert may be impeached is the expert’s method for discovering data. Did the method follow a logical, verifiable pattern? This is the key to admissibility.

In addition, the expert should know how to help the attorney manipulate the discovered data so that it becomes useful. Data is usually discovered in several formats and may be redundant, disorganized, and uncataloged. The well-considered deployment of document banks, case management software, and extranets is a critical key to success in actually being able to make use of the data after it is obtained. Electronic discovery often involves many more than one “dig” through the data. As new facts are revealed, the data will need to be reviewed. Throughout this process the value of the evidence ultimately
depends on the way it is presented. Enormous tables that humans cannot understand are of little or no use to attorneys and juries, however easy it may be for a computer to search them. Electronic discovery should ultimately involve considerations of trial presentation software that can make a testifying expert’s opinion carry more weight.

**Limiting Discovery**

Experts can also have a vital role to play on the other side of the electronic discovery process. Attorneys with clients that seek to limit the scope of discovery must also find ways to apply the basic rules of discovery to areas of law that are still being defined. The attorney and client on the defense side should remember that the plaintiff’s electronic discovery expert will try to focus the search on the smoking gun or on the trail to the smoking gun. For this reason, it may be advisable to have a firearms policy rather than to engage in a poorly planned cover-up.

Specifically, businesses should develop retention and destruction schedules for all data, including e-mail, voice mail, backups, and operational hard drives. Courts have held that in the absence of formal, enforced document retention and destruction policies, everything is discoverable. For this reason, it is better to have policies in effect, and an expert can help a company create these policies. If production is ordered for all documents produced by an executive between September 18, 1986, and September 18, 2003, but the executive’s company has a formal policy that required the destruction of some or all of the information in question, then the defense may be able to argue successfully that the records do not exist. A policy such as this can provide the first level of defense against production.

Another policy that can lessen discovery burdens is to create, enforce, and maintain a network security system. This will not only reduce the risk of a security breach but also reduce the opportunity for copies of data to spread (and as a result, for discovery orders to become broader). Network administrators should create a proper folder structure so that the electronic data that pertains to one department or person is not needlessly accessible to another person or department. For example, if the electronic files belonging to a CEO of a corporation are being subpoenaed, and those files were not accessible by the marketing manager, then the marketing manager’s electronic files should be outside the scope of discovery.

Although it is tempting to do so, computer users should not allow themselves to believe that information that has been deleted is truly deleted. After deletion, files typically remain on storage devices until they are overwritten by new files. A company’s data retention and destruction policy should address this issue as well as the related issue of the retention of previous drafts of a document within that document and on backup media. When an employee borrows or rents computer equipment with storage capabilities, the data that is left on the equipment may be discoverable. These same principles apply to the Internet. Caches store older versions of Web pages. Security and encryption measures may protect data while it is shared, but once it arrives it is likely to be stored on a disk drive that is discoverable. Nothing on the Internet is private, period.

In short, the general rules of electronic discovery are like those of paper discovery, but the details that result from the ease with which electronic data is copied, modified, and stored are complex and fact-specific. Without a thoroughly analyzed methodology, firms conducting discovery and companies facing production are at a disadvantage. For this reason, experts may aid attorneys in crafting effective, documented methods of discovery and data management.
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**CLE Preview**

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**Mastering Research on Lexis**

ON WEDNESDAY, DECEMBER 17, the Los Angeles County Bar Association will present a course titled “Certificate of Mastery in Legal Research and Factual Discovery.” This Lexis-Nexis training program, led by speakers Deborah J. Cohan and Tim Dawson, is designed to greatly increase your research proficiency. It will familiarize you with the search options that will help you to find the types of information you really need. This one-day program will cover initial case analysis and cite checking as well as offer coverage of how to conduct factual discovery using the Lexis system. Participants will also receive the California Paralegal Guide and the California Law Guide. These materials, to be covered at the close of training, will add to your research and practice skills, making you a valuable member of any legal team. The program will take place at the LACBA/Lexis Publishing Conference Center, 281 South Figueroa Street, Downtown. Parking at the Figueroa Courtyard Garage is $7 with LACBA validation. On-site registration will begin at 9 A.M., with the program continuing from 9:30 A.M. to 4:30 P.M. The registration code number is 7096L17. The prices below include meals.

- $160—CLE+PLUS members
- $320—LACBA members
- $395—paralegals special discount
- $475—all others
- 5 CLE hours

**Proofs of Claims**

ON THURSDAY, DECEMBER 11, the Bankruptcy Committee of the Commercial Law and Bankruptcy Section will present a program that will address the right way to prepare proofs of claims and provide an overview of the process for litigating disputed claims in bankruptcy proceedings, as well as procedures for assigning and resolving claims. The program will take place at the LACBA/Lexis Publishing Conference Center, 281 South Figueroa Street, Downtown. Parking at the Figueroa Courtyard Garage is $7 with LACBA validation. On-site registration will begin at 11:45 A.M. and lunch at noon, with the program continuing from 12:30 to 1:30 P.M. The registration code number is 8100LL11. Preregistered CLE+PLUS members may attend for free ($15 meal not included). Prices below include meal.

- $55—Commercial Law and Bankruptcy Section members
- $65—LACBA members
- $75—all others
- 1 CLE hour

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**The Work Letter**

On Thursday, December 18, the Commercial Development and Leasing Subsection of the Real Property Section will present a seminar on the work letter, as seen from the landlord’s and the tenant’s perspectives. Panelists Marcia Z. Gordon and Mitchell C. Regenstrief will discuss the major issues of a work letter that is attached to office and retail leases. The program will take place at the LACBA/Lexis Publishing Conference Center, 281 South Figueroa Street, Downtown. Parking at the Figueroa Courtyard Garage is $7 with LACBA validation. On-site registration will begin at 11:45 A.M. and lunch at noon, with the seminar continuing from 12:30 to 1:30 P.M. The registration code number is 803LL18. Preregistered CLE+PLUS members may attend for free ($15 meal not included). Prices below include meal.

- $45—Real Property Section members
- $55—LACBA members
- $65—all at-the-door payments
- 1 CLE hour

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

Collaborative family law seeks to smooth the transition into the postdivorce period

As a marriage and family fall apart, the act of stepping into the traditional family law courtroom, with its adversarial orientation, increases the stress and anxiety of separation and divorce. Until recently, mediation has been the main alternative. However, over the last decade, a third approach has gained momentum nationwide and in the last few years has become a successful and viable alternative to litigation in Los Angeles County.

Collaborative family law seeks to ease the pain of divorce through a negotiation process that takes place completely outside the walls of a courtroom. Collaborative divorce is an interdisciplinary approach that gives family law attorneys the opportunity to interact collaboratively with other mental health and financial professionals. These professionals work as a team to provide a safety net for the parties who are involved in a divorce. The team works to minimize conflict and to assist in the restructuring from a one-family unit to a two-family, interactive system.

Collaborative family law sets a stage on which attorneys for the parties work together, in a cooperative rather than adversarial setting, to assist them during the process of dissolving their marriage. In fact, the parties and the attorneys enter into agreements that commit everyone to the resolution of all marital issues without entering a courtroom. There is a commitment not to litigate.

In collaborative family law, each party to the divorce is represented by legal counsel. Negotiations involve attorneys and mental healthcare professionals as well as accountants and financial planners. The collaborative process considers the needs of the entire family and is designed to resolve all levels of conflict peacefully.

The mental healthcare professionals, sometimes referred to as coaches, play a crucial role in this nonlitigious process. They address the emotional fallout that one or both parties face. Children of the marriage can also directly benefit from the involvement of the coaches. They are committed to helping each side understand and validate the feelings and concerns of the other as well as their own. Each party may select his or her own coach or the parties may agree to have only one coach assist in the collaborative process.

Financial advisers are brought into the collaborative negotiation to educate the parties in the various ramifications of the division of property and assignment of support obligations. Trained in the sensitivities of the collaborative forum, their objective advice helps to foster a more businesslike approach to the division of assets and debts.

Traditional family law litigation reinforces antagonism between spouses, which adversely affects the children, who become victims without recourse. The litigious process between divorcing parents often overlooks representation of the minor children altogether. It fails to address the coparenting of minor children under a split parenting system. In contrast, this new movement seeks to assist the family in the transition into the postdivorce period. The collaborative process better effectuates resolution, through cooperative restructuring parenting, than the adversarial atmosphere in family law litigation.

Until recently, mediation was the most common alternative to litigious divorce. Collaborative family law takes mediation a step further because both parties’ attorneys act as mediators. Although each attorney is the legal adviser to only one party, the approach from both attorneys is not to attack or bully the opposing party but rather to assist both parties in understanding the law. Moreover, both attorneys work to create a nontlitigious, safe environment for both parties.

At first glance, one may think that the involvement of so many professionals would increase the expense of divorce. On the contrary, this negotiation setting—typically meetings involving four to eight persons—can actually facilitate a more expeditious resolution without the voluminous paper blizzards of a courtroom. Thus, the collaborative process can actually reduce the overall cost of the divorce.

The first seed of collaborative family law was planted in Minneapolis, Minnesota, in 1990 by Stuart Webb. Collaborative family law has since grown into a nationwide movement, with lawyers in at least 35 states engaging in this type of legal representation. Delegates from several regions throughout the country recently met in Chicago to develop a national approach to the education of both professionals and the public in this new approach to divorce. The president of A Better Divorce, an organization in the South Bay area committed to the advancement of the practice of collaborative family law, attended the conference as the representative of Southern California. Practitioners wanting to learn more can contact that organization or two others in Los Angeles County, Los Angeles Collaborative Family Law Association and the Coalition for Collaborative Divorce in the San Fernando Valley, which are also committed to the same purpose.

Collaborative family law professionals commit to a teamwork approach that excludes the courtroom. The parties can still feel secure that their individual interests are being represented legally, financially, and emotionally, while avoiding the damages that are typically wrought by the adversarial approach of litigation.

By Cozette Vergari

Cozette Vergari is a partner in the law firm of Vergari & Fu, LLP, focusing her practice on family and estate planning issues.
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