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From the Chair

BY GARY S. RASKIN

ur goal at Los Angeles Lawyer magazine is to publish articles on a wide range of legal topics that we believe are interesting and informative. In this month’s issue, we present a combination of articles that analyze core legal issues as well as issues that are more on the fringe of legal interest.

In this month’s MCLE article, John S. Caragozian explores the legal and practical issues that arise from the retention and use of private investigators by lawyers. Caragozian’s article analyzes the interplay of investigations with the attorney work product privilege and professional responsibility. He also explores the issue of what constitutes fair play during private investigations.

The core issues that are raised when lawyers use private investigators are significant. Indeed, as Caragozian explains, violations of the law applicable to private investigations may lead to professional discipline or civil liability. The fringe issues raise interesting questions about fact-finding in connection with litigation, including the use of deception by private investigators.

As Caragozian explains, in one appellate case the court found that a private investigator violated California’s Private Investigator Act when he misled witnesses about which party the investigator had retained, even though the investigator had not told the witnesses a lie. In holding that the investigator violated the act, the court focused on the lack of good faith, fairness, and integrity.

In the realm of private investigations of prelitigation and litigation matters, should society place a particular value on whether a private investigator acts in good faith and with fairness and integrity? Unfortunately, lying is part of our society. Our litigation system recognizes that parties and witnesses do not always tell the truth. One of the functions of discovery is to provide each party with tools to protect against dishonesty, and one of the functions of cross-examination is to expose dishonesty. If our litigation system accepts that some witnesses and some parties will lie, even when placed under oath and subject to penalty of perjury, and if police can lie in gathering evidence, is it hypocritical to enact laws that prohibit private investigators from obtaining information through deception?

On another topic, one of the important questions litigators must analyze in every case is whether, to what extent, and against whom a judgment may be enforced. Determining the enforcement of U.S. judgments in foreign countries raises significant business and litigation issues. This month, Yasuhiro Fujita analyzes the enforcement of U.S. money judgments in Japan. As Fujita explains, U.S. money judgments are enforceable in Japan provided that certain procedural and substantive requirements are met. Fujita also explains why the Japanese Supreme Court has held that punitive damages awards issued by U.S. courts are not enforceable in Japan.

In this month’s cover story, Allen B. Grodsky and B. Alexander Moghaddam analyze whether corporate officials may be personally liable for corporate torts. Grodsky and Moghaddam illuminate the different factors considered by courts in determining whether corporate officers and directors may be held liable for the intentional and negligent torts of the corporation. As the authors explain, the corporate shield is not impenetrable, but the courts have yet to establish a bright-line test.

In the arts and entertainment world, receiving credit for one’s contribution to a creative work is very important. With the decision of the U.S. Supreme Court in Dastar v. Twentieth Century Fox, artists who do not receive proper credit for their contributions may find themselves, in some circumstances, without a remedy. Steven Lowe and Abhay Khosla explore the ramifications of Dastar as well as the various laws and guild agreements that provide potential protection for artists.

Gary S. Raskin is a principal of Garfield Tepper & Raskin, where his primary area of practice is entertainment litigation. He is the chair of the 2004-05 Los Angeles Lawyer Editorial Board.
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Appointing a Discovery Referee in California State Court

IN THE COURSE OF LITIGATION, it is almost inevitable that disputes arise about discovery. Whether they pertain to objections at deposition or the timeliness and scope of written discovery responses, they often can be resolved through informal discussions or compromises between counsel. At other times, counsel may need to involve the court through discovery motions. In a few instances, however, particularly in those involving obstructionist counsel or a multitude of discovery issues, it may be prudent to consider the appointment of one or more discovery referees. The presence of a referee during depositions can often persuade even the most obstreperous counsel and witnesses to behave in a more reasonable manner. On the other hand, the costs associated with the appointment of a discovery referee may far exceed the utility provided.

California statutory law provides for the appointment of a discovery referee by a written stipulation of the parties or, when the parties cannot agree, upon the court’s own motion or its ruling on a party’s noticed motion.1 When one party’s counsel demonstrates an intention to obstruct the discovery process at every turn (whether by engaging in abusive behavior at deposition or ignoring discovery requests) or when the case is complicated by an enormous amount of documents and issues, the court may decide that a discovery referee’s appointment is the most efficient method by which to resolve such matters.2

While a referee may make matters more efficient from the court’s perspective, the parties in the litigation may be more concerned with the expense. Counsel should remember that discovery referees are paid by the hour, and the fees are usually apportioned equally between the parties.3 If a referee is appointed early in discovery and is compelled to attend depositions, analyze objections, and consider numerous discovery requests and motions, his or her fees can pose a daunting obstacle to settlement—and, possibly, an attorney’s relationship with the client. Counsel should therefore be familiar with the process by which referees are appointed and what steps may be taken to advocate or oppose an appointment.

The Appointment Process

The first step a trial court must take to appoint a discovery referee is to make a written determination that “exceptional circumstances” require the appointment. The finding also must be specific to the circumstances of the particular case.4 Case law provides guidance as to what constitutes exceptional circumstances.5 Examples include the following:

• Multiple issues must be resolved.
• Multiple motions must be heard simultaneously.
• A discovery motion before the court is only one in a sequence of many.

Counsel may expect referees to schedule informal conferences and hearings to seek input.7

Referees generally do not make the actual decisions on discovery disputes but rather they simply make recommendations to the court.8 The recommendation and approval process may allow for the parties, including those parties that are represented by obstructionist counsel, to get multiple opportunities to object and present their arguments. Specifically, the court may allow the parties to object within 10 days of the service and filing of the referee’s recommendations and another 10 days for responses to the objections.9 Alternatively, the court may set a schedule that is based on the parties’ stipulation or that is based on its own convenience. Whatever the schedule, the delays stemming from objections to the referee’s recommendations may make litigation even more costly and may force the parties to spend more time in the courtroom than they would have if a referee had not been appointed.

Counsel should also keep in mind that the referee’s report may include recommendations not only on procedural and substantive discovery matters but also for sanctions against parties and counsel.10 Thus, maintaining a civil approach to discovery disputes, especially before the referee, is paramount. Let those on the other side be the jerks.

Richard Lee is a litigation associate at Holland & Knight LLP in Los Angeles and a member of the Barristers Executive Committee.
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Furthermore, unless the court sets forth, in its written ruling appointing the referee, a ceiling on the amount of hours that the referee should bill, it is possible that the referee may stay with the litigation until the case’s final disposition, whether that means settlement or the close of trial.

A Motion to Disqualify

With all these considerations regarding ballooning costs, delays, and additional, time-consuming courtroom appearances, what can counsel do to avoid the court’s appointment of a referee? Either or both parties can move to disqualify a discovery referee, much in the way that the parties can use peremptory challenges to disqualify a trial judge.11 Such a motion to disqualify must be timely. When a referee is to be appointed only for a limited number of discovery disputes, the motion must be made at least 5 days before the hearing or trial date, so long as the referee assigned to hear the disputes is known for at least 10 days prior to the hearing or trial date.12 And when a discovery referee is appointed for all discovery purposes, generally, the motion must be made within 10 days of the notice of the appointment of the referee.13

A discovery referee, while sometimes useful when dealing with numerous complicated discovery issues, can open a Pandora’s box of consequences for all parties, not the least of which may be substantial expense. Caution is the word of the day when considering agreeing to a discovery referee or when the court imposes one. In a perfect world, disputes can be resolved with phone calls and letters, but litigation can be an imperfect, contentious battleground that unfortunately may lead to incivility and stubbornness. Resorting to a discovery referee is an extreme measure, and so the threat of moving for a referee’s appointment may actually be an effective negotiating tool in resolving disagreements with obnoxious opposing counsel. Nevertheless, in some high-stakes cases in which a referee’s fees will constitute only a fraction of the total discovery costs, the appointment of a referee may save the parties trouble.

1. CODE CIV. PROC. §§638, 639(a)(5); CAL. R. CT. 244.1, 244.2.
2. See CODE CIV. PROC. §639(a)(5); see also Hood v. Superior Court, 72 Cal. App. 4th 446, 449 (1999).
3. CODE CIV. PROC. §645.1.
4. CODE CIV. PROC. §619(h)(2).
7. See generally CAL. R. CT. 244.2(h).
8. CODE CIV. PROC. §§639(a)(5), 643.
9. CODE CIV. PROC. §643(c).
11. CODE CIV. PROC. §§170.6, 639(b).
12. CODE CIV. PROC. §639(b)(B).
13. CODE CIV. PROC. §639(b)(A).
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The 2005 California Tax Amnesty

ON AUGUST 16, 2004, GOVERNOR SCHWARZENEGGER SIGNED into law California’s latest version of tax amnesty. The new legislation grants taxpayers a penalty-free opportunity—for two months beginning February 1, 2005—to pay delinquent California income, franchise, sales, and use taxes for tax years 2002 and before. The new legislation encourages compliance with the tax laws and is expected to generate badly needed revenue for the state.

The amnesty under the new legislation is not a full pardon; it only applies to penalties. To earn this waiver of penalties, taxpayers must pay in full, including interest, the delinquent taxes. Nevertheless, penalties may be significant and even become a substantial portion of the total amount due. Moreover, the new legislation includes increased penalties for those who are eligible to participate in the new amnesty program but fail to do so. These penalties include double civil penalties, additional interest-based penalties, and even criminal prosecution. Given this reality, the new amnesty program warrants the serious consideration of all California taxpayers, including corporations and other taxpaying entities.

California’s new amnesty program is part of a recent trend among many states and is the latest installment of amnesty programs California has enacted over the last two decades. In 1984, California conducted a similar program that covered individual income tax and sales tax. The 1984 amnesty program generated $197 million in revenue.1 In 1994, California enacted the Employment Tax Amnesty, administered by the Employment Development Department, to collect unpaid state employment taxes. Although no final statistics are available, the 1994 Employment Tax Amnesty was expected to generate $15.1 million.2 The new amnesty program is expected to generate $333 million over the next three years.3

The legislation grants the Franchise Tax Board (FTB) and the State Board of Equalization (BOE) the authority to administer a tax amnesty program with regard to their respective tax collection responsibilities.4 The FTB is the governmental agency responsible for collection of all state-imposed income and franchise taxes.5 The BOE is the agency responsible for collection of all state-imposed sales and use taxes.6 Thus, income, franchise, sales, and use taxes are all eligible for inclusion in the amnesty program, if these tax liabilities arose in 2002 and earlier tax years.7 The amnesty program is to take place for the two-month period of February 1 through March 31, 2005, or some other period that ends by June 30, 2005.8

The advantages of participating in the amnesty program are significant. Taxpayers can avoid penalties by paying all past-due taxes, plus interest.9 Even though the state was willing to make a good-faith effort to resolve unpaid tax liabilities by creating the amnesty program, it did not wish to provide taxpayers with an interest-free loan for outstanding tax liabilities. Another benefit is the avoidance of criminal prosecution.10 However, the amnesty program is not available to taxpayers who are under, or have been given notice that they are under, criminal tax investigation or who have had a civil tax court proceeding initiated against them.11

The benefits of the amnesty program are available to all taxpayers with tax liabilities that result from nonfiling of returns, underreported income on filed returns, claimed excessive deductions, or any unpaid tax liabilities from previously determined or proposed-to-be-determined amounts.12 However, the amnesty program does not apply to those tax liabilities arising from tax shelter items that could have been reported pursuant to the FTB’s Voluntary Compliance Initiative, which took place in early 2004, or the IRS Offshore Voluntary Compliance Initiative (described in Revenue Procedure 2003-11), which occurred in early 2003.13

Requirements for Participation

To participate in the amnesty program, taxpayers must meet multiple requirements. The threshold requirements are that taxpayers must have no criminal matters pending and the taxes at issue must be for tax years 2002 or before.14 Next, taxpayers must complete the appropriate amnesty application, sign it under the penalty of perjury, and file the application with the appropriate state agency with a postmark of no later than April 1, 2005.15 The FTB Web site indicates that the amnesty application will be made available on January 15, 2005.16 Third, taxpayers must file all necessary tax returns (original or amended) and pay all tax and interest due on these tax returns by May 31, 2005.17 Taxpayers who have filed for bankruptcy protection must also obtain an order from the U.S. Bankruptcy Court allowing the taxpayer to participate in the amnesty program and submit a copy of the order with the amnesty application.18

Some taxpayers may be in a position to take advantage of both the FTB and BOE amnesty programs. Although it is advisable for these taxpayers to file amnesty applications with both agencies, the legislation does not appear to condition the successful amnesty application with one agency on the application for amnesty with the other.19 However, if only one application is filed, the taxpayer remains exposed to penalties and possible criminal sanctions from the other agency.

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The new legislation left the task of creating the forms and instructions to the FTB and the BOE. In addition, the legislation requires the FTB and BOE to publicize the amnesty program so that all potential participants are given the opportunity to take advantage of its benefits, as well as become aware of the consequences of not participating. Further, the FTB and the BOE must make reasonable attempts to identify taxpayers with eligible liabilities and notify these taxpayers in writing of their ability to participate in the amnesty program. However, the failure of the FTB or BOE to notify eligible taxpayers will not prevent them from participating in the amnesty program.

Taxpayers who have already paid fees or penalties for the tax years covered by the amnesty program are prevented from applying for refunds or credits of these amounts. In addition, taxpayers who participate in the FTB amnesty program forfeit all appeal rights with respect to amounts paid pursuant to the amnesty program.

There may be taxpayers who, for a variety of reasons, feel compelled to begin the process of correcting past errors before the amnesty period begins. The question arises whether one can obtain the benefits of amnesty by filing the necessary or corrected returns before the amnesty period. The legislation is quite clear that the amnesty application and accompanying tax returns must be filed after February 1, 2005. A taxpayer who cannot wait until February 1, 2005, however, should consider sending in designated advance tax and interest payments to the tax agency to begin the process and then follow up with the formal amnesty application and tax returns. A taxpayer in this situation should first seek advice from an experienced tax professional to help ensure that all matters are handled appropriately.

**Not Coming Forward**

The consequences of not participating in the amnesty program can be dire, including increased interest-based and other penalties, potential criminal prosecution, and other possible sanctions. The interest-based civil penalty will require taxpayers to pay an additional 50 percent of the accrued interest on any deficiencies. This interest-based penalty is in addition to any other penalties that may be imposed on taxpayers who owe back amounts. The interest-based penalty will not apply to taxpayers who executed an installment payment agreement at the start of the amnesty period. In addition, no refund claims will be permitted with respect to the interest-based penalty.

The new legislation contains penalties that are unique to the BOE and its enforcement responsibilities. First, for those taxpayers who are eligible for the amnesty program but choose not to participate, the BOE will impose penalties at double the normal rate. This new rule results in penalties equal to 20 percent of the tax owed, and in the case of fraud, a 50 percent penalty. In addition, the BOE can institute criminal action against these taxpayers. These penalties would also apply to taxpayers who do not file accurate amnesty returns or choose not to participate in the amnesty program, the BOE has been given an extended statute of limitations of 10 years to make a deficiency determination.

The FTB is also armed with new penalties for those taxpayers who are eligible but do not participate in the amnesty program. An increased accuracy-related penalty, determined pursuant to Revenue and Taxation Code Section 19164, would be imposed on taxpayers who fail to make an amnesty application. Section 19164 normally provides for a 20 percent penalty on any “substantial understatement of income tax.” The new amnesty legislation increases the Section 19164 penalty from 20 percent to 40 percent for any proposed deficiency arising in taxable years beginning before January 1, 2003. This penalty will not apply to those taxpayers who are under audit by the FTB, have filed a protest or an appeal, are engaged in settlement negotiations, or who have a pending judicial proceeding. A “substantial understatement of income tax” is an understatement in any taxable year that exceeds the greater of 10 percent of the tax required or $5,000, or in the case of a corporation, $10,000. But, for those corporations that the FTB has already contacted regarding the use of a potentially abusive tax shelter, a “substantial understatement of income tax” exists if the understatement exceeds the lesser of 10 percent of the tax required to be shown on the return, or $5 million.

Additionally, the new legislation provides the FTB with mechanisms for dealing with amnesty participants who are not completely accurate and compliant. For example, if a taxpayer who participates in the amnesty program fails to fully pay taxes owed for the 2005 and 2006 tax years, the taxpayer would lose all the previously received benefits of the amnesty program. Thus, all the penalties and fees previously waived pursuant to the amnesty program would become immediately due and payable, along with any associated interest. If a taxpayer who participates in the amnesty program does not divulge all the amounts of unreported or underreported income, the FTB has the authority to impose fees, penalties, and criminal action as warranted with regard to the amounts that were not disclosed.

It is important to note that the new legislation presents a quandary for taxpayers who were eligible but did not participate in the FTB Voluntary Compliance Initiative in early 2004 or the IRS Offshore Voluntary Compliance Initiative in early 2003. These taxpayers are prohibited from participating in the new amnesty program; yet, because they will not have participated, they will be subject to increased penalties pursuant to Section 19164 for deficiency determinations made after the close of this latest amnesty program. Presumably, without the new legislation, these taxpayers would be subject to a 20 percent accuracy-related penalty pursuant to Section 19164, unless other penalty sections apply. The new legislation doubles the accuracy-related penalty to 40 percent. Thus, the amnesty program would impose increased penalties upon those taxpayers who did not participate in the previous FTB and IRS settlement programs.

The possibility of penalties, increased interest-based penalties, as well as criminal sanctions are enough encouragement for most taxpayers to participate in the amnesty program. Furthermore, in the current environment of heightened tax-compliance enforcement, tax agencies are likely to impose the complete spectrum of possible sanctions, from civil to criminal. Governor Arnold Schwarzenegger has stated his intent to balance the state budget without raising taxes, and taxpayers may find themselves the subject of fairly aggressive enforcement actions to collect revenues for a state that is in great need of money. However, California is not alone in its pursuit to enact and administer an amnesty program, and California taxpayers who pay taxes in other jurisdictions should be aware of other state programs as well.

**Other State Programs**

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that this is an opportune time to enact tax amnesty programs. States that have enacted such programs include Arkansas, Connecticut, Illinois, Maryland, Mississippi, Nebraska, New Jersey, South Carolina, and West Virginia.

The details of each state initiative vary, but all the programs provide an extremely limited time frame within which taxpayers may participate. These programs vary in penalties and fees imposed, duration of the program period, types of taxes involved, and the taxpayer eligibility requirements that must be met. However, a common theme to all these programs is that taxpayers are required to file amended returns and promptly pay the additional tax and interest. Another common theme of amnesty legislation is the increased enforcement mechanisms that will be used against those taxpayers who choose not to participate.

Arkansas enacted a tax amnesty program that took place from July 1, 2004, through September 30, 2004.\(^3\)\(^4\) Taxpayers could come forward, apply for amnesty, file all the applicable tax forms, and pay all taxes owed. The result was that taxpayers were able to avoid paying any penalties and interest. Mississippi is conducting a tax amnesty program from September 1, 2004, through December 31, 2004, for all types of taxes that arose in tax years 1999 and later.\(^5\) Participants receive a waiver of all civil and criminal penalties for nonpayment of taxes. Nebraska conducted a tax amnesty program from August 1, 2004, through October 31, 2004, for all types of taxes that were due on or before April 1, 2004.\(^5\)\(^5\) All interest and penalties were waived for participants. West Virginia’s amnesty program ran from September 1, 2004, through November 1, 2004.\(^5\)\(^6\) Participants had to pay the tax owed and 50 percent of the applicable interest. In return, participants avoided the imposition of penalties, criminal action, and the remaining 50 percent of the accrued interest on any outstanding liabilities.

On June 16, 2004, Connecticut announced that it was administering an abusive tax shelter compliance initiative through July 31, 2004, for all taxpayers that participated in any potentially abusive tax shelters.\(^5\)\(^7\) Eligible taxpayers were permitted to come forward, disclose their investment in any abusive shelter, and avoid the imposition of civil penalties as well as criminal sanctions. Similarly, on July 30, 2004, Illinois enacted an amnesty program for taxpayers who invested in tax shelters.\(^5\)\(^\)\(^8\) The program is running from October 15, 2004, through January 31, 2005. During the program period, eligible taxpayers must come forward, file amended returns reporting their income without the benefit of the tax shelter transaction, and pay all required tax and interest. The benefit of participation in the program is the avoidance of penalties and criminal prosecution.

New Jersey also conducted a tax amnesty program specific to taxpayers that invested in tax shelters.\(^5\)\(^9\) New Jersey’s program, which ran through September 15, 2004, required taxpayers to concede 100 percent of the tax and pay all interest on the tax owed. Taxpayers who participated in the amnesty program avoided penalties, but they also forfeited the right to deduct fees related to participation in the transaction. South Carolina’s amnesty program encouraged investors in abusive tax shelters to make a disclosure in return for avoidance of penalties.\(^5\)\(^0\) South Carolina’s amnesty program expired on September 1, 2004.

Maryland enacted a version of tax amnesty, though it was limited in scope. The Maryland law sought to entice disclosure only from corporations that used payments to out-of-state affiliates to shelter income from Maryland taxes.\(^5\)\(^1\) The program was administered from July 1, 2004, through November 1, 2004. Eligible taxpayers were required to complete an application, file all amended returns with the application, and pay all tax due. In return for their participation, taxpayers were assessed at a reduced interest rate, avoided all penalties, and retained the right to deduct fees related to participation in the transaction. South Carolina’s tax amnesty program expired on September 1, 2004.

A payment of tax and interest or an application for a refund will not qualify as an application for the amnesty program. Rev. & Tax. Code §§7073(e) and 19733(c).

4. REV. & TAX. CODE §§7070 and 19730, added by 2004 Cal. Stats. 226, §§6, 11, (effective Aug. 16, 2004). This authority exists in two separate parts of the Revenue and Taxation Code, which makes it necessary, where applicable, to cite to two code sections in each citation.
5. REV. & TAX. CODE §19501.
6. REV. & TAX. CODE §7051.
7. REV. & TAX. CODE §§7070 and 19731.
8. Id.
9. REV. & TAX. CODE §§7072(a) and 19732(a).
10. Id.
11. REV. & TAX. CODE §§7072(b) and 19732(b).
12. REV. & TAX. CODE §§7072(a) and 19732(a).
13. REV. & TAX. CODE §19732(c). See also Charles P. Rettig and Steven Toscher, Deadline Looms to Come Clean on Offshore Credit Card Tax Schemes, LOS ANGELES LAWYER, Apr. 2003, at 12.
14. REV. & TAX. CODE §§7073(a) and 19733(a).
15. Id. An appropriate application must be completed.
Enforcing U.S. Judgments in Japan

U.S. PRACTITIONERS SHOULD NOTE that Japanese courts are enforcing money judgments rendered by U.S. courts. A foreign judgment will be recognized and enforced in Japan if it satisfies four requirements: 1) jurisdiction, 2) service of process, 3) public policy, and 4) reciprocity. To date, judgments issued in California, Connecticut, Hawaii, Maryland, Minnesota, Nevada, New York, Texas, Virginia, and Washington, D.C., have been enforced in Japan. California far exceeds the other states in the number of its judgments enforced in Japan.

Nevertheless, under the third requirement, the Japanese Supreme Court in 1997 refused to enforce a California punitive damages award because it was contrary to Japanese public policy. The court held that the punitive damages portion of a California judgment should be treated as a criminal sanction rather than a civil remedy. The basic principle of Japanese law concerning civil remedies is that damages should be limited to actual damages and nothing more.

The jurisdiction requirement will be satisfied if the U.S. court rendering the judgment had reasonable contacts with the defendant or the underlying transaction. Typically, Japanese courts will uphold the U.S. court’s jurisdiction over the case in question if, in the state in which the judgment was issued: 1) the defendant had a residence or place of business, 2) the contract was performed, 3) the tort was committed or the injury occurred, or 4) the subject-matter property was located.

So-called transient jurisdiction, however, will not be accepted in Japan. While visiting his children in Ohio, a Japanese husband was served with process for divorce. The Tokyo High Court in 1997 denied enforcement to the Ohio default judgment granting divorce and alimony. Although the High Court discussed the enforceability of the judgment exclusively in terms of the second requirement involving service of process—in this case, the service of process was held to be inadequate because the summons and complaint were not translated from English into Japanese—the same conclusion could have been reached for a jurisdictional reason. The Japanese rules of jurisdiction do not recognize a temporary stay as a sufficient basis for jurisdiction. The personal delivery of the summons and complaint occurred during the husband’s temporary stay in Ohio.

In a contract case, the Osaka High Court in 1992 denied enforcement of a Minnesota money judgment because, in the view of the Japanese court, the Minnesota court’s jurisdiction was based solely on the plaintiff’s place of business. The Minnesota importer had bought certain nylon products from the Japanese exporter and found defects in the delivered products. The Minnesota importer sued the Japanese exporter in Minnesota for breach of contract. The trade was under cost, insurance, and freight (CIF) terms, and the parties expressly agreed that the risk of loss would pass to the buyer upon loading of the products at the Kobe Port. The Osaka High Court held that the “place of performance” of this sales contract was Kobe, Japan, and, by Japanese standards, the Minnesota court did not have sufficient contacts with this case or the defendant.

Significantly, there was an arbitral clause in the sales contract providing that all disputes arising from or relating to the contract should be settled by arbitration in Japan. The Osaka case thus presents an interesting and practical issue. If a plaintiff sues a Japanese defendant in California despite a written agreement between the parties providing that the arbitration or litigation of any disputes involving the contract will take place in Japan, can the defendant ignore the lawsuit and challenge the default judgment at the time of the plaintiff’s subsequent action for enforcement in Japan? Of course, the defendant’s failure to defend will amount to a waiver in California and, if the defendant has substantial assets in California, the default judgment will be executed there immediately. (However, if the defendant’s assets are all in Japan, the default judgment only can be enforced in Japan.)

Whether a Japanese defendant can ignore a lawsuit in a foreign court is burdensome for several reasons, not the least of which are the language difficulties, and the defendant should not be compelled to go abroad and present a defense in California when the contract clearly states that the plaintiff must come and litigate or arbitrate any dispute in Japan. The 1999 preliminary draft Hague Convention on Jurisdiction and Foreign Judgments in Civil and Commercial Matters would allow the defendant to ignore the plaintiff’s action in California—which is in violation of a forum selection clause in the agreement between the two parties—by dictating that Japan’s court should deny enforcement to the plaintiff’s default judgment in California.

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The basic principle of Japanese law concerning civil remedies is that damages should be limited to actual damages and nothing more.

Hague Service Abroad Convention

The United States and Japan are parties to the Hague Service Abroad Convention. Japanese courts expect that a U.S. service of process upon

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a resident in Japan, in which the summons and complaint from the United States are transmitted to Japan, will be effected by two methods recognized under the convention: service through the Japanese Central Authority (the Foreign Affairs Ministry) or the U.S. consular officer stationed in Japan. Since U.S. administrative regulations prohibit U.S. consular officers from performing service of process on behalf of a private litigant, a U.S. plaintiff must request the Japanese Central Authority to effect service of process upon a resident in Japan, and the U.S. summons and complaint must be translated into Japanese.

In 1990, a Hawaiian judgment was denied enforcement because the summons and complaint were mailed directly to the defendant in Japan and the judicial documents had not been translated into Japanese. Article 10(a) of the Hague Convention recognizes “the freedom to send judicial documents, by postal channels, directly to persons abroad.” However, “to send judicial documents” is merely a method of giving actual notice as a matter of pure fact (pur fait), and the Hague Convention itself distinguishes between “the freedom to send judicial documents” and, under Article 10(b) and (c), “the freedom...to effect service of judicial documents.” The Japanese government did not object to Article 10(a), but it lodged an objection to Article 10(b) and (c).

U.S. courts have been seriously divided over whether a U.S. plaintiff's direct mail of its summons and complaint to a defendant residing in Japan constitutes valid service in light of the Japanese government’s failure to object to Article 10(a) of the Hague Convention. However, if the resulting judgment must be enforced in Japan because of the absence of the defendant’s assets in the United States, a U.S. plaintiff's attorney should request the Japanese Central Authority to handle service of process according to Article 5(a) of the Hague Convention. Doing so is easy and cost-effective. The attorney should: 1) Obtain the Hague Convention Service Request Form from the Japanese Consulate General's Office in Los Angeles or San Francisco. 2) Make sure that a sample form accompanies the request form. 3) Fill in the Request Form by faithfully following the sample form. 4) Make the complaint as succinct as possible. It can be amended at a later stage, if necessary. 5) Have the summons and complaint translated into Japanese by a knowledgeable person. For example, the attorney can choose a graduate student as a translator. Neither an officially qualified translator nor an official certification of translation is required. 6) Send the judicial documents to the Foreign Affairs Ministry in Tokyo (the address is shown in the sample form) by regular airmail.

Service will be completed in two months, at most. Under the Hague Convention, there will be no charges for this official service. As Justice Sandra Day O’Connor stated in Volkswagen AG v. Schlunk, the Hague Convention does not apply if, according to the internal law of the forum state, service of process upon the foreign defendant can be completed in the United States without any transmittal of the judicial documents from the United States to a foreign country. Examples of this include substituted service of process upon a resident “general manager” (such as the president of a U.S. subsidiary) of a foreign parent company, or personal delivery of process while the defendant is temporarily staying in the United States. However, at the time of enforcement of the U.S. judgment in Japan, such domestic service may be held invalid not for violation of the Hague Convention but for lack of translation into Japanese. The Tokyo High Court has held that the rule requiring translation must apply to all Japanese national defendants regardless of their respective levels of English proficiency.

Public Order and Good Morals

Regarding the public policy requirement, Japanese courts in business transaction cases generally have been peculiarly reluctant to sustain a Japanese party’s “public order and good morals” defense against a foreign party. For instance, the Tokyo District Court enforced a California judgment ordering the defendant Japanese company to pay television film licensing fees according to a licensing agreement that the parties had entered into without obtaining the Japanese government’s prior approval, which was required under the post-war Foreign Exchange Control Law. In Las Vegas Hilton v. Chin and Caesar's Palace v. Japan, the Tokyo District Court allowed foreign casino owners to collect gambling debts in Japan. These decisions occurred even though, in a domestic case, a claim based on gambling will be dismissed as contrary to Japanese public order and good morals.

Indeed, in commercial transaction cases, the public policy defense has been sustained only twice. The first case involved conflicting judgments. A Washington state's judgment ordering an Osaka machinery company to pay indemnification money was denied enforcement because, by the time the U.S. plaintiff brought the enforcement action before the Osaka District Court, that court's default judgment denying the indemnification claim had become final and conclusive as a result of the failure of the U.S. party to appeal. The Osaka District Court held that enforcement of a foreign judgment directly conflicting with a final and conclusive Japanese judgment would disturb the public order.

In the second case, North Con I v. Mansel, a portion of a California judgment that ordered payment of punitive damages ($1,125,000) was not enforced, while other portions of the judgment awarding compensatory damages ($425,251), litigation costs ($40,105), and postjudgment interest (at 10 percent per annum according to California Code of Civil Procedure Section 685.010) were enforced. Rejecting the Tokyo District Court’s approach involving a case-by-case analysis, the Tokyo High Court and the Japanese Supreme Court held that a punitive damages award is a criminal sanction and thus unenforceable in Japan as repugnant to the Japanese fundamental public order, under which a clear distinction is made between a civil remedy and a criminal sanction.

In light of this decision, only one-third of an award for triple damages under U.S. antitrust law or consumer protection statutes will be enforced in Japan; two-thirds will be considered punitive damages.

In drafting a money judgment, a U.S. plaintiff's attorney who anticipates enforcing the judgment in Japan should clearly separate the punitive damages portion from the compensatory damages portion. Additionally, if the amount of compensatory damages is unusually large (exceeding, say, $1 million), as happens sometimes in cases involving emotional distress, the decree—the conclusive part of the judgment—must specifically state that the amount is for compensatory damages. If “there is no clear line of demarcation between punishment and compensation,” and the judgment includes inseparable elements of both, then a Japanese court may have to deny the enforcement of the U.S. judgment in its entirety.

Also, it should be noted that in bringing an action before a Japanese court, a plaintiff must buy a revenue stamp in the amount of approximately 0.3 percent of the total claim and attach it on the surface of the complaint. This also applies to an action for enforcement of any foreign money judgment. Therefore, to save costs, a U.S. plaintiff’s attorney should allow local counsel to exclude, at the outset, the punitive damages portion (or two-thirds of a triple-damages award) from the enforcement action.

In the past, the reciprocity requirement posed a major problem in an action for enforcement of a U.S. judgment. That changed in 1983, when the Japanese Supreme Court enforced a Washington, D.C., judgment and held that the U.S. rules concerning recognition and enforcement of foreign judgments under Hilton v. Gonzi (as incorporated in the Uniform Foreign Money-Judgments Recognition Act, which has been adopted by almost all the states, including California) are “substantially the same as” and “not different in important points from” the Japanese
rules. Hence, a “mutual guaranty” (or reciprocity) exists between Japan and the United States (that is, Washington, D.C., as well as those states that have adopted the Uniform Act) regarding the enforcement of each other’s judgments. Although Japanese defendants’ counsel still continue to raise the reciprocity issue, there have been no cases in which U.S. money judgments were denied enforcement for failure to satisfy the reciprocity requirement.

A U.S. plaintiff who battles to victory in a U.S. court may also face a second battle to enforce the judgment in Japan. Although U.S. judgments, excepting punitive damages awards, generally are enforced in Japan, it will take at least two years to complete the enforcement procedure at the district court level. If a decision granting enforcement is appealed, the process could easily take another two years or more. Clearly the best approach for plaintiffs and their lawyers is to bring a lawsuit in the country where the defendant has sufficient assets. There, one battle will do.

1 Minji Soshoho (Japanese Code of Civil Procedure) (hereinafter MINSOHO), art. 188.
3 North Con I, 51 MINSHU 2573.
4 See MINSOHO, supra note 1, arts. 4, 5.
6 See MINSOHO, supra note 1, art. 4(2).
11 Hague Convention, supra note 9, art. 5.
15 See also United Kingdom Protection of Trading Interests Act §§5, 6 (1988).
17 Hilton v. Guyott, 159 U.S. 113 (1895).
18 See note 17, infra.
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A client calls with a business tort case. A competitor has not only been negligent but has also engaged in fraud, intentionally interfered with prospective business relations, and competed unfairly. These acts have caused several million dollars in damages. There is only one problem: the competitor—a corporation—does not have the money to pay a judgment. However, the competitor’s president is personally very wealthy. The client queries whether the president can be sued individually. The answer may be yes, for some claims.

The courts have not yet articulated a single clear rule governing the liability of corporate officers or directors in tort. One broad conclusion, however, may be gleaned from the body of case law that has addressed the issue: Courts are more sympathetic to claims against corporate officers and directors for intentional misconduct than for negligence.

In *Frances T. v. Village Green Owners Association*, the California Supreme Court set forth a two-part test to determine whether an officer or director can be held personally liable for a tort. Specifically, a plaintiff must prove that:

1. The director or officer either
   - “[S]pecifically authorized, directed or participated in the allegedly tortious conduct”; or
   - “[A]lthough they specifically knew or reasonably should have known that some hazardous condition or activity under their control could injure plaintiff, they negligently failed to take or order appropriate action to avoid the harm”; and
2. “[A]n ordinarily prudent person, knowing what the director knew at that time, would not have acted similarly under the circumstances.”

Courts apply this test very differently depending on the nature of the tort. For example, it is well established that “[a]ll persons who are shown to have participated in an intentional tort are liable for the full amount of the damages suffered.” Courts also have held that “[t]his rule applies to intentional torts committed by shareholders and those acting in their official capacities as officers and directors of a corporation, even though the corporation is also liable.” Indeed, courts repeatedly have held corporate officers and directors personally liable for damages caused

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by their own fraud:
A corporate officer or agent is personally liable for damages caused by his fraud or deceit, to the person directly injured thereby. As to third persons dealing with a corporation, the directors are merely agents of the corporation, their liability being the same, and if they assist or participate knowingly or recklessly without knowledge, in obtaining property by fraud or deceit, they are liable to an injured person who relies on their representations.¹

Thus, in Croeni v. Goldstein, a buyer's officer—the person who allegedly made false representations on behalf of the buyer to induce the sellers to sell their business—was held potentially liable in tort for fraud.⁷

Courts also have found officers and directors personally liable for acts of unfair competition or misappropriation of trade secrets. In PMC, Inc. v. Kadisha, the majority shareholders of a corporation filed suit for misappropriation of trade secrets against former managers of the corporation who had formed a new company. The plaintiffs also sued individuals who had invested in, and become officers and directors of, the new corporation, for, among other things, misappropriation of trade secrets and unfair competition. The latter group of defendants brought a motion for summary judgment on the ground that they could not be held personally liable for the alleged torts. The trial court granted summary judgment, and the court of appeal reversed, finding that the plaintiffs had stated valid claims against the defendants and raised a triable issue of material fact regarding the defendants' participation in, consent to, or approval of the alleged intentional tortious conduct.⁹

The court of appeal broadly observed that anyone who is found to have “participated in an intentional tort” will be held liable for the full measure of damages incurred.¹⁰ The court cited cases in which corporate officers and directors had been held liable for unfair competition when they had been aware of, or ratified acts of, unfair competition and benefited from the misconduct,¹¹ or for misappropriation of trade secrets when the corporation not only gained unauthorized access to the secrets but used them on a continuing basis.¹²

The court rejected the defendants' contention that they could not have participated in any trade secret misappropriation violations because the alleged violations predated their investments in the corporation. The court found that “misappropriation is not limited to the initial act of improperly acquiring trade secrets; the use and continuing use of the trade secrets is also misappropriation.”¹³

In Granoll v. Tackle, the court of appeal held that an officer or director can be individually liable for conversion:
It is well settled by the great weight of authority in this country that the officers of a corporation are personally liable to one whose money or property has been misappropriated or converted by them to the uses of the corporation, although they derived no personal benefit therefrom and acted merely as agents of the corporation.¹⁵

The court of appeal further explained that “[t]he underlying reason for this rule is that an officer should not be permitted to escape the consequences of his individual wrongdoing by saying that he acted on behalf of a corporation in which he was interested.”¹⁶

**Haidinger-Hayes and Negligence**

Courts are less likely to find an officer or director personally liable when the tort is negligence. In particular, courts have set a high bar in determining whether an officer or director owes a duty of care to a third party. Indeed, if there is no duty, there can be no negligence.¹⁷

The California Supreme Court explains this principle well in United States Liability Insurance Company v. Haidinger-Hayes, Inc., a case in which the plaintiff, an insurance company, brought a negligence action against its licensed California insurance agent, Haidinger-Hayes, Inc., and the agent's president, V. M. Haidinger. The negligence alleged by the plaintiff involved the computation of the premium rate charged to one of the plaintiff's insureds. The plaintiff had entered into a general agency contract with the defendant corporation, and under this contract the corporation had the authority to solicit and issue contracts of insurance on behalf of the plaintiff and to determine the premium rates.

The negotiations regarding the Crescent policy were the personal responsibility of the president of Haidinger-Hayes. The president had issued the policy to Crescent on behalf of the corporation and determined the premium rate that was charged. The plaintiff asserted that the defendants were negligent in setting the premium rate charged to Crescent. The trial court found against both defendants on the issue of negligence and awarded $137,606.20 in damages in favor of the plaintiff.

On appeal, the supreme court unanimously reversed the trial court's ruling regarding the president's personal liability to the plaintiff. The court did not dispute the trial court's finding that the president did not exercise reasonable care. However, the court, in essence, found that the president, while certainly owing a duty to the corporation, owed no duty to the plaintiff and thus could not be liable for negligence.

The supreme court initially affirmed the trial court's express finding of the defendant corporation's liability to the plaintiff. But the court observed that “[t]he relationship of defendant V.M. Haidinger to plaintiff is somewhat different. Liability was imposed on him for his active participation in the tortious (negligent) act of his principal which caused pecuniary harm to a third person.”¹⁹ The court noted that, based on the facts of that case, it was undisputed that the acts of the corporate officer were done in the course and scope of his employment for and on behalf of the corporation and not as a contracting party.²⁰

The court further stated that “[d]irectors or officers of a corporation do not incur personal liability for torts of the corporation merely by reason of their official position, unless they participate in the wrong or authorize or direct that it be done.” Corporate officers are not responsible to third persons for “negligence amounting merely to nonfeasance, to a breach of duty owing to a corporation alone; the act must also constitute a breach of duty owed to the third person.” The court also observed that liability imposed on agents who actively participate in the tortious acts of their principal have been “mostly restricted to cases involving physical injury, not pecuniary harm, to third persons.”²¹

This statement is interesting in that the court framed it in terms of all torts, not just negligence. But courts have shown no reluctance to hold officers or directors personally liable for intentional torts, even if the only damage is pecuniary. Indeed, courts have drawn the distinction between intentional torts and negligence. For example, in PMC,²² the court of appeal distinguished Haidinger-Hayes because it “was a negligence action” and “did not involve intentional misconduct.”

In Self-Insurers Security Fund v. Esis, Inc.,²³ the court followed the Haidinger-Hayes decision. The plaintiff, Self-Insurers Security Fund, sued, among others, the former vice president of an insolvent self-insured employer, California Canners and Growers (CCG), to recover worker's compensation benefits the plaintiff paid to the company's employees. The plaintiff, which was formed in response to CCG's bankruptcy, alleged, among other things, a cause of action for negligent misrepresentation against the officer, William C. Gruber.

Under the Labor Code, CCG was required to file annual reports with the Department of Labor Relations estimating the company's anticipated worker's compensation liabilities. The department used the reports as a basis for determining the amount of security to be posted by the company. The Labor Code required both the person administering CCG's self-insurance plan and an officer or an autho-
ized employee to sign the reports under oath. Defendant Gruber was the officer who signed the reports in 1981 and 1982, and the company began bankruptcy proceedings in 1983. It was subsequently determined that CCG had underestimated its outstanding worker's compensation liabilities by more than $1 million.

The trial court sustained Gruber's demurrer, and the court of appeal, relying on Haidinger-Hayes, affirmed the trial court's decision. The appellate court noted "[t]he two] traditional limitations on a corporate officer's personal liability for negligence" articulated by Haidinger-Hayes and later by Frances T.: 1) the general resistance to holding a corporate officer personally liable in the absence of physical injury, and 2) the rule that officers are not liable to third parties for breach of duties owed to the corporation alone. Applying these limitations to the facts before it, the appellate court in Self-Insurers Security Fund observed that Gruber's conduct, "allegedly resulting in pecuniary harm to CCG employees, was not directed in any fashion toward, or in response to, the employees."25

Frances T. and Personal Injury

While acknowledging the traditional limitations, the state supreme court in Frances T. held that the director defendants could be personally liable for negligence. The ruling was reached in the context of particularly egregious facts and was carefully circumscribed so that it applies only to negligence cases that also involve personal injury. In Frances T., the plaintiff brought suit against the condominium owner's association for the condominium project in which she lived and individual members of its board of directors for injuries suffered when she was molested, raped, and robbed on the premises of the project. The trial court sustained all of the defendants' general demurrers to the negligence claim without leave to amend, and the plaintiff appealed. The supreme court reversed.

The basis for the plaintiff's negligence claim against the defendants was the lack of exterior lighting on the night of her attack. The plaintiff alleged in her complaint that, throughout the year in which her attack occurred, the condominium project was subject to an exceptional crime wave. All the project's residents, as well as the board, were aware of and concerned about this significant increase in crime on the premises. The condominium association's newsletter, distributed to residents and directors, published details about the problem and possible protective measures to address it. Earlier in the year, the board began to investigate what could be done to improve the lighting in the project. The plaintiff was burglarized about five months before her attack, and four months before her attack she and other residents of the project made a formal request to the project manager, with a copy to the board, for new lighting to be installed as soon as possible. The plaintiff submitted another written request before her attack because the board had still not taken action. When this request went unheeded, the plaintiff installed additional exterior lighting, but the project manager told the plaintiff to remove the lighting because it violated the project's covenants, conditions, and restrictions. After initially refusing to comply with the manager's request, and after appearing at a board meeting where she requested permission to maintain her lighting, the board specifically instructed her to remove the exterior lighting. As a result, "her unit was in total darkness on October 8, 1990, the night she was raped and robbed."26

The supreme court held that the plaintiff had pleaded facts sufficient to state a cause of action for negligence against both the condominium association and its individual directors. The court discussed at some length the plaintiff's claim against the directors individually. Citing its prior decision in Haidinger-Hayes, the court began by noting that "corporate directors cannot be held vicariously liable for the corporation's torts in which they do not participate. Their liability, if any, stems from their own tortious conduct, not from their status as directors or officers of the enterprise."27

The court recalled that in its decision in Haidinger-Hayes, it had discussed "the traditional limitations on a corporate officer's or director's liability for negligence." The first limitation was that "no special agency relationship imposed personal liability on the defendant corporation's president for failing to prevent economic harm to the plaintiff corporation, a client of his principal." This limitation "reflected the oft-stated disinclination to hold an agent personally liable for economic losses when, in ordinary course of his duties to his own corporation, the agent incidentally harms the pecuniary interests of the third party."28

The second traditional rule to which the Frances T. court referred was the Haidinger-Hayes court's admonition that "directors are not personally liable to third persons for negligence amounting merely to a breach of duty the officer owes to the corporation alone. [T]he act must also constitute a breach of duty owed to the third person....More must be shown than breach of the officer's duty to his corporation to impose personal liability to a third person upon him."29 Thus, "a distinction must be made between the director's fiduciary duty to the corporation (and its beneficiaries) and the director's ordinary duty to take care not to injure third parties. The former duty is defined by statute, the latter by common law tort principles."30

Regarding the facts of the case before it, the court in Frances T. explained:

[It] would be insufficient to allege that because the directors had a duty as agents of the Association to manage its property...
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and conduct its affairs, that they also necessarily owed a personal duty of care to plaintiff regardless of their special knowledge of the allegedly dangerous condition that led to her injury. As this court suggested in Haidinger-Hayes, such a broad application of agency principles to corporate decision makers would not adequately distinguish the director’s duty of care to third persons, which is quite limited, from their duty to supervise broad areas of corporate activity. Virtually any aspect of corporate conduct can be alleged to have been explicitly or implicitly ratified by the directors. But their authority to oversee broad areas of corporate activity does not, without more, give rise to a duty of care with regard to third persons who might foreseeably be injured by the corporation’s activities.31

The court concluded that the plaintiff’s complaint alleging that each of the directors participated in the tortious activities was sufficient to withstand a demurrer. The court proceeded to hold, however, that only the directors who actually voted for the commission of the tort may be held personally liable.32

Liability imposed upon agents for active participation in the tortious acts of the principal have been mostly restricted to cases involving physical injury, not pecuniary harm, to third persons. The Frances T. court reiterated the statement in Haidinger-Hayes that the reason liability in the latter case was denied was because “the harm in that case was pecuniary in nature and resulted from good faith business transactions.”

Questionable Expansion
The Second District Court of Appeal decision in Michaelis v. Benavides34 merits discussion because of its apparent expansion of Haidinger-Hayes. In Michaelis, the plaintiffs hired a general contractor to build their home. The general contractor subcontracted the construction of the patio and driveway to A&J Stamped Concrete, Inc., and defendant Anthony Benavides was the president of A&J. Benavides personally made the construction decisions for the patio and driveway.

After construction was completed, the patio developed severe cracks and other problems. In addition, the plaintiffs alleged that the driveway was four feet narrower than specified, and the driveway drains were incorrectly placed, causing rain water to flood. This, in turn, “posed a hazard to the home’s structural integrity and caused a safety hazard to persons entering or leaving” the home.

At the hearing on the defendant’s motion for nonsuit, the defendant generally stipu-
lated that he had been negligent in constructing the patio and driveway. Relying on Haidinger-Hayes, the trial court held that the plaintiffs had no negligence claim against the defendant because the plaintiff had only suffered economic losses.

The court of appeal reversed. In construing Haidinger-Hayes—and also Frances T.—the court rejected the respondent’s distinction between damage to property and personal injuries. Still, the court also observed, somewhat cryptically, that “[i]t is not unlikely that personal injury could have resulted from the unsafe conditions caused by the structurally defective patio and driveway.”

Does this mean that an officer may be liable for property damage only if the damage created a risk of personal injury?

The Michaelis court’s construction of Haidinger-Hayes is questionable. The supreme court in Haidinger-Hayes seemed to draw a clear line between liability for purely pecuniary harm and liability for personal injury. A standard that would also impose liability on officers and directors who negligently create the risk of personal injury would be a significant expansion of the standard of liability enunciated in Haidinger-Hayes.

California courts have opened the door wide to claims for intentional torts against officers and directors. Indeed, the misconduct need not even be active; the knowing failure to act in the face of intentional misconduct by others in the corporation may be enough to give rise to personal liability.

With respect to negligence claims, on the other hand, the door generally has been shut to all but those that involve personal injury claims. Whether Michaelis is the first decision to pry open the door for other types of negligence claims or simply a bad decision with ultimately no precedential value remains to be seen.

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1 Frances T. v. Village Green Owners Ass’n, 42 Cal. 3d 490, 504 (1986).
2 Id. at 508-09.
4 Id. at 1382.
8 PMC, 78 Cal. App. 4th 1368.
9 Id. at 1372.
10 Id. at 1381 (citations omitted).
11 Id. at 1383 (citing Bancroft-Whitney Co. v. Glen, 64 Cal. 2d 327, 333 (1966)).
15 Id. at 257 (quoting Hirsch v. Phily, 73 A. 2d 173, 177 (N.J. 1950)).
16 Id. at 257.
19 Id. at 594.
20 Id. at 595.
21 Id.
24 Id. at 1162.
25 Id. at 1162-63.
27 Id. at 503 (citation omitted).
28 Id. at 505.
29 Id. at 505-06 (citing United States Liab. Ins. Co. v. Haidinger-Hayes, Inc., 1 Cal. 3d 586, 595 (1970) (emphasis in original)).
30 Id. at 506.
31 Id. at 506-07 (emphasis in original).
32 Id. at 511.
33 Id. at 505.
35 Id. at 687.
Lawyers often engage private investigators for sensitive assignments, such as conducting surveillance, obtaining admissions, and finding assets. Many lawyers do not know how investigators perform their work; other lawyers do not want to know. However, ignorance may not be bliss for California lawyers and investigators. In fact, it can be dangerous. An investigation that involves deception—even if the investigator has avoided perpetrating an outright lie—may jeopardize an investigator’s license. Further, if the investigation invades someone’s privacy or is otherwise tortious, both the investigator and the person hiring the investigator may face civil liability. Finally, criminal penalties exist for unlicensed investigators and persons who knowingly hire them.

California’s Private Investigator Act (PIA)1 prohibits private investigators from committing “any act constituting dishonesty or fraud.”2 The court of appeal in Wayne v. Bureau of Private Investigators and Adjusters3 broadly applied this prohibition. In Wayne, an investigator retained by the defendants’ insurance companies visited accident victims at home and misled them about who had retained him. The investigator never lied but did not identify his principals. The court of appeal upheld suspension of the investigator’s license: “[T]he [investigator] in this case did not act entirely in good faith with the persons he interviewed…. [H]e knew the interviewees wanted….to know whom he represented, he knew that he did not tell the interviewees the whole truth about whom in fact he represented, and further he knew from what he told the interviewees that they were mistakenly of the belief that in some capacity or way he was connected or associated with those whose interests were with the interviewees. There was a want of full probity or fairness in the transactions. The [investigator] was acting…to the end that he would gain a benefit to himself and those companies…he represented to the disadvantage of the interviewees or [their] insurance carriers…. It was not a simple or harmless act of deception.”

California courts have broadly applied the strict provisions of the Private Investigator Act

PRIVATE EYES

by John S. Caragozian

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casual omission to tell the exact and whole truth on a single occasion, but...was a studied course deliberately to mislead the unwary and by telling part truths thereby to deceive the interviewees into believing that [the investigator] in some respect represented their agents or principals.

There was a disposition to deceive, betray, and mislead the interviewees. In other words, there was a lack of complete integrity.\(^4\)

Wayne does not define the PIA’s prohibition narrowly or technically. Rather, “dishonesty may very well be something less than criminality,” and “fraud embraces multifarious means whereby one person gains advantage over another...” Thus, “the conduct complained of constituted dishonesty or fraud...”\(^5\)

Wayne’s interpretation of the PIA’s “dishonesty or fraud” language has been repeatedly cited by California courts.\(^6\) While investigators may argue that “in pursuing their business [they] must necessarily resort to tricks and ruses” and that investigators “will get nowhere by the direct approach,” such arguments have not been accepted.\(^7\) Likewise, the argument that the “dishonesty or fraud” prohibition applies only to investigators’ conduct toward their clients and does not apply to their “dealings with opponent’s clients” has been rejected.\(^8\)

The California Supreme Court approved and extended Wayne in Redner v. Workmen’s Compensation Appeals Board.\(^9\) A workers’ compensation insurance carrier retained an investigator who hired someone to pose as a friend of an injured worker. The purported friend plied the worker with alcohol and then induced the worker to go horseback riding, which the investigator captured on film. The carrier proceeded to offer the film as evidence. The supreme court held that “the workers’ compensation [referee] should have refused to rely upon [the film] because the carrier obtained it by fraudulent inducement...” Moreover, according to the court: [T]he carrier should not profit from its own deceitful conduct. The investigators feigned friendship and concealed their employer’s identity...Nothing in the record so much as suggests that in the absence of the fraudulent inducement [the worker] would have taken the ride. Indeed, the referee found that the carrier fraudulently obtained the film by means of violation of [the worker’s] rights...\(^10\)

Further, the Redner court held that victims of investigators may seek damages:

[Pr]ivate investigators may well make an intrusion in to the individual’s right of privacy which would be objectionable or offensive to the reasonable man.... Courts have permitted such an individual to maintain an action for damages against the intruders.\(^11\)

In Noble v. Sears, Roebuck and Company,\(^12\) the court of appeal extended Redner by holding that lawyers retaining an investigator may be liable for at least some of the investigator’s torts. In Noble, an investigator was retained by Sears’s lawyers who had been defending Sears in an underlying personal injury suit. According to the pleadings, the investigator had “gained admittance to a hospital room where plaintiff was confined” and, “by deception,” obtained a witness’s address. The plaintiff sued Sears, its lawyers, and the investigator, but the trial court sustained a demurrer to the complaint. Ruling on the plaintiff’s appeal of the demurrer, the Noble court held that, under the pleaded facts, “an unreasonably intrusive investigation may violate a plaintiff’s right to privacy.”\(^13\) Further, Sears and the lawyers may have vicarious liability:

[It] appears that in California the hirer of a detective agency for either a single investigation or for the protection of property, may be liable for the intentional torts of employees of the private detective agency committed in the course of employment.\(^14\)

Also, under the pleaded facts, Sears and Sears’s lawyers may have primary liability for their own “negligent supervision” or “negligent entrustment” of the investigator.\(^15\)

### Undercover Investigations

In sum, California case law indicates that:

1) The PIA prohibits investigators from misrepresenting themselves or their principals—whether the misrepresentation occurs affirmatively or by silence and whether or not an investigator actually lies.

2) Evidence obtained as a result of misrepresentation might be excluded in civil proceedings.

3) Victims of torts related to misrepresentations may seek damages against investigators.

4) Victims of intentional torts may seek damages against attorneys or others hiring the investigators.

5) Victims of negligently supervised or entrusted investigators may seek damages from attorneys or others hiring the investigators.

Indeed, this case law might possibly be read as precluding all undercover investigations—that is, those investigations in which the investigators fail to disclose their true status, pose as someone they are not, and thereby seek to obtain admissions or other evidence. If so, then investigators who conduct undercover investigations—with the possible exception of investigations into certain insurance claims\(^16\)—might be engaging in “dishonesty or fraud” under the PIA.

The breadth of this possibility is significant. The use of investigators in today’s business climate may be exemplified by two scenarios. In the first, a business owner experiencing a loss of inventory and suspecting theft by workers retains a private investigator to pose as a worker in order to observe and learn whether employees are indeed involved in theft. The investigator usually avoids telling lies but engages in casual conversations that serve to encourage his or her acceptance by the other workers and elicit approaches by would-be thieves. (For example, the investigator might say, “I could use some extra money,” or “How secure is this warehouse?”)

In the second, a business suspects that a competitor is misrepresenting itself and hires an investigator to pose as a prospect for the competing business. The investigator, without disclosing his or her true role, asks questions as a means of gathering information about how the competitor is describing its status and activities. For example, an accredited vocational school may want to discover whether an unaccredited vocational school is misleading prospective students by claiming to be accredited. The investigator might say, “I am thinking about your school, but I want to know if it is accredited.” By asking this question, the investigator is avoiding a direct lie but is misleading. The investigator clearly wants to know about the school’s accreditation, but he or she wants to be perceived as a real potential student.

In both types of scenarios, investigators do not disclose that they are investigators and do not reveal who has hired them. Moreover, investigators deliberately mislead others into believing that they are something they are not. Indeed, they are not fellow workers or business prospects. Investigators use the misconceptions about their identity to obtain evidence that most likely would not have been forthcoming if they had disclosed that they were investigators.

If these scenarios portray prohibited conduct, then many investigators and their principals will have difficulty in ferreting out wrongdoing and wrongdoers. On the other hand, if the scenarios portray permitted conduct, then courts may have difficulty in articulating objective standards that allow private investigators to pose as colleagues or prospective customers but not as allies (as in Wayne) or friends (as in Redner). Of course, Wayne also included in-home visits, Redner involved intoxication, and Noble featured a hospital room visit, but the case law did not indicate that, absent these particular facts, the subject investigations would have been permissible.

In addition to the general prohibition of
1. Private investigators have a statutory duty to maintain the confidentiality of client information.
   True.  False.
2. If private investigators commit negligent torts, are the lawyers who hire them vicariously liable for those torts?
   A. Yes.  B. No.  C. The question is left undecided by case law.
3. Persons who locate lost or stolen property and conduct no other types of investigations must be licensed as private investigators.
   True.  False.
4. A private investigator who is retained by a lawyer may assert the attorney work product doctrine to object to the lawyers who hire them vicariously liable for those torts?
   A. Doctors.  B. Accountants.  C. Handwriting experts.  D. All of the above.  E. None of the above.
5. Under Kennard v. Rosenberg, who may be retained as experts or consultants to investigate matters in litigation without being licensed as private investigators?
   A. Doctors.  B. Accountants.  C. Handwriting experts.  D. All of the above.  E. None of the above.
6. May lawyers be held liable for their own negligence in supervising or entrusting private investigators?
   A. Yes.  B. No.  C. The question is left open by case law.
7. If a private investigator obtains evidence via fraudulent or deceitful conduct, trial courts may exclude the evidence.
   True.  False.
8. Licensed private investigators are exempt from the California Privacy Act’s prohibition on secret wiretapping, eavesdropping, and recording.
   True.  False.
9. In response to relevant discovery, do private investigators have a privilege to withhold the identity of their clients?
   A. Yes.  B. No.  C. The question is left open by case law.
10. A recently enacted prohibition against viewing the interiors of bedrooms and bathrooms applies to the use of cameras or camcorders but does not apply to binoculars or telescopes.
    True.  False.
11. A lawyer has no vicarious liability for the torts of a private investigator when the lawyer retains the investigator for only a single investigation.
    True.  False.
12. The Rules of Professional Conduct prohibit lawyers from sharing client fees with private investigators.
    True.  False.
dishonesty or fraud, the PIA provides for denial, suspension, and revocation of an investigator's license for specific types of misconduct. These include: impersonating a law enforcement officer; using a badge; using a uniform, insignia, or identification card “to give an impression” of connection with the government; committing assault, battery, or kidnapping, or using “force or violence without proper justification”; committing any violation of the California Privacy Act, which outlaws secret wiretapping, eavesdropping, and recording; “using illegal means” in debt collection; or accepting employment “adverse to a client or former client” relating to a matter about which the investigator obtained “confidential information.”

**Protections and Risks**

While the PIA does not expressly confer privileges or immunities on private investigators, the Civil Code accords every person a qualified privilege against some tort liability if his or her conduct consisted of a communication “to a person interested therein...” who “requested...the information” and an absolute privilege if the conduct was in a “judicial...or...other proceeding authorized by law.” However, no reported case has held that investigators have any greater claim to these privileges than other persons.

Accordingly, investigators may be liable for torts such as fraud, trespass, invasion of privacy, battery, and false imprisonment. Likewise, investigators may be liable for violating statutes such as the Uniform Trade Secrets Act. Other persons may be vicariously liable for any of this wrongdoing by retaining an investigator, especially if the investigator had advertised his or her capabilities for working undercover. The advertising may impute notice to the hirers of the investigator of potential Wayne-type problems.

Also, no per se private investigator-client privilege or private investigator work product doctrine has been held to exist. The PIA does provide that, in the absence of a client’s consent, an investigator “shall not divulge..., except as he or she may be required by law..., any information acquired...” (though “criminal offense” information “may” be divulged to law enforcement officers). Thus, investigators have a duty of confidentiality, but the case law expressly leaves open the question of whether this duty creates any corresponding privilege against discovery. Nevertheless, investigators must allow relevant discovery of the identity of their clients.

Without the certainty of a privilege, private investigators face the possibility that their work product and communications with clients might be discoverable. Investigators are not entirely vulnerable in this area, however. There are two grounds for objection to discovery that investigators may be able to utilize. First, an investigator (or the investigator’s client) may assert a privacy objection.

Second, while investigators might not have their own protections, investigations retained by lawyers might avail themselves of the lawyers’ protections. Investigators retained by lawyers in litigation may assert the attorney work product doctrine to prevent disclosure of the lawyer’s or the investigator’s “impressions, conclusions, opinions, or...theories.” Similarly, communications between a lawyer’s client and an investigator who is the lawyer’s agent may be protected by the lawyer-client privilege.

Lawyers retaining investigators face their own set of prohibitions and risks. For example, a lawyer may not compensate an investigator by “directly or indirectly” sharing fees from the lawyer’s client. Also, lawyers must be careful not to violate Rule 2-100 of the California Rules of Professional Conduct, which prohibits a lawyer from “directly or indirectly” communicating “about the subject of the representation” with a party represented by another lawyer. A violation of Rule 2-100 can occur if a lawyer engages an investigator to communicate with a party that the lawyer knows to be represented by another lawyer.

In *Jorgensen v. Taco Bell Corporation*, the court of appeal found no violation of Rule 2-100 when a prospective plaintiff’s lawyer retained an investigator to interview a corporation’s employees seven months before the plaintiff sued the corporation. The court expressly rejected the corporation’s argument that the lawyer “should have known” that the corporation “would be represented” or had “house counsel.” However, the *Jorgensen* court implied that a closer question would be presented if the investigator had conducted the interviews “on the eve of the filing of the lawsuit” and that a lawyer would violate Rule 2-100 if the lawyer hired an investigator to communicate with a represented adversary or represented witness after filing suit.

Lawyers who violate Rule 2-100 face sanctions by the trial court, including disqualification from any role in the lawsuit at issue. These sanctions are in addition to any disciplinary actions that the State Bar of California may take. However, a Rule 2-100 violation does not give rise to a civil action for damages.

Given these proscriptions, investigators and their principals may worry if any private investigation is lawful. In California, at least five investigatory activities generally are permissible:

1. Overt investigations, in which investigators identify their roles and principals and do not otherwise mislead or deceive anyone.
2. Public records searches.
3. Physical observations, measurements, and the like.
4. Protection of a person, if it is “incidental” to an investigation and if the investigator complies with the PIA’s firearms and insurance requirements.
5. Surveillance, even if covert, provided that investigators do not trespass or invade privacy.
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The privacy issue bears careful study, because California has common law, constitutional, and statutory protections against the invasion of privacy. The privacy statutes are numerous and scattered, ranging from an antipaparazzi law (banning certain photography of "personal or familial activity") and an antistalking law to a recently enacted ban on the use of a "telescope, binoculars, camera,...or camcorder" to view the interior of a "bedroom, bathroom,...or the interior of any other area in which the occupant has a reasonable expectation of privacy." To complicate matters further, federal privacy statutes also exist.

**Licensing Issues and Exempt Persons**

Under the PIA, a private investigator is any person:

- [W]ho, for any consideration...whatever engages in business or accepts employment to furnish, or agrees to make, or makes, any investigation for the purpose of obtaining, information with reference to:....
- (b) The identity, habits, conduct, business, occupation, honesty,...knowledge,...whereabouts,...associations,...acts, reputation, or character of any person.
- (c) The location...of lost or stolen property.
- (d) The cause or responsibility for fires, libels, losses, accidents, or damage or injury....
- (e) Securing evidence to be used before any court....

Private investigators must be licensed by the Bureau of Security and Investigative Services (BSIS), which is part of the Department of Consumer Affairs. To obtain a license, an investigator must submit an application, pay a fee, possess certain experience requirements, and pass an examination—and once the license is granted, it must be renewed periodically.

Unlicensed persons (not including those considered exempt under the PIA) who represent themselves as licensed or act as private investigators are committing a misdemeanor and may be jailed for up to one year and fined $5,000. In addition, anyone—presumably including a lawyer—who "knowingly" engages an unlicensed investigator or who conspires to have an unlicensed person operate as an investigator also commits a misdemeanor with the same penalties. Public prosecutors may seek civil remedies against unlicensed investigators, their coconspirators, and anyone who knowingly engages such investigators. The civil remedies include an injunction (for which prosecutors need not "show lack of adequate remedy at law or irreparable injury"), a civil fine of up to $10,000, and reimbursement of BSIS investigation expenses.

The PIA does not contain a private right of action for licensing violations. However, private parties might have at least three indirect remedies. First, a licensing violation would be an "unlawful...business act or practice" under the Unfair Competition Law, which generally affords private parties equitable relief, including an injunction and, if appropriate, restitution. Second, an aggrieved litigant might move to exclude evidence gathered by an unlicensed investigator. Third, a person who contracts with an unlicensed investigator might seek to avoid paying the investigator's fees on the ground that the contract is illegal.

May a licensed investigator employ or contract with unlicensed persons to perform investigative tasks? The answer appears to be a qualified yes. Under the PIA, a licensee may be an individual, partnership, corporation, or other business. If the licensee is a corporation, corporation, or other business, it must designate a licensed "manager," under whose "direction, control, charge, or management the business...is operated." The individual or manager licensee is "legally responsible for the good conduct...of his or her employees or agents,...." and only the licensee, manager, or other person authorized by them may submit a "written report...to a client." Also, employees of licensed investigators may provide "incidental" personal protection.

The PIA exempts several classes of persons from its purview, including its licensing requirement. Among those for whom the PIA does not apply are:
- Employees "employed exclusively and regularly" by an employer "in connection with the affairs of such employer." While this exemption requires the unlicensed, in-house investigator to be a W-2 employee, no court has interpreted the "affairs of such employer" language. Is the unlicensed employee limited, say, to investigations on the employer's premises or relating to the employer's suppliers, customers, or other employees? Or may the unlicensed employee also visit the employer's competitors and investigate their businesses? May the unlicensed employee investigate prospective employees or potential competitors? No reported case law has addressed these questions.
- Peace officers who are "off duty" and privately employed (unless they carry firearms).
- Lawyers. No case law indicates whether lawyers' employees also are exempt.
- Insurance carriers, agents, brokers, and adjusters.
- Banks, savings associations, secured creditors seeking repossession, and credit-reporting agencies.
- Persons obtaining information solely from public records.
- Process servers.

Beyond the statutory exemptions, some case law holds that at least some experts, consultants, and others performing investigatory work also need not be licensed. However, these decisions are neither recent nor fully developed.

In *Kennard v. Rosenberg*, two licensed chemical engineers and a retired city fire inspector sued Nate Rosenberg to collect their professional fees. Rosenberg had been indicted for arson of his nightclub. His lawyer retained the fire inspector after the inspector had stated that he was not licensed and "acted only in the capacity of consultant or an expert." The lawyer also retained the engineers who conducted tests, examined photographs, prepared court exhibits, and—along with the inspector—attended the preliminary hearing and consulted with the lawyer. Rosenberg's defense for not paying the three was that the PIA required them to be licensed as private investigators. The trial court rejected this defense, and the court of appeal affirmed. The appellate court, announcing that "none of the [three experts/consultants] were engaged in the private detective business," reasoned that the engineers were licensed engineers and thus "were authorized to make investigations in connection with that profession...." Moreover, the court continued:

- [T]he private detective license law was not intended...to place a limitation on the right of professional engineers to make chemical tests...and to testify....A physician, geologist, accountant, engineer, surveyor or a handwriting expert, undoubtedly, may lawfully testify in court in connection with his findings without first procuring a license as a private detective, and...a photographer may be employed to take photographs of damaged premises for use in the court without procuring such a license. Thus, experts—particularly in recognized, forensic disciplines—may be retained to investigate matters in litigation without being licensed as investigators.

In *Mason v. Peaslee*, Russell Mason, an unlicensed sound engineer, sued his client Margaret Peaslee after she refused to pay his fees. For eighteen years, Mason had taped "meetings,...speeches,...and personal conversations" for corporations, attorneys, individuals, and law enforcement agencies—"in many instances" without the subjects' knowledge. Peaslee requested Mason to install recording devices in her husband's office to determine if the husband was "dishonest and secreting money" or "a sex pervert." Mason did so. The trial court granted a nonsuit on
the ground that the contract was illegal, because Mason lacked an investigator’s license. The court of appeal reversed, on two grounds. First, the PIA’s requirement of a license for persons who “engage” in the investigation business connotes “frequency of action,” and the trial court “could not draw the inference that [Mason’s] work in recording conversations for others was done in such a manner as to constitute doing business as a private investigator….”61 Second, the court noted that Mason did not personally “conduct any investigation….” Indeed, according to the court, “Mason…merely furnished to [Peaslee] the devices with which she could carry out her own investigation and…in operating the devices he acted not as an investigator but as one employed by [Peaslee] to render technical aid to her in operating the devices which she had rented from him.”62

The Mason court seemed to hold that 1) an investigator need not be licensed to conduct a one-time investigation, and 2) merely furnishing and operating surveillance equipment is not an investigation. Mason’s holdings, though, appear unsound. For example, if the word “engage” connotes “frequency,” then, using the same logic, an unlicensed person could perform dental surgery on one occasion, because dentists’ licenses are required only for persons who “engage in the practice of dentistry…”63 Unsurprisingly, no court has ever cited Mason’s interpretation of the PIA, and it would be risky for unlicensed investigators or anyone contemplating retention of an unlicensed investigator to rely on it.

Persons exempt from the PIA (such as inhouse investigators) enjoy not only freedom from licensing, but, ironically, perhaps greater latitude than licensed investigators in undercover investigations. To be sure, exempt persons still must avoid torts and statutory violations, but Wayne holds licensed investigators to higher standards. For example, Wayne suggests that the PIA’s “dishonesty or fraud” language could—at least in part—encompass silence, does not expressly require that the victims’ reliance be reasonable, and does not mention damages. By contrast, actionable fraud excludes misrepresentations by silence except in limited circumstances,64 requires that the reliance be reasonable,65 and requires actual damages.66 Thus, in Wayne, as well as in the typical types of scenarios in which businesses use undercover investigations, exempt persons might have been able to conduct the investigations, even if licensed investigators could not. Indeed, exempt persons might be able to investigate in ways that avoid tort or statutory liability, but licensed investigators must also reckon with Wayne.67

In the celebrated 1939 novel and 1946 movie The Big Sleep, Los Angeles private detective Philip Marlowe was retained by...
General Guy Sternwood to investigate Arthur Geiger, after Geiger had requested payment of some suspect promissory notes. Marlowe’s investigation included two visits to Geiger’s book shop on Hollywood Boulevard. On the first visit, Marlowe pretended to be interested in buying books; on the second, he pretended to have a book to sell. In neither visit did Marlowe disclose that he was an investigator or that General Sternwood had retained him. Under Wayne and its progeny, Marlowe might well have violated the PIA and risked BSIS discipline and civil liability. The fictional Philip Marlowe could ignore such risks. Nonfictional investigators and lawyers cannot.

1 BUS. & PROF. CODE §§7512-73.
2 BUS. & PROF. CODE §7538(b). See also BUS. & PROF. CODE §7561.4.
4 Id. at 437.
5 Id. See also Taylor v. Bureau of Private Investigators & Adjusters, 128 Cal. App. 2d 219, 227-238 (1954) (upholding the bureau’s suspension of a license after an investigator truthfully said he was an investigator but lied about who had retained him).
7 Taylor, 128 Cal. App. 2d at 227. See also Wayne, 201 Cal. App. 2d at 437-38 (An investigator’s admission that, without concealing information from interviewees, “undoubtedly he would have had to return to his office with no statements” is evidence of fraud.).
10 Id. at 93-94.
11 Id. at 94 n.13 (citations omitted).
13 Id. at 660.
14 Id. at 663 (footnote omitted). Noble expressly leaves open the question of whether the “hirer” could be liable for an investigator’s “negligent torts.” Id. at 663 n.8.
15 Id. at 663-64.
16 See the Insurance Information and Privacy Protection Act, INS. CODE §§791-791.27. The act allows “pretext interviews” (meaning interviewers pretend “to be someone [they are] not, misrepresent their principals’ identities, misrepresent the interview’s ‘true purpose,’ or refuse to identify themselves) to investigate insurance claims “where there is a reasonable basis for suspecting criminal activity, fraud,…or material non-disclosure….” INS. CODE §§791.02(u), 791.03. No reported decisions have considered this language, much less opined whether or how it applies to private investigators.
17 PENAL CODE §§630-637.9.
18 BUS. & PROF. CODE §§7539(d), (e), 7561.4(e), (b), (m), 7561.4(b), (d). See also PENAL CODE §§631, 632.
19 CIV. CODE §47(3).
20 CIV. CODE §47(2). How closely related the conduct must be to the proceedings has been the subject of substantial case law. See, e.g., Knoell v. Petrovich, 76 Cal. App. 4th 164 (1999); Rosenthal v. Irell & Manella, 135 Cal. App. 3d 121 (1982).
21 See CIV. CODE §§3426-3426.11.
22 BUS. & PROF. CODE §7539(a).
Intrusion upon one's most intimate activities and exposure with their capacity to destroy an individual's anonymity, expressed concern about, inter alia, "electronic devices..."

However, the investigator's own "comments about [the witness's] statement" are "protected absolutely from disclosure," and the comments were "so intertwined" with the notes that "all portions...should be held protected..." (emphasis in original)); and O'Connor v. Boeing N. Am., Inc., 216 F.R.D. 640, 652-53 (C.D. Cal. 2003) (A private investigator who interviewed witnesses "on plaintiff's counsel's behalf" was protected by the federal attorney work product doctrine from having to disclose what the witnesses said.).

On the other hand, parties seeking discovery of investigators' records should note that the "personal records" listed in Code of Civil Procedure §1985.3 (which codified Valley Bank of Nevada) do not include investigators' records.

See Code Civ. Proc. §2018(c); Fed. R. Civ. P. 26(b)(3). See also Rodriguez v. McDonnell Douglas Corp., 87 Cal. App. 3d 626, 647-48 (1978) (An investigator retained by a defendant's lawyer took notes regarding what a witness stated. The notes would have been discoverable under California law, because they were "nonderivative or noninterpretive." However, the investigator's own "comments about [the witness's] statement" are "protected absolutely from disclosure," and the comments were "so intertwined" with the notes that "all portions...should be held protected..." (emphasis in original)); and O'Connor v. Boeing N. Am., Inc., 216 F.R.D. 640, 652-53 (C.D. Cal. 2003) (A private investigator who interviewed witnesses "on plaintiff's counsel's behalf" was protected by the federal attorney work product doctrine from having to disclose what the witnesses said.).

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Artistic creators used to have an independent right under the Lanham Act to redress false attribution or obliteration of their credit. Recent years, however, have been tough for creators. In June 2003, in Dastar Corporation v. Twentieth Century Fox Film Corporation, the U.S. Supreme Court “considerably narrowed” the scope of these Lanham Act claims, and perhaps abolished them entirely.

Lanham Act claims protected the significant interest of creators in getting credit for their contributions. In the entertainment industry, credit is often more valuable than the direct compensation a creator receives for a particular project. With each credit, artists gain in the ability to obtain additional work. Agents use credit in negotiating client fees and participation in the revenue streams generated by DVD, cable, and foreign television. Lanham Act claims also provided the additional bite of treble damages for intentional violations and, in exceptional cases, attorney’s fees. Unfortunately for creators, the Copyright Act does not provide a moral right to attribution nor a right to prevent false attribution. This leaves few avenues for creative talent to redress the denial of proper credit.

Before Dastar, when people contributed intellectual property to a creative project, whether or not the intellectual property was separately copyrightable, they possessed a right to sue under the Lanham Act if others were falsely credited for the contribution or if credit was obliterated. This important right was recognized in the 1981 Ninth Circuit case Smith v. Montoro.

In Smith, the defendants had removed the name of an actor from the credits of a film and had substituted the name of another actor in his place. The Ninth Circuit held that this misattribution of credit could be classified as “reverse passing off,” in which a wrongdoer removes the name or trademark on another party’s product and sells that product in an unbranded state or under a name chosen by the wrongdoer. The Ninth Circuit held, therefore, that the defendants had violated Section 43(a)(1)(A) of the Lanham Act, which provides:

Any person who, on or in connection with any goods or services…uses in commerce any word, term, name, symbol, or device, or any combination thereof, or any false designation of origin, false or misleading description of fact, or false or misleading representation of fact, which…is likely to cause confusion, or to cause mistake, or to deceive as to the affiliation, connection, or association of such person with another person, or as to the origin, sponsorship, or approval of his or her goods, services, or commercial activities by another person…shall be liable in a civil action by any person who believes that he

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or she is or is likely to be damaged by such act.10

Later, in 1988, the Ninth Circuit similarly applied the Lanham Act in Lamothe v. Atlantic Recording Corporation,11 which concerned four cowriters who had written two songs released by the band Ratt. Two of the cowriters brought a Lanham Act claim against the other two cowriters (and their licensees) for falsely claiming to be the sole authors of the compositions. The defendants argued that the credits were partially correct in that they correctly identified two of the coauthors, and the failure to credit the remaining two was a “mere omission.” The Ninth Circuit rejected the defendants’ argument. Instead, the court expressly held that the failure to credit some of the authors violated the Lanham Act’s policy goal that “the producer of a good or service receives appropriate recognition and that the consuming public receives full information about the origin of the good.”12

The Lanham Act claim was crucial to the plaintiffs in Lamothe because the license that was granted by the coauthor defendants barred any claim for copyright infringement. Under the Copyright Act, any coauthor has the right to license the work without the consent of the other coauthors.13 Thus, the Lanham Act provided an important remedy in cases in which a copyright infringement claim could not be asserted and in which claims for breach of contract afforded remedies that were insufficient. Neither the cowriters in Lamothe nor the actor in Montoro had separate claims for copyright infringement.14 In fact, copyright infringement claims are often unavailable for creators. For example, a copyright infringement claim will not survive when a court finds that the artist gave the infringers an implied license to exploit the work.15 Perhaps most commonly in the entertainment industry, a copyright infringement claim will not lie when only ideas are utilized.16 However, misappropriation of ideas can nevertheless become actionable,17 and the credit for an idea (for example, a “story by” credit) can be an important consideration for creators.

When copyright infringement claims did not exist, creators could make a Lanham Act claim to recover for false attribution for creation.18 This was an important deterrent to potential wrongdoers.19

**Dastar**

In 2003, without expressly overruling any of the foregoing misattribution cases, the U.S. Supreme Court all but abolished misattribution claims. In Dastar v. Twentieth Century Fox, defendant Dastar created derivative works based upon a television series that had been produced in Europe by Twentieth Century Fox. After the television series fell into the public domain in 1977, Dastar edited the content of the series and added some new content, producing a video series titled *World War II Campaigns in Europe*. Dastar listed itself and its employees in the credits and on advertising materials as the producers of the series. Twentieth Century Fox and its sublicensees brought a Lanham Act claim against Dastar, in which it was alleged that Dastar falsely designated the origin of the goods when it failed to give credit to Fox and when it designated itself, not Fox, as the producer of the video series.

The Supreme Court held that there was no violation of the Lanham Act because the term “origin,” as used in Section 43(a) of the Lanham Act, referred only to the manufacturer or producer of the tangible physical goods and not to the creator of the intellectual property contained in those goods.20

The Supreme Court based this interpretation on three grounds. First, because the underlying creative work was no longer subject to copyright protection, the defendants in Dastar were merely benefiting from works in the public domain. The court reasoned that to allow the Lanham Act to redress false attribution when copyright protection was lacking would cause the act to conflict with copyright law, and would “be akin to finding that §43(a) created a species of perpetual patent and copyright, which Congress may not do.”21 In addition, the court noted the practical difficulties of determining the origin of a creative work in a case in which the origin encompassed authorship.22

Second, the Court found that the Lanham Act should not allow a lawsuit when a copier gives credit (for falsely implying a creator’s “sponsorship or approval”) and when a copier does not give credit (for reverse passing off).23 It did not seem logical that Lanham Act claims could be justified by an action and by the opposite action.

Third, the Supreme Court reasoned that requiring attribution of the creative source of goods would be inconsistent with previous interpretations of the Lanham Act.24 For example, the Court previously had held that product design trade dress always required proof of secondary meaning to be valid.25 Thus, the Court feared that if it ruled against Dastar, future plaintiffs could maintain a Lanham Act claim for a product design trade dress, even when it lacked secondary meaning, simply by means of bringing a claim for false attribution.

The holding of Dastar appeared to be that there is no right for creators or owners of works that have fallen into the public domain to redress false attribution that is contained on products placed into the stream of interstate commerce. However, the U.S. Central District Court has applied Dastar far more expansively.

In Williams v. UMG Recordings, Inc, the Central District applied Dastar in dismissing a Lanham act claim arising from the misappropriation of a copyrighted work.26 In Williams, the plaintiff worked on the production of a film, but the parties disagreed about the nature and extent of the plaintiff’s involvement. The plaintiff contended that he reedited and rescored the film and that the film incorporated his copyrighted narration script. The plaintiff was not credited for any of this work.

The plaintiff filed a lawsuit that included claims for copyright infringement and violation of the Lanham Act. Before Dastar was published, the defendants filed a motion for summary judgment that attacked the Lanham Act claim, and the motion was dismissed. However, after Dastar, the district court granted partial summary judgment and, following Dastar, dismissed the Lanham Act claim. In contrast to Dastar, the works at issue in Williams were protected by copyright law and were not in the public domain. The district court held, however, that the definition of “origin” established in Dastar “did not depend on whether the works were copyrighted or not.”27

In two subsequent cases, federal courts, including the First Circuit, have dismissed Lanham Act claims without making any distinction about whether the disputed work was within the public domain.28 Thus, for courts that follow the holding in Williams, Section 43(a)(1) of the Lanham Act is a closed avenue for creators seeking to redress false attribution or obliteration of credit.

**What Options Remain?**

In the wake of Dastar, aggrieved creators who have been improperly denied credit should consider an alternative to a claim under the Lanham Act. For their attorneys, the first line of prosecution is to check applicable collective bargaining agreements. The Directors Guild of America, for example, requires its signatories to credit directors in the film as well as in publicity materials for the film. Similarly, the Writers Guild of America has credit requirements for screenwriters.29 Signatories to the agreements that fail to accord credit to a director, creator, or writer may be subject to arbitration, liability, and, in some cases, expulsion from the guild.30

However, there are numerous situations that are not covered by collective bargaining agreements. If one of the parties to an agreement is not a member of a guild, for example, then the bargaining agreement does not apply. This is often the case for young artists looking for their first big break into a creative profession. If a collective bargaining agree-
The principle of an implied contract claim is simple—nothing is free. Thus, whenever one party uses another’s intellectual property, that person must compensate the creator on terms that are customary and reasonable.

work should be protected and preserved. Accordingly, moral rights exist independently of an artist’s ownership of copyright. The rights granted under VARA include the rights to claim authorship in a work as well as limited rights to prevent distortion, mutilation, or modification of a work—even after it is sold. However, only a work of visual art, as defined by the Copyright Act, is covered by VARA. This definition encompasses exhibition photographs and single or limited edition paintings, drawings, prints, or sculptures. Posters, magazines, films, advertising material, and several other types of works are expressly excluded from the protection of VARA. Furthermore, Section 106A(c)(3) creates an exception that effectively means that only works in an “artistic setting” (e.g., a museum) are protected from misattribution.

California has adopted its own protective statute for fine art. Civil Code Section 987(d) provides: “[T]he artist shall retain at all times the right to claim authorship, or, for a just and valid reason, to disclaim authorship of his or her work of fine art.” The California statute authorizes injunctive relief, actual and punitive damages, and attorney’s and expert witness fees. However, these terms also are narrowly defined to exclude a number of major categories of visual art.

Another potential avenue of legal redress is the implied contract. Ideally, before contributing to a creative work, creators enter into written contracts that govern the allocation, scope, and placement of credit. However, artists are often persuaded to work on a handshake. Even in this situation, however, creators can bring claims for breach of an implied or oral contract.

The principle of an implied contract claim is simple—nothing is free. Thus, whenever one party uses another’s intellectual property, that person must compensate the creator on terms that are customary and reasonable. Since credit is valuable, it is a term of the implied contract that constitutes an item of damage in a breach of implied contract case. The theory of “expectancy damages” appears to require this result. Evaluating damages for failure to credit can be difficult because ascribing a precise economic value is far from an accounting exercise. Thus, expert testimony may be attacked as speculative, but despite this possible difficulty, damages for loss of credit have been awarded.

A famous example concerns the Taco Bell chihuahua. The creators of the Taco Bell chihuahua presented their idea to Taco Bell, which proceeded to use it without compensating the creators. On June 4, 2003, a Michigan jury awarded them $30.1 million, based in part on implied contract claims. The court also awarded $11.8 million in interest. Although this case does not involve misattribution, the judgment indicates that damages for breach of an implied contract can be significant.

In most cases, a breach of implied contract claim does not arise until after the damage has been done. In contrast, under the Lanham Act, one remedy was a judgment compelling proper attribution of credit, which is often the goal of creators in the entertainment industry. California Business and Professions Code Section 17200 prohibits “unlawful, unfair, or fraudulent” business practices. Prior to Dastar, misattribution qualified as an unfair business practice and entitled plaintiffs to injunctive relief.

In limited situations, visual artists are protected by the 1990 Visual Artist’s Rights Act (VARA), found in Section 106A of the Copyright Act. VARA protects the moral rights of certain artists. These rights spring from a reasoning that because an artist “injects his spirit” into an artistic work, the artist’s personality and the integrity of the goal of creators in the entertainment industry.

The court relied upon cases that held that Lanham Act claims are “substantially congruent” to state unfair competition claims. However, congruent is not identical, and the language of Section 43a of the Lanham Act is not even remotely similar to that of Section 17200 of the Business and Professions Code. California courts consistently have interpreted Section 17200 broadly “precisely to enable judicial tribunals to deal with the innumerable ‘new schemes which the fertility of man’s invention would contrive.’” Certainly, if one person takes credit for creating intellectual property that was created by another, an unfair business practice has occurred; to the extent that interpretation of the Lanham Act has changed to no longer prohibit a particular unfair business practice, this should indicate only that the two sections are no longer congruent and not that the dismissal of one should compel the dismissal of the other.

Where the false attribution is contained “in commercial advertising or promotion” and misrepresents “the nature, characteristics or qualities” of the work, a claim under Section 43(a)(1)(B) of the Lanham Act is still viable. In one of the leading treatises, McCarthy on Trademarks and Unfair Competition, the authors conclude that the holding in Smith v. Montoro could be justified under the false advertising prong of the Lanham Act. Advertising for a film that misrepresents the performers, for example, would constitute a misrepresentation of the “nature, characteristics or qualities” of a film.

Although the Supreme Court’s recent definition of “origin” was motivated out of a refusal to extend protection to copyrighted works that lapsed into the public domain, the
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In the wake of Dastar, Congress should extend the moral rights of copyright beyond its current limited state to ensure that artists receive credit for their work or, at least, that others do not falsely take credit for the work. Until then, creators can become the victims of case law.

1. The Lanham Act, 15 U.S.C. §§1051-1129. False attribution occurs when one person takes credit for another person’s creation or contribution to a creative work. See, e.g., Lamoth v. Atlantic Recording Corp., 847 F. 2d 1403, 1406 (9th Cir. 1988) (holding that a partially correct credit did not excuse defendants); Smith v. Montoro, 648 F. 2d 602, 607 (9th Cir. 1981).

2. See, e.g., Newton v. Diamond, 349 F. 3d 591 (9th Cir. 2003) (holding that a composer, who typically transfers sound recording copyright to record company, has no claim for infringement of composition copyright in a sample utilized by rap artists).


9. Smith, 648 F. 2d at 607.


11. Lamothe v. Atlantic Recording Corp., 847 F. 2d 1403, 1405-06 (9th Cir. 1988).

12. Id.


14. Lamothe, 847 F. 2d 1403, 1405-06; Smith, 648 F. 2d 602, 603.

15. See Effects Assocs., Inc. v. Cohen, 908 F. 2d 555 (9th Cir. 1990) (granting summary judgment to a copyright infringement claim that resulted from the plaintiff’s grant to the defendants of an implied license to reproduce special effects sequence in a film). See also 17 U.S.C. §102(b).


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Keeping Up-to-Date with Blogs

FOR YEARS, ATTORNEYS HAVE USED clipping and alert services provided by database vendors to keep current on professional issues. Whether an attorney is involved in a class action lawsuit involving thousands of claimants, a divorce case, a business transaction, or a medical malpractice case, access to the most up-to-date information can make the difference between a good outcome and a bad one. For years, attorneys have subscribed to manual and automated clipping and alert services to keep current on professional issues.

Typically, clipping and alert services scoured print publications or proprietary databases and charged per clip or by the month. With the advent of the Internet and its abundant news and information, attorneys found they could no longer rely upon clipping services alone. It became necessary to use the Internet, visiting numerous Web sites and discussion boards to keep current. This is time-consuming, and as the Internet grew so too did the amount of time needed to review sites of interest, locate reputable sources, and download information.

Advances in Internet technology have made it possible, however, to allow an automated system to perform a large part of these tasks. RSS (rich site summary) feeds allow Web content providers to deliver information directly to one’s desktop on a continual basis. Web users do not have to return to sites to view newly posted information. (For this reason, RSS is sometimes said to stand for “really simple syndication.”) Another advance is personal Web logs (or blogs), which are online journals that are easily updated (because they require little or no technical expertise to start or maintain). Blogs have proliferated and matured rapidly, and it is now possible to use them to gather useful information on a given topic. A blog that uses RSS can syndicate updates to subscribers instantly.

Law-related blogs are often referred to as blawgs. Los Angeles lawyers may note that Los Angeles intellectual property and appellate attorney Denise Howell is generally credited with coining the term on her blawg (Bag & Baggage, at http://bgbg.blogspot.com). Blawgs may cover a single legal practice area (such as intellectual property), or they may cover a broader topic such as how to manage your practice. Many respected blawgs are maintained by lawyers who are experts in a particular area of practice and use their blawgs to track pertinent case law and legislative and regulatory developments. Ernest Svenson’s Ernie the Attorney (www.ernieheattorney.net), Tom Mighell’s Inter-Alia (www.inter-alia.net) and Sabrina Pacifici’s beSpacific (www.bespacific.com) are some of the more well-known blawgs. Each of these blawgs also has links to numerous other blawgs that their respective owners find useful. The news, information, and commentary provided by blawgs can provide informational support to attorneys who practice in the same areas of law. To help readers stay current with blog entries, bloggers are increasingly turning to RSS feeds to deliver their content directly to readers.

Attorneys can keep up-to-date, while saving the time that they might have spent waiting for Web pages to download, by monitoring RSS feeds that are closely related to their areas of practice or interest. Additionally, RSS feeds allow users to control the intervals at which they receive updates. As a result of the rising popularity of RSS, established news Web sites are also utilizing RSS feeds to distribute their information to readers almost instantly. RSS feeds allow bloggers and Web content editors to deliver their content directly to Web users, and the users are freed from having to visit the sites from which the content originates. RSS feeds offer readers continual updates without having to worry about missing a post or publication.

To receive and read RSS feeds, users need news aggregator software. Recently, Yahoo added a virtual news aggregator onto its My Yahoo page, which the site’s registered users see when they log on. Clicking on the Choose Content button on the My Yahoo page allows users to enter a URL for a specific RSS feed or to conduct a key word search to retrieve and select up to 50 RSS feeds. After the feeds are selected, they are displayed on the My Yahoo page.

For users who do not want to use My Yahoo, the first step in receiving RSS feeds is to download a news aggregator. Many RSS news aggregators are available for download online; most require a monthly service fee or flat usage fee. Some RSS news aggregators are stand-alone applications with interfaces that resemble those of Web browsers, while others function as an enhancement to a Web browser. One popular aggregator, called Pluck (www.pluck.com) for its ability to pluck pertinent information from the Web, is free. Other news aggregators, including Newzcrawler (www.newzcrawler.com), require a monthly service fee but offer free 30-day trials.

Once a user’s computer has the capability to take advantage of RSS, how does one find appropriate blogs? As with Web pages generally,
the first step in locating blogs on a particular subject is a search engine. When searching with nearly any search engine, one trick for increasing the number of search results that come from blogs is, appropriately enough, to include the word “blog” in the search terms. On Google, for example, a search for “blog intellectual property” (without the quotation marks) returns results that are almost exclusively from blogs that cover intellectual property issues.

In addition to searches, users establishing their particular list of blogs can visit directory sites, which offer categorized lists of links to blawgs. These sites include Blawg Republic (www.blawgerepublic.com) and The Blogs of Law (www.theblogssoftlaw.com). These sites allow users to browse through their collection of links or to search for blawgs on a particular topic. To locate nonlaw-related blogs, users can search Daypop.com, Feedster.com, and BlogStreet.com. Attorneys can also use Daypop.com and Feedster.com to find relevant RSS feeds.

Syndic8.com offers an extensive directory of over 26,000 news feeds, although few are law-related. Click on Categories at the top of the Syndic8 home page to start browsing through the categories. Web sites that offer RSS feeds of their content usually announce this feature by means of a small orange button that reads XML, Atom, or RSS. To add a feed to a news aggregator such as Pluck, users simply click on the orange button that appears on a page to which they want to subscribe and drag it to the news aggregator. Pluck also allows users to decide the rate (daily or weekly, for example) at which they wish to receive updates.

RSS feeds can decrease the amount of time a user needs to spend browsing the Internet for news, but reviewing the news headlines in one’s RSS feeds still takes time. To help users narrow their search for specific, up-to-date information, search engines such as Topix.net and AllHeadlineNews.com allow users the option of receiving updates on specific search terms via an RSS feed. In this way, users can tailor their RSS feeds to a more limited list of articles, blog entries, and the like.

Blogs and RSS feeds can be created easily. As a result, users can access feeds on a variety of topics—from criminal law to sports, travel, and technology. On the other hand, anyone can use a blog and an RSS feed to create what appears to be an authoritative Web presence. In short, it still takes a critical mind to evaluate and investigate the credibility of any information source, whether it is online or in print. With this caveat in mind, the increasing usefulness of blogs and RSS feeds promises to help make it easier for lawyers to stay well informed.
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EXECUTORY CONTRACTS

ON TUESDAY, DECEMBER 7, the Commercial Law Section will present a comprehensive program on executory contracts. Speakers Judge Thomas B. Donovan, Michael Gottfried, and Brian L. Holman will cover such topics as when a contract constitutes an executory contract for purposes of a bankruptcy case; whether a contract may be assumed, assumed and assigned, or rejected by the trustee or debtor in possession; which provisions of a contract are unenforceable in bankruptcy; and the rights and obligations of the debtor, trustee, debtor in possession, and nondebtor parties to an executory contract prior to and after any assumption, assignment, or rejection of the contract.

The speakers will offer tips on drafting contracts to minimize the adverse effects of a party’s or counterparty’s bankruptcy upon a party’s rights and obligations under an executory contract. The program will take place at the LACBA/Lexis Publishing Conference Center, 281 South Figueroa Street, Downtown. On-site registration and the meal/reception will begin at 11:45 A.M., with the program continuing from 12:00 to 1:30 P.M. The registration code number is 008698. CLE+PLUS members may attend for free ($15 meal not included). The prices below include the meal.

$55—Commercial Law Section members
$65—other LACBA members
$80—all others
3.25 CLE hours

Power Points for Litigators

ON THURSDAY, DECEMBER 9, the Los Angeles County Bar Association will present a seminar on how demonstration programs (especially Microsoft’s Power Point) can enhance trial and business presentations. Speaker Russell Jackman will show participants how to create a variety of dynamic, informative, and useful slides for a number of legal scenarios. Participants are encouraged to bring their laptops for a more interactive experience. Registration for this well-attended class will be given on a first-come, first-served basis. Participants will receive Power Point for Litigators with their program registration. The program will take place at the LACBA/Lexis Publishing Conference Center, 281 South Figueroa Street, Downtown. The meal and reception will begin at 5:30 P.M., with the program continuing from 6 to 9:15. The registration code number is 008834.

$150—CLE+PLUS members
$200—Litigation Section members
$300—other LACBA members
$450—all others
3.25 CLE hours

Lawyers: A High Risk Profession

ON WEDNESDAY, DECEMBER 8, the Barristers will present a program on prevention of substance abuse. Speaker Jeanie Griffin will lead a presentation covering such issues as what to do when you or an attorney close to you has a problem with alcohol or drugs or is facing a mental health or stress problem. Learn to recognize the signs and how the Lawyer Assistance Program can help. The program will take place at the LACBA/Lexis Publishing Conference Center, 281 South Figueroa Street, Downtown. On-site registration and the meal will begin at 11:45 A.M., with the program continuing from 12:30 to 1:30 P.M. The registration code number is 008814. CLE+PLUS members may attend for free ($15 meal not included). The prices below include the meal.

$25—Barristers Section members
$30—other LACBA members
$40—all others
1 CLE prevention of substance abuse hour

Environmental Indemnities in Loan Documents

ON WEDNESDAY, DECEMBER 8, the Real Property Section will present a program to review lender liability under environmental laws and relief legislation. Speaker Donald C. Nanney will discuss the practical impact on the structure and content of environmental indemnities in loan documents, whether separate unsecured environmental indemnities are enforceable beyond the scope of the legislation, and revisions that a borrower may expect. The program will take place at the LACBA/Lexis Publishing Conference Center, 281 South Figueroa Street, Downtown. On-site registration will begin at 11:45 A.M. and lunch at noon, with the program continuing from 12:00 to 1:30 P.M. The registration code number is 008721. CLE+PLUS members may attend for free ($15 meal not included). The prices below include the meal.

$45—Real Property Section members
$55—other LACBA members
$65—all others
1 CLE hour
Accountability and Fraud in Arbitration Proceedings

THE CHECKS AND BALANCES of our judicial system are the reason for its success for more than 225 years. Unfortunately, the voluntary, widespread use of arbitration to resolve disputes—a process without sufficient and proper safeguards—threatens the foundation of this time-honored system.

Arbitration administrators now dictate how disputes are decided. These lucrative businesses have been empowered to bypass the rules of law followed by courts for more than two centuries.

The most disturbing result of this “anything goes” system is that arbitration decisions face practically no scrutiny. There is very little accountability regarding the appropriateness of an arbitrator’s award. In fact, arbitrators have more power than judges. Judges’ decisions can be appealed, improper behavior can be subject to judicial review, and judges can be voted out of office. With arbitrators, if there is any review of their conduct, it is only on extremely limited and narrow grounds. Decisions are binding regardless of whether arbitrators misapply or fail to follow the law or make procedural rulings that defy logic. In addition, disputants are required to pay the arbitration administrator and the arbitrator even if a party is successful in overturning an arbitration award due to an arbitrator’s misconduct or fraud.

How, then, can parties in a dispute feel confident that a truly neutral third party will hear their case and render a fair decision? One way is for the parties to review the arbitrator’s background for possible conflicts and eliminate arbitrators who do not meet specific criteria for impartiality. Still, even with this potential safeguard, arbitrators and their administrators have found loopholes to avoid accountability. More often than not, they decide what background information should be disclosed. Although Code of Civil Procedure Section 1281.9 sets forth disclosure requirements, it allows arbitrators to pick and choose what information they find necessary to disclose.

All of us in the legal profession know that, historically, trial courts provide a rubber stamp for arbitrators’ awards. Unfortunately, parties often learn about facts that would have influenced their selection of an arbitrator during or even after the arbitration. The losing party must then go through the arduous task of attempting to vacate the arbitration award. In rare cases, such as Azteca Construction, Inc. v. ADR Consulting, Inc., arbitration awards are overturned due to arbitrator misconduct.1

In Azteca, the appellate court acknowledged the importance of establishing the neutrality of an arbitrator: “Finally, the neutrality of the arbitrator is of such crucial importance that the legislature cannot have intended that its regulation be delegable to the unfettered discretion of a private business.” The court stated that arbitrators failing to disclose information that could have an impact on their selection constitutes fraud. But instead of sanctioning the arbitration administrator or the arbitrator for fraud, the court’s only remedy for the losing party was to force the winning party back to the arbitration table. Neither party caused the arbitration decision to be vacated, yet the parties must arbitrate the case again at their own cost. Amazingly, the arbitrator and arbitration administrators were allowed to keep their fees.

In O’Flaherty v. Belgum,2 an American Arbitration Association arbitrator in a law partnership dispute felt it unnecessary to reveal that he had previously sued his former partners after being let go, asserting the same partnership breaches that were alleged by a terminated partner in the O’Flaherty arbitration. Not surprisingly, the arbitrator ruled in favor of the terminated partner. News of the arbitrator’s previous law firm experiences surfaced after the arbitration decision was made. Eventually, the California Court of Appeal overturned a $7 million judgment confirming the arbitration award. The court vacated the award because of other arbitrator misconduct. The decision not to disclose prejudicial information prior to the arbitration is the subject of a current lawsuit against the arbitrator and the AAA. Meanwhile, the original partnership dispute must be reheard before another arbitrator—all at the parties’ expense.

Why are the courts not holding arbitrators and arbitration administrators accountable for their actions? Why must the parties to an arbitration bear the financial burden to fix the arbitrator’s wrong? Shouldn’t there be some liability for an arbitrator’s breach of contract?

The overburdened court system is relying too heavily on arbitration to lighten its caseload. Courts must realize that, with regard to prearbitration background reviews, an arbitrator is like any other contract worker. Before arbitrators are hired, they are, for all intents and purposes, soliciting business. Thus, they should be required to comply with state arbitration rules and disclose everything that might affect the hiring decision. This is the least that arbitrators should do in order for disputing parties to have a fair chance for an impartial arbitration. Anything less is fraud and should not be protected by our court system.

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Michael R. Brown is a trial attorney and partner with Los Angeles-based Kabateck Brown Kellner LLP. He argued on behalf of the successful appellant in O’Flaherty v. Belgum.
A Major Gift was received from David Beitchman and Sara Polinsky, both of the Whittier Law School class of 1998, in memory of their classmate and friend, Harry S. Zekian, for the establishment of the Harry S. Zekian Memorial Scholar.

Harry Zekian graduated from Whittier Law School in 1998, at the top of his class. He was a member of the Whittier Law Review and was the recipient of several American Jurisprudence awards for scholastic excellence. Mr. Zekian was a founding principal in the law firm of Beitchman & Zekian, where he focused his practice on business transactions and commercial litigation. He was a role model and inspiration to his friends, colleagues and family. Mr. Zekian died an untimely death on July 6, 2003.

David Beitchman co-founded the law firm of Beitchman & Zekian, and practices in the areas of intellectual property, commercial transactions/litigation, and entertainment law. He has successfully litigated against inequitable restrictive intellectual property provisions that permeate most personal service entertainment contracts. Mr. Beitchman is dedicated to the continued growth and development of Mr. Zekian’s vision on which the firm was established. Sara Polinsky is a sole practitioner, concentrating on estate planning, elder law, and family law. She conducts seminars and workshops, and volunteers at numerous senior centers in Los Angeles County, providing free legal advice to senior citizens and their families.

Professor Gail Frommer (formerly Gail Brod) became the first Harry S. Zekian Memorial Scholar on October 1, 2004. Professor Frommer earned her B.S. from Cornell University and her J.D. from the University of California, Los Angeles, where she was a member of the Order of the Coif and the Order of the Barrister. She has been a Whittier Law School faculty member since 1977, and currently teaches Community Property; Employment Law; Labor Law; and Wills and Trusts. Professor Frommer directed the first Whittier Law School Summer Abroad Program at Sun Yat-sen University in Zhuhai, China during June 2004.

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