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California Code of Civil Procedure Section 998 and Rule 68 of the Federal Rules of Civil Procedure are well-intentioned statutes. Offers to compromise under Section 998 and offers of judgment under Rule 68 were enacted to promote settlements. Unfortunately, neither Section 998 nor Rule 68 has satisfied its objective.

In this month's issue, Judith Ilene Bloom examines many of the pitfalls that face practitioners when serving Section 998 offers. As Bloom explains, the consequences of a procedurally defective Section 998 offer may be severe and, as a result, many lawyers do not believe that the risk is worth the potential advantages of a Section 998 offer. The conclusions reached by Bloom apply to Rule 68 offers as well (although Rule 68 is limited to offers by defendants).

Section 998 and Rule 68 also do not achieve the goal of promoting settlements because the disincentives for rejecting an offer under Section 998 or Rule 68 and then receiving a less favorable result during trial are insufficient—and they frequently are not imposed by courts. Lawyers and litigants simply do not perceive that potential cost shifting is a sufficient motivator to encourage statutory offers in most cases.

Usually, the most expensive aspect of civil litigation is attorney's fees. It is difficult to imagine litigating a moderately complex case through trial for less than $200,000 in attorney's fees; indeed, most cases with any degree of complexity are significantly more expensive. If Congress and the California legislature want to ensure that the statutes they enacted promoting the settlement of litigation will actually achieve their goal, the statutes should be amended. Section 998 and Rule 68 should include a penalty that will enable parties to shift their attorney's fees. (Rule 68 also should be expanded to include offers by plaintiffs.) In addition to the existing disincentives for rejecting an offer that was more favorable than the trial result, a party would be obligated to pay the offeree's reasonable attorney's fees accruing from the date the offer was made.

This modification to the statutes would turn the American Rule—each party bears its own attorney's fees—on its head. In some circumstances, however, the shifting of attorney's fees already applies to offers under Section 998 and Rule 68, such as when attorney's fees are deemed an item of costs. But in most cases attorney's fees fall outside the scope of the cost-shifting provisions contained in Section 998 and Rule 68.

The inclusion of a provision for shifting attorney's fees in Section 998 and Rule 68 offers would raise the stakes for rejecting those offers. It would also increase the number of offers made and should increase their reasonableness, because an offer that is in the range of the value of the case would result in significant benefits.

Amending Section 998 and Rule 68 to include a penalty that shifts attorney's fees is not without its drawbacks. Most notably, in cases involving contracts in which there is no provision for attorney's fees, an amendment would, in essence, supersede the intent of the parties. In addition, in cases in which one party has limited assets, the attorney's fees penalty effectively would be one-sided (which often is a reason for excluding attorney's fees provisions from contracts).

The attractiveness of shifting attorney's fees is that the penalty genuinely rewards the party that reasonably evaluated its case and offered to compromise on terms that were consistent with the value of the case. It also helps neutralize the power that one party with superior financial resources may have to flood the other party with a sea of paper, since the fees incurred in response could be recovered.

The real question for legislators and everyone in the legal profession is: How badly do we want to promote settlements?

Gary S. Raskin is a principal of Garfield Topper & 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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Compelling Arbitrations and Confirming an Arbitration Award

**MOST COMMERCIAL CONTRACTS** executed today contain an arbitration clause. Parties typically opt to include an arbitration clause to avoid the expense of litigation. Arbitration is the less expensive, speedier route for parties to resolve their disputes. Ironically, however, keeping a dispute “out” of a courtroom often involves going to court to compel and manage the arbitration and confirm the arbitration award. A brief step-by-step guide can help new practitioners learn to utilize a court solely to effectuate an arbitration rather than defeat its purpose.

Code of Civil Procedure Sections 1280 et seq. set forth the statutory framework for the enforcement of arbitration clauses. If the parties agree to arbitrate, there is no need for the involvement of any court, because the parties are, in effect, performing duties that are pursuant to a contract. Despite a proper arbitration clause in a valid contract, however, a party may attempt to avoid its obligation to arbitrate. This party may either ignore an arbitration demand or file a lawsuit.

If a party ignores its opposing party’s arbitration demand, the aggrieved party may file a petition requesting that the court order the parties to arbitrate any dispute that is covered by the contract. The petition is, in essence, a suit in equity to compel the specific performance of a contractual provision. Once a party has refused to arbitrate a dispute that is covered by the contract, the party seeking to compel arbitration faces the four-year contract statute of limitations.1

**Contents of the Petition**

The petition sets forth specific allegations (including the existence of the arbitration clause and contract) and includes a prayer for judgment requesting an order requiring that, pursuant to the contract, the parties submit any claims or disputes to arbitration. If the contract provides for the manner of service of the petition, the petition should comply with the contract. Otherwise, the petition must be served in the same manner as a complaint. In order to ensure a party’s compliance with arbitration, the petitioner should request that the court retain jurisdiction over the matter until the court confirms the final award. This request, if granted, will enable the petitioner to file a motion to confirm the arbitration award with the same court, should the petitioner prevail at arbitration.

Once the petition is filed with the court and served on the parties, the opposing party has 10 days to oppose the petition (30 days if the party is outside California). By statute, the hearing must be set at least 10 days from the date of service of the petition. The petitioner must also file a motion to compel arbitration, including a memorandum of points and authorities and supporting declarations. This motion, in essence, reiterates the petition.

If, instead of ignoring a demand for arbitration, one party files suit, the opposing party may file the motion to compel arbitration and a motion to stay the pending action, and need not file the petition.

**Back to Arbitration**

Once the parties are on the track to arbitration, they must choose an arbitrator. Despite the vast number of competent arbitrators that are available, at times parties cannot even agree upon an arbitrator. If the parties are unable to agree, a party should file a motion with the court for an order appointing a neutral arbitrator. If the contract provides for a specific method of appointing an arbitrator, this must be included in the motion. If the contract does not describe a method, the parties must provide the court with a list, made jointly, of five potential arbitrators.

Once the dispute has been arbitrated and the arbitrator has rendered an award, any party may petition the court to confirm, correct, or vacate the award. Specifically, the prevailing party should petition the court to confirm the arbitration award and enter a judgment. However, the petitioner must wait 10 days after the date the final award is served on the parties before filing the petition. The petitioner has up to four years from the date of service of the final award to file a petition. If the petitioner had previously petitioned the court to compel arbitration, the petition to confirm the arbitration award must be filed in the same court. Otherwise, the petition will be filed as a new matter and will be assigned to a courtroom.

If the award is confirmed by the court, the prevailing party obtains the same rights of enforcement as it would under any civil judgment, including the right to attach property and enforce liens. Otherwise, the arbitration award has the same force and effect as the contract between the parties.

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The Use of Private Annuities in Estate and Tax Planning

THE PRIVATE ANNUITY HAS SURFACED PERIODICALLY over the past 75 years as a financial planning tool. Its usefulness fluctuates in concert with income tax and interest rates. Congress imposes the former on the payor, and the Internal Revenue Code of 1986 is used to calculate the annuity benefit set by the latter. Presently, tax and interest rates are relatively low, leading to a healthy reconsideration of this well-established tax and estate planning tool. The principal benefits of a private annuity include:

1) Removing assets from the annuitant’s gross estate for federal estate tax purposes without the payment of a gift tax while at the same time retaining a steady stream of income.

2) Spreading the taxation of capital gains over the life expectancy of the annuitant when exchanging appreciated property for the annuity.

3) Delivering the appreciated property to the payor with a new basis (its value on the date of the exchange) that permits its immediate sale without the payor incurring capital gain taxes.

If used artfully, private annuities may thus be the most powerful weapon available today for postponing income taxes, avoiding wealth management and investment worries, and preserving a source of income.

A private annuity is an agreement between two parties, neither of whom (or which) is in the business of issuing annuities. Under the agreement, one party (the annuitant) transfers property to the other (the payor) in exchange for the payor’s promise (usually unsecured) to make periodic payments in specific amounts to the annuitant, typically for the annuitant’s lifetime. For example, a father gives his son the family farm in exchange for the son’s promise to pay the father $1,000 per month for life. The private annuity differs from grantor-retained interest trusts of one stripe or another in at least one respect: The tax objectives are substantially satisfied whether or not the annuitant lives out his or her life expectancy.

The defining characteristics of the private annuity include an agreement that establishes the annuitant as a general creditor of the payor. The parties are usually individuals who are related to each other, although other entities are permitted. Private annuities can be arranged between a corporation and an individual, a trust and an individual, or between an estate and a corporation (with the estate exchanging property or stock for payments by the corporation measured by the life of an estate beneficiary). Annuities are also used between a corporation and a retiring shareholder under a stock redemption arrangement, with annuity installments serving in lieu of the more usual lump-sum payment.

The payor must not be a person who is engaged in the business of issuing annuity contracts, even occasionally. If this condition is not met, the difference between the present value of the annuity on the date of exchange (set by treasury regulations) and the annuitant’s basis in the property is immediately recognized as a capital gain.

As soon as the private annuity agreement is executed, the payor acquires legal title to the transferred property and may sell or otherwise dispose of it as desired. The annuitant could retain a security interest in the transferred property, but doing so leads to recognition of capital gain on the exchange. This is not an issue, of course, when the exchange property is cash or a high-basis capital asset.

The periodic installments must be in the nature of an annuity—the systematic liquidation of principal and interest over a specified period of time. For the desired estate tax results, the annuity should continue for the annuitant’s lifetime, no matter how long, but not one day more. This, of course, has an economic impact on the annuitant and payor quite apart from tax considerations. The annuity installments are ordinarily level for life, but may be inflation-adjusted so long as the present value at the date of exchange is the same.

A private annuity should not be confused with a life estate. The former provides a predetermined income lasting for the lifetime of the annuitant, whereas a life estate does not guarantee income and pays only as much income as the supporting principal earns. With a life estate, the transferor transfers the property but retains an interest in it. This is not the case with a properly arranged private annuity. The Internal Revenue Service has argued that the purchase of a private annuity constitutes a transfer with a retained interest that causes the property to be brought back into the gross estate of the annuitant under IRC Section 2036(a), as if it were a life estate. The courts, however, have firmly rejected that contention, based on the character of the private annuity transaction as a purchase and sale at fair market value.

However, this characterization is not automatic. Whether the annuitant is treated as having retained an interest in the property exchanged for the annuity is based on the substance and effect of the transaction, not on the subtleties of draftsmanship. Several factors are to be taken into account, no one of which controls the result. The payor must be personally liable for the annuity payments, the annuity payments should not be an encumbrance on the property exchanged, and the amount of the annuity installments should have no relationship to the income from the property exchanged. Other factors considered include:

- The transaction must transfer all dominion and control over the property from the annuitant to the payor and may not include any
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- The payor must be free and able to sell, assign, transfer, and convey the property exchanged for the promised payments.
- The payments must be based on the Treasury Regulations under IRC Section 7520.
- The annuitant should not retain control over the property, its investment, or the investment of its sale proceeds.

**Benefits of Private Annuities**

The private annuity may be used as a “last chance retirement fund.” For the annuitant who never prepared for retirement, a private annuity may provide economic security in a variety of ways. The annuity may be used to create a market for an otherwise unmarketable business or assist in the sale of undeveloped land owned by the annuitant.

Avoiding gift and estate taxes is a popular use for a private annuity. Taxable gifts will use up part of the donor’s lifetime (unified) applicable exclusion amount and increase the tax payable on death if the date-of-death value of the estate exceeds the remaining exclusion. Because a private annuity involves a bona fide purchase, it reduces the annuitant’s estate without characterizing the transaction as a gift and, thus, without using any of the annuitant’s lifetime exclusion. Therefore, the annuitant may remove unlimited amounts from the estate without gift tax.

Shifting appreciation to the next generation is another attraction. When a valuable business shows promise of continued growth, the owner approaching retirement may wish to exchange it with his or her children for a life annuity. This removes it from the annuitant’s gross estate and replaces it with an annuity income of equal value. It simultaneously adjusts the business’s basis to what amounts to fair market value in the hands of the children as payors. This, in turn, shifts any future appreciation in the business to the next generation. Congress attempted in 1990 to eliminate this type of appreciation-shifting technique by enacting IRC Chapter 14 and repealing IRC Section 2036(c). The techniques addressed by the new Chapter 14, however, are gift arrangements requiring retention of an interest in the gift property. The private annuity is a purchase. So, if made at fair market value, the undesirable effects of Chapter 14 are avoided.

Trading capital for income offers another use for private annuities. The prospective annuitant may own property producing little or no income (such as unimproved real property), which as often as not has appreciated substantially. Rather than retain the property and deliver it to the children at the stepped-up basis acquired at death, the annuitant may exchange it for a private annuity from the children. The children take ownership with the current fair market value as its basis (so they can sell it without capital gains taxes and redeploy the proceeds into income-producing investments). The annuitant thereby converts the potential estate tax burden to a life income.

Because of a private annuity’s dramatic effect in eliminating gift and estate taxes on property exchanged for the annuity, the IRS is clearly on the lookout for “deathbed” arrangements. Revenue Ruling 80-8014 established that the mortality tables are to be disregarded if death is imminent, thereby depriving the annuitant of the tax benefits of an annuity conforming to all legal requirements. In challenging transactions involving seriously ill annuitants, the IRS contended in one case that the annuity payments were never intended. The U.S. Tax Court, however, was more generous. In *Estate of Fabric*, the annuitant was scheduled for open heart surgery at the time the annuity was established. She survived the surgery by 17 months. In affirming the legitimacy of the transaction, the court stated:

At the time of decedent’s execution of the annuity agreement, it was not established that her maximum life expectancy was one year or less. In addition, while the decedent underwent open heart surgery five days later, she survived the operation by one year and five months. Furthermore, the uncontested testimony of decedent’s physician was that as of late 1975, decedent should live several more years, possibly even five more years....

The evidence demonstrates that the decedent’s death was not clearly imminent or predictable at the time she entered into the annuity agreement. Only where death is imminent or predictable will departure from the tables be justified. Similarly, in the *Estate of McDowell*, the transaction was respected because, although the annuitant’s death was imminent, his life could be prolonged by treatment.

The regulations now provide more of a bright-line test: If the probability of death within a year is at least 50 percent, the annuitant is considered terminally ill for these purposes. However, if the annuitant survives for 18 months after purchasing the annuity, he or she is rebuttably presumed not to be terminally ill.

**Tax Consequences**

The income tax treatment to the annuitant under a private annuity transaction varies, depending on the facts and circumstances. The annuitant’s investment in the annuity for purposes of computing the income tax exclusion ratio is the annuitant’s basis in the exchange property. If the exchange property is classified for income tax purposes as a capital asset (e.g., a commercial building), the annuitant realizes a capital gain on the exchange in an amount equal to the difference between its basis and the present value of the annuity received in exchange. But, if the promise to pay is unsecured, the exchange is classified as an open transaction, with capital gain recognized ratably over the life expectancy of the annuitant. Therefore, each annuity installment is allocated partly to basis (recovered tax free), capital gain (taxed at the preferred rate if long term) and ordinary income (taxed at ordinary income tax rates). If the annuity is a life annuity and the annuitant survives beyond life expectancy, the capital gain portion of the annuity becomes taxable as ordinary income. The portfolio allocated to recovery of basis, however, continues tax free for life.

If the promise to pay the annuity installments is secured (as with a deed of trust), the result is different: Any capital gain must be fully recognized in the year of the exchange. As noted earlier, this is not an issue when the exchange property is cash or a high-basis capital asset.

If the annuity becomes worthless (e.g., the payor becomes insolvent), the remaining value (price paid less the value of annuity installments received) may be deducted by the annuitant as a capital loss.

Basis is affected by the existence of a gift interest in a private annuity. Specifically, a tax may be incurred if the fair market value of the property exchanged exceeds the present value of the annuity or if it exceeds the amount the annuitant would have paid an insurance company for the same benefit. The excess is the amount treated as a gift. If this happens, the payor assumes the annuitant’s basis in that part of the property. This affects both depreciation/amortization deductions available to the payor and capital gain on a later sale.

If the primary purpose of private annuities is to remove the asset from the annuitant’s gross estate for estate tax purposes, the payments stop at the death of the annuitant, leaving no remaining value to tax. If at death there is a surviving spouse and the annuity is structured to continue for the lifetime of the survivor (joint and survivor annuity), the marital deduction permits deferral of any estate tax on the value of the annuity payments remaining unpaid at the first death. On the death of the survivor, the annuity term expires, leaving no remaining value to tax.

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annuity payments for the life of the annuitant, for a specific period of time, for the joint lives of joint annuitants and that of the survivor, and for life of the annuitant with the refund of any principal remaining upon premature death paid to a named beneficiary. As noted above, the annuity installments may also be level or inflation-adjusted. To the extent a benefit is payable on the death of the annuitant, that benefit constitutes an asset included in the gross estate of the deceased.24

There are income tax consequences for the payor as well. First, there is no deduction for payments made to the annuitant25 since they are deemed payments on the purchase price of the property. Also, if the property exchanged for the annuity is a wasting asset, the depreciation/amortization deductions are adjusted in accordance with the basis adjustment in the hands of the payor.26 This is particularly important if the property was fully depreciated/amortized by the annuitant prior to the exchange.

There may also be gift tax consequences to the payor. Gift tax may be imposed on the private annuity transaction if the value of the annuity exceeds the fair market value of the property exchanged, because the payor is deemed to make a gift to the annuitant with every annuity payment. These sometimes unexpected—and often unfavorable—consequences should be avoided unless part of a larger plan.

There may also be consequences for the payor’s estate tax if the payor dies before the annuity obligations have ended. Remember that the obligation to make annuity payments does not attach to the property exchanged; it is personal to the payor. Thus, even if the property is sold after the exchange, the obligation to pay the annuity payments continues as a claim against the payor’s estate, and the estate receives an estate tax deduction in a like amount. The then-present value of the remaining annuity payments sets the amount of the estate tax deduction for that claim.27 Of course, if the payor dies after the exchange, the payor’s obligation remains. If the payor dies before the annuitant, the annuity obligation continues as a claim against the payor’s estate, and the estate receives an estate tax deduction in a like amount. The then-present value of the remaining annuity payments sets the amount of the estate tax deduction for that claim.27 Of course, if the payor dies still owning the exchange property—no matter the exchange property—no matter the extent a benefit is payable on the death of the annu-
or part of an important advantage of the private annuity, effectively converting the transaction into an installment sale.

The most effective way to eliminate these core risks is to combine a private annuity with a foreign, nongrantor trust. This avoids the risk that creditors of the annuitant will take the annuity income or that creditors of the payor will take the exchange property or its proceeds. It eliminates—or substantially eliminates—income taxes of the payor (by selecting a no-tax jurisdiction), thereby reducing any pressure to take unwarranted investment risks in satisfying the annuity obligation. It also avoids the problems that can arise if the payor dies before the annuitant by reducing basis in the hands of the payor. The absence of a gift or estate tax eliminates the generation-skipping transfer tax. By selecting a jurisdiction that has repealed or lengthened the perpetuities period, an enormous multigenerational family capital resource becomes possible for even modest estates.

1 In 1991, the rate was 11%. In September 2004, it was 4.6%.
2 In Re Baker’s Estate, 345 Pa 308, 26 A. 2d 202 (1942) (private annuity agreement held enforceable even though the transferor-annuitant died prematurely).
5 Estate of Bell, 60 T.C. 469 (1973).
7 All references to the Internal Revenue Code (I.R.C.) are to the Internal Revenue Code of 1986, as amended.
9 Lazarus v. Commissioner, 38 TC 854 (1972), aff’d, 513 F. 2d 824, 829 (9th Cir 1975).
10 I.R.C. §2505(a).
11 I.R.C. §§2701 and 2702 are predicated on a gift with a retained interest by the donor.
12 I.R.C. §1014.
13 Basis in the hands of the children (as payor) is the total payments paid to the parent (the annuitant) to the date of sale, plus the then-present value of the remaining payments. Thus, if 1) the annuitant’s life expectancy on the date of exchange is 12.5 years (a father’s life expectancy at age 75 under Treas. Reg. §1.72-9, Table V), 2) the annual installments are set at $14,042, and 3) the children immediately sell the property, the basis for computing gain is $175,525.

To further illustrate this example, if the property is depreciable, such as an apartment building, and if payments were made to the annuitant for 10 years before the the children sell the property, the calculation of the children’s new basis would be:

1) Payments made to date of sale ($14,042 x 10): $140,420
2) Present value of remaining payments (12.5 x $14,042): $175,525
3) Total (1+2): $315,945
4) Less depreciation: ($40,000)
5) Children’s basis for computing gain on sale: $275,945

Proving Willfulness in Copyright Infringement Actions

WHEN A COPYRIGHT HOLDER IS ABLE TO PROVE that a properly registered work has been infringed, the Copyright Act provides for the recovery of either statutory damages or actual damages, which are frequently minimal, hard to prove, or both. The Copyright Act also gives the court discretion to award attorney’s fees to the prevailing party in an action based on copyright infringement. This combination of statutory damages and the potential for recovery of attorney’s fees provides a potent weapon for plaintiffs in copyright actions.

Indeed, copyright holders need not suffer any actual damages nor prove that the infringer made any money from the infringement to be entitled to a statutory recovery. If the copyrighted work is published, all that copyright holders need show is that they registered their works with the U.S. Copyright Office either before the infringement or within three months of first publication. An eligible copyright holder can elect between statutory and actual damages at any time before final judgment is rendered.

Pursuant to amendments adopted in 1999 for actions filed on or after December 9, 1999, the recovery for statutory damages ranges from $750 to $30,000. However, if the plaintiff can prove that the infringement was willful, the upper limit rises to $150,000 per infringement. The plaintiff in a copyright infringement action, therefore, can gain a tremendous amount of leverage if it can credibly argue that an infringement was willful.

The statute itself does not define “willfulness.” The Ninth Circuit has explained that to prove willfulness a plaintiff must demonstrate that the defendant knew that its conduct infringed the plaintiff’s copyright. Thus the plaintiff must be able to prove that the defendant knew two things: 1) that the work was copyrighted, and 2) that the defendant’s activities constituted infringement.

These elements are most easily satisfied when the infringer continues to infringe after receiving written notice (such as a cease and desist letter) from the copyright owner. However, such written notice is not necessary. Lacking evidence of actual notice, the courts can look to a variety of factors to help determine whether the two elements of the test have been met.

One frequently invoked factor is the extent of a defendant’s familiarity with the copyright laws. There are numerous cases holding that the fact that the defendant has been sued in the past for copyright infringement suggests that the defendant should have known better this time around. For example, in Hideout Records and Distributors v. El Jay Dee, Inc., the defendant nightclub performed music without a license from ASCAP. Previously, ASCAP had successfully sued the nightclub and its owners on a similar claim. In this case, the nightclub and its owners contended that they refused to enter into a license agreement with ASCAP based on the advice of their counsel, who maintained that the ASCAP license violated antitrust laws. The defendants argued that their reliance on counsel was reasonable and that they acted in good faith.

Moreover, the fact that the defendants previously had been sued by ASCAP demonstrated to the court that the defendants had “deliberately violated the copyright laws.”

The holding that prior copyright lawsuits against the defendant support a finding of willfulness occurs time and again. In Flyte Tyme Tunes v. Miszkiewicz, the plaintiffs’ musical compositions were publicly performed in the defendants’ establishment, the Bamboo Room. The defendants had refused to enter into a license agreement with ASCAP, despite previous suits brought against them by ASCAP. Noting that the defendants’ actions constituted “sneer[ing] in the face of copyright owners and laws,” the court found that the previous lawsuit and warnings by ASCAP were sufficient to establish that the infringements were willful.

The foregoing cases underscore another, equally important point: Evidence of the defendant’s prior copyright violations may be admissible. A plaintiff should argue that this evidence is relevant to show that the defendant was aware of the copyright laws at the time of the alleged infringement. The admissibility of prior infringement actions is not guaranteed, however. The defendant will maintain that the evidence is unduly prejudicial and should be excluded—and the evidence presumably would be excluded unless the defendant argued that it lacked familiarity with the copyright laws. The plaintiff’s counsel, therefore, would be well advised to file a motion in limine prior to trial. An advance ruling will avoid the possible disruption to the flow of the plaintiff’s case that might result from a fight over admissibility in the middle of the trial.

A variation on the argument that the defendant has been previously sued appeared in A & M Records, Inc. v. Abdallah. In that case the defendant provided blank cassettes to counterfeiters that had been “timed” to the length of a target recording. Under the arrangement, the counterfeiter would submit a legitimate cassette of the recording to the defendant, who would time the cassette, create blank cassettes of the appropriate length, and ship the legitimate cassette along with the requested number—typically thousands—of timed, blank cassettes back to the counterfeiter. The counterfeiter would then complete the process by making illegal copies of the original cassette on the timed cassettes.

The evidence established that the defendant was aware that his largest customer had been raided by the police for counterfeiting activities. Moreover the defendant’s business was raided on at least three occasions by police. Nonetheless, the defendant continued to make and sell timed cassettes. The court found that the defendant was liable for contributory infringement and that the infringement was willful.

The police raids played a role analogous to prior copyright litigation in providing evidence that the defendant knew that its activities violated the copyright laws.

Clearly, submitting evidence of police raids on the defendant’s busi...
ness can be an extremely effective method of convincing the jury that the infringement was willful. Opinions such as those in Hideout Records, Flyte Tyyme Tunes, and A & M Records can be used to support the admissibility of such evidence in an appropriate case.

Sometimes the nature of the defendant’s business itself supports an inference that it is aware that its actions constitute copyright infringement. In Fallaci v. New Gazette Literary Corporation, for instance, the defendant newspaper published a Russian language translation of an article appearing in the Washington Post. The court held that “as a publisher of a copyrighted newspaper, the defendant was or should have been aware that its unauthorized republication of a Washington Post article constituted copyright infringement.” 22 Partly on this basis, the court found the infringement to be willful for purposes of enhanced statutory damages.

The court used similar reasoning in Fitzgerald Publishing Company, Inc. v. Baylor Publishing Company, Inc. 24 Fitzgerald owned the copyright to a 16-volume series titled Golden Legacy and entered into a written agreement with Baylor authorizing it to reprint the series. The contract did not give Baylor a right to change the copyright notice, which named Fitzgerald as the owner. After Fitzgerald terminated the agreement when Baylor failed to make certain required payments, Baylor presented the written agreement to arrange for a printer, which became a codefendant in the suit, to reprint the series. Baylor also instructed the printer to delete Fitzgerald from the copyright notice and insert Baylor in the notice as the owner of the copyright.

The court rejected the printer’s defense that it innocently relied on the written contract between Fitzgerald and Baylor, noting that the contract was silent as to changing the copyright notice. In finding the printer liable for willful infringement, the court stated: “[T]he printer] had a copy of the Baylor-Fitzgerald contract on March 22, which we may assume it read, and—as an experienced publisher must have realized—that it contained no authorization to change the copyright notice.” 23

A plaintiff in a copyright action should consider carefully the defendant’s involvement with copyrighted works as part of its normal business activities. As the foregoing cases suggest, a finding of willfulness may be obtained as a result of the nature of the defendant’s business.

Piracy Cases

Not unexpectedly, piracy cases frequently result in findings of willful infringement. These cases often include evidence of prior involvement in copyright litigation and/or express notice of infringement. In N.A.S. Import Corporation v. Chenson Enterprises, Inc., 26 for example, the defendant infringed a handbag buckle design. The court concluded that the striking similarity of the plaintiff’s and the defendant’s design, along with the defendant’s access to the plaintiff’s design, provided strong evidence of willfulness. The deciding factor, however, was that the defendant continued to sell handbags incorporating the buckle after receiving notice of infringement and even after the defendant hired an attorney who advised the plaintiff that the defendant would stop selling the infringing handbags. Under these circumstances, the Second Circuit took the unusual step of reversing a finding that the infringement was not willful.

In Sega Enterprises v. MAPHIA, 27 the court found willful contributory copyright

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The Peer-to-Peer Conundrum

Recently, the Recording Industry Association of America (RIAA) initiated lawsuits against individuals who have downloaded copyrighted musical works through peer-to-peer services such as Morpheus, E-Donkey, Grokster, Kazaa, and Imesh. The media have reported that the number of individuals sued by the RIAA for copyright infringement is now approaching 5,000. 1 None of these cases has resulted in a published decision indicating whether these defendants will be held liable for willful infringement. Nonetheless, a consideration of the factors invoked in more traditional willful infringement analysis—along with a review of the decision in UMG Recordings, Inc. v. MP3.Com, Inc., 2, an early action by several recording companies against a peer-to-peer service—may provide a clue as to how the courts will treat the RIAA claims.

MP3.Com created a service that ostensibly allowed individuals who had purchased CDs to store, listen, and customize the recordings contained on their CDs via any Internet connection. 3 MP3.com provided this service by purchasing tens of thousands of CDs, converting the CDs into MP3 format, and storing the MP3-formatted recordings on its computer servers. A subscriber, before being allowed access to the service, had to prove that he or she had actually purchased a copy of the CD. This could be accomplished by inserting a copy of the purchased CD into a computer drive for a few seconds (“Beam it Service”) or by purchasing a copy of the CD from a cooperating online retailer (“Instant Listening Service”). Once having demonstrated ownership of the CD, the subscriber could then listen to the recording via MP3.com from anywhere in the world.

A number of recording companies sued for copyright infringement. MP3.com contended that its service was a fair use in that its service merely provided subscribers with the ability to effectively store and “space-shift” their recordings without carrying around the physical discs they had purchased. The court rejected the fair use defense and granted the plaintiffs’ summary judgment motion on liability. 4

After a bench trial, the court issued findings on whether the infringement had been willful. 5 The court found that defendant was aware of the copyright laws, referring to a book put out by the defendant that warned MP3 users not to post copyrighted songs on the Internet. The court also noted concerns raised by some of defendant’s engineers over potential liability for copyright infringement for the unauthorized copying for commercial purposes of hundreds of thousands of songs. Finally, the court found the fair use justification to be little more than a sham: “Under either the ‘Beam It’ service or the ‘Instant Listening’ service users of My.MP3.Com did not, in fact, store their own CDs or the sounds transmitted from their own CDs with My.MP3.Com.” 6 Based on those findings, the court concluded that the defendant had actually knowledge that it was infringing the plaintiff’s copyright. Despite the finding of willfulness, the court awarded statutory damages of only $25,000 per CD. 7

The plaintiff always has the burden of proving willfulness. Thus, in the RIAA actions the question of willfulness will have to be determined case by case and will depend on the knowledge of the individual defendant. Presumably, individuals sued by the RIAA will not previously have been subjected to an action for copyright infringement. Similarly, in most cases, one would not expect these individuals to be involved in a business whose nature would support an inference that they were aware of their infringement. Nonetheless, the publicity given to the issue in general and the RIAA lawsuits in particular makes it fairly likely that most individuals are aware that the unauthorized downloading of copyrighted songs constitutes copyright infringement.

In MP3.com, evidence that company engineers had expressed concern about infringement supported a finding of willfulness. Similarly, in the RIAA cases evidence that individual defendants had discussed the issue with friends or associates could be decisive. Individuals who download copyrighted works through the peer-to-peer services, therefore, face a fairly substantial risk of liability for willful infringement.—F.F.M.

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4 The court found that none of the fair use factors favored a finding of fair use. UMG Recordings, Inc., 92 F. Supp. 2d at 351-52 (“In sum, on any view, defendant’s ‘fair use’ defense is indefensible and must be denied as a matter of law.”).


6 Id. at *3, *5.

7 The court noted that given the large number of works infringed, even under the defendant’s calculation, the total award approximated $118 million.
infringement as a matter of law in ruling on a motion for summary judgment. In that case, the defendant operated an electronic bulletin board containing downloadable versions of SEGA copyrighted video games. The evidence showed that the defendant sold “copiers” that allowed users to play games on SEGA consoles that had been downloaded from the bulletin board. The copiers also allowed users to copy SEGA game cartridges onto floppy discs. The bulletin board encouraged visitors to upload SEGA games and charged a “donation” fee for downloads. The knowledge that users were uploading and downloading SEGA games, the solicitation of uploads, and the sale of the copiers was sufficient for the court to find that the contributory infringement was willful as a matter of law.

Many of the factors that lead to a finding of willfulness in ordinary copyright infringement cases support a similar finding in piracy cases. For example, the nature of the defendant’s business was invoked by the Second Circuit to support an inference of knowledge in a piracy action. In Yurman Design, Inc. v. PAJ, Inc.,28 the court affirmed a jury finding of willfulness based, in part, on the defendant’s experience in the relevant business—in this case, jewelry manufacturing. A buyer from Zales had asked the defendant if it could manufacture jewelry similar to some samples that the buyer said had been made by an Italian manufacturer. The buyer did not disclose to the defendant, however, that the Italian manufacturer had made the samples based on Yurman’s designs at the request of the Zales buyer. After the defendant manufactured and sent to Zales pieces similar to the samples, Zales returned the pieces, saying they were similar to the plaintiff’s design. The defendant thereafter engaged in a massive advertising campaign and sold the pieces under its own label.

In its defense, the defendant claimed that, although it admittedly copied the samples, it did not know that they were copyrighted or owned by Yurman. The court sustained the jury’s finding of willfulness after considering evidence that the defendant had been in the jewelry business for 23 years, had attended major jewelry industry trade shows, knew of the plaintiff’s designs, and had failed to investigate any copyright violations after Zales had rejected the pieces.29

Artificial Entities

If the defendant is not a natural person, a finding of willfulness requires that the appropriate person in the organization have knowledge of the infringement. One of the few cases to discuss this issue is Los Angeles News Service v. Reuters Television International, Ltd.30 In Reuters, the plaintiff testified that he had spoken with the defendant’s “top dog” in Los Angeles and had offered to license the copyrighted material for several thousand dollars. The top dog had refused the offer, and acknowledged that it “would be wrong” to use the plaintiff’s tapes without permission. Subsequently, the corporate defendant distributed the plaintiff’s works to its subscribers.

The court found these facts to be insufficient to conclude that the infringement was willful “in the absence of any evidence that [the top dog himself] copied the [plaintiff’s] works or knew of or contributed in any way to their unlawful copying” by the defendant.31 Nimmer cites legislative history to support the same conclusion:

Language in some of the legislative history supports the interpretation that the knowledge underlying willfulness must in fact be possessed by the person responsible for the infringing conduct. Under that interpretation, it would not suffice to impute knowledge by an agency relationship with another employee, who in fact was notified of, or was otherwise aware of, the possible infringement.32

The legislative history cited by Nimmer is contained in the 1965 Supplementary Register’s Report on the General Revision of the U.S. Copyright Law. This report summarized proposals for an overhaul of the 1909 Copyright Act and commented on the suggested changes. An earlier Register’s Report on the General Revision of the U.S. Copyright Law, published in 1961, had noted that the 1909 Act contained a provision that allowed enhanced statutory damages when a defendant continued to infringe the plaintiff’s work after either written notice of infringement or service of a complaint for infringement. The 1961 report pointed out that the obvious assumption underlying this provision—that receipt of actual notice was proof of willfulness—was not always true. The report suggested that notice sent to, for instance, a television station may arrive too late for the broadcaster to prevent the broadcast. In such a situation, the infringement would not be willful despite the notice.

The 1965 report referenced with approval this conclusion and provided a further example of when actual notice would not conclusively prove willfulness: “where notice is sent to a large retail store but fails to reach the individual employees responsible for the infringement for some time.”33 Although this discussion reflects a flaw in the 1909 Act, its clear import is that, in order to find willfulness in cases involving an artificial entity, the person who is aware of the owner’s copyright must also be involved in the infringement. The holding in the Reuters case is consistent with this interpretation.

Nonetheless, other submitted evidence may provide inferences sufficient to fill in the gap. For instance, in Spencer Promotions Inc. v. 5th Quarter Enterprises Inc.,34 the defendant owner of a bar testified at a bench trial that he knew that he needed a license to show a televised pay-per-view fight in the bar, having previously purchased similar licenses. He also testified that he did not know his bar was televising the fight and that he had instructed his employees to notify callers that the fight would not be shown. The court found this testimony not credible in light of evidence that an illegal or unauthorized descrambling, decoding, and/or recording device had to be used to intercept and decode the signal and the defendant’s admission that he knew he needed a license to show the broadcast.35 This additional evidence was deemed sufficient to support a finding of willfulness.

The significance of actual notice in proving willfulness may be questioned if the defendant submits convincing evidence of a good faith belief in the innocence of its conduct. In this situation, even if the notice reaches the appropriate person, the defendant can avoid a finding of willfulness.36 For instance, in Frank Music Corp. v. Metro-Goldwyn-Mayer, Inc.,37 the defendant believed that its use of the infringing work was permitted pursuant to an ASCAP license, despite having received notice of infringement from the plaintiff. Under these circumstances the court considered whether the defendant could deduct a portion of its overhead from its revenues in determining its profits from the infringement under the 1909 Act. The plaintiff maintained that the defendant had infringed its work consciously and deliberately and should not have been allowed to deduct overhead. In rejecting this argument on appeal, the Ninth Circuit affirmed the trial court’s determination that the defendant’s good faith belief supported a finding that the infringement was not willful.38

A credible claim that an infringement was willful can greatly increase the value of a copyright case. Not only may the plaintiff seek an enhanced statutory damage award but a finding of willfulness can also be a factor in the court’s determination of whether to award attorney’s fees.39 Although providing notice of infringement may be the easiest way to demonstrate willfulness, the lack of notice is not fatal to a plaintiff’s claim. In building a case for willful infringement, the plaintiff should explore the defendant’s prior history with copyright actions and any other experience it has had with copyright issues. Knowledge of infringement by the defendant may be inferred from such factors as the nature of the defendant’s business or the frequency of the defendant’s appearance at trade
§504(c).

potential to recover attorney's fees.

ment to entitle the holder to statutory damages and the registration must precede the infringe-
the work is published, 17 U.S.C. §412(1) applies, 11 Hideout Records and Distribs. v. El Jay Dee, Inc.,


Contrast this formulation with the statutory requisites for the defendant to prove an infringement was inno-

contrast with the innocence of its conduct…[and] that it was rea-


In order to be marketable, a counterfeit tape must be the same length as the legitimate tape. Otherwise, periods of silence would appear at the ends of both sides of the tape.

A & M Records, 948 F. Supp. at 1455.


Id. at 1173.

Fitzgerald Publ’g Co., Inc. v. Baylor Publ’g Co., Inc., 807 F. 2d 1110 (2d Cir. 1986).

Id. at 1115.


25 4 MELVILLE B. & DAVID NIMMER, NIMMER ON COPY-

RIGHT, App. 15, 165.

24 Fitzgerald Publ’g Co., Inc. v. Baylor Publ’g Co.,

23 Id. at 1172.


20 A & M Records, 948 F. Supp. at 1455.

19 Id. at 1457.


16 25 MELVILLE B. & DAVID NIMMER, NIMMER ON COPY-


12 ASCAP is a performing rights organization that licenses third parties such as bars, nightclubs, and radio stations, to perform nondramatic musical works, the rights to which are owned by the members of ASCAP. See 17 U.S.C. §101.


9 In order to be marketable, a counterfeit tape must be the same length as the legitimate tape. Otherwise, periods of silence would appear at the ends of both sides of the tape.


7 17 U.S.C. §504(c)(2). If the defendant proves that the infringement was innocent, the lower end of the statutory range is reduced to $200. Id.

6 17 U.S.C. §412(2). If the infringement occurs before the work is published, 17 U.S.C. §412(1) applies, under which the registration must precede the infring-
ent to entitle the holder to statutory damages and the potential to recover attorney’s fees.

5 17 U.S.C. §504(c)(1).

4 17 U.S.C. §504(c)(2). If the defendant proves that the infringement was innocent, the lower end of the statutory range is reduced to $200. Id.

3 Columbia Pictures Television, Inc. v. Krypton Broad.

of Birmingham, Inc., 259 F. 3d 1186, 1194 (9th Cir. 2001).

2 17 U.S.C. §412 has certain regis-

tration requirements that must be met for the court to be authorized to award statutory damages or attorney’s fees. See note 4, infra, and accompanying text.
With the passage of the State Bar Act in 1927, codified at Business and Professions Code Sections 6000 et seq., efforts to define the practice of law and, by derivation, proscribe the unauthorized practice of law (UPL) began to gather steam. The act mandated membership in, and the payment of dues to, the State Bar of California for the privilege of practicing law in this state. A flurry of cases followed in the early 1930s in which the State Bar held attorneys accountable under the act for their actions involving nonattorneys.

In 1931, for example, the State Bar imposed a one-year suspension on an attorney for violating the prohibition against fee sharing with nonattorneys. The attorney’s fees were derived from the fees collected by personal injury adjusters.1 Also in 1931, an attorney was suspended for having knowingly and intentionally aided and abetted UPL when he authorized a nonattorney to control case settlement negotiations and litigation.2 A few years later, in 1937, two attorneys were disbarred based on evidence that each had misled the court into believing a nonattorney was a licensed attorney.3 Business and Professions Code Section 6125 states a seemingly clear prohibition: “No person shall practice law in California unless the person is an active member of the State Bar.”4 But questions persist about what constitutes the practice of law. One court noted:

As the term is generally understood, the practice of law is the doing and performing services in a court of justice in any manner depending therein throughout its various stages and in conformity with the adopted rules of procedure. But in a larger sense it includes legal advice and counsel and the preparation of legal instruments and contracts by which legal rights are secured although such matter may or may not be pending in court.5 Other courts concur. Logic suggests that an understanding of what constitutes the practice of law should lead to a corollary...
understanding of what constitutes UPL. However, the advent of real-time communications, the ease of interstate travel, increased use of nonattorney office employees and services, and other business pressures complicate the issue.

The activities of the legal profession continue to provide fertile ground for UPL by those who are suspended, disbarred, or never licensed in the first place, and well-intentioned but unwaried licensed practitioners may inadvertently become ensnared in violations and exposed to criminal charges, civil liability, and State Bar discipline. Therefore, basic knowledge about what constitutes UPL in California is crucial for every licensed attorney in the state.

The most common occurrences in which duly licensed attorneys run afoul of the rules against aiding and abetting UPL by nonattorneys include: forming unauthorized partnerships between attorneys and nonattorneys, misrepresenting that an unlicensed person is entitled to practice law, permitting legal advice and counsel to be given by unlicensed staff persons, and allowing unsuper visioned preparation of legal instruments that require legal expertise.

**Aiding and Abetting UPL**

Law offices traditionally rely on the services of paralegals and other nonattorney support staff to achieve efficient operations. Undue reliance on nonattorneys, however, can exact a high price when an attorney fails to exercise adequate oversight. Although some attorneys have been found guilty of aiding and abetting UPL for failing to control or limit the activities of disbarred, suspended, or out-of-state attorneys rendering advice in California, liability arises far more frequently from inadequate control or supervision of nonattorneys such as student law clerks, employees, and business collaborators.

Attorneys who aid and abet UPL committed by their nonattorney employees face stiff penalties and disciplinary actions. Aiding and abetting occurs when an attorney delegates too much authority to nonattorneys or fails to supervise legal services performed by nonattorneys. Attorneys frequently take these measures as a means to expand their practices. A typical situation involving the aiding and abetting of UPL occurs when a nonattorney performs the bulk of the work on a client’s case, with the attorney making all the necessary court appearances. In Matter of Steele, for example, an attorney delegated substantial control of his legal practice to a paralegal, including all initial investigations and even control of his client trust accounts. The attorney also created an arrangement in which the paralegal and attorney each received a portion of the firm’s profits, effect ively creating an unauthorized partnership with a nonattorney. The attorney was disbarred for aiding and abetting the paralegal’s UPL and for fee splitting.9

In immigration cases, the practice of relying on immigration consultants is particularly rampant.10 Collaborations between attorneys and nonattorneys in this context are characterized by flagrant violations of the Rules of Professional Conduct. Typical rules violations arise from an attorney failing to perform due diligence, relying completely on the nonattorney consultant’s work, and forming fee-splitting partnerships with nonattorney consultants. In Matter of Valinoti, an immigration attorney was suspended for 28 instances of professional misconduct in nine separate client matters. The attorney had handled over 2,720 immigration matters over the course of a year and a half. However, in achieving this high volume he failed to adequately evaluate each individual case, relying solely on the documents and forms prepared by nonattorney immigration consultants. The result was irreparable harm to his clients, who faced deportation due to fraudulent asylum claims.11 Indeed, UPL performed by nonattorney immigration consultants frequently causes the irreversible loss of crucial legal rights.12

The role of nonattorney consultants is not readily evident to the immigration court because licensed attorneys make all appearances, giving the impression that the applicant is adequately represented. And, all too commonly, the clients rarely learn of irregularities in their immigration documents until after their cases are already in jeopardy. Attorneys operating these schemes are actively aiding and abetting the UPL committed by unscrupulous immigration consultants and are exposing themselves to the full panoply of criminal and civil sanctions.

The potential for UPL frequently presents itself when attorneys and nonattorneys work together on matters embedded with legal questions and legal consequences. The problem posed by the intersection of legal and nonlegal work is especially perilous when attorneys collaborate with other professionals to deliver services in related fields. The danger is underscored by the general prohibition against the formation of partnerships between attorneys and nonattorneys.

For example, a young attorney was disciplined by the State Bar for forming a partnership with his father, a disbarred attorney.13 At issue in the case was whether the association between the attorney and his father was a partnership, in violation of Rule 3 of the Rules of Professional Ethics (the precursor to the California Rules of Professional Conduct).14 Such an arrangement raises two concerns: It may lead the public to believe that the nonattorney is authorized to practice law, causing detrimental reliance, and the union between an attorney and a nonattorney may inhibit the attorney’s autonomy in a way that causes harm to the client.

Loss of autonomy is of particular concern to the courts because partnerships between attorneys and nonattorneys in related fields can evolve into “feeder” businesses, with each business dependent on the referral of clients from the other.15 Under these circumstances, if a law practice depends upon a feeder business to sustain itself, the duties of loyalty and confidentiality owed to clients may be compromised by economic pressures and other business circumstances.16 Throughout the statutory scheme for the practice of law, the protection of clients’ rights is of paramount importance and provides the underpinnings for both the prohibition against partnerships between nonattorneys and attorneys and the sanctions imposed on attorneys who aid and abet UPL.

For an attorney who has worked years to develop an expertise and build a career, relinquishing that unique professional identity is difficult. Nevertheless, under Business and Professions Code Section 6126(a), “[A]ny person advertising or holding himself or herself out as practicing or entitled to practice law or otherwise practicing law who is not an active member of the State Bar, or otherwise authorized pursuant to statute or court rule to practice law in this state at the time of doing so, is guilty of a misdemeanor.”17 Furthermore, attorneys who are involuntarily enrolled as inactive or are suspended or disbarred and who continue to identify themselves as authorized to practice law are committing a felony and may be sentenced to state prison.18

There are certain narrow exceptions to the requirement that attorneys practicing in California must be active members of the State Bar. These allow some flexibility for out-of-state attorneys to lend legal assistance in limited circumstances. Out-of-state attorneys may even represent California clients and serve as cocounsel with California attorneys in some situations.19 Nonetheless, while the multijurisdictional reality of modern legal practice often requires attorneys in different states to collaborate, individual states have a right and obligation to regulate the practice of law within their jurisdictions and protect members of the public from UPL.20 Thus, the exceptions for otherwise nonauthorized attorneys are limited.

For example, an attorney was found to have aided and abetted the UPL of an unlicensed person because he introduced his California clients to a New York lawyer for advice regarding the laws of a foreign jurisdiction in which the New York lawyer was
not admitted. 21 (The New York lawyer could advise the California clients on New York law or on the law of any other jurisdiction in which the lawyer was admitted.) The California attorney was disciplined because he caused his clients to rely inappropriately on the advice of an attorney not licensed in California, and the California lawyer did so by drawing on the clients' trust in the attorney-client relationship he had established with them. 22 This illustrates how even the informal assistance of an attorney licensed in another state can evolve into UPL.

Courts have taken a further step by finding that the mere promise by a suspended attorney to perform the duties of an attorney was a violation of the UPL statutes. 23 The suspended attorney promised a client that he would file a complaint on her behalf. Although he received no compensation and submitted no documents to the court, by promising to perform duties normally relegated to an attorney he effectively held himself out as entitled to practice law, thus violating the prohibition against UPL. 24

These cases are warnings to California attorneys working with out-of-state attorneys or forming working relationships with nonattorneys. Similar fact patterns are increasingly common. Also, attorneys find themselves under pressure to acquire specializations that often require collaborations with nonattorney professionals. Nevertheless, while working with nonattorneys may be a reality of modern legal practice, attorneys continue to have a duty to remain alert to representations that may induce a client's trust in someone who does not have the requisite authority or skills to properly represent the client's interests.

Advice and Counsel
While there is no bright-line definition in the UPL statutes of the practice of law, courts have stepped in to establish a definition with broad parameters. 25 Within those parameters is the rendering of advice and counsel on matters requiring legal expertise in which a client's rights may be affected significantly. 26 This expansive view creates problems for nonattorney professionals who find their work entangled in complex transactions that require at least a cursory understanding of basic legal concepts. 27 Nonattorney professionals and lay persons may find themselves in trouble regarding UPL when they venture beyond the basic knowledge required to perform their tasks and attempt to include legal advice within the scope of their services.

Courts have addressed some of the issues presented by the intersection between the legal profession and other professions. An accountant was found guilty of UPL for advising a client on a complicated tax issue. 28 The advice required a very close analysis of the federal tax code to determine whether the corporate client qualified for an unusual method of calculating tax. By the accountant's own admission, the complex legal question required several days of research in a law library. This led the court to observe: “Generally speaking, whenever, as incidental to another transaction or calling, a layman, as part of his regular course of conduct, resolves legal questions for another at the latter's request and for consideration, by giving him advice or by taking action for and on his behalf, be is practicing law if difficult or doubtful legal questions are involved which, to safeguard the public, reasonably demand the application of a trained legal mind.” 29

Thus, while the services of a nonattorney may require basic knowledge of certain laws, advice given to clients in delivering these services cannot extend to matters involving complex legal issues. 30 Conversely, advice on matters of slight importance to a case is not regarded as an attempt to practice law. 31

In determining whether UPL has occurred, the extent to which advice given by an unlicensed person has crossed the boundary into the practice of law is analyzed within the framework of the entire pattern of conduct. 32 Thus, activities that independently might not constitute UPL may, in the aggregate, lead to advice that is more than merely incidental. Of obvious concern are the consequences stemming from a client's potentially detrimental reliance on advice that goes beyond matters of minor importance.

In circumstances involving advice on foreign matters, UPL occurs when that advice is provided to a California client from an attorney not licensed in California, 33 with some exceptions. This general rule does not, for example, preclude a foreign attorney from advising a client on the law of any foreign jurisdiction in which he or she is admitted. California Rules of Court permit foreign legal consultants to register with the State Bar and advise on foreign law so long as they do not advise on California law, make appearances, or prepare pleadings and instruments in California. 34

Preparation of Legal Instruments
The general dearth of free and low-cost legal services in California has compelled many low-income and working class residents to turn to self-help services or nonattorney legal document preparers to address their legal needs. 35 Typically these services purport to assist persons representing themselves in a variety of legal matters, including bankruptcy, family law, landlord-tenant disputes, and immigration. 36 These services are often touted as a low-cost alternative to expensive representation by an attorney, and the market for them continues to grow. 37

Some of the activities taken to assist pro
per litigants do not involve UPL. These include providing access to written materials on legal procedures such as evictions or acting as scriveners in the preparation of legal documents at the direction of a client. Courts also have found that work performed by nonattorneys that is merely preparatory and under the direct supervision of an attorney generally does not violate the UPL statutes.

The very limited scope of tasks nonattorneys can perform in connection with legal documents includes filling out forms at the behest of the client. By contrast, the preparation of instruments that will affect the client's legal rights, in accord with decisions made by the document preparer on behalf of the client, has long been held to fall within the ambit of the practice of law. As the demand for low-cost document preparation services continues to grow, there is an increased tendency for these service providers to make decisions that have legal consequences. The average consumers of self-help or scrivener's services are often unaware that the legal document assistant or paralegal they have hired to fill out their forms has committed UPL in the course of helping them with their case. Frequently, the unfortunate consequence is the consumer's loss of important rights or remedies. In numerous cases—ranging from landlord-tenant matters to bankruptcy assistance—courts have found that the mere selection of the types of forms a client should prepare to address a particular legal issue constitutes UPL. The California legislature has enacted regulatory schemes to govern a broad spectrum of nonattorney legal services. Business and Professions Code Sections 6400 et seq. regulate the role of legal document assistants, Sections 6450 et seq. regulate paralegals, and Sections 22440 et seq. regulate immigration consultants. Federal law regulates the activities of bankruptcy petition preparers.

These various statutory provisions restrict nonattorney legal service providers from practicing law in the course of performing their services. These statutes also require that nonattorneys perform their duties under the direct supervision of an attorney or register with the appropriate state agency and post a bond in order to operate as scriveners at the client’s specific direction.

Sanctions for Engaging in UPL

Persons engaging in UPL, whether by intention or inadvertence, violate California statutes and State Bar ethics rules and may face criminal sanctions, civil consequences, and State Bar discipline.

Though some complain that the term “practice of law” remains imprecise and unworkable, courts have found it to be sufficiently certain to form the basis for a criminal prosecution. For persons who have never been licensed in California and are convicted of UPL, the statutes prescribe misdemeanor punishment of up to one year in a county jail, a fine of up to $1,000, or both. A stiffer penalty may be applied for subsequent convictions.

For licensed attorneys and formerly licensed attorneys (such as suspended or disbarred attorneys) the UPL statutes provide for felony punishment with the possibility of a state prison sentence. UPL-related offenses also carry the risk of sanctions for contempt of court. Each criminal penalty is cumulative with other criminal penalties and any other remedy provided by law.

Nonattorney UPL offenders also have been charged with violations of Penal Code Sections 484 and 487, under a theory of theft by false pretenses. The Los Angeles County District Attorney's Office aggressively prosecutes UPL cases, with District Attorney Steve Cooley stating that his office is “committed to combating this form of fraud.” While noting that “UPL occurs in all legal fields,” Cooley states that it is especially rampant in immigration matters, with unsuspecting immigrants falling prey to fraud by unscrupulous consultants.

In the civil arena, attorneys who facilitate or assist nonattorneys in UPL can be sued for a variety of remedies, including a permanent injunction, damages, and sanctions for contempt. Through civil actions, violators of the UPL statutes can face penalties and damages outlined in the regulatory schemes governing paralegals, legal document assistants, bankruptcy petition preparers, and immigration consultants. In addition, defending against a civil suit for UPL can have profound implications for an attorney’s future practice.

Violators of the Immigrant Consultant Act, including any attorney complicit in a violation, may be liable for civil penalties of up to $100,000 per violation in addition to actual damages, treble damages, and reasonable attorney’s fees and costs. Victims may also seek broad injunctive relief against the violators.

Those who violate statutes regulating nonattorney legal document assistants, including complicit attorneys, may be liable for damages, restitution, injunctive relief, and attorney’s fees. The same relief is available for violations of statutes regulating paralegals. In addition, an attorney who uses a paralegal’s services may be liable for the paralegal’s negligence, misconduct, or other violation of the statutes governing the practice of law.

UPL also may expose nonattorneys and attorneys to common law tort actions, such as fraud, intentional misrepresentation, negligent misrepresentation, and the intentional infliction of emotional distress. Depending on the severity of the fraud charges, defendants may be liable for punitive and exemplary damages. An attorney working with a nonattorney assistant or partner also may face a separate malpractice claim for failure to properly handle a client’s case.

An attorney who aids and abets a nonattorney in committing UPL may face claims based on unfair competition and false advertising. Anyone not properly authorized to practice law who promulgates or distributes information that has the “capacity to deceive” consumers into believing he or she is qualified to practice law is violating California’s false advertising law.

The ban on false advertising applies to supervising attorneys who knowingly deceive the public into thinking that a nonattorney employee is properly authorized to handle a legal matter or that a case is being handled entirely by the attorney. Relief to clients harmed by the deception may include permanent injunctive relief, with both prohibitory and mandatory terms, and restitution for money or property taken as a result of false advertising.

Similarly, injunctive relief and restitution can be awarded to a prevailing party bringing suit against a nonattorney or attorney guilty of UPL under California’s unfair competition law. Business and Professions Code Section 17200 was designed to prevent unfair competition through deceptive business practices, including false advertising. Absent a charge of false advertising, however, the broad forms of relief enumerated in Section 17200 can be sought if a business is found to have violated any statutory scheme designed to protect the public. Criminal violations of the UPL statutes also may result in liability under Section 17200, because UPL can be characterized as an intentionally deceptive business activity.

When civil actions are brought by public enforcement agencies, such as county prosecutors or the State Attorney General’s Office, violators may be assessed civil penalties of up to $2,500 per violation. The civil penalties are cumulative and mandatory in an amount determined by the court once a violation is established. In all other civil actions, permanent injunctive relief is available as well as restitution for any money or property taken by means of the false and deceptive business practice.

The State Bar lacks jurisdiction over persons never licensed to practice law or attorneys who have resigned or been disbarred. Nonetheless, in 2003 the State Bar received 262 UPL complaints regarding nonattorneys. Most of those cases were referred to the local district attorney’s office for prosecution.
During this same period, 41 complaints were received regarding disbarred or resigned attorneys. Many of these also were referred to the local district attorney’s office.

Violators who come within the purview of the State Bar discipline system are licensed attorneys and attorneys suspended from the practice of law. In 2003, the State Bar received 246 UPL complaints regarding suspended attorneys. These complaints constituted 20 percent of all complaints received via the State Bar intake line in 2003.56

The State Bar adheres to a comprehensive set of standards for disciplining attorneys that are published in the State Bar’s Rules of Procedure and Rules of Practice. Standard 2.6 provides for disbarment or suspension of an attorney for specified violations of the Business and Professions Code, with the punishment depending on the gravity of the harm. Standard 2.3 mandates suspension or disbarment if the offenses involve moral turpitude, fraud, dishonesty, or concealment, with the sanction depending upon the harm to the victim, the degree to which the victim was misled, the magnitude of the act of misconduct, and the degree to which it relates to the attorney’s practice of law. It is worth noting that when the State Bar’s disciplinary actions have been challenged in court, judges have not been reluctant to increase the severity of the administrative sanctions imposed by the State Bar.57

The credibility and effectiveness of our justice system depends on effective enforcement of UPL statutes, but there are mounting pressures to modify existing restrictions on the practice of law. For example, in a nod to the interstate realities of modern law practice, the California Supreme Court has approved new rules, effective this month, regarding out-of-state lawyers practicing in California under limited circumstances. Also, recognizing the economic constraints that reduce accessibility to legal services for those with limited resources, attorneys are now able to unbundle legal services in an effort to compete with do-it-yourself clinics. Efforts to regulate a profession that requires consistency and flexibility reflect the evolving demands on lawyers.

All licensed practitioners should be aware of what constitutes UPL to avoid inadvertent violations and to preserve the rigorous standards of the legal profession. Awareness protects the attorney, the consumer, and—perhaps most important of all—the integrity of a system that provides access to justice. One court noted that “[t]he right to practice law not only presupposes in its possessor integrity, legal standing and attainment, but also the exercise of a special privilege, highly personal and partaking of the nature of a public trust.”58 It behooves every licensed prac-
Unauthorized Practice of Law

Attorney for Aiding or Assisting Another Person in

(1985).

6 Russell Donaldson, 4 BUS. & PROF. CODE §6125.

1 Shaw v. State Bar of Cal., 212 Cal. 5 (1931);
2 Smallberg v. State Bar of Cal., 212 Cal. 113 (1931);

4 BUS. & PROF. CODE §6125.

1 People v. Merchants Protective Corp, 189 Cal. 531, 535 (1922); see also Baron v. City of Los Angeles, 2 Cal. 3d 535, 542 (1970); Bluestein v. City of Los Angeles, 13 Cal. 3d 162, 173-74 (1970); People v. Landlords Prof'l Servs., 215 Cal. App. 3d 1599, 1604-08 (1989).


7 Ridley v. State Bar of Cal., 6 Cal. 3d 551 (1972) (attorney disbarred for misconduct, including UPL by employee left in charge of attorney’s office during attorney’s absence); In the Matter of Steele, 3 Cal. State Bar Ct. Rptr. 708 (1997) (State Bar opinion; disbarment for failure to supervise and for fee splitting).

8 Steele, 3 Cal. State Bar Ct. Rptr. 708.

9 Id.


11 Id.


13 Id. at 665.

14 Id. at 665-66.

15 Id. at 666.

16 Id.

17 BUS. & PROF. CODE §6126(a).

18 BUS. & PROF. CODE §6126(b).


20 State Bar of Cal. v. Superior Court, 202 Cal. 323, 331 (1929); In re McKenna, 16 Cal. 2d 610, 611 (1940), cited in Agran v. City of Los Angeles, 2 Cal. 3d 535, 540 (1970) (State Bar Act preempts the regulation of attorneys only insofar as the regulation involves the practice of law within the meaning of the act.).


22 Id. at 171.


24 Id. at 612.


26 Merit Protective Corp, 189 Cal. 531; Birbower, 17 Cal. 4th 119 (New York firm committed UPL by giving advice pertaining to California law and performing other legal services for a California company.).


28 Id. at 809.

29 Id. at 818 (emphasis added).

30 Id. at 818.

31 In re McKelvey, 82 Cal. App. 426, 429 (1927).


38 Landlords Prof'l Servs., 215 Cal. App. 3d 1599.


41 Kaz, supra note 10, at 125.

42 In re Anderson, 79 B.R. 482 (1987) (Client assistance by a paralegal required legal judgment generally beyond the capacity of a nonattorney.). See also Landlords Prof'l Servs., 215 Cal. App. 3d 1599 (self-help service committed UPL by generating individualized forms and advising some clients on which forms to prepare.); People v. Fremont Life Ins. Co., 104 Cal. App. 4th 508 (Preparation of wills, trusts, and other legal instruments by annuity sales representatives constituted UPL.).


45 BUS. & PROF. CODE §6126(a).

46 BUS. & PROF. CODE §6126(b).

47 BUS. & PROF. CODE §6126.

48 LOS ANGELES COUNTY OFFICE OF DISTRICT ATTORNEY, UNAUTHORIZED PRACTICE OF LAW MANUAL FOR PROSECUTORS 2 (Feb. 2004).

49 BUS. & PROF. CODE §32440-22448.

50 BUS. & PROF. CODE §32445.

51 BUS. & PROF. CODE §32440 et seq.

52 BUS. & PROF. CODE §6452(b).

53 BUS. & PROF. CODE §17500.

54 Id.

55 BUS. & PROF. CODE §6125, 6126.

56 Telephone interview with Djinna Gochis, General Counsel, State Bar of California (June 15, 2004).

57 In re Morse, 11 Cal. 4th 184 (1995).

Although **Section 998 is designed to encourage settlements**, certain court decisions have actually served to discourage them.

**CASES SETTLE IN A VARIETY OF WAYS.** Some cases settle after a few telephone calls between opposing counsel. Others need a settlement officer to pound the table and drag a settlement out of the parties. It is not uncommon for cases to settle when a courtroom suddenly becomes available for trial. And in some cases, parties rely on the carrot or the stick (or both) contained in Code of Civil Procedure Section 998 to develop a settlement.

Under Section 998, a party can offer to have judgment entered under specific terms and conditions. If the adverse party accepts, then the case is settled, and judgment is entered with no requirement for court approval. If the adverse party does not accept, goes to trial, and is victorious but wins less than the proposed settlement, the party is not awarded postoffer costs even though the party is the prevailing party—and the party making the offer may recover postoffer costs. The benefits and drawbacks of the Section 998 process are seemingly straightforward, but the risks for both parties are more dangerous than they may appear at first glance. Indeed, Section 998 is not just a way to settle a case. It is a trap for the merely careful.

Section 998 contains gaps and ambiguities. Courts have exercised considerable discretion regarding some aspects of Section 998 and in doing so have rewritten the statute. They also have declined to act in other areas implicated by the statute. The effect of the judicial interpretations is to discourage settlements, even though Section 998 is designed to encourage them.

The conventional wisdom is that either party has a motive to make a Section 998 offer or demand because of the possibility of shifting postoffer costs. That seems a weak reason.

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in most cases, however, because recoverable costs usually are not economically significant. Unless there are numerous postoffer depositions or extensive use of high-tech computer presentations at trial, it is difficult to incur a big bill for costs. A plaintiff whose offer is rejected and who does better at trial may also, in the court’s discretion, recover expert witness fees, which are ordinarily not a recoverable cost. But since expert witness fees are not automatically awarded, it is hard to rely on the possibility of recovering those fees when analyzing whether or not to make or accept a settlement offer.

Of course, a settlement by definition leads to savings because it renders unnecessary the expenditure of considerable costs, including attorney’s fees. However, this savings is included in the calculation of a reasonable settlement offer and is not unique to the use of a Section 998 procedure. Although Section 998 does not offer a big tasty carrot or a big sharp stick, most attorneys ascribe an unwarranted importance to making or receiving a Section 998 offer, even though the often insignificant benefits of a Section 998 offer can be outweighed by its serious risks.

Unlike most other pleadings or discovery, for example, there is little opportunity to correct an error in a Section 998 offer or acceptance. Code of Civil Procedure Section 473 can be used to ameliorate the devastating effect of a default judgment, and provisions exist to correct erroneous discovery responses, but there is no established way to correct an error in a Section 998 offer or acceptance. An offer that is made too early or that is too low may, even if it is an accurate forecast of the result at trial, not give the party making the offer the benefits of Section 998. It may even cause the parties to incur additional costs to litigate the underlying good faith of the offer.

Clearly, numerous opportunities abound for parties using Section 998 to err and lose money. Moreover, courts have increased the risks of making Section 998 offers. The offering party must calculate an offer that will create an incentive to settle. For a defendant, the offer must be high enough to include all the elements of a plaintiff’s expected recovery so that the cost-shifting mechanism will actually work. This means that, unlike calculating a settlement offer for a settlement conference or mediation, the calculation must include estimated preoffer costs (including attorney’s fees if applicable) and interest.

Section 998 does not refer to its procedures as an offer of settlement but instead as an “offer...to allow judgment to be taken...” The statute does not recognize that a Section 998 settlement is unlike any other settlement, which is a product of compromise and good faith bargaining. A settlement pursuant to Section 998 is instead an offer (if made by the defendant) to be the losing party. Thus the courts are not encouraged to use their discretion to enforce the actual bargain the parties intended but may have misstated.

The most dangerous risk to a defendant who wants to settle using Section 998 is failing to prepare an offer that addresses liability for additional costs. Defendants who use the standard form and offer to allow judgment to be entered for a stated sum accept that they are the losing party and liable not for only costs but also for attorney’s fees if the complaint is based on a statute or contract with an attorney’s fees clause. A defendant trying to settle a case arising from a contract with an attorney’s fees clause must make sure the offered sum includes all damages, claims, costs, expenses, fees, and interest. Further, the offer should state that “each party shall bear its own costs and attorney fees and expenses,” or it should specifically limit attorney’s fees or costs.

**Limited Relief for Mistakes**

The risk that a defendant offering to settle will find itself liable for the amount of the offer plus costs and attorney’s fees is by now so well documented that no one can be ignorant of it. *Rappenecker v. Sea-Land Services Inc.* established the liability of a settling defendant for court costs when the terms of the Section 998 offer were silent as to those costs. *Lanyi v. Goldblum* alerted defendants offering to settle for a stated sum that they will be liable for costs and attorney’s fees as well. Even since *Lanyi*, which was decided 18 years ago, courts have held, more often than not, that trial courts lacked authority even to consider a motion for relief under Code of Civil Procedure Section 473 from a poorly drafted Section 998 offer that contained inadvertent flaws. *Pazderka v. Caballeros Dimas Alang, Inc.* held that a motion for reconsideration as well as a motion for relief are beyond the trial court’s discretion. The plainly stated rationale of the court was the protection of 998-type settlements and the avoidance of “spawn[ing] separate, time-consuming litigation.”

Similarly, in *Premium Commercial Services Corporation v. National Bank of California*, an appellate court reversed the trial court’s granting of relief when the Section 998 offer inadvertently omitted the “each party to bear its own costs and attorney fees” limitation customarily used by defense counsel. This was not deemed the type of mistake for which Section 473 provides relief from a Section 998 offer.

The California Supreme Court, however, has acknowledged that a motion for relief under Section 473 is appropriate when the error in a Section 998 offer or acceptance is a clerical one—the type of error for which Section 473 does provide a remedy. In *Zamora v. Clayborn Contracting Group, Inc.* the plaintiff sent a Section 998 offer dictated by counsel and then mistyped by an assistant to provide for a judgment “taken against himself and for defendant Clayborn” rather than for a judgment in the plaintiff’s favor. (Counsel in *Premium* had not reviewed the erroneous written offer before serving it and did not realize the error until after the defendant had filed its notice of acceptance.) Plaintiff Zamora then moved to set aside the judgment. The court first dispelled the theory that a 998-based judgment is never reviewable under Section 473, citing *Palace Hardware Company v. Smith* and other cases. The court then proceeded to determine if the trial court had properly exercised its discretion by granting relief under Section 473. The standard was whether “a reasonably prudent person under the same or similar circumstances might have made the same error.”

The typographical error, substituting “against” for “in favor of,” was the kind of error anyone could make, the court reasoned, which was distinguishable from the errors in *Pazderka* and *Premium*. The supreme court, however, carefully avoided stating that *Pazderka* or *Premium* had been properly decided. Further, the court emphasized that the policy favoring settlements is not impaired by a rule that a settlement on terms not authorized by the parties is not a settlement that public policy requires to be enforced.

Of course, these cases do not completely answer the question of how to resolve errors in a Section 998 offer or acceptance. An error that easily meets anyone’s definition of a typo can probably be relieved under Section 473. This might include mistakenly adding a digit to the actual amount to be paid in settlement of a case—for example, changing $67,150 to an unintended $671,150. What if the address of the recipient of the offer or the acceptance is mistyped, and thus the offer or acceptance is not timely received? What if the offer or acceptance is miscalculated or misfiled? What if a word is left out of an offer so that it reads “$300,000 against defendant and attorney fees and costs,” with the word “no” inadvertently omitted before the words “attorney fees and costs”? What if the entire phrase “no attorney fees and costs” is omitted? What is the distinction between a clerical typo and an attorney’s failure to review documents before they are served? The Zamora court hinted at this issue but did not resolve it, and the similar circumstances of *Premium* and *Zamora* led to dramatically different results.

The effect of ordinary contract law also is still unclear. The cases dutifully recite the
The Los Angeles County Bar Association certifies that this activity has been approved for Minimum Continuing Legal Education credit by the State Bar of California in the amount of 1 hour.

1. For a settlement to be enforceable under Code of Civil Procedure Section 998, it must be approved by the court.  
   True. 
   False.

2. If a defendant serves a proper Section 998 offer that the plaintiff rejects and at trial the plaintiff is awarded its costs, which are ordinarily not recoverable, if the plaintiff recovers more than the amount offered.  
   True. 
   False.

3. A defendant in a civil case whose Section 998 offer was rejected may be awarded its expert witness fees, which are ordinarily not recoverable, if the plaintiff recovers less than the amount offered.  
   True. 
   False.

4. Pursuant to the language of Section 998, a party making an offer is offering to allow judgment to be entered and is not offering to compromise.  
   True. 
   False.

5. A defendant making a Section 998 offer must offer to allow judgment to be entered against it and is not offering to compromise.  
   True. 
   False.

6. A defendant making an offer for a judgment in a stated amount to be entered against it under Section 998 is offering to be the losing party.  
   True. 
   False.

7. If counsel makes an error in a Section 998 offer that omits any limitation on a settling party’s liability for costs or attorney’s fees, and the error was due to counsel’s lack of awareness of the case law addressing this issue, courts generally will not grant relief under Code of Civil Procedure Section 473.  
   True. 
   False.

8. Section 473 ordinarily does not provide relief for clerical errors made by attorneys or their staffs in preparing Section 998 offers.  
   True. 
   False.

9. The standard applied by a court hearing a motion for relief under Section 473 for a drafting error in a Section 998 offer is whether an attorney skilled in litigation would have made that same error.  
   True. 
   False.

10. In making a motion for relief under Section 473 for an error in a Section 998 offer, attorneys can and should check published case law for well-established and well-defined standards to determine if the error for which they are seeking relief is the type of error for which relief may be granted.  
    True. 
    False.

11. The California Supreme Court in Zamora v. Clayborn Contracting Group, Inc. stated that two court of appeal decisions—Premium Commercial Services Corporation v. National Bank of California and Paderka v. Caballeros Dimas Along, Inc.—were wrongly decided.  
    True. 
    False.

12. Under Zamora, the supreme court established that an attorney can never obtain relief under Section 473 if the attorney delegates the drafting of a Section 998 offer to a nonattorney staff member and does not review the work before it is served.  
    True. 
    False.

13. In Zamora, evidence was admitted to show that the offeror knew that the Section 998 offer was a mistake.  
    True. 
    False.

14. One way for a defendant to avoid making an error in a Section 998 offer that renders the defendant liable for costs or attorney’s fees is to frame the Section 998 offer as an offer to accept a dismissal.  
    True. 
    False.

15. If a case is dismissed, no attorney’s fees may be awarded under Civil Code Section 1717.  
    True. 
    False.

16. Courts have discretion to determine if a Section 998 offer was made in good faith when awarding any costs under Code of Civil Procedure Section 1033.5 to a party whose Section 998 offer was rejected.  
    True. 
    False.

17. The court of appeal in Elrad v. Oregon Cummins Diesel, Inc. established a two-part test to determine the good faith of a Section 998 settlement offer.  
    True. 
    False.

18. It is well-established that a defendant who makes a very low Section 998 offer early in the case has made the offer in bad faith and is not entitled to the benefits of Section 998.  
    True. 
    False.

19. A defendant who seeks to make an early and low Section 998 offer can show good faith by providing a letter to plaintiff’s counsel explaining how the facts of the case—including facts previously unknown to the plaintiff—and applicable law support a conclusion that the case against the defendant has no merit.  
    True. 
    False.

20. The two-part test for determining the good faith of a Section 998 offer is 1) whether the offer is a reasonable prediction of the results at trial (reduced to the present value) and 2) whether the party receiving the offer reasonably knew or should have known the underlying facts.  
    True. 
    False.
A defendant should try to frame a Section 998 offer as an offer to accept a dismissal. This prevents the imposition of costs and attorney’s fees since the plaintiff will not be the prevailing party.

The Good Faith Requirement

Before awarding discretionary costs to a party entitled to request them under Section 998, the court has authority to determine whether or not a Section 998 offer was made in good faith, although that language appears nowhere in the statute. This is an area in which the courts have rewritten the statute in a way that can only discourage settlements, especially early settlements.

The good faith requirement was first discussed in 1980 in Pineda v. Los Angeles Turf Club, Inc., in which the family of a jockey killed in a race sued the race track and the manufacturer of the helmet he wore. A month before trial the manufacturer offered to settle for $2,500 pursuant to Section 998. The offer was rejected, and at trial judgment was entered in favor of the manufacturer. The victorious defendant filed a motion for expert witness fees, but the motion was denied. On appeal the court held that the trial court "had ample reason" to conclude that the offer was not reasonable, because the defendant "had no expectation that its offer would be accepted." Based on that ground and nothing else, the appellate court reasoned "that the sole purpose of the offer was to make Defendant eligible for the recovery of large expert witness fees at no real risk." The court declined to find that the offer was not in good faith but did conclude it was not "realistic" and affirmed the denial of expert witness fees. The court did not explain its basis for determining that an offer must meet a test of good faith or "realism" or that the party offering to settle had to take a demonstrable risk by doing so.

The following year, however, in Wear v. Calderon, the court of appeal formally and specifically imposed a good faith requirement for Section 998 offers—a requirement that the legislature had not included in the statute. In Wear, which arose from a car accident, one defendant offered to settle for $1 pursuant to Section 998, but the plaintiff rejected the offer. The plaintiff recovered from the other defendants but was awarded nothing against the defendant who had made the Section 998 offer. The defendant sought and received an award of her expert witness fees, and the appellate court reversed the substituted its judgment for the trial court’s and concluded that there was no good faith accompanying the settlement offer. The language and holding in Wear are what later cases have cited and recited to discuss the good faith requirement. Post-Wear appellate courts, however, have not shown as much willingness to interfere with a good faith determination by a lower court.

In Culbertson v. R. D. Werner Co., Inc., the court made obeisance to Wear and Pineda but explained why a plaintiff who rejected a low settlement offer and lost at trial should not be able to complain about paying costs, including expert witness fees:

Reduced to its simplest terms, the essence of plaintiff’s argument is that the filing of a complaint for damages, no matter how unmeritorious the claim might be, imposes upon a defendant, no matter how meritorious its defense may be, an obligation to reward the plaintiff by making an offer of settlement which would liquidate any outstanding liens, pay plaintiff’s attorney’s fees and costs and yield some significant sum to the plaintiff, or lose the benefits of section 998. That, of course, is diametrically opposed to the clear language and intent of section 998. Such a strained interpretation of the statute and the cases would result in an increase of spurious lawsuits and a reduction in the number of settlements.
The only effect of this grafted good faith element is to burden the trial court with a challenge to an award of expert witness fees (and attorney’s fees for cases filed in Riverside County) or interest in a personal injury case, when the whole objective of the Section 998 procedure is to settle cases and avoid litigation.

The court explained that, for defendants faced with what they perceive to be a meritless action, making a low offer is consistent with the goals of Section 998. When the offer is rejected, hiring experts to help with the defense of the case also is consistent with the statute.42

In Elrod v. Oregon Cummins Diesel, Inc.,43 a case brought by the driver of a logging truck who became a paraplegic after an accident, the court disallowed requested expert witness fees for one defendant. This defendant had made an offer of $15,001 before the other two defendants settled. The two defendants paid $500,000 that would be offset from any jury verdict against the remaining defendant. Workers’ compensation awards were also to be deducted from any verdict. The damages awarded were less than the $500,000 offset, and the plaintiff was awarded nothing against the defendant who had offered $15,001 to settle. The court established a two-part test to determine the good faith of a Section 998 offer. First, the reasonableness of the offer “is measured...by determining whether the offer represents a reasonable prediction of the amount of money, if any, defendant would have to pay plaintiff following a trial, discounted by any appropriate factor for receipt of money by plaintiff before trial, all premised upon information that was known or reasonably should have been known to the defendant.”44 The court noted that the test does not require an accurate prediction; instead, the prediction of an experienced attorney or judge will be sufficient evidence to determine reasonableness.45

Once the offer is deemed to be reasonable under the first part of the test, then the second part of the test is implicated. This part questions whether the information the defendant had was known, or reasonably should have been known, by the plaintiff. The answer shows whether the offeree had the information necessary to gauge the reasonableness of the offer.46

This two-part test suggests that a defendant intending to make an early or low offer should include with the offer a written explanation of the basis for the offer. This may require the defendant to disclose explosive evidence not yet known to the plaintiff.47 Of course, if this evidence is disclosed but the plaintiff does not appreciate its impact, the objective standard enunciated in Elrod has still been met. In Colbaugh v. Hartline,48 the series of demand letters written by the successful defendant were admitted to show that the plaintiff knew why the defendant believed there was no liability, and thus the plaintiff should not have been surprised by the non-suit. The trial court however, failed to follow the two-part test and did not decide to award attorney’s fees under Code of Civil Procedure Section 1021.1.49 The case was remanded for the trial court to exercise its discretion—presumably to award the attorney’s fees—under the two-part test.

In Nelson v. Anderson,50 a principal of a corporation formed to market products through an infomercial sued the other principal and the attorneys for the enterprise. The law firm made a Section 998 offer of $5,000, with each party to bear its own costs and attorney’s fees. The plaintiff rejected the offer and, at trial, the law firm was awarded a nonsuit. The trial court taxed all costs claimed by the law firm, reasoning that the offer was a “token” and thus not reasonable or propounded in good faith. This case applied the good faith test not just to expert witness fees or attorney’s fees—with both available only in the court’s discretion—but to all costs as well. Without explaining how or under what theory the court had discretion to refuse to award the postoffer costs specified in Section 998, the court simply applied the two-part test of Elrod. The court found that the law firm had met the first part of the test because $5,000 was within the range of expected recovery due to defects in the pleading, but the court also found that there was no evidence regarding the second part of the test, and thus the law firm had failed to meet its burden.

Incorrect Analysis

The reason this good faith analysis is a mistake is that it forces the court to examine the subjective motives, knowledge, and intent of parties who make or reject settlement offers. Courts ordinarily eschew such examinations, for good reason. In examining the good faith or realism of a low and unsuccessful settlement offer, the court permits the parties to introduce statements made by settlement judges,51 notwithstanding the lack of competence of the judges to so testify.52 Apparently it is now permissible to introduce these otherwise inadmissible statements through the hearsay declarations of counsel. Of course, in settlement conferences, judges often give their opinions to one side or the other and out of the hearing of the adverse party. Permitting reference to seemingly inadmissible statements is a bad idea. The statements by a settlement officer may be an exaggeration designed to encourage a settlement.
The assumption that an early or low offer is unrealistic or unfair and that the adverse party should not be obligated to consider it and provide a thoughtful response makes no sense. A defendant who believes that the case against it is without merit, behaves in a manner consistent with that belief, and makes an immediate low offer to the plaintiff should, if proven right at the end of trial, be accorded the same benefits as if the offer had been made at a later point in the process. The purpose of the statute is to encourage settlements, not just to encourage predictable settlements.

A party who receives an early and low offer should not be excused from giving it every consideration. A law designed to encourage settlements should recognize this and not give parties a loophole through which to reject an early or low offer. No public policy is served by forcing the court to inquire into the reasons for the offer or the rejection.

The legislature states that it wants to encourage settlements, and the courts proclaim the same goal. Section 998 should be interpreted and applied to promote settlements and not, by increasing risks and costs, to discourage them. To accomplish this, the legislature should:

1) Disapprove Pazderka and Premium.
2) Eliminate the good faith requirement.
3) Endorse Zamora and ease access to Section 473 motions for relief for clerical or ministerial errors in offers or acceptances.

Until the legislature takes these actions, attorneys making or responding to Section 998 offers should remember that even clerical errors may not be relieved by a timely motion and that a low-ball offer may be construed as a bad faith effort rather than a true attempt to settle the case. Section 998 remains a trap that belies its purpose.

1 This article is not a blueprint of all the requirements for a §998 offer. For a thorough discussion of how to make a successful offer or demand, see Frank E. Marchetti & Eric A. Schneider, Making Effective Use of Section 998 Offers to Compromise, LOS ANGELES LAWYER, Oct. 2002, at 22.
2 CODE CIV. PROC. §998(c)(1).
3 See, e.g., CODE CIV. PROC. §§2031(m)(amending interrogatory answers), 2033(m) (amending answers to requests for admissions).
4 See text, infra. The party formulating an offer should try to anticipate what will be added to a basic recovery in order to determine what will truly induce a party to settle.
5 This is not unlike the provisions of Code of Civil Procedure §1025 permitting a defendant to deposit with the court the amount claimed by the plaintiff in order to avoid liability for costs. Taking this step is an admission of liability.
4th 249 (2002).

for a new trial.

judgment notwithstanding the verdict and its motion for

Indus., Inc. v. Olen, 21 Cal. 3d 218 (1978).

App. 3d 53 (1980).


Oregon Cummins Diesel, Inc., 195 Cal. App. 3d 692,


requirement imposed by the court of appeal in Wear

sumed that it adopted and accepted the good faith

knew Zamora was facing financial pressure.

offer was for almost the same amount, and 3) Clayborn

sought damages of over $140,000, 2) Zamora never

of real property, and the agreement contained a broad

tion arose from a written agreement for the purchase

54

 See Bus. & Prof. Code §6103.5 (permitting dis-

covery of counsel's transmittal of a written settlement

offer to his or her client).
Then, in 2001, California passed one of the nation’s first identity theft laws, the Identity Theft Victim’s Rights against Claimants Act, to address the growing menace of identity theft. Unquestionably among the best consumer protection statutes in the nation, these California laws are threatened by opinions holding that the federal Fair Credit Reporting Act (FCRA) preempts state law. A finding of preemption is an incorrect conclusion of law that is bad for California consumers.

In 1996, Congress addressed federal preemption in passing a series of amendments to the FCRA. These 1996 amendments were left intact when Congress again amended the FCRA in 2003. The 2003 amendments, known as the Fair and Accurate Credit Transactions Act (FACTA), resulted from lobbying by the credit and banking industries. They feared the prospect of state laws that imposed diverse regulations on the credit reporting industry and that were tougher than the federal law. FACTA was intended to overcome the sunset provisions of the FCRA that would have ended its federal preemption. It is important to note, however, that the FCRA as amended in 1996 contained a specific provision precluding federal preemption.

Erroneous federal district court decisions on California’s Consumer Credit Reporting Agencies Act need to be overruled

Among the states, California has a long tradition of being in the vanguard in passing laws that address new problems. In 1975, for example, the California Legislature passed the Consumer Credit Reporting Agencies Act (CCRAA), providing consumers with effective remedies for damage to credit reports caused by incorrect derogatory information.

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bureaus. At the federal level stand the FCRA against furnishers but not against credit theft. This California law offers remedies against Claimants law addresses identity theft. The more recent Identity Theft Victim’s Rights Act of 2008, known as the Identity Theft Revised Credit Act (CCRAA), creates a private right of action for identity theft victims. The CCRAA contains a provision that allows consumers to sue credit bureaus for failing to correct credit reports containing serious errors or inaccuracies.

The furnisher liability provisions of the California law are vital. Consumers face rampant inaccuracies in credit reports. According to one study of consumer credit reports:

- 25 percent of credit reports surveyed contained serious errors, such as false delinquencies or accounts that did not belong to the consumer, that could result in the denial of credit.
- 54 percent of the surveyed reports contained personal demographic information that was misspelled, outdated, belonged to a stranger, or was otherwise incorrect.
- 22 percent of the surveyed reports listed the same mortgage or loan twice.
- Almost 8 percent of the surveyed reports were missing major credit, loan, mortgage, or other consumer accounts that demonstrate the creditworthiness of the consumer.
- 30 percent of the surveyed reports contained credit accounts that had been closed by the consumer but remained listed as open.
- Altogether, 79 percent of the surveyed reports contained either serious errors or other mistakes of some kind.

These statistics follow more than a decade of enforcement of the FCRA by the Federal Trade Commission and private attorneys. In other words, existing enforcement and private remedies under the FCRA have been shown to be insufficient to alleviate the problem of inaccuracies in credit reports.

**Remedies for Consumers**

California has two statutes to protect Californians from identity theft, false credit reporting, wrongful credit reporting, and improper access to credit information. The CCRAA addresses identity theft, credit report damage and abuse, and improper access to private credit report information. The more recent Identity Theft Victim’s Rights against Claimants law addresses identity theft. This California law offers remedies against furnishers but not against credit bureaus. At the federal level stand the FCRA and FACTA. The FCRA and the CCRAA contain an identical requirement that creditors and credit reporting agencies are obligated to pursue maximum possible accuracy in credit reporting.

There is a recent California case, Schoendorf v. U. D. Registry, that addresses this requirement. The plaintiff, Schoendorf, used the CCRAA to challenge information on one of her credit reports concerning a dispute she had successfully resolved with a landlord. The credit reporting agency, U. D. Registry, refused to correct its credit report, claiming in its defense that what it had reported about Schoendorf was consistent with existing public records (although Schoendorf provided U. D. Registry with ample evidence that its derogatory marks were inaccurate). U. D. Registry filed an anti-SLAPP motion against the plaintiff, who appealed the adverse decision in trial court. The Second District sided decisively with Schoendorf and, quoting from an earlier decision, held that U. D. Registry “overlooks its broader obligations under the statutes as a credit reporting agency. Both [the] CCRAA and FCRA require ‘maximum possible’ accuracy.…Certainly reports containing factually correct information that nonetheless mislead their readers are neither maximally accurate nor fair to the consumer.’”

Schoendorf illustrates the difficulties that consumers face when they attempt to correct a derogatory item on their credit reports. Unfortunately, this is not the only problem confronting consumers. For example, consumers today are collectively carrying more debt on their credit cards than they ever have before. This development is made more worrisome by the result of a 1978 U.S. Supreme Court case, Marquette National Bank v. First Omaha Service Corporation. This decision allowed credit card companies to charge the highest interest rate permissible in the state in which the issuing bank is located—not the state where the cardholder lives. Many banks responded to this decision by moving their home offices to states such as South Dakota and Delaware, where there are no caps on the interest rates that banks may charge on credit card accounts. It may be argued, therefore, that if banks can exploit the differences among state laws, consumers should likewise be able to avail themselves of state laws that enhance their credit rights.

**Against Federal Preemption**

Additionally, there is a strong legal argument against the federal preemption of California’s CCRAA and Identity Theft Victim’s Rights against Claimants Act. Federal preemption occurs in two instances. First, it occurs when Congress expresses a clear intent to exert exclusive authority over a particular area of interstate commerce.

Second, preemption occurs when state law interferes with or frustrates the operations of federal congressional enactments. In cases in which Congress has not expressed a clear intent to have exclusive authority over a particular area of interstate commerce, federal courts are obligated to weigh against preemption and may only find it in two instances: one, when compliance with both state and federal law is a “physical impossibility”; or two, when the state law “stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.”

Nowhere does the FCRA state a congressional intention to exert exclusive authority over credit reporting. On the contrary, the FCRA expressly leaves room for state law that is not inconsistent with the federal law. Thus, the FCRA contemplates that state laws affecting credit reporting will be enforced. The FCRA even includes two express exceptions to any presumed preemption of state law. Specifically, the federal law mentions Chapter 93 of the Massachusetts Annotated Laws and Section 1785.23(a) of the California Civil Code as not being preempted by that part of the federal law that addresses the responsibilities of those entities or persons who furnish credit information to consumer credit reporting agencies.

The federal and California laws have consistently provided consumers with a right to sue credit bureaus (such as Experian or Transunion) for credit reporting abuse and government agencies with enforcement authority. Until 1993, however, there was no clear private right of action against furnishers. That year, the California Legislature amended Civil Code Section 1785.25 to impose specific requirements upon furnishers of “incomplete or inaccurate” derogatory credit information. The remedies for any violation of the CCRAA include actual damages, attorney’s fees, and punitive damages. This 1993 amendment left no question that the legislature intended to provide a private right of action to consumers against furnishers.

Creditor and debt collectors quickly challenged the 1993 amendment, claiming that the federal law preempted the CCRAA. The issue came to the Second District in 1995 in *Cisneros v. U. D. Registry, Inc.* The court relied upon applicable commentary from the FTC on the federal law and firmly decided against preemption. *Cisneros* is still good law and has not been overturned or distinguished on the preemption issue by any other California court. However, it did not stop the efforts of credit companies and furnishers to obtain preemption of the CCRAA.

In 1996 Congress struck a blow on behalf of consumers by amending the FCRA to provide a private remedy against furnishers for providing false or inaccurate credit information. Previously, a consumer could only
seek recourse with the FTC. Even after this amendment, furnishers still argued that the FCRA provided only for FTC enforcement. In 2002, the Ninth Circuit firmly disagreed in Nelson v. Chase Manhattan Corporation.28 In Nelson, the plaintiff appealed the judgment of the district court dismissing his suit under the FCRA against the creditor-defendant, Chase. The corporation had furnished allegedly false or inaccurate credit information to the three major credit bureaus. The parties in Nelson did not dispute that the FCRA creates a private right of action against the credit bureaus; rather, the controversy concerned whether the FCRA created a private right of action against a furnished.

The Ninth Circuit reversed the decision of the district court and unequivocally held that the primary purpose of the FCRA is to provide a private remedy to injured consumers and to protect consumers against inaccurate and incomplete credit reporting. Furthermore, the court held that the federal law conferred a private right of action against furnishers and credit bureaus. The Ninth Circuit held that although Section 1681s-2(a) limits enforcement to governmental bodies, Section 1681s-2(b) was specifically enacted to confer a private right of action to consumers against furnishers. The Ninth Circuit held that it is not for a court to remake the balance Congress struck between the two subsections or to introduce limitations on an express right of action.30

Well-Settled Error

The 1996 amendment to the FCRA that specifically exempts California Civil Code Section 1785.25(a) should have rendered preemption arguments nonexistent. After the amendment, however, federal district courts in California began citing a case decided in 1986, Pulver v. Aeco Financial Services. It held, in essence, that the CCRAA, as it existed in 1986, did not provide for a private right of action against furnishers. Simply put, to the extent that the 1993 amendments to the CCRAA expressly create a private right of action against furnishers, Pulver is no longer applicable law. Nevertheless, erroneous decisions granting federal preemption of the CCRAA remain well-settled error.

For example, the U.S. District Court for the Northern District of California relied on Pulver in finding preemption of the CCRAA in Quigley v. Pennsylvania Higher Education Assistance Agency,32 an unpublished case involving a pro per plaintiff and a short opinion, among other things. The same court nevertheless heeded Quigley in Lin v. Universal Card Services Corporation.33 Relying on Quigley, the court in Lin erroneously found preemption of the CCRAA on the basis that Section 1785.25 does not create a private right of action.34

In essence, Lin holds that if Section 1785.25(a) offered a private remedy it would conflict with federal law. The Lin court, however, reaches this conclusion by ignoring 15 U.S.C. Section 1681s-2(b), which, under Nelson, expressly gives a private right of action to consumers wishing to bring an action against furnishers. Lin also neglects Cisneros, which found against preemption in 1995. Later amendments to the FCRA do not negate the reasoning of Cisneros, which is that no real conflict between state and federal law exists on this issue. While the FCRA and the CCRAA have been amended since Cisneros, the key decisional language of Cisneros—that state laws are preempted if inconsistent with the FCRA “and then only to the extent of the inconsistency”—remains the same. Moreover, with the passage of Section 1681s-2(b), which provides a private right of action against furnishers under the FCRA, the state and federal statutes have grown more, rather than less, consistent.

Lin also ignores key language of 15 U.S.C. Section 1681t(b) exempting Section 1785.25(a) of the California Civil Code “as in effect on the date of enactment” of the CCRAA. The section was in effect on that date with reference to the remedies found at Section 1785.31. Particularly, it was never in effect as creating a law enforcement remedy only, as argued in Lin. Trying to pull Section 1785.25(a) away from Section 1785.31, which provides the remedies for violations, makes no sense whatsoever. The Lin court left Section 1785.25(a) floating in limbo, out of the reach of consumers, who are its intended beneficiaries.

Lin and other cases, however, have contended that Section 1785.25(a) is not a statute without a remedy, because California law enforcement agencies could enforce it, and such enforcement is what Congress intended in exempting Section 1785.25(a) from preemption. But this whole-cloth creation of legislative intent is not found in the language of the federal law or congressional records. Furthermore, the CCRAA contains no mention of law enforcement use of Section 1785.25(a).

To argue that Section 1785.25(a) gives a remedy only to law enforcement agencies renders other express provisions of the FCRA superfluous. In 1996, Congress specifically granted state attorneys general the power to enforce the FCRA. This enforcement power includes USC Section 1681s-2(a), which is essentially identical to Section 1785.25(a). In amending the FCRA, Congress did not intend to pass superfluous legislation.35 The argument that Congress intended Section...
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1785.25(a) for law enforcement use only compels this conclusion, however. Congress already gave the law enforcement powers of Section 1681s-2(a) to state attorneys general; there is no need for Congress to do so again by exempting California Civil Code Section 1785.25(a) from federal preemption only for law enforcement agencies and not for consumers.

Another argument for private enforcement of the California law is that the federal remedies do not provide California consumers with adequate redress against false and inaccurate credit reporting. As noted previously, after more than a decade of enforcement of the federal law by the FTC and private attorneys, 79 percent of the credit reports checked in a recent survey contained errors. One reason that the federal law has not led to better credit report accuracy may be the circuitous route that a consumer must take for redress. The federal law provides for a private right of action only after the furnisher receives “notice…of a dispute with regard to the completeness or accuracy of any information provided by a person to a consumer reporting agency.” In other words, under the FCRA, a consumer must first bring a dispute about false or inaccurate credit report information to the credit bureau. When the consumer disputes something on the report, the credit reporting agency then sends an automated dispute verification form to the furnisher. The furnisher then—supposedly—investigates the debt and reports to the agency with instructions to correct, delete, or keep the derogatory. If the credit derogatory is not corrected after the reinvestigation, then the consumer has a private right of action against the furnisher and the agency.

False derogatory information may exist on a consumer’s credit report for months or years without being discovered. The consumer may suffer severe financial damage as a result, yet the furnisher and agency may escape liability merely by removing or correcting the derogatory information after the consumer notifies the agency. However, by then, the damage is often already done.

Another problem with federal enforcement is that a consumer’s dispute does not trigger a duty to reinvestigate, and thus the potential for liability, unless it is directed at the credit reporting agency. If a consumer sends a letter to the furnisher only, no legal obligation to reinvestigate is triggered. It is logical, however, to dispute a false derogatory from Wells Fargo with Wells Fargo, not necessarily with Experian. Thus, consumers have disputed false derogatories sometimes for months or even years with the furnishers without triggering any legal duty to reinvestigate.

The CCRAA does not require that con-
Consumers complain via a credit bureau to trigger their rights. Under the California law, if a furnisher furnishes false or derogatory credit information that damages the consumer, the furnisher faces liability. The CCRAA is not, however, a strict liability statute. Civil Code Section 1785.25(g) states that a person who “furnishes information to a consumer credit reporting agency is liable for failure to comply with this section, unless the furnisher establishes by a preponderance of the evidence that, at the time of the failure to comply with this section, the furnisher maintained reasonable procedures to comply with those provisions.” This provision provides a safe harbor for furnishers while requiring them to maintain reasonable procedures to avoid liability.

Congress specifically excepted California from preemption in credit reporting law, so California clearly has the right to enact consumer protection laws that are more effective than their federal counterparts. The well-settled error of Lin and its predecessors needs to be brought to light, because it is depriving consumers of remedies that the state and federal governments intended to belong to California consumers.

1 The Consumer Credit Reporting Agencies Act, Civ. Code §§1785.1 et seq.
2 The Identity Theft Victim’s Rights against Claimants Act, Civ. Code §§1798.92 et seq.
7 Id.
8 Civ. Code §1785.25(a).
9 Nat’l Ass’n of State PIRGS, MISTAKES DO HAPPEN: A LOOK AT ERRORS IN CONSUMER CREDIT REPORTS (2004).
10 Civ. Code §§1785.1 et seq.
11 Civ. Code §§1798.92 et seq.
14 In addition to the familiar Big Three credit bureaus—Equifax, Experian, and Transunion—several smaller credit bureaus often cater to specific clients, such as landlords.
21 Except as provided in 15 U.S.C. §1681r(b) and (c), the “FCRA does not annul, alter, affect or exempt any person subject to the Act from complying with any state law with respect to the collection, distribution or use of any information on consumers, and then only
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22 15 U.S.C. §1681t(b) states: [N]o requirement or prohibition may be imposed under the laws of any state…with respect to any subject matter regulated under…15 U.S.C. Section 1681s-2…relating to the responsibilities of persons who furnish information to consumer reporting agencies, except…with respect to section 54A(a) of Chapter 93 of the Massachusetts Annotated Laws…or with respect to section 1785.25(a) of the California Civil Code (as in effect on September 30, 1996).
23 Civ. CODE §1785.25(a).
24 Civ. CODE §1785.31.
25 Civil Code §1785.25(a) has always provided for a private right of action and was never passed with any restriction preventing a private right of action.
  In enacting FCRA, Congress did not attempt to reserve to itself all efforts to regulate the consumer reporting business….California is not foreclosed from enacting greater protections for consumers injured by the activities of reporting agencies….The remedies afforded to injured consumers by CCRAA are not inconsistent with, but are in addition to, remedies provided by FCRA….We find further support for this view in the FTC’s official commentary on the FCRA’s preemption provision. According to the FTC, “State law is pre-empted by the FCRA only when compliance with inconsistent State law would result in violation of the FCRA.” (citations omitted)
28 Nelson v. Chase Manhattan Corp., 282 F. 3d 1057 (9th Cir. 2002).
29 Id. at 1060:
  It can be inferred…that Congress did not want furnishers of credit information exposed to suit by any and every consumer dissatisfied with the credit information furnished. Hence, Congress limited the enforcement of the duties imposed by §1681s-2(a) to governmental bodies. But Congress did provide a filtering mechanism in §1681s-2(b) by making the disputations consumer notify a CRA and setting up the CRA to receive notice of the investigation by the furnisher….With this filter in place…Congress put no limit on private enforcement….
35 See Nelson v. Chase Manhattan Mortgage Co., 282 F. 3d 1057, 1060 (2002) (“We cannot suppose that Congress made an amendment without a purpose.”). See also TRW v. Andrews, 534 U.S. 19, 31 (2001); “[I]t is a cardinal principle of statutory construction [that] a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant…. [W]e are reluctant to treat statutory terms as surplusage in any setting,” (citations omitted).
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Please join us in welcoming Jennifer and Stephanie.

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Improving Your Expert Deposition Results Is Easy

By David Nolte

In the vast majority of circumstances, your deposition results can be improved by adding a few questions that usually challenge expert witnesses. Consider the following practical advice gleaned from hundreds of actual depositions.

The questions should be modified slightly depending upon your deposition strategy. Before the deposition begins, determine whether you plan to use the deposition for persuading your opponent to settle or to prepare for trial. Whatever strategy you adopt will involve trade-offs. For example:

- If you aggressively cross-examine during the deposition, you may get exact admissions and a better chance of settlement. However, you will also reveal your attacks, which will allow your opponent to create responses between the deposition and trial. This is particularly troubling with experts, who presumably are required to modify their opinions as new information is learned.
- If you just ask for the expert’s opinion and the basis for the opinion, your opponents are more likely to remain unaware of their vulnerabilities. However, you will also lose opportunities to obtain valuable concessions.

Since the deposition is your time to learn, ask plenty of questions that you would never use at trial. Most examiners make insufficient use of open-ended questions that force the witness to explain what work was done and the rationale for the conclusions.

Questions that demand a yes or no response should be limited to areas in which you already know, or specifically wish to clarify, the expert’s conclusion and rationale.

Questions that start with who, what, where, when, why, and how will generate information that you would never get with questions that demand a yes or no response. Simple follow-up questions that will almost always work include “How do you know that?”, or “Why is that true?”

Ask questions that elicit limitations in, or concerns with, your opposing expert’s work. Examples include:

- What assumptions did you make?
- What is the factual basis for this opinion, and how do these facts lead to your conclusion?
- What information have you relied on that was provided by counsel or your client?
- What concerns do you have regarding your conclusions?
- Under what circumstances would you use a different methodology?
- What alternative hypotheses could explain what you observed?
- What other work would you have liked to have performed?

Use your expert to assist with the deposition. If you’ve hired the right expert, he or she will be able to provide years’ worth of insights and understanding. However, do not let your expert complicate the deposition with details that the jury will not understand. Instead, look for key points of underlying disagreement that alter your opponent’s entire conclusion.

Use hypothetical questions to move an expert witness off the established script that your opposing counsel is presenting. Hypothetical questions can turn an opposing expert into your witness when a different set of facts are presented. Hypothetical questions can also be used to support the positions of your other witnesses or positions. Similarly, reverse psychology is sometimes the best way of isolating a witness. Test the limits of how far the opposing expert will go to support the untenable. Isolate and discredit a witness who takes an extreme position by taunting him or her into taking positions that most will see as being silly.

Most depositions take proportionately too much time on the expert’s background. Unless the expert is truly inexperienced in the relevant field(s), many background questions can be covered by simply having the expert agree that his or her resume or CV is accurate. However, you should spend time looking for areas in which the current testimony contradicts or is impeached by:

- Authoritative works in the field. Get the expert to acknowledge which works are authoritative.
- Texts that the witness uses as references, or in classes the witness teaches.
- The witness’s testimony in other matters. Some of this can be obtained through databases that provide such information for a fee.
- The witness’s writings. The Internet is useful for obtaining this and other background information.

These same questions can also help your expert to prepare. Review the above areas with your expert well in advance of his or her deposition. Allow sufficient time for your expert to perform whatever additional work is cost-justifiable to remedy the problems that you uncover.

David Nolte is a principal at Fulcrum Financial Inquiry LLP with 28 years of experience performing forensic accounting, auditing, business appraisals, and related financial consulting. He regularly serves as an expert witness.
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Considering the Utility of Digital Pens

PEOPLE STILL RELY ON PEN AND PAPER to record important ideas and events. Pens remain unbeatable in terms of portability and ease of use, and their digital manifestation is now available to preserve and transcribe handwritten notes to a computer. I reviewed three digital pens, all having the properties of a normal ink pen and not requiring a wire connection while they are used to write. These pens also have the ability to digitally record their strokes, whether lettering or illustration. The motion is recorded into an image file that can be saved or exported in a common image file format.

Two pens use technology developed by Anoto. They are offered by Logitech (www.logitech.com) and Nokia (www.nokia.com). A different digital pen technology is offered by Seiko Instruments (www.seikosmart.com).

The Logitech is the largest pen of the group. Its girth is about three times that of a normal stick pen. This heft is required to hold the memory, image capture technology, and a rechargeable battery. Surprisingly, the pen is still light in weight. The Logitech pen holds about 40 pages of notes at a time, but users should expect to be able to capture no more than 20 to 25 pages on one battery charge. The information captured by the pen is downloaded to a computer through a USB docking station, which can also recharge the pen’s batteries.

For the Logitech pen to capture your handwriting, you must use special Anoto paper. This paper can be purchased in various standard sizes and has a slightly gray color because it is imprinted with very small dots, which the pen uses as a frame of reference for capturing handwriting and drawings. To facilitate downloading, the dot patterns vary on different pages and parts of pages.

For example, notebooks have pages that are formatted for e-mail messages, appointments, and to-do items. Formatted pages have sections for identifying information such as subject, date, and whether the user is finished writing on the page. The different sections have distinct dot patterns that the pen recognizes; information in the different areas automatically flows into corresponding fields on a computer. Thus, when the pen’s information is downloaded, the data is transferred into e-mail, text, or a calendar. Anoto paper is available through different vendors, including Mead Westvaco (www.ataglance.com), Esselte Worldwide (www.esselte.com), or Oxford Easybook (www.oxfordeasybook.com).

A Software Requirement

The Logitech comes with handwriting recognition software called My Script, but it is a 30-day trial version. Users are required to train the software by writing the alphabet and various symbols. In order to obtain reasonable results, users must print rather than use cursive, and very consistent handwriting is a must. In my testing the results were uneven. Someone who consistently writes in print would be better able to make full use of the Logitech pen. The Logitech software can only be installed on a computer that has Microsoft Network Framework. As hard as I tried, I could not install Net Framework on a Windows 98 computer, but it is preinstalled on XP.

The Nokia pen is somewhat sleeker that the Logitech and looks more like a normal pen but is still a bit heftier than a fountain pen. Although the Nokia uses the same technology as the Logitech, it operates in a different manner. The Nokia is designed to be used with a Bluetooth-enabled phone. The pen captures handwriting and then sends it to a cell phone over a Bluetooth connection. The cell phone can then send the originally handwritten note via e-mail. With a PC, however, the Nokia requires users to dock the pen to a USB connection.

Nokia claims the pen holds up to 100 pages in its memory. Like the Logitech, however, users can expect the battery to need recharging after about 20 to 25 pages or about 2 hours of steady use. As with the Logitech, users need to use Anoto paper for the Nokia to capture handwriting, and to connect the Nokia to a PC, the user must have Microsoft Net Framework installed. The Nokia pen does not come with the trial version of the My Script application and does not have the MS Word and Outlook integration that is found with the Logitech pen.

The Seiko

In size, the Seiko pen is the most similar to a traditional pen. The Seiko emits an ultrasonic sound that is received by a clip that can be attached to the top of a pad. No special paper is required. The clip, in turn, must be attached by a USB cable to a computer or by an infrared device connected to a PDA. The pen, receiver clip, and infrared transmitter all fit in the pen’s carrying case. The pen works with Palm and Microsoft Pocket PC devices, and the Seiko’s software installation is simple. Another potential bonus: Microsoft Net Framework is not required.

Gordon K. Eng is a business transactional and real estate lawyer in Torrance and a member of the Los Angeles Lawyer Editorial Board.
The Seiko is configured to work with a PDA. To use the Seiko this way, load its application onto the PDA via a hot sync with a desktop computer. Once that is accomplished, the user is ready to capture handwritten notes via the PDA. The pen is smaller than the other two because it does not have on-board memory. The PDA captures the handwriting as it is transmitted from the pen. The software also allows a direct transfer of images generated by the pen and stored on the PDA to the user's desktop computer. If the PDA has e-mail capability, the user may send handwritten notes as an e-mail attachment.

The Seiko pen does not come with handwriting recognition software. However, a handwriting recognition program called Rite Script (visit http://pi.parascript.com/piweb/products/ritescript) is available. In order for the software to recognize a section of text, the user must cut and paste the text into a MS Word document. I found the accuracy of Rite Script to be better than that of My Script. Rite Script also works wonders with hand-drawn charts. It will straighten lines and make your circles and rectangles look like you used a stencil to sketch them.

The Seiko pen must be in line of sight with the clip sensor. This may present difficulty for users who have a tendency to curve their hand around their pen. If your hand rests between the pen and the top of the page, where you would ordinarily put the sensor clip, you will block the signal from the pen. One solution is to put the sensor clip at the bottom of the page, although the images generated by this technique must be turned right-side-up after they have been captured.

The Seiko uses AAA batteries for the clip and watch batteries for the pen. The watch batteries for the pen last longer than the rechargeable batteries for the Logitech and Nokia pens but must be replaced rather than recharged.

The prices of all three pens are in Mount Blanc territory. The Logitech sells for $129 to $199, the Nokia for $249, and the Seiko for $97 to $110. The Nokia and Seiko pens succeed in the task of capturing and saving what the user writes. This feature alone may be reason enough for some users to begin using a digital pen. The Logitech has promise as a more complete solution, but its handwriting recognition software must improve—or the user must have or learn to have highly legible handwriting—before the Logitech’s added capabilities can be used to advantage. None of the solutions allow the user simply to pick up the pen and go. The user either needs Anoto paper, a compatible cell phone, or a PDA and receiver clip. Even with these inconveniences, however, the pens are portable, potentially valuable tools to capture information and preserve it digitally.
28th Annual IPEL Symposium

ON SATURDAY, NOVEMBER 13, the Intellectual Property and Entertainment Law Section (IPEL) will present its 28th annual symposium, titled “The Art of the Deal, Hollywood Style.” Speakers including Robert J. Dowling (who will deliver the keynote address), Jay L. Cooper, Eric Weissmann, Beth Roberts, Lawrence J. Ulman, Louis M. Meisenger, and Jeanne Newman will lead programs on production and financing deals, talent deals, and distribution deals. The symposium will take place at the Bel Air Hotel, 701 Stone Canyon Road in Los Angeles. On-site registration will begin at 7:45 A.M., with the program continuing from 8:30 A.M. to 2:00 P.M. The registration code number is 008645. The prices below include the meal.

$75—CLE+Plus members
$170—IPEL Section members
$200—LACBA members
$235—all at-the-door registrants
4.75 CLE hours

Ethics 2004

ON SATURDAY, NOVEMBER 20, the Los Angeles County Bar Association will present an ethics program titled, “Keeping Current in a World of Change.” Speakers John W. Amberg, Richard J. Burdge, Stanley E. Goldich, Diane L. Karpman, and Judge Michael D. Marcus will discuss four ethics issues: 1) mediation and arbitration, including disclosure obligations, conflicts of interest, and the confidentiality of mediation discussions, 2) ethics as affecting pocketbook issues—including fee agreements, referral arrangements, conflicts of interest, advertising, and multijurisdictional practice, 3) confidentiality of privileged communications, including inadvertent disclosures, waiver situations, and confidentiality agreements in settlements, and 4) responding ethically and effectively to hardball tactics, including how to counter groundless litigation, discovery abuses, and scheduling by ambush. 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 9 A.M. to 12:15 P.M. The registration code number is 008766. The prices below include the meal.

$55—CLE+Plus members
$80—LACBA members
$100—all others
3.25 CLE ethics hours

THE SEARCHABLE CIVIL REGISTER

ON THURSDAY, DECEMBER 2, the Los Angeles County Bar Association will present a demonstration of its searchable civil register database. LACBA has a searchable database replete with information about judges, commissioners, and parties. In addition, LACBA regularly downloads the superior court civil register (docket sheets) and has created a search engine allowing for searches by almost any criteria. After learning to use the database, attorneys can research a judge’s history of: peremptory challenges filed against the judge in any given year, motions for summary judgment granted and denied, days spent in trial, demurrers granted and denied, SLAPP motions granted and denied, motions to compel granted and denied, continuances granted and denied, and much more. Researchers can also find out about the number and types of cases in which various parties and law firms are or have been involved. For example, Is your opposing party a vexatious litigant? Which other firms has your client retained? This powerful system will be demonstrated by two masters: John Collins, veteran trial lawyer and current president of LACBA; and Rich Walch, the departing executive director of LACBA for the last 20 years. The program will take place at the LACBA/Lexis Publishing Conference Center, 281 South Figueroa Street, Downtown. On-site registration and a meal will begin at 6 P.M., with the program continuing from 6:30 to 7:30 P.M. The registration code number is 008828. CLE+Plus members may attend for free.

$15—LACBA members
$30—all others
1 CLE hour
Judging at the Games

IN ADDITION TO INSPIRING MILLIONS around the world, the 2004 Summer Olympics offered interesting lessons on the difficulty of uniformly judging human performance and technical skill while, at the same time, rewarding the athletic expression of originality and virtuosity. In sport as in law, the more subjective judging becomes, the more a corrosive dilemma intrudes in choosing between ideal process and ideal outcome.

The opening ceremonies in Athens lent a spectacularly beautiful and meaningful beginning to the Games, reminding us with spectacular imagery of the peculiarly Greek origin of our notions of justice, perfectionability, and grace through competition. Implied, however, in our concept of justice is the possibility of corruption; in perfectionability, flaw; and in glory, cowardice. One hitch in the otherwise flawless first night was the dashed expectation that lionized Greek sprinter Kostas Kenteris would light the torch. Instead, he had missed a mandatory drug test the day before, under circumstances heightening suspicions of doping that have dogged his career. His suspension underscored how the relative simplicity of officiating track and field—determining who runs fastest, jumps highest, or throws farthest—has been replaced by sophisticated laboratory science, investigation, and legal process. Still, technological innovations add objectivity, incrementally improving the measure of man.

More problematic is fairly rewarding athletic achievement in sports that are judged, such as gymnastics, diving, and figure skating, or refereed, such as basketball, soccer, and water polo. Sometimes judging bias is as prosaic as the sentimentalism of home field advantage. Although the 2004 Greek gold medalist on rings, Dimosthenis Tampakos, was outstanding, Bulgarian silver medalist Jordan Jovtchev’s execution and degree of difficulty were plainly superior.

A more corrosive bias is judging influenced by national origin. In men’s gymnastics, for example, controversies with nationalist overtones arose over the start values of various routines. The use of a start value is a judging reform introduced to improve scoring objectivity. Elements of a gymnast’s routine are prescored for difficulty. To compete for a perfect 10, the participant must complete a certain number of sufficiently difficult skill-routines in combination. From the start value, judges deduct for flaws, such as breaks in form or continuity.

Prior to the introduction of start values, men’s routines typically began at 9.4 points, with judges permitted to add up to .6 for risk, originality, and virtuosity—amorphous Olympic values. Predictably, the reform has diminished creativity, and risk is now less rewarded. Russian Alexi Nemov, for example, might have taken gold instead of fifth on horizontal bar for his dynamic, crowd-pleasing routine.

Still, the reform provides competitors, judges, and educated spectators with better “notice”—that is, a commonly shared objective frame of reference for how a routine will be judged. But reform has not resolved all problems. Video review, for example, demonstrated that a U.S.-led, three-judge panel incorrectly devalued the start value of the parallel bars routine of South Korean all-around bronze medalist, Yang Tae-Young. But for this 0.1 error, Yang would have placed ahead of American gold medalist Paul Hamm. But video review also suggested that judges missed a critical error in Yang’s routine—a 0.2 deduction that would have canceled the original mistake.

In the team preliminary, a Japanese judge controversially informed two U.S. gymnasts that their horizontal bar start value would be 9.8, notwithstanding that the same routines were consistently scored at 10.0 in prior international competition. Ironically, the judge involved in the controversy had been a competitor on the horizontal bar for Japan in 1976 in Montreal during the men’s team final, which involved perhaps the most overt attempt to improperly influence gymnastic judging. Sensing that a Soviet effort to defeat dominant Japan was unraveling, a Soviet judge left his station at rings, as the Japanese team competed on the last event, to join a caucus among the horizontal bar judges. His only possible reason for entering the huddle, it would seem, was to exert improper influence.

When cheating appears this blatant, it raises an ethical dilemma for a would-be neutral judge. If the judge knows to a reasonable certainty that a judge scoring another event is distorting team scores, is it ethical for the neutral judge to correct the balance by inflating competitors’ scores on the event he or she is judging? If the neutral judge gauges the bias and alters scores, the deserving team wins, but the judge has corrupted the sport. No amount of chalk will create friction on that slippery slope. It is no sweeping endorsement of situational ethics to suggest that in the case of blatantly corrupt judging, the best ethical choice may vary depending upon the situation.

Our daily practice of law can be quite similar, dependent as it is on the skill and discretion of judges. Every time a court selects a path that expands or contracts judicial discretion, it potentially alters the balance between objective and subjective determination and, thereby, between process and outcome. The natural imperative, then, difficult though it may be, is to make judging decisions as objective as possible, but without sacrificing the freedom—that is, the risk, originality, and virtuosity—which is the end goal or, as Aristotle might say, telos, of individual athletic participation in the Games as well as our individual participation in civic life.

If a judge knows that a judge scoring another event is distorting team scores, is it ethical for the neutral judge to correct the balance?

Robert L. Bastian Jr. is a partner in the Law Offices of Bastian & Dini, in Los Angeles. He competed in gymnastics for the University of Wisconsin, Madison.
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