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It is Thursday, 7:45 A.M., at Sixth and Alvarado. I drive past a guy with clean-cut hair and a nice suit making a deal with another guy whose black granite eyes and fire hydrant shoulders are the stuff of suburban nightmares. I am tempted to pull over and take the suited guy aside and say, “Man, you do not have to live like this.” But I don’t. I proceed to the parking structure below my office building, and before going up to my office I pray that the suited guy finds his way to sobriety before he loses everything.

Some years ago, that suited guy getting a fix at Sixth and Alvarado was me. Blessedly, my substance abuse and my eventual recovery and rehabilitation did not involve getting arrested, committing legal malpractice, jeopardizing my career track, or ruining my marriage. Although my colleagues knew me as a connoisseur of bourbons and scotches, they were shocked when I announced I was going to rehab. Were they in denial, or did I hide it that well? I still don’t know. I do know that their grace and understanding during those early months means a great deal to me, and the firm elevated me to partner less than two years later. I would not have made partner if I had not sought help when I did.

My point is that a lawyer with a drug or alcohol problem often fears professional reprisals for admitting that there is a problem and seeking help. I understand that fear, but the costs and reprisals, not to mention the personal degradation, of letting the problem explode publicly is far worse than seeking help when help is needed. Take a look at the suspensions and disbarments published in the Daily Journal, and you will see that many lawyers destroy their careers with drug and alcohol addiction. The 2001 Report on the State Bar of California Discipline System listed “Drug Court” as its second highest priority to address “the problem of substance abuse that is related to attorney misconduct.”

Thankfully, resources have since been made available for attorneys struggling with alcohol and drug abuse. The new State Bar president has made drug and alcohol treatment for lawyers a top priority. In 2002, the State Bar’s Lawyer Assistance Program substantially expanded State Bar aid to attorneys with substance abuse or mental health problems by providing confidential counseling and recovery programs. There is also the Alternative Discipline Program for attorneys facing disciplinary action as a result of addiction. And finally, there is the abstinence support group known as the Other Bar. Information for each program is available at the State Bar’s Web site. The goals of all these programs is to provide recovery assistance before an attorney wipes out his or her career and reputation.

In addition, most reputable legal employers have policies in place that expressly accommodate attorneys who voluntarily seek substance abuse treatment. These policies rarely address the issue of protecting attorneys from disfavor or bias as a result of their decision to seek treatment, but legal employers should not only take steps to do so but include the necessary protection in their policies. I know of no law firm with a policy to accommodate an attorney, especially an associate, who is forced into treatment as a result of arrest, prosecution, or legal misconduct.

A lawyer’s first and last credential is his or her reputation. Reputation is the first casualty of an addiction that emerges messily in the public spotlight and is often the last piece of an attorney’s life that is rehabilitated. Voluntary treatment, however, protects an attorney’s reputation. If you or a colleague need treatment for substance abuse, the discomfort involved in confronting the issue immediately will be nothing compared to the devastation of awaiting and experiencing the disastrous consequences of untreated addiction.

—from the Chair

R. J. Comer is a partner at Allen Matkins Leck Gamble & Mallory LLP, where he specializes in land use law and municipal advocacy. He is the chair of the 2005-06 Los Angeles Lawyer Editorial Board.
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ONE PIECE OF ADVICE that the novice litigator learns quickly if he or she wants to be successful is that it is not enough to know all about the law, you must also know enough about the judge. This means that counsel should have a thorough understanding of the various types of judges.

In the federal court system, trial-level federal bench officers include district court judges, magistrate judges, bankruptcy court judges, and administrative law judges (ALJs). Bankruptcy judges (appointed by the court of appeals for 14-year terms) and ALJs have specialized jurisdiction. District court judges are nominated by the president of the United States and confirmed by the U. S. Senate pursuant to Article III of the Constitution. These are lifetime appointments to the bench.

District court judges handle civil and criminal matters. Generally, a case is sent to a particular judge when it is filed, and that judge retains the case through its disposition. This includes pretrial proceedings, motions, trial, and posttrial proceedings.

Other Federal Bench Officers
Magistrate judges are Article I judges appointed for terms of eight years by the district court judges to assist them in handling cases. Magistrate judges generally oversee such issues as the initial proceedings in criminal cases (e.g., search warrants, bail hearings), try criminal misdemeanor cases, try civil cases with the consent of the parties, and conduct other proceedings referred to them by district court judges (e.g., pretrial and settlement conferences, discovery disputes, review of prisoner petitions). It is common for a district court or some or all of the district judges of that court to issue one or more orders making a blanket reference of certain types of matters, such as discovery, to magistrate judges.

Each federal district court has a chief judge (and many have a chief magistrate judge as well) who exercises administrative authority over the court in addition to handling a normal workload. In addition, district courts will often have committees of judges that serve to review and make recommendations regarding various aspects of court administration.

Appeals from district court rulings go to the circuit courts of appeals. The judges of the circuit courts of appeals, like district court judges, are Article III judges. However, unlike state appellate bench officers, they are referred to as judges, not justices. (This has led to the quip, “There’s no justice in the court of appeals.”) One sure way to distract a panel of circuit judges from focusing on the merits of the matter being argued is to mistakenly call one of the judges a justice, which may lead to the rejoinder, “Thanks for the promotion, counsel, but I’m not on the Supreme Court yet.” This is funny to everyone except the lawyer trying to argue the case.

Los Angeles County Superior Court Rule 8.5 succinctly provides:

“When addressing the trial judge in court, ‘Your Honor’ is proper; ‘Judge’ or ‘Judge (Name)’ is improper.” Obey this rule—many judges take umbrage at being addressed improperly.

The Ninth Circuit also has an appellate commissioner. This is a non-Article III officer who makes nondispositive decisions on case management issues, such as appointment or release of counsel, attorney discipline, case settlement, and special masters. The commissioner also may reconsider decisions made by a procedural motions clerk.

Although appointed for life (technically while showing “good behavior”), district and circuit court judges have the option of retiring from regular active service and taking senior status, which is based on a formula involving their age and years of service. Senior judges may opt for a reduced caseload. Judges on senior status are an indis-
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elected and does not appear on the ballot. The judge is elected for a six-year term.

A judicial aspirant who has not been appointed may also seek a spot on the superior court bench by running for election against a judge whose term is expiring or running for a vacant seat after the retirement or death of a judge.

Los Angeles County Superior Court Rule 8.5 succinctly provides: “When addressing the trial judge in court, ‘Your Honor’ is proper; ‘Judge’ or ‘Judge (Name)’ is improper.” Obey this rule—many judges take umbrage at being addressed improperly.

Almost a quarter of superior court judicial positions statewide are occupied by subordinate judicial officers who are selected by the superior court judges. These include commissioners, referees, and magistrates. Commissioners commonly hear preliminary hearings (among many other types of cases), misdemeanor and small claims matters, juvenile matters, family law matters, and traffic cases. They set bail and perform other tasks to assist the superior court, including acting as judges pro tempore. Commissioners are generally addressed as “judge” as an appropriate sign of respect.

Referees and Others
A referee is a lawyer appointed by the court to hear and make decisions on limited legal matters. Magistrates issue arrest warrants and find probable cause at preliminary hearings (among many other types of cases), misdemeanor and small claims matters, juvenile matters, family law matters, and traffic cases. They set bail and perform other tasks to assist the superior court, including acting as judges pro tempore. Commissioners are generally addressed as “judge” as an appropriate sign of respect.

The court of appeal is divided into districts, and some of those are subdivided into divisions, with each district having an administrative presiding justice and each division having a presiding justice. The California Supreme Court consists of a chief justice and six associate justices.

Before appearing before any judicial officer, the wise advocate reviews the relevant judicial profile to learn more about the person wearing the robe. Another good idea is to search for relevant opinions that the judge or justice has authored and to talk to other lawyers who have appeared before the judge. Always remember that despite their robes, judges simply are fellow professionals with a difficult job to accomplish.
A MOTION PICTURE STUDIO produces an independent film that includes infringing footage from a third-party production. The film becomes a huge hit. A year later, the owner of the infringed footage sues the studio for copyright infringement, seeking profits from the infringing film—and profits from all the other films the studio produced after using the infringing footage.

The footage owner claims that the infringement increased the visibility and reputation of the studio and contributed to higher revenue for the studio, not just from the infringing film but from the studio’s other productions. The footage owner has no evidence to support its claim for a portion of all of the studio’s profits, other than the conclusory testimony of its expert witness that approximately 5 percent of the studio’s profits are attributable to the infringement.

Until fairly recently, the footage owner’s claim for so-called indirect profits—that is, profits not directly related to or flowing from the copyright infringement—might have met with some success in the Ninth Circuit. Over the past few years, however, the Ninth Circuit has made it more difficult for copyright plaintiffs to recover indirect profits.

Prior to 2002, the footage owner may have been entitled to recover profits from the studio’s noninfringing films because the Ninth Circuit required virtually no evidence to support such a claim, allowing indirect profits on the faintest showing of some promotional purpose for the infringement. Under the current standard, by contrast, it is unlikely the footage owner would recover any profits from the noninfringing films because the owner lacks any nonspeculative evidence of a causal connection between the infringement and the profits from those other films. Although the Ninth Circuit first articulated this stricter standard several years ago, it did so in conclusory terms that offered little guidance as to the type and scope of evidence needed to support an indirect profits award. It was not until the recent Polar Bear Productions, Inc. v. Timex Corporation case that the Ninth Circuit finally fleshed out that standard.

Under the Copyright Act, a copyright plaintiff may recover actual damages (often referred to as injury to market value) as well as the infringer’s profits to the extent the profits are not included in the award of actual damages. In order to recover profits, the copyright plaintiff must demonstrate that the profits are “attributable to the infringement.”

The Ninth Circuit has recognized two types of profits in copyright cases: direct profits and indirect profits. Direct profits are profits that are generated by selling or otherwise exploiting an infringing product, while indirect profits do not flow directly from the sale or exploitation of the infringing product.

Pre-Polar Bear Cases
The Ninth Circuit first discussed indirect profits in Frank Music Corporation v. Metro-Goldwyn-Mayer, Inc. (Frank Music I). That case arose out of defendant Metro-Goldwyn-Mayer, Inc.’s use of music from the plaintiffs’ musical play Kismet in a dance revue staged at MGM’s Las Vegas hotel. Approximately 12 percent of the dance revue’s weekly running time included music from Kismet.

The Ninth Circuit held that because the dance revue served, in part, to promote the hotel’s lodging and gaming operations, a portion of the profits from those operations was recoverable as indirect profits. The court remanded the case to the district court for a determination of the amount of indirect profits attributable to the infringing music.

In Frank Music II, the Ninth Circuit affirmed the district court’s determination of indirect profits. The court noted that the district court considered a number of factors that contributed to MGM’s profits—including the hotel’s restaurants, guest accommodations, cocktail lounges, casino, and banquet facilities, as well as “the role of advertising and general promotional activities in bringing customers to the hotel.” With no substantive analysis, the appellate court affirmed the district court’s seemingly arbitrary conclusions that 2 percent of the hotel’s profits from lodging and gaming operations were attributable to the revue and that 9 percent of that amount was attributable to the infringing music. The Ninth Circuit did not question the district court, concluding that “[i]n light of the general promotion and the wide variety of attractions available at MGM Grand, the conclusion

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is not clearly erroneous.”7

The Frank Music cases created an amorphous and lenient standard for recovering indirect profits. Under those cases, in order to recover a portion of the infringer’s profits from all of its business operations, a copyright plaintiff need only demonstrate that the infringement had some promotional purpose, however minimal, that could benefit the infringer’s business. Because any infringement arguably has a promotional purpose for the infringer, the Frank Music cases provided an incentive for plaintiffs to inflate their damages demands with the hope of receiving a windfall.

In Mackie v. Rieser, the Ninth Circuit sought to clarify its rulings in the Frank Music cases and set forth a more coherent standard for the recovery of indirect profits. In Mackie, the defendant, the Seattle Symphony Orchestra, included a copy of the plaintiff’s art work in its promotional brochure for its “pops” series of concerts. The plaintiff sought recovery of a portion of the total profits generated by the symphony during the time in which the symphony used the infringing brochure.8

The Ninth Circuit denied recovery, concluding that the plaintiff failed to establish a causal link between the symphony’s infringing use of the plaintiff’s art work and the symphony’s revenue. The court held that in order to recover indirect profits, “a copyright holder must proffer sufficient non-speculative evidence to support a causal relationship between the infringement and the profits generated indirectly from such an infringement.”9

The court rejected the plaintiff’s expert’s testimony that the infringing brochures were responsible for generating 1.5 percent of the symphony’s profits for the year. In doing so, the court emphasized that the same expert had admitted that he “could not ‘understand’ how it would be possible to establish a causal link” between the infringement and the indirect profits. The court opined that there are endless reasons why an individual would attend a concert (such as the “[s]ymphony’s reputation, or the conductor, or a specific musician, or the dates of the concerts, or the new symphony hall, or the program, or the featured composers...”) and that it would be pure speculation to conclude that the symphony’s infringement of the plaintiff’s art work was an influencing factor. The court observed that the plaintiff’s art work was included on just one of the 24 pages of the brochure and noted that “rank speculation” cannot support a claim for indirect profits.10

The Mackie court found support for its stricter standard for the recovery of indirect profits in the Frank Music cases but acknowledged that the indirect profits discussion in those cases “was somewhat opaque.” According to the Ninth Circuit in Mackie, the Frank Music cases “strongly implied that a district court must conduct a threshold inquiry into whether there is a legally sufficient causal link between the infringement and subsequent indirect profits.”11 However, because the plaintiff’s own expert essentially conceded that the plaintiff’s indirect profits claim lacked merit in that case, it was unnecessary for the Mackie court to explore the precise contours of the new standard. Thus, although the Ninth Circuit purported to clarify its stricter standard for the recovery of indirect profits in Mackie, the decision left unclear precisely what type and amount of evidence will satisfy that standard.

The Polar Bear Directive

In Polar Bear, the Ninth Circuit finally applied and gave substance to the indirect profits standard set forth in Mackie. For the first time, the court analyzed and quantified the evidence required to demonstrate a sufficient causal connection between copyright infringement and indirect profits.

The plaintiff, Polar Bear Productions, Inc., created film footage featuring whitewater kayaking stars “paddling through exotic locales in North and South America” while using equipment bearing the logo of defendant Timex Corporation. After Timex’s license to use the video expired, Timex continued to display the video at trade shows, in a promotional campaign, and in training videos. Polar Bear sued Timex for copyright infringement and trademark infringement, among other claims.

Polar Bear’s expert identified three categories of indirect profits sought by Polar Bear. The plaintiff was requesting indirect profits from “1) Timex’s direct sales at trade shows; 2) its use of a still image in a promotion affiliated with the soft drink Mountain Dew; and 3) the overall enhancement of brand prestige resulting from Timex’s association with the sport of extreme kayaking.”12 The jury awarded Polar Bear $2.1 million in indirect profits without apportioning its award among those three categories.

On appeal, although the Ninth Circuit concluded that a sufficient causal connection had been established regarding the first and second of the three categories of indirect profits, the court vacated the jury’s award in its entirety. Although the jury did not delineate the components of its $2.1 million award, it was clear that the bulk of that award (at least $1.77 million) necessarily related to the third category of indirect profits, as to which the Ninth Circuit held that no causal link had been established. It also was possible that the jury attributed the entire award to the unproven “brand premium effect.”13

In a somewhat lengthy opinion, the court first explained that the Ninth Circuit has repeatedly allowed the recovery of indirect profits in copyright cases.14 The court quoted Mackie: “[A] copyright holder must establish the existence of a causal link before indirect profits damages can be recovered.”15 The Polar Bear court proceeded to emphasize that:

We do not suggest that a showing of causation is required only for claims of indirect profits, but that causation in indirect profit claims is often more attenuated than claims for actual damages or direct profits. It is therefore particularly important for the plaintiff in [an] indirect profit action to demonstrate the alleged causal link between the infringement and profits sought.16

The court then discussed in detail the amount of evidence required to establish a sufficient causal link.

The Ninth Circuit found that Polar Bear had established the requisite causal link with regard to the first category of indirect profits, direct sales from trade booths. Polar Bear’s expert calculated Timex’s sales from trade booths and concluded that approximately 10 to 25 percent of the sales were the result of “excitement created by the booth promotion,” of which the Polar Bear footage was a substantial part. Out of $360,000 in gross trade show revenue, the expert estimated that between $20,000 and $50,000 in net profits were related to the infringing footage.17

The court also found that Polar Bear met the indirect profits standard for the second category of indirect profits, Timex’s use of a still image in a Mountain Dew promotion. The court held that Polar Bear had established a causal connection between the infringement and revenue through “circumstantial evidence” that 1) the Mountain Dew promotional booklet contained an advertisement that included infringing material, 2) customers who ordered watches through the promotion would have seen the advertisement, and 3) Timex earned profits from the promotion.18

The court rejected the jury’s determination regarding the third and largest category of indirect profits, namely, profits allegedly attributable to the overall enhancement of brand prestige of Timex’s Expedition line of watches. Polar Bear’s causation theory, summarized by the court, was “that the infringement at the trade shows created excitement about the product and an association between Expedition watches and outdoor sports, that the excitement and association generated at the trade shows somehow translated into consumers purchasing Timex’s products, and that consumer enthusiasm permitted Timex to..."
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In an effort to demonstrate a connection between the infringed footage and the indirect profits, Polar Bear’s expert testified that “a significant portion of the price increase for Expedition watches during a four-year period was the result of customers’ favorable feelings generated by Timex’s promotional efforts” involving the infringing material. By multiplying the increase in watch price by the number of watches sold, the expert estimated that $1.5 million to $3 million in indirect profits were connected to the infringement. Polar Bear claimed that the causal link was evidenced by Timex’s statement that the promotion was “an unqualified success” and that the infringing images formed “a significant part” of Timex’s promotion at the trade shows.

The Ninth Circuit disagreed and struck down the jury’s indirect profits award, which was principally related to Polar Bear’s “enhanced brand prestige” claim. The court held that Polar Bear had not satisfied, and could not satisfy, its duty “to establish a causal connection between the infringement and the gross revenue reasonably associated with the infringement” when the gross revenue at issue was the overall revenue derived from enhanced brand prestige.

The court noted that Polar Bear was not required to put Timex customers on the witness stand to testify as to why they purchased the watches but held that “too many question marks remain between the promotional infringement, the purported enthusiasm generated among wholesalers and retailers by the advertising, the increased prices, and Timex’s ultimate profits.” The court concluded that “it is impossible to connect the dots of [the plaintiff’s] theory because there is a gap between the infringement and actual sales revenue—and thus, the alleged profits.”

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In rejecting the third prong of Polar Bear’s indirect profits claim, the court cited an Eighth Circuit decision in which indirect profits were allowed when 1) there was evidence that the infringing material used by an automobile manufacturer in a widely aired commercial was the centerpiece of the commercial, 2) sales during the period in which the commercial was aired were above the auto manufacturer’s projections, and 3) the auto manufacturer paid the advertising company that created the advertisement a “substantial bonus.” The Ninth Circuit distinguished the Eighth Circuit case on the grounds that, in *Polar Bear*, retail purchasers were never exposed to the infringing images from the trade shows, and there was no evidence that
vendors at the trade shows “somehow transmitted enthusiasm to retail customers.”23

Because “the invalid portion of the indirect profit award far eclipsed the legitimate portion,” the Ninth Circuit vacated the entire indirect profits award.24 After first acknowledging the availability of indirect profits in a copyright infringement case 20 years ago, the Ninth Circuit has finally articulated and meaningfully applied an intelligible standard for the recovery of this type of profits. Although copyright plaintiffs may feel left out in the cold by the Polar Bear case, the decision should deter baseless claims for business profits that have little, if any, connection to the alleged copyright infringement.

1 Polar Bear Prods., Inc. v. Timex Corp., 384 F. 3d 700 (9th Cir. 2004).
2 17 U.S.C. §504(b) (A copyright owner who prevails in an infringement action “is entitled to recover the actual damages suffered by him or her as a result of the infringement, and any profits of the infringer that are attributable to the infringement and are not taken into account in computing the actual damages.”).
3 Mackie v. Rieser, 296 F. 3d 909, 914 (9th Cir. 2002).
4 Frank Music Corp. v. Metro-Goldwyn-Mayer, Inc. (Frank Music I), 772 F. 2d 505, 517 (9th Cir. 1985).
5 Earlier in 1985, the Ninth Circuit arguably permitted the recovery of indirect profits but without making any explicit reference to the term “indirect profits” or the standard for the recovery of such profits. Cream Records, Inc. v. Joseph Schlitz Brewing Co., 754 F. 2d 826, 829 (9th Cir. 1985).
6 Frank Music Corp. v. Metro-Goldwyn-Mayer, Inc. (Frank Music II), 886 F. 2d 1545, 1546 n.2 (9th Cir. 1989).
7 Frank Music I, 772 F. 2d at 517. The case involved the application of the 1909 Copyright Act rather than the 1976 Copyright Act. Nevertheless, profits are recoverable under both acts, and the Ninth Circuit’s ruling regarding indirect profits should apply to both acts. See Mackie, 296 F. 3d at 914.
8 Frank Music II, 886 F. 2d at 1550. In particular, the court found that 9% of the MGM Grand Hotel’s operational expenses related to the infringing portion of the revue and affirmed the district court’s indirect profits award of approximately $700,000 (2% of 9% of the total profits of $389 million—amount that excludes MGM’s $6.1 million in direct profits from the revue).
9 Mackie, 296 F. 3d at 912-14.
10 Id. at 916.
11 Id. at 915.
12 Polar Bear Prods., Inc. v. Timex Corp., 384 F. 3d 700, 705, 712 (9th Cir. 2004).
13 Id. at 712-13, 716.
14 Id. at 710.
15 Mackie, 296 F. 3d at 914.
16 Polar Bear, 384 F. 3d at 711 n.7.
17 Id. at 712.
18 Id. at 712-13.
19 Id. at 713-14.
20 Id.
21 Id. at 715.
22 Id.
23 Id. at 714 (citing Andreas v. Volkswagen of Am., Inc., 336 F. 3d 789, 796-98 (8th Cir. 2003)).
24 Id. at 716.
IRS Scrutiny of Tax-Exempt Organizations

INTERNAL REVENUE SERVICE COMMISSIONER Mark Everson recently urged charities to head off what he called “the gathering storm” of tax compliance problems facing the tax-exempt sector.1 In its strategic plan for 2005-09, the IRS has identified several problems as abuses by tax-exempt entities and by nonexempt parties that use these entities to avoid taxes or engage in noncharitable activities.

Tax-exempt entities are usually viewed as benign organizations that present the IRS with few issues. However, with enforcement now being given greater attention, the agency is focusing on four abuses involving these entities: 1) abusive tax avoidance transactions, 2) excessive compensation, 3) credit counseling agencies, and 4) diversion of funds to support terrorist activities.

An organization may qualify for tax-exempt status if it serves a public purpose designated by the Internal Revenue Code as justifying exclusion from paying federal income taxes. These include groups benefiting the poor; promoting religion, education, and social welfare; and supporting fraternal organizations.2 The opportunity to avoid paying taxes has encouraged some to use tax-exempt entities for their private inurement. Self-dealing between insiders and these entities, such as when a director or officer inflates the value of the goods or services sold to a tax-exempt entity, is but one example. In 1996 the intermediate sanction regime was enacted to severely penalize those engaging in such transactions. Self-dealers must now repay the excess benefit with interest to the tax-exempt entity and are liable for a 25 percent tax.3 Any director who approves an inflated contract is also required to pay a 10 percent tax on the value of the transaction.4

A perceived increase in abuses has focused the attention of the IRS on exempt entities. Recent public events—such as the September 11 terrorist attack, the collapse of huge corporations because of executive mismanagement, questionable practices by credit counseling organizations, and a multibillion dollar revenue loss partially caused by tax shelters—have also contributed to the heightened scrutiny.

These events and congressional mandates have given the IRS the impetus to increase its enforcement resources. Under the IRS Restructuring and Reform Act of 1998, Congress directed the agency to organize itself into separate divisions based on taxpayer groupings.5 Accordingly, the IRS created the Exempt Organizations Division within the new Tax Exempt and Government Entities Division to monitor, apply, and enforce the tax laws applicable to tax-exempt groups. The release in 2004 of the 2005-09 strategic plan established the IRS’s new mantra: “Service plus enforcement equals compliance,” and the establishment of the Fraud and Financial Transactions Unit (FFTU) in the Exempt Organizations Division augmented the agency’s ability to provide law enforcement agencies with expertise on exempt organizations and to track foreign grant activities.

The Exempt Organizations Division’s attention to what the IRS characterizes as abusive tax avoidance transactions (ATATs), excessive executive compensation, credit counseling agencies, and terrorist activities is reflected in a recent reallocation of agency staff resources. In fiscal year 2005 the division is dedicating more than 30 percent of its resources to combating these abuses, compared to roughly 5 percent for the previous fiscal year.6 The hiring by the Exempt Organizations Division of 72 new revenue agents in September 2004 is another example.7 The IRS also plans to hire an additional 75 new agents by September 30, 2005, to work in the FFTU and the Data Analysis Unit of the Exempt Organizations Division.8

ATATs rank as one of the highest IRS enforcement priorities. One group of ATATs identified by the IRS is known as “listed transactions.” A listed transaction is defined as a tax-avoidance transaction the IRS has identified by notice, regulation, or other published guidance, or a transaction that is expected to obtain the same or substantially similar tax consequences.9 Of the roughly 30 different listed transactions identified by the IRS, more than a few involve a tax-exempt entity. Taxpayers participating in listed transactions are contesting the IRS characterization of the transactions as abusive, and these taxpayers continue to affirm the merits of these transactions.

Under recently enacted provisions to the IRC that require disclosure of involvement in listed transactions,10 a tax-exempt party in a listed transaction can be deemed a participant in the transaction even though it receives no tax benefit.11 While a tax-exempt entity may assert it is not receiving a tax benefit and is not a participant, the IRS can and will treat a tax-exempt entity as a participant for purposes of satisfying disclosure requirements. Thus, tax-exempt entities need to recognize the arrangements that may qualify as “listed transactions” and the applicable disclosure requirements. Stiff sanctions are imposed on tax-exempt organizations that fail to disclose involvement in a reportable or listed transaction. If a tax-exempt entity fails to make the proper disclosures on IRS Form 8886, it faces a $200,000 penalty that the IRS commissioner cannot rescind and that cannot be appealed.12

The risk is also heightened by the authority granted the IRS to determine the types or classes of persons that will be treated as participants in a listed transaction.13 A tax-exempt entity may become involved in a transaction that becomes listed after the fact. In that case, an entity has the duty to report its involvement in the transaction. Retroactive application of disclosure requirements and penalties for transactions executed in earlier tax years require tax-exempt entities and their advisers to give careful thought to participating in a transaction that could qualify as abusive.

Excessive Compensation

Excessive compensation paid to executives is a second enforcement priority. IRS Commissioner Everson said, “We are concerned that some charities and private foundations are abusing the tax-exempt status by paying exorbitant compensation to their officers and others.”14

Organizations may cross the line by not disclosing the compensation

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they provide or by paying salaries deemed inappropriate because they exceed the fair market value of the services performed. IRS Form 990 (the annual information return required to be filed by most tax-exempt entities) mandates disclosure of all forms of compensation provided to the five highest-paid employees of a tax-exempt entity. Nevertheless, many entities try to evade this requirement by answering “available on request” or using a similar phrase. IRS Form 990 also inquires into whether a tax-exempt entity engaged in any excess benefit transactions during the year or became aware of such a transaction from a prior year. Many tax-exempt entities also fail to answer this question. The IRS is requiring these organizations to provide a response. Failure to answer this question will likely result in a full examination of the tax-exempt entity.

The IRS deems compensation to be excessive when an officer’s salary exceeds the fair market value of the services performed by that individual. Many factors are used to determine whether compensation is excessive, including, most importantly, surveys of what executives at other tax-exempt entities are paid. When this threshold is surpassed, the IRS may impose a 25 percent tax on an officer receiving inappropriate compensation and a 10 percent tax against any involved organization manager. An officer would also be required to repay the amount found excessive. If the excessive benefit is not “corrected” within a certain period, the IRS may assess a 200 percent penalty on certain individuals. “Corrected” means the excess benefit is returned to the tax-exempt entity and its financial standing restored as if this benefit had not been conferred.

Compensation may take forms other than cash, such as providing executives with vehicles and other excessive benefits. Many who receive vehicles fail to maintain contemporaneous records of personal mileage. By not tracking mileage, the entire fair market value of the automobile is treated as a benefit and its financial standing restored as if this benefit had not been conferred.

The IRS introduced the Tax Exempt Compensation Enforcement Project last year to 1) address executive compensation or questionable practices, 2) make entities aware of the tax consequences in setting future compensation, and 3) expand the information available to tax-exempt entities on organizational compensation and reporting practices. In November 2004, Martha Sullivan, Director of the IRS Exempt Organizations Division, said the agency was issuing 2,000 letters to charities asking how they determine executive compensation. She also indicated roughly 25 percent of these charities would be audited on the issue of executive compensation.

A third focus of the IRS’s scrutiny of tax-exempt entities are credit counseling agencies (CCAs). Commissioner Everson said, “It is not fair to taxpayers struggling with financial problems to be taken advantage of by credit counseling groups exploiting gaps in the law.” CCAs create repayment plans for debtors for a fee. CCAs also provide educational and other financial counseling. According to the IRS, certain CCAs charge excess fees to low-income customers for debt management services instead of providing education on how to manage personal finances. This puts the debtor further into debt. Some CCAs partner with a for-profit lending institution to make loans with unconscionable fees and costs. Another abuse requires debtors to make “voluntary contributions” to the CCA.

The IRS is taking a tough stance by working with other federal agencies and state regulators to combat abuse in this area. A compliance team to combat abuses by CCAs has been created within the Exempt Organization function of the Tax Exempt and Government Entities Division. Congress has previously regulated CCAs by enacting The Credit Repair Organizations Act (CROA) to “protect the public from unfair or deceptive advertising and business practices by credit repair organizations.” The CROA imposes restrictions on CCAs and the services they provide. It prohibits CCAs from receiving any payments prior to services being fully performed for a debtor. CCAs may try to circumvent this by using a provision in the CROA excluding any credit repair organization which is a “nonprofit organization...exempt from taxation under section 501(c)(3) of the Internal Revenue Code of 1986.” A CCA that satisfies the IRS that it is formed for educational and/or charitable purposes is potentially able to avoid federal consumer protection laws and engage in practices that it would otherwise be prohibited from doing as a nonprofit organization.

Recognizing this, the IRS has denied requests by CCAs for tax-exempt status because the agency concluded the CCAs were formed to circumvent consumer protection laws and not to engage in a legitimate exempt purpose. In rejecting one application, the IRS stated, “An organization cannot prove that it is entitled to exemption where one of its purposes is the avoidance of regulation.” The IRS can also examine organizational activities to prevent abuses by CCAs. In addition, the Joint Committee on Taxation recently recommended that Congress impose tougher conditions on CCAs seeking exempt status. The underlying theme of these proposed restrictions is to ensure the purpose of tax-exempt CCAs is to provide consumer education.

Preventing terrorism is another priority. The IRS plays a crucial role in identifying and dismantling organizations supporting terrorism in the United States and elsewhere. Many terrorist organizations use tax-exempt entities—such as religious and other charitable groups—to direct funds from the United States to terrorists abroad. While charitable organizations are restricted from diverting New IRS Form 1023

To ensure greater understanding of the purposes and activities of an applicant for tax-exempt status and to restrain potential abuses, the IRS recently revised Form 1023: Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code. Any applicant seeking tax-exempt status must use the revised Form 1023. The revised form contains a more extensive and detailed questions designed to aid the IRS in making its determination of an entity’s eligibility for tax-exempt status. In addition, the IRS is in the process of revising the annually filed Form 990 Return of Organization Exempt from Income Tax to better monitor the activities of exempt organizations.

Most notably, the revised Form 1023 contains a new Part V: Compensation and Other Financial Arrangements with Your Officers, Directors, Trustees, Employees, and Independent Contractors, which is now two and one-half pages in length. This section is designed to more thoroughly disclose the compensation arrangements and other benefits given to officers, directors, trustees, employees, and independent contractors. The revised section includes questions regarding related entities and entities under common control; possible agreements between the entity and its officers, directors, trustees, employees, and independent contractors for compensation bonuses, sales of goods, services, or assets to the entity, and loans with the entity; and whether the entity has adopted a conflict of interest policy consistent with the sample policy provided by the IRS in Appendix A to the form. The new Form 1023 also contains a new Part VIII: Your Specific Activities, including questions regarding the foreign grant-making activity of a potential tax-exempt entity.

The detailed questions in the new Form 1023 reflect the IRS’s concerns about excessive compensation, foreign grants, terrorist activities, and other abusive arrangements and will aid the IRS in its efforts to curb such abuses.—S.T. & C.N.
funds for noncharitable uses, the IRS is concerned that existing rules are not well-suited to prevent funds from being used to support terrorist activities. The Fraud and Financial Transactions Unit was created to prevent this occurrence. The FFTU is staffed with fraud specialists, forensic accountants, and agents with expertise in tracking foreign grant activities. The unit assists or leads examinations of tax-exempt entities making grants to foreign organizations or individuals with a view toward thwarting terrorist funding. The IRS has not issued any published sequences under Executive Order 13224, which allows the government to issue an order blocking funds and/or property interests. The IRS has not issued any published guidance regarding these guidelines. Thus, the application of the guidelines remains unclear.

Congressional response to abuses involving financial support for terrorism has also been strong. IRC Section 501(p), enacted in 2003 under the Military Family Tax Relief Act, permits an organization’s exempt status to be suspended if it is properly characterized under 1) certain provisions of the Immigration and Nationality Act as a foreign or domestic terrorist organization, 2) an executive order related to terrorism and issued under the authority of the International Emergency Economic Powers Act or Section 5 of the United Nations Participation Act of 1945 for the purpose of imposing economic or other sanction on such organization, or 3) an executive order, referring to IRC Section 501(p)(2), issued under the authority of federal law, if the order specifically identifies the organization as supporting or engaging in terrorist activity or supporting terrorism. No administrative or judicial challenge is permitted when an organization’s exempt status is suspended or a charitable deduction is disallowed under IRC Section 501(p).

The USA Patriot Act forbids tax-exempt entities from providing material resources or financial support to foreign terrorist organizations or listed persons. Further, President Bush issued Executive Order 13224 on September 23, 2001, effectively freezing assets located in the United States of all foreign persons engaging in or posing a risk of committing terrorist acts. The order also prohibits making contributions to or dealing in property owned by persons subject to the order.

**Legislative Scrutiny**

Congress continues to monitor the activities of exempt organizations and consider further changes. On January 27, 2005, the Joint Committee on Taxation issued a staff report proposing new compliance requirements for tax-exempt entities. One major reform would require exempt entities to file a statement with the IRS every five years explaining why the entity still deserves exempt status. Congress has also sought out the recommendations of tax-exempt entities on the subject. On September 22, 2004, U.S. Senators Charles Grassley and Max Baucus sent a letter to Independent Sector, an organization that represents thousands of tax-exempt entities on national, state, and local issues, requesting it convene a “panel on the nonprofit sector to consider and recommend actions that will strengthen good governance, ethical conduct and effective practice of public charities and private foundations.” The Panel on the Nonprofit Sector, convened by Independent Sector, issued its report to Congress in June 2005. The report contains many recommendations, such as requiring financial statements prepared in accordance with generally accepted accounting principles, disclosure of performance data, strengthening of laws and regulations governing donor-advised funds, as well as other recommendations related to travel expenses and noncash contributions.

The report also includes recommendations concerning IRS enforcement. First, the panel suggested increased funding to the IRS for overall tax enforcement and oversight of charitable organizations, as well as an elimination of the statutory barriers that prevent the IRS from sharing information with state officials. Second, the panel made recommendations on the IRS forms filed by charitable organizations. The report includes recommendations for improving the accuracy and completeness of Forms 990, 990-EZ, and 990-PF and the suspension of the tax-exempt status for those entities that fail to correct incomplete or inaccurate returns for two consecutive years. In addition, the panel recommended that Congress impose penalties for those preparers who willfully omit or misrepresent information on the returns. Third, the panel argued that a periodic review to verify that entities are continuing to meet the qualifications for tax-exempt status—as suggested by the Joint Committee on Taxation—would be a misallocation of IRS resources. Rather the IRS should focus on review and investigation of the current returns filed by these entities. Fourth, the report includes a recommendation that Congress make clear to all tax-exempt organizations their responsibilities with respect to reporting involvement in potentially abusive listed and other reportable tax shelter transactions. The panel suggested organization managers should be penalized for failure to properly report an entity’s involvement in such transactions, and the tax-exempt entity itself should be penalized for participation in such transactions. Finally, the panel recommended that charitable organizations should be required to more clearly disclose compensation paid to the chief executive officer (and other “disqualified persons”) and the five highest compensated employees and recommended increased penalties for those individuals who receive, and managers who approve, excessive compensation.

The perception of tax-exempt entities as benign organizations has been altered by the proliferation of abuses associated with these entities. Abuses run the gamut from individuals using exempt entities for personal gain to organizations engaging in activities raising national security concerns. These abuses and recent current events have provided Congress and the IRS with justification for heightened scrutiny of exempt entities. At the legislative level, more stringent laws have been enacted enabling the IRS to pursue enforcement actions more aggressively against certain tax-exempt entities. Administratively, the IRS has redeployed and enhanced administrative resources, increased audits, assessed greater penalties, and, in some cases, revoked tax-exempt status. The recent increased level of enforcement and scrutiny against tax-exempt entities is unprecedented.

Exempt entities also face other practical consequences from the potential tarnish of their public reputations. Foremost is a reduction in, or the loss of, grants and other public and private funding. Many exempt entities rely on these donations for their existence. Other consequences include broadening the liability of directors and officers of these entities and reducing free public services such as access to public service announcements on various media.

Exempt entities can restore public confidence in themselves and avoid more drastic legislative and administrative action by ensuring that they are fulfilling the public purposes for which they qualified for exempt status. The IRS commissioner has urged the tax-exempt sector to avoid the “risk management and value creation” model that hurt the legal and accounting professions. Tax-exempt organizations that are not adhering
to legal requirements should take the initiative to make any changes needed to demonstrate compliance with these requirements. The IRS as an institution respects self-correction, and an organization’s interests are better served by addressing problems before the agency comes knocking at the door. Those entities that persist in abusing their exempt status will need to put on their rough weather clothing and be prepared to encounter an unprecedented level of IRS scrutiny and enforcement action.

2 I.R.C. §501(c).
4 I.R.C. §4958(a)(2).
7 Id.
9 Treas. Reg. §1.6011-4(b)(2).
15 I.R.C. §6707A.
18 I.R.C. §§6707A(b), (d).
21 I.R.C. §4958(a).
22 I.R.C. §4958(b).
27 Gordon C. Milbourn III (acting deputy inspector general for audit), Memorandum for Commissioner, Tax-Exempt and Government Entities Division 15 (Sept. 29, 2004).
31 Id.
37 But see Zimmerman v. Cambridge Credit Counseling Corp. et al., 2005 U.S. App. LEXIS 9901 (To be excluded from CROA, a credit repair organization must actually operate as a nonprofit organization and be exempt from taxation under I.R.C. §501(c)(3)).
41 Gilroy, supra note 25 (citing I.R.S. EO Division Director Martha Sullivan).
42 Id. (citing IRS Specialist Leonard J. Henzke).
43 Id.
44 I.R.C. §501(p)(2).
45 I.R.C. §501(p)(5).
46 18 U.S.C. §§2339A, 2339B. Listed persons are found on the Designated Nationals list maintained by the Office of Foreign Assets Control, the U.S. Government Terrorist Exclusion List, and United Nations list.
50 A copy of the report issued by the Panel on the Nonprofit Sector can be found at 2005 TAX NOTES TODAY 122-30.
51 Bennett, supra note 1.
The new bankruptcy law eliminates the Bankruptcy Code’s prior presumption in favor of granting the relief sought by the debtor

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005—signed into law by President George W. Bush on April 20, 2005—is an outright overhaul of the Bankruptcy Code that will have a dramatic impact on consumer and business bankruptcy cases. It generally will become effective for bankruptcy cases filed on and after October 17, 2005. The act’s major changes to the Bankruptcy Code will place additional burdens on many of the participants in the bankruptcy system, including judges, the Office of the United States Trustee (a branch of the Department of Justice charged with administering bankruptcy cases), bankruptcy trustees, and counsel.

The act will affect numerous aspects of the law applicable to consumer bankruptcy cases. The new law eliminates the presumption in favor of granting the relief requested by the debtor and imposes what the act refers to as a “means test” on individual debtors whose debts are primarily consumer debts. Should an individual debtor fail this test, a presumption of an abusive filing arises, and a chapter 7 bankruptcy case can be dismissed under new Section 707(b) or, with the debtor’s consent, converted to chapter 11 or 13.

The first inquiry with regard to the means test is whether the debtor’s income exceeds a defined state median family income. If the debtor’s income is at or below the applicable state median family income, the means test does not apply and the presumption of abuse cannot arise. Dismissal (or conversion to chapter 11 or 13 upon consent of the debtor) could then be sought only by the court, on its own motion or on motion of the Office of the United States Trustee, provided that the dismissal is based on grounds recognized under current law, such as bad faith or the totality of the circumstances.

If the debtor’s income exceeds the defined state median family income, then the means test will apply, and any party in interest may bring a motion to dismiss the chapter 7 case under new Section 707(b). Under the means test, the debtor’s “current monthly income,” a newly defined term, is reduced by certain expenditures or deduc-

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tions to get a “Net Amount.” The presumption of abuse arises if the Net Amount multiplied by 60 is greater than the lesser of 1) 25 percent of the debtor’s nonpriority unsecured claims in the case or $6,000, whichever is greater, or 2) $10,000. For example, if the Net Amount is less than $100, there is no presumption of abuse, because $100 times 60 months equals $6,000. On the other hand, if the Net Amount is equal to or greater than $166.67, a presumption of abuse is applicable, because $166.67 times 60 exceeds $10,000. If the Net Amount is greater than $100 but less than $166.67, the presumption of abuse arises depending on whether the debtor’s nonpriority unsecured claims are greater than $6,000 but less than $40,000.

In order to administer the means test, the debtor must file a statement regarding the debtor’s means test calculation at the time the debtor files the statement of current income and expenses. If a motion pursuant to new Section 707(b) is granted, a court can sanction debtor’s counsel if it finds that counsel’s filing of the case under chapter 7 violated Rule 9011 of the Federal Rules of Bankruptcy Procedure. Accordingly, the signature of an attorney on the bankruptcy petition constitutes a certification that the attorney has made an inquiry and has no knowledge that the information in the schedules filed with the petition is incorrect.

In addition to the means test, the act now requires individual debtors to receive, within 180 days of the bankruptcy filing, an individual or group briefing from a nonprofit budget and credit counseling agency approved by the Office of the United States Trustee or a bankruptcy administrator, under standards set forth in new Section 111(a). Limited exceptions exist for 1) districts found not to have adequate credit counseling services, 2) debtors who submit a certification that exigent circumstances required an immediate bankruptcy filing and, within the five-day period preceding bankruptcy, sought and was unable to obtain credit counseling (although compliance within 30 days of the petition date will be required in any event), and 3) debtors who are incapacitated, disabled, or on active military duty in a combat zone. Failure to comply with the credit counseling provisions could result in a denial of the discharge under chapters 7, 11, or 13.

**Consumer Disclosure Requirements**

All debtors now face more disclosure requirements than they did under prior law. For example, the new act requires debtors to disclose and file with the court 1) copies of all “payment advice” or other evidence of payment received within 60 days before the bankruptcy filing from any employer, 2) a statement of monthly net income, including how the amount is calculated, and 3) a statement disclosing any reasonably anticipated increase in income or expenses over the 12-month period following the bankruptcy filing. In cases filed under chapter 7 or 13, individual debtors must provide the trustee and any creditor making a timely request with a copy of the debtor’s federal income tax return or, at the debtor’s option, a transcript of the return for the period for which the return was most recently due and for which the debtor filed a return. The copy or transcript must be provided at least seven days prior to the Section 341(a) meeting of creditors. Failure to file the information required under new Section 521(a)(1) within 45 days of filing the petition results in the dismissal of a voluntary chapter 7 or 13 case on the 46th day. Any party in interest may request that the court enter an order to that effect.

In small consumer cases, in which nonexempt assets are less than $150,000, attorneys will have additional disclosure and record-keeping requirements. Counsel handling these cases will now be referred to as “debt relief agencies” and their clients as “assisted persons.” Failure to meet certain record-keeping and disclosure requirements could subject counsel to loss of fees, damages, sanctions, and other remedies. The new disclosure provisions include a brief description of chapters 7, 11, 12, and 13 and the general purpose, benefits, and costs of proceeding under each of those chapters; the types of services available from credit counseling agencies; and a new form disclosure that is expressly provided in new Section 527(b). Counsel must give reasonably sufficient information to an assisted person regarding completion of the bankruptcy schedules and list of creditors, how to determine current monthly income and the amounts specified in new Section 707(b)(2), and how to determine exempt property and its value.

Certain marital dissolution and support obligations gain more favorable treatment under the new act. Under the law prior to the act, specified obligations arising out of marital dissolution proceedings, such as support and alimony, were excepted from the debtor’s discharge and thus survived bankruptcy. However, there were limited circumstances in which claims relating to nonsupport obligations, such as property settlements, could be discharged. The new act eliminates the exceptions or defenses and essentially renders all debts that are incurred in connection with marital separation or dissolution proceedings as nondischARGEABLE. Additionally, “domestic support obligations,” a newly defined term under the act, will now have the first priority in distribution ahead of other administrative claims. The only notable exception to that priority would be the expenses of a trustee who administered assets that might otherwise be used to pay support obligations. In chapter 13 cases, the act requires that all domestic support obligations that first became due after the bankruptcy filing be paid in order for a plan to be confirmed.

Employees of a debtor also will receive more favorable treatment, because the new act increases wage and employee benefit priorities to $10,000 per employee and lengthens the time frame for incurring those wages from 90 to 180 days before the bankruptcy petition date.

Consumer finance and leasing companies will fare better under the act than they did in prior bankruptcy law. Before the new act, an individual debtor who scheduled debts secured by estate property—such as automobiles, large appliances, and the like—was required to file a statement of intention regarding the proposed disposition of that property within a specified time. The new law compels the debtor to act no later than 30 days from the date first set for the Section 341(a) meeting of creditors concerning secured debt. Otherwise, failure to timely file the statement of intention or to perform the requisite intention will result in termination of the automatic stay under Section 362(a). The creditor will then be free to enforce its secured claim.

Prior to the new act, debtors had four options regarding secured claims: 1) surrender the collateral to the secured creditor, 2) redeem the property, 3) reaffirm the debt, or 4) merely retain the collateral, pursuant to applicable case law. Retention was a viable and preferred option if the debtor was otherwise current on the debt. If the debtor later decided to surrender the collateral postpetition, the potential deficiency claim would have been discharged and the creditor would have no further in personam claim against the debtor.

The act removes retention as an option and requires full payment of an allowed secured claim at the time of redemption. Moreover, in determining the amount of the secured claim, the new law requires the use of replacement value, which for consumer goods is the retail price for property of similar age and condition. Reaffirmation under the act involves extensive disclosures to debtors that were not required previously under the old law.

Secured creditors, most particularly creditors holding consensual liens on real property, have been plagued by serial bankruptcy filings by individual debtors. The new law attempts to modify the automatic stay provisions of Section 362 to address these concerns. If an individual chapter 7, 11, or 13 case is filed within one year of the dismissal of a prior bankruptcy (with the exception of a chapter 11 or 13 case refiled after a Section 707(b) dismissal), then the automatic stay in the second case terminates 30 days after the filing. The debtor, however, can avoid dismissal of the second case if the debtor can demon-
strate that the second case was filed in good faith with respect to the creditors that would be subject to the stay.37

If a second serial case is filed within a one-year period, the automatic stay will not go into effect in the latter case and the court, upon request of a party in interest, must confirm that no stay is in effect.38 A party in interest can seek re-imposition of the automatic stay upon a showing that the case was filed in good faith regarding the creditors whose claims would be stayed.39 If there are two or more previous cases within the one-year period, a rebuttable presumption of a lack of good faith arises. Clear and convincing evidence is required to rebut the presumption in order to have the stay imposed in the current case.40

The automatic stay has been modified to address a similar issue relating to multiple bankruptcy filings affecting real property. The new act affords in rem relief to creditors.41 The stay will be terminated upon request of a party in interest if the court finds that the bankruptcy petition was part of a scheme to delay, hinder, and defraud creditors involving either a transfer of ownership or other interest in real property or multiple bankruptcy filings.42 Once recorded in the public records for real property interests (the county recorder’s office in the case of California real property), an order entered under new Section 362(d)(4) (the “in rem order”) will be binding on any other case under Title 11 that purports to affect the real property and is filed within two years after entry of the in rem order.43 After giving the proper notice, a party can seek relief at a hearing from an in rem order based on changed circumstances and for good cause.

The new law provides exceptions to the automatic stay for landlords of residential real property. A landlord seeking an exception must serve the debtor and file with the court a certificate setting out the facts pertaining to the exception.44 The exceptions allow the continuance of an eviction if the eviction judgment was obtained prior to the bankruptcy filing or was based on endangerment of the demised premises or illegal use of controlled substances. The act provides a debtor with a limited right to contest the certificate and seek imposition of the stay.45

The homestead exemption has received considerable attention in the press in the wake of major corporate scandals like the Enron bankruptcy as well as unwelcome notoriety in the O. J. Simpson civil proceedings. Federal bankruptcy law defers to state law in determining what property is exempt from attachment and levy by creditors.46 Exemptions vary considerably from state to state, including the homestead exemption amount. In some states, such as Texas or Florida, the state homestead exemption is unlimited in dollar amount while in others it is limited to relatively small dollar amounts. The new law attempts to limit the availability of the exemption by imposing a residency restriction based on the debtor’s domicile for the 730 days before the filing.47 The act also attempts to limit the homestead to $125,000 when value is added to the homestead during the 1,215 days preceding the bankruptcy filing. The new law imposes an absolute cap if the court determines that the debtor was convicted of a felony under circumstances that demonstrate that the filing of the case was an abuse of the Bankruptcy Code or the debtor owes a debt arising from the violation of federal securities law, any criminal act, or an intentional tort or willful or reckless misconduct that caused serious physical injury or death in the preceding five years.48

The act will have an impact on discharge. The new law extends the time between receiving a discharge in a subsequent chapter 7 bankruptcy and a previous bankruptcy from six to eight years.49 In chapter 13 cases, the debtor in a pending chapter 13 case cannot receive a discharge if a case was filed under chapter 7, 11, or 12 during the four-year period (2 years if the prior case was filed under chapter 13) preceding the entry date of the order for relief of the current chapter 13 case.50

The modifications to chapter 13 are numerous. Included among the changes is the elimination, for the most part, of the “super discharge,” which allowed debts not dischargeable under chapter 7 to be discharged under chapter 13.51 Under the new act, the discharge in chapter 13 is now almost coequal with the chapter 7 discharge. Thus, one of the chief benefits for filing chapter 13 no longer exists. Second, the definition of “disposable income” has been modified to incorporate the means test. Under a chapter 13 plan, upon the objection of a creditor, the debtor’s disposable income must be contributed to the plan during its minimum term. “Disposable income” is defined as current monthly income, other than child support income, that is not necessary to provide for support for the debtor or a dependent of the debtor. For debtors whose income is more than the applicable median, the means test of new Section 707(b) will determine their support needs.52 For debtors whose income exceeds the applicable median and whose plan does not provide for the full payment of claims, the minimum plan term is now five years instead of three.53

The new law amends several provisions of chapter 11 to conform the treatment of individual chapter 11 cases to those cases filed under chapter 13.54 Under the new legislation, the property of the estate now includes an individual’s earnings from services performed by the debtor after the commencement of the case.55 To the extent necessary for the plan, funding for an individual debtor’s chapter 11 plan includes future earnings from personal services performed by the debtor. Upon objection of a creditor, the value to be distributed under a chapter 11 plan must include at least the projected disposable income of the debtor to be received during the five-year period beginning on the date the first payment is due under the plan or during the period for which the plan provides payment—whichever is longer.56

**Business Bankruptcies**

The new act also will have a major effect on business bankruptcy cases. Since the advent of the Bankruptcy Code in 1978, a number of amendments have targeted Section 365 of the code, which addresses executory contracts and unexpired leases. The 2005 act is no exception to this focus on Section 365. The act’s amendments to Section
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365 will have a particularly dramatic effect on the relationship between landlords and bankruptcy estates in any case in which the debtor operates from multiple leased locations, such as large retail chains.

Under prior law, the trustee—or in a chapter 11 case, the debtor in possession (DIP)—had 60 days from entry of the order for relief to assume or reject an unexpired lease of nonresidential real property. Failure to assume or reject within that period resulted in the lease being deemed rejected and required the trustee or DIP to immediately surrender possession, giving rise to a prepetition damage claim. However, that period could have been extended for cause, provided the trustee or DIP made a motion within the 60-day period. The court was free to grant further extensions irrespective of the landlord’s consent, provided that cause was shown.

The new law alters this framework. First, the period for assuming or rejecting unexpired leases of nonresidential real property is extended from 60 days to the earlier of 120 days after the order for relief or the date of entry of an order confirming a plan of reorganization. However, the court’s discretion to extend that period has been curtailed. The court may extend the 120-day period for up to 90 days on motion of the trustee or DIP upon a showing of cause. No subsequent extensions may be granted without the prior written consent of the landlord in each instance. In the event the landlord refuses to consent, 210 days is the maximum possible period for determining whether to reject or assume an unexpired real property lease.

As a result, the decision to assume or reject will have to be made early, if not prematurely, resulting in potentially large administrative claims against the estate.

In this context, it is important to note that a landlord’s damages differ markedly depending on whether an unexpired lease is rejected or assumed. Rejection of an unexpired lease gives rise to an unsecured claim that is subject to a cap regarding future damages. The landlord also may be entitled to an administrative expense (the highest level of unsecured priority) for possession from the bankruptcy petition date until the actual surrender of the premises to the landlord.

Assumption, however, binds the bankruptcy estate to the contractual obligations under the lease, and any subsequent breach gives rise to an administrative expense to the extent of the damages allowed under applicable nonbankruptcy law. In that case, under prior law, the Section 502(b)(6) cap on future damages did not apply. Debtors typically deferred the decision on whether to assume leases until the end of the bankruptcy case, after which a determination would be made regarding which leases had value to the debtor’s business operations. That process often takes considerable time in larger cases.

To ameliorate some of the harsh effects of this amendment, the act provides for a cap on the administrative rent expense with regard to a nonresidential real property lease that was assumed and subsequently breached or rejected. The cap is equal to all monetary obligations due (excluding those arising from or relating to a failure to operate or a penalty provision) for the period of two years following the later of the rejection date or the date of the actual turnover of the premises (without reduction or setoff except for sums actually received or to be received from any entity other than the debtor). A claim for the remaining sums due for the balance of the term of the lease will be characterized as a general unsecured claim under Section 502(b)(6).

In order to assume an executory contract or unexpired lease when there has been a default, the trustee or DIP must cure the default or provide adequate assurance that the default will be promptly cured. Under case law, assumption of executory contracts was prohibited following a nonmonetary default that was incapable of cure, such as a requirement in a franchise agreement that prohibits the debtor from “going dark.” The new act codifies this result for executory contracts. However, in the case of unexpired real property leases, the act clarifies that nonmonetary defaults need not be cured if it is impossible for the trustee or DIP to do so.

If the nonmonetary default arises from a failure to operate in accordance with a nonresidential real property lease, then the default will be cured by performance at and after the time of assumption in accordance with the lease, and pecuniary losses resulting from the default will be subject to compensation. For reorganization plans, the new act amended Section 1124(2) to conform the concept of impairment of a claim to the changes made to Section 365 regarding the cure of nonmonetary defaults in executory contracts and unexpired leases.

The so-called avoidance powers of a trustee or DIP pursuant to which they can set aside prebankruptcy transfers, also received some attention in the new legislation. An adversary proceeding to recover a preference or a nonconsumer debt against a noninsider in an amount of less than $10,000 or to recover a money judgment or property worth less than $1,000 or a consumer debt of less than $15,000 must now be commenced in the district in which the defendant resides.

The preferences contained in Section 547 of the Bankruptcy Code are the focus of several of the new act’s significant changes. There
is a new minimum threshold for preference claims under the act. A transfer may not be avoided as a preference if the value of all property that constitutes or is affected by the transfer is less than $5,000. Moreover, the burden of establishing the ordinary course of business (OCB) defense under Section 547(c)(2) has been eased under the new legislation. To prevail on the OCB defense under prior law, defendants had to establish the following three elements: 1) the transfer was in payment of a debt that was incurred in the ordinary course of business, 2) the transfer was ordinary as between the debtor and the defendant based on their historical dealings, and 3) the transfer was made according to ordinary business terms (construed to mean in accordance with standards in the defendant’s industry). It was the second prong of the defense that often proved the most problematic for defendants. Under the new law, to prevail on the OCB defense, defendants must establish that 1) the transfer was for payment of a debt that was incurred in the ordinary course of business, and 2) either one of the prior law’s last two conditions.

This new basis for the OCB defense represents a significant departure from prior law because case law already has eased dramatically the burden of establishing industry standards under old Section 547(c)(2)(C) (now Section 547(c)(2)(B)). Consequently, in many cases in which defendants can establish that payments were made according to industry standards, old Section 547(c)(2)(B) and new Section 547(c)(2)(A)—which focus on historical dealings, the most difficult element of the OCB defense to prove—will be irrelevant. Absent any unusual or aggressive collection efforts, this change should eliminate many preference claims for payments made to noninsider trade vendors.

A transfer made within two years (as opposed to one year under prior law) of the petition date can be avoided as a fraudulent transfer under new Section 548. Transfers made or obligations incurred to insiders under an employment contract and not in the ordinary course of business are expressly subject to avoidance as a fraudulent transfer without the need to prove insolvency. Also added to the fraudulent transfer law is the avoidance of transfers to certain self-settled trusts if the transfers were made within 10 years before the bankruptcy petition was filed. For a transfer to be avoidable, the debtor must have made the transfer to a self-settled trust in which the debtor is also a beneficiary, with the actual intent to hinder, delay, or defraud any entity to which the debtor was or would become indebted on or after the date that the transfer was made.

Both prior law and the new act provide that unauthorized postpetition transfers can be avoided by a trustee or DIP. The old law provides a good faith exception for a transfer of real property for value to a good faith purchaser without knowledge of the commencement of the bankruptcy. The new law modifies that exception to provide good faith protection in connection with a transfer for value of an interest in real property. This modification should protect good faith encumbrancers who, without knowledge of the bankruptcy case, extend new value.

A seller’s right to reclaim goods has been significantly expanded under the new legislation. First, the period for making the reclamation demand has been expanded from 10 to 45 days after receipt of the goods by the debtor. If the 45-day period expires after commencement of the bankruptcy case, then the demand must be made not later than 20 days after the commencement of the case. Second, if the seller complies with the notice requirements under amended Section 546(c), it appears that the seller’s reclamation right is absolute, and unlike prior law, the court cannot deny reclamation to the seller. Third, even if the seller fails to give notice, it still may assert rights provided in amended Section 503(b)(9) to treat as an administrative expense

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the value of any goods received by the debtor within 20 days before the date of commencement of the bankruptcy case.86

If the red hot real estate market cools and interest rates continue to rise, changes to the single asset real estate provisions could prove to be one of the more far-reaching changes implemented by the new act. The $4 million cap on the definition of what constitutes single asset real estate has been eliminated.87

“Single asset real estate” is now defined as real property constituting a single property or project, other than residential real property with fewer than four residential units, that generates substantially all of the gross income of a debtor who is not a family farmer and on which no substantial business is being conducted by the debtor other than the business of operating the real property and incidental activities.88 This definition could now include major real estate projects such as a financial center office tower. However, if the debtor’s project is a hospital or a hotel resort, it may not fall within the ambit of single asset real estate.

If the debtor’s operations constitute single asset real estate, special provisions for relief from the automatic stay will apply.89 Any case involving single asset real estate will require the debtor, within 90 days from entry of the order for relief (or a later date that the court may determine for cause and order within the 90-day period), to either 1) file a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time, or 2) commence monthly payments to the consensual lien holders. The new legislation provides that the debtor may use rent or other income to make the payments irrespective of the restrictions on the use of the rent that existed under prior law.90

Under the new law, the commencement of payments to creditors can be delayed pending resolution of whether the single asset provisions apply. The amount of those payments has been clarified to constitute an amount equal to interest at the previously applicable nondefault contract rate of interest on the value of the creditor’s interest in the real estate.

A number of provisions affecting the plan process are included in the act. For example, under prior law, the debtor has the exclusive right to file a plan of reorganization during the first 120 days after entry of the order for relief and has an additional 60 days to confirm that plan. Under the new law, the court can extend those periods without limitation for cause.91 The new act does place limits on the court’s ability to extend the debtor’s exclusive period to file a plan (18 months from the petition date) and to obtain confirmation (20 months from the petition date).92

The act contains many other changes that may be well beyond the interest of most general practitioners but worthy of careful consideration by those who practice bankruptcy law. The new law has completely remodeled the Bankruptcy Code and may have serious consequences for those groups that previously realized advantages under prior law. The key beneficiaries of the new act appear to be creditors, both secured and unsecured (most particularly credit card issuers and consumer finance companies); utilities; holders of domestic support obligations; and landlords. Those who may come up short under the new law are individuals facing medical crises, loss of employment, or marital dissolution; consumer bankruptcy practitioners; and small businesses.

3 S. 256 §1501.
4 Consumer bankruptcy cases involve individuals whose debts were incurred primarily for a personal, family, or household purpose.
6 S. 256 §§102(a)-(k), new 11 U.S.C. §§101(39A), 707(b)(2)-(7). The debtor’s monthly income multiplied by 12 is compared to the median family income of the applicable state, which is based on the median income for a family of the appropriate size.
family income calculated and reported by the Bureau of the Census in the most recent year. The Census Bureau median family income is available at www.census.gov/hhes/www/income/statemedianfaminc.html.

7 Id.; see also new 11 U.S.C. §707(b)(3).
8 S. 256 §§102(a), (b), new 11 U.S.C. §§101(10), 707(b)(2). The categories of expenditures can generally be described as:
- Living expenses specified under Internal Revenue Service standards.
- Expenses related to protection from family violence.
- Actual expenses paid by the debtor that are reasonable and necessary for the care of certain dependent family members.
- For a debtor eligible to file under chapter 13, the monthly expenses can include certain actual administrative expenses of a chapter 13 plan.
- Certain actual expenses related to a child’s elementary or secondary school education up to $1,500 annually per child.
- Certain additional utility costs in excess of the IRS standards based on actual costs and a showing that additional expenses are reasonable and necessary.
- Average monthly payments for secured debts based on an average over a 60-month period commencing on the petition date and ending on the 60th month thereafter.

12 S. 256 §102(a), new 11 U.S.C. §§707(b)(4)(C), (D).
14 S. 256 §106(b), (c), new 11 U.S.C. §§727(a)(11), 1141(d)(3)(C), 1328(g).

21 Id.
23 11 U.S.C. §§523(a)(15); In the Matter of Crosswhite, 148 F. 3d 879 (7th Cir. 1998).
31 Capital Communications Fed. Credit Union v. Boodrow (In re Boodrow), 126 F. 3d 43 (2d Cir. 1997).
33 Id.
34 S. 256 §327, new 11 U.S.C. §§327(a), (b). However, in a chapter 13 case, a debtor’s ability to modify purchase money secured claims, such as automobile loans, by stripping down the amount of the claim to the value of the collateral has been severely limited. S. 256 §§306(b), new 11 U.S.C. §§1325(a)(9).
37 Id.
31 Id.
38 S. 256 §322, new 11 U.S.C. §§522(p), (q).
43 S. 256 §321(b), (c), new 11 U.S.C. §§1123(a)(8), 1129(a)(15).
48 S. 256 §322, new 11 U.S.C. §§522(p), (q).
52 S. 256 §102(h), new 11 U.S.C. §1325(b).
57 S. 256 §321(b), (c), new 11 U.S.C. §§1123(a)(8), 1129(a)(15).
58 11 U.S.C. §§365(d)(4), 365(g), 502(g).
60 Id.
61 Id.
63 Id.
64 S. 256 §328(a), new 11 U.S.C. §365(b)(2)(D). However, the trustee or DIP is not required to cure a penalty rate or penalty provision relating to the failure to perform a nonmonetary default.
67 Id.
68 S. 256 §328(a), new 11 U.S.C. §365(b)(2)(D). How- ever, this amendment will not take effect until more than one year after the date of enactment of the new act and will be applicable only to bankruptcy cases commenced at that same time. S. 256 §1406.
69 Id.
71 Id.
74 Id.
76 Nostas Assocs. v. Costich (In re Klein Sleep Prods., Inc.), 78 F. 3d 18 (2d Cir. 1996).
77 S. 256 §1402, new 11 U.S.C. §548(a)(1). However, this amendment will not take effect until more than one year after the date of enactment of the new act and will be applicable only to bankruptcy cases commenced at that same time. S. 256 §1406.
78 Id.
79 Id.
81 Id.
82 11 U.S.C. §549(c).
83 S. 256 §1201, 1211, new 11 U.S.C. §§54(D), 549(c).
85 S. 256 §1227 (striking prior 11 U.S.C. §546(c)(2), which gave the court the power to deny reclamation).
86 S. 256 §1227, new 11 U.S.C. §§101, 1101(c), 1107(a).
88 Id.
91 S. 256 §1227 (striking prior 11 U.S.C. §546(c)(2), which gave the court the power to deny reclamation).
92 S. 256 §1227, new 11 U.S.C. §§101, 1101(c), 1107(a).
94 Id.
97 S. 256 §1227 (striking prior 11 U.S.C. §546(c)(2), which gave the court the power to deny reclamation).
100 Id.
Electronic discovery involves the collection, review, and production of electronically stored information—such as e-mail, word processing documents, spreadsheets, and databases—in accordance with state or federal discovery requirements. With the increased proliferation of electronic data, electronic discovery is one of the most rapidly evolving areas of the law.

Just one personal hard drive can contain 1.5 million pages of data, and one corporate backup tape can contain 4 million pages of data. Thus the magnitude of electronic data that needs to be handled in discovery is staggering. In most corporate civil lawsuits, several backup tapes, hard drives, and removable media are involved. Depending on the circumstances of a case, the costs of electronic investigation and production can be significant. Not surprisingly, some of the most intense arguments ensue over how to allocate the costs associated with e-discovery.

Under traditional discovery rules, each side typically bears the cost of producing its own documents.1 As one California court noted, “It is a well accepted principle that each party to litigation normally bears the ordinary burden of financing his or her own suit.”2

In the e-discovery arena, Zubulake v. UBS Warburg,3 a 2003 decision, generally has provided guidance for analyzing...
cost-shifting arguments, even though the case—from the Southern District of New York—is only persuasive authority in jurisdictions other than its own. Zubulake sets forth a seven-factor balancing test to determine whether the requesting party or producing party should bear the costs of a discovery request. Under the Zubulake test, cost shifting for electronic discovery may be warranted based on the weight accorded to:

1) The extent to which a discovery request is specifically tailored to discover relevant information.
2) The availability of the requested information from other sources.
3) The total cost of production compared to the amount in controversy.
4) The total cost of production compared to the resources available to each party.
5) The relative ability of each party to control costs and its incentive to do so.
6) The importance of the issue at stake in the litigation.
7) The relative benefits to the parties of obtaining the information.

Last year, however, California charted a new course in the cost-shifting debate with the Sixth District Court of Appeal's decision in Toshiba America Electronic Components, Inc. v. Superior Court of Santa Clara County. Toshiba is the first appellate court ruling providing direction on e-discovery cost-shifting issues in California state courts and could significantly affect the way litigators in the state approach cost-shifting arguments. Rejecting the Zubulake cost-shifting test, the Toshiba court created an alternative standard for determining who bears e-discovery costs in cases pending in California courts. In today's technology-driven environment, California lawyers handling discovery matters must be familiar not only with the case law in this area but also with the complexities of backup tape discovery.

The underlying action of Toshiba involved Lexar Media, Inc., filing suit against Toshiba America Electronic Components, Inc. (Toshiba), and its parent company Toshiba, Inc., for misappropriating trade secrets, breaching fiduciary duty, and unfair competition. Lexar moved for production of over 800 backup tapes and asked that Toshiba bear the costs for the data retrieval. After receiving an estimate that the tapes would cost $1.5 million to $1.9 million to produce, Toshiba asked Lexar to assist in or completely cover the costs. Toshiba claimed that paying for the costs on its own would result in an undue burden and expense because of the large volume of data and because some of the tapes had become obsolete, making the data accessible only through the use of specialized tools. Moreover, the staff members that performed the tape backup work for the company were no longer employed by Toshiba and were thus unavailable to assist with the discovery request.

Lexar refused to bear any production costs. Instead, Lexar filed a motion to compel and contended it should not be penalized because Toshiba chose to keep records in a format that made data retrieval difficult. Without comment, explanation, or a suggestion of a sampling protocol, the trial court ordered Toshiba to produce the backup tape data and to bear all production costs.

Toshiba appealed, claiming that Code of Civil Procedure Section 2031(g)(1) was an automatic cost-shifting provision that required Lexar to pay all or part of the costs of restoring and searching the tapes. In its ruling, the appellate court declined to apply the Zubulake seven-factor cost-shifting test. Instead, the court referred to Section 2031 and stated, “[O]ur Legislature has identified the expense of translating data compilations into usable form as one that, in the public’s interest, should be placed upon the demanding party.” Thus the appellate court, using Section 2031 as authority, held that Lexar must pay for translating the backup tape data into a usable form if the restoration costs for the backup tapes were found to be a “reasonable expense for a necessary translation.” The court also indicated that the parties should consider using data sampling to determine the relevancy of the data contained on the tapes.

While seemingly resolving a major e-discovery issue, Toshiba raises several unanswered questions for California lawyers in future matters. For instance, what kinds of problems will continue to be associated with backup tape discovery? What does the phrase “reasonable expense for a necessary translation” mean? How can a California practitioner address these issues?

The Challenges of Backup Tapes
Many obstacles can prevent a company from recovering or restoring backup data, such as hundreds of tapes, and failed to produce e-mails and attachments throughout the discovery process. The court declared that Morgan Stanley “gave no thought to using an outside contractor to expedite the process of completing the discovery, though it had certified completion months earlier; it lacked the technological capacity to upload and search the data at that time, and would not attain that capacity for months.” The court issued an adverse inference instruction, directing the jury to accept that Morgan Stanley helped defraud investors. In May 2003, relying in part on that instruction, the jury awarded $1.45 billion in total damages against Morgan Stanley.

When backup tapes are at issue, one of the biggest initial challenges is developing an understanding about a particular company’s network infrastructure. While most networks are similar in theory, each company’s network environment is unique. For example, a simple network is similar to a wagon wheel—the center of the wheel is the server, the spokes are cables, and the end points represent individual workstations. In this type of network, a single server processes all e-mail, accounting data, word processing, and Web surfing and hosting, among other functions. Depending on the organization’s retention policy, the network server could be backed up and stored on a backup tape on a daily,
The Sixth District Court of Appeal in Toshiba America Electronic Components, Inc. v. Superior Court of Santa Clara County adopted the Zubulake standard for determining which party pays electronic discovery costs. True. False.

3. The Sixth District Court of Appeal in Zubulake v. UBS Warburg for determining whether the requesting party or the producing party should bear the costs of discovery of electronic information?
   A. One.
   B. Three.
   C. Five.
   D. Seven.
   E. Nine.
   True. False.

4. Based on Code of Civil Procedure Section 2031, the appellate court stated that Toshiba should pay for translating the backup tape data into a useable form if the restoration costs for the backup tapes were found to be a “reasonable expense for a necessary translation.”
   True. False.

5. Since every corporate network environment is unique, one of the biggest challenges for legal counsel involved in discovery of electronic data is simply understanding the network infrastructure of the company at issue.
   True. False.

6. The Toshiba court indicated that the parties should not use data sampling to determine the relevancy of the data contained on the requested backup tapes.
   True. False.

7. When data sampling will be used in a case, the requesting party chooses a small portion of data for the producing party to restore, search, and produce.
   True. False.

8. Corporate electronic data that could be subject to legal discovery may be stored on:
   A. Hard drives.
   B. Backup tapes.
   C. PDAs.
   D. USB drives.
   E. All of the above.
   True. False.

9. To date, no federal court has addressed whether requesting parties must pay production costs associated with electronic data.
   True. False.

10. One way to narrow down the amount of data required for production is to examine backup tape logs for relevancy and to segregate potentially relevant data.
    True. False.

11. Backup tape data must be restored before anyone can review the data saved on the tape.
    True. False.

12. The Toshiba court stated that the requesting party must pay all the costs associated with retrieving usable data.
    True. False.

13. Data that was created with applications that no longer exist on the company’s servers is known as legacy data.
    True. False.

14. The Toshiba court left no questions unanswered in the area of e-discovery and cost shifting.
    True. False.

15. In a simple network environment, a single server could process:
    A. E-mail.
    B. Accounting data.
    C. Word processing.
    D. Web surfing and hosting.
    E. All of the above.
    True. False.

16. Toshiba is the first appellate court ruling providing direction on e-discovery cost-shifting issues in California state courts.
    True. False.

17. In a storage area network (SAN) environment, all the data for various corporate functions, such as accounting and customer service, may be commingled.
    True. False.

18. The Toshiba court declared that a trial court does not have discretion to determine what constitutes a “reasonable expense for a necessary translation” of electronic data compilations.
    True. False.

19. In Toshiba, the defendant moved for production of more than 800 backup tapes and asked that the plaintiff bear the data retrieval costs.
    True. False.

20. Properly documented backup tape logs keep track of what data is contained on a particular backup tape and specify the time frame and data type (such as e-mail server, accounting server, human resources server).
    True. False.
weekly, and/or monthly basis.

In today’s increasingly digital workplaces, a small or medium-sized office may have five to 30 network servers that may be backed up to a single backup tape or backed up independently by server or function. Furthermore, larger corporations typically operate by using hundreds or thousands of servers that may be segregated by function or task, business unit, or geography. Each of these servers may be backed up by a system of multiple backup tapes. To add further complexities, the server or network may have undergone significant upgrades or application changes during the time in which relevant data is being sought. With all of this stored data, identifying the specific backup tape that contains relevant information can be an overwhelming task.

Producing data from backup tapes is hardly a straightforward task. For instance, a company may have experienced a merger, an acquisition, or downsizing. In a merger or acquisition, the new company likely has a completely different network configuration. As with corporate downsizing, in a merger or acquisition situation it is not atypical for the IT department to lose resources. Thus, many of the key people who are knowledgeable about data locations, associated time periods, and the company’s tape retention policy may no longer be with the company. This leaves counsel with mounds of data and no IT guides to offer insight about them.

The lack of backup tape logs can present further difficulties. In a perfect world, backup tape logs would keep track of what data is contained on a particular backup tape, specifying the time frame and data type (such as e-mail server, accounting server, human resources server, and the like). However, when backup tape logs are not properly kept or the individuals who knew where the logs are located are no longer with the company, problems arise. Some companies’ IT departments do a commendable job of individually labeling each backup tape so that anyone retrieving the tape will know what data is contained on it. Unfortunately, however, when tapes are labeled merely with a tag number, a log must be found to identify what data and date range correspond to the tag and are included on the tape.

The use of storage area networks (SAN)—an alternative (and less expensive) approach to network storage—may add further complications to backup tape discovery. A traditional backup environment is configured so that backups are segregated by function or task. When it is necessary to pull tapes, a backup log provides a reference for determining which specific tapes are needed. For example, if there is a group of 6,000 backup tapes for an entire network, but tapes containing accounting data or customer service data are irrelevant to a particular case, IT experts can quickly and easily remove those tapes from the group. In a SAN environment, however, this process may not be so easy, because all the data may be lumped together, adding time and costs to the recovery of specific requested information.

When data is stored overseas, language and timing issues may arise. Also, as in the situation in Toshiba, the personnel that handled the tape backups may no longer work for the company. Without the expertise of the people best able to determine the most effective way of retrieving the specified data, the information may not only be expensive to reach but may sometimes be lost.

Indeed, locating relevant tapes is simply step one in the discovery process. Tapes must be “restored” in order to review the data contained on them. Many corporations may not be able to restore their backup tapes if they no longer have the tape drive hardware and software to read the tapes or if the backup tapes contain “legacy” data (that is, data created with applications that no longer exist on the company’s servers). Corporations also may not have the requisite server capacity, or they may have outsourced the staff they need to perform the work. These problems do not mean that restoration is impossible, but a company may need third-party resources for assistance. During the restoration process, the requested data must be segregated from all other data that may also reside on the tapes. The segregated data must be reviewed, with items noted as privileged or for redaction, and ultimately produced to the opposing party or court.

**Toshiba’s Lessons**

With the potential complexities and costs associated with discovering and restoring backup tape data, the Toshiba case serves as an important reminder that counsel must remain focused on continuing changes in the law of electronic discovery. In one of Zubulake’s e-discovery opinions,7 the court, in addressing the general role of counsel in litigation, stated that “[c]ounsel must take affirmative steps to monitor compliance so that all sources of discoverable information are identified and searched.” This includes assuming responsibility for uncovering relevant documents (with the assistance of an expert if necessary), evaluating discovery requests for electronic information, and properly preserving this information. Unmistakably, litigators have a clear-cut duty to locate, preserve, and produce relevant electronic information. When faced with complex discovery involving backup tapes, practitioners should take the following steps:

Become knowledgeable about the data.

From hard drives and backup tapes to PDAs
and USB drives, electronic data can exist in a variety of formats, locations, and volumes.

Whether representing the requesting or producing party, practitioners must become technologically savvy to make the best argument for or against the “reasonableness” of expenses that are “necessary” to translate electronic data compilations. Thoroughly researching the accessibility of the data and how much it will cost to recover, search, and produce the data in discovery will put counsel in the best position to zealously argue for their clients. In addition, counsel should know where the data is located. Is it stored overseas? In multiple offices? Counsel also should pinpoint relevant time periods and specify which tapes address those periods. Finally, attorneys should become knowledgeable about the tape rotation policy of a company. For instance, if a company has only preserved monthly backup tapes for the time period at issue, they may not contain the information sought. In fact, the data may only reside at the workstation where it was created.

**Determine what data is necessary.** After pinpointing key data locations, counsel should ascertain which tapes may be pertinent. Examining the backup tape logs for relevance and segregating potentially relevant data can help winnow down the amount of data. For example, if one-third of the tapes represent accounting data and that data is not subject to the litigation, the tapes are unnecessary. If backup logs are unavailable, a personal inspection of the tapes can reveal whether they are self-identifying. Alternatively, an electronic evidence expert can restore the content of the tapes.

**Revamp cost-shifting arguments.** While the *Toshiba* decision requires the requesting party to pay the reasonable expense of translating a data compilation into usable form, the court noted that reasonableness and necessity are factual issues. The opinion does not require the requesting party to pay all the costs associated with retrieving usable data. Rather, the requesting party is expected to pay only reasonable expenses when it is necessary to translate electronic data compilations—such as those contained on a backup tape—to obtain usable information. The trial court will determine what is reasonable and necessary on a case-by-case factual basis, leaving practitioners room to craft an argument one way or the other. The *Toshiba* court further stated that if the demanding party does not believe the translations are necessary or if it disagrees with the producing party on the reasonableness of the data costs, it has the option of seeking a protective order.

Carefully consider cost-shifting trends. The *Toshiba* decision is not alone in requiring requesting parties to pay production costs. Other courts have issued a variety of opinions.
shifting burdensome or expensive discovery to the requesting party.\textsuperscript{8}

Consider data sampling. Although the importance of preserving any data that may be relevant in litigation cannot be overstated, counsel should consider data sampling. For example, in \textit{McPeek v. Ashcroft},\textsuperscript{9} the court adopted a sampling approach for backup tapes, noting that “economic considerations have to be pertinent if the court is to remain faithful to its responsibility to prevent ‘undue burden or expense’….If the likelihood of finding something was the only criterion, there is a risk that someone will have to spend hundreds of thousands of dollars to produce a single e-mail. That is an awfully expensive needle to justify searching a haystack.” In a subsequent decision,\textsuperscript{10} after examining the likelihood of relevant data being contained on each of the backup tapes, the magistrate ordered additional searches of selected backup tapes likely to contain relevant evidence.

In \textit{Hagemeyer North American, Inc. v. Gateway Data Sciences Corporation},\textsuperscript{11} the court used a sampling approach to evaluate the applicability of cost-shifting. It instructed the defendant to recover responsive data from any five backup tapes of the plaintiff’s choosing, and after that process the court would assess whether the cost of recovering e-mails from the remaining backup tapes would be proportionate to the likely benefit.

The \textit{Toshiba} court also indicated that data sampling would be an appropriate test for determining necessity. When sampling is used, the requesting party chooses a small selection of data for the producing party to restore, search, and produce. The selected data usually exists on so-called inaccessible sources, such as backup tapes for which restoration and production costs may be significant. The court then evaluates the effectiveness of the sample search and fashions an appropriate production and cost order test that the court deems appropriate. If data sampling will be helpful in a case, the practitioner should commence the process by meeting with opposing counsel to forge an agreement on sampling procedures, including the time period of the sample and the custodian. If necessary, the attorneys should seek assistance from the court and an electronic evidence expert.

The \textit{Toshiba} decision is a pioneering opinion regarding cost allocation in e-discovery. Attempting to chart a course for California, the \textit{Toshiba} court plainly stated that California law should apply in California e-discovery issues. However, e-discovery case law remains jurisdiction-specific, unsettled, and conflicting. Staying on top of various e-discovery standards and judicial decisions will put litigators in the best position to effectively manage the discovery of electronic data.

\begin{itemize}
\item \textsuperscript{1} Oppenheimer Fund, Inc. v. Sanders, 437 U.S. 340, 358 (1978).
\item \textsuperscript{3} Zubulake v. UBS Warburg, 216 F.R.D. 280 (S.D. N.Y. 2003).
\item \textsuperscript{7} Zubulake v. UBS Warburg, 2004 WL 1620866 (S.D. N.Y. July 20, 2004).
\item \textsuperscript{8} Wiginton v. CB Richard Ellis, Inc., 2004 WL 1895122 (N.D. Ill. Aug. 10, 2004) (The court determined that cost shifting was appropriate and ordered the plaintiff to pay 75 percent of the costs of restoring the backup tapes, searching the data, and transferring it to an online review tool.); Multitechnology Servs. v. Verizon Southwest, 2004 WL 1553480 (N.D. Tex. July 12, 2004) (The magistrate judge ordered the plaintiff to pay half of the costs, despite the fact that the plaintiff argued that it was requesting only “accessible” data.).
\item \textsuperscript{9} McPeek v. Ashcroft, 202 F.R.D. 31 (D. D.C. 2001) (initial e-discovery ruling).
\item \textsuperscript{10} McPeek v. Ashcroft, 212 F.R.D. 33 (D. D.C. 2003) (follow-up to e-discovery sampling ruling).
\item \textsuperscript{11} Hagemeyer N. Am., Inc. v. Gateway Data Sciences Corp., 222 F.R.D. 594 (E.D. Wis. 2004).
\end{itemize}
Becoming Justice Blackmun: Harry Blackmun’s Supreme Court Journey

By Linda Greenhouse
Times Books, 2005
$25, 288 pages

AT HIS DEATH IN 1999, Justice Harry A. Blackmun left behind 1,585 boxes containing more than a half million items. The documents—ranging from childhood diaries to drafts of Supreme Court opinions to notes scribbled during arguments of landmark cases—occupy some 600 feet of shelf space at the Manuscript Division of the Library of Congress. By the terms of his will, five years after Blackmun’s passing, the library was to make the collection publicly available. Blackmun’s family, anticipating that opening the private papers of the author of Roe v. Wade to public view could generate a frenzied response, made the considered decision to provide veteran New York Times reporter Linda Greenhouse with access two months in advance.

The result is Becoming Justice Blackmun, a riveting personal history that emerges from the collection. In her prologue, Greenhouse, who won a Pulitzer prize for her Supreme Court reporting in 1998, compares foraging through Blackmun’s papers to “plunging down a rabbit hole” into a private world vastly different from the public one she had covered for over 25 years.

Harry Blackmun, the son of a St. Paul, Minnesota, fruit wholesaler, graduated high school in 1925. Although the family finances were precarious at best, Blackmun gained a rare scholarship to Harvard, and, before turning 17, boarded a sleeping car for Chicago, where he would change trains for Boston. The atmosphere at Harvard would prove dauntingly foreign for the young Harry, who lacked the money and connections of his privileged classmates. Not infrequently, however, he was cheered on by long, avuncular letters from his boyhood friend, Warren Burger. In 1933, Blackmun served as best man at Burger’s wedding, and, decades after the two were kindergarten classmates, they served together as Supreme Court justices.

At Blackmun’s 1970 Senate confirmation hearing—which lasted less than four hours—no senator asked him about abortion. Indeed, a more pressing concern was that Blackmun and Burger, who had been appointed to the Court as chief justice the year before, would serve as “Minnesota twins,” echoing each other’s judicial positions. As it happened, Blackmun and Burger were hardly jurisprudential clones. The cases of the next 20 years, Burger’s imperfect bedside manner in his role of chief justice, and the evolution of Blackmun’s more liberal views would all work toward the ultimate dissolution of their friendship.

Greenhouse makes a persuasive case that this last factor may have been the strongest and that it all began with Roe, a case that arrived at the Supreme Court only months after Blackmun’s appointment.

Although the Supreme Court would decide the landmark abortion case by a 7-to-2 vote, Blackmun, as the author of the 1973 opinion, would have his legacy forever linked with Roe. He was hailed as a feminist icon by Roe’s supporters and demonized by its detractors.

Blackmun’s papers as well as a rereading of Roe reveal the error of both characterizations. Blackmun, a former general counsel to the Mayo Clinic, saw many problems with laws forbidding abortion, but his 1973 conclusions were largely animated by the view that criminalizing a medical procedure impeded the ability of doctors to apply their judgment. Thus, Roe’s concluding paragraphs read in part, “The decision vindicates the right of the physician to administer medical treatment according to his professional judgment” and, absent a compelling state interest, “the abortion decision in all its aspects is inherently, and primarily, a medical decision, and basic responsibility for it must rest with the physician.”

Blackmun’s notes in other cases similarly undermine the feminist icon status, or, at a minimum, make clear that the label was far from well earned in 1973. When Ruth Bader Ginsburg, as the director of the ACLU’s Women’s Rights Project in the 1970s, argued several gender discrimination cases before the Court, Blackmun found her overbearing and even “too smart.” A 68-page brief penned by Ginsburg was “filled with emotion.” Time and again, Blackmun’s notes on Ginsburg’s arguments included descriptions of her attire: “In red and red ribbon today,” Blackmun wrote of Ginsburg in 1976.

Even so, Blackmun brought a tireless work ethic and rigorous devotion to the principles of his office to all of his cases and, more than once, found himself deciding in favor of Ginsburg. In finding that an Idaho law establishing automatic preference for men over women in the appointment of estate executors was unconstitutional, Blackmun reached the then-unestablished conclusion that sex, just as race, could be considered a suspect classification. But in 1982, in Mississippi v. Hogan, which held state-supported single-sex colleges unconstitutional, Blackmun retreated. After jotting down Burger’s observations (which included “we all belong to all-male organizations,” and “all Powells have gone to single-sex schools”), Blackmun’s dissenting opinion criticized a “needless conformity” in the name of equality and expressed the view that “go[ing] too far with rigid rules in the area of claimed sex discrimination” could destroy “values that mean much to some people.”

By the late 1980s and early 1990s, however, a series of Supreme Court cases seeking to undermine, if not overturn, Roe proved a catalyst for Blackmun’s consciousness of gender equity, ultimately causing what Greenhouse concludes was a convergence of the abortion and sex discrimination cases. For Blackmun, that convergence was consummated in 1992 when he wrote, in Planned Parenthood v. Casey, that state restrictions on a woman’s right to terminate a pregnancy implicated fundamental constitutional guarantees of gender equality and went so far as to “conscript[t] women’s bodies into [the State’s] service.” In an unmistakable gesture, Blackmun cited the Mississippi case from which he had dissented 10 years earlier.

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Blackmun went a step further two years later, after Ginsburg joined him on the Supreme Court. The Court accepted *J.E.B. v. Alabama*, which questioned the use of peremptory challenges in jury selection based solely on gender. The Court had earlier ruled, in *Batson v. Kentucky*, that peremptory challenges to remove jurors based upon race were unconstitutional. In writing the 1994 opinion to extend *Batson* to sex discrimination, Blackmun traced the history of the Court's gender discrimination jurisprudence, citing four of Ginsburg's cases, and noting in a footnote that sex-based jury challenges violated even mid-level scrutiny.

In the aftermath of *Roe*, Blackmun faced picketing, hate mail, and death threats. A letter Blackmun wrote to the Reverend Vern Trocinski, a Minnesota Catholic priest and personal friend, reveals the depths of Blackmun's commitment to his judicial oath notwithstanding his personal views. In response to the reverend's letter "in defense of the unborn," Blackmun wrote: “I share your abhorrence for abortion and am personally against it.” The Court's task, however, “was to pass only upon the narrow issue of constitutionality. [The Court] did not adjudicate that abortion was right or wrong or moral or immoral.”

In like manner, Blackmun voted repeatedly to uphold the lawfulness of capital cases, notwithstanding his personal opposition to the death penalty. Only after more than 20 years of service on the high Court, and observing what he concluded was irremediable unfairness in the application of death sentences, did Blackmun famously write, “I shall no longer tinker with the machinery of death.” Even then, Blackmun painstakingly made clear his wish to avoid broad-brush expressions of political opinion and to instead articulate his own legal analysis. He declined to find, as had other justices before him, that all death penalty cases violated the Eighth Amendment. Rather, his more nuanced opinion was that arbitrariness, discrimination, and mistake rendered it impossible to impose the death penalty fairly within the constraints of the Constitution.

Many will celebrate *Becoming Justice Blackmun* for showing the “evolution” of the justice’s decidedly liberal principles. But, in an era of pervasive litmus tests for judicial appointments, and the accompanying assumption that jurists will rule in allegiance with their personal views rather than the mandates of their oaths of office, Blackmun’s rigorous devotion to the highest of judicial principles and his demonstrated commitment to ruling in accordance with the law, even when it ran against his personal predilections, is even more laudable—and far more instructive—for our time.
The Significance of Technobabble

MANY PEOPLE CONSIDER LEGALESE something used by lawyers in an effort to complicate things unnecessarily. Some argue that lawyers use legalese to confuse, impress, and even justify their salary. In fact, legalese is a necessary part of legal practice used to keep concepts on point. Ironically, many attorneys complain that computer jargon is something used by computer experts in an effort to complicate things unnecessarily. When attorneys pay as much for computer support as their clients do for legal services, they may be tempted to say that computer engineers use technobabble to confuse, impress, and even justify their salary.

The legal and scientific communities have long realized that Latin is useful because Latin words have stopped evolving into other meanings or slang. Technobabble, in stark contrast, is the creation of people who do not care about Latin and may never have taken an English literature class. The result is that, unlike Latin, technobabble continues to evolve with technical advancements, marketing needs, or other factors. But like legalese, technical terminology grants a particular term a particular meaning within a specific industry.

Take for instance the terms “data recovery” and “forensic data discovery.” Both concern the same act—copying bytes of information from storage devices—but the latter is specific to law office technology. Forensic discovery requires a particular set of actions that will ensure that data recovered is admissible in court. Data recovery does not. Admissibility for electronically discovered information is maintained very differently than it is for paper. When the criteria for admissibility of electronic data change, so too will the meaning of the term “forensic data recovery.”

No matter how electronic data is found, however, the goal in electronic forensics is specific: Produce an exact copy of the original data so that the copy can be stored for long periods of time. Beyond this basic goal, it is usually also desired that a copy can be used again and again, that it has an internal verification mechanism to prove that the copy is exact, that it does not introduce viruses, that it does not damage or corrupt the data, and that it captures unallocated space found on the original storage device. According to the courts, these are the most important steps in electronic discovery. Without an admissible copy, the data discovered will be valueless. The difference between forensic discovery and data recovery is therefore significant. With this example in mind, it is helpful to review some technobabble at the core of law office technology.

Document depositories, case management software, and extranets are all important in managing the data that applies to a case. A document depository is the next step after forensic discovery, which creates a body of information. Document depositories put all the gathered data into one place, to allow for searches for such items as names or dates. In addition to electronically discovered data, the document depository can hold scans of paper documents that have been processed with optical character recognition (OCR) software, which can translate the image of a written page into a text file. The depository’s large amount of data can also be grouped into categories such as correspondence, faxes, e-mail, voice recordings, and so on. If the depository is large—and this is likely—it must have good relational management. In technobabble, “relational” is short for “relating one item to another.”

In a document depository, a relational database can help draw the connections between varied documents and the information they contain. A relational database even can provide control over the entire case, including time and billing. When the relations among documents and users are well managed, it is relatively easy to keep track not only of names, terms, dates, amounts, and other evidentiary information but also of which user examined what and for how long. A relational database can also help an attorney to do research and cross-reference.

A relational database is an electronic spreadsheet with columns and rows that can be linked (or related). This matrix of columns, rows, and links allows for unlimited categorizing. The use of spreadsheet software intended for simple bookkeeping for a relational database is a mistake because it does not allow for the development of the relations that must be present for the best results. The connections between seemingly unconnected facts are best uncovered with relational databases, which allow for complex queries. Time lines, names, types of documents, and legal issues can all be related. Even the queries can be saved for attorneys to reuse as new data is discovered and added to the depository.

Another technobabble term of interest to lawyers is “war room.” After electronic data has gone through forensic discovery, paper documents have been processed with OCR software, and all the data placed in a relational database, the next step is to have a place dedicated to the management of this trove of data. This place is the war room. A properly designed war room can help an attorney dis-
cover that key piece of information upon which the entire case may turn. The simple guiding principle of a war room is that the computers and other machines placed there are as accessible and easy to use as possible, allowing for lawyers to perform legal research rather than struggle with gadgetry.

For this reason, the best war room consists of nothing more than a computer with access to the Internet. The most advanced data management software is Web based. These applications rely on servers to access data depositories and present results to anyone with a password. The Internet is the entire Web; an extranet is a part of that Web; an extranet is a part of the Internet, for example, they are using an extranet. The bank manages the data and provides secure access. An extranet requires that servers and technology stand behind the curtain of that easy-to-use Web page.

The utility of Web-based database management is not limited to text documents. Depositions, for example, now typically generate electronic records. Once upon a time, paralegals used word processors or spreadsheets to process depositions and prepare them for cross referencing and case management software. This laborious task has been streamlined. Another technobabble term, “live deposition digesting,” describes this technology. With live deposition digesting, cocounsel can sit in an office 8,000 miles away and not only view the deposition in real time but also interact with any number of other people watching the deposition remotely, while flagging portions of the deposition for later ease of retrieval.

Ultimately, relational database management operates in parallel with case management. Not only can an extranet allow scattered users access to the same data and help keep track of billable hours, it can also be used to take the case to trial. The management software that simplified the war room can also be applied to trial presentation. The same database that allowed counsel to follow the money can generate 3-D animations and place images of documents and excerpts of video depositions onto time-lines.

As long as opposing counsel and clients pressure law firms to cut costs while employing more and more tools, understanding the interconnection between these technologies is vital to a firm’s survival. For this reason, the meaning of such supposedly obfuscatory terms as “forensic data discovery,” “document depository,” “relational database,” “case management software,” and “extranet” should be crystal clear to a lawyer.
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CLE Preview

Using Time Matters
ON TUESDAY, OCTOBER 18, the Los Angeles County Bar Association, with the cosponsorship of the Law Practice Management Section, will present a program on making the best use of the well-known time and billing management software Time Matters. Participants will learn seven core tasks that Time Matters and Billing Matters help attorneys accomplish quickly, easily, and efficiently. In addition, the LexisNexis version of Time Matters lets attorneys manage case and client matters, calendar, documents, firm billing, and communications while using LexisNexis services to do research.

Participants will see how to use the application to refer to relevant client information while preparing research, incorporate research findings directly into case and client documents, share research records, and record the time spent researching a matter and create a billing record. The program will take place at the LACBA/LexisNexis Conference Center, 281 South Figueroa Street, Downtown. Reduced parking with validation costs $8. On-site registration and the meal will begin at 5:30 P.M., with the program continuing from 6 to 8 P.M. The registration code number is 009156. The prices below include the meal.

$15—CLE+PLUS members
$50—Law Practice Management Section members
$75—other LACBA members
$90—all others
2 CLE hours

Excel and Word for Attorneys
On Thursday, October 13, the Los Angeles County Bar Association will present a seminar on Microsoft Word and Excel. Speaker Russell Jackman will show participants how to go beyond the basics to use the applications to benefit the specific needs of their legal practices. The program is taught with hands-on techniques that novice users can follow but is also designed so that veteran users can gain useful new skills. Techniques such as using a pleading wizard; creating templates; using autotext and callouts; formatting text boxes, columns, and page layouts; and using a spreadsheet to create budgets, graphs, and charts will all be discussed in this informative MCLE-credited seminar. The program will take place at the LACBA/LexisNexis Conference Center, 281 South Figueroa Street, Downtown. Reduced parking with validation costs $9. On-site registration and the meal will begin at 5:30 P.M., with the program continuing from 6 to 8 P.M. The registration code number is 009116. The prices below include the meal.

$45—CLE+PLUS members
$75—other LACBA members
$100—all others
3.25 CLE hours

PENDING CHANGES IN FEDERAL CIVIL PROCEDURE
On Thursday, October 27, the Los Angeles County Bar Association will present a program on how the Federal Rules of Civil Procedure may change to address the nature of electronic evidence, which is voluminous, volatile, and pervasive. The impact on discovery has been dramatic as seen in recent case decisions and verdicts. This interactive presentation will include opportunities for group discussion. It also includes practical advice for planning effective electronic discovery whether representing the requesting or producing party.

Participants will gain a basic understanding of the key differences between electronic evidence and paper evidence, review recent electronic discovery case law, and learn of proposed amendments to the Federal Rules of Civil Procedure. The program will be presented by Julie Locke and Shaun Murphy, authors and presenters on the topic of electronic discovery, and will take place at the LACBA/LexisNexis Conference Center, 281 South Figueroa Street, Downtown. A reduced parking fee is available with LACBA parking validation.

On-site registration and the meal will begin at 5:30 P.M., with the program continuing from 6 to 8. The registration code number is 009164. The prices below include the meal.

$50—CLE+PLUS members
$70—other LACBA members
$95—all others
$105—at-the-door payment
2 CLE hours

PLEASE NOTE: FIGUEROA COURTYARD NOW USES AN AUTOMATED PARKING PAYMENT SYSTEM. PLEASE BRING YOUR PARKING TICKET WITH YOU TO THE PROGRAM.

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

ONE OF THE MOST COMMON MISTAKES of litigators, even very experienced litigators, is making too many arguments. Ask a lawyer why he thinks he should win his case and he will rattle off a host of reasons. When a lawyer prepares an answer, he takes pride in how many affirmative defenses he can assert. When was the last time you saw an answer that did not include “estoppel,” “laches,” and “failure to mitigate” as affirmative defenses, even in cases in which these doctrines do not even remotely have any application? When a lawyer opposes a motion, he will list 10 reasons why he should win, reasons that are often contradictory or inconsistent with each other.

Lawyers love arguments; the more the merrier. It may seem logical that the more arguments you can make in support of your case, the greater are your chances of winning. Who knows which of your arguments an ever-fickle judge or jury will latch onto? Better safe than sorry. But this is not true. Lawyers often lose cases precisely because they make too many arguments.

For some reason, lawyers seem to forget that judges and juries are not trying to decide which party has the cleverer lawyer but which has justice and the law on its side. Justice is not determined by counting up arguments but by determining which side’s arguments make sense, that call for a result that is consistent with legal and equitable principles. The challenge for a lawyer is to present a case that resonates on those two levels.

The way to accomplish this is to identify a few arguments—among the many possible ones—that you believe you can win and will really matter to the outcome of the case. To do this, you need to fully and thoroughly analyze your case. Look at it dispassionately. Don’t ask yourself what the strengths of your case are; instead, ask what its fundamental weakness is. And then devote your lawyerly skill to addressing that weakness by identifying a correct legal argument that solves the fundamental problem and also makes equitable sense.

Of course, in many cases there is no perfect argument, but by seeking the arguments that address the fundamental weakness of your case, you will be getting to the heart of the issue that the judge or jury most needs to hear you talk about. And then—and this is the hard part—leave out the long list of other possible arguments. Once you have identified the arguments that answer the fundamental weakness in your case, everything else is a distraction, or worse. If you have analyzed your case well, you will see that your case will stand or fall based upon the success of these arguments. That is not a situation to be feared; it is precisely what you want. When you have a good, persuasive argument that makes equitable sense and is consistent with the law upon which your case will turn, you are in good shape.

Contrary to conventional wisdom, in almost every case, the fewer arguments the better. One is best. If you make only one argument, you can be sure that the jury will be discussing that argument in the deliberation room. Who knows which argument the jury will be discussing if you give them a dozen to choose from. Notwithstanding the logic of this approach, lawyers are afraid to follow it. Part of the problem is that lawyers are often unwilling to leave anything out that has any potential.

A deeper problem is that lawyers often do not fully analyze their cases, so they do not realize what arguments really matter. If you are unable to make a confident determination about which arguments are better than others, the safer course is to include them all. But it is not the better course of action. As with most things in life, it takes time and hard work to do it right. In order to adopt this approach, it is absolutely essential that you roll up your sleeves, hit the law library (or the Westlaw or Lexis terminal), look at every document, talk to every witness, and think your case through. Only then will you be able to select the best arguments. When you have developed the habit of thinking about your cases in this way, I am confident that you will find that in pleadings, motions, and trials—in virtually all cases—one good argument is better than ten.

For example, suppose you are representing a defendant charged with breaching a contract. Suppose, when you analyze the case, you realize that he pretty clearly did breach the contract, but that the plaintiff did not suffer any damages as a result of the breach. Most lawyers would argue, “My client did not breach the contract, but even if he did, the plaintiff was not damaged so he should not collect any money in this case.” But, if your first argument is weak, you are much better off leaving it out. Compare this approach: “My client did breach the contract. We admit that. But the plaintiff did not suffer any damages, so any recovery you award him would be a pure and unjustified windfall.” With this approach you gain enormous credibility, and you can use that credibility to focus the jury exclusively on the issue that really matters.

This approach requires courage, confidence, maturity and, perhaps most important of all, judgment—precisely the qualities a client wants in his or her lawyer. Carefully selecting a few good arguments, and rejecting the rest, will not guarantee victory. However, by adopting this approach, you will focus the judge or jury on the issues you want them to be focused on, you will have consistency and credibility throughout your case, you will maximize your chances of prevailing, and you will be a better lawyer.

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