In Command

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Mr. Gleitman has practiced sophisticated estate planning for 26 years, specializing for more than 14 years in offshore asset protection planning. He has had and continues to receive many referrals from major law firms and the Big Four. He has submitted 52 estate planning issues to the IRS for private letter ruling requests; the IRS has granted him favorable rulings on all 52 requests. Twenty-three of those rulings were on sophisticated asset protection planning strategies.

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Biography available at lawyers.com or by request.
Richard’s bank understands the intricacies and demands of his legal profession arranged the loans to remodel the firm and his home provides a private banker who’s both resourceful and responsive regards his client referrals as a personal responsibility never settles for less than a perfect partnership.

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his month, with great enthusiasm, I begin my term as the 2006-07 chair of the Los Angeles Lawyer Editorial Board. I am honored to have been chosen to lead the group of 41 lawyers serving on the board. Through the collaborative efforts of these volunteers—all of whom possess vast knowledge and experience in different areas of law—and the magazine’s proficient staff, our publication is known as one of the most well-respected bar publications in the country. I am also thrilled to have served as the articles coordinator under the insightful leadership of last year’s chair, R. J. Comer, whose shoes will be hard to fill.

As I embark on this adventure, I cannot help but look back at how I came to this position as incoming chair. I can say, without hesitation, that it all began with one man—my first mentor and good friend, Abilio “Bil” Tavares. Most of us are lucky enough to cross paths with that one lawyer who takes us under his or her wing during the first and most stressful year of practice. Bil was that lawyer for me, and it was his encouragement that led me to submit an application for appointment to the magazine’s Editorial Board in 2000. That year, as a lawyer with few miles on me, I felt unqualified to make a significant contribution to the board. Bil suggested that I would learn a lot by serving on the board and offered to help me edit the first couple of articles that were assigned to me. But for Bil’s kind encouragement and gracious offer, I would not have joined the board.

As the articles coordinator for the 2001-02 bar year, Bil very much looked forward to chairing the Editorial Board for the 2002-03 term. Sadly, Bil died unexpectedly on July 15, 2002, of cardiac arrest, only a few days after he assumed his role as the chair. Although he wrote his first From the Chair column, which was published in the July/August 2002 issue of the magazine, Bil never had the opportunity to chair his first meeting. He was a young 46 years old.

Bil, who grew up in Rhode Island, was the kind of lawyer that everyone enjoyed working with. He was knowledgeable, experienced, ethical, fair, and, most importantly, generous with his time. He was the kind of lawyer who gets referrals from opposing counsel. Bil always offered help, even if it meant he would have to work late at night or sacrifice his weekends. Bil consistently looked after the new associates and offered advice on how to weather the long hours and often overwhelming stress of being a baby lawyer. He was a rare find.

So I dedicate this and all my future From the Chair columns to my mentor and good friend, Bil. I wish he was still here, mentoring other lawyers as he mentored me. I encourage you to look back and remember those generous people who helped and encouraged you to get where you are today. If your mentor is still here, pick up the phone and call to say “thank you.” As a trusts and estates lawyer, I experience role reversals on a regular basis. This may be your chance to return someone’s act of kindness, perhaps as a mentee who becomes the adviser of a soon-to-retire lawyer. Or this may be an opportunity to honestly look within yourself and see if you have done a good job as someone’s mentor.

Throughout my tenure as a board member, there have been occasions when the time required for my practice and family life led me to think selfishly about quitting the board. However, Bil’s memory weighed heavily against taking that step. Life moves at a very fast pace, and before one realizes it, the journey is over. I hope that when my time comes, someone will remember me like I remember Bil. I wish the same for you.

Bil, wherever you are, thank you for your generosity. We miss you.

Jacqueline M. Real-Salas is a partner at Calleton, Merritt, De Francisco & Real-Salas, LLP, where she specializes in estate planning, trust administration, probate, and elder law. She is the chair of the 2006-07 Los Angeles Lawyer Editorial Board.
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IN 1880, MY GREAT-GRANDFATHER, Chun Cup Choy Acoon, left his small fishing village near Canton, China, at age 16, to harvest pineapples in Hawaii. Six decades later, after the Imperial Japanese Army ended its eight-year occupation of his homeland, he returned to China a successful businessman.

Acoon bought land, started businesses, and had a small fleet of fishing boats. But when the dark clouds of Communism swirled over China and after a commissar demanded my grandfather’s cattle, he returned to Maui, leaving one son, my uncle, to manage the family’s properties. The Communists eventually seized everything, including my uncle, who died in prison. Everything vanished into the hands of the powerful. What was left was an empty gun. The great achievement of the American people has been the attainment of liberty for its citizens through the rule of law—where the rights of the individual and respect for property ownership are protected from the grasp of the powerful and wealthy.

While the rule of law and American core values have produced a great nation, many poor among us still suffer. We, as lawyers who possess a monopoly on the practice of law, have a solemn duty to help. While our system of justice has worked well for much of our history, this has been due to the efforts of those, particularly lawyers, who have stood up for truth, who have had the courage to challenge injustice, and to help those who are most vulnerable. In the process of protecting others, lawyers have changed our society peacefully and avoided bloodshed and violence.

Those trained in the law have played important roles in the struggle for liberty and equality throughout America’s history. Men like John Adams and Thomas Jefferson laid the foundations for our legal system. It was lawyer Thomas Jefferson who drafted the Declaration of Independence. It was lawyer John Adams who insisted that the Bill of Rights be a part of the Constitution as a condition for its ratification. In 1863, it was lawyer Abraham Lincoln who changed history when he proclaimed the abolition of slavery. In 1954, it was lawyer Thurgood Marshall who argued Brown v. Board of Education before Los Angeles native and Supreme Court Chief Justice Earl Warren, asking the court to end that particular legacy of slavery. Marshall’s goal was to open doors to all, extend opportunities to those of every color, and ensure equal education for all our children. Our own city has produced its share of committed lawyers. For example, Warren Christopher, in addition to conducting a thriving law practice, has played a leadership role in our national government and acted locally as a steward of this Association and leader of the Independent Commission on the Los Angeles Police Department.

We should be proud of our profession. Lawyers have been at the forefront of the battle against injustice and inequality and for the fight to preserve our liberties. The legal profession is a noble calling—one that calls for continued courage, vigilance, and a dedicated commitment to the people we serve and to our system of justice.

Lawyers are the ultimate volunteers and public servants in our society—a service that shows many faces. Through the American Bar Association, the California State Bar, the Los Angeles County Bar Association, and our multitude of specialty and ethnic bars—and, particularly through our public interest law firms like Public Counsel and Legal Aid—great work for this country has been done. There is no church, synagogue, nonprofit board, symphony, chamber of commerce, or Boys and Girls Club in our community that does not benefit immensely from the involvement of lawyers.

In our Association, thousands of volunteer hours are donated by those who serve on our boards, sections, committees, the Dispute Resolution Services, and our public service projects—the AIDS Legal Services Project, Domestic Violence Project, and the Immigration Legal Assistance Project. We owe a special thanks to the many volunteers who donate so much of their valuable time to the numerous facets of this organization. Yet much remains to be done. The path-breaking 2002 study by the California Commission on Access to Justice reported that only 28 percent of the urgent needs for legal services of California’s poor and lower income residents are being addressed. Equal justice is no more than a pipe dream unless citizens can use our justice system. The words of former slave Frederick Douglas haunt us still today:

Where justice is denied, where poverty is ignored, and where ignorance prevails, and where any one class is made to feel that society is an organized conspiracy to oppress, rule, and degrade them, neither persons nor property will be safe.

Some have made deep commitments to public service and to pro bono; others have not. I call upon all of you to look deep inside yourself and ask, “Why not?” When you give unto others, you leave a small corner of the world a bit better, and, just as important, you nourish your own heart and soul. There is still much to do. Join us in this great endeavor.

Charles E. Michaels, vice president and general counsel of LAACO, Ltd., is 2006-07 president of the Association. He can be reached at charles.michaels@laaco.net.
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How and Why to Practice Networking

PEOPLE MEET OTHER PEOPLE, make contacts, share information, and develop mutually beneficial relationships through good networking. Highly successful lawyers who participate on career panels for Barristers events always stress the importance of networking in the professional development of junior lawyers. For new lawyers, networking can put a face to a name for prospective employers, mentors, judicial officers, colleagues, and referral sources.

Many new lawyers enter the job market and the practice of law without a clear concept of how to go about networking. Certainly everyone is familiar with the experience of meeting new people and making connections, but somehow the process becomes all the more daunting when labeled “networking” and repeatedly declared to be critical to your future.

Effectively expanding your network of contacts generally requires getting out of the office and into the world. The phone and e-mail are useful tools, but if you really want to establish an identity, you have to appear in person. For example, Association activities provide new lawyers with an excellent forum in which to network. Whether engaged in pro bono activities, attending informative panels, or receptions geared specifically for networking, Barristers can develop the basic networking skill: making contacts.

Meeting strangers involves taking risks. For the person who was not born with the networking gene, those risks are self-evident. Every child remembers the first day of school, unfamiliar faces, and heart-pounding uncertainty. (What if they don’t like me?) Many new lawyers say their two biggest fears are that of rejection and, more specifically, looking dumb.

Rejection happens. Not every swing connects with the pitch. If “hello” is met with a cold reception, politely say, “nice meeting you” and move on. Maybe you will meet again at a better time, maybe not. Either way, never burn your bridges.

A lawyer’s intellect is a key tool of the trade, and new lawyers often fear that a social misstep in networking might be mistaken for lack of intellectual firepower. But veteran attorneys often note that contact networking is not so much about dazzling people with your intellect as simply coming across as a reasonable human being, someone others would want to work with or hire. Do not worry about being brilliant or funny. Concentrate on being polite and positive. Listen and learn something about every person you meet. Share something about yourself, but do not focus solely on yourself, because that is not a conversation but a commercial. When in doubt, keep eye contact and keep a tight rein over your words.

Networking fears aside, there is also a general feeling of awkwardness in approaching strangers. In any given room, there will be people standing alone, in pairs, trios, or small circles. The newcomer may perceive huge social walls standing before them.

Beginning with people who are standing alone is a good initial strategy. This works best at the beginning of a reception, and arriving early is therefore very worthwhile. Later on, each of your new acquaintances will likely be talking to others you do not know. Swing around and say hello. This reinforces your identity with the new acquaintance and facilitates a new contact.

The most daunting part of networking is breaking in an ongoing conversation. You will have to break into some conversations. Make eye contact, briefly but solidly, with as many of the participants as possible. If someone is speaking, you may have to wait a few moments for him or her to conclude and acknowledge you. Eventually, you may just have to break in with a hello, and no one expects you to wait forever.

Many bar events involve honorees, speakers, or VIPs, who can be good test cases for new lawyers to practice upon. VIPs are used to being approached at bar events, and a VIP may be particularly open to contact with a new lawyer. The VIP is usually surrounded by people and engaged in conversation but is aware that others are waiting and will eventually acknowledge you. There are also usually other interesting people waiting to speak to the VIP. Briefly introduce yourself to them as well, but do not try too hard to engage in further conversation at that time (they really want to talk to the VIP). After greeting the VIP, greet the other person again, even with something as simple as, “Hi, we were both waiting to speak to the honoree, and I didn’t get a chance to properly say hello.”

For example, last spring, the Association celebrated Chief Justice Ronald M. George’s first 10 years of leading California’s judiciary. In a crowd that included former governors of California as well as prominent jurists and lawyers, new lawyers who summoned the gumption to approach the chief justice and his colleagues were met with graciousness and encouragement. Those Barristers who participated in other Association activities also had the benefit of being able to say not just “hello” but “hello again” to members of the California Supreme Court who have been supportive of Barristers.

Wherever you go, make it a habit to bring business cards and a pen. New lawyers often forget cards, whether attending a pro bono session or a major reception. Somebody paid for the cards, so use them. At the very least, they assist people in getting your name right. Getting information is even more crucial for follow-up. If someone does not have any cards, offer to write his or her e-mail address or phone number on the back of one of your own cards. Take a moment to jot down a fact about the person on whatever card you are using. Be sure to follow up with an e-mail message.

There is also awkwardness in leaving a conversation. While there are many ways of gracefully exiting, the simplest is to politely excuse yourself, saying, “It was very nice to meet you.” You are better off trusting your instincts and moving on when the thought first occurs to you rather than fidgeting impatiently.

Strong networking goes beyond simply making contacts. A professional relationship, like any other relationship, takes time and effort to nurture. However, every relationship begins with “hello.”

Gavin Hachiya Wasserman, managing partner of Wasserman & Wasserman, LLP in Torrance, is president of the Barristers.
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Selling Life Insurance on the Secondary Market

FOR SOME SENIORS with high net worth, the golden years have taken on a literal meaning. Thanks to a burgeoning secondary market for the purchase of life insurance policies by investment funds searching for competitive returns, persons in their early 70s to early 80s, with relatively good health and at least several million dollars in assets (net worth is a criterion for how much life insurance a company will offer an applicant) have discovered an unexpected financial resource in their unused insurance capacity. Under the right circumstances, their purchase and later sale of life insurance, a new variation on senior life insurance settlements, can be very lucrative, realizing returns of double or even triple the investment over two years. For example, two years ago, a 75-year-old man with a certain actuarial life expectancy could have paid two years of premiums in the amount of $500,000 for a $10 million life insurance policy and now, two years later, sell the policy net of fees for approximately $1.5 million.

The potential for gain should not, however, lead a senior to step blindly into any transaction that has complicated legal ramifications, as senior life insurance settlements typically do. The first step for counsel is to appreciate how the new transactions work and then to inquire about certain personal and financial questions. Although the transactions may take many forms, legal issues regarding insurable interest, disclosure, and taxes should always be examined. While guiding clients through the minefields, counsel can help them make knowledgeable decisions to further their financial goals.

To understand new life insurance settlement transactions, counsel should know the history of how they evolved. The secondary market for life insurance started with viatical settlements in the 1980s. A viatical settlement is defined in California as an agreement by which a person owning a life insurance policy upon the life of a person with “catastrophic or life-threatening illness or condition” sells the policy or the right to death benefits for an amount less than the policy’s death benefits, except assignments to a licensed lender or credit union as collateral for a loan. In response to the AIDS epidemic, investors began purchasing the existing life insurance policies of persons who suffered from the illness and desired immediate cash to pay for end-of-life care. Like other states, California enacted consumer protections for the sellers of viatical policies and special licensing requirements for the purchasers. As AIDS patients started living longer due to medical advancements, the market began to include third-party purchases of existing policies on the lives of people who were not necessarily in critical condition.

Unlike the highly regulated viatical settlements, senior life insurance settlements, generally speaking, are treated legally as the sale of any insurance policy. The third-party transactions that originated from viatical settlements then morphed into simply an alternative way for any senior, regardless of health, to sell a life insurance policy for more than the cash value that might be received from its surrender. It was estimated in 2003 that more than 20 percent of almost $500 billion of life insurance already in place for those over 65 had an economic value exceeding cash surrender value.

The growth of the secondary market has spawned a new type of insurance settlement, one in which a senior takes additional life insurance and actually anticipates, as one available option, the policy’s subsequent sale even without a decline in the senior’s health. The basic transaction is that the senior (alone or with a third party, who may or may not be a family member) “invests” in a policy by paying two years of premiums. The policy insures the senior’s life, the insurer is investment-grade quality, and the death benefit is typically $5 million or more.

Then, if the senior chooses, depending upon future circumstances, the policy is sold after two years have passed. The significance of the two-year period is that life insurance policies in California, like those of other states, must contain a clause that they cannot be contested by an insurer after a period not exceeding two years from the policy’s issuance, except for failure to pay premiums and situations that make the policy void ab initio. A buyer in the secondary market typically wants an investment free of claims by the insurer that could oth-
erwise be brought prior to the expiration of the incontestability period. New health risks for the insured over the two years would also make the policy attractive in the secondary market.

How can there be such significant profit in a life insurance settlement, however, when the health of the insured does not decline? For the senior to buy low and sell high, so to speak, the insurer and the subsequent buyer clearly must have different analyses regarding an expected return from the policy. The insurance company’s lower price is based upon an anticipated return that includes some percentage of policy lapses for nonpayment. The purchaser in the secondary market can pay a higher price, on the other hand, with the knowledge that it will not allow the policy to lapse and nullify its return. In addition, the discrepancy between the determination of value by the insurance company and the buyer in the secondary market may be attributed to differences of opinion on the actuarial life of the insured. Accentuating the price arbitrage, an agent with business acumen and a high dollar amount of insurance sales can negotiate a more favorable premium rate for the policy. If the insurer gives the senior a preferred rating, for example, that is built in additional potential for profit on the later sale. Currently, there is significant competition for the policies in the secondary market.

There are also risks, as with any type of investment. Someone is basing a decision on the anticipated market two years after the policy’s inception. Insurance companies could start raising the premiums on certain older age groups. The actuarial analysis of life expectancy could result in higher life expectancies due to new methodology. As interest rates rise, the secondary market could find more desirable investments, though the increase in interest rates may also result in a higher return on cash value. There are other economic circumstances that are difficult, if not impossible, to predict. To warrant this investment, one must conclude, after evaluation, that there will be some stability in the factors affecting the price arbitrage over a two-year period and that a well-negotiated purchase price at the policy’s inception allows ample cushion for a change.

Though media attention has focused on investor involvement, the most straightforward approach for the transaction is taken when the senior or family uses their funds for the first two years of premiums. The senior’s existing life insurance may be a source of this funding through a loan, exchange, sale, or surrender, each of which will have an economic tradeoff that must be analyzed. The senior may take a short-term loan on the cash value in existing policies and then pay back the loan when the new policy is sold. If the new policy is better than the existing one (for example, larger death benefits for the same premiums or the same death benefits for smaller premiums), then the old policy could be surrendered for cash value or exchanged for the new policy using existing cash value or proceeds from another initial sale in the secondary market. The senior’s children may also want to participate in paying for premiums or receiving a policy as a gift.

Requiring a review on a case-by-case basis, the transactions with investors, other than family, will undoubtedly undergo permutations in response to ongoing changes in insurance company application procedures. One popular approach in the past was for the investor to make the senior a nonrecourse loan secured by the policy for the senior’s payment of the first two years of premiums and with an extra advance to the senior. In two years, the senior could choose to maintain ownership of the policy and pay back the loan or to keep the advance from the financier if the policy is transferred to the financier in exchange for the cancellation of the indebtedness. To the extent more life insurance application procedures dissuade applicants from borrowing, however, it will become more difficult for investors to participate through nonrecourse loans.

An alternative to loans is for the senior and the investor to form a limited liability company or a trust that is the owner and beneficiary under the policy. As members of the limited liability companies or beneficiaries of the trust, the investor and senior share the benefits of the insurance (in a sale or on death of the insured) depending upon how much either of them pay toward the premiums. Outright contributions, instead of a loan, may sometimes be treated more favorably in insurance company application procedures.

Two threshold personal issues must be examined before someone even considers the transaction. First, the senior must appreciate that, once any policy is sold, the ability to obtain additional life insurance will be limited to some degree depending upon the growth of the senior’s net worth. Careful consideration must be given to anticipate if there are estate taxes or other special needs for which additional life insurance would be helpful. Of course, provided the senior can continue to afford the premiums, he or she may decide to maintain the insurance rather than sell a policy, a choice that is often more financially advantageous for heirs. The purchase of more than one policy with varied amounts of insurance may provide the senior with flexibility to keep, instead of sell, some insurance.

Second, the senior must of course feel comfortable that a stranger has a vested interest in his or her death. Any promised confidentiality for the name and address of the insured party may be breached, and the senior really has no control over where the investment will find its home. In Victorian England, waging with maritime insurance and life insurance on strangers was prohibited due to public policy concerns about the gambler’s accelerating, so to speak, the death benefits of policies. Yet no one really expects money managers of hedge or pension funds to hire hit squads. To the extent it provides some solace, however, a named beneficiary who “feloniously and intentionally” kills the insured is not entitled in California to any benefit under the policy.

If someone is comfortable with the personal and financial issues, then counsel can provide advice on the legal implications. No matter the format for the transaction, the key factors for analysis typically are insurable interest, disclosure, and taxes. The beginning legal inquiry is whether the policy owner has an insurable interest in the senior’s life, and the consequences to the senior if there is no insurable interest.

**Insurable Interest**

In California there is an insurable interest for a life insurance policy when the initial owner has a substantial interest engendered by love and affection in the case of individuals closely related by blood or law, or, alternatively, a reasonable expectation of pecuniary advantage through the continued life, health, or bodily safety of the insured and consequent loss by reason of death or disability. Without an insurable interest, the policy is void. The insurable interest is required when the insurance contract becomes effective, not at the time the loss occurs. A life insurance policy may be transferred to any person, whether or not the transferee has an insurable interest. This, in essence, has enabled the operation of the strong secondary market for the policies.

The insurable interest is well established in situations in which the senior or the senior’s family pays for the insurance without outside financial assistance. There is no doubt that the insured has an insurable interest in his or her own life. Likewise, when a senior’s spouse or children apply for the policy, they also have an insurable interest in the senior’s life. Certain business relationships may also create an insurable interest.

Yet there is always some risk that life insurance financed by an investor may run afoul of insurable interest requirements. When a senior borrows money from an investor to pay for a policy, he or she owns it at inception and seemingly has an insurable interest in his or her own life. Even a creditor-debtor relationship is sufficient for an insurable...
interest, at least to the extent of the debt. Nonetheless, opining on a transaction in which the insured was given a recourse loan for the premiums and a “put” for the financier to buy the policy on a date certain, the Office of the State of New York Insurance Department concluded there was no insurable interest under New York law. The department reached this conclusion, according to the opinion, because the policy was purchased “as a speculative investment for the ultimate benefit of a disinterested third party,” which ostensibly New York’s insurable interest requirement was enacted to prevent. While the opinion was neither law nor necessarily well founded, many major insurance companies followed shortly afterwards with more extensive inquiries in applications about whether the applicant was obtaining a loan in connection with the policy and memorandum to their agents that they would not issue insurance on those who did. The structure of a limited liability company or trust with a contribution by the investor may satisfy application inquiries specifically about a loan, but, depending upon the allocation of a policy’s benefits between the insurer and the investor, it is uncertain whether there is an insurable interest.

Even after the incontestability period expires, an insurance policy might still be challenged on the ground it is void ab initio for lack of an insurable interest. The insurer is the only party who may challenge whether the insured had an insurable interest, though in connection with its own liability an insurer is entitled to rely in good faith on whatever representations are made by an applicant for insurance relative to his or her insurable interest in the insured. If the policy is rescinded, any consideration received by the insurance company, such as paid premiums, must be returned.

When the transaction passes muster in the application phase, the senior who uses investor’s funds to pay the premiums at the policy’s inception is thus still taking some risk as a result of the insurable interest issue. The senior is betting that the insurer is unlikely to seek rescission upon the senior’s death due to the insurer’s prior knowledge of the financing structure in the application process, as well as a supportable position for insurable interest where there are no legal bright lines. While this may indeed be a reasonably calculated decision, what the insurer will do in the future is uncertain.

Disclosure

After insurable interest is addressed, another important legal issue is disclosure. Needless to say, an applicant must be truthful. An insurer may within two years rescind a life insurance policy for material misrepresentations in the application, regardless of whether they had a causal connection to the death of the insured. Materiality is determined solely by the probable and reasonable effect that truthful answers would have had upon the insurer. Applicants should thus make as complete a disclosure as possible regarding financial aspects of the transaction as well as health.

For accurate disclosure, attention must also be focused upon the application, since by statute a life insurance contract consists of the policy form, the endorsements, and the attached application. Unless the application is attached to the policy when delivered, however, no statement made in the application may be used as a defense to payment of benefits. The application may ask whether the applicant intends to sell the policy.

In order at once to respond accurately and at least to anticipate the possibility of a sale, the applicant must really intend to maintain the policy for estate or other purposes when the application is submitted, notwithstanding the extant opportunity to sell it. The future decision to sell will depend upon yet unknown circumstances. If the estate continues to be the chief concern and cash for premiums is available, maintenance of a policy in fact is often the better financial decision. However, any formal arrangement, such as an option or a nonrecourse loan, weighs against
The applicant's position that there is no intent to sell.
The applicant's risk from an insurer's challenge due to lack of disclosure, however, is significantly mitigated by the strength that courts have afforded the two-year incontestability clause. “The object of the clause is plain and laudable—to create an absolute assurance of the benefit, as free as may be from any dispute of fact except the fact of death, and as soon as it reasonably can be done,” writes Justice Oliver Wendell Holmes in a seminal U.S. Supreme Court opinion.34 To the benefit of the senior, any investor, and the ultimate buyer, U.S. and California courts have been wont to circumvent the public policy protection provided by the two year incontestability clause. This has been the case, for example, when there are grossly fraudulent statements on an application or even when an imposter was used for an applicant’s medical exam.35 Counsel should inform an applicant about the diligence insurers employ in the application process because they are aware of the seriousness of the two-year clause.

In addition to reviewing disclosure in the application, counsel must examine carefully any representations the senior may make to an investor at the policy’s inception or a buyer when the policy is sold. Any contract with an investor or buyer may provide an opportunity to include disclaimers. Yet when there has been no investor involvement and there is a pending sale to an institutional buyer, the senior may be inclined to minimize changes in documentation out of concern for getting the best price possible for the policy’s sale. Especially if there is investor involvement, however, counsel may consider providing in any sales agreement that the insured cannot make representations that really are legal opinions, such as those regarding insurable interest.

Counsel should also inform the senior that the applicant for the policy is not protected by the two-year incontestability clause with respect to actions by an investor or the ultimate buyer. The senior’s representations thus can allow, in effect, certain recourse for the investor or buyer even when, for example, a loan itself is nonrecourse. If representations to an investor or buyer can be tailored to minimize liability, however, challenges to a policy based upon disclosures may generally be less problematic than those based on insurable interest. This is due chiefly to the established protection of the two-year incontestability clause for failure of disclosure but not necessarily for failure of an insurable interest.

**Tax Issues**

There are estate and income tax consequences to any of these transactions. Tax issues for the...
senior buying the policy without outside financial assistance often relate to the new policy’s ownership or an existing policy loan, surrender, or sale to fund the new insurance. The senior must weigh who should apply for the policy. When an irrevocable insurance trust is the policy’s owner, the sale proceeds or death benefit can, with proper estate planning, be sheltered from estate tax if the insured does not possess incidents of ownership. When the senior is the owner, he or she has the opportunity, rather than only the heirs, for the personal use of the funds if the policy is sold. The sale proceeds (if the senior outlives the sale) or the death benefit (if the senior does not outlive the sale) would then be included in his or her estate for estate tax purposes. There are consequences to delaying the ownership decision, since the policy will still be included in the senior’s estate if the senior transfers it within three years of death.

Due to anticipated taxable gain upon the policy’s sale, the senior should compare federal and state income tax for the sale by the irrevocable trust or the senior. Income tax on sale proceeds in the trust may be based upon compressed income tax rates for non-grantor trusts if the funds are held in the trust or the individual tax rates of the trust’s beneficiaries if the proceeds are distributed. Income tax on sale proceeds by the senior, on the other hand, are based upon his or her individual rate. Counsel should note that even wealthy seniors may have a relatively low tax rate if, for example, much of the net worth consists of investments that do not generate taxable income.

Depending upon how the existing policies are used, there are tax effects relating to the cash value. With regard to loans on the cash value, there is no deduction for interest when the proceeds are used to purchase other life insurance. If surrender or sale is economically appropriate, seniors should appreciate that the lump sum payment from the surrender value of a policy generally is taxable as ordinary income to the extent it is greater than the premiums and other consideration paid. No gain is ordinarily recognized on the exchange of an insurance policy for another insurance policy, endowment policy, or annuity. In addition, there are special exclusions from gain categorized as “accelerated death benefits” if the insured is considered “terminally” or “chronically” ill.

Particularly when a family member is involved in the transaction, it should be noted that the proceeds of the policy paid in a lump sum by reason of the death of the insured are generally excluded from the recipient’s gross income. However, if the policy has been transferred for value to a party other than the insurance company, such as that family mem-

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1 See, e.g., Warren Buffet, Berkshire Hathaway, Inc., 2004 Annual Report, at 22 (2005). 2 While insurance companies do their own actuarial analysis, independent companies make a determination of life expectancies used in connection with the sale of policies in the secondary market. 3 See generally INS. CODE §§10113.1 et seq. 4 Neil Doherty & Hal Singer, The Benefits of a Secondary Market for Life Insurance Policies, 38 REAL


See Amex Life Assurance Co. v. Superior Court, 14 Cal. 4th 1231 (1997).

457, 460 (1877).


35 Ins. Code §10110.3; Paul Revere Life Ins. Co. v. Raoul G. Fima, 105 F. 3d 490, 491 (9th Cir. 1997).


29 See also §10110.4 re §10110.2.


27 Policies of insurable interest are not limited to life insurance policies. A M. Best Company, Standard & Poor’s, Moody’s, Fitch Ratings, and Weiss Ratings.

26 The policy typically is universal life insurance, which resembles ordinary whole life insurance except there are flexible premiums.

25 Five prominent rating systems for financial strength of insurance companies are A. M. Best Company, Standard & Poor’s, Moody’s, Fitch Ratings, and Weiss Ratings.

24 California has minimal advertising and disclosure requirements for life insurance sold to persons 65 and older. Ins. Code §§787, 789.8(a). Agents may be subject to claims of elder abuse for misleading clients. See WELF & INST. CODE §§15600 et seq.

23 Doherty & Singer, supra note 4, at 452.


21 See Ins. Code §§10110.1(c) and 10110.4 regarding an employer’s insurable interest in directors, officers, employees, and others or in connection with the reacquisition by shareholders of shares or the primary obligor of a contract guaranteed by the employer.

20 §10113.1(a)(1). There is an exception for the statutory examples of insurable interest are not exclusive. Ins. Code §10110.1(g).

19 “Absent statutory pronouncement, insurable interest in the context of life insurance is difficult to define with precision, as, in the effort to avoid waiver of the defense of insurable interest or estoppel from patients, no clear rule has been established by the courts.” COUCH ON INSURANCE §41:17 (3d ed. 1985).

18 Ins. Code §10110.1a(i). There is an exception for charities. Ins. Code §10110.1(f).

17 Ins. Code §10110.1(e).

16 Ins. Code §10110.1(d).

15 Ins. Code §10130. See also Gregory v. Russell, 222 U.S. 149, 154 (1911), in which Justice Oliver Wendell Holmes distinguished the public policy concern over granting “a general license to all to insure whom they like” from the policyholder’s right to transfer the policy “to one whom he...is not afraid to trust.” Ins. Code §§10110(a) & 10110.1(b).


12 Whether estoppel or waiver is sufficient to avoid rescission for a lack of insurable interest for life insurance in California is uncertain. Some other states hold that insurer’s actions and knowledge may be a waiver of the defense of insurable interest or estoppel from asserting it, while some do not. COUCH ON INSURANCE 3d §41:18. See also §16 I.R. 4th 828.

11 §10110.1(f). There is an exception for the statutory examples of insurable interest are not exclusive. Ins. Code §10110.1(g).

10 §§10110.2. (Individual tax rates).


8 §10110.3; Paul Revere Life Ins. Co. v. Raoul G. Fima, 105 F. 3d 490, 491 (9th Cir. 1997).


6 Givens v. Russell, 222 U.S. 149, 154 (1911), in which Justice Oliver Wendell Holmes distinguished the public policy concern over granting “a general license to all to insure whom they like” from the policyholder’s right to transfer the policy “to one whom he...is not afraid to trust.”
**The Expanded Liability Analysis in Premises Asbestos Cases**

**AS THOUSANDS OF PARTIES** can attest, asbestos litigation has been a part of the legal landscape in the United States for nearly 40 years. The claims, however, are far from over. Across the nation, the number of asbestos filings has increased dramatically over the past several years, with the number and diversity of defendants expanding significantly. Employing clever theories and creative claims, asbestos plaintiffs have extended their reach far beyond the companies that produced raw asbestos or manufactured products containing asbestos.

Notably, asbestos litigation now often ensnares defendants who did not make or sell anything that contained asbestos but who merely owned a facility where outside workers installed or encountered asbestos-containing building materials. A typical case involves a worker—an insulator, electrician, or pipe fitter, for example—who is exposed to asbestos while working for an independent contractor that a facility owner hires to undertake a particular task on the owner’s premises. The workers’ compensation laws prevent the laborer from suing his or her employer, so the worker instead files suit against the facility owner. Among attorneys involved in asbestos litigation, this type of case is referred to as a “premises action” and the facility owner as a “premises defendant.”

For a number of years, premises defendants in California have been able to escape liability by establishing that they did not retain control over the independent contractor or the safety conditions of the work and did not affirmatively contribute to the worker’s injuries. That changed late last year with the California Supreme Court’s decision in Kinsman v. Unocal.

Premises defendants now face an expanded analysis when assessing their potential liability in asbestos actions. Before Kinsman, facility owners in premises cases could obtain summary judgment by establishing that the independent contractor, and not the facility owner, controlled the plaintiff’s work and working conditions that resulted in exposure to asbestos. Although the work and the exposure occurred at the facility, courts reasoned that the facility owner was not liable because responsibility for the work and the plaintiff was transferred to the contractor. Many California appellate courts have applied this legal principle in cases that did not involve asbestos exposure.

The plaintiff in Kinsman was employed by a scaffolding company that Unocal hired to build and dismantle scaffolding at a Unocal refinery where a variety of repair work was taking place. Although the plaintiff did not work directly with asbestos-containing materials, he was exposed to asbestos dust and fibers released by other tradesmen working in the area—in particular, insulators and pipe fitters. The jury found that Unocal did not retain control over the plaintiff’s work, but still held Unocal partially liable for causing the plaintiff’s asbestos-related injuries for negligently maintaining the areas where the plaintiff worked.

The California Court of Appeal overturned this verdict, embracing the rule that “[a] property owner cannot be liable to a contractor’s employee for a dangerous condition a contractor has created on the land unless the owner exercised control over the condition and, in doing so, affirmatively contributed to the employee’s injury.” This was the case, the court explained, even though the airborne asbestos was not created by the plaintiff or his employer, but instead resulted from the activities of other contractors on site. As long as the hazard “was not created by the property owner, or within the owner’s control,” the owner did not bear liability for asbestos-related injuries to a contractor’s employee.

The Expanded Analysis

The supreme court began its analysis by acknowledging that “when there is a known safety hazard on a hirer’s premises that can be addressed through reasonable safety precautions on the part of the independent contractor…the hirer generally delegates the responsibility to take such precautions to the contractor, and is not liable to the contractor’s employee if the contractor fails to do so.” The court, however, explained that a different rule applies when the hazard is unknown to the contractor but known to the facility owner. In such a case, the facility owner “cannot effectively delegate to the contractor responsibility for the safety of its employees if it fails to disclose critical information needed to fulfill that responsibility.”

Accordingly, a facility owner may be liable for injuries sustained by employees of an independent contractor caused by an undisclosed hazard on the premises. The court captured this notion in a multipart test:

[T]he hirer as landowner may be independently liable to the contractor’s employee, even if it does not retain control over the work, if (1) it knows or reasonably should know of a concealed, pre-existing hazardous condition on its premises; (2) the contractor does not know and could not reasonably ascertain the condition; and (3) the landowner fails to warn the contractor.

In its discussion of this new test for liability, the court also artic...
ulated an additional prong: The facility owner must know, or should have known, that the contractor was unaware of the hazard at issue. This last prong, not included in the court's initial articulation of the test nor discussed in detail, injects a requirement of subjective knowledge (or, at least, subjective constructive knowledge) on the part of the facility owner regarding the state of mind of the contractor. This is a marked departure from the legal analysis that previously pertained to premises asbestos actions. Now, in addition to the "control" analysis, a defendant may be liable under the court's newly articulated "knowledge/warning" test.

While expanding the legal analysis with respect to premises defendants, the court ultimately agreed with the lower court that the verdict against Unocal could not stand. The court determined that the standard premises liability instruction given to the jury, BAJI No. 8.01, did not fully articulate the legal analysis required in a premises asbestos case. That instruction states, in relevant part:

The owner of premises is under a duty to exercise ordinary care in the use, maintenance and management of the premises in order to avoid exposing persons to an unreasonable risk of harm. This duty exists whether the risk of harm is caused by the natural condition of the premises or by an artificial condition created on the premises....

This duty of care is owed only to those persons whom the owner, as a reasonably prudent person under the same or similar circumstances, should have foreseen would be exposed to a risk of harm. You must determine whether a person under the same or similar circumstances as the defendant should have foreseen that the plaintiff would be exposed to an unreasonable risk of harm. If you so find, you are instructed that the defendant owed plaintiff a duty of care and you should determine if the defendant exercised that care, considering all the surrounding circumstances shown by the evidence.

The court concluded that this instruction failed to "make clear that the hazard must have been unknown and not reasonably ascertainable to the independent contractor" before Unocal could be liable to the plaintiff for his injuries. Finding this instructional error to be prejudicial, the court reversed the judgment and remanded the matter for a new trial on these issues.

Meeting the Kinsman Analysis

The Kinsman analysis appears fairly straightforward when articulated as a mechanical legal test. The complexity increases significantly, however, when the test is given a prac-
tical application. In fact, although the court identified only four prongs to the test, the nature of asbestos-containing products as a potentially hazardous condition causes the test to splinter into at least six distinct inquiries:

1) Did the facility owner know, or should it have known, that the particular materials on the premises that allegedly caused the plaintiff’s injury contained asbestos?
2) If so, was the facility owner aware at the time, or should it have been aware at the time, of the dangers of asbestos?
3) Did the independent contractor know, or should it have known, that the particular materials on the premises that allegedly caused the plaintiff’s injury contained asbestos?
4) If so, was the independent contractor aware at the time, or should it have been aware at the time, of the dangers of asbestos?
5) Did the facility owner know, or should it have known, that the independent contractor was unaware of, or could not have reasonably learned about, the hazard posed by the asbestos-containing materials on the premises?
6) Did the facility owner properly inform the contractor about the hazard posed by the asbestos-containing materials on the premises?

If the answer is yes, the analysis ends and the facility owner escapes liability. If the answer is no to either of these questions, the analysis continues:

If the answer is yes to both these inquiries, the analysis concludes and no liability attaches to the facility owner. If the answer is no to either question, the analysis continues:

If the answer is yes to both of these inquiries, the analysis concludes and no liability attaches to the facility owner. If the answer is no to either question, the analysis continues:

If the answer is no to this question, the analysis ends and the premises owner is not liable for the plaintiff’s injuries. If the answer is yes, the analysis continues:

Although not addressed by the supreme court, the plaintiff presumably bears the burden of proof with respect to each of these six points. Moreover, given the court’s rejection of BAJI No. 8.01, a premises defendant in an asbestos action could effectively argue that each of these six points must be set forth in a multipart special instruction to the jury. Such an instruction could create a high hurdle for a plaintiff, particularly since the vast majority of asbestos cases involve events that occurred decades ago. It may be a rare case, indeed, in which a plaintiff is able to present evidence as to what a facility owner or contractor knew or did not know 20, 30, or 40 years ago. Furthermore, it may be difficult in many cases for a plaintiff to overcome the intuitive notion that an independent contractor hired to perform a particular task, such as applying insulation or hanging wallboard, is much better suited and much more likely
to know about the hazards associated with their materials and whether those materials contain asbestos.

Given these potential challenges, plaintiffs are likely to embrace the “should have known” aspect of the test as it relates to facility owners, and rely heavily on expert testimony addressing industry knowledge and industry standards. It remains to be seen whether expert testimony of this nature will alone be enough to meet a plaintiff’s burden on each prong of the Kinsman analysis. Notably, the Kinsman court recognized that an environmental health expert provided testimony at trial regarding “knowledge of the hazards of asbestos in the 1950s” and that the record also contained evidence relating specifically to asbestos as a known hazard at oil refineries. Notwithstanding this evidence, the court concluded that the record was “inconclusive” on the issue of whether the plaintiff’s employer was aware of asbestos and the hazards it posed.

In considering the Kinsman decision, it is important to note that the analysis set forth by the court will not apply in all cases in which an employee of a contractor is exposed to asbestos while performing work for a third party. There are at least two such scenarios, and perhaps a third.

First, the Kinsman analysis will not apply if the contractor performs all the work on its own premises. For example, a facility owner may hire an independent contractor to fabricate and apply customized insulation to certain fixtures. The contractor performs all work at its own plant and then ships the insulated fixtures to the facility owner. In this situation, although the facility owner hires a contractor to perform certain work, neither the contractor nor any of its employees set foot on the premises. As a result, the Kinsman analysis—which is grounded in principles of premises liability—will obviously not apply, and the more traditional analysis of worker-control will govern. Thus, to the extent an employee of the contractor develops an asbestos-related condition and files suit against the facility owner, that party should be able to obtain judgment in its favor by establishing that it did not control or become involved with the contractor’s work.

Second, Kinsman will not apply if the asbestos-containing materials that allegedly caused the plaintiff’s injury were brought to the facility by the contractor or other workers. This will be true even if the work at issue is performed directly on the facility owner’s premises. For example, the owner of a warehouse hires a contractor to apply insulation to bare steel pipes inside the warehouse. If the workers do not come into contact with any asbestos-containing materials that exist on the premises—most notably, they do not disturb...
or remove any old insulation from the pipes—but rather only work with materials provided by the contractor. Kinsman is inapposite. As the Kinsman court explained, the analysis relates only to “pre-existing” hazards on the premises. Accordingly, in this example, the warehouse owner will not be liable to employees of the contractor who claim asbestos exposure in the warehouse, so long as the warehouse owner did not control or become involved with the contractor’s work.

Finally, in articulating its multipronged test, the Kinsman court specifically noted that the test “would not apply to a hazard created by the independent contractor itself.” This qualifier, and particularly the way in which the term “hazard” may be defined, could be significant in an asbestos case. It is generally accepted that asbestos-containing building materials do not pose a health hazard when they are intact and undisturbed and that danger arises only when asbestos particles are liberated from the building materials. Accordingly, if the term “hazard” refers specifically to airborne asbestos particles—as opposed to the asbestos-containing building materials themselves—the court’s exception could relieve a facility owner of liability when, in most cases, it is the contractor who releases asbestos fibers through the manipulation of the building materials. In such a case, the contractor, and not the facility owner, would be the one who “created” the “hazard.”

Neither this potential application of the court’s exception nor the exception itself is fully defined or explained in the opinion. As a result, these issues are ripe for further analysis by the courts. It is interesting to note, however, that the court of appeal in Kinsman chose to characterize the dangerous condition at issue as “airborne asbestos,” rather than the existence of asbestos-containing materials on the premises.

With Kinsman, the supreme court set forth a new test for premises liability asbestos cases that is separate from the traditional “control” analysis, and the new test is multifaceted and significantly complicated. Indeed, it may well be the case that asbestos plaintiffs, even with the assistance of expert witnesses, will have great difficulty marshalling evidence sufficient to carry the day under the six-part Kinsman analysis. For this reason alone, further court decisions will likely shape and explain the Kinsman analysis, its many prongs, and the proof necessary to meet each of them.

1 Estimates place the number of asbestos claims to date at more than 600,000. RAND INSTITUTE FOR CIVIL JUSTICE, ASBESTOS LITIGATION COSTS AND COMPENSATION: AN INTERIM REPORT 4 (2002).

2 Id. at v.


4 Kinsman v. Unocal, 37 Cal. 4th 659 (2005), reh’g denied (Mar. 1, 2006).


6 Kinsman, 37 Cal. 4th at 664-66.


8 Kinsman, 110 Cal. App. 4th at 841.

9 Kinsman, 37 Cal. 4th at 673-4.

10 Id. at 674.

11 Id. at 675.

12 Id. at 682.

13 Id. at 683 n.7.

14 Id. at 683.

15 Id. at 675.

16 Id. at 675 n.3.

17 “EPA does recommend in-place management whenever asbestos is discovered. Instead of removal, a conscientious in-place management program will usually control fiber releases, particularly when the materials are not significantly damaged and are not likely to be disturbed.” OFFICE OF AIR QUALITY PLANNING & STANDARDS, U.S. ENVIRONMENTAL PROTECTION AGENCY, THE ASBESTOS INFORMER (1990), available at http://www.epa.gov/region04/air/asbestos/inform.htm.

The federal False Claims Act (FCA), which was originally adopted in 1863, is an extraordinarily effective statute in combatting fraud committed against the government. While the federal government can bring FCA actions on its own, whistle blowers and their counsel also can file FCA suits on behalf of the United States as government watchdogs. In FCA actions, the plaintiff is called the “relator.” If successful, relators receive 15 to 30 percent of any recovery.

In 1986, Congress amended the FCA to make it easier to litigate cases and expanded it to “reach all fraudulent attempts to cause the Government to pay out sums of money or to deliver property or services.” Since then, the Department of Justice has recovered approximately $16.5 billion in FCA actions, more than half of which were brought by whistle blowers. Of this amount, whistle blowers and their counsel have received approximately $2.5 billion; the remaining $14 billion has been returned to the U.S. Treasury. Thus, in addition to deterring fraud, the FCA has provided a substantial monetary benefit to taxpayers.

In spite of this success, the FCA has been subject to numerous attacks. It faces its latest challenge because of an appellate decision written by then U.S. Court of Appeal Judge (now Supreme Court Chief Justice) John G. Roberts Jr. That decision, United States ex rel. Totten v. Bombardier Corporation, limits the government’s ability to combat fraud committed by certain federal grant recipients and subcontractors. In Totten, whistle blower Edward Totten brought an FCA action against Bombardier Corporation and Envirovac, Inc., alleging that these companies were liable under the FCA for delivering defective rail cars to Amtrak and submitting invoices for payment to Amtrak from an account funded primarily with taxpayer dollars. At the time of the events at issue, Amtrak operated as a private entity.

The District of Columbia Circuit held that the defendants could not be held liable for the false claims they submitted to Amtrak—even though those claims had been paid largely with federal funds—because

Whistle STOP

A split among federal courts means that Chief Justice Roberts may have an opportunity to revisit his 2004 decision limiting whistle blower suits

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Amtrak was a private entity and not a part of the federal government. In doing so, the court rejected Totten’s argument that a “claim submitted to Amtrak is effectively a claim presented to the Government.” Moreover, the court did not accept Totten’s contention that the action should not be dismissed because the FCA defines claims to “include a request or demand for payment made to a grantee if the United States Government will reimburse...[the] grantee...for any portion or property which is requested or demanded.” Totten argued that this definition would encompass the defendants’ demands.

The Totten decision—if it is read expansively and its reasoning is adopted widely—has a potentially substantial reach because the federal government is increasingly reliant on grantees and subcontractors. Recognizing this possibility, the DOJ submitted an amicus brief in Totten noting that dismissal of the case could leave significant amounts of federal funds vulnerable to fraud and beyond the reach of the FCA.

While the full scope of Totten is still to be determined, there are strong reasons to believe that other courts will depart from its holding or will not interpret it expansively. One possible approach lies in veering away from the Totten majority’s interpretation of the statutory language of the FCA and the act’s legislative history, as Judge Merrick B. Garland did in his dissenting opinion in Totten.

Significantly, Judge Paul Cassell of the U.S. district court in Utah specifically adopted Judge Garland’s analysis of the FCA and its legislative history.

The Totten decision found Judge Roberts taking a position that differed from the one held by his now former colleague Judge Garland. Nevertheless, when questioned about the decision at his Supreme Court confirmation hearing in 2005, nominee Roberts described Totten as a “difficult” decision and respectfully acknowledged the alternative analysis offered in the dissent. “It’s certainly possible that the majority in that case didn't get it right,” Judge Roberts said, “and the dissent, and that was a very strong dissent, did get it right...I'm happy to concede that it was among the more difficult cases I’ve had over the past two years.”

“Totten” cases are moving through the district courts—and the majority of these have either declined to follow the reasoning in Totten or have not interpreted the Totten opinion expansively. Indeed, numerous courts outside the District of Columbia have already reached of the FCA.

Moreover, there are strong reasons to believe that other courts will depart from its holding or will not interpret it expansively. First, the Totten court fails to give effect to 31 U.S.C. Section 3729(c), which defines “claims” to include “any request or demand, whether under a contract or otherwise, for money or property which is made to a contractor, grantee, or other recipient if the United States Government provides any portion of the money or property which is requested or demanded, or if the Government will reimburse such contractor, grantee, or other recipient for any portion of the money or property which is requested or demanded.” Totten thus ignores the rule of statutory construction that requires courts to presume Congress intended its amendments to have effect.

Second, the decision is not consistent with the legislative history of the FCA—specifically the intent of Congress, in its 1986 amendments, to add a broad definition of the term “claim” to encompass false claims submitted to third-party recipients of federal funds that “ultimately result in a loss to the United States.”

More troubling, however, is the majority’s interpretation of Section 3729(a)(2), which is the focus of Judge Garland’s dissent. The dissent begins by noting the DOJ’s concerns: The False Claims Act, “adopted in 1863 and signed into law by President Abraham Lincoln in order to combat rampant fraud in Civil War defense contracts,” S. Rep. No. 99-345, at 8 (1986), is the “Government’s primary litigative tool for combating fraud.”
MCLE Test No. 150

The Los Angeles County Bar Association certifies that this activity has been approved for Minimum Continuing Legal Education credit by the State Bar of California in the amount of 1 hour.

1. Either the federal government or a private party can start an action under the federal False Claims Act.
   True. False.

2. The 1986 amendments to the FCA made it harder to bring whistle-blower lawsuits.
   True. False.

3. Since 1986, the Department of Justice has recovered less than $3 billion from actions filed under the FCA.
   True. False.

4. The FCA has proved to be an ineffective tool in combating fraud committed against the government.
   True. False.

5. Congress passed the FCA:
   A. After World War II.
   B. During the War of 1812.
   C. After World War I.
   D. During the Civil War.

6. The FCA imposes liability for false claims and for false statements made in support of false claims.
   True. False.

7. It is too early to assess the full impact of the United States ex rel. Totten v. Bombardier Corporation decision.
   True. False.

8. In the Totten case, the District of Columbia Circuit Court of Appeals held that the defendants could be held liable for false claims submitted to Amtrak.
   True. False.

9. All courts that have interpreted Totten have found that its reach is expansive.
   True. False.

10. U.S. Supreme Court Chief Justice John Roberts was questioned about the Totten decision at his Senate confirmation hearing.
    True. False.

11. Effective presentment occurs when a claim for reimbursement is submitted to a federal grantee.
    True. False.

12. Chief Justice Roberts has described the Totten case as:
    A. A “difficult” one.
    B. A “no brainer.”
    C. A “waste of time.”
    D. None of the above.

13. To date, the Totten majority opinion has been strictly adopted by all federal courts.
    True. False.

14. The Department of Justice submitted an amicus brief in Totten.
    True. False.

15. Judge Merrick B. Garland based his dissent in Totten partly on the plain language of the FCA.
    True. False.

    True. False.

17. Cases similar to Totten are currently under review before courts of appeals in the Sixth and Eleventh Circuits.
    True. False.

18. Several cases similar to Totten and filed subsequent to it were brought against health care providers.
    True. False.

19. In United States ex rel. Sialic Contractors Corporation v. Sequel Contractors, Inc., Judge Gary Klausner held that Totten did not preclude an action under the FCA against the subcontractors who paved John Wayne Airport.
    True. False.

20. United States ex rel. DRC, Inc. v. Custer Battles, LLC involved alleged false claims submitted to the Coalition Provisional Authority, the agency established to rebuild Iraq.
    True. False.

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1. Study the MCLE article in this issue.
2. Answer the test questions opposite by marking the appropriate boxes below. Each question has only one answer. Photocopies of this answer sheet may be submitted; however, this form should not be enlarged or reduced.
3. Mail the answer sheet and the $15 testing fee ($20 for non-LACBA members) to:
   Los Angeles Lawyer
   MCLE Test
   P.O. Box 55020
   Los Angeles, CA 90055

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Mark your answers to the test by checking the appropriate boxes below. Each question has only one answer.

1. □ True □ False
2. □ True □ False
3. □ True □ False
4. □ True □ False
5. □ A □ B □ C □ D
6. □ True □ False
7. □ True □ False
8. □ True □ False
9. □ True □ False
10. □ True □ False
11. □ True □ False
12. □ A □ B □ C □ D
13. □ True □ False
14. □ True □ False
15. □ True □ False
16. □ True □ False
17. □ True □ False
18. □ True □ False
19. □ True □ False
20. □ True □ False
Today, the court adopts an interpretation that, the government warns, leaves “vast sums of federal monies” without False Claims Act protection.  

Next, he states that Section 3729(a)(2) was properly before the court—despite the contrary view of the majority and the fact that the subsection was largely ignored in the briefing—because Totten’s complaint “was not limited to subsection (a)(1), but rather asserted liability under 31 U.S.C. §3729 in its entirety.”  

Judge Garland proceeds to methodically discuss the statutory language of Section 3729(a)(2) and the legislative scheme and history of the 1986 FCA amendments. He gives three reasons why Subsection (a)(2) does not require presentment: 1) The “plain language” of the statute imposes no such requirement, 2) imposing such a requirement is not consistent with the definition of “claim” in Section 3729(c), and 3) the majority’s interpretation “is not just inconsistent, but irreconcilable, with the legislative history of the 1986 Amendments to the False Claims Act.”

Judge Garland noted that the express language in Section 3729(a)(1), which contains the words “presents” and “causes to be presented,” coupled with the absence of such language in Section 3729(a)(2) gives added weight to his view that Subsection (a)(2) imposes no requirement for presentment to an agency of the United States. This discrepancy, he states, triggers an important canon of statutory construction: When “Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion and exclusion.”

Post-Totten Interpretations of the FCA

Courts interpreting the Totten decision have chosen to depart from it by using one of three approaches:

1) Adopting Judge Garland’s position that Section 3729(a)(2) imposes liability against subcontractors who have made false statements or records to get a false or fraudulent claim paid or approved but who have not necessarily presented claims.

2) Holding that subcontractors and grant recipients are liable under Section 3729(a)(1) when they “effectively” present claims.

3) Giving credence to the nonexpansive language of Totten, specifically the majority’s recognition that the act of presentment can be indirect.

In United States ex rel. Maxfield v. Wasatch Construction, the court adopted Judge Garland’s dissent. The plaintiff alleged that Wasatch Construction made false statements in connection with its contract to reconstruct Interstate 15—the largest highway project in the country at the time. Wasatch made these allegedly false statements to the Utah Department of Transportation. The department acted as the intermediary for the Federal Highway Administration, which financed the project.

In denying a motion to dismiss, Judge Cassell rejected Totten, choosing instead to follow “Judge Garland’s well-reasoned dissent”:

As Judge Garland explained, the starting point for any issue of statutory construction is “the existing statutory text.” The plain language of §3729(a)(2) lacks any “presentment” requirement. Instead, it allows a suit against anyone who “knowingly makes, uses or causes to be made or used, a false record or statement to get a false or fraudulent claim paid or approved by the Government.” To be sure, the provision also provides that the claim must be paid or approved “by the Government.” But this simply means that the government must be the ultimate source of the funds, either directly or indirectly. Any doubt on this point is erased by the fact that the term “claim” paid by the government is defined elsewhere in the statute as including contractors and others who receive government funds.

To Judge Cassell, Judge Garland also seems to have the better argument on how policy considerations might play a role in determining issues of statutory construction. To construe the FCA as covering only false claims presented directly to the government rather than to federal grantees would leave billions of federal dollars outside the act. As an illustration, Wasatch received tens of millions of dollars for its work on the Interstate 15 project, with a substantial portion of these dollars coming from the federal government. From the perspective of combating fraud in the program, it is important to recognize the fact that, by pure happenstance, a federal grantee (the Department of Transportation) was directly writing the checks.

In United States ex rel. Yesudian v. Howard University, a pre-Totten opinion, the District of Columbia Circuit found that “effective” presentment was enough. According to the court:

It is also possible to read the language [in Section 3729(a)(1)] to cover claims presented to grantees, but “effectively” presented to the United States because the payment comes out of funds the federal government gave the grantee. Such a reading would be in harmony with the legislative history of the FCA. As the Senate Judiciary Committee put it, without adding a “presentation” caveat, a false claim to the recipient of a grant from the United States or to a State under a program financed in part by the United States is a false claim to the United States.

The Totten court not only rejected this reasoning but also viewed this part of the Howard University decision as dicta. Still, despite the District of Columbia Circuit’s rejection of the view that “effective presentation” to an agency of the United States is sufficient, a Texas district court, in United States ex rel. Farmer v. City of Houston, recently held that effective presentment was enough.

The case involved false claims submitted by the defendants to the Houston Area Urban League (HAUL), a nonprofit entity financed with grants from the federal government. The court held:

Even though an RFP [request for payment] is submitted by HAUL to the City, the City uses federal funds to pay an RFP, therefore a request under the Program to be paid by the City is a request to be paid by federal funds, and payment by the City is payment by the federal government. Moreover, an RFP demonstrates that the City paid HAUL’s fraudulent claims. Relator alleges that the City paid the claims with federal funds, knowing the claims were false; therefore, she has properly alleged that Defendants made, and conspired to make, false claims in violation of the FCA.

Thus the court held that the presentment requirement was satisfied because HAUL effectively acted as an arm of the federal government.

The Totten court recognized that the act of presentment can be indirect, a view supported by the “causes to be presented” language in Subsection (a)(1) and the phrase “causes to be made or used” in Subsection (a)(2). In recent months, several courts have held that indirectly presenting false claims was sufficient to pursue an FCA action against subcontractors. These decisions focus on the causation requirements of presentment and are consistent with Totten and an earlier precedent that “gives the United States a cause of action against a subcontractor who causes a prime contractor to submit a false claim to the Government.”

Two of these recent cases—United States v. Squire and Accucare, Inc. and United States ex rel. Tyson v. Amerigroup Illinois—were brought against healthcare providers that allegedly defrauded Medicare, in one case, and Medicaid, in the other. Significantly, under Medicare and Medicaid, states pay
healthcare providers for the services the providers render to program recipients, and the federal government then reimburses the states for almost all the funds they advance to the healthcare providers. Based on this fiscal and regulatory structure, the courts in these two cases held that the healthcare providers “caused claims to be presented” to the federal government through intermediary state agencies.\textsuperscript{35}

Similarly, in *United States ex rel. Sialic Contractors Corporation v. Sequel Contractors, Inc.*,\textsuperscript{36} Judge Gary Klausner of the Central District of California held that the reasoning in *Totten* did not preclude an FCA action against a subcontractor paid to pave John Wayne Airport in Orange County. Citing *Totten*, Sequel Contractors unsuccessfully moved to dismiss on the grounds that it presented claims to Orange County, not to the federal government. Rejecting Sequel’s argument, Judge Klausner held that the defendants interpreted *Totten* too broadly because *Totten* does not require direct presentation by the defendants. Judge Klausner explained:

> The *Totten* Court held that liability under the FCA requires presentation of a false claim to the federal government. However, *Totten* did not require that the defendants themselves directly present the false claim to the federal government. Instead, the *Totten* court held that someone must directly present a false claim to the federal government in order for liability under the FCA to arise….

The *Totten* court found no FCA liability for the false claims presented to Amtrak because the claims were never presented to the federal government by any party, not because the defendants themselves failed to directly present the claims to the federal government. Thus *Totten* holds that the FCA is not implicated if no claim is ever presented to the federal government. The FCA is implicated where the defendants directly present a false claim to the federal government, or cause a third party to present the false claim.\textsuperscript{37}

The court held that the complaint was sufficient because it alleged that the defendants submitted false cost reports—the false claims—to Orange County, which were then forwarded for reimbursement to the Federal Aviation Administration, a federal agency. The defendants’ failure to present its claims directly to the FAA was not a determining factor in the outcome of the case.

Last year, in *United States ex rel. DRC, Inc. v. Custer Battles, LLC*,\textsuperscript{38} a Virginia district court also held, at least implicitly,
that indirectly presenting a false claim to an agency of the United States sufficed to pursue an FCA action. The case involved alleged false claims submitted to the Coalition Provisional Authority, the agency established to govern and rebuild Iraq. This international agency was overseen by the United States and administered with funds from a variety of sources, including the United States, the United Nations, and other international organizations. Moreover, some of its funds came from money confiscated from the former government of Iraq.

The district court sidestepped the issue of whether a fraud on the CPA constituted a fraud on the United States. Instead, the court held that the relator satisfied the presentment requirement because the defendants caused the CPA to submit false claims to the U.S. Army.39

Totten warrants serious consideration because of its author, the influential circuit in which it is controlling law, and the potential implications of the decision. Nevertheless, it is too early to assess the full impact of Totten. Indeed, those who are overstating its significance may have spoken too soon. No doubt, the issues raised in Totten will continue to appear in some grantee and subcontractor cases. As they do, other courts will decide whether or not to reject Totten as well as whether to focus on the nonexpansive language in that case. In the end, Chief Justice Roberts might well have another opportunity to address the issues that came before the District of Columbia Circuit in Totten, though these issues might come before the U.S. Supreme Court in a slightly different form and context.

1 Congress enacted the FCA to reduce widespread military contracting fraud, which was pervasive during the Civil War. Congress recodified the FCA in 1982 under Title 31 of the U.S. Code. 31 U.S.C. §§ 3729-31 (1982). Following its initial enactment, the FCA was amended several times. Congress’s most significant overhaul of the FCA came in 1986 in response to massive military contracting fraud during the Cold War. In recent years, the largest FCA cases have involved military contracting fraud, healthcare fraud, and pharmaceutical fraud, though there also have been many other large cases involving other areas of government fraud and abuse.

2 S. Rep. No. 99-345, 99th Cong., 2d Sess., at 9, reprinted in 1986 U.S.C.C.A.N. 5266, 5274. Among other things, the 1986 amendment of the FCA increased the recoverable penalties and provided greater opportunities and incentives—including more significant protections against employer retaliation—for whistle blowers to initiate and litigate FCA cases, particularly when the United States declines to actively participate. Id. at 5266 et seq.; see also 31 U.S.C. § 3730.

3 These numbers come from information compiled by the DOJ, which annually releases statistics on these types of settlements and judgments. See http://www.tas.org/ftacstatistics2006.pdf.

4 United States ex. rel. Totten v. Bombardier Corp., 380
Totten, 380 F. 3d at 502-16.


Other sections of the FCA that impose liability include 31 U.S.C. §3729(a)(5) (for conspiring to receive payment for a false claim) and 31 U.S.C. §3729(a)(7) (for, among other things, “reverse false claims,” which include the failure to return money wrongly paid by the government to a contractor).

31 U.S.C. § 3729(a)(1) imposes liability on “[a]ny person who knowingly presents, or causes to be presented, to an officer or employee of the United States Government or a member of the Armed Forces of the United States a false or fraudulent claim for payment or approval.” The statute uses the word “person” in §3729(a)(1) and (2), but it is undisputed that this term encompasses entities as well.

In 31 U.S.C. §3729(b), “knowingly” is defined to include actual knowledge, deliberate ignorance, or acting in reckless disregard of the truth or falsity of the information.

United States ex rel. Totten v. Bombardier Corp., 380 F. 3d 488 (D.C. Cir. 2004). The majority, however, bases part of its opinion on a reading of the legislative history of the FCA that ignores its 1986 amendments and instead focuses on its earlier legislative history. Id. at 501.


31 U.S.C. §3729(c). In amending the FCA in 1986, the Senate Judiciary Committee stressed that it did not matter whether the claim was made to a government employee or to a grantee. See also S. Rep. 99-345, 99th Cong., 2d Sess., at 10, reprinted in 1986 U.S.C.C.A.N. 5266, 5275.

Totten, 380 F. 3d at 502.

Id. at 503-05.

Id. (quoting Barnhart v. Sigmon Coal Co., 534 U.S. 438, 452 (2002)).

Id.


Id. at *19-*27.


Id. at 738. Judge Garland wrote this opinion for the court.

In Yesudian, the court considered the present question, but expressly concluded that it “need not resolve the question today”….That was because the issue in Yesudian was not liability under the False Claims Act for false claims, but whether an employer retaliated against an employee for filing a qui tam action under the Act. Such retaliation,…the Yesudian court concluded, could be shown without establishing that the qui tam plaintiff would have prevailed in the suit.


Id. at *3.

Totten, 380 F. 3d at 499-500, 507 n.8.

31 U.S.C. §3729(c). In amending the FCA in 1986, the Senate Judiciary Committee stressed that it did not matter whether the claim was made to a government employee or to a grantee. See also S. Rep. 99-345, 99th Cong., 2d Sess., at 10, reprinted in 1986 U.S.C.C.A.N. 5266, 5275.

Totten, 380 F. 3d at 502.

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Id. (quoting Barnhart v. Sigmon Coal Co., 534 U.S. 438, 452 (2002)).

Id.


Id. at *19-*27.


Id. at 738. Judge Garland wrote this opinion for the court.

27 Totten, 380 F. 3d at 493-94.
AS PART OF THE BANKRUPTCY ABUSE PREVENTION AND CONSUMER PROTECTION ACT OF 2005 (BAPCPA), Congress added a new chapter 15 to the U.S. Bankruptcy Code. Chapter 15 provides for a new bankruptcy case category as a means to coordinate international insolvency cases. It is the most important piece of international commercial legislation that Congress has enacted in a long time. Unfortunately, the adoption of chapter 15 is a development that has been largely lost in the din surrounding the passage of BAPCPA. Chapter 15 is the domestic version of the Model Law on Cross-Border Insolvency drafted by the United Nations Commission on International Trade Law (UNCITRAL) and promulgated in 1997. The stated purpose of chapter 15 is “to provide effective mechanisms for dealing with cases of cross-border insolvency.” To accomplish this purpose, chapter 15 articulates five specific objectives: 1) Cooperation between U.S. courts and estate representatives (such as trustees and debtors in possession) involved in cross-border insolvencies with their foreign counterparts. 2) Greater legal certainty for trade and investment. 3) Fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested entities, including the debtor. 4) Protection and maximization of the value of the debtor’s assets. 5) Facilitation of the rescue of financially troubled businesses, thereby protecting investment and preserving employment.

It would have been more logical for UNCITRAL to choose the treaty format for this purpose, because a model law is essentially unknown as a vehicle for creating international law. However, treaties historically have been an unsuccessful means to coordinate international insolvency cases. Indeed, no treaty for the coordination of multinational bankruptcy cases has ever enjoyed widespread adoption and success.

by JUDGE SAMUEL L. BUFFORD

INTERNATIONAL ACCORD

Included in the new bankruptcy law are provisions adopting the U.N. model law on international insolvencies

Samuel L. Bufford is a U.S. bankruptcy judge for the Central District of California.
A model law, in contrast, was perceived as a more modest proposal that could more easily achieve acceptance. Unlike a treaty, which generally must be accepted or rejected as a whole, a model law can be tailored by each country to its particular needs and interests. In addition, a treaty takes much longer to draft because every participant has a vested interest in the text. A model law, in contrast, does not require the same level of commitment because of the possibility of modification by an adopting nation.

The model law approach has borne fruit. The Model Law on Cross-Border Insolvency has been adopted in a number of countries in addition to the United States, including England, Spain, Japan, Canada, Mexico, South Africa, Poland, Romania, and Serbia. Adoption of the model law is pending in a number of additional countries and will likely be spurred by its adoption in the United States. In addition, many of the model law's provisions are similar to those in the European Union Regulation on Insolvency Proceedings, which provides a framework for coordinating transnational insolvency cases within the European Union member countries.

The statutory mandate for interpretation of chapter 15 requires that a court applying the law “consider its international origin, and the need to promote an application...that is consistent with the application of similar statutes adopted by foreign jurisdictions.” This mandate requires that courts applying chapter 15 consider the interpretation that courts in other countries have given to similar provisions in their laws.

Chapter 15 has three principal themes. First, chapter 15 provides for timely, effective, and efficient procedures for recognizing foreign insolvency proceedings. Second, it provides for the accreditation of a representative in a U.S. case to participate in foreign courts and proceedings. Third, it mandates the cooperation by courts and authorized estate representatives in the United States with courts and estate representatives of foreign countries with related proceedings. The cooperation is subject to the primacy of local proceedings and deference to the local judge's statutory discretion and to applicable principles of due process and customary court practices.

Chapter 15 has three features that are especially important for U.S. interests. First, it recognizes debtors in possession as proper estate representatives. Chapter 11 debtors in the United States have had substantial difficulty in obtaining recognition in foreign insolvency proceedings, in which a trustee is customarily appointed to represent the estate. Second, the chapter 15 automatic stay applies to both secured and unsecured creditors, while in a number of countries the automatic stay (or its functional equivalent) applies only to unsecured creditors. Third, reorganization is deemed a fundamental goal of chapter 15, even though the bankruptcy laws of many countries provide only for liquidation.

Generally, a chapter 15 case is ancillary to a primary proceeding brought in another country—typically the debtor's home country. Chapter 15 does not create a bankruptcy estate under Section 541. Moreover, an automatic stay does not commence for a case filed under chapter 15, except when a U.S. court issues an order for the recognition of a foreign proceeding as a foreign main proceeding.

As an alternative, the debtor or a creditor may commence a full chapter 7 or chapter 11 case in the United States if the assets in the United States are sufficiently complex to merit a full-blown domestic bankruptcy case. Such a case would create a bankruptcy estate. In addition, certain avoidance powers can be exercised only in a full bankruptcy case and not in a case under chapter 15. A foreign representative seeking to commence a case under another chapter must 1) obtain an order of recognition under Section 1517, 2) give notice to the court if the petition for recognition has been filed, and 3) thereafter file the case under another chapter. Chapter 15 replaces the former Section 304, which previously governed U.S. cases ancillary to an international insolvency proceeding.

While chapter 15 is a much more elaborate body of law, the substantive provisions of Section 304 and the voluminous case law interpreting them are preserved in chapter 15 in the context of making an application for “additional assistance” after recognition is granted. This case law applies only in circumstances not addressed by the explicit provisions of chapter 15.

The concept of comity, which played a dominant role under Section 304, occupies a less central role under chapter 15. Comity is a weaker version of the doctrine requiring the granting of “full faith and credit” to the judicial proceedings of one state by other states of the United States. Under the concept of comity, a domestic court must give substantial weight to the provisions of a foreign law and the decisions of a foreign court while paying attention to issues of fairness and due process regarding U.S. parties in interest. Chapter 15 explicitly provides for a court's application of comity only when granting additional assistance following recognition of a foreign insolvency proceeding and granting relief in connection with that proceeding. Section 1508 also reflects the concept of comity by stating that “[i]n interpreting this chapter, the court shall consider its international origin, and the need to promote an application of this chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions.”

Chapter 15 is not the ultimate step in international cooperation in insolvency cases. Indeed, it leaves unresolved many difficult legal issues. Perhaps the most important of these is the treatment of related business entities. Chapter 15 (and its foreign counterparts, including the European Union Regulation on Insolvency Proceedings) deals only with a single legal entity and not a multi-entity corporate group. In addition, chapter 15 generally does not address conflict of laws and choice of law issues.

At press time, procedural rules for chapter 15—and for the rest of the BAPCPA amendments—had not yet been issued nationally. The Central District of California is in the process of adopting an interim general order to provide procedural rules for the period before national procedures are promulgated.

Definitions and Application

Chapter 15 introduces several new definitions that were previously unknown in U.S. law. A “foreign proceeding” is defined broadly to include any collective judicial or administrative proceeding in a foreign country pursuant to a law relating to insolvency, in which the assets and affairs of the debtor are subject to control or supervision by a foreign court (or administrative agency) for the purpose of reorganization or liquidation of the debtor. A “foreign main proceeding” is a foreign proceeding pending in the country where the debtor has the center of its main interests. A “foreign non-main proceeding” is a foreign proceeding, other than a foreign main proceeding, pending in a country where the debtor has an establishment. An “establishment” is broadly defined to include any place of operations where the debtor carries out a nontransitory economic activity.

A “foreign court” is a judicial or other authority (such as an administrative agency) competent to control or supervise a foreign proceeding. A “foreign representative” is defined as a person or body authorized in a foreign proceeding to administer the reorganization or liquidation of the debtor’s assets or affairs or to act as a representative of the foreign proceeding.

In addition to the concepts that chapter 15 specifically defines, there are several other terms that are crucial to understanding the new chapter. “Insolvency” is a broad umbrella term that includes both reorganizations and liquidations. The term does not necessarily mean a financial, balance sheet insolvency: A debtor is not required to be financially insolvent to qualify for a liquidation or reorganization. A “proceeding” is the generic term for an insolvency (or bankruptcy) case. The term is not limited to what U.S. bankruptcy law defines as
Perhaps the most important feature of chapter 15 is the provision for the recognition of a foreign insolvency proceeding and the consequences of that recognition.

debtor’s main interests.”22 In its preamble, the European Union Regulation on Insolvency Proceedings further specifies that the center of main interests “should correspond to the place where the debtor conducts the administration of its interests on a regular basis and is therefore ascertainable by third parties.”26 This term, as it is used in the EU regulation, has provoked substantial controversy in EU countries. Indeed, it is the subject of a decision recently issued by the European Court of Justice arising from a bitter conflict between the Ireland Supreme Court and an Italian court of appeals over the proper venue of the main proceeding for the Eurofood subsidiary of Parmalat, SpA.27

Chapter 15 specifies that it applies in four types of situations: 1) A foreign court or foreign representative seeking assistance in the United States in connection with a foreign insolvency proceeding, 2) A trustee or other entity acting in a U.S. bankruptcy case and seeking authority to act in a foreign country on behalf of a U.S. estate, 3) A foreign insolvency case and a U.S. bankruptcy case involving the same debtor that are pending at the same time, 4) Creditors or other parties in interest in a foreign country seeking to commence or participate in a U.S. bankruptcy case.28

Notwithstanding the broad scope of chapter 15, there are three important restrictions to its application. First, chapter 15 is preempted by any applicable international treaty or agreement to which the United States is a party.29 Second, a U.S. court is given discretion to qualify, condition, limit, modify, or terminate an order for relief with respect to a foreign proceeding or foreign representative as appropriate.30 Finally, chapter 15 permits a U.S. court to refuse to apply chapter 15 if doing so would be manifestly contrary to U.S. public policy.31

Recognition of Foreign Proceeding

Perhaps the most important feature of chapter 15 is the provision for the recognition of a foreign insolvency proceeding and the consequences of that recognition. Chapter 15 provides a structured but flexible framework for a court to recognize a foreign insolvency proceeding and thereby trigger the statutory consequences, rights, and benefits of chapter 15 (and to a certain extent, other provisions of the U.S. Bankruptcy Code).

A duly authorized and qualified foreign representative may apply to a U.S. bankruptcy court32 to obtain recognition of a foreign proceeding.33 This application must be made in a language acceptable to the court and must be accompanied by two types of documents: 1) a statement identifying all other known foreign insolvency proceedings related to the debtor,44 and 2) certificated documents from the foreign court reflecting the existence of a pending insolvency case and the appointment of the foreign representative, or other evidence acceptable to the bankruptcy court demonstrating the existence of the foreign proceeding and the authority of the foreign representative.35

To simplify the application and recognition processes, a bankruptcy court is permitted to invoke a presumption as to the legitimacy and accuracy of documentation supporting the application for recognition.36 This eliminates the complex and time-consuming exequatur formalities for authenticating foreign judgments and court filings. A foreign representative has a duty to supplement the information supplied to the U.S. court if there is a substantial change in the status of the foreign proceeding or of the foreign representative.37

A bankruptcy court is required to recognize a foreign proceeding if two requirements are met. First, the foreign proceeding for which recognition is sought must be either a foreign main proceeding or a foreign non-main proceeding as defined in chapter 15.38 Second, the application must be legally sufficient and submitted to the proper court.39 In addition, this recognition is “[s]ubject to section 1506,” which permits a U.S. court to refuse to take any action that would be “manifestly contrary to the public policy of the United States.”40

After notice and a hearing, the court is authorized to recognize a foreign proceeding as a foreign main proceeding if it is pending in the country where the debtor’s center of main interests is located.41 Alternatively, the court may recognize the foreign proceeding as a foreign non-main proceeding if it is pending in a country where the debtor has an establishment but its center of main interests is located in another country.42 The bankruptcy court may modify or terminate the decision to recognize a foreign proceeding if its grounds were lacking at the outset or have subsequently ceased to exist.43

There are two procedural timing requirements that cabin the recognition decision. First, the court is directed to decide the issue of recognition “at the earliest possible time.”44 However, this decision may be made only “after notice and a hearing,”45 which invokes the notice procedures applicable throughout the Bankruptcy Code.46

Upon recognition of a foreign proceeding as a foreign main proceeding, the U.S. automatic stay applies with respect to the debtor and the property of the debtor located within the territorial jurisdiction of the United States.47 Because chapter 15 incorporates Sections 361 and 362 in their entirety, the exceptions to the automatic stay also apply in chapter 15 cases, and the procedures for obtaining relief from the stay are available. In contrast, an automatic moratorium or stay is not imposed if the foreign proceeding is recognized as a non-main proceeding. Furthermore, chapter 15 authorizes a foreign represen-
tative to operate the debtor’s business and, unless the court orders otherwise, to exercise trustee powers under Section 363 (use, sale, or lease of property) and Section 552 (limiting the postpetition effect of a prepetition security interest). In addition, Section 549 applies to the postpetition transfer of an interest of the debtor in property in the United States.

After the recognition of any foreign proceeding, main or non-main, the foreign representative may request additional relief to protect the debtor’s assets or creditors’ interests. Further, if the court is satisfied that the interests of creditors in the United States are adequately protected, it may entrust the distribution of all or part of the debtor’s U.S. assets to the foreign representative or another person designated by the court. In addition, after recognition of a foreign proceeding, the foreign representative may intervene in any civil action in any court in the United States in which the debtor is a party.

Chapter 15 grants substantial discretion and flexibility to the court after it grants recognition to a foreign proceeding. At any time after recognition, the court may condition, qualify, or terminate any relief granted pursuant to the recognition order.

A bankruptcy court may grant emergency relief to a foreign representative while an application for recognition is pending. Emergency relief may include 1) staying execution against the debtor’s property, 2) suspending any right to transfer, encumber, or dispose of the debtor’s property, 3) providing for examination of witnesses and discovery concerning the debtor’s assets, affairs, and obligations, 4) entrusting the debtor’s property to the foreign representative or other custodian to protect and preserve value, and 5) any other relief available to a trustee under U.S. law (except for the exercise of avoidance powers). Emergency relief is subject to applicable notice requirements of the forum court. Furthermore, any such emergency relief terminates upon recognition of the foreign proceeding.

Access of Foreign Representatives and Creditors to U.S. Courts

Chapter 15 is the principal gateway for a foreign representative to obtain access to a federal or state court in the United States. The foreign representative must obtain an order for recognition of the foreign proceeding before appearing in any case in the United States for any purpose, except “to sue in a court in the United States to collect or recover a claim which is property of the debtor.” Once a foreign proceeding is recognized, its foreign representative may seek additional relief from the bankruptcy court or from other state and federal courts and is authorized to bring a full (as opposed to ancillary) bankruptcy case. In addition, the representative is authorized to participate as a party in interest in a pending U.S. bankruptcy case and to intervene in any other U.S. case in which the debtor is a party.

Under chapter 15, the accreditation procedure for foreign creditors and representatives of foreign proceedings is much more expeditious, simplified, and certain than it was under the old law. A foreign representative is entitled to apply directly to the bankruptcy court with minimal formalities. The representative may be subject to the routine requirements and generally applied practice procedures of the court in which the representative is applying for access. However, by seeking access, the foreign representative—as well as assets subject to the foreign proceeding—do not become subject to the general jurisdiction and authority of the domestic court for purposes other than the proceeding at issue.

Under chapter 15, foreign creditors are entitled to the same rights as domestic creditors to commence or participate in a U.S. bankruptcy case. The claims of foreign creditors are to be treated generally the same as local claims of equal rank, according to the priorities and treatment of claims established under U.S. bankruptcy law. When notice to creditors in a bankruptcy case is required by U.S. law, notice also must be given to the known foreign creditors. Unless the court orders otherwise, that notice must be direct and individual, without requiring letters rogatory or other similar formalities. Notice by publication, whether in a commercial register or a newspaper of general circulation, is insufficient to notify a known creditor.

Notification to a foreign creditor of the commencement of a U.S. bankruptcy case must state the deadline for filing claims and the location where filing is required. In addition, the notification must specify whether secured creditors are required to file claims, and must contain any other information to which domestic creditors are entitled by U.S. law or by court order. A notice for filing claims must provide to creditors with foreign addresses any additional time that is reasonable under the circumstances.

Cooperation and Communication

A mandate for communication and cooperation between judges, courts, and parties in interest in related domestic and foreign insolvency cases is an innovative central feature of chapter 15 and the Model Law on Cross-Border Insolvency. Chapter 15 mandates a maximum level of cooperation and direct communication by the parties and the courts. The chapter directs a domestic bankruptcy court to “cooperate to the maximum extent possible with a foreign court or a foreign representative, either directly or through the trustee.”

For the purposes of chapter 15, the “trustee” referred to includes a bankruptcy trustee, a debtor in possession in a case under any applicable chapter, or a debtor in a municipality case under chapter 9. Chapter 15 specifically authorizes a judge to communicate directly with a foreign judge and foreign representatives and to request information or assistance directly from them, subject to the rights of a party in interest to notice and participation.

In furtherance of these goals, U.S. bankruptcy courts and courts in several other countries have conducted joint hearings by video or telephone conference in a number of cases in recent years. A joint hearing can be a highly effective means to coordinate proceedings and avoid misunderstandings and overlapping efforts.

Chapter 15 also requires a trustee or debtor in possession to “cooperate to the maximum extent possible” with a foreign court or a foreign representative, subject to the supervision of the court.

Furthermore, the trustee or debtor in possession is authorized to communicate directly or indirectly with foreign courts and foreign representatives, also subject to court supervision. Chapter 15 mandates that the cooperation be “implemented by any appropriate means,” which may include 1) the appointment of a person to act at the direction of the court, 2) sharing of information by any court-approved method of communication, 3) coordination of administration of the debtor’s assets and affairs, 4) court approval of agreements concerning coordination of proceedings, and 5) coordination of concurrent proceedings regarding the same debtor.

The coordination and communication mandates of chapter 15 and the model law are altogether new in U.S. and international law. It will be highly interesting to see how these mandates take shape in individual cases, particularly in countries where court traditions (and even codes of judicial conduct) have prohibited this type of communication and coordination.

Concurrent Proceedings

Chapter 15 places a premium on an application for the recognition of a foreign main proceeding being made before a domestic bankruptcy case involving the same debtor is filed in the United States. Once a U.S. court has recognized a foreign main proceeding, a domestic main proceeding (whether voluntary or involuntary) regarding the same debtor may be filed only if the debtor has assets in the United States. Such a case must be limited principally to the assets of the
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Third, even if the foreign debtor located in the United States and to the coordination of the U.S. case with the foreign proceedings.78

A more complex problem arises if there are concurrent proceedings in the United States and one or more other countries at the time that an application for recognition of a foreign main proceeding is made under chapter 15. In such a circumstance, chapter 15 and the Model Law on Cross-Border Insolvency first impose on the U.S. court and the applicable foreign courts an obligation of mutual cooperation and communication.79

Second, any emergency relief or postrecognition relief in the chapter 15 case must be consistent with relief previously granted in the U.S. case.80 Third, even if the foreign proceeding is recognized as a main proceeding, the Section 1520 automatic stay and the suspension of rights to transfer or encumber the debtor’s property—which would apply if there were no pending domestic case—are inapplicable.81

If a plenary bankruptcy case is filed in the United States after the recognition of a foreign proceeding has been granted, or while such recognition is pending, the court considering the chapter 15 case must review any emergency or postrecognition relief to make it consistent with the domestic plenary proceeding.82 If the foreign proceeding is a main proceeding, the automatic stay resulting from the recognition order must be modified if it is inconsistent with the previously filed domestic bankruptcy case.83

If there are two or more foreign proceedings involving the same debtor, the obligations that chapter 15 imposes on the U.S. bankruptcy court and the parties are essentially the same as those that apply when there is only one foreign proceeding.84 Relief in the local proceeding must be coordinated with each of the foreign proceedings. In particular, if one of the foreign proceedings is a main proceeding, the relief in the domestic proceeding must recognize its status as a non-main proceeding.85

Finally, in determining the distribution of funds to unsecured creditors, chapter 15 requires a U.S. court to take into account the payments to those creditors from a foreign insolvency proceeding. No distribution may be made from local assets to an unsecured creditor who has received a distribution from an insolvency proceeding in a foreign country until the other local creditors of the same rank have received an equal distribution.86

Chapter 15 dramatically changes the handling of cross-border insolvency cases in U.S. bankruptcy courts. It applies a much more elaborate structure than previously existed under Section 304. Chapter 15 is challenging: There are new concepts—pre-
The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), Pub. L. No. 109-8. BAPCPA generally is effective for cases filed on or after October 17, 2005, unless otherwise specified in the new law.


11 U.S.C. §541(a) (omitting chapter 15 from the provisions under which an estate results from the filing of a bankruptcy case).


U.S. CONST. art. IV, §1.


See EU Regulation, supra note 4, at pmbl. (13). This elaboration on the concept of “center of main interests” should be accepted as authority for the interpretation of the term in the Model Law, supra note 3, and chapter 15.

Case C-341/04, Eurofood IFSC Ltd., at http://curia.eu.int/en/content/juris (May 2, 2006).


The appropriate court for this type of application is a U.S. district court—if the case at issue has not been referred to the bankruptcy judges of the district pursuant to 28 U.S.C. §157(a) (2006).


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The current term of the Honorable Ernest M. Robles, U.S. Bankruptcy Judge for the Central District of California, is due to expire in June 2007. The U.S. Court of Appeals for the Ninth Circuit is considering the reappointment of the judge to a new term of office of 14 years. The court invites comments from the bar and public about his performance as a bankruptcy judge. The duties of a bankruptcy judge are specified by statute, and include conducting hearings and trials, making final determinations, and entering orders and judgements.

Members of the bar and public are invited to submit comments concerning Judge Robles for consideration by the Court of Appeals in determining whether or not to reappoint him. Anonymous responses will not be accepted. However, respondents who do not wish to have their identities disclosed should so indicate in the response, and such requests will be honored.

Comments should be submitted no later than Tuesday, August 15, 2006 to the following address:
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Attn: Reappointment of U.S. Bankruptcy Judge Ernest Robles
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This is the last editorial index that will appear in print. *Los Angeles Lawyer* articles are indexed online at http://www.lacba.org/lalawyer.

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Formal Opinion No. 516: Ethical Considerations Relating to an Attorney Who Concurrently Serves in an Of Counsel Relationship with a Law Firm and Maintains a Separate Solo Practice

SUMMARY: An attorney is not precluded by ethics rules from concurrently being affiliated in an of counsel capacity with another attorney or law firm and maintaining his or her own solo practice. In communicating with a former, present, or prospective client concerning the availability of professional employment, prior to or at the commencement of an engagement, the attorney should disclose his or her dual capacities and take reasonable steps to ensure that the actual or potential client understands whether the attorney will handle the client’s matter in his or her solo practice or in his or her of counsel capacity. In subsequent communications with the client and the public, the attorney should take reasonable steps to avoid confusion concerning the capacity in which he or she represents the client. Notwithstanding rule 1-400(E), standard (9) of the California Rules of Professional Conduct, the attorney may use separate business cards and stationery to indicate when he or she is acting on behalf of the firm with which he or she is affiliated or through his or her solo practice. The attorney must ensure that his or her communications to the public are not false, deceptive, misleading, or confusing as to the capacity in which he or she is acting. The attorney must also comply with all other applicable ethics rules, including rules 3-310 (conflicts of interest) and 2-200 (fee splitting).


FACTS AND ISSUES PRESENTED:
An attorney maintains a general practice as a solo practitioner. As such, she routinely distributes to past, current, and potential clients business cards and stationery identifying her practice. Recently the attorney has been offered the opportunity to affiliate with a law firm in an of counsel capacity. If the of counsel attorney accepts the offer, when working on the law firm’s business, she would like to use a set of business cards and stationery that identifies her affiliation with the law firm. The of counsel attorney also wishes to continue to maintain her solo practice. For matters handled through her solo practice, she would like to continue to use the business cards and stationery identifying her solo practice. The law firm has asked the following questions:...
1. Does rule 1-400 of the California Rules of Professional Conduct preclude an attorney from concurrently serving in an of counsel capacity with the law firm and maintaining a solo practice? In particular, is such an arrangement prohibited by standard (9) of rule 1-400(E), which states that a member's "communication in the form of a firm name, trade name, fictitious name, or other professional designation... which differs materially from any other such designation used by such member or law firm at the same time in the same community" is presumed to contain an untrue, deceptive, confusing or misleading statement in violation of rule 1-400(D)?

2. Is the law firm vicariously liable for any legal malpractice committed by the of counsel attorney in matters handled by the of counsel attorney in her solo practice?

3. Is the of counsel attorney vicariously liable for any legal malpractice committed by the law firm in its matters in which the of counsel attorney has no involvement?

**DISCUSSION:**

As an initial matter, questions 2 and 3 do not constitute ethical issues, but legal issues, albeit of obvious and current interest to the bar. See, e.g., Stichting ter Behartiging van de Bel. v. Schreiber, 407 F. 3d 34 (2d Cir. 2005) (legal malpractice claim by shareholder group against its attorney and law firm with which its lawyer had "of counsel" relationship). In keeping with its longstanding policy, the Committee declines to opine on legal issues.

The first question, however, poses an ethical issue involving the interpretation of California Rules of Professional Conduct 1-400(D) and (E) and standard (9) in the context of the contemplated of counsel relationship. As explained below, an attorney is not ethically precluded from concurrently maintaining a solo practice and serving in an of counsel relationship with a law firm or another attorney. Assuming that "of counsel" is an appropriate designation for the relationship with the law firm, the Committee does not believe that the concurrent use of two sets of business cards and stationery—one set identifying the of counsel's solo practice, the other indicating she is affiliated with the law firm—would constitute a violation of rules 1-400(D) or (E) or standard (9). The of counsel attorney should disclose to her actual and potential clients the nature of her dual capacity and take reasonable steps to ensure that a client understands the capacity in which she is working—as a solo practitioner or through the law firm—on the client's specific matter. The of counsel attorney should take whatever steps are appropriate under the circumstances to be certain that the recipients of her professional communications understand when she is acting on behalf of the law firm with which she is affiliated and when she is acting through her solo practice. The Committee believes that to avoid confusion, it may be appropriate for the of counsel attorney to use two sets of business cards and stationery, one for client matters handled in her solo practice and the other for client matters handled in her of counsel role with the law firm. The Committee also briefly addresses two additional ethical issues, although not specifically raised by the inquiry, that the of counsel attorney and law firm should be aware of—conflicts of interest and fee splitting.

**The Of Counsel Designation**

Over the years, of counsel and similar designations have been used in private practice to characterize a wide range of relationships between individual attorneys and law firms. See H. G. Wren & B. J. Glasscock, *The Of Counsel Agreement*, ABA Senior Lawyers Division (2d ed. 1998) at 1; *see also People ex rel. Dept. of Corporations v. Spee Dee Oil Change Systems, Inc.*, 20 Cal. 4th 1135, 1152-53 (1999) (providing examples of of counsel relationships); Cal. Bar Ass'n Form. Op. 1993-129 (1993) at 2; ABA Form. Op. 90-357 (May 10, 1990). In addition, two individual lawyers may maintain an of counsel relationship. See Cal. Bar Ass'n Form. Op. 1993-129 (1993). The of counsel designation may also be used to describe one law firm's relationship with another law firm. *Id.* ("[W]e conclude the current standard for 'of counsel' relationships may still be satisfied where a law firm, rather than an individual member, serves in the 'of counsel' role."); *see also ABA Form. Op. 90-357 (1990); ABA Form. Op. 84-351 (1984)."

Under California ethics standards, the use of an of counsel designation in communications with former, current, or potential clients is presumed to be false, misleading, confusing, or deceptive unless two requirements are met. First, the of counsel attorney or law firm must have a relationship with the other attorney or law firm "which is close, personal, continuous, and regular." Cal. Rules of Professional Conduct 1-400(E), std. (8); *see also Spee Dee Oil, supra*, 20 Cal. 4th at 1153; Cal. Bar Ass'n Form. Op. 1993-129; Cal. Bar Ass'n Form. Op. 1986-88 (1986) (defining permissible use of of counsel designation prior to adoption of rule 1-400(E) standard (8)). Second, the of counsel attorney or law firm must have a relationship with the other attorney or law firm "other than as a partner or associate" or, if the law firm is a professional corporation under Business of Professions Code Sections 6160 to 6172, as an "officer" or "shareholder." Cal. Rule of Professional Conduct 1-400(E), std. (8).

By characterizing an attorney as of counsel to another lawyer or law firm, the other lawyer and law firm are representing to the public and their clients that the services of the of counsel attorney are reasonably available to the other lawyer/law firm. See *Spee Dee Oil, supra*, 20 Cal. 4th 1153; S.D. Co. Bar Ass'n Form. Op. 1996-1 (1996) (two solo practitioners who do not share office space, but regularly discuss cases and clients on an anonymous basis are not acting in an of counsel relationship); S.F. Co. Bar Ass'n Form. Op. 1985-1 (1985) at 2 (of counsel attorney must be treated as member of law firm for conflicts purposes). The contact between the of counsel and other lawyer or law firm need not be daily to meet the "close, personal, continuous, and regular" standard. See ABA Form. Op. 90-357 (May 10, 1990) at 3. But the relationship must involve more than merely collaborating upon an individual or occasional matter, forwarding or receiving legal business or infrequent independent consulting. See Cal. Bar Ass'n Form. Op. 1993-129 (1993) at 3.

An attorney may concurrently have more than one "of counsel" designation provided each relationship is "close, personal, continuous, and regular." Cal. Bar Ass'n Form. Op. 1993-129 (1993) ("[W]e believe that the number of 'of counsel' relationships in which a member or law firm may serve is limited not by any strict numerical standard. Instead, the number of such relationship[s] is limited by the strict observance of the qualitative criteria of rule 1-400."; *see also ABA Form. Op. 90-357 (May 10, 1990). For the same reason, an attorney is not ethically precluded from concurrently maintaining a solo practice and an of counsel relationship with a law firm or another lawyer.

For purposes of this opinion, the Committee assumes that the relationship between the attorney and law firm in this inquiry can properly be designated "of counsel."

**Communications with the Public**

In the inquiry, the of counsel attorney contemplates using two sets of business cards and stationery—one when providing services for the law firm, the other when providing services for the of counsel attorney's solo practice. The law firm asks whether such a practice would violate California Rule of Professional Conduct 1-400(E), standard (9).

Rule 1-400 regulates certain communications by members of the bar to the public. Rules 1-400(A) and 1-400(A)(3) define "communication" as "any message or offer made by or on behalf of a member concerning the availability for professional employment of a member or a law firm directed to any former, present, or prospective client, including but not limited to...stationery, letterhead, business card, sign, brochure, or other comparable..."
written material describing such member, law firm, or lawyers.”

Rule 1-400(D) prohibits members of the bar from distributing false, deceptive, misleading or confusing communications to the public. It provides:

“A communication or a solicitation (as defined herein) shall not:
(1) Contain any untrue statement; or
(2) Contain any matter, or present or arrange any matter in a manner or format that is false, deceptive, or which tends to confuse, deceive, or mislead the public; or
(3) Omit to state any fact necessary to make the statements made, in light of circumstances under which they are made, not misleading to the public.”

Rule 1-400(E) provides that “[t]he Board of Governors of the State Bar shall formulate and adopt standards as to communications which will be presumed to violate...rule 1-400.” There are currently 15 such standards.

Standard (9) describes one type of communication that is presumed to be in violation of rule 1-400:

“A ‘communication’ in the form of a firm name, trade name, fictitious name, or other professional designation used by a member or law firm in private practice which differs materially from any other such designation used by such member or law firm at the same time in the same community.” Cal. Rule of Professional Conduct 1-400(E), std. (9).

Initially, the Committee notes that communications described in standard (9) (and the other standards) do not per se violate rule 1-400, but may presumptively do so. See Cal. Rule of Professional Conduct 1-400(E) (“The standards shall only be used as presumptions affecting burden of proof in disciplinary proceedings involving alleged violations of these rules.”). “Presumption affecting the burden of proof” means the presumption defined in Evidence Code sections 605 and 606. Id.

Revisions to the standards, including the addition of standard (9), became effective on May 27, 1989, after adoption by the California State Bar Board of Governors. In explaining the goal of the revised standards, the Board of Governors noted that standards (6), (7), and (8) “were included to clarify areas of concern which are frequently raised with respect to firm or trade names, and the use of the term ‘of counsel.’” 2 Request that the Supreme Court of California Approve Amendments to the Rules of Professional Conduct of the State Bar of California, and Memorandum and Supporting Documents in Explanation, Office of Professional Standards of the State Bar of California (Dec. 1987), Memorandum at 22; see also Cal. Bar Ass’n Form. Op. 2004-167 (on use of trade name and former government positions in client communications). The Board of Governors did not, however, explicitly make reference to of counsel designations in their explanation of standard (9):

“Standard (9) is new and was added because multiple trade names may be misleading because each trade name used may imply to the public the existence of a separate and distinct entity.” Id.

Although the Board of Governors apparently intended standard (9) to apply primarily to the use of trade names (for example, the “Immigration Law Group”), the title “of counsel” is a “professional designation” and, thus, standard (9) is relevant to the law firm’s inquiry. The Committee also believes that the two business cards and separate letterhead that the of counsel attorney intends to use at the same time in the same community “differ materially” within the meaning of standard (9). That is, for example, one business card will indicate that the attorney maintains a solo practice. The other will indicate that she has an of counsel affiliation or is working as an attorney at the law firm.

The purpose of rule 1-400 is to ensure that an attorney’s communications directed to any former, present, or prospective client concerning the availability of professional employment are truthful and not misleading or confusing. That an attorney maintains both a solo practice and an affiliation with a law firm is potentially significant to a former, present, or prospective client. For example, a client’s decision to retain an attorney—even as a solo practitioner—may be influenced positively or negatively by the fact that the attorney concurrently maintains an of counsel relationship with another attorney or law firm. Also, as explained below, because of her of counsel relationship, the attorney must check whether a prospective engagement— even in her solo capacity—conflicts with the engagements of the law firm. To perform this conflicts check, the attorney must give the law firm the prospective client’s name as well as other pertinent information about the proposed engagement. Because of the need to give the prospective client’s name to the law firm, at some time prior to or at the inception of a client relationship, the attorney should tell her potential or actual client (a) that the attorney works in both capacities and (b) the actual capacity in which the attorney will handle the client’s specific matter. The attorney should take reasonable steps at that time to ensure that the client understands whether the attorney will handle the matter in her solo practice or with the law firm.

Thereafter, consistent with rule 1-400(D)(2), the attorney should take reasonable steps to avoid communications with the client and the public that might create confusion and, of course, at no time may the attorney disseminate communications that are false, deceptive, or misleading. In that regard, for subsequent communications it may be appropriate to use separate sets of business cards and letterheads. When the attorney communicates with clients, opposing counsel, or others about matters handled through her solo practice, it may be appropriate for her to use her solo practice business cards and letterhead identifying her affiliation with the law firm. If there is a reasonable possibility of confusion, the of counsel attorney and law firm may need to take affirmative steps, such as further direct communications confirming or disclaiming the of counsel’s affiliation with the law firm, to ensure that particular recipients of their communications understand when the attorney is acting on behalf of the law firm and when she is acting through her solo practice.

Conflicts of Interest

Because protecting communications between an attorney and his or her client, as well as the duty of loyalty and trust to the client are fundamental (Los Angeles Co. Bar Ass’n Form. Op. 386; SpeeDee Oil, supra, 20 Cal. 4th at 1146), the Committee addresses the issue of conflicts of interest raised by this inquiry.

A basic obligation of every attorney is “[t]o maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client.” Bus. & Prof. Code §6068(e)(1). California Rule of Professional Conduct 3-310(C) prohibits an attorney from accepting, without the client’s “informed written consent,” representation of more than one client in a matter in which the interests of the clients potentially or actually conflict. 3 The same rule also requires the client’s, or former client’s, informed written consent before the attorney accepts employment adverse to a client or former client where by reason of the representation of the client or former client, the attorney has obtained confidential information material to the employment. Cal. Rules of Professional Conduct 3-310(E).

In the case of an of counsel relationship, the California Supreme Court has disqualified a law firm where an of counsel attorney represented an interest adverse to a client of the law firm and additionally had obtained material confidential information which was adverse to the law firm’s client. SpeeDee Oil, supra, at 1156-57. Therefore, it is crucial that the of counsel attorney and the law firm run
conflicts checks for the of counsel’s clients, and vice versa. Where a potential or actual conflict exists within the meaning of rule 3-310(C), or where confidential information material to the representation has been obtained which is adverse to an existing or former client of the of counsel or of the firm within the meaning of rule 3-310(E), the attorney(s) must also comply with the requirements of rule 3-310 by obtaining the client’s or former client’s informed written consent. 3

Fee Splitting

Rule 2-200 provides that “a member shall not divide a fee for legal services with a lawyer who is not a partner of, associate of, or shareholder with the member unless: (1) [t]he client has consented in writing thereto after a full disclosure has been made in writing that a division of fees will be made and the terms of such division; and (2) [t]he total fee charged by all lawyers is not increased solely by reason of the provision for division of fees and is not unconscionable....” Cal. Rule of Professional Practice 2-200(A); see also Chambers v. Kay, 29 Cal. 4th 142 (2002) (agreement between former co-counsel to split fees on client matter made with client’s knowledge, but not with client’s written consent, was unenforceable). Likewise, rule 2-200(B) prohibits the gift of “anything of value” in return for a referral of business, except between partners, associates, or shareholders of a firm.

As noted above, rule 1-400(E), standard (8) provides that an “of counsel” designation should not be used to describe “a partner or associate, or officer or shareholder [of a professional law corporation].” Cal. Rule of Professional Conduct 1-400(E), std. (8). Because, according to standard (8), an “of counsel” attorney by definition cannot be a partner, associate, or shareholder, this Committee has previously concluded that an attorney (or law firm) cannot split client fees with an of counsel attorney unless the requirements of rule 2-200, including written client consent, are met. See Los Angeles Co. Bar Ass’n Form. Op. 470 (1993) (opining that client consent under rule 2-200 is required for a law firm to pay a year-end bonus to an of counsel attorney). Some law firms and attorneys, however, treat their of counsel attorneys as employees, for example, by issuing W-2 forms for tax purposes; others do not. Rule 1-400(B)(4) defines “associate” for purposes of the Rules of Professional Conduct, including the rules on fee splitting, as “an employee or fellow employee who is employed as a lawyer.” Cal. Rule of Professional Conduct 1-400(B)(4). Therefore, the language of standard (8) notwithstanding, 4 in certain situations, an of counsel attorney may be characterized as an “employee” of a law firm within the meaning of rule 2-200. If so, the Committee does not believe that the law firm must obtain client consent under rule 2-200 before splitting fees (for example, in the form of a year-end bonus) with the of counsel attorney. Unless the of counsel can be properly characterized as an employee of the law firm, the of counsel and law firm must comply with the requirements of rule 2-200 before splitting fees. Whether an of counsel is properly characterized as the law firm’s “employee” depends on the facts and circumstances of the of counsel attorney’s relationship with the law firm.

This opinion is advisory only. The Committee acts on specific questions submitted ex parte, and its opinion is based on the facts set forth in the inquiry submitted. 5


2 Standards 6, 7, and 8 provide:

(6) A “communication” in the form of a firm name, trade name, fictitious name, or other professional designation which states or implies a relationship between any member in private practice and a government agency or governmental or a public or non-profit legal services organization.

(7) A “communication” in the form of a firm name, trade name, fictitious name, or other professional designation which states or implies that a member has a relationship to any other lawyer or a law firm as a partner or associate, or officer or shareholder pursuant to Business and Professions Code sections 6160-6172 unless such relationship in fact exists.

(8) A “communication” which states or implies that a member or law firm is “of counsel” to another lawyer or a law firm unless the former has a relationship with the latter (other than as a partner or associate, or officer or shareholder pursuant to Business and Professions Code sections 6160-6172) which is close, personal, continuous, and regular.

3 “‘Informed written consent’ means the client’s or former client’s written agreement to the representation following written disclosure.” Cal. Rule of Professional Conduct 3-310(a)(2). “Disclosure” means informing the client of the relevant circumstances and of the actual and reasonably foreseeable adverse consequences of the client or former client.” Cal. Rule of Professional Conduct 3-310(a)(1).


In Speedee Oil, the court expanded the rule of vicarious disqualification to include attorneys acting “of counsel” to a law firm. In that case, a number of Speedee Oil franchisees brought...
suit against the franchisee, Mobil. The Shapiro firm was associated in as counsel for one of the franchisees. At around the same time the Shapiro firm became involved, Mobil consulted with Attorney Eliot Disner, who was of counsel to the firm. Neither Mobil nor Disner was aware of the firm’s representation of the franchisee at the time of the consultation. Thereafter, Mobil objected to the Shapiro firm’s continued involvement in the case because Mobil believed it had imparted confidential information about the litigation to Disner.

Disner was of counsel to the firm at the time of the disqualification motion and had no plans to leave his position, so the primary issue was whether the relationship between the tainted attorney and the firm was sufficiently close to justify disqualification of the entire firm. The record showed “without contradiction that Disner received material confidential information concerning [the] claims against Mobil.” (SpeeDee Oil, supra, 20 Cal. 4th at 1152). Although Disner sought to assure the court that “he did not discuss ‘the merits’ of the case with attorneys or employees of the Shapiro firm,” there were no “effective screening procedures” set up by the firm to secure confidences from disclosure, and “[t]he potential for a breach of the duty of confidentiality, whether inadvertent or otherwise” was apparent. (Id.) The court concluded that “[t]he close, personal, continuous, and regular relationship between a law firm and the attorneys affiliated with it as of counsel contains many of the same elements that justify the rule of vicarious disqualification applied to partners, associates, and members.” (Id. at 1154.)

The Committee believes that in appropriate circumstances, an effective ethical screen would preclude the disclosure of confidential information and, thus, should protect the lawyer and law firm from disqualification for failure to comply fully with rule 3-310. See SpeeDee Oil, supra, at 1152, n. 5 (in which the Court points out that “none of the Shapiro firm’s declarations suggested that it instituted any formal ethical screen to prevent even inadvertent disclosures after the problem became known.”). The Committee notes, however, that to date no reported California appellate decision has specifically approved of the use of screening where a lawyer in private practice transfers to another law firm in private practice. See City of Santa Barbara v. Superior Court, 122 Cal. App. 4th 24-25 (2004) (denial of motion to disqualify City Attorney’s Office which hired and screened attorney, previously in private practice, from matter against attorney’s former client). The court in City of Santa Barbara denied disqualification of the City Attorney’s Office and limited its holding to ethical screens erected in public law offices, as opposed to private law firms. But see Hempstead Video, Inc. v. Incorporated Village of Valley Stream, 409 F. 3d 127 (2d Cir. 2005) (in which the Second Circuit rejected a per se imputation rule for counsel attorneys in favor of a functional approach that examines the substance of the relationship under review and the procedures in place). Like the Second Circuit, the Committee “see[s] no reason why, in appropriate cases and on convincing facts, isolation—whether it results from the intentional construction of an ethical screen, or from de facto separation that effectively protects against any sharing of confidential information—cannot adequately protect against taint” that would constitute a basis for disqualification. 409 F. 3d at 138.

The Committee suggests that the Board of Governors correct this apparent inconsistency between standard (8) and rule 1-100(B)(4)
Online MCLE Update

IF YOU ARE AN ATTORNEY OR PARALEGAL, probably no day goes by in which you do not receive e-mail about online continuing legal education. As recently as 2000, however, you would not have received any, because the State Bar of California did not approve online continuing education courses until then.

Since 2000, online continuing education offerings have evolved to meet increased demand. Unfortunately, some things have not changed in six years, for example the lack of consistency between each state’s online CLE requirements and the confusion this causes attorneys who are licensed in more than one state. Online programs are now accepted in 42 states, but there are as many rules as there are states. Some states limit the total number of hours that can be earned online. California, for example, allows an attorney to fulfill all required CLE online—self-study and participatory. Minnesota only allows participatory credit for a live webcast, while California allows a participatory credit for an archived webcast. More confusion arises from the way online vendors categorize courses. For example, if a course is labeled as conferring law practice management credit, California attorneys may think it is ineligible for CLE credit since California no longer has a separate law practice management CLE category. However, California attorneys can still take the course and count it as general credit.

A more positive change is the growing acceptance of online seminars, as evidenced by the increased number of seminars available as well as the number of lawyers who take them. In 2000, West LegalEdcenter did not exist, but six years later the concern offers 7,000 online seminars covering 17,000 hours. The number of lawyers taking online CLE has grown along with the supply. According to Robert Reich of LegalSpan and Brian Emerson of law.com, online CLE participation has seen substantial growth in volume and revenue since 2003.

Another big change in electronic seminar delivery is the downloadable podcast. Spurred on by the popular downloading of music to handheld players (such as Ipods), podcasts make CLE more portable and thus more convenient. Downloads allow attorneys to take programs along with them and earn CLE hours while waiting for a flight, waiting for a case to be called, or driving to work (with the use of a car stereo adapter). Podcasts also allow users to stop at any time and go back to any part at any time that is convenient. The State Bar of California considers podcasts participatory credit as long as the provider can verify that a lawyer has listened to the entire podcast. For example, the State Bar of California’s podcasts include a series of code words throughout the podcast that the lawyer is required to enter into an online account before receiving the certificate of participation.

The Los Angeles County Bar Association and the State Bar of California are embracing podcasts. All 55 of LACBA’s newest CLE seminars are offered as podcasts (see www.legalspan.com/lacba), and the State Bar of California has 612 seminars in the podcast format (www.legalspan.com/calbar). West has five podcast programs about to be released. In contrast, Law.com does not yet offer podcasts, but it is offering free Ipods to those who sign up for their “state bundle” of 25 hours of California CLE for $699. Printed course materials (in PDF) that are easily printed and referred to generally accompany podcasts.

LACBA Podcasts

The LACBA podcasts can be downloaded to an Ipod, Mp3 player, computer, or any other device that supports the Windows Media Audio file format. The podcasts have been so popular that in the first three months they were available, 50 percent of LACBA courses taken online were in the podcast format. For those who forget to finish a LACBA podcast course, an e-mail reminder is sent a few days after a podcast is downloaded. Podcasts are priced at $25 an hour. To introduce lawyers to podcasts, LACBA offers a free one-hour podcast that teaches how to use LACBA’s Civil Register online database. LACBA also has audio and video online seminars that can be previewed for free (most online providers offer this feature).

The State Bar’s online program (www.legalspan.com/calbar) offers more than 1,200 seminars. Like LACBA’s online program, many of the seminars are produced by the State Bar and focus on California law. However, the State Bar’s catalog also includes generic seminars from the archives of technology partners such as LegalSpan. The State Bar’s advanced search menu offers ways to find courses by key words, faculty name, course number, and type of media. To further narrow the search, results can be limited to participatory only or ethics only.

One of the earliest providers of online legal education was America Lawyer Media’s (ALM) Law.com, which began offering online courses in 1995. By 2000, Law.com had 250 hours of online programming and now has about 350 active seminars ranging from one to three hours. The most popular format is audio only. It also offers live webcasts (which are later archived) lasting about 1.5 hours, with the last 20 minutes reserved for questions using a chat interface. Law.com users can purchase individual seminars (prices vary) or select a discounted bundle in a state or practice area. Lawyers can also use law.com’s wizard to customize their own bundle of seminars. Law.com is the exclusive provider of Lexis online seminars and partners with the New York City Bar, LACBA, and the Recorder (ALM’s San Francisco legal newspaper).

Thomson-West’s LegalEdcenter (http://westlegaledcenter.com) started offering online CLE in 2001 and now claims to provide the largest collection of online CLE programs available on the Internet. Its CLE catalog includes live webcasts and archived versions of previously recorded online programming.

The site’s advanced search function allows the user to search for...
a program among the 7,000 offerings by numerous criteria. West offers bonus features such as links to program materials and links to its online database. West also offers My CLE Tracker, which displays a user’s completed LegalEdcenter credits and the number of credits yet to be completed for the current reporting period. West LegalEdcenter programs start at $4.5 an hour.

The Rutter Group’s (www.rutteronline.com) online CLE course feature streaming audio and video with written materials and links to related Web sites. Rutter’s 75 courses range from one to six hours, with most lasting three, at a cost of $35 per credit hour. Rutter offers an unlimited use pass at $495. Although this is a $100 increase from five years ago, the pass also includes free admission to Rutter’s live programs, video replay programs, and lending library of video and audio tapes. To choose a course, browse through the list of courses or select a topic from the menu. Rutter tracks the amount of time a user spends online and offers participatory credit. Users can sample Rutter’s offerings (and earn one hour of MCLE credit) with the free one-hour trial course, “Persuasive Speaking Skills Inside and Outside the Courthouse.”

CEB

Continuing Education of the Bar (CEB) offers 149 hours of streaming online audio courses (with written materials) in seven practice areas plus the categories that are required in California. The programs, which can be listened to in increments of 15 minutes, are offered for participatory credit. To access CEB’s online CLE, users must first establish a free account before taking courses that cost $35 per hour. CEB offers “passport” discount programs, ranging from $495 for one individual to access any online seminar to $945 for one user to take 45 hours of live seminars and 30 hours of online seminars (with access to program handbooks). Transferable passports cost up to $2,095. Passport users must wait 48 hours to take their initial seminar. CEB provides an online method to track credits completed with CEB online, and also adds the ability to record live event CEB credits, self-study credits, and even credits earned from other providers. In addition, CEB offers a free trial course, but unlike Rutter, users can select from any CEB online course (even a 3-hour course).

Practising Law Institute’s (www.pli.edu) online courses are offered in a variety of formats, including 343 podcasts and 383 on-demand or archived programs. Forty-nine live webcasts and 13 interactive courtroom skills courses are forthcoming. Each course description includes a statement listing which states do not give credit for the specific course.
PLI offers a free sample of an online course, but unlike CEB, there is no CLE credit attached to the offer. PLI course prices vary widely: $49 per hour for podcasts, $249 for its three-hour courtroom interactive course, and $1,299 for the 16-hour securities institute (with the option of buying segments for $80 each). Courses are key word searchable.

The American Bar Association Center for Continuing Legal Education (www.abanet.org/cle/cle/home.html) offers audio or video webcasts at $59 per 1.5 hours of credit. In addition, they also offer three free podcasts and over 60 free webcasts (www.abanet.org/cle/clenow). The free webcasts are self-study credits only and some are even available to non-ABA members.

LegalSpan (www.legalspan.com) began offering online CLE in 1998. Since then, it has expanded to offering a catalog of hundreds of programs from four dozen partner content providers around the country, like the State Bar of California and the Los Angeles County Bar Association. The majority of LegalSpan's content is currently offered as archived video, according to Reich. However, the popularity of the CLE-to-Go products offered through partners such as the State Bar of California and the Association will likely push the company's archived audio-only offerings past their current 10 percent. Archived programs, audio and video, are priced at $35 per hour, with live webcasts priced higher.

Similarly, other national vendors like Taecan (www.taecan.com) and FastCLE (www.fastcle.com) have partnered with various content providers, including the Association and Internet For Lawyers (respectively), to provide California CLE courses. Taecan offers primarily streaming audio courses for $25 per hour, while FastCLE offers archived video seminars that are synchronized with PowerPoint slides and downloadable printed materials for $49 per hour.

Online availability of MCLE allows lawyers to take courses any time, anywhere. This is quite an alluring feature to the busy attorney who wants to earn MCLE credits or simply gain some new knowledge quickly.

Vendors have increasingly removed the technological barriers to taking courses online, with most providing phone support and system requirements tests to determine whether a user's computer is compatible with the vendors' online systems before a purchase is made. The rising popularity of online MCLE has not diminished live program attendance, however, according to Tim Elliott, who is director of marketing at the Association. Live programs have their following, especially for lawyers who want to network with other lawyers at live events.

Local Retired Judge Offers $5000 Reward.

Judge Peter S. Smith (Ret.) recently completed The Magistrates: Murder at the Rose Bowl, the eagerly awaited sequel to his award-winning novel, The Magistrates.

To promote both books, Judge Smith is having a contest. If you can correctly answer 10 simple questions based on the contents of both novels, you could win FIVE THOUSAND DOLLARS!

L.A. County District Attorney Steve Cooley said, “Murder at the Rose Bowl would make an extraordinary movie.”

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**Thirty-Hour Basic Mediation Training**

Starting on Tuesday, August 8, and ending on Saturday, August 19, the Association’s Dispute Resolution Services group will host a program led by Lynne Bassis, Gail Nugent, John Rodriguez, and L. Therese White involving 30 hours of small group exercises and role-playing designed for persons who wish to acquire a strong foundation in basic mediation skills and wish to satisfy the classroom requirements of the California Dispute Resolutions Act of 1998. The training session will take place at the Buena Vista Library, 300 North Buena Vista Street in Burbank. On-site registration and the meal will begin at 6 P.M., with the program continuing until 9. The registration code number is 009332.

- $465—DRS associates, early bird rate
- $495—LACBA members, early bird rate
- $565—all others, early bird rate
- $520—DRS associates
- $555—LACBA members
- $595—all others

**Forming and Advising Nonprofit Corporations**

On Tuesday, July 25, the Business and Corporations Law Section will present an introduction to the legal issues involved with forming and representing nonprofit corporations. Speakers Shashi K. Hanuman and Louis E. Michelson will explain how to form a nonprofit corporation, how to obtain federal and state tax exemptions, the duties and liabilities of a nonprofit board of directors, and general nonprofit corporate compliance issues. Attendees will also learn about opportunities for pro bono work with nonprofit corporations. This program will take place at Twin Palms Pasadena, 101 West Green Street in Pasadena. Valet parking on Green Street costs $5 with validation. On-site registration and the meal will begin at 6 P.M., with the program continuing from 6:30 to 8:30. The registration code number is 009254. The prices below include the meal.

- $25—CLE+ members
- $25—Barristers Section, Business and Corporations Law Section, and Corporate Law Departments Section members
- $35—LACBA members
- $45—all others
- $45—all at-the-door registrants
- 2 CLE hours

**SECURITIES, REAL ESTATE PARTNERSHIPS, AND LLCs**

On Thursday, September 14, the Business and Corporations Law Section and speaker Harriet B. Alexson will present a program on securities issues in forming and advising real estate partnerships and limited liability companies. The program will take place at the LACBA/LexisNexis Conference Center, 281 South Figueroa Street, Downtown. Reduced parking is available with validation for $9. On-site registration and lunch will begin at 11:30 A.M., with the program continuing from noon to 1:30 P.M. The registration code number is 009255. The prices below include the meal.

- $15—CLE+ members
- $40—Barristers Section, Business and Corporations Law Section, and Corporate Law Departments Section members
- $55—LACBA members
- $65—all others
- $65—all at-the-door registrants
- 1.5 CLE hours
The Ninth Circuit offered this guidance: “A part of the public service obligation of the bar is the performance of pro bono work. That obligation runs not only to indigent litigants, but to the court, of which attorneys are officers. Failure to come forward to assist individual litigants at the request of the court is an indication of loss of professionalism….It may also be a violation of section 6068 of the California Business and Professions Code.” The Ninth Circuit offered this assessment more than 20 years ago.

Today, only 46 percent of lawyers nationwide are committing 50 hours or more per year to pro bono work. This unfortunate circumstance is occurring at a time in California when the ranks of the defenseless and oppressed in need of justice are growing dramatically, by as much as 30 percent in the last decade.

This increasing need for pro bono representation can only be satisfied if each of us acknowledges and fulfills our professional obligation to do pro bono work. Under Section 6068, an attorney has the duty to “maintain the respect due to the courts of justice” and “never to reject, for any consideration personal to himself or herself, the cause of the defenseless or the oppressed.” These responsibilities are not independent of one another or mutually exclusive. Nor are they triggered only when a court drafts an attorney into service.

Numerous organizations have resolved that more attorneys should commit more time to pro bono work. The ABA requires that lawyers “aspire” to render at least 50 hours of pro bono work per year. The State Bar’s 2002 Pro Bono Resolution “urged” the same, specifically referring to attorneys’ duty to take up the causes of the defenseless and oppressed. Also, the California Legislature adopted a bill, which was signed by then Governor Gray Davis, that calls on law firms with which the state contracts to make “good faith” efforts to fulfill specific pro bono obligations.

Apparently, none of these efforts has adequately inspired lawyers to devote themselves to pro bono work. It is time for karma.

When I attended law school, I took a semester-long externship at the ACLU, thereafter referring to the experience as “earning karma points.”

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History of the Red Mass

The Red Mass was first celebrated in Paris in 1245 and began in England about 1310 during the reign of Edward I. The entire Bench and Bar would attend the Red Mass together at the opening of each term of Court. The priest and the judges of the High Court wore red robes, thus the Eucharistic celebration became popularly known as the Red Mass.

The tradition of the Red Mass has continued in the United States. Each year in Washington, D.C. the members of the United States Supreme Court join the President, and members of Congress in the celebration of the Red Mass at the National Shrine of the Immaculate Conception. Los Angeles has celebrated a Red Mass for almost a quarter of a century. The Mass is attended by government officials, judges, members of the legal profession and their supporters and is open to all faiths.

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