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FROM THE CHAIR

It is reported that most people will change careers at least three times during their lifetimes. Although I have not seen any statistical studies to support this statement, common sense tells me that it contains a lot of truth. Many of us have chosen law as a second or third career, while some of us will want to abandon it in pursuit of another profession.

Perhaps a more interesting statistic is how many of us will change practice areas over the span of our legal careers. As a lawyer who made the transition from litigation to trusts and estates law, this phenomenon is something about which I have firsthand knowledge. I frequently get calls from attorneys who would like to change the focus of their practices to estate planning and want to know how to do this.

There is no doubt that switching practice areas can be done successfully—but doing so requires careful planning. Most likely, making the transition into a new practice area will require a cut in pay, at least temporarily. Often it will also require new credentials. For me, it involved going back to law school in order to obtain an L.L.M. This meant paying for books and tuition and working part-time for about one year. Therefore, making the switch can carry a hefty price tag, particularly if the area you are interested in requires specialized knowledge. For those fortunate enough to work in large firms, moving from one department to another may be possible without suffering a significant financial setback.

If you are considering changing your practice area, it is important to be honest about why the change you seek seems appealing. You may be lured by the prospect that some practice areas may be less demanding than others over time. Still, making a change to a new field of law will take you back to those first couple of years as a new associate, fresh out of law school. While some of your acquired knowledge is transferable, you will be humbled by your lack of experience all over again. On the other hand, perhaps you took the first job available out of law school and now realize that you do not want to live the rest of your life doing whatever it is that you do now. Once you are clear on the reasons for wanting a change, have evaluated realistically whether making the change will address those reasons, and have found a way to finance the transition, making the switch will be an exciting new beginning.

Here are some suggestions for those embarking on the adventure of changing practice areas. First, find a mentor. Offer to buy lunch or coffee in exchange for an informational interview. Second, if you cannot find a job working with a seasoned practitioner in your proposed area of practice and you are considering going solo, find an experienced attorney who is available for consultation. Third, attend MCLE programs on the subject. You will learn a few pointers and get acquainted with your new colleagues. Fourth, join the State Bar and Los Angeles County Bar Association sections and participate in relevant committees. Fifth, read every article about your new area of practice that you can find.

This brings me to my last point—take advantage of this magazine. We publish articles written by leading practitioners in every practice area. In this issue, for example, we feature articles about litigation, torts, bankruptcy, real property, family law, and intellectual property. Most of the articles we have published over the years are available online. Consider Los Angeles Lawyer an integral part of your tool kit for making the transition from one practice area to another.

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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Considering a Career Specialization in Intellectual Property Law

**INTELLECTUAL PROPERTY** is an exciting and growing practice area covering patent, trademark, copyright, and trade secrets law. Those who want to become IP lawyers should first identify what area of IP law interests them, and then pursue career opportunities that will allow them to learn the ropes in their chosen specialty.

Each of the several different subspecialties of intellectual property law has its own body of law. Some areas, such as patent law, require particular undergraduate preparation, but most merely require a good mentor. IP practitioners can be found working solo, in small boutiques, at mid-sized specialty firms, as well as for departments of major law firms. The IP bar has many organizations with resources for learning more about IP practice, such as the American Intellectual Property Law Association and the International Trademark Association. Many general and regional bars—such as LACBA, the California Bar, and the Beverly Hills Bar Association—have large and active IP sections. All these groups are an excellent source of mentors as well as CLE events. They are always looking for new members.

The source of most IP protection lies in Article 1, Section 8, of the U.S. Constitution, which provides that Congress shall have the power “to promote the progress of science and the useful arts, by securing for limited times to authors and inventors the exclusive right to their respective writings and discoveries.” This clause has given rise to patent law and copyright law. Federal trademark law finds its authority in the commerce clause. While patent law and copyright law are preemptively federal, trademarks, trade secrets, and some antitrust litigation may take place in state court.

IP attorneys generally practice before the U.S. Patent and Trademark Office, as well as various federal and state agencies. They typically handle complex cases involving millions of dollars, years of litigation, and voluminous discovery. Resolution options may include administrative proceedings, mediation, or suing in U.S. District Court. Disputes between parties and the PTO may be appealed to the District Court for the District of Columbia. Patent and copyright cases are appealed to the Court of Appeals for the Federal Circuit and ultimately the Supreme Court.

**Patent Law**

Patent law’s purpose is to protect ideas. The Patent Act of 1793 defined patentable subject matter as “any new and useful art, machine, manufacture, or composition of matter or any new or useful improvement [thereof].” A congressional committee report once held that Congress intended patent law to protect “anything under the sun that is made by man.”

Patent law practice comes in many forms. To protect an invention, one files an application describing the invention with the PTO. Patent prosecutors draft applications and respond to actions from the PTO. If the application is accepted, often after delicate negotiation with the PTO, a patent is granted. If granted, a patent gives a limited monopoly to prevent others from making, using, selling, or importing the invention for a period of years. Patent lawyers can practice a broad range of legal services, including licensing negotiation, drafting agreements, litigation, arbitration, administrative hearings, and resolving patent disputes. Patent attorneys may also draft opinions regarding the scope of an issued patent, perform due diligence for corporate clients, and act as expert witnesses in questions of patent procedure and ethical conduct before the PTO. There are a broad range of clients searching for patent services, including manufacturers, software developers, corporations, individual inventors, and startups, to name just a few.

**Requirements**

To represent clients before the PTO in patent cases, one must be a registered patent attorney or agent, and to register, one must pass the Patent Bar Exam. The patent bar is very tough, with a pass rate for 2003 (the last year statistics are available) of 45 percent. To sit for the exam, applicants must demonstrate technical competence in one of the numerous areas of science and technology covered by patent law. To demonstrate technical competence, applicants generally will need an undergraduate degree in a particular field of study. Applicants must also demonstrate good moral character. Requirements for sitting for the exam are available from the PTO at www.uspto.gov/web/offices/dcom/gcounsel/oed.htm. As with state bar exams, a patent bar review course is a good idea. There are a number of good review courses.

Patent practitioners can often command higher salaries at IP firms than their peers with comparable experience at general practice firms. To those qualified to sit for the exam, many firms will pay for a review course and the significant fees required to sit for the examination. There is no longer a filing deadline, as the exam is given on demand by computer at Thomson Prometric testing sites. Those

Patent lawyers can practice a broad range of legal services, including licensing negotiation, drafting agreements, litigation, arbitration, administrative hearings, and resolving patent disputes.

Cynthia A. Casby is a registered patent attorney practicing in the Los Angeles office of Holland & Knight LLP.
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who fail the exam can apply to sit again in 30 days. To be listed as a patent attorney you must also submit a certificate of good standing from a state bar in any state. A list of all registered patent attorneys can be found at the PTO Web site. There are currently almost 34,000 registered patent attorneys in the United States, although some likely no longer practice. Registration as a patent attorney is not required to represent litigants in a patent lawsuit, but it can be an advantage.

Trademark Law

Trademark law protects the association or source of a product or services with the producer of the product or services. Famous trademarks include well-known brand names such as Coke, Microsoft, and Nike. Businesses protect their good name by registering and enforcing their trademarks. Trademark disputes involving Internet domain names are routinely handled through arbitration. Trademark practice may involve filing trademark applications or preventing infringement, such as stopping the importation of gray market goods at the border. Trademark practice also includes drafting licenses and handling license disputes. Trademark litigators may block the registration of confusingly similar marks, prevent dilution of similar marks, and stop infringers, in practice before the Trademark Trial and Appeal Board of the PTO, or in federal or state court.

Unlike patent law, there is no registration or special bar exam required to practice trademark law and to represent others before the PTO in trademark cases, other than admission to the bar of the highest court of the state.

Copyright Law

Copyright law protects the expression of an idea. Copyright holders can prevent others from making or selling unauthorized copies of their work. Registration is not required to provide copyright protection, but registration is required to sue for copyright infringement. Copyright practice is growing as the arts try to find ways to thrive in the digital world. The Copyright Office reported over half a million new registrations in 2005. Copyright lawyers often work with artists, authors, publishers, filmmakers, musicians, architects, and software developers.

More information on the differences between patent, trademark, and copyright protection can be found at www.uspto.gov and www.loc.gov/copyright. Information on other types of IP practice, such as trade secret and misappropriation, as well as the overlap with areas such as unfair competition and antitrust law, can be found from the California Bar IP section at www.calbar.ca.gov/ipsection.
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The Limitations of Wrongful Life Claims and Genetic Diagnosis

ONE OF THE MOST DIFFICULT CHALLENGES for the law is to assign a value to life itself. In a wrongful death case, for example, the value is the benefit the deceased had for the surviving spouse or other heir. In a wrongful life context, however, a person is born with a genetic disease, and the claim is that the person would never have been born but for the negligence of a physician or other healthcare provider. Thus, what is the value of not having been born at all as opposed to life with a genetic disease?

Wrongful life is a recognized cause of action in only three states, one of which is California. Distinguished from the cause of action known as wrongful birth (which is a claim asserted by a parent), wrongful life is asserted by a person who claims that he or she should not have been born. In most jurisdictions, recovery by the genetically deformed child has been uniformly denied on the dual grounds that 1) a legal remedy contradicts the fundamental belief that human life has value, and 2) measuring damages by comparison of an impaired life with nonexistence is impossible. The philosophical question of the value of life versus nonlife is precisely the reason why the overwhelming majority of states have not accepted wrongful life as a viable cause of action.

Recently, in rejecting the wrongful life claim, the South Carolina Supreme Court stated: “Our civil justice system places inestimable faith in the ability of jurors to reach a fair and just result under the law, but even a jury collectively imbued with the wisdom of Solomon would be unable to weigh the fact of being born with a defective condition against the fact of not being born at all, i.e., nonexistence. It is simply beyond human experience.” The court further stated, “We acknowledge, as many courts have done, that formidable theological and philosophical issues surround such an action.”

The California Supreme Court first recognized wrongful life in Turpin v. Sortini, and has since only permitted the child to recover special damages for the extraordinary additional medical care and training occasioned by the genetic defect. The wrongful life jury instruction under CACI requires the following elements to sustain the cause of action: 1) the defendant negligently failed to diagnose and warn the parents that their child would probably be born with a genetic impairment or disability, 2) the child was born with a genetic impairment or disability, 3) if the parents had known of the hereditary ailment or disability, the mother would not have conceived the child or would not have carried the fetus to term, and 4) the child will have to pay extraordinary medical or training expenses because of the genetic impairment or disability.

Claims for wrongful life are essentially actions for malpractice based on negligent genetic counseling and testing. In Simmons v. West Covina Medical Clinic, in which wrongful life was asserted by a child born with Down syndrome, the child argued that his mother had been informed through genetic testing and counseling that the child had a genetic defect, she would have terminated the pregnancy. In that case, the genetic test (an alpha fetoprotein test) that had not been performed had only a 20 percent chance of detecting Down syndrome.

The court affirmed the trial court’s order granting the defendant’s motion for summary judgment. The trial court found that the 20 percent chance of detecting Down syndrome, if the alpha fetoprotein test had been performed, did not establish the causal connection between the physician’s failure to offer the test and the mother’s failure to terminate the pregnancy.

Even as genetic testing improves and becomes more common, failures can still occur. Given the complexity and evolving scientific and technological nature of genetic testing, the source of a misdiagnosis will often be extremely difficult to identify. This was demonstrated in a recent Los Angeles Superior Court case, Rubell v. U.S.C. Keck School of Medicine, in which a local fertility clinic was sued along with several other entities for the wrongful life of a child born with a rare genetic defect. The defendant fertility clinic was involved with, among other things, a procedure called preimplantation genetic diagnosis (PGD), which has been performed for only about the last 15 years and continues to evolve with science and technology. This procedure involves either the analysis of part of a DNA strand (polymerase chain reaction, or PCR) or chromosomes (fluorescent in-situ hybridization, or FISH) to identify genetic defects.

In Rubell, the child’s mother had PGD genetic testing performed to determine if any of six embryos developed by another fertility clinic through the in-vitro fertilization process (IVF) was affected with a rare genetic defect, linked to the X chromosome, of which she was a recessive carrier. The mother had suffered minor symptoms of the disease. On the other hand, males with the condition suffer life-threatening and debilitating symptoms. As a carrier, she had the PCR type of PGD performed.

In order for the embryos to be genetically tested, a single cell from each embryo had to be removed and tested. The fertility clinic defendant had performed the individual biopsies of each embryo. The biopsy entailed the removal of one cell from each living multicelled embryo so that the cell’s DNA could be tested for the genetic defect. The cells were taken from each embryo (along with samples of the fluid in which the embryos were contained to test for DNA contamination). These samples were then sent out of state to one of three facilities in the United States that are capable of performing the PCR form of PGD. The test identified two embryos as genetically affected males and two as genetically affected females and did not return results on the remaining two. However, the sex of the embryos was simply inferred from the PCR results because the PCR technique is designed to identify a genetic defect on a certain point on the DNA strand, not to test for sex. The FISH technique is a much more accurate procedure to determine sex. Based upon the results, the mother decided to have the two embryos that had tested as female implanted into her uterus. She understood a female child would be a carrier of the dis...
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An Affected Male

During a routine ultrasound, the mother learned she carried a male fetus. A subsequent amniocentesis confirmed that the male was affected by the genetic defect. At that time the mother was in the early stages of her second trimester. She decided to carry the baby to term knowing it was an affected male and chose not to terminate the pregnancy. Experts in the case agreed that the child would require tens of thousands of dollars per year in medication to control the symptoms of the disease.

After the child was born, the mother filed a claim for medical malpractice and wrongful life, as guardian ad litem for the child, against the IVF laboratory, the fertility clinic, the PCR facility, and various other individuals. She also asserted negligence under the res ipsa loquitur doctrine. Her main assertion was not that the misdiagnosis was a result of a technological failure but rather a product of human error, such as a sample mixup or DNA contamination by one or more of the defendants. Something had gone wrong, but she could not prove who was to blame.

The plaintiff could not prove within a reasonable medical probability that mislabeling or DNA contamination occurred in the case, let alone by any particular defendant, which led to her reliance on res ipsa loquitur doctrine. DNA contamination could have occurred by negligence or by nonnegligence, because experts agreed that the risk of contamination could not be eliminated even with the best protocols. There were also other factors that could have caused the outcome that were not the result of anyone’s negligence. One such possibility was the inherent technological error rate of the PCR procedure (about 3 to 5 percent), of which the plaintiff had been informed. Another possibility was a natural phenomenon called mosaicism. Because the test cells are taken at a stage in which the embryo contains only approximately 8 to 12 cells, this rare phenomenon occurs when the extracted cell is not representative of the whole. In other words, one cell may give a normal test result whereas the other remaining cells in the embryo would give an abnormal result, or vice versa.

The plaintiff also argued that a second cell should have been removed and tested with the FISH technique, since FISH is a more accurate procedure to determine sex. However, scientists in the field generally agree that the removal of more than one cell will pose a greater risk to the viability of the embryo. The mother’s genetic counselor at her hospital advised her of both the FISH and PCR procedures, but she elected PCR with the intent of obtaining a child free from her rare genetic defect. She decided to implant what she believed were two affected female embryos. When she learned the fetus was male, she decided to carry the affected male to term.

Arguments against Wrongful Life

Notwithstanding the lingering question regarding the philosophically questionable cause of action for wrongful life, particularly in the context of this cutting-edge and rapidly expanding field of genetic testing, the maintenance of this claim may have wide-ranging legal and economic effect. Given the rapid expansion of genetic testing, such as PGD, this cause of action may encourage more litigation and discourage advancement in the genetic testing field for such reasons as the unavailability or unaffordability of liability insurance for the people and entities that conduct tests. Suits such as Rubell may also lead to an increase in the exposure of healthcare practitioners to litigation.

With exposure to such claims against practitioners in the field of genetic testing, particularly when the undesired outcomes could be caused by natural phenomena unrelated to human error, technological limitations, or other nonnegligent causes, insurance carriers will either charge exorbitant premiums or refuse to write policies for those involved in PGD and genetic testing. Yet, society cannot afford to permit litigation to destroy vital technologies such as PGD because of rare and unfortunate outcomes like the one in Rubell. PGD has already proven itself to be an essential technology, improving the quality of life for children who are born free of costly and life-imparing genetic abnormalities, their parents, and the public who is tasked in large part with paying for the care for children afflicted with preventable genetic diseases. In fact, genetic screening for Down syndrome and cystic fibrosis has become commonplace for pregnant women. Should a vital benefit to society be denied based upon a few unfortunate incidents that result from known, inherent risks?

A second issue is the applicability of res ipsa loquitur to a case such as Rubell. The important case Ybarra v. Spangler established the doctrine, which shifts the burden of proof to the defendants in cases in which 1) the injury does not occur in the absence of someone’s negligence, 2) the injury was caused by an instrumentality in the exclusive control of the defendant, and 3) the injury was not due to any voluntary action or contribution on the part of the plaintiff. Res ipsa loquitur jury instructions are typically requested in the context of medical malpractice. However, the complexity of certain medical procedures may often bar applicability of this doctrine.

Further, res ipsa loquitur instructions are inapplicable when it is shown that injury might normally occur in spite of the exercise of due care. This case presented a clear scenario in which nonnegligent possibilities could have caused the outcome. Not only could nonnegligent causes have occurred, the various defendants in the case were acting separately and independently of one another. Thus, the requirement that the harm was caused by something that only the defendant controlled could not be satisfied. Further, if an intervening natural force may have occurred, the inference of negligence may not be justified.

Moreover, in the context of medical malpractice law, permitting an inference of negligence to be drawn solely upon evidence that a particular accident rarely occurs when due care is exercised would place an undue burden on the medical profession and would discourage procedures that involve inherent risks even when due care is used. As one California court explained, “Lesser standards of proof are understandably attractive in malpractice cases in which physical well being, and life itself, are the subject of litigation….However, we have trepidations that such a rule would be so loose that it would produce more injustice than justice.”

The IVF process and PGD technology at issue in Rubell, including the related processes of intracytoplasmic sperm injection, the culturing of human embryos, the biopsy of embryonic cells, and the actual genetic testing of the chromosomes and/or DNA from embryonic cells, have already had significant, positive, and vitally important social consequences.

The fact that liability may be difficult (or impossible) to prove does not mandate the use of the res ipsa loquitur doctrine. Liability resting on theoretical possibilities would result in these technologies becoming too expensive or simply not available to patients in need. In its refusal to establish a more lenient standard of causation with respect to the facts of its wrongful life case, the Simmons court articulated the chilling effect it predicted would result from the abandonment of established tort law principles of causation with respect to “mere possibilities.”

A third issue is the inherent conflict between CACI 513 and a woman’s right to choose whether to terminate a pregnancy. California Civil Code Section 43.6(b) provides: “The failure or refusal of a parent to prevent the live birth of his or her child shall not be a defense in any action against a third party, nor shall the failure or refusal be considered in awarding damages in any such action.” Based on CACI 513’s very language that if the parents had known of the heredi-
tary ailment or disability, the mother would not have conceived the child or would not have carried the fetus to term, it would seem to be a defense to argue that this element cannot be satisfied if the mother knew of the genetic defect with sufficient time to terminate the pregnancy and chose not to do so.21

Section 43.6 was enacted into law in 1982, and CACI 513 was approved for use in 2003. Surely the judicial panelists who approved these jury instructions were aware, or should have been aware, of the existence of Section 43.6. This inherent conflict is ripe for appellate review. Invoking Section 43.6(b), the court in Rubell denied a motion for summary judgment on this issue. The fertility clinic argued that the plaintiff could not satisfy the third element of the wrongful life cause of action because she knew of the genetic defect with sufficient time to terminate the pregnancy but failed to do so. This inherent conflict further questions the wisdom of the wrongful life cause of action.

With the increasing use of genetic testing, specifically PGD, how does an individual or entity protect itself against wrongful life claims? Some experts suggest that PGD should be renamed preimplantation genetic screening, thereby removing the expectation that the test makes a diagnosis. That suggestion is probably a good start, but other more significant changes should be made.

Informed consent agreements should better clarify the risks involved in the procedure and describe the state-of-the-art techniques that are employed. They should also specifically address the technological limitations and natural phenomena that could render a misdiagnosis or erroneous result. These agreements should also describe the differences between the PCR and FISH techniques and their respective accuracy and risks for a particular patient’s genetic testing goals. Healthcare professionals should thoroughly discuss the content of these agreements with patients instead of simply providing the form to the patient and asking for a signature. In fact, the form should include a specific statement of acknowledgment by the patient that all the risks have been thoroughly discussed with the healthcare professional and are understood and accepted by the patient.

Facilities, laboratories, and clinics in any way involved with genetic testing should conform to generally accepted standards of care applicable to genetic testing and have clearly defined protocols to address each step of the procedure in which it is involved and identify each method it utilizes to minimize risks. These protocols should be reviewed regularly for compliance with any new or developing standards of care or governmental regulations. To the extent that facilities work together, they should also ensure their respec-
tive protocols are consistent.

Efforts should also be made to seek clarity from the legislature regarding Civil Code Section 43.6 with respect to wrongful life claims and in light of genetic testing. The legislature and supreme court should certainly reevaluate whether wrongful life should remain a viable claim in California, particularly since the claim requires as an element a fact that California appears to have deemed irrelevant as a matter of public policy. Along this same vein, the Judicial Council should reexamine its jury instructions vis-à-vis Section 43.6, and judges should be more vigilant in understanding the social ramifications of such claims and take a more active and firm position in disposing of them (or at least not relaxing the traditional concepts of causation) in the context of important and infinitely beneficial PGD technology.

3 Id.
5 See CACI 513; BAJI 6.08.
6 CACI 513.
9 Id. at 699.
10 Id. at 702-04.
14 Bardessono v. Michels, 3 Cal. 3d 780 (1970). “This doctrine of res ipsa loquitur applies in cases in which (1) the accident is of a kind which ordinarily does not occur in the absence of someone’s negligence and (2) defendant is probably the person who is responsible.” Id. at 788.
16 Fraser v. Sprague, 270 Cal. App. 2d 736 (1969). Evidence of rarity, together with some other evidence indicating negligence, may warrant a conditional res ipsa loquitur instruction, particularly if the injury resulted from a commonplace procedure rather than from a complex or unusual operation. Id. at 745.
19 Id. at 699 (“had she learned of the abnormality, she would have terminated the pregnancy”); Turpin v. Sortini, 31 Cal. 3d 220, 234 (“depriving parents of information which may be necessary to determine whether it is in the child’s own interest to be born with defects or not to be born at all”).
IN CALIFORNIA, THE OVERWHELMING MAJORITY of lawsuits settle before trial, thanks in part to an abundance of statutory and decisional law specifically calculated to foster early resolution of civil disputes. Included among these inducements to settle are cost-shifting schemes, the “good faith settlement” doctrine that bars cross-claims for indemnity, evidentiary rules excluding expressions of sympathy from introduction into evidence, and laws permitting arbitral tribunals and certain courts to postpone trial proceedings in order to facilitate settlement discussions. These and other incentives to settle apply with equal vigor to collection cases, which constitute a sizeable percentage of all contract cases filed.

Yet there is one legal rule applicable to collection cases that provides a curious disincentive to settlement. This rule involves a widely accepted mechanism for resolving collection cases before trial: installment payment plans backed by a stipulated judgment. Typically, such settlement agreements involve payment of the debt over time, often with a significant discount from the original debt amount. As an incentive to the debtor to actually make the agreed-to payments, the settlement agreement will provide that any breach in payment terms will result in entry of a judgment for the full amount of the original obligation, less payments already made. For example, a $100,000 debt could be settled for, say, $72,000, payable over time, provided that any breaches in payment would result in restoration of the original $100,000 debt, minus payments made, via entry of a stipulated judgment.

Settlement agreements structured in this way are standard operating procedure among commercial litigators in California. Undoubtedly, dozens if not hundreds of collection lawsuits are resolved each year in California through the use of some variant of these agreements. Payment agreements backed by stipulated judgments make sense for a number of reasons: They avoid the need for costly litigation, they free the court system for cases involving more significant disputes, and they provide a common-sense mechanism for the payment of debts over time—with real financial incentives to assure that the debt is paid, and the case stays settled.

Utility alone, however, does not equate to legality. What many practitioners do not recognize is that, under settled California law, agreements like the one just described are not enforceable in most cases. This is so because, under the law of liquidated damages, the amount of the judgment to be entered in the event of default is typically so disproportionate to the actual damages flowing from the breach as to constitute an invalid penalty.

The leading case addressing this issue is Sybron Corporation v. Clark Hospital Supply Corporation, in which the plaintiff sold and delivered hospital beds to the defendant but never got paid. The plaintiff sued the defendant for about $150,000, and the defendant counter-sued, claiming defective merchandise. The parties ultimately reached a settlement, under which the defendant agreed to pay $72,000 over a year. The settlement agreement was backed by a stipulated judgment for $100,000. That judgment would be entered only if one or more of the agreed-to payments were missed, and only after the defendant received notice and an opportunity to cure the default.

The defendant paid $42,000 under the settlement agreement but then stopped paying. After giving proper notice, the plaintiff moved to obtain judgment as provided in the settlement agreement, based on the stipulated amount of $100,000. But the defendant objected, claiming that entry of a judgment for $100,000 on a $72,000 obligation effectively amounted to a $28,000 penalty for missing monthly payments of a mere $6,000. The trial court was unpersuaded by this argument and entered judgment based on the stipulated amount of $100,000.

The court of appeal reversed, however, finding that the $28,000 increase in debt was an unenforceable penalty since it bore no rational relationship to the amount of actual damages flowing from the missed payments:

The creditor is entitled to bargain that if the installment debtor imposes upon the creditor by a continuing course of dilatory payment, the creditor may accelerate and collect the entire obligation, plus a reasonable amount to compensate for delay. On the other hand, the equitable powers of the court exist to insure that the ultimate obligation imposed on the debtor is not unreasonable in proportion to the original obligation and the seriousness of the default.

Penalty Defense

The Sybron court reached its result by applying, in the context of litigation settlements, established California rules relating to the enforceability of structured settlements in collection cases. Paul S. Marks practices civil and commercial litigation with the Neufeld Law Group in Los Angeles. He is a member of the Los Angeles Lawyer Editorial Board.
ability of liquidated damages clauses. Generally, the validity of liquidated damages clauses in California is governed by Civil Code Section 1671. With limited exceptions, Section 1671 provides that liquidated damages clauses are enforceable “unless the party seeking to invalidate the provision establishes that the provision was unreasonable under the circumstances existing at the time the contract was made.” The California Supreme Court has held that a liquidated damages clause will generally be considered unreasonable—and thus unenforceable—“if it bears no reasonable relationship to the range of actual damages that the parties could have anticipated would flow from a breach.”9 Without such a relationship to actual damages, a contract clause purporting to predetermine damages “must be construed as a penalty.”10 A contractual provision imposing a penalty is ineffective, and the wronged party can collect only the actual damages sustained.11

Although Sybron was decided under a former version of Civil Code Section 1671, which deemed liquidated damages clauses invalid except in certain circumstances, the California Supreme Court has relied on Sybron as a correct expression of the governing principle that “unreasonable” attempts to liquidate damages will not be enforced.12 Further, Sybron has been followed in other cases applying California law, both published and unpublished.13

The practical problem for the civil justice system is apparent: Sybron provides a significant disincentive to the settlement of collection lawsuits. If settlement agreements are invalid simply because they seek to ensure compliance by reinstating the original debt upon breach, creditors will lose a major incentive to resolve litigation by discounting debts. Although acceleration of installment payments upon breach remains legally permissible under Sybron, acceleration alone is often an insufficient incentive for a creditor to discount a debt to reach a settlement. Creditors agreeing to stipulated judgments in the event of default usually demand not only acceleration of future payments but also reinstatement of the original debt amount, or something close to (or even greater than) that amount. But if that amount is large enough to achieve the desired result—such as motivating the debtor to pay on time—then the amount will almost certainly be deemed an unenforceable penalty under Sybron.

Those who contend that the result in Sybron is at odds with a system that is supposed to encourage settlements are not alone. Courts in Ohio, Colorado, and Florida have disagreed with Sybron, holding that the “penalty” defense is not available in cases of stipulated judgments.14

Even though its holding is a barrier to
settlement of collection cases, Sybron has not sounded a death knell for stipulated judgments that impose a penalty in case of default. Such agreements remain common in California and are rarely challenged. This is so largely because Sybron remains an obscure decision, and its progeny are relatively flimsy. Thus, there appears to be little reason to advise creditors’ lawyers to conform their settlement agreements to the rule of Sybron. Indeed, like most affirmative defenses, the penalty defense can easily be waived. Thus, unless the debtor raises the Sybron holding in the short window of opportunity between payment default and entry of judgment, he or she will face an uphill battle having the judgment set aside or overturned on appeal.

On the other hand, practitioners representing debtors whose only hope of achieving a workable payment plan is to agree to a sizeable penalty in case of default would do well to keep the Sybron case in mind. Its holding may come in handy on that future day when the client calls to say, “Remember me? I can’t make those settlement payments we negotiated. What can we do now?”

3 Evid. Code §1160.
4 Code Civ. Proc. §§1297.301 (arbitration continuances); 116.610(b) (small claims trial continuances).
6 See, e.g., 1 Debt Collection Practice in California §4.67, at 249 (CEB 2d ed. 1999).
8 Id. at 903.
12 Ridgley, 17 Cal. 4th at 978.
A member of a chapter 11 committee of creditors or equity security holders who is selected to represent the class has a fiduciary responsibility to protect the interests of all members of the committee. Indeed, because of the fiduciary nature of committee membership, members must not be subject to conflicting interests. Committee members are required to serve in good faith and with honesty and loyalty. They must avoid self-dealing and may not use their position or the information gained as a result of membership to advance their own interests as a creditor or an equity security holder. Even before any controversy arises, a committee may seek to protect its members by requesting a court order—known as a comfort order—authorizing a course of action and insulating committee members from liability as long as that course is followed.

The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA) added Section 1102(b)(3) to the Bankruptcy Code. The section—effective in cases filed on or after October 17, 2005—mandates that appointed committees provide “access to information” to creditors holding claims of the kind represented by the committee but who do not serve on the committee and that the appointed committee “solicit and receive comments” from its constituents who are not members of the committee. This provision creates discomfort for committee members by failing to specify, among other things: 1) the type of information that must be made available, 2) whether creditors are entitled to nonpublic, confidential, and privileged information received by the committee and, if so, under what terms, 3) whether the

Creditors’ committees are more frequently seeking comfort orders since recent bankruptcy law changes increased their disclosure duties.
committee must actually provide the information as opposed to merely providing access to information, 4) the extent of the detailed information required to be provided, 5) whether certain creditors may be excluded from the disclosure requirement, 6) the consequences of a committee’s failure to provide information, 7) the impact of securities law and Securities and Exchange Commission rules on the duty under Section 1102(b)(3) to provide access to information, 8) the kind of matters for which the committee must solicit and receive comments, 9) the manner for soliciting and receiving comments, 10) how often comments are to be solicited, and 11) how the requirement to solicit comments works in accordance with Bankruptcy Code Section 1125, which prohibits solicitation of acceptances and rejections of a chapter 11 plan prior to the bankruptcy court’s approval of a disclosure statement.

Not surprisingly, in various large chapter 11 cases filed since the enactment of Section 1102(b)(3), committees have sought protective orders defining and limiting the scope of their duty to provide access to information and to solicit comments from their constituents. In order to avoid violating the prohibition against self-dealing, it might seem that chapter 11 committee members should refrain from trading the securities of, or claims against, the debtor. However, especially in certain larger cases, this type of trading may be desired by certain committee members and has been authorized by courts, subject to the implementation of appropriate information-blocking procedures.

The comfort orders now being requested from and issued by some courts are in response to the tensions created by a chapter 11 committee’s necessary receipt of confidential, proprietary, privileged, and material nonpublic information and BAPCPA’s explicit obligation to provide constituents with “access to information” and to “solicit and receive comments.” These orders seem patterned after and descended from the information-blocking procedures and protocol orders issued by courts prior to the 2005 amendments to the Bankruptcy Code. These pre-2005 procedures and protocol orders allowed committee members to trade claims against or securities in a debtor.

**Protective Orders in Response to Section 1102(b)(3)**

The “access to information” requirement codified in Section 1102(b)(3) allows creditors to receive meaningful information during the reorganization process while preserving the ability of the debtor to provide confidential and nonpublic information to the creditors’ committee without prejudicing the debtor’s business and diminishing the value of the estate. In the initial months following the enactment of Section 1102(b)(3), debtors and creditors’ committees have sought orders from bankruptcy courts designed to protect the confidentiality of information and preserve privilege rights while satisfying the section’s requirements. Some courts have been hesitant to provide comfort orders, but it appears that they have generally been inclined in large cases to issue orders based on precautionary motions submitted prior to any creditor actually contending that the committee had failed to provide adequate access to information.4

*In re Refco, Inc.* is the first published opinion addressing a committee’s duties under Section 1102(b)(3). The creditors’ committee in *Refco* took prompt action to establish a protocol for complying with Section 1102(b)(3). Indeed, in the initial days of the case, the committee was involved in exchanging information with the debtor and other interested parties, developing factual and legal analyses of significant inter-creditor issues, and pursuing a confidential investigation. The committee expressed the concern that the premature, unguarded, or selective disclosure of information connected with these matters could undermine the committee’s goals and possibly violate securities laws or an order of the court. Within three days of its appointment, the committee filed a motion for approval of a protocol for complying with Section 1102(b)(3). Addressing the ripeness of the relief requested at the inception of the case and its discomfort with providing a comfort order, the court stated:

> [T]he Court’s first inclination, particularly given the review process contemplated by section 1102(b)(3)(C), the absence from the statute of any adverse consequences for an initial failure to comply, and the qualified immunity accorded official committees and their professionals, was to deny the motion as not raising a case or controversy. Until a creditor contends that the Committee was being too stingy with information, the Committee could be left to make reasonable efforts to provide access to relevant information consistent with its resources and any conflicting duties.

This is, however, a large and rapidly moving case, and meaningful information may become stale before the completion of litigation over whether and how it should be provided. Moreover, it appears that the Committee’s motion did not arise in a vacuum; unsecured creditors apparently were pressing for information in ways that raised issues neither expressly addressed by the statute nor, given the section’s recent enactment, the case law. Under the circumstances, therefore, the Committee’s request to establish parameters for the provision of information under section 1102(b)(3)(A) of the Bankruptcy Code was appropriate, although, as the law develops, the need for comfort orders should end.5

With minimum deviation from the relief requested by the committee, the *Refco* court entered an interim order providing that the committee was not required to divulge any confidential, proprietary, nonpublic information concerning the debtor or any other information if the affect of the disclosure would constitute a waiver of the attorney-client or other privilege of the committee. The court’s interim order also required the debtor to assist the committee by identifying the proprietary or nonpublic nature of any information provided to the committee, pending a final hearing.6

Less than two months following entry of the interim order, the *Refco* court issued a final order establishing detailed information-sharing protections and procedures. The final order required that the committee provide creditors with access to information by 1) establishing and maintaining a Web site with detailed information regarding the chapter 11 case, including, among other things, monthly reports, highlights of significant events, a calendar of upcoming events, responses to creditors’ requests, and answers to frequently asked questions, 2) distributing case updates by e-mail to creditors who registered for this service on the committee Web site, and 3) establishing and maintaining a telephone number and e-mail address for creditors to submit questions and comments.7

The final order in *Refco* further provided that the committee would not be required to disseminate, without further order of the court, confidential, proprietary, or other nonpublic information concerning the debtor or the committee, or any other information if the effect of the disclosure would constitute a general waiver of attorney-client, work product, or any other applicable privilege or protection that the committee had. Like the interim order, the final order required the debtor to assist the committee in identifying confidential information. The final order also provided a procedure for creditors to request information. If the committee determined that a request was seeking confidential or privileged information, the committee could 1) deny the request (and the order established a procedure for the creditor to seek to compel the information it desired), or 2) indicate that it would comply with the request (and the order allowed the debtor an opportunity to prevent the information from being disclosed). The final order further required the committee to consider whether the creditor requesting confidential information was willing to agree to reasonable confidentiality, trading restrictions, and information-screening protections. Finally, the order contained an excusal provision
protecting the debtor, the committee, their representatives, and attorneys from liability for any act taken or not taken in connection with the preparation, dissemination, and implementation of the protocol, the committee Web site, and other information provided pursuant to Section 1102(b)(3). Acts involving breach of fiduciary duty, gross negligence, or willful misconduct were excluded from this protection.8

In the months following the effective date of Section 1102(b)(3), a number of courts have entered information-blocking orders very similar to the order in Refco.9 In In re Riverstone Networks, Inc.,10 the court followed the approach in Refco and imposed additional restrictions on competitors and claims traders. Under the order in Riverstone, if the creditor requesting information was a competitor or potential competitor of the debtor and the release of the requested information might negatively impact the debtor, the committee was precluded from disclosing the requested information without a court order. Additionally, the order required any creditor who was involved in trading claims against, or equity interests in, the debtor and who requested information to file with the court and complete service on the committee, the debtor, and the U.S. Trustee of all documentation showing that the creditor had erected an information-screening wall so that no confidential information would be revealed to traders of claims or equity interests.11 Some courts have issued, at the behest of committees, protective orders providing that the committees are not authorized or required to provide their creditor constituents access to any confidential or privileged information of the debtor and that the committee is permitted, but not required, to provide access to privileged information when the information is not confidential information and the privilege is held and controlled only by the committee.12

The limitation on soliciting an acceptance or rejection of a plan of reorganization under Bankruptcy Code Section 1125 without providing a written disclosure statement approved by the court should be taken into account by a committee attempting to comply with the literal meaning of Section 1102(b)(3)(B). A cautious approach would be for the committee to obtain court approval of its solicitation documents (or any communications that might be considered to be in the nature of a plan solicitation) regarding a plan of reorganization prior to the dissemination of the materials to ensure the avoidance of a Section 1125 violation.

Information-Blocking Procedures and Protocols

Prior to the 2005 amendments, courts had approved information-blocking procedures to allow committee members to trade in securities of and claims against the debtor. In In re Federated Department Stores, Inc.,13 the motion of Fidelity Management & Research Company, a member of the Official Bondholders’ Committee of Allied Stores Corporation, requested an order determining that Fidelity would not be violating its duties as a committee member (and, accordingly, would not be subjecting its claims to possible disallowance, subordination, or other adverse treatment) by trading in securities of Allied, codebtor Federated Department Stores, Inc., and Ralphs Grocery Company, a nondebtor, during the pendency of the Allied and Federated cases, if Fidelity established and effectively implemented policies and procedures to prevent the misuse of nonpublic information that it obtained through its activities as a committee member.

The order issued in the Federated case provided that Fidelity would not be in violation of its fiduciary duties as a committee member and would, therefore, avoid subjecting its claims to possible disallowance, subordination, or other adverse treatment, as a result of trading in securities of Allied, Federated, and Ralphs during the chapter 11 cases, provided that Fidelity employed an appropriate information-blocking procedure that was reasonably designed to prevent Fidelity’s trading personnel from receiving any nonpublic committee information through Fidelity’s committee personnel and to prevent Fidelity’s committee personnel from receiving information regarding Fidelity’s trading in securities in advance of the trades.

The order spelled out the procedures to be employed by Fidelity if it wished to trade in securities of Allied, Federated, and Ralphs and remain on the committee: 1) Fidelity’s committee personnel who would have access to nonpublic information in the bankruptcy proceeding were required to execute a letter acknowledging that they might receive nonpublic information and that they were aware of the information-blocking procedures, 2) Fidelity’s committee personnel were prohibited from sharing nonpublic committee information with other Fidelity employees, with the exception of Fidelity’s general counsel for the purpose of rendering legal advice to committee personnel and who was precluded from sharing this nonpublic committee information with other Fidelity employees, 3) Fidelity’s committee personnel were required to maintain all files containing nonpublic information in a manner inaccessible to other employees, 4) Fidelity’s committee personnel were precluded from receiving any information regarding Fidelity’s current security trades in advance of those trades, except that committee personnel were allowed to receive monthly reports on Fidelity’s ownership of the securities represented by the committee, and 5) Fidelity’s compliance department personnel were required to review Fidelity’s trades in securities of Allied, Federated, and Ralphs to confirm that the trades were made in compliance with the information-blocking procedures and to keep and maintain

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records of their review. The *Federated* court’s order explicitly provided that the court was not precluded from taking any action it deemed appropriate in the event that it was determined that an actual breach of fiduciary duty had occurred.14

The court in *In re House of Fabrics, Inc.*15 issued an order involving information-blocking procedures that was similar to the order issued by the *Federated* court. In doing so, the *House of Fabrics* court emphasized that the order would not insulate a member of the committee trading nonpublic information or engaged in any other improper use or improper disclosure of information. Indeed, the court stated that such activities were illegal and would constitute a violation of a committee member’s fiduciary duties to constituents and to the bankruptcy estate.16

In *In re Pacific Gas & Electric Company,*17 the creditors’ committee filed a motion for an order authorizing members to trade in securities of the debtor and declaring that members of the committee would not be violating their fiduciary duties—and that they and their affiliates would not suffer adverse consequences—by trading in and preparing and publishing research in gas, power, coal and other commodities, including physical, financial, derivative, and other transactions and products, involving or related to PG&E and its affiliates, or in the markets in which PG&E and its affiliates conduct the same or similar operations or in other markets (collectively referred to as the affected commodities) upon establishment of certain information-blocking procedures.18

The court in *PG&E* bifurcated the securities and commodities trading aspects of the motion and granted, subject to the imposition of additional “ethical wall procedures,” the securities trading order. At that point, the court deferred consideration of the request for a commodities trading order and set the matter for further hearing. The creditors’ committee consisted of 11 members, five of whom were engaged in a wide variety of trading, preparing, and publishing research in the affected commodities and desired the commodities order. These members said that they would seriously consider resigning from the committee if the commodities order was not entered. However, no member said it would resign and no member had actually resigned.19

The court determined that although the proposed commodities order was nearly identical to the previously issued securities order—including the fact that both contained ethical wall procedures—the court would not issue the commodities order for a number of reasons. First, the court found a fundamental difference between trading in securities issued by PG&E and engaging in commodities trading at the same time that PG&E did so as part of its fundamental business. The court found that securities abuse tends to primarily hurt the parties (admittedly for a limited range of conduct), and there was no reason to believe that the committee could not function without the members. The *PG&E* court concluded that the committee had shown no threat to the reorganization requiring entry of the commodities order.20

Finally, the court found an inadequate basis for the issuance of the protection requested for commodities traders when the benefits of the order were uncertain. Members want a comfort order that insulates them as long as certain procedures are in place, yet the corresponding benefit to *PG&E* and its estate was speculative and vague at best. While the relief the commodities order would grant was relatively narrow in scope, the risk that members would have court authority to compete in the same business arena as PG&E while they obtain sensitive and confidential information as fiduciaries to the estate was simply too great.21

In *In re Speigel,*22 the creditors’ committee requested an order approving information-blocking procedures and permitting trading of the debtor’s securities in certain situations. The committee consisted of nine members, including bank lenders, trade creditors, and a landlord. Additionally, JPMorgan Chase was a nonvoting ex-officio member of the committee. The committee sought an order determining that committee members, including ex-officio members, acting in any capacity and engaged in the trading of securities for others or on their account as a regular part of their business would not violate their duties as committee members by trading in the debtor’s debt or equity securities or other claims or interests during the debtor’s chapter 11 cases, provided that they effectively implemented and strictly adhered to the information-blocking policies and procedures that had been approved by the court in another case (*In re Iridium Operating LLC*) in an unpublished opinion.23 The court in the *Speigel* case denied the requested relief and rejected a procedure providing for general court approval in advance with specific affidavits to follow.24 Unlike the other case, the *Speigel* court was not presented with a factual record detailing the specific circumstances surrounding the request for at least one particular committee member.

The *Speigel* court proceeded to conclude that even if it had been presented with an adequate factual record, it would not have been inclined to grant the relief requested by the creditors’ committee and intended to hold the committee to full and strict compliance with its fiduciary obligations. The court provided the following example to highlight its concern regarding the committee’s request:

For example, if members of the Committee are allowed to trade in the securities of the Debtor, regardless of how the creditor internally divides its office, there is an appearance of impropriety—to the extent such trading information is made public, the trades of a creditor-company which sits on an official...
Committee of unsecured creditors could influence non-members in the marketplace who may not be aware that the creditor has a screening wall or other such device in place.\(^3\) Accordingly, in *Spiegel*, while the decision was based on a failure to provide an adequate factual record, it appears that the court was moving toward adopting a more restrictive view under which trading in securities by members of a committee would be per se impermissible. This is in contrast with BAPCPA and *Refco*. BAPCPA did not address the implementation of information-blocking procedures or the issuance of comfort orders protective of committee members.\(^3\) In *Refco*, the post-BAPCPA decision, the order required the committee, in responding to a request for access to confidential information, to consider whether the requesting creditor was willing to agree to reasonable confidentiality and trading restrictions.\(^3\)

**Availability and Strength of Comfort Orders**

The *Refco* court may have been engaging in wishful thinking when it speculated that the need for comfort orders in connection with Section 1102(b)(3) would end as case law develops in this area. While the need for such orders may ultimately be reduced, the desire of committee counsel and committee members for the additional protection that these orders may provide is unlikely to subside. Undoubtedly, it will be difficult to wean those accustomed to receiving comfort orders from the practice. Some orders are commonly referred to as comfort orders because they do nothing more than confirm a state of affairs that already exists.\(^3\) When faced with what appears to be a request for a comfort order, some courts simply decline to enter advisory opinions.\(^3\) Other courts take a middle ground and, while declining to enter the requested comfort order, include language in the order denying the requested order that itself provides comfort.\(^3\) Other courts, such as the *Refco* court, may grant the requested comfort order reluctantly.\(^3\)

In the bankruptcy context, some may have thought that comfort orders were largely a thing of the past. Under the old Bankruptcy Act, bankruptcy courts were involved in virtually every decision made by the bankruptcy trustee. This resulted in comfort orders being the norm. But the post-BAPCPA era has fostered a different reality: “[T]he Bankruptcy Code radically changed the relationship between the bankruptcy court and the trustee by removing the bankruptcy judge from the day-to-day administration of the bankruptcy estate.”\(^3\) Some courts hold that bankruptcy court intervention is now limited to those situations in which the Bankruptcy Code actually authorizes court involvement.\(^3\) Even under the Bankruptcy Code, other courts reject the standard application of the “cases or controversies” requirement to bankruptcy cases and take a broader view of justiciability in bankruptcy.\(^3\) Nevertheless, there is nothing in the Bankruptcy Code in general, or Section 1102(b)(3) specifically, that precludes a court from issuing an order providing committees and their members and counsel with some level of comfort. Moreover, the fact that such orders may be procured on a consensual, nonadversarial basis does not mean that the orders are any less valid determinations of the court. This is particularly true when the orders are made after deliberation and examination of the issues, and when the orders do not purport to authorize conduct expressly prohibited by the Bankruptcy Code.\(^3\) Orders designed to provide comfort and protection to committee members will continue to be sought regarding the uncertain requirements of Section 1102(b)(3) and the delicate question of trading in claims against and securities of the debtor by committee members.

Committees may request protective court orders to reconcile their obligation to provide access to information to constituents and the desire of certain committee members to trade in securities of or claims against the debtor with the need for protection and preservation of confidential, nonpublic, and privileged information required by the committee in order to fulfill its responsibility to investigate, monitor, and negotiate with the debtor. With recently enacted information-sharing obligations under the Bankruptcy Code, which raise more questions than they answer, orders implementing procedures for information sharing and blocking can provide committee members with the comfort that, assuming they follow the designated protocol, their risk of being penalized for breaching their fiduciary duty as committee members is minimized. However, as determined by the courts in *Spiegel* and *PG&E*, courts should be provided with factual evidence demonstrating that comfort orders are necessary in order for committees to adequately fulfill their duties. Finally, the *Spiegel* court laments having opened a Pandora’s box by having approved a trading protection order in a prior case, and the *Refco* court states that as the law develops in response to the new information-sharing duties of the committee under Section 1102(b)(3), the need for comfort orders should end. Both views seem unrealistic, at least in the foreseeable future. Committee members and counsel will want to ensure that they maximize the protection available in their cases.\(^3\)

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1. In re Johns-Manville Corp., 26 B.R. 919, 925 (Bankr. Los Angeles Lawyer April 2007 27
S.D. N.Y. 1983).
1 Id.
5 Id. at 191-92.
6 Id. at 200.
7 Id. at 200-203.
8 See Calpine Corp., Case No. 05-60200 (Bankr. S.D. N.Y. 2006), Lifland, J., Order to Show Cause Regarding Motion of the Official Committee of Unsecured Creditors, Pursuant to 11 U.S.C. §§105(a), 102(b)(3)(A), and 1103(c), dated Feb. 23, 2006 (Dkt. No. 869); In re Musicland Holdings Corp., Case No. 06-10064 (Bankr. S.D. N.Y. 2006), Lifland, J.), Order to Show Cause Regarding Motion of the Official Committee of Unsecured Creditors, Pursuant to 11 U.S.C. §§105(a), 102(b)(3)(A), and 1103(c), for nunc pro tunc Order Clarifying Requirement to Provide Access to Information Pursuant to Order Setting Forth Procedures for Sharing of Information by Creditors’ Committee Pursuant to Section 1102(b)(3)(A) of the Bankruptcy Code, dated Nov. 17, 2005 (Dkt. No. 145); In re Dana Corp., Case No. 06-10334 (Bankr. S.D. N.Y., Lifland, J.) (filed Mar. 3, 2006), Order Pursuant to Sections 105(a), 107(b), and 1102(b)(3)(A) of the Bankruptcy Code, Confirming that the automatic stay has been terminated.
10 Id. at 153.
11 Id. at 751.
12 CALIFORNIA RULE OF PROFESSIONAL CONDUCT §405(b) (2005).
13 Id. at *17-*24.
14 Id. at *2-*4.
15 Id. at *2-*4.
16 Id. at *2-*4.
17 Id. at *2-*4.
18 Id. at *2-*4.
19 Id. at *2-*4.
20 Id. at *2-*4.
21 Id. at *2-4.
22 Id. at *2-*4.
23 Id. at *2-4.
24 Id. at *17-*24.
25 Id. at *17-*24.
26 Id. at *17.*24.
27 Id. at *17.*24.
28 Id. at *1-2.
29 Id. at *17-*24.
30 Id. at *23.
31 Id. at *23.
32 Id. at *2-4.
33 Id. at *2-4.
34 Id. at *2-4.
35 Id. at *2-4.
36 Id. at *2-4.
37 Id. at *2-4.
38 Id. at *2-4.
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148 Id. at *2-4.
149 Id. at *2-4.
150 Id. at *2-4.
151 Id. at *2-4.
152 Id. at *2-4.
Insurers and insureds continue to fight over the meaning of narrowly crafted court decisions on the payment of attorney’s fees in contract disputes.

A common provision of the standard commercial (formerly “comprehensive”) general liability insurance (CGL) policy excludes coverage for contractual damages. Insureds—and some insurers—are surprised to learn this exclusion does not affect coverage for awards of attorney’s fees under Civil Code Section 1717 and Code of Civil Procedure Sections 1032 et seq. Section 1717 provides for awards of attorney’s fees to parties prevailing in contract actions in which the contract at issue contains a provision for attorney’s fees. Sections 1032 and 1033.5(a)(10)(A) allow recovery of attorney’s fees under contract as costs. California’s courts have held that an insurer is obligated—under the supplementary payments provisions (SPP) that are part of the standard CGL policy—to reimburse its insured for awards of attorney’s fees under Sections 1717 and 1032 et seq.

However, a 2006 opinion by the First District of the California Court of Appeal held that an award of fees under statute—as opposed to a contractual provision—does not trigger the insurer’s duty under the SPP to pay an attorney’s fee award. This decision may significantly limit the scope of an insurer’s obligations under the SPP. Also, and curiously, case law would apparently deny a judgment creditor the right to recover attorney’s fees under Insurance Code Section 11580(b)(2), the so-called Direct Action Statute.

A typical SPP might provide that the insurer “will pay, with respect to any claim or ‘suit’ we defend...[a]ll costs taxed against the insured in the suit.” Courts have faced the question whether, despite the exclusion of contract damages, a party proceeding on a claim defended by an insurer under a CGL policy might be entitled to recover (or, in the

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The insurer’s indemnity obligation.”9 The costs would otherwise be covered by way of defend the suit, independent of whether those party clause in a contract between the plain- tion was based was a default judgment obtained against the insured after the defendant refused to provide a defense.17

The Rights of Judgment Creditors

The Prichard court recognized the potentially unfair result of indemnifying an insured “for exposure on claims the defense of which he never paid a premium for. The problem, however,” the court observed, “is in the insurance contract, not the law. If the ISO [Insurance Services Office] forms are written so that attorney fees awarded as part of pre- vailing party clauses can be considered costs associated with the insurer’s defense obligation, there is nothing we can do about it.”11

INA was a suit by one insurance carrier against another to recover payments made on a judgment entered against a defendant whom both carriers insured. Among other issues the court considered was whether the defendant’s contribution of $289,983.72 to pay an award of attorney’s fees and costs in the underlying action was against the policy limits or was a “cost taxed against the Insured in any suit defended by the Company...in addition to the applicable limit of liability” under the policy’s SPP.12 The court affirmed the trial court’s ruling that the payment fell in any suit defended by the Company’s liability thereon.”20 The court viewed the SPP as part and parcel of the duty to defend, which it concluded was owed only to the insured, and not to any third party. Thus, the SPP did not inure to the benefit of the direct action plaintiff.21 Accordingly, the court held the judgment creditor could not recover an award of attorney’s fees under the Direct Action Statute.22

San Diego Housing involved somewhat unusual facts. The opinion’s denial of a judgment creditor’s right under the Direct Action Statute to recover an award of attorney’s fees from the judgment debtor’s insurer under the SPP might properly be limited to those facts.

Notably, in San Diego Housing the insurer did not defend its insured in the underlying action. This allowed the court to separate with a bright line the duty to defend from the duty to indemnify. The San Diego Housing holding was based in large measure on the court’s analysis of the duty to defend. It might not apply to a judgment creditor’s right to recover under the Direct Action Statute for an award of fees made in an action the insurer defended, since the insurer’s performance of its duty to defend would presumably include the duty to perform under the SPP.

Bad Faith

Moreover, the holding in San Diego Housing probably could not be applied to a claim against a nondefaulting judgment debtor. Since Prichard found that the insurer that owes a duty to defend also owes a duty to
MCLE Test No. 158

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. Holders of commercial general liability insurance policies generally are not insured for damages arising from breach of contract.
   True. False.

2. Commercial general liability insurers must reimburse insureds for awards of attorney’s fees under Civil Code Section 1777 and Code of Civil Procedure Sections 1032 et seq.
   True. False.

3. California case law provides that commercial general liability insurers must reimburse insureds for a statutory award of attorney’s fees.
   True. False.

4. According to California case law, judgment creditors may be denied the right to recover an award of attorney’s fees under the Direct Action Statute.
   True. False.

5. An insured is not obligated to pay costs that are not covered as a result of the insurer’s indemnity obligation.
   True. False.

6. Due to the wording of most insurance policies, attorney’s fees that are awarded as part of prevailing party contract clauses can be considered costs associated with the insurer’s defense obligation.
   True. False.

7. California law permits a judgment creditor to recover from the judgment debtor’s insurer if the insurer is a nonadmitted Mexican insurer.
   True. False.

8. The recovery of a judgment creditor in a direct action against the judgment debtor’s insurer is subject to the terms and limitations of the judgment debtor’s policy.
   True. False.

9. The duty of a California commercial general liability insurer to pay an award of contractual attorney’s fees against its insured is part of the insurer’s duty to defend and thus is owed only to its insured.
   True. False.

10. If an insured has performed its duty to defend its insured against a lawsuit, the judgment creditor may have a right to recover an award of attorney’s fees from the insured.
    True. False.

11. An insurer that owes its insured a duty to defend might be liable to its insured for breach of the duty of good faith and fair dealing if it refuses to pay an award of attorney’s fees.
    True. False.

12. An insurer cannot be held liable to a judgment creditor under the Direct Action Statute for bad faith as a result of the insurer’s failure to pay a judgment obtained against its insured.
    True. False.

13. An insured judgment debtor cannot assign a bad-faith claim to its judgment creditor.
    True. False.

14. A judgment creditor with a final judgment against an insured defendant becomes a third-party beneficiary of the insurance policy—and the insurer owes duties to that judgment creditor, such as good faith and fair dealing.
    True. False.

15. An insurer can be held liable to a judgment creditor under the Direct Action Statute for bad faith for filing a frivolous appeal.
    True. False.

16. Insurance Code Section 533 precludes a commercial general liability insurer from paying an award of attorney’s fees as part of a judgment for intentional discrimination on the basis of race.
    True. False.

17. Insurance Code Section 533 precludes indemnification of an insured but does not affect the insurer’s duty to defend.
    True. False.

18. The obligation to pay costs taxed to the insured arises only after liability is established.
    True. False.

19. Case law is clear that Insurance Code Section 533 would preclude a commercial general liability insurer from paying an award of attorney’s fees as part of a judgment for intentional conduct as well as willful statutory violations.
    True. False.

20. A commercial general liability insurer need not pay costs taxed against an insured if any part of the costs are awarded for uncovered claims.
    True. False.

ANSWERS

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

1.  □ True □ False
2.  □ True □ False
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indemnify its insured for an award of attorney’s fees and other costs taxed against it under the SPP, if a judgment creditor enforces the judgment against an insured judgment debtor, the insurer owes its insured a duty to pay the costs award—including attorney’s fees—under the SPP. Refusing to do so could expose the insurer to liability to its insured for breach of the duty of good faith and fair dealing—in other words, bad faith—implied in the insurance contract. In addition to bad faith exposure to its insured, the insurer could also be subject to defending this type of claim assigned by its insured to the judgment creditor.23

An insurer might take the position that, as a result of San Diego Housing, the judgment creditor is not entitled to recover an award of attorney’s fees or costs under Section 11580. However, as long as a likelihood exists that the judgment creditor might enforce the judgment against the insured, the insurer would risk exposure to the insured’s bad faith claim, since the insurer would be contractually obligated under Prichard to reimburse its insured for the award of costs and fees.

Additionally, the court of appeal in Hand v. Farmers Insurance Exchange24 held that an insurer may be liable to a judgment creditor under the Direct Action Statute for bad faith when the insurer refuses to pay a judgment obtained against its insured. In Hand, the court of appeal reversed a grant of summary judgment in a bad faith claim brought by a judgment creditor under the Direct Action Statute against an insurer that had refused to pay a final judgment.25 Citing Murphy v. Allstate Insurance Company26 as authority, the Hand court held that the implied covenant of good faith and fair dealing protected a third-party claimant under the Direct Action Statute.27 According to Hand, “[O]nce having secured a final judgment for damages, the plaintiff becomes a third party beneficiary of the policy, entitled to recover on the judgment on the policy. At that point the insurer’s duty to pay runs contractually to the plaintiff as well as the insured. And the plaintiff having also become a beneficiary of the covenant of good faith, the duty to exercise good faith in not withholding adjudicated damages necessarily is owing to the plaintiff also.”28 Thus, the insurer risks liability to a judgment creditor if, in bad faith, it withholds payment of damages adjudicated in a final judgment.

The Hand court distinguished Coleman v. Gulf Insurance Group,29 in which the California Supreme Court affirmed an order sustaining, without leave to amend, demurrers to a third-party claimant’s action against an insurance company alleging it filed a frivolous appeal in order to coerce the plaintiff to settle for a low sum. The court’s ruling was based on the grounds that the judgment the
Coleman plaintiffs obtained was not final when the insurer committed the alleged bad faith, since the conduct at issue was the insurer’s pursuit, on the insured’s behalf, of an appeal from the judgment: “Lacking a final judgment, the Coleman plaintiffs did not enjoy the status of judgment creditor beneficiaries under section 11580.”

If solid grounds exist for appeal, the insurer might file a notice of appeal and protect its insured against efforts to enforce the judgment by posting an appeal bond. At the same time, the insurer can make good faith arguments on appeal for reversal of the judgment due to a lack of substantial evidence or for reduction of the attorney’s fees award based on, for example, the necessity to allocate the fees for efforts to recover from settling defendants. Also, the insurer can request the court of appeal to reject Prichard’s holding allowing for recovery of benefits for which insureds have not bargained—though a better strategy may be to make this argument in a declaratory relief action against the insured rather than in an appeal of the judgment against it.

Willful Statutory Violations

The insurer may be spared these concerns in claims alleging a statutory violation by its insured. Last year, in Combs v. State Farm Fire & Casualty Company, the court of appeal affirmed summary judgment for State Farm against its insured’s demand for reimbursement under his policy’s SPP for the attorney’s fees and costs that he was ordered to pay in an underlying action.

Combs was sued in federal district court by Fair Housing of Marin (FHOM), which alleged that Combs, in his management of an apartment complex in San Rafael in Marin County, violated federal and state law prohibiting racial discrimination. State Farm had issued an Apartment Policy to Combs, under which it provided him with a defense to the suit with a full reservation of rights. At various times during the litigation, Combs demanded State Farm settle the claims, but State Farm refused, citing Insurance Code Section 533, which provides “[a]n insurer is not liable for a loss caused by the wilful act of the insured.”

The court struck Combs’s answer and entered a default against him as a discovery sanction. The court then held a default prove-up hearing and found “direct evidence of racial animus...amply present on this record” and “the record on liability” to be “damning.” The court awarded compensatory and punitive damages against Combs and, later, the attorney’s fees and costs, which eventually totaled about $639,000.

State Farm refused to indemnify Combs for the damages or the attorney’s fees and
Combs sued State Farm, asserting that the insurer was obligated under the Apartment Policy’s SPP to reimburse him for the attorney’s fees and costs. Combs moved for summary adjudication of the issue, State Farm filed a cross-motion, and the trial court denied Combs’s motion and granted relief for State Farm. In doing so, the court concluded that “Combs’ adjudicated liability for intentional race discrimination in the FHOM action precludes insurance coverage for the default judgment, including the award of attorneys fees, under section 533.”

Combs appealed, conceding he was not entitled to have State Farm pay any portion of the award of compensatory or punitive damages. He sought a reversal of the trial court’s adjudication of the issue of reimbursement for the attorney’s fees and costs under the SPP. The court of appeal affirmed the original judgment.

In its ruling, the court distinguished cases from other jurisdictions, stating they were based solely on the interpretation of policy provisions without any consideration of Section 533. The court also dismissed Combs’s argument, based on Gray v. Zurich Insurance Company, that Section 533 precludes only indemnification but does not affect the duty to defend, and that the payment of costs taxed against the insured is a function of the insurer’s defense obligation, not its indemnity obligation:

The fact that the supplemental payment of costs taxed against the insured is viewed as arising from the insurer’s defense obligation, and under the supplementary payments provision of the insurance policy arises with respect to claims that the insurer defends, does not mean that section 533 permits the insurer to indemnify the insured for such costs and fees....

As indicated above, section 533 prohibits coverage for any loss caused by the willful misconduct of the insured. Liability for the adversary’s costs and attorney fees in this case is a loss caused by and incurred as a result of the insured’s intentional racial discrimination....Like the duty to indemnify, the obligation to pay costs taxed to the insured arises only after liability is established. The attorney fees of the opposing party become payable only if and when the insured has been found liable, in this case as a statutory consequence of its liability....Despite its contractual agreement to pay these costs, section 533 prohibits State Farm from doing so.

Some might try to limit the Combs holding to its facts, which involved Combs’s acts of racial discrimination as well as his conduct...
supporting the court’s decision to strike his answer and enter a default as a sanction. Too, the misconduct in Combs was willful; it is unclear whether the case holding would apply to less culpable—that is, merely intentional—violations of a statute. Even the most expansive reading of Combs would probably restrict its limitation of the insurer’s obligation to pay attorney’s fees and costs under the SPP to cases in which the insured’s liability is based solely on the insured’s intentional conduct. But Combs plainly limits the rights of insureds under the SPP. Prichard and INA continue to impose on insurers liability for awards against their insureds of attorney’s fees under terms of a contract to which the insureds are parties, regardless of policy provisions excluding coverage for contractual liabilities. However, despite the terms of the SPP, Combs allows insurers to refuse to pay attorney’s fee awards made in connection with a finding of an insured’s statutory violations.

Policyholders and their attorneys should be aware of their rights under Prichard and INA to have their insurers reimburse them for contract-based awards of attorney’s fees. Likewise, judgment creditors and their attorneys should recognize their probable right to recover such awards from the insurers of judgment debtors. On the other hand, Combs relieves insurers of the obligation to reimburse insureds for awards of attorney’s fees and costs in a significant category of cases. Insurers’ attorneys will no doubt press hard to solidify these limitations of insurers’ duties and exposure regarding a variety of claims.

1 Compare Bank of the West v. Superior Court, 2 Cal. 4th 1254, 1258 (1992) (construing advertising injury coverage under “[c]omprehensive general liability insurance policies”) with Buss v. Superior Court, 16 Cal. 4th 35, 39 (1997) (resolving “issues relating to standard commercial general liability insurance policies, which were formerly called comprehensive general liability insurance policies”).


6 See Prichard, 84 Cal. App. 4th at 911.

7 Id. at 890.

8 INA, 37 Cal. App. 4th 195.

9 Prichard, 84 Cal. App. 4th at 895.

10 Id. at 912.

11 Id. at n.22 (italics in original).

12 INA, 37 Cal. App. 4th at 206 n.6.

13 Id. at 206-07.


15 Id. at 688-90.

16 Id. at 672-73.

17 Id. at 673, 675.

18 Ins. Code §11580(a)(1), (2).

19 Ins. Code §11580(b)(2).

20 San Diego Housing, 95 Cal. App. 4th at 676.

21 Id. at 691-92.

22 Id. at 673.


25 Id. at 1851.


28 Id. (citation omitted).


32 Id. at 1341-42.

33 Id. at 1341.

34 Id. at 1342.

35 Id. at 1341.


37 Combs, 143 Cal. App. 4th at 1344-46 (citations and internal quotations omitted).

38 Id. at 1343.

LIKE A BRIDE AND GROOM who vow to keep the bonds of marriage together “till death do us part,” a landlord and tenant who enter into a ground lease make a long-term commitment to each other. However, in a ground lease contract, the economics of the deal, rather than love, is the consideration. At the outset, the parties must agree that the relationship will bring value to both sides over its term regardless of good times or bad and that each will treat the other fairly to ensure their relationship will endure.

As often occurs in marriages, however, money can become a source of conflict. In the context of a ground lease, the parties must agree to a rent that will be paid over decades and adjusted under economic or financial circumstances that will almost invariably differ from what at least one, if not both, parties expected when they first entered into the lease. If the ground lease is not well drafted, there is a greater likelihood that the parties will find themselves in litigation—the commercial equivalent of divorce.

To avoid this eventuality, a landlord and tenant must give careful attention when negotiating and drafting the ground lease provisions that govern future rent. Critical to these provisions is not only the rent adjustment mechanism (which usually calls for an appraiser to be appointed and to then determine the fair market value of the fee property by applying an agreed-upon formula) but also the alternative dispute resolution (ADR) procedures often intricately woven into the rent adjustment mechanism. The more clearly the mechanism is drafted, the less chance

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by Lawrence Teplin and Heather Stern
that a dispute will arise in the first place, and, if one does occur, the enforceable ADR provisions may prevent the dispute from destroying the relationship altogether.

A ground lease is an instrument by which a fee owner leases real property to a tenant for an extended term lasting anywhere from 20 to 100 years. The tenant typically intends to develop the property by constructing improvements or renovating existing facilities. Commercial ground leases are frequently used for office buildings, shopping centers, hotels, and other commercial projects.

Both parties have to be assured that the economics of the lease will still work decades in the future and that each party will be treated fairly.

Ground leases are also present in residential projects in which, for example, the land is owned by a government entity (such as the land Los Angeles County owns in Marina del Rey) or a Native American tribe (as certain home development sites are in the Palm Springs area).

Because of the extended term, the parties to a ground lease face a unique problem. From the landlord's perspective, the rent terms must be structured so that decades later the rental income will provide a reasonable return. From the tenant's perspective, the future rent must bear a reasonable relationship to the income-producing ability of the improvements that the tenant has constructed to service the debt or other financing. In other words, both parties have to be assured that the economics of the lease will still work decades in the future and that each party will be treated fairly if, as is likely, the economic assumptions underlying the deal change.

The Rent Adjustment Mechanism

Given these circumstances, one of the most highly negotiated, if not litigated, sections in a ground lease is the mechanism for adjusting rent and resolving any disputes related to the rent. The goal of this section of the lease should be twofold. First, it should clearly and comprehensively detail the parties' agreement as to how rent will be adjusted in a manner that will be capable of being understood and implemented over the entire lease term. In addition, the parties must agree to be bound to a cost-effective and efficient means of resolving any dispute that does arise concerning future rent.

A formula that relies on the fair market value of the land and/or the improvements at some specified date in the future, and then applies a percentage of that value is one means of setting future rent. As an example, a commercial ground lease might state the following:

For the initial 10-year period commencing January 1, 2007, the annual rent shall be $20,000 per year. For the remaining term the annual rent shall be set every 10 years based on an amount equal to five percent of the fair market value of the leased land fixed as hereinafter provided.

Another, but less prevalent, method of calculating future rent is to set rent at the fair rental value of the property based on either the land or the land and a percentage of the building.

To determine fair market value (which is then used as the input into the rent adjustment formula) or fair rental value, a lease typically includes a form of alternative dispute resolution by providing for appointment of an appraiser (or panel of appraisers) who serves as the neutral arbitrator. The appraiser or arbitrator is empowered to enter a determination of value that is binding on all parties. By including this mechanism, a landlord and tenant can ensure that a fair process is available to adjust the rent at any time during the lease term. Further, because this process constitutes an enforceable arbitration provision, it includes all the benefits of arbitration, including cost efficiency and finality.

In addressing the appointment of an appraiser or panel of appraisers, a lease should set forth, at a minimum, the parties' agreement on the following critical terms: 1) the number of appraisers to be appointed, 2) the required qualifications, if any, of the appraisers, 3) who will appoint the appraisers and by what process, 4) who pays for the appraisers, 5) who is bound by the appraisers' determination of value, 6) the method of appraisal, if any, that must be followed, and 7) the specific assignment that the appraisers and efficiency that follow from having one final arbiter of value. The disadvantage of leaving value in the hands of one person—and the advantage of a panel of appraisers (recognizing that a panel will always be more expensive and take more time to render a determination of value)—is that the parties are trusting their future economic relationship to a single person who may make a mistake or be biased. This is particularly risky because an appraiser acting in this capacity is deemed by law to be an arbitrator whose decision is effectively final.

To ameliorate this concern, the parties will frequently agree that the appraiser (or panel of appraisers) must have certain qualifications. The assumption is that the more qualified the appraiser is, the less likely that individual will make a mistake or allow bias to interfere with making an objective determination of value. These qualifications may include having a certain number of years of experience as an appraiser, especially in valuing the particular property at issue, and/or being a Member of the Appraisal Institute (MAI). In specifying qualifications, however, the parties should not overlook the potential number of appraisers who will be able to satisfy these criteria when the time comes to appoint an appraiser (or panel of appraisers). The parties could find themselves in the future in the ironic situation of having imposed so many qualifications that few, if any, appraisers can meet the criteria imposed by the lease, thus leading a court to appoint an entirely unqualified appraiser based on a finding that the appraisal provision as drafted has "failed"
or “cannot be followed.”

One common requirement is that the appraisers be neutral. In imposing such a requirement, the parties should be aware that by statute, a neutral arbitrator is one “who is 1) selected jointly by the parties or by the arbitrators selected by the parties or 2) appointed by the court when the parties or the arbitrators selected by the parties fail to select an arbitrator who was to be selected jointly by them.”

If the parties wish to impose any other qualification, they should make their intentions known in the lease.

A landlord and tenant can also specify the method of appraisal. For example, they can agree that the appraiser must determine value through one or more of the following methods: comparable rentals, return on investment, or residual value. However, even if a landlord and tenant do not specify the method of appraisal, they should certainly provide as much detailed guidance as possible as to what valuation the appraiser is expected to provide and when. An appraiser is often asked to determine “fair market value” or “fair rental value,” but leases often neglect to guide the appraiser as to what this determination is to be based upon. For example, is the appraiser determining the fair market or rental value of the land by itself without any improvements? The land with certain specified improvements? The building? The leasehold premises? The property description should be as specific as possible.

In addition, the lease should specify whether fair market or rental value is being determined at the property’s “highest and best use,” as the property is then currently being used, or as the parties contemplate the property to be used in the future. It is also critical that the lease designate the date of value, which is typically the date that the adjusted rent first takes effect.

**Appointment of the Appraisers**

The decisive factor in resolving many of the issues associated with defining the rent adjustment mechanism—including the number of appraisers and their qualifications—is the provision that defines who will appoint the appraisers and set the appointment process. Who appoints the appraisers may seem obvious—presumably, it will be the parties to the lease. However, the obvious answer may not always be the appropriate one. For example, if a landlord enters into a lease with two individual partners as tenants, a provision giving each individual party a right to participate in the appointment process would result in the tenants having an inherent numerical advantage over the landlord. The tenants would then want to use their majority “vote” to obtain a low valuation of fair market value, to the disadvantage of the landlord, who would be seeking a high valuation. In these situations, the landlord and tenants should agree that each group having a common interest will designate one individual to represent that group in deciding who will be appointed as the appraiser. Doing so will eliminate any unfair advantage that a group with multiple parties could gain by participating individually in this process rather than collectively.

Landlords and tenants have several options for appointing appraisers through a fair process and, hopefully, thereby obtaining a fair result. The following are five different procedures prevalent in commercial ground leases and the advantages and disadvantages of each:

1) Each party or side selects one appraiser, and the two appraisers meet and confer to select a third, neutral appraiser. The third, neutral appraiser is then charged with the responsibility of determining value under the lease. The advantage of this method is that it is bilateral, and if it works, it is efficient and perceived as fair by both sides. However, the disadvantage is that it often does not work because the two appraisers are unable to reach agreement on the third appraiser. When this occurs, the parties have to petition a court to appoint the third appraiser on the ground that the method set forth in the lease has failed or cannot be followed. Accordingly, if the parties want to use this method, they should be comfortable with the statutory procedure that a court will follow in this eventuality.

2) Under the “baseball” method, each party selects an appraiser. Each appraiser arrives at a reasoned, supportable conclusion of value and then they mutually agree to the appointment of a third, neutral appraiser. This appraiser is provided with the two different valuations and then must make a binding selection as to which of the two appraisals most closely approximates the true value. The advantage in this option is that both parties are active participants in the process. However, this method is more costly to both parties and less efficient because it calls for multiple appraisers to each determine the property’s value. This method can also result in a finding of value that lies at an extreme, because the third, neutral appraiser must accept one of the conclusions provided by the party-appointed appraisers. This method also suffers from the same disadvantage as the first option if the two appraisers are unable to agree on the designation of the third, neutral appraiser.

3) In the “appraiser average method,” each party selects an appraiser who conducts an appraisal according to the requirements of the lease. If the two appraisers are unable to agree on a determination of fair market rent, they must together pick a third appraiser who conducts his or her own appraisal. If a majority of the three appraisers cannot agree on fair market rent, the three appraisals are averaged together, and the average is binding on the parties. A variation of this method is that the parties agree to disregard any low or high appraisal that varies by more than 10 percent from the middle appraisal before averaging the results. This option, too, has the advantage of actively involving the parties, while its disadvantage is that it will not avoid litigation if the two appraisers are unable to agree on a third appraiser. This method can also be more expensive, not only for this latter reason but also because up to three different appraisals may have to be conducted.

4) The landlord is granted the power to unilaterally adjust the rent after engaging an appraiser who meets certain qualifications and determines fair market value. If the tenant disagrees with that value, the tenant has the right to demand arbitration of the issue within a prescribed time. The arbitration can follow one of the appraisal methods described above, or a standard arbitration clause can be applied whereby the arbitrator (usually a judge or real estate lawyer) hears testimony and argument and then renders findings of fact and conclusions of law binding on the parties. Some clients are more comfortable with the “private judge” approach because it involves a familiar, adversarial process, similar to a judicial action, in which they can be assured that, at a minimum, their arguments will be heard. The disadvantage is that this dispute resolution mechanism is potentially much more expensive because the client will have to pay not only for the appraisal but also for the lawyers and arbitrators involved in the dispute.

5) The parties do not directly appoint the appraiser (or panel of appraisers) but place their fate directly in the hands of others by agreeing that the appraisers will be appointed by a court under the statutory procedures in place at the time of the dispute. The advantage of this mechanism, in the minds of some parties, is the belief that they will get a fair result from a court in a relatively short amount of time without having to endure a back-and-forth process in what may be a futile attempt to try to agree on an appraisal without court intervention. The disadvantage is that the parties lose the ability to control the appraiser-appointment process on their own, without court intervention, and instead may be stuck—as a first resort, not as a last resort—with an unfavorable appointment by the court.

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binding on the parties is deemed to be an arbitrator. This is significant because appraisers appointed to determine value under commercial ground leases are generally held to the same statutory requirements as those governing arbitrators, such as disclosure rules on conflicts of interest. However, unless the lease clearly states otherwise, an appraiser appointed to determine value is not required to hold hearings, make evidentiary rulings, hear testimony, and render findings of fact and conclusions of law.

The law distinguishes between an appraiser acting as an appraiser (whose finding of value is binding like an arbitration award) and an appraiser acting as an arbitrator. In the former case, the duly appointed appraiser (or panel of arbitrators) does its own investigation and appraises the property—following the guidelines set out in the lease and mandated by the industry—just as the appraiser would if a party hired it to prepare an appraisal to obtain a loan or acquire or dispose of property. In the latter case, the duly appointed appraiser (or panel of appraisers) holds court like an arbitrator or judge in an eminent domain action, which includes receiving evidence from experts, hearing argument, and rendering findings of fact and conclusions of law.

While this distinction is recognized legally, the parties should nevertheless leave no doubt in the lease as to the role of the appraisers. For example, the parties should carefully consider any broad language empowering the appraiser to resolve “all disputes” between the parties. Although the parties may feel comfortable leaving a dispute concerning value in the hands of an appraiser, the parties would likely not want that same person determining complex legal issues such as interpreting ground lease terms or the parties’ intentions at the time at which they entered into the lease.

In drafting a rent adjustment mechanism and accompanying ADR provision in a long-term lease, the parties should be familiar with the statutes governing arbitration, especially Title 9 of the Code of Civil Procedure. This will enable the parties to be aware of certain key issues, such as what happens if the method of appointing the appraiser set forth in the lease fails or cannot be followed, what disclosures they are entitled to receive regarding ethical conflicts that a proposed appraiser may have, and the procedure and grounds for disqualifying an appointed appraiser.

As an example, when the method of appointing an appraiser under a lease has failed or cannot be followed, there is a relatively simple, express statutory procedure (sometimes referred to as the “five-pack”) governing the appraiser-appointment process.
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The process begins with one party filing a petition with a court for appointment of an appraiser and obtaining a hearing date. In the briefing, each party proposes five appraisers to the court (sometimes more, sometimes less), and the court ultimately nominates five appraisers from among all the proposed appraisers. Upon receiving the court’s nominations, the parties meet and confer to determine if they can agree to an appraiser from among the court’s list of five. If no agreement is reached, then the court selects one. Since a neutral arbitrator—which includes an appraiser selected under this method—can be disqualified on the same grounds as a judge, a party may exercise its peremptory challenge to disqualify the court’s choice of appraiser much as a judge can be removed by a Code of Civil Procedure Section 170.6 motion. The court will then nominate a second appraiser who is also subject to challenge by the other party. If this occurs, the court nominates a third appraiser who cannot be disqualified except for cause. Assuming the third appraiser satisfies legally mandated disclosure requirements and is not otherwise subject to disqualification for cause, the parties will finally have an appraiser.

The same level of careful thought and drafting that is given to the appraisal process provisions should, of course, be applied to the entire ground lease. For example, recitals should be written to make clear the parties’ intent in entering into the lease; other lease terms should be drafted with precision, and other provisions should be drafted to avoid any dispute over conscionability. By following these principles, a landlord and tenant can achieve their mutual objective of establishing a fair process that can help them each achieve their economic objectives, avoid lease disputes, and preserve the long-term viability of their relationship.

1 Jerome D. Whalen, Commercial Ground Leases 1 (1988).
2 Id. at 4.
3 See, e.g., Bullock’s, Inc. v. Security-First Nat’l Bank, 160 Cal. App. 2d 277, 279 n.1 (1958). In this example, or any other, the key negotiated items are the resetting term and the percentage of value to be used (which of course, could change at each term).
4 Code Civ. Proc. §1280(a); Moncharsch v. Healy & Blase, 3 Cal. 4th 1, 10 (1992) (“The arbitrator’s decision should be the end, not the beginning, of the dispute.”).
6 Code Civ. Proc. §1280(d).
7 While an agreement that the appraiser will determine “value” has been held in at least one case to refer to “fair market value,” to avoid any dispute over the interpretation of the agreement, the lease should specify “fair market value” (unless some other value, such as “use value” or “rental value,” is intended). Bullock’s, 160 Cal. App. 2d at 281-82. See also Elinge & Graziadio Dev. Co. v. Childs, 49 Cal. App. 3d 294, 298-99 (1975).
8 This issue particularly becomes critical when, decades
in the future, new laws or ordinances are enacted that restrict the development of the real property. The tenant, desiring a lower rent, will insist that the restrictions be taken into account in any appraisal of the highest and best use of the land. See, e.g., Humphries Invs., Inc. v. Walsh, 202 Cal. App. 3d 766, 770-73 (1988).

For example, in a case in which a lease specified that the adjusted rent should be based on the fair market rental value of a theater building, the court found that the appraiser could not consider the potential highest and best use to the landlord as a retail shopping center. Wu v. Interstate Consol. Indus., 226 Cal. App. 3d 1511, 1517 (1991).

For an example of a dispute that arose when an agreement called for the appointment of an arbitrator by each of the parties to the agreement, as opposed to each of the aligned "sides," see Tate v. Saratoga Sav. & Loan Assn., 216 Cal. App. 3d 843, 852 (1989).

See, e.g., Humphries Invs., Inc. v. Walsh, 202 Cal. App. 3d 766, 770-73 (1988) ("An agreement providing for an appraisal is...considered to be an arbitration agreement subject to statutory contractual arbitration law in the California Arbitration Act.")

For cases that have discussed the differences between these two types of appraisal ADR provisions, see Bewick v. Mechem, 26 Cal. 2d 92 (1945); Coopers & Lybrand v. Superior Court, 212 Cal. App. 3d 524, 535 (1989).

While issues such as whether the parties agreed in the first place to arbitrate the particular dispute are generally decided by the court and not the arbitrator, the parties can agree to have these issues determined by the arbitrator. See, e.g., Freeman v. State Farm Mut. Auto. Ins. Co., 14 Cal. 3d 473, 480 (1975) ("It is, of course, possible for the parties to agree that the arbitrator may determine the scope of his authority. The arbitrability of a dispute may itself be subject to arbitration if the parties have so provided in their contract.") (quoting McCarroll v. Los Angeles County Carpenters, 49 Cal. 2d 45, 65 (1957)).

The use of recitals to establish the intent of the parties can be particularly important with a ground lease, given that the extended term of the ground lease means that at the time of a dispute, it will likely be very difficult to garner evidence about the original "intent" of the parties, other than the language of the contract itself. Of course, the intent of the parties is critical to contract interpretation. CIV. CODE §1636; Oberg v. City of Los Angeles, 132 Cal. App. 2d 151, 158 (1955) ("In construing a contract, the primary object is to ascertain and give effect to the intention of the parties as it existed at the time of contracting.").

Among the conscionability guidelines is the idea that the appraisal appointment mechanism should be bilateral, allowing each party to participate in the appointment of an appraiser. Graham v. Scissor-Tail, Inc., 28 Cal. 3d 807, 825 (1981); Schuster Tunnels/Pre-Con v. Traylor Brothers, Inc./Obayashi Corp., 111 Cal. App. 4th 1328, 1341 (2003). As the court said in Graham: “A well-recognized principle of ‘natural justice’...is that a man may not be a judge in his own case.” Graham, 28 Cal. 3d at 824 (quoting Matter of Cross & Brown Company, 4 App. Div. 2d 501 (N.Y. 1957)).
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com. Web site: www.neoma.com. Jonathan S. Rutitch, MD, MPH is a physician who is board certified in both Neurology and Occupational and Environmental Medicine. He provides clinical evaluations and treatment, including electroencephalograms of individuals and populations with suspected neurological illness secondary to workplace injuries or chemical exposure. Services include medical record and utilization review and consulting to industrial, legal, government, pharmaceutical, and academic institutions on topics such as metals and paints, mold illness, Baycol issues, Persian Gulf War syndrome, musicians’ injuries, and others. See display ad on this page 60.

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P.O. Box 15597, Long Beach, CA 90815, (310) 963-1966, fax (310) 798-7029, e-mail: jrpmsonmd@earthlink.net. Contact Dr. Simpson, Board certified psychiatrist, Clinical Assistant Professor, USC. Education: Harvard, Washington University, UCLA Neuropsychiatric Institute; forensic psychiatric fellowship at USC Institute of Psychiatry and Law. PhD in human brain Imaging. Several publications in peer-reviewed scientific journals. Experienced in inpatient, emergency and correctional psychiatry, alcohol and substance abuse, PTSD, psychopharmacology, psychosis, mood disorders, and mental health firearm laws.

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Professor, Golden Gate University School of Law, 536 Mission Street, San Francisco CA 94105(415) 666 3343, fax (415) 974 1549, e-mail: RBernhardt@GGU.EDU. Web site: www.RogerBernhardt.com. Specialties: Real estate and mortgage law and transactions; standard of care. Publica-
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CALIFORNIA BROKER LICENSE NO. 00469880
Whether There Is a Self-Defense Exception to an Attorney’s Duty to Protect and Preserve Confidential Client Information in Order to Permit the Attorney to Defend against Third Party Claims

Summary: Under current California law, an attorney cannot, without his or her former or present client’s consent, disclose the client’s privileged communications with the attorney or the client’s confidential information, for the purpose of defending allegations brought against the attorney by a third party. No matter how critical the client’s information is to the lawyer’s defense, there is no statutory “self-defense” exception to the attorney-client privilege or the lawyer’s duty to maintain the confidentiality of client information under Business and Professions Code Section 6068(e). Of course, such evidence would be available upon the client’s informed consent to such disclosure or as to information otherwise protected by the lawyer-client privilege. While there is authority for such disclosures in other jurisdictions and in the federal courts, it remains an open question whether a California court, on application by the attorney, may order the limited disclosure of the privileged communication or, in the alternative, may dismiss the action against the attorney because of the attorney’s inability to use the evidence to defend the third party action.


Facts and Issues Presented

Attorney assisted her corporate client in preparing a private placement memorandum (PPM), including a trust indenture which became an exhibit to the PPM and was distributed by the corporation’s agents to potential note purchasers. After many notes had been sold and attorney was no longer representing the corporation, an involuntary chapter 7 bankruptcy proceeding was brought against the corporation. Nonetheless, the bankruptcy trustee has refused to in the class action any privileged confidential communications between the corporation. The inquirer seeks the committee’s opinion as to whether the privileged communications with the corporation’s principals, attorney, and other parties. The causes of action against attorney are violations of state and federal securities laws, common law fraud, and legal malpractice. The principals cannot be located, are insolvent, or both. Although they have not appeared in the class action, their defaults have not been taken.

The chapter 7 trustee has filed a separate suit on behalf of the corporation against attorney in state court for legal malpractice, alleging different acts of negligence than those alleged in the class claims. The malpractice action has not been consolidated or coordinated with the class action. The trustee has not acknowledged that this suit constitutes a waiver of the corporation’s attorney-client privilege.

Attorney contends that she cannot defend against the class claims without disclosing communications between her and representatives of the corporation. Nonetheless, the bankruptcy trustee has refused to waive the attorney-client privilege for purposes of the class action and has instructed attorney that under no circumstances is she to disclose in the class action any privileged confidential communications between herself and the corporation’s representatives regarding her representation of the corporation.

The inquirer seeks the committee’s opinion as to whether the attorney may disclose the attorney-client communications with the corporation to defend against the third party class claims and, assuming that she may, in this instance, avail herself to a “self-defense exception” to the attorney-client privilege, how she can most prudenty assert that right. Lastly, the inquirer asks whether the privileged communi-
cations she may use in her defense of the malpractice action may also be used in her defense of the class claims.

The committee’s opinion below is presented in three parts. First we examine the relevant rules and statutes relating to our determination that there is no currently recognized self-defense exception in the context of third party actions against attorneys. In the second part of this opinion, we briefly analyze case law, primarily federal and from other jurisdictions, suggesting that the courts may, on application, permit limited disclosures in aid of an attorney’s defense of a third party claim. Third, we discuss the ethical issues that arise in the context of seeking client consent to waive the attorney-client privilege.

Discussion

The attorney’s duty to maintain client confidences is fundamental to the profession. This duty is captured in statutory law (Business and Professions Code and Evidence Code) and in the California Rules of Professional Conduct. Under California Business and Professions Code Section 6068(e)(1), an attorney has a duty “to maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client.” This fundamental duty is also set forth in the newly approved Rule 3-100(A), which provides that “A member shall not reveal information protected from disclosure by Business and Professions Section 6068, subdivision (e)(1) without the informed consent of the client, or as provided in paragraph (B) of this rule.”

Subsection (B) states that “A member may, but is not required to, reveal confidential information relating to the representation of a client to the extent that the member reasonably believes the disclosure is necessary to prevent a criminal act that the member reasonably believes is likely to result in death of, or substantial bodily harm to, an individual.” Further, pursuant to the California attorney-client privilege, an attorney has a duty to maintain the confidentiality of attorney-client communications. The duty requires the affirmative assertion of the privilege in the absence of a client (and, by inference, a client directive otherwise). California Evidence Code Section 953.

There are various statutory exceptions to the attorney-client privilege recognized in the California Evidence Code, such as “crime-fraud” (Section 956) and “joint clients” (Section 962), and yet none of these are cross-referenced or have been cited as exceptions to the ethical prohibition in Section 6068(e)(1). These are but two instances where the Evidence Code and the Business and Professions Code do not align.

Of import here, Evidence Code Section 958 permits an attorney to disclose attorney-client communications in a dispute with a client or former client when the communication is “relevant to an issue of breach, by the lawyer or by the client, of a duty arising out of the lawyer-client relationship.” As with Sections 956 and 962, this self-defense exception is not recognized in Section 6068(e). Nonetheless, it is clear that attorneys are allowed to make disclosures in aid of their defense to a client malpractice action, in support of a claim for unpaid legal fees against a client and in defense of client-initiated State Bar disciplinary complaints. Less clear are the circumstances when a terminated lawyer-employee may make disclosures in aid of his or her wrongful termination claim against the employer-client based on an alleged public policy violation. What is clear, however, is that attorneys may themselves seek legal advice concerning whether and to what extent disclosures are permitted and in the course of which disclose to the consulting attorney confidential communications with the client. It is likewise true that the client may seek advice whether to risk disclosures by alleging a breach on the part of prior counsel, without fear that such communications with successor counsel will be subject to scrutiny.

Applied here, it is clear that, pursuant to Section 958, there is no privilege relevant to the charging allegations and the attorney’s defenses in the malpractice action initiated by the trustee, who is the successor to the corporate client and, by law, the holder of the privilege. Commodity Futures Trading Co. v. Weintrob, 471 U.S. 343, 348-349, 352-353 (1985).

There are two limitations on the application of Section 958 relevant to this inquiry. First, the scope of the attorney’s license to disclose is limited by (a) the “relevancy” requirement of Section 958 (“relevant to an issue of breach”) and (b) the ethical directive that an attorney’s disclosures pursuant to this exception be limited to the necessities of the case and its issues. A lawyer who discloses confidential information not bearing on the issues of breach in the attorney-client litigation is subject to discipline.

Second, Section 958 is not premised on the concept of “waiver.” The statutory language instead states “There is no privilege....” This, coupled with the client’s well established right to preserve unrelated confidential information, and the public policy underlying Section 958, leads us to conclude that the targeted attorney is not ethically permitted to exploit the confidential information disclosed in the malpractice action for other, unrelated purposes, whether it be public disclosure outside the confines of the malpractice litigation proceedings, or use in connection with other third party litigation, as the class action litigation referenced in the subject inquiry.

We therefore conclude that even if the attorney is allowed to make or compel disclosures in the trustee’s malpractice action that would otherwise be relevant to the class action, Section 958 does not sanction such disclosures in defense of the third party action initiated by the investor class.

This then brings us to the question whether there is a self-defense exception in California that permits an attorney to disclose confidential information when necessary to defend a third party’s claims and in the absence of the client’s consent or waiver.

Clearly, there is no California authority that allows an attorney to disclose attorney-client communications or confidential information in defense of a lawsuit or other attack by a third party (i.e., someone other than the client or former client). There is no such exception in the Business and Professions Code or the Evidence Code; nor do the Rules of Professional Conduct recognize such an exception.

Additionally, while no California appellate court has specifically confronted the exception issue, there is dictum in various cases strongly suggesting that it does not exist. See, e.g., Commercial Standard Title Company v. Superior Court, 92 Cal. App. 3d 934, 945 (1979) (assuming without discussion that no self-defense exception to Section 6068(e) exists); Glade v. Superior Court, 76 Cal. App. 3d at 746-747. It is also the case in California that the courts lack the authority to create exceptions to the attorney-client privilege and other privileges in the California Evidence Code. See, e.g., Titans v. Superior Court, 87 Cal. App. 4th 738, 745 (2001). While there is authority amongst the federal courts recognizing a self-defense exception, this notion was rejected in McDermott, Will & Emery v. Superior Court, 83 Cal. App. 4th 378, 385 (2000).

We recognize that California attorneys are permitted to make a good faith argument for an extension, modification, or reversal of existing law. Rule 3-200(B). And, in the committee’s opinion, the lack of direct judicial precedent coupled with supportive precedent amongst the federal courts allows an attorney to make such an argument on the issue before us. We also believe that if a trial court was persuaded to recognize such an exception, disclosures made pursuant to leave of court would not be grounds for discipline. However, absent such judicial authorization, client consent or further development in the case law, we conclude that the attorney in the inquiry may not disclose confidential client communications in aid of her defense. Below, we discuss the ethical issues to be encountered by the attorney in the inquiry.

The client is the holder of the attorney-client privilege and the party to whom the ethical duty of Section 6068(e)(1) is owed. The client is therefore empowered to waive the attorney-client privilege, and to determine the con-
ditions or scope of such a waiver. In the subject inquiry, there is no impediment to the attorney seeking the former client’s consent.20

Obtaining a past or present client’s consent21 to disclosure of a significant portion of a confidential communication22 may involve a conflict of interest between the attorney and the client because the contents of the revealed communication might expose the client to civil or criminal charges or to becoming involved as a witness in litigation while, at the same time, benefiting the attorney. None of the Rules of Professional Conduct explicitly deal with this form of lawyer-client conflict.

The primary rule dealing with lawyer-client transactions is Rule 3-300, which is limited to lawyer-client “transactions” and lawyers who obtain an “adverse interest” to their client’s property rights. There is also Rule 3-400, which imposes certain conditions where an attorney seeks to settle a claim or potential claim regarding the attorney’s liability to the client for the attorney’s professional malpractice. Neither of these ethical rules applies squarely to the situation posed here. Yet both rules address a fundamental precept of professional responsibility that attorneys should not use their position of influence or legal knowledge to a client’s or former client’s disadvantage.

In the absence of an explicit rule, the committee concludes that so long as there is the potential for a conflict between the attorney’s interest in being able to use confidential communications to mount a defense and the client’s right to keep such communications confidential, the attorney, in requesting an existing or former client’s consent to a waiver of the attorney-client privilege in the same, past, related and/or unrelated matter, should follow the guidelines common to both Rule 3-300 and Rule 3-400 and obtain the client or former client’s written informed consent.

First, the attorney should advise the client or former client in writing about the existence and nature of the conflict or potential conflict, and the reasonably foreseeable adverse consequences of such a waiver.23 The disclosure of the potential adverse consequences to the client should be as comprehensive as warranted by the facts at hand. Any disclosure should be preceded by an explanation of Business and Professions Code Section 6068(c)(1) and what it is intended to cover. Next, the warnings, where appropriate, should discuss the possibilities that the client may become a party in civil litigation, a witness in such litigation, a target of a criminal investigation, and/or a defendant in a criminal prosecution. When the possible consequences have criminal implications, the client should also be advised that the revealed communication may be used against the client in a future criminal proceeding and may constitute a waiver of that client’s Fifth Amendment right against self-incrimination. As to all of the foregoing, the client should be further advised that his or her potential involvement in a civil or criminal matter may require him or her to hire independent counsel at his or her own expense to defend or represent the client in the matter.24

Second, the written disclosure should also advise the client that he or she has the right or option to seek independent legal advice, at his or her own expense, regarding the waiver of his or her privileged communications with the requesting attorney.

Lastly, the written disclosure should explain the scope of the waiver being sought; in other words, that the revelation of a portion of a privileged communication may cause that party to permanently lose his or her protected status and that there is a further possibility that a third party could argue successfully that the client’s waiver of a part of his or her privileged communications with the attorney is grounds for a waiver of the entire privileged communication.

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.

1 This disciplinary rule was an outgrowth of the only legislative exception to §6068(e) ever enacted and its related exception to the attorney-client privilege, California Evidence Code §956.5. RULES OF PROFESSIONAL CONDUCT R. 3-100(A): “A member shall not reveal information protected from disclosure by Business and Professions Code section 6068, subdivision (e)(1) without the informed consent of the client, or as provided in paragraph (B) of this rule.”

2 “Client” in both §6068(e) and the attorney-client privilege (see EVID. CODE §950 et seq.) applies to present and former clients. See, e.g., Whittum & Co. v. Bailey, 216 Cal. 564, 571 (1952); David Welch Co. v. Erskine & Tulley, 203 Cal. App. 3d 884, 890 (1988); Commercial Standard Title Co. v. Bailey, 216 Cal. 564, 571 (1932); David Welch Co. v. Superior Court, 92 Cal. App. 3d 934, 945 (1979).

3 Whereas the attorney-client privilege concerns “confidential communications” between lawyer and client (California Evidence Code §952), the scope of the ethical mandate in Section 6068(e) is broader. In fact, paragraph 2 of the discussion accompanying Rules of Professional Conduct, Rule 3-100, indicates that the attorney’s duty extends to protecting information that is encompassed by the attorney work product doctrine: “Client-lawyer confidentiality encompasses the attorney-client privilege, the work-product doctrine and ethical standards of confidentiality. The principle of client-lawyer confidentiality applies to information relating to the representation, whatever its source, and encompasses matters communicated in confidence by the client, and therefore protected by the attorney-client privilege, matters protected by the work product doctrine, and matters protected under ethical standards of confidentiality, all as established in law, rule and policy. (See In the Matter of Johnson (Rev. Dept. 2000) 4 Cal. State Bar Ct. Rptr. 179; Goldstein v. Lees, 46 Cal. 3d 614, 621 (120 Cal. Rptr. 233); see also State Bar of California Formal Op. 2003-161 and Los Angeles County Bar Assn. Formal Op. 456, 436, and 386.

4 We do not suggest that an attorney who testifies pursuant to one of these exceptions is subject to discipline, only that the legislature has not always kept in mind the need for alignment between evidentiary rules and ethical commandments.

5 The language of the statute is not framed in terms of a waiver of the privilege. Waiver is construed separately in Evidence Code §912(a) as to all of the evidentiary privileges, providing that a privilege “is waived with respect to a communication protected by the privilege if any holder of the privilege, without coercion, has disclosed a significant part of the communication or has consented to disclosure made by anyone.” Subsection (b) deals with waivers by fewer than all of those who are “joint holders” of the privilege (i.e., joint clients), providing that a waiver by one is not a waiver by others.

6 See, e.g., Glade v. Superior Court, 76 Cal. App. 3d 738, 746-747 (1978) (“Section 958 is invoked when either the attorney or client charges the other with a breach of duty arising from their professional relationship. The Legislature deemed it unjust for a party to that relationship to maintain the privilege so as to preclude disclosure of confidential communications relevant to the issue of breach which another party thereto has raised.”); Carlson, Collins, Gordon & Bold v. Banducci, 257 Cal. App. 2d 212, 227-228 (1967). In an action to recover unpaid attorney’s fees for legal services rendered in the settling of a will contest and a cross-action to recover payments allegedly made under duress and under influence, the court held that “[i]t can be seen that the principle involving the relationship of attorney and client that an attorney is released from those obligations of secrecy which the law places upon him whenever the disclosure of the communication, otherwise privileged, becomes necessary to the protection of the attorney’s own rights. (citations omitted) Accordingly, when in litigation between an attorney and his client, an attorney’s integrity, good faith, authority, or performance of his duties is questioned, the attorney is permitted to meet this issue with testimony as to communications between himself and his client.”


8 Compare Fox Searchlight Pictures, Inc. v. Paladino, 89 Cal. App. 4th 294 (2001) with General Dynamics v. Superior Court of San Bernardino County, 7 Cal. 4th 1164 (1994). General Dynamics recognizes the general rule: “[The] in-house attorney who publicly exposes the client’s secrets will usually find no sanctuary in the courts. Except in those rare instances when disclosure is explicitly permitted or mandated by an ethics code provision or statute, it is now widely believed that one cannot disclose publicly the secrets of the client. In any event, where the elements of a wrongful discharge in violation of fundamental public policy claim cannot, for reasons peculiar to the particular case, be fully established without breaching the attorney-client privilege, the suit must be dismissed in the interest of preserving the privilege.”

General Dynamics, 7 Cal. 4th at 1190, but suggests that disclosure may be permitted under trial court imposed limitations, such as sealing or protective orders. Id. at 1191. Fox Searchlight makes clear the right of lawyers to make disclosure of client confidential information in seeking advice from their own legal counsel whether for their own protection or in aid of the client’s cause. Fox Searchlight, 89 Cal. App. 4th at 313-14.

9 It is also permitted that the attorney may make disclosures to a defending malpractice insurer where the communications are intended to be directed to the attorney who will be appointed to represent the lawyer. Travelers Ins. Cos. v. Superior Court, 143 Cal. App. 3d 436, 443-46 (1983).

10 Schenberger Ltd. v. Superior Court, 115 Cal. App. 3d 386, 392 (1980). “Evidence code section 958 was not intended to abrogate the privilege as to communication between the client and the lawyer representing the client when suit is filed against a former lawyer for malpractice. The exception is limited to communications.
between the client and the attorney charged with malpractice. [citation omitted] “Clearly, in an attorney breach case this exception applies only where the alleged breach is by the attorney from whom the information is sought. Where, as here, the client has not alleged a breach by the attorney involved in the communication in question, the privilege for that communication remains intact.”) (emphasis added).

13 Dixon v. State Bar, 32 Cal. 3d 728 (1982) (In response to a client filing suit seeking to enjoin an attorney from harassing her, the attorney filed a declaration, which included gratuitous and embarrassing information about the client that “was irrelevant to any issues then pending before the court” and was found by the State Bar court to be irrelevant to the purpose of “harassing and embarrassing” the former client.).

14 Section 958 has been extended to criminal proceedings where the client or former client, but not the attorney, is a party, and where the client puts the lawyer’s advice in issue, usually claiming misrepresentations inducing a plea or ineffectiveness assistance of counsel in a habeas corpus proceeding. See, e.g., People v. Morris, 20 Cal. App. 3d 659 (1971) (citing Witkin, CALIFORNIA EVIDENCE §824 (2d ed. 1966): “If, in litigation between an attorney and his client or between the client and a third person, or in any other proceeding, the attorney’s integrity, good faith, authority or performance of his duties are questioned, the attorney should be permitted to meet this issue with testimony as to communications between himself and his client.”). See also In re Scott, 29 Cal. 4d 783, 814 (2003): “[B]y trial counsel calling professional ineffective assistance, petitioner waived the attorney-client privilege to the extent relevant to the claim. It has also been held that §958 authorizes a court to compel an attorney to testify against a client who has attacked counsel, claiming a breach of duty. Durdines v. Superior Court, 76 Cal. App. 4th 247, 255, n.14 (2000)."

15 “In its codified form (Evid. Code §§950 et seq.), the statutory attorney-client privilege has been extended to cover a third party situation such as that involved in this case. See, e.g., Caliper Techs. Corp., 2001 WL 777083 (N.D. Cal. 2000) (unreported). George v. Siemens Indus. Automation, Inc., 182 F.R.D. 134, 139 (D. N.J. 1998) goes so far as to state: ‘A third highly recognized exception is the ‘self-defense’ exception. Counsel may waive client’s privilege in order to defend himself against accusations or others which they believe materially advance the client’s cause. See 3A ABA A. 20(2)(c); N.J.R.E. 504(2)(c). Indeed, long before the 1986 ruling of the California federal district court, the Second Circuit Court of Appeals permitted an attorney to “blow the whistle” on securities violations by a client in Meyerhofer v. Empire Fire & Marine Ins., 497 F.2d 1190, 1194-96 (2d Cir. 1974), cert. denied, 419 U.S. 998, 95 S. Ct. 314, 42 L. Ed. 2d 272 (1974).”

16 There the attorney was representing a shareholder’s derivative action could not proceed against the lawyer because there was no waiver by the corporate client, and the self-defense exception did not apply. “[B]ecause a derivative action does not result in the corporation’s waiver of the privilege, such a lawsuit against the corporation’s outside counsel has the dangerous potential for revelation of confidential information to the client or former client. The client or former client may choose not to have the attorney disclose any confidential information to the plaintiff, and she may have to mount any meaningful defense. It effectively places the defendant attorney in the untenable position of having to ‘preserve the attorney client privilege’ (the client having done nothing to waive the privilege) while trying to show that his representation of the client was not negligent.” (citation omitted) The court also cites precedents in California and elsewhere: “[I]long-standing California case authority has rejected this application of the federal doctrine, noting it contravenes the strict principles set forth in the Evidence Code of California which precludes any judicially-created exceptions to the attorney-client privilege. Dickerson v. Superior Court, 135 Cal. App. 3d 93, 99, 185 Cal. Rptr. 97 (1982); Hosley v. Superior Court, 137 Cal. App. 3d 1198 (1982)."

17 It is clear that an attorney should not make any disclosure of confidential information unless and until securing court authorization and that in undertaking to seek such authorization, the attorney must act in a way that respects the duty to maintain client confidentiality. Although it is beyond the scope of this opinion and involves matters of strategy and law, including in civil procedure, we presume the issue of whether to recognize a self-defense exception might be raised by way of a motion for protective order (under California Code of Civil Procedure §2023 or the federal equivalent, which provides the trial courts with substantial discretion to enter “any order that justice requires.”). The exception to the federal court in v. Superior Court of San Bernardino County, 7 Cal. 4th 1164 (1994), offered a litany of suggestions relating to alternative methods of using evidence of confidential communications and at the same time protecting them from public disclosure.

18 See, e.g., Fox Searchlight, 89 Cal. App. 4th at 314, “Finally, fundamental fairness requires the plaintiff be allowed to make a limited disclosure of her former client’s ostensibly confidential information to her own attorneys for purposes of preparing and prosecuting a wrongful termination suit against the former client. If the employer can stifle even this limited disclosure, then General Dynamics is nothing more than a judicial practical joke because, even in in-house counsel succeeds in a wrongful termination action against the former client, she may be sanctioned or lose her license to practice or be sued...for breach of fiduciary duty.”

19 We assume for the purposes of the inquiry that the sole client was the corporation, and not its individual shareholders, officers or directors, though we are mindful that such individual representation may occur from time to time and that, in some instances, putative clients may be mislead into reasonably believing their communications with the attorney are confidential and protected. This issue is beyond the scope of this opinion. We also assume that if the client or former client is then represented by other counsel, that the attorney will communicate through that attorney. See RULES OF PROF’L CONDUCT R. 2-100.

20 Present and former clients are treated similarly in this discussion since the duty to maintain client confidences continues after a self-defense exception, the attorney could seek dismissal of the class action. Two precedents may support such relief. See McDermott, Will & Emery v. Superior Court, 83 Cal. App. 4th at 385 and Solin v. O’Melvy & Myers, 89 Cal. App. 4th 451 (2001). In McDermott, the court declined to allow an action to proceed against the law firm, stating: “We simply cannot conceive how an attorney is to mount a defense in a shareholder derivative action alleging a breach of duty to the corporate client, where, by the very nature of such an action, the attorney is foreclosed, in the absence of any waiver by the corporation, from disclosing the very communications which are alleged to constitute a breach of that duty. Thus, while we decline to view a shareholder derivative action in the same vein as an assignment, the rationale used to prohibit all assignments of legal malpractice actions, on the ground attorneys would be unable to defend such actions in the absence of a waiver of the privilege by their own client, applies with equal force here.” By contrast, Solin did not involve a third party action. Rather, the plaintiff was an attorney who sued another law firm from whom he sought referral. In that context, the attorney alleged his former clients were not party to the malpractice litigation and refused to waive the attorney-client privilege. Since the defendant law firm could not defend without disclosing their confidential information (which had been transmitted to the defendant firm by the consulting attorney), the court dismissed the law suit. Whether McDermott or Solin will or should be extended to cover a third party situation such as that posed by this inquiry is not something about which the committee offers any opinion.
Business and Commercial Litigation in Federal Courts

The second edition of Business and Commercial Litigation in Federal Courts is a practical treatise that every federal court litigator will find useful. For example, the multivolume set devotes chapter 22 (of 96) to e-discovery. Another example is the treatment of the ever-evolving use of litigation technology, covered by renowned trial attorney David Boies. Nor does editor Robert L. Haig’s compilation limit itself to the domestic realm. The work also offers insight from former Secretary of State Warren Christopher into litigating international disputes in federal courts.

Haig’s compilation avoids the pitfall that tends to ensnare treatises on the federal courts—namely, skewed too far toward the academic. By collecting the work of judges and active federal practitioners, Haig maintains a practical focus in each of the chapters. The value of Haig’s treatise to new and seasoned litigators is demonstrated by chapter 5, titled “Case Evaluation.” New litigators will find helpful the comprehensive consideration given to all aspects of case evaluation, including the impact of Sarbanes-Oxley and the possibility that case evaluations may later be subject to disclosure.

Compilations are generally only as good as their contributors, and in this set all of them are plainly experts in their fields. An example of this shines in chapter 20, “Depositions.” In an area that arguably has already been covered quite comprehensively, authors Patrick Lynch and Paul Salvaty add new and important insights. For example, they suggest exploring stipulated predesignation of deposition exhibits in large business cases, which can result in a time and cost savings for all involved. The chapter also includes great suggestions on language for discovery plans.

This set is relevant to daily practice thanks to its focus on cutting-edge legal issues. Foremost among them is the issue of e-discovery, which chapter 22 addresses directly. Practitioners should note, however, that the current version of this chapter was written prior to adoption of the new Federal Rules of Civil Procedure addressing the subject. This caveat aside, the chapter serves as a great primer on important issues to consider, including prelitigation planning relating to electronic information retention and the distinctive aspects of electronic information.

Like other chapters on topics well covered in other works—this treatise’s chapter 38, “Evidence,” adds significant value to the set. The chapter’s authors provide a concise and compelling summary of the federal evidentiary rules. Most notable, however, are the practical pointers not found elsewhere. For example, the chapter includes great question-and-answer vignettes that highlight fundamental principles in a highly effective way. Also helpful are the checklists on presenting and admitting evidence, which are as valuable to a new litigator researching an evidentiary issue as they are to experienced first-chair counsel. Finally, the sample demonstrative exhibits at the end of the chapter are exceptional.

Excellent Content Throughout

Haig’s treatise does more than address such preliminary topics as case evaluation and discovery. The set is strong in its latter volumes too. In volume 5, chapter 56, for example, Boies is the reader’s able guide through the tangled world of litigation technology, exploring the ever-changing challenge of using technology during the various phases of litigation. Standout sections address 1) how to choose an e-discovery firm, which is invaluable for young associates who are often charged with identifying potential vendors, 2) common courtroom devices and document management techniques, and 3) advice and case law on recovering a client’s technology costs.

Chapter 60, “ Civility,” is perhaps the best of volume 5. In this chapter, the author offers a concise discussion of the standards of attorney interaction and what recourse an attorney has when an adversary fails to meet the minimal requirements of civility. The chapter includes a checklist that assists the reader in mulling over options when confronted with incivility.

Insurance issues are part and parcel of almost every case that attorneys handle, but the rather dry subject is often overlooked in law school. Haig remedies this in chapter 69, which explores all species of insurance and risk allocation, including doctrines, tactics, and recent trends in federal court. Volume 6 also features a chapter devoted to director and officer liability authored by Judge Paul S. Diamond and litigator Mathieu J. Shapiro. At first glance, the reader may be surprised to see a “D&O” discussion in a federal practice treatise, because this area traditionally has been the province of state law, and the authors provide a terrific discussion of state-law liability. They also discuss Congress’s foray into the D&O arena with Sarbanes-Oxley.

Volume 7 addresses the dreaded federal code-based topics, including labor law, ERISA, and copyright. Chapter 76 explores the busy area of copyright litigation in an approachable manner. The chapter provides a valuable exploration of the origins of and developments in modern copyright litigation and touches upon alternative dispute resolution options. Chapter 77 tackles labor law, going beyond the fundamentals by providing a detailed plan for using injunctive and equitable maneuvers. The labor chapter is thorough but not too dense, with a welcome focus on practical applications.

Ultimately, volume 8 illustrates the breadth and depth of Haig’s compilation, covering topics from commercial paper (chapter 87) to construction (chapter 93). In the final analysis, Haig’s treatise is worth its price of nearly $1,000. Every lawyer’s library would benefit from having this set.
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Consultants and Experts


GRAHAM A. PURCELL, MD, INC. Assistant Clinical Professor Orthopaedic Surgery, UCLA. 3600 Wrightwood Drive, Studio City, CA 91604, (818) 985-3051, fax (818) 985-3049, e-mail: expert@gpurcellmd.com. Web site: gpurcellmd.com. Contact Graham A. Purcell, MD. Dr. Purcell is a board certified orthopedic surgeon, sub-specialty in spinal disorders affecting adults and children. Examples of spinal disorders treated by Dr. Purcell include disc diseases, stenosis, infections, tumors, injuries, and deformities including scoliosis. He possesses 27 years of orthopedic and 17 years of med-legal experience, including defense, plaintiff, insurance carriers, CA Attorney General’s office and Public Defender’s office. Expert testimony pertains to med-mal, personal injury, and workers’ compensation cases. As qualified medical evaluator, Dr. Purcell has extensive experience in performing QMEs, AMEs, IMEs, WC evals.

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Legal Services

LEGAL SERVICES CORPORATION. Notice of availability of competitive grant funds for calendar year 2008. The Legal Services Corporation (LSC) announces the availability of competitive grant funds to provide civil legal services to eligible clients during calendar year 2008. A Request for Proposals (RFP) and other information pertaining to the LSC grants competition will be available from www.ain.lsc.gov during the week of April 16, 2007. In accordance with LSC’s multiyear funding policy, grants are available for only specified service areas. The listing of service areas for each state and the estimated grant amounts for each service area will be included in Appendix-A of the RFP. Applicants must file a Notice of Intent to Compete (NIC) in order to participate in the competitive grants process. The NIC will be available from the RFP. Please refer to www.ain.lsc.gov for filing dates and submission requirements. Please e-mail inquiries pertaining to the LSC competitive grants process to Competition@lsc.gov.

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Personal Injury and Worker’s Comp. cases accepted on lien basis.
ON THURSDAY, APRIL 19, the Remedies Section will host an update on what judges and commissioners in the provisional remedies departments of the Los Angeles Superior Court Central District expect of injunctions, writs of attachment and possession, and receiverships. Ask direct questions of Mel Aranoff, Commissioner Victor Greenberg, Judge Dzintra Janavs, Commissioner Bruce E. Mitchell, and Judge David Yaffe about Departments 59, 66, 85, and 89. This event will take place at the Los Angeles Superior Court, 111 North Hill Street, Downtown. Parking is available in lots near First Street and Olive Street entrances. On-site registration and a meal will be available from 7 A.M., with the program continuing from 7:30 to 8:30. The registration code number is 009653. The prices below include the meal.

- $18—CLE+Plus cardholders
- $55—Remedies Section members
- $70—LACBA members
- $85—all others, including at-the-door registrants

1 CLE hour

Debt Relief for People Living with HIV and AIDS

ON WEDNESDAY, APRIL 25, the Barristers Section and the AIDS Legal Services Project/HALSA will present a CLE training program to recruit and train pro bono attorneys to assist clients living with HIV and AIDS who have debt problems, including student loans, car loans, and creditor harassment. The program will be led by Thomas R. Mulally, who specializes in business and real property litigation and debtor-creditor relations. The program will take place at the LACBA Conference Center, 281 South Figueroa Street, Downtown. Reduced parking is available with validation for $10. On-site registration and the meal will begin at 5:30 P.M., with the program continuing from 6 to 7:30 P.M. The registration code number is 009656. The price for all, including the meal, is $20.

1.5 CLE hours

Computer Forensics in Litigation Webinar

ON THURSDAY, APRIL 26, the Association will present an online seminar led by Alexander H. Lubarsky covering the new FRCP amendments and nearly all evidence in digital form. Today’s discovery professionals (attorneys, litigation support staff, IT staff, and paralegals) must be schooled in computer forensics to understand how and why data is preserved, exchanged, and produced. Knowing how to get at the other side’s smoking guns and be cognizant of yours is critical to success in today’s courtroom. This seminar will discuss the technologies, rules, and strategies to give yourself the edge in litigation in today’s high-tech world. The program begins at noon and continues until 1 P.M. The registration code number is 009641.

- $40—CLE+Plus cardholders
- $80—LACBA members
- $120—all others

1 CLE hour

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

HAVE YOU EVER BEEN ASHAMED to be a lawyer? Did the involvement of all those lawyers in the Watergate scandal make you cringe? That may have been bad enough, but when’s the last time you took a look at the yellow pages ads for attorneys? I realize that lawyer advertising has been around for 30 years or so, and I have nothing against it. However, the yellow pages ads have simply gotten out of hand. Attorney ads have become one of the largest subject headings in phone books. Often there is even a separate color on the sides of the pages for attorneys.

I suggest you take out your yellow pages and have a closer look at the attorney ads, particularly the full-page ads. Most of these large ads do not benefit clients. On the contrary, these ads are very expensive. Full-page ads in large cities typically cost more than $2,000 per month—that is per month, not per year. Moreover, most of these ads don’t really say very much to inform potential clients. They seem to exist only for their size.

I want to emphasize that I am not against advertising. What I am against is the huge “big bully” ads that run a full page or even double pages. Perhaps it is time for the State Bar or state lawmakers to place some reasonable limit on the size of the ads in the yellow pages; perhaps we could limit them to a certain number of square inches. This regulation could be justified as in the public interest, because the high prices are just passed on to clients in the form of higher fees to pay for the ads.

Little Benefit to Clients

Yet, these higher fees don’t mean better service to the client. Let’s look at some of them. Some of the ads do not even contain the full name of the lawyer or the lawyer’s State Bar number. I am not sure why. It could be so that potential clients are unable to check the State Bar of the lawyer or the lawyer’s State Bar number. I am not sure why. It could be so that potential clients are unable to check the State Bar at some of them. Some of the ads do not even contain the full name of the lawyer or the lawyer’s State Bar number. I am not sure why. It could be so that potential clients are unable to check the State Bar at some of them.

Unfortunately, many of these ads are negative or play on people’s worst fears. Personal injury ads frequently show someone being rushed to a hospital or a crashed car. One divorce ad had a mother and father arguing with a minor child, who is sitting between them. The parents have mean and hateful looks on their faces. The young boy has covered his face, apparently from the pain and agony of having his parents argue. Criminal law ads frequently use the symbol of handcuffs.

And then there are the ads that stress “fathers’ rights” or “men’s rights.” Could this be considered sex discrimination? The ads do not actually say that women are not welcome as clients, but they clearly stress the preference of one sex over the other. One wonders what the response would be if someone ran an ad stressing “white people’s rights” or “Christians’ rights.”

In fact, very few of the ads are really advertisements; they are just announcements. The lettering is very large. If you compare one ad to another in the same category you will find that they all say about the same thing and offer little that differentiates them from other attorneys. Workers’ compensation, criminal law, divorce law, personal injury, and others could be interchanged with any of the others in the same category. Under these rules, the winner is inevitably going to be the one with the largest announcement.

Potential clients may think that because the ad is large that the lawyer must be really great. But any lawyer who has practiced for any significant amount of time knows that a full-page ad is as likely to be an indication of failure as success. Most successful lawyers have already built up a word-of-mouth referral service from past satisfied clients. If they advertise in the yellow pages at all, they will probably purchase only a modest-sized ad or just stick with a basic phone book listing.

The law firm that uses the full-page ads and other expensive advertising campaigns may, in fact, make lots of money and be well known. However this success may only be due to the advertising and not because the firm has a pool of satisfied clients who are making referrals. My office and many others do not use full-page ads. We rely on word of mouth rather than full-page ads.

If you had a choice between two lawyers—one who gets clients from full-page ads and another who has only a modest advertising budget and relies on word-of-mouth referrals from satisfied clients and members of the community—for which would you have more respect? In which would you have more trust and confidence? And which lawyer would you want to represent you?

Take another look at the yellow pages for yourself, and then ask any lawyer if having a full-page ad means that the lawyer is better than those who do not use full-page ads. And while you’re at it, be sure to ask the lawyer if seeing those ads makes him or her proud to be an attorney.

Perhaps it is time for the State Bar or state lawmakers to place some reasonable limit on the size of the ads in the yellow pages; perhaps we could limit them to a certain number of square inches.
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