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3.) Measured by the variability in achieving cost, performance objectives
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2.) The quality of being enduring and free from change
or variation. – syn: LMIC

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In January of this year, the ABA Journal reported that the nation’s law firms had laid off over 1,300 employees that month. Little did we know, that statistic would seem like “good” news only one month later, when the same publication reported new law firm layoffs of approximately 2,500 in February. Newspapers and legal periodicals leave the impression that among lawyers willing to speak publicly about their practices, virtually all have adjusted their plans in order to better meet the current economic climate. In short, the new economy has made it appear that having no Plan B is like having no plan at all.

For many, the very term “Plan B” is disheartening. The slang lexicon urban dictionary.com defines it as “the person, thing, place, or idea that you go to when your first one fails.” That definition notwithstanding, at least a few writers have come to embrace Plan B not as a postfailure last resort but as a path truly “chosen” and ultimately more “successful” than the original plan. Thus, writer Ann Lamott in *Plan B: Further Thoughts on Faith* describes what, for her, was a spiritual antidote to chaotic political times. Similarly, environmentalist Lester R. Brown’s prescription to stop global warming is titled *Plan B: Mobilizing to Save Civilization*.

The concept of Plan B as a process toward betterment may be worth bearing in mind as we devise our own backup strategies. Although bottom lines will be the foremost concern of law firms and individual attorneys, more than a few seem to be finding that strategic involvement in pro bono work may be a component of a successful Plan B. A New Jersey law firm that recently laid off several attorneys, for example, arranged for a number of the unlucky lawyers to fill one-year posts at public interest firms. The individuals filling these positions will earn substantially less than they had expected, but, on the other hand, they will not have the dreaded “blank spots” on their resumes, they may very well gain courtroom experience in a shorter period of time than ordinarily possible at a firm, and they will likely develop strong relationships with their similarly situated peers. The firm itself, which will fund the one-year stints, gained goodwill and good press from the move.

Recent experience also suggests that individual attorneys—even associates in big firms—may be better equipped to weather the insecurities brought on by the current economy by similarly devising a Plan B that incorporates some pro bono work. Toward the end of 2008, an associate at a major California firm approached her supervising partners and diplomatically suggested that, since she was light on work and had completed the minimum billable hour requirements for the year, the firm might allow her to volunteer at a local public agency. The firm said yes; the associate ended up gaining trial experience; and, when, just a few months later, the firm was one of the many to announce massive layoffs, the associate kept her job.

One can easily imagine that the foregoing examples represent only some of the ways in which lawyers, acting to a large degree out of self-interest, may at the same time serve the greater good. Legal aid organizations, who are themselves facing a financial crisis, appear willing to work with attorneys and firms seeking to incorporate pro bono work into a broader professional strategy. The Legal Aid Foundation of Los Angeles and Bet Tzedek, to take two examples, currently have a number of programs tailored to involve private attorneys in finite projects. By exploring these opportunities, attorneys may discover new avenues for professional development while simultaneously serving the increasing needs of their communities.
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Protecting Intellectual Property during Layoffs

**ECONOMISTS PREDICT TWO MILLION** lost jobs by the end of 2009.1 Lawyers who advise any business that is contemplating reductions in force must be particularly vigilant in protecting its intellectual property—lest the employees it lays off today improperly use its intellectual property to unfairly compete tomorrow. In the digital age, a company’s most valuable proprietary, trade secret information may be downloaded with the click of a mouse and used to jump-start a competitive company. A competitor can be staffed with that company’s former employees, without the development costs.

There are several steps that an attorney may advise an employer to take to protect its intellectual property. The first is to analyze existing employment agreements and handbooks to determine whether they include explicit protections for intellectual property. Employment agreements should explicitly provide for the confidentiality of all proprietary material, provide that all work created during employment is a work for hire, and assign all inventions and work product relating to the employer’s business to the employer. Such a provision must, however, comply with Section 2870 of the California Labor Code.2 Any employer contemplating layoffs—and any employee concerned about layoffs—will want to understand first and foremost whether the existing employment agreements include a proper and enforceable assignment of inventions and confidentiality provisions.

**Noncompetition Clauses**

Second, the existing employment agreements must be analyzed to determine whether they contain a noncompetition clause. In the past, courts allowed nonsolicitation provisions that only narrowly restrained competition. California’s Business and Professions Code Section 16600 provides that “except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void.” Despite Section 16600, the Ninth Circuit Court of Appeals had found that narrow restrictions on competition did not violate Section 16600. In *Campbell v. Board of Trustees of Leland Stanford University*,3 the Ninth Circuit held that Section 16600 banned only those restrictions that preclude the pursuit of an *entire* business, trade, or profession.4 Although subsequent California appellate court cases did not embrace the narrow restraint doctrine, the doctrine enjoyed continued vitality in the Ninth Circuit and its district courts.5 As a result, many employment agreements contain language crafted to meet the *Campbell test*.

However, in September 2008, the California Supreme Court unequivocally rejected the narrow restraint doctrine, affirmed California’s longstanding ban on noncompete agreements, and confirmed that it extends to provisions restricting a former employee’s ability to solicit clients—so-called nonsolicitation provisions—as well. The *Edwards v. Arthur Andersen LLP*6 court ruled that noncompetition and nonsolicitation clauses are void under Business and Professions Code Section 16600 unless they fall within a statutory exception. Indeed, under *Edwards* an employer that requires employees to sign an agreement containing such a clause may commit an unlawful business practice subject to tort damages.

As the *Edwards* court explained: “Section 16600 represents a strong public policy of the state which should not be diluted by judicial fiat.” Indeed, “Section 16600 is unambiguous, and if the Legislature intended the statute to apply only to restraints that were unreasonable or overbroad, it could have included language to that effect.” Attorneys may advise an employer—and especially one contemplating layoffs—to evaluate any nonsolicitation or noncompetition clauses that it included in existing employment agreements in reliance on *Campbell* and its progeny to determine whether the clause may survive *Edwards* or merits revision.

While California employers can no longer include “narrow restraint” nonsolicitation clauses that are untethered to trade secrets in employment agreements, the *Edwards* court expressly declined to rule regarding the trade secrets exception to Section 16600. California courts have previously found that nonsolicitation clauses may be upheld if the agreement is necessary to protect trade secrets. Under California’s enactment of the Uniform Trade Secret Act, information may qualify for trade secret protection if it 1) derives independent economic value from being secret, and 2) is the subject of efforts that are reasonable under the circumstances to maintain its secrecy. Because the trade secret exception is supported by a California statute—the UTSA—agreements that are reasonably necessary to protect a trade secret may well survive a post-*Edwards* challenge, even if the agreements, either expressly or implicitly, restrain parties from engaging in a lawful profession. To date, at least one district court has found that, while *Edwards* does bar nonsolicitation clauses generally, the trade secret exception continues to survive.7

From the perspective of an employer, ideally enforceable provisions protecting a business’s intellectual property will be found in the employer’s existing written employment contracts and employee
to neglect its long-term intellectual property protection strategy.

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handbook. With daily headlines lamenting job losses, layoffs, furloughs, and mandatory unpaid vacations, it would be easy for a business to neglect its long-term intellectual property protection strategy in favor of short-term cost cutting. But it would be wrong. In light of the risk that a terminated or furloughed employee will take steps to compete with the employer, employers would be well advised to audit their intellectual property protection policy, especially as it applies to termination.

The many issues that a company may want to address upon terminating an employee include incorporating intellectual property concerns into its exit process. While the exact procedures may vary depending upon the circumstances, at a minimum a company should ensure that any passwords are changed and that any computers, cell phones, or Blackberries are returned. It may be appropriate to ask that the departing employees confirm in writing that any and all company information and other property has been returned, and that they have kept no copies of any company data. It also may be worthwhile to notify the employee of the information that the company believes is a trade secret, including proprietary formulas, customer lists, or other information.

If a business has reason to believe that its employees—current or former—are using its intellectual property to compete, it must act promptly. First, it must seize and preserve any internal evidence—especially backup tapes, computers, and other digital media that can be overwritten. If a person is improperly using a company’s intellectual property to contact customers or to replicate proprietary products or services, an employer may be well served to take prompt legal action, as a temporary restraining order and preliminary injunction forbidding the infringement of the employer’s intellectual property can halt the unfair competition. At the same time, however, any person contemplating a lawsuit based upon trade secrets, copyrights, or patents must consider the possibility of fee shifting; a losing plaintiff may well end up footing the other side’s bills.

2 See LAB. CODE §2870.
3 Campbell v. Board of Trs. of Leland Stanford Univ., 817 F. 2d 499 (9th Cir. 1987).
4 Id. at 502.
Applying Contractual Attorney’s Fees Clauses after *Marina Glencoe*

**WHEN LITIGATING CASES INVOLVING** contracts with attorney’s fee clauses, the possibility of recovering attorney’s fees, or being held responsible for the other side’s fees, can profoundly affect the decision of whether to proceed, dismiss, or seek a settlement with mutual releases. Given this reality, it is critical to understand just when a voluntary dismissal can be effective as a means of avoiding exposure to a claim for the attorney’s fees of the opposing party.

A recent Second District Court of Appeal opinion in the case *Marina Glencoe v. Neue Sentimental Film AG* provides some lessons on the litigation strategy of voluntary dismissals in the context of a potential attorney’s fees claim. However, although it does not expressly say so, *Marina Glencoe* may be significantly limited in its application based upon the narrow nature of the particular claims that were being litigated. Analyzing the impact of a voluntary dismissal upon the recovery of attorney’s fees requires an understanding of the procedural posture of the case at the time of dismissal, the wording of the attorney’s fees clause, and whether the claims being litigated are contract claims, noncontract claims, or some combination thereof.

In *Marina Glencoe*, a plaintiff commercial landlord sued its tenant and two of the tenant’s related entities allegedly to be its alter egos. The lease contained a fairly typical attorney’s fee clause:

> [I]f any action for breach of or to enforce the provisions of this Lease is commenced, the court in such action shall award to the party in whose favor judgment is entered, a reasonable sum as attorneys’ fees and costs. The losing party in such action shall pay such attorneys’ fees and costs.”

Before trial, the tenant filed for bankruptcy, and trial proceeded only against one of the alleged alter ego defendants. At the request of the plaintiff, trial was bifurcated to adjudicate first the issue of liability based upon alter ego, and then if necessary to determine damages if such liability were found.

When the plaintiff landlord rested upon completing its evidence in the alter ego liability phase of the trial, the defendant moved for judgment in its favor under Code of Civil Procedure Section 631.8. The trial court took the motion under submission overnight, but before it could rule, the plaintiff landlord voluntarily dismissed its suit with prejudice the next morning. Upon the defendant’s subsequent motion for its attorney’s fees under the contractual attorney’s fee clause, the trial court ruled that the defendant was not entitled to the fees under Civil Code Section 1717.

On appeal by the defendant, the court of appeal held that the trial court’s refusal to award attorney’s fees was correct under the express language of Civil Code Section 1717(b)(2), which provides: “When an action has been voluntarily dismissed or dismissed pursuant to a settlement of the case, there shall be no prevailing party for purposes of this section.” The *Marina Glencoe* opinion notes that Section 1717(b)(2) contains no temporal limitation—for example, whether trial has already commenced—and “bars recovery of Section 1717 attorney fees regardless of when the dismissal was filed.”

The tenant asserted on appeal that a dismissal with prejudice while a motion for judgment is already pending should not be deemed a voluntary dismissal within the meaning of Section 1717(b)(2), and so supposedly should not fall within its proscription denying any award of attorney’s fees to the dismissed party. The court of appeal rejected this contention, finding that it is not the stage of proceedings that distinguishes a voluntary dismissal from an involuntary one but rather the plaintiff’s role in bringing the dismissal about.

The *Marina Glencoe* court also was not persuaded that it should allow an award of attorney’s fees by analogy to other situations in which a voluntary dismissal short of a full trial—even a dismissal without prejudice—has been held not to relieve the dismissing party from having to pay the prevailing party’s attorney’s fees. For example, attorney’s fees are recoverable by a prevailing party defendant notwithstanding the plaintiff’s voluntary dismissal without prejudice if the dismissal occurs either after a general demurrer has been granted without leave to amend or a general demurrer has been granted with leave to amend but no amendment is timely made, and thus all issues have been deemed admitted in the defendant’s favor. Similarly, when a defendant’s right to obtain summary judgment has ripened to the point of inevitability because the plaintiff’s opposition papers, which are inadequate to defeat the motion, have all been filed, the plaintiff does not avoid having to pay the prevailing party defendant’s attorney’s fees by filing a voluntary dismissal without prejudice before the trial court actually rules on the motion.

The *Marina Glencoe* opinion distinguishes the dismissal in its case, which was with prejudice, from these other situations. The dismissal in *Marina Glencoe* was made with the intent to end the litigation rather than to avoid its end. This would appear to be a distinction created judicially on policy grounds, since neither Civil Code Section 1717 nor Code of Civil Procedure Sections 1032 and 1033.5 contain language that distinguishes prevailing party defendants according to whether the judgment of dismissal is voluntary or involuntary, or whether it is with or without prejudice.

It may be argued that as a result of this line of reasoning that *Marina Glencoe* contains an unstated limitation that significantly limits its scope and applicability. Unlike the language and court interpretations of Civil Code Section 1717(b)(2), different rules apply when attorney’s fees are sought under Code of Civil Procedure Sections 1032 and 1033.5 for claims that are not purely contractual. *Marina Glencoe* specifically states that the dismissed defendant’s motion for attorney’s fees was denied because the trial court concluded that the dismissed defendant “was not entitled to attorney fees under either Civil Code Section 1717 or Code of Civil Procedure Section 998.” Although the opinion does not expressly explain its reasoning for a distinction, it appears that the motion for attorney’s fees in the trial court was made only under Civil Code Section 1717 and Code of Civil Procedure Section 998 and not under Code of Civil Procedure Sections 1032 and 1033.5.

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Sections 1032 and 1033.5 allow attorney’s fees to be awarded as costs in favor of a prevailing party defendant—i.e., “a defendant in whose favor a dismissal is entered, a defendant where neither plaintiff nor defendant obtains any relief, and a defendant as against those plaintiffs who do not recover any relief against that defendant” in cases in which attorney fees are “authorized by...[c]ontract.” Marina Glencoe does not mention that it has been held that Civil Code Section 1717(b)(2) applies to bar recovery of attorney’s fees in a voluntarily dismissed action only if the action is for breach of contract. In noncontract cases, Civil Code Section 1717(b)(2) does not apply to bar the recovery of attorney’s fees as costs under Code of Civil Procedure Sections 1032(a)(4) and 1033.5(a)(10)(A).

Section 1032(a)(4) deems a defendant who has suffered no adverse results a prevailing party. This view is not based on whether the case is dismissed voluntarily or on the merits, or with or without prejudice. Section 1033.5(a) simply enumerates costs that—under Subsection (a)(10)(A)—include attorney’s fees that are permitted by contract. A contract may include a clause for attorney fees that are permitted by contract claims. This may explain why the decision turns only on Civil Code Section 1717 and Code of Civil Procedure Section 998, without mentioning Code of Civil Procedure Sections 1032 and 1033.5.

Similarly, the court of appeal held in Xuereb v. Marcus & Millichap, Inc. that the trial court erred in denying the prevailing defendants their attorney’s fees under the authority of Section 1717, since the case had been tried on tort theories. The court of appeal found that Civil Code Section 1717, governing contract cases, did not govern the interpretation of the attorney’s fee provision at issue. Instead, the court determined that the reach of Civil Code Section 1717 is, by its terms, limited to breach of contract actions, and its only effect is to make an otherwise unilateral right to attorney’s fees reciprocal. Therefore, since the language of the attorney’s fees clause in Xuereb permitted an award of fees under the circumstances of that tort-based case, Code of Civil Procedure Section 1021 authorized the award of attorney’s fees.

California courts have also ruled that attorney’s fees are recoverable under Sections 1032 and 1033.5 nor only if all the claims are noncontract claims but also if breach of contract and noncontract claims are so intertwined that it would be impracticable or impossible to separate the contract and noncontract components. As a result, attorney’s fees for time spent on tort and other noncontract causes of action that arise out of a contract are recoverable, being “on the contract” and recoverable by both sides under Civil Code Section 1717.

Whether a party has prevailed for purposes of recovering attorney’s fees is a question of fact that must be determined by identifying which party achieved the greater relief in the action or the litigation objective. As the court opined in Silver v. Boatwright Home Inspection, Inc.: Regarding the noncontract claims, the court must look to the parties’ contractual attorney’s fees provision to determine if it defines who is a prevailing party or addresses voluntary pretrial dismissals. If the contract does not provide such guidance, the court must utilize its discretion in determining whether such defendant should be considered a prevailing party for the purpose of recovering attorney’s fees as costs under sections 1032 and 1033.5.

Nor does the recoverability of attorney’s fees for noncontract and mixed claims appear, under existing California law, to depend on whether a voluntary dismissal causing the defendant to be the prevailing party is a dismissal with prejudice or without. The definition of a “prevailing party” defendant in Code of Civil Procedure Section 1032 is simply a “defendant in whose favor a dismissal is entered, a defendant where neither plaintiff or defendant obtains any relief, and a defendant as against those plaintiffs who do not recover any relief against that defendant.” No distinction is made as to whether a defendant has prevailed voluntarily or involuntarily, or whether the judgment in its favor is with or without prejudice.
Applicable case law likewise does not appear to support any such distinction. In Santisas, the court did note in passing that the dismissal there was with prejudice. However, this fact was not cited as being determinative that the defendants were the prevailing parties within the meaning of Code of Civil Procedure Section 1032.17

The presence of a prevailing party attorney's fee clause in a contract between parties engaged in litigation can significantly affect litigation strategy, including the decision of whether to dismiss a case voluntarily, and if so, at what stage of the proceedings. Marina Glencoe and other cases show that a voluntary dismissal terminating an action leaves open the possibility that the other side can recover attorney's fees, and this possibility is crucial in advising clients.

1 Absent a contractual clause allowing the prevailing party to recover attorney’s fees from the nonprevailing party, under California law all parties bear their own attorney’s fees whether they win or lose, unless the case is governed by a statute allowing recovery of attorney’s fees.


3 Civil Code §3717 is the statute generally providing that an attorney’s fee clause drafted to give only one side the right to recover if it prevails will be enforced in favor of any prevailing party, whether or not it is the party so specified. See also text and notes, infra, regarding Code of Civil Procedure §§5998, 1032, and 1033.5 as they may apply to recovery of attorney’s fees in cases unlike Marina Glencoe.

4 Marina Glencoe, 168 Cal. App. 4th at 877 (quoting Topanga and Victory Partners v. Togha, 103 Cal. App. 4th 775, 782 n.3 (2002)).


10 Id. at 1341.

11 Id. at 1342.

12 Id.

13 See Reynolds Metals Co. v. Alperson, 25 Cal. 3d 124, 129-30 (1979); Abdallah v. United Savs. Bank, 43 Cal. App. 4th 1101, 1111 (1996) (Apportionment is not necessary when “various claims were ‘inextricably intertwined,’ making it ‘impracticable, if not impossible, to separate the multitude of conjoined activities into compensable or noncompensable time units.’”).

14 See Santisas v. Goodin, 17 Cal. 4th 599, 608 (1998); see also Mustachio v. Great W. Bank, 48 Cal. App. 4th 1145, 1151 (1996) (The attorney’s fees for time spent on conversion cause of action based on a contract between the parties were recoverable since they were incurred for a claim “on the contract.”).


16 Silver, 97 Cal. App. 4th at 452.

17 See also MacLeod v. Tribune Co., 157 Cal. App. 2d 665 (1958) (affirming an order denying a motion to vacate an order for attorney’s fees based upon a voluntary dismissal without prejudice).
A NEW AND IMPROVED uniform statute for recognizing and enforcing judgments from foreign countries has been in place in California for just over a year. The new law has brought clarity to when and how to use a judgment from foreign shores to collect money that is here in the state. While some hotly contested issues remain, the new law contains most of what anyone would need to know to obtain recognition of a foreign country money judgment for the purpose of enforcing that judgment in California. Still, practitioners must be cognizant of issues arising under the old law. Indeed, the California Supreme Court recently resolved two significant issues relating to the statute of limitations under the old law.

The enforceability of foreign country money judgments in California is an issue that arises in a variety of circumstances. For example, a business deal in the Middle East goes south. One party gets a multimillion-dollar judgment in Israel. The offender has moved to California, along with his ill-gotten gains, and there is not a shekel available in Israel for the plaintiff to execute on.

In another example, a car jumps the curb in Chile and turns a single mother into a paraplegic. She sues the manufacturer of the part that caused the brakes to fail. She succeeds, but her record judgment against the part manufacturer is worthless in Chile because the judgment debtor has no assets there. Indeed, the judgment debtor is a California corporation with plenty of assets in the state.

Parties seeking to enforce a foreign country money judgment in California may wonder whether their victory is supported by the full faith and credit clause in the U.S. Constitution.1 However, the clause only requires one state to honor the judgment of another U.S. state or territory. It imposes no requirement to honor the judgment of a foreign country.2 In fact, nothing in the U.S. Constitution or federal statutes requires that any state, or the United States, honor a foreign country’s judgment. State law determines whether a foreign country’s judgment will be enforced.3

Uniform Statute

For years, the doctrine of comity was the governing law for situations like those faced by the plaintiffs in the examples. A body of case law sets forth the conditions that must be satisfied for a foreign country judgment to be recognized by one of the states in the United States.4 For money judgments, that case law has been codified into a uniform statute that has been adopted by at least 30 states, including California.5

In 1962, the Commissioners on Uniform Laws promulgated the Uniform Foreign Money Judgment Recognition Act (UFMJRA) to create a set of uniform principles for the recognition and enforcement of foreign country money judgments. In 2005, that uniform law was overhauled. It morphed into the Uniform Foreign Country Money Judgment Recognition Act (UFCMJRA), the difference in title remedying confusion by states referring to the judgments of other U.S. states as foreign judgments. Much of the uniform law remained the same, but some changes occurred. California adopted the UFMJRA in 19676 and the UFCMJRA in 2007. The new law is applicable to any actions for recognition of a foreign country judgment that are filed in California on or after January 1, 2008.7

Sister-state judgments receive full faith and credit because all states accord basic due process protections and have relatively corruption-free judiciaries. Sister-state judgment debtors need no protection from the possibility the judgment was rendered without regard to basic standards of fairness. A foreign country judgment, though, could emerge from a country with protections similar to those in the United States or where judgments are dispensed based on a dictator’s whim or who pays the larger bribe. Therefore, the uniform law requires a foreign country judgment to be recognized by a state for it to be enforced. Recognition is the means by which California

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ensures that the foreign judgment debtor received basic due process and converts the foreign country judgment into a domestic judgment enforceable by all the means available for collecting on a California judgment.9

The UFMJRA as originally adopted referred to “recognition” but did not say how to obtain it. Some states adopted a version of the UFMJRA providing for registration of a foreign country judgment with the court clerk and notification of that registration to the judgment debtor. The judgment debtor then had 30 days to initiate a proceeding for nonrecognition of the foreign country judgment on one of several grounds identified by the uniform law that preclude recognition.9 California did not adopt this registration procedure. To secure recognition of a foreign country judgment in California for enforcement under the old law, the judgment creditor had to file an action for relief.10 As adopted by the Uniform Law Commissioners and by California, the new law, the UFCMJRA, codifies the requirement of filing an action for recognition to enforce a foreign country judgment.11 Parties seeking recognition for some purpose other than enforcement, such as applying res judicata or collateral estoppel, can do so by asserting a counterclaim, cross-claim, or affirmative defense.12

Requirements for Recognition

Both the old and new uniform law contain certain threshold requirements for a judgment to be recognized. First, the judgment must grant or deny recovery of a sum of money.13 Judgments that grant or deny a divorce, child custody, title to or possession of property, an injunction, or other nonmonetary relief are not eligible for recognition under the uniform law. Such judgments remain recognizable and enforceable as a matter of comity.14 A judgment will be deemed to be for a sum of money when an amount of money is awarded, even if that amount is subject to change by an accounting ordered by the foreign court.15

Second, the judgment must be final, conclusive, and enforceable under the law of the foreign country in which it was rendered.16 This is the language of the new law. The old law authorized recognition of “any foreign judgment that is final and conclusive and enforceable where rendered even though an appeal therefrom is pending or it is subject to appeal.”17 This language gave rise to an interesting statute of limitations dilemma: When did the cause of action for recognition start running?18 The language of the new law mandates the same result. Once a judgment becomes final, conclusive, and enforceable under the law of the country where it was rendered, it can be recognized in California, and the statute of limitations starts running on an action for recognition.

In Manco, the supreme court also determined that the limitations period for bringing an action to recognize a foreign country judgment under the old law is 10 years.19 This issue arose because the UFMJRA contained no explicit statute of limitations. The supreme court reasoned that the legislature intended the statute of limitations to be the same for a foreign country judgment as for a sister-state judgment, based on a provision in the UFMJRA that a “foreign judgment is enforceable in the same manner as the judgment of a sister state which is entitled to full faith and credit.”20 An action to enforce a sister-state judgment is subject to a 10-year limitations period.21

The UFCMJRA eliminates this issue. The new law contains an explicit limitations period for an action to recognize a foreign country judgment. These actions must be commenced while the judgment is effective in the foreign country but not more than 10 years from when the judgment becomes effective in the foreign country.22

As the supreme court noted, the difference between “final” and “conclusive.”23 Even if a judgment is final in the foreign country, and therefore ripe for a recognition action in California, California courts have discretion to stay the recognition action pending conclusion of the foreign appeal or expiration of the time to appeal.24

Judgments for taxes, fines, and penalties are excluded from the old and new uniform law. Domestic relations judgments, even those for money such as support orders, are similarly excluded.25 Judgment creditors have the burden of proving that they are presenting a money judgment that is final, conclusive, and enforceable and not for taxes, fines, penalties, or domestic relations.26

Defenses

Even if a foreign country money judgment is final, conclusive, and enforceable where rendered, it must still survive several possible defenses before California will recognize it. At this point in the proceedings the burden of proof shifts to the judgment debtor.27

A foreign country judgment will not be recognized in California if rendered under a judicial system that does not provide impartial tribunals or procedures compatible with due process.28 A judicial system has procedures compatible with due process if 1) it affords defendants a full and fair trial before an impartial tribunal, 2) the tribunal conducts regular proceedings after proper service or voluntary appearance of the defendants, and 3) there is no showing of prejudice in the court system or the system of governing laws. A lack of due process is indicated by a judiciary dominated by the political branches of government or the opposing litigant, or if a party is unable to obtain counsel, secure documents, or attendance of witnesses or have access to appeal or review.29

The foreign country need not have all the features of the U.S. judicial system to demonstrate the presence of due process. In case law, the bar has been set fairly low as to what is required to satisfy the due process standard for recognition. Procedures that courts have deemed compatible with due process include those in which all evidence is submitted in writing or judges conduct “cross-examination.”30 As long as the defendant has a right to counsel and some means of putting forth his or her case, the judiciary has some measure of independence, and rampant corruption is not demonstrated, the foreign judicial system generally will be found sufficient for the purpose of recognizing its judgments.31

Nevertheless, if human rights reports indicate the lack of a fair judiciary and defendants cannot personally attend their own litigation without endangering their lives, a court may not find the requisite due process.32 However,
a judgment debtor cannot avoid recognition on this ground merely by proving a lack of due process regarding the judgment in the case at issue. According to case law prior to the new law, the foreign country’s judicial procedures as a whole are under scrutiny. Indeed, the due process deficiencies cited by the judgment debtor have to be systemic.33

A foreign country judgment also will not be recognized if the foreign court lacked subject matter jurisdiction over the dispute or personal jurisdiction over the defendant.34 These defenses result in mandatory prohibition against recognition of the foreign country judgment.

In other circumstances, the uniform law grants courts discretion not to recognize a foreign country judgment. If the defendant did not receive notice of the foreign proceeding in sufficient time to defend, or if the judgment was obtained by fraud that deprived parties of an opportunity to present their case, the California court does not have to recognize the foreign judgment.

The same is true if the judgment or the cause of action or claim for relief on which the judgment is based is repugnant to the public policy of California or the United States or if the judgment conflicts with another final and conclusive judgment. The exception for judgments repugnant to public policy is applied narrowly. The level of contravention of the state’s policy must be high. A mere difference in laws or remedies is not enough to invoke this exception.35 However, the new law slightly broadens this exception by making it applicable if the judgment, not just the cause of action or claim for relief on which it is based, is repugnant. Now, if the cause of action is not repugnant but the recovery is, recognition of the judgment may be denied. Debt collection, for example, may not be repugnant to California policy, but usurious interest as part of such a judgment might be.36

A California court may choose not to recognize the judgment if the proceeding in the foreign court contravened an agreement by the parties to resolve the dispute by means other than the foreign court. Courts have the same discretion for cases in which jurisdiction was by personal service and the forum was seriously inconvenient for the trial.37

All the foregoing defenses were available under the old law and remain available.38 The UFCMJRA added two new discretionary defenses. If the circumstances raise substantial doubt about the integrity of the rendering court regarding the judgment, or if the specific proceeding leading to the judgment was not compatible with the requirements of due process, then California courts may choose not to recognize the judgment.39 These new defenses promise to relieve judgment debtors of having to prove that an entire judicial system is corrupt or does not afford basic due process—a more difficult burden than just showing the individual foreign judge denied due process.

The UFCMJRA specifically addresses the defense of the lack of personal jurisdiction. A court may not refuse recognition for lack of personal jurisdiction if:
• The defendant was personally served in the foreign country.
• The defendant voluntarily appeared other than to avoid seizure of property or to contest jurisdiction.
• The defendant agreed to submit to the foreign jurisdiction.
• The defendant was domiciled in the foreign jurisdiction when the proceeding began or was a corporation or business principally located in, or organized under the laws of, the foreign jurisdiction.
• The proceeding involved conduct by the defendant’s business office in the foreign country.
• The proceeding involved an accident arising out of the defendant’s operation of a vehicle or aircraft in the foreign country.

The statute also permits a finding of personal jurisdiction on other bases.40

Since the UFCMJRA—like its predecessor, the UFMJRA—is a uniform law, it instructs courts construing it to give consideration to the need to promote uniformity among the states enacting it. This is a slightly watered-down version of the old law, which mandated that the law be construed to effectuate its purpose of making uniform the law of the states that enact it.41 Even in its slightly diluted form, this provision enables the practitioner to argue that courts should give decisions of other states the same precedential value as California decisions to effectuate uniformity among the states. The purpose of the uniform law is to promote reciprocity among foreign countries in enforcing judgments rendered in the United States, and uniformity of interpretation advances that goal.42

The UFCMJRA codifies in one convenient location the procedural and substantive requirements for recognition of foreign country money judgments. Practitioners can provide assistance for their clients without having to devote hours of research into the law of comity on enforcing foreign country judgments.

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1 U.S. Const. art. IV, §1. See also 28 U.S.C. §1738.
3 Society of Lloyd’s v. Reinhart, 402 F. 3d 982, 993 (10th Cir. 2005); RESTATEMENT (THIRD) OF FOREIGN
205-07.

205-06.

2d 1313, 1323 (2d Cir. 1973).


2001).

18122 CODE CIV. PROC. §1713.4(b).

18122 CODE CIV. PROC. §1712.1. California shortened the maximum limitations period in the model UFMJRA from 13 years to 10 years to make it consistent with California’s domestic and sister-state limitations periods. Manco, 45 Cal. 4th at 209.

18122 CODE CIV. PROC. §1716(b); former CODE CIV. PROC. §§1713.2, 1713.4.

18122 CODE CIV. PROC. §1721. California shortened the maximum limitations period in the model UFMJRA from 13 years to 10 years to make it consistent with California’s domestic and sister-state limitations periods. Manco, 45 Cal. 4th at 209.

18122 CODE CIV. PROC. §1716(b); former CODE CIV. PROC. §§1713.2, 1713.4.

18122 CODE CIV. PROC. §1720.

18122 CODE CIV. PROC. §1715(b).

18122 CODE CIV. PROC. §1715(c).

18122 CODE CIV. PROC. §1716(d); The party contesting the judgment also had the burden of proof before passage of the old law. 164 East 72nd Street Corp. v. Ismay, 65 Cal. App. 2d 574, 576-77 (1944).

18122 CODE CIV. PROC. §1716(b)(1).

18122 CODE CIV. PROC. §1716(c)(1)-6.

18122 CODE CIV. PROC. §1716(c)(7), (8); former CODE CIV. PROC. §1713.4(b).

18122 CODE CIV. PROC. §1717.

18122 CODE CIV. PROC. §1722; former CODE CIV. PROC. §§1713.8.

18122 CODE CIV. PROC. §1716(c)(1)-6.

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18122 CODE CIV. PROC. §1717.

18122 CODE CIV. PROC. §1722; former CODE CIV. PROC. §§1713.8.

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18122 CODE CIV. PROC. §1717.

18122 CODE CIV. PROC. §1722; former CODE CIV. PROC. §§1713.8.

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18122 CODE CIV. PROC. §1722; former CODE CIV. PROC. §§1713.8.

18122 CODE CIV. PROC. §1716(c)(1)-6.

18122 CODE CIV. PROC. §1716(c)(7), (8); former CODE CIV. PROC. §1713.4(b).

18122 CODE CIV. PROC. §1717.

18122 CODE CIV. PROC. §1722; former CODE CIV. PROC. §§1713.8.
The Viability of No Contest Clauses in Estate Planning

REPORTS BY COMMENTATORS that the California Legislature is eliminating the enforcement of no contest clauses in estate plans are—as Mark Twain once quipped about reports of his death—greatly exaggerated. While new laws—effective January 1, 2010—represent a serious effort by the legislature to reform no contest clauses, the effect of the clauses remains. However, their impact may be diminished by challenges based on probable cause.

The current law creates serious dilemmas for devisees. For example, a parent devises her estate equally between her two children, a son and a daughter. However, just prior to the mother’s death, while she is in the hospital and heavily medicated, the son convinces her to amend her will to leave him 75 percent of the estate, with his sister to receive only 25 percent. Moreover, the will contains a no contest clause that disinherits any beneficiary who challenges its validity, directly or indirectly. When the mother dies, the son petitions to probate the revised will.

The daughter is in a quandary. She must either accept the 25 percent share, even though she knows her mother intended for her to receive half of the estate as evidenced by the original will, or challenge the validity of the instrument and risk the consequences. Under the current Probate Code, a challenge to the will on the grounds of undue influence or lack of capacity would make the daughter vulnerable to complete disinheritance.

The well-established public policy for enforcing no contest clauses is to discourage litigation and give effect to the expressed intent of the testator or settlor. However, the statutory scheme as it exists now has spawned confusing and at times contradictory decisions regarding when a clause will be enforced. To ameliorate this, the legislature sought to overhaul the applicability and enforcement of no contest clauses.

The Probate Code contains statutes that attempt to define what actions are contests and therefore in violation of the no contest clause. Under current law, Probate Code Section 21300 defines contests by dividing them between those that are direct and those that are indirect. Section 21300(b) defines a “direct contest” as any pleading alleging the invalidity of an instrument based upon revocation, lack of capacity, fraud, misrepresentation, menace, duress, undue influence, mistake, lack of due execution, or forger. Under Probate Code Section 21300(c), an “indirect contest” involves a pleading in any court proceeding that challenges the validity of an instrument or one or more of its terms based on a ground not specified in Section 21300(b).2

The broad language of these statutes essentially encourages litigation over whether a pleading violates the no contest clause, since any challenge to the validity of a will or trust could be construed as a contest. The reward for a successful challenge may be a substantially larger share of the property without any truly significant deterrent. The only risks for those claiming a violation of the clause is, first and foremost, having their petition denied and secondarily enduring the necessary delay required for making a determination one way or the other.

To stem the increase of no contest litigation, the legislature enacted Probate Code Section 21305 to specifically delineate those pleadings that are statutorily not considered a contest. Among the section’s 15 categories of actions that are not contests are such commonly used pleadings as petitions to compel an accounting and to remove a trustee, and a pleading challenging the exercise of a fiduciary power. These types of pleadings are covered by the section for instruments executed after January 1, 2001.

However, even with the clear language of Probate Code Section 21305, practitioners cannot necessarily be free of the threat of a no contest clause when filing a petition on any of these grounds. First, practitioners must consider when the instrument was executed to determine if the statute even applies. If the instrument was executed before 2001, the statute provides no protection.3 Further, the no contest clause must be free of language that specifically characterizes the action as a contest. Even if one fully complies with Section 21305, a court may still disregard it if the court believes that the underlying pleading, no matter how it is labeled, is a direct attack on the will or trust at issue.4

Prudent action requires practitioners to protect their clients from disinheritance—and themselves from a malpractice claim—by securing an advance determination, pursuant to Probate Code Section 21320, that a proposed petition or objection will not violate the no contest clause if it is filed. Petitions filed under Section 21320 are extremely common in probate court and effectively prolong litigation for many months and even years if there is a trial and the order is appealed. The evidentiary hearing can include extrinsic evidence, if the evidence is relevant to the clause, as well as any evidence pertaining to the execution of the instrument that helps to establish an ambiguity in the clause.5

The lengthy delay caused by an evidentiary hearing and the appellate process does not have an impact on any statutes of limitation. This is because Probate Code Section 21308 stays the applicable statute of limitations while the Section 21320 petition is pending. The party attacking the will or trust cannot be heard on his or her proposed petition until there is a final determination of the declaratory relief petition.

A precursor to the new laws, and another legislative attempt to limit enforcement of no contest clauses, is Probate Code Section 21307. This section allows a potential contestant to challenge an instrument under certain conditions without triggering enforcement of the no contest clause.

Probate Code Section 21307 provides:

[A] no contest clause is not enforceable against a beneficiary

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to the extent the beneficiary, with probable cause, contests a provision that benefits any of the following persons:
(a) A person who drafted or transcribed the instrument.
(b) A person who gave directions to the drafter of the instrument concerning dispositive or other substantive contents of the provision or who directed the drafter to include the no contest clause in the instrument, but this subdivision does not apply if the transferor affirmatively instructed the drafter to include the contents of the provision or the no contest clause.

Under current law, there is no provision in the Probate Code other than Section 21307 that prevents enforcement of a no contest clause on a party who files a direct contest with probable cause. Therefore, under the example, if the son wrote the entire will and had his mother merely sign it, under Probate Code Section 21307 the daughter would very likely prevail if the son tried to enforce the no contest clause against her. This is because she has probable cause to bring the action.

But if the son simply arranged for an attorney to visit with his mother and otherwise had no involvement with the will, any action filed by the daughter to contest the will would likely trigger the no contest clause since, under current law, a direct contest triggers enforcement of a no contest clause, probable cause or not. Under current law, the daughter’s only option would be to file a Section 21320 petition for declaratory relief for an advance determination that the proposed petition is not a contest of the will. If the court denies that declaratory relief petition, then the daughter cannot file her contest without risking forfeiture of her entire share of the estate.

The New Laws and Probable Cause
Effective January 1, 2010, Part 3 of Division 11 of the Probate Code—encompassing current Probate Code Sections 21300 through 21322—will be repealed. The new laws limit their application to three types of actions.

New Probate Code Section 21310(b) defines “direct contest” as a contest that alleges the invalidity of a protected instrument or one or more of its terms, based on one or more of the following grounds:
1) Forgery.
2) Lack of due execution.
3) Lack of capacity.
4) Menace, duress, fraud, or undue influence.
5) Revocation of a will, trust, or an instrument other than a will or trust.
6) Disqualification of a beneficiary on the grounds that he or she is a witness, a drafter of the instrument, a care custodian of a dependent adult, or a fiduciary who transcribes or causes the instrument to be transcribed as defined under Probate Code Sections 6112 or 21350.

New Probate Code Section 21310(b) does not significantly change the current definition of “direct contest” other than to add pleadings to disqualify beneficiaries pursuant to Probate Code Sections 6112 or 21350 as direct contests.

The most significant change to the law affecting no contest clauses is in new Probate Code Section 21311, which provides:
(a) A no contest clause shall only be enforced against the following types of contests:
(1) A direct contest that is brought without probable cause.
(2) A pleading to challenge a transfer of property on the grounds that it was not the transferor’s property at the time of the transfer. A no contest clause shall only be enforced under this paragraph if the no contest clause expressly provides for that application.
(3) The filing of a creditor’s claim or prosecution of an action based on it. A no contest clause shall only be enforced under this paragraph if the no contest clause expressly provides for that application.
(b) For the purposes of this section, probable cause exists if, at the time of filing a contest, the facts known to the contestant would cause a reasonable person to believe that there is a reasonable likelihood that the requested relief will be granted after an opportunity for further investigation or discovery.

The effect of new Probate Code Section 21311 is dramatic. For most cases, the no contest clause will be triggered only when there is no probable cause. Probable cause is a low standard designed to protect a litigant’s right to assert arguable legal claims: “The term ‘reasonable likelihood’ has been interpreted as more than merely possible, but less than ‘more probable than not.’” Consequently, the new probable cause standard, while a component of new laws aimed at reducing litigation over no contest clauses, is likely to cause an increase in will or trust contests.

However, new Probate Code Section 21311(a)(2) and (3) still provides that when testators or settlors expressly state in the no contest clause that beneficiaries will be disinherited if they file a creditor’s claim or challenge a transfer of trust property on the grounds that they own the property, probable cause will not protect the beneficiaries. Estate planners most likely will be including this language in all their no contest clauses, since a failure to bar these actions in the no contest clause will mean that the actions do not constitute a contest.

Another significant alteration is the repeal of Probate Code Section 21320. Under the new laws, parties will no longer have an express right to an advance ruling to determine whether or not the no contest clause will be triggered by a proposed pleading. The new laws apply to any instrument, whenever executed, that became irrevocable on or after January 1, 2001. Instruments that became irrevocable before January 1, 2001, are subject to current law and not the new changes.

Under the new laws, no contest clauses will continue to be strictly construed in determining the intent of the transferor. Further, the legislature has retained current Probate Code Section 21302, which establishes that the new laws apply notwithstanding a contrary provision in the instrument. Finally, the new laws preserve current Probate Code Section 21301, which provides that “this part is not intended as a complete codification of the law governing enforcement of a no contest clause. The common law governs enforcement of a no contest clause to the extent this part does not apply.”

Nevertheless, once the new laws go into effect, under the example, the daughter’s risk in challenging the will is reduced significantly. Though her proposed filing will be construed as a direct contest because probable cause exists, the no contest clause will not be enforced against her. Thus, the daughter may litigate the merits of her claim, and the son will be unable to hide his conduct behind the cloak of forfeiture provided by the no contest clause.

The legislature’s stated goal of revising, recasting, and clarifying the statutes pertaining to no contest clauses seems to have been realized to some extent. Nevertheless, the new statutes also leave many questions unanswered.

It would still be desirable in most, if not all, situations to obtain declaratory relief to determine if the court believes a party has probable cause to file a contest or if the action otherwise violates the no contest clause. This option, however, is seemingly no longer available.

Practitioners desiring this relief still have one prospect to pursue, however slim. While the new laws have repealed Section 21320, the Probate Code does not specifically state that a party has no right to declaratory relief. Prior to the enactment of Section 21320, parties could seek declaratory relief in trust and will cases pursuant to Code of Civil Procedure Section 1060. However, in 1994, presumably because of the enactment of Probate Code Section 21320, Code of Civil Procedure Section 1060 was amended to specifically
excludes trust and will cases. Consequently, it seems that there is no statutory authority for declaratory relief in these cases. Nevertheless, new Probate Code Section 21313 does allow for common law principles to apply. Since Code of Civil Procedure Section 1060 no longer allows declaratory relief in trust and will cases, and since Section 1060 was enacted in 1921, a party looking for authority for declaratory relief must find supporting common law predating 1921.12

Effect of the New Statutes

The key question for determining whether a party had timely probable cause is, what was the basis for the contest at the time of the filing? It is important to recognize that the new statutory language does not appear to allow enforcement of the no contest clause against a party who simply loses a contest. Rather, a no contest clause can only be enforced against a party if the court finds that, at the time the pleading was filed, no reasonable person would believe that the requested relief would be granted after the party has an opportunity of further investigation or discovery. While probable cause at the time of filing protects a contestant, the mere filing of a contest without probable cause can trigger the no contest clause. Therefore, it is imperative that a contest not be filed just to investigate if a beneficiary has potential grounds for a contest.

Practitioners should be aware that the attorney for an alleged contestant may be an essential witness against a petition to enforce the no contest clause. Attorneys could be forced to testify regarding what they advised their client regarding the existing grounds for the action at the time of filing. Alleged contestants may be forced into a conflict between the preservation of their attorney-client privilege and attorney work product protection and the need for testimony to establish probable cause. Therefore, before filing any direct contest on behalf of a client, practitioners should ensure that probable cause can be established without disclosing attorney-client communications.

After January 1, 2010, filing a petition to enforce a no contest clause against contestants almost immediately after the contest is filed may be an effective tactic. In defense of the petition for enforcement of the no contest clause, contestants will have to state all the bases for their petition. If the court believes that the contest lacks probable cause, the no contest clause will be enforced. However, even if the court finds that probable cause does exist, contestants may still be forced to state all the bases for their petition in a verified pleading. These facts could be beneficial for trial preparation.

Thus, with the passage of the new laws, the volume of litigation regarding no contest clauses, which is currently large, may not be reduced if the probable cause challenge becomes common. This result may occur no matter whether the litigation arises from a petition for declaratory relief pursuant to Probate Code Section 21320 or a petition for enforcement of a no contest clause.

Extensive California authority spanning more than a century supports the general validity of no contest clauses that disinherit a contesting heir.13 According to the California Supreme Court, “[E]ven though a no contest clause is strictly construed to avoid forfeiture, it is the testator’s intentions that control, and a court must not rewrite the [testator’s] will in such a way as to immunize legal proceedings plainly intended to frustrate the [testator’s] unequivocally expressed intent from the reach of the no contest clause.”14 Yet despite these principles, the effect of the new statutes will be to rewrite the testator’s intent by allowing contests based upon probable cause even when a no contest clause expressly states otherwise. Litigants with a reasonable belief that they will prevail after being permitted to conduct some discovery are no longer deterred from contesting an estate plan under the new laws since the probable cause standard drastically reduces the probability of beneficiaries suffering from enforcement of a no contest clause against them.

The only limited areas in which the law preserves the teeth of a no contest clause are either a creditor’s claim or a beneficiary’s pleading claiming ownership of trust property—for example, a forced election. Still, while no contest clauses may be enforceable in actions in which the party had no real basis for bringing the claim, the vast majority of beneficiaries can now escape forfeiture simply by having probable cause.

References

2 Prob. Code §21300(c).
5 Burch, 7 Cal. 4th at 258, n.8.
6 New Probate Code Section 21311 (a)(2) and (3) has codified what is known as a “forced election.”
12 Maurice E. Harrison, Forms of Declaratory Relief at Equity and Law Pre-1921, 9 CAL. L. REV. 339 (July 1921).
14 Id. at 1173; Burch v. George, 7 Cal. 4th 246, 254-55 (1994).
A recent California Supreme Court decision has eviscerated the effectiveness of the Mandatory Fee Arbitration Act

For more than 30 years, attorneys and clients in California have resolved disputes over legal fees and costs through the Mandatory Fee Arbitration Act (MFAA). Under the MFAA, local bar associations conduct non-binding arbitrations for the disputants, and parties dissatisfied with the result of an arbitration can move for a trial de novo in superior court. But the days of the MFAA appear to be numbered. A recent California Supreme Court case, Schatz v. Allen Matkins Leck Gamble & Malloy LLP, has eviscerated the MFAA and, if that were not enough, cases construing the Federal Arbitration Act have created authority that threatens to preempt what little remains of the MFAA.

The unraveling of the MFAA has been sudden, but it should not have been unexpected. In 2004, the California Supreme Court in Aguilar v. Lerner found that the binding arbitration clause in an attorney-client fee agreement was not superseded by the MFAA, but the majority opinion narrowly based the decision on the client’s waiver of the MFAA. Justice Chin, in a concurring opinion joined in by two other justices, advocated overruling Alternative Systems, Inc. v. Carey, a 1998 decision in which the court of appeal held that the MFAA displaced agreements between attorneys and clients for binding arbitration of their fee disputes. Indeed, until Schatz, a unanimous court upheld binding arbitration clauses, enforceable under the CAA, as being complementary to—and not in conflict with—MFAA arbitration.

In 1976, the State Bar of California Board of Governors found that attorney-client fee disputes “were the most serious problem between members of the bar and the public.”

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by Kurt L. Schmalz
The State Bar proposed the creation of a consumer-oriented arbitration system that would counteract the perceived disparity in bargaining power between attorneys and clients.7 In enacting the MFAA, the California Legislature opted to devise an arbitration scheme that was separate and distinct from the previously established CAA. Under the MFAA, the State Bar Board of Governors was tasked with setting up a system and procedure for the arbitration of disputes over fees charged for professional services by members of the California bar or by members of the bar of other jurisdictions.8

The MFAA offers a dispute resolution scheme that includes arbitration, mediation, and ultimately (if either party rejects the arbitration award) a trial in superior court. The MFAA’s dispute resolution procedure is limited to disputes between attorneys and clients over attorney’s fees and costs and is specifically inapplicable to “claims for affirmative relief against the attorney for damages or otherwise based upon alleged malpractice or professional misconduct.”9 The MFAA system that has developed over the past 30 years involves arbitrations conducted through local bar association programs that are subject to review by the State Bar Board of Governors.10

An MFAA arbitration usually is triggered when an attorney sends a client a written notice of the client’s right to arbitrate under the MFAA. If the client fails to initiate an MFAA arbitration before a local bar association within 30 days following receipt of this notice, the client waives the right to arbitration under the MFAA, and the attorney is entitled to sue the client in court for fees or, if appropriate, to initiate a private arbitration outside the MFAA.11 The client can also waive the right to an MFAA arbitration by seeking judicial resolution of the fee dispute or suing the attorney for legal malpractice or other affirmative relief.12 If the attorney files a lawsuit or other legal proceeding against the client to collect fees (including a private arbitration) without giving the client written notice of the right to MFAA arbitration, the client can stay the legal proceeding by serving and timely filing a request for arbitration, pursuant to the MFAA, or ask the court to dismiss the legal proceeding brought by the attorney.13

The MFAA, designed to be consumer friendly, allows the client to participate in the MFAA arbitration without having to hire a second attorney. Indeed, the MFAA system is voluntary for the client but mandatory for the attorney, if the arbitration procedure is properly initiated by the client.14 However, unlike arbitration under the CAA, the award in an MFAA arbitration is only binding if neither the attorney nor the client rejects the award and seeks a trial in superior court no later than 30 days after service of the award on the parties.15

Significantly, the ability of the parties to reject an MFAA award and proceed to trial in court is in conflict with California’s strong policy that parties who agree to resolve their disputes in private arbitration should be allowed to do so in a single binding arbitration. Moreover, the MFAA is a “closed system” of special arbitration before local bar associations, not a binding arbitration in a private forum like the American Arbitration Association or similar organizations.16 The hybrid nature of the MFAA system—a combination of nonbinding arbitration and judicial proceedings—clearly clashes with the core concept of arbitration, which is the private resolution of a dispute in a single proceeding outside of court.

### State and National Public Policy

The CAA, which was enacted in 1961, “represents a comprehensive statutory scheme regulating private arbitration in California.”17 The CAA emphasizes private arbitration as a favored procedure for “speedy and relatively inexpensive means of dispute resolution.”18 In enacting the CAA, the legislature expressed a “strong public policy” in favor of private arbitration when the parties to a contract have agreed to arbitrate their disputes.19 The CAA sets forth procedures for the enforcement of agreements to arbitrate;20 establishes rules for conducting arbitration proceedings, but the parties may otherwise agree to their own;21 describes the circumstances in which the awards of arbitrators may be judicially vacated, corrected, confirmed, and enforced;22 and specifies where, when, and how court proceedings that relate to arbitration matters will take place.23

Private arbitration is a policy priority not only in California. The Federal Arbitration Act (FAA) makes agreements to arbitrate disputes a national policy priority as well.24 Moreover, a growing body of case law cites the federal preemption doctrine to invalidate state laws that interfere with contracts between parties to resolve disputes through a single binding arbitration.25

Thus the interplay between the MFAA, on the one hand, and the FAA’s strong public policy in favor of the contractual arbitration of disputes, on the other, does not bode well for the continued viability of the MFAA. In the FAA, not only did Congress declare “a national policy favoring arbitration,”26 but it also used its authority to regulate interstate commerce to withdraw the power of the states to require a judicial forum for the resolution of claims that the contracting parties agreed to resolve by arbitration.27

The FAA applies to arbitration provisions in written maritime contracts or contracts “evidencing a transaction involving commerce.”28 The courts have found the FAA to apply when a contract facilitates interstate commercial transactions or directly or indirectly affects commerce between the states.29 Given the wide scope of what constitutes a transaction involving or affecting commerce, few commercial transactions, including those between attorneys and clients, would fall outside the ambit of the FAA. Even a garden variety sale of residential property in California was held to be a transaction involving interstate commerce when the purchase of the property was financed by a Federal Housing Administration loan and the parties used the forms copyrighted by the National Association of Realtors in the transaction.30

Accordingly, a large number of attorney-client fee agreements in California could involve commerce sufficient to invoke the FAA—even agreements between a California attorney and a California-based client.

The FAA establishes an obligation to arbitrate notwithstanding any state substantive or procedural policy to the contrary.31 The national policy in favor of arbitration applies in state as well as federal courts and “forecloses state legislative attempts to undercut the enforceability of arbitration agreements.”32 Thus, when parties agree to arbitrate all issues arising under a contract, “state laws lodging primary jurisdiction in another forum, whether judicial or administrative, are superseded by the FAA.”33

### The Impact of Schatz

The MFAA scheme clearly is fundamentally different from binding arbitration under the CAA or FAA. Until Schatz, the prevailing view was that if an attorney and his or her client specified in their initial fee agreement that all disputes would be resolved by binding arbitration, the MFAA system displaced binding arbitration for a fee dispute. In Schatz, however, the California Supreme Court tried to harmonize the MFAA’s nonbinding arbitration with the binding arbitration provided for by the standard arbitration clause in attorney-client fee agreements enforceable under the CAA.

As a follow-up to Justice Chin’s concurring opinion in Aguilar, the Schatz court found that the MFAA’s right to a trial de novo was not intended to override a contractual obligation to arbitrate disputes pursuant to the CAA. In examining the statutory language of the MFAA and the CAA and “the strong public policy in favor of binding arbitration as a means of resolving disputes,” the court found that after completion of the nonbinding arbitration under the MFAA, the dissatisfied party could seek a trial de novo “unless the parties had agreed to binding arbitration.”34 In that situation, according to
the court, the parties would move to a binding arbitration, as they had agreed, and not to a trial in court. The justices rejected the contention, adopted by the court of appeal reviewing Schatz, that the MFAA had implicitly repealed a portion of the CAA as it related to attorney-client fee disputes:

It would be illogical, and contrary to the purpose behind both the MFAA and the CAA, for the Legislature to permit attorneys to evade their agreement to arbitrate if, but only if, the client invokes the MFAA. An adoption of Schatz's position of implied repeal would result in a statutory scheme that is quite illogical. Giving effect to both the MFAA and the CAA, on the other hand, would be consistent with the distinct purposes behind both of those statutory schemes.

Despite the court's efforts to harmonize the MFAA system with CAA binding arbitration, after Schatz, it is hard to tell what is really left of the MFAA. Why would clients opt for a nonbinding MFAA arbitration when they had agreed to binding arbitration in the first place? Are two arbitrations—one under the MFAA and the other under the CAA—something that furthers a client's interest in an efficient and relatively inexpensive resolution of an attorney's fee dispute? A nonbinding arbitration—with its significant filing fees of up to $5,000 as well as other expenses and burdens on the client—seems to be pointless. The client would be better off skipping the nonbinding MFAA arbitration and adjudicating all claims against the attorney in a single binding arbitration or, if the arbitration clause is waived or challenged, in court. Two arbitrations to solve one attorney-client fee dispute is not the consumer-oriented, cost-efficient system that the MFAA was supposed to create.

Before Schatz, clients could use the MFAA system to avoid binding arbitration agreements they had signed, using the trial de novo provision to get a jury trial. Schatz closed the door on that strategy in those circumstances when a valid arbitration agreement exists between attorney and client.

Thus, there seems to be little upside for clients to invoke the MFAA following Schatz. The next step may be for the legislature to clarify whether it actually intended for the MFAA to modify the CAA for attorney's fee disputes. Alternatively, it may be time to repeal the MFAA and have fee disputes governed by the CAA when attorneys and clients have agreed to binding arbitration in their initial fee agreements.

Federal Preemption Analysis

In crafting a response to Schatz, the legislature should be mindful that the current MFAA system does not fare well under a federal preemption analysis involving the FAA. To date, the issue of whether an arbitration under the FAA supersedes the MFAA system has not been squarely addressed in a published decision by either the California state or federal courts. However, after Schatz, the likelihood is high that a state or federal court will soon address the issue of whether the MFAA is preempted by the FAA.

At first glance, an argument could be made that an agreement between a California-licensed lawyer and a California resident for a legal matter arising in California does not evidence “a transaction involving [interstate] commerce.” Several unpublished California cases have reached this conclusion and rejected the FAA's applicability to attorney-client disputes. One recent published court of appeal decision, in dictum, noted that when parties have a California choice of law provision in their agreement and choose to arbitrate in accordance with California law, preemption under the FAA would not occur.

However, the preemption analysis employed by federal courts, and a few California courts, supports the argument that a fee agreement between a California attorney and a California client could evidence a transaction involving commerce or an activity that directly or indirectly affects commerce. The U.S. Supreme Court has stated repeatedly that the practice of law is important to the national economy and, in the aggregate, the activities of lawyers have a significant effect on interstate commerce. Thus, even though a specific attorney-client agreement at issue may not actually reflect a transaction in interstate commerce, the cumulative effect of this legal activity creates an impact sufficient to affect commerce and trigger the FAA.

Moreover, what might first appear to be a completely intra-state transaction between a California attorney and a California resident could affect interstate commerce if either the lawyer or client had offices outside California or if significant meetings or depositions in the case were expected to take place outside California. Similarly, if lawyers touted themselves to clients as having a reputation for representing clients or handling matters outside California, a court may find that the representation probably evidences interstate commerce. Also, if all or some of the defense costs of an engagement are being paid by an insurance company located outside California, the effect on interstate commerce from the payment of insurance money should be sufficient to trigger the applicability of the FAA to a dispute between the attorney and the client when there is a signed arbitration agree-
an enforceable binding arbitration clause and one that opens the door to state-mandated administrative or judicial proceedings. As the U.S. Supreme Court has stated: “[A]ny doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.”

While these precautions could make the difference, ultimately practitioners will gain further guidance from the inevitable head-on clash between the FAA and the MFAA. Recently, in Preston v. Ferrer, the U.S. Supreme Court held that the FAA preempted the administrative review provisions of the California Talent Agencies Act. In 1984, the Supreme Court invalidated the arbitration preclusion provisions of California’s Franchise Investment Law on the basis of FAA preemption. The MFAA is likely to meet a similar fate once the FAA preemption issue is properly raised in court.

Even after the California Supreme Court held in Schatz that binding arbitration could replace the trial de novo option when the parties had agreed to binding arbitration, the nonbinding arbitration component of the MFAA would probably conflict with the FAA. As the U.S. Supreme Court noted in Preston, “A prime objective of an agreement to arbitrate is to achieve ‘streamlined proceedings and expeditious results.’” The Preston Court rejected the argument that an administrative proceeding that merely postponed the arbitration did not conflict with the FAA. According to the Court, the initial proceeding would delay the binding arbitration in contravention of the intent of Congress to move parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible.

Accordingly, if the state legislature decides to review the MFAA post-Schatz, it may want to consider repealing the MFAA and letting the CAA control fee disputes when the parties have agreed to binding arbitration. Having attorney-client disputes for fees and other issues, including legal malpractice, resolved in a single binding arbitration rather than multiple arbitrations or other proceedings could be a more efficient and inexpensive alternative to the present system.

Another legislative alternative would be to keep the MFAA initial arbitration in place but make that arbitration binding only on the attorney. The client could reject the arbitration award and thereafter seek a trial de novo or go to binding arbitration if the parties had agreed to binding arbitration in the fee agreement. The lawyer, however, would have to accept the results of the MFAA arbitration. Although many lawyers would object to such an arrangement as being unfair, this change in the MFAA by the legislature would be consistent with its original consumer-orientated purpose. Moreover, the client would have an incentive to use the MFAA, whereas after Schatz the initial arbitration—which either party could reject—would probably be a waste of the client’s money. Clearly the MFAA, without legislative resuscitation, has reached the end of its useful life as an efficient dispute resolution system.

1 BUS. & PROF. CODE §§6200 et seq.
2 Schatz v. Allen Matskin Leck Gamble & Malloy LLP, 45 Cal. 4th 557, 87 Cal. Rptr. 3d 700 (2009). The court has extended the date for finalizing its opinion until March 27, 2009, pending a decision on Schatz’s request for modification of the opinion.
5 The California Arbitration Act, CODE CIV. PROC. §§1280 et seq.
6 Aguilar, 32 Cal. 4th at 983 (discusses background of the MFAA and contrasts the MFAA dispute resolution system with the CAA procedures).
7 Id.
8 Id.
9 BUS. & PROF. CODE §6200(a), (b)(2).
10 BUS. & PROF. CODE §6200(d).
11 BUS. & PROF. CODE §6201(a); see also Ervin, Cohen & Jessup, LLP v. Kassel, 147 Cal. App. 4th 821, 828-29 (2007) (Binding arbitration clause in an attorney fee agreement is applicable when the client fails to invoke MFAA arbitration within 30 days after written notice.).
12 BUS. & PROF. CODE §6201(d); see also Aguilar, 32 Cal. 4th at 988-99.
13 BUS. & PROF. CODE §6201(b), (c); see also Alternative Sys., Inc. v. Carey, 67 Cal. App. 4th 1034, 1042 (1998).
14 BUS. & PROF. CODE §6200(c).
15 BUS. & PROF. CODE §6204(b), (c). In addition, the parties can agree in writing that the MFAA award shall be binding, provided that the agreement is made after the fee dispute arises. BUS. & PROF. CODE §6204(a).
16 Aguilar, 32 Cal. 4th at 984.
18 Id.
19 Id.
20 CODE CIV. PROC. §§1281.2–1281.95.
21 CODE CIV. PROC. §§1282–1284.2.
22 CODE CIV. PROC. §§1283–1288.8.
23 CODE CIV. PROC. §§1290–1294.2.
24 U.S.C. §§1 et seq.
25 Federal preemption is based upon the Supremacy Clause in the U.S. Constitution, which provides: “This Constitution, and the Laws of the United States…shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.” U.S. CONST. art. 6, cl. 2.
27 Id.
28 Id. at 10; see also 9 U.S.C. §2.
32 Id. at 16.
35 Id.
36 Id. at 713-14.
37 According to the current fee arbitration schedule for the Los Angeles County Bar Association, administered through Dispute Resolution Services, Inc., the filing fee for a client is 7% of the amount in dispute when the total dispute is $20,000 or more, with a $5,000 maximum. Thus, for a $75,000 fee dispute, a client pays a $5,000 filing fee to initiate the nonbinding arbitration. As of January 1, 2009, the filing fee for an unlimited jurisdiction civil action in Los Angeles Superior Court was $350. For a commercial claim over $10,000 but not exceeding $75,000, the American Arbitration Association charges a filing fee of $980. Also, the AAA charges a case service fee of $300, payable after the first hearing. Ironicaly, the cost to the client to initiate a non-binding MFAA arbitration is significantly more than the other supposedly less consumer-friendly alternatives.
38 In a footnote in Schatz, the California Supreme Court declined “to address any issue concerning the Federal Arbitration Act” because the parties had not raised the issue. Aguilar v. Lerner, 32 Cal. 4th 974, 991, n.8 (2004). Justice Moreno’s concurring opinion also notes that the court was not addressing “whether a state statute that precludes binding predispit arbitration agreements of legal fees would be preempted by the Federal Arbitration Act.” Id. at 994.
41 Reber v. Provident Life & Accident Ins. Co., 93 F. Supp. 2d 995, 1009-10 (S.D. Ind. 2000) (“There can be no doubt that the practice of law in the aggregate significantly affects commerce.”); Miller v. Travelers Ins. Co., 723 F. Supp. 1345, 1346 (E.D. Mo. 1989) (The extent of interstate communication, travel, and commerce necessarily involved in the practice of law today is significant that practice of law is an activity “affecting commerce.”). Reber and Miller involved ERISA jurisdiction, not the FAA, but the commerce analysis appears to be similar under the two statutes.
46 Preston, 128 S. Ct. at 986 (citations omitted).
47 Id.
48 This amendment would still face potential preemption under the FAA. However, with the amendment in place, a party could argue that the initial arbitration does not directly conflict with the FAA because it promotes binding arbitration consistent with the FAA and the CAA.
After a long evolution in case law, minimum resale price agreements are no longer per se illegal

Over a year and a half ago, with some fanfare, the U.S. Supreme Court overruled a 1911 decision, Dr. Miles Medical Company v. John D. Park & Sons Company.1 Dr. Miles held that it was illegal per se under Section 1 of the Sherman Act2 for manufacturers to require their distributors to adhere to minimum resale prices. This practice is known as resale price maintenance, and in the lexicon of antitrust law, a practice is illegal per se only when it is so inherently pernicious that no explanation will save it. Justice Kennedy, writing for the Court in Leegin Creative Leather Products, Inc. v. PSKS, Inc,3 ruled that minimum resale price agreements would no longer be illegal per se but would be judged on a case-by-case basis under the rule of reason.4

The 5-4 decision in Leegin split down ideological lines, ending a century-old article of faith for liberal antitrust scholars. For many, the demise of Dr. Miles—the last bulwark against vertical price fixing—will sound the death knell for discounters. Since Leegin, forces on both sides of the issue have been vocal.

Tim Craig, writing in Retailing Today, suggested that the end of Dr. Miles would have a convulsive effect on retailing, forcing millions of businesses to close.5 University of North Florida marketing professor Gregory Gunlach—an expert witness for the plaintiff in Leegin—said, “What we’re seeing here is the potential for a reshaping of the retail landscape in America.”6

Are these theories plausible? The day after Leegin was decided, Cendant Corporation, parent of Avis and Budget Rent-a-Car, successfully moved the U.S. District Court in Alaska to dismiss a vertical price-fixing case brought against it by one of its franchisees. Citing Leegin, the district court found that while the challenged agreement might reduce

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competition between Avis and Budget, Avis remained competitive with Hertz and National.

Jacob Weiss, the owner of Baby-Age.com, a seller of maternity items, said that since *Leegin*, 100 of his company’s 465 suppliers now require minimum pricing, and a dozen suppliers no longer deal with his company. Weiss said that if the trend continues it will put him out of business. Brian Okin, founder of online retailer WorldHomeCenter.com Inc., said, “[It’s becoming a nightmare operating a business.” Okin is suing lighting supplier L.D. Kichler on grounds that its minimum price policy caused WorldHomeCenter to forego substantial profits. In response, Kichler states that it has no policy against discounting, so long as prices are not advertised. Okin claims that the policy selectively discriminates against online retailers because the practice of online retailing requires price posting.

In May 2008, the attorneys general of 35 states wrote Congress asking that legislation be enacted to reverse *Leegin*. Even consumers have been dragged into the fray. In April 2008, the president of Old Mother Hubbard Dog Food Company threatened to cut off a retailer if it did not cease selling Mother’s 30-pound bags at 20 cents below the minimum price of $39.99. The retailer, Morris Sussex Pet Supply, put up signage asking its customers to boycott Old Mother Hubbard Dog Food. A full 85 percent of Old Mother Hubbard customers switched brands.

When a century-old precedent is overruled, it is cause for comment and controversy among the legal community. But in some quarters there was more than that—a reaction approaching shock. Whatever result one might have desired in *Leegin*, it is curious that Justice Breyer in his dissent should suggest that *Dr. Miles* ought to have been maintained on grounds that it is a “well-established...statutory precedent.” At its conception, *Dr. Miles* was so tenuous a ruling that the Supreme Court tried, in effect, to undo it as early as 1919. For 70 years after that, its reasoning and validity were whipsawed from decision to decision. By the late 1980s it was clear to all but those still believing that the antitrust laws were enacted to further populist and sociopolitical aims that *Dr. Miles* would not survive.

Less than a decade later, the Supreme Court tried to undo the mischief of *Dr. Miles* by—as it so often does—creating more mischief. In *United States v. Colgate & Company*, the Court held that while resale price maintenance was illegal, a manufacturer could announce to the world the terms on which it would do business, including resale prices, and simply refuse to deal with those unwilling to comply. This, said the Court, was mere unilateral conduct and not subject to the antitrust laws. However, this was a fiction. A dealer who agreed to distribute the product of a manufacturer that had announced its price terms to the world could refuse to deal with those unwilling to comply. This, said the Court, was mere unilateral conduct and not subject to the antitrust laws. The conundrum remained unresolved for decades. In opinions stretching from 1920 to 1960, the Court restricted *Colgate’s* already limited utility, culminating in *United States v. Parke, Davis & Company*. In that case, the Court held that while a manufacturer could announce the price terms on which it would do business, under no circumstances could it do more than that, such as enforce the terms. Parke, Davis & Company, a national distributor of pharmaceuticals, decided not only to exercise its *Colgate* rights but to enforce them. Justice Brennan held that in so doing, the company had “put together a combination in violation of the Sherman Act.” This was because enforcement goes beyond the mere “unilateral act” of refusing to deal with those who refuse to comply. So, after *Parke, Davis & Company*, a manufacturer could announce its terms, sign up wholesalers and retailers and, if they failed to comply, take one of two steps: 1) do nothing, or 2) seek enforcement and risk a private, treble damages antitrust suit. Justice Brennan and the majority effectively overruled decisions chart their course.

In 1963 the Supreme Court decided *White Motor Company v. United States*. White, a maker of custom-built trucks, sought to maximize sales through franchise agreements employing territorial and customer allocation restrictions. The Justice department claimed the restraints were per se illegal under the Sherman Act, but the Court disagreed. Adumbrating modern antitrust analysis, Justice Douglas opined, “There exists too little of the actual impact of... that restriction...to reach a conclusion on the bare bones of the documentary evidence before us.” Justice Douglas was effectively saying that the form of a restraint (in this case, vertical) will not necessarily doom it if its actual impact is not anticompetitive. But what the Court giveth, the Court taketh away. And four years later it did just that.

In *United States v. Arnold, Schwinn & Company*, Justice Fortas delivered a tangled opinion holding certain resale nonprice restraints illegal per se. Schwinn sold to wholesale distributors both outright and on consignment, employing territorial restrictions and confining sales to franchised Schwinn dealers. Fortas’s reasoning was formalistic—a stark counterpoint to that of Justice Douglas in *White Motor Company*. In a nod to *Dr. Miles*, Fortas hung his hat on alienation. Where Schwinn departed “with title, dominion, or risk with respect to the article,” the restraint was illegal per se. But in all other circumstances he declined “to introduce the inflexibility which a per se rule might bring if it were applied to prohibit all vertical restrictions of territory...where the manufacturer retained ownership of the goods...” This reasoning may have something to do with property rights; it has nothing to do with competition and antitrust law.
the product through a discounter.

True.
False.

12. There is now a consensus among antitrust scholars that the problem of free riding is properly resolved through resale price maintenance.

True.
False.

13. In the 1988 *Business Electronics Corporation v. Sharp Electronics Corporation* decision, the U.S. Supreme Court held that nonprice vertical restraints, though leading to higher consumer prices, may be legal so long as there is no actual agreement on price.

True.
False.

14. Among the benefits of online retailing is that it does not present a forum for free riding.

True.
False.

15. Prior to *Leegin*, vertical price-fixing agreements were illegal per se under Sections 1 and 2 of the Sherman Act.

True.
False.

16. Only in the *Dr. Miles* decision does the U.S. Supreme Court rely on the concept of restraints on alienation as a basis to prohibit minimum resale price agreements.

True.
False.

17. One of the arguments in favor of resale price maintenance is that it can prevent excessive competition among retailers that drives prices down to levels at which a profit is no longer obtained or is negligible.

True.
False.

18. It may always be necessary for certain luxury goods to be sold through retail establishments to retain brand perception and customer loyalty.

True.
False.

19. Vertically integrated manufacturers of consumer goods will usually take advantage, through lower prices, of efficiencies achieved at the retail level.

True.
False.

20. Economic consequences are not a valid basis on which to base antitrust decisions.

True.
False.
Continental T. V., Inc. v. GTE Sylvania Inc.

In 1977 *Schwinn* was overruled in *Continental T. V., Inc. v. GTE Sylvania Inc.* The *Continental* decision marks the Court’s final and decisive rejection of per se illegality in the area of resale nonprice restraints. The case emerged when Sylvania sought to increase its market share by selling to franchised retailers bound by location clauses under which they could sell only from certain locations. When Continental was forbidden to sell Sylvania products through one of its new outlets, it claimed the location clause was illegal per se under *Schwinn*. Justice Powell, writing for the majority, disagreed.

The *Continental* opinion is ground-breaking. It rejects *Schwinn’s* formalistic distinctions and relies instead on economic reasoning and business efficiency as key elements in antitrust analysis. While Justice Powell conceded that certain vertical restraints may restrain “intrabrand” competition (that is, competition among retailers selling the same brand), he recognized that they may also create fierce “interbrand” competition (competition among retailers selling different brands), thus mitigating anticompetitive dangers.

*Continental* was the beginning of the end for *Dr. Miles*. The ensuing decision in *Monsanto Company v. Spray-Rite Service Corporation* is illustrative. Spray-Rite claimed it was terminated following complaints of price cutting by fellow distributors. Spray-Rite alleged a vertical price-fixing conspiracy between Monsanto and its other distributors. Monsanto said Spray-Rite was terminated because it failed to hire a trained staff and promote sales. Monsanto moved that the case be dismissed outright, citing no evidence of a price-fixing scheme. Prior to *Monsanto*, the mere fact of a complaining competitor followed by termination would have been enough to proceed to trial. In *Monsanto*, Justice Powell declared that plaintiffs would henceforth be required to adduce “evidence that tends to exclude the possibility of independent action by the manufacturer and distributor.” Moreover, “there must be... evidence that reasonably tends to prove... a conscious commitment to a common scheme designed to achieve an unlawful objective.” *Monsanto* ensures the gains made in *Continental*. It protects manufacturers using procompetitive nonprice restraints (such as requiring retailers to maintain trained staff) from the threat of treble damage awards when there is no evidence of collusion.

Finally, in 1988 the Court held in *Business Electronics Corporation v. Sharp Electronics Corporation* that it is not illegal per se for a manufacturer to terminate a discounting dealer at the insistence of a premium dealer; even if it means higher consumer prices, so long as the vertical agreement between the manufacturer and premium dealer does not contain an actual agreement on price. Business Electronics was terminated by Sharp after Sharp received complaints from a rival dealer about price cutting. Business Electronics claimed the real reason was a price-fixing agreement between Sharp and the rival dealer, but the agreement between Sharp and the rival dealer had no price component. Instead, the agreement required servicing, repair, and product demonstration.

Justice Scalia, writing for the majority, opined that “a vertical restraint is not illegal per se unless it includes some agreement on price or price levels.” Under Justice Scalia’s analysis, Sharp could exercise its unilateral *Colgate* rights and terminate Business Electronics for discounting to ensure the premium dealer’s financial ability—through higher prices—to engage in nonprice activity essential to brand integrity. While the entire arrangement could lead to a higher price, it was not illegal per se under *Dr. Miles*.

After *Business Electronics*, the writing was on the wall: All vertical restraints would eventually be decided under the rule of reason. To understand why, it is necessary to survey the economic debate that allowed the *Leegin Court* to do what it did.

### The Economics of Vertical Restraints

Settled law holds that restraints of trade having no effect other than to decrease output and increase price should under no circumstance be tolerated. Thus, price fixing and divisions of territories, when effected horizontally, are justly deemed illegal per se. But in the area of vertical restraints the analysis is different.

Horizontal arrangements exist between parties who compete for market share at the same level of distribution. They are usually implemented with the intent and effect of decreasing output while raising costs to consumers. In contrast, vertical arrangements are not typically between competitors. Rather, manufacturer and retailer may be cast as partners or joint venturers, together seeking optimum sales and distribution of a product. In this light, vertical restraints are but a tool in the distribution process. Whether a manufacturer places restraints on independent retailers or integrates forward, building its own retail network, it has no apparent incentive to restrict output.

However, can it justly be said that because a manufacturer builds its own distribution and retail network it should also have unrestricted control over independent distributors? An independent retailer obtains efficiencies through its own business decisions; for example, how it structures its financial base, its choice of employees, its policies on customer service, its product-line decisions, where it will locate, and its choice of target customers. Wise choices create efficiencies leading to greater distribution and lower prices, thus stimulating competition. But when pricing and distribution are determined solely at the manufacturing level, efficiencies may go unrealized. This is not easy to rationalize.

For example, a low markup policy will generate increased sales. Increased sales not only enhance retail profits but create efficiencies upstream at the manufacturing level. Perhaps, then, the integrated manufacturer is likely to take advantage of efficiencies in its own retail operations in order to maximize sales. Assuming this to be true, it is fair to ask why a manufacturer would forego these benefits when its distributor or retailer is independent. Indeed, some have argued that because the manufacturer’s natural concern is to maximize return, it will often seek retailers and distributors who can market and distribute its product at less cost than the manufacturer can on its own. Arguably, when this benefit is achieved, the manufacturer’s interest will not lie in requiring the retailer to increase the price of the product. The natural consequence of this action would be a reduction in sales to the retailer and ultimately in revenue to the manufacturer as requests for orders falter.

Nevertheless, the commercial reality is that few manufacturers distribute through a single source. Moreover, discord among retail- ers can wreak havoc upon a manufacturer’s business. Intense intrabrand competition may drive a price down to a point at which distributors and retailers, themselves unable to sustain a return, demand that the manufacturer cut its wholesale price. This may be feasible in some cases, but not if the manufacturer operates on a thin margin. Resale price maintenance can alleviate this situation by stabilizing retail prices.

Indeed, broad-based assumptions about vertical restraints are imperfect and unwise. For example, a major objection to vertical restraints is that they facilitate cartelization at both the dealer and manufacturing levels. A cartel of retailers can deter holdouts from the cartel by enlisting manufacturers to impose resale price maintenance. Thus, in this argument, resale price maintenance stabilizes the cartel, and defection—in the form of price cutting—becomes more difficult. Resale price maintenance also is said to effectuate manufacturer cartels because it removes the incentive to cheat and, if cheating occurs, makes it more readily apparent. A manufacturer will not defect from a cartel unless its cut in price can be passed on to consumers—and this is impossible when resale price maintenance is in place. Moreover, policing the cartel becomes easier.
because a cut in price at the point of sale is likely due to a defection.44

These arguments, however, are ill-conceived. They rely on naked horizontal restraints. It makes no sense to condemn horizontal restraints and vertical restraints if, standing alone, the latter is found to enhance efficiency. Joint ventures may facilitate a “conspiracy,” yet joint ventures are not so readily condemned.

The question of cartelization has been addressed directly by Robert Bork, who shows that when retailers carry a multiplicity of brands, an effective cartel would generally require fixed prices for all or most of them, necessitating the cooperation of numerous manufacturers in the resale price scheme. Not only would such an arrangement be almost impossible to manage,45 but it is illogical to assume that manufacturers will be easily seduced into participating in dealer conspiracies designed to restrict output.46 A high markup, low volume program is not in a manufacturer's best interest.

Bork believes that resale price maintenance is not a necessary means of policing manufacturer cartels. Dealers usually carry more than a single brand of any given product and “continually play one supplier off against another....” Thus, when a manufacturer cheats on the cartel, cutting its price to dealers, the dealers are likely to demand similar cuts from other manufacturers—and thus, in the process, exposing the defector.47

The most widely offered justification for vertical restraints (and resale price maintenance) is that they prevent “free riding.” In the typical free-ride situation, dealer A has invested a substantial sum in maintaining adequate sales staff, repair services, and promotional devices, all desired by the manufacturer. Dealer B, selling the same product, is a discounter and provides no point-of-sale services. In this scenario, potential customers may learn about the product through Dealer A's advertising, partake of A's demonstration program, and educate themselves with A's brochures, but the purchase will be through Dealer B, the discounter.48

This is anticompetitive because, eventually, the point-of-sale services and promotional devices employed by Dealer A are necessary to provide proper product reliability and to engender goodwill among the manufacturer's target customers. Dealers will not long incur the costs of maintaining necessary point-of-sale services when discounting rivals, constrained neither by resale price maintenance nor the costs of providing such services, consistently underbid them.

The result is that ultimately no dealer provides these services, product reliability and appeal falter, and sales are lost, leading to reduced output and decreased interbrand competition.49 Proponents of resale price maintenance argue that it prevents this unfair result by not only foreclosing discounters but also providing retailers with increased profits, enabling them to engage in service and promotional activity that will actually increase demand and output.50

But is this a universal truth? Professor Robert Pitofsky has argued persuasively against resale price maintenance as a viable remedy for free riding. He cites not only what he sees as the pernicious cartel-like effects of resale price maintenance, but that it is probably incapable of inducing the activity that its proponents applaud. Pitofsky questions whether increased profits with respect to any given item will cause a retailer, selling perhaps thousands of items, to increase the level of its service or promotional activity.51 Moreover, assuming less than perfect nonprice competition, what is to prevent the retailer from simply pocketing increased profits?52 Pitofsky argues that since retailers form the front line in customer contact, it is they who are best able to determine what services are needed to achieve optimum sales. When

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services are necessary, they can easily be contracted for separately between retailer and customer.53

**Online Retailing**

This sampling of competing perspectives suggests at least some, or perhaps much, justification for the *Leegin* Court’s decision, which is focused almost entirely on traditional retailing. Curiously absent from the Court’s analysis was a consideration of whether the advent of online retailing will affect the arguments for or against resale price maintenance.

While online retailing remains relatively new, several themes have emerged regarding the issue of vertical restraints. Generally, online retailing can be said to have three laudable characteristics: lower operating costs, the instant availability of price comparison, and broad and immediate product advertising and distribution, well beyond even catalog mailings.54 Is it a forum ripe for free riding and hence a justification for resale price maintenance? There is evidence to suggest this is so.

The classic example is the shopper who visits brick-and-mortar establishments to check out a product firsthand but who buys the product online at a reduced price. One study suggests that over a quarter of online buyers investigate their purchases at brick-and-mortar establishments before buying online.55 In effect, these purchasers are free riding on the investments of shop retailers in their establishments.

Still, some have suggested that free riding can work both ways in the world of e-commerce. For example, a potential buyer can sample music or books online, read online reviews and ratings, and eventually drive to the local music or bookstore to make the purchase.56

Yet another issue arises when a manufacturer sells its product through both brick-and-mortar specialty retailers and online catalogs. The services offered by the online retailer are static and represent fixed costs—no shop need be leased nor expenditures made for a trained sales staff or expensive décor, not to mention upkeep. But the costs of actually running a store—such as hiring employees and training them to explain luxury goods or to demonstrate specialty electronics—constitute a variable cost well beyond what the online retailer must bear.57 When a manufacturer decides to dual-track its retailing, the existence of the specialty shop remains essential to maintaining brand perception and, consequently, sales. In these cases, resale price maintenance may be an appropriate means of protecting brick-and-mortar retailers and, in the process, ensuring brand integrity.59

The broader question is the future of traditional retailing. The continued existence of the retail shop does not seem in doubt. First, a large segment of the population enjoys the traditional, physical experience of shopping. Second, buyers who simply will not purchase a good they have not first touched and examined will remain a contingent with which retailers must reckon.

Nevertheless, an increasing number of manufacturers of consumer goods of all kinds are vertically integrating, selling online and only through their own specialty outlets. These firms need not deal with independent wholesalers or retailers; they can dual-track sales online and at the mall, all the while controlling point-of-sale pricing without regard to vertical pricing agreements. This is even more true for those manufacturers that have decided to forego all independent forms of distribution and sales, selling to and servicing the public directly and exclusively online.

Thus, the overruling of *Dr. Miles* was long overdue, since commercial realities rendered its utility questionable. For the massive discount retail industry that has emerged over the last generation, the end of *Dr. Miles* and the per se rule will likely have little effect.

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3 *Leegin Creative Leather Prods.*, Inc. v. PSKS, Inc., ___
The facts in *Leegin* are typical of vertical price-fixing cases. Leegin discovered that the plaintiff was marking down its line by 20%. Leegin demanded that the plaintiff cease discounting. When the plaintiff refused, Leegin ceased doing business with the plaintiff. The plaintiff then filed suit alleging, inter alia, that Leegin refused, Leegin, 127 S. Ct. at 2710-12.

With few exceptions, both the majority and the dissent rely overwhelmingly on authorities extending the per se illegality had been made and digested—and it was clear that Leegin was about to do likewise. The per se rule would not survive. See *Monsanto*.

See *Monsanto* supra note 38, at 2710-12. The rule of reason employs a facts-and-circumstances inquiry to determine whether a given restraint is an unreasonable restraint of trade. The language of the Sherman Act has never been interpreted literally; only “unreasonable” restraints of trade are unlawful. *See* *State Oil Co.* v. *Khan*, 522 U.S. 3, 10 (1997).

Id. at 37-39.

See *Attorneys' Fees in Antitrust Litigation*, 57 FORDHAM L. REV. 51, 63-64 (1988). Professor Cavanagh aptly bemoans the hopeless conceptual strains created in the wake of the conceptual strains created by the[se] early Supreme Court decisions...”.


Id. at 307.


Professor Cavanagh aptly bemoans the hopeless conceptual strains created in the wake of the conceptual strains created by the[se] early Supreme Court decisions...

127 S. Ct. at 2731 (Breyer, J., dissenting).


Id. at 404. No one today takes the second pillar seriously.

At the time of Justice Hughes’s writing, restraints on alienation were designed to prevent the removal of real property from the stream of commerce. They have nothing to do with consumer welfare and competition, the proper focus of antitrust analysis.


Id. at 307.


Professor Cavanagh aptly bemoans the hopeless conceptual strains created in the wake of the conceptual strains created by the[se] early Supreme Court decisions...


Id. at 43-44.


Id. at 261.


Id. at 378-80.


Id. at 54-56.


Id. at 762-63, 768.


Id. at 735-36.

With few exceptions, both the *Leegin* majority and dissent rely overwhelmingly on authorities extending no further than *Business Electronics*. By the late 1980s, all the essential arguments in favor of and against per se illegality had been made and digested—and it was clear that the per se rule would not survive.


*See* *United States v. Socony Vacuum Oil Co.*, 310 U.S. 150, 223 (1940); and *Addyston Pipe & Steel Co.* v. *United States*, 175 U.S. 211, 241 (1899).


See L. Sullivan, *Antitrust §134*, at 380-81 (1977); see also Robert Pitofsky, *The Sylvania Case: Antitrust Analysis of Non-Price Vertical Restrictions*, 78 COLUM. L. REV. 1, 19 (1978) (High markup yields reduced sales volume.). This is generally not true of forwardly integrated manufacturers in an oligopolistic market in which commodities are sold for commercial use, such as the ammonia market.

See *Sullivan*, supra note 38, §134, at 380-81.


See Pitofsky, supra note 41, at 1490; see also United States v. General Motors Corp., 384 U.S. 127 (1966); cf. *Sullivan*, supra note 38, §134, at 383. A dealers’ cartel is attractive only if the manufacturer sets supra-competitive prices. But to sustain sales at those prices, the product must be sufficiently differentiated from others of its kind. Id.

See Pitofsky, supra note 41, at 1490-91.

See Bork, supra note 37, at 292.


See Bork, supra note 37, at 293.


Pitofsky, supra note 41, at 1493.

Pitofsky, supra note 38, at 20.

Pitofsky, supra note 41, at 1493 (Distributors can be depended upon to recognize which services are essential.).


Chevalier, supra note 54.

See id.

See id.
For many years, patent law has struggled with the question of whether a series of thoughts can be patented. Under the mental steps doctrine, the answer was no. More recently, the answer has been maybe. With In re Bilski, the U.S. Court of Appeals for the Federal Circuit, which has exclusive jurisdiction over patent appeals, recently revisited the issue. The mental steps doctrine holds that an invention is not entitled to patent protection if it involves only mental steps. The threshold question concerns whether an invention constitutes patentable subject matter under 35 USC Section 101, which outlines four categories: machines, processes, manufactures, and compositions of matter.

Over the years, the courts have applied several differing and changing tests, from a strict no-mental-steps rule to the more recent physical-transformation rule. The physical-transformation rule essentially states that in order for a process to be patentable, it must undergo a physical transformation during the process. Recently, a second proposed test—utility—surfaced.

A string of recent cases stemming from the U.S. Supreme Court’s Diamond v. Diehr decision and continuing through the recent In re Bilski has outlined a utility-based test for patentable subject matter as it pertains to mental steps. Under the utility test, an invention is patentable subject matter under Section 101 if it produces a useful, concrete, and tangible result.

Beginning in the 1970s and continuing through the 1980s, a series of three cases laid the groundwork for what became the transformation test for patentability of subject matter for processes. The first two cases that led to the transformation test are Gottschalk v. Benson and Parker v. Flook. In Benson, the court held that computer software was not patentable subject matter as a process since the algorithm that it encompassed was a mathematical formula and, therefore, a law of nature. The court specifi-
ically stated that “transformation and reduction of an article to a different state or thing” is the clue to the patentability of a process claim that does not include particular machines.”8 This sentiment was continued in Flook, in which the court held that the patent being applied for was not patentable “not because it contains a mathematical algorithm as one component” but because there is a lack of “inventive application of the principle.”9 In other words, it was not the fact that the application involved a mathematical formula that doomed it (as in Benson) but the lack of application to an “invention.”10

In 1981, the courts continued down this line of reasoning in the case of Diamond v. Diehr, in which the U.S. Supreme Court reiterated the reasoning from Benson and Flook, creating the transformation doctrine in which the Court held that “transformation and reduction of an article to a different state or thing is the clue to the patentability of a process claim” not involving machines.11 This “transformation” test focused solely on whether a physical transformation occurs during the process and on little else.

However, in the 27 years since the Diehr decision, the Federal Circuit has expanded upon the physical-transformation rule handed down in Diehr. In the 1998 decision of State Street Bank and Trust Company v. Signature Financial Group, Inc., the Federal Circuit held that the repetitive use of the term “any” within 35 USC Section 101 shows congressional “intent not to place any restrictions on the subject matter for which a patent may be obtained beyond those specifically recited in § 101.”12 The court in State Street continued to carve out an exception for the transformation of data and began to outline the formation of a “utility-based” test for patentability of subject matter under Section 101. The court held that the transformation of data was valid subject matter since it transformed and produced a “useful, concrete, and tangible result.”13 The court focused on whether the transformation of the data involved was “useful” and not whether a strict physical transformation occurred.14 Over the next 10 years, the Federal Circuit would continue to move further away from a “physical transformation” test and move closer and closer to the adopting of a utility test in tune with the congressional desire to allow “anything under the sun that is made by man” to obtain a patent.15

The Utility-Based Test

In AT&T Corporation v. Excel Communications, Inc., the court noted that at one point, the “PTO published guidelines essentially rejecting the notion that computer programs were patentable. As technology progressed, the courts disagreed…and announced more expansive principles formulated with computer technology in mind.”16 The Federal Circuit, mindful that it could not overrule the Supreme Court’s physical-transformation test handed down in Diehr, telegraphed its intent to limit the impact of the rule when it stated that “the notion of physical transformation can be misunderstood.” The physical-transformation test “is not an invariable requirement, but merely one example of how a mathematical algorithm may bring about a useful application.”17 In this manner, the Federal Circuit has effectively displaced the Supreme Court’s physical-transformation test and supplanted it with a utility test as the standard for patentability of subject matter under Section 101. The utility test asserts that a process is patentable if the process produces a “useful, concrete, and tangible result.”18 The Federal Circuit in AT&T reinforced the trend away from requiring a physical transformation when it explained that an invention that dealt solely in numbers did not “render it non-statutory subject matter, unless, of course, its operation does not produce a useful, concrete, and tangible result.”19

The court’s shift to the utility test from more outdated legal methodologies is also evidenced by the Federal Circuit’s most recent reinterpretation of the mathematical algorithm exception established in State Street. The court explained that if a process uses a mathematical algorithm to achieve a “new and useful end, it ‘at the very least is not barred at the threshold by § 101.’”20 While there are conflicting decisions in the case law, the utility test appears to have taken root as the new standard for determining patentable subject matter under Section 101.

The twin cases of In re Comiskey21 and In re Nuijten,22 decided in late 2007, epitomize the struggle over whether the physical-transformation test retains any applicability. Although the decisions were published on the same day, they came to different conclusions concerning the patentability of mental steps processes. The court in Comiskey effectively held that an invention must include a physical transformation in order for it to be the type of thing for which a patent is granted. This conclusion was reached by following a line of cases that had ultimately held that mental steps processes must be tied to another category of subject matter in order to be patentable.23 The court in Comiskey breathed renewed life into the mental steps doctrine by once again concluding that mental steps were not patentable subject matter and likened them to abstract concepts.24

However, the Nuijten court ultimately avoided the question of the patentability of mental steps processes by holding that the proposed invention, a method for embedding a “watermark-type” signal within an audio or video format, did not fall into any category of Section 101 and therefore was not patentable subject matter since it was neither a process (as the court defined it), method, composition of matter, nor a machine.25 Comiskey and Nuijten illustrate the continuing struggle of courts to apply the physical-transformation test and the utility test, as well as whether mental steps processes are patentable.

For example, after granting an en banc hearing and collecting some 100 plus amici curiae briefs, the Federal Circuit Court of Appeals decided in Bilski that the utility test was not the test that should be used in order to ascertain whether a process application indicates Section 101 patentable subject matter. In Bilski, the court held that “while looking for a ‘useful, concrete, and tangible result’ may in many instances [be useful]...that inquiry is insufficient to determine whether a claim is patent-eligible under § 101.”26 The court then proceeded to reaffirm the preeminence of the transformation test, stating that in order to denote patentable subject matter, the process must be tied to a particular machine, or transform an article “to a different state or thing.”27 However, while the court completely dismissed the utility test, it left open the possibility—discussed in the appellant’s supplemental brief—that a patentable process could involve, if not be based completely on, several mental steps.

In explaining this new reasoning, the court held that “the proper inquiry under Section 101 is not whether the process claim recites sufficient ‘physical steps,’ but rather the claim meets the machine-or-transformation test... A claim that purportedly lacks any ‘physical steps’ but is still tied to a machine or achieves an eligible transformation passes muster under §101.”28 As to what constitutes an “eligible transformation,” the court was a little unclear. The court did hold that the “transformation” must be one that “is central to the purpose of the claimed process” and that the patentability of a process that involves a “chemical or physical transformation of physical objects or substances” was “virtually self-evident.”29 Whether the purported transformation could take place entirely in the ether of computer circuitry is less certain.

The court, however, reaffirmed a previous ruling in which it held that the transformation of raw data into a particular visual depiction of a physical object on a display “was sufficient to render that more narrowly-claimed process patent-eligible.”30 As the court stated: “[T]he claim was not required to involve any transformation of the underlying physical object that the data represented.”31 The court continued on—perhaps leaving the door of
Mental Steps after Bilski

To understand why mental steps should be patentable, a review of first principles is in order. The patent system is mandated by the U.S. Constitution in order to “promote the Progress of Science and useful Arts.” To achieve this goal, the patent system stimulates the creative activity of authors and inventors by the provision of a special reward [a limited monopoly], and [allowing] the public access to the products of the genius after the limited period of exclusive control has expired. By allowing a creator to establish a limited monopoly over the invention, the sciences and useful arts are promoted. Society reaps the benefits of the invention during and after the grant of monopoly. The Supreme Court has stated that the patent system was created to foster productive efforts that, in turn, will have a positive effect on society. This is the constitutional and public policy backdrop against which the debate about patenting of mental processes is conducted.

In 1952, the 82nd Congress rewrote what was essentially a nineteenth century version of the patent laws by creating what became Title 35 of the U.S. Code. Two important changes were that Congress eliminated the term “art” from the categories of patentable subject matter, replacing it with the term “process,” and defined a term of the term “process” in what would become Sections 100 and 101.

The legislative history contains an explanation of the intent of Congress when it changed “art” to “process.” Congress explained that the change was necessary in order to clarify that Congress intended “art” in this instance to be synonymous with “process or method” and not to be the same as “useful art” or the way the term is used in “other places in the statute.” In order to make its intent clear, Congress included a definition of the term “process” in the statute. Congress defined it to be “a process, art or method, and includes a new use of a known process, machine, manufacture, composition of matter, or material.” While usage of the term “process” in its own definition is problematic, this usage indicates that the process category is a separate category of patentable subject matter independent of any of the other physical categories of subject matter (machine, manufacture, composition of matter, or material). The legislative history supports this interpretation.

Congress placed no further limitation or restriction on the categorical definition. It is a judicially created truism that the courts “should not read into federal patent laws limitations and conditions which [the] legislature has not expressed.” Since Congress did not divide processes into “mental” and “physical,” the suggestion that somehow these two categories exist—one patentable and the other not—runs contrary to congressional intent.

Since enactment of Title 35, courts have interpreted it as an effort to “to change the slow but steady drift of judicial decision[s] that had been hostile to patents.” This sentiment was echoed by Supreme Court Justice Robert Jackson, who wrote in 1949 that there existed a “strong passion in this Court for striking [patents] down, so that the only patent that is valid is one which this Court has not been able to get its hands on.” Thus, when Congress changed the patent laws in 1952, the change was meant to create a broader and more patent-friendly system. As the legislative history illustrates, “anything under the sun that is made by man” and fulfills the conditions of the title is worthy of patent protection. The wide berth given to the subject-matter standard derives from these patent-friendly policies.

The courts have interpreted the usefulness of an invention in similar terms of benefits to society. Courts have used language such as “capacity to perform function,” “practicability, and accomplishment of a “purpose practically when applied in industry.” Therefore, utility is found in the practicability and application of the process and not from the process itself or an intra-process transformation. Under this rubric, mental steps processes that are practicable, accomplish a purpose, and are applicable to industry and do not fall into the judicially created pitfalls of unpattentable subject matter (e.g., abstract concepts) denote patentable subject matter. This formulation is also in line with congressional intent to create a system that would benefit society. A mental steps process that conforms to these practical requirements is within the applicability and social usefulness standard from which patentability derives.

Alternatively, if the physical-transformation test were to be held as the standard for patentability of a process, the utility and usefulness of the process is taken out of the equation. This would, in turn, defeat the purpose of granting a patent. Precedents and legislative history illustrate that the genius of the patent system rests in the dual benefit conferred upon inventor and society. The inventor benefits monetarily from the limited monopoly, and society benefits from the invention.

While Bilski disavowed the utility test as the test for patentability of subject matter, it did recognize that the standard could be beneficial and did not bar the courts from using the standard entirely. Therefore, it could be
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argued that it would be prudent for a court to employ the utility standard in a case in which additional factors were needed in order to ascertain patentability. While the Bilski court merely mandated that the courts employ the machine or transformation standard first, it did not state that the standard should never be employed.

Additionally, cases that potentially prevent the patentability of mental steps processes run contrary to congressional intent of fostering invention and rewarding risk. Technology has evolved to the point where many processes do not have physical representations. The final product of these processes may be useful, but they would fail a physical-transformation test for subject matter, since no corresponding physical material is produced or changed. Advances in computer science and related industries are illustrative and have made it routine that nothing physical is involved in processes that have a useful result. Software patents typically recite how the physical components of the computer act as a result of the software’s instructions. Essentially, the mental step processes in the software are being patented. Freeing software patents from physical computer components would be a major improvement in patent law.

Furthermore, the court’s assertion that a process claim must be tied to another category of subject matter in order to be patentable (in this instance, the category of machines) erodes the process category as a separate category of patentable subject matter. If a process were tied to another category of subject matter, then it would cease to truly be a process. Instead, it would simply be a new and useful way to use a machine, or manufacture, or composition of matter, which would effectively eliminate the process category as a separate category of patentable subject matter. This would be a way to make a process invention truly patentable, not because it is a process under Sections 100(b) and 101 but rather because it would fall within one of the other categories of subject matter. Thus, once this position is broken down, it becomes apparent that this first prong of the court’s machine-or-transformation test is essentially a pure transformation test, only by another name.

The physical-transformation test was workable in a world where most inventions were physical things. But it is arguably an outdated test of patentability in the twenty-first century. The Bilski court’s reemphasis on the machine-or-transformation test, however, indicates the court’s unwillingness to move forward and evolve the patent law system. Nevertheless, even under the recently affirmed machine-or-transformation test, mental steps processes, in their current forms, are not patentable per se. Instead, an added layer of judicial scrutiny must be applied in order to ascertain whether or not the process is patentable. In the end, the courts must finally recognize that mental steps processes are essential to the evolution of both technology and society and deserve protection.
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Assistant Clinical Professor Orthopaedic Surgery, UCLA 3600 Westwood 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, subspecialty 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 29 years of orthopedic and 21 years of medical legal experience, including defense, plaintiff, insurance carriers, CA Attorney General’s office and Public Defender’s office. Expert testimony pertains to medical, personal injury, and workers’ compensation cases. As a qualified medical evaluator, Dr. Purcell has extensive experience in performing QMEs, AMEs, IMEs, WC evals. See display ad on page 68.

PATENTS

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6815 Noble Avenue, Van Nuys, California 91405
Tel. 818.901.6600 ext. 2810 • Fax: 818.901.6685 • Email: mfriedman@sci.com
Web Site: www.sci.com

Education:
Princeton University and Cornell Medical School

Certificate:
Board Certified Orthopedic Surgeon

Memberships:
Fellowship Sports Medicine
Fellow American Academy of Orthopedic Surgeons
Fellow in the Arthroscopy Association of North America
Fellow in the International Arthroscopy Association
Fellow in the American Knee Society
Fellow in the American Orthopedic Society of Sports Medicine
ACL Study Group
Certified QME, IME, AME

Specialties:
Sports Medicine, Arthroscopic and Reconstructive Surgery of the Knee and Shoulder, and Knee Replacement

Appointments:
Assistant Clinical Professor, Division of Orthopedics, UCLA School of Medicine, Chairman, Education Committee Arthroscopy Association of North America 1997-1999
World Cup Soccer Team Physician, 1985
Physician Specialist XXIII Olympiad 1984

Publications:
60 Publications including handbook for Orthopedic Surgeons on Prosthetic Ligament Reconstruction of the Knee

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9454 Wilshire Boulevard, 6th Floor, Beverly Hills, CA 90212, (310) 247-2637, e-mail: trimarco@ao1.com. Web site: www.jacktrimarco.com. Contact Jack Trimarco. Former manager of the Federal Bureau of Investigation’s Polygraph program in Los Angeles. Former Inspector General Polygraph Program—Department of Energy; Nationally known and respected Polygraph Expert. I have the credentials you would want when you have a client polygraphed, a case reviewed, or a motion made regarding polygraph. My unique background allows me to bring the highest levels of service and expertise to any polygraph situation. Current member of the board of directors and chairman of the Ethics Committee, California Association of Polygraph Examiners (CAPE). Hundreds of appearances on national TV, including Dr. Phil, Oprah, Greta, Nancy Grace, O’Reilly Factor and Hannity & Colmes. Degrees/licenses: BS Psychology; Certified APA, AAPP, CAPE, AAFE. See display ad on page 6.

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Superior Court Commissioner (Retired), P.O. Box 1508, Brea, CA 92822-1508, e-mail: privatejudge92822-1508@att.net. Web site: http://adr-shapiro.com. Retired Los Angeles Superior Court commissioner. (15 years) available to serve as a probate expert witness in cases involving wills and trust issues. Presided in Long Beach Probate Department five years. See display ad on page 4.

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Norton Parker Chipman

What if you were in law school when the U.S. Supreme Court decided Dred Scott? What if you fought in the Civil War, met President Abraham Lincoln, served in the War Department with Secretary of War Edwin M. Stanton, and stood on the stage with Abraham Lincoln during his Gettysburg Address? What if you were asked to prosecute Confederate Army Captain Henry Wirz for war crimes at the notorious Andersonville prison of war camp? What if you were one of the founders of Memorial Day, raised the funds to complete the Washington Monument, and were elected the representative of Washington, D.C., to the U.S. Congress? And if that were not enough accomplishment for one life, what if you were among the first to figure out how to transport redwood lumber to growing California cities and served as the first presiding justice of the California Court of Appeal, Third Appellate District? These are the accomplishments of Norton Parker Chipman.

Modern biographies of historical figures tend to be of two kinds. They either attempt to further illuminate the inner workings of men or women whose public lives and accomplishments are already well documented in previous biographies, or they attempt to save an important and inspiring contributor from becoming an unrecognized name below an unrecognizable portrait hung in a less-traveled hallway of some government building or library. These latter biographies serve a more important purpose than the former. Without them, we would only know the icons of history. Without them, we would believe the fallacy that history is made by the celebrated few, when in fact it is made by the easily forgotten many who spend their lives in service to the very ideals embodied by the often-overexposed celebrities of history. For every Martin Luther King, there were people like Dr. Benjamin Elijah Mays who stood by him. And for Abraham Lincoln, there were men like Chipman.

Jeffery A. Hogge’s biography of Chipman resurrects him from obscurity. In Norton Parker Chipman: A Biography of the Andersonville War Crimes Prosecutor, Hogge chronicles Chipman’s adventures in direct service to Abraham Lincoln as well as to Lincoln’s loftiest ideals of preserving the Union, protecting human rights, and promoting justice. Hogge’s account rightly focuses on Chipman’s public life, rarely illuminating the private man. After all, to rescue Chipman from obscurity, Hogge must recount in detail Chipman’s public accomplishments in a life of service that began in 1860 and ended in 1921.

From this biography, we learn that Chipman, like his father and many of the Founders of this country, was a Freemason. He was born in Ohio but moved to Iowa with his family and attended Washington College. He earned his law degree from Cincinnati Law School in 1859. The Dred Scott case sealed Chipman’s already growing sympathy with the abolitionist movement and his support for Abraham Lincoln for president. He left the practice of law to join the Union Army and distinguished himself leading the charge at the Battle of Fort Donelson, where he was shot in the leg. Thereafter, he served in non-combat command positions as an administrator and military lawyer.

Over half of Hogge’s biography of Chipman is dedicated to Chipman’s life through the Civil War and his prosecution of Wirz for war crimes committed at the infamous Confederate prisoner of war compound in Andersonville, Georgia. Chipman met Lincoln in 1863 and joined the War Department, working directly for Secretary Stanton, and Chipman stood with Lincoln during the Gettysburg Address. Immediately following the war, he prosecuted and secured the conviction of Wirz for war crimes. Hogge’s contribution to these facts is his facility for setting them in context. Often Hogge’s book reads more like a history than a biography, but it is Hogge’s detailed history lessons that illuminate the human drama and the significance of Chipman’s achievements. For example, Hogge reveals the depths of the controversies surrounding the prosecution of Wirz, and the Confederate claims that the Union’s decision to terminate prisoner-of-war exchanges caused the overcrowding and deplorable conditions at Andersonville. Also, the policy of the postwar federal government was reconstruction and reconciliation. So it was no easy task to prosecute Wirz for war crimes, and Wirz’s conviction was anything but a foregone conclusion.

Despite Hogge’s gifts for bringing Chipman and his times vibrantly to life, Hogge’s biography lacks that critical evaluation of his subject that is so important to the credibility of a biographer. Arthur James Balfour once observed that “biography should be written by an acute enemy.” Although Hogge’s credibility does not depend on being Chipman’s enemy, it does require that he be more than an acolyte at Chipman’s memorial. Hogge recounts that Chipman considered the peace movement during the Civil War “intolerable” and that Chipman criticized advocates for peace as “prolonging the war and jeopardizing ultimate Union victory.” A biographer need not be a critic of our last president or his war policies to at least recognize the controversy of Chipman’s opinion of Americans opposed to war. Yet Hogge passes by this without question or critique.

Nevertheless, Norton Parker Chipman is a valuable work. It resurrects Chipman from obscurity and, in Hogge’s exacting historic detail, tells the story of an exceptional man whose public service began during America’s fight to preserve the Union and continued through America’s transition to a dominant world power. Hogge allows us to witness extraordinary events in the life of an extraordinary man. ■

R. J. Comer is a graduate of the Coro Fellowship in Public Affairs Leadership and is a partner at Armbruster & Goldsmith, LLP, where he practices land use law and municipal advocacy.
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Entertainment Year in Review

ON WEDNESDAY, APRIL 29, the Intellectual Property and Entertainment Law (IPEL) Section will host a program covering significant developments in entertainment law over the past year. Speakers Jay F. Dougherty and Stan Soocher will present a practical look at recent key court rulings affecting entertainment industry transactions and litigation. Topics to be covered this year include: digital music sales and artist royalties; the scope of content licenses in new media; video game production; right-of-publicity statutory changes; challenges to unlicensed uses of trademarks; jurisdiction in entertainment industry Internet disputes; copyright terminations; fair use, including its interplay with DMCA takedown notices and new “best practices” proposals; remote DVRs; copyright preemption of state claims, including the right of publicity and misappropriation; the relation between a film and its underlying story; personal jurisdiction and DMCA takedown notices; and the “making available” right. The program will take place at Lawry’s Restaurant, 100 North La Cienega Boulevard in Beverly Hills. Parking is free. On-site registration will begin at 11:45 A.M., with the program continuing from 12:30 to 1:30 P.M. The registration code number is 010383. The prices below include the meal.

<table>
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<th>Price</th>
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<tr>
<td>$31</td>
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<td>$75</td>
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<td>all others with meal</td>
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1 CLE hour

The 110 Days Before Trial

ON TUESDAY, APRIL 7, the Litigation Section will present a program on preparing a civil case for trial in the Los Angeles Superior Court. Speakers Daniel M. Crowley, Judge Mary Thornton House, and James R. Robie will review the many tasks that must be accomplished to get a case ready for successful trial, including calendaring deadlines, getting witnesses lined up, expert witness designations and depositions, organizing exhibits, and preparing for a jury trial. The program will take place at the Los Angeles County Bar Association’s new offices at 1055 West 7th Street, 27th floor, Downtown. Self parking costs $8 with LACBA validation. On-site registration and breakfast will begin at 7 A.M., with the program continuing from 7:30 to 8:30. The registration code number is 010370. The prices below include the meal.

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<td>$15</td>
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<td>$55</td>
<td>attorneys (over 2 years in practice)</td>
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<td>$65</td>
<td>all others</td>
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3 CLE hours

Healthcare Bankruptcies

ON TUESDAY, APRIL 28, the Healthcare and the Commercial Law and Bankruptcy Sections will present an overview presentation on recent developments in the area of healthcare bankruptcies. The program will focus on the recent changes in the bankruptcy laws as applied to healthcare organizations. Specific case examples will be provided where applicable. The registration code number is 010381. The program will take place at the Olympic Collection, 1301 Olympic Boulevard in Los Angeles. Parking costs $7. On-site registration and the meal will begin at 5:30 P.M., with the program continuing from 6:00 to 9:00 P.M. The registration code number is 010381. The prices below include the meal.

<table>
<thead>
<tr>
<th>Price</th>
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<td>$85</td>
<td>Healthcare Section members</td>
</tr>
<tr>
<td>$110</td>
<td>LACBA members</td>
</tr>
<tr>
<td>$120</td>
<td>all others</td>
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<tr>
<td>$130</td>
<td>all at-the-door registrants</td>
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3 CLE hours
The Need to Clarify Creditors’ Rights in Probate

Imagine that a client has been solicited to loan a substantial sum of money on an unsecured basis to an individual residing in a mythical Third World country. On inquiring with foreign legal counsel, you learn that, under the law of the foreign jurisdiction, following the death of the individual, your client’s ability to enforce its rights against the decedent’s estate could be delayed between six months and three years, and that during this period, the decedent’s heirs could be distributed a substantial part, if not all, of the estate’s assets. Clearly, few clients would knowingly subject themselves to these risks.

Surprise! The law of the state of California does not differ materially from that of the mythical Third World nation, at least without careful lawyering. Many of the pitfalls facing California creditors attempting to collect following the death of an obligor were outlined in a previous article appearing in this magazine. These include a one-year statute of limitations for commencing suit against a personal representative of the decedent, the requirement for filing a claim in a probate if the heirs or legatees fail to do so, and, as a condition to filing a probate claim, the need to secure appointment of a personal representative through initiation of a probate if the heirs or legatees fail to do so.

The case of Arluk Medical Center Industrial Group, Inc. v. Dobler illustrates other potential impediments to enforcement of creditor claims when the decedent had established a revocable inter vivos trust. During the individual’s lifetime, property held in a revocable inter vivos trust is liable to be applied in satisfaction of judgments against the individual. After the death of the individual trustee, matters are not so simple. Probate Code Section 19001(a) provides that trust property that was subject to a power of revocation at the time of the trustor’s death “is subject to the claims of creditors of the deceased [trustor’s] estate and to expenses of administration of the estate to the extent that the deceased [trustor’s] estate is inadequate to satisfy those claims and expenses.” The court in Arluk construed this language to prohibit action against a successor trustee until a claim in a pending probate has been reduced to judgment. And, while proceedings are pending, the trustee may without liability pay or distribute trust assets to beneficiaries, even if the remaining assets are insufficient to satisfy creditor claims. (The harshness of this rule may be mitigated by permissive recourse against distributees, subject to the one-year statute of limitations of Code of Civil Procedure Section 366.2.)

This is a warning that, whenever a contract or guaranty provides for personal liability, the obligor should be required to sign both in the obligor’s name as trustee of the trust, as well as in the obligor’s name individually thus permitting direct action against the trust.

It is clear from Arluk that if a probate has been initiated, the creditor must establish its claim in that forum. The course a creditor should follow is also clear when a successor trustee provides optional notice to creditors to file claims. However, when no probate has been commenced and the successor trustee has not initiated the optional claims notice procedure, the recourse of the claimant is unclear.

A leading treatise states that in these circumstances “the creditor may file suit against the trustee to enforce a debt, claim, or action against the deceased settlor.” However, the treatise does not indicate how long the creditor must wait, and it may be argued that the creditor must institute a probate proceeding, rather than suing the trustee, in order to establish the insufficiency of the probate estate.

The law has doubtless reached this state of complexity for legitimate reasons. However, it would seem that many of the policies intended to be served by the present statutory scheme could be implemented by simpler measures. Rather than requiring a creditor to institute a probate proceeding to preserve a claim from the bar of the statute of limitations, it would seem far more efficient for the state to maintain a statewide death registry in which creditors could file claims within one year of the reporting of a death. Filing a claim in the death registry would serve to toll any statute of limitations, pending receipt of a notice of rejection by a legally authorized successor, whether a personal representative in probate or the successor trustee of an inter vivos trustee.

Further, there would seem little justification in prohibiting suit against a successor trustee while probate is pending or while a successor trustee evaluates whether to provide optional statutory notice. By allowing a creditor to file suit against a successor trustee of a revocable trust at any time following the initial trustor’s death, the creditor will be empowered to seek a prejudgment writ of attachment or preliminary injunction if appropriate. California is an acknowledged leader in areas such as science and technology. It is time that our probate laws reflect the twenty-first rather than the nineteenth century.

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1 Stacie S. Polashuk, Death of a Litigant, LOS ANGELES LAWYER, July/Aug. 2003, at 43.
3 Prob. Code §9370.
5 Prob. Code §19400.
7 See Prob. Code §§19001(a) and 19400 and the discussion in Arluk, 116 Cal. App. 4th at 1333-34.

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