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The new, more stringent content standards for lead and phthalates in consumer products apply to businesses at every level of the supply chain.

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BY JAMES R. REPKING AND KATHRYN J. PARADISE
Recent supreme court decisions lay out more exacting requirements for approving zoning variances to ensure that they remain the exception rather than the rule.

A Matter of Opinion
BY JAMES JUO
Patent opinions are being more closely scrutinized in light of the adoption of the “objective recklessness” standard for willful infringement.

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STEVEN L. GLEITMAN, ESQ.
310-553-5080
Biography available at lawyers.com or by request.

Mr. Gleitman has practiced sophisticated estate planning for 26 years, specializing for more than 14 years in offshore asset protection planning. He has had and continues to receive many referrals from major law firms and the Big Four. He has submitted 52 estate planning issues to the IRS for private letter ruling requests; the IRS has granted him favorable rulings on all 52 requests. Twenty-three of those rulings were on sophisticated asset protection planning strategies.
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Silver & Freedman is pleased to announce the addition of our new partner,
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(formerly of Loeb, Katz & Sundberg LLP)

Mr. Bender will continue his practice in the areas of complex commercial litigation, employment counseling and litigation, sports law and trial work.

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As the incoming chair of the Los Angeles Lawyer Editorial Board, it is both my honor and my burden to come up with a few hundred pithy words every month for this column. I will do my best to rise to the challenge by discussing thought-provoking topics in an entertaining, albeit brief, manner. Thankfully, however, for this first month I get to cop out. No need for depth; no need for sublime writing. All I have to do is give appropriate thanks.

Before having to get truly creative, I get the chance to praise the people who have produced this magazine for the past year. I get to recognize Angela Davis who, for the past year, has been the chair and champion of the Editorial Board. Angela led the board to develop the diverse selection of articles we published and set a tone that allowed for an unprecedented degree of discussion and collaboration among board members.

I get to thank Sam Lipsman, our publisher and editor, whose focus and passion inspired us all to work harder to produce the very best articles for our readers. I get to thank the other members of the professional staff—Lauren Milicov, Eric Howard, Les Sechler, Patrice Hughes, Linda Bekas, Meryl Weitz, Aaron Estrada, Tracy Nadeau, and Matty Jallow Baby—who work tirelessly behind the scenes month after month, handling the immense number of nitty gritty details required to ensure that the magazine makes it to readers’ hands every month. I get to thank the authors of our articles—without whom, let’s face it, we would not have anything to publish. I get to thank the advertisers who actually pay the bills and the Los Angeles County Bar Association which, well, pays the rest of the bills. And I get to thank last year’s articles coordinator (me!) who—eh, he wasn’t that special.

Los Angeles Lawyer may only be a regional bar magazine. But the fact is that we live in one of the largest and most diverse cities in the world. Association members come from a variety of different backgrounds and practice in every field of law imaginable. Month after month, the people working on this magazine strive to do justice to that readership by finding fascinating subjects and knowledgeable, engaging authors to write about them. Because of the enduring commitment of our Editorial Board and the unflagging support of the staff, we continue to find new and interesting topics to cover. Whether readers are looking to learn new areas of law or to familiarize themselves with an aspect of a well-known field, they can find something worthwhile in this magazine.

Over the next 12 months we will be working to deliver more articles on legal issues of interest to our readers. In addition to our annual special issues on entertainment and real estate law, we are also developing a special issue focused on legal subjects arising from the financial crisis. A number of our existing board members will be returning to continue their work for another year. We also have a very capable group of new board members who will help bring some new ideas and new topics. I am looking forward to working with them to develop another year of quality content. I hope you enjoy the result.

It is a great honor to be a part of this longstanding (by Los Angeles standards, at least) publication and to follow in a long line of very talented board chairs. I am humbled by the example they have set and hope I can do it a little justice over the next year.

David A. Schnider is general counsel for Leg Avenue, Inc., a distributor of costumes and apparel. He is the 2009-10 chair of the Los Angeles Lawyer Editorial Board.
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The New Challenges Facing the Legal Profession

AS OUR PROFESSION AND THE JUDICIAL BRANCH of government come under increasing stress, the Los Angeles County Bar Association must reach out to do whatever it can to offer assistance. It is, put simply, our responsibility as the largest metropolitan bar association in the country.

Many lawyers in our city have seen their practices and their firms severely affected by the global economic downturn. Hundreds of the best and brightest of recent law school graduates have lost their jobs, and third-year law students have had offers of employment withdrawn or delayed. In this unprecedented situation, the Association needs to develop and offer programs to assist Los Angeles lawyers in these difficult times.

Our Barristers, under the leadership of new President David Swift and Kimberly Clancy, stepped up to the plate by organizing a program for lawyers suffering a dislocation in their practice. The program featured a panel of experienced legal recruiters who discussed topics including the state of the legal market in light of recent layoffs, the types of jobs that are available (law firm, in-house, and legal alternatives), active practice areas where jobs may be available, resume and interviewing tips, how lawyers can make themselves marketable, and how to start a new firm. About 250 lawyers and law students attended the program, which received very positive reviews. Programs like this are not only valuable to our current members, but also attract new members. I very much appreciate the leadership of David and Kim, and we hope to build on their success and develop other programs that will offer assistance to lawyers in identifying employment opportunities.

In a further attempt to assist attorneys whose careers have been disrupted, we have created two new electronic services. The first is the Attorney Career Support List Serve Forum (http://www.lacba.org/careersupport). The purpose of the forum is to allow participants to share information and assistance about topics such as job availability, job-seeking guidance (resume development, interviews skills, etc.) and changing or opening a new practice, as well as the myriad personal and family issues that arise from economic dislocation. The forum is open to Association members as well as attorney nonmembers and nonattorneys who are able to provide guidance and assistance to attorneys seeking career support. Individuals may sign up for the list serve online or by contacting Member Services at (213) 896-6560 or at msd@lacba.org. The second service is a revised Jobs Bulletin Board (http://www.lacba.org/jobs). This bulletin board lists jobs offered and jobs wanted, for attorneys and for other legal professionals, in an easily searchable format.

LACBA is a service organization, and to retain members and attract new members we must offer programs and services that have value. We believe the following innovations and programs will show the lawyers of Los Angeles that Association membership is well worth the money.

We have 24 substantive law sections, which in the 2007-08 program year offered 416 CLE programs, attended by well over 16,000 lawyers. In March we moved our offices to 1055 West Seventh Street. The new facilities for conducting educational programs are first class and present a fine environment for learning. However, we are well aware that it is difficult for many lawyers to come to downtown Los Angeles at noon or at the end of the day. As part of our move, we therefore invested in technology that permits us to transmit online training, briefings, and courses via the Internet with state-of-the-art technology. Lawyers will be able to access our programs in real time in audio, video, and Power Point. Through Webcasting we will be able to reach a wider audience by making presentations available to those not able to attend in person. Webcasting also allows subsequent online distribution of the recordings for lawyers to watch at their own convenience. This technology will offer our members a new means of participating in our programs, on an economical basis, without leaving their offices.

A large segment of lawyers in the county have solo practices or practice in small firms. Recognizing this reality, we have supported our Small Firm and Solo Practice Division in its efforts to provide valuable practice management information to our members. The division currently has 374 members and has put on a number of programs and networking events. On June 24 and 25, the Association held its second annual Solo and Small Firm Conference at the Los Angeles Convention Center. The first conference was very well attended, confirming our belief that lawyers in solo practice or with small firms are a segment of the Los Angeles legal community that we must continue to serve.

To make the Association relevant to lawyers at all levels of practice, we offer a exemplary outreach program to law schools, with hun-
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dreds of law students and faculty members involved in all aspects of the Association. At the other end of the experience spectrum, under the leadership of our former president David Pasternak, we now have a Senior Lawyers Division with over 3,000 members. This section will create opportunities for the senior members of the Association to provide valuable mentorship to our newer members.

Even though LACBA is the largest metropolitan bar association in the country, with many valuable membership benefits, there are numerous lawyers in Los Angeles County who have, for one reason or another, chosen not to become members, including too many lawyers in the largest firms. We have therefore created a committee under the leadership of Senior Vice-President Eric Webber that is looking into how we can remedy this situation. These lawyers should be members, and if we can offer programs they deem valuable to their practices, we should be able to gain their membership. We are committed to identifying the various reasons that these lawyers have chosen not to become members and to remedy the situation.

We also have a responsibility to the Los Angeles Superior Court, the largest and best trial court in the world. It operates 49 court-houses, has 600 judicial officers, and tens of thousands of people pass through its doors each business day. The court-houses are overcrowded, their physical condition continues to deteriorate, and the gap between population growth and judicial positions continues to widen, resulting in overwhelming case-loads, and the judicial officers working in this environment are grossly undercompensated. Meanwhile, the funding available to our court continues to decline. Unless something unforeseen occurs, the services litigants and attorneys in Los Angeles are used to will begin to be seriously diminished. The leadership of the court is committed to avoiding a reduction in services, but with diminishing resources this may not be possible. The public and the legislature seem oblivious to this serious threat to the administration of justice. Our association is committed to doing whatever it can to assist the court when it is within our power to do so. We will not need to be asked. If a need arises and we can help, we will.

The officers and trustees of the Association are committed to being of service to our members. If anyone feels we are falling short in any respect, we need to know. We will do our best to be responsive to the concerns of our members. Contact information for all the officers and staff will become available in the Association directory (inserted in the October issue of this magazine) and on our Web site. We welcome comments and suggestions on how we can better serve you.
Charting a New Course for the Barristers

**AS THE BARRISTERS SECTION** of the Los Angeles County Bar Association celebrates its 80th anniversary, it is important to reflect on the state of the organization. Under new membership requirements adopted in 2004, every member of the Los Angeles County Bar Association who is 36 years of age or younger, or who has been admitted to the bar for 10 years or fewer, is a Barristers member. Over 7,200 attorneys fall within these criteria, including first-year associates, big-firm partners, government attorneys, public interest attorneys, in-house counsel, sole practitioners, and more. With such a large and diverse membership, the Barristers has the capacity and the obligation to help shape the future of the legal community.

The mission of the Barristers is “to further the personal and professional development of our members, to promote public service, and to provide a forum for addressing legal and social issues of importance in our profession and community.” This mission is as important today as it was when the organization was founded. The legal community is struggling with a host of issues, including access to legal services, the retention and promotion of women and minorities, growing salary disparities between the public and private sectors, overburdened courts, a growing lack of civility within the profession, increased calls for alternative billing methods, and recently, large-scale layoffs. By focusing on our mission, we can make the Barristers more relevant and more meaningful. Two recent Barristers programs reveal our new focus.

In April, the Barristers hosted a panel discussion with a number of prominent legal recruiters on the state of the legal job market and the realistic job possibilities for recently laid off attorneys. Over 150 attorneys came to hear the panel’s advice and views on the state of the legal market. Layoffs have become an unfortunate reality, and through programs of this type, the Barristers can continue to support our colleagues who have been affected.

In May, the Barristers joined forces with the Asian Pacific American Legal Center, Legal Aid Foundation of Los Angeles, Neighborhood Legal Services of Los Angeles County, and Public Counsel to host three separate foreclosure relief clinics in some of the most affected areas of Los Angeles County. Over 250 attorneys signed up to be trained and to volunteer to counsel homeowners facing foreclosure. In addition to providing a great pro bono opportunity for the volunteer attorneys, the Barristers was able to make a difference in the lives of many hundreds of families. By hosting pro bono programs such as the foreclosure relief clinics, the Barristers can provide opportunities for our members and services to the community.

In light of this new focus, the Barristers is in the process of reorganizing its board into a series of independent committees, each tasked with a discreet area of programming. We hope that this committee system will enable more young attorneys to become involved in Barristers leadership and improve our programming. We have some exciting announcements about our committees:

- Jen Flory, of the Western Center of Law and Poverty, will chair the Barristers Pro Bono Committee, which will focus on establishing meaningful clinics and pro bono opportunities for our members.
- Andrew Dhadwal, of the California Department of Justice, will chair our Bench and Bar Committee, which will focus on planning events with members of the judiciary.
- Sarah Luppen, of Simpson Thacher & Bartlett, will chair our Professional Development Committee, which is responsible for all the Barristers CLE programming and will continue to build on the huge successes of our annual Nuts and Bolts of Litigation program.
- Wes Shih, of Munger Tolles & Olson, will chair our Outreach Committee, which will focus on providing interesting and meaningful charitable opportunities for our members.
- David Reinert, of the Los Angeles County District Attorney’s office, will chair our Moot Court Committee, which hosts and provides judges for the western regional round of the annual New York Bar National Moot Court Competition.
- Kim Clancy, of Sidley Austin, will chair our Legal Profession Committee, which will focus on events that address the many difficult issues facing our profession.
- Laura Shin, of the Los Angeles mayor’s office, will chair our Government Relations Committee, which will focus on planning events in which our members will have an opportunity to meet and interact with local elected officials and those running for office.
- Mhare Mouradian, of Murchison & Cumming, will chair our Networking Committee, which will continue to plan appropriate events for our members.
- Sarah Luppen, of Simpson Thacher & Bartlett, will chair our Huawei Committee, which will focus on events that address the many difficult issues facing our profession.
- Jen Flory, of the Western Center of Law and Poverty, will chair the Barristers Pro Bono Committee, which will focus on establishing meaningful clinics and pro bono opportunities for our members.
- Andrew Dhadwal, of the California Department of Justice, will chair our Bench and Bar Committee, which will focus on planning events with members of the judiciary.
- Sarah Luppen, of Simpson Thacher & Bartlett, will chair our Professional Development Committee, which is responsible for all the Barristers CLE programming and will continue to build on the huge successes of our annual Nuts and Bolts of Litigation program.

Over 250 attorneys signed up to be trained and to volunteer to counsel homeowners facing foreclosure.

- Mhare Mouradian, of Murchison & Cumming, will chair our Networking Committee, which will continue to plan appropriate events for our members.
- Wes Shih, of Munger Tolles & Olson, will chair our Community Outreach Committee, which will focus on providing interesting and meaningful charitable opportunities for our members.
- David Reinert, of the Los Angeles County District Attorney’s office, will chair our Moot Court Committee, which hosts and provides judges for the western regional round of the annual New York Bar National Moot Court Competition.
- Laura Shin, of the Los Angeles mayor’s office, will chair our Government Relations Committee, which will focus on planning events in which our members will have an opportunity to meet and interact with local elected officials and those running for office.
- Kim Clancy, of Sidney Austin, will chair our Legal Profession Committee, which will focus on events that address the many difficult issues facing our profession.

I hope that you are as excited as I am about this year and that you will see fit to join a Barristers committee and help plan a pro bono program, a CLE program, a networking event, or a discussion on any of the many issues affecting our profession. With your involvement and with new energy and an increased focus on addressing the issues of importance to our profession, the Barristers can become a more meaningful organization for you and for the community.

If you are interested in becoming involved, please e-mail your resume, along with a list of committees on which you’d like to serve, to Gail Coleman at the Association (gcoleman@lacba.org).

David W. Swift, president of the Los Angeles County Bar Association Barristers, is an associate at Kinsella Weitzman Iser Kump & Aldisert LLP, where he focuses on general business litigation and white collar criminal defense.
SEVERAL FEDERAL TAX ISSUES arise in film production financing deals with foreign investors. The foreign investors may be interested in a screenplay that could be produced in the United States on a relatively small budget but has the potential to attract A-list actors and actresses for the leading roles. To finance production for the film, from the development stage through post-production, the producer and the foreign investors typically enter into a joint venture by forming a limited liability company (LLC) in Delaware. If all goes well, they may use the same LLC to invest in future films with box office potential.

The popularity of the LLC structure is easy to understand. From a corporate perspective, the LLC structure requires fewer formalities than a traditional corporate structure but has the same limited liability protection for its members. It has more flexibility in management, organization, and operation. Units or membership interests in an LLC are treated as a member’s personal property, and units or interests that are issued to non-U.S. persons do not require any formal registration under exemptions to certain federal and state securities laws.

From a U.S. income tax perspective, an LLC may or may not be recognized as a separate entity. It is either a disregarded entity, a partnership, or a corporation. Unless the LLC agreement provides for an affirmative election to be classified as a corporation, it is treated for tax purposes either as a disregarded entity or a partnership.

Unlike income from traditional C corporations, which can be taxed twice, partnership income is taxed only once at the partner level. As a result, the income, profits, deductions, and losses generated by the partnership generally flow through the LLC to the investor on a pretax basis as reflected on a Schedule K-1. Typically, investors seeking to maximize returns on their capital prefer this arrangement, because their distributive share of partnership income will involve only one level of tax.

Generally, an LLC classified for U.S. tax purposes as a partnership may allocate items of partnership income, gains, deductions, losses, and credits and make distributions—in cash or in-kind—to its members in any given taxable year. These allocations and distributions reflect a member’s distributive share of partnership income, for which a member may incur federal and state income tax liabilities. These taxes are the direct liability of each member of the LLC.

Under the U.S. tax system, foreign investors in an LLC have exposures that are different from what U.S. investors face. Tax issues affecting foreign investors who are members of LLCs must be vetted at the start of a deal to avoid undesirable tax consequences.

Foreign Partners in LLCs
An LLC classified as a partnership is subject to one level of tax at the partner level, but the amount of tax payable at this level is contingent on the partner’s status as a domestic or non-U.S. (i.e., foreign) person. Domestic U.S. investors who are partners expect to pay taxes, based on their prevailing U.S. federal and state tax rates and income and cash distributions received from the LLC, as shown on each partner’s Schedule K-1. Foreign partners may not have these expectations. Indeed, how does a foreign partner who 1) is not physically located in the United States, 2) does not maintain an office in the United States, and 3) does not have any employees or representative agents in the United States, become subject to federal and state income taxes simply because of a one-time investment in a small feature film?

According to a maxim of Sir Arthur Conan Doyle, “When you have excluded the impossible, whatever remains, however improbable, must be the truth.” Under the Internal Revenue Code of 1986 and its accompanying regulations, if a foreign partner has business activities, offices, or employees within the United States, his or her distributive share of partnership income is deemed to be “effectively connected” with trade or business conducted within the United States. Effectively connected income, or ECI, is taxed at graduated rates.

Marsha-laine F. Dungog, a tax partner at Hobson Dungog LLP, advises clients on business tax planning matters, including cross-border film production and distribution deals, tax credit financings, and joint ventures.
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The Red Mass was first celebrated in Paris in 1245 and began in England about 1310 during the reign of Edward I. The entire Bench and Bar would attend the Red Mass together at the opening of each term of Court. The priest and the judges of the High Court wore red robes, thus the Eucharistic celebration became popularly known as the Red Mass.

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

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posing that a domestic LLC engaged in film production activities within the United States probably constitutes a trade or business within the United States. Thus, a foreign partner’s mere ownership interest in the LLC makes the partner the recipient of partnership income that is effectively connected to trade or business conducted within the United States. This tax issue must be discussed with the foreign partner at the negotiation stage of the deal, so it can be taken into account in the financing terms of the deal.

A foreign partner may wonder how the IRS would know about the foreign partner’s distributive share of partnership income from the LLC if the foreign partner does not file tax returns in the United States. The answer is simple: The LLC is required to disclose the existence of a foreign partner. The IRC imposes certain obligations on a partnership with a foreign partner regarding the reporting of tax returns and income tax, including disclosing the identities of a foreign partner and amounts actually or constructively received by the foreign partner from the LLC.

The LLC must file a partnership return (IRS Form 1065) with the IRS if it has income, deductions, or credits to report. The LLC also must provide a Schedule K-1—containing the information shown on Form 1065—to each of its members, including foreign partners.

The LLC must withhold taxes for each foreign partner’s distributive share of partnership income, even if no actual distributions are made to the foreign partner. The rate of withholding depends on whether the foreign partner’s distributive share of partnership income is ECI or not. If there is ECI, the LLC must withhold on the ECI amount at the maximum rate prescribed under the IRC, depending on the corporate or noncorporate status of the foreign partner. If there is no ECI, the amount of withholding is 30 percent, unless the foreign partner provides the applicable Form W-8 to the LLC entitling the foreign partner to a reduced rate of withholding or an exemption from withholding altogether. The foreign partner should present a Form W-8 at the start of the LLC year to avoid any unnecessary withholding on the foreign partner’s cash distributions. Obtaining a tax attorney’s review of the partner’s Form W-8 at the start of the LLC year to avoid unnecessary withholding problems is advisable, because a defective W-8 can lead to many unnecessary problems.

If the foreign partner’s distributive share of partnership income is ECI, then the LLC must report and pay a withholding tax under the IRC because of the foreign partner. This tax is referred to as Section 1446 withholding tax. The amount of Section 1446 withholding tax payable by the LLC generally is determined by multiplying the effectively connected taxable income (ECI) allocable to each foreign partner with the highest rate of tax to which the foreign partner is subject under the IRS. The Section 1446 withholding tax must be paid on an installment basis by the partnership itself, regardless of the foreign partner’s ultimate U.S. tax liability amount and whether actual distributions are made to the foreign partner during the tax year. It is likely in the foreign partner’s best interests to file a U.S. tax return in order to claim a credit for any Section 1446 taxes paid by the LLC on the foreign partner’s account. Doing so will reduce the foreign partner’s own U.S. tax liability.

The LLC must file a disclosure statement with the IRS if it has participated in certain transactions—such as a sale, exchange, retirement, or other taxable disposition—that constitute “reportable transactions” under the IRC’s tax shelter provisions. The LLC—or its members taking part in a reportable transaction—must file a disclosure statement, Form 8886, with the IRS that describes the transaction with “adequate information.” This generally includes information about other members of the LLC, including any foreign partners.

Corporate Blockers

Foreign investors may have a multitude of reasons to avoid direct investment in an LLC taxed as a partnership, not the least of which is the tax exposure. Most foreign investors do not relish the prospect of filing U.S. informational returns as a result of LLC membership and are repelled further by the likelihood of being subject to U.S. withholding and income taxes on amounts received (or deemed received) from the LLC, particularly if these investors have no other connections to the United States.

The result is that foreign investors regularly invest in domestic LLCs by way of corporate entities known as corporate blockers. The benefit to using a corporate entity is that it effectively blocks any income and withholding taxes that would otherwise be imposed on the foreign investor if he or she were to invest directly in the LLC. The trade or business conducted within the United States by a domestic corporate entity is not attributed to the foreign investor. This means that mere ownership of shares in a corporate blocker will not give rise to ECI, nor will the LLC be required to pay Section 1446 withholding tax, because the entity holding the LLC membership’s interests is a domestic corporation.

There are, however, several downsides to the corporate blocker structure. The most obvious is that a corporation is subject to two levels of taxation. Tax is imposed once on the corporation for income earned by the corporation and again at the shareholder level upon the corporation’s distribution of earnings and profits to shareholders in the form of dividends. If a shareholder receiving dividends is a foreign shareholder, the received dividend amount is net of witholding taxes taken out by the corporation.

A domestic corporate blocker incorporated in Delaware pays federal taxes on its distributive share of LLC taxable income at a rate of 35 percent. A U.S. shareholder of the corporate blocker pays an additional 35 percent on the dividends distributed by the corporate blocker because those dividends are taxed as ordinary income (unless they are qualified dividends, in which case the applicable rate is 15 percent). A foreign shareholder, on the other hand, receives the dividend amount net of 30 percent withholding tax in addition to paying taxes imposed under the tax laws of the foreign shareholder’s country on the same dividend amount. This outcome can be reduced or altogether avoided if there is an income tax treaty in place between the United States and the foreign shareholder’s country of residence for tax purposes. Most income tax treaties between the United States and other countries provide for a reduced rate of withholding or an elimination of the withholding tax altogether on certain dividends remitted from the United States to the foreign shareholder, provided certain conditions are met. More recent tax treaties also impose additional restrictions on those seeking to qualify for the elimination of withholding tax. These are provided under the limitation of benefits (LOB) article of the applicable treaty.

Some foreign investors try to reduce the impact of U.S. federal and state taxes on the domestic corporate blocker by domiciling the corporation in foreign jurisdictions that have effective corporate tax rates that are substantially less than the corporate tax rates in the United States. These corporations thus become foreign corporate blockers. Other foreign investors aggressively pursue a maximum rate of return domicile corporate blockers in tax haven jurisdictions, which not only provide for the incorporation of foreign corporations but offer the benefits of a corporate blocker structure without the burden of U.S. corporate tax rates.

However, a foreign corporate blocker is anything but a tax-free alternative. A foreign corporate blocker structure is still subject to U.S. federal and state income taxes based on its distributive share of partnership income received from the LLC, because it owns a membership interest in a domestic partnership. The amount of taxes payable by the foreign blocker is contingent on
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whether or not its distributive share of partnership income from the LLC is effectively connected with a trade or business conducted within the United States. If the income is non-ECI, it is subject to a 30 percent withholding tax at source.18 But if the foreign corporate blocker's distributive share of partnership income from the LLC is ECI, it is required to file a U.S. tax return and pay tax on that income at graduated rates.19

The LLC's film production business is likely to be characterized as a trade or business in the United States. One of the consequences is that the LLC may end up having to pay a Section 1446 withholding tax because a portion of the foreign corporate blocker's distributive share of partnership income from the LLC is ECI. Additionally, a foreign corporate blocker with ECI may be subject to an additional tax known as the branch profits tax.20 Generally, the branch profits tax is a 30 percent tax on the foreign blocker's earnings and profits (without diminution as a result of any distributions made by the foreign blocker during the taxable year) that are attributable to income effectively connected (or treated as effectively connected) with a trade or business conducted within the United States.21 The reality is that a foreign corporate blocker may ultimately end up with tax results similar to those arising from a U.S. corporate blocker's ownership, on behalf of a foreign investor, of LLC membership interests. Tax treaties do play a critical role in reducing the overall amount of U.S. tax liability due from any foreign entity. Tax treaties entered into between the United States and other countries can provide for reduced rates of withholding or elimination of withholding on certain dividends received by a foreign investor. The tax treaties can also determine the imposition of branch profits taxes. But before any review of the tax treaties applicable to a foreign partner, counsel must ensure that the foreign partner is truly foreign22 and that the structure meets the criteria set forth in the LOB provisions found in most U.S. tax treaties.23

Ultimately, the tax issues in a film financing deal with a foreign investor component are resistant to the use of the corporate blocker as a “one size fits all” solution. The best approach for dealing with the additional tax burden triggered by foreign investors in a film project is to flag all issues at the outset and discuss these with clients and foreign investors to formulate the most sensible solution.


2 Technically, the Treasury Regulations do recognize at least one type of LLC—the single member limited liability company, which is treated by default as a disregarded entity. See Treas. Reg. §301.7701-3(b).

3 See generally Treas. Reg. §§301.7701-1 to 301.7701-4. For a state-by-state survey of LLC tax statutes, see generally COMMITTEE ON STATE TAXATION, 50 STATE SURVEY ON LLC/LLP TAXES (2004).

4 The default classification is contingent on the number of members of the LLC. An LLC with one member is treated as a disregarded entity, while an LLC with two or more members is treated as a partnership. See Treas. Reg. §301.7701-3.

5 Corporate income tax is paid at the corporate level and then at the shareholder level when distributed as dividends. See generally BORIS I. BITTKER & JAMES S. EUSTICE, FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS §1.01 (2000 ed.).

6 See generally I.R.C. §7701(a)(30), which defines a “U.S. Person” as a citizen or resident of the United States, a domestic partnership, or any estate (except foreign estates), and any trust (provided certain requirements are met).

7 ARTHUR CONAN DOYLE, THE SIGN OF THE FOUR (1890); see http://www.brainyquote.com/quotes/authors/a/arthur_conan_doyle.html (site visited Feb. 20, 2009).

8 See generally I.R.C. §871(b).

9 I.R.C. §864(b) provides a very limited definition of “U.S. trade or business.” Exactly what constitutes a trade or business within the United States has been the subject of various IRS rulings and court cases over the years. See generally JOEL D. KUNTZ & ROBERT J. PERONI, U.S. INTERNATIONAL TAXATION §C.104 (2009).

10 I.R.C. §875 and Treas. Reg. §1.875-1, which provide that a foreign partner’s ownership in a partnership is considered to be engagement in a trade or business within the United States.

11 The partnership is also subject to certain backup withholding and information reporting obligations. These requirements may apply to distributions of cash and proceeds from the sale, exchange, or other disposition of membership interests held by domestic partners in the partnership. If the domestic member fails to furnish a U.S. taxpayer identification number (typically by providing a completed and executed IRS Form W-9) and certify that it is not subject to backup withholding, or fails to otherwise comply with applicable backup withholding exemption requirements, the partnership and/or its agent, broker, or any paying agent may be required to apply backup withholding to relevant payments to members. However, certain domestic members that are U.S. persons (including, among others, corporations) are not affected by these requirements. Because backup withholding is not an additional tax, any amounts withheld under backup withholding rules from payments to a domestic member may generally be claimed as credits against that domestic member’s U.S. federal income tax liability, provided that the required information is timely furnished to the IRS.

12 See generally I.R.C. §6031, Treas. Reg. §1.6031(a)-1; see also I.R.C. §6698.

13 See Temp. Treas. Reg. §1.6031(b)-1T; see also I.R.C. §6722.


15 Foreign persons aresubject to a taxation rate of 30 percent on income received from U.S. sources that consist of interest, dividends, rents, premiums, annuities, compensation for services, or other fixed determinable annual or periodic payments, profits, or income. The rate is imposed on the gross amount and collected through a withholding-at-source mechanism. See I.R.C. §§861(a), 871, 881, 864.

16 The appropriate form of withholding documentation depends on the foreign partner’s status. See generally I.R.C. §§1441, 1442.

17 See generally Treas. Reg. §§1.1441-1(c) and 1.1441-1(c), which describe the information that must be filed in Form W-8 and provide guidelines for determining the validity and execution of the form.

18 I.R.C. §1446(a).

19 Taxable income, subject to certain adjustments, is effectively connected with trade or business conducted within the United States.

20 See Treas. Reg. §1.1446-1 through 1.1446-6. For the highest applicable percentage rate for noncorporate partners, see I.R.C. §§1; for corporate partners, see I.R.C. §§11(b)(1).


22 The foreign partner cannot rely on the LLC’s tax filings. Instead, it must file its own tax returns (Form 1040NR, Form 1065, Form 1120F, or other applicable forms) and pay tax due.

23 Amounts paid by the LLC as I.R.C. §1446 withholding tax with respect to any foreign partner 1) are creditable against that partner’s tax liability for the tax year in which the LLC’s tax year ends, and 2) are treated as distributed to that foreign partner by the partnership. The foreign partner must file its own tax return (whether on Form 1040NR, Form 1065, or Form 1120F) and pay tax due.

24 See generally I.R.C. §6101-4(b). If the partnership participates in a reportable transaction, each member of the partnership is treated as participating in the transaction.

25 Failure to disclose a reportable transaction incurs a penalty under I.R.C. §6611, which ranges from $50,000 (noncorporate) to $50,000 (corporate) depending on the status of the offending taxpayer.

26 See generally I.R.C. §871(a).

27 See generally I.R.C. §11.

28 See generally I.R.C. §§61 and 861(a). The dividends-received deduction, which reduces the effective rate on dividends, is not available to foreign shareholders for dividends received from a corporate blocker. See generally I.R.C. §243.

29 See generally I.R.C. §§861(a) and 871(a).

30 See I.R.C. §1(b)(11)(B)), as amended by the 2003 Jobs and Growth Act §302, Pub. L. No. 108-27 (May 28, 2003). “Qualified dividend income” involves dividends received during the tax year from domestic corporations and certain foreign corporations described under I.R.C. §1(d)(1)(C). Qualified dividends are taxed at the same rates applicable to net capital gains. Qualified dividend income received by partnerships is passed through to partners and taxed at the partner level at the 15 percent rate, provided these dividends are received after December 31, 2002, and before December 31, 2010. See §102, Pub. L. No. 109-222 (May 17, 2006) and §402, Pub. L. No. 108-311 (Oct. 4, 2004).

31 For some foreign investors, it is not the 30 percent withholding that generally reduces their rate of return. After all, they would be subject to the same 30 percent withholding if they had invested directly in the LLC rather than through a corporate blocker. Rather, it is the underlying corporate tax rate, applied at the corporate blocker level, that could potentially impact the foreign investor’s rate of return unless managed effectively.

32 If the foreign investor does not expect to receive any dividends from the domestic corporate blocker, an opportunity exists to avoid the dividend withholding tax under the applicable tax treaty. In these circumstances, foreign investors would receive their return of capital (and some) invested in the corporate blocker through a sale of the blocker’s shares owned...
by the foreign investors. A sale of corporate shares would result in capital gain, which generally would not be subject to tax in the United States but in the country of residence of the foreign investors. See, e.g., United States-Italy Income and Capital Tax Convention art. 13(4) (entered into force Dec. 30, 1985) (U.S.-Italy Tax Treaty).

For example, dividends from the U.S. domestic corporate blocker to a foreign shareholder who is an Italian resident would be subject to a withholding tax of 5 percent if certain conditions are met. See U.S.-Italy Tax Treaty art. 10(2)(a), supra note 33.

See, e.g., Convention between the United States and the Kingdom of the Netherlands for the Avoidance of Double Taxation and Prevention of Fiscal Evasion with Respect to Taxes on Income art. 10 (Dec. 1992) (the U.S.-Netherlands Tax Treaty), which provides for a withholding tax on dividends at a rate of 15 percent and a reduced withholding tax rate of 5 percent on dividends paid from the United States to a resident of the Netherlands if the resident owns shares that represent 10 percent or more of the voting power of the U.S. company paying the dividend. The withholding rate is completely eliminated if the dividend is paid to a resident company that owns 80 percent or more of the voting power of the company declaring the dividend for the 12-month period ending on the date the dividend is declared. Further restrictions on the ability to claim the 0 percent withholding rate were added as art. 26 of the U.S.-Netherlands Tax Treaty, titled “Limitation of Benefits.” Article 26 contains certain ownership and derivative benefits tests that were formulated specifically to protect against treaty shopping and prevent certain taxpayers from reorganizing to become eligible for the elimination of withholding tax on dividends. See art. 3 and art. 7 of the Protocol Amending the U.S.-Netherlands Tax Treaty (Mar. 2004) and the Department of the Treasury Explanation of the Protocol signed at Washington on Mar. 8, 2004, Amending the U.S.-Netherlands Tax Treaty (2004). See also art. 28 of the Convention between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with respect to Taxes on Income and Capital and to Certain Other Taxes (Jan. 1990) and art. 21 of the Convention between the Government of the United States of America and the Government of the Kingdom of Belgium for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income (Nov. 2006).

The U.S. effective tax rate is currently 39.6%, compare the tax rate of other countries, such as Cyprus (10%), Hungary (20%), Ireland (12.50% excluding capital gains), Switzerland (16.9% excluding capital gains, which are taxed at 7.80%), the Netherlands (25.3%), Luxembourg (28.59%), and Belgium (33.99%).

Tax haven jurisdictions include the Bahamas, Bermuda, British Virgin Islands, Cayman Islands, and the Isle of Man.

See generally I.R.C. §881. The 30 percent withholding rate may be further reduced by timely and appropriate invocation of the applicable treaty between the United States and the foreign corporate blocker’s domicile. Note, however, that certain jurisdictions commonly referred to as tax havens do not have any tax treaty with the United States.

See generally I.R.C. §882.

See generally I.R.C. §884.

See I.R.C. §884(a), (d).

Various U.S. tax antideferral mechanisms embedded in the Internal Revenue Code are triggered when 10 percent or more of the foreign corporate blocker (or the foreign investor in the corporate blocker) is directly or indirectly owned by a U.S. person. See generally I.R.C. §§5954 (subpart F) and 1297 (PFIC).

See note 35, supra.
Gaining Land Use Approvals for Los Angeles Charter Schools

ACCORDING TO THE ANNUAL charter school research survey conducted by the Center for Education Reform (CER), California leads the nation in the number—698—of operating charter schools. An additional 65 schools will be opening in the 2008-09 school year. According to CER, a charter school is a public, tuition-free school that serves a majority of at-risk, minority, and poor students, enjoys freedom and autonomy to manage its operations, and offers longer school days, longer school years, and innovative curricula not available in conventional public schools. A charter school may be operated as or by a nonprofit public corporation. However, despite their public school status, charter schools must first obtain the grant of a charter (usually from the local school district) and comply with local zoning regulations of cities or counties and applicable permitting procedures before they can open their doors to students. Just like any residential, commercial, or industrial project developer, the organization behind a charter school must obtain local zoning and land use approvals.

The governing board of a school district has the power, by a two-thirds vote, to render a city or county zoning ordinance inapplicable to a proposed use of property by the school district for classroom facilities. This general exemption authority can also be exercised by a school district to exempt charter school facilities from city or county zoning ordinances when those facilities are physically located within the geographical jurisdiction of the school district. In Los Angeles, the Board of Education of the Los Angeles Unified School District adopted a Charter School Zoning Exemption Policy and Trial Program in July 2008 to implement this authority on a trial basis. This trial program terminates July 1, 2009, involves only 10 charter school sites, and includes a hefty application fee ($10,000). Consequently, most new charter schools in Los Angeles will not obtain a zoning exemption from the district and will be required to obtain zoning and land use approvals.

For those proposed new charter schools in Los Angeles that do not secure one of the district's 10 zoning exemptions under its trial program, some form of discretionary zoning and land use permit or approval will be required from the city. Counsel for a charter school can expect to begin the approval process by examining the zoning requirements and limitations applicable to a proposed charter school site. This examination should also extend to reviewing existing zoning regulations of cities or counties and applicable permitting procedures before they can open their doors to students. Just like any residential, commercial, or industrial project developer, the organization behind a charter school must obtain local zoning and land use approvals.

The City Planning Commission decides whether to grant a CUP for a charter school. A CUP is a land use permit issued to a landowner that allows a particular use or activity within a zoning district that, as a matter of right, would not be permitted. It has been described as a zoning procedure that allows uses that are essentially desirable to the community but their nature (noise, traffic, etc.) mitigate against their existence in every location in a zone, or any location without restrictions tailored to fit the special problems which the uses present. Four specific findings must be made by the commission, based on substantial evidence, to justify approval of a CUP. The school will need to be 1) desirable to the public convenience or welfare, 2) proper in relation to adjacent uses or the development of the community, 3) not materially detrimental to the character of development in the immediate neighborhood, and 4) in harmony with the various elements and objectives of the city’s General Plan.

Even if the zoning permits a public school by right, requirements of the zone or other Zoning Code regulations (including any applicable specific plans) regarding building setbacks, yards, height, floor area, parking, landscaping, and other issues should be checked. To deviate from those standards, some form of zoning approval or relief is needed, such as an adjustment, slight modification, or variance. It is important to determine all the zoning approvals that might be needed for a charter school project so that all the necessary applications can be combined into one city approval process.

All the land use approvals necessary for charter schools are discretionary. As such, the government agency is authorized to exercise judgment or deliberation in deciding whether or how to approve the project, and the approval is subject to the California Environmental Quality Act. CEQA requires the city to assess the potentially significant environmental impacts that the proposed charter school could have on the environment. The environmental impacts assessed include those related to aesthetics, air quality, cultural resources, hazards and hazardous materials, noise, public services, transportation and circulation, and other factors. CEQA requires an initial study or checklist that assesses the proposed project in terms of its impact on the environment. Based on that analysis, a determination is made whether all potentially significant impacts can be avoided or mitigated to a level of insignificance by changes to the project or other measures. If they can, then a mitigated negative declaration (MND) is prepared and goes through a minimum 20-day public review process before the project can be approved. If the identified impacts cannot be mitigated, then an environmental impact report (EIR) must be prepared on the project and circulated for comments before the project can be approved. Any mitigation measures identified for the project must be made enforceable conditions of the project’s approval.

Since an EIR takes about a year to prepare and be certified by the city, most projects try to utilize an MND. Although faster than an EIR, an MND is subject to a less favorable standard of review upon a legal challenge. The standard for a legal challenge to an EIR is whether substantial evidence in the record supports the city’s decision, but the stan-
dard for a challenge to a MND is whether substantial evidence in the record shows that a potentially significant effect on the environment may result from approval of the project.17 When the CEQA clearance is an MND, legal counsel should review the administrative record to ensure that the city’s environmental determinations are supported by substantial evidence, and that the record does not contain any substantial evidence that a significant environmental impact may occur. The need for substantial evidence in support of the environmental determinations usually requires one or more third-party reports on specialized environmental factors—for example, a traffic study prepared by a traffic engineer.

Due to the expense and timing of new construction and other factors, most charter school sites in the city have already been developed with commercial, industrial, or even church buildings. Adaptive reuse can convert these buildings into classrooms. Adaptive reuse of existing buildings has obvious advantages in terms of reduced construction costs and timing and assessment of potential environmental impacts (since existing uses of the site’s buildings and the traffic that they generate can often be included in the environmental baseline under CEQA). But some existing buildings can also present significant environmental issues that require in-depth environmental analysis, such as buildings that have some historic or architectural significance.18 If a new school use has the potential to adversely change significant aspects or character-defining features of a historical resource, then a detailed analysis must be included in the CEQA environmental analysis. The potential for impacts to historical resources should be considered early in designing the project to avoid delays in the approval process and the possible need for an EIR.

The typical zoning approval process followed for most charter schools in the city is a CUP granted by the City Planning Commission, along with any other particular zoning approvals that are needed. This process is best illustrated by examining some representative charter school projects.20

**East 27th Street Charter School.** This site, in the southeast area of the city, was zoned M1 (light industrial) and R2 (two-family), is bisected by 27th Street and improved with a 1963 vintage, 48,880 square-foot industrial building on the northerly M1-zoned portion and a surface parking lot on the southern R2-zoned portion. In June 2008, the City Planning Commission approved a 20-year CUP for two charter high schools with a maximum enrollment of 1,120 students in the existing building, along with a 26,345 square-foot second-story addition. The approval allowed the required off-street parking to be reduced to 70 spaces (in lieu of the minimum 173 required spaces) and to be located in the R2-zoned portion across 27th Street in a tandem configuration without an attendant. Zoning adjustments and variances were also approved along with the CUP.

**Foothill Learning Complex.** This site, in the Arleta-Pacoima area, was zoned M1 (light industrial) and P (parking) and improved with an 84,000 square-foot light manufacturing building in which a health clinic operated. On August 7, 2006, the commission denied a CUP and other approvals to establish three charter schools serving grades 6 through 12 for 1,100 students in a 73,000 square-foot portion of the existing building. The commission’s decision noted that industrial uses surrounded the site and that at its hearing, testimony received from the surrounding manufacturing community indicated that radioactive material was handled by a manufacturing facility one block away.

**Magnolia Science Academy.** This site, in the Harbor Gateway area, was zoned C1 (limited commercial) and improved with a 2-story, 51,000 square-foot building used for medical offices and adult education. On December 16, 2008, the City Planning Commission denied a CUP for a charter high school in the building. The staff report had recommended approval and noted that the project had the support of the area’s elected City Council member. The report also noted, however, that the local neighborhood council opposed the school and that there were significant issues regarding the site, including its location next to a freeway, ramps, and a major highway. Additional issues included the many industrial uses surrounding the site, its proximity to a Hazardous Waste Area/Border Zone Property and an adult novelty business, and its location along the proposed route for a jet fuel pipeline. The opponents said that an EIR should be prepared instead of an MND.

**North Valley Charter.** This site in the Granada Hills area was zoned A1 and improved with seven modular buildings as part of an existing charter school on the rear portion of a 3.6-acre site used for a church and parking. On April 17, 2008, the commission approved a 10-year CUP for a charter high school and middle school (grades 6 through 12) with a maximum enrollment of 213 students utilizing a total of nine modular buildings and a new 2,160-square-foot building. The City Planning Commission required additional street dedication of an adjoining major highway but waived the requirement for constructing a wider 12-foot sidewalk that would have removed an existing pathway. The commission also modified a transportation requirement for a 30-foot two-way driveway because it would have required demolition of portions of the existing church.

**Watts Learning Center.** This site, in the Southeast area, was zoned C2 and R1 and improved with a church and various buildings associated with a former parochial school, in addition to four modular classroom buildings that were used in the charter school’s existing operations on the C2-zoned portion of the site. On August 1, 2007, the commission approved a phased expansion of the existing charter elementary school from 260 students to 350 students in two new two-story classroom buildings, and conversion of the church facility in the R1 zone to a multipurpose school facility. The commission also approved a variance to address yard reductions, parking issues, and construction phasing and waived the requirement to dedicate and improve portions of a “paper” public alley that adjoined the site. (The alley was so designated because it was unimproved, discontinuous, and had residential encroachments that did not allow it to function as an alley.) Requirements to dedicate and improve an adjoining street, which would have resulted in the removal of several mature trees, were also waived.

Not all the charter school projects were approved, even though each case described above had a favorable staff report recommendation. Clearly, having detailed knowledge of the industrial and other potentially problematic uses in the surrounding area is necessary to determine whether a school is proper for a particular site and whether any issues are likely to arise during the entitlement process.

The first issue is politics. Because a charter school is treated like any other development, it should follow the time-honored steps of meeting early (even before site acquisition) and often with the local councilmember or other elected official in the area to garner political support for the project. The City Planning Commission’s decision on a project can be appealed to the City Council, and having the support of the local councilmember is crucial in the circumstances of an appeal.21 The official should be asked early about any particular constituencies, associations, or groups in the area whose views should be considered and should be advised of any expected problems, such as requirements for dedications and public improvements. The elected official’s support for waiving or modifying requirements is often needed even after the commission has acted.

As part of this political effort, land use counsel for a charter school should register with the City Ethics Commission. The city’s Municipal Lobbying Ordinance requires lobbyist registration.22 The ordinance defines as a lobbyist any individual who is compensated to spend 30 or more hours in any consecutive three-month period to engage in activities that include at least one direct communication with a city official or employee for
the purpose of attempting to influence action on municipal legislation, which includes land use permits. Individual lobbyists and the entities that employ them must register with the City Ethics Commission within 10 days after the end of the calendar month in which the individual or an employee qualifies as a lobbyist. Limited exemptions exist for persons acting without any compensation (other than reimbursement or payment of reasonable travel expenses); for organizations exempt from federal taxes pursuant to Section 501(c)(3) of the Internal Revenue Code that receive federal, state, or local agency funding for the purpose of representing the interests of indigent persons and whose primary purpose is to provide direct services to those persons; and for persons employed by such 501(c)(3) organizations.

A third aspect of the politics of getting a charter school’s land use permit approved is to get involved in neighborhood and community outreach. Because a noticed public hearing is involved, a developer usually does not want the neighbors who may be affected by the project to receive their first knowledge or awareness of it from a hearing notice received in the mail or published in a newspaper. Project developers and their counsel should meet early with the neighbors who would be immediately affected by the project to determine their level of support or opposition and to understand any issues or concerns they raise. Often, a better quality wall, additional or more mature landscaping, or relocation of particular facilities (such as trash storage and recycling) may address their concerns. In the city, there is also a system of neighborhood councils, composed of elected residents, business owners, and other stakeholders, that often weigh in with their recommendations on local land use projects. Scheduling a presentation to the local neighborhood council and receiving its support for a project can go a long way toward the justification needed for a project approval. In the project examples listed above in which the CUP was denied, neighborhood opposition and formal opposition by a neighborhood council had clear impact on the decision.

Finally, attorneys should meet not only with the local councilmember but also with city staff. Any developer needs to determine whether a site’s issues can be designed around or otherwise addressed in an economical manner. A charter school developer should meet with the staff of various city departments (such as Planning, Building and Safety, Public Works, Fire, and Transportation) and review the proposed site plan to determine what will be required for the proposed school. A supportive council office can often help set up such meetings. In the charter school cases listed above, issues regarding public dedication and improvement requirements often arose because
the particular sites had been developed for many years and, consequently, did not meet current public street standards. For the Watts Learning Center, the condition of the public alley and the impact of the normal dedication and improvement requirements on the adjoining street were explained to the commission, and it acted to waive those particular requirements because they were not needed.

Meeting with various officials and stakeholders can help land use counsel anticipate issues. For example, if the project site is near a freeway or major highway, how will air quality impacts on the students be mitigated? It is better to have such information covered in the CEQA analysis and submitted to the hearing officer than to surprise the commission with new information at the public hearing. A study may be prepared to document the ability of increased air filtration systems to keep pollutants out of classrooms. Another issue that will arise is the particular conditions of approval that may be imposed. It is good practice to review the standard school conditions that normally apply in a CUP and provide a written submission explaining which conditions are appropriate and which are not.

Issues also can arise regarding planning policies to maintain industrial areas for industrial uses instead of public schools, which was the case in the two denied projects listed above. Although policies are not regulations and may not be officially adopted, they are nevertheless cited by neighboring property owners and city planning officials as justification for some particular condition or decision. Legal counsel should examine the source of any policies that are cited to determine whether they are based on policy language in the text of the applicable community plan for the area (for example, chapter 3, Land Use, in the Citywide General Plan Framework) or represent something that has no basis in an adopted community plan. These issues often arise in entitlement proceedings, and legal counsel may have to decide whether to accept a condition or decision based on a questionable policy or to challenge it. Counsel should also be prepared to explain why a school use on a particular industrial site would not be inconsistent with applicable industrial use policies, based on development and use trends in the area.

Although the local entitlement zoning process for a charter school can be characterized as daunting, it is not impossible, and many examples exist to guide the way. In April 2007, the City Council voted to streamline and centralize the permitting process for charter schools by having each city department designate a lead person as a participating member of a charter school permitting team. Although this streamlined process has suffered from city budget constraints, certain departments (such as the Building and Safety Department) do have staff with expertise and experience in handling charter school cases. With attention to zoning details, thorough investigation of a site and surrounding uses, active outreach to neighborhood and community groups, and political support, the local zoning process can be successfully navigated and achieve a result benefiting students and the community.

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3 The Charter Schools Act of 1992, EDUC. CODE §§47600 et seq., allows charter schools to operate as, or be operated by, a nonprofit public benefit corporation. EDUC. CODE §47604(a).
4 Gov’t Code §53094(b).
5 Gov’t Code §53097.3.
10 L.A. MUN. CODE §12.24 E; see also note 27, infra.
13 PUB. RES. CODE §§21000 et seq.
14 State CEQA Guidelines, 14 CAL. CODE REGS. §§15073(a), 15105(b).
15 A CEQA Process Flow Chart and other CEQA information can be found at: http://ceres.ca.gov/ceqac.
16 PUB. RES. CODE §21081.6(b).
17 Friends of “B” Street v. City of Hayward, 106 Cal. App. 3d 988, 1002 (1980). This text requires a reviewing court to examine the record and overturn the agency’s action if the court finds substantial evidence that a significant impact might result, even though the record also contains substantial evidence supporting the agency’s determination of no significant impact.
18 The Department of City Planning’s Office of Historic Resources will be conducting a historic resources survey beginning in 2009 to identify, research, and document properties that reflect important themes in the city’s growth and development. See http://preservation.lacity.org/survey.
19 See State CEQA Guidelines, 14 CAL. CODE REGS. §15064.5 (archaeological and historical resources).
23 L.A. MUN. CODE §48.02.
25 L.A. MUN. CODE §48.03.
IN AUGUST 2008, Congress enacted the Consumer Product Safety Improvement Act (CPSIA), a sweeping piece of legislation that heightened existing product safety standards and created a new compliance regime for manufacturers, importers, retailers, and others. All consumer products previously subject to safety rules under the jurisdiction of the Consumer Product Safety Commission (CPSC) are subject to the CPSIA. Broadly, the term “consumer products” includes any product used in a residence or school, or for recreational or personal use, subject to enumerated exceptions. Various CPSC bans and standards already in place—such as the Federal Hazardous Substances Act, the Flammable Fabrics Act, the Poison Prevention Packaging Act, and the Refrigerator Safety Act—will now operate in conjunction with the CPSIA. Generally, the new standards and rules apply to all consumer products, but there are some additional, more stringent new mandates regarding products for children.

The CPSIA also expands independent, state-level enforcement activities, authorizing state attorneys general to initiate proceedings in federal courts and imposing stricter civil penalties. Under the previous version of the Consumer Product Safety Act, a single violation carried a fine of no more than $5,000, and the total penalty cap was $1.25 million. The CPSIA now provides for the assessment of penalties up to $100,000 per violation, with an overall cap on penalties of $15 million.

Under the CPSIA, anyone who makes, produces, or assembles a product is considered a manufacturer for purposes of the act. This includes those who purchase ready-made goods and alter them in some way before selling, such as adding silkscreens or appliqués to T-shirts, or gluing ribbons to hair clips. In terms of heightened standards, the CPSIA primarily targets two substances that have received substantial media attention of late—lead and phthalates. Lead can be found in nearly any kind of product, from toys to clothing to furniture, while phthalates (chemicals used to soften plastics) are generally found in things like bath toys, teething rings, bibs, and other plastic and rubber products. The CPSIA sets strict limits on the amount of lead and phthalates that can be in various products and implements

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progressively lower lead limits over a three-year period. The CPSIA is anticipated to affect a wide swath of manufacturers, importers, and retailers. Those dealing in consumer goods at every level of the supply chain must become familiar with the scope and effect of the CPSIA and take appropriate steps to modify and update their business practices to ensure compliance.

Notably, manufacturers and retailers that do business in California must also be in compliance with the parallel state laws regarding lead and phthalate limits in products. California’s restrictions are largely identical to the federal limits set forth in the CPSIA but apply to broader classes of products. California law is among the strictest in the nation, so, generally, compliance with those requirements will help to ensure that the federal standards are also satisfied. The California phthalate restrictions went into effect on January 1, 2009, and apply to all products, regardless of date of manufacture.

Products sold in California are also subject to additional regulation under Proposition 65. It requires that businesses provide a warning before knowingly and intentionally exposing persons to chemicals identified by the state as known carcinogens or reproductive toxins, unless the business can show that the level of exposure is below the statutorily defined level of significant health risk. Given the stringency of the requirements of the CPSIA and the related California statutes, it is likely that adherence to those laws will generally obviate the need for Proposition 65 warnings with regard to lead and phthalates, but manufacturers and retailers should still take measures to ensure full compliance with all applicable state and federal law.

Certification and Children’s Products

While the CPSIA does not alter preexisting safety standards for most products, it does require certified compliance with current standards. Imported products not certified must be refused entry into the United States and destroyed unless permission is given for reshipment. For the majority of consumer products (children’s products being the exception), the primary impact of the CPSIA is this certification requirement.

The CPSIA mandates that all products subject to any ban or safety standard be accompanied by a General Certificate of Conformity. The GCC must contain the following information: 1) date and place of manufacture, 2) date and place of testing, 3) a suitable identification of the manufacturer or private labeler issuing the certificate (including the name and contact information for the individual responsible for maintaining records of test results), and 4) certification of conformance with any and all applicable consumer product safety rules, along with a specification of those applicable standards. For products not intended for children, the testing program need not be one of those specifically accredited by the CPSC but need only be “reasonable.”

For products intended primarily for use by children, the testing requirements are more stringent—they must be tested by a “third party conformity assessment body” that has been accredited by the CPSC. An up-to-date list of accredited testing bodies is available on the CPSC Web site.

The GCC must also “accompany” the certified product and be “furnished” to distributors and retailers. The CPSC has issued a final rule construing this provision, which allows for GCCs to be made available through electronic means. Electronic GCCs can be posted on a Web site for inspection or included with other electronic documents accompanying shipments through customs or to distributors or retailers. Under the rule promulgated by the CPSC, an electronic certificate is “accompanying” a shipment if the certificate has a unique identifier and can be accessed via a World Wide Web URL or other electronic means, provided the URL and unique identifier are created in advance and are available with the shipment. The critical factor is that the GCCs can be readily accessed upon demand by customs, distributors, and retailers as well as the CPSC.

There has been some confusion over which parties in the stream of commerce bear the responsibility for obtaining and issuing GCCs. The CPSC has mandated a streamlined approach, limiting the number of parties who must issue conformity certificates. Under this approach, for imported products, only the importer needs to issue the conformity certificate. Foreign manufacturers and private labelers of imported products will not be required to issue GCCs, nor be listed as parties on GCCs. For products manufactured in the United States, only the domestic manufacturer is required to supply a GCC. The CPSC has further announced that enforcement efforts will, at least initially, primarily be directed toward compliance with the safety requirements themselves, rather than strict adherence to form in the certificates.
were to take effect on February 10, 2009. However, in response to widespread criticism that the original deadline set an unrealistic timetable for compliance, the CPSC deferred those requirements for an additional year. Lawmakers plan to introduce legislation exempting some small businesses from the CPSIA and requiring the commission to clarify the law. Despite this reprieve for many businesses, manufacturers can still face criminal and civil penalties for selling non-compliant products in the interim, even though they are not required to test or certify them yet. In other words, the stay does not change the requirement that the products themselves be in compliance with the toxin limits set by the CPSIA—it merely extends the time in which manufacturers have to begin proving compliance through testing and certification.

It should also be noted that the stay in enforcement is limited in scope. For example, manufacturers are still required to test jewelry, cribs, paint, and small parts of children’s products. Manufacturers should determine what provisions of the CPSIA are not impacted by the stay, and all businesses should watch for further developments in the legislation that may exempt them from the act’s expensive compliance requirements or otherwise affect their rights and responsibilities.

Another considerable and potentially burdensome mandate of the CPSIA is the requirement that children’s products must now bear tracking labels or other distinguishing permanent marks. These tracking labels—which must be present on the product and its packaging—are required to contain certain information that will enable the ultimate purchaser of the product to identify the manufacturer or private labeler, the location and date of manufacture, and any additional related identifying information (such as batch or run numbers). Congress at least qualified this requirement, however, by inserting the phrase “to the extent practicable,” recognizing that including tracking labels or other permanent marks on small toys or other small products may not be practical.

In any event, the tracking label requirement is significant and may prove onerous. The label or mark must be permanently affixed to the product itself; the requirement will not be satisfied by including the necessary information on a hangtag or adhesive label, as those can be easily removed and are therefore not sufficiently permanent. The tracking label requirement becomes effective one year from enactment of the CPSIA, thus all products primarily intended for children age 12 or younger must bear conforming labels beginning August 14, 2009. While this section currently only applies to children’s products, the CPSC has been empowered to extend it to encompass other categories of consumer products.

Phthalate and Lead Restrictions

Section 108 of the CPSIA imposes more stringent phthalate content standards on certain children’s products because infants and children may be more susceptible to phthalate’s toxic effect, and there is concern that the chemicals may disrupt a child’s hormonal development, causing long-term and irreversible reproductive damage. As of February 10, 2009, children’s toys and child care articles are also subject to additional restrictions if they contain certain phthalates specified in the CPSIA. In spite of the CPSC’s attempt to exempt existing inventory from the reach of Section 108, it applies to all products offered for sale after February 10, 2009, including existing inventory that was manufactured before then.

Under Section 108, it is illegal to manufacture for sale, offer for sale, distribute in commerce, or import into the United States any children’s toy or child care article that contains concentrations of more than 0.1 percent of these phthalates. Additionally, for an interim period, the same prohibition applies to “any children’s toy that can be placed in a child’s mouth or child care article that contains concentrations of more than 0.1 percent” of other phthalates. Those covered by the CPSIA that deal in children’s toys or child care articles must determine whether their products contain those phthalates specified by this section of the CPSIA.

The term “children’s toy” means a consumer product “designed or intended by the manufacturer for a child 12 years of age or younger for use by the child when the child plays.” The term “child care article” means a consumer product “designed or intended by the manufacturer to facilitate sleep or the feeding of children age 3 and younger, or to help such children with sucking or teething.” This section of the CPSIA has caused considerable confusion among manufacturers, retailers, and distributors—especially because many children’s products, which are not necessarily designed as toys or care articles, look like toys to make them appealing to children (e.g., a shampoo bottle shaped like a cartoon character). The CPSC has developed a factor test, to be applied on a case-by-case basis, to help determine whether a product is covered by this section for purposes of compliance with the phthalate limits. More specific guidance from the CPSC is available online. Those covered by this section of the CPSIA should also determine, based on this factor test, whether their children’s products would be classified as “children’s toys” or “child care articles.”

Section 101 of the CPSIA generally classifies children’s products with lead content in excess of the legal limit as banned hazardous substances under the Federal Hazardous Substances Act. The legal limit for lead content is being reduced over a three-year period. In February 2009, the legal limit was 600 parts per million (ppm) by weight for any part of the product. Beginning in August 2009, the legal limit will be 300 ppm, and beginning August 2011, the legal limit will be 100 ppm. If the CPSC determines, however, that it is not “technologically feasible” to comply with the 100 ppm limit, it may establish an amount (lower than 300 ppm) that is technologically feasible. A limit shall be deemed “technologically feasible” if: 1) another product or manufacturing technology that complies with the limit is “commercially available,” 2) industrial strategies have been or are being developed to achieve the limit, which companies acting in good faith are capable of adopting, or 3) alternative practices would enable manufacturers to comply.

There are certain exceptions to the new lead limits. For example, the limits do not apply to component parts of a product that are inaccessible to a child through normal and reasonably foreseeable use and abuse of the product. A part is “inaccessible” if it is not, or cannot become, physically exposed to the child, and “reasonably foreseeable use and abuse” include swallowing, mouthing, breaking, “or other children’s activities” (a broad and, thus far, undefined term), and aging of the product. Paint, coatings, or electroplating do not constitute “barriers” that render a component part “inaccessible” under this section. Finally, the CPSIA places even more stringent limits specifically on lead in paint and amends Title 16, Section 1303.1, of the Code of Federal Regulations from a limit of 600 ppm down to 90 ppm, effective August 14, 2009.

The CPSIA also reaches the labor and employment policies and procedures of a business that deals in consumer products. The CPSIA specifically affords protection to whistleblowers against retaliation by their employers. The whistleblower employee is protected from being discharged or otherwise discriminated against after the employee provides the federal government or the state attorney general with any information related to a violation of the CPSIA, testifies or assists in a proceeding concerning a violation, or objects to any activity that the employee believes is in violation of the CPSIA. As under other federal whistleblower laws, an employee that believes he or she has been discharged or otherwise discriminated against for these reasons may file a complaint with the secretary of labor not later than 180 days after the date of the violation. If the secretary of labor determines that the employee was retaliated against for any of these reasons, the CPSIA authorizes the secretary to take affirmative action to abate the violation, reinstate the employee (with back pay), and
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provide compensatory damages. If the secretary of labor does not issue a final decision within a certain period, or the administrative case is dismissed, the CPSIA authorizes the employee to bring an action for de novo review in the federal district court of appropriate jurisdiction, which may grant additional relief beyond what the secretary of labor is authorized to grant.

The CPSIA continues to implement the remedial scheme of reinstatement that is a feature of federal whistle-blower laws. This feature has proven unsettling to many employers and is often challenged. Challenges have resulted in some exceptions to the general rule. For example, in the Ninth Circuit, a court may deny reinstatement if it finds that hostility between the plaintiff and former coworkers would make reinstatement not feasible. In addition, because the whistle-blower protection of the CPSIA applies to “manufacturers,” which includes importers, and because the CPSIA is largely a response to importation of defective or unsafe products from overseas, the question of whether this provision has any extraterritorial effect has arisen for many but has not yet been adjudicated.

Proposition 65
California has its own laws concerning lead and phthalates. To the extent that California law overlaps with the CPSIA and the federal limits are more restrictive, products that are in compliance with the CPSIA will also be compliant with California law. For example, California’s A.B. 1108 (regulating phthalate content) is largely identical to the corresponding sections of the CPSIA in its reach. Both statutes have the same acceptable concentration limit (0.1 percent) for the same six phthalates. A product that complies with one statute complies with both. To the extent that the statutes differ, A.B. 1108 applies its phthalate restrictions to a broader class of products. The definition of “child care articles” in A.B. 1108 includes all items that facilitate “sleep, relaxation, or the feeding of children,” while the CPSIA definition does not include the word “relaxation.” Further, the CPSIA includes age limits to which its restrictions apply, while California law does not.

California has also enacted a statute regulating lead content in jewelry that may affect the responsibilities of some manufacturers, importers, and retailers. The California law concerning lead in jewelry is complex. It is stricter in some respects than the CPSIA but more permissive in others. As a threshold matter, it should be noted that the statute restricts lead content in all jewelry, not only jewelry that is intended for children, though the lead restrictions are more stringent with respect to children’s jewelry. Furthermore, the law extends to charms and other attachments to shoes or clothing that can be removed. Vendors should become familiar with the full range of products and components included within the statutory definition of “jewelry,” as it is quite inclusive and not necessarily intuitive.

At its most permissive, California’s jewelry law prohibits manufacture, shipping, sale, or offering for sale any jewelry product containing more than 600 ppm lead by weight. This restriction applies to all classes and categories of jewelry, while more restrictive lead limits are set for jewelry made from certain materials. For example, jewelry made out of plastic or rubber may contain up to 600 ppm lead until August 30, 2009, after which the limit drops to 200 ppm. This change will create a tighter restriction than that under the CPSIA with regard to children’s jewelry, but only until August 2011, when the permissible lead limit under the CPSIA drops to 100 ppm. Additionally, California’s jewelry law mandates that children’s jewelry made from metallic components not contain more than 200 ppm lead, which until August 2011 will be more than what is compliant with the CPSIA.

There are several additional exceptions and classifications that may affect the compliance duties of a particular vendor; thus it is incumbent upon potentially affected vendors and their counsel to determine exactly which regulations apply and ensure that products meet whichever standard is more restrictive at any given time.

Vendors doing business in California must also be aware of their notification duties under Proposition 65. Businesses must provide a warning before knowingly and intentionally exposing persons to known carcinogens or reproductive toxins, unless the business can show that the level of exposure is below the statutorily defined level of significant health risk. While both lead and phthalates are among the chemicals covered by Proposition 65, the notification requirement is tied to potential exposure levels rather than chemical content. As such, the precise interplay between the content-restricting statutes and the duty to warn under Proposition 65 is not clear. As a general matter, it is likely that products in full compliance with the CPSIA and California law will not require Proposition 65 warnings regarding lead and phthalates, but vendors must still become familiar with the Proposition 65 standards, including those applying to individual policies and procedures adopted by suppliers or retailers, and provide warnings when necessary. There are no bright-line rules with respect to when a Proposition 65 duty to warn is triggered, so comprehensive knowledge of all parties, procedures, and products in a given supply chain is critical to compliance.
As in every other facet of legal practice, the most knowledgeable attorneys are the best attorneys. As publicly acknowledged by CPSC Acting Chairman Nancy Nord, the swift enactment and tight timelines of the CPSIA require mindfulness “of the chaos and confusion that this new law has created in the marketplace.” The CPSC is doing what it can to ease the transition by promulgating explanatory rules and urging Congress to clarify its intentions, but attorneys remain the last line of defense between affected clients and potential liability under new and rapidly evolving regulation. The CPSC has been inundated with requests from importers, manufacturers, and retailers for advisory opinions on their products. However, the commission does not have the resources to respond directly to each and every inquiry. It is vitally important, therefore, for attorneys to stay informed of the latest developments and to advise clients accordingly.

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2 CPSIA §217.
4 See A.B. 1108 (phthalates) and A.B. 1681, as amended by A.B. 2901 (lead in jewelry), codified at HEALTH & SAFETY CODE §§25214.1-25214.4.2.
5 HEALTH & SAFETY CODE §§25249.5-25249.13; CAL. CODE OF REGS. tit. 27, ch. 1, §§25102-27001.
6 CPSIA §102(a).
7 CPSIA §223.
8 CPSIA §102(a)(1).
9 CPSIA §102(g).
10 CPSIA §102(a)(1)(A).
11 CPSIA §102(f)(2).
12 See http://www.cpsc.gov/about/cpsia/cpsia.html.
13 CPSIA §102(i)(3).
15 16 C.F.R. §1110.13.
16 Id.
17 16 C.F.R. §1110.7.
18 16 C.F.R. §1110.7(a).
19 16 C.F.R. §1110.7(a), 1110.11.
20 16 C.F.R. §1110.7(b).
23 CPSIA §103(a).
24 CPSIA §103(a)(5)(A)-(B).
25 CPSIA §103(a)(5).
26 Id.; http://www.cpsc.gov/about/cpsia/faq/103faq.html#hangtags.
27 CPSIA §103(a)(5).
30 Id. at 379-94.
31 CPSIA §108.
32 Id.
33 CPSIA §108(e)(1)(B).
34 CPSIA §108(e)(1)(C).
36 CPSIA §101(a)(1); 15 U.S.C. §§1261 et seq.
37 CPSIA §101(a)(2)(A).
38 CPSIA §101(a)(2)(B)-(C).
39 CPSIA §101(a)(2)(C)-(D).
40 CPSIA §101(d).
41 CPSIA §101(b).
42 CPSIA §101(b)(2)(A).
43 CPSIA §101(b)(3).
44 CPSIA §101(f).
45 CPSIA §219.
46 Id.
47 Id.
48 See Cassino v. Reichhold Chems., Inc., 817 F. 2d 1338, 1346 (9th Cir. 1987).
50 A.B. 1108, codified at HEALTH & SAFETY CODE §§108935-108939; CPSIA §108(d).
51 CPSIA §108(d).
52 Id.
53 HEALTH & SAFETY CODE §§25214.1-25214.4.2.
54 HEALTH & SAFETY CODE §25214.1(d)(3).
55 HEALTH & SAFETY CODE §25214.1(d)(4).
56 HEALTH & SAFETY CODE §25214.1(g)(2).
57 HEALTH & SAFETY CODE §25214.1(h)(A)-B).
58 CPSIA §101(a)(2)(B)-(C).
60 Further guidance can be found at http://www.dtsc.ca.gov/LeadInJewelry.cfm.
61 HEALTH & SAFETY CODE §§25249.5-25249.13; CAL. CODE OF REGS. tit. 27, ch. 1, §§25102-27001.
62 Id.
Property owners or project proponents may be lulled into complacency when their local planning department tells them, “Don’t worry about that zoning code requirement. We will just give you a variance.” However, this statement actually can be more dangerous than comforting. While a variance may be easy to attain if a project enjoys political support, it can be difficult to defend if challenged in court.

The requirements for variances under California law are very strict. As a result, variance approvals are often overturned in litigation due to insufficient findings or a lack of relevant evidence to support the findings. A project opponent may seize upon the project proponent’s reliance on a variance as a weakness to be exploited in the opponent’s efforts to overturn the project. Therefore, project proponents—as well as engineers, planners, and lawyers—must 1) be mindful of the strict requirements for variances and their associated risks, 2) carefully craft variance findings to meet the applicable legal standards, and 3) consider alternatives to a variance that are more defensible if challenged.

A variance is a safety valve preventing a property from becoming unusable if the zoning code were strictly applied. It protects against an unconstitutional taking and allows the owner to enjoy the benefits afforded to other properties in the applicable zone.¹ One typical use of a variance is to provide relief from design or development standards—such as height, density, setback, floor area ratio, parking, or other requirements—if those standards would prevent a property owner from using the property at issue.

Some jurisdictions may grant a variance to allow a land use that would otherwise be prohibited, such as a commercial use in a...
residential zone. This type of variance is referred to as a use variance. Charter cities can approve these variances if permitted by their charter and zoning code. In contrast, state law prohibits a general law city or county from granting use variances.

Over the past four decades, case law addressing variances has evolved considerably. Prior to the mid-1960s, courts generally deferred to agencies’ decisions and routinely upheld variances. Indeed, as of 1966, no

with the purpose and intent of the zoning code, consistent with the general plan, and not injurious to the public or surrounding properties. Generally, the findings for a variance must meet a three-prong test. Applicants must show that 1) they will suffer practical difficulties and unnecessary hardships in the absence of the variance, 2) these hardships result from special circumstances relating to the property that are not shared by other properties in the area, and 3) the variance is necessary to bring the applicants into parity with other property owners in the same zone and vicinity.

The first finding, the hardship prong, generally is evaluated based on economics and whether the property can be put to “effective use” without the variance. A variance is not intended to be used for the purposes of convenience or to increase the value of a property. If a property can be put to effective use, consistent with its existing zoning, the fact that a variance would make the property more valuable or increase the income of the owner is immaterial.

The Second District Court of Appeal addressed the hardship prong in Stolman v. City of Los Angeles. The variance applicant in Stolman operated a gas station in Santa Monica Canyon. The property was zoned for single-family uses only, but the gas station—which had been in operation since 1925—was grandfathered as a legal non-conforming use. The applicant began detailing cars, and the city cited the applicant for illegally operating a car wash. In response, the applicant requested a variance for the detailing services, which the city approved.

Nevertheless, the court overturned the variance based on a lack of hardship justifying the variance. The court viewed the key issue as whether the car-detailing operation was either so crucial that the property owner would “face dire financial hardship” without the variance, or the owner sought to provide additional services simply to make the gas station more profitable. Holding that the evidence in the record was insufficient to support a finding of financial hardship, the court noted that although the applicant represented that he made a profit of eight cents per gallon of gasoline, he did not state how many gallons were sold or whether the profit was net or gross. Moreover, the applicant did not provide any information from which to determine whether the profit was so low as to amount to “unnecessary hardship.” To the contrary, more than one person testified that the applicant sought the variance “not just to survive, but [to] earn even more money.”

The Stolman case exemplifies the strict approach most courts have taken with respect to hardships, highlighting the need for the applicant to document hardships with evidence in the record. The Stolman court suggested that this evidence include detailed financial documentation, creating concern for applicants who do not want to publicly divulge sensitive financial information. However, in contrast to Stolman, the court in Committee to Save the Hollywoodland Specific Plan v. City of Los Angeles held last year that applicants do not need to address hardships solely in economic terms but can take into account other factors, such as safety hazards. The court did so in ruling on a specific plan exception, which is similar to a variance. Thus, courts have differed over the
The Los Angeles County Bar Association certifies that this activity has been approved for Minimum Continuing Legal Education credit by the State Bar of California in the amount of 1 hour.

1. A general law city can grant a “use” variance.
   - True
   - False

2. California law requires that an agency make findings supporting the adoption of a variance.
   - True
   - False

3. Applicants for a variance are forbidden from providing an agency with proposed variance findings.
   - True
   - False

4. A “special circumstance” justifying a variance may involve:
   A. Existing historic structures.
   B. Unusual topography.
   C. Characteristics of the users of the proposed project.
   D. Overlapping regulations.
   E. All of the above.

5. A variance may not be used:
   A. To relieve a property owner from height and density limitations.
   B. To allow for the use of a property when a strict application of the zoning code would render the property unusable.
   C. To increase an applicant’s property values regardless of whether the property is usable under its current zoning status.
   D. To bring a property owner into parity with other similarly situated properties.

6. There must be a “logical relationship” between the identified special circumstance and the requested variance.
   - True
   - False

7. A property owner may be able to obtain a variance even when the hardship justifying the variance was self-imposed.
   - True
   - False

8. A variance is a safety valve that protects property owners from an unconstitutional taking.
   - True
   - False

9. Charter cities may impose additional variance requirements, including:
   A. The variance must be consistent with the purpose and intent of the zoning code.
   B. The variance must be consistent with the general plan.
   C. The variance must not be injurious to the public or surrounding properties.
   D. All of the above.

10. The standard of review for a zoning change is stricter and less deferential than for a variance.
    - True
    - False

11. Special circumstances claimed to justify a variance must be related to the physical nature of the property.
    - True
    - False

12. California courts did not reverse a variance grant in a reported decision prior to 1966.
    - True
    - False

13. A charter city must impose the same variance findings required by Government Code Section 65906.
    - True
    - False

14. Which of the following facts is relevant to justify a variance?
    A. Project design and amenities.
    B. Benefits to the community.
    C. The superiority of the proposed project to the viable alternatives.
    D. None of the above.

15. A court hearing a challenge to an agency’s variance grant or denial may consider extra-record evidence in determining whether the agency’s action was proper.
    - True
    - False

16. A variance is the only way property owners can obtain relief from regulations limiting the use of their land.
    - True
    - False

17. Courts generally defer to agencies’ decisions granting variances.
    - True
    - False

18. A developer’s voluntary adoption of stricter building standards is a hardship justifying the approval of a variance.
    - True
    - False

19. In deciding whether to grant a variance, agencies must consider similarly situated properties in the same zone and geographic area.
    - True
    - False

20. Applicants seeking a variance for a project should use the required variance findings to focus on project benefits to sell the project to decision makers and the public.
    - True
    - False

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1. Study the MCLE article in this issue.
2. Answer the test questions opposite by marking the appropriate boxes below. Each question has only one answer. Photocopies of this answer sheet may be submitted; however, this form should not be enlarged or reduced.
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8. □ True □ False
9. □ A □ B □ C □ D
10. □ True □ False
11. □ True □ False
12. □ True □ False
13. □ True □ False
14. □ A □ B □ C □ D
15. □ True □ False
16. □ True □ False
17. □ True □ False
18. □ True □ False
19. □ True □ False
20. □ True □ False

MCLE Test No. 183
ZONE DEFENSE

MCLE Answer Sheet #183

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Some property owners have attempted to create a hardship to justify a variance, but courts have generally condemned this practice. In one case, a property owner deliberately sold a portion of its land to create a claimed “hardship” that allegedly justified a front-yard tennis court prohibited by the zoning code. Not surprisingly, the court upheld the city's denial of the variance.

Similarly, in another case, a court held the developer's use of “attractive architectural features” and voluntary adoption of stricter building standards were self-imposed hardships that did not justify a variance from floor-area-ratio requirements. Self-imposed hardships also include circumstances in which property owners purchase property in anticipation of obtaining a variance for a use forbidden at the time the owners bought the property. Hardships created by the previous owner of a property also may be considered self-imposed and thus are insufficient for a variance.

The “special circumstances” finding required for a variance—the second prong of variance analysis—relates to the property itself. Classic special circumstances are unusual physical characteristics of the property, such as size, shape, topography, location, or surroundings. For example, courts have found special circumstances when a lot was irregularly shaped and graded, had no real backyard, and faced a winding street. These special circumstances warranted the granting of a variance from building setback and fence height requirements. Similarly, a variance from off-street parking requirements was appropriate because of the special circumstances involving a parcel partially submerged by the San Francisco Bay. To meet the parking requirements, the owner would have needed to fill the submerged area and demolish an existing building on the parcel. Special circumstances also can include existing historic structures and landscaping.

The particular characteristics of the expected occupants or users of a building can be a special circumstance. For example, special circumstances supported a reduction in parking for a neighborhood synagogue, to which most regular attendees walk rather than drive. Another court found that reduction in parking for an apartment building was supported by the fact that most prospective residents would not own cars. Close proximity to other parking facilities can also be a special circumstance supporting a parking variance.

Special circumstances do not necessarily need to be physical. Overlapping regulations that create a disparate impact can be grounds for a variance. In Craik v. County of Santa Cruz, a Federal Emergency Management Act (FEMA) regulation prohibited the owner of a beachfront parcel from using the ground floor as living space. The local zoning code also imposed various height, setback, and floor-area-ratio limits that further constrained development of the parcel. The court found that although the FEMA and related zoning regulations applied in the abstract to all owners in the applicable zone, in reality the regulations only affected a few vacant parcels because most of the other properties in the zone were already developed. The court concluded that this disparity was a special circumstance that could support a variance.

Finally, in order to qualify as a special circumstance, there must be a “logical relationship” between the condition identified and the variance requested. This means that the unusual condition must cause the hardship. For example, in Broadway Laguna, the applicant presented evidence the property had unusual topsoil conditions; however, he was requesting a variance from floor-area-ratio requirements, and he failed to show any link between the topsoil and the need for additional floor area ratio. Therefore, the court concluded a variance was improper.

In another case, a property was closer to the freeway than other similarly regulated properties, but the findings failed to provide a rationale for why the property's proximity to the freeway justified a height variance.

The third finding establishes that the variance is necessary to bring the property owner into parity with other properties in the same zone and vicinity. Conversely, a variance cannot grant the applicant a special privilege. Thus, the particular characteristics of a property are not by themselves sufficient to support the grant of a variance. The applicant must show that these characteristics differ from other similarly situated properties. For example, in Topanga, the staff report described the property's “rugged features” but did not conclude that the property was any different from neighboring land.

Therefore, agencies must examine the characteristics of similarly situated properties in the same zone and geographic area. For example, a yard variance to allow a 4,000-square-foot residence might not be justified if other homes in the neighborhood are generally half that size. In one case dealing with a variance for a hotel, the court upheld a variance because the agency had compared the hotel with a competitor hotel in the same zone and concluded that the variance was necessary to create parity between them.

Additionally, in Stolman, part of the court's reason for overturning the variance allowing detailing operations at a gas station was because the similarly situated properties relied upon by the city to approve its variance findings were not in the same zone or even the same city. The closest property was in Eagle Rock, over 19 miles from the gas station, which was located in Santa Monica Canyon. The court found that the city's reliance on these other properties was "not only a reach but [was] an irrational stretch." With Stolman and other cases as a guide, counsel should ensure that variance findings provide sufficient detail regarding similarly situated properties in the same zone and located as close as possible to the subject property.

Many agencies permit or even require the applicant to prepare an initial draft of the agency's written findings to support the variance. Even when the agency drafts its own findings, it is essential that the applicant review them to ensure the variance findings are tailored to the applicable legal requirements.

One common problem with variance findings is that an applicant or planning staff will often focus on project benefits in order to “sell” the project to the decision makers and the public, ignoring the relevant legal requirements. However, courts have been clear that project design, amenities, benefits to the community, and the superiority of the proposed project design to ones developed in conformity with zoning regulations are irrelevant when considering whether to grant a variance. As one court explained, the agency cannot use a variance to balance one code provision against another and “earn immunity from one code provision merely by overcompliance with others.” Variance findings should demonstrate that the agency based its approval on the relevant legal requirements and did not simply grant a variance because it favored the particular project.

Variance findings should be as detailed as possible, providing specific facts 1) demonstrating the hardship—preferably the economic hardship, 2) describing the unusual circumstances and showing that those circumstances are different from other properties, and 3) showing that the unusual circumstances cause the hardship. Furthermore, the findings should provide details about many properties in the same zone and vicinity, as close as possible to the property, to show that the variance is necessary to bring the property into parity with others similarly situated.

Also, it is essential that the administrative record contain evidence in support of those findings. This evidence can be in the form of photographs, view simulations, maps, technical reports from experts, and other documentation. Counsel should submit the evidence to the agency as part of the administrative proceedings relating to the
variance. The law prohibits extra-record evidence from being submitted after the variance has been challenged in court.54

Alternatives to Variances

Because variances are one of the most difficult entitlements to defend in court, it is important to consider alternatives that are more legally defensible. For example, an applicant can request a zone change or a zoning code amendment. A zone change constitutes a legislative approval, even if it affects only one single parcel, and under state law is afforded more deference than an agency’s adjudicative decisions.55 Additionally, a zone change does not require explicit findings,56 is entitled to a strong presumption of correctness, and can only be overturned “if it has no reasonable relation to the public welfare.”57 However, although a zone change is easier to defend in court, the drawback is the approval process is more time consuming. A zone change takes longer because a public hearing must be held before the planning commission and legislative body of the agency (such as the city council or board of supervisors) prior to approval, unlike a variance, which can be approved by a planning commission or a hearing officer.58 Furthermore, some agencies may be reluctant to process zone changes without an elected official sponsoring the amendment.

“Variance-light” procedures are another alternative adopted by many jurisdictions. These allow minor adjustments and modifications of development standards but do not require the same strict findings as those needed for a variance. For example, the City of Los Angeles allows a zoning administrator to approve adjustments and minor modifications in yard, area, building line, and height requirements, sometimes even without a public hearing if the matter is not controversial.59 Likewise, the County of Los Angeles has a parking permit procedure that allows the planning director to reduce the amount of required parking spaces if certain requirements are met.60 The requisite findings for these adjustments are similar but less strict than for a variance.

Nevertheless, it is presently unclear whether a court would be more deferential regarding these approvals or would apply the same standards for unnecessary hardships and special circumstances otherwise applicable to variances. One of the only reported cases that has addressed a variance-light procedure (in that case, a specific plan exception) generally applied the same hardship and special circumstances standards that apply to variances.61 Thus, an applicant should always ensure that adequate written findings address each requirement of the applicable code and the record contains evidence supporting these findings.

Other alternatives may be available for relief from otherwise applicable restrictions. Depending on the jurisdiction, these alternatives may be included in overlay zones or other zoning provisions. Furthermore, the recently strengthened density bonus law may provide relief from certain requirements for residential projects that incorporate affordable housing.62 This relief involves permitting additional density beyond code mandates as well as other concessions and incentives, such as a reduction in setbacks and parking requirements. These incentives should be considered as an alternative to a variance.

Relying on a variance is always a matter of calculated risk. A variance can speed the approval of a project initially but can dramatically slow down the process if the variance is challenged and overturned by a court. With this risk in mind, an applicant should gauge potential opposition before applying for a variance. If a variance is opposed, the applicant should consider changing course and pursuing an alternative entitlement strategy. In any event, the applicant should not blindly rely on planning staff or other government officials to ensure the record is adequate. Considering variance alternatives and bullet-proofing variance findings can make the difference in preventing a project from being overturned in court and incurring years of costly delays.


2 A charter city is organized pursuant to its own city charter. CAL. CONST. art. XI, §§5-6, 8. A general law city is organized under the general laws of the state. GOV’T CODE §§34100-34102.

3 See, e.g., L.A. MUN. CODE §12.27.

4 GOV’T CODE §65906.


6 Broadway Laguna Homeowners Ass’n v. Board of Permit Appeals, 66 Cal. 2d 767 (1967).

7 Topanga Ass’n for a Scenic Cmtty. v. County of Los Angeles, 11 Cal. 3d 506 (1974).

8 Id. at 517.

9 Id.; Orinda Ass’n v. Board of Supervisors, 182 Cal. App. 3d 1145, 1161 (1986).

10 GOV’T CODE §§50000 et seq.

11 GOV’T CODE §65906.

12 GOV’T CODE §65700. The Planning and Zoning Law is not applicable to charter cities.


14 Id.


18 Id. at 920.

19 Id. at 926.


21 Broadway Laguna Homeowners Ass’n v. Board of Permit Appeals, 66 Cal. 2d 767, 778 (1967); see also L.A. MUN. CODE §12.27 (”The Zoning Administrator may deny a variance if the conditions creating the need for the variance were self-imposed.”).


23 Id.

24 Broadway Laguna, 66 Cal. 2d at 776-78.


26 See PMI Mortgage Ins. Co. v. City of Pacific Grove, 128 Cal. App. 3d 724, 731-32 (1981) (holding that the illegal subdivision of a property by a previous owner was not a hardship justifying a variance).

27 See GOV’T CODE §65906.


29 Id. at 1184.


33 Siller v. Board of Supervisors, 58 Cal. 2d 479, 485 (1962).

34 Id.; Lucas Valley Homeowners Ass’n, 233 Cal. App. 3d at 153.


36 Id. at 886.

37 Id.

38 Id. at 890.

39 Id.

40 Broadway Laguna Homeowners Ass’n v. Board of Permit Appeals, 66 Cal. 2d 767, 774 (1967).

41 Id. at 774-75.


43 GOV’T CODE §65906; Topanga Ass’n for a Scenic Cmtty. v. County of Los Angeles, 11 Cal. 3d 506, 520 (1974).

44 Topanga, 11 Cal. 3d at 520.

45 Id.

46 Id.


49 Stolman, 114 Cal. App. 4th at 929.

50 Id.

51 Id.


53 Id. at 1165.

54 See CODE CIV. PROC. §1094.5.


56 Arnel Dev. Co., 28 Cal. 3d at 522.


58 Compare GOV’T CODE §§65853-65856 with §65901a.

59 L.A. MUN. CODE §12.28.

60 L.A. COUNTY CODE §§22.56.990 et seq.


A competent patent opinion can provide an effective defense against a charge of willful infringement

BEFORE INTRODUCING ITS NEWEST product into the marketplace, a company often will seek an opinion from patent counsel on whether the new product infringes any valid patent known to the company. Many consider this exercise in vigilance regarding the patent rights of others to be a prerequisite before launching a new product. Indeed, until recently, the failure to obtain an opinion of counsel was often used as evidence that a company did not exercise due care in respecting the patent rights of others—and this lack of due care meant that any patent infringement was “willful” and subject to enhanced damages.

If a patent dispute does arise, a favorable opinion of counsel that a company’s new product does not involve the infringement of a patent held by others could be useful in litigation—but only if the company chooses to waive the attorney-client privilege, a decision not to be taken lightly. A charge of willful infringement can lead to an award of attorney’s fees and treble damages if the patent in question is found to be infringed. A patent opinion can provide an effective defense to this charge. Furthermore, a patent opinion also can provide a defense for a company accused of indirectly infringing a patent by active inducement in addition to associated charges of willfulness for that infringement.

Recently, the Federal Circuit has significantly redefined the standard for finding willful infringement. Instead of a “due care” standard, which in practice became little to no standard, the Federal Circuit has adopted a “reckless disregard” standard. This standard is more stringent and requires a showing of deliberate indifference to the risk of infringing another’s patent.

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more than a negligence standard, a showing of “objective recklessness” is now required. Some have called into question the need for commercial companies to continue obtaining patent opinions before marketing products. However, opinions of counsel remain useful tools for avoiding patent disputes altogether and also provide an effective defense to charges of willful infringement as well as justified an enhancement of damages.

Subsequent Federal Circuit decisions further developed the factors for evaluating willfulness and the duty of due care under the totality of the circumstances. The presence or absence of a favorable opinion of counsel regarding patent infringement, validity, or enforceability remained a crucial, but not dispositive, part of the willfulness inquiry. The due care standard of Underwater Devices was not intended to be applied as a per se rule so that every possibly related patent must be exhaustively studied by expensive legal talent, lest infringement presumptively incur treble damages. In practice, however, the due care standard in the analysis of willful infringement became more like a negligence standard, even though the word “willful” in the civil context is generally understood to refer to conduct that is not merely negligent.

**Objective Recklessness**

The Federal Circuit recently revisited the due care standard in *In re Seagate Technology, LLC*, an en banc decision. Seagate Technology was accused of willfully infringing patents owned by Convolve, Inc., and the Massachusetts Institute of Technology. Seagate had received legal opinions upon which the company intended to rely to show that it had exercised the requisite due care in determining that its conduct was not infringing or that the asserted patent was invalid or unenforceable. These opinions were part of the advice of the company’s patent counsel regarding the company’s defense to willful infringement.

The district court broadly defined the scope of the waiver associated with Seagate’s reliance on the opinions of its patent counsel. The court held that the attorney-client privilege was waived for all communications with counsel, including Seagate’s trial attorneys and in-house counsel, involving the subject matter of the patent opinions. Based on this ruling, Convolve sought production of trial counsel opinions regarding the patents and also noticed depositions of Seagate’s trial counsel. After the district court denied Seagate’s motion for a stay and certification of an interlocutory appeal, Seagate petitioned the Federal Circuit for a writ of mandamus.

Although Seagate’s writ of mandamus focused on the scope of the waiver that should apply to a defense based on advice of counsel, the Federal Circuit stated that it was also interested in whether, “[g]iven the impact of the statutory duty of care standard announced in [Underwater Devices], on the issue of waiver application of attorney-client privilege, should this court reconsider the decision in Underwater Devices and the duty of care standard itself?” The appellate court first noted that the affirmative duty of due care in Underwater Devices had led to a threshold for willful infringement that was more akin to negligence. This result, according to the Federal Circuit, did not comport with the general understanding of willfulness in the civil context and was inconsistent with U.S. Supreme Court precedent regarding punitive damages.

The appellate court first noted that the affirmative duty of due care in Underwater Devices had led to a threshold for willful infringement that was more akin to negligence. This result, according to the Federal Circuit, did not comport with the general understanding of willfulness in the civil context and was inconsistent with U.S. Supreme Court precedent regarding punitive damages. Rejecting the due care standard, the Federal Circuit held that to prove willful infringement and the appropriateness of enhanced damages, a patentee must, at a minimum, make a showing of “objective recklessness.” The court further emphasized that “there is no affirmative obligation to obtain opinion of counsel.” To establish objective recklessness for willful infringement, a patentee must present clear and convincing evidence to meet a two-prong test: 1) The infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent, as determined by the record developed in the infringement proceeding. 2) This objectively defined risk was either known or so obvious that it should have been known to the accused infringer.

Because the state of mind of the accused infringer is not relevant to whether there is an objectively high likelihood of infringing a valid patent, an opinion of counsel should only be relevant with regard to the subjective second prong of the test—whether the objectively high risk of infringement was either known or so obvious that it should have been known to the accused infringer: “The

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The appellate court first noted that the affirmative duty of due care in Underwater Devices had led to a threshold for willful infringement that was more akin to negligence. This result, according to the Federal Circuit, did not comport with the general understanding of willfulness in the civil context and was inconsistent with U.S. Supreme Court precedent regarding punitive damages.
fundamental issue remains the reasonableness, or in turn the culpability, of commercial behavior that violates legally protected property rights.” The Federal Circuit stated that it would “leave it to future cases to further develop the application of this standard.”

Subsequently, in Cohesive Technologies Inc. v. Waters Corporation, the Federal Circuit concluded that claim construction was “a sufficiently close question to foreclose a finding of willfulness” in light of the specification and prosecution history of the patent. The defendant’s noninfringement defense was based on a construction of the claim term “rigid” that was not adopted by the court. But because that claim term “was susceptible to a reasonable construction under which [the accused products] did not infringe, there was not an objectively high likelihood that [the defendant’s] actions constituted infringement.”

In Lexion Medical, LLC v. Northgate Technologies, Inc., an unpublished decision, the defendant liquidated its remaining inventory of accused products after a jury returned a verdict of infringement. To justify these post-verdict sales as not being willful, the defendant relied upon a post-verdict opinion of counsel that had predicted a favorable outcome in view of a renewed motion for judgment as a matter of law (JMOL) then pending before the district court. Although the district court denied the JMOL motion, the Federal Circuit later vacated the infringement verdict and remanded the case for further proceedings based on a new claim construction. The Federal Circuit held that the post-verdict sales liquidating the remaining inventory of accused products did not constitute willful infringement because the defendant’s reliance on the post-verdict opinion of counsel was justified, as demonstrated by the appellate court’s overturning of the infringement verdict on the merits.

The Federal Circuit also found no willful infringement in Finisar Corporation v. DirecTV Group, Inc. The defendant in Finisar had relied on an opinion of counsel on the absence of patent infringement. But the opinion took no position on the issue of validity, and the district court weighed the opinion’s failure to do so in favor of finding willfulness against the defendant. Nevertheless, the Federal Circuit found no willful infringement because a patent opinion is not required to address validity. An opinion concluding that a patent is either invalid or not infringed can provide an effective defense against a charge of willful infringement of that patent without having to rely solely on the objective merits of the case to foreclose a finding of willfulness.

An opinion of counsel can also help support summary judgment of no willful infringement—if the opinion is competent. In VNUS Medical Technologies, Inc. v. Diomed Holdings, Inc., the district court denied a motion for summary judgment of no willful infringement because the defendant had relied upon conclusory opinions, including “a self-described ‘preliminary’ assessment” with “no legal analysis,” instead of a competent opinion of counsel. The substantive requirements for an opinion of counsel were not expressly addressed in Seagate, and subsequent district court decisions, such as VNUS, have applied pre-Seagate case law regarding the criteria for evaluating the competency of an opinion of counsel.

A Competent Patent Opinion
The factors to consider in determining whether an opinion is competent and may be relied upon include:
1) Whether counsel examined the patent file history.
2) Whether the opinion is oral or written.
3) The objectivity of the opinion.
4) Whether the attorney rendering the opinion is a patent attorney.
5) Whether the opinion is detailed or merely conclusory.
6) Whether material information was withheld from the attorney.

According to the Federal Circuit, “To serve

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as exculpatory legal advice the opinion of counsel is viewed objectively, to determine whether it was obtained in a timely manner, whether counsel analyzed the relevant facts and explained the conclusions in light of the applicable law, and whether the opinion warranted a reasonable degree of certainty that the infringer has the legal right to conduct the infringing activity.”

Patent law is a specialized field of law, so having a registered patent attorney provide the opinion of counsel will help assure that the legal advice is competent. Also, selecting an outside registered patent attorney, from a law firm other than trial counsel, to provide the patent opinion may help limit the scope of the waiver associated with relying on an advice-of-counsel defense. Generally, disclosing an opinion of patent counsel does not constitute a waiver of the attorney-client privilege for communications with trial counsel. Similarly, “relying on opinion counsel’s work product does not waive work product immunity with respect to trial counsel.” The court, however, has the discretion to extend the waiver to trial counsel if the party or counsel engages in “chicanery.”

**Active Inducement of Infringement**

In addition to serving as a defense to a charge of willful infringement, an opinion of counsel may also serve as a defense in the first instance against a type of indirect infringement known as active inducement of infringement. To prove active inducement of infringement under 35 USC Section 271(b), the patentee “has the burden of showing that the alleged infringer’s actions induced infringing acts and that he knew or should have known his actions would induce actual infringements.” A claim of active inducement of infringement may arise when the defendant does not directly infringe the patent but instead sells a product with instructions that would induce a third party to use the product in a manner that would infringe the patent.

This type of indirect infringement often occurs when method or system claims are asserted against medical devices, computers, or electronics. For example, a patent claiming a new method of using a medical device such as a catheter may be indirectly infringed by a catheter that is sold with instructions for use that involve the patented method. Also, if the product is sold in a first configuration, and the patent claim requires the device to be in a specific second configuration, liability for active inducement of infringement may attach if the defendant provides instructions for the specific second configuration covered by the patent.

To prove a charge of active inducement of infringement, the plaintiff must provide evidence that the defendant had the specific intent to cause another to infringe the patent. A defendant may show a lack of specific intent to infringe with an opinion of counsel that the instructed use of the product would not infringe a valid patent. The Federal Circuit in *DSU Medical Corporation v. JMS Corporation* recently held that an opinion of counsel may serve as a defense against a claim involving this form of indirect infringement. Thus, liability for active inducement of infringement, including damages, may be avoided when a company properly relies upon a competent opinion from patent counsel when entering the marketplace, although future sales may be subject to an injunction.

In *Broadcom Corporation v. Qualcomm, Inc.*, the Federal Circuit clarified the standard for establishing the intent element of active inducement of infringement. Specifically, to establish the “affirmative intent to cause direct infringement,” a patentee must show, by a preponderance of the evidence, that:

1. The defendant “intended to cause the acts that constitute the direct infringement.”
2. The defendant “knew or should have known that its action would cause the direct infringement.”

This test is similar to the subjective second prong of the two-prong test for willful infringement but lacks the objective first prong of that
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test. By focusing on the state of mind of the accused infringer, this test resembles the old due care standard of *Underwater Devices*.

The Federal Circuit also held that the failure to obtain an opinion of counsel could be considered “circumstantial evidence of intent to infringe.” The defendant in *Broadcom* had opinions of counsel regarding patent invalidity but did not waive those opinions. The Federal Circuit upheld the jury’s finding of active inducement of infringement, remarking that the district court properly excluded the opinions in light of the defendant’s decision not to waive the attorney-client privilege with respect to those opinions.44 Clearly, for a party faced with the prospect of defending against a claim of active inducement of infringement, a competent opinion of counsel is particularly important.

Opinions of patent counsel are valuable tools for companies navigating the complexities of launching technology products in today’s competitive marketplace. Patent opinions assist companies in identifying potential restrictions in their freedom to operate as well as areas for investment and development. Vigilant awareness of the patent rights of others can help to minimize or avoid patent disputes.

In addition, if a patent dispute does arise, and the company chooses to waive the attorney-client privilege, a competent patent opinion may be useful in litigation. Although there is no legal duty to obtain an opinion of counsel, a competent patent opinion can provide an effective defense against a charge of willful infringement and avoid a punitive award of trebled damages if patent infringement is found. A competent opinion can also improve the likelihood of obtaining summary judgment of no willful infringement to eliminate the issue of punitive damages at trial. Moreover, when a company is accused of indirectly infringing a patent by active inducement, a competent patent opinion may provide a defense against that charge to avoid liability for damages in the first instance.

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1 In re Seagate Tech., LLC, 497 F. 3d 1360, 1371 (Fed. Cir. 2007) (en banc).
3 Knorr-Bremse Systeme Fuer Nutzfahrzeuge GmbH v. Dana Corp., 383 F. 3d 1337, 1343 (Fed. Cir. 2004) (en banc) (citing DEPARTMENT OF COMMERCE, ADVISORY COMMITTEE ON INDUSTRIAL INNOVATION FINAL REPORT (Sept. 1979)).
4 Seagate, 497 F. 3d at 1385 (Newman, J., concurring).
5 *Underwater Devices*, 717 F. 2d at 1390.
6 Id. at 1385, 1390.
7 Id. at 1390.
8 See, e.g., Read Corp. v. Portec, Inc., 970 F. 2d 816, 826-27 (Fed. Cir. 1992); Rolls-Royce Ltd. v. GTE Valeron Corp., 800 F. 2d 1101, 1110 (Fed. Cir. 1986).
9 See, e.g., Electro Med. Sys., S.A. v. Cooper Life Scis., Inc., 34 F. 3d 1048, 1056 (Fed. Cir. 1994) (“Possession of a favorable opinion of counsel is not essential to
avoid a willfulness determination; it is only one factor to be considered, albeit an important one.

10 In re Seagate Tech., LLC, 497 F. 3d 1360, 1385 (Fed. Cir. 2007) (en banc) (Newman, J., concurring).

11 Id. at 1371 (citing McLaughlin v. Richland Shoe Co., 486 U.S. 128, 133 (1988)).

12 Id. at 1366.

13 Id. at 1366-67. The district court conducted an “in camera review of documents relating to trial strategy, but said that any advice from trial counsel that undermined the reasonableness of relying on [the] opinions would warrant disclosure” under the waiver. Id. at 1367.

14 Id.

15 Id. (citing In re Seagate Tech., LLC, 214 Fed. Appx 997 (Fed. Cir. 2007) (unpublished order).


17 Id.; see also Knowz-Bremse Systeme fuer Nutzfahrzeuge, GmbH v. Dana Corp., 383 F. 3d 1337, 1345 (Fed. Cir. 2004) (en banc) (There is no legal duty for a potential infringer to consult with counsel.).

18 Seagate, 479 F. 3d at 1371.


20 Seagate, 479 F. 3d at 1385 (Newman, J., concurring).

21 Id. at 1371; see also Informatica Corp. v. Business Objects Data Integration, Inc., 527 F. Supp. 2d 1076, 1083 (N.D. Cal. 2007) (“Seagate significantly raised the bar for a finding of willfulness.”). In re Seagate, LLC, 497 F. 3d 1360, 1371 (Fed. Cir. 2007) (en banc).

22 Cohesive Techs. Inc. v. Waters Corp., 543 F. 3d 1351, 1374 (Fed. Cir. 2008).

23 Id.; see also Black & Decker, Inc. v. Robert Bosch Tool Corp., 260 Fed. Appx 284, 291 (Fed. Cir. 2008) (unpublished) (“Under [Seagate’s] objective standard, both legitimate defenses to infringement claims and credible invalidity arguments demonstrate the lack of an objectively high likelihood that a party took actions constituting infringement of a valid patent.”); TGP, Inc. v. AT & T Corp., 527 F. Supp. 2d 1067, 1079 (E.D. Tex. 2007) (“It cannot be said there is clear and convincing evidence that it was known or obvious that there was an objectively high likelihood that [the defendant’s] non-infringement position was incorrect.”). Lexem Med., LLC v. Northgate Techs., Inc., 292 Fed. Appx 42, 51 (Fed. Cir. 2008) (unpublished).

24 Finisar Corp. v. DirecTV Group, Inc., 523 F. 3d 1323, 1339 (Fed. Cir. 2008).

25 Id.; see also Graco, Inc. v. Binks Mfg. Co., 60 F. 3d 785, 793 (Fed. Cir. 1995) (“There is no requirement that an opinion must address validity to negate a finding of willful infringement.”).

26 See Pivonka v. Central Garden & Pet Co., 2008 WL 486049, at *2 (D. Colo. 2008) (Summary judgment of no willful infringement was granted in part because the “defendants have presented evidence showing that they consulted with patent counsel after learning of the plaintiffs’ patents and, following that consultation, believed there were defenses to infringement.”).

27 VNUS Medical Techs., Inc. v. Dormed Holdings, Inc., 527 F. Supp. 2d 1072, 1076 (N.D. Cal. 2007) (citing Amsted Indus. v. Buckeye Steel Castings, 24 F. 3d 178, 182-83 (Fed. Cir. 1994)).


29 SRI Intl, Inc. v. Advanced Tech. Labs., Inc., 127 F. 3d 1462, 1467 (Fed. Cir. 1997); see also Underwater Devices Inc. v. Morrison-Knudsen Co., 717 F. 2d 1380, 1390 (Fed. Cir. 1983) (An opinion may contain sufficient internal indicia of being competent if it contains “a patent validity analysis, properly and explicitly predicated on a review of the file histories of the patents at issue, [or] an infringement analysis that, inter alia, compared and contrasted the potentially infringing method or apparatus with the patented inventions.”, overruled on other grounds by In re Seagate Tech., LLC, 497 F. 3d 1360, 1371 (Fed. Cir. 2007) (en banc).

30 Seagate, 497 F. 3d at 1374.

31 Id. at 1376.

32 Id. at 1375, 1376. An opposing party may seek more opportunities to claim “chicanery” when trial counsel and patent counsel are members of the same law firm.


34 DSU Medical Corp. v. JMS Corp., 471 F. 3d 1293, 1306 (Fed. Cir. 2006) (en banc in relevant part).

35 Broadcom Corp. v. Qualcomm, Inc., 543 F. 3d 683 (Fed. Cir. 2008).

36 Id. at 699 (citing DSU, 471 F. 3d at 1305).

37 Id.

38 Id. at 699-700.

39 See In re Seagate Tech., LLC, 497 F. 3d 1360, 1385 (Fed. Cir. 2007) (en banc) (Newman, J., concurring) (“Industrial innovation would falter without the order that patent property contributes to the complexities of investment in technologic R&D and commercialization in a competitive marketplace.”).
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PERSONAL INJURY CASES ACCEPTED ON LIEN BASIS
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IF SOME POLITICIANS AND PRIVACY ADVOCATES have their way, private investigators and the attorneys who hire them may soon face a severe professional challenge. Legislation before the U.S. House and Senate aims to restrict access to consumer information. If it passes, civil plaintiff and criminal defense attorneys can look forward to dramatic increases in the cost of locating witnesses. Insurance companies and prosecutors, who may be exempt from the proposed restrictions, will enjoy a new advantage. Attorneys who hire investigators can also expect less likelihood of recovering funds in child support matters and greater dependence upon the diminishing resources of law enforcement to investigate claims of theft, burglary, fire, and embezzlement.

Recent concerns over so-called data breaches of consumer information have placed scrutiny and pressure upon data brokers to stop selling aggregated information to private investigators. Most of this aggregated data is tied to Social Security numbers. The SSN has become a unique personal identifier linked to property, residence histories, and public transactions. As such, the SSN has become a critical tool for private investigators.

Three recent bills have sought to limit access to SSN information. H.R. 3046, sponsored by former representative Michael McNulty, sought to prohibit the sale of SSNs to the public but allow access to law enforcement and taxing authorities. The Social Security Number Protection Act of 2007 (H.R. 948), sponsored by Representative Edward Markey, sought to outlaw the display of an individual’s SSN on a Web site and ban the sale of SSN information without the written permission of the number’s holder. Finally, S.B. 2915, introduced by Senator Charles Schumer, calls for the Commissioner of Social Security to issue uniform standards for the truncation of SSNs in an effort to reduce fraud and identity theft.

The theft of consumer information has become epidemic. The statistics are staggering. According to the Federal Trade Commission, in 2006 the total cost to victims of identity theft was $15.6 billion. Measures must be taken to combat the problem, but keeping SSNs from private investigators is not likely to help. While many may assume that identity theft is largely the result of relatively solitary criminal acts involving, for example, dumpster diving, in fact massive numbers of consumer records have been hijacked through large-scale data breaches. Victims of data-breach theft include the U.S. Veteran’s Administration, Ohio State University, FEMA, the Royal Bank of Scotland, Pulte Homes, and the Pentagon. Class action lawsuits have already been filed against TJX, Lending Tree Mortgage, and Certegy. In early 2008, ChoicePoint settled a class action (in connection with the 2004 theft of over 163,000 personal information records) for $10 million.

Privacy activists argue that private investigators have been directly involved in the theft of information, citing the recent Hewlett-Packard case and the conviction of Anthony Pellicano. They cite those cases as reason enough to bar investigators from access to consumer information. In fact, private investigators have been involved in very few data breaches, and many large organizations have improperly guarded data. Furthermore, taking away access to SSNs will cripple investigative efforts in a number of ways. For example, in cases involving fraud prevention, the recovery of stolen goods, gray market activity, theft of intellectual property, casualty claims, missing persons, and locating witnesses, the identifying information provided by data brokers can be critical.

Privacy advocates, for all their passion for individual rights, ought to think carefully about some of the unintended consequences that could be unleashed if some of these restrictive bills are passed. Investigative expenses will become much higher if the door to certain consumer data is barred. For example, confirming identities and finding witnesses with common surnames will likely have to begin without the residential starting points that data with SSNs typically provides. As a result, investigators may return to the days of wearing out shoes and knocking on doors. Such labor-intensive work would probably be a prohibitive expense for all but the wealthiest clients.

Another consideration is that the proposed bills contain exemptions for law enforcement and, in some instances, insurance companies. When criminal defense attorneys and their investigators have no access to information that a prosecutor can obtain with one call, what are the implications for due process? Do we want government to enjoy sole access to information that might exonerate innocent defendants?

Nor will civil attorneys escape consequences. If insurance companies maintain access to proprietary databases from which private investigators are barred, how will plaintiffs be operating on a level playing field? These questions must be addressed before passage of one of these bills creates unanticipated consequences.

In the Old Testament Book of Exodus, Moses, speaking for the children of Israel, asks Pharaoh for time off to worship. Pharaoh responds by dismissing the request and adding to the children of Israel’s burdens while scaling back their resources. “You shall no more give the people straw to make brick,” says Pharaoh. “Go therefore now, and work; for there shall no straw be given you, yet shall you deliver the tale of bricks.” Those of us who work in the justice system ought to be gravely concerned over what unintended consequences may result from asking investigators to make their bricks with no straw.

Tracy J. Hasper, a licensed private investigator and attorney, is the director of investigations at Batza & Associates in Valencia.
We have had great success with Randall Alexander. He is an ex-marine, is also a Paralegal and very honest. I would recommend him any time for any investigation problem. — George R. Hillsinger, Esq.

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