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Swindlers’ List

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

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For many veterans of the organized bar, new “bar years,” like birthdays, seem to increase in frequency and familiarity. This year, however, is different. As I prepare to pass the Los Angeles Lawyer gavel, my overwhelming sense is that the environment in which this magazine is published has changed dramatically in the 12 months during which it has been my privilege to serve as chair of its Editorial Board.

A magazine focused on substantive legal developments brings together two professions: publishing and law. Without question, both have endured enormous blows during the past year. From January 1 to May 5, 2009, law firms have laid off over 11,000 people. That statistic does not account for the many firms that are postponing the start dates for new associates, those that have rescinded employment offers, and the law offices (large and small) that have permanently shut their doors.

As depressing as the current economic climate has been for lawyers, it has arguably been worse for journalists. Barely half a year after the collapse of Heller Ehrman, employees of the San Francisco Chronicle agreed to painful cuts in an effort to save the paper from extinction. The New York Times Company reported a mind-boggling loss of $74.5 million for the first quarter of 2009. Other papers have halted their conventional presses and will henceforth live only in cyberspace.

The decline of traditional news media represents not only the loss of jobs for writers but also the loss of a forum for democratic debate, and with that, a vehicle for challenging ourselves. It is no secret that when we go online, we select the topics and opinions we care about and filter out the rest, creating what Nicholas Negroponte of M.I.T. has dubbed “The Daily Me.” As New York Times columnist Nicholas Kristof has recently pointed out, The Daily Me has serious implications for our individual intelligence as well as our ability to function in democratic environments. We may believe intellectually in diversity of opinion, but in practice, we are profoundly susceptible to the comforts of writers who articulate our own perspectives.

My own view is that, in a similar vein, organized bar activities have an enormous capacity to bring together individuals from across the professional spectrum and, accordingly, to improve our profession. Thirty years ago, this publication featured an article expressing the view that it was virtually impossible for women and minorities to gain election to the State Bar Board of Governors. Today, our State Bar president is an Asian woman and the five individuals most recently elected to the board included three people of color and one woman. Even more important, the insular board derided in these pages three decades ago has given way to an entity that places accountability in bar governance, elimination of bias, and access to justice at the forefront of its concerns.

All of which brings me to the conclusion that participation in bar activities—like reading a newspaper without the use of personalized filters—is an effort that will only increase in relevance in these challenging economic times. I have every confidence that LAL will continue to serve as a vital forum for the cross-pollination of ideas and information and the resulting betterment of our profession.

My personal and heartfelt thanks to Publisher and Editor Sam Lipsman and Senior Editor Lauren Milicov, whose talents and tireless professionalism have made my tenure as chair both rewarding and thoroughly enjoyable. Congratulations to incoming chair David Schnider, who will soon lend his own style and wit to these pages. It has been an honor and a pleasure to serve as chair of LAL’s Editorial Board.

Angela J. Davis is an assistant U.S. attorney and the 2008-09 chair of the Los Angeles Lawyer Editorial Board. Her views do not necessarily reflect those of the U.S. Department of Justice.
Justice Roger Boren’s Closing Argument, “An ACE for Los Angeles High School Students,” in the November issue of Los Angeles Lawyer provided an insightful behind-the-scenes look at the inception of the Appellate Court Experience (ACE) program by the Constitutional Rights Foundation, the Appellate Courts Committee of the Los Angeles County Bar, the California Academy of Appellate Lawyers, and the Second District Court of Appeal. We want to add that the feedback we have received from students, teachers, volunteer lawyers, and the appellate court justices concerning the ACE program has been exceedingly positive, with schools and teachers continuing to request to participate. ACE serves many Los Angeles schools that lack the means to participate in such outreach programs. As with many programs of its kind, ACE operates through the generosity of its volunteers and its financial sponsors. We encourage law firms and individuals interested in volunteering and/or in sponsoring the program to please contact us.

Randee Barak and Benjamin Shatz
Co-chairs, ACE Program

The article on the “Made in the USA” litigation was very interesting and timely (“American Made,” December 2008). As the attorney who initiated both of the leading California cases on the topic, Bensons v. Kwikset and Colgan v. Leatherman, I would like to make a few comments. First, the authors claim that there is no bright-line rule to please contact us. As the attorney who initiated both of the leading California cases on the topic, Bensons v. Kwikset and Colgan v. Leatherman, I would like to make a few comments. First, the authors claim that there is no bright-line rule

Stephen G. Mason’s “The Price is Right” in the April 2009 issue of Los Angeles Lawyer offers a provocative viewpoint on resale price maintenance (RPM), also known as vertical price fixing.

However, Mason’s article is seriously incomplete as a primer on RPM, because it ignores California’s antitrust law, which was not affected by the U.S. Supreme Court’s Leegin decision, which overturned the 1911 Dr. Miles decision’s per se ban on vertical price fixing under federal law. California’s Cartwright Act (Business and Professions Code Sections 16720 et seq.) broadly outlaws direct and indirect price fixing and makes no distinction between the horizontal and vertical varieties. Accordingly, California courts have repeatedly held RPM to be a per se violation of the Cartwright Act. See, e.g., Mailand v. Burckle, 20 Cal. 3d 367, 377 (1978); Kunert v. Mission Financial Services Corporation, 110 Cal. App. 4th 242, 263 (2003); Chavez v. Whirlpool Corporation, 93 Cal. App. 4th 363, 370 (2001).

Many commentators have wondered whether the California Supreme Court will reinterpret the Cartwright Act (and, in my opinion, depart from the text’s plain and unambiguous meaning) to follow Leegin. But, as California ex rel. Van de Kamp v. Texaco, Inc., 46 Cal. 3d 1147, 1165 (1988), affirmed, courts applying the Cartwright Act are not bound by federal cases construing the federal Sherman Act. Kathleen E. Foote, the senior assistant attorney general in charge of the Antitrust Law Section at the California Department of Justice, has stated that California’s antitrust enforcers treat RPM as a per se violation of California law.

Mason further fails to mention pending legislation in the U.S. Congress to restore the per se ban on RPM under federal law. Just after publication of Mason’s article, Maryland enacted a “Leegin repealer” law that confirms that RPM is a per se antitrust offense in that state.

Without this other information, Mason’s article could lead to errant legal advice.

I am a deputy attorney general in the Antitrust Law Section at the California Department of Justice, Los Angeles branch office. I am also secretary/treasurer of the Antitrust and Unfair Business Practices Section of the Los Angeles County Bar Association. This letter reflects my own views and not necessarily those of the California D.O.J. or LACBA.

Jonathan M. Eisenberg

The Author Replies: Jonathan M. Eisenberg makes several thoughtful observations about state antitrust enforcement. In writing “The Price Is Right,” however, my aim was to tailor the article narrowly to address the Dr. Miles decision in detail, to examine the most influential Supreme Court decisions assessing and affecting its utility spanning a century, and to analyze the competing economic developments in federal antitrust jurisprudence which ultimately led to its demise.

Stephen G. Mason

Kurt L. Schmalz’s “A Fee Change” (April 2009) sounds catchy but is wrong. Mr. Schmalz’s eulogy for mandatory fee arbitration (MFA) exemplifies that many people in the profession do not have a clear understanding of the MFAA, which leads them to disregard the many benefits of the program and prefer court or private arbitration, both venues being more expensive for the non-lawyer than for the lawyer.

The MFAA is a consumer (client) friendly program that allows parties to have their fee dispute arbitrated without having to retain counsel, in an informal, cost effective and relatively summary proceeding. It is not, as Mr. Schmalz implies, administered only
through local bar associations (the State Bar of California is an alternate venue). It does not deal only with nonbinding arbitrations (the parties may agree to binding arbitration at the outset). Furthermore, under the MFAA program it is not necessarily so that, in addition to the program filing fee, there are “other expenses and burdens on the client.” For example, through the Los Angeles County Bar’s program a party can have a fee dispute arbitrated by a well trained, free, fee dispute arbitrator with subject matter expertise within 4 to 12 weeks of the filing of a petition and payment of program fees. Experience also has established that in attorney-client fee disputes, over 90 percent of the matters submitted to MFA arbitration result in a final and binding resolution.

What Mr. Schmalz completely and utterly misses, by not mentioning it at all, is that there is an added, essential, component to the MFAA. Should the client prevail and be entitled to a refund of fees and/or costs and the attorney fails to pay, the State Bar of California has the authority to enroll that attorney as inactive until the award or judgment after MFA is paid. In the absence of an MFAA arbitration, the State Bar of California does not have such authority nor the client such protections. In other words, a private arbitration can result in a “binding” resolution, but the client may never collect the judgment as there would be very little pressure on the attorney to satisfy it.

In reading Mr. Schmalz’s article, one would never know any of the above, but will believe that MFA should, and will, in time be exchanged for the costly, time consuming, cumbersome private arbitration programs favored by some in the profession for reasons which have little to do with any state or federal arbitration act favoring expediency or consumer protection.

Anahid Agemian

In its opening paragraph, your cover story discussing the recent legislation clarifying California’s posthumous publicity rights law (“Everlasting Fame,” May 2009) incorrectly asserts that this amended statute is “controversial,” was “rushed through the legislature” and “will likely spawn litigation.” All three of these claims are refuted by the facts.

Senate Bill 771 merely reaffirmed the understanding of this statute that prevailed since the time it first became effective in 1985. See, e.g., Miller v. Glenn Miller Productions, 318 F. Supp. 2d 923 (C.D. Cal. 2004) and Joplin Enterprises v. Allen, 795 F. Supp. 349 (W.D. Wash. 1992). Specifically, this law always protected the rights of “deceased personalities”—a term statutorily defined as including “any such natural person who died within 50 years prior to January 1, 1985.” See former Civil Code Section 990(h). In 1999, the statute was amended to extend its protection to those who died “within 70 years” prior to that date. See Civil Code Section 3344.1(h). In a July 2007 letter to the legislature, retired State Senator Bill Campbell, the author of California’s original law, wrote that his legislation was always intended to protect the rights of celebrities who had already died. “In point of fact,” wrote Senator Campbell, “the overwhelming testimony on my bill throughout the legislative process came from heirs or representatives of celebrities who had already passed, such as, the widow of Elvis Presley, the son of John Wayne, and the grandson of W.C. Fields. There was even written testimony from the widow of the great American General, Omar Bradley.” Moreover, SB 771 received the standard two committee hearings and votes—before the Assembly and Senate Judiciary Committees. It was also voted upon on the floors of both legislative chambers. At none of these stages was a single “no” vote cast. So much for any genuine claims of controversy or precipitousness.

Finally, the article’s assertion that this clarifying legislation will prompt litigation by “prior users who acted in reliance on their pre-SB 771 rights and are harmed as a result of this retroactive bill” is wrong for at least three reasons. First, until the now-abrogated May 2007 decision of the U.S. District Court for the Central District of California, “prior users”—and would-be infringers—uniformly understood that California’s postmortem right of publicity was possessed by those who had predeceased the law’s 1985 effective date. This understanding of the original California statute was never challenged during the 22 years prior to that decision, and indeed has never been contested with respect to the similar postmortem publicity rights statutes that currently exist in 13 other jurisdictions. Second, any statute that clarifies preexisting law, or otherwise affirms an original legislative intent, does not effect any change in the law; rather, it states the law as it always was. In such cases, no question of retroactive application is involved. See, e.g., Western Security Bank v. Superior Court, 15 Cal. 4th 232, 243 (1997) and In re Marriage of Fellows, 39 Cal. 4th 179, 183 (2006). Third, the Senate Judiciary Committee specifically examined SB 771 on constitutional grounds and concluded that it “would not create a new ‘retroactive’ effect of 3344.1.” California’s Legislative Counsel similarly confirmed to Governor Schwarzenegger that SB 771 was constitutional. Any misguided litigation over these issues should be regarded as nothing short of frivolous.

Douglas E. Mirell
Weighing the Consequences of Section 998 Offers to Compromise

OFFERS TO RESOLVE CIVIL LITIGATION frequently come in two forms: a settlement offer, or an offer to compromise under Code of Civil Procedure Section 998. While a settlement offer and an offer to compromise both involve attempts by one or more parties to a dispute to resolve a matter in litigation or arbitration, an offer to compromise pursuant to Section 998 is very different from a settlement offer because it is subject to different standards and has different consequences upon acceptance or rejection.

The offer to compromise provides defendants with advantages and disadvantages relative to a standard settlement offer. The major advantage to a defendant is the consequences that a plaintiff faces if he or she rejects the offer and goes to trial or arbitration and fails to achieve a more favorable result. The consequences are the cost-shifting provisions of Section 998(c)(1), in which postoffer costs that a defendant normally pays are instead paid by the plaintiff if the plaintiff fails to achieve a better result. A defendant’s disadvantages in making an offer to compromise include limits on when an offer to compromise may be made, the terms that may be included, and the parties that may be included in a release.

The time frames in which a settlement offer or an offer to compromise may be made are different. A settlement offer may be made and accepted anytime. In contrast, Section 998(b) requires that an offer to compromise be made at least 10 days prior to arbitration or trial, and Section 998(b)(2) provides that the parties to whom the offer to compromise is made shall have either 30 days or to the time of trial or arbitration, whichever is sooner, to accept the offer.

Additional Terms
A settlement offer may contain whatever terms the offering party proposes, but an offer to compromise may not. A defendant’s ordinary settlement offer will often contain more than a simple release and dismissal. The release, for example, will frequently list more than the litigating parties, adding the defendant’s agents, servants, employees, heirs, successors in interest, and anybody else the defendant wants to protect. The settlement offer may also provide for the release of unknown claims, include a Civil Code Section 1542 waiver, make warranties of nonassignment, and append other recitals, for example a statement that the settlement is not an admission of fault. The settlement offer will often contain more than a simple release and dismissal before payment of any agreed amount, either nonparty and unnamed defendants—the terms dilute the monetary worth of a standard settlement, making valuation impossible. Inclusion of Section 1542 waivers also appear to be precluded since they expand the release to cover matters beyond what would be covered in a judgment. Therefore, adding additional terms to a Section 998 offer may turn it into an ordinary settlement offer and render it invalid for the purpose of shifting costs. As a result, once a properly made offer to compromise is accepted, an attorney must use care in preparing its release and dismissal, making sure that they do not contain terms or add parties or otherwise go beyond what is allowed in an offer to compromise.

Application of Section 664.6(a)
The language of Section 998(b)(1) provides that judgment should be promptly entered or an arbitration award promptly rendered. An accepted offer to compromise (unlike an offer for entry of judgment) is not self executing, so the settlement enforcement provisions of Code of Civil Procedure Section 664.6(a) may apply. A defendant who after acceptance of an offer to compromise 1) insists on releases protecting nonlitigating parties, 2) adds other terms that go beyond a general release and dismissal before payment of any agreed amount, or 3) fails or refuses to pay the agreed amount faces the possibility that the plaintiff may, pursuant to Section 664.6(a), make a motion for entry of judgment in the agreed amount.

Despite the limitations on the scope of allowable releases and preclusion of other terms, a properly made offer to compromise can give a defendant significant advantages over a standard settlement. A Section 998 offer can shift postoffer costs to the plaintiff should the plaintiff fail to do better at trial. On the other hand, a properly made offer to compromise subjects a defendant to significant disadvantages, because under Section 998 a defendant cannot 1) obtain Section 1542 waivers, 2) prevent future actions by the plaintiff that are not covered in the pending litigation, 3) obtain releases of nonlitigants, or 4) obtain additional terms that would not be part of a judgment.

A Section 998 offer to compromise is a double-edged sword, so a defendant needs to use it with care. A defendant may find that a properly made offer to compromise, when accepted, is nothing more than the resolution of but one round of an ongoing dispute in which additional battles involving additional issues and additional parties will still remain to be fought.

5 Valentino, 201 Cal. App. 3d at 697-98; Barella, 84 Cal. App. 3d at 800.
8 Barella, 84 Cal. App. 4th at 801-03.

BY PAUL EISNER

Paul Eisner is with the law offices of Duncan David Lee.
The Future of Injunctive Relief in Copyright Infringement Cases

TWO MOTION PICTURES are slated for release on the same day by different studios, both of which become the target of lawsuits seeking prerelease injunctions. The first studio is sued because its film, while nominally fictional, is alleged to portray the real-life plaintiff in a defamatory way. Assuming the plaintiff establishes a likelihood of prevailing on his or her libel claim and presents abundant evidence that his or her reputation will be irreparably harmed by the film, will the plaintiff get a preliminary injunction? Almost certainly not. The court most likely will hold that an interim injunction barring the release of the film would be an unconstitutional prior restraint on speech and will deny the plaintiff’s motion—citing Supreme Court precedent dating back to Near v. Minnesota.

The second studio, however, is sued because its film briefly but prominently displays, without permission, the plaintiff’s copyrighted sculpture. Assuming the plaintiff establishes a likelihood of prevailing on his or her copyright infringement claim but presents little if any evidence of irreparable harm, will the plaintiff get a preliminary injunction? The answer—at least until three years ago in most courts—was probably yes. Because the case was a copyright suit, the court most likely would have presumed the existence of irreparable injury based on a showing of likely success on the infringement claim and granted the motion—citing scores of appellate decisions across the country to that effect.

In recent years, many lawsuits like this have been filed on the eve of (or immediately following) the nationwide release of motion pictures—including Amistad, The Devil’s Advocate, The Full Monty, Twister, The Island, Knocked Up, and most notoriously, 12 Monkeys. In the 12 Monkeys case, a graphic artist sued Universal for copying the plaintiff’s drawing of a wall-mounted chair as a set design that appeared for a total of five minutes in Universal’s 130-minute film. The court found the plaintiff had demonstrated a likelihood of success on his infringement claim and accordingly concluded that “irreparable harm is presumed.” The court then issued a preliminary injunction, requiring Universal temporarily to withdraw the $30 million film from theatrical distribution. Similar scenarios can threaten the release of other works, like software applications or video games, that take years and cost millions of dollars to develop, and that may incorporate copyrighted artwork, music, or computer code.

Following the U.S. Supreme Court’s 2006 decision in eBay, Inc. v. MercExchange, LLC, such cases arguably should come out differently, or at least should be analyzed in a way that makes it less likely that a court will grant injunctive relief reflexively. In eBay, the Court held that permanent injunctive relief in patent infringement cases should be guided by the traditional four-part equitable test, instead of a collapsed test that assumes an entitlement to injunctive relief based on a showing of infringement. The extent to which eBay applies beyond the patent context or undermines the conventional wisdom that irreparable harm may be presumed in intellectual property cases remains an open question.

In eBay, the holder of a business method patent for an electronic marketplace sued eBay, Inc., for patent infringement. A jury found that the patent was valid and that eBay had infringed, but the district court declined to grant permanent injunctive relief. The Federal Circuit reversed, purporting to apply a “general rule that courts will issue permanent injunctions against patent infringement absent exceptional circumstances.” The Supreme Court unanimously reversed. In an opinion by Justice Thomas, it held that under “well-established principles of equity” a plaintiff seeking a permanent injunction under the Patent Act must satisfy the traditional four-factor test by demonstrating “(1) that it has suffered an irreparable injury; (2) that remedies available at law, such as monetary damages, are inadequate to compensate for that injury; (3) that, considering the balance of hardships between the plaintiff and defendant, a remedy in equity is warranted; and (4) that the public interest would not be disserved by a permanent injunction.”

In holding that these familiar equitable principles “apply with equal force to disputes under the Patent Act,” the Court noted that the Patent Act itself expressly defers to equitable precepts when it states that injunctions “may” issue “in accordance with the principles of equity.” The Court emphasized that this approach “is consistent with our treatment of injunctions under the Copyright Act.” It then cited three decisions in which it had stated that injunctive relief should not automatically follow upon a finding of copyright infringement—Dun v. Lumbermen’s Credit Association, Campbell v. Acuff-Rose Music, and New York Times v. Tasini—cases the Court said “consistently rejected invitations to replace traditional equitable considerations with a rule that an injunction automatically follows a determination that a copyright has been infringed.”

On this latter point, the Court noted that copyright law, like patent law, gives the owner of the intellectual property “the right to exclude others from using his property,” but that the Copyright Act’s injunction provision likewise is not absolute: It provides that a court “may” grant injunctive relief “on such terms as it may deem reasonable to prevent or restrain infringement of a copyright.”

Justice Thomas’s relatively short opinion for the unanimous Court drew two concurring opinions. In the first, Chief Justice Roberts, joined by Justices Scalia and Ginsburg, stresses that the Court’s opinion does not mean that district courts are left to write on a “clean slate” in applying the four-factor equitable test. Noting that since the early nineteenth century, courts have granted injunctive relief upon a finding of infringement in the “vast majority of patent cases,” the chief justice observes that, while this “historical practice” may not “entitle a plaintiff to a permanent injunction, it nevertheless should inform the application of the equitable test since...in this area as others, a page of history is worth a volume of logic.”

In a second concurring opinion, Justice Kennedy, joined by Justice Stevens, Souter, and Breyer, observed that such historical practices are
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less relevant when a court is confronting dif-
ferent circumstances and considerations than
in the classic paradigm of patent infringe-
ment. In particular, Justice Kennedy referred
to the rise of an industry "in which firms use
patents not as a basis for producing and sell-
ing goods but, instead, primarily for obtaining
licensing fees." For these firms, he noted, an
injunction can be employed as a "bargaining
tool to charge exorbitant fees." He cautioned
that "[w]hen the patented invention is but a
small component of the product the companies
seek to produce and the threat of an injunction
is employed simply for undue leverage in nego-
tiations, legal damages may well be sufficient
to compensate for the infringement and an
injunction may not serve the public interest."14

Decisions after eBay

Does eBay's rejection of a categorical rule
favoring injunctions upon a showing of
infringement apply beyond the patent context
to copyright actions and other intellectual
property litigation? Given the eBay Court's
explicit reliance on copyright case law in
reaching its result, the answer surely must be
yes. To date, however, only one federal appel-
late court has squarely held that eBay applies
to copyright infringement cases. In
Christopher Phelps & Associates v. Galloway,
the Fourth Circuit held that a copyright plain-
tiff is not automatically entitled to permanent
injunctive relief upon a showing of copyright
infringement and a threat of continuing
infringement; instead, courts must apply the
traditional four-factor equitable test.15

Although the Ninth Circuit has yet to
address eBay in a copyright case, the court has
indicated that eBay will apply to permanent
injunction cases generally. In Reno Air Racing
Association v. McCord, the court noted that
eBay "reiterated" that courts should apply
"traditional equitable principles" in deciding
whether to grant permanent injunctive relief.
It upheld the district court's grant of a per-
manent injunction after a bench trial in a
trademark infringement case, noting that the
defendant did not challenge the district court's
application of these principles.16 The Fifth and
Eleventh Circuits also have strongly hinted
that eBay should control trademark injunc-
tion requests.17 While some district courts
have accepted that eBay applies to copyright
injunction cases, many have continued to
grant injunctions based on less than weighty
showings of irreparable injury.18

Courts have disagreed whether, in light of
eBay, irreparable harm still may be presumed
based solely on a showing of infringement.
Read narrowly, eBay merely precludes courts
from automatically granting a permanent
injunction based on a finding of infringe-
ment. In theory, it does not preclude them
from continuing to presume the existence of
irreparable injury based on a finding of infringe-
ment, provided they consider all four
traditional equitable factors—including the
public interest—in exercising their discretion
to grant injunctive relief.

A number of courts have been reluctant to
abandon longstanding rules that irreparable
injury will be presumed upon a finding of
infringement and that a plaintiff is entitled to
a permanent injunction upon showing the
defendant's past infringement and threat of
continuing infringement. Two recent New
York cases illustrate this trend.

In Lennon v. Promise Media, the district
court denied a motion for preliminary injunc-
tion brought by the owners of a copyright in
the John Lennon song "Imagine" based on the
inclusion of 15 seconds from the song in the
motion picture Expelled: No Intelligence
Allowed. The court found that the plaintiffs
could not establish a likelihood of success on the
merits because the defendants were likely to
prevail on their defense of fair use.19 Before
making its fair use finding, however, the court
opined in dicta that eBay did not disturb the
longstanding Second Circuit rule that irrepara-
tble harm will be presumed if the plaintiff
makes a prima facie case of copyright infringe-
ment. The court read eBay narrowly to pro-
hibit only a categorical rule that required an
injunction upon a showing of infringement
and concluded that under Second Circuit law
the court still exercised its equitable discretion
to grant or deny an injunction even after it
presumed irreparable harm.20

In Warner Bros. Entertainment v. RDR
Books, Warner Bros. and author J.K. Rowling
brought a copyright infringement suit against
the publisher of a "companion book" to the
Harry Potter series of novels called The
Lexicon. Following a bench trial, the court
engaged in a fair use analysis and concluded
that The Lexicon was not a fair use, largely
because of its extensive literal copying and
close paraphrasing from the Potter novels
and from two earlier companion guides by
Rowling.21 In considering whether to issue a
permanent injunction, the court held that in
eBay "the Supreme Court made clear that an
injunction does not automatically follow" a
determination that a copyright has been
infringed.22 The court noted the question of
whether the Second Circuit's presumption of
irreparable injury survives eBay but con-
cluded that the plaintiffs had demonstrated
irreparable injury in any event, relying mainly
on Rowling's testimony that publication of the
defendant's Lexicon would have disheartened
her as an author and destroyed her creative
desire to publish her own Harry Potter ency-
clopedia, on a finding that the Lexicon would
suppress sales of Rowling's earlier companion
guides, and on a finding that the defendants
likewise would continue infringing.23

The Central District of California has
gone the opposite way. In the most detailed
analysis to date of eBay's application to copy-
right injunctions, Judge Wilson in Metro-
Goldwyn-Mayer Studios, Inc. v. Grokster,
Ltd.24 granted a permanent injunction in
favor of the plaintiff copyright owners and
against StreamCast Networks, the operator of
the Morpheus peer-to-peer file-trading ser-
vice. Judge Wilson found that eBay governed
the injunction request and held that the Ninth
Circuit's former two-part test for a permanent
injunction in copyright cases—proof of past
infringement plus a likelihood of future
infringement—had effectively been overruled
by eBay, which required the court to apply the
traditional four-factor test.25

Judge Wilson then held that "the pre-
sumption of irreparable harm no longer inures
to the benefit of plaintiffs."26 He relied on
the Supreme Court's statement in eBay that
plaintiffs "must demonstrate" that the traditional
factors favor an injunction, which he inter-
preted to mean that the plaintiff has the bur-
den of proof on the question of irreparable
harm and that even a rebuttable presumption is
no longer permitted.27 In finding irrepara-
tble harm, Judge Wilson looked beyond the
defendant's established liability for secondary
copyright infringement and considered the
fact that StreamCast had actively induced
infringement, that it would not have been
feasible for the plaintiffs to file suits against
the myriad direct infringers who used the
Morpheus service, and that the defendants
could not remotely satisfy the massive statu-
tory damages award that would be justified
by the magnitude of the infringement of thou-
sands of copyrighted works.28

Notably, Judge Wilson contrasted the mas-
sive and deliberately induced infringement at
issue in Grokster with the defendant's infringe-
ment in the "patent troll" scenario addressed
by Justice Kennedy's concurring opinion in
eBay. Unlike the situation in which the
patented invention "is but a small compo-
ment of the product" the defendant companies
seek to produce and "the threat of an injunc-
tion is employed simply for undue leverage in
negotiations," Judge Wilson found that
"StreamCast's entire business was built around
the fundamental premise that Morpheus
would be utilized to infringe copyrights."29

eBay and Preliminary Injunctions

Before eBay courts generally applied a pre-
sumption of irreparable harm at the prelimi-
ary injunction stage as well.30 Although
eBay does not expressly address preliminary
injunctions, the case casts doubt on this long-
standing rule. A preliminary injunction can
have a devastating effect on the defendant, as
illustrated above. Moreover, because of the
relatively undeveloped factual record at the
preambusi preliminary injunction stage, there is a greater risk that courts may enjoin the distribution of expressive works—that is, constitutionally protected speech—that are not infringing or otherwise unlawful.

In particular, collapsing of the traditional equitable test to presume an entitlement to preliminary injunctive relief upon a showing of likely infringement can lead to injunctive relief in situations in which the allegedly infringing material is only a small part of the expressive work that is sought to be enjoined, or in which monetary damages almost certainly would provide an adequate remedy. Nevertheless, one might argue that it would be consistent with equitable principles to presume irreparable harm and issue interim injunctive relief upon a plaintiff’s showing of a likelihood of success on its infringement claim—even if such an approach is foreclosed at the permanent injunction stage. After all, preliminary injunctions are temporary and often are conceived of as merely preserving the status quo.

The Southern District of New York embraced this view in *Lennon v. Premise Media Corporation*. The court drew a distinction between preliminary and permanent copyright injunctions, opining that even if eBay precluded a presumption of irreparable harm at the permanent injunction phase of a copyright case, “A presumption temporarily removing the need to prove irreparable harm may serve the ends of equity at this early stage of the litigation.”

Other courts, however, have assumed that eBay’s reasoning applies equally to preliminary and permanent injunctions in intellectual property cases. This conclusion finds support in the eBay opinion, in which the Supreme Court twice cites its earlier opinion in *Amoco Production Company v. Village of Gambell*, a 1987 decision holding that a presumption of irreparable harm at the preliminary injunction stage in an environmental case “is contrary to equitable principles.” The inference that eBay applies to intellectual property cases also finds support in the Supreme Court’s decision last year in *Winter v. Natural Resources Defense Council, Inc.*, in which the court reversed and remanded a preliminary injunction, affirmed by the Ninth Circuit, that prohibited the Navy from conducting training exercises using active sonar due to alleged environmental harms caused to marine mammals.

The Court rejected as “too lenient” the Ninth Circuit’s longstanding preliminary injunction standard, which allowed for the issuance of injunctive relief on a showing of a mere “possibility” of irreparable harm, if the plaintiff demonstrated a strong likelihood of prevailing on the merits. Instead, the Court emphasized that the moving party must satisfy the traditional four-factor test and must demonstrate “that irreparable injury is likely in the absence of an injunction.”

Echoing its pronouncements in eBay (and again invoking *Amoco*), the Supreme Court stated that “[a] preliminary injunction is an extraordinary remedy never awarded as of right,” and “[i]n exercising their sound discretion, courts of equity should pay particular regard for the public consequences in employing the extraordinary remedy of injunction.”

Although *Winter* is not an intellectual property case, its embrace of the traditional equitable test and its rejection of “lenient” approaches to finding irreparable harm certainly suggest that eBay will apply with equal force at the preliminary injunction stage in copyright cases.

**Limits on Copyright Injunctions**

After eBay, studio defendants may no longer face the doomsday scenario of a preliminary injunction that prevents the release of a movie. Indeed, in such situations as eBay, it may have the most impact on the decisions of district courts to grant or deny injunctions in copyright cases. Defendants can argue that the court must consider all four factors in the traditional equitable test for injunctive relief, including whether the plaintiff can be adequately compensated with money damages. Moreover, the Supreme Court’s instruction—in eBay and *Winter*—that courts must consider the “public interest” in deciding whether to issue injunctions may open the door to more explicit considerations of First Amendment values in the determination of appropriate copyright remedies.

When the material that allegedly has been infringed constitutes only a small portion of the defendant’s expressive work, or when the defendant presents a strong argument that its use of copyrighted material is protected by the fair use doctrine, the public interest favoring the dissemination of the defendant’s work—including First Amendment interests in free expression—is at its strongest. In contrast, when the defendant is accused of wholesale literal copying, as in piracy cases, no public interest is likely to be negatively affected by preliminary or permanent injunctive relief upon a showing of infringement.

The three copyright cases cited by the Supreme Court in eBay all support this view. A century ago, in *Dun v. Lumbermens Credit Association*, for example, the Supreme Court upheld the lower court’s refusal to enter an injunction in a case in which it found that the defendant publisher improperly had copied some information from the plaintiff’s reference book for use in the defendant’s similar reference book. The Supreme Court held that an injunction preventing the dissemination of the defendant’s entire work would be inequitable:

The infringing “proportion is so insignificant compared with the injury from stopping appellées’ use of their enormous volume of independently acquired information, that an injunction would be unconscionable.”

In *Campbell v. Acuff-Rose Music*, the Supreme Court reversed the appellate court’s rejection of the defendant’s fair use defense of its parody of the song “Pretty Woman.” In doing so, the Court cautioned that copyright injunctions are not mandatory and suggested that courts should refrain from imposing injunctive relief in cases involving “close questions” of fair use. The Court quoted at length from Judge Leval’s influential article on fair use, which argues that while in the “vast majority of cases, [an injunctive] remedy is justified because most infringements are simple piracy,” such cases are “worlds apart from many of those raising reasonable contentions of fair use” in which there may be a strong public interest in the publication of the secondary work [and] the copyright owner’s interest may be adequately protected by an award of damages for whatever infringement is found.”

The Supreme Court returned to this theme in *New York Times v. Tasini*, in which it held that the republication of newspaper articles in electronic databases was not a “revision” of a collective work permissible under Section 201(c) of the Copyright Act but instead infringed the copyrights of the freelance writers who contributed some of the articles in the database. In response to arguments from the defendant publishers that the Court’s ruling would have dire consequences in the form of injunctions requiring the deletion of articles from online databases, the Court explained: “It hardly follows from this decision that an injunction...must issue.” The Court noted that the courts and Congress “may draw on numerous models for distributing copyrighted works and remunerating authors....”

**Circuit Court Antecedents**

A number of appellate decisions anticipate and support this view as well. In *Rosemont Enterprises v. Random House*, for example, the Second Circuit reversed a preliminary injunction restraining publication of a 1966 biography of Howard Hughes that allegedly infringed the copyrights of three *Look* magazine articles, noting that the injunction deprived the public of an opportunity to learn about a “newsworthy personality.” In *Abend v. MCA, Inc.*, the Ninth Circuit held that the defendant’s release of the motion picture *Rear Window* without a valid renewal copyright infringed the plaintiff’s copyright in the short story on which the movie was based. But in remanding to the district court, the court observed that the case presented “compelling equitable considerations” because an injunction could result in “great public
injury." The court noted that the success of the movie Rear Window “resulted in large part from factors completely unrelated to the underlying story”—including the “outstanding performances” of Grace Kelly and James Stewart and the “brilliant directing of Alfred Hitchcock,” and that an injunction would cause public injury “by denying the public the opportunity to view a classic film for many years to come.”44

The Eleventh Circuit echoed the Supreme Court’s admonitions in Campbell about injunctions in close fair use cases in Suntrust Bank v. Houghton Mifflin Company,45 in which it reversed a preliminary injunction that restrained the publication of Alice Randall’s The Wind Done Gone, a fictional parody that drew substantially on the novel Gone with the Wind. The court cited Campbell for the proposition that “while injunctive relief may be particularly appropriate in cases involving simple copying or ‘piracy’ of a copyrighted work,…such relief may not be consistent with the goals of copyright law in cases in which the alleged infringer…has a colorable fair-use defense.”46

After eBay, all owners of intellectual property would be well advised to assume they no longer can rely solely on a general presumption of irreparable injury, without concrete proof of such harm, in seeking either preliminary or permanent injunctive relief. Nevertheless, it would appear that injunctive relief still may be obtained fairly readily in cases—like Grokster—of simple copying or piracy, provided the plaintiff can establish some palpable risk of harm beyond its showing of past infringement.

Case law has yet to address fully the question of eBay’s application to copyright infringement suits in which the material infringed amounts to only a small portion of the defendant’s expressive work or in which the defendant raises a colorable fair use defense. Based on Supreme Court and circuit decisions, however, these scenarios—in which free speech interests are at their strongest—may present the most likely opportunity for courts to apply eBay to limit the use of injunctions in copyright actions.

2 See, e.g., Cadence Design Sys., Inc. v. Avant! Corp., 125 F. 3d 824, 827-28 (9th Cir. 1997); ABKCO Music, Inc. v. Stellar Records, Inc., 96 F. 3d 60, 64 (2d Cir. 1996).
4 See id. (citing Fisher-Price, Inc. v. Well-Made Toy Mfg., 25 F. 3d 119, 124 (9th Cir. 1994)).
6 Many courts—including the Ninth Circuit—have held that irreparable injury may be presumed in trademark cases upon a finding of a likelihood of confusion, See, e.g., GoTo.com, Inc. v. Walt Disney Co., 202 F. 3d 1199, 1209 (9th Cir. 2000).
7 See eBay, Inc. v. MercExchange, LLC, 401 F. 3d 1323, 1339 (Fed. Cir. 2005).
8 eBay, 547 U.S. at 391.
9 Id. at 391-92 (quoting 35 U.S.C. §283).
10 Id. at 392.
11 Id. (quoting 17 U.S.C. §502(a)).
12 Id. at 395 (quoting New York Trust Co. v. Eisner, 256 U.S. 345, 349 (1921) (Holmes, J.).)
13 Id. at 395-96. Specifically, Justice Kennedy observed: “To the extent earlier cases establish a pattern of granting an injunction against patent infringers almost as a matter of course, this pattern simply illustrates the result of the four-factor test in the contexts then prevalent.” Id. at 396.
14 Id. at 396-97.
15 See Christopher Phelps & Assocs., LLC v. Galloway, 492 F. 3d 352, 543 (4th Cir. 2007). Last year, the Federal Circuit, applying Ninth Circuit law in a rare copyright appeal, observed, with only a passing mention of eBay: “[W]here a copyright holder has shown sufficient evidence of permanence, the Ninth Circuit has held that irreparable harm is presumed.” Jacobson v. Katzer, 535 F. 3d 1377, 1378 (Fed. Cir. 2008).
16 Reno Air Racing Ass’n v. McCord, 432 F. 3d 1126, 1137-38 (9th Cir. 2006); accord Geertson Seed Farms v. John Deere, 541 F. 3d 938, 944 (9th Cir. 2008) (eBay’s four-factor test governed a plaintiff’s request for a permanent injunction based on violation of the National Environmental Policy Act.).
20 See id. at 320 n.1.
22 Id. at 551.
23 Id. at 552-53. See also UMG Recordings, Inc. v. Blake, 2007 WL 1853956 (E.D. N.C. June 26, 2007) (citing eBay but concluding without analysis that irreparable injury is presumed when a plaintiff succeeds on the merits); Warner Bros. Entm’t v. Carsagno, 2007 WL 1655666 (E.D. N.Y. June 4, 2007) (applying eBay and granting permanent injunction in a default judgment case involving the defendant’s distribution of the film Million Dollar Baby on a peer-to-peer file-sharing network).
25 Metro-Goldwyn-Mayer, 518 F. Supp. 2d at 1209 (discussing MAI Sys. Corp. v. Peak Computer, Inc., 991 F. 2d 511, 520 (9th Cir. 1993)).
26 Id. at 1211.
27 Id.
28 Id. at 1217-18.
29 Id. at 1216.
30 See, e.g., LGS Architects, Inc. v. Concordia Homes of Nev., 434 F. 3d 1150, 1155-56 (9th Cir. 2006); Johnson Controls, Inc. v. Phoenix Control Sys., Inc., 886 F. 2d 1173, 1174 (9th Cir. 1989).
31 See Mark Lemley & Eugene Volokh, Freedom of Speech and Injunctions in Intellectual Property Cases, 48 D x. L. J. 147 (1998) (arguing that courts should be more reluctant to enjoin copyright infringement at the preliminary injunction stage than at the permanent injunction stage, because of the danger of restraining speech that ultimately is found not to be infringing).
34 See, e.g., Allora, LLC v. Brownstone, Inc., 2007 WL 1246448 (W.D. N.C. Apr. 27, 2007) (declining to presume irreparable harm at preliminary injunction stage in copyright case).
41 Id. (quoting Leval, Toward a Fair Use Standard, 103 Harv. L. Rev. 1105, 1132 (1990)).
43 See Rosemont Enters. v. Random House, 366 F. 2d 303, 310-11 (2d Cir. 1966); see also Belushi v. Woodward, 598 F. Supp. 36, 37 (D. D.C. 1984) (denying preliminary injunction sought by photographer Judith Belushi over one of her photographs in a biography of John Belushi, despite finding a likelihood of success on the merits; legal remedies “would vindicate any rights that may have been impinged” and that the public interest in “the promotion of free expression” outweighed the plaintiff’s interest).
44 See Abend v. MCA, Inc., 863 F. 2d 1465, 1478-79 (9th Cir. 1988), aff’d sub nom. Stewart v. Abend, 495 U.S. 207 (1990); see also Silverstein v. Penguin Putnam, Inc., 368 F. 3d 77 (2d Cir. 2004) (citing Dun and Abend in holding that an injunction barring publication of a Dorothy Parker poetry collection was an abuse of discretion, where plaintiff had only a “slight” protectible interest in some of the poems).
46 Id. at 1265 (citing Campbell v. Acuff-Rose Music, Inc., 510 U.S. 569, 578 n.10 (1994)).
WHEN GOVERNMENT ACTION or inaction threatens protected interests, state and federal due process clauses guarantee certain procedural protections as well as substantive limitations on government power. However, these constitutional guarantees generally offer no protection when a private organization or association excludes or expels members. This void can be harmful. Individuals subjected to adverse membership decisions by professional or social organizations can suffer a devastating economic impact.

In 1944, the California Supreme Court announced a common law right, under certain circumstances, to judicial review of membership decisions by private organizations and associations. In *James v. Marinship Corporation*, the court held that a union could not arbitrarily deny membership privileges to applicants on grounds of race if the union held monopolistic power over the right to work. The judicial remedy for the arbitrary exclusion of the plaintiffs as potential members was injunctive relief. Later cases referred to this common law right as the fair procedure doctrine to avoid confusion between it and constitutional due process rights.

The use of the fair procedure doctrine has expanded since 1944, and its arsenal of remedies now includes substantial tort damages. When an organization or association serves as a gatekeeper to a profession or trade, that entity must offer members or prospective members a fair procedure when it makes exclusionary membership decisions. For a procedure to be fair, it must include adequate notice and an opportunity to be heard. However, the California Supreme Court has stopped short of defining the procedural rules that must be followed in exclusionary membership decisions. Instead, the court has left this task first to the organizations themselves and then to trial and intermediate appellate courts, which continue to draw the contours of the doctrine as well as the means to implement it.

A purely private enterprise may affect the public interest by providing important products or services, by making representations to the public about those products and services, by superior bargaining power, by legislative recognition, or a combination of those factors. If that entity also possesses substantial power to thwart an individual’s pursuit of a lawful trade or profession or to control the manner in which it is practiced, that entity’s membership decisions may be subject to judicial review for substantive rationality and procedural fairness.

The doctrine today, with its elements of public interest and economic interest, is flexible and has been applied to situations outside of the context of unions, including healthcare providers, expert associations, the Boy Scouts, and even private clubs. Still, it is not without limits. Nevertheless, the doctrine has been invoked in settings that show it to be sufficiently robust to supply procedural safeguards when a private organization or association acts as a gatekeeper with power to influence or control the right to practice a trade or profession. Although the decisions invoking the fair procedure doctrine may appear at times to be inconsistent in their application and scope, some notable and consistent themes have emerged.

The right identified by the court in *Marinship* was not necessarily new. Earlier decisions justified court intervention on the premise of protecting property rights in members’ funds and assessments. *Marinship* was groundbreaking because it offered a remedy to those who were excluded, not expelled, and who thus had no property interest. The court departed from the property right requirement in favor of a more expansive rule grounded in public policies underlying the right to work.

Expanding the Doctrine

In the ensuing decades, California courts expanded the doctrine in right-to-work cases, most notably in the medical and dental professions. For instance, the supreme court applied the doctrine in *Pinsker v. Pacific Coast Society of Orthodontists (Pinsker I)*. The case involved exclusionary decisions by associations that certify specialists in orthodontics. Since those associations held a virtual monopoly to determine professional standards, they were imbued with the public interest, subjecting their membership decisions to judicial review. Although membership was not essential for a specialist’s certification, it had become a practical necessity. Applicants thus had the right to have their applications heard.

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cations “considered in a manner comporting with the fundamentals of due process, including the showing of cause for rejection,” and that cause must not be arbitrary or capricious.

The court built on that foundation in Pinsker v. Pacific Coast Society of Orthodontists (Pinsker II), explaining that an organization’s decision to exclude or expel an individual may be arbitrary either because the reason for doing so is irrational or because the organization has proceeded unfairly. A private organization’s exclusionary decisions that affect the public interest must be substantively rational and procedurally fair. This means that the applicant must be notified of the reason for the proposed rejection and given a meaningful opportunity to be heard. The court stepped away from the “due process” language it had used in Pinsker I, distinguishing the common law right of fair procedure from broader constitutional duties.

Since the court was reluctant to second-guess the management decisions of a private organization, it was naturally unwilling to set rigid rules. Justice Tobriner wrote, “The common law requirement of a fair procedure does not compel formal proceedings with all the embellishments of a court trial, nor adherence to a single mode of process. It may be satisfied by any one of a variety of procedures which afford a fair opportunity for an applicant to present his position....” This court should not attempt to fix a rigid procedure that must invariably be observed. The court thus left it to associations themselves to devise methods that provide applicants with adequate notice and an opportunity to respond.

In Ezekiel v. Winkley, the supreme court stretched the fair procedure doctrine to reach the expulsion of a surgical resident from a private hospital’s residency program. The court made a pragmatic decision that was grounded in economics. Expulsion and exclusion implicate different concerns, because a member on whom a benefit has already been conferred enjoys broader legal protections than an initial applicant for the same benefits. The post-license specialty training of physicians through residency programs is part of the “vital link” of private regulation that is essential to modern medical practice. No longer did the court couch its concerns in terms of the public interest or restraint of trade. Instead, the court acknowledged that residency programs substantively affect an “important economic interest.” Exclusion from this type of program is deemed “arbitrary” when it is substantively unreasonable, internally irregular, or procedurally unfair. Because a private hospital’s resident admission and expulsion policies effectively control a physician’s practical ability to use a state-issued medical license and thus the right to practice a lawful profession, the licensee seeking to remain in the resident program was entitled to “rudimentary procedural and substantive fairness.”

Medical insurers as well are fair game for the fair procedure doctrine when they have the power to control the flow of patients to healthcare professionals through a preferred provider network. A public interest is affected when medical services are provided through the “unique tripartite relationship among an insurance company, its insureds, and the physicians who participate in the preferred provider network.” In Potvin v. Metropolitan Life Insurance Company, the court trained its focus on public and consumer interests that, along with economic restraints, justified extending the doctrine again. The court concluded that the insurer “possesses power so substantial that the removal [from the preferred provider network] significantly impairs the ability of an ordinary, competent physician to practice medicine or a medical specialty in a particular geographic area, thereby affecting an important, substantial economic interest.” Health insurers hold a virtual monopoly on managed care and have substantial economic power over physicians on the preferred provider lists by controlling the flow of patients. If expulsion of a physician from an insurer’s preferred provider list will impair the physician’s practice of medicine and thereby affect an important economic interest, the insurer must afford fair procedures.

A groundbreaking decision in 2008 gave new teeth to the fair procedure doctrine by recognizing a cause of action with a tort remedy for an organization’s failure to afford fair procedures. That same decision placed the determination of the factual basis of the doctrine squarely in the hands of a jury. In Palm Medical Group, Inc. v. State Compensation Insurance Fund, an occupational medical clinic was excluded from an insurer’s preferred provider network and was thus omitted from its online search tools, which are an important means for steering patients to the clinic. The clinic sued and secured a hefty jury verdict for damages for violation of the fair procedure doctrine, but the trial court granted the insurer’s motion for judgment notwithstanding the verdict.

However, the court of appeal reversed, making three noteworthy observations. First, a corporate plaintiff is entitled to the same fair procedure protections as individuals. Next, the issue of the insurer’s power over the local market is one of fact for the jury to decide. Finally, the court affirmed a monetary tort verdict for the clinic’s lost profits, over the insurer’s objection that the only remedy under the fair procedure doctrine is remand to the organization to reconsider its decision, pursuant to fair procedures. While a claimant may be obliged to first exhaust administrative remedies, once that is accomplished, the organization under scrutiny may be exposed to tort damages for failure to afford fair procedures.

These judicial forays into the managed healthcare setting skirt an important but competing policy issue. When patient care is at issue, an uneasy tension exists between management autonomy and quality of care. Judicial deference to a legitimate business rationale—such as public safety or “economic credentialing”—may take a back seat to a healthcare practitioner’s quality-of-care decisions if those decisions lead to expulsion or “deselection” from a plan or program. While some commentators and opinions make the case for judicial restraint in a hospital’s disciplinary process, others argue for intervention after concluding that the public interest may be affected by exclusionary decisions. Courts may be asked to confront these issues with greater frequency as the economics of modern medicine and managed care collide with the medical ethics of patient care.

Invoked and Not Invoked

Courts have remarked repeatedly on their reluctance to interfere with management autonomy. Thus it is no surprise that when they have done so, they have refrained from drafting mandatory guidelines to be followed by managers, opting instead for a flexible analysis. The organization itself has the primary responsibility to devise a method that provides the applicant or member with adequate notice and a reasonable opportunity to be heard—orally, or in writing. Whether a particular procedure is “fair” depends largely on the nature of the issue in question.

Under the doctrine’s relatively spartan requirements, the reasonable notice should provide the reasons for the membership decision, and the hearing or procedure should afford the member or applicant with an opportunity to respond to those reasons. This opportunity to respond may be nothing more than the chance to make a written defense submission. Articles of association or an organization’s bylaws may supply procedural rules for charges against a member, but those rules do not supplant the underlying obligation to act fairly.

The California Legislature has recognized the need for procedural protections and, accordingly, has codified the right to fair procedure in some settings. For instance, Corporations Code Section 18320, as adopted in 2005, requires that when a property right or important substantial economic interest is involved, the expulsion of a member of an unincorporated association must be done in good faith and in a fair and reasonable man-
ner. This can be satisfied by including the procedures in the unincorporated association’s governing documents, such as delivering notice and a statement of reasons for expulsion at least 15 days before the effective date of expulsion, and providing an opportunity to be heard, orally or in writing, at least five days before the expulsion. Expulsion of a member is reviewable, if suit is timely filed, and the court may order any relief it deems equitable, including reinstatement. Similarly, membership in a nonprofit mutual benefit corporation cannot be terminated unless the statutory minimum requirements for notice and procedures have been met. The notice and hearing procedures outlined in these provisions serve as useful guidance for corporations and organizations in drafting their own governing documents.

Fairness in physician peer review also has been the subject of legislation. While common law still applies in those settings, courts may also rely on the uniform procedures provided in a codified procedural scheme.

As with healthcare providers and insurers that have power to restrict the flow of business, an association that privately peer reviews the work of experts may be constrained to occupy a gatekeeper function. For instance, the Association of Firearm and Toolmark Examiners was held to be a gatekeeper organization that promotes the integrity of expert testimony in firearms forensics. It was not a surprise that this group was of special interest to the judiciary. The court held that its members were entitled to fair procedure in censure proceedings.

The exclusionary policies of the Boy Scouts have been successfully challenged under the doctrine, resulting in judicial review for fair procedure when the Scouts attempted to expel a Scout because of his homosexuality. The court returned to the doctrine’s origins in the public interest to prohibit an arbitrary expulsion based solely on the Scout’s status as a homosexual. However, while the Boy Scouts may not arbitrarily expel a Scout, their refusal to promote a Scout to the rank of Eagle Scout does not affect a substantial economic interest; the loss of prestige and honor did not suffice to justify judicial interference in the organization’s autonomy.

In a modest departure from the economic and public interests that animated Marinship and its progeny, the fair procedure doctrine has been extended to apply to private golf and country club memberships, which may have only a remote influence over a member’s professional opportunities. The court ruled that a club with a “men-only” policy contained in the club’s bylaws could not unilaterally terminate a woman’s membership upon her divorce. The member was entitled to notice and an opportunity to be heard, because she used her membership to help earn a living as a real estate agent—an economic interest the court deemed important. Country club memberships are property rights, and members are entitled to fair procedure to protect rights they enjoy as members.

California courts usually hold that the fair procedure doctrine is not applicable when the economic- or public-interest threshold has not been met. When organizations do not perform a gatekeeper function for a profession, courts generally find that the organizations cannot be compelled to supply a fair procedure to offended applicants. For instance, neither the Academy of Motion Picture Arts and Sciences nor the Producers Guild of America was considered to be a gatekeeper controlling the right to practice the trade or profession of movie producing. The court further observed that they did not operate in the public interest, so no fair procedure concerns were implicated when one of the producers of the Academy Award-winning film Crash was bypassed for award recognition because the Academy did not feel that he met the award criteria.

The courts have given institutions of higher learning a pass when dealing with tenure considerations, holding that a university does not exercise sufficient control to thwart a professor’s right to pursue his or her profession. Thus a university is under no obligation to provide a hearing before removing the professor from the tenure track. Further, a nonprofit sports organization’s disciplinary suspension of two volunteer umpires was also not subject to fair procedure requirements, as neither public nor economic interests were deemed to be threatened by the organization’s decisions. Although finding that there was no legal obligation to afford fair procedure under common law, the court observed that the organization’s disciplinary procedure was nonetheless fair and complied with Corporations Code Section 7341. That section is part of the laws governing nonprofit corporations that are designed to codify existing case law concerning the procedural steps required for suspending or expelling members.

Organizations that are accustomed to management autonomy may now wish to reexamine their procedures for participant selection and deselection in light of decisions applying the fair procedure doctrine. With tort damages potentially available to an offended party, it is reasonable to expect that the fair procedure doctrine will be invoked with greater frequency and in new settings. An organization making exclusionary decisions must now weigh the potential for tort damages in membership decisions that may
adversely impact a member or applicant’s livelihood and should provide the appropriate fair procedures as a result.

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3 Id. at 732 (quoting Wilson v. Newspaper & Mail Deliverers’ Union, 123 N.J. Eq. 347, 187 A. 720 (1938)). The Marinship court reasoned: “Where a union has...attained a monopoly of the supply of labor...such a union occupies a quasi public position similar to that of a public service business and it has certain corresponding obligations...Its asserted right to choose its own members does not merely relate to social relations; it affects the fundamental right to livelihood and should provide the appropriate fair procedures as a result.

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Until the collapse of Bernard Madoff’s reported $65 billion investment scheme late last year, many people had never heard the term “Ponzi scheme”—and those who had would have been hard-pressed to define it. Thanks to Madoff, Ponzi schemes are now part of the mainstream lexicon and are no longer solely the obscure subjects of court opinions and law review articles. Indeed, talk of Ponzi schemes seems to dominate not only the headlines but also late-night talk shows, cocktail parties, and weekend soccer games.

Despite all the recent notoriety, most people (including many attorneys) still have no idea what happens when Ponzi schemes collapse. For law enforcement, attorneys, accountants, and other professionals, that is when the real work begins. Given the prevalence of these schemes and the rate at which they are being discovered, the legal and logistical issues involved in excavating the financial ruins of a collapsed Ponzi scheme will remain for years to come.

Operators of Ponzi schemes typically represent them as legitimate investment opportunities providing substantial returns, but those returns are not supported by any type of underlying, legitimate business. Instead, investors are paid profits from the principal sums paid by newer investors. The initial investors usually receive the promised returns, which attracts additional investors. To keep the scheme going, Ponzi operators must garner more new investors in order to continue paying earlier investors.

Ponzi schemes are a species of pyramid scheme. In essence, Ponzi schemes are upside-down pyramids that inevitably collapse because the number of new investors cannot keep pace with the number of earlier investors. As new investors decrease and the number of earlier investors increases, the scheme will inevitably collapse.

R. Alexander Pilmer and Mark T. Cramer are partners at Kirkland & Ellis LLP in Los Angeles, where they are members of the firm’s litigation department. Pilmer and Cramer handled hundreds of cases arising out of a failed Ponzi scheme operated by Reed Slatkin, including In re Slatkin and Neilson v. Union Bank of California, N.A. They are currently counseling a number of investors in the Bernard Madoff Ponzi scheme.

Formal dissolution proceedings are usually necessary to sort through the wreckage of failed Ponzi schemes.
they are structurally unsound from their inception. While Ponzi schemes can last for years, eventually—and inevitably—their operators are unable to recruit enough new investors to fund the withdrawal requests and returns of the earlier investors. Thus, like death and taxes, the ultimate failure of a Ponzi scheme is certain.

The Ponzi scheme’s namesake, Carlo “Charles” Ponzi, was an Italian immigrant who, in the 1920s, solicited other immigrants to invest their life savings with him.\(^1\) Ponzi falsely claimed that his investors’ money would be used to buy international postal coupons that he could resell for a 100 percent profit. Ponzi convinced his investors that he was able to earn substantial profits by exploiting differences in international currency exchange rates. In fact, the only thing Ponzi exploited was his investors’ trust because he was not actually using their money to purchase postal coupons and, therefore, would not earn any return on their investments. Instead, he used the money he received from new investors to pay the returns he had promised to earlier investors. Although Ponzi convinced more than 20,000 people to invest more than $10 million, an audit of Ponzi’s assets after the scheme collapsed turned up less than $100 worth of postal coupons.

Many Ponzi operators target specific religious or ethnic groups to get their schemes off the ground. They exploit the built-in trust of these so-called affinity investors or affinity groups to establish their credibility, to identify potential investors, and to promote their schemes. There are countless examples of this sort of affinity fraud in the context of Ponzi schemes. Ponzi himself targeted his fellow Italian immigrants. More recently, Madoff preyed on members of the Jewish community, including numerous Jewish charities. A large percentage of the investors in Reed Slatkin’s $600 million Ponzi scheme—one of the largest Ponzi schemes in U.S. history—were followers of L. Ron Hubbard’s Church of Scientology. Other recent schemes have targeted Baptists, Mormons, and members of the Saddleback Church, as well as African Americans, Koreans, and Latinos. In recent years, hardly any religious or ethnic group has been spared from some sort of affinity fraud.\(^2\)

As Ponzi schemes progress, some investors—typically those who were recruited early in the scheme—withdraw more money from the scheme than they invested. In essence, these early investors receive fictitious profits on their principal investments, while other investors receive either less than they invested or nothing. Whether an investor receives more or less than they invested looms large in deter-

Liquidation, Mitigation, and Litigation

 Failed Ponzi schemes often end up in bankruptcy, SEC receivership, Securities Investor Protection Corporation (SIPC) liquidation, or other formal dissolution proceedings. Any number of business entities created in connection with the schemes, in addition to the personal estates of the Ponzi operators, may need to be liquidated as well. Depending on the circumstances, the personal estates of Ponzi operators and related business entities may file for liquidation in a bankruptcy or through a receiver appointed pursuant to securities laws and regulations.

The bankruptcy trustee or the receiver may pursue claims against coconspirators, financial institutions, and certain investors. The recoveries based on these claims often are among the largest assets the trustee or receiver has available to pay creditors’ claims, including the claims of investors who lost money in the scheme. Trustees and receivers share the same objective—namely, to return as much money as possible to the victims of the scheme.

While trustees and receivers have many of the same rights and abilities to pursue money from potential defendants, the Bankruptcy Code provides trustees with some additional powers that are not available to receivers. For example, bankruptcy trustees are empowered under the Bankruptcy Code to undo many financial transactions conducted by Ponzi operators in the 90 days leading up to the bankruptcy filing.\(^4\) The purpose of undoing these “preferences,” as these transactions are known, is to spread the effect of the bankruptcy across a greater number of creditors and prevent earlier-paid creditors who received money immediately prior to the bankruptcy from receiving a windfall.

Another tool available to trustees that would not be available outside the bankruptcy context is the ability to obtain documents and testimony pursuant to Federal Rule of Bankruptcy Procedure 2004.\(^5\) At any time after a bankruptcy petition is filed, the trustee may seek an order from the bankruptcy court to conduct an examination under oath of “any entity”\(^6\) and compel the production of documents.\(^7\) Consistent with the rule’s purpose to discover information regarding the assets of the bankruptcy estate, a permissible “2004 examination” is broad in scope.\(^8\) To that end, and distinct from depositions and other standard discovery devices, a trustee can obtain information through 2004 examinations without initiating litigation.

Separate from and independent of the claims brought by the trustee or receiver, certain aggrieved investors in a Ponzi scheme may have standing to pursue various claims of their own. These can be pursued individually or on a classwide basis on behalf of all similarly situated investors. These claims, however, are likely to have no value because a Ponzi operator will almost always be the subject of a receivership or bankruptcy case. The investors also may have claims against third parties who had some connection with or facilitated the Ponzi scheme.

Upon appointment, a trustee or receiver must investigate, assess, and account for the finances of the Ponzi operator’s personal estate and any business entities associated with the scheme.\(^9\) Because fraud artists rarely maintain complete (much less accurate) books and records, this process can be painstaking, time consuming, and complicated.\(^10\) The trustee or receiver typically will rely on bank records to re-create the activity predating his or her appointment. In most cases, the trustee or receiver will need to retain forensic accounting experts not only to complete the process reliably but also to provide expert testimony to support the methodology used and the conclusions reached.\(^11\) Armed with that data, the trustee or receiver will then 1) identify creditors (those who are owed money), 2) identify debtors (those who owe money to the estate), 3) initiate litigation against the debtors to recover the sums owed, and 4) ultimately distribute the proceeds to the creditors.

The first two steps involve a calculation of cash in and cash out: comparing each investor’s payments to and withdrawals from the Ponzi operator. The “net winners” in the scheme are those investors who received more payments from the scheme than they paid to it. The “net losers” are those who received less in return than they invested in the scheme. Depending on when the net winners received their payments (relative to the date the Ponzi scheme collapsed or the date a bankruptcy petition was filed), they may be legally required to pay back some or all of their fictitious profits.

Given this reality, it is critical for Ponzi scheme investors—especially those unaware of the fraud before the collapse—to immediately identify how much money they invested with the Ponzi operator compared to their actual returns. Investors who made money will likely face litigation by a trustee or receiver seeking to claw back the over-payments.

Nearly all investors in Ponzi schemes consider themselves innocent victims. Whether they were net winners or net losers in the scheme, most investors will feel betrayed by the Ponzi operator—some one they considered a trusted adviser, if not a friend. Beyond that, even the net winners who made money in the scheme often feel victimized because they thought they still had money legitimately invested with the Ponzi operator, only to find that it was an elaborate hoax. Indeed,
these investors likely will have used the proceeds from the scheme to pay various expenses, such as capital gains and income taxes related to the investments, or unrelated and unrecoverable expenses such as college tuitions and property taxes. Moreover, most investors will have received periodic “account statements” in which the Ponzi operator reported the supposed value of the investments. But these fraudulent statements typically have no weight or relevance for purposes of determining whether a particular investor is a creditor or a debtor of the estate. All that ultimately matters is the calculation of cash in versus cash out—not the phony amounts the Ponzi operator reported to investors based on fictitious profits.

Given the necessarily increasing complexity and size of their schemes, Ponzi operators rarely act by themselves. Those who participated in the scheme with a Ponzi operator are likely to be the targets of claims by the receiver or trustee; they may also be targeted by law enforcement.

In addition to the receiver’s or trustee’s claims, individual investors also may pursue claims against third parties. The targets of these claims can, and commonly do, include the Ponzi operator’s banks, accountants, and lawyers. The Ponzi operator also is likely to have taken at least some of the proceeds of the scheme and invested them in any number of different businesses, including real estate ventures, shares in publicly traded companies, or closely held enterprises. The receiver or trustee will closely scrutinize all aspects of the Ponzi operator’s prior dealings, many of which will also end up in litigation.

**Avoidance of Fraudulent Transfers**

Trustees and receivers both have a powerful tool at their disposal—namely, the ability to avoid fraudulent transfers. Many states, including California, have adopted some version of the Uniform Fraudulent Transfer Act.

There are two basic types of fraudulent transfers: actual (or intentionally) fraudulent transfers, and constructively fraudulent transfers. An intentionally fraudulent transfer is a transfer made with the “actual intent to hinder, delay, or defraud” any creditor. A constructively fraudulent transfer is a transfer made without receiving reasonably equivalent value when the transferor: 1) was insolvent when the transfer was made or became insolvent as a result of the transfer, 2) was engaged in or was about to engage in a business or a transaction for which his or her remaining assets were unreasonably small in relation to the business or transaction, or 3) intended to incur, or believed or reasonably should have believed that he or she would incur, debts beyond his or her ability to pay as they became due.

The Bankruptcy Code gives bankruptcy trustees the avoidance rights of a creditor under state law, thus empowering the trustee to bring state law fraudulent transfer claims. In addition to fraudulent transfers under state law, the Bankruptcy Code contains its own fraudulent transfer provisions.

The test for determining whether a Ponzi operator made a transfer with the “actual intent to hinder, delay, or defraud any creditor of the debtor” generally requires an inquiry into the Ponzi operator’s subjective state of mind. To establish an intentionally fraudulent transfer claim, only the subjective mental state of the Ponzi operator is relevant. The investors’ intent is irrelevant to the analysis and is considered, if at all, only to determine whether a potential “good faith” defense applies.

To establish a Ponzi operator’s subjective intent, the trustee or receiver will often rely on affirmative evidence—such as admissions or a plea agreement—from the operator. Courts have consistently held the guilty pleas and other admissions of Ponzi operators to be admissible and binding on the issue of actual intent to defraud. Similarly, actual intent to defraud can be established if the court finds that the operator was in fact running a Ponzi scheme.

If the trustee or receiver is unable to demonstrate actual fraud, net winners may still be liable based on a constructively fraudulent transfer claim. In constructively fraudulent transfer cases, the key issues are whether the transfers were made at a time of insolvency, and whether the recipient provided reasonably equivalent value. Insolvency is rarely an issue in Ponzi scheme litigation; given their fraudulent nature, Ponzi schemes are consistently held to be insolvent from their inception.

A recipient of a fraudulent transfer—even a transfer made by a Ponzi operator with the actual intent to defraud his or her creditors—may establish a defense (and keep the money or property transferred) if the recipient provided reasonably equivalent value and received the payment in good faith. Whether the recipient provided reasonably equivalent value turns on the nature of the payments received. Some courts have held that no reasonably equivalent value can be given for the fictitious profits of a Ponzi scheme. In contrast, most courts will allow innocent investors to retain the payments they received, up to the amount of their principal investment. Critical to this analysis is whether the investor received the payments in good faith.

In fraudulent transfer litigation, however, “good faith” has a different meaning than it does in other areas of the law. Courts apply an objective standard in determining what the recipient “knew or should have known”; the recipient’s subjective good faith is irrelevant. Moreover, the burden to establish good faith falls on the recipient of the fraudulent transfer.
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Another key issue in Ponzi scheme litigation involves how far the trustee or receiver can “reach back” to avoid the fictitious profits distributed to net winners. Federal bankruptcy law provides a two-year reach-back period for fraudulent transfer claims. But federal bankruptcy law also empowers a bankruptcy trustee to bring fraudulent transfer claims under applicable state law.

State law claims to recover fraudulent transfers vary and can exceed the Bankruptcy Code’s two-year reach-back period. California law provides a seven-year statute of repose for intentionally fraudulent transfer claims. Certain claims for transfers beyond four years must be brought under California law within one year after the fraudulent transfers could reasonably have been discovered by the claimant. Thus, depending on the jurisdiction, and whether the claims are brought by a receiver or a trustee, investors could be faced with disgorging all payments that they received between one to seven years before the scheme collapsed.

Potential Claims against Third Parties

Just about any third party who conducted business with a Ponzi operator faces some litigation risk. The Ponzi operator’s attorneys, accountants, banks, and even certain investors may find themselves the target of litigation after the scheme collapses. Class actions brought by investors who have suffered damages are fairly common in the context of Ponzi scheme litigation.

A Ponzi operator’s coconspirators, including individuals and business entities, can face direct liability for damages if they independently committed torts against investors or other parties suffering harm. Among other claims, coconspirators may have engaged in fraud, negligent misrepresentation, breach of fiduciary duty, or other torts, depending on the coconspirator’s relationship with the plaintiff.

Aggrieved investors also may pursue vicarious liability theories against third parties, including financial institutions. The most common of these theories are conspiracy and aiding and abetting. Under basic tort principles in many states, including California, a claim for conspiracy is proper if there is an agreement to commit a tort and the plaintiff suffers damage as a result of an act committed in furtherance of the agreement.

As for aiding and abetting, “liability may...be imposed on one who aids and abets the commission of an intentional tort if the person (a) knows the other’s conduct constitutes a breach of duty and gives substantial assistance or encouragement to the other to so act or (b) gives substantial assistance to the other in accomplishing a tortious result and the person’s own conduct, separately con-
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1 Charles Ponzi is often credited with being the first to mastermind the type of scheme that was eventually named for him. Although Ponzi was perhaps the most famous fraudster to carry out such a scheme, he was not the first. Just before the start of the twentieth century, a man named William Miller engineered a scheme in which he cheated investors out of more than $1 million by promising 10 percent investment returns per week. For that, he was nicknamed “520 Percent” Miller. Miller’s fraud was widely publicized and, notwithstanding its failure, probably inspired Ponzi to devise his own scheme.

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3 See generally Cunningham v. Brown, 265 U.S. 1 (1924).


5 See 11 U.S.C. §547. See Fed. R. Bankr. P. 2004. Because these examinations are authorized pursuant to the rule, they are often referred to as “2004 examinations.”

6 See Fed. R. Bankr. P. 2004(a). The right to take 2004 examinations is not limited to trustees. The rule permits “any party in interest” to seek an order from...
the Bankruptcy Court to take this type of examination. See id.

7 See FED. R. BANKR. P. 2004(c).
8 Courts have consistently held that the scope of a 2004 examination is “unfettered and broad.” See, e.g., In re Table Talk, Inc., 51 B.R. 143, 145 (Bankr. D. Mass. 1985).
9 See, e.g., 11 U.S.C. §1106(a)(3) (The trustee shall “investigate the acts, conduct, assets, liabilities, and financial condition of the debtor, the operation of the debtor’s business…and any other matter relative to the case….”).
10 See, e.g., In re Bonham, 251 B.R. 113, 116 (Bankr. D. Alaska) (concluding that the trustee has established the existence of a Ponzi scheme through a meticulous reconstruction of the debtors’ disarrayed records).
11 See id. at 118-25; see also In re Bayou Group, LLC, 396 B.R. 810, 831-33 (S.D. N.Y. 2008).
12 CIV. CODE §§3439.04(a)(2)(A); CIV. CODE §§3439.05.
13 CIV. CODE §§3439.04(a), 3439.05.
18 11 U.S.C. §544(b); see also In re United Energy Corp., 944 F. 2d 589, 593 (9th Cir. 1991) (“A bankruptcy trustee has the power to avoid fraudulent transfers pursuant to state law and/or the provisions of the Bankruptcy Code.”).
20 See In re Cohen, 199 B.R. 709, 716 (B.A.P. 9th Cir. 1996).
21 Under the good faith defense, a fraudulent transfer cannot be avoided to the extent the transferee received the transfer in good faith and provided value in exchange for the transfer. 11 U.S.C. §548(c); CIV. CODE §3439.08(a). In the context of Ponzi scheme litigation, this defense typically insulates a good faith investor’s principal investment but not the investor’s fictitious profits.
22 See, e.g., In re Starkin, 525 F. 3d 805, 811-15 (9th Cir. 2008) (affirming partial summary judgment regarding actual intent to defraud as a matter of law based on the Ponzi operator’s plea agreement); In re AFICorp., 916 F. 2d 528, 535 (9th Cir. 1990) (“Courts have consistently found that criminal proceeding admissions of a fraudulent scheme to defraud investors made in guilty pleas and plea allocations are admissible as evidence of ‘actual intent’ to defraud creditors.”).
23 See Cohen, 199 B.R. at 717 (“Proof of a Ponzi scheme is sufficient to establish the Ponzi operator’s actual intent to hinder, delay, or defraud creditors for purposes of actually fraudulent transfers….“); In re Agricultural Research & Tech. Group, Inc., 916 F. 2d 1101, 1127 (9th Cir. 1990) (“Having been convicted of a Ponzi scheme, Randy was insolvent from its inception."
24 See, e.g., Scholes v. Lehmann, 56 F. 3d 755, 755 (7th Cir. 1995) (“Having been convicted of a Ponzi scheme, Randy was insolvent from its inception as a matter of law.
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In 1981, six-year-old Adam Walsh was abducted from a Sears store in Hollywood, Florida. His severed head was found two weeks later in a canal 120 miles away. Adam’s tragic death quickly drew national attention, but it was not until 2008 that investigators revealed that his murderer was a convicted serial killer who had died in prison. Since Adam’s death, his father, John Walsh, has become a famous advocate for missing children and unsolved crimes and hosts the well-known America's Most Wanted television show. With John Walsh’s efforts, many child protection and sex offender laws have passed, including the Adam Walsh Child Protection and Safety Act of 2006 (AWA). On July 27, 2006, the AWA became federal law, and with it came nationwide fiscal and constitutional controversy.

The AWA's most significant provision is the Sex Offender Registration and Notification Act (SORNA), which mandates the creation of a national sex offender registry. Pursuant to the AWA, every state in the country is required to implement, or at least substantially comply with, the provisions of SORNA no later than July 27, 2009, or lose 10 percent of its Byrne Justice Assistance Grant funds for each year of noncompliance. These funds are grants generally applied to law enforcement and drug laws.

According to a Justice Policy Institute study, it will cost California $59,287,816 just to implement SORNA in 2009. But if California chooses not to implement SORNA, it will lose 10 percent of its Byrne Grant money, or a mere $2,187,682 per year. The study found that in all 50 states, the first-year costs of implementing SORNA are significantly greater than the financial loss of a 10 percent reduction of Byrne Grant funding. Given today’s economy and the financial burden that the AWA imposes, many states are not complying with the AWA because they cannot afford to do so. Equally, if not more, important are the thousands of state and federal lawsuits that have been filed across the country alleging that the AWA is unconstitutional and therefore unenforceable.

The constitutional challenges to the AWA have arisen due to the unprecedented and aggressive requirements that the AWA imposes on convicted sex offenders and state governments. By requiring all states to adopt SORNA, the AWA endeavors to standardize the various state sex offender registries so that one uniform national sex offender registry can be created. However, all states have adopted their own laws regarding which sex offenses are registerable and maintain their own individualized sex offender registries. California, for example, maintains not only a state sex offender registry but, more recently, a publicly searchable sex offender Web site—a product of Megan’s Law. The AWA effectively seeks to displace existing state sex offender laws and state-run sex offender registries.

Under the AWA, the national registry and Web site will be an amalgam of each state’s sex offender registry and will also include those offenders who have been convicted of federal sex crimes. To create this Web site, the AWA requires each state to maintain a sex offender registry that conforms to SORNA. However, the AWA only provides the minimum standards that states must impose on their sex offenders. States are free to set more stringent requirements for offenders and to enforce harsher penalties.

SORNA creates a three-tiered classification system of sex offenders who must register. Tier I offenders—the least serious offenders, but not defined by SORNA—will be required to register for 15 years, renewing once annually. Tier II offenders generally are felons convicted of, among other crimes, sex trafficking, and other serious sex crimes. Tier III offenders are sex offenders who have committed crimes against minors, such as child pornography. The constitutional challenges to the AWA have arisen due to the unprecedented and aggressive requirements that the AWA imposes on convicted sex offenders and state governments. By requiring all states to adopt SORNA, the AWA endeavors to standardize the various state sex offender registries so that one uniform national sex offender registry can be created. However, all states have adopted their own laws regarding which sex offenses are registerable and maintain their own individualized sex offender registries. California, for example, maintains not only

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Implementation of the Adam Walsh Act raises fundamental questions of constitutional rights

the use of minors in prostitution, sexual contact with minors, and the production and distribution of child pornography. Tier II also includes Tier I offenders who reoffend. Tier II offenders must register for 25 years, renewing every six months. Tier III offenders, the most serious offenders, generally are felons convicted of crimes such as aggravated sexual abuse, sexual acts with a child under 13 years old, and nonparental kidnapping of a minor. Tier III also includes Tier II offenders who reoffend. Tier III offenders are subject to lifetime registration, which must be renewed every three months. Tier I offenders can apply for removal from the registry after 10 years, and juveniles classified as Tier III offenders and Tier II offenders can apply for removal after maintaining a clean record for 25 years. Nonjuvenile Tier III offenders will never be allowed to apply for removal from the Web site. Under existing California law, by contrast, all sex offenders required to register must register for life, with no possibility for early removal.

Under the AWA, sex offenders with convictions that predate the enactment of the AWA must register under SORNA. SORNA applies to anyone who is currently incarcerated or on parole, anyone who currently registers as a sex offender, or anyone previously convicted of a sex offense who reenters the system due to a conviction for a new offense that is not necessarily a sex crime—even if he or she is under no current obligation to register as a sex offender.

All offenders required to register under SORNA will, at the very minimum, have to provide the following to the national registry: names and aliases, e-mail addresses and other Internet identifiers like instant message addresses, telephone numbers, Social Security number, residence and travel information (for example, passport information), employment information, school information, vehicle information, date of birth, physical description, criminal history, current photograph, fingerprints, DNA sample, and driver’s license or ID card information. Each state must provide the following for disclosure on the national Web site: name of the offender, residence address, address of employer, address of school, vehicle information, physical description of the offender, a list of the offender’s sex offense convictions, and a current photograph. Each state has discretion to require additional information from each offender.

SORNA imposes other stringent requirements for registration. All offenders must register in the jurisdictions in which they were convicted and in all jurisdictions where they live, work, and attend school. The timeline within which to register is very exact: Registration must be accomplished no later than three business days after the offender moves to another jurisdiction or changes his or her name, employment, or student status. The offender must appear in person in at least one of the applicable jurisdictions, and that jurisdiction must inform all the other jurisdictions in which the offender is required to register. The AWA enables states to determine the penalties to impose on an offender who fails to properly keep up with registration requirements. Though states have broad discretion, the AWA requires that the maximum prison term for failure to register must be greater than one year.

Aside from the new registration requirements, the AWA also includes provisions that affect those who have been convicted of federal sex crimes. Specifically, the AWA revises the definition and classification of a sex offender, creates the Jimmy Ryce Civil Commitment Program for sexually dangerous offenders, lengthens the statute of limitations for various sex crimes, expands more victims’ rights, creates more stringent discovery rules in sex cases, and imposes pretrial release conditions.

In response to the AWA and SORNA, a host of constitutional challenges have emerged to these laws. Federal and state courts disagree on how to implement and enforce the AWA. The two most contentious issues that already plague the implementation of the AWA are: 1) whether the AWA’s application to sex offenders convicted before the AWA was enacted violates the ex post facto clause of the
U.S. Constitution, and 2) whether the AWA’s new Civil Commitment Program violates the equal protection and due process clauses of the Constitution.

Retroactive Application

The AWA does not specify whether the new law applies to offenders who were convicted before implementation of the AWA. Instead, the AWA delegates authority to the U.S. attorney general to determine whether the new law applies retroactively. On February 28, 2007, in response to Congress’s grant of authority, then Attorney General Alberto Gonzales issued an interim order (later codified and made into a final order) stating that SORNA applies to all sex offenders, including those convicted of a sex offense prior to the enactment of the AWA. Therefore, those who fall under the new national standard of a sex offender will be required to register nationally, regardless of when they were convicted.

Under the AWA, it is a federal offense for state registrants, whether they were convicted before or after the AWA was enacted, to travel interstate and thereafter fail to register in the new jurisdiction. This crime is punishable by up to 10 years of imprisonment. An offender’s registration requirements following interstate travel do not depend on whether the state to which he or she travels has implemented SORNA. If sex offenders are required to register in their home state, they are required to register in every state to which they travel and stay longer than seven days. Even an offender whose underlying offense was a state crime can be found guilty of the federal offense of failure to register after interstate travel. The federal offense occurs as soon as offenders fail to register by the end of the third day after they change their residence, school, or work.

The retroactive application of SORNA has divided state and federal courts across the country—most notably among the U.S. Circuit Courts of Appeals. For example, in United States v. Dixon, the Tenth Circuit held that a prosecution must prove that an offender “travels in interstate commerce” for the offender to be prosecuted for failure to register after crossing state lines. The AWA’s seemingly deliberate use of the term “travels,” the court reasoned, is prospective and only applies to offenders who travel after the AWA was enacted. Thus the court held that since the defendant traveled and failed to register before the AWA was enacted in July 2006, he was not guilty of failing to register under SORNA.

In United States v. May, the Eighth Circuit agreed with the Tenth Circuit’s rationale in Dixon but considered whether a SORNA violation applies to a registered sex offender who travels interstate in the period between the passage of the AWA on July 27, 2006, and the attorney general’s interim order on February 28, 2007. The court declared that SORNA applies to all sex offenders retroactively. The defendant in May argued that SORNA did not apply to him because he traveled in interstate commerce after the passage of the AWA but before the attorney general’s interim ruling. The Eighth Circuit denied the defendant’s challenge under the ex post facto clause because the defendant “traveled in interstate commerce and failed to update his registration after enactment of SORNA.”

The court explained that SORNA applies to all sex offenders and did not change in the period between its enactment and the interim order because “the Attorney General only promulgated the rule as a precautionary measure to foreclose such claims as May’s by making it indisputably clear that SORNA applies to all sex offenders regardless of when they were convicted.” Therefore, the court held the statute was not retroactively applied to May and did not violate the Constitution’s ex post facto clause because May traveled and failed to register after the AWA was enacted.

The Seventh Circuit disagreed with the holdings in Dixon and May. In United States v. Dixon, the defendants relied upon Dixon and May for the propositions that they did not violate SORNA because they had traveled interstate before the AWA was enacted and, further, that their failure to register occurred before the attorney general issued his order regarding retroactivity of SORNA. The Seventh Circuit disagreed and held that SORNA could be applied retroactively to sex offenders who travel interstate before the AWA was enacted. Unlike the Tenth Circuit, the Seventh Circuit found that the need to track sex offenders traveling interstate “is as acute in a case in which the offender moved before the AWA was passed as in one in which he moved afterward.”

The Dixon court reached this holding by analogy to a felon with a gun who crosses state lines: The danger to the public remains the same no matter when the gun crosses state lines. So too, the danger to the public exists whether sex offenders travel before or after the attorney general issued his retroactivity order. The court was unconvinced by the Tenth Circuit’s present tense analysis of the word “travels” and instead referenced a Ninth Circuit case that held that a word from an opinion that was used in the present tense could be applicable to past, present, or future actions. Therefore, the defendants who traveled before the AWA passed but failed to register once the AWA became law were found guilty of violating SORNA’s registration requirements.

While the Ninth Circuit has not yet determined whether SORNA may be applied retroactively to offenders who travel interstate, it will soon have the opportunity to do so. On September 11, 2008, the U.S. District Court for Nevada entered a preliminary injunction against the state of Nevada in American Civil Liberties Union v. Catherine Masto. The district court enjoined the state from retroactively enforcing state legislation designed to comply with the AWA and SORNA. U.S. District Court Judge Mahan ruled that the retroactive application of Nevada’s sex offender registration law, inter alia, violated the constitutional ban on ex post facto laws and violated the due process clauses of the Fifth and Fourteenth Amendments. In October 2008, the Nevada attorney general’s office appealed Judge Mahan’s ruling to the Ninth Circuit Court of Appeals. At press time, it was uncertain whether oral argument, much less a briefing schedule, had been scheduled in the case. However, it appears that the Ninth Circuit will soon hear this case of first impression.

Challenges to the Civil Commitment Program

Another hotly contested component of the AWA is the implementation of the Jimmy Ryce Civil Commitment Program, which authorizes the allocation of federal funding to the supervision, care, and treatment of “sexually dangerous people.” While many states, including California, have laws providing for the civil commitment of sexually violent predators, the AWA is the first federal program to commit sexually dangerous people. Under the AWA, the government can seek to civilly commit any federal prisoner—not only those convicted of sex offenses—and can stay the release of that person for the duration of the civil commitment proceedings. The government need only prove by clear and convincing evidence that 1) the defendant has engaged or attempted to engage in sexually violent conduct or child molestation, and 2) is sexually dangerous to others. If the government carries its burden in proving both elements, then the defendant is committed to the custody of the U.S. attorney general until the state will assume responsibility or until the defendant is found to be no longer sexually dangerous.

Under the AWA, the government can wait until an offender has completed his or her prison sentence before moving for a determination of sexual danger. Consequently, the offender remains in custody beyond his or her sentence, without the opportunity to post bail. While the government must afford a hearing for each person being evaluated for civil commitment, the government has no obligation to provide an attorney or present Miranda warnings. Furthermore, the bur-
3. The Adam Walsh Act was named for the abducted and murdered child of John Walsh, host of America’s Most Wanted and an advocate for missing children.

2. The Adam Walsh Act was enacted 20 years ago, is being revamped in the wake of new legislation.

1. Most Wanted

4. Under SORNA, offenders must register in all jurisdictions where they live, work, and attend school.

5. States that do not comply with the AWA will lose 10 percent of their Byrne Justice Assistance Grant funds for each year of noncompliance.

6. States are not allowed to create more stringent requirements for sex offenders than those provided by the AWA.

7. Under SORNA, offenders are required to register for life.

8. Federal courts disagree on whether the AWA should apply to sex offenders convicted before the AWA was enacted.

9. It is a federal offense for offenders to fail to register within three days after changing their home address, work, or school.

10. The government cannot move to commit an offender who has completed his or her prison sentence.

11. People are afforded free legal representation for a hearing under the Civil Commitment Program.

12. It will cost California close to $10 million just to comply with the AWA in 2009.

13. On February 28, 2007, the U.S. attorney general issued an order stating that SORNA applies retroactively to all sex offenders.

14. The Ninth Circuit ruled that SORNA applies retroactively to California sex offenders.

15. The AWA creates the Jimmy Ryce Civil Commitment Program, the first federal program to commit sexually dangerous people.

16. The AWA permits the government to detain inmates for a hearing under the Civil Commitment Program.

17. Prisoners are afforded free legal representation for a hearing under the Civil Commitment Program.

18. The Fourth Circuit, in United States v. Comstock, held that Congress exceeded its power under the commerce clause when it created the Civil Commitment Program.

19. Offenders have argued that the Civil Commitment Program violates due process because the AWA permits the government to detain inmates past their release dates without bail and without the right to a prompt postdeprivation hearing.

20. In advance of the AWA compliance deadline, federal courts are in agreement on how to implement the new law.

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19. □ True □ False
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den of proof to determine whether an offender is sexually dangerous is not based on the reasonable-doubt standard; rather, the standard is clear and convincing evidence.\(^\text{44}\) Although committed offenders have the right to request a review of their commitment every 180 days, a civil commitment actually is akin to a life sentence because it is very difficult for offenders to be removed from the program. For an offender to be released from civil commitment, the court must find by a preponderance of the evidence that the committed person is no longer sexually dangerous.

Not surprisingly, common challenges to the Civil Commitment Program have been based on the due process, equal protection, and commerce clauses of the Constitution. Defense counsel have argued 1) that the AWA permits the government, in violation of due process, to detain inmates past their release dates without bail or the right to a prompt postdeprivation hearing, 2) that the law is too broad because it applies to all federal prisoners in violation of the equal protection clause, and 3) that civil commitment is not related to any economic or commercial activity in violation of the commerce clause.

To date, no Ninth Circuit or California district court cases have addressed these constitutional challenges regarding the civil commitment of sex offenders under the AWA. However, courts in other jurisdictions have considered these arguments. The U.S. District Court in Massachusetts, in the First Circuit Court of Appeals, recently held that because civil commitments fall under civil law and are therefore not intended to be a criminal punishment, due process procedures required in criminal proceedings are not mandatory in civil commitment hearings.\(^\text{42}\) The court further held that there is a rational basis for the government to differentiate between a sexually dangerous offender and a person with a mental disorder without violating the mandates of equal protection: “[A] person with a mental disorder of a sexual nature is qualitatively more dangerous than another mental patient who nonetheless threatens danger to himself or others…[and so, the differing provisions…pass rational basis review.]”\(^\text{43}\)

Conversely, the U.S. District Court in Massachusetts held in another case that the standard of clear and convincing evidence is not a sufficient evidentiary threshold to force an inmate into civil commitment. Accordingly, the court held that “any application of the [AWA] to an individual without a finding beyond a reasonable doubt of sexually violent conduct or child molestation is unconstitutional. The government can meet its burden by demonstrating that the person has been previously convicted of a relevant sex crime.”\(^\text{44}\)

In United States v. Comstock, the Fourth Circuit Court of Appeals addressed the argument that the civil commitment provisions of the AWA exceed the powers of Congress under the commerce clause. First, the court held that the federal civil commitment program “lie[s] beyond the scope of Congress’ authority. The Constitution does not empower the Federal government to confine a person solely because of asserted ‘sexual dangerousness’ when the Government need not allege (let alone prove) that this ‘dangerousness’ violates any Federal law.”\(^\text{45}\) Just as the states control civil commitment of the mentally ill, so too should the states have jurisdiction over civil commitment of sex offenders because, as the court noted, the federal government has no general police power.

Next, the Comstock court found unpersuasive the government’s arguments that civil commitments fall under the commerce clause and the necessary and proper clause. The court relied upon United States v. Lopez, in which the U.S. Supreme Court held that a federal law regulating the possession of a firearm in a school zone exceeded the powers of Congress under the commerce clause because the law lacked a sufficient nexus to interstate commerce. The court held that, likewise, “sexual dangerousness does not substantially affect interstate commerce.”\(^\text{46}\) Furthermore, a federal civil commitment program is not necessary and proper, according to the court, because the federal government only maintains jurisdiction over offenders while they are in federal prison. The government does not continue to possess this power after the prison sentence expires. If the government retained this power, it would clash with the parens patriae power, or police power, reserved for the states.\(^\text{47}\)

While the Ninth Circuit has yet to rule on these issues, the U.S. District Court for the Northern District of California recently held in United States v. Hardeman that SORNA does represent a valid exercise of Congress’s power under the commerce clause.\(^\text{48}\) The Northern District made this determination notwithstanding the fact that other district courts have found SORNA unconstitutional under the commerce clause.\(^\text{49}\) Congress has the power under the commerce clause to regulate 1) the channels of interstate commerce, 2) the instrumentalities of interstate commerce, or people or things in interstate commerce, and 3) activities that substantially affect interstate commerce.\(^\text{50}\) The defendant in Hardeman argued that SORNA is unconstitutional because there is no nexus between interstate travel and the defendant’s crime—the failure to register. The government, on the other hand, maintained that SORNA squarely falls within the parameters of Congress’s power under the commerce clause because Congress, by enacting SORNA, is regulating the movement of people in interstate commerce.\(^\text{51}\)

The court, agreeing with the government, held that SORNA falls under the power of Congress to regulate interstate commerce because SORNA is a lawful attempt to ensure that the channels of interstate commerce do not “become the means of promoting or spreading evil, whether of a physical, moral or economic nature.”\(^\text{52}\) Furthermore, although the court admitted that SORNA has shortcomings and “is not as narrowly tailored as it could be,” the court held that the registration requirement in potentially multiple jurisdictions is a proper exercise of congressional authority under the commerce clause because it appropriately tracks offenders who move across state lines.\(^\text{53}\)

Defense attorneys have crafted a variety of additional arguments to challenge the AWA, with little success. Some have argued that the Tenth Amendment prevents the federal government from forcing state officials to carry out federal laws.\(^\text{54}\) Other challenges have been based on the doctrines of separation of powers and nondelegation. These two arguments essentially address the same issue: whether Congress, by giving the attorney general the sole power to determine the applicability of SORNA to those convicted of sex offenses prior to its enactment, impermissibly delegated a legislative task to the executive branch. Thus far, challenges based on the doctrines of separation of powers and nondelegation have been largely unsuccessful.

One of the primary purposes of the Adam Walsh Act is to create uniformity among states. However, the question remains whether this goal can be achieved within the parameters of the U.S. Constitution and individual state constitutions. The difficulty lies in the fact that each of the 50 states has the ability to create more stringent rules than required by the AWA or simply disregard the requirements and instead lose a small portion of grants. Before the looming state compliance deadline arrives, courts are already in disagreement over how to apply the AWA and SORNA. With inconsistent judicial decisions across the country regarding the constitutionality of these new laws, the AWA and SORNA face a certain fate: a date with the U.S. Supreme Court.

\(^4\) Justice Policy Institute, What Will It Cost States
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PATENT HOLDERS ARE OFTEN VICTIMS OF MULTIPLE INFRINGERS BUT RARELY USE CLASS ACTIONS TO PROSECUTE THEIR PATENT CLAIMS COLLECTIVELY. TYPICAL CLASS ACTIONS INVOLVE A NAMED PLAINTIFF THAT SEEKS TO REPRESENT A CLASS OF UNNAMED PLAINTIFFS Whose INTERESTS ARE ALIGNED WITH THOSE OF THE NAMED PLAINTIFF. ANOTHER TYPE OF CLASS, HOWEVER, THAT MAY ACHIEVE EFFICIENCY IN PATENT LITIGATION IS A NON-OPT-OUT, OR MANDATORY, ISSUES CLASS. THIS CLASS CAN BE CREATED TO RESOLVE ISSUES OF PATENT OWNERSHIP, VALIDITY, ENFORCEABILITY, AND CLAIM CONSTRUCTION.

In a mandatory class action, class members cannot voluntarily exclude themselves from the class as defined in the court’s class certification order. A rarely used feature of Rule 23 of the Federal Rules of Civil Procedure allows for certification of a mandatory defendant class action. In this suit, a named defendant is compelled, almost invariably against its wishes, to represent a class of unnamed defendants that share one or more common issues appropriate for joint adjudication. Mandatory defendant class actions are a potent tool to resolve common issues involving multiple defendants.

The drafters of Rule 23 intended the rule to enable those with small claims to achieve relief even if their individual claims are too small to be viable. Another purpose of Rule 23 is to “achieve economies of time, effort, and expense and promote uniformity of decision as to persons similarly situated, without sacrificing procedural fairness or bringing about other undesirable results.” Rule 23(a) establishes four prerequisites to maintaining a class action: 1) the number of people or entities in the class should be too numerous to permit their joinder, 2) members of the class should share common questions of law or fact, 3) the “claims or defenses of the representative parties are typical of the claims or defenses of the class,” and 4) the “representative parties will fairly and adequately protect the interest of the class.”

Of these prerequisites, the second is central to the creation of a common issue class, but the other three must also
be considered. The first, numerosity, exists when a proposed class is so numerous that joinder is impracticable. “Impracticable” does not mean impossible. A reasonable estimate of the number of purported members satisfies the numerosity requirement; a precise number is not required. Numerosity is presumed at the level of 40 class members. Indeed, one patent case in which a defendant class was certified—Dale Electronics, Inc. v. R. C. L. Electronics, Inc.—involved only 13 alleged patent infringers.

The third test, typicality, “is a permissive standard.” The basic inquiry is whether the action is based on claims or defenses that are unique to the class representatives: “Typicality refers to the nature of the claim or defense of the class representative, and not to the specific facts from which it arose or the relief sought.”

Issues of patent validity and invalidity, patent ownership, and claim construction (among others) are standard in many patent infringement actions. Cases often are based exclusively upon plaintiff-specific facts and legal principles that are identical for all defendant class members and therefore apply classwide. Typicality should be found to exist if the claims of class representatives arise from the same events and practices as the claims of absent class members and are based on the same legal theories.

Rule 23(a)’s fourth prerequisite—adequate representation—“depends on the qualifications of counsel for the representatives, an absence of antagonism, a sharing of interests between representatives and absentees, and the-unlikelihood that the suit is collusive.” To satisfy this requirement, the patent holder plaintiff should consider, if possible, naming a defendant that can afford to and has the incentive to retain a law firm with the experience and resources to handle complex patent litigation. Any unwillingness on the part of defendants to represent the class is entitled to little weight in the certification analysis. What defendant ever wishes to be sued, or if sued, seeks to represent other unnamed defendants?

Three Class Categories

Once the requirements of Rule 23(a) are satisfied, the plaintiff patent holder must demonstrate compliance with one of the three different categories of class actions listed under Rule 23(b). The different requirements of these three categories attempt to strike a balance between the desirability of classwide adjudication and the interests of class members to pursue claims separately or not at all. The different type of class actions are categorized according to the different objectives of class treatment envisioned by the rule’s drafters, or the nature or effect of the relief being sought.

In general, Rule 23(b)(1) permits the use of the class action device when necessary to prevent the possible adverse effects—on either the parties opposing the class or on absent class members—that might result if separate actions were brought, with a risk of inconsistent results. Structurally, that provision is divided into two clauses that describe the risk of prejudice, which is to be avoided by allowing class action. A Rule 23(b)(1) class action applies when the defendant or plaintiff is obligated to treat class members alike, when class members are asserting claims against a common fund in which joint or common rights or obligations demand unitary treatment, or when there is a limited fund that is insufficient to satisfy all the claims.

A Rule 23(b)(2) class action was intended to focus on cases in which broad, classwide injunctive or declaratory relief is necessary. Finally, a Rule 23(b)(3) class action—by far the most common—was intended to embrace other cases in which a class action would be “convenient and desirable,” including those involving complex litigation for money damages.

The drafters of Rule 23 deemed it unnecessary, however, to provide subdivision (b)(1) and (b)(2) class members with a universal right to notice or to opt out of the class. This right is part, however, of Rule 23(b)(3) class actions, which primarily seek monetary recoveries. In the three subsections, the different presumptions of homogeneity and cohesiveness of interests among members of the classes that may sue support each section’s different procedural safeguards. Aside from common fund or limited fund cases, in cases that seek ordinary monetary remedies the varying characteristics of individual claims often complicate class relief. Rule 23(b)(1) and (b)(2) cases, on the other hand, typically involve relatively homogeneous and cohesive groups in which a unitary result may not only be preferable but necessary, given the group nature of the harm inflicted and the interrelated nature of the relief sought.

For these reasons, “[c]ertification under either (b)(1) or (b)(2) constitutes a mandatory class. That is, the class members may not opt out of the action and ‘pursue separate litigation that might prejudice other class members or the defendant.’” Many courts have held that mandatory classes under Rule 23(b)(1)(A), (b)(1)(B), and (b)(2) fully comport with due process.

In Phillips Petroleum Company v. Shutts, the Supreme Court considered the due process requirements necessary to bind an absent plaintiff in a Rule 23(b)(3) state court money damages class action. The Court chose not to insist upon “minimum contacts” as the touchstone of due process for jurisdiction over absent plaintiffs. The structure of a class action provides adequate procedural due process. The court approves competent class counsel to represent the class, and representative plaintiffs (also court approved) have an incentive to pursue class claims identical or substantively similar to their own. Another due process safeguard is that the trial judge must approve class certification and any settlement or dismissal. Further, absent class members are rarely subject to discovery and are almost never liable for attorney’s fees, costs of suit, or judgment.

The plaintiff class in Shutts was certified under the Kansas equivalent of Rule 23(b)(3)—not Rule 23(b)(1) or (b)(2)—and the Court expressly limited its opt-out requirement to “those class actions which seek to bind known plaintiffs concerning claims wholly or predominately for money damages,” noting that the Court’s “discussion of personal jurisdiction [did not] address class actions where the jurisdiction is asserted against a defendant class.” The Court offered “no view concerning other types of class actions, such as those seeking equitable relief.” Accordingly, Shutts should not be read as establishing opting-out rights in actions maintained under Federal Rule 23(b)(1) or (b)(2).

A better reading of Shutts is that the opt-out right does not apply to classes that have 1) the same interest in a particular patent, 2) the same defense regarding a particular patent, or 3) allegedly violated the same claim or claims of a particular patent. In the post-Shutts decision Ortiz v. Fibreboard Corporation, the Court rejected a mandatory class based upon a litigation-generated limited fund that would have bound all potential asbestos claimants in a single action. However, the Court made clear that mandatory classes are still appropriate in proper cases.

Common Issues

The issues of patent ownership, validity, proper claim construction, and enforceability may be appropriate for mandatory adjudication in an issues class under Rule 23(c)(4)(A). Under the rule (“[w]hen appropriate, an action may be brought or maintained as a class action with respect to particular issues”), a district court is empowered to certify a mandatory defendant class only with respect to particular issues, even if subsequent actions would be required regarding issues of infringement and damages. The plain language of Rule 23(c)(4)(A), its structural relationship with Rule 23(a), and the Advisory Committee Notes that accompany it permit trial judges not only to sever issues for class certification purposes and for trial but also to employ those procedures when doing so would facilitate Rule 23’s purpose of “achieving economies of time, effort, and expense, and promoting uniformity of deci-
sion as to persons similarly situated.” Mandatory certification also serves Rule 1’s goal of ensuring a fair and efficient remedy.27

As one court has noted regarding mandatory certification, Rule 23(c)(4)(A) is “intended to advance judicial economy by permitting adjudication of any issues common to the class even though the entire litigation may not

satisfy the requirements of Rule 23.”28 The relevant inquiry for a court is whether resolution of particular common issues would materially advance the disposition of the litigation as a whole. If the resolution of even one common issue would simplify subsequent individual proceedings, certification of that issue for class treatment under Rule 23(c)(4)(A) may be appropriate.29

In many cases, a classwide resolution of the common issues of patent ownership, validity, enforceability, and claim construction would materially advance the disposition of litigation. In subsequent actions for infringement and damages, those key issues would not need to be adjudicated again. In re Gap Stores Securities Litigation holds:

In patent cases, for example, this has meant that issues of patent validity, fraud on the patent office, and patent misuse have been litigated as class issues while each case of infringement has been separately tried. E.g., Technograph Printed Circuits, Ltd. v. Method Electronics, Inc., 285 F. Supp. 714 (N.D. Ill. 1968). Thus, defendant class actions are commonly used in a conservative fashion to adjudicate less than the whole controversy.30 The Rule 23(a)(2) commonality require-

ment is not difficult to meet.31 Because Rule 23(a)(2) is written in the disjunctive, a single common question of either fact or law should satisfy the commonality requirement.32 Accordingly, a plaintiff patent holder may want to request that the issues of patent infringement and damages be tried separately under Federal Rules of Civil Procedure 42(b) after the mandatory defendant issues class is certified and the class issues are adjudicated.33

The issue of patent ownership, when disputed, is a common question that may be appropriate for treatment in a mandatory issues class. The patent holder has the burden of proving that it is the owner of the patents it asserts.34 Whether a patent holder owns the patents it asserts in a particular patent infringement action typically will involve unique facts. The issues are the same regardless of the identities of defendants and absent class members—and accordingly may be appropriate for classwide resolution.

The facts relevant to patent validity also are the same regardless of the identities of defendants or absent class members and include the properly construed patent claims, the patent specification, and the relevant prior art, which by definition is publicly available to any defendant, named or not. Any accused infringer may challenge the validity of any issued patent by showing with clear and convincing evidence that the patent fails to meet any one of the statutory requirements for patentability, such as showing that the claimed invention is anticipated by, or obvious in view of, prior art, or that the patent specification is insufficient. Patent validity therefore also is an issue which may be common to and typical of accused infringers who are members of an issues class.

Finally, the issue of patent enforceability also may present common questions appropriate for mandatory adjudication in an issues class. An accused infringer may allege—by way of affirmative defense or counterclaim, for example—that the patents are unenforceable due to the inequitable conduct of the inventors and their attorney while prosecuting the patents, that the patentees misrepresented the content of prior art references to the patent examiner, that the patentees provided too many references to the patent examiner, or that the patentees intentionally withheld relevant references from the patent examiner. The evidence necessary to prove patent enforceability or unenforceability under such circumstances would be the same regardless of the identity of the defendant. Under the circumstances, patent enforceability would present issues that are common to and typical of the named defendant and other unnamed members of the defendant class.35

**Patent Claim Construction**

The issue of patent claim construction also may often be appropriate for mandatory defendant class resolution. In Markman v. Westview Instruments, Inc.,36 the Federal Circuit held that a district court in a patent infringement case must first construe the meaning of the claim terms of a patent before determining whether any claim of that patent is infringed by any defendant class member, or whether any claim of these patents is invalid. Claim construction involves an examination by the district court of the patent claims and the intrinsic evidence (i.e., the patent specifications and file histories). Extrinsic evidence may also warrant review in appropriate cases.37 For purposes of a defendant issues class, the evidence necessary to construe the claims will be the same regardless of the identities of defendant class members. Claims are not construed by ref-
ference to any accused methods or systems. In Shire LLC v. Sandoz, the Federal Circuit granted review, however, to decide whether collateral estoppel and/or stare decisis applies to a previous court’s unappealed claim construction rulings. District courts have reached conflicting positions on this issue. It is unclear what effect the Federal Circuit’s decision in Sandoz may have on binding rulings on claim construction applied to defendant issues classes.

Sandoz may be significant in light of Rule 23(b)(1)(A)’s requirement regarding “incompatible standards of conduct.” Depending on the outcome of Sandoz, defendants may be able to argue that when it comes to claim construction issues, defendant issues classes are unavailable under Rule 23(b)(1)(A). This is because in these situations a plaintiff faces no risk of inconsistent judgments, and thus an issues class is not necessary. After Blonder-Tongue, a judgment of patent invalidity against a plaintiff precludes it from pursuing further patent infringement actions, and any inconsistent rulings could be resolved by the Federal Circuit.

In Blonder-Tongue, the Supreme Court held that when a patent is found invalid or unenforceable in one action, the patentee is collaterally estopped from claiming that the patent is valid or enforceable in another, so long as the patentee had a full and fair opportunity to litigate the validity of its patent.40 Following Blonder-Tongue, several patent infringement defendant classes have been certified under Rule 23(b)(1)(A), on the ground that inconsistent or varying adjudications on validity and enforceability issues in individual actions could establish incompatible standards.

For example, in Standal’s Patents, a patent infringement action involving sawmill equipment, the court certified a defendant class under Rule 23(b)(1)(A) despite the argument that Blonder-Tongue meant that the absent defendants would not be harmed by an adverse ruling and could only benefit from separate adjudications in separate actions. Suppose that Standal’s brought an action against one infringer, i.e., the first class member, and its patent was found valid. Under Blonder-Tongue Standal’s would be permitted to bring an action against the second infringer—the second class member. As long as the patent was found valid in each subsequent action, Standal’s could bring an action against the next infringer. However, once the patent was found invalid, for example, in the tenth suit, Standal’s would be precluded from seeking redress from any of the other 260 alleged infringers. If this action were not certified as a class action there would be a risk of inconsistent or varying adjudication with respect to individual members of the class which would establish incompatible standards of conduct for individual class members.

The Dale Electronics court reached the same conclusion based upon the same analysis, noting that actions involving patent validity are particularly well suited for Rule 23(b)(1) defendant class treatment: The prosecution of separate actions by or against individual members of the class would create a risk of inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class. Rule 23(b)(1)(A). While Blonder-Tongue makes an invalidity determination final and binding on the plaintiff, it does not meet the problem of a possibility of a validity finding by this court and an invalidity finding by another court. The alleged infringers could continue infringing until such time as the plaintiff brought suit against each of them and relitigated the question of validity.42 A Rule 23(b)(1)(B) defendant class also may be warranted. As previously noted, Rule 23(b)(1)(B) class treatment is appropriate if individual adjudications either would be dispositive of the interests of other class members or would substantially impair or impede the ability of absent class members to protect their interests. Certification of a defendant class under Rule 23(b)(1)(B) is appropriate in patent enforcement actions because the typical expense and complexity of a patent infringement action may, as a practical matter, give patent rulings in one court significant persuasive value in another court, even in the absence of a published decision or any res judicata or collateral estoppel effect. As the court indicated in Research Corporation v. Pfister Associated Growers, Inc.: The difficulty of subject matter inherent in most patent cases...give selected adjudications of validity or invalidity more than the usual weight when a court is considering the adoption of another court’s opinion or reasoning by means of comity. This practical fact, added to the great expense of defending a patent suit of this type, would tend towards impairing or impeding the nonparty class members’ ability to protect their interests.43 Other decisions, such as Technograph and Dale Electronics, have reached the same conclusion.44 A plaintiff patent holder may also wish to request certification of a mandatory defendant issues class under Rule 23(b)(2). Certification of a class is proper under Rule 23(b)(2) if the party opposing the class has acted on grounds generally applicable to the class. When allegedly infringing defendants assert a reverse declaratory relief action requesting a declaration that the plaintiff patent holder’s patents are invalid and unenforceable and that the patent holder does not own the patent or otherwise have the right to enforce it, and when the action requests the issuance of a permanent injunction prohibiting the plaintiff patent holder from claiming infringement or requesting licensing fees from defendants and other class members, a mandatory defendant class with respect to the class issues may comply with the letter and spirit of Rule 23(b)(2).

The Methode Electronics court certified a defendant patent infringement class under Rule 23(b)(2) under similar circumstances. The court held: [B]y obtaining patents, notifying some alleged infringers of the patents, and threatening some of them with infringement suits unless they take licenses, and by bringing civil actions against some of them, the plaintiffs herein have acted on grounds generally applicable to the class and any subclasses thereof. Further plaintiffs’ claims for relief against each defendant contain prayers for injunctions. Each defendant has amended its counterclaims to pray for declaratory and injunctive relief. These prayers are typical of the requests for relief usually made by patentees and alleged infringers in patent infringement actions. By these counter-claims final injunctive relief and declaratory relief with respect to the class as a whole has been made appropriate.45 To be sure, the certification of a defendant issues class may not always be appropriate. In Tilley v. TJX Companies, Inc.,46 the court stated that “there will be no single act or refusal to act on the part of the plaintiff (the party opposing the class) that makes injunctive or declaratory relief appropriate.” In patent lawsuits presenting a true “reverse declaratory relief case” that satisfies Rule 23(b)(2)’s requirement of a request for “final injunctive relief” or “corresponding declaratory relief” in favor of the class and against the party opposing the class,47 however, certification of a defendant issues class may be appropriate.

When, as in Methode Electronics, a patent holder allegedly has acted on grounds generally applicable to members of the defendant class—and in particular, when the defendant accused infringer has raised one or more common issues by means of its affirmative
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Class Notice
Although notice to members of the defendant class is not automatically required in a mandatory defendant issues class under Rules 23(b)(1), (b)(2), and (c)(4), the plaintiff patent holder usually should request that notice be given anyway. The court is given discretion by Rule 23(d)(2) and (c)(2)(A) to direct “appropriate” notice to be given in Rule 23(b)(1) and (b)(2) class actions “for the protection of the members of the class or otherwise for the fair conduct of the action.”50

Following notice to absent defendant class members, well-funded and motivated defendants may step forward. Plaintiff patent holders should recognize that the provision of notice to absent defendant class members in a high-stakes patent infringement case—even if the infringement issue itself is not being adjudicated in the lead proceeding—may result in the intervention or joinder in the action of additional defendants that have the incentive and resources to mount vigorous, supplemental defensive challenges to the plaintiff’s claims. Such defendants may seek, for example, to reopen claim construction issues or to challenge patent validity based on the production of new sources of alleged invalidating prior art. This scenario may increase the delay and cost of the proceedings.

Therefore, a defendant issues class may be appropriate only in cases in which the plaintiff patent holder is quite confident in the validity of its patent(s), is well versed in all prior art, and has chosen an initial defendant class representative and class counsel that can be expected to mount a comprehensive, thorough, and vigorous defensive effort that will not leave defensive “holes” that subsequent intervening defendants can exploit. It may be prudent in some circumstances for a plaintiff patent holder to first bring one (or even more) non-class-action patent infringement cases against one or more select defendants to obtain favorable rulings on common patent ownership, validity, enforceability, and claim construction issues before commencing a subsequent defendant class action proceeding in a separate case. This is so because, although the prior favorable rulings against the nonclass defendants would not be binding on subsequent class defendants in a separate action, such prior rulings on common issues nonetheless, as a practical matter, likely would be highly persuasive on the district judge in the subsequent proceeding—as a simple matter of judicial economy. Having “tested” the strength of its patents in prior nonclass proceedings, the plaintiff patent holder may be able to significantly increase the likelihood that the same common issues would withstand more intensive scrutiny in a subsequent defendant class action in which multiple defendants may combine their defensive resources.

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2 Harris v. Palm Springs Alpine Estates, Inc., 329 F. 2d 909, 913-14 (9th Cir. 1964).
3 See General Tel. Co. of Northwest, Inc. v. EEOC, 446 U.S. 318, 330 (1980); Pederson v. Louisiana State Univ., 213 F. 3d 858, 868 (5th Cir. 2000).
8 Rosario v. Livaditis, 963 F. 2d 1013, 1018 (7th Cir. 1992).
9 Local Joint Exec. Bd. of Culinary/Bartender Trust Fund v. Las Vegas Sands, Inc., 244 F. 3d 1152, 1162 (9th Cir. 2001).
11 See Research Corp. v. Pfister Assoc. Growers, Inc., 301 F. Supp. 497, 499 (N.D. Ill. 1969) (“This court weighs the defendants’ protestations that they do not ‘desire’ to represent the entire class, but this is hardly enough to overcome the overwhelming evidence of their ability and intention to challenge the plaintiff’s assertions of validity and infringement.”); Technograph Printed Circuits, Ltd. v. Methode Elecs., Inc., 285 F. Supp. 714, 721 (N.D. Ill. 1968).
14 See Advisory Committee Notes, 39 F.R.D. 69, 100-03 (1966).
15 See id.; see also Holmes v. Continental Can Co., 706 F. 2d 1144, 1155 n.8 (11th Cir. 1983).
16 See Amchem Prods., Inc., 521 U.S. at 615; see also Penn v. Terminal Transp. Co., 634 F. 2d 989, 993 (5th Cir. 1981) (citing Fed. R. Civ. Proc. 23 Advisory Committee Notes (1966)).
18 See Holmes, 706 F. 2d at 1155-56.
19 See id.
23 Id. at 811 n.3. See also Kan. Stat. Ann. §60-223.
24 Id.
26 Id. at 864-65.


32 Harris v. Palm Springs Alpine Estates, Inc., 329 F. 2d 909, 914 (9th Cir. 1964).


36 Markman v. Westview Instruments, Inc., 52 F. 3d 967, 976 (Fed. Cir. 1995).

37 Compare, e.g., Graco Children’s Prods., Inc. v. Regalo Int’l, LLC, 77 F. Supp. 2d 660, 663 (E.D. Pa. 1999) (“[D]espite a previous court having held a hearing on the claim construction of a patent pursuant to Markman, issue preclusion would not apply under the facts of the case.”) with Kollmorgen Corp. v. Yaskawa Elec. Corp., 147 F. Supp. 2d 464, 469 (W.D. Va. 2001) (Issue preclusion applies only where the earlier claim construction “was essential to a final judgment on the question of the patents’ infringement.”).


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48 Id. at 39.

49 See FED. R. CIV. PROC. 23(b)(2).

50 Quinlan v. Fort Griffin Fandangle Ass’n, Inc., 624 F. 2d 717 (5th Cir. 1980).
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**Gang Prosecutions**

ON THURSDAY, JUNE 11, the Association and the Small and Solo Division will present a program on gang injunctions. The program, led by Mohamad Khatibloo, will include the history of area gangs, varying definitions of gang membership, as well as gang injunctions. The presentation will cover proper service and notice, minors, language, and FL cards. Attorneys who attend will learn about cross-examination and re-cross of experts. Criminal law attorneys who attend will learn from vast recent experience concerning area gangs and the efforts being made to combat them. The program will take place at the Los Angeles County Bar Association, 1055 West 7th Street, 27th floor, Downtown. On-site registration will begin at 4:30 P.M., with the program continuing from 4:30 to 8:30 P.M. The registration code number is 010420. The prices below include the meal.

- $135—CLE+PLUS members
- $150—Small and Solo Section members
- $180—LACBA members
- $225—all others
- 3.5 CLE hours

**Practical Persuasion**

ON TUESDAY, JUNE 2, the Los Angeles County Bar Association will host an interactive, hands-on program led by Scott Wood that delivers the key principles for writing motions and briefs. In addition to these principles, the workshop includes a brisk review of 10 tips for clarity. On-site registration and the meal will begin at 5 P.M. at the LACBA Conference Center, 1055 West 7th Street, 27th floor, Downtown, with the program continuing from 5:30 to 8:15 P.M. The registration code number is 010145. The prices below include the meal.

- $20—CLE+PLUS members
- $135—LACBA members
- 2.5 CLE hours

**Small Firms and Solo Practitioners Conference**

ON WEDNESDAY AND THURSDAY, JUNE 24 and 25, the Second Annual 2009 Small Firm and Solo Practitioners Conference will provide those who attend with the practice tools they need to run an efficient and profitable firm prepared to meet the complex requirements of clients. The impressive lineup of speakers will guide attorneys through such topics as rainmaking, technology, practice management, how small and solo firms can address public relations (including blog items, story pitches, and press releases), how to compete with the big guys, collections, unbundling, financial management, fee setting, negotiation strategies, and e-discovery.

The conference will take place at the Los Angeles Convention Center, 1201 South Figueroa Street, Downtown. On-site registration will begin at 8 A.M. Wednesday, with the program continuing on both days from 9 A.M. to 5 P.M. The registration code number is 010211. The prices below include meals.

- $255—CLE+PLUS members
- $285—Small and Solo Division members
- $350—LACBA members
- $415—all others

The Los Angeles County Bar Association is a State Bar of California MCLE approved provider. To register for the programs listed on this page, please call the Member Service Department at (213) 896-6560 or visit the Association Web site at http://calendar.lacba.org/where you will find a full listing of this month’s Association programs.
Who Owns the Rebate?

**EVERYONE LOVES SOMETHING FOR NOTHING**, including members of the legal profession. The recent explosion of so-called rebate programs and expensive gifts and rewards that many court reporting firms now offer to attorneys or their staff for scheduling depositions is a case in point. In some situations, secretaries and paralegals participate in a rebate program even without the knowledge of their firms or attorneys. The rebates, in the form of cash, gift cards, travel, and shopping, are made to influence the selection of court reporting firms when scheduling depositions.

Historically, court reporting companies have been local “mom and pop” operations. However, over the past several years the industry has experienced considerable consolidation as well as an influx of non-court reporter principals, including lawyers who buy and run court reporting firms. To maximize their return on investment, many of these firms have expanded beyond their cities of origin.

Along with the trend to consolidate and expand has come the push to gain new business. In the early 1990s salespeople began delivering trays of cookies and providing other low-cost items to lawyers and their staffs. What began as an inexpensive treat has grown to the point of some court reporting firms proudly posting on their Web sites programs to earn “points” for every deposition that a law firm schedules with the reporter. The points may be redeemed for all-expenses-paid vacations, limousine travel, rounds of golf, and the like. One recent flier boasted, “You Book The Depo, We’ll Bring The Dom. Take your next deposition with us and we’ll hand deliver a complimentary bottle of…Dom Perignon.” In addition, that firm, whose president and vice president are lawyers, offers the options of a donation to charity or a $125 State Liquor Store gift card. There are anecdotal reports in court reporting circles of payments in excess of $25,000 going to a secretary to switch court reporting firms.

The first question is, Who is entitled to these gift-rebates? The answer to this question is not as simple as it might seem. It is one matter if a nonlawyer staff member is allowed to retain the rebate. However, if the rebate goes directly to the attorney, shouldn’t the benefit inure to the client who is paying for the service? This scenario raises both tax and ethical questions.

In 2006, the Internal Revenue Service began to crack down on the gift bags that had become common in the entertainment industry. The IRS reasoned that, since the donors took the cost of the “gifts” as a tax deduction, they really weren’t gifts at all and should be taxable to the recipient. According to tax practitioners, the IRS would probably look at court-reporting rebates similarly. Whether the rebate is paid to the law firm or to an employee of the firm, and whether it comes through an immediate transfer of the rebate property or service or by way of a points system, there is no reason for excluding it from the recipient’s taxable income since it is plainly not a gift.

If the recipient is the law firm, the rebate would conform to legal ethics only if it is revenue neutral. That means the firm is obligated to give its client the benefit of the reduced cost reflected in the value of the rebate. Thus, if the reporter charges the law firm $100 and provides a $10 rebate, the firm should charge the client $90. But if the firm charges the client the full $100, the firm should report the $10 rebate as taxable income. (If the firm charged the client only $90, there would, of course, be no taxable income.) A more complicated ques-

Whether the rebate is paid to the law firm or to an employee of the firm, and whether it comes through an immediate transfer of the rebate property or service or by way of a points system, there is no reason for excluding it from the recipient’s taxable income.

The court reporter’s situation is, if anything, even more complicated. The reporter generally would be required to provide an IRS information return to the recipient if the annual value of the rebate exceeds $600. The rebate would be deductible by the reporter unless it is a bribe, kickback, or other illegal payment under U.S. law or under generally enforced state laws that provide for criminal penalties or loss of license. Section 162(c)(2) of the Internal Revenue Code says that a kickback includes “payment in consideration of the referral of a client, patient, or customer.” So where does that leave the too-generous court reporter? Not in a very enviable position.

A more in-depth discussion of the legal and ethical implications of these rebate programs may be forced upon those who participate in giving or receiving these excessive gifts from court reporting firms. The message is clear though: No court reporting service should venture into the world of “rebates” without a solid understanding of the potential problems they are creating for themselves and for their customers—both the attorneys and their clients.

James DeCrescenzo is a registered diplomat reporter and a fellow of the Academy of Professional Reporters. Gordon R. Downing is a member of the tax department, and Joseph J. Serritella is a member of the litigation department, of Pepper Hamilton LLP.
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