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BY JUDGE MICHAEL D. MARCUS (RET.)
Although designed to enhance the mediation process, confidentiality carries the risk of shielding attorney misconduct and incompetence.

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BY BEN M. DAVIDSON
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elevated sleeping on the sidewalk outside of a McDonald’s to a protest art form. I didn’t realize we have had protesters in Los Angeles for years. You go, sleeping-in-a-box-in-the-Third-Street-tunnel people. And I thought you were just homeless.

This protest is aimed at the top 1 percent of U.S. households, who in 2007 controlled a stunning 42 percent of America’s financial wealth. I don’t even control 42 percent of the wealth in my own household!

It is not exactly clear what the protesters would do about the wealth gap in America. Perhaps the 1 percenters could divide their money among the other 99 percent, like a class action settlement. This could be done through a time-honored formula: Each 99 percent receives a check for 32 cents, and the lawyers get $26 billion.

Unfortunately for the occupation movement, the reaction of the business and finance world has been a magnificent corporate yawn, like a great lion on Mutual of Omaha’s Wild Kingdom that has feasted after the kill. Other than being mildly inconvenienced by the long line for lattes, the 1 percenters are unfazed. Except for Warren Buffett (speaking of Omaha), who wants to pay more taxes but—we can only surmise—is caught in a vortex of tax loopholes he just can’t figure out how to escape. But Buffett seems like a good guy, and I know deep down he wants to alleviate his guilt by writing me a check that will put my kids through college. That’s S-W-E-N-S-O-N.

Perhaps this wealth gap persists because it is part of our DNA. The signers of the Declaration of Independence were 1 percenters in their time, and financial inequality has defined the societies of virtually all of our forebears around the world since, well, forever. It’s Economics 101 for all great societies: The top 5 percent becomes the top 1 percent, which becomes the top tiny fraction of 1 percent, which becomes Louis XVI. This is followed by revolution, debauchery, and dark ages, and then society hits the reset button, with wealth redistributed to a new 5 percent. Of course, that whole French Revolution thing might be something we would all rather avoid.

Sharing a lawn with the really down-and-out is not likely to garner much sympathy. If the occupiers want to attract the attention of the 1 percenters, they are going to have to hit where it hurts. Sew their Versace and Prada clothes with dissolvable stitches. One day of inclement weather and, voilà, the emperor has no clothes. Literally. Make their lattes with nonfat yak milk. I don’t really know what that will do, but it can’t be good. Top the food at Puck’s highest end restaurants with bread crumbs, Cheese Whiz, and Cool Whip. (If you’ve ever eaten at a potluck in a small Bible Belt town, you know what I’m talking about.) But lines must be drawn. Serve them Jell-O topped with some unidentifiable white fluffy stuff that tastes vaguely of pineapple? No! We have to show some humanity.

Could we be on the verge of another 1960s-style social revolution? The truth is, many Americans are fed up with the inequities of our economy—at least during this period of high unemployment, stagnant salaries for most, and rising food and energy prices for all—and if the Occupy movement makes a difference, we will all owe it a debt of gratitude. Good thing, because with the wealth gap, gratitude is all I will have to offer as payment.

The Occupy Something movement started in a park near Wall Street near the middle of September and, as I write this, is settling in for the holidays in downtown Manhattan. Think Valley Forge, but with roasted chestnut vendors and porta-potties. In fact, the occupiers have
Protecting Intellectual Property Rights with the ITC

ALTHOUGH YOU MAY NOT HAVE LEARNED ABOUT the U.S. International Trade Commission in law school, chances are good that if your practice involves intellectual property you will soon find yourself litigating there. In recent years, the ITC has become perhaps the hottest new battleground for patent infringement disputes. This is primarily because, in comparison to federal district courts, the ITC offers faster proceedings and easier access to injunctive relief.

The ITC is a federal agency charged with preventing unfair trade practices related to the importation and sale of goods into the United States, including the infringement of a valid U.S. patent.1 As part of this mission, the ITC is empowered to conduct investigations to determine whether goods infringe a valid U.S. patent. In the ITC, unlike in federal court, there is no right to a jury trial, and all issues are tried before an administrative law judge.

There are three sides to an ITC investigation and trial. The patent holder is called the complainant. The accused infringers, who often include manufacturers and importers of allegedly infringing goods, are called respondents. A group within the ITC, called the Office of Unfair Import Investigations (known informally as the staff), is a party to every investigation and is involved at every stage. Like the complainant and respondent, it can initiate discovery, conduct motion practice, and examine witnesses at trial.

Speedy Procedures

The ITC has its own procedural rules.2 Unlike in federal court, the filing of a complaint does not automatically start a lawsuit. Instead, the complaint goes to the six commissioners of the ITC (the commission), who then decide whether to initiate an investigation. From the commission’s perspective, the investigation is not merely a private intellectual property dispute but a public investigation involving U.S. international trade.3

A unique feature of ITC investigations is their speed. By statute, an ITC investigation must be resolved “at the earliest practicable time.”4 A typical ITC action is completed in 12 to 16 months—a significantly shorter time than the two- to three-year life span of many district court patent cases.

If the investigation proceeds through trial, the ALJ is authorized to issue a ruling on the merits of the case but not to order remedies. Only the commission may issue a permanent remedy. The ALJ will deliver an initial determination on the merits (similar to a district court judgment on the merits) and a recommended determination on a remedy that has no binding force but offers guidance for the commission.5

The parties may then petition for commission review. The commission may grant review of some or all issues or may decline to review the initial determination, in which case it becomes final. Because only the commission may issue a remedy, if infringement is found, it will necessarily rule on the remedy whether or not it reviews the finding of infringement.

The ITC’s most significant difference from district court is its remedial relief. The ITC is not statutorily authorized to award damages. The ITC provides only prospective relief, primarily via exclusion orders, which are somewhat like injunctions.

An ITC exclusion order prevents a product from being imported into the United States. A limited exclusion order prevents the parties named in the investigation from importing the infringing product.6 A general exclusion order prevents the infringing product from being imported regardless of who manufactures or imports it. This means that a general exclusion order can prohibit all importation of infringing goods, even if the importing or manufacturing entity did not participate in the proceedings, and regardless of whether the ITC could have exercised personal jurisdiction over that entity.

Injunctive Relief

The ITC’s authority to issue permanent injunctive relief contrasts greatly with that of federal courts. In eBay Inc. v. MercExchange, LLC,7 the Supreme Court cautioned district courts against granting injunctions to patent holders unless the plaintiff demonstrates the traditional equitable factors. Since eBay, it has become relatively difficult for patent holders to obtain injunctive relief in federal court. The ITC, in contrast, is statutorily required to issue an exclusion order once the patent holder proves infringement unless the “public health and welfare” or certain economic conditions weigh against it.8 To date, the commission has determined not to issue an exclusion order in light of these conditions on only three occasions.9 An ITC exclusion order is thus significantly easier to obtain than a federal court injunction.

A party dissatisfied with an ITC determination can seek judicial review only by appealing directly to the U.S. Court of Appeals for the Federal Circuit. The Federal Rules of Appellate Procedure govern on appeal. The appellant is the party that lost before the ITC. The ITC, which during the investigation acted as a neutral fact finder, becomes the appellee defending its determination before the Federal Circuit. The party that won before the ITC must intervene in order to participate in the defense of the ITC’s determination on appeal.

In sum, the ITC offers fast, effective relief against the importation of products that infringe intellectual property rights. Intellectual property lawyers should become familiar with the ITC’s procedures and consider the commission for future disputes.

Mark A. Kressel, an associate at the law firm of Horvitz & Levy, LLP, is vice president of the Barristers Section.

5 19 C.F.R. §210.42.
6 Kyocera Wireless Corp. v. ITC, 545 F. 3d 1340, 1358 (Fed. Cir. 2008).
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EXECUTIVES BOUND FOR FOREIGN ASSIGNMENTS and their employers face complex tax issues. The optimal structure for a particular overseas posting depends on the employer’s circumstances and its global tax plan, the individual circumstances of the executive, the location and duration of the foreign posting, the applicable tax laws of pertinent jurisdictions, and applicable tax treaties, all of which are subject to change.

U.S. citizens and resident aliens are taxed by the United States on their worldwide income, including income derived from foreign activities. Nonresident alien individuals are taxed only upon domestic activities generating income that is derived in the United States or that is effectively connected with a domestic trade or business. For this reason, the threshold issue for the foreign posting of an employee is whether the employee is a U.S. citizen or resident alien for U.S. tax purposes.

Every person born or naturalized in the United States is a citizen unless action has been taken to relinquish citizenship. U.S. citizens who are also citizens of another jurisdiction are taxed like any other U.S. citizen. Even if not a U.S. citizen, a foreign citizen is taxed on worldwide income if he or she is a resident of the United States for tax purposes. An alien individual will be considered a U.S. resident with respect to any calendar year if the individual is present in the United States at any time during the calendar year (the green card test), or 2) the individual meets a substantial presence test. In all other cases, the individual is classified as a nonresident alien for tax purposes.

The substantial presence test focuses on the alien individual’s physical presence in the United States. Under the test, an alien is treated as a resident alien if he or she is present in the United States 1) on at least 31 days of the current year, and 2) the individual meets a substantial presence test. In all other cases, the individual is classified as a nonresident alien for tax purposes.

The Internal Revenue Code (IRC) also provides nonresident status under the substantial presence test if the facts and circumstances and the individual’s physical presence during the current year indicate that the individual has more significant ties to another jurisdiction. Under this tax-home exception, an alien individual is treated as a nonresident even if he or she meets the substantial presence test for any current year if the individual 1) is present within the United States for fewer than 183 days during the current year, 2) establishes that, for the current year, his or her “tax home” is in a foreign country, and 3) has a closer connection to the foreign country than to the United States. This tax-home exception is not available for any year in which an individual has applied for a green card or has taken other affirmative steps to become a permanent resident.

A U.S. citizen or resident alien has a continuing obligation to file annual tax returns on the appropriate form, typically IRS Form 1040, despite being posted outside the country. An individual residing abroad on April 15 has an automatic extension to June 15 to file the tax return for the prior calendar year if he or she attaches a statement to the return showing that he or she is entitled to the extension.

The U.S. taxation of the compensation and fringe benefits will be determined under U.S. tax principles, which may vary significantly from the tax rules of the foreign jurisdiction.

However, interest will be assessed on any unpaid tax from the due date of the return (without regard to the automatic extension) until the tax is paid. Additional extensions to October 15, followed by a discretionary extension to December 15, are also available for filing of the return. If the employer is not withholding U.S. taxes, the individual taxpayer is required to pay estimated income taxes quarterly in addition to whatever other estimated taxes are required.

In addition, if at any time during the year that an individual had an interest in, or signature or other authority over, a bank account, securities account, or other financial account in a foreign country, Form TD F 90-22.1 (also known as a Foreign Bank Account Report, or FBAR) must be filed by June 30 of the following year with the Department of the Treasury. No extensions are available for filing of an FBAR. An FBAR is required if the combined assets in the account(s) are more than $10,000.

Civil and criminal penalties may apply for the failure to file a report or supply information and for filing a false report. The criminal penalty is a fine of not more than $250,000 or imprisonment for not more than five years (or both). If the violation is part of a pattern of illegal activities, the maximum amount of the fine is increased to $500,000, and the maximum length of the sentence is increased to 10 years. The civil penalty can be up to $10,000, but this can be waived if the income from the account was properly reported, and there was reasonable cause for failure to report. The civil penalty for willfully failing to file an FBAR can be as high as the greater of

David S. Boyce is a certified specialist in taxation law who practices with Jones Day in Los Angeles.
$100,000 or 50 percent of the aggregate balance of the foreign accounts. Taxpayers who can show reasonable cause for the failure to file the FBAR can avoid penalties.

The Tax Home

A distinction is made between a taxpayer's citizenship and residency for U.S. tax purposes generally and the individual's tax home as determined for purposes of the deduction of business expenses. An individual's tax home, for purposes of the IRC, is the taxpayer's principal place of employment and not where his or her personal residence is located. If an individual is away from his or her tax home for a temporary assignment, related travel expenses for transportation, housing, and food are deductible for U.S. income tax purposes. If the assignment is for an extended period of time or indefinite, however, the new assignment is deemed to be the taxpayer's new tax home, and no deduction is provided for these expenses.

The IRS has ruled that if employment away from home in a single location is realistically expected to last (and does in fact last) for one year or less, the employment is temporary in the absence of facts and circumstances indicating otherwise. If employment away from home in a single location is realistically expected to last for more than one year or there is no realistic expectation that the employment will last for one year or less, the employment is indefinite, regardless of whether it actually exceeds one year. If employment away from home in a single location initially is realistically expected to last for one year or less, but at some later date the employment is realistically expected to exceed one year, that employment will be treated as temporary (in the absence of facts and circumstances indicating otherwise) until the date that the taxpayer's realistic expectation changes.

The IRS view may be used to shape an assignment to qualify as temporary duty for which travel expenses would be deductible. For assignments expected to last more than one year, however, a new tax home results under the IRS view, and related transportation expenses from the taxpayer's old home, in the United States to his or her new posting, and living expenses at the new home, would not be deductible business expenses.

Who Will Be the Employer?

Tax considerations for the foreign posting of an employee typically are subject to overriding tax considerations of the employer. Posting an employee in a foreign country presupposes a presence in the foreign country by the employer, and that may involve a foreign branch of the U.S. employer or a foreign affiliate of the employer. A foreign branch generally subjects the U.S. employer to taxation in the foreign jurisdiction but could be used to facilitate use of foreign losses against U.S. income, since U.S. corporations, like U.S. citizens, are taxed on their worldwide income and, subject to certain limitations, may be able to offset income in the United States with losses incurred in direct foreign operations.

A foreign affiliate could be used to limit the taxation by the foreign jurisdiction, since most jurisdictions would tax only the activities conducted within their country, or to defer U.S. taxation of foreign income in certain circumstances and subject to the limitations under the IRC for controlled foreign corporations.

If the employer will be operating in the foreign jurisdiction as a branch, the employment structure will remain one of direct employment. The issues then focus on the amount and structure of the compensation package and fringe benefits. Employment by a branch of a U.S. company has the advantage of permitting direct deduction of the employment costs by the employer. It also permits the employee to remain a participant in the benefit plans of the employer and, for a cost, to continue to earn credit for employment for U.S. Social Security benefits. If the U.S. employer wishes to avoid a taxable presence in the foreign jurisdiction, a U.S. subsidiary may be formed to establish the branch, with consolidation of the income and losses for U.S. tax purposes, subject to the dual consolidated loss rules, and continued inclusion of the employee in the U.S. benefit plans of the affiliated U.S. corporations.

If the employer will be operating in the foreign jurisdiction through an affiliate, other options for structuring the employment arrangement include 1) employment by a foreign affiliate, 2) continued employment by the U.S. employer or a U.S. affiliate with secondment of the employee to the foreign affiliate, and 3) employment by both the U.S. employer and the foreign employer with compensation from both dependent on tax considerations and the respective services to each.

Tax considerations are involved in each option. The first, employment by foreign affiliate, is a simple approach for handling the foreign employment for extended periods. If there is a foreign affiliate in place, this approach simplifies withholding and payroll taxes and can avoid a taxable foreign presence for the U.S. affiliate. Potential disadvantages arise for the employee, who may not be eligible for continued coverage under the U.S. affiliate's benefit plans or U.S. Social Security unless the foreign affiliate is a member of the U.S.-controlled group that adopts the U.S. plans, and the U.S. affiliate elects under the IRC to have the Social Security Act extended to services performed outside the United States by the foreign affiliate's employees. The election by the U.S. employer applies to all employees who are U.S. citizens or residents, provided their employment would not be excluded if the services were performed in the United States. The Social Security election may not be necessary if a Social Security agreement (commonly called a totalization agreement) between the United States and the foreign jurisdiction is in place, in which case Social Security taxes generally only are paid to the country in which the services are provided, but coverage under U.S. Social Security would continue. Countries with whom the United States has entered totalization agreements include Canada and most European countries.

Another approach is for the U.S. employee to be seconded to a foreign affiliate. Under this arrangement, the employer remains the U.S. corporation, and the employee's services are provided to a foreign affiliate under a contractual arrangement between the U.S. corporation and its foreign affiliate. This arrangement has the advantage of continued inclusion of the employee in the U.S. corporation's benefit plans without the necessity of the foreign affiliate's adoption of the plans. The employee would also continue to earn credit in the U.S. Social Security system without the need for the foreign affiliate to elect coverage or a totalization agreement to be in place between the United States and the foreign jurisdiction. The presence of an employee in the foreign country for an extended period of time, however, may result in a taxable foreign presence by the U.S. corporation and obligations to pay foreign income, withholding, and payroll taxes.

A third approach is dual employment. Although this can be burdensome from an administrative standpoint, it is sometimes used to customize packages and minimize taxation when the foreign jurisdiction has very high taxes for which U.S. tax relief is not efficient. Also, the overall tax rate and benefits package may be optimized with payroll in more than one country by reasonable allocations of employee responsibilities and wages and fringe benefits so net taxable income in high tax jurisdictions is minimized.

U.S. Income Exclusion

In recognition of the general hardships and frequently higher costs of being posted overseas, the IRC provides an elective income exclusion and housing allowance exclusion for U.S. individual taxpayers who meet specified statutory requirements. To qualify for the exclusion, the individual must have a principal residence in a foreign country and must either be a bona fide resident of one or more foreign countries for at least one entire taxable year or have spent at least 330 full
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days in foreign countries during a period of 12 consecutive months. If such tests are met, the employee can exclude from U.S. taxable income the income earned from sources within a foreign country that is attributable to services provided overseas during the qualifying period. To be eligible for the exclusion, the compensation must be received by the employee no later than the year following the year in which it was earned.

The amount of the income exclusion—which is $91,500 for 2010—is indexed for inflation. The exclusion is computed on a daily basis and is applicable to each taxpayer with qualifying foreign income. Consequently, spouses may each qualify for the income exclusion to the extent of their respective earnings for foreign employment.

A separate exclusion is provided for a housing allowance or free housing that is provided by the employer. The maximum amount of foreign housing expenses that may be excluded is the excess of 1) the taxpayer’s reasonable foreign housing expenses for the tax year, limited to 30 percent of the maximum foreign earned income exclusion amount for the calendar year ($27,450 or $75.21 per day for 2010), over 2) a base housing amount that is equal to 16 percent of the maximum foreign earned income exclusion amount for the calendar year ($14,640 or $40.11 per day for 2010), multiplied by the number of days of foreign residence or presence for the year. Thus, the maximum annual amount that may be excluded in 2010 is $12,810, or $35.10 per day.

Foreign housing expenses may be excluded only to the extent of the lesser of the expenses attributable to employer-provided amounts or the individual’s foreign earned income for the tax year. Eligible expenses include rent or the fair rental value of housing provided in kind by an employer, utilities (other than telephone charges), real or personal property insurance, household repairs, rental of furniture and accessories, and residential parking. They do not include expenses that are otherwise deductible, such as interest and taxes. They also do not include the cost of buying property, capital improvements to property, purchased furniture or accessories, or the cost of domestic labor.

The IRS allows the amount of expenses that may be used in calculating the maximum exclusion limit to be adjusted upward for the year in which it was earned.

Other Relief
To mitigate the otherwise harsh impact of the U.S. taxation of global income of U.S. citizens and residents, the IRC permits taxpayers to claim, as credits against U.S. taxes, income taxes and taxes imposed in lieu of income taxes that are paid to foreign jurisdictions on income sourced in those jurisdictions. The credits are generally available for foreign taxes paid with respect to personal services rendered in the foreign jurisdiction, subject to certain limitations, but the credits are not available for income excluded from gross income under the IRC.

In lieu of claiming a foreign tax credit, a taxpayer may deduct foreign taxes under the IRC. The foreign tax credit generally provides a greater tax benefit to the taxpayer, but a deduction may be advantageous in certain situations, such as a year in which the taxpayer is reporting a net operating loss that will carry over to other years.

The United States has tax treaties with many countries. The treaties generally are intended to minimize the exposure of taxpayers to double taxation. A review of applicable treaties should be part of the tax analysis for the outbound executive.

Treaties typically permit the country in which personal services are rendered to tax the related income. Exceptions are available if the services are provided for a limited time, such as 183 days or less, sometimes measured by the calendar year and sometimes measured by any consecutive 12-month period. The specifics vary by treaty and may be important in planning the start or end of an executive’s foreign posting.

Other Taxes
In addition to continuing U.S. federal tax obligations, executives posted outside the country may have continuing tax obligations to their state. In California, for example, a resident for state tax purposes is an individual who is present in California for other than a temporary or transitory purpose, or who is domiciled in California but outside California for a temporary or transitory purpose.

California residents are taxed on all income, including income from sources outside California. Consequently, an executive who is domiciled in California but is posted outside the country for temporary duty could still be subject to California income taxation, and California offers no counterparts to the IRC exclusions for compensation and housing allowance, the federal tax credits for foreign taxes, or the deduction for foreign taxes. Further, U.S. income tax treaties generally do not apply to state taxes.

California, however, provides a safe harbor from California state taxation for certain individuals leaving California under employment-related contracts. Under the safe harbor, an individual domiciled in California who is outside California for an uninterrupted period of at least 546 consecutive days will be considered a nonresident unless the individual has intangible income exceeding $200,000 in any taxable year during which the employment-related contract is in effect. The principal purpose of the absence from California must not be to avoid personal income tax. Return visits to California that do not exceed a total of 45 days during any taxable year covered by the contract are considered temporary.

The safe harbor also applies to a spouse accompanying the employee on the foreign posting. Individuals not covered by the safe harbor determine their residency status based on all facts and circumstances.

California is a community property state, and the domicile of the spouse earning the income determines the division of income between spouses. If both spouses are domiciled in California, and one spouse qualifies as a nonresident under the safe harbor or the facts and circumstances test but the other remains in California, half of the compensation of the spouse posted outside the country could still be taxed by California under community property principles even if separate returns are filed. California taxation on the foreign income may be avoided if the spouses have entered into an agreement that their respective earnings are separate property and file separate returns. The community property laws generally should have less of an impact for U.S. federal tax purposes, since the foreign income would be taxable for federal purposes (subject to exclusions) in any event if both spouses are U.S. citizens or residents. As is the case with the income tax, U.S. estate and gift taxes have a global reach for U.S. citizens. A citizen may also be subject to foreign estate or inheritance taxes as a result of having a residence or property located in a foreign jurisdiction. The potentially competing U.S. and foreign taxes and rules dictating property rights and forced inheritance in this context must be examined on a case-by-case basis. There may be tax treaty in place between the United States and the for-
eign county that specifies the applicable rules. In certain circumstances, a credit for foreign tax paid may be available against the U.S. estate tax. In any event, tax planning for a foreign posting should also include a review of the executive's estate plan from a global perspective.

Crafting the Package

Whichever structure is adopted for the employment arrangement, it is necessary to craft a compensation package including salary, deferred compensation, housing allowance, employee benefits, vacation, family leave, and travel to reach an agreeable level and maximize the tax efficiencies that are available under the selected structure. For executives with a current compensation package for their existing U.S.-based employment, this sometimes takes the form of a tax equalization package that accounts for variations in tax and other costs that will be incurred as a result of the foreign assignment.

Frequently, but not always, foreign taxes and housing costs will be significantly higher, and sometimes will be in addition to baseline U.S. costs. If the foreign posting also represents a promotion or increased work and responsibilities, a merit-based adjustment may also be appropriate. Other items that may be included in the compensation package are a relocation bonus, reimbursement of relocation expenses for moving and sale of a residence, dependent education allowance to cover the extra cost of educating a child in a foreign country, car allowance, home leave and travel allowance, emergency leave allowance, currency fluctuation allowance, spousal or family assistance to cover a relocating spouse's lost wages, and U.S. and foreign tax compliance services.

The U.S. taxation of the compensation and fringe benefits will be determined under U.S. tax principles, which may vary significantly from the tax rules of the foreign jurisdiction. This could create a mismatch that complicates planning to use U.S. tax benefits (such as the foreign income exclusion) together with any foreign tax credit. Various U.S. tax rules, in addition to the foreign tax credit and income exclusion, may nonetheless prove helpful. For example, certain fringe benefits are excludable: qualified tuition reductions provided to an employee; meals or lodging furnished to an employee for the convenience of the employer; benefits provided under a dependent care assistance program; and no-additional-cost services, qualified employee discounts, working condition fringes, and de minimis fringes.

Similarly, the value of the use by an employee of an employer-provided vehicle or a flight provided to an employee on an employer-provided aircraft may be excludable from income (because, for example, the transportation is provided for medical reasons) if and to the extent that the applicable requirements are satisfied. Also, deductions of qualified moving expenses are allowed under the IRC, and any reimbursement of moving expenses that would be deductible generally are excludable from gross income. Business travel may be deductible even if paired with incidental personal visits while visiting the United States for business.

Qualified retirement plans should be reviewed to determine whether the employee would be covered and, if not, whether amendments to the plan would be appropriate. This would depend on the terms of the plans and whether the employee is part of the control group. In addition, the IRC contains special rules for including employees of foreign affiliates and employees of domestic subsidiaries who are working in a foreign country.

The tax equalization component generally is the last piece of the compensation package to be calculated. If the after-tax economic benefit of the package, after taking into account various subsidies to offset any increased costs of living, materially varies from the compensation the executive would receive in the United States, the tax equalization payment can make the executive whole. Since the tax equalization payment itself will be taxable, a gross up may be provided to cover the related tax cost. Whether equalization is achieved for a particular executive will depend on many factors, including the compensation policies of the employer and the individual circumstances of the executive.

If paid after the taxable year for which the tax equalization payment accrues, the tax payment would constitute deferred compensation and, as is the case for all nonqualified deferred compensation, must be tested for compliance with the applicable IRC provisions. Treasury Regulations generally exempt tax equalization payments if paid no later than the end of the second calendar year beginning after the calendar year in which the executive's return for the year in issue is due.

The issues affecting compensation of the foreign-bound executive are complex. Their analysis requires consideration of foreign tax law as well as U.S. federal and state tax law, all of which are subject to change. In these circumstances it is essential that experienced and knowledgeable tax advisers are part of the team for the employer and for the executive.

References

2. Id.
7. I.R.C. §3121(t).
9. Id.
10. Id.
11. Id.
12. Id.
13. Id.
14. See I.R.C. §51(a)(1), 61(a), 162. Limitations include, for example, the dual consolidated loss rules, which provide that, if a U.S. corporation is subject to a foreign country's tax on worldwide income or on a residence basis, any net operating loss incurred cannot reduce the taxable income of any other member of the U.S.-affiliated group for that or any other taxable year. Losses of many foreign branches and other separate and clearly identifiable foreign business operations are treated as if that operation were a wholly owned subsidiary corporation. See I.R.C. §1503(d); Treas. Reg. §1.1503-3(d)(5) to §1.1503-3(d)(8).
25. I.R.C. §911(c).
29. See IRS Notice 2010-27.
32. Id.
34. I.R.C. §164.
36. Id.
37. I.R.C. §§901, 903, 111.
42. Rev. & Tax. Code §17014.
43. For findings by the California State Board of Equalization of one resident spouse and one nonresident spouse, see Appeal of Konstantine Karavakis, Cal. St. Bd. of Equal. (Feb. 23, 2010) and Matter of Wu, Cal. St. Bd. of Equal. (Mar. 24, 2004).
44. I.R.C. §911.
45. I.R.C. §§901, 903.
46. I.R.C. §§117(d).
47. I.R.C. §119.
49. I.R.C. §132.
50. I.R.C. §105.
54. See I.R.C. §409A.
CONFIDENTIALITY dominates the mediation process in California. With rare exceptions, all writings and statements prepared for and made at mediation cannot be divulged. Confidentiality is a cornerstone of mediation because it enables all participants to discuss openly the legal and factual elements of their cases without consequence or detriment.1

Along with the clear advantages of confidentiality, however, are its less obvious and sometimes criticized byproducts, including the protection of misconduct and incompetence. Indeed, while an attorney is constrained from misleading a judicial officer2 or opposing attorney,3 misrepresentations to neutrals or other mediation participants are not subject to either sanctions or discipline.4 The interpretation by courts of the scope of mediation confidentiality thus carries high stakes for all involved. As a result, practitioners should be aware of recent decisions by the California Supreme Court and a Ninth Circuit Court of Appeals case to fully grasp the current breadth of confidentiality applicable to mediation.

Mediation confidentiality in California’s state courts derives from the California Evidence Code,5 which states that every communication, whether oral or in writing, that was “made for the purpose of, in the course of, or pursuant to mediation” is confidential and not admissible at any subsequent proceeding or subject to discovery.6 The source of mediation confidentiality in California’s federal courts is based on local rules as well as case law and is thus more nuanced.7 The California Supreme Court's 2001 decision in Foxgate Homeowners' Association, Inc. v. Bramalea California, Inc., is the natural starting point for an analysis of mediation confidentiality in California state courts. In Foxgate, the supreme court held that pursuant to Evidence Code Sections 1119 and 1121, a mediator may not report attorney misconduct or bad faith to a jurist with the underlying case on his or her calendar. According to the Foxgate court, “Neither a mediator nor a party may reveal communications made during mediation.” Moreover, Section 1121 prohibits mediators “and anyone else from submitting a document that reveal[s] communications during mediation and [bars] the court from considering them.”8 The opinion further held that:

Although a party may report obstructive conduct to the court,

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none of the confidentiality statutes currently make an exception for reporting bad faith conduct or for imposition of sanctions under that section when doing so would require disclosure of communications or a mediator’s assessment of a party’s conduct although the Legislature presumably is aware that Code of Civil Procedure section 128.5 permits imposition of sanctions when similar conduct occurs during trial proceedings.9

The court elaborated on that point in an extensive footnote, stating in part that:
The conflict between the policy of preserving confidentiality of mediation in order to encourage resolution of disputes and the interest of the state in enforcing professional responsibility to protect the integrity of the judiciary and to protect the public against incompetent and/or unscrupulous attorneys has not gone unrecognized. (Citations omitted.) As noted, however, any resolution of the competing policies is a matter for legislative, not judicial, action.

Therefore, we do not agree with the Court of Appeal that the court may fashion an exception for bad faith in mediation because failure to authorize reporting of such conduct during mediation may lead to “an absurd result” or fail to carry out the legislative policy of encouraging mediation.10

The Foxgate court recognized, however, that occasionally it is necessary for courts to create a judicial exception to a statute to avoid “an absurd result.”11 Nevertheless, this was not required by the facts in Foxgate because Evidence Code Section 1119—which prohibits any person from revealing any written or oral communication made at mediation—and Section 1121—which prohibits mediators from advising the court about conduct during the mediation—were clear and unambiguous.12

A logical extension of Foxgate is Rojas v. Superior Court,13 in which the supreme court in 2003 extended confidentiality to all writings, including exhibits, prepared for mediation. For example, a document created for mediation that summarizes a plaintiff’s damages is not accessible in the specific proceedings in question, such as a related mediation about the identities of the juveniles. The court found that a minor’s due process right of confrontation outweighs the right of confidentiality.21

The federal counterpart to Rinaker is Olam v. Congress Mortgage Company,22 which holds that a mediator’s testimony can be compelled in a civil proceeding to establish whether a defaulting party was competent to enter into a settlement agreement that the opposing party is seeking to enforce. Foxgate factually distinguishes Olam because the parties in Foxgate had waived confidentiality. Otherwise, Foxgate acknowledges Olam as a comprehensive discussion of mediation law.23

Both Rinaker and Olam explain the process that a trial court should use to decide whether or not to compel a mediator’s testimony. Rinaker states that a court should conduct an in camera hearing “to weigh the public’s interest in maintaining the confidentiality of mediation against the minors’ constitutionally based claim of need for the testimony, and to determine whether the minors have established that the mediator’s testimony is necessary to vindicate their right of confrontation.”24 For example, the mediator would be excused from testifying in open court if he or she could not recall the statement needed to impeach the witness.21 Also, the in camera process allows the trial court to assess the probative value of the mediator’s testimony.25 Rinaker rejects the suggestion that the moving party should be required to demonstrate that “there is no other evidence, unrelated to the mediation, which could be used to undermine” the testimony of the witness to be impeached.27

If a plaintiff is claiming undue influence at the mediation and seeking the voiding of the settlement, Olam, relying on Rinaker, allows the mediator to first testify in closed proceedings regarding the plaintiff’s statements at mediation.26 Like Foxgate, Olam notes that Evidence Code Section 703.5 confers on the mediator an independent privilege not to testify about statements or conduct in the mediation—and that Rinaker does not focus on that provision. The mediator in Rinaker had objected to testifying only on the basis of Evidence Code Section 1119, not Section 703.5.29

Olam posits a two-step approach for balancing the requirements of confidentiality and due process. According to the Olam court: [The goal of the first step] is to determine whether the harm that would be done to the values that underlie the mediation privileges simply by ordering the mediator to participate in the in camera proceedings can be justified by the prospect that [the mediator’s] testimony might well make a singular and substantial contribution to protecting or advancing competing interests of comparable or greater magnitude.30

In the second step, the court should weigh and assess:

(1) the importance of the values and interests that would be harmed if the mediator was compelled to testify (perhaps subject to a sealing or protective order, if appropriate), (2) the magnitude of the harm that compelling the testimony would cause to those values and interests, (3) the importance of the rights or interests that would be jeopardized if the mediator’s testimony was not accessible in the specific proceedings in question,
MCLE Test No. 209

What happens in mediation...

1. Mediation confidentiality in California’s state courts is a product of both statute and case law.
   True.
   False.

2. The basis for mediation confidentiality in California’s federal courts is found only in the Federal Rules of Evidence and not in common law.
   True.
   False.

3. Mediation confidentiality in California’s state courts is absolute, with no exceptions.
   True.
   False.

4. A mediator may not report an attorney who misbehaves at the mediation to the superior court judge who has the underlying case on his or her calendar.
   True.
   False.

5. Mediation confidentiality prevents a mediator from reporting the failure of an attorney or party to attend a mediation to the superior court judge who has the underlying case on his or her calendar.
   True.
   False.

6. Mediation confidentiality allows attorneys to misrepresent facts and law to mediators and opposing counsel at the mediation.
   True.
   False.

7. A diagram drawn by a witness to an accident at the time of the accident becomes confidential if referred to or used by an attorney at a mediation.
   True.
   False.

8. A diagram drawn at a mediation by a witness to an accident is protected by mediation confidentiality.
   True.
   False.

9. A mediator’s testimony about statements or conduct by parties at a mediation regarding whether one of the parties was competent to enter into the settlement agreement can be compelled in a federal civil proceeding to enforce the mediation settlement agreement.
   True.
   False.

10. When attempting to enforce a mediation settlement in state court, a party must show that the parties had expressly waived mediation confidentiality pursuant to language in the Evidence Code.
    True.
    False.

11. Mediation confidentiality protects attorneys in state court from being sued for legal malpractice by their clients for anything they said or did during a mediation.
    True.
    False.

12. Mediation confidentiality does not apply to communications between clients and their attorneys that were made outside the presence of the mediator and opposing counsel.
    True.
    False.

13. Communications between clients and their attorneys before the commencement of a mediation are not confidential.
    True.
    False.

14. In Cassel v. Superior Court, the California Supreme Court invited the state legislature to reverse the court’s holding that mediation confidentiality applies to all communications made at mediation, including those that may involve legal malpractice.
    True.
    False.

15. Like the state courts, California’s federal district courts strictly apply confidentiality to all communications and writings made during a mediation.
    True.
    False.

16. Despite the fact that federal courts are authorized to establish rules regarding dispute resolution, a recent decision makes it doubtful that they have the authority to create their own local rules concerning mediation confidentiality.
    True.
    False.

17. Parties engaged in court-ordered and private mediations in federal court proceedings can negotiate for the total confidentiality of mediation communications.
    True.
    False.

18. Communications in state court mediations conducted by court-connected or appointed mediators are as confidential as communications in private mediations.
    True.
    False.

19. California’s attorney-client privilege in the Evidence Code is a further basis for protecting attorney-client communications at mediations.
    True.
    False.

20. Evidence Code Section 703.5 confers on a mediator an independent privilege not to testify about statements or conduct by parties at a mediation.
    True.
    False.

ANSWERS

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

1. [ ] True [ ] False
2. [ ] True [ ] False
3. [ ] True [ ] False
4. [ ] True [ ] False
5. [ ] True [ ] False
6. [ ] True [ ] False
7. [ ] True [ ] False
8. [ ] True [ ] False
9. [ ] True [ ] False
10. [ ] True [ ] False
11. [ ] True [ ] False
12. [ ] True [ ] False
13. [ ] True [ ] False
14. [ ] True [ ] False
15. [ ] True [ ] False
16. [ ] True [ ] False
17. [ ] True [ ] False
18. [ ] True [ ] False
19. [ ] True [ ] False
20. [ ] True [ ] False
and (4) how much the testimony would contribute toward protecting those rights or advancing those interests—an inquiry that includes, among other things, an assessment of whether there are alternative sources of evidence of comparable probative value.31

Rinaker and Olam are applicable when 1) a party to a mediation settlement agreement, in which all of the parties have expressly waived mediation confidentiality, wants the mediator to testify as to what took place at the mediation, and 2) a due process violation might occur if mediation confidentiality were to prevent a mediator’s testimony.

The court reasoned that the attorney-client privilege and mediation confidentiality statutes achieve separate and unrelated purposes. The former “allows the client to consult frankly with counsel on any matter, without fear that others” may use these confidences, whereas the latter “serve the public policy of encouraging the resolution of disputes by means short of litigation.”

As the supreme court noted in Simmons v. Ghaderi,32 parties seeking the trial court’s assistance in enforcing a settlement may avoid mediation confidentiality by expressly waiving its application. According to Evidence Code Section 1122(a)(1) and (2), a mediation writing is admissible if all participants agree to its disclosure and it does not reveal anything said or done during the mediation. To be valid, the waiver must be clear and unambiguous. Thus, a mediation settlement agreement should incorporate the language of Evidence Code Section 1123(a), (b) and (c) and state either that the agreement “provides that it is admissible or subject to disclosure….,” is “enforceable or binding…,” or “all parties to the agreement expressly agree in writing, or orally in accordance with Section 1118, to disclosure of the agreement.”33

Thus Foxgate and its progeny allow attorneys and mediators to report to the trial court the failure of an attorney or party to appear at a mediation. However, unless disclosure is permitted by consent of the parties or required to uphold a due process right, all communications during the mediation process, no matter how scurrilous or misleading, are confidential in California’s state courts—until the legislature states otherwise.34

The Impact of Cassel

This year, Cassel v. Superior Court reaffirmed the scope of mediation confidentiality in California’s state courts.35 The California Supreme Court was faced with two clear options—continue to hold that mediation confidentiality should be liberally construed despite the surrounding circumstances, or find that confidentiality should not be used to shield negligent attorneys from malpractice suits. The court chose to stay the course and held that mediation confidentiality has few exceptions.

In Cassel, the plaintiff filed a complaint against his former attorneys for breaching their professional, fiduciary, and contractual duties. The plaintiff claimed that the defendants forced him to settle a case through the use of bad advice, deception, and coercion. To prove his case, Cassel wanted to introduce as evidence his conversations with his attorneys immediately preceding and at the mediation. The trial court ruled that these discussions were inadmissible. The court of appeal granted mandamus relief, reasoning that mediation confidentiality statutes are not intended to prevent a client from using communications with his or her lawyer outside the presence of all other mediation participants in a legal malpractice case against the lawyer.

Cassel begins with a reminder that the legislature has provided only one exception to mediation confidentiality—an express waiver by the participants. Moreover, the judicially crafted exceptions are only available when “due process is implicated, or where literal construction would produce absurd results, thus clearly violating the Legislature’s presumed intent.”36 The court reviewed Foxgate, Rojas, Fair, and Simmons—cases that, collectively, are authority for the broad application of mediation confidentiality.37 With these decisions as a foundation for its ruling, the Cassel court held that the purpose of Evidence Code Section 1119(a)—which provides that “[n]o evidence of anything said or any admission made for the purpose of, in the course of, or pursuant to, a mediation…is admissible or subject to discovery….”—extends to all oral communications at a mediation, even if they only take place between parties and their own attorneys.38

The Cassel court also found that the plaintiff’s discussions with his attorneys before the mediation concerning mediation strategy and settlement were confidential because Section 1119(a) and (b) applies to all utterances and writings “for the purpose of, in the course of, or pursuant to, a mediation.” Instead of attempting to create a bright-line test for establishing when a pre- or post-mediation utterance or writing is related to mediation and thus confidential, the court simply held that the plaintiff’s discussions with his attorneys came within the statute because they “concerned the settlement strategy to be pursued at an immediately pending mediation…[and] were closely related to the mediation in time, context, and subject matter….39

The court in Cassel notes that the mediation confidentiality statutes are unlike Evidence Code Section 958—which eliminates confidentiality protections otherwise afforded by the attorney-client privilege in suits between clients and their lawyers—because the mediation confidentiality statutes contain no exception for legal malpractice actions. The court reasoned that the attorney-client privilege and mediation confidentiality statutes achieve separate and unrelated purposes. The former “allows the client to consult frankly with counsel on any matter, without fear that others” may use these confidences, whereas the latter “serve the public policy of encouraging the resolution of disputes by means short of litigation.”40

The Cassel court also discussed the nonapplicability of the due process exception and the more general “absurd result” test to the facts before it. Due process was not a factor because “the mere loss of evidence” in a lawsuit for civil damages does not implicate a fundamental interest. Nor did the result produced by applying the plain terms of the statutes to the facts of the case create a result that was absurd or clearly contrary to legislative intent.41

In sum, the Cassel court reversed the appellate court judgment and left the plaintiff with the inability to introduce evidence of his attorneys’ alleged misconduct immediately prior to and at the mediation. The short-term impact of Cassel’s extensive analysis should foreclose
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further lower court attempts to carve exceptions to mediation confidentiality. This effect may not last too long, however. While the court chose not to create a bright-line rule allowing clients to use communications with their attorneys at mediations in subsequent malpractice actions, it unambiguously invited the legislature to do so: “Of course, the Legislature is free to reconsider whether the mediation confidentiality statutes should preclude the use of mediation-related attorney-client discussions to support a client’s civil claims of malpractice against his or her attorneys.” This far-from-subtle invitation may be hard for the legislature to ignore, especially if it also considers Justice Ming Chin’s reluctant concurrence that shielding attorneys from being held accountable for their incompetent or fraudulent actions during mediation “is a high price to pay to preserve total confidentiality in the mediation process.”

The Ninth Circuit

The federal district courts and court of appeals in the Ninth Circuit take a different approach toward mediation confidentiality than do California’s state courts. With no federal statute governing the concept, each of the four federal districts have adopted their own local rules. For example, in a commentary to its local rules regarding mediation, the Northern District—while relying, in part, on Foxgate, Rosas, and Sammons—noted that the concept of absolute mediation confidentiality may be excused in “limited circumstances in which the need for disclosure outweighs the confidentiality of a mediation.” These circumstances include threats of death or substantial bodily injury, the use of the mediation to commit a felony, and the right to cross-examination in a quasi-criminal proceeding.

The Eastern District provides that all communications during that court’s Voluntary Dispute Resolution Program (VDRP), except as otherwise required by law or stipulated in writing by all parties and the neutral, are privileged and confidential. One exception to confidentiality in the Eastern District is that a communication may be disclosed to the assigned judge if “ordered by the court—after application of pertinent legal tests that are appropriately sensitive to the interests underlying VDRP confidentiality—in connection with a proceeding to determine: whether a person violated a legal norm, rule, court order, or ethical duty during or in connection with the VDRP session.” The Eastern District local rules do not apply to mediation proceedings conducted outside the court’s VDRP unless stipulated to by the parties.

The Central District has proposed that courts, mediators, all counsel, and other persons attending mediations “shall treat as confidential information” the contents of the written mediation statements, any documents prepared for the purpose of, in the course of, or pursuant to the mediation, anything that happened or was said relating to the subject matter of the case in mediation, any position taken, and any view of the merits of the case expressed by any participant in connection with any mediation. The Southern District protects “[a]ll proceedings of the mediation conference, including any statement made by any party, attorney or other participant.”

The mediation confidentiality rules fashioned by the district courts in the Ninth Circuit were recently tested in the well-publicized case of The Facebook, Inc. v. Pacific Northwest Software, Inc. In that case, twins Cameron and Tyler Winklevoss and Divya Narendra sued Mark Zuckerberg, Facebook’s founder, for allegedly stealing the Facebook concept from them. In turn, Facebook sued the Winklevosses and Narendra. A Northern District Court judge ordered everyone into mediation, during which the participants signed a confidentiality agreement stipulating that all statements made during the process were privileged, nondiscoverable, and inadmissible “in any arbitral, judicial, or other proceeding.”

In the mediation, the parties entered into a written settlement, with the Winklevosses and Narendra agreeing to give up their competing company for cash and an interest in Facebook. Facebook filed a motion seeking to enforce the settlement after negotiations over the form of the final deal documents fell apart. The Winklevosses and Narendra argued that the settlement agreement was unenforceable because it lacked certain material terms and had been procured by fraud.

The district court found the settlement agreement enforceable, in part, because what was said and not said during the mediation was excluded under the Northern District’s Alternative Dispute Resolution Local Rule 6-11. Because there are no federal rules or statutes concerning mediation confidentiality, California’s federal district courts have adopted their own approaches to the matter. The court found that the rule creates a “privilege” for “evidence regarding the details of the parties’ negotiations in their mediation.”

On appeal, Ninth Circuit Court of Appeals Chief Judge Alex Kozinski, writing for a unanimous court, affirmed the exclusion of the alleged mediation misrepresentations—but with reasoning that differs from the California Supreme Court’s approach to the issue. Facebook undercuts the effectiveness of the district courts’ local rules: “It’s doubtful that a district court can augment the list of [federally created] privileges by local rule.”

The court then proceeded to sidestep this
conundrum of its own making by holding that the local rules did not apply because the parties had used a private mediator.54

The Ninth Circuit further held in Facebook that the district court had been right to exclude the proffered evidence because the parties’ confidentiality agreement provided that all statements made during the course of the mediation were privileged settlement discussions and inadmissible for any purpose, including in any legal proceeding.55 Accordingly, the Ninth Circuit affirmed that the Winklevosses and Narendra had been properly prohibited from introducing evidence of any alleged mediation misrepresentations.56

Facebook unambiguously holds that parties in federal proceedings, when involved in private mediations, can negotiate for the total confidentiality of mediation communications. Less clear is the status of confidentiality in federal courts in the Ninth Circuit for mediations conducted by court-appointed neutrals. Added to this confusion is that each of the Ninth Circuit’s four district courts has its own approach to confidentiality. In contrast, the mediation communications in Facebook would have been absolutely confidential in a California state court whether the mediator had been privately retained or court appointed and whether or not the parties had agreed in writing to apply confidentiality to all court proceedings—as long as the parties had complied with the requirements of Evidence Code Sections 1122 and 1123.

For now, practitioners in California state courts should know that the exceptions to mediation confidentiality are rare. However, the California Supreme Court in Cassel has invited the state legislature to revise the mediation confidentiality statutes so that they do not protect acts of legal malpractice. Practitioners in the federal courts in California should be aware that, in the absence of a controlling statute, the courts’ approach to mediation confidentiality is more ad hoc. ■

2 BUS. & PROF. CODE §6068(d); CAL. RULES OF PROF’L CONDUCT R. 5-200 (B).
4 Foxgate, 26 Cal. 4th at 13.
5 EVID. CODE §§1115 et seq.
6 EVID. CODE §1119.
7 See the Alternative Dispute Resolution Act of 1998, 28 U.S.C. §651(b). The act gives U.S. district courts the right to authorize, by local rule, the use of alternative dispute processes in all civil actions.
8 Foxgate, 26 Cal. 4th at 13.
9 Id. at 17.
10 Id. at n.13.
11 Id. at 14.
12 Id.
15. Id. at 197.
16. Id.
18. Id. at 583.
19. Id. at 584-88.
21. Simmons, 44 Cal. 4th at 582.
25. Id. at 170.
26. Id.
27. Id. at 171.
29. Id. at 1132-33.
30. Simmons v. Ghaderi, 44 Cal. 4th at 580.
31. See also Fair v. Bakhtiari, 40 Cal. 4th 189, 197, 199-200 (2006).
33. See also Wimsatt v. Superior Court (Kausch), 152 Cal. App. 4th 137 (2007) (affirming the extension of mediation confidentiality to any writing or statement that would not have existed but for a mediation), quoted with approval in Cassel v. Superior Court, 51 Cal. 4th 113 (2011).
34. Cassel, 51 Cal. 4th at 128.
35. Id. at 137.
36. Id. at 132.
37. Cassel, 51 Cal. 4th at 113. 
38. Babasa v. Lenscrafter, Inc., 498 F. 3d 972 (9th Cir. 2007) (affirming the extension of mediation confidentiality). Babasa—which preceded Facebook and has been mentioned by at least one commentator as applicable to federal mediation confidentiality—is not on point. Babasa is a federal remand case in which the trial court relied upon a letter from one of the parties that arguably was protected by California’s mediation confidentiality statutes. Whether the trial court could or could not rely upon that letter as a basis for remand became a nonissue after the appellate court found that California privileges did not apply, since the Federal Rules of Evidence limit the application of state privileges in federal proceedings. Still, Babasa is incorrect when it states that California’s mediation statutes have created a privilege. California’s privileges are found in Evidence Code §§900 et seq.; the mediation statutes are in Evidence Code §§1115 et seq. Cassel v. Superior Court distinguishes the applicability of certain privileges and mediation confidentiality when a client sues his or her attorney for malpractice arising out of mediation. Cassel v. Superior Court, 51 Cal. 4th 113, 132 (2011).
39. Facebook, 640 F. 3d at 1041.
40. Id.
41. Id.
42. See 28 U.S.C. §651(b) and note 7, supra.
44. E.D. Cal. Local R. 271(m)(1).
46. E.D. Cal. Local R. 271(iii).
50. See Babasa v. Lenscrafter, Inc., 498 F. 3d 972 (9th Cir. 2007), Babasa—which preceded Facebook and has been mentioned by at least one commentator as applicable to federal mediation confidentiality—is not on point. Babasa is a federal remand case in which the trial court relied upon a letter from one of the parties that arguably was protected by California’s mediation confidentiality statutes. Whether the trial court could or could not rely upon that letter as a basis for remand became a nonissue after the appellate court found that California privileges did not apply, since the Federal Rules of Evidence limit the application of state privileges in federal proceedings. Still, Babasa is incorrect when it states that California’s mediation statutes have created a privilege. California’s privileges are found in Evidence Code §§900 et seq.; the mediation statutes are in Evidence Code §§1115 et seq. Cassel v. Superior Court distinguishes the applicability of certain privileges and mediation confidentiality when a client sues his or her attorney for malpractice arising out of mediation. Cassel v. Superior Court, 51 Cal. 4th 113, 132 (2011).
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IN SEPTEMBER, President Barack Obama signed the Leahy-Smith America Invents Act (AIA), the most significant reform of U.S. patent law in decades. The AIA increases opportunities for companies and individuals to challenge issued U.S. patents through the U.S. Patent and Trademark Office (PTO) instead of the courts. This new legislation has drawn attention to the PTO’s system of ex parte and inter partes reexamination and how a party can use that system to invalidate a patent and affect litigation.

Reexaminations can be a powerful weapon in the hands of those who seek to invalidate a patent. The PTO reports that since the inception of the ex parte reexamination program in July 1981, 66 percent of all ex parte reexaminations resulted in changes to the reexamined claims, and 11 percent resulted in cancellation of all the claims. Additionally, since the inception of the inter partes program in November 1999, 43 percent of all inter partes reexaminations have resulted in amendment of the claims, while 44 percent have resulted in cancellation of all claims.

While reexamination is not conducted in the courts, it is often pursued to invalidate a patent being asserted against a defendant in a patent infringement lawsuit. The statistics demonstrate that reexamination should certainly be considered in that context. The potential benefits, however, must be weighed against the risk that reexamination can back-
For example, the PTO may find that the accused infringer’s prior art defenses are not persuasive and refuse to reject claims based on that prior art. In one case, the PTO issued a reexamination certification for Amazon’s much-criticized one-click patent. The reexamination lasted four years but resulted in only a minor amendment of the claims. Many would argue that the reexamination left Amazon with a stronger patent.

As the arguably failed attack on Amazon’s one-click patent demonstrates, litigants considering reexamination must evaluate such factors as 1) the facts of the individual case, 2) the objectives of the challenger, 3) the time available to pursue the challenge, 4) prior art, 5) the effects of reexamination on litigation, and ultimately 6) the likelihood that a patent may survive reexamination with claims that are even stronger and more difficult to challenge in litigation.

Anyone can request that the PTO conduct an ex parte reexamination of an issued patent to examine the validity of the patent based on a substantial new question of patentability raised by the requester. An ex parte request can be made anonymously. Typically, this is done so that the requester does not become the target of a patent infringement action. After the request has been made, a third-party requester has no further right to participate in the process. A requester can, however, file more than one petition for reexamination and can do so while other requests are pending. These reexaminations will typically be merged together and decided by the same patent examiner. Because the requester does not participate in the reexamination, it is not estopped from challenging the patent in subsequent litigation.

Inter partes reexaminations are currently available only for patents that issued based on applications filed on or after November 29, 1999. Beginning on September 16, 2012, they will be available for any patent. In contrast to an ex parte reexamination, the requester in an inter partes reexamination has the right to participate in the PTO proceedings; the requester can respond to the arguments of the patentee and the PTO. Only third parties can request an inter partes reexamination, not patentees or their privies. The requester in an inter partes reexamination is estopped in subsequent litigation from raising art that was raised, or that could have been raised, in the reexamination. The estoppel does not apply, however, to prior art that is “newly discovered” and that was “unavailable to the third-party requester and the [PTO] at the time of the inter partes reexamination proceedings.” The inter partes requester also must wait until reexamination is complete before filing another inter partes petition. The requester may also later find itself limited to the positions it took during the inter partes proceeding and estopped from taking inconsistent positions in litigation.

The choice of whether to file an ex parte or inter partes reexamination depends on the goals of the requester. If the objective is a prompt rejection of the claims—for example, to put pressure on settlement—the better vehicle is an inter partes reexamination, because it will usually result in a first office action several months before an ex parte reexamination. For requesters whose objective is to seek the greatest chance of invalidating the patent, the greater participation and appeal rights offered by inter partes reexamination are preferable.

Reexamination vis-à-vis Litigation

Reexamination in either form should also be considered in light of whether litigation will be pursued. Ex parte and inter partes reexaminations can be more favorable than litigation for patent challengers. First, reexamination is much less expensive than litigation. While it is not unusual for litigants to incur millions of dollars in fees, an ex parte reexamination petition can often be filed for less than $50,000. Even the most straightforward patent litigation is almost always more expensive than even the most complicated inter partes reexamination.

Second, the standard of proof for a patent challenger is lower in a PTO reexamination than in litigation. In litigation, patents are presumed valid, a challenger can prevail only by presenting “clear and convincing evidence” of invalidity. In contrast, during a reexamination, the patent is not presumed valid, and only a “preponderance of the evidence” must point to a claim being invalid.

Third, the scope of interpretation of the patent’s claims is different in reexamination and litigation. District courts typically interpret claims narrowly, in order to sustain their validity over a defendant’s prior art challenges. In reexamination, however, the PTO gives a claim its broadest reasonable interpretation, making it more likely the new prior art will read on it and the claim will be found invalid.

Fourth, the fact finders in reexamination are examiners from the Central Reexamination Unit. They are highly skilled in patent examination and the technology of the patents. In contrast, the fact finder in litigation is typically a jury, whose members typically have no legal or technical education. Jurors often believe that they simply are not capable of second-guessing the decision of the experts at the PTO.

Ligation does, however, offer some of its own advantages over reexamination. Litigation provides no option for patentees to rewrite their claims to defeat an accused infringer’s prior art defenses. Therefore, if an accused infringer finds prior art that clearly invalidates broadly written claims, it may prefer to litigate and even to seek an early summary judgment of invalidity. In addition, unlike reexamination, litigation provides parties with the opportunity to take discovery, including discovery from the inventor and from third parties, which may uncover evidence of prior art. Furthermore, a jury trial may provide a more powerful opportunity to present a strong invalidity defense than would a written submission to the PTO’s Central Reexamination Unit. Lastly, while a reexamination can only be based on patents and printed publications, a litigant can challenge validity on any basis that could have resulted in rejection of the original application.

Reexamination during Litigation

The potential advantages of litigation do not preclude reexamination. A party may file a reexamination request during litigation but should consider timing. It is almost always preferable to file the reexamination as early as possible. However, defendants sometimes seek reexamination in later stages of a case—for example, after a plaintiff construes the claims in a patent more broadly than the claims were construed by the PTO during the original examination of the patent application. The plaintiff is bound by that construction during the reexamination.

Another issue to consider regarding reexamination during litigation is a stay. Courts have discretion to stay litigation in response to a reexamination. District courts generally consider three factors in deciding whether to stay a case: 1) whether a stay will simplify issues at trial, 2) the status of litigation at the time of the request, and 3) prejudice to the patentee.

Some courts have been skeptical about whether reexamination actually simplifies a case. This view is based, in part, on statistics showing that—particularly in the case of ex parte reexaminations—patents are likely to survive in some form even after PTO review.

At the other extreme, courts have suggested that a reexamination can simplify a case enough to justify a stay even if the reexamination does nothing more than provide greater insight into how the claims should be construed. Some judges, however, will only find that a reexamination will sufficiently simplify the issues if defendants agree to suffer the claim preclusion effects of inter partes reexamination.

Courts also have differing views on how long a litigant can wait before seeking a stay based on a reexamination. For instance, in the Northern District of California, a court found that a reexamination request that was filed less
than two months after the federal action was filed was acceptable; yet, in another action, a court in the Eastern District of Texas found that a similar two-month delay in filing a reexamination request was not justified. As recent decisions indicate, it is better to request reexamination promptly.

The evaluation of prejudice resulting from a stay also varies among jurisdictions. For example, the Eastern District of Texas has taken note of the long delays (as much as 78 months) patent owners must endure before the PTO will conclude a reexamination. Other courts (such as the District Court for the Northern District of California) have not found the delays caused by reexamination as persuasive in showing prejudice. In addition, courts have sometimes found that a showing of undue prejudice from a stay is easier to meet when the parties are competitors and continuing infringement could affect the parties’ relative positions in the marketplace. Other courts, however, have noted that allowing a competitor to continue selling an allegedly infringing product is no more prejudicial during reexamination than during litigation.

**Other Litigation Issues**

Reexamination during litigation can affect not only stays but also preliminary injunctions. A defendant can defeat a preliminary injunction motion by showing there is a substantial question concerning validity of the patent at issue. Defendants faced with the prospect of a preliminary injunction have sometimes used reexamination to meet that burden. If, after initiating reexamination, the PTO rejects some claims, the defendant can make a persuasive argument for denial of a preliminary injunction. The AIA has changed the standard for initiating inter partes reexamination to whether a challenger has a “reasonable likelihood” of prevailing on at least one patent claim. Because this is a higher standard than the prior “substantial new question of patentability” test, it should now be easier, if the PTO decides to grant an inter partes reexamination, for a defendant to defeat a preliminary injunction motion.

Another strategic consideration regarding reexamination is that a defendant found to have infringed an issued patent may be able to nullify the judgment if it succeeds in invalidating the patent through reexamination—even if a case is not stayed and even if judgment is already entered for the plaintiff. However, the reexamination decision must come before the defendant has exhausted its appeals. Litigants may also seek reexamination to create a record to bolster a position they are asserting in litigation. For example, defendants may also use the reexamination process to support an inequitable conduct defense, which may be available if a patent applicant intentionally withheld material prior art during patent prosecution. The Federal Circuit has recently raised the standard for proving inequitable conduct, making it significantly harder to prevail on this defense. The accused infringer must now prove by clear and convincing evidence that the patent applicant knew of a prior art reference, knew that it was material, and then made a deliberate decision to withhold it. This defense may be less difficult to establish, however, if the PTO examiner uses prior art that the patentee

...
Pitfalls in Reexamination Practice

The complexities of reexamination go beyond its strategic use in litigation. Although PTO rules governing reexamination are fairly straightforward, practicing before the PTO involves nuances that can only be learned through experience. For example, an important practice in conducting reexaminations is to make each reexamination petition persuasive with respect to every claim that can be asserted in litigation. A reexamination that leaves some claims unchallenged is of little use in defending against an infringement lawsuit.

When companies are involved in multi-defendant patent litigation, it is usually a mistake for one defendant to rely on an already-pending reexamination filed by another party on independent claims and only attack the dependent claims that recite additional details of the invention. If the PTO dismisses the pending reexamination of the independent claims, there will no longer be a substantial question of patentability supporting reexamination of the dependent claims.

In addition, litigants must be mindful of the requirements of protective orders issued by district courts. These orders typically include a so-called prosecution bar that precludes those who are prosecuting patents from participating in reexamination. The purpose of a prosecution bar is to prevent use of the other party’s confidential information in drafting patent applications or patent claims. Several courts have held that reexamination of a patent is a type of patent prosecution because the claims can be changed during reexamination. Courts have, therefore, precluded attorneys involved in reexamination from having access to confidential material during litigation.

The result is that the patentee’s litigation attorneys—the ones most familiar with the prior art challenges that a defendant has been making—will often be precluded from defending the patent in reexamination. In light of this problem, it is good practice to have a separate attorney handling the reexamination from the beginning of the case. It is equally important that litigators obtain all nonconfidential documents from the patent owner during the litigation that are relevant to the defendant’s prior art challenges. These nonconfidential documents can be provided to the patent prosecutor involved in the reexamination without violating a protective order.

Another nuance of the practice is that a reexamination that appears favorable to a defendant in the initial stages of a case may turn out to be damaging by the time of trial. For example, a defendant in a patent infringement case that persuaded the PTO to issue an initial rejection of the claims may try to have evidence of the rejection admitted to the jury. But the defendant may regret having that request granted if the PTO ultimately allows some of the reexamined claims. In that event, the plaintiff will be the one who will rely on the PTO examiner’s decision, because it supports the plaintiff’s position that the claims are valid. The defendant will then be hard-pressed to exclude that evidence. The best the defendant can do in this position is explain that the PTO operates under significant limits on what it can do in reexamination.

Expected Changes to Reexamination Practice

The AIA increases opportunities to challenge or correct issued patents through PTO reexamination. Some practitioners therefore predict that the AIA may decrease federal court litigation and increase activity at the PTO. Until now, reexamination proceedings could only be brought based on prior art publications. Beginning September 16, 2012, however, Section 321 of the AIA will allow any person other than the patent owner to challenge the validity of a patent on any ground that could be used in litigation. For example, a patent may be challenged for failure to provide a written description or an enabling disclosure, and reexamination based on nonpublic prior art will be available.

To take advantage of postgrant review of patents, interested challengers must closely monitor patents as they issue, because the postgrant review must be requested within one year of the date that the patent issues. To initiate a postgrant review, the PTO director must find that it is more likely than not that at least one of the challenged claims is unpatentable.

Although postgrant review offers a less expensive way to challenge the validity of a patent, it is not without its risks. A company seeking such a review must identify itself and any other real parties in interest. An unsuccessful PTO challenge may therefore identify the challenger as a target of patent litigation. In addition, a final decision on a postgrant review will result in a finding of collateral estoppel “on any ground that the petitioner raised or reasonably could have raised during that postgrant review.”

The AIA will affect more than postgrant review. Another pending change is supplemental examination. Beginning September 16, 2012, a patent owner may file a request for supplemental examination of a patent to initiate reexamination based on information that was not disclosed during the original prosecution of the patent. If the PTO decides that the information raises a substantial new question of patentability, it will initiate reexamination. Using this procedure, patent owners who have not yet been accused of inequitable conduct in patent litigation can avoid a possible future finding of inequitable conduct based on information that they did not disclose during the original prosecution of the patent.

The AIA does not significantly change the availability of reexamination as a vehicle for challenging patents based on prior art that was not considered by the PTO. As before, reexamination may proceed either on an ex parte basis, which does not allow the patent challenger to participate after submitting the petition, or an inter partes basis, through which the challenger can respond to arguments made by the patent owner or the PTO. An inter partes reexamination may not be filed more than one year after a party that wants
to institute review has been sued for infringing the patent.

PTO reexamination allows those accused of patent infringement to present their invalidity defenses to a fact finder, the PTO, that may more fully understand patent law and technology. However, a poorly executed reexamination can leave the accused infringer worse off, facing a patent that has been inoculated against prior art challenges and been confirmed by the PTO. If properly executed, however, a reexamination can lead to a number of benefits, including: 1) nullifying an infringement judgment, 2) staying litigation, 3) providing intervening rights, 4) avoiding preliminary injunctive relief, and 5) obtaining admissions that bolster claim construction arguments or inequitable conduct defenses. Although reexamination is far from perfect, it is sure to grow in popularity as companies seek alternatives to expensive and often unpredictable district court litigation as a means of challenging the validity of patents.

5 See MANUAL OF PATENT EXAMINING PROCEDURE §2213 (8th ed. 2008).
6 37 C.F.R. §1.560.
7 37 C.F.R. §1.913.
11 Id.
12 37 C.F.R. §1.935. The requester, like the patentee, can also appeal a finding of validity to the Board of Patent Appeals and Interferences and to the Federal Circuit. 37 C.F.R. §1.983(a).
15 See MANUAL OF PATENT EXAMINING PROCEDURE §706 (8th ed. 2008).
16 See, e.g., Phillips v. AWH Corp., 415 F. 3d 1303, 1327 (Fed. Cir. 2005).
17 The PTO is more likely to find that the prior art anticipates the claims of the patent. See In re Swanson, 540 F. 3d 1368, 1377 (Fed. Cir. 2008).
21 See Soverain Software, 356 F. Supp. 2d at 662,


Compare Like.com, 2010 U.S. Dist. LEXIS 70458 with Affinity Labs of Texas, LLC, 9-08-cv-00163.


36 Inland Steel Co. v. LTV Steel Co., 364 F. 3d 1318 (Fed. Cir. 2004).
41 Id.
45 Grayzel, 162 Fed. Appx. at 966.
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Beyond _Elkins_: New Rules, New Forms, New Year!

ON WEDNESDAY, DECEMBER 14, the Family Law Section will host a program on how the California Rules of Court are being restructured and amended to implement _Elkins_ reforms in family law practice. Many new forms are being adopted. Judge Marjorie S. Steinberg, supervising judge of the Family Law Departments of the Los Angeles Superior Court; Judge Michael J. Convey, who presides in Department K of the Los Angeles Superior Court, Northwest District; and Peter M. Walzer, CFLS, a member of the Elkins Implementation Task Force and secretary of the Los Angeles County Bar Association Family Law Section, will offer guidance on these new rules and forms. The panel will also discuss how Family Code Section 217 (and Rules 5.118 and 5.119) are being implemented in courtrooms. In addition, the Family Law Section will donate $5 from every paid registration to support the operations of LACBA’s Domestic Violence Project.

The program will take place at the Los Angeles Marriott Downtown (333 South Figueroa Street). Hotel valet parking costs $13. On-site registration and the meal will be available at 5:30 P.M., with the program continuing from 6 to 9:30 P.M. The registration code number is 011473. The prices below include the meal.

- $85—CLE+ Plus member
- $140—Family Law or Barristers Section member
- $165—LACBA member
- $180—all others, including at-the-door registrants

3.25 CLE hours, including 3.25 hours of family law legal specialization credit

New Patent Litigation Pilot Program in the Central District

ON TUESDAY, DECEMBER 6, the Litigation Section and the Federal Courts Coordinating Committee will host a discussion about the new Patent Pilot Program of the Central District of California. U.S. District Court Judges Audrey B. Collins, Andrew J. Guilford, Samuel James Otero, Otis D. Wright II, and George H. Wu will offer insight into this new program and what it means for patent litigators. The discussion will take place at the Ronald F. Deaton Civic Auditorium, Downtown. On-site registration will be available at 4:30 P.M., with the program continuing from 5 to 7, followed by a meal and reception. The registration code number is 011455. The prices below include the meal. Audio conference pricing is available for this program.

- $60—CLE+ Plus member
- $100—Litigation Section member
- $135—LACBA member (including program and Litigation Section membership)
- $170—all others

2 CLE hours

Client Trust Accounting

ON WEDNESDAY, DECEMBER 7, the Real Property Section and the General Real Property Subsection will host a program in which Suzan Anderson of the California State Bar will discuss rules and case law governing the fiduciary duties applicable to client trust accounts, including what must (and what cannot) go into a client trust account, the difference between advance fees and a true retainer, and record keeping and reconciliation issues. The program will take place at the Los Angeles County Bar Association, 1055 West 7th Street, 27th floor, Downtown. Parking is available at 1055 West 7th and nearby parking lots. On-site registration and lunch will be available at noon, with the program continuing from 12:30 to 1:30 P.M. The registration code number is 011455. The prices below include the meal. Audio conference pricing is available for this program.

- $45—Real Property Section member
- $55—LACBA member
- $65—all others

1 CLE hour

The Los Angeles County Bar Association is a State Bar of California MCLE approved provider. To register for the programs listed on this page, please call the Member Service Department at (213) 896-6560 or visit the Association Web site at http://calendar.lacba.org, where you will find a full listing of this month’s Association programs.
Why Can’t Children Have Three Parents?

WHEN ASSISTED REPRODUCTION technology (ART) is used to conceive children, who the legal parents are and the rights of those parents may be unclear. Today, a child may have eight adults with a claim to be a parent, including the intended parents, the sperm donor and his partner, the egg donor and her partner, and the gestational surrogate and her partner.

As a result of ART, more married and unmarried people are arranging to have children with a third party. This may involve two men and a surrogate, two lesbians and a sperm donor, or a heterosexual couple and a known donor. Even when a physician does the insemination, which under Family Code Section 7613(b) provides that the donor is not a parent, the donor may act in a parental capacity after the child is born. Due to the lack of clarity of each adult’s role in relation to the child, litigation in this area is increasing.

Many gay men are having children with lesbians with the intent and consent of the women to be a parent to the child. Many other lesbian couples are using a known donor but do not intend for the donor to have any parental rights. The laws are not always clear on whether the non-biological mother or the donor father is a parent. The courts are being called on to decide if they will recognize the social parent (usually the lesbian mother’s partner) or the biological parent (usually the sperm donor, or “father”).

In May, 2011, the second appellate division issued a decision in a dependency court case.1 The court was faced with a married lesbian couple and a known father, with whom the biological mother had had an affair during the women’s marriage. The trial court found that all three people qualified as presumed parents and were entitled to dependency court services. The court of appeals reversed and held that the trial court must balance the three presumed parents’ claims and determine which two should be found to be parents based upon the requirements of Family Code Section 7612. As a result of this decision, this child will lose one of the adults that she considers a parent.

Many gay couples want the heterosexual model of two parents with the donor having no rights, as it preserves their nuclear family unit. However, the downside of this model is that the donors or surrogates have no right to guaranteed future contact with their biological or gestational child. This model also does not allow people to choose to move away from the heterosexual norm, nor does it provide for the child’s right to know his or her biological heritage. In the case of In Re M.C., it caused a child to lose a relationship with a parental figure.

A new multiparent model could look like kinship parenting that is used by some tribes or could provide rights like some states provide for a stepparent. It would allow the adults conceiving the child to decide if there would be three parents and what their roles would be. Possibly a new category of parenthood could be created, something that is not a full parent but still provides that a biologically connected adult is not a stranger to the child. Further, the laws could require the parties to clarify their roles with a parentage contract. A multiparent model would also allow the children to determine their own needs and could balance the children’s needs for stability with their caregiving parents with their need to know and have a relationship with their biological parent.

One problem with the multiparent model is that a donor might be able to assert rights to a child over the lesbian parents’ objections. If these disputes are brought into a courtroom, some judges might see a father as necessary to the child’s well-being, because they are viewing two same-sex parents as providing the same stability. Needing a father undermines the legal validity of the lesbian family unit.

Is it time to recognize a different model for families in which multiple adults have a legal role in raising children? In practice, this model might be harder for the adults to embrace. Who among the parents has decision-making rights regarding the children would need to be clearly defined, including who has the right to custody and/or visitation. It would allow adults to decide in advance what role each would have, and it would allow children to know their genetic parents while still recognizing their caregivers and their relationship to the children.

Count me among those who believe that it takes a village to raise children. Two of my lesbian clients chose to have children with a gay male friend. The mothers raised the children, and the father and his partner visited weekly. When the children were young, both mothers died, three years apart. As a result, the children ended up being raised for one-half of their childhood by their donor father and his partner. These children clearly benefited from their parents’ nontraditional choices, as they needed four adults to help them reach adulthood. For this family, a multiparent model was not only successful but imperative to meeting these children’s needs.

1 In Re M.C., 195 Cal. App. 4th 197 (Cal. App. 2011).

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