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Until the advent of the Internet and social media, it was easy to assume your name gave you a singular identity. You could imagine that if someone else actually had the same name as you, that person would just be a kind of doppelganger—a twin identity. Today, though, you can test that singular identity theory by simply Googling your name. (Yes, I accept that Google is now officially a verb.) But a word of warning: You may not like what you see all those people doing in your name! I tried this, and here is what I learned about Ken Swenson.

Ken Swenson is a member of AMTA in Iowa. I will let you know how that is working out as soon as I figure out what AMTA is. And where Iowa is.

Ken Swenson was a track star in college and ran in the Olympic trials. True story: I was once mistaken for Ken-Swenson-the-runner—except I didn’t even know he existed. So for 20 years I thought the old guy who said he had “heard of me” as a track athlete was a bit touched in the head. It took the Internet to prove that the joke was on me. If you’re still out there, old-guy-who-followed-obscure-track-athletes, you’re not so crazy after all.

Ken Swenson is a dentist in Queensland, Australia. Now, I like that idea. Not being a dentist, of course. I’m such a baby about tooth pain that just passing the Orajel aisle in the drugstore makes me cry. But I do like the idea of living in Australia.

One Web site noted, “To my great surprise, I received a small manila envelope in the mail today from Ken Swenson.” You think you’re surprised? I don’t even own any small manila envelopes!

Some good news: Ken Swenson can cook. Or maybe not. The online recipe for Ken Swenson’s “Cheesy Chili Dip” says that the recipe only has “two ingredients.” I am guessing those would be cheese and, er, chili?

Then there is the “Ken Swenson Forum,” a “place where people who are interested in Ken Swenson come together and discuss about [sic] Ken Swenson.” Sadly, there were no posts on the forum. I suspect this is because, according to the site rules, “no offensive words are allowed in this forum.”

The Ken Swenson Daily also is available online. Let me just say that there can be too much of a good thing, and daily Ken Swenson probably crosses that line.

Apparently Ken Swenson is a member of a pigeon racing club. (This is not a joke.) Racing pigeons sounds a bit like playing polo on goats. Riding the Tour de France on a beach cruiser. Of course, pigeon racing is probably as much of a sport as poker, and you can find that on ESPN almost 24/7. So maybe there’s hope for those speedy pigeons. It seems that Ken Swenson spends a lot of time being lost, since there are several dozen Web sites devoted to finding him. In fact, it’s a little unnerving. “Find out everything about Ken Swenson!” “Looking for Ken Swenson in Canada?” “We searched Ken Swenson…” You know the feeling that someone is watching you, but when you look up, it seems like no one is there?

The truth is, Ken Swenson is a jack-of-all-trades. He is an insurance agent, a corn and soybean farmer, a financial operations risk manager, a visual effects artist and model maker, an engineer, an appraiser, a paving contractor, a business manager, a carpet store owner, a director of government programs, a lawyer in two California locations at the same time, and also, most unfortunately, deceased. Twice. However, since Ken Swenson is also a minister, I have high hopes for Ken Swenson’s afterlife.

Ken Swenson is in-house counsel for Bank of America in Los Angeles. He is the 2011-12 chair of the Los Angeles Lawyer Editorial Board.
McKool Smith and Hennigan Dorman LLP have joined to solidify a national litigation powerhouse with more than 165 trial lawyers across offices in Austin, Dallas, Houston, Los Angeles, Marshall, New York, and Washington, DC. The combined firm, McKool Smith, will do business as McKool Smith Hennigan in California.

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Shaping the Role of ACOs in the Government’s New Healthcare Program

BY SAM WALD

A PRIMARY GOAL of the Patient Protection and Affordable Care Act (PPACA) is to make the country’s healthcare delivery system more effective and efficient, and one of the most discussed vehicles for achieving that goal is the Accountable Care Organization, or ACO. Section 3022 of the PPACA mandates the Secretary of the Department of Health and Human Services (HHS) to establish a Medicare Shared Savings Program no later than January 1, 2012. The purpose of the program is to “promote accountability for a patient population and coordinate services under [Medicare] Parts A and B, and encourage investment in infrastructure and redesign of care processes for high quality and efficient service delivery.”

Congress has begun to examine critical questions related to the role of ACOs in American healthcare. The issues to be decided include how to align physicians, hospitals, and health plans through an ACO and how to successfully structure and implement an ACO. Given the incentives being created, ACOs have the potential to affect every aspect of the country’s healthcare delivery system.

ACOs are provider-led organizations. This means that physicians and hospitals are responsible for managing a patient’s full range of care and assuming risk for that care. True to its name, the ACO is accountable for the overall costs and quality of care for its patients. The ACO model incentivizes providers based on the value of the care provided—not the sheer volume of patients treated. Incentives are designed to compel providers to place emphasis on disease management at the primary care level while encouraging coordination of care among all providers. At its best, an ACO will create more efficient care for the patient, increasing patient satisfaction and outcomes while controlling costs through preventive efforts and fewer hospital admissions.

In March, the Centers for Medicare & Medicaid Services (CMS) published regulations meant to guide the implementation of the Section 3022 mandate. Under the regulations, groups of medical providers are given financial incentives to work together in an ACO to manage care for Medicare beneficiaries. Providers can participate by joining an existing ACO or creating a new one. The specific provisions establishing the requirements for the eligibility, structure, and governance of an ACO that wishes to participate in the Medicare Shared Savings Program can be found at 42 CFR Section 425.5. In pertinent part, an ACO must meet the following requirements in order to participate:

• The ACO must be a recognized legal entity and have a Tax Identification Number.
• The ACO must enter into a three-year contract with CMS.
• The ACO must have at least 5,000 beneficiaries and a sufficient number of primary care physicians to meet the primary care needs of its patients.
• The ACO must have a mechanism for shared governance that provides its participants shared control over the ACO’s decisions.

The ACO must have a governing body that includes persons who represent the ACO participants. Participant representatives must hold at least 75 percent control of the governing body.

• The ACO’s governing body must include a Medicare beneficiary representative.

The ACO must be prepared to 1) receive and distribute shared savings, 2) repay shared losses if it takes economic risk, and 3) establish reporting systems and ensure compliance with program requirements, including quality and reporting standards.

The issuance of the proposed regulations initiated a 60-day comment period during which CMS encouraged interested members of the public—including providers, medical suppliers, and Medicare beneficiaries—to submit comments for consideration in the development of the final regulations.

The 429 pages of proposed regulations were not entirely well received by the healthcare community, due to concerns that the proposed rules created overly costly organizational and operational requirements and inadequate financial incentives. In fact, in late May, seven senators on the Senate Finance Committee sent a letter to HHS asking for the withdrawal of the proposed regulations.

Despite the delay and ensuing controversy surrounding the regulations, healthcare organizations are moving forward in organizing ACOs. For example, Blue Shield of California will head a new ACO pilot that will enroll 8,000 patients in the Central Valley. The ACO will launch in 2012 and run for at least three years. Additionally, CMS is moving forward with its proposed Pioneer ACO Model, which is designed to provide experienced ACOs with an opportunity to enhance their shared savings and quality performance abilities.

Medicare is the country’s largest purchaser of healthcare and has made a commitment to give ACOs incentives to operate. This shift will undoubtedly have an impact. Lawyers—especially those with clients in the industry—would be wise to monitor developments closely so they can provide advice to clients on the opportunities and hazards of ACOs.

The issues to be decided include how to align physicians, hospitals, and health plans through an ACO and how to successfully structure and implement an ACO.

Sam Wald formerly practiced litigation at Heller Ehrman LLP and Hunton & Williams LLP and is now a manager at Prospect Medical Systems.
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Legal and Tax Issues in Cause Marketing Initiatives

CAUSE-RELATED MARKETING is an increasingly significant means by which innovative nonprofit, tax-exempt organizations can generate revenue. As nonprofit organizations and commercial enterprises continue to build and leverage relationships, the Internal Revenue Service is giving them greater scrutiny. To avoid taxation and preserve their tax-exempt status, nonprofits must therefore ensure that these relationships are structured to comply with IRS regulations.

The Foundation Center, an online database of grants and philanthropic materials, describes cause-related marketing as “a mutually beneficial collaboration between a corporation and a nonprofit in which their respective assets are combined to: create shareholder and social value; connect with a range of constituents (be they consumer, employees, or suppliers); and communicate the shared values of both organizations.” According to the 2010 Cone Nonprofit Marketing Trend Tracker, “More than three-quarters (78%) of Americans believe a partnership between a nonprofit and a company they trust makes a cause stand out.” In addition, “59% of Americans are more likely to buy a product associated with [a nonprofit-corporate] partnership; 50% are more likely to donate to the nonprofit; 49% are more likely to participate in an event for the nonprofit; and 41% are more likely to volunteer for the nonprofit.”

Qualified sponsorship payments and commercial co-venture arrangements are the primary types of cause-related marketing relationships. A critical element in structuring a compliant, effective qualified sponsorship or commercial co-venture relationship requires an understanding of the principle of unrelated business income and its application to tax-exempt organizations. Nonprofit activities subject to unrelated business income taxation (UBIT) are currently taxed at the for-profit corporate rates in effect on the income. While no definitive UBIT test exists, a nonprofit could endanger its tax-exempt status by earning an excessive amount of unrelated business income. In addition, “[u]nrelated business income could also result in a partial or complete loss of the welfare exemption from property tax, disqualification of tax-exempt bond financing, and limitation on reduced postal rates.”

A three-prong test is applied in determining if nonprofit income is subject to UBIT: 1) the activity must be a “trade or business,” 2) the trade or business must be regularly carried on, and 3) the trade or business must not be substantially related to the exempt purposes of the organization.

First, while the term “trade or business” in the context of UBIT is not clearly defined, courts have held that the term has the same meaning as used in other Internal Revenue Code provisions. Specifically, trade or business for UBIT generally includes “any activity carried on for the production of income from the sale of goods or performance of services.” However, an activity does not lose its characterization as a trade or business merely because it is carried on within a larger aggregate of similar activities or within a larger complex of other endeavors which may, or may not, be related to the exempt purposes of the organization. Thus, by way of example, federal regulations indicate that “the regular sale of pharmaceutical supplies to the general public by a hospital pharmacy does not lose its identity as a trade or business, even though the pharmacy also furnishes supplies to the hospital in accordance with its exempt purpose.” Similarly, while an educational journal may be within an organization’s tax exempt purposes, if the organization sells advertising in the journal, the advertising revenue would be considered a trade or business separate from the organization’s tax exempt purposes. When an activity carried on for profit constitutes an unrelated trade or business, no part of that trade or business is excluded from the classification merely because it does not result in profit or the organization suffers a loss.

Second, whether an activity is regularly carried on is determined by the frequency and continuity “with which the activities productive of the income are conducted and in the manner in which they are pursued.” One indicator of frequency and continuity is to compare how a nonprofit carries out a trade or business with the way in which it is done by a for-profit counterpart. If a nonprofit only operates a particular activity for a few weeks, it would not be deemed to have carried out that activity on a regular basis if a commercial enterprise would do so over an entire year. Federal regulations explain, by way of example, that “the operation of a sandwich stand by a hospital auxiliary for only 2 weeks at a state fair would not be the regular conduct of trade or business, ” but if that auxiliary operated a sandwich stand once a week on a year-round basis, the activity would be considered to be carried out on a regular basis.

Activities that are deemed “intermittent” or infrequent in conduct are not considered to be regularly carried on unless these infrequent activities are consistent with those of the nonprofit’s commercial counterparts. Income from an annual fund-raising event would not be considered a regularly carried on trade or business by a tax-exempt organization. A federal court also held that the one-time lease by a tax-exempt museum of an airplane to an aircraft manufacturer to test engines did not constitute a regularly conducted activity.

In contrast, if a nonprofit engages in seasonal sales of goods unrelated to its exempt purposes even for a short period, this may be considered “regularly carried on” if it occurs when commercial sales of such items also typically take place—for example, a charitable organization operating a pumpkin patch only in the fall of each year.

Third, “whether the trade or business is substantially related to exempt purposes” is determined by whether the trade or business has a causal relationship to the achievement of exempt purposes (other than through the production of income). The IRS equates a “causal” relationship with a substantial relationship under this analysis.

Kent E. Seton is the founder and managing partner of Seton & Associates, a transactional law practice in Beverly Hills. Jessica Shofler is an associate at the firm and primarily assists tax-exempt organizations. Courtney Waggoner, a former associate at Seton & Associates, is currently senior counsel for Nationwide Mutual Insurance Company in Columbus, Ohio.
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“Thus, for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.”

The classification of the relationship as “casual” or “substantial” depends on the facts and circumstances of each situation. One major factor in this analysis is the size and extent of the activity in relation to the exempt purposes the activity purports to advance. The reasonableness of a trade or business will be examined as to whether the trade or business is being carried out to support the tax-exempt purposes of the organization or if the trade or business extends beyond what is reasonably necessary to support these objectives. That portion of the activity that extends beyond what is needed to accomplish the exempt purpose of the organization would be considered an unrelated trade or business. A performing arts school that derived revenue from admission tickets for student performances carried on an activity substantially related to its tax exempt function. This was because the performances were an essential component of educating students. On the other hand, a television station operated by a state university was held to be unrelated to the university’s tax exempt purposes even though there was substantial student and faculty involvement. The rationale for this decision was that the station was run similarly to a commercial station and the few factors that distinguished the station from a for-profit venture did not justify the scope of the commercial operations.

In evaluating if a trade or business is related to an organization’s tax exempt functions, other factors should be considered. One is the relationship of product sales to the tax exempt purposes. The proceeds of sales of articles made by handicapped individuals, which are arranged by a nonprofit formed to assist in their rehabilitation, does not constitute UBIT. A different situation is presented where a facility or certain assets are used for both tax-exempt and commercial purposes, such as a museum that has a theater that is used both to present educational programs and to screen commercial films when the museum is closed. The latter is not related to the exempt purposes of the museum and would be deemed UBIT. A final consideration is whether the trade or business is a commercial exploitation that contributes substantially to the tax exempt purposes of an organization. A well-regarded research institute selling endorsements of various research equipment to manufacturers of such equipment was found to be conducting an unrelated trade or business.

Although a trade or business would be considered UBIT under the above three-pronged analysis, the IRS has also created exceptions. Of these exceptions, the one for “qualified sponsorship payment” is important to cause-related marketing because it allows a tax-exempt organization to accept sponsorship monies from for-profit companies without incurring UBIT.

The term “sponsorship” often brings to mind a situation in which Company X gives $10,000 to Nonprofit Y towards Nonprofit Y’s 5K run or gala event. In return, Nonprofit Y recognizes Company X as a “sponsor.” The IRS has imposed strict rules on what constitutes a “qualified sponsorship payment” and established the adverse consequences that can result for a tax-exempt organization that accepts corporate monies that do not qualify as these types of payments. Generally, the IRS defines a “qualified sponsorship payment” as “any payment made by any person engaged in a trade or business to which there is no arrangement or expectation that such person will receive any substantial return benefit other than the use or acknowledgment of the name or logo (or product lines) of such person’s trade or business in connection with the activities of the organization that receives such payment.” The activity that is being sponsored is usually irrelevant and may or may not be related to the tax-exempt organization’s mission. Also, the activity may be a one-time event or may be permanent. Payment includes “the payment of money, transfer of property, or performance of services.”

To ensure that a tax-exempt organization will not be subject to UBIT in accepting sponsorship monies, its board of directors and professional advisers must determine if the for-profit entity is receiving a “substantial return benefit” from the relationship. The IRS considers a “substantial return benefit” to be anything other than a “use or acknowledgment” or a “disregarded benefit” by the tax-exempt organization.

“Use or acknowledgment” may include “exclusive sponsorship arrangements; logos and slogans that do not contain qualitative or comparative descriptions of the payor’s products, services, facilities or company; a list of the payor’s locations, telephone numbers or Internet address; value-neutral descriptions, including displays or visual depictions, of the payor’s product-line or services; and the payor’s brand or trade names and product or services listings.” The tax-exempt organization may also display the sponsor’s logos or slogans, display or distribute (for free or for compensation) a sponsor’s product line to the general public at the sponsored activity, and sell or use the sponsor’s products. On the other hand, advertising is excluded from this definition and will trigger UBIT. “Advertising includes messages containing qualitative or comparative language, price information or other indications of savings or value, an endorsement, or an inducement to purchase, sell, or use any company, service, facility or product.” If the for-profit entity is receiving a substantial return benefit from the relationship, then the arrangement will not qualify as a qualified sponsor payment and the tax-exempt organization will likely be subject to UBIT.

In addition to “use or acknowledgment,” a sponsor may receive those benefits that fall within the scope of “disregarded” without subjecting the tax-exempt organization to UBIT. “[B]enefits are disregarded if the aggregate fair market value of all the benefits provided to the payor...during the organization’s taxable year is not more than 2% of the amount of the [sponsorship] payment.” If the benefits exceed this disregarded amount, then the entire amount of the sponsorship payment, and not just the sum above 2 percent, will be considered a substantial return benefit and subject the tax-exempt organization to UBIT. The benefits that must be included in this aggregate calculation include advertising, exclusive provider arrangements (i.e., those that limit the “sale, distribution, availability, or use of competing products, services, or facilities in connection with an exempt organization’s activity”), goods, facilities and other privileges (e.g., complimentary tickets, pro-am playing spots in golf tournaments, receptions for major donors), and rights to use the intangible assets owned by the tax exempt organization (e.g., trademarks, patents, copyrights, logos).

Consider the following example. A for-profit entity provides drinks, refreshments, and prizes to a tax-exempt organization for a charity walkathon. The organization recognizes the corporation by “listing the corporation’s name in promotional fliers, in newspaper advertisements of the event and on T-shirts worn by participants.” The charity also changes the name of the event to include the corporation’s name to acknowledge the sponsorship. Each of these activities is an acknowledgment and the items provided to the tax-exempt organization are not considered UBIT. However, if the sponsorship payment is contingent on a certain attendance level or other success measure being achieved by the charitable event, that support will not constitute a qualified sponsorship payment and will be subject to UBIT.

In addition to qualified sponsorship arrangements, many for-profit organizations engage in promotional or cause-based marketing campaigns that are typically described...
as “commercial co-ventures,” which are defined and regulated by state law. In California, a for-profit company will be considered part of a commercial co-venture when it, “for profit, is regularly and primarily engaged in trade or commerce other than in connection with the raising of funds, assets, or property for charitable organizations or charitable purposes, and…[it] represents to the public that the purchase or use of any goods, services, entertainment, or any other thing of value will benefit a charitable organization or will be used for a charitable purpose.” 43 Through these arrangements, consumers become aware that a portion of their purchases will benefit a designated charity. In addition to raising UBIT issues for a tax-exempt organization, a commercial co-venture relationship also imposes an obligation on the tax-exempt organization to ensure that it actually receives the funds that the general public thinks would be generated from that relationship.

The Foundation Center credits American Express with the first “cause-related marketing” campaign. American Express “used the phrase ‘cause-related marketing’ in 1983 to describe its campaign to raise money for the Statue of Liberty’s restoration.” 44 The company agreed to donate one cent to the project each time a card holder used an American Express credit card. This co-venture relationship was able to raise nearly $19 million dollars for the restoration project. 45 More recently, rock musician Bono started Red, a large scale commercial co-venture initiative. During the past few years, this campaign has generated more than $22 million to fight HIV and AIDS in Rwanda through consumer purchases of clothing, accessories, and other merchandise branded “(Product) RED.” 46 The New York Times reports that “[a]ccording to Rwandan officials, Red contributions have built 33 testing and treatment centers, supplied medicine for more than 6,000 women to keep them from transmitting HIV to their babies, and financed counseling and testing for thousands more patients.” 47 This year, the Nancy Davis Foundation for Multiple Sclerosis, a tax-exempt organization, teamed up with Harry & David, a purveyor of gourmet food products and gifts, for the Orange Campaign—a commercial co-venture arrangement. 48 Harry & David advertised to the public that 20 percent of the profits generated from the sale of six-pound boxes of its Royal Oranges would be donated to the foundation. 49 This relationship not only benefitted the Nancy Davis Foundation by raising funds and awareness of multiple sclerosis, but also created goodwill for Harry & David.

Despite these apparently mutually beneficial relationships, many states’ attorneys general have created detailed and comprehensive frameworks for regulating these initiatives to ensure that charitable donations reach their intended tax-exempt recipients. In California, these arrangements are subject to the Uniform Supervision of Trustees for Charitable Purposes Act. 50 Once the regulations required under this act are triggered by the creation of a commercial co-venture arrangement, for-profit entities and the charities they hope to help are required to have either 1) a written agreement containing specific statutory language prior to the commencement of the relationship or any representations to the public, or 2) registered the for-profit entity with the California attorney general’s office and paid an annual registration fee of $200. 51 In addition, states’ attorneys general often impose specific requirements concerning when a commercial co-venture partner must transmit monies to the charity and the reports and accounting that must be prepared and delivered in connection with these transactions. For-profit organizations operating in California must transfer charitable funds raised during a commercial co-venture campaign to the intended tax-exempt recipient organization at the end of each 90-day period while the arrangement exists. 52 Steep penalties may be assessed for failing to comply with state-imposed requirements. The California attorney general retains the right to institute proceedings against individuals and organizations failing to comply with these requirements, and the California legislature has created statutory grounds for recovery of civil penalties of up to $10,000 as well as attorney general’s investigation fees. 53 In addition, the statute of limitations on such an action brought by the attorney general is 10 years after the cause of action accrued. 54

Cause-related marketing is becoming an increasingly prominent and effective tool. For a nonprofit, it can be a successful means of generating needed revenue while also promoting public awareness of the objectives for which the organization was formed. For a commercial enterprise, it can improve the bottom line and create immeasurable goodwill. Nonprofits and for-profits, however, must respect the legal complexities involved in structuring these relationships to preserve the tax-exempt status of the former and maximize the benefits that both hope to realize from these marketing campaigns.

3 J. Patrick Whaley, TAXATION OF INVESTMENT AND BUSINESS ACTIVITIES OF TAX-EXEMPT CORPORATIONS (CEB).
4 I.R.C. §513(a).
5 Cooper Tire & Rubber Co. Employees’ Retirement Fund, 16 T.C. 96 (1961), aff’d, 306 F. 2d 20 (6th Cir. 1962).
7 I.R.C. §513(c).
8 IRS Publication 598, TAX ON UNRELATED BUSINESS INCOME OF EXEMPT ORGANIZATIONS (rev. Mar. 2010).
10 I.R.C. §513.
11 26 C.F.R. §1.513-1(c)(1).
12 Id.
13 26 C.F.R. §1.513-1(c)(2)(ii).
14 Id.
15 26 C.F.R. §1.513-1(c)(2)(iii).
16 Id. See National Coll. Athletic Ass’n v Commissioner, 914 F. 2d 1417 (10th Cir. 1990) (Selling advertising space for annual basketball championship programs held not to be regularly carried on business.).
18 Id.
19 26 C.F.R. §1.513-1(d)(2).
20 Id.
21 Id.
22 Id.
24 26 C.F.R. §1.513-1(d)(4).
25 Iowa State Univ. of Science & Technol. v. United States, 500 F. 2d 508 (Ct. Cl. 1974).
26 26 C.F.R. §1.513-1(d)(4)(ii).
29 I.R.C. §513.
31 26 C.F.R. §1.513-4(c)(1).
32 Id.
33 26 C.F.R. §1.513-4(c)(2)(iv).
34 Id.
35 26 C.F.R. §1.513-4(c)(2)(vi).
36 26 C.F.R. §1.513-4(c)(2)(ii).
37 Id.
38 26 C.F.R. §1.513-4(c)(2).
39 26 C.F.R. §1.513-4(c).
40 Id.
41 Id.
43 Gov’t Co’n §12599.2(a).
47 Id.
49 Gov’t Co’n §12580 et seq.
50 Gov’t Co’n §12599.2 and 12586.1.
51 Gov’t Co’n §12599.2(b)(2).
52 See Gov’t Co’n §12591.1, and 12591.2.
53 See Gov’t Co’n §12596.
Compensating Receivers and Their Professionals in Bankruptcy Court

TO INITIATE A STATE COURT RECEIVERSHIP under the Code of Civil Procedure, a party to a lawsuit files a motion for the appointment of a receiver. The court-appointed receiver is an officer of the court and is generally subject solely to the supervision of the appointing judge. The terms of the receivership, including the powers of the receiver and terms of his or her appointment, are controlled by statute and the order issued by the judge appointing the receiver. The appointing order usually defines the receiver’s authority and normally includes the terms of the receiver’s compensation.

However, when the entity in receivership files for bankruptcy protection, the receiver immediately and involuntarily becomes subject to the mercy of the bankruptcy system—including a judge who initially knows little, if anything, about the case or how it was administered prior to the petition date. Among the numerous administrative issues that arise in this situation is the compensation of the receiver and the professionals that the receiver employs.

Code of Civil Procedure Sections 564 through 570 and California Rules of Court 3.1175 through 3.1184 govern receivers in state court. Although there is no specific code section governing the employment of professionals (such as accountants) other than attorneys, it is well settled that a receiver is permitted to employ nonattorney professionals to assist the receiver in the administration of the receivership estate. The rate of compensation for these employees also is not governed by any particular code section. However, the receiver’s motion to employ a particular professional generally sets forth the proposed rates of compensation. If the court approves, those rates are applied throughout the administration of the receivership estate.

Nevertheless, for the receiver and any other court-approved professionals employed by the receiver to actually receive their compensation, the receiver must file and serve a fee application and obtain approval from the court. Although there is no mandated frequency by which fee applications must be filed, it is not uncommon for the appointing order to authorize the payment of interim fees, which are subject to approval by the court under Rule 3.1183(a) of the California Rules of Court. Generally, a receiver and his or her professionals are compensated by and through the various assets of the receivership estate—whether these assets exist at the time of inception, or are recovered by the receiver, or generated through liquidation. If there are insufficient funds to compensate the receiver and the professionals for the services they rendered over the course of the receivership, the party who sought to have the receiver appointed may be held responsible for the satisfaction of the outstanding fees.

This otherwise straightforward process regarding compensation can be unduly complicated by the filing of a bankruptcy petition by or against the receivership entity. Once the bankruptcy petition is filed, the receivership estate ceases to exist, and a bankruptcy estate is created. Under 11 USC Section 543(b)(1), a receiver is obligated to turn over all property of the debtor to the debtor, debtor-in-possession, or the trustee on the date that the receiver acquires knowledge of the commencement of the bankruptcy case.

In some situations, however, the receiver will be asked or desire to remain as custodian over the assets throughout the bankruptcy. If so, the receiver will need to file a motion under 11 USC Section 543(d)(1) to retain possession of the debtor’s assets. In this case the receiver should not be surprised if the debtor vigorously opposes the motion. Indeed, the debtor may have filed the bankruptcy petition to divest the receiver of his or her control over the assets. If the bankruptcy court ultimately determines that the receiver should remain as custodian of the assets, the receiver’s compensation going forward will then be determined in accordance with 11 USC Section 330.

In contrast, if the court determines that the receiver must turn over the assets, the receiver’s job is complete—but the issue of compensation is complex. Several sections of the Bankruptcy Code may be applicable when the receiver and the receiver’s employed professionals seek payment for services rendered prepetition and postpetition, and before the receiver turned over the assets to the debtor.

According to 11 USC Section 543(c)(2), “The court, after notice and a hearing, shall provide for the payment of reasonable compensation for services rendered and costs and expenses incurred by a [superseded] custodian.” Case law provides that a “custodian,” as that

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Dear Jack:

As you know, Bryan Stow, a San Francisco Giants fan, was brutally attacked by two men in the Dodger Stadium parking lot on opening day, March 31, 2011.

On May 22, 2011, Los Angeles Police Department (LAPD) SWAT officers arrested my client, Giovanni Ramirez at an East Hollywood apartment complex. LAPD Chief Charlie Beck said at a news conference that day, “I believe we have the right guy. I wouldn’t be standing here in front of you, I certainly wouldn’t be booking him later on tonight. You know this is a case that needs much more work, but we have some significant, significant pieces to it that leads me to believe that we do indeed have the right individual”.

Mr. Ramirez agreed to take a LAPD polygraph examination, to be conducted on June 1, 2011.

I retained your services as a nationally known and respected polygraph examiner. You agreed to polygraph my client at Los Angeles County Men’s Central Jail, on that day prior to the LAPD examination. Further, you agreed to monitor the LAPD polygraph examination in an observation room within Parker Center (LAPD Headquarters).

After you polygraphed Giovanni Ramirez, as you departed the jail, you telephoned me. You said, “LAPD arrested the wrong guy, Giovanni Ramirez was not on Dodger stadium property on March 31, 2011”.

On June 1, 2011, you accompanied me to Parker Center to monitor the LAPD polygraph examination. The respect shown to you by the LAPD polygraph personnel comforted me. You advised them that Mr. Ramirez passed your exam as you handed them your report.

Although this case had many interesting facets, central to Giovanni Ramirez being eliminated as a suspect, were your “non deceptive” polygraph results.

It is a tribute to your reputation that polygraph testing conducted by you is so well received and respected by the prosecution, as well as the defense. You saved my client’s life...thank you.

Very truly yours,

DONALD B. MARKS
ANTHONY P. BROOKLIER

August 4, 2011

Jack Trimarco & Associates
Polygraph/Investigations, Inc.
9454 Wilshire Blvd., 6th Floor
Beverly Hills, CA 90212
receivership assets. For example, in defeat a debtor’s request to turn over the expenses incurred by a receiver or the prosated by the bankruptcy estate for any the fund available to creditors.”

According to the court, these actions “served to increase the cost of administering trust. Moreover, the primary focus will likely be whether or not the receiver has made a “substantial contribution” to the bankruptcy estate. In addition to allowing compensation for the receiver and the professionals employed by the receiver, the Bankruptcy Code, pursuant to 11 USC Section 503(b)(3)(E), affords administraive claim status to the actual and necessary expenses incurred by a custodian or receiver superseded under 11 USC Section 543. Section 503(b)(3)(E) is one of the few sections of the Bankruptcy Code that provides the extraordinary circumstance of a prepetition expense enjoying administrative claim status. This is a priority that is awarded to very few creditors of the bankruptcy estate—and generally only those creditors who have demonstrated that they provided some measurable benefit to the estate. According to one court, administrative status is justified because “the court views the [superseded] receiver as being entitled to ‘deduct’ the expenses of the receivership from the property surrendered to the bankruptcy court.”

It is important to note, however, that in order to receive administrative priority status, the receiver must actually be superseded. That is, if the receiver continues in possession of the assets of the debtor, the receiver’s compensation will be determined in accordance with 11 USC Sections 327 and 330 going forward rather than 11 USC Section 503(b)(3)(E).

Moreover, the primary focus will likely be whether or not the receiver has made a “substantial contribution” to the bankruptcy estate. In In re Statepark Building Group, the court refused to award administrative priority to the fees incurred by the receiver and his counsel because the receiver filed the bankruptcy petition—and thus he was not superseded. In addition, the court determined that the services rendered postpetition by the receiver and his counsel did not benefit the bankruptcy estate.

Based on 11 U.S.C. Section 503’s administrative priority scheme, the legislature appears to have made a conscious decision to award administrative priority status to those claims believed to benefit the estate in some form or another. Although on its face 11 USC Section 503(b)(3)(E) does not initially seem to fit into this mold, bankruptcy courts opening on the issue have bolstered the legislative decision by relying on traditional notions of comity. For example, receivership-related expenses are elevated to administrative priority in deference to the state court’s determination regarding appointment—presumably because the state court acted appropriately in appointing the receiver to protect what eventually became property of the bankruptcy estate.

The Bankruptcy Code appears to recognize that were it not for the acts of the receiver and the receiver’s professional employees in protecting the assets of the party (later the debtor) while administering the receivership estate, the assets might not have been preserved for the benefit of the bankruptcy estate. To this end, if the receiver does not possess any assets to turn over, he or she is not entitled to an administrative claim for the fees incurred for the receiver’s prepetition services. The Bankruptcy Code presumes that unlike creditors who act primarily for their own interests, a receiver acts primarily for the benefit of the receivership estate. With due deference to the prior determination of the state court and on the assumption that the receiver has preserved the debtor’s property for the benefit of its creditors, the Bankruptcy Code ensures that the receiver will be paid for his or her prepetition work as an administrative expense.

Although the award of administrative priority is not without limitation, if the fees and costs incurred by the receiver are found to be reasonable and necessary, the court does not have the discretion to deny the receiver compensation by and through an administrative claim. Nothing in either 11 U.S.C. Section 503(b)(3)(E) or Section 543(c)(2) sets forth a standard for awarding compensation for the services of the receiver, so in determining what is reasonable, courts often look at various factors such as time, complexity of issues, estate size, and results. Also, the compensation schedules set forth under the law by which the receiver was appointed are relevant but not controlling. Further, unlike the remaining subparagraphs of 11 U.S.C. Section 503(b)(3),
subsection (E) does not require that the services of the receiver were a “substantial contribution” to the bankruptcy case.21

Once a court deems that the expenses of a receiver are not only allowable but also entitled to administrative priority status under 11 U.S.C. Section 503(b)(3)(E), the next step involves a determination of compensation for the professionals that the receiver retained for assistance with the administration of the receivership estate. Under 11 U.S.C. Section 503(b)(3)(F), reasonable compensation for professional services rendered by a receiver’s attorney or accountant—whose expenses are allowable under 11 U.S.C. Section 503(b)(3)(E)—may receive administrative priority.22

If the fees and costs incurred by the receiver’s professional employees are found to be reasonable, based upon the language in 11 U.S.C. Section 503(b)(3) that mandates this finding, the court does not have discretion to deny a request by the professionals for compensation via an administrative claim.

Interestingly, the requirement in 11 U.S.C. Section 330 that any professional who wishes to be compensated by and through the bankruptcy estate must first be employed by the bankruptcy estate does not appear to apply to receivers or their professional employees. Neither 11 U.S.C. Section 503(b)(3)(E) and (b)(4) nor Section 543(c)(2) expressly requires that the receiver or the professionals retained by the receiver obtain an employment order from the bankruptcy court or the state court as a prerequisite to receive compensation for their prepetition, postpetition, or preturnover services.23 Bankruptcy courts—which did not appoint the receiver in the first place—generally reason that they are not in an appropriate position to retroactively evaluate and determine the appropriateness of the receiver’s retention of professional assistance to act on the receiver’s behalf.24 Rather, in accordance with the standard set forth in 11 U.S.C. Section 503(b)(4), bankruptcy courts award reasonable compensation based on the time, nature, extent, and value of the professional services and the cost of comparable services. They also reimburse professionals for their actual and necessary expenses.

Few Defenses

More perplexing than the fact that a superseded receiver need not obtain an employment order from the bankruptcy court before being compensated by the bankruptcy estate, however, is the fact that the absence of a state court order authorizing the receiver to retain professionals is not fatal to an award for compensation to those professionals—irrespective of the length of the receivership. Interpreting 11 U.S.C. Section 503(b)(3)(E) and Section 543(c)(2) literally, neither section states that the actual, necessary legal expenses
of the superseded receiver must have been incurred with the prior approval of the court that appointed the receiver. Therefore, it appears that the bankruptcy filing of an entity in receivership leads to the incongruous result of allowing professionals that otherwise would not have been compensated through the receivership estate to be compensated with the highest priority afforded a creditor in the bankruptcy system—and thereby receive funds that otherwise would have inured to the benefit of the remaining unsecured creditors of the bankruptcy estate.

Furthermore, a debtor has few defenses to the allowance of an administrative claim of a receiver and his or her professionals. The debtor can assert that a portion of the post-petition expenses incurred by the receiver and the professionals were incurred either after the turnover of the assets or in an attempt to prevent or delay the turnover of the assets—and thus should not be paid. The debtor may also argue against payment by asserting that the expenses incurred were neither reasonable nor necessary. Although bankruptcy courts have the authority to evaluate the activities of the receiver and the receiver’s professionals in determining whether compensation is appropriate—and if so, in what amount—this evaluation is obviously difficult to perform retroactively, particularly when deference is accorded the state court that appointed the receiver.

The only time period during which the bankruptcy court actually has jurisdiction over the receiver and his or her professionals is after the filing of the bankruptcy petition and before the turnover of the assets is completed. This is usually only a brief period, as 11 U.S.C. Section 543(b)(1) mandates that turnover must occur as soon as the receiver learns that the bankruptcy case has commenced. The only argument by the debtor that is likely to be successful is that a portion of those fees and expenses were incurred by the receiver in an attempt to defeat the turnover.

Considering the impact that a large administrative claim of a receiver and the receiver’s professionals could have on the ability of a chapter 11 debtor to reorganize, as well as the difficulty in defeating such a claim, a chapter 11 debtor may want to reconsider filing a bankruptcy petition if the debtor’s sole motivation in doing so is to deprive a receiver of control over its assets. If a debtor is prevented from proposing a viable plan of reorganization because it is unable to satisfy all of the claims against the estate, bankruptcy protection may not provide the debtor’s hoped-for solution.

However, if a debtor has a motivation separate and apart from depriving the receiver of control over the debtor’s assets or is seeking protection under chapter 7 of the Bankruptcy

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**Los Angeles Lawyer November 2011**
Code (and is thus not obligated to satisfy all allowed claims against the estate in order to subsist in bankruptcy), the award of an administrative claim to the receiver and his or her professionals may deserve nothing more than a second thought. In any event, compensation for a receiver and the professionals whom the receiver employs is definitely an important factor to consider when determining whether the filing of a bankruptcy petition, particularly under chapter 11, is the best course of action.

1 See Cal. R. Ct. 3.1180.
3 Interim fees are subject to final review and approval by the court. The court retains jurisdiction to award a greater or lesser amount as the full, fair, and final value of the services rendered. Cal. R. Ct. 3.1183(a).
4 See Stanton v. Pratt, 18 Cal. 2d 599, 603 (1941) (citing Meli v. Crane, 102 Cal. App. 144, 282 P. 960 (1929)).
5 See Vena v. Vena, 101 Cal. App. 2d 678, 681 (1951) (“[i]t is generally held that the receiver’s expenses are payable from the receivership fund, and are not taxable against the party who procured the appointment.”).
6 In determining whether a turnover should be excused, the bankruptcy court considers whether it is in the interest of creditors and, if the debtor is not insolvent, whether equity security holders would be better served by permitting the receiver to continue in possession of the property. 11 U.S.C. §544(d)(1).
10 Id.
13 Id.
17 Id. See In re 245 Assocs., LLC, 188 B.R. 743, 748 (Bankr. S.D. N.Y. 1991); In re Posadas Assocs., 127 B.R. at 280.
21 Id.
22 In re Lake Region Operating Corp., 238 B.R. at 101.
23 Id.
ATTORNEYS WHO PARTICIPATE in the negotiation and preparation of prenuptial agreements must think ahead to the time when the marriage ends. One party or the other may be dissatisfied with the agreement, and it may be challenged. Attorneys face two dangers: First, they will be sued for malpractice. Second, they will be dragged into litigation by the parties as a percipient witness. Attorneys can protect themselves from both dangers if, from the outset of their representation, they guard against the claims that clients are likely to make.

The attorney did not negotiate the agreement on the client’s behalf. This claim is likely to be made by a party who was presented with an agreement on a take-it-or-leave-it basis. It may also be made by a party who had actually instructed his or her attorney not to negotiate the agreement.

In the latter case, the attorney should ensure that correspondence with the client confirms that the attorney was not only unauthorized to negotiate the agreement but was specifically instructed not to do so. In the former situation, no negotiation is possible. The attorney should nonetheless attempt to negotiate the agreement and create a record that negotiation was attempted. The attempt to negotiate may have no realistic chance of succeeding. But without a record that negotiation was attempted, the client is likely to claim that the lawyer was derelict in discharging the lawyer’s professional responsibilities.

For attorneys representing a client but not negotiating for the client, specific forms of documentation are necessary. The attorney should present admonitions to the client, in writing, at least twice: first, in a letter explaining the meaning and legal effect of the agreement, and then in a document entitled “Acknowledgement”.

Franklin R. Garfield is a family law attorney and mediator in Los Angeles.
A conscientious attorney promised by a relationship with the other keep your money and refuse to sign off. I do not think your agreement is fair, I will keep your money and refuse to sign off or “if obvious reasons, few attorneys are willing to those limitations should be disclosed. For limitations on the attorney’s ability to do that, have been explained to the client. If there are being hired to sign a certification that the attorney has a personal or professional rela- \tionship with the other party.6

The attorney did not explain the agree- ment to the client. A conscientious attorney usually has two compatible goals regarding representation of a client who is party to a prenuptial agreement: Explain the meaning and legal effect of the agreement, and guard against the accusation that he or she failed to do so. To accomplish these goals, an attorney should meet with the client to review the agreement in person and follow up that meeting with two written communications. The first is a one-sentence summary of each paragraph of the agreement. The second is a detailed explanation of each material provision of the agreement. A face-to-face meeting, in conjunction with those two documents, should ensure that the client is fully informed and protect the lawyer from the claim that the client did not understand the agreement.

The attorney told the client that the agreement would expire. There are many variations on this claim. For example, “My attorney told me that the agreement was invalid or unenforceable,” or “My attorney told me that the agreement would be set aside if a judge considered it unfair,” or “My attorney told me that I could renegotiate the agreement after the marriage.” When a party is trying to get out of an agreement, he or she will say just about anything. No attorney may count on a client’s loyalty, honesty, or memory. If a party discerns that what it takes to dodge the agreement is adopting a version of reality that bears no relationship to what actually transpired—and blaming the attorney in the process—that is what the party will do. It thus becomes important to create a record of what the attorney did and did not say. A separate set of acknowledgements and understandings that is prepared by the attorney and signed by the client will enable the attorney to rebut inconsistent claims that may be made by the client many years later.

The acknowledgments have nothing to do with the other party or the other party’s attorney. They are a matter that is between the attorney and the party he or she represents. The content of those acknowledgments—or even their existence—is no one else’s business. They will come in handy if and when a party ever tries to claim that the agreement was signed on the basis of purported representa- tions by the attorney that were never made. This is not a hypothetical concern. Some clients will do just about anything to get their attorneys to tell them that “you are pro- tected” or “the agreement is okay” or even that “the agreement is invalid and will not be enforced.” It is not unheard of for a client to claim that he or she only signed the agreement based on such assurances. Whenever a party asserts a claim based on the lack of inde- pendent or effective legal representation, the attorney-client privilege will be deemed waived as a condition of pursuing the claim. This is because the privilege is not absolute: When a party asserting a claim invokes privilege to withhold crucial evidence, the policy favoring full disclosure of relevant evidence conflicts with the policy underlying the privilege. Courts have resolved this conflict by holding that the proponent of the claim must give up the privilege in order to pursue the claim. Where privileged information goes to the heart of the claim, fundamental fairness requires that it be disclosed for the litigation to proceed. In short, if a party asserts the privilege, that party forfeits the right to proceed with the claim. A party is not estopped from making claims along the lines under any circum- stances. To the contrary, if a party thinks the claims will help, the party will make the claims. However, those claims will be signifi- cantly undermined by a set of contradictory acknowledgments.

The mandatory waiver of the attorney-client privilege with respect to claims that implicate the attorney’s representation has several salutary implications. If the attorney is accused of malpractice, a contemporaneous written record will be difficult to contradict. A party can hardly deny the receipt of doc- uments—such as a retainer agreement, explanatory letter, and acknowledgments—that he or she countersigned. A client’s assertion that he or she did not read or understand the documents is unlikely to be accepted.

The existence of these documents also will be a major factor in dissuading a former client from making claims that will be fatally undermined by the attorney’s file. The cli- ent’s former attorney is likely to become the star witness for the other party—an uncom- fortable situation not only for the attorney but also for the former client. This alone should deter the client, but if it does not, the attor- ney can be consoled by the fact that the dis- comfort results entirely from the client’s actions.

The consideration was inadequate. Some clients may claim that they did not receive enough in exchange for what they gave up. However, the validity of a prenuptial agree- ment does not depend on whether there is adequate consideration. To the contrary, Family Code Section 1111 provides that “[a] premarital agreement…is enforceable without consideration.” There is always a danger, however, that patently inadequate consider- ation could affect a judge’s evaluation. According to the court in Estate of Nelson, “Where the consideration to one party is so small as to shock the conscience of the court, the fact of inadequacy may be considered as a circumstance tending to support the claim of fraud.”6 Nelson is not a recent case, but practitioners should remember that some judges are more easily shocked than others.

The agreement was signed the day before the wedding. Ideally, the agreement should be signed before wedding invitations are sent out. But this is the exception rather than the rule. For that reason, this claim is common- place. Nevertheless, practitioners have several safeguards in this circumstance.

First, the Uniform Prenatal Agreement Act does not address this issue. The act requires only that the agreement must be signed no fewer than seven days “between the time that [the party against whom enforce- ment is sought] was first presented with the agreement and advised to seek independent legal counsel and the time the agreement was signed.” In Marriage of Cadwell-Faso and Faso, the court of appeal ruled that the statu- tory requirement did not apply when both
When a party is already represented by counsel in the transaction, obtaining the requisite advice can occur very quickly and no purpose is served by imposing a statutory waiting period... Further,...the legislative history reveals that the Legislature was concerned with protecting unrepresented parties. The seven-day rule allows time for the unrepresented party to locate and consult with independent counsel, or time to consider the agreement after receiving it.9

Does the seven-day requirement apply to the first draft or the final version of the agreement? This issue has been debated since the act’s passage. In its recent decision, the Cadwell-Faso court has now compounded the uncertainty. Given a conflict between the ambiguous language of the statute and the debatable interpretation of that language by an intermediate appellate court, careful practitioners should insist on asserting that the seven-day waiting period commences after the agreement is in final form under all circumstances.

Practitioners should also note that the California Supreme Court appears to be relatively unconcerned with this issue. An agreement signed the day before the wedding was upheld by the supreme court in Marriage of Bonds.10 However, the court stated that “[t]he wedding was a small impromptu affair...with no invitations or caterer, and only Barry’s parents and a couple of friends, including Barry’s godfather, Willie Mays, were invited to attend. No marriage license or venue had been arranged in advance of their arrival in Las Vegas.” A court may not be as dismissive if the wedding was a formal affair with 250 invited guests. Practitioners should assess whether the prospect of humiliation or even social embarrassment constitutes a form of coercion or duress.

Another recent court of appeal decision contributed to the debate but did not definitively resolve the issue. In Marriage of Howell,12 the trial court found that “a significant amount of preparation” had been undertaken and that financial consequences would ensue if the May 1999 wedding had been canceled when the prenuptial agreement was signed in January 1999. However, the court also found that, at a minimum, the prenuptial agreement was provided to the wife more than four months before the wedding date. This allowed the trial judge to conclude that “[t]he amount of time between the presentation of the premarital agreement and the wedding diminished the coercive force of the normal desire to avoid social embarrassment or humiliation.”

No reported California case has set aside a prenuptial agreement because it was signed too close to the wedding date. The question remains whether a future court will find that a prenuptial agreement signed after wedding invitations have been sent out should be invalidated because the fear of prospective financial loss, social embarrassment, or personal humiliation may constitute duress.13 In the meantime, an attorney may have an affirmative duty to advise the client of this mental incapacity shall constitute grounds for setting aside any of the provisions of this Agreement. The parties waive and relinquish any rights either of them may have to make a motion to set aside this Agreement on the grounds of mental or physical incapacity.

If either party to the agreement is pregnant or sick or on medication, a specific reference to that circumstance should be placed in the agreement. In addition, the agreement should contain a recital that the enumerated conditions have not affected either party’s physical or mental capacity to enter in the agreement, and the affected party is relinquishing the right to claim otherwise at any time for any reason.15

The other party’s financial disclosures were inadequate. Full, fair, and reasonable disclosure of the parties’ financial circumstances has long been considered an essential part of any prenuptial agreement. Although Family Code Section 1615(a)(2)(B) permits the parties to waive any disclosure beyond the information they provide, comprehensive disclosure strengthens the agreement. There is rarely a legitimate reason to withhold or limit disclosure of a party’s assets, debts, and, where appropriate, income.

Privacy concerns may be addressed by withholding details. “Liquid assets with a total value of SX” or “real property located in Anywhere, CA with a value of SX” is sufficient. It is not necessary to provide the names of financial institutions, account numbers, or street addresses. If a party is attaching a financial statement that has previously been prepared, sensitive information may be redacted. The parties also may agree to delete the exhibits if the agreement is recorded.

Practitioners can add an extra layer of protection by ensuring that the agreement provides for written acknowledgment that:
1) The other party has made a full, fair, and reasonable disclosure.
2) Both parties had an opportunity to request additional information.
3) Both parties are satisfied with the disclosures that have been made and waive any further disclosure.
4) No failure to disclose will constitute grounds for setting aside the agreement.

A party may hesitate to make a claim that the other party’s disclosure was inadequate when the party previously acknowledged, in writing, the adequacy of the disclosure in the agreement or waived any further disclosure.

**The agreement is unfair.** In evaluating a claim of unfairness, the issue is not whether the agreement is objectively fair. After all, fairness is a subjective concept. Rather, the question is whether the client was willing to enter into the agreement voluntarily. More often than not, one party to a prenuptial agreement considers it unfair in various particulars.

Apart from the parties’ emotional perspectives, many prenuptial agreements may seem unfair to a third party, especially in retrospect. Some judges believe that they are entitled to inquire into the substantive fairness of an agreement or even the procedural aspects of its preparation. Was it negotiated? Were concessions made? How many drafts were prepared? This approach undermines the purpose of a contract, which is to prevent one party from accepting its benefits (even if the only benefit is a marriage) and then attempting to avoid its burdens. The law does not authorize a judge to set aside an otherwise valid prenuptial agreement on the grounds that it is unfair or that it does not reflect negotiated compromises.

An attorney has no incentive to opine that an agreement is fair. When representing the weaker economic party (usually the party that does not want the agreement), the attorney should consider giving the client the following admonition: “In my opinion, the agreement is unfair to you. What you are getting in exchange for what you are giving up is insufficient. Based on that consideration alone, I advise you not to sign it.” Most likely the client will sign the agreement anyway, and a subsequent claim that he or she was relying on the advice of counsel is unlikely to be accepted.

**The attorney should have “red-flagged” certain provisions of the agreement.** Consider the scenario of a recent unpublished arbitration award, in which a prenuptial agreement provided that each party would have a half-interest in any property acquired in the names of both parties. The agreement further stated that neither party would have the right to reimbursement of any separate funds contributed to the acquisition of the property unless the right to reimbursement was set forth on the deed. The husband’s attorney explained the agreement to him, and the husband acknowledged his understanding of the agreement.

Several years later, the husband used $500,000 in separate funds to purchase real property in the names of both parties. The deed did not mention the husband’s right to reimbursement for his separate property contribution. At the time of the transaction, the husband did not consult counsel or even review the prenuptial agreement.

Subsequently, the parties divorced, and the prenuptial agreement was enforced. Pursuant to the prenuptial agreement, the reimbursement to which the husband would have been entitled under Family Code Section 2640 was disallowed.

The husband brought a malpractice action against the attorney who represented him in connection with the preparation of the prenuptial agreement. The claim was submitted to binding arbitration. The arbitrator ruled that the husband’s attorney should have “red-flagged” this provision of the agreement in writing and awarded damages to the husband.

While an unpublished arbitration award does not have the same weight as a reported appellate opinion, it is nonetheless instructive. Based on this award, attorneys must consider the possibility that a judge or jury may someday conclude that merely explaining the material provisions of the agreement is insufficient, and that certain provisions should be red-flagged both orally and in writing. Of course, the attorney must do this based entirely on speculation about future conduct of the parties—over which the attorney has no control—and the possibility that a judge may conclude that the attorney is responsible if the client simply ignores a provision of the agreement that the client claims should have been highlighted.

Clients have a tendency to assume that, once signed, the agreement will protect them; that they can put it away and forget about it for all practical purposes. For this reason, an attorney should explain that the failure to follow the agreement could deprive the client of its protections and even undermine its validity. Although there is extensive authority for the proposition that failure to follow the provisions of an agreement may constitute evidence of revocation or modification, Family Code Section 1614 requires a revocation or modification of a prenuptial agreement to be in writing. This requirement undermines claims that the agreement was modified or revoked by conduct.

Certain items in the agreement may require further action after the agreement is signed and the marriage takes place. For example, upon marriage, each spouse automatically acquires certain rights with respect to the other party’s retirement benefits. If the parties agree that their retirement benefits will be separate property, or even that each party may designate his or her beneficiaries without the other’s consent, the parties must waive their rights on forms that may be obtained from the plan administrator and that cannot be signed until the parties are married. An agreement to waive these rights in the prenuptial agreement is insufficient. For this reason, a lawyer should alert the client to the importance of obtaining the appropriate forms from the plan administrator and making sure they are signed by the other party after the marriage occurs.

Similarly, some estate planning vehicles change the character of assets from separate to community for the purpose of reducing estate taxes upon the death of either party. A client may erroneously believe that the character of property may be changed from separate to community for any purpose, such as estate planning, but preserved for other purposes, such as the dissolution of marriage. An attorney should alert the client to the danger inherent in changing the characterization of property from separate to community for any purpose.

It is not possible to red-flag every provision of an agreement—even the material provisions. However, practitioners may emphasize, both orally and in writing, that it is essential for the client to ensure that all future transactions conform to the provisions of the prenuptial agreement by consulting counsel regarding any significant transaction.

Practitioners should anticipate some claims with the addition of provisions that fall into the category of boilerplate. For example, a party may claim that his or her spouse made oral representations, commitments, and promises—either before the agreement was signed or during the marriage—that should be enforced. The agreement can guard against this type of claim with catch-all language:

This Agreement supersedes and replaces all prior written or oral agreements. Neither party has any legal rights or duties except as set forth in this Agreement. Neither party has made any representations or promises to induce the party to enter into the Agreement. No failure to follow the Agreement shall be deemed to constitute a modification of its provisions. The Agreement may only be modified or revoked in a writing signed by both parties.

Some claims border on the frivolous. A party may state that if he or she had not signed the agreement, the party would not have been able to get married. While this type of claim may seem persuasive to a party desperate to get out of the agreement, the vast majority of lawyers would consider such a claim untenable. That reality underlies vir-
tually every prenuptial agreement.
Careful practitioners have devised a host of strategies to further minimize the possibility of challenges to the agreement. One involves offering additional consideration—sometime after the marriage takes place—to the party who did not want the agreement. That consideration is conveyed pursuant to a postnuptial agreement that reaffirms all provisions of the prenuptial agreement. At the very least, it would be awkward for a party to make the same claims with respect to a prenuptial agreement and a postnuptial agreement that were signed years apart.\(^20\)

As long as there are prenuptial agreements, they will be challenged if and when the marriage ends in divorce. When memories have faded and present recollections are tainted by self-interest, the success or failure of the challenge will often be determined by the written record. In drafting prenuptial agreements, attorneys are uniquely positioned to create a written record that will someday protect them and their clients. \(^\)\(^\)\(^\)

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The following statements apply to that certain Prenuptial Agreement between _____________ and _____________ dated on _____________.

1. I was represented by _____________ in connection with the preparation of the Prenuptial Agreement. I did not hire my attorney to negotiate the terms of the Prenuptial Agreement. My fiancé and I negotiated those terms. My attorney rendered the assistance I requested. I decided when to end the negotiations.

2. I understand that any agreement could theoretically be improved upon. I also understand that attempting to improve upon an agreement in practice involves additional time, money, and emotional wear and tear with no guarantee of success. I have taken these factors into account in deciding to sign the Prenuptial Agreement in its current form.

3. I understand that I have a choice: If the Prenuptial Agreement is not acceptable to me, I am under no obligation to get married.

4. I have considered whether my willingness to enter into the Prenuptial Agreement is affected by the proximity of the wedding date, and I am willing to enter into the Agreement regardless of the proximity of that date. I am giving up the right to contend that I signed the Prenuptial Agreement to avoid the financial loss, social embarrassment, or personal humiliation that might have occurred from cancellation or postponement of the wedding.

5. I understand that recitals of fact in a written agreement are conclusively presumed to be true as between the parties to that agreement, and that I will not be able to dispute those facts at some later date.

6. I understand the material provisions of the Prenuptial Agreement. I have asked such questions of my attorney as I deemed appropriate, and I have received satisfactory answers to those questions from my attorney.

7. I understand that various provisions of the Prenuptial Agreement are commonly referred to as “boilerplate.” My attorney has explained the meaning and legal effect of each and every one of those provisions to me, and I have had the opportunity to ask questions. I am aware that all such provisions are negotiable.

8. I am satisfied with my fiancé’s financial disclosures and acknowledge that I have had the opportunity to ask questions and to request copies of supporting documents. I have waived any further disclosures of my fiancé’s financial circumstances.

9. I understand that the Prenuptial Agreement is intended to govern the parties’ legal rights and duties during the marriage, as well as upon termination of the marriage by death or divorce, unless and until it has been modified or revoked by a further written agreement.

10. I have not been told that the Prenuptial Agreement expires at any time in the future.

11. I have not been told that the Prenuptial Agreement is definitely valid and enforceable. To the contrary, I have been informed that the Agreement could be upheld or set aside if it is challenged by either party. There are no guarantees one way or the other. However, my attorney has informed me that the Agreement is likely to be upheld if the parties have complied with the provisions of the California Uniform Premarital Agreement Act. I acknowledge that I have read and understood those provisions.

12. My attorney has informed me that the parties may someday disagree about the interpretation of one or more provisions of the Prenuptial Agreement. There is no way to know how any such disagreements might be resolved, either as a result of negotiations between the parties (directly or through counsel) or by a third-party decision-maker.

13. I acknowledge that whether the Prenuptial Agreement is fair and reasonable is a matter of opinion. My attorney has not told me that the Prenuptial Agreement is fair and reasonable in [his or her] opinion.

14. My attorney has not approved the Prenuptial Agreement or advised me to sign it. My attorney has explained its meaning and legal effect to me, and I have decided to sign it. I acknowledge receipt of a letter from my attorney dated _____________ explaining the Agreement.

15. I have been informed that it is essential to consult counsel prior to engaging in any significant transaction to ensure that the transaction conforms to the pertinent provisions of the Prenuptial Agreement. I understand that nonconforming transactions will not be covered by the Agreement and may undermine its validity.

16. I am satisfied with the analysis, assistance, and advice I have received from my attorney.

17. I am signing the Prenuptial Agreement freely and voluntarily. I have had sufficient time to consider it. I have not been subjected to any coercion, duress, or undue influence.

18. I am competent to enter into the Prenuptial Agreement and to sign these Acknowledgments and Understandings. I am not mentally or physically incapacitated or impaired as a result of prescription medications, nonprescription drugs, alcohol, or any other cause.

19. I agree that all disputes between my attorney and me, including claims of professional negligence (“malpractice”), will be resolved by submission to binding arbitration pursuant to Sections 1280 et seq. of the California Code of Civil Procedure and not by a lawsuit. The decision of the arbitrator will be final. Neither party will have the right to a trial in any court. Both of us are giving up our constitutional rights to have disputes resolved by a judge or jury.

20. I have had a reasonable opportunity to consult with independent counsel before signing these Acknowledgments and Understandings. Dated: _____________

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Sample Acknowledgements and Understandings

Attorneys who represent clients in the preparation of prenuptial agreements should require them to acknowledge their understanding, in writing, of a comprehensive set of admonitions.

ACKNOWLEDGMENTS AND UNDERSTANDINGS
The following statements apply to that certain Prenuptial Agreement between _____________ and _____________ dated on _____________.

1. I was represented by _____________ in connection with the preparation of the Prenuptial Agreement. I did not hire my attorney to negotiate the terms of the Prenuptial Agreement. My fiancé and I negotiated those terms. My attorney rendered the assistance I requested. I decided when to end the negotiations.

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20. I have had a reasonable opportunity to consult with independent counsel before signing these Acknowledgments and Understandings. Dated: _____________

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agreements….

3) The parties have agreed to the material provisions of the agreement without the advice of the attorney.

2) The parties have negotiated their deal under the auspices of a mediator.

1) The agreement is being presented on a take-it-or-leave-it basis.

We have not been directed to relevant authority


4 In subsequent litigation regarding the agreement in which a party places the integrity or competence of prior counsel into issue, a party must waive the attorney-client privilege. See Pacific Tel. & Tel. Co. v. Fink, 141 Cal. App. 2d 332, 335 (1956).


2) See Chicago Title Ins. Co. v. Superior Court, 174 Cal. App. 3d 1142 (1985). The court held that the attorney-client privilege is impliedly waived when “the plaintiff has placed in issue a communication which goes to the heart of the claim in controversy.” Id. at 1149. However, the general rule is that the attorney-client privilege is sacrosanct and, because its basis is statutory, courts do not have the power to create exceptions based on notions of policy or ad hoc justification.

1) The substantive fairness of a prenuptial agreement is [generally] not open to examination….” Marriage of Bonds, 24 Cal. 4th 1, 30 (2000).


8 FAM. CODE §1615(c)(2).


5 See also Carmma v. Carmma, 544 F. 3d 988, 1005-06 (9th Cir. 2008). This type of waiver in a prenuptial agreement is ineffective.

4 ERISA allows for a waiver of surviving spouse benefits only with both spouses’ written consent in the benefits election period before the participant’s retirement. 29 U.S.C. §1055(c). See also Carmma v. Carmma, 544 F. 3d 988, 1005-06 (9th Cir. 2008). This type of waiver in a prenuptial agreement is ineffective.


1 The postnuptial agreement must comply with the parties’ fiduciary obligations as spouses. Unlike prenuptial agreements, postnuptial agreements are subject to scrutiny for fairness. This may be accomplished by ensuring that the material consideration flows only to the party who is more likely to challenge the prenuptial agreement, the consideration to the other party is the additional assurance that the prenuptial agreement will serve its intended purpose. The existence of a postnuptial agreement affirming all provisions of the prenuptial agreement discourses potential claims and mitigates the pressure to settle unmeritorious claims.

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Full Disclosures

Before vacating an arbitration decision based on the arbitrator’s lack of disclosure, courts must weigh the conflicting principles of finality and fairness

NEUTRAL ARBITRATORS IN CALIFORNIA must comply with a complex set of disclosure requirements intended to root out potential bias and ensure the integrity of the arbitration process. These rules are contained in the California Arbitration Act (CAA),1 the Ethics Standards for Neutral Arbitrators in Contractual Arbitration (adopted by the Judicial Council in 2002 as Division Six of the Appendix to the California Rules of Court),2 and the internal rules of each arbitration provider.3

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Some of the disclosure requirements are clearly defined and easily applied. Nevertheless, they are all subject to the CAA’s overarching rule, codified in Code of Civil Procedure Section 1281.9, that a proposed neutral arbitrator “shall disclose all matters that could cause a person aware of the facts to reasonably entertain a doubt that the proposed neutral arbitrator would be able to be impartial.”

This standard continues to generate disputes that find their way to the appellate courts. It does so not only because it is broad and general but also because the consequence of an arbitrator’s failure to properly disclose is so drastic: mandatory vacation of the arbitration award. With limited ability to directly challenge an arbitrator’s factual or legal conclusions, losing parties in arbitration have a strong incentive to seek vacatur by challenging the adequacy of an arbitrator’s disclosures.

The CAA and the Ethics Standards do not attempt to identify matters that must be disclosed under the appearance-of-partiality requirement. Thus, it has been left to the courts to decide, on a case-by-case basis, whether a particular “fact” would cause a reasonable person to doubt the arbitrator’s ability to be impartial. The California Supreme Court stated last year that the appearance-of-partiality rule is a “fluid concept” that takes its substance from context and cannot be reduced to simple legal rules. Certain basic themes have emerged from the cases, however—and these can guide arbitrators and lawyers confronting disclosure issues.

Practitioners should ask several questions:

• Do the facts show potential bias? The appearance-of-partiality requirement does not require disclosure of “things a party might want to know” about a potential arbitrator.
• Do the facts show that the arbitrator may have a financial incentive to favor one side over another, even if that incentive is somewhat remote from the particular case? Determining the extent of an arbitrator’s required disclosure of business activities is key to this issue.
• How old are the facts? Facts emerging from an arbitrator’s distant past are less likely to trigger a disclosure obligation than current events and relationships.
• What have the lawyers done since discovery of the facts occurred? The courts recognize that losing parties in arbitration use the disclosure rules tactically. Lawyers who are on notice of facts suggesting an arbitrator’s potential bias but do nothing until an adverse award is rendered may find an unreceptive response to a motion to vacate the award.

The Potential for Bias

Two decisions last year—one by the California Supreme Court and another by the Ninth Circuit—highlight the difference between facts showing a potential for bias and “improper” or “inappropriate” past conduct of arbitrators that fails to show that potential. In Haworth v. Superior Court,7 the supreme court was faced with a claim of potential gender bias in an arbitration brought by a female patient alleging negligence by her physician in performing plastic surgery on her lip. The arbitrator, a retired superior court judge serving as the neutral chair of a three-arbitrator panel, had been publicly censured a decade earlier based on findings that he had made sexually suggestive remarks to, and asked sexually explicit questions of, female staff members; referred to a fellow jurist’s physical attributes in a demeaning manner; and mailed a sexually suggestive postcard to a female staff member. The result was “an overall courtroom environment where discussion of sex and improper ethnic and racial comments were customary,” according to the Commission on Judicial Performance in the censure proceedings.8 Moreover, the judge had engaged in “conduct prejudicial to the administration of justice that brings the judicial office into disrepute.”9 The retired judge—now arbitrator—did not disclose the prior censure in the arbitration proceedings.

In a 2-1 decision with the retired judge in the majority, the arbitration panel decided in favor of the respondent physician. Two months later, the claimant learned of the judge’s prior public censure. She petitioned the superior court to vacate the award based on his failure to disclose the public censure, and the superior court granted the petition. On writ proceedings, the court of appeal framed the issue as whether an “average person on the street” aware of the facts would harbor doubts as to the arbitrator’s impartiality. The court concluded that a person aware of the censure “might reasonably entertain a doubt as to his ability to be impartial in a case involving a woman’s cosmetic surgery.”10 The court denied a petition for mandate seeking to reinstate the award.

Applying a de novo standard of review, the California Supreme Court reversed. The court found that while the arbitrator’s prior conduct had been “clearly inappropriate” and “disrespectful toward staff members” and had tended to “create an offensive work environment,” nothing in the public censure would “suggest to a reasonable person that [the judge] could not be fair to female litigants, either generally or in the context of an action such as the one now before us.”11 The court then cited judicial disqualification decisions to the effect that all judges have varying experiences and backgrounds, and disqualifying bias must be “related to the case or the parties.” Moreover, the standard must not be so broadly construed so that recusal is required “upon the merest unsubstantiated suggestion of personal bias or prejudice.” Instead, the standard is what a “reasonable person” might believe, not someone who is “hypersensitive or unduly suspicious.” The court underscored that the disclosure standards are intended to bring to light matters reflecting potential bias, not other factors that might bear on a party’s choice of an arbitrator:

There are many reasons why a party might, reasonably or unreasonably, prefer not to have a particular arbitrator hear his or her case—including the arbitrator’s prior experience, competence, and attitudes and viewpoints on a variety of matters. The disclosure requirements, however, are intended only to ensure the impartiality of the neutral arbitrator. [Citation omitted.] They are not intended to mandate disclosure of all matters that a party might wish to consider in deciding whether to oppose or accept the selection of an arbitrator.12

Applying these principles, the court noted that the judge’s conduct had occurred more than 15 years prior to the arbitration proceeding, and that the sanction of censure, rather than removal from the bench, implied a finding that the judge could continue to be fair to female litigants. In addition, the court concluded that even if the judge’s past conduct gave rise to “speculative inferences” that he valued a woman’s physical appearance rather than attributes more relevant to the workplace, that did not necessarily create an inference that he would be biased against a woman suing her physician for negligence in performing plastic surgery. The opposite inference, said the court, might be just as reasonable.13

Finally, in rejecting the claimant’s argument that arbitrator disclosure should be broader than required for judicial recusal, the court put weight on the importance of arbitral finality and avoidance of “gameplaying” by the losing party. The court observed that whether to make a disclosure under a general standard of appearance of partiality may be “difficult for an arbitrator to determine,” and such a broad interpretation of the arbitrator’s duty to disclose “could subject arbitration awards to after-the-fact attacks by losing parties searching for potential disqualifying information only after an adverse decision has been made.” In the court’s view, such a result would undermine...
Under California law, the California Arbitration Act is

an objective test for determining whether

Courts have interpreted the appearance-of-partial-

the appearance-of-partiality standard requires dis-

An arbitrator's failure to make required disclosures

courts may consider whether the arbitrator failed to dis-

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The dissenting justices in Haworth wrote that the

The appearance-of-partiality standard requires dis-

Mark your answers to the test by checking the

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7. True False
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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

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finality of arbitrations without contributing to the fairness of the process.15

The two dissenting justices saw the case very differently. Emphasizing the detailed findings of the Commission on Judicial Performance concerning the judge’s conduct, the dissenting justices concluded that a reasonable person could believe that the arbitrator would bring “biased attitudes toward women” into the arbitral proceedings. The dissent criticized the majority for acknowledging the reasonable-person standard but failing “actually to apply it.” Therefore, by “condoning the failure of disclosure here, the majority sacrifices system integrity on the altar of arbitral finality.”16

Hanworth illustrates how different judges, assessing the same facts under the appearance-of-impartiality rule, can reach opposite conclusions.17 Its central ruling, however, is that arbitrator disclosure standards are intended to reveal potential bias—not merely “bad facts” from the arbitrator’s past that might reflect negatively on his or her fitness to serve. This principle was reinforced by Lagstein v. Certain Underwriters at Lloyd’s, London,18 a decision by the Ninth Circuit. Lagstein involved an insured’s claims against his insurer for denying benefits under a disability policy. The dispute was arbitrated, and a 2-1 majority issued an interim award in favor of the claimant, granting him $900,000 (the full value of his policy), $1.5 million for emotional distress, and, after a separate hearing, $4 million in punitive damages. After the initial award, the respondent investigated the backgrounds of the two majority arbitrators and discovered their roles in a judicial ethics controversy over a decade earlier.

In 1993, the Nevada Commission on Judicial Discipline filed a complaint against one of the arbitrators, who was then a Nevada trial judge. The complaint was ultimately dropped, but after an FBI investigation, the judge signed a nonprosecution agreement, retired from the bench, and agreed not to serve again in a state judicial capacity. Meanwhile, a related controversy arose over the commission’s procedures and jurisdiction in the investigation. The matter came before the Nevada Supreme Court and the second arbitrator, then a member of that court, sided with the trial judge (later his fellow arbitrator).

Lloyd’s filed a motion to vacate the arbitration award on various grounds, including the failure of both arbitrators to disclose their involvement in the prior ethics matter. The district court vacated the award.

Like the California Supreme Court in Haworth, the Ninth Circuit panel rejected the challenge to the arbitration award and reversed, emphasizing that vacatur of an arbitration award is not required “simply because an arbitrator failed to disclose a matter of some interest to a party.” Rather, the required disclosure is only of facts indicating that the arbitrator might reasonably be thought biased against one litigant and favorable to another. The panel found that the first arbitrator’s alleged misconduct occurred more than a decade before the arbitration began and did not concern any of the parties to the case.

The court also noted that the arbitrators had disclosed their connections with the parties to the case and that the past ethics controversy was publicly available and could have been discovered “if Lloyd’s had conducted even minimal due diligence” on the arbitrators’ backgrounds.19 The Ninth Circuit declined “to create a rule that encourages losing parties to challenge arbitration awards on the basis of pre-existing background information on the arbitrator that has nothing to do with the parties to the arbitration.”20

Financial Incentives to Favor a Party

If Hanworth and Lagstein can arguably be seen as loosening the stringent arbitrator disclosure standards, the decision this year of the First District Court of Appeal in Benjamin, Weill & Mazer v. Kors21 underscores that the standards—and vacatur of arbitration awards for failure to comply with them—are very much alive. The case involved a fee dispute between Kors, a psychologist and adoptive parent, and the BASF, which had represented Kors in litigation arising out of her adoption services. After five months of litigation, the plaintiff voluntarily dismissed its complaint without prejudice, but Kors was unsuccessful in obtaining a fee award. At that point, she had paid $227,537.75 in legal fees but had not paid a balance of $68,986.38 billed by the firm. In accordance with the parties’ fee agreement, the dispute was ordered to binding arbitration pursuant to the rules of The Bar Association of San Francisco. The BASF appointed a three-arbitrator panel, with an attorney as “chief arbitrator.” After a hearing, the panel found in favor of the law firm, which was awarded $76,041.59 in unpaid fees and costs as well as prejudgment interest.

Kors moved to vacate the award on several grounds. Her primary challenge, based on information obtained by Kors’s counsel shortly after the issuance of the arbitration award, was to the adequacy of the chief arbitrator’s disclosures. While reading the California Supreme Court’s opinion in Schatz v. Allen Mattina, Leck, Gamble & Mallory LLP,22 Kors’s counsel noticed that the chief arbitrator in the Kors arbitration was counsel for the defendant law firm in Schatz, which sought to compel arbitration of a fee dispute with its client. Upon further investigation, Kors’s counsel learned that the chief arbitrator had personally argued the Schatz case before the supreme court six days after he presided over the Kors arbitration hearing, and that while writing the award in the Kors case, he had filed petitions for writs of mandate on behalf of another large law firm in an attorney malpractice case.23

The superior court denied Kors’s petition to vacate, concluding that the “gravamen” of Code of Civil Procedure Section 1286.2(a)(6) is an arbitrator’s relationship with a party or an attorney or a set of facts or specific issues in the case—and none of these was present in the Kors arbitration. The First District Court of Appeal reversed. As a threshold matter, the court held that the Kors arbitration was properly one under the CAA, not under the Mandatory Fee Arbitration Act.24 Having concluded that the CAA governed, including the disclosure requirements of Code of Civil Procedure Section 1281.9, the court applied the appearance-of-partiality rule and held that there was a duty to timely disclose the nature of the chief arbitrator’s legal practice and the fact that he was then representing a law firm in a fee dispute with its client. Because the superior court had erroneously ordered arbitration under the BASF rules, which did not require these disclosures, the award was vacated.

In applying the appearance-of-partiality test, the court of appeal in Kors quickly disposed of BWM’s first argument that Section 1281.9 requires disclosure only of relationships with a party or attorney or other matters specifically enumerated in Section 1281.9(a)(1) through (6). Pointing to the “including all of the following” language in Section 1281.9(a) and its requirement that “all matters” that might cause an informed reasonable person to doubt the arbitrator’s ability to be impartial must be disclosed, the court ruled that the enumerated disclosures in subparagraphs (1) through (6) of Section 1281.9(a) are not an exclusive list of required disclosures.25 The court also noted that Section 1281.9(a)(2) requires disclosure of matters required to be disclosed by the Ethics Standards, which themselves contain a general appearance-of-partiality disclosure requirement.26

The Kors court then addressed BWM’s argument that neutral arbitrators need only disclose matters that would require a sitting judge’s mandatory disqualification under Code of Civil Procedure Section 170.1. The court acknowledged the California Supreme Court’s statement in Haworth that it “found no reason to interpret the appearance of partiality rule more broadly in the context of arbitrator disclosure than in the context of judicial recusal.”27 However, the Kors court found that the facts in Kors highlighted sig-
significant differences between judicial recusal and arbitrator disclosures that had not been present in Haworth or the other cases BWM relied on. These differences center around the economic incentives in private arbitration that are not present in court litigation. The court described judges as salaried public employees charged with applying the law to the facts, with their decisions subject to appellate review, and with “no economic interest in

The superior court vacated the award, finding that disclosure was necessary regarding one of the lawsuits cited by Citigroup.34 In its order, the court compared the subject matter of the arbitrator’s lawsuit with Hagman. The arbitrator and his wife had invested in a real estate limited partnership to be man-

Although making the required disclosures is the arbitrator’s responsibility, under certain circumstances it becomes a party’s responsibility to investigate and question the arbitrator, move for disqualification, or otherwise assert the party’s right to obtain disclosure.

potential customers’ response to their decisions.24 Arbitrators, on the other hand, are part of a “major commercial enterprise,” selected and compensated by the parties, with their decisions frequently not based on “strict rules of law” and for the most part lacking substantive judicial review.

The Kors court quoted from the U.S. Supreme Court’s opinion in Commonwealth Coatings Corporation v. Continental Casualty Company: “We should, if anything, be even more scrupulous to safeguard the impartiality of arbitrators than judges, since the former have completely free rein to decide the law as well as the facts and are not subject to appellate review.”29 In this context the Kors court concluded that the chief arbitrator’s “active and pervasive representation of law firms in disputes against clients” could cause an informed person to reasonably doubt his ability to be impartial.30

The Kors decision is unusual in holding an arbitrator bound to disclose business and professional activities not involving the parties or their counsel, but it is not without precedent. In Advantage Medical Services, LLC v. Hoffman,31 the court of appeal upheld vacatur of an arbitrator’s award based on his failure to disclose business relationships that created a reasonable doubt of his impartiality. One of the defendants’ counsel, who became involved in the case during the arbitration, learned that the arbitrator and his law firm were heavily involved in maritime and insurance defense practice. Further, the arbitrator acted as “correspondent counsel” for certain P&I (protection and indemnity) Clubs that provided insurance to ship owners, and Lloyd’s of London—the dominant force in the maritime insurance industry—sometimes reinsured ship owners insured by the P&I Clubs. The defendants successfully argued that the arbitrator had a powerful incentive not to take any action against the interests of Lloyd’s, and this required the arbitrator to disclose the nature of his practice and business relationships—even though he had never actually represented a Lloyd’s syndicate as a legal client.

BWM’s attempt to distinguish Advantage Medical Services did not convince the Kors court. The chief arbitrator was “extremely involved” in the defense of lawyers and law firms, just as the arbitrator in Advantage Medical Services had been involved with maritime defense. According to the Kors court, a reasonable person could entertain a doubt about whether the chief arbitrator’s dependence on business from lawyers and law firms would prevent him from taking the side of a client in a fee dispute with her lawyers. The court also emphasized that the arbitrator’s business and economic relationships with law firms were ongoing and financially significant, unlike those in prior cases that were financially trivial or ended many years in the past and thus, according to some courts, unnecessary to disclose.32

The Arbitrator’s Life Experiences

An unresolved issue facing arbitrators in California is whether events in the arbitrator’s life may create an appearance of partiality. All arbitrators—like judges and jurors—bring to their duties a history of experiences, both professional and personal. Some of those experiences may have some similarity to the factual setting of the arbitration and may require disclosure.

California appellate courts have yet to explore this issue. However, a recent Los Angeles Superior Court action, Hagman v. Citigroup Global Markets, Inc.,33 did just that. Actor Larry Hagman sued his broker, Citigroup, claiming that the broker’s mismanagement of his securities investment account had resulted in a loss of his retirement funds. A three-arbitrator Financial Industry Regulatory Authority (FINRA) panel found for Hagman and awarded damages exceeding $11 million. Citigroup petitioned the superior court to vacate the award, contending that one of the arbitrators had failed to disclose that several years earlier he had been a plaintiff in two lawsuits involving

invested funds and breach-of-fiduciary claims. Citigroup contended that this fact created a reasonable doubt about whether the arbitrator could be impartial in the Hagman case.

The superior court vacated the award, finding that disclosure was necessary regarding one of the lawsuits cited by Citigroup.34 In its order, the court compared the subject matter of the arbitrator’s lawsuit with Hagman. The arbitrator and his wife had invested in a real estate limited partnership to be man-

The claim in Hagman involved securities, not real estate. The suit alleged that Citigroup, an institutional investment manager, purchased unsuitable securities that were over-concentrated in equities and sold a life insurance policy that Hagman and his wife did not need and could not afford. Notwithstanding these differences, the court found that the arbitrator’s claims were similar enough to create an appearance of partiality.

It remains an open question whether the California appellate courts will endorse the type of disclosure obligation imposed by the superior court in Hagman.35 The decision required disclosure of events in the arbitrator’s life that did not involve any relationship with the parties to the arbitration or their counsel, nor did the undisclosed facts suggest any financial incentive for the arbitrator to favor one side in the Hagman/Citigroup dispute. Nonetheless, in the court’s view, the experience of losing investment retirement funds entrusted to others to manage—a fate common to Hagman and the arbitrator—created an appearance of partiality requiring disclosure. The court acknowledged that Citigroup may have been attempting to “extricate themselves from the arbitral award” but noted that the remedy for this “societal ill” is to “encourage complete disclosure before the matter is heard, giving honest objectors the opportunity to exercise their rights, and causing would-be after-the-fact attackers to
waive their ulterior objections before the award is issued.”

Tactical Use of Arbitrator Disclosure Rules

As the Hagman court’s comment illustrates, courts are aware of the potential for tactical challenges to arbitrators’ disclosures by “after-the-fact attackers.” Indeed, preventing “game-playing” by losing parties was an explicit ground for the decision in Haworth. Thus, a party who knows or has reason to believe that the arbitrators’ disclosures are inadequate but remains silent, hoping for a favorable arbitration award but relying on the arbitrator’s inadequate disclosure as an “insurance policy,” is adopting a risky tactic.

Although the vacatur language of Code of Civil Procedure Section 1286.2 appears to require vacation of an award when an arbitrator’s disclosures are insufficient, courts have found a waiver of the right to vacate the award when a party was aware of the facts suggesting partiality but did not raise the issue until after an unfavorable award was issued. For example, a court of appeal found a waiver when a party knew that the arbitrator had previously served as a party-appointed arbitrator for the opposing party but failed to inquire about the undisclosed details of this prior matter.

In a recent Ninth Circuit case, Johnson v. Grema Corporation, a party’s attorney admitted in oral argument that he had known “for a year or two” that the arbitrator’s wife previously had been a law partner of opposing counsel, but the attorney did not raise the issue until after the arbitrator’s award had issued. Applying the CAA standards, the Ninth Circuit denied vacatur, holding that the conduct suggested that the party “may have been sand-bagging, holding his objection in reserve in the event that he did not prevail in the arbitration.” Although the court ultimately decided that the arbitrator’s disclosures had been adequate, the court stated that even if there had not been adequate disclosure it would have held that the party “waived any objection by not raising it in a timely fashion.”

What if a party does not know of the undisclosed fact but could have discovered it before selecting the arbitrator? As courts become more sensitive to tactical use of the disclosure rules by losing parties, there is an increased willingness to hold parties to a duty to investigate potential arbitrators, particularly when the information is available online. An example is the 2011 decision in Rehmann v. Rohde. A U.S. company controlled by persons of German ancestry brought commercial claims in arbitration against a German company. The claimant lost and then conducted a Google search on the arbitrator, discovering that the arbitrator’s parents were German Jewish escapees who had lost relatives and property in the Holocaust. The claimant sought to vacate the award based on the arbitrator’s failure to disclose these facts before he was selected.

After rejecting the appearance-of-bias argument as meritless, the court noted that the information about the arbitrator’s background was readily available before he was appointed and that the claimant had a duty to inquire about the arbitrator’s background before selecting him. Although making the required disclosures is the arbitrator’s responsibility, under certain circumstances it becomes a party’s responsibility to investigate and question the arbitrator, move for disqualification, or otherwise assert the party’s right to obtain disclosure.

As courts reach widely divergent decisions on arbitrator disclosure, it is tempting to conclude that the appearance-of-partiality test is purely subjective and rests entirely in the eye of the beholder. While losing parties have an incentive to seek vacatur on grounds of inadequate disclosure, courts continue to wrestle with the appearance-of-partiality standard. Nevertheless, for practitioners uncertain how to proceed, several principles can be distilled from recent cases. These may give a measure of predictability and guidance to arbitrators and lawyers faced with arbitrator disclosure issues:

- The underlying purpose of the disclosure rules is to shed light on potential bias, not to reveal facts bearing on general qualifications or the “fitness” of the potential arbitrator. Thus, parties challenging the arbitrator’s disclosures have less success when their attack is based on alleged past “bad acts” by the arbitrator (Haworth and Lagstein) than when the undisclosed matters directly affect the arbitrator’s ability to be impartial in deciding the present dispute (Kors and Advantage Medical Services). Disagreements are inevitable regarding whether particular facts create an appearance of impartiality—see the majority and dissenting opinions in Haworth—but the analysis must focus on the appearance of partiality, not whether the arbitrator is qualified to serve.

- In applying the appearance-of-partiality standard, courts are highly sensitive to any financial incentives that an arbitrator may have to favor one party over another. In both Kors and Advantage Medical Services, in which the courts required disclosure of business relationships and activities beyond those with the parties or their attorneys, there were facts suggesting a possible financial incentive for the arbitrator to favor one party over another in the arbitration.

- Time is important in applying the appearance-of-partiality test. Understandably, the courts place less weight on an incident or event in the distant past (Haworth, Lagstein) than on a recent or ongoing circumstance or relationship (Kors, Advantage Medical Services, and Hagman). Courts recognize that arbitrators and judges make mistakes but may be able to avoid repeating them. The courts in Haworth and Lagstein could recognize years of apparently good conduct after the troublesome incidents in the arbitrators’ pasts. In Kors and Advantage Medical Services, the courts could not do likewise.

At a minimum, appellate courts in California have made clear that neglecting the arbitrator’s duties of disclosure has a serious potential for vacating an award. The strict disclosure standards in California most likely have increased the information available to parties in selecting an arbitrator. Under these standards, a potential arbitrator should prudently resolve all doubts in favor of disclosure, even in the face of economic incentives to the contrary in the competitive “commercial enterprise” of arbitration.

2. Ethics Standards for Neutral Arbitrators in Contractual Arbitration [hereinafter Ethics Standards], available at http://www.courts.ca.gov/documents/ethics_standards_neutral_arbitrators.pdf. According to Standard 1(a), the Ethics Standards were adopted pursuant to Code of Civil Procedure §1281.85 and “establish the minimum standards of conduct for neutral arbitrators who are subject to these standards.”
5. Code Civ. Proc. §§1286.2(a)(6)(A). Failure to make required disclosures can also lead to disqualification of the arbitrator. Code Civ. Proc. §1281.91. However, a recent decision held that an arbitrator’s failure to make appropriate disclosure falls within arbitral immunity under California law and is not independently actionable. LaSerena Props. v. Weisbach, 186 Cal. App. 4th 893 (2010).
7. Id.
8. Id. at 379.
9. Id. (citing In re Gordon, 13 Cal. 4th 472, 473-74 (1996)).
10. Id. at 380.
11. Id. at 390.
12. Later in the opinion, the court acknowledged that some of the policies applicable to judicial recusal may differ from those applicable to arbitrator disclosure. Nonetheless, the court stated that “we find no reason to interpret the appearance of partiality rule more broadly in the context of arbitrator disclosure than in the context of judicial recusal.” Id. at 393. This proposition was questioned in a post-Haworth decision, Benjamin, Weil & Mazer v. Kors, 195 Cal. App. 4th 40 (2011), petition for review and depublication denied, 2011 Cal. LEXIS 8972 (Aug. 17, 2011). See
text, infra. 15 See Rebmann v. Rohde, 196 Cal. App. 4th 1283 (2011) (following Haworth). See also text, infra. 16 The court stated that if the case had involved workplace sexual harassment, it might have reached a different conclusion regarding the judge’s disclosure obligations. Haworth, 50 Cal. 4th at 392 n.13. 17 Id. at 393. 18 Id. at 396 (Werdiger, J., dissent, joined by Moreno, J.). 19 “It may be appropriate for an arbitrator to resolve doubts in favor of disclosure, but the arbitrator has no legal duty to do so.” Id. at 393. 20 Lagstein v. Certain Underwriters at Lloyd’s, London, 607 F. 3d 634 (9th Cir. 2010). 21 Id. at 646. 22 The court in Lagstein applied the disclosure standards under the Federal Arbitration Act (FAA), not the CAA. Under FAA § 10(a)(2), the standard for vacatur is “evident partiality...in the arbitrators.” 9 U.S.C. § 10(a)(2). In nondisclosure cases, the Ninth Circuit has interpreted that standard to require disclosure of information that would create a “reasonable impression of partiality.” Schmitz v. Zilveti, 20 F. 3d 1043 (9th Cir. 2004). At least one California court has equated the federal and California court vacatur standards in nondisclosure cases. Mahnke v. Superior Court, 180 Cal. App. 4th 565, 579 n.8 (2009). 23 Benjamin, Weil & Mazer v. Kors, 195 Cal. App. 4th 40 (2011), petition for review and publication request denied, 2011 Cal. LEXIS 8972 (Aug. 17, 2011). 24 Schatz v. Allen Markins Leck Gall & Mallory LLP, 45 Cal. 4th 557 (2009). 25 Kors, 195 Cal. App. 4th at 51. 26 The MFAA’s rules differ in important ways from rules applicable to contractual arbitration under the AAA. See BUS. & PROF. CODE § 6200 et seq. See also ETHICS STANDARDS, supra note 2. The standards expressly exempt MFAA arbitration from the standards’ disclosure requirements. 27 Most, but not all, of the subsections of Code of Civil Procedure § 1281.9(a) concern relationships with the parties or their attorneys. 28 See ETHICS STANDARDS, supra note 2, at Standard 7(d)(1)(A). This standard requires neutral arbitrators to disclose “[a]ny other matter that might cause a person aware of the facts to reasonably entertain a doubt that the arbitrator would be able to be impartial.” 29 Haworth v. Superior Court, 50 Cal. 4th 372, 393 (2010). 30 Kors, 195 Cal. App. 4th at 54. 31 Commonwealth Coatings Corp. v. Continental Cas. Co., 393 U.S. 145, 149 (1968). 32 The court noted that it did not suggest that the chief arbitrator, a “distinguished lawyer in a highly regarded law firm,” harbored any actual bias against Kors. The only question was the reasonable appearance of partiality based on the arbitrator’s focus on representation of law firms in disputes with clients. 33 Advantage Med. Servs., LLC v. Hoffman, 160 Cal. App. 4th 806 (2008). 34 The Kors court was “mindful” that arbitrators cannot “sever all their ties to the business world...” It distinguished several cases, cited by BWM, in which the relationships or incidents were remote in time or economically trivial. United Farm Workers of Am. v. Superior Court, 170 Cal. App. 3d 97 (1985) (Trivial economic relationship of arbitrator’s wife need not be disclosed); Leland Stanford Jr. Univ. v. Superior Court, 173 Cal. App. 3d 403 (1985) (The judge’s role as officer in the Stanford Law Society 13 years earlier was not grounds for disqualification). 35 Hagman v. Citigroup Global Markets, Inc., Los Angeles Sup. Ct. Case No. BS124800. 36 While the Hagman arbitration was conducted under the FINRA rules—which require a potential arbitrator to state whether the arbitrator had, within the past five years, been involved in a dispute involving the same subject matter as contained in the case to which you are assigned”—the superior court cited and applied Code of Civil Procedure § 1281.9(a)’s appearance-of-partiality test in its order. 37 The claimants filed a notice of appeal from the Hagman order but withdrew the notice after the case was settled. The terms of the settlement have not been disclosed. 38 Hagman, minute order, at 4 (Feb. 9, 2011). 39 Britz v. Alfa-Laval, 34 Cal. App. 4th 1085 (1995). 40 Dornbush v. Kaiser Found. Health Plan, 166 Cal. App. 4th 831 (2008). 41 Johnson v. Gruma Corp., 614 F. 3d 1062 (9th Cir. 2010). 42 Id. at 1069. 43 Id. The issue of waiver is frequently fact-specific, creating additional uncertainty regarding the finality of an award. See, e.g., International Alliance of Theatrical Stage Employees v. Laughon, 117 Cal. App. 4th 1188 (2004). 44 Rebmann v. Rohde, 196 Cal. App. 4th 1283 (2011). 45 Id. at 1293 (same point made in Lagstein v. Certain Underwriters at Lloyd’s, London, 607 F. 3d 634, 646 (9th Cir. 2010)). 46 ETHICS STANDARDS, supra note 2, at Standard 7, cmt.: “It is good practice for an arbitrator to ask each participant to make an effort to disclose any matters that may affect the arbitrator’s ability to be impartial.” 47 The Haworth majority and dissenting justices disagreed on whether the facts required disclosure, and in Haworth, Lagstein, and Kors, the appellate courts reached opposite conclusions from the trial courts. The underlying facts in these cases were not disputed.
Some works created after January 1, 1978, may fall between the two sections under which creators may terminate a copyright assignment.

The First Copyright Transfers executed under the Copyright Act of 1976 will soon be eligible for termination, but controversy has already arisen concerning “gap works”—those created on or after January 1, 1978 (the effective date of the 1976 Act) but to which transfers were assigned by an agreement dated before that day. For example, while on break from a recording session in 1979, musician Charlie Daniels composed his hit “The Devil Went Down to Georgia.” The copyright to this composition, however, was assigned to Universal Music Publishing Group in an agreement dated prior to January 1, 1978. The controversy concerns whether Daniels will soon have the right to terminate the assignment and take back the copyright from Universal Music.

Daniels is not alone. According to the Songwriters Guild of America, hundreds if not thousands of songwriters will be affected by this issue, which extends to literary publishing as well. The Authors Guild believes that the majority of books published in 1978, 1979, and 1980 will be subject to the same termination controversy.

The origins of this controversy lie in two of the most substantial changes that the 1976 Act made to copyright law: Sections 203 and 304(c)-(d), better known as the termination provisions. The act marked a change in congressional support away from publishers and in favor of authors, with the termination of transfer provisions being demonstrative of that support. Sections 304(c)-(d) allow for the termination of licenses and assignments of copyrights subsist-
In a response to the Copyright Office’s Notice of Inquiry, Kenneth D. Freundlich and Neil W. Netanel suggested that full execution of the grant does not occur until the day copyright title vests. This would permit termination pursuant to Section 203, as this date would necessarily fall on or after January 1, 1978, leaving no gap. Citing Black’s Law Dictionary, the Eleventh Circuit in Kornegay v. HBC Florida declared “executed” to mean “carried into full effect,” and that a contract expressly conveys rights in future inventions, no further act is required once an invention comes into being, and the transfer of title occurs by operation of law. With patents, as with copyrights, the property must exist before title can vest. However, there is no statutory termination-of-transfer mechanism in patent law, and therefore the determination of the date of execution for such purposes has never been an issue.

The Uniform Commercial Code specifically addresses goods not yet existing and identified but subject to a present contract for sale. The code states that “goods must be both existing and identified before any interest in them can pass.” Goods which are not both existing and identified are ‘future’ goods. A purported present sale of future goods or of any interest therein operates as a contract to sell. A recurring theme in any agreement attempting to transfer property not yet existing is the necessity of its existence prior to the vesting of title. If the goods do not yet exist, the signed agreement functions as an executory agreement or a contract to sell, not as an executed agreement.

The Argument against Termination

Despite the general consensus surrounding the vesting of both legal and equitable title in a contract, authority exists to date the transfer from the time of the signed agreement. In Kornegay v. Miller, the Supreme Court of North Carolina addressed the issue of after-acquired property, reaching the same conclusions as T.B. Harms regarding the vesting of equitable and legal title. However, quoting George Tucker Bispham in his treatise on equity, the court went on to note that “instantly upon the acquisition of the thing, the assignor holds it in trust for the assignee, whose title requires no act on his part to perfect it. The assignee, therefore, has an equitable title from the time of the assignment.” While Kornegay addressed real property and contingent interests preventing vesting, the principle is the same. Despite equitable title vesting only when the property comes into the possession of the assignee, title should be dated
as of the assignment. Additionally, no intervening act is required on the part of the assignee to perfect equitable title; it is fully executed and dated as of the signed agreement.39 James W. Eaton, in his hornbook on equity, states that in situations such as these “the assignee has an equitable title in the property...dating from the time of the assignment.”29

Bispham’s treatise, Eaton’s hornbook, and the court’s opinion in Kornegay cite to Holroyd v. Marshall in support of the conclusion that equitable title dates from the time of assignment rather than vesting. Holroyd, an English case from the House of Lords decided in 1862, set forth the now settled principle that in equity all things which are not yet in existence, or not yet belonging to the contracting party, may be the subject of an assignment or contract.30 [A]nd the assignee will have the same rights as to them as if the things had belonged to the assignor or the contracting party at the time of the contract.30

T.B. Harms cites the same case, yet appears to stand for the proposition that title dates from the time of vesting. Upon close examination these differing conclusions coexist without conflict. T.B. Harms and Buck do not extend their discussions of equitable title beyond the date of vesting. In T.B. Harms the defendant author had transferred the copyright to a composition created during the term of an exclusive songwriter agreement to a third party. In the course of litigation the contract that spawned the controversy had been declared invalid by a New York state court, and this was the basis for initially denying relief to the plaintiff.31 A short time later this state court ruling was overturned, and the Second Circuit vacated its decision in favor of the defendant. The court never had reason to address the possibility of back-dating equitable title.33

Like T.B. Harms, Buck appears to date equitable title at the time title vests. In Buck, the plaintiff was licensed the performing rights to several compositions, many of which had not yet been created. The defendant moved to dismiss, claiming neither legal nor equitable title could vest pursuant to such an agreement.34 Citing T.B. Harms, the court disagreed as to equitable title.35 The court declared that title attached the moment the composition came into existence. This reading allowed the court to deny the motion without need to extend inquiry further.

In no case can legal or equitable title vest prior to the existence of the property itself.36 Nevertheless, while equitable title may not vest until the property exists, it can date from the time of assignment. In fact no further act is required on behalf of the assignee to perfect title, arguably providing the assignee with a fully executed equitable title dated as of the signed agreement.37 In a gap work this could make the date of the assignment agreement identical to that of the transfer in copyright interest.

**Legislative History**

While analysis of the termination provisions (and the word “executed”) uncovers ambiguities that may arguably favor authors who seek the termination of the assignment of copyright of gap works, the Copyright Office’s Supplementary Register’s Report on the 1976 revision, Nimmer asserts that the alternative method of computation is the result of lobbying by book publishers.42

The publishers pointed out that years may elapse between the signing of a publication contract and the creation of the work.43 This common occurrence in publishing (as exemplified by the example of the song written in 1979 but published under an agreement dated prior to January 1, 1978), as well as the legislative history pointing to the date of a signed publication agreement, provide a compelling argument for dating gap works from the time of the signed agreement. This rationale supports the argument that Congress understood the dilemma facing the publishing industry regarding transfer agreements entered into before the delivery of a work and intended the date of execution to be synonymous with the date of the signed agreement.

In a footnote, Nimmer argues that the alternative method of computation was probably intended to affect only book and periodical publishing, pointing to the rationale and lobbying instrumental in its development.44 Still, the legislative history makes no such limiting statement. Nowhere in the House Report is there any indication that the alternative method or its rationale should be applied only to literary publishing. The termination provisions as they stand are the result of the lobbying and influence of particular interest groups, but the result is meant to be applied generally. It would be a stretch to argue that the benefits of any one provision should be limited to the interests championing its cause.45

Finally, it should be noted that certain
nonexclusive licenses require no writing whatsoever. These transfers may be executed orally or may even be implied. As these licenses require no signed agreement, a permissible inference may be drawn that within the context of Section 203 the term “executed” refers to the date of the completed transaction and not to the date of a signed agreement, because there may be no signed agreement.

While there is evidence that Congress may have intended the date of execution to be synonymous with the date of the signed agreement for termination purposes, there does not appear to be any evidence that Congress intended to exempt gap works from termination. A literal reading of the statute could generate an unintended outcome that may be the result of inattentive drafting or omission. However unintended the outcome, if sufficient evidence exists to convince a court that the date of execution is the date of signing, it is beyond the judicial function to remedy the legislative omission. To quote the U.S. Supreme Court in *Iselin v. United States*, when what is asked “is not a construction of the statute, but, in effect, an enlargement of it by the court, so that what was omitted, presumably by inadvertence, may be included within its scope,” the request should be denied.

The *Iselin* decision, however, was less ambiguous than the termination provisions, and the court was able to give effect to the statute’s plain meaning without having to interpret the language. Nevertheless, the decision stands for the proposition that a potentially inadvertent outcome does not alone provide the courts with latitude to extend a law beyond the province that Congress has granted to it.

A court trying a gap work case may simply find a way around resolution of the dilemma of statutory interpretation. A court may simply declare, for example, that the general intent of the termination provisions (coupled with a lack of mention in the code sections and legislative history of some exception for works created after January 1, 1978) is that the assignment of copyright to gap works may be terminated. Congress could speak for itself and provide a legislative fix. If it does not act, the controversy regarding the termination provisions may compel courts to rule on whether publishers or authors own the copyright to gap works.


2 Id.


An exception akin to a right of first negotiation allows for a further grant between the original contracting parties or their successors in interest once notice of termination has been served. 17 U.S.C. §203(b)(4), 304(c)(6)(B), 304(d)(1).

The execution of the transfer must be dated January 1, 1978, or later. 17 U.S.C. §304(c)(d) (apply only to copyrights subsisting as of January 1, 1978).

Notice of termination has been served. 17 U.S.C. §203(a)(4)(A).


See also Matter of Black v. Sally, 38 App. Div. 562, 564 (N.Y. 1910) (“An assignment of something which has no present, actual, or even potential existence when the assignment is made…operates as an executory contract.”).

Black’s Law Dictionary 369 (9th ed. 2009).

T.B. Harms, 229 F. 48 (citing Holroyd v. Marshall, 10 HLC 191 (1862)).


U.C.C. §2-1052).

Kornegay v. Miller, 137 N.C. 659, 664 (1905).

Id. at 667-68 (quoting George Tucker Bisham, The Principles of Equity (10th ed. 1925)).

Id.

James W. Eaton, Equity Jurisprudence 243 (1901).

Holroyd v. Marshall, 10 HLC 195 (1862).

T.B. Harms & Francis, Day & Hunter v. Stern, 229 F. 42, 50 (2d Cir. 1915).

Id.


Id.

T.B. Harms, 229 F. 49.

Kornegay v. Miller, 137 N.C. 659, 667-68 (1905).

40 17 U.S.C. §§203(a), 304(a), 304(d).

41 Id. §11.05[A] n.6.

42 For an excellent discussion on this point, see Curtis, Caveat Emptor in Copyright, 25 BULL. CR. SOC’Y, 19, 43-46 (1977).

43 Effects Assoc., Inc. v. Cohen, 908 F. 2d 555, 558-59 (9th Cir. 1990) (The lack of a signed writing memorializing transfer of copyright did not prevent the defendant from utilizing in a motion picture special effects produced by the plaintiff under an implied license); see also Nimmer, supra note 42, §10.03[A][7] (”By negative implication, nonexclusive licenses may…be granted orally, or may even be implied from conduct.”).


45 Iselin, 270 U.S. at 251.

46 Id. at 250.
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Licensure & Certifications:
- Medical Board of California-Active California Medical License
- American Board of Orthopedic Surgery-Board Certified Orthopedic Surgeon
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Memberships:
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- Fellow, North American Spine Society
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Assistant Clinical Professor Orthopaedic Surgery, UCLA 3600 Wightwood Drive, Studio City, CA 91604, (818) 985-3051, fax (818) 985-3049, e-mail: gpurcellmd@gmail.com. Web site: gpurcellmd.com. Contact Graham A. Purcell, MD. Dr. Purcell is a board certified orthopaedic surgeon, subspecialty in spinal disorders affecting adults and children. Examples of spinal disorders treated by Dr. Purcell include disc diseases, stenosis, infections, tumors, injuries, and deformities including scoliosis. He possesses 30 years of orthopedic and 24 years of med-legal experience, including defense, plaintiff, insurance carriers, CA Attorney General’s office and Public Defender’s office. Expert testimony per-tains to med-legal issues, workers’ compensa-tion cases. As a qualified medical evaluator, Dr. Purcell has extensive experience in performing QMEs, AMEs, IMEs, WC eva-. See display ad on page 63.

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Web Site: www.scoi.com

EDUCATION:
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CERTIFICATE:
Board Certified Orthopedic Surgeon

MEMBERSHIPS:
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Fellow American Academy of Orthopedic Surgeons
Fellow in the Arthroscopy Association of North America
Fellow in the International Arthroscopy Association
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LACBA
Cell Phone Security for Attorneys

FOR MANY ATTORNEYS and business professionals, smart phones have become their primary e-mail reader, Internet browser, contact manager, data storage device, word processor, camera, entertainment source, and status symbol. Smart phones have lured many lawyers into stockpiling data in a small device that can easily be left on a counter at a coffee shop, making e-mail, documents, passwords, and access to office servers available to the nearest thief.

It is a matter of professional responsibility to safeguard client secrets. The first, most basic way to do so with a smart phone is to use its pass code or locking feature. Without entering the code, a user cannot access the data on the phone. This feature may not stop a hacker, but it offers a valuable first line of defense. Some phones receive calls even when the pass code feature is set, which can reduce some of the inconvenience.

The next level of security is software. Several vendors offer all-in-one security for phones. Some features to look for include malware and firewall protection, as well as encryption and software that allows the owner of a lost or stolen phone to track its location. The risk of viruses and other malware has increased as smart phones have grown more popular. E-mail attachments, downloaded applications, and Internet browsing are access points for infection. Previously, cell phones were not at great risk for infection because they did not make appealing targets. Now that they contain such a wealth of information, however, phones are becoming worthy prey for hackers.

No security software can be foolproof. The antivirus vendors are always playing catch-up as the bad guys develop new ways to exploit breaches. An antivirus protection program that regularly updates itself is, as a consequence, constantly running. This gives users better odds at protection but taxes the phone’s performance. While processor speed and memory are increasing with each generation of smart phone, users of most current models will likely notice some slowdown in performance with security software running at full protection.

Antivirus, antimalware, and firewall software needs to work with a smart phone’s operating system. There are several major systems, including Symbian, Android, Blackberry, Apple, and Windows Mobile; but not all vendors have designed versions of their security software for all cell phone operating systems, so users will need to do some research before buying. Some of the more comprehensive security software providers include Bull Guard Mobile Security (www.bullguard.com), Kapersky Mobile Security (usa.kaspersky.com), Eset Mobile Security (www.eset.com), Norton Mobile Security (us.norton.com), and McAfee (www.mcafee.com). Bull Guard has versions for Symbian, Android, Blackberry, and Windows Mobile. Kapersky has versions for Symbian, Blackberry, and Windows Mobile. Eset has versions for Symbian and Windows Mobile. Norton has a version for Android. McAfee has versions for Android, Blackberry, Apple, and Windows Mobile.

Attorneys who want to avoid ever having to tell a client about lost personal data should consider encryption for their smart phones. Also, the California State Bar has issued an opinion that addresses the use of wireless Internet connection with laptop computers and concludes that “whether an attorney violates his or her duties of confidentiality and competence when using technology to transmit or store confidential client information will depend on the particular technology being used and the circumstances surrounding such use.” The opinion reminds attorneys that the duties of confidentiality and competence owed to clients are intertwined with understanding the sensitivity of the information handled, the weakness in the security of the mode of transmission and storage, and the reasonable steps that can be taken to enhance security.

Civil Code Section 1798.82(a) requires “[a]ny person or business that conducts business in California, and that owns or licenses computerized data that includes personal information [to] disclose any breach of the security of the system following discovery or notification of the breach in the security of the data to any resident of California whose unencrypted personal information was, or is reasonably believed to have been, acquired by an unauthorized person.” Section 1798.81.5(d)(1) defines “personal information” to include a client’s name combined with the client’s Social Security number, driver’s license number, or credit card numbers and PIN or password. Without encryption, a lost cell phone containing a client’s personal information may trigger the notice provision. A number of smart phones offer encryption capability, and there are relatively powerful encryption programs available for free.

Another feature that may help when a smart phone is lost is remote GPS tracking. This allows the phone’s user to locate the phone online. Civilian GPS accuracy is to about eight feet, possibly better. This level of accuracy will not tell you which pile of paper to look under for your phone, but it can tell you if you left your phone at home. It may also lead you to the person who “found” your phone. To use a smart phone’s GPS, the user must activate the phone online. Civilian GPS accuracy is to about eight feet, possibly better. This level of accuracy will not tell you which pile of paper to look under for your phone, but it can tell you if you left your phone at home. It may also lead you to the person who “found” your phone. To use a smart phone’s GPS, the user must activate the

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Gordon Eng practices business transactions law in Torrance, representing technology and real estate companies.
phone’s location feature, which may be used by other programs that collect location data for social networking, advertising, and a range of other purposes. The privacy issues raised by allowing third parties to track the user’s location may be a concern.

Finally, users who have lost their phones may be able to invoke a remote data wipe. This is the nuclear option in cell phone security. Some security software will allow remote access to the phone that restores the phone to its original factory settings. Doing so deletes any nonoriginal applications and data stored on the cell phone. Depending on the configuration of the cell phone and the security software used, this data wipe may not delete the data stored on an SD card that is plugged into the phone. This drastic step can bring some peace of mind to IT professionals concerned with maintaining the integrity of a law firm’s security systems. But just as data deleted from a PC may sometimes be recovered with specialized software, so too the remote data wipe is not necessarily absolute. As with computers, backing up a phone’s data will save time and trouble later, when a phone is lost and a remote wipe becomes necessary.

Aside from loss and theft, another security risk for cell phones is cloning. This allows a third party to make calls illegally on the user’s cell phone account. When a mobile phone makes a call, it transmits its Electronic Security Number (ESN), Mobile Identification Number (MIN), Station Class Mark (SCM), and the number being called in a short burst. The ESN is a 15-digit serial number that is supposed to be unique to each phone. The MIN is the phone number of the sending phone. The SCM is technical data about the transmission protocols used by the phone. The MIN and ESN are used for subscriber verification. If that pair of numbers is recognized as being on the carrier’s subscription list, the cell tower transmits a control signal back to the cell phone that allows the call to be placed.

If a hacker is able to capture the MIN and ESN numbers, he or she can program them into a new cell phone. This new phone is a phone that allows the call to be placed. This drastic step can bring some peace of mind to IT professionals concerned with maintaining the integrity of a law firm’s security systems. But just as data deleted from a PC may sometimes be recovered with specialized software, so too the remote data wipe is not necessarily absolute. As with computers, backing up a phone’s data will save time and trouble later, when a phone is lost and a remote wipe becomes necessary.

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Cloning is more likely to occur where the hackers can intercept many new call origination protocols used by the phone. The new call origination protocols used by the phone. The new call origination protocols used by the phone.

Los Angeles attorneys who cannot change their calling habits may consider upgrading, if they have not already, to a 4G phone. An unlimited usage plan may be of some protection against the economic effects of cloning. Another way to limit the damage is not subscribing for international service. Without it, the hacker will not be able to use the cloned phone for international calling.

As the recent phone hacking scandal concerning Rupert Murdoch’s News of the World has shown, the security of voice mail and cell phone calls must be considered. Voice mail account passwords must be chosen with the same care as those used for an office network password. Live digital cell phone signals present a greater challenge to hackers, but that does not mean that digital cell phone calls cannot be listened to—they are radio signals that travel through the air to the nearest cell tower. A hacker may be able to build a device to listen to digital cell phone calls.

This does not necessarily mean that a lawyer should not use a cell phone. Rather, a “lawyer should exercise caution when engaging in conversations containing or concerning client confidences or secrets by cellular or cordless telephones or other communication devices readily capable of interception, and should consider taking steps sufficient to ensure the security of such conversations.”

As cell phones continue to grow in use and capabilities, they will become a more appealing target for wrongdoers. Stealing data has not been as interesting to cell phone hackers as stealing service, but now that applications are available to use cell phones for credit card payments, the cell phone has become a source of cash. Unlawful access to cell phones may be expected to rise.

Pass codes and security software are inconvenient, add cost, and reduce a phone’s speed, but it would be wise to consider them, even though they are unlikely to stop sophisticated hackers. Some protection is better than none. For lawyers an appropriate question may be: If you lost your cell phone in a crowded public venue, what would you need to disclose to your clients?
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The Los Angeles County Bar Foundation’s 2010-2011 Fund Drive raised more than $281,000 from corporations, individuals, law firms, and others. Direct contributions from law firms totaled $104,600; individuals contributed $94,975; and corporations, Foundations and others contributed $81,873 in addition to these direct contributions, $64,079 was contributed to the Foundation by individuals, corporations, and law firms by means of the Association’s annual dues statement voluntary contribution.

The Foundation wishes to express sincere thanks to all who contributed during the 2010-2011 campaign. As part of the procedures required in connection with its annual audit, the Foundation hereby lists all individuals who made contributions of $200 or more, and all law firms, corporations, and other organizations that contributed $1,000 or more during the period beginning July 1, 2010, and ending June 30, 2011. If you are not listed below, and you made a contribution to the Foundation fitting any of the above criteria, please contact the Foundation’s independent certified public accountants, Green, Hasson & Janks LLP, by calling Tom Barry directly at (310) 873-1647. (Note: The Foundation records gifts made by check on the date of receipt, not the date written on the check.)

The Foundation regrets that space limitations prevent the listing of the names of all contributors.
From the November 2011 issue of Los Angeles Lawyer.
Inn of Court: Voir Dire

ON WEDNESDAY, NOVEMBER 2, the Litigation Section will host an Inn of Court program on how to conduct voir dire. In addition to learning practical tips and techniques for selecting the best jury possible, participants will be able to network with other legal professionals in an intimate, relaxed setting. Inn of Court membership is required, and LACBA and Litigation Section memberships are required to join the Inn of Court. The program will take place at the Los Angeles Athletic Club, 431 West 7th Street, Downtown. Parking is available at the club for $4.50 with club validation. The parking entrance is on the east (right) side of Olive Street. The club’s main entrance is on the north side of 7th Street between Olive and Hill. On-site registration will be available starting at 5:30 P.M., with the meal and reception continuing until 7:30 P.M., followed by the program from 7:30 to 8:30. Membership for the Inn of Court is under program code 011390; the event registration code number is 011392.

$75—guest with meal
1 CLE hour

Nonprofit 501(c) (3) Organizations

ON TUESDAY, NOVEMBER 8, the Taxation Section and its Exempt Organizations Subsection will host a program featuring speakers Christian G. Canas and Louis E. Michelson that will cover the following topics: defining a California nonprofit, the formation of a California nonprofit, applying for federal (Form 1023) and state (Form 3500A) tax exemption, and how to maintain a nonprofit’s tax-exempt status. 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 5:30 P.M., with the program continuing from 6 to 8. The registration code number is 011471. The prices below include the meal.

$35—CLE+PLUS member
$65—Taxation Law Section member
$65—Business & Corporations Law Section member
$75—LACBA member
$90—all others
2 CLE hours

Report from Official California

ON TUESDAY, NOVEMBER 8, the Antitrust and Unfair Business Practices Section will present its annual Report from Official California. Speakers Kathleen Foote, Jeffrey A. Klerfeld, Thomas A. Papageorge, and Phillip H. Warren will represent the U.S. Department of Justice, the Federal Trade Commission, the California Attorney General’s Office, and the San Diego District Attorney’s Office in a briefing on the priorities and activities of the federal, state, and local government agencies actively engaged in antitrust and unfair business practices law enforcement in California. The program will take place at the Los Angeles Athletic Club, 431 West 7th Street, Downtown. Parking is available at the club for $4.50 with the club validation. The parking entrance is on the east (right) side of Olive Street. The club’s main entrance is on the north side of 7th Street between Olive and Hill. On-site registration and lunch will be available starting from 11:30 A.M., with the program continuing from noon until 1:30 P.M. The registration code number is 011427. The prices below include the meal.

$27—CLE+PLUS member
$40—Antitrust Section member
$55—LACBA member
$70—all others
1.5 CLE hours
The Exaggerated Demise of the Billable Hour

DURING THE CURRENT GREAT RECESSION, many observers have pronounced the coming end of the billable hour. No final hour has been set for the final hour, but we are assured its demise is close at hand. The litany of evils of the billable hour—most prominently, that it encourages unnecessary work and rewards inefficiency, and that any negotiated reductions in rate are offset by increases in hours worked—seem generally supported by anecdotal evidence, including my own experiences. Nevertheless, after 13 years as in-house counsel, including working on significant alternative billing projects, my opinion, to borrow from Mark Twain, is that the death of the billable hour has been greatly exaggerated.

Despite all the rhetoric, the billable hour survives for two fundamental reasons. First, the hour (or any unit of time) remains the standard measure of internal and external output for law firms. Second, the seller of services (the law firm) dictates the price floor for legal services, not the buyer (the client).

Even a casual observer can see the billable hour is inherent in the DNA of today’s legal practice. Most firms continue to provide the vast majority of their services according to this standard, notwithstanding client pressure to provide alternative fee structures. Further, firms measure attorney productivity and set attorney compensation, at least to some degree, by using the number of hours the attorney has billed. Even the U.S. Supreme Court has lent its weight to the billable hour (multiplied by an hourly rate, sometimes referred to as the “lodestar” method of fee calculation) as constituting a “reasonable” fee in the context of fee-shifting statutes, giving law firms a safe harbor in the billable hour.

The billable hour is also an integral component of many so-called alternative billing arrangements. One need only scratch the surface of most of these arrangements to reveal the hour as the underlying framework. For example, blended rates are simply a mathematical variation of the hourly charge, and most fixed-fee arrangements are based on a firm’s estimate of the number of hours that it expects will be required to handle a client matter plus a cushion to cover any margin of error. In short, these arrangements amount to little more than an advance fixing of an expected hourly price. A true contingency fee based solely on a percentage of a damage award would actually transcend the billable hour. However, very few such fee arrangements exist beyond a narrow set of practice areas, and even many so-called contingency fees include reduced or capped hourly rates, so that the contingency is more a value-added charge for a successful outcome.

The price floor issue is less obvious but equally relevant. Large purchasers of physical products and commodities, such as Walmart, often dictate to suppliers the wholesale price they will pay for a product. The supplier, to maintain and even expand its relationship with such a reliable purchaser, determines how to produce the product at that price and still make a profit. The supplier might make employee changes, adjust the manufacturing process, or more closely manage its supply chain. In this model, the supplier modifies its business to meet the buyer’s quoted price rather than the buyer paying a higher price to support the supplier’s current business practices.

If purchasers of legal services want to bring about a paradigm shift away from the billable hour as the determiner in the pricing of legal services, they will need to dictate the price they are willing to pay, and they will need to do so based upon factors other than time spent. Of course, the market for legal services is subject to supply and demand much like any other market. The demand for legal services to handle our country’s growth industry of litigation and increasingly complicated contracts may simply outstrip supply and make it impossible for the buyer to dictate the price. However, if corporations satisfied their legal needs by hiring more in-house attorneys and reduced their demand for outside legal services, the market forces would compel “sellers” to be more creative in setting fees to attract and retain business, thereby giving the “purchasers” more of an upper hand.

If firms and clients addressed unnecessary and wasteful work, the flaws of the billable hour might be addressed without throwing out the proverbial baby with the bath water. In the meantime, it will take far more action and considerably less talk for those who hope to finally push the billable hour to its own private Waterloo.

The billable hour is inherent in the DNA of today’s legal practice.
Most firms continue to provide the vast majority of their services according to this standard, notwithstanding client pressure to provide alternative fee structures.

1 See Gisbrecht v. Barnhart, 535 U.S. 789 (2002) and Perdue v. Kenny A., 599 U.S. ___ (2010). Perdue involved the arbitrary, after-the-fact imposition of success-based value billing by the prevailing firm—that is, the addition of a substantial amount to the bill for winning the case—which was neither consensual nor prenegotiated. Perhaps the Court, which did not dismiss the possibility of alternative billing (although it may have been a bit dismissive of it), would look more favorably upon an alternative billing calculation that was market driven and consensually determined.

Ken Swenson is in-house counsel for Bank of America in Los Angeles and the 2011-12 chair of the Los Angeles Lawyer Editorial Board.
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