

Los Angeles Lawyer

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CONGRATULATIONS TO PROFESSOR DONALD KOCHAN ON HIS PROMOTION TO ASSOCIATE DEAN



Donald J. Kochan

Associate Dean for Research & Faculty Development, Professor of Law

Promoted to Associate Dean in July 2014, Donald Kochan is the first Associate Dean for Research and Faculty Development at Chapman University's Dale E. Fowler School of Law. The new Associate Dean works with current faculty members to develop and enhance scholarship and implement programs to advance pedagogical innovation.

Dean Kochan has published more than 30 scholarly articles and essays in respected law journals, including recently in the BRIGHAM YOUNG UNIVERSITY LAW REVIEW, GEORGETOWN JOURNAL OF LEGAL ETHICS, UNIVERSITY OF PITTSBURGH LAW REVIEW, BERKELEY JOURNAL OF INTERNATIONAL LAW, and VIRGINIA JOURNAL OF SOCIAL POLICY & LAW. His work has been cited in more than 250 published law review articles, in addition to numerous citations in other sources including legal texts, treatises, briefs, and case law. Dean Kochan has also published opinion editorials in leading newspapers across the country, recently including the WALL STREET JOURNAL and the LOS ANGELES TIMES.

Dean Kochan received the 2014 Valerie Scudder Award from Chapman University, a merit-based award selected by peers in recognition of outstanding achievement in scholarship, teaching, and service, and one of the highest honors given to a faculty member at the University. Among his numerous activities, Dean Kochan serves on the Executive Committee of the Section on Property Law for the Association of American Law Schools and was elected as a Fellow of the American Bar Foundation in 2014.

A graduate of Cornell Law School, Dean Kochan previously served as a judicial clerk for The Honorable Richard F. Suhrheinrich on the United States Court of Appeals for the Sixth Circuit, as an Olin Fellow at the University of Virginia School of Law, and as a Visiting Assistant Professor of Law at George Mason University School of Law. He also was an associate with the law firm Crowell & Moring in Washington, D.C.

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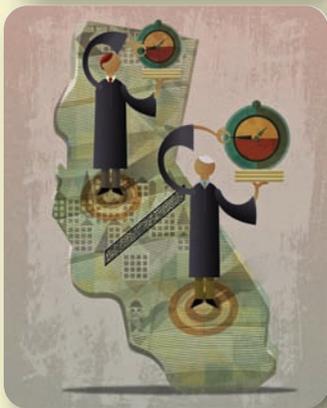
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FROM THE CHAIR

The California State Board of Governors recognizes October as the Campaign for Justice Month and the last week in October as the National Pro Bono Week. These observances remind us of how important it is to increase our pro bono services and financial contributions to

legal services agencies. Soon after the California State Bar initiated the Campaign for Justice Month, LACBA followed suit with a supporting resolution to demonstrate its dedication to increasing access to justice. (See www.caforjustice.org.) LACBA has a history of providing critical and life-changing legal services to those with nowhere else to turn. LACBA has many pro bono projects that address a variety of legal issues and methods of resolution, including mediation, self-help clinics, and litigation.

The Domestic Violence Project, through the leadership of Directing Attorney Debbie Kelly, provides victims of domestic violence and elder abuse the opportunity to obtain life-saving legal services in a clinic setting. Clients receive pro bono assistance to obtain restraining orders, stay-away orders, move-out orders, and child custody orders in a one-stop shop. Volunteers are asked to bring compassion and a willingness to make a difference in someone's life. LACBA provides the training and a setting to make the best use of an attorney volunteer's time commitment.

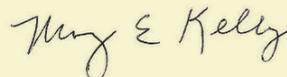
The AIDS Legal Services Project, through the leadership of Project Director Laurie Aronoff, is a lifeline to dignity and fundamental rights of clients living with HIV or AIDS. The project's low-income clients obtain free direct legal services on a variety of legal issues, including the traditional poverty law challenges of eviction defense and public benefit denials, as well as debt relief, tax and estate planning, and the cutting edge civil rights issues of discrimination and denial of care.

The LACBA Immigration Legal Assistance Project, under the leadership of Directing Attorney Mary Mucha, is another LACBA project that serves those needing help with the complex questions of political asylum, green cards, work permits, family petitions, citizenship, and Dream Act applications. The project trains law students and attorneys in all aspects of immigration law.

LACBA's Veterans Project, under the leadership of Directing Attorney Andrew Culberson, works to assist veterans, active-duty military personnel, and reservists with their legal needs. The project expanded in May of 2014 to offer services at Patriotic Hall in downtown Los Angeles. The project launched a series of legal clinics and workshops designed to help veterans clear outstanding tickets and warrants and expunge criminal records.

These worthwhile projects improve access to justice in Los Angeles. As the Honorable John A. Sutro Jr., a legal services trust fund commissioner, remarked regarding the Campaign for Justice: "There is nothing more important to the stability and welfare of our country than our justice system. Critical to the proper functioning of the judicial system is the public's confidence in and respect for it. We have the chance to see that the needy are provided with the legal services they need, a goal that I strongly believe is critical to the maintenance of the public's confidence in and respect for our justice system."

LACBA's pro bono projects provide Los Angeles lawyers with opportunities to make a difference in someone's life. Please consider volunteering, donating money, or both. An easy way to get started is to visit lacba.org/volunteer or contact LACBA's pro bono coordinator, Laurie Aronoff, at volunteer@lacba.org. ■



Mary E. Kelly is a nurse attorney and an administrative law judge II with the California Unemployment Insurance Appeals Board. She is cochair of the California Access to Justice Commission's Administrative Agency Committee.

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Tax Consequences of Business Entity Choice

WHEN ADVISING A CLIENT that wishes to form an entity for a closely held, operating business, it is important to carefully delineate the differences in tax consequences among limited liability companies (LLCs), S corporations, and C corporations. Although the default choice for most business attorneys is to suggest a pass-through entity, such as an LLC or an S corporation, clients—and sometimes their attorneys—do not always understand the tax differences between these two business forms. Also, while it has become rare, there can be situations in which, from a tax perspective, a C corporation may be preferable to a pass-through entity. Since all three business entities provide limited liability and corporate formalities are relatively inexpensive to implement, the tax consequences of the choice of business entity may be the most important factor to consider.

The profits and losses of an LLC and an S corporation, as pass-through entities, are only taxed once at the member or shareholder level, while the profits and losses of a C corporation are taxed twice—once at the corporate level and again at the shareholder level. In practice, however, for the purpose of forming a closely held, operating business entity, the real division is between entities that require the payment of a salary to the owner (C and S corporations) and those that do not (LLCs). Although the business entity may already have payroll for its employees, the payroll for the shareholders of C and S corporations is not as straightforward.

LLCs are often the default business form choice because they require few corporate formalities and do not require salaries for the owners. Owners are taxed on their allocable share of the profits and losses, with self-employment taxes being calculated on the member's individual tax return. The LLC provides a great deal of flexibility in the determination and timing of members' allowable reimbursements, which can be determined when preparing the tax return. If there is only one member, there is no federal LLC filing requirement, and the Franchise Tax Board only requires a short-form LLC tax return.

In comparison with LLCs, C corporations are on the opposite end of the flexibility spectrum. Due to the double taxation regime, any profits not paid out as bonuses or salary by the end of the year are taxed at the corporate level. When the profits are distributed to shareholders in the form of dividends, they are taxed at the individual level, albeit at preferential tax rates. In practice, closely held businesses engage a qualified tax planner to “zero out” the corporation by paying bonuses to the shareholders or employees or both. Although any salary or bonus paid to a shareholder incurs payroll taxes and is taxed at the shareholder's individual tax rates, there is usually a net benefit to avoiding the double taxation regime. While the IRS could theoretically claim that a salary is excessive, this would be unusual for a closely held, operating business reliant upon the efforts of the shareholder-employee. Thus, shareholders of C corporations who diligently perform their tax planning will usually end up in the same position as the owners of an LLC. However, if a C corporation implements medical and retirement plans that are available to the owner, the choice of forming a C corporation can provide a clear advantage.

The S corporation is somewhere in the middle of this flexibility spectrum. Although the profits and losses of an S corporation flow through to the shareholder, shareholders in a nonpassive business are classified as shareholder-employees, who must draw a reasonable salary. Despite the debate as to what constitutes a reasonable salary, the IRS reliably takes the position that it is most if not all of the ordinary income of the business. Any ordinary income of the S corporation not paid as a salary to the shareholder-employees is taxed at the ordinary income rates of the individual shareholder-employees; however, self-employment taxes, including the new Medicare taxes as part of Obamacare, are not levied on this ordinary income. This self-employment tax savings can benefit shareholder-employees of an S corporation, but if a reasonable salary is not paid, however, the IRS can recharacterize the amount of ordinary income as a salary and require self-employment taxes be paid on the recharacterized amount, thereby eliminating this advantage.

Basics of California Taxation

Divergent taxation of business entities in California can provide opportunities for tax savings but also pitfalls. Besides an annual \$800 tax, LLCs pay a fee on gross receipts, with a maximum fee of \$11,790, although LLCs with gross receipts between \$250,000 and \$499,999 will only pay \$900. S corporations pay a net income tax of 1.5 percent, and C corporations pay income tax of 8.84 percent—although if a reasonable salary is paid or the profit is zeroed out, there may be very little net income—with a minimum annual payment of \$800.

In practice, LLCs can often end up with the highest California tax burden due to the gross receipts tax. By contrast, C corporations may avoid all state income taxes other than the minimum \$800 annual tax by paying a reasonable salary. S corporations too could avoid all state income taxes other than the minimum \$800 annual tax by zeroing out the corporation, but doing so would eliminate the potential self-employment tax savings gained by paying less than 100 percent of the net income as salary—as long as the salary paid is reasonable.

Ultimately, the appropriate choice of business entity from a tax perspective depends on a complete review of federal as well as California taxation. The correct choice for one client may be the wrong choice for another. For example, a client with high gross receipts may value the flexibility and ease of administration of an LLC over the potential tax savings of C and S corporations, while another may be willing to pay for the additional administrative costs of a C or S corporation in order to maximize tax savings. It is much better to have a complete understanding of the available choices before forming the business rather than waiting until it comes time to file the business's first tax return. ■

Daniel C. Schwartz, a shareholder in the law firm of Schwartz & Schwartz, a professional corporation, in Calabasas, is an attorney and CPA whose work focuses on income, gift, and estate tax planning and compliance.

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ZEV YAROSLAVSKY | Since 1994, Zev Yaroslavsky has represented District 3 on the Los Angeles County Board of Supervisors

What is the perfect day? Getting things done, helping people, solving problems, thinking of big ideas, and getting them to fruition. I'm lucky. I've had a lot of perfect days.

What is overrated in the profession of government? Some people perceive it as glamorous, it's not.

Why did you choose to be a politician? Politics and world affairs, national affairs, were always a subject of conversation around the dinner table at our house—that's where I cut my teeth.

What was your best job? I've had two real jobs that lasted a while: the Los Angeles City Council and the Board of Supervisors. This is by far the most impactful; the stakes are much higher at the county.

What was your worst job? When I was in college I worked in a film development lab as a maintenance man, for four summers. It taught me what I didn't want to do.

What characteristic did you most admire in

your mother? She passed away when I was 10 years old. It is my greatest regret not to have been reared by my mother in my teen years.

Your parents expected you and your sister to emigrate to Israel, which your sister did. Is that something you considered, too? No. We visited the country in 1954; I was five and my sister was 13. I didn't like their milk and they didn't have good hamburgers.

If you were handed one million dollars tomorrow, what would you do with it? I'd put it to some good charitable, nonprofit use and invest it in the community in some way.

Who is on your music playlist? I'm a classical music fan, first and foremost.

What book is on your nightstand? Robert Caro's *The Passage of Power*.

Which fictional hero would you like to be? I don't want to be like anybody. I'm me.

Which magazine do you pick up at the doctor's office? National Geographic.

What scared you the most when you became the then-youngest member of the City Council at age 26 in 1975? I wasn't scared—nervous maybe. I didn't know how I'd be treated by people older than my grandfather.

What were you most nervous about when you became a supervisor in 1994? I had a good idea of what I wanted to accomplish—healthcare, law enforcement, fiscal stability, public safety, environment, transportation, and arts and culture.

You are terming out in December. Is there one specific thing you wish you had more time to accomplish? I don't look back.

What is your favorite vacation? I love to ski, my kids love to ski, and my wife loves to read, so she sends us off skiing while she sits in the condo reading.

What do you do on a three-day weekend? I usually spend it at a local parade.

What is your favorite hobby? I'm an avid jogger.

What are your retirement plans? I'm going to write a book, try to put pencil to paper and write a memoir.

What is your favorite sport as a participant? Running.

What is your favorite spectator sport? College football and basketball.

Which television shows do you record? *Jeopardy*.

Do you have a Facebook page? Yes.

How often do you check it? I have three or four pages now—not a personal one as much as my supervisorial Facebook. My staff checks it all the time.

Are you on Twitter? Yes.

Who do you follow? Lots of people, mostly in the public sector.

What is your favorite radio station? I have an app, Tune-In Radio. I can listen to any radio station in almost any country in the world.

Which person in history would you like to take out for a beer? Benjamin Disraeli.

What would you ask Disraeli? What the hell is your long-term plan for India?

If you had to choose only one dessert for the rest of your life, what would it be? Blueberries.

What are the three most deplorable conditions in the world? Poverty. Illness. Genocide.

Who are your two favorite U.S. presidents? Abraham Lincoln. JFK—the jury is still out on his presidency, but he summoned Americans to be bigger than themselves as individuals.

What is the one adjective you would like on your tombstone? Good.

What Courts Consider When Deciding E-Discovery Cost Awards

IN DISCOVERY, SEARCHING FOR AND PRODUCING electronically stored information (ESI) can be an extremely time-consuming task that may require costly help. Although parties may avoid prohibitive ESI production expense if they can “show that the information is not reasonably accessible” due to excessive burden or cost,¹ it is not always evident who will have to pay for complying with e-discovery without a protective order or other ruling that identifies the liable party.

Some costs may be recouped, but courts remain divided as to what e-discovery costs are recoverable. Courts appear, however, to be trending toward a more conservative approach that makes them reluctant to award a prevailing party the significant costs that can be associated with e-discovery.

An award of costs in federal court is typically governed by Federal Rule of Civil Procedure 54(d), which provides that “[u]nless a federal statute, these rules, or a court order provides otherwise, costs—other than attorney’s fees—should be allowed to the prevailing party.”² While Rule 54(d) gives the federal courts discretion to tax costs, this does not mean that a court can award costs as it feels appropriate. Federal law limits the costs that a court may award under Rule 54(d) to 1) fees of the clerk and marshal, 2) fees for printed or electronically recorded transcripts necessarily obtained for use in the case, 3) fees and disbursements for printing and witnesses, 4) fees for exemplification and the costs of making copies of any materials where the copies are necessarily obtained for use in the case, 5) docket fees under section 1923, and 6) compensation of court-appointed experts and interpreters, in addition to salaries, fees, expenses, and costs of special interpretation services.³

ESI costs are analyzed under 28 USC Section 1920(4)—“fees for exemplification and the costs of making copies of any materials where the copies are necessarily obtained for use in the case.”⁴ Not long ago, the statute only permitted the courts to tax costs for “fees for exemplification and copies of *papers*....”⁵ In 2008, Congress amended Section 1920(4) to allow fees for the costs of making copies of any materials.⁶ The federal courts have recognized that this amendment was specifically intended to permit the taxing of the cost of copying digital materials.⁷ Yet, while everyone understands what it means to make a copy of a paper document, what constitutes a copy of digital materials and what types of ESI activity fall under the category of exemplification is not always so clear. The courts are divided on the issue.

Nontaxable ESI Costs

For example, in one case, the Third Circuit denied over \$334,000 in e-discovery costs as nontaxable.⁸ In another, the Southern District of Illinois denied over \$850,000.⁹ In *Cordance Corporation v. Amazon.com, Inc.*, the Delaware district court awarded only \$2,722 of the \$447,695 requested by the defendant.¹⁰ In *Plantronics, Inc. v. Aliph, Inc.*, the defendants requested \$135,407 for in-house e-discovery costs and \$100,948 for third-party vendor costs to search, gather, and electronically produce documents to the plaintiff. The Northern District of California awarded the defendants \$20,613 for their in-



house costs and denied their request for vendor costs entirely.¹¹ As these cases suggest, courts can be reluctant to award a prevailing party the significant costs of e-discovery.

E-discovery can encompass a variety of tasks, including:

- Searching for, collecting, reviewing and determining which documents are relevant to a case or responsive to a document request.
- Imaging hard drives.
- Scanning documents.
- Creating a database.
- Converting files from native format to a noneditable format such as to a TIFF file.¹²
- Extracting metadata.
- Converting documents into a text searchable format.
- Bates numbering.
- Transferring data to a disc.
- Hosting and storing the data.

Some or all of these activities may be necessary in order for a party to respond to a request for ESI. Some of these tasks may also be necessary in order to preserve the attorney-client privilege, attorney work product, or confidentiality of the information. Nevertheless, the costs of performing these tasks are not necessarily taxable as fees for either exemplification or making copies.

The Ninth Circuit, like the majority of the circuits, has not yet considered the issue of what e-discovery costs may be awarded. The lead-

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ing case on this issue comes from the Third Circuit in *Race Tires America, Inc. v. Hoosier Racing Tire Corporation*.¹³ Pursuant to a case management order, the parties were directed to 1) produce electronic documents in TIFF accompanied by “[a] cross reference or utilization file, in standard format (e.g., Opticon, Summation, DII, or the like) showing the Bates number of each page and the appropriate utilization of the documents,” unless native file format was reasonably necessary to enable the other parties to review the files, 2) produce specific metadata fields if reasonably available (e.g., author, copied to, custodian name, date created, date last modified, and time), and 3) produce extracted text files or searchable versions for each electronic document.¹⁴ Hoosier and codefendant Dirt Motor Sports, Inc. (DMS), hired separate vendors to assist with the production and paid in excess of \$125,000 and \$240,000, respectively, for the services, which included “(1) preservation and collection of ESI; (2) processing the collected ESI; (3) keyword searching; (4) culling privileged material; (5) scanning and TIFF conversion; (6) optical character recognition... and (7) conversion of racing videos from VHS format to DVD format.”¹⁵

The district court granted summary judgment in favor of Hoosier and DMS and, pursuant to Rule 54(d), Hoosier and DMS submitted a bill of costs to the clerk seeking to recover e-discovery costs. The clerk, noting that there was no precedent from the Third Circuit on the issue, concluded that e-discovery costs were taxable and awarded Hoosier \$125,580.55 (excluding only amounts that lacked supporting detail and amounts for services performed by Hoosier’s law firm) and awarded DMS \$241,778.81, the entire amount it had requested.¹⁶ The district court affirmed the award, finding that “the steps the third-party vendor(s) performed appeared to be the electronic equivalent of exemplification and copying.”¹⁷

Race Tires appealed. The Third Circuit framed the issue as follows: “whether § 1920(4) authorizes the taxation of an electronic discovery consultant’s charges for data collection, preservation, searching, culling, conversion and production as either the ‘exemplification [or] the making [of] copies of any materials where the copies are necessarily obtained for use in the case.’”¹⁸ The Third Circuit began its analysis by distinguishing between the terms “exemplification” and “making copies.”¹⁹ The court noted that exemplification had been defined as “an official transcript of a public record, authenticated as a true copy for use as evidence” by the Federal Circuit and as “the act of illustration by example,” by the Seventh Circuit but held that none of the ESI charges qualified as exemplification fees under either definition.²⁰ The

court next considered whether the fees could be awarded as the “costs of making copies” and held that, of all the activities undertaken by the vendors, only the conversion of native files to TIFF, the scanning of copies to create digital duplicates, and the transfer of VHS recordings to DVDs constituted “making copies” under the statute and were therefore taxable. These costs totaled \$30,370—less than 10 percent of the amount incurred.²¹ The fact that the vendors’ services may have been necessary or “indispensable” to the production process was irrelevant:

It may be that extensive ‘processing’ of ESI is essential to make a comprehensive and intelligible production. Hard drives may need to be imaged, the imaged drives may need to be searched to identify relevant files, relevant files may need to be screened for privileged or otherwise protected information, file formats may need to be converted, and ultimately files may need to be transferred to different media for production. But that does not mean that the services leading up to the actual production constitute ‘making copies.’

The process employed in the predigital era to produce documents in complex litigation similarly involved a number of steps essential to the ultimate act of production. First, the paper files had to be located. The files then had to be collected, or a document reviewer had to travel to where the files were located. The documents, or duplicates of documents, were then reviewed to determine those that may have been relevant. The files designated as potentially relevant had to be screened for privileged or otherwise protected material. Ultimately, a large volume of documents would have been processed to produce a smaller set of relevant documents. None of the steps that preceded the actual act of making copies in the predigital era would have been considered taxable.²²

While some courts have found that the technical nature of a task supports a finding that the costs are taxable,²³ the Third Circuit concluded that neither the highly technical nature of e-discovery services nor the potential cost savings attributable to using an e-discovery consultant were relevant to the analysis.²⁴ Finally, the court rejected the argument that because the Federal Rules of Civil Procedure provide for discovery of ESI or the parties agreed to exchange ESI, the costs should be taxable.²⁵

The Ninth Circuit

The Ninth Circuit has yet to directly address the issue of what e-discovery costs may be

awarded to a prevailing party. In *Romero v. City of Pomona*, a 1989 case decided well before the 2008 amendment to Section 1920(4), the Ninth Circuit held that “fees are permitted only for the physical preparation and duplication of documents, not the intellectual effort involved in their production.”²⁶ District courts in the Ninth Circuit and elsewhere have relied on *Romero* to hold that costs associated with producing ESI that are attributable to intellectual effort are not taxable; however, the courts have varying interpretations of what constitutes intellectual effort. For example, in *Oracle America, Inc. v. Google Inc.*, the district court for the Northern District of California relied on *Romero* to disallow nearly \$3 million in e-discovery costs incurred by an outside vendor, holding that “the problem with...[the] bill of costs is that many of item-line descriptions seemingly bill for ‘intellectual effort’ such as organizing, searching, and analyzing the discovery documents....”²⁷ In *Jardin v. DATAlegro*, the district court for the Southern District of California upheld an award of costs for “project management” by an outside technician. The court in *Jardin* reasoned that the technician had been “engaged to perform duties limited to technical issues related to the physical production of information.” The court determined that the project manager’s tasks did not involve any intellectual effort because he did not review any documents or make any strategic decisions but rather oversaw the process of conversion “to prevent inconsistent and duplicative processing.”²⁸

Jardin, however, was decided before *Race Tires*. It was also decided before the U.S. Supreme Court’s decision in *Taniguchi v. Kan Pacific Saipan, Ltd.*²⁹ Although *Taniguchi* addressed the costs of interpreters, not e-discovery, the case nevertheless has influenced the interpretation of Section 1920(4). Reversing a Ninth Circuit decision holding that the cost of document translation was taxable as “compensation of interpreters” under Section 1920(6), the Supreme Court rejected the notion that district courts are “free to interpret the meaning of the cast of categories listed within [Section] 1920.”³⁰ The Court reasoned that taxable costs under Section 1920 are not synonymous with the everyday meaning of “expenses” but instead “are limited to relatively minor, incidental expenses.”³¹ Several district courts have since relied on *Taniguchi* to limit the scope of e-discovery costs that may be recovered.³²

The Fourth Circuit is the only court of appeal to date to have expressly adopted *Race Tires*,³³ but numerous district courts across the country have relied on the Third Circuit’s decision in analyzing whether to tax certain e-discovery costs. Most of those courts have agreed that the conversion of native digital files to an

agreed-upon production format (e.g., TIFF or PDF) and the scanning of paper documents to create digital duplicates for production in discovery are compensable costs under Section 1920(4).³⁴ The courts, however, are split on whether other types of ESI costs are taxable, especially those incurred prior to the conversion of the data to another format, such as TIFF or PDF. Examples of these “processing costs” include those incurred for performing key word searches, creating and maintaining an electronic discovery database, extracting metadata, OCR, eliminating duplicates, and hosting or storing electronic data.

Some courts take a conservative approach and hold that activities undertaken prior to conversion of the document to a PDF or TIFF are not taxable.³⁵ Other courts have read Section 1920(4) more broadly and have allowed a party to recover costs for collecting and processing ESI.³⁶ One factor that may be relevant is whether or not the parties agreed to the form of production or whether one party unilaterally decided to produce the information in a particular format.³⁷ Even having an agreement, however, does not guarantee that costs will be recoverable. In *Plantronics*, the parties had agreed on the form of production, yet the Northern District of California declined to tax over \$200,000 in e-discovery processing costs when the agreement only discussed the form of production and not the costs associated with the production under Rule 54(d).³⁸

While the courts are trending toward constraining costs to specific types of e-discovery tasks, case law in this area is continuing to evolve and consists for the most part of unpublished decisions. Unfortunately, it does not appear likely there will be a legislative fix soon. Last year, the Advisory Committee on Civil Rules published for public comment Proposed Amendments to the Federal Rules of Civil Procedure. No amendments to Rule 54 were proposed. Nor does it appear that the district courts are willing to resolve the question through amendments to the local rules. For now, the courts remained tasked with defining “exemplification” and “making copies” on a case-by-case basis—whether the courts will rely on the Supreme Court’s rationale in *Taniguchi* to tip the scales against the recovery of e-discovery costs remains to be seen. Until then, attorneys and their clients should assume that the costs of meeting discovery requirements may be borne by the litigant that incurred them. ■

¹ FED. R. CIV. P. 26(b)(2)(B).

² FED. R. CIV. P. 54(d) (emphasis added).

³ See generally 28 U.S.C. §1920.

⁴ Some district courts have local rules that attempt to clarify or expand the foregoing categories. See, e.g., N.D. CAL. CIV. R. 54-3(d)(3) (providing that “[t]he cost of reproducing disclosure or formal discovery documents when used for any purpose in the case is allow-

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able” but that “[t]he cost of reproducing copies of motions, pleadings, notices, and other routine case papers is not allowable”); S.D. CAL. CIV. R. 54.1(b)(6) (listing various criteria that must be met before costs of copies will be taxable).

⁵ 28 U.S.C. §1920(4) (2008) (amended by Judicial Administration and Technical Amendments Act of 2008, Pub. L. No. 110-406, 122 Stat. 4291) (2008) (emphasis added).

⁶ *Race Tires Am., Inc. v. Hoosier Racing Tire Corp.*, 674 F. 3d 158, 165 (3d Cir. 2012) (citing Judicial Administration & Technical Amendments Act of 2008, Pub. L. No. 110-406, §6(2), 122 Stat. 4291 (2008)).

⁷ See, e.g., *Race Tires*, 674 F. 3d at 165; *Jardin v. DATAllegro, Inc.*, No. 08-cv-1462, 2011 WL 4835742, at *5 (S.D. Cal. Oct. 12, 2011); *El Camino Res., Ltd. v. Huntington Nat. Bank*, 1:07-cv-598, 2012 WL 4808741, at *5 (W.D. Mich. May 3, 2012) *report and recommendation approved*, 1:07-CV-598, 2012 WL 4808736 (W.D. Mich. Oct. 10, 2012).

⁸ *Race Tires*, 674 F. 3d 158.

⁹ *Johnson v. Allstate Ins. Co.*, No. 07-cv-0781, 2012 WL 4936598 (S.D. Ill. Oct. 16 2012).

¹⁰ *Cordance Corp. v. Amazon.com, Inc.*, 855 F. Supp. 2d 244 (D. Del. 2012).

¹¹ *Plantronics, Inc. v. Aliph, Inc.*, No. C 09-01714, 2012 WL 6761576 (N.D. Cal. Oct. 23, 2012).

¹² “TIFF” stands for Tagged Image File Format.

¹³ *Race Tires Am., Inc.*, 674 F. 3d 158.

¹⁴ *Id.* at 161.

¹⁵ *Id.* at 161-62.

¹⁶ *Id.* at 162-63.

¹⁷ *Id.* at 163.

¹⁸ *Id.* at 164-65.

¹⁹ Not all courts distinguish between “exemplification” and “making copies,” sometimes treating the terms as interchangeable. See, e.g., *Eaglesmith v. Ray*, No. 2:11-cv-00098, 2013 WL 1281823, at *3 (E.D. Cal. Mar. 26, 2013) (“costs related to converting e-data from one format into another, blowbacks, and Bates stamping are valid exemplification costs”); *Pacificorp v. Northwest Pipeline GP*, No. 3:10-cv-00099, 2012 WL 6131558, at *6 (D. Or. Dec. 10, 2012) (When “circumstances require conversion of electronic data into a different format to share with parties during discovery, ‘exemplification’ has been deemed to encompass all costs stemming from that process of conversion.”); *BDT Prods., Inc. v. Lexmark Int’l, Inc.*, 405 F. 3d 415, 420 (6th Cir. 2005), *abrogated on other grounds by Taniguchi v. Kan Pacific Saipan, Ltd.*, 132 S. Ct. 1997, 182 L. Ed. 2d 903 (2012) (“[E]lectronic scanning and imaging could be interpreted as ‘exemplification and copies of papers.’”).

²⁰ *Race Tires Am.*, 674 F. 3d at 166.

²¹ *Id.* at 167-68.

²² *Id.* at 169.

²³ See, e.g., *Pacificorp*, 2012 WL 6131558, at *7 (D. Or. Dec. 10, 2012) (“Because the task of converting already selected files into a database is a purely technical one,...these costs are taxable.”)

²⁴ *Id.*

²⁵ *Race Tires Am.*, 674 F. 3d at 170.

²⁶ *Romero v. City of Pomona*, 883 F. 2d 1418, 1428 (9th Cir. 1989), *overruled in part on other grounds by Townsend v. Holman Consulting Corp.*, 914 F. 2d 1136 (9th Cir. 1990).

²⁷ *Oracle Am., Inc. v. Google Inc.*, No. C 10-03561, 2012 WL 3822129, at *3 (N.D. Cal. Sept. 4, 2012); see also *Gabriel Techs. Corp. v. Qualcomm Inc.*, 2010 WL 3718848 (S.D. Cal. Sept. 20, 2010) (\$1.5 million fee for third-party consultant to assist with e-discovery was not recoverable).

²⁸ *Jardin v. DATAllegro, Inc.*, No. 08-cv-1462, 2011 WL 4835742, at *9 (S.D. Cal. Oct. 12, 2011).

²⁹ *Taniguchi v. Kan Pacific Saipan, Ltd.*, 132 S. Ct. 1997, 2006, 182 L. Ed. 2d 903 (2012).

³⁰ *Taniguchi v. Kan Pacific Saipan, Ltd.*, 633 F. 3d 1218, 1221 (9th Cir. 2011).

³¹ *Taniguchi*, 132 S. Ct. at 2006.

³² See *Country Vintner of N.C., LLC v. E&J Gallo Winery*, 718 F. 3d 249, 260 (4th Cir. 2013) (limiting taxable costs to converting electronic files to noneditable formats and burning files on to disks); *Ancora Techs., Inc. v. Apple, Inc.*, No. 11-cv-06357, 2013 WL 4532927, at *3 (N.D. Cal. Aug. 26, 2013) (Costs associated with storage and hosting of electronic documents were not recoverable under Section 1920 in light of *Taniguchi*'s holding—rejecting authority that predated *Taniguchi*.); *Plantronics, Inc. v. Aliph, Inc.*, No. C 09-01714, 2012 WL 6761576, at *16-17 (N.D. Cal. Oct. 23, 2012) (The costs for electronic TIFF and PDF conversion and OCR of documents produced in discovery were permissible exemplification costs, but pre-production document collection and processing costs were not.).

³³ *Country Vintner*, 718 F. 3d 249 (4th Cir. 2013).

³⁴ See, e.g., *El Camino Res., Ltd. v. Huntington Nat. Bank*, 1:07-cv-598, 2012 WL 4808741, at *7 (W.D. Mich. May 3, 2012) *report and recommendation approved*, 1:07-CV-598, 2012 WL 4808736 (W.D. Mich. Oct. 10, 2012) (“Under the *Race Tires America* approach, the only compensable costs are (a) the conversion of native digital files to the agreed-upon production format and (b) the scanning of paper documents to create digital duplicates for production in discovery.”); *Warner Chilcott Labs. Ireland Ltd. v. Impax Labs., Inc.*, No. 08-6304, 2013 WL 1716468, at *10 (D. New Jersey, Apr. 18, 2013) (taxing only costs associated with TIFF conversion and making copies of original DVDs and CD); *Eaglesmith v. Ray*, No. 2:11-cv-00098, 2013 WL 1281823, at *4 (E.D. Cal. Mar. 26, 2013) (holding that costs associated with OCR were not recoverable); *Amana Soc’y, Inc. v. Excel Eng’g, Inc.*, No. 10-cv-168, 2013 WL 427394, at *6 (Feb. 4, 2013) (disallowing cost of OCR performed by on the ground that OCR is an activity “traditionally...done by attorneys or support staff, and therefore, are not taxable”). At least one court, however, has disallowed even the costs for conversion of native files to TIFF because the decision to convert the files was voluntary. See *Eolas Techs. Inc. v. Adobe Sys., Inc.*, 891 F. Supp. 2d 803, 807 (E.D. Tex. 2012), *aff’d sub nom. Eolas Techs. Inc. v. Amazon.com, Inc.*, 521 F. App’x 928 (Fed. Cir. 2013).

³⁵ See, e.g., *Country Vintner*, 718 F. 3d at 253 (allowing costs in the amount of \$218.59 but disallowing \$101,858 in ESI processing charges); *Abbott Point of Care, Inc. v. Epocal, Inc.*, No. CV-08-S-543, 2012 WL 7810970, at *2-4 (N.D. Ala. Nov. 5, 2012) (denying request for costs in the amount of \$340,498 for maintaining an electronic discovery database); *Finnerty v. Stiefel Labs., Inc.*, 900 F. Supp. 2d 1317 (S.D. Fla. Oct. 16, 2012) (refusing to award the costs of an electronic database that was solely for the creating party’s convenience); *Johnson v. Allstate Ins. Co.*, No. 07-cv-0781, 2012 WL 4936598, at *6 (S.D. Ill. Oct. 16 2012).

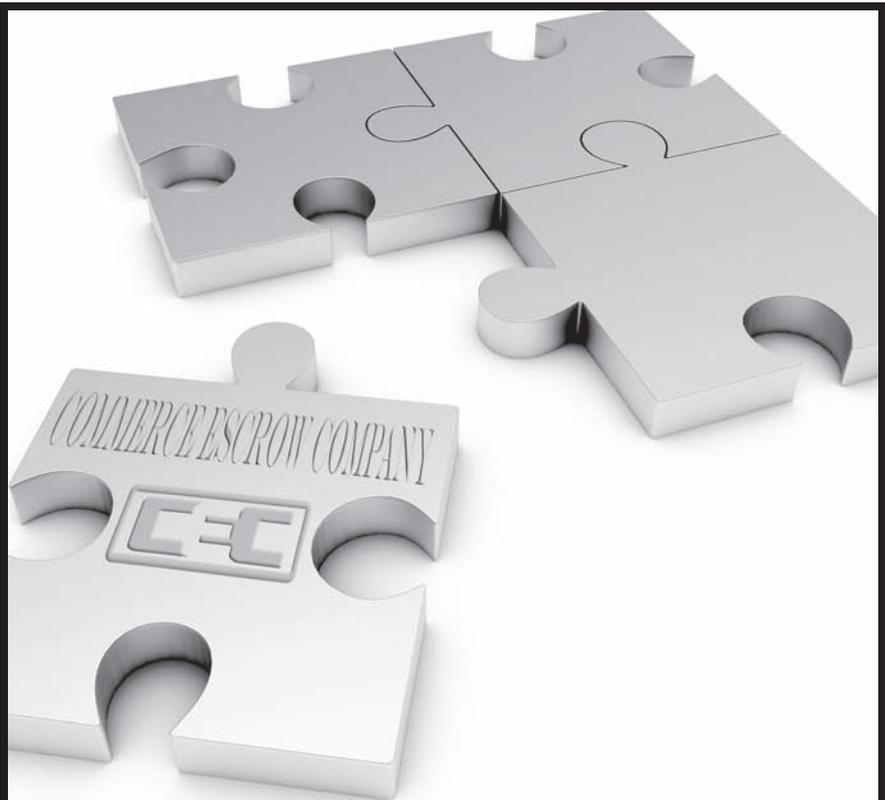
³⁶ See, e.g., *Pacificorp v. Northwest Pipeline GP*, No. 3:10-cv-00099, 2012 WL 6131558, at *7 (D. Or. Dec. 10, 2012) (costs of converting selected files into a database and the storage of electronic data were taxable); *eBay Inc. v. Kelora Sys., LLC*, No. C 10-4947, 2013 WL 1402736, at *8-9 (N.D. Cal. April 5, 2013) (allowing “relatively modest” processing costs); *Parrish v. Manatt, Phelps & Phillips, LLP*, No. 10-03200, 2011 WL 1362112, at *2 (N.D. Cal. Apr. 11, 2011) (“The reproduction costs defendants incurred...were necessary....As such, they are properly taxable.”)

³⁷ See, e.g., *Race Tires Am., Inc. v. Hoosier Racing Tire Corp.*, 674 F. 3d 158, 166 (3d Cir. 2012); *In re Ricoh Co., Ltd. Patent Litig.*, 661 F. 3d 1361, 1367 (Fed. Cir. 2011); *eBay*, 2013 WL 1402736, at *8; *Plantronics, Inc.*, 2012 WL 6761576, at *15.

³⁸ *Plantronics*, 2012 WL 6761576 at *16.



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The Effect of *Howell* on Personal Injury Medical Cost Recovery

IN *HOWELL V. HAMILTON MEATS & PROVISIONS, INC.*, the California Supreme Court established that personal injury plaintiffs are limited to recovering the amounts actually paid for medical costs, not the amounts supposedly billed by their medical providers.¹ This decision is an example of how the law evolves to reflect a changing society. When doctors still made house calls, they billed for services at the rates they expected to be paid. *Howell* confronted the new financial reality that almost nobody pays the full amount billed by medical providers. A special report in *Time* magazine offered numerous examples of the gap between billed and paid amounts, such as a patient with “[c]harges for blood and lab tests [that] amounted to more than \$15,000; with Medicare, they would have cost a few hundred dollars.”² Indeed, government data reveals that “hospitals charge Medicare wildly differing amounts—sometimes 10 to 20 times what Medicare typically reimburses.”³

In *Howell*, the supreme court held that a plaintiff may recover “no more than the amounts paid by the plaintiff or his or her insurer for the medical services received...”⁴ The court explained that, “[t]o be recoverable, a medical expense must be...incurred.”⁵ “[I]f the plaintiff negotiates a discount and thereby receives services for less than might reasonably be charged, the plaintiff has not suffered a pecuniary loss or other detriment in the greater amount and therefore cannot recover damages for that amount.”⁶

Howell's holding is founded on longstanding damages principles. In 1872, the California Legislature decreed that tort damages require detriment.⁷ As the *Howell* court summarized: “damages are awarded to compensate for detriment suffered” and “detriment is a loss or harm to person or property.”⁸ Accordingly, when a healthcare provider has accepted as full payment an amount less than stated in the bill, the plaintiff cannot recover for “the undiscounted sum stated in the provider’s bill but never paid by or on behalf of the injured person...for the simple reason that the injured plaintiff did not suffer any economic loss in that amount.”⁹

The amount incurred for medical care is not the only limit on recoverable medical damages: A plaintiff may recover the lesser of the amount actually paid for, or the reasonable value of, medical services. As the court stated in *Howell*: “To be recoverable, a medical expense must be both incurred *and* reasonable.”¹⁰ The *Howell* court explained that pricing for medical services is controlled by a highly complex market—one in which prices vary to a significant extent depending on the categories of payees and payors.¹¹ Some payors, such as private health insurers, are “well equipped to conduct sophisticated arm’s-length price negotiations.”¹² Other payors are guaranteed discounted rates by state law.¹³ Consequently, most patients, including those who are insured, uninsured, and recipients under government healthcare programs, pay steeply discounted rates.¹⁴ Indeed, as the facts of some published decisions reveal, a 5-to-1 ratio between amounts billed and amounts paid is not unusual.¹⁵

Due to these industry practices, medical care billing is unlike that in other commercial contexts in which the word “bill” is generally understood as a demand for payment in the amount stated. As the *Howell* court explained: “Because so many patients, insured, uninsured, and recipients under government healthcare programs, pay discounted rates, hospital bills have been called ‘insincere, in the sense that they would yield truly enormous profits if those prices were actually paid.’”¹⁶

Given market realities, *Howell* held that the amount nominally billed for medical expenses does not reflect the value of the services provided. Thus, drawing any generalizations about the relationship

As the facts of some published decisions reveal, a 5-to-1 ratio between amounts billed and amounts paid is not unusual.

between the cost of medical care and the amounts billed for that care “other than that the relationship is not always a close one—would be perilous.”¹⁷ Further, the court found that “it is not possible to say generally that providers’ full bills represent the real value of their services, nor that the discounted payments they accept from private insurers are mere arbitrary reductions”; and “how a market value other than that produced by negotiation between the insurer and the provider could be identified is unclear.”¹⁸

Nevertheless, a recent court of appeal decision provides some hard numbers quantifying the discrepancy between what is billed and what is paid. In *Children’s Hospital Central California v. Blue Cross*, the evidence at trial showed that, “in 2007 and 2008, less than five percent of the payors paid Hospital the full billed charges.”¹⁹ Stated differently, 19 out of 20 bills were paid at a discounted amount. Moreover, other sources examining the issue nationally have come up with similar numbers.²⁰

As a result, the medical bills have little if any evidentiary value. Addressing the facts before it, the California Supreme Court held “evidence of the full billed amount is not itself relevant on the issue of past medical expenses.”²¹ By contrast, evidence of the amount actually paid for medical expenses is relevant and not barred by the collateral source rule. “[W]hen a medical care provider has...accepted as full payment for the plaintiff’s care an amount less than the provider’s full bill, evidence of that amount is relevant to prove the plaintiff’s damages for past medical expenses and, assuming it satisfies other rules of evidence, is admissible at trial.”²²

The principles of the collateral source rule remain intact because the plaintiff can still recover as damages the amount paid for med-

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ical expenses even if the plaintiff's insurance company made the payment. Since the plaintiff does not owe the higher amount that the medical providers have stated in their bills, but was never incurred, that higher amount "simply does not come within the rule."²³

Corenbaum and Romine

The *Howell* court did not address whether evidence of the billed amount might be relevant to other issues not before that court, "such as noneconomic damages or future medical expenses."²⁴ These issues were decided by the court of appeal in *Corenbaum v. Lampkin*.²⁵ The *Corenbaum* court held that evidence of the billed amount is not relevant to these other issues for the same reasons that it is not relevant to the issue of past medical damages.

Applying *Howell's* reasoning, *Corenbaum* began with the proposition that "the full amount billed is not an accurate measure of the value of medical services."²⁶ From that starting point, the court of appeal concluded that the billed amount "is not relevant to a determination of the reasonable value of future medical services."²⁷ For the same reasons, *Corenbaum* precluded expert witnesses from relying on the inflated billed amount" to support opinions regarding future medical expenses: evidence of billed amounts "cannot support an expert opinion on the reasonable value of future medical services."²⁸

Corenbaum further concluded that the amount billed is inadmissible to prove a plaintiff's noneconomic damages. During trial, evidence of medical costs is often used as an argumentative construct to assist a jury in determining a plaintiff's noneconomic damages.²⁹ The *Corenbaum* court, however, held that evidence of the billed amount could not be used for that purpose and is generally "inadmissible for the purpose of proving noneconomic damages."³⁰

Corenbaum determined that "evidence of the full amounts billed for [the plaintiffs'] medical care was not relevant to the amount of [the plaintiffs'] damages for past medical expenses, future medical expenses or noneconomic damages."³¹ Thus, under *Howell* and *Corenbaum*, a plaintiff's evidentiary showing should be limited to the paid amount, not the inflated amount listed on a hospital bill, and the plaintiff's recoverable damages should be limited to the lesser of the amount paid or the reasonable amount.

Some have argued that *Howell* and *Corenbaum* turn on the existence of private insurance and that plaintiffs without insurance, unlike those with it, should be able to introduce evidence of the billed amounts. Courts have rejected this argument. The principles in *Howell* and *Corenbaum* have been applied to plaintiffs with coverage under Medicare and

the workers' compensation system.³² As one court of appeal explained, any attempt to limit *Howell* to its facts "does not account for the fact that, whatever the source of the payments...the end result is the same: [the plaintiff] has no liability for past medical services in excess of those payments, so he is not entitled to recover anything more than the payment amount."³³

A decision from earlier this year is informative. In *Romine v. Johnson Controls, Inc.*,³⁴ the court of appeal primarily addressed the issue of prejudice from the erroneous admission of evidence in a pre-*Howell* trial. However, the court of appeal summarized the broad legal principles from *Howell* and *Corenbaum*: "evidence of the full amount billed for a plaintiff's medical care is not relevant to damages for future medical care or noneconomic damages and its admission is error."³⁵ The *Romine* court applied this rule without regard to the source of the payments. Indeed, the court noted only that the jury's award of past medical damages was properly reduced to "the amount that plaintiff's medical care providers accepted."³⁶ As understood by the *Romine* court, the legal principles from *Howell* and *Corenbaum* apply regardless of the payer's identity.

Uninsured Plaintiffs

Some have argued that *Howell* and *Corenbaum* do not apply to future medical expenses if the plaintiff is uninsured or might become uninsured. This argument raises interesting issues involving the interplay of the bar against speculative damages, the obligation to obtain insurance, and the duty to mitigate damages.

First, although damages need not be established with absolute certainty, they cannot be speculative. "Where the fact of damages is certain, the amount of damages need not be calculated with absolute certainty. The law requires only that some reasonable basis of computation of damages be used, and the damages may be computed even if the result reached is an approximation."³⁷ Nonetheless, while the bar is not set so high as to require absolute certainty, it is not set so low as to require only a possibility: "damages which are speculative, remote, imaginary, contingent, or merely possible cannot serve as a legal basis for recovery."³⁸

Second, the Patient Protection and Affordable Care Act of 2010 (PPACA), also known as Obamacare, now generally mandates that everyone obtain and maintain health insurance.³⁹ The PPACA requires that health insurance policies be offered on a guaranteed issue and guaranteed renewal basis.⁴⁰ The PPACA also prohibits health insurers from discriminating against prospective insureds on the basis of health status, including any preexisting condition: "A group health plan and a

health insurance issuer offering group or individual health insurance coverage may not impose any preexisting condition exclusion with respect to such plan or coverage."⁴¹

Finally, a plaintiff has a duty to mitigate damages by taking reasonable steps to minimize the loss caused by a defendant's actions.⁴² "A plaintiff cannot recover damages that would have been avoidable by his or her ordinary care and reasonable exertions [and] [i]ncreased loss due to the plaintiff's willfulness or negligence is the plaintiff's own burden."⁴³

The interplay of these three legal principles could be significant. Although the courts have yet to directly confront the issue, the duty to mitigate damages might obligate a plaintiff to purchase medical insurance to obtain future medical treatment at negotiated rates. Because a plaintiff now has the right and obligation to obtain insurance under the PPACA, the plaintiff arguably cannot recover medical damages premised on a failure to obtain the insurance mandated by federal law. Any argument that the plaintiff may fail to comply with the PPACA would be impermissible speculation.

Gratuitous Medical Care

The *Howell* court observed that in other states the collateral source rule is often applied to gratuitous services and would allow a plaintiff to recover the value of donated medical care. However, the *Howell* court also observed that California law on this point was unclear.⁴⁴ Decades ago, in *Helfend v. Southern California Rapid Transit District*, the California Supreme Court suggested that the collateral source rule applied to unpaid services only when rendered "with the expectation of repayment out of any tort recovery."⁴⁵ But in *Arambula v. Wells*, the court of appeal declined to follow the *Helfend* dictum.⁴⁶ The *Arambula* court instead held the collateral source rule allowed recovery of "gratuitous payments...by family or friends to assist tort victims through difficult times."⁴⁷ The *Arambula* court reasoned that any other rule would conflict with the policy of encouraging charity.⁴⁸

In *Howell*, the Supreme Court recognized the conflict between *Helfend* and *Arambula*, but left it to be resolved another day. The *Howell* court explained that the rationale for allowing recovery for gratuitous care—an incentive to charity—did not apply to the facts before it involving commercially negotiated price agreements between medical providers and health insurers.⁴⁹

In *Sanchez v. Strickland*, the court of appeal dealt with this issue that had been left open in *Howell*.⁵⁰ The case involved personal injuries from an automobile accident. The medical provider billed \$113,988.58, and Medicare paid \$66,704, declining to pay \$40,264.58.⁵¹

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This left a balance of \$7,020. The decision did not fully explain the handling of this balance but quoted a declaration from a medical provider that the provider “billed the remaining \$7,020.00 to Medi-Cal, but wrote off that amount, as [the provider was] not contracted with Medi-Cal.”⁵²

While the *Sanchez* court discussed *Howell* and *Arambula*, it ignored the contrary dictum in *Helfend*. This court held that a plaintiff may recover damages for past medical expenses that have been written off so long as the medical provider has “(1) rendered medical services to a plaintiff, (2) issued a bill for those services, and (3) subsequently written off a portion of the bill gratuitously.”⁵³ Thus, the court held the plaintiff could recover the \$7,020 balance that had been “gratuitously” written off by the medical provider.⁵⁴

Sanchez is perplexing because not every write-off is gratuitous. Indeed, *Howell* emphasized the distinction between write-offs made for commercial versus charitable purposes.⁵⁵ In *Sanchez*, the provider purportedly wrote off the \$7,020 balance only because the provider lacked a Medi-Cal contract.⁵⁶ This seems a singularly commercial reason for writing off a medical bill, but perhaps facts before the *Sanchez* court—not apparent from the decision—showed otherwise.

Third-Party Financing

In *Dodd v. Cruz*, the court of appeal addressed the effect on recoverable medical damages when the bill for medical services is sold to a third-party financing company (a factor), which asserts a claim against the plaintiff for the full amount billed.⁵⁷ However, the California Supreme Court later ordered the *Dodd* opinion depublished, so the opinion can no longer be cited as authority in California state courts.⁵⁸

The plaintiff in *Dodd* was referred by his lawyer to a medical services provider. That provider, in turn, sold its account receivable to a factor, which coincidentally was owned in part by the plaintiff’s attorney. The defendant subpoenaed documents to ascertain the amount that the factor actually paid the medical provider for the lien.⁵⁹ The trial court granted the plaintiff’s motion to quash the subpoena and sanctioned defense counsel \$5,600.⁶⁰

The defendant appealed, and the court of appeal reversed both the discovery ruling and the sanctions award while reaffirming the rule that the amount billed by the medical provider (with no expectation of full payment) is not the test: “The amount a health-care provider bills a plaintiff for its medical services is not relevant to the amount of the plaintiff’s economic damages for past medical services.”⁶¹ Therefore, the subpoena sought information concerning what the medical provider actually accepted from the factor

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pursuant to the arrangement to discharge the medical provider's account receivable.⁶² As the court noted, the defense expert could rely on this figure in calculating the amount of the plaintiff's past medical expenses.⁶³ Further, discovery could establish that the arrangement was distinct from one in which the plaintiff remained fully liable for the medical provider's charges.⁶⁴

Although the court of appeal's decision in *Dodd* can no longer be cited as authority, the court of appeal in another case reaffirmed *Dodd's* discovery analysis in a decision that was filed in June of 2014. In *Children's Hospital*, the court of appeal held that Blue Cross should have been allowed to conduct discovery into the amounts paid by other parties for the hospital's medical services. The hospital argued that the discovery would disclose proprietary financial information and trade secrets. The court of appeal held that any such interests could be protected through the use of protective orders.⁶⁵

As these decisions show, the change in law that the California Supreme Court began three years ago in *Howell* continues to reverberate through the appellate courts today. *Howell's* recognition of fundamental market realities for medical pricing continues to necessitate corresponding changes across a range of medical damages issues, and those reverberations are likely to persist. ■

²³ *Id.* at 565.

²⁴ *Id.* at 567.

²⁵ *Corenbaum v. Lampkin*, 215 Cal. App. 4th 1308 (2013).

²⁶ *Id.* at 1330.

²⁷ *Id.* at 1331.

²⁸ *Id.*

²⁹ *Helfend v. S. Cal. Rapid Transit Dist.*, 2 Cal. 3d 1, 11 (1970) ("[T]he cost of medical care often provides both attorneys and juries in tort cases with an important measure for assessing the plaintiff's general damages.").

³⁰ *Corenbaum*, 215 Cal. App. 4th at 1333.

³¹ *Id.*

³² *Luttrell v. Island Pac. Supermarkets, Inc.*, 215 Cal. App. 4th 196, 198 (2013) (Medicare); *Sanchez v. Brooke*, 204 Cal. App. 4th 126, 131 (2012) (workers' compensation system).

³³ *Luttrell*, 215 Cal. App. 4th at 206 (emphasis in original).

³⁴ *Romine v. Johnson Controls, Inc.*, 224 Cal. App. 4th 990 (2014).

³⁵ *Id.* at 1014.

³⁶ *Id.*

³⁷ *GHK Assocs. v. Mayer Grp. Inc.*, 224 Cal. App. 3d 856, 873 (1990) (citations omitted) (emphasis in original).

³⁸ *Piscitelli v. Friedenber*, 87 Cal. App. 4th 953, 989 (2001) (quoting *Frustuck v. City of Fairfax*, 212 Cal. App. 2d 345, 367-68 (1963)).

³⁹ 26 U.S.C. §5000A(a) (2012) ("An applicable individual shall for each month beginning after 2013 ensure that the individual, and any dependent of the individual who is an applicable individual, is covered under minimum essential coverage for such month.").

⁴⁰ 42 U.S.C. §§300gg-1(a), 300gg-2(a).

⁴¹ 42 U.S.C. §300gg-3(a); see generally *National Fed'n of Indep. Bus. v. Sebelius*, 567 U.S. ___, 132 S. Ct. 2566, 2580 (2012) (discussing the PPACA's provisions).

⁴² See *Placer County Water Agency v. Hofman*, 165 Cal. App. 3d 890, 897 (1985).

⁴³ *Mayer v. Sturdy N. Sales, Inc.*, 91 Cal. App. 3d 69, 85-86 (1979) (citations omitted); *accord*, *Thrifty-Tel, Inc. v. Bezenek*, 46 Cal. App. 4th 1559, 1568 (1996).

⁴⁴ *Howell v. Hamilton Meats & Provisions, Inc.*, 52 Cal. 4th 541, 557-58 (2011).

⁴⁵ *Helfend v. Southern Cal. Rapid Transit Dist.*, 2 Cal. 3d 1, 7 n.5 (1970).

⁴⁶ *Arambula v. Wells*, 72 Cal. App. 4th 1006, 1010 (1999).

⁴⁷ *Id.* at 1008.

⁴⁸ *Id.* at 1013.

⁴⁹ *Howell*, 52 Cal. 4th at 559.

⁵⁰ *Sanchez v. Strickland*, 200 Cal. App. 4th 758 (2011).

⁵¹ *Id.* at 767.

⁵² *Id.* (quoting declaration of Vibra Healthcare operations manager).

⁵³ *Id.* at 769.

⁵⁴ *Id.*

⁵⁵ See *Howell v. Hamilton Meats & Provisions, Inc.*, 52 Cal. 4th 541, 558-59 (2011).

⁵⁶ *Sanchez*, 200 Cal. App. 4th at 767.

⁵⁷ *Dodd v. Cruz*, 167 Cal. Rptr. 3d 601 (2014).

⁵⁸ "A Supreme Court order to depublish is not an expression of the court's opinion of the correctness of the result of the decision or of any law stated in the opinion." Cal. R. Ct. 8.1125(d).

⁵⁹ *Dodd*, 167 Cal. Rptr. at 603-04.

⁶⁰ *Id.* at 604.

⁶¹ *Id.* at 606-07.

⁶² *Id.* at 608.

⁶³ *Id.*

⁶⁴ Cf. *Katiuzhinsky v. Perry*, 152 Cal. App. 4th 1288, 1296 (2007).

⁶⁵ *Children's Hosp. Cent. Cal. v. Blue Cross*, 226 Cal. App. 4th 1260, 1277 (2014).

¹ *Howell v. Hamilton Meats & Provisions, Inc.*, 52 Cal. 4th 541, 566 (2011).

² Steven Brill, *Bitter Pill: Why Medical Bills Are Killing Us*, TIME, Mar. 4, 2013, at 10, 19.

³ Barry Meier, Jo Craven McGinty & Julie Creswell, *Hospital Billing Varies Wildly, Government Data Shows*, N.Y. TIMES, May 8, 2013, at A1.

⁴ *Howell*, 52 Cal. 4th at 566.

⁵ *Id.* at 555.

⁶ *Id.*

⁷ CIV. CODE §§3281, 3283.

⁸ *Howell*, 52 Cal. 4th at 548.

⁹ *Id.*

¹⁰ *Id.* at 555 (emphasis in original).

¹¹ *Id.* at 561-62.

¹² *Id.* at 562.

¹³ *Id.* at 561.

¹⁴ *Id.* at 561-62 & n.9.

¹⁵ See, e.g., *Luttrell v. Island Pac. Supermarkets, Inc.*, 215 Cal. App. 4th 196, 199 (2013) (\$138,082 accepted as full payment, despite a bill of \$690,548.).

¹⁶ *Howell*, 52 Cal. 4th at 561 (quoting Uwe E. Reinhardt, *The Pricing of U.S. Hospital Services: Chaos behind a Veil of Secrecy*, 25 HEALTH AFFAIRS 57, 63 (2006)).

¹⁷ *Id.* at 562.

¹⁸ *Id.*

¹⁹ *Children's Hosp. Cent. Cal. v. Blue Cross*, 226 Cal. App. 4th 1260, 1268 (2014).

²⁰ George A. Nation III, *Obscene Contracts: The Doctrine of Unconscionability and Hospital Billing of the Uninsured*, 94 KY. L.J. 101, 104 (2005) (Labeling hospital charges as "regular," "full," or "list," [is] misleading, because in fact they are actually paid by less than five percent of patients nationally.").

²¹ *Howell*, 52 Cal. 4th at 567.

²² *Id.*

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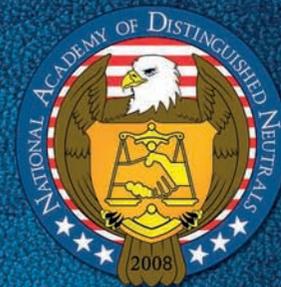
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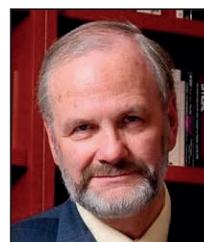
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SmartPhone Link

by Lawrence Segal and Andrew D. Shupe

Who's LISTENING?

The broad protections of the California Invasion of Privacy Act against unauthorized recording of telephone communications are not without idiosyncrasies

VIRTUALLY EVERYONE has noticed that telephone conversations with customer service representatives often begin with a familiar warning that the call “may be monitored or recorded for quality assurance,” or some similar statement. However, whether the monitoring or recording of telephone calls is illegal in the absence of such a warning and the nature and type of civil remedies that may be available, in addition to any criminal penalties that could be imposed, are subject to complex guidelines set out in the California statutes. Defendants who engage in the monitoring or recording of telephone conversations without all parties’ consent may face significant exposure, but plaintiffs who ignore the idiosyncrasies of California’s statutory scheme do so at their peril when preparing claims based upon the unannounced monitoring or recording of their telephone calls. Plaintiffs’ claims may fail if they do not allege and prove that the monitored or recorded communications were confidential, a finding that may depend upon the content of the communications and the relationship and past interaction of the parties. California and federal district courts have variously interpreted this aspect of the law in recent years.

The California Invasion of Privacy Act (CIPA), enacted in 1967 and subsequently amended, bars various acts of eavesdropping upon, intercepting, or recording commu-

nications.¹ With regard to recording telephone conversations, CIPA replaced prior laws that permitted the recording of calls with the consent of one party to the conversation.² “The purpose of the act was to protect the right of privacy by, among other things, requiring that all parties consent to a recording [or monitoring] of their conversation.”³ For example, even if a company has assigned a supervisor only to listen while a customer service representative talks by telephone with a customer, the monitoring may violate CIPA; the two employees do not constitute a single corporate party because CIPA “protects the consumer’s right to know *the audience* to whom he or she is speaking....”⁴ The privacy rights affected are the same regardless of whether a conversation is secretly recorded by a machine or monitored by a human being.⁵

Section 637.2

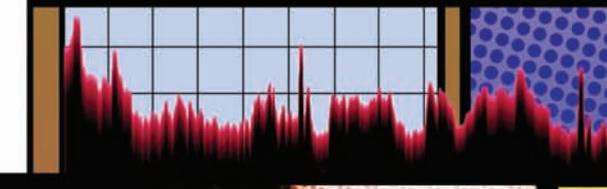
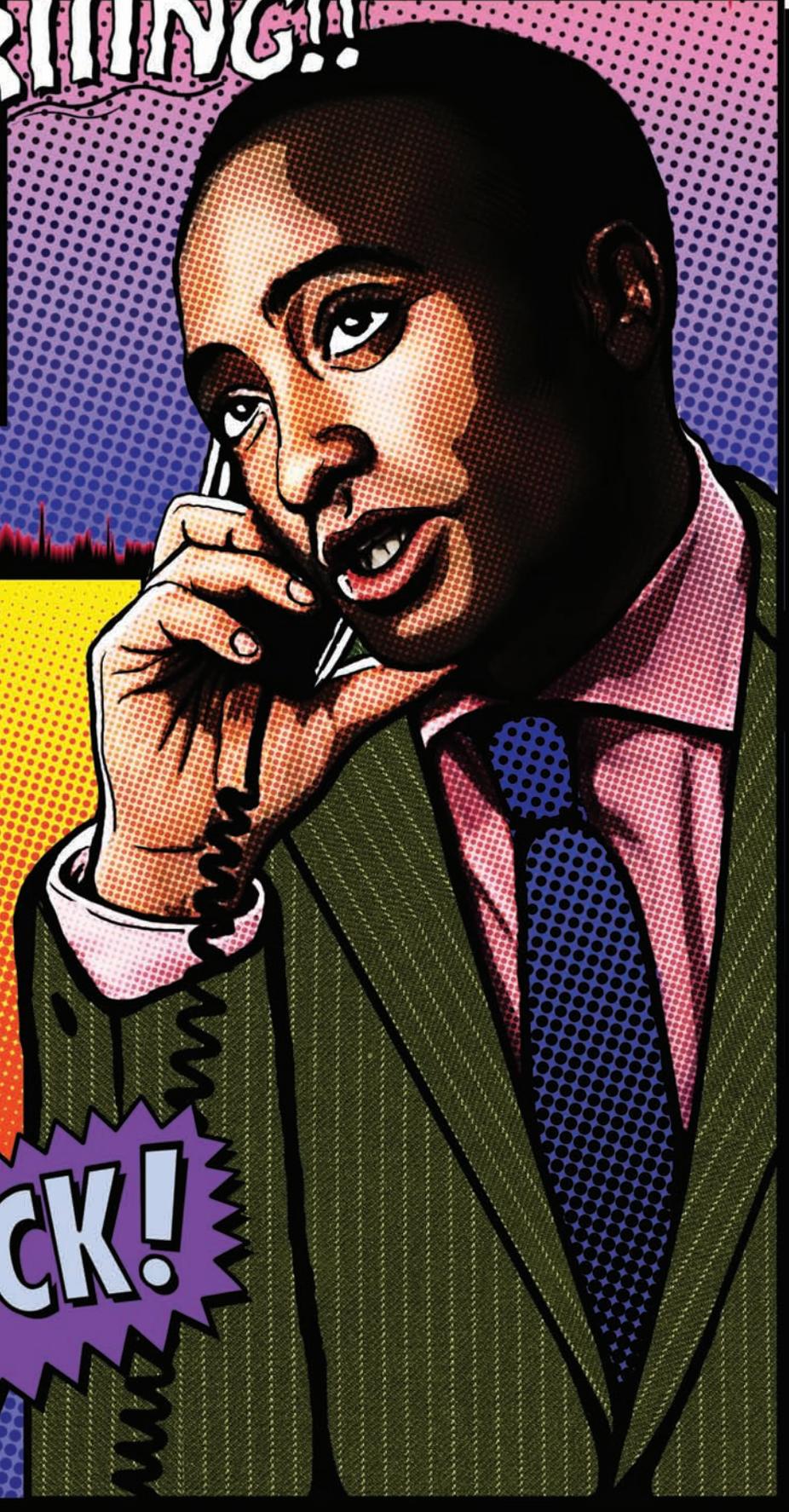
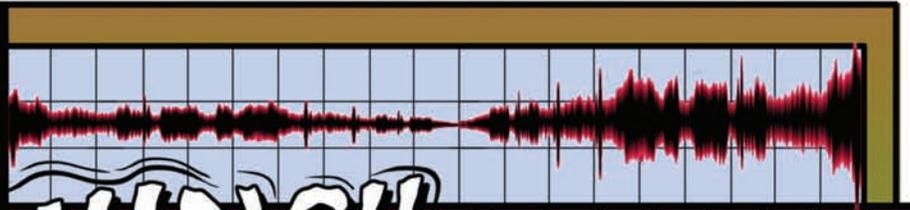
In addition to criminal penalties for monitoring or recording communications without the consent of all parties to the conversation, CIPA explicitly provides for a private right

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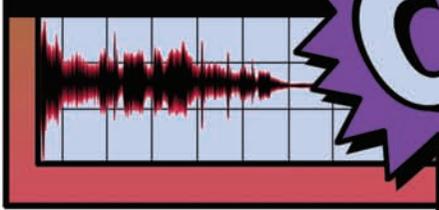
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of action in Penal Code Section 637.2, authorizing any person who has been injured by a violation of CIPA to bring a civil action to recover damages and to obtain injunctive relief.⁶ The right to relief accrues at the moment of CIPA's violation and does not depend upon the monitored or recorded communication subsequently being disclosed to an additional party.⁷ If a communication is protected by CIPA, its mere unconsented monitoring or recording violates CIPA.

While a plaintiff may attempt to prove actual damages—which may be tripled pursuant to Section 637.2(a)(2)—CIPA does not require a showing of actual harm. Section 637.2(a)(1) provides for alternative statutory damages (effectively a civil penalty) of

communication may be overheard or recorded.”

Section 632.7, added to CIPA in 1992, expands the protection of Section 632 to conversations communicated at least in part via cordless or cellular telephones, but with a subtle yet significant difference in language. While Section 632(a) refers to a “confidential communication,” Section 632.7(a) refers only to a “communication,” omitting the word “confidential.” Therefore, Section 632.7 would seem to apply to all communications involving cellular or cordless telephones, while Section 632 would cover only confidential communications.

In *Flanagan v. Flanagan*, the California Supreme Court resolved a conflict among

“confidential communications” referred to in Section 632, which confirmed that the legislature was concerned “with eavesdropping or recording of conversations, not later dissemination.”¹⁷

The court then added that CIPA “protects against intentional, nonconsensual recording of telephone conversations regardless of the content of the conversation or the type of telephone involved.”¹⁸ This statement may have been overbroad, however. Whereas the language of Section 632.7, which concerns cellular and cordless telephones, protects all telephone communications, the language of Section 632—for landline telephones—still requires that the communications be confidential, meaning that the plain-

Plaintiffs' claims may fail if they do not allege and prove that the monitored or recorded communications were confidential, a finding that may depend upon the content of the communications and the relationship and past interaction of the parties. California and federal district courts have variously interpreted this aspect of the law in recent years.

\$5,000 per violation. Each recorded telephone call constitutes a violation or incident triggering the award.⁸

At the pleading stage, a plaintiff may bring a claim for violation of CIPA and a claim for common law violation of privacy, seeking both statutory damages under CIPA as well as compensatory and punitive damages for the corresponding common law claim.⁹ However, if the plaintiff prevails at trial, he or she must then elect whether to accept statutory damages pursuant to Section 637.2 or a punitive damages award, as both awards are considered punitive.¹⁰

Confidential Communication

CIPA includes several statutes addressing the monitoring or recording of telephone communications. Section 632(a) forbids an individual from intentionally and “without the consent of all parties to a confidential communication,” by means of any electronic amplifying or recording device, eavesdropping upon or recording a confidential communication, whether it “is carried on among the parties in the presence of one another or by means of a...telephone....” Section 632(c) defines “confidential communication” as including “any communication carried on in circumstances as may reasonably indicate that any party to the communication desires it to be confined to the parties thereto” but excludes a communication made in any circumstance “in which the parties to the communication may reasonably expect that the

two lines of appellate decisions regarding the meaning of the term “confidential communication” in Section 632(a). Although the statute itself attempts to define the term in Section 632(c), two competing lines of interpretive authority had emerged. One line (established by *Frio v. Superior Court*¹¹) held that “a conversation is confidential if a party to that conversation has an objectively reasonable expectation that the conversation is not being overheard or recorded.”¹² The other, established by *O’Laskey v. Sortino*,¹³ held that “a conversation is confidential only if the party has an objectively reasonable expectation that the content will not later be divulged to third parties.”¹⁴

In *Flanagan*, the California Supreme Court adopted the *Frio* definition of “confidential communication” and read the phrase “confined to the parties” in the first clause of Section 632(c) to refer to “the actual conversation, not its content.”¹⁵ The court found support for its holding in its prior decision in *Ribas v. Clark*, which explains that “a substantial distinction has been recognized between the secondhand repetition of the contents of a conversation and its simultaneous dissemination to an unannounced second auditor, whether that auditor be a person or a mechanical device.”¹⁶ The court also noted that when the legislature amended CIPA, adding Section 632.7 to cover communications made via cellular and cordless telephones, the legislature barred the recording of “any communication,” not just the

tiff had an objectively reasonable expectation that the conversation was not being overheard or recorded.

Several years later, in *Kearney v. Salomon Smith Barney, Inc.*, the California Supreme Court determined that CIPA's protections also extend to telephone conversations in which only one party is actually in California (meaning that California plaintiffs potentially can sue out-of-state defendants for the unannounced monitoring or recording of calls to or from California consumers).¹⁹ *Kearney* also briefly touched on the issue of a party's reasonable expectations regarding the confidentiality of telephone conversations. In a footnote, the court cited *Flanagan* for the proposition that CIPA's “statutory scheme” protects against the unauthorized recording of conversations “regardless of the content of the conversation....”²⁰ In another footnote, the court wrote that “in light of the circumstance that California consumers are accustomed to being informed at the outset of a telephone call whenever a business entity intends to record the call, it appears equally plausible that, in the absence of such an advisement, a California consumer reasonably would anticipate that such a telephone call is not being recorded....”²¹

Taken together, these statements about the scope of CIPA and consumers' expectations were interpreted by some courts to mean that Section 632 applies to all landline telephone conversations regardless of content, leading to conflicting decisions and,

eventually, a decision by the Ninth Circuit—construing California law—as to whether, under Section 632, the reasonableness of a party’s expectation depended in part on the content of the conversation.

Federal Interpretations

In recent years, as putative class actions brought pursuant to Section 632 have been removed from California courts to federal courts by defendants, the body of federal case law (published and unpublished) interpreting CIPA has steadily grown. Indeed, some federal decisions address scenarios not seen in published California decisions. For example, one federal district court granted a defendant’s motion to dismiss a Section 632 class action complaint with prejudice because the plaintiff—the defendant’s customer—had entered into an agreement with the defendant concerning the terms of service, including a contractual notice and consent provision informing the plaintiff that the defendant might monitor or record customers’ telephone conversations with the defendant’s representatives.²² The court ruled that, in light of that provision, the plaintiff customer could not have had an objectively reasonable expectation that calls would not be recorded and that the plaintiff had consented to the recording, thus enabling the defendant company to “contract around” CIPA for purposes of monitoring or recording calls with its customers.

Similarly, the question of whether the content of a conversation is relevant in determining whether a plaintiff had an objectively reasonable expectation that his or her telephone call was not being recorded or monitored appears to have been debated more extensively in recent federal case law than in that of California. In May 2011, a judge in the U.S. District Court for the Northern District of California dismissed with prejudice the putative class action filed by a customer of a home security provider in *Faulkner v. ADT Security Services, Inc.*²³ The plaintiff, alleging a claim under Section 632, had alleged that he called the defendant to dispute a charge on his bill and that when he asked about beeping audible on the telephone line, he was told that his conversation was being recorded. The court ruled that the plaintiff had failed to allege that his telephone call to the defendant was a “confidential communication” under Section 632 because the plaintiff had not alleged that the call concerned “personal financial affairs” or “private family matters” or any other circumstance that would support an objectively reasonable expectation that his telephone call would not be recorded or monitored.

Over the next 18 months, a split developed among federal district courts in California as

to whether the *Faulkner* trial court was correct to dismiss the plaintiff’s CIPA claim. At least three courts followed the order in *Faulkner* and granted defense motions—either for summary judgment or dismissal—in class actions or putative class actions in which the plaintiffs failed to plead or show that the telephone conversations at issue involved any personal family information, private financial information, or other information sufficiently sensitive to justify an objectively reasonable expectation that the calls would not be recorded or monitored.²⁴ Although these courts did not refer to this finding as a “content-based” standard, this would seem to be a fair description of their



emphasis on the lack of sensitive content in the plaintiffs’ telephone conversations.

Meanwhile, other federal district courts in California rejected the idea of a content-based standard. At least twice in 2012, courts acknowledged the holding of the *Faulkner* trial court but rejected motions to dismiss putative class actions, based on two statements from *Kearney* and *Flanagan*: 1) *Kearney*’s footnote 10, which reasoned that California consumers may be so accustomed to hearing warnings regarding recording and monitoring that they now reasonably assume that the absence of such a warning means the absence of recording and monitoring; and 2) *Flanagan*’s rather broad statement that CIPA protects against nonconsensual recording “regardless of the content of the conversation....”²⁵

This more liberal line of cases may have seemed promising to plaintiffs, but it came to an abrupt halt when the Ninth Circuit issued its decision affirming the *Faulkner* trial court’s content-based standard.²⁶ The Ninth Circuit emphasized that *Kearney* and *Flanagan* had already determined that a “confidential com-

munication” under Section 632 requires that a party have “an objectively reasonable expectation that the conversation is not being overheard or recorded.”²⁷ The circuit court noted that California courts interpreting Section 632 in the context of business-related telephone calls had looked to the circumstances surrounding the call, such as the nature of the defendant’s business and the character of the communications, including content such as market data, business strategy, and sensitive or personal information.²⁸

The Ninth Circuit agreed with the district court that the plaintiff had only alleged that his telephone call was confidential because it was “carried on in circumstances

that may reasonably indicate that any party to the communication desires it to be confined thereto,” which was characterized as “no more than a ‘threadbare recital’ of the language of Section 632,” clearly insufficient under the heightened federal pleading standard.²⁹ However, because the complaint had been filed in a California state court prior to its removal to federal court, the Ninth Circuit remanded the case to allow the plaintiff a chance to amend his pleading to satisfy the federal standard in “an abundance—perhaps an overabundance—of caution....”³⁰

At least one federal district court has cited *Faulkner* when dismissing a Section 632 action pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure for failure to allege facts showing an objectively reasonable expectation that a telephone conversation would be confidential.³¹ *Faulkner* has also been cited by a federal district court denying a motion for class certification, which found that commonality could not be shown because determining whether each class member had an expectation of confidentiality in telephone

conversations with a weight-loss company would require a detailed factual inquiry into the circumstances of each call.³²

However, two other plaintiffs managed to keep their Section 632 claims—and class allegations—alive under *Faulkner*. A trial court denied a motion to dismiss filed by the Cosmopolitan Hotel of Las Vegas, noting that the plaintiff had alleged “that he shared his credit card number, expiration date, billing address, and security code” in telephone calls recorded by the hotel.³³ The district court added that such information “[c]ertainly... qualifies as potential private information.”³⁴ In another matter, a motion to dismiss failed because the plaintiff alleged that his telephone conversation with defendant concerned a “mutual client’s account balance, past due amount, last payment, and settlement offer, as well as personal and private financial information” that was “protected by the attorney-client privilege.”³⁵

Factor Tests in California Appellate Decisions

In the 2011 decision *Kight v. CashCall*, the California Court of Appeal reversed a summary adjudication order for the defendant, concluding that the defendant had not met its burden of showing that, as a matter of law, the plaintiffs did not have an objectively reasonable expectation of privacy in their telephone calls with the defendant—a requirement for the calls to be “confidential communications” within the meaning of Section 632. In so holding, the court cautioned that it did not intend to opine as to whether plaintiffs would ultimately prevail on the issue at trial, and it offered the following comment: “The issue whether there exists a reasonable expectation that no one is secretly listening to a phone conversation is generally a question of fact that may depend on numerous specific factors, such as whether the call was initiated by the consumer or whether a corporate employee telephoned a customer, the length of the customer-business relationship, the customer’s prior experiences with business communications, and the nature and timing of any recorded disclosures.”³⁶

A recent California Court of Appeal decision, *Hataishi v. First American Home Buyers Protection Corporation*, cited *CashCall*’s list of factors when it affirmed the denial of a plaintiff’s motion for class certification for lack of the requisite community of interest.³⁷ In that action, the named plaintiff was a customer of the defendant for several years, participating in numerous telephone calls with the defendant. During in-bound calls to the defendant, the plaintiff was advised that the call might be monitored or recorded. During calls placed by the defendant, the plaintiff was

not so advised, but the calls were recorded anyway.³⁸ The plaintiff brought a single cause of action for violation of Section 632.

The *Hataishi* plaintiff attempted to distinguish *CashCall*’s list of factors by arguing that *CashCall* was applicable only to cases involving eavesdropping rather than recording calls.³⁹ The court of appeal dismissed this idea as unsupported by the language of the statute and the case law, and it saw “no reason why the factors listed in *CashCall* would not apply equally where a business records telephone conversations with its customers.”⁴⁰

The court of appeal agreed with the trial court that common questions of fact did not predominate because whether a customer’s call constituted a confidential communication—whether a customer had an objectively reasonable belief that a conversation with a business would not be recorded or monitored absent warning—would require individualized proof of, among other things, the length of the customer-business relationship and the plaintiff’s prior experiences with business communications.⁴¹

For reasons left unexplained in the opinion, the plaintiff never moved for leave to amend to add a cause of action under Section 632.7, which applies to calls involving cordless and cellular telephones without requiring that the calls be confidential. However, the court of appeal noted that, even if the plaintiff had amended her complaint to add a claim under Section 632.7 to get around the confidential communication requirement, an individualized factual inquiry still would have been required to determine what type of telephone was used by a class member to receive the call—landline, cordless, or cellular.⁴²

In light of the factors identified by the Ninth Circuit in *Faulkner* and the California Court of Appeal in *CashCall* and *Hataishi*, questions to be kept in mind when preparing or responding to a claim under Sections 632 and/or 632.7 may include: 1) Has the plaintiff alleged the type of telephone he or she used during the calls? 2) Did the plaintiff convey personal financial information, information that could lead to identity theft, information regarding private family or health matters, privileged information, or sensitive business data, plans, or strategy? 3) Was the call between the plaintiff and an organization with which the plaintiff already had a relationship, or was this a cold call? 4) How long did the call last? and 5) If there is a contract between the plaintiff and the defendant, does it contain a provision in which the plaintiff consented to having calls monitored or recorded? As has been shown repeatedly in published and unpublished decisions in recent years, ignoring these details and alleging only the monitoring or

recording of a telephone call, without more, may leave a CIPA claim vulnerable to dismissal. ■

¹ PENAL CODE §§630-638.

² *Flanagan v. Flanagan*, 27 Cal. 4th 766, 768 (2002).

³ *Id.* at 769.

⁴ *Kight v. CashCall, Inc.*, 200 Cal. App. 4th 1377, 1392 (2011) (emphasis in original).

⁵ *Id.* at 1393. In so holding, the Kight court rejected a contrary rule from the unpublished Ninth Circuit decision *Thomasson v. GC Servs. Ltd. P’ship*, 321 Fed. Appx. 557 (9th Cir. 2008).

⁶ *Kearney v. Salomon Smith Barney, Inc.*, 39 Cal. 4th 95, 115-16 (2006).

⁷ *Ribas v. Clark*, 38 Cal. 3d 355, 365 (1985); *Friddle v. Epstein*, 16 Cal. App. 4th 1649, 1660 (1993).

⁸ *Lieberman v. KCOP Television, Inc.*, 110 Cal. App. 4th 156, 167 (2003).

⁹ *Clauson v. Superior Court*, 67 Cal. App. 4th 1253, 1256 (1998).

¹⁰ *Id.*, citing *Turnbull & Turnbull v. ARA Transp., Inc.*, 219 Cal. App. 3d 811, 826-27 (1990).

¹¹ *Frio v. Superior Court*, 203 Cal. App. 3d 1480 (1988).

¹² *Flanagan v. Flanagan*, 27 Cal. 4th 766, 768 (2002).

¹³ *O’Laskey v. Sortino*, 224 Cal. App. 3d 241 (1990).

¹⁴ *Flanagan*, 27 Cal. 4th at 768.

¹⁵ *Id.* at 774.

¹⁶ *Id.* at 775 (citing *Ribas v. Clark*, 38 Cal. 3d 355, 360-61 (1985)).

¹⁷ *Id.* at 776 (citing *inter alia* PENAL CODE §632.7).

¹⁸ *Id.*

¹⁹ *Kearney v. Salomon Smith Barney, Inc.*, 39 Cal. 4th 95 (2006).

²⁰ *Id.* at 117 n.7 (citing *Flanagan*, 27 Cal. 4th at 776).

²¹ *Id.* at 118 n.10.

²² *White v. FIA Card Servs., N.A.*, 2013 WL 756292 (S.D. Cal. Feb. 26, 2013).

²³ *Faulkner v. ADT Sec. Servs., Inc.*, 2011 WL 1812744 (N.D. Cal. May 12, 2011).

²⁴ *Sajfr v. BBG Comm’ns, Inc.*, 2012 WL 398991 (S.D. Cal. Jan. 10, 2012); *Weiner v. ARS Nat’l Servs., Inc.*, 887 F. Supp. 2d 1029 (S.D. Cal. 2012); *Shin v. Digi-Key Corp.*, 2012 WL 5503847 (C.D. Cal. Sept. 17, 2012).

²⁵ *Brown v. Defender Sec. Co.*, 2012 WL 5308964 (C.D. Cal. Oct. 22, 2012); *Roberts v. Wyndham Int’l, Inc.*, 2012 WL 6001459 (N.D. Cal., Nov. 30, 2012).

²⁶ *Faulkner v. ADT Sec. Servs., Inc.*, 706 F. 3d 1017 (9th Cir. 2013).

²⁷ *Id.* at 1019.

²⁸ *Id.* at 1020.

²⁹ *Id.*; see also *Bell Atlantic Corp. v. Twombly*, 550 U.S. 544, 127 S. Ct. 1955 (2007); *Ashcroft v. Iqbal*, 556 U.S. 662, 129 S. Ct. 1937 (2009).

³⁰ *Faulkner*, 706 F. 3d at 1021.

³¹ *Hoffman v. Cenlar Agency, Inc.*, 2013 WL 1285126 (S.D. Cal. Mar. 27, 2013).

³² *Torres v. Nutrisystem, Inc.*, 289 F.R.D. 587, 592 (C.D. Cal. Apr. 8, 2013).

³³ *Mirkarimi v. Nevada Prop. 1 LLC*, 2013 WL 3761530, at *3 (S.D. Cal. July 15, 2013).

³⁴ *Id.*

³⁵ *Bernstein v. United Collection Bureau, Inc.*, 2013 WL 5945056, at *4 (S.D. Cal. Nov. 5, 2013).

³⁶ *Kight v. CashCall, Inc.*, 200 Cal. App. 4th 1377, 1396 (2011).

³⁷ *Hataishi v. First Amer. Home Buyers Protection Corp.*, 223 Cal. App. 4th 1454, 1466 (2014).

³⁸ *Id.* at 1458.

³⁹ *Id.* at 1467.

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² *Id.* at 1469.



by Peter Zablotsky and Sa'id Vakili

Still

STANDING

Defendants in shareholder derivative lawsuits are unlikely to disqualify plaintiffs who can meet ownership and demand requirements

UNDER CALIFORNIA LAW, to qualify as a derivative plaintiff and institute an action on behalf of a corporation, the plaintiff must show: 1) status as a shareholder of record, holder of a beneficial interest, or holder or a voting trust certificate, 2) shareholder status at the time of the wrong to the corporation giving rise to the action (the contemporaneous-ownership rule), and 3) that reasonable effort was made to inform the corporate directors about the action and induce them to commence suit (a prelitigation demand), unless those efforts would have been “useless” or “futile” (demand futility).¹ Various challenges have been advanced to disqualify plaintiff shareholders in derivative actions in state court. Whether based on the existence of a simultaneous direct claim or action, the lack of contemporaneous ownership, the principles of guardian ad litem, or even Rule 23.1 of the Federal Rules of Civil Procedure, these challenges have met with little success.

As a general rule, a shareholder may have

separate direct and derivative claims and may maintain a direct action and a derivative action.² Nothing prevents shareholders from enforcing their personal rights against the corporation while simultaneously enforcing the rights of the corporation in a derivative action. As the court held in *Denevi v. LGCC*, one who has “suffered injury both as an owner of a corporate entity and in an individual capacity is entitled to pursue remedies in both capacities.”³ Typically, the personal and derivative claims arise out of the same course of action, but the plaintiff’s injuries and claims differ from those of the corporation.⁴ Moreover, in the case of closely held corporations with a small number of shareholders, the distinction between direct and derivative actions may blur if the acts of one or a few director- or officer-shareholders directly affect the corporation and the other shareholders. Thus, even a shareholder who has other individual claims may also be a plaintiff in a derivative action.⁵

An exception exists when the interests of the plaintiff in the direct action are so adverse or in such conflict with the interests of the other shareholders that the plaintiff cannot adequately represent the other shareholders. For example, in *Hornreich v. Plant Industries*,⁶ which was prosecuted under the provisions of Rule 23.1,⁷ the plaintiff and his brother sold their company to an independent corporation in exchange for shares of the latter’s corporate stock. As part of the transaction, the plaintiff was also hired by the acquiring corporation in exchange for covenants not to compete. When a dispute arose several years later, the plaintiff was fired. He sued on the sales and employment contracts, and later filed a shareholder deriv-

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ative suit and an unlawful detainer action. He made three offers of omnibus settlement that appeared to include a settlement of the derivative case as well as the other actions. Under these facts, the court found that he could not adequately represent the other shareholders' interests.⁸

Similarly, in *Zarowitz v. Bank of America Corporation*,⁹ two sets of litigation were again involved: the bank sought damages from the plaintiff and other former employees for its losses, and one plaintiff—William T. Powers—sued individually for wrongful termination and defamation. Meanwhile, a series of four class actions and a dozen derivative actions were filed against the bank's officers and directors. With the exception of Powers, the other plaintiffs reached a comprehensive settlement agreement with the bank's insurers. Powers attempted to block two of the settlements because he thought they would have an adverse effect on his damages action for wrongful termination. Under these facts, the court agreed that the plaintiff had a conflict of interest with the other shareholders and thus had no standing to object to the settlement of the derivative action.¹⁰

Regarding close corporations, in *Smith v. Ayers*,¹¹ a derivative action involving a family feud over a closely held corporation, the court found that the derivative plaintiff could not adequately represent the interests of other similarly situated shareholders, largely because there were none. The plaintiff's stake in the corporation was 1/10,000,000 of the authorized shares. Moreover, he received no cooperation from any other shareholders; he was a class of one.¹² In holding that he could not fairly and adequately represent the interest of other similarly situated shareholders, the court distinguished another case, *Larson v. Dumke*,¹³ in which the court allowed a derivative action to proceed with a class of one because the plaintiff, who was the original founder of the franchise, still retained an interest of almost 25 percent.¹⁴

Similarly, in *Owen v. Modern Diversified Industries, Inc.*,¹⁵ the court held that the holder of a small number of shares of corporate stock of minimal value, who also owned debentures of substantial value issued by the same corporation, could not maintain a derivative action under Rule 23.1. The plaintiff did not "fairly and adequately represent the shareholders" because he owned only 24 shares of stock whose value did not exceed \$21, and debentures of the same corporation with a face value of \$34,900. Moreover, the court found that his real concern was to protect his status as holder of the debentures and not his investment as a shareholder.¹⁶

The cases above involved clear conflicts,

but others have permitted shareholders to act as plaintiffs in a derivative action despite having positions adverse to the defendant directors. For example, in *Tyco Laboratories, Inc. v. Kimball*,¹⁷ the plaintiffs who brought the derivative action owned a substantial interest in the corporation and may have been in an adversary position to the defendant directors earlier over control of the corporation. The court found, however, that this did not disqualify them from representing the corporation's shareholders in a derivative action. The court reasoned that the plaintiff shareholders were pursuing common interests with the other shareholders by seeking redress on the corporation's behalf for alleged breaches of fiduciary duties and other violations of state and federal laws, and that any recovery would inure to the corporation's benefit and not to the plaintiffs in their individual capacities.¹⁸

Finally, in *Ravenswood Investment Company, L.P. v. Bishop Capital Corp.*,¹⁹ the plaintiff shareholders had offered to buy the corporation's outstanding shares and had attempted to buy select assets from it. The court found that this history did not establish that they had an "antagonistic" economic interest and held that they were adequate representatives of all the shareholders.²⁰ The court concluded that "[u]ltimately, it is the defendant's burden to show that the derivative plaintiff does not fairly and adequately represent the other shareholders," and that the burden had not been met.²¹ Unless particular circumstances reveal a clear conflict between the direct and derivative actions (which would disqualify a plaintiff in any event), the mere existence of simultaneous direct and derivative claims will not lead to the disqualification of the plaintiff shareholder.

Contemporaneous Ownership

Conflicts of interest are not the only challenge raised against plaintiff shareholders. The contemporaneous ownership rule requires that the plaintiff be a shareholder when the action is filed and when some part of the transaction complained of occurred.²² In addition, the plaintiff must remain a shareholder for the duration of the proceeding.²³ Several challenges to plaintiff shareholder standing have been mounted pursuant to this rule, with limited success. For example, in *Pearce v. Superior Court*,²⁴ the appellate court reversed the trial court's dismissal of a derivative action on the ground that the plaintiff trust beneficiary had no standing because she was not a record owner of corporate stock, which was held in the name of the trust. The appellate court held that the plaintiff had a beneficial interest as a trust beneficiary, and that the law did not require the plaintiff to have stock registered in her name to give her standing to

bring a derivative action.²⁵

Along the same lines, in *Patrick v. Alacer Corporation*,²⁶ a wife sought standing as a plaintiff shareholder based on the community property interest in her husband's shares. In addition, she alleged that the increase in the stock's value, in excess of that attributed to a fair return on her husband's original investment, was community property. The court held that a wife could establish standing as a derivative plaintiff based on her community property interest in her husband's shares, a beneficial ownership that gave the spouse standing.²⁷ The court reasoned that since income arising from a spouse's skill, efforts, and industry is community property, the community should receive its fair share of the profits deriving from the spouse's devotion of more than minimal time and effort to handling his or her separate property.²⁸ The court noted that even if the stock was initially her husband's separate property, the plaintiff spouse might have acquired a community property interest in it through their alleged joint devotion of time and effort to it during their marriage.²⁹

In holding that the trial court erred in sustaining a demurrer to the derivative cause of action on the ground that the wife lacked standing, the appellate court commented on the nature of the standing requirements. The court stressed that the legislature extended standing from record owners to beneficial owners as part of "the 1975 liberalization of the standing requirements," which were intended to "bring California in line with the majority rule that 'it is sufficient that the plaintiff be an equitable shareholder or unregistered owner of shares.'" The court further reasoned that while a trust may be the only record shareholder, the plaintiff's alleged community property interest in a corporation essentially makes her an unregistered shareholder, and that the community property interest in the corporation satisfies the liberal standing requirement of beneficial ownership.³⁰

Finally, it is worth noting the relevance of the continuing-wrong doctrine in the contemporaneous ownership context. Specifically, Section 800(b)(1) of the California Corporations Code provides that the court has discretion to waive the contemporaneous-ownership requirement if it finds that no one else can enforce the claim on the corporation's behalf and that the defendants would otherwise retain the benefits derived from their willful breaches of fiduciary duties unless the action is permitted to proceed. As such, the continuing-wrong doctrine overcomes the contemporaneous-ownership rule if the alleged wrong was still in progress when the shareholder acquired his or her shares, even if the initial action was initiated previously.

MCLE Test No. 239

The Los Angeles County Bar Association certifies that this activity has been approved for Minimum Continuing Legal Education credit by the State Bar of California in the amount of 1 hour.

1. A shareholder bringing a derivative action does not need to include the corporation as a party in the action.
True.
False.
2. A shareholder may assert both direct and derivative claims in the same action.
True.
False.
3. A nonshareholder spouse can establish standing as a derivative plaintiff through community property rights in his or her spouse's shares.
True.
False.
4. A plaintiff in a derivative action must show:
A. Status as shareholder of record.
B. Status as holder of a beneficial interest.
C. Status as a holder of a voting trust certificate.
D. Any of the above.
5. The contemporaneous-ownership rule requires a derivative plaintiff to be a shareholder:
A. At the time the action is filed.
B. For a portion of the time that the wrong complained of occurred.
C. For the duration of the action.
D. All of the above.
6. A derivative plaintiff must fairly and adequately represent all shareholders and not just those that are similarly situated.
True.
False.
7. A derivative plaintiff owning 20 percent of a closely held corporation cannot adequately represent the interest of the corporation in an action which his or her interests are adverse to the corporate officers owning the remaining 80 percent of the shares.
True.
False.
8. Under California law, a court can waive the contemporaneous-ownership rule if it determines that there is no one else to enforce the claims on the corporation's behalf against defendants who would otherwise retain their ill-gotten gains.
True.
False.
9. Fair and adequate representation is a requirement under:
A. The Federal Rules of Civil Procedure.
B. The California Corporations Code.
C. California case law.
D. None of the above.
10. The continuing-wrong doctrine is an exception to contemporaneous ownership rule if the alleged wrong was in progress when the shareholder acquired his or her shares.
True.
False.
11. Under federal law, factors that determine whether a derivative plaintiff can properly represent the interest of other shareholders include whether the plaintiff:
A. Is the real party in interest.
B. Has personal interests outweighing interests in the derivative action.
C. Has a personal commitment to the action.
D. All of the above.
12. California cases have required the appointment of a derivative plaintiff the same as one would appoint a guardian ad litem.
True.
False.
13. Demand futility is a prefiling requirement that a derivative plaintiff make a demand on the board to take action.
True.
False.
14. A derivative action inherently involves a conflict between the minority shareholders bringing the action and the majority shareholders whose administration is being challenged.
True.
False.
15. *Grosset v. Wenaas* was an action involving a derivative plaintiff
A. Who lost standing as a result of voluntarily selling his shares.
B. Who lost standing as a result of involuntarily selling his shares in a merger.
C. Who maintained his standing after involuntarily selling his shares in a merger.
D. None of the above.
16. Generally, in actions involving both derivative and direct claims, the claims arise from the same course of conduct, but the injuries differ.
True.
False.
17. A prelitigation demand is a necessary first step in a derivative action unless such a demand would be useless or futile.
True.
False.
18. A plaintiff can be disqualified for bringing both direct and derivative claims.
True.
False.
19. The Federal Rules of Civil Procedure and the California Corporations Code have analogous requirements for fair and adequate representation.
True.
False.
20. Any recovery in a derivative action goes to:
A. The nominal defendant.
B. The nominal plaintiff.
C. Both the nominal plaintiff and the nominal defendant.
D. The minority shareholders.



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10. True False
11. A B C D
12. True False
13. True False
14. True False
15. A B C D
16. True False
17. True False
18. True False
19. True False
20. A B C D

The Corporations Code incorporates this concept in its requirement that the plaintiff be a shareholder “at the time of the transaction or any part thereof of which plaintiff complains.”³¹ At least one court has interpreted the language to mean that “because every wrongful transaction may be viewed as a continuing wrong to the corporation until remedied...the ‘test to be applied in such situations concerns whether the wrong complained of is in actuality a continuing one or is one which has been consummated....’”³²

Guardian Ad Litem

In addition to contemporaneous ownership, another question that may arise is whether a derivative plaintiff who brings an action for the benefit of a corporation must meet the fiduciary requirements for a guardian ad litem. Historically, some courts have made this analogy. For example, in *Hogan v. Ingold*,³³ the court reasoned that a shareholder who “has gone into equity seeking redress for a corporation under disability to obtain relief itself” has done so “precisely as the guardian ad litem goes into court to obtain like redress for a client under disability by reason of incompetency or nonage. The principles governing the conduct of a guardian ad litem are in full strictness applicable to the conduct of such a plaintiff stockholder.”³⁴

The statements in *Hogan*, in *Whitten v. Dabney*, and in similar cases should be considered, however, only in the context in which they were made. Specifically, the *Hogan* court held that the amendment to former Section 834 of the Corporations Code allowing the court to require the plaintiff to post a bond applied to pending actions. The *Whitten* court held that the plaintiff could not settle a derivative suit without the court’s approval.³⁵ Both cases recognized limitations on the conduct of plaintiffs who sought to enforce rights belonging to another. But neither of them, nor any other cases, require appointment of a plaintiff as one would appoint a guardian ad litem.³⁶

On a related guardianship issue, some courts have held that a guardian who pursues an interest adverse to his or her ward and the faithful performance of his or her duties may be removed. For example, in *Middlecoff v. Middlecoff*,³⁷ the guardian ad litem sought to initiate a will contest on her ward’s behalf so that she would be in a position to inherit from the ward. In *McCallum v. Hornaday*,³⁸ the guardian obstructed the sale of a corporation to other potential buyers and formed a new corporation with proxies through which the guardian intended to acquire his ward’s corporation for himself. Similarly, in *Howard v. Howard*,³⁹ the guardian set up a dummy sale of the minor’s jewelry so that he could purchase it for himself.

These cases, however, all involved guardians who were trying to steal from their wards. In contrast, a shareholder derivative action is “filed on behalf of the corporation for injury to the corporation for which it has failed or refused to sue.”⁴⁰ When the claim is derivative, the shareholder is merely a nominal plaintiff. Although the corporation is joined as a nominal defendant, the corporation is the real party in interest to which any

However, while fair and adequate representation is a requirement at the federal level, Corporations Code Section 800(b) contains no such requirement. In addition, no California case has held that fair and adequate representation is a requirement in derivative actions.

Nonetheless, some California authorities have suggested that the federal requirement potentially limits plaintiff standing in state

“The true measure of adequacy of representation under Rule 23.1 is not how many shareholders the plaintiff represents but rather how well the representative advances the interests of similarly situated shareholders.” Rule 23.1 does not require a derivative plaintiff to represent the interests of shareholders with whom he or she is not similarly situated.

recovery actually belongs.⁴¹ Indeed, unlike the guardian ad litem, in a shareholder derivative action, the shareholder plaintiff is required to have an ownership or beneficial interest in the corporation in order to bring the action.

Plaintiff Standing

In comparison to California law, federal law imposes an additional requirement in shareholder derivative actions. Specifically, Rule 23.1 provides that a “derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of shareholders or members who are similarly situated in enforcing the right of the corporation or association.”⁴² The question of whether derivative plaintiffs can fairly and adequately represent the interests of other shareholders turns on such factors as 1) whether the plaintiffs are the real parties in interest, 2) the plaintiffs’ familiarity with the litigation, 3) the support or opposition of other shareholders, 4) the existence of any adverse interests that might present an actual conflict with the corporation’s interests, 5) the degree of personal commitment to the action, 6) the relative magnitude of plaintiffs’ personal interests as compared to their interest in the derivative action, and 7) any “vindicative” motivation in bringing the action.⁴³

shareholder derivative actions, but the precedential value of these authorities is uncertain. For example, in *Grosset v. Wenaas*,⁴⁴ the court stated:

[The plaintiff-shareholder] argues the cases involving rule 23.1 of the Federal Rules of Civil Procedure are inapt because that rule contains a provision requiring a derivative plaintiff to “fairly and adequately represent” the interests of similarly situated shareholders... whereas section 800 does not...[W]e reject the implication that section 800’s failure to expressly state a fair and adequate representation requirement reflects any intent on the part of our Legislature to secure the standing of a derivative plaintiff who, for whatever reason, cannot provide fair and adequate representation.⁴⁵

This language, however, is mere dicta. The issue *Grosset* presented was whether, under the continuous-ownership requirement of Section 800(b), a plaintiff who ceased to be a stockholder by reason of a corporate merger lost standing to continue the derivative action. *Grosset* held that because, as a result of the merger, the plaintiff no longer owned stock, he lacked standing under California law to continue litigating the

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derivative action.⁴⁶ More specifically, shortly after the plaintiff brought a derivative action, he involuntarily sold his shares as part of a corporate merger. The California Supreme Court upheld the trial court's dismissal under Delaware's continuous-ownership rule.⁴⁷ The court then held that Corporations Code Section 800 imposed a similar rule.⁴⁸ The court made its statement about Rule 23.1 in a citation referring to courts in other jurisdictions that required continuous ownership of stock.⁴⁹ It rejected the plaintiff's suggestion that California's different statute requires a different rule.⁵⁰ Furthermore, the court inserted its discussion of Rule 23.1 in a footnote at the end of the paragraph quoted above. At the end of that footnote, it added, "[m]oreover, as noted previously, maintaining continuous stock ownership is reasonably viewed as a requirement that is distinct from the fair and adequate representation requirement."⁵¹ In another footnote, the court also points out that, under Section 7.41 of the American Bar Association's Model Business Corporation Act, "maintaining continuous stock ownership is a requirement that is distinct from the fair and adequate representation requirement."⁵²

The Rutter Group's practice guide on corporations also discusses a requirement for fair and adequate representation, stating: "A

shareholder pursuing personal litigation against a corporation ordinarily will not qualify to serve as the 'representative' plaintiff who must 'fairly and adequately' represent the other shareholders in the derivative suit.... Indeed, such a shareholder will also lack standing to object to settlement of the shareholders' derivative action."⁵³

The difficulty here is that, as authority for this statement, the authors of the treatise cite a federal case, *Zarowitz v. BankAmerica Corporation*,⁵⁴ brought under Rule 23.1 rather than under California law. In that case, a shareholder who was also the corporation's former employee objected to settlement of a derivative suit. That plaintiff, named Powers, had also initiated a wrongful termination action against it arising out of the same series of events. The court held that Powers had no standing to do so because under Rule 23.1, he

could not serve as a representative plaintiff. His personal litigation strategy militates against any settlement. Powers' interests converge with the interests of BAC's shareholders in a few respects, but they diverge from them significantly in others. Powers' interest in increasing the value of his BAC stock through a larger derivative suit recovery is dwarfed by his

interest in pursuing his litigation with the Bank.⁵⁵

The court did not state the criteria for fair and accurate representation, instead only observing that the employee's interests diverged from those of the other shareholders more than they converged.

In any event, when Rule 23.1 is applied, it requires that derivative plaintiffs fairly and adequately represent the interests of only those shareholders or members who are similarly situated in enforcing the right of the corporation of association.⁵⁶ By its nature, a derivative suit "poses inherent conflicts between those minority shareholders who are bringing the suit and the majority shareholders whose administration is challenged either directly or indirectly."⁵⁷

Adequacy of Representation

For example, in *Larson v. Dumke*, the Ninth Circuit emphasized that the issue was not whether the plaintiff could fairly and adequately represent all shareholders but whether he could fairly and adequately represent similarly situated shareholders.⁵⁸ Because the plaintiff before it was not similarly situated to other shareholders, whether he could fairly or adequately represent others was not at issue. The court noted a number of factors federal courts have considered in determining whether a plaintiff can adequately represent the interests of other similarly situated shareholders and then held that a single shareholder who owned 23.41 percent of the stock could pursue a derivative action even if he were the only shareholder similarly situated.⁵⁹ Similarly, in *Halsted Video, Inc. v. Guttillo*,⁶⁰ a shareholder who owned 20 of 100 shares of a closely held corporation was permitted to bring a derivative action against corporate officers owning the remaining 80 shares, notwithstanding the claims that his interests were adverse to those of the corporate officers. The court found that he could adequately represent the interest of the corporation on behalf of which the action was being maintained.⁶¹ As such, "Rule 23.1 does not require that derivative action plaintiffs have the support of a majority of the shareholders or even that they be supported by all of the minority shareholders." As the *Halsted Video* court held, "The true measure of adequacy of representation under Rule 23.1 is not how many shareholders the plaintiff represents but rather how well the representative advances the interests of similarly situated shareholders."⁶² Rule 23.1 does not require a derivative plaintiff to represent the interests of shareholders with whom he or she is not similarly situated.⁶³

The theoretical basis for challenges to plaintiff-shareholder standing are certainly



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interesting. There clearly is potential for conflicts between direct and derivative actions. Contemporaneous ownership can be subtle and nuanced. Certain aspects of guardian ad litem are analogous to derivative actions. At first blush, it appears that the California requirement of continuous ownership would be buttressed by the federal requirement of fair and adequate representation. To date, however, none of these theories have presented a significant obstacle to plaintiff-shareholder standing in derivative actions. Rather, despite the creativity of the theoretical arguments, plaintiffs have by and large been successful in their efforts to maintain their standing. ■

¹ See generally CORP. CODE §800.

² Denevi v. LGCC, 121 Cal. App. 4th 1211, 1221-22 (2004).

³ Id. at 1221 (citing Jones v. H.F. Ahmanson & Co., 1 Cal. 3d 93, 106-107 (1969)).

⁴ Id.

⁵ See Jara v. Supreme Meats, Inc., 121 Cal. App. 4th 1238, 1253-60 (2004).

⁶ Hornreich v. Plant Indus., 535 F. 2d 550 (9th Cir. 1976).

⁷ Id. at 550.

⁸ Id. at 552.

⁹ Zarowitz v. Bank of Am. Corp., 866 F. 2d 1164 (9th Cir. 1989).

¹⁰ Id. at 1166.

¹¹ Smith v. Ayers, 977 F. 2d 946, 949 (5th Cir. 1992).

¹² Id. at 948.

¹³ Larson v. Dumke, 900 F. 2d 1363 (9th Cir. 1990).

¹⁴ Smith, 977 F. 2d at 949.

¹⁵ Owen v. Modern Diversified Indus., Inc., 643 F. 2d 441 (6th Cir. 1981).

¹⁶ Id. at 443-44.

¹⁷ Tyco Labs., Inc. v. Kimball, 444 F. Supp. 292 (E.D. Pa. 1977).

¹⁸ Id. at 299.

¹⁹ Ravenswood Inv. Co., L.P. v. Bishop Capital Corp., 374 F. Supp. 2d 1055 (D. Wyo. 2005).

²⁰ Id. at 1062.

²¹ Id. (citations omitted).

²² Pacific Lumber Co. v. Superior Court, 226 Cal. App. 3d 371 (1990).

²³ See, e.g., Grosset v. Wenaas, 42 Cal. 4th 1100, 1114-15 (2008).

²⁴ Pearce v. Superior Court, 149 Cal. App. 3d 1058 (1983).

²⁵ Id. at 1067-68.

²⁶ Patrick v. Alacer Corp., 167 Cal. App. 4th 995 (2008) (citing Pearce v. Superior Court, 149 Cal. App. 3d 1058, 1065 (1983)).

²⁷ Id. at 1011-12.

²⁸ Id. at 1011 (citing Beam v. Bank of Am., 6 Cal. 3d 12, 17 (1971)).

²⁹ Id.

³⁰ Id. at 1011-12 (citations omitted).

³¹ CORP. CODE §800(b)(1).

³² Blasband v. Rales, 971 F. 2d 1034 (1992) (citing Newkirk v. W. J. Rainey, Inc., 76 A. 2d 121, 123 (Del. Ch. 1950) and Schreiber v. Bryan, 396 A. 2d 512, 516 (Del. Ch. 1978)).

³³ Hogan v. Ingold, 38 Cal. 2d 802, 809-10 (1952); see also Whitten v. Dabney, 171 Cal. 621, 631 (1915).

³⁴ Hogan, 38 Cal. 2d at 810.

³⁵ Whitten, 171 Cal. at 630-31.

³⁶ Cf. CODE CIV. PROC. §373.

³⁷ Middlecoff v. Middlecoff, 199 Cal. App. 2d 22 (1962).

³⁸ McCallum v. Hornaday, 30 Cal. 2d 297 (1947).

³⁹ Howard v. Howard, 133 Cal. App. 2d 535 (1955).

⁴⁰ Schuster v. Gardner, 127 Cal. App. 4th 305 (2005).

⁴¹ Id. at 312.

⁴² FED. R. CIV. P. 23.1.

⁴³ See Larson v. Dumke, 900 F. 2d 1363, 1367 (9th Cir. 1989).

⁴⁴ Grosset v. Wenaas, 42 Cal. 4th 1100 (2008).

⁴⁵ Id. at 1115, n.10.

⁴⁶ Id. at 1104.

⁴⁷ Id. at 1109.

⁴⁸ Id. at 1110-19.

⁴⁹ Id. at 1114 n.9.

⁵⁰ See id. at 1114-15.

⁵¹ Id. at 1115 n.10.

⁵² Id. at 1111 n.7.

⁵³ FRIEDMAN ET AL., CAL. PRACTICE GUIDE: CORPORATIONS §6.620.1 (Rutter 2014).

⁵⁴ Zarowitz v. BankAmerica Corp., 866 F. 2d 1164, 1166 (9th Cir. 1989).

⁵⁵ Id. at 1166.

⁵⁶ FED. R. CIV. P. 23.1.

⁵⁷ In re Applied Micro Circuits Corp. Secs. Litig., 2003 U.S. Dist. Lexis 9371, at *4 (9th Cir. 2003) (quoting Kirkpatrick v. J.C. Bradford Co., 827 F. 2d 718, 728 n. 7 (11th Cir. 1987)).

⁵⁸ Larson v. Dumke, 900 F. 2d at 1368-69.

⁵⁹ Id.

⁶⁰ Halsted Video, Inc. v. Guttillo, 115 F.R.D. 177 (N.D. Ill. 1987).

⁶¹ Id. at 179.

⁶² Id. (citations omitted).

⁶³ Id. at 180.

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Untolled Limitations

The fact-intensive nature of cross-jurisdictional tolling disputes presents courts with significant challenges to balancing equity and efficiency

THIS YEAR marks the 40th anniversary of one of the U.S. Supreme Court's most significant class-action decisions—*American Pipe & Construction Company v. Utah*¹—involving the tolling of the statute of limitations for putative class plaintiffs. *American Pipe* was a state-initiated antitrust dispute. The Court held that the filing of a class-action lawsuit in federal court can toll the statute of limitations for the federal-law claims of all intervening putative class members until class certification is denied. Later, in *Jolly v. Eli Lilly & Company*,² the California Supreme Court declined, as a matter of California law, to apply *American Pipe*'s federal tolling rule to a tort lawsuit brought against multiple pharmaceutical manufacturers. Between these two fact-dependent precedents lie many unsettled issues concerning class-action tolling in California courts, as well as in courts across the country. Perhaps the most important and actively litigated of these tolling issues is whether

cross-jurisdictional class-action tolling exists—that is, whether the filing of a class action in one jurisdiction tolls the statute of limitations applicable to claims in another jurisdiction.

In *American Pipe* the state of Utah, in bringing a putative antitrust class action against several defendants in federal court, purported to represent Utah public bodies, agencies, and local governments that were end users of pipe acquired from the defendants. The trial court denied class certification on the ground that the putative class could not meet the numerosity requirement of Rule 23(a)(1) of the Federal Rules of Civil Procedure. Thereafter, several Utah towns, municipalities, and water districts moved to intervene. The district court denied the motions as untimely, but the Ninth Circuit reversed.

The U.S. Supreme Court affirmed the Ninth Circuit, holding that if class-action status is denied solely for lack of numerosity,

“the commencement of that original class suit tolls the running of the statute for all purported members of the class who make timely motions to intervene after the court has found the suit inappropriate for class action status.”³ The Court reasoned that application of tolling in this instance furthered Rule 23's purpose of promoting the “efficiency and economy of litigation” because it ensured that putative class members would not be “induced to file protective motions to intervene or join in the event that a class was later found unsuitable.”⁴ It also concluded that tolling protected the “functional operation” of statutes of limitations by “ensuring essential fairness to defendants” and “barring a plaintiff who ‘has slept on his rights.’”⁵

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Nearly 10 years later, in *Crown, Cork & Seal Company v. Parker*,⁶ the Court extended *American Pipe* to allow tolling not only in circumstances in which plaintiffs sought to intervene but also in which they filed separate actions. In *Crown, Cork & Seal*, a federal district court denied certification of a putative class asserting employment discrimination claims against Crown, Cork & Seal, finding that the class did not meet several of Rule 23(a)'s requirements. Parker, a member of the putative class in that case, later filed a separate action, claiming that Crown, Cork & Seal unlawfully discharged him on the basis of race. The district court found Parker's suit untimely, but the Fourth Circuit reversed on tolling grounds. The Supreme Court agreed and held that *American Pipe*'s tolling principle applies not just to intervenors but to all members of a putative class, even when they file a new action.

American Pipe and *Crown, Cork & Seal* considered only the tolling effect of class actions filed in federal court on claims arising under federal law. In the case of state class actions with state-law claims, however, state law supplies the relevant tolling principles. And, in the wake of *American Pipe* and *Crown, Cork & Seal*, state courts—including California's—have weighed in frequently on whether filing a state-law class action in state court tolls the statute of limitations on state-law claims filed later in the same state court.

California's Treatment of *American Pipe*

In *Jolly*, the seminal class-action tolling case in California, the plaintiff relied on *American Pipe* in arguing that a prior mass-tort class action filed in California state court pursuant to California law, and of which she was a putative class member, tolled the statute of limitations for her tort claims filed in a later lawsuit. The California Supreme Court rejected that argument, refusing to extend class-action tolling on the record before it.

In its analysis, the California supreme court acknowledged that in *Bangert v. Narmco Materials, Inc.*,⁷ a case involving factory-pollution damages, the court of appeal "extended *American Pipe*" and applied it to toll the statute of limitations when the denial of class certification was based on an insufficient community of interest—not on lack of numerosity.⁸ However, the *Jolly* Court found both *American Pipe* and *Bangert* inapplicable to the mass-tort setting because the key policy considerations underlying tolling were absent. The tolling principle was intended to protect "the efficiency and economy of litigation" and "the defendant from unfair claims."⁹ Concerning the former case, the court concluded that the prior class action did not foster efficiency because putative class members seeking personal-injury damages

could not reasonably have relied on the complaint as a basis for postponing their own personal injury actions. With regard to the latter case, the court found that the prior class-action complaint—which "did not seek personal injury damages on behalf of the class"—obviously did not put defendants on notice that personal injury damages were being sought against them on a classwide basis.¹⁰

In the wake of *Jolly*, there have been a handful of published cases addressing class-action tolling. The first case of significance, *Becker v. McMillin Construction Company, Inc.*,¹¹ considered whether a putative class action filed by a homeowner against a developer for construction defects in his home and the homes of others in his development, and which had been denied class certification for lack of a common question, tolled the claims in another individual homeowner's suit against the developer. Unlike *Jolly*, which involved diverse personal-injury claims, the *Becker* Court believed it was more likely that property damage would provide adequate notice of potential plaintiffs and claims.¹² It then concluded that tolling was appropriate because the prior class action made the identity and number of potential homeowner claimants "ascertainable to a significant degree" and gave the defendant notice of the potential construction defect claims.¹³ The court went out of its way to stress, however, that its decision "should not be broadly construed to apply to any and all construction defect cases" and cautioned that "the applicability of *American Pipe* can only be determined by individualized attention to the identity of the claimants and the nature of the claims involved, and by a careful weighing of the important policy considerations in this area."¹⁴

Becker, like *Jolly*, underscores that California courts considering application of class-action tolling will take each case on its specific facts. For example, *Perkin v. San Diego Gas & Electric Company*,¹⁵ presents a cautionary approach. In *Perkin*, the court provided a very helpful analysis of California's tolling precedents before rejecting the tolling claim before it. There, class actions had been filed by numerous individuals, insurance companies, and government entities seeking recovery for damages caused by multiple wildfires in San Diego County. Years after the filing of the class actions, the Perkins, whose home was damaged by one of the wildfires, filed an individual suit. The trial court found the Perkins' action time-barred and refused to apply *American Pipe* tolling; the court of appeal affirmed.

After an extensive analysis of *Jolly*, the court focused on its post-*Jolly* decision in *Becker*. In *Becker*, the court explained, "the potential plaintiffs were limited to a set num-

ber of homeowners within a known residential subdivision containing a defined number of homes and would make claims of certain construction defects."¹⁶ But in *Perkin*, the relevant prior class action "did not provide similar notice"—rather, "would-be plaintiffs could be found anywhere in California claiming that their properties were damaged in some way" by the fire that had damaged the Perkins' house.¹⁷ Additionally, the court found that the "equities" did not favor the Perkins because they waited "16 months after the court denied class certification in which to file suit" and that their inaction raised concerns that they "slept on [their] rights."¹⁸

Perkin confirms that, at present, class-action tolling is applied sparingly and narrowly in California state courts. For tolling to be considered, the prior class action must, on its facts, provide sufficient notice to the defendant of the follow-on claims. Equity and efficiency must also favor tolling for the benefit of the claimants involved.

Cross-Jurisdictional Class-Action Tolling

As noted, cross-jurisdictional tolling generally involves a plaintiff who was a class member in a prior class action and is now seeking to toll the statute of limitations for claims filed in a different jurisdiction. At least four state supreme courts—Illinois, Louisiana, South Dakota, and Tennessee—have rejected cross-jurisdictional tolling under their respective states' laws.¹⁹ And, in their *Erie* capacity as predictors of state law, two federal courts of appeals and numerous district courts likewise have determined that the highest courts of the states at issue would not adopt cross-jurisdictional tolling.²⁰

There are multiple reasons supporting the results in these cases. One is the desire to prevent state courts from being flooded with litigation filed by those seeking to take advantage of the state's generous tolling rules following the denial of class certification in another jurisdiction.²¹ Another is that it would essentially grant courts of other jurisdictions the power to decide when a state's statute of limitations begins to run, an outcome "contrary to [a state] legislature's power to adopt statutes of limitations and the exceptions to those statutes."²² Additionally, courts have "no interest, except perhaps out of comity, in furthering the efficiency and economy of the class action procedures of another jurisdiction, whether those of the federal courts or of another state."²³

On the other hand, the highest courts of three states—Delaware, Montana, and Ohio—have adopted cross-jurisdictional tolling.²⁴ In holding this view, the Delaware and Montana courts were more concerned with the consequence of denying cross-juris-

dictional tolling—the burden that could be placed on their states’ courts by plaintiffs filing protective claims prior to a class-certification decision—than they were about the consequence of adopting cross-jurisdictional tolling—a flood of litigation that might follow the denial of class certification.²⁵ The Supreme Court of Ohio showed great deference to the fact that the bulk of the Ohio class-action rules are identical to the federal class-action rules.²⁶

In California, the only reported appellate case addressing cross-jurisdictional tolling is *San Francisco Unified School District v. W.R. Grace & Company*, in which the trial court granted summary judgment to the defendant manufacturer and seller of asbestos-containing material on the grounds that the plaintiff school district’s claims were untimely.²⁷ On appeal, the school district argued that a prior nationwide asbestos class action filed in a federal court in Pennsylvania tolled the relevant statutes of limitations during the time in which it was a class member.²⁸

The court of appeal agreed, indicating, first, that *Jolly* did not establish a blanket rule against *American Pipe* tolling and that *Becker* acknowledged that in property damage cases it is possible to provide adequate notice to defendants so that tolling is proper. The court then held that the plaintiff’s asbestos claims were more similar to the property-damage claims in *Becker* than they were to the personal injury claims in *Jolly*, noting that “the federal class members raised the same claim affecting the same subject matter, and the members could be identified through public contracts....”²⁹

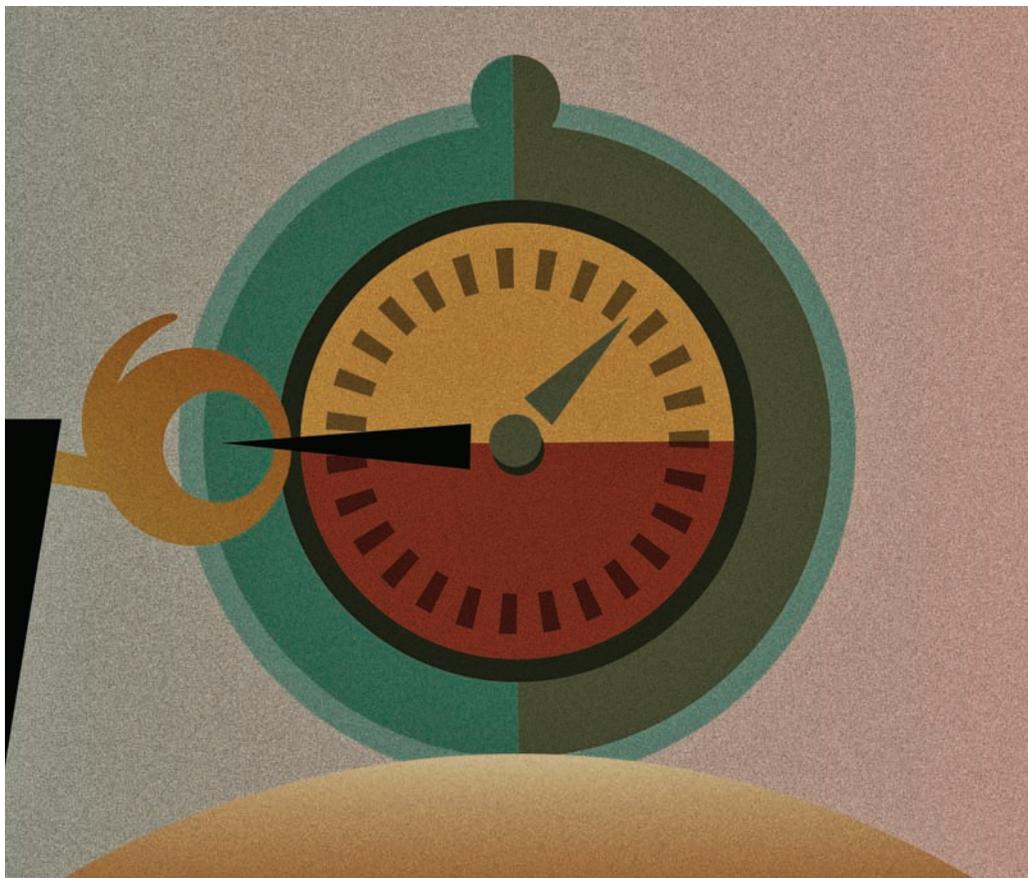
The court also rejected the defendant’s contention that California should not permit the federal court class action to dictate how California’s state-law statutes of limitations should be applied. The court reasoned that, because the “United States Supreme Court is the ultimate authority on the meaning of Federal Rules of Civil Procedure”—a meaning “which was the basis” of the Supreme Court’s decisions in *American Pipe* and *Crown, Cork & Seal*—“the fact that the class action was filed in federal court makes it more likely that the United States Supreme Court cases apply” to the tolling issue at hand.³⁰

In contrast to *San Francisco Unified*, however, federal courts applying California law have refused to apply *American Pipe* tolling in the cross-jurisdictional context. In *Clemens v. DaimlerChrysler Corporation*,³¹ for example, the plaintiff filed a class action in federal district court against the defendant asserting claims under both federal and California law. The plaintiff argued that a prior class action filed in Illinois state court tolled the statute of limitations for his fraud claim under

California law. The district court rejected the argument, and the Ninth Circuit affirmed.³² The Ninth Circuit pointed out that the California Supreme Court had not adopted cross-jurisdictional tolling and that, in fact, few states had. It also stressed that federal courts predicting state law—the role the Ninth Circuit was playing in *Clemens*—had “declined to

filed the putative class action in federal court, and the district court determined that the statute of limitations barred the investor’s claims, refused to toll the statute, and dismissed the suit.

The Ninth Circuit reversed, concluding that tolling applied under California’s three-part equitable tolling test established in *Collier*



import the doctrine into state law where it did not previously exist.”³³ As a result, and together with “the weight of authority and California’s interest in managing its own judicial system,” the Ninth Circuit also declined “to import the doctrine of cross-jurisdictional tolling into California law.”³⁴

It should be noted that on one occasion, in *Hatfield v. Halifax PLC*, the Ninth Circuit applied tolling under California’s equitable tolling principles, even though—adhering to its decision the previous year in *Clemens*—it refused to apply cross-jurisdictional tolling under *American Pipe* and *Jolly*.³⁵ In *Hatfield*, an investor brought a putative class action against a building society alleging that she and similarly situated individuals were wrongfully deprived of the right to share in the proceeds of the sale of the society to the defendant. The investor had been a named plaintiff in a prior putative class action arising out of the same set of circumstances filed in New Jersey state court. The New Jersey trial court dismissed the class action. Subsequently, the investor

v. City of Pasadena.³⁶ Under *Collier*, equitable tolling applies if the following elements exist: 1) timely notice to the defendant in filing the first claim, 2) a lack of prejudice to the defendant in gathering evidence to defend against the second claim, and 3) good faith and reasonable conduct by the plaintiff in filing the second claim. The Ninth Circuit determined that each element had been met, and the New Jersey suit tolled the statute of limitations as to the investor’s individual claims.

Since *Hatfield*, several federal courts considering the application of *American Pipe* and *Jolly* have interpreted *Hatfield* as requiring an analysis of equitable tolling as well.³⁷ Nonetheless, other than *Hatfield*, no court applying California law has applied equitable tolling principles in the cross-jurisdictional setting while refusing to apply the class-action tolling principles of *American Pipe* and *Jolly* in that context.

Class-Action Tolling Going Forward

California’s courts recognize that the tolling principles embraced in *American Pipe* should

be invoked with caution, and then only when it is clear that equity and efficiency demand it. While one court of appeal applied *American Pipe* tolling in the cross-jurisdictional context, it remains to be seen how the California Supreme Court will view that issue, particularly where several federal cases applying California law rejected that extension of *Jolly*. What does seem clear is that, if and when the supreme court faces a cross-jurisdictional tolling dispute, it will adopt a fact-specific approach, focusing keenly on the kind of equitable and efficiency considerations that drove the result in other tolling cases, including *Jolly*.

If the California supreme court adopts cross-jurisdictional tolling, California likely will see an influx of cases brought by former putative class members seeking to take advantage of California's more generous tolling rules after the denial of class certification. The costs and expense of that litigation for the targeted defendants would be significant, and there would be public costs for our court system and for the adjudication of local disputes as well. In any event, given the prevalence of class actions nationwide, the cross-jurisdictional tolling issue is certain to make its way to the supreme court very soon. When it does, we can expect a robust debate from multiple

interested parties and amici because of the widespread significance of the issue. ■

¹ *American Pipe & Constr. Co. v. Utah*, 414 U.S. 538 (1974).
² *Jolly v. Eli Lilly & Co.*, 44 Cal. 3d 1103 (1988).
³ *American Pipe*, 414 U.S. at 552-53.
⁴ *Id.* at 553.
⁵ *Id.* at 554 (citation omitted).
⁶ *Crown, Cork & Seal Co. v. Parker*, 462 U.S. 345 (1983).
⁷ *Bangert v. Narmco Materials, Inc.*, 163 Cal. App. 3d 207 (1984).
⁸ *Jolly v. Eli Lilly & Co.*, 44 Cal. 3d 1103, 1119 (1988).
⁹ *Id.* at 1122.
¹⁰ *Id.* at 1125.
¹¹ *Becker v. McMillin Constr. Co., Inc.*, 226 Cal. App. 3d 1493 (1991).
¹² *Id.* at 1501.
¹³ *Id.*
¹⁴ *Id.* at 1502.
¹⁵ *Perkin v. San Diego Gas & Elec. Co.*, 225 Cal. App. 4th 492, 2014 WL 1395479 (2014).
¹⁶ *Id.* at *10.
¹⁷ *Id.* (quotation marks and citation omitted).
¹⁸ *Id.*
¹⁹ See *Portwood v. Ford Motor Co.*, 701 N.E. 2d 1102, 1104-05 (Ill. 1998); *Quinn v. Louisiana Citizens Prop. Ins. Corp.*, 118 So. 3d 1011, 1019 (La. 2012); *One Star v. Sisters of St. Francis*, 752 N.W. 2d 668 (S.D. 2008); and *Maestas v. Sofamor Danek Group, Inc.*, 33 S.W. 3d 805, 808-09 (Tenn. 2000). (In each of these cases, the plaintiffs in their respective state actions were former class members of a prior federal class action.)
²⁰ *Clemens v. DaimlerChrysler Corp.*, 534 F. 3d 1017,

1025 (9th Cir. 2008) (declining to toll California's statute of limitations); *Wade v. Danek Med., Inc.*, 182 F. 3d 281, 286 (4th Cir. 1999) (declining to toll Virginia's statute of limitations); *In re Fosamax*, 694 F. Supp. 2d 253, 258 (S.D. N.Y. 2010) (citing cases).
²¹ See *Portwood*, 701 N.E. 2d at 1104-05.
²² *Maestas*, 33 S.W. 3d at 809.
²³ *Wade*, 182 F. 3d at 287.
²⁴ See *Dow Chem. Corp. v. Blanco*, 67 A. 3d 392, 395 (Del. 2013) (the plaintiff in a state action was a former class member of a prior federal class action); *Stevens v. Novartis Pharms. Corp.*, 247 P. 3d 244, 256-57 (Mont. 2010); *Vaccariello v. Smith & Nephew Richards, Inc.*, 763 N.E. 2d 160, 162-63 (Ohio 2002).
²⁵ *Blanco*, 67 A. 3d at 395; *Stevens*, 247 P. 3d at 256-57.
²⁶ *Vaccariello*, 763 N.E. 2d at 162-63.
²⁷ *San Francisco Unified Sch. Dist. v. W.R. Grace & Co.*, 37 Cal. App. 4th 1318, 1322 (1995).
²⁸ *Id.* at 1323.
²⁹ *Id.* at 1338-39.
³⁰ *Id.* at 1339.
³¹ *Clemens v. DaimlerChrysler Corp.*, 534 F. 3d 1017 (9th Cir. 2008).
³² *Id.*
³³ *Id.* at 1025.
³⁴ *Id.*; see also *Hatfield v. Halifax PLC*, 564 F. 3d 1177, 1187 (9th Cir. 2009) (recognizing that *Clemens* forecloses application of cross-jurisdictional tolling); *Hendrix v. Novartis Pharms. Corp.*, No. CV-13-2402-MWF, 2013 WL 5491846, at *9 (C.D. Cal. Oct. 2, 2013); *Centaur Classical Convertible Arbitrage Fund Ltd. v. Countrywide Fin. Corp.*, 878 F. Supp. 2d 1009, 1017 (C.D. Cal. 2011).
³⁵ *Hatfield*, 564 F. 3d 1177.
³⁶ *Collier v. City of Pasadena*, 142 Cal. App. 3d 917 (1983).
³⁷ *Hendrix*, 2013 WL 5491846, at *11 (listing cases).

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Basic Measures Law Firms Can Take to Improve Cybersecurity

LAW FIRMS ARE THE CARETAKERS of highly confidential information, and cybersecurity has become essential to the ethical and practical responsibilities that the legal profession owes its clients. While large corporate firms may be viewed as prime targets for hacking activity,¹ small firms are also vulnerable since they do not have the same level of financial and technical resources. There are, however, many simple and cost-effective precautions that any size firm can take to safeguard firm and client records.

Although hacking may occur in order to obtain secrets regarding a law firm client, hackers are often simply seeking any confidential information such as passwords, home addresses, bank account information, e-mail addresses, credit card information, and other personal information. Hackers also access a Web site and e-mail server to act as a conduit for sending spam messages. Some hackers maliciously seek to insert a virus into a computer system to destroy data or to extort the user by asking for a ransom to unlock the data in the computer system. Attorneys need to prevent themselves from being a target. According to the California State Bar, attorneys have the ethical duties of confidentiality and competence, and these oblige firms to take reasonable steps to protect client data.²

The first line of defense is effective password protection. According to Mark Burnett, an Internet security expert and author of *Perfect Passwords*, 23 percent of passwords are either “password,” “123456,” or “12345678.” Fourteen percent of passwords are among the top 10 most common passwords, and 40 percent of passwords are among the top 100 most common passwords. Shockingly, 91 percent of all passwords are found in the top 1,000 passwords. In other words, if a hacker knows the top 100 most common passwords, he or she has a 40 percent chance of hacking into a computer system, and if a computer program is used to test for the top 1,000 passwords, there is fairly easy access to 91 percent of users.³

The first measure that can be taken to ensure password integrity is creating a sufficiently complex password. Predictable password formulas such as hobbies, pets, names, or places should be avoided. The password should not contain a word. Second, use of a separate password for each site is recommended, despite the admitted difficulty of remembering different passwords for a number of different sites. Third, a random password can be generated via technical media, for example LastPass. Fourth, the information pertaining to a lost password must be kept secret and should not be easily discovered by looking through online profiles. It can be very easy to find out the name of a user’s high school or family pet, the date of a wedding, a mother’s maiden name, or other personal information on social media. Secret information should be selected either requiring physical presence—the title of the second book on the top shelf of a home book shelf—or relating to something very personal—for example, the

name of the person the user first kissed. Fifth, there should be two factors of authentication—for example, a token and a memorized password—to verify the user. Finally, the password must be changed regularly.

Another area of potential vulnerability can arise from something as simple as giving a legal assistant permission to review a confidential file for a limited purpose. While the computer system can limit the number of people that have access to a directory or file, unfortunately, once permission is given to a new type of user, it is often not subsequently revoked. For example, if attorneys in a firm are given

According to the California State Bar, attorneys have the ethical duties of confidentiality and competence, and these oblige firms to take reasonable steps to protect client data.

permission to view a confidential client document, but a secretary needs to access the document to quote something, once the secretary is given permission, all people with that same level of clearance may be authorized to review the document unless the permission is revoked. The simple solution is to go back and reset permissions.

Every law firm must also ensure the security of its wireless network. On any given day it may be possible to roam a large building and find unsecured wireless networks ready to be hacked. Every wireless router must be secured and password protected. Failure to do so is likely an ethical violation.⁴ Another option is to rotate wireless passwords frequently. This step is probably necessary if there is a lot of traffic in the firm’s office or outside the office. Also, clients should only be allowed to use guest access versus corporate access, the latter of which could give them access to secure documents on the firm’s server thus permitting unauthorized nonemployees complete access to the entire law firm computer system and all its documents.

Public wireless access points should not be used to check items that require passwords. Accessing client data across a public wireless system may be an ethical violation.⁵ If public WiFi must be accessed, the standard in protection is to ensure that the firewall is turned on and to use a Virtual Private Network (VPN) that securely connects with the Internet. The public WiFi is used only to connect to the VPN.

Steven G. Mehta is a full-time mediator in the Los Angeles area specializing in employment law, elder law, major personal injury, and business disputes. Adam Ashby, MCSE, is CEO of a Southern California information technology firm that specializes in business IT networks, security, and managed service support.

A second but less effective option is to install a firewall on the laptop and connect to the WiFi directly via the firewall. It can also be helpful to use a personal hotspot through a cell phone carrier. When an attorney is mobile, it is critical to protect the firm's information on portable media—for example, USBs and laptops—by encrypting the hard drive. If the computer or device is lost or stolen, the data contained on it cannot be accessed.

A smartphone is vulnerable to hackers. According to a 2013 ABA survey, 91 percent of all attorneys use smartphones.⁶ Android users can go into the settings menu and select the "encrypt data" option that will scramble the contents of the phone if the phone is lost or stolen and it has been hacked. This setting will also encrypt any data on flash drives used with the Android. For Apple products, a user can create a passcode to lock the phone and wipe it after a certain number of attempts to unlock it. It is very important not to use a standard 4-digit pin for a smartphone. Instead, the setting for a simple password should be turned off, and a complicated passcode relevant only to the owner should be selected.

Another method of protecting mobile devices is to use a mail server as a tool to destroy data on the phone. If an in-house mail server is employed rather than an external company that hosts e-mail, a setting can be created that will allow destruction of the entire phone's contents with one signal.

If a personal laptop is lost, several tools are available to assist in recovering the computer or erasing its data. A new startup, Tileapp.com, professes to be the world's largest lost and found. If the Tile application is operating on a laptop, a mobile phone can track the location of the computer via Bluetooth and through other Tile users. There is also LoJack for the laptop, which was created by the same company that developed LoJack for the car. LoJack will install software on the computer that erases data on command.

Even though the legal environment is a prominent target for hacking, many security precautions are now available to practitioners that can prevent these potentially devastating invasions of privacy. ■

¹ Michael A. Riley & Sophia Pearson, *China-Based Hackers Target Law firms to Get Secret Deal Data*, BLOOMBERG, Jan. 31, 2012, <http://www.bloomberg.com/news/2012-01-31/china-based-hackers-target-law-firms.html>.

² See CAL. STATE BAR FORMAL OPINION NOS. 2010-179, 2012-184.

³ See Mark Burnett, 10,000 Top Passwords, <https://xato.net/passwords/more-top-worst-passwords>.

⁴ See CAL. STATE BAR FORMAL OPINION No. 2010-179; see also CAL. RULES OF PROF'L CONDUCT R. 3-100, 3-110.

⁵ *Id.*

⁶ Tom Mighell, *Going Mobile*, ABA TECHREPORT2013, http://www.americanbar.org/publications/techreport/2013/going_mobile.html.

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CLE PREVIEW

Witness Examination Skills Workshop

ON MONDAY, OCTOBER 13, Trial Advocacy and the Litigation Section will host a workshop providing instruction on how to examine a witness under oath. The first part of the program will be a lecture with questions and answers covering the rules relating to direct examination, how to lay the foundation for demonstrative evidence, how to create a strategy for cross-examination, how to control the witness, and how to employ advanced techniques. The second part is a workshop in which participants conduct direct examination and cross-examination of witnesses and receive constructive feedback on their performance. Written course materials will be distributed via e-mail prior to the first class, so a correct e-mail address at the time of registration is needed. 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 Street and nearby lots. On-site registration and breakfast will be from 8 to 8:30 A.M., with the program continuing from 8:30 A.M. to 12:30 P.M. The registration code number is 012245.

\$250—CLE+ member

\$350—LACBA member

\$500—all others

3.75 CLE hours

11th Annual Healthcare Law Compliance Symposium

ON THURSDAY, OCTOBER 9, the Healthcare Law Section will host the 11th Annual Healthcare Law Compliance Symposium, in which experts in the field will offer guidance on the most important healthcare compliance issues. The program will take place at the L.A. Hotel Downtown (formerly the Marriott), 333 South Figueroa Street, Downtown. Self-parking costs \$9 and valet parking \$15. On-site registration will be available starting at 8:00 A.M., with the program continuing from 8:30 A.M. to 4:45 P.M., and a breakfast and reception at 8:00 A.M. and lunch at 12:15 P.M. The registration code number is 012347.

\$175—CLE+ member

\$230—Healthcare Section member

\$250—LACBA member

\$265—all others

7 CLE hours

47th Annual Securities Regulation Seminar

ON FRIDAY, OCTOBER 24, the Business and Corporations Law Section will host its 47th Annual Securities Regulation Seminar. Senior SEC officials, as well as representatives of other regulatory agencies and leading private practitioners, will present a comprehensive review of current events and developments in the securities field. The seminar will include discussions of SEC priorities with the new SEC division directors as well as an overview of judicial, regulatory, and enforcement developments, recent trends in SEC enforcement, the public and private offerings of securities, regulation of investment advisors, and other matters of interest. The program will take place at the Millennium Biltmore Hotel, 506 South Grand Avenue, Downtown. Self-parking is available at Pershing Square for \$9.35 and hotel valet parking for \$20. On-site registration and breakfast will begin at 8:00 A.M., with the program continuing from 8:30 A.M. to 5:00 P.M. The registration code number is 012338.

\$225—CLE+ member (with meal)

\$395—Business and Corporations Law Section member (with meal)

\$415—LACBA member

\$475—all others (with meal)

7.25 CLE hours, including 1 hour in ethics



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

How the Mock Trial Program Became a Cherished Part of My Life

IN NOVEMBER 2004, I VOLUNTEERED to be a scorer for one evening at the Stanley Mosk Courthouse for the Constitutional Rights Foundation's mock trial competition for middle and high school students. Little did I know that this simple act would be a transforming experience. Every year in early fall, flyers are posted throughout courthouses in Los Angeles County seeking volunteer scorers for the CRF mock trial competition and seeking volunteers to coach middle and high school teams. I do not remember why I volunteered. Was it because of the minimal time commitment—only a few hours after work one evening? Was I responding to a plea for volunteers because there were not enough volunteer lawyers signed up to score the competition? Or was it because I remembered my senior year in high school, when I competed in the CRF competition, then still in its infancy? Whatever the reason, there I was.

On the appointed day, after work I went to Department 1 for orientation. The scoring rules were explained, and I was grouped with two other lawyers and assigned to a courtroom. We chatted about our respective careers and the competition as we walked to the courtroom. The other lawyers had been volunteer scorers for seven years. They raved about the competition. Both announced to me that, because I was a deputy district attorney, I should take the role of presiding judge for the mock trial. "But you two have mock trial experience!" I protested vigorously. "Yes, but you are in court every day," was their response. "Just follow the CRF script," they counseled. "It's in making the evidentiary rulings that you'll be better and quicker than either of us."

Nervously, I ascended to the bench, trying to appear calm as I arranged the script, the fact pattern booklet, and the scoring sheets. With great trepidation, and feeling totally at a loss, I looked out at the tableau before me. At counsel table were six fresh-faced 12- and 13-year-old students, three for each team, dressed in suits: the girls with their hair pulled back neatly and the boys wearing ties. Their families and fellow students watched from the audience, murmuring encouragement and support. Over the next two hours, the students presented opening statements, put on their witnesses, conducted direct and cross-examination, presented evidence, and gave closing arguments. For lack of a better term, I was awestruck. Those six students, sixth through eighth graders at the height of the awkward teenage years, were well-spoken, articulate, and confident. Clearly, participation in the mock trial program had endowed them with uncharacteristic and remarkable poise and confidence.

Thus began my nine years—to date—as a mock trial coach. The following school year, my son, Adam (then a middle school student), and I inaugurated a mock trial program at his middle school—an inner-city LAUSD magnet school. Somehow, during that year I was wrangled into becoming coach of the related magnet high school's mock trial team. Becoming a coach (and occasional scorer) for mock

trial competitions is now one of my favorite activities.

The CRF Mock Trial program teaches students basic trial skills: how to conduct direct and cross-examinations, how to give a compelling opening statement, and how to deliver a persuasive closing argument. The students also learn about the law along with the analytical skills that enable them to conceptualize and argue issues of constitutional law. They learn how to raise basic trial objections and how to argue and respond to objections. Throughout the process of instruction and preparation that lead up to the competition, students develop the arts of reasoning, listening, and communication.

Participation in the mock trial program had endowed them with uncharacteristic and remarkable poise and confidence.

They learn when and how to utilize subtle, nuanced communications as well as dramatic and overstated ones. These skills will serve them well throughout their lives.

The Benefits of the Mock Trial Program

While the CRF Mock Trial program teaches students about our legal system, it is the teaching methodology that makes the program unique. Mock Trial immerses and engages the students in a way that requires them to think on their feet. Furthermore, while gaining insight into our legal system, some students may also be inspired to consider a career path in the law. Apart from the clear benefits that students receive from the CRF mock trial program, ultimately I, too, have benefitted greatly. I have had the privilege of working one-on-one with students and nurturing their nascent skills, helping them develop those skills as they grow personally and academically. Some have gone on to attend our finest universities: Harvard, Princeton, Yale, Stanford, Brown, UCLA, and Berkeley, to name just a few. During this process I have forged long-lasting connections with former students, connections that I will cherish forever. Coaching has benefited me in countless other ways as well, too numerous to mention. And, not surprisingly, the more time and effort I give, the more satisfaction I get.

My life was enriched immeasurably through the simple act of volunteering. Whether it is as a volunteer scorer or as a coach, participation in the annual CRF Mock Trial Program can be a transforming experience for even the most jaded lawyers among us. The 2014 Mock Trial competition will take place throughout the month of November at the Stanley Mosk Courthouse. Would you like to volunteer? Go to www.crf-usa.org and sign up. ■

Renee Korn is a Los Angeles Superior Court judge.



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