

Letter from  
the President

**W**e lawyers have a problem. While the public perception of our profession is no longer declining, the reason may well be that it can't get any lower.

When I was growing up in the 1950s and 1960s, the image of the lawyer was personified by Perry Mason and Atticus Finch. Lawyers represented people who were wrongly accused of crimes, or discriminated against because of race. They were heroes and worked not to get rich, but to benefit their clients and their communities. Lawyers — well, at least the ones in the movies, on television and in novels — didn't get clients acquitted by deception and artifice; they did it by proving innocence. Law firms weren't portrayed as fronts for organized crime or Satan, they were bastions of civility, honesty and integrity.



David M. Stern

It wasn't just the mass media that cultivated the image of lawyers as professionals deserving of the highest respect; it permeated down to

common citizens. I recall very well my family, after my mother was involved in a car accident, going to see "the lawyer." My father and mother both dressed up very well in recognition that this was an important occasion and they were seeing an important man. Although I was only about 10, I was well dressed also. I'm sure I chafed at having to wear a tie, but dressing otherwise was unthinkable.

We went to the lawyer's office which was, by today's standards, very modest. The office was part of the lawyer's unimpressive house on a street in a large tract — everyone else's house was equally unimpressive. But none of that mattered, just as no one would have been less impressed by a doctor, clergyman or college

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Suing Clients Can Jeopardize  
Malpractice Coverage

**A**ccording to professional liability insurance carriers, the vast majority of malpractice actions filed against attorneys begin with a fee collection suit initiated by an attorney or law firm. The incidence of malpractice counterclaims in fee dispute litigation has become so aggravated that insurance providers are beginning to explore policy limitations to protect themselves against firms who frequently commence fee collection litigation. A firm may find it difficult to obtain professional liability coverage with a conventional insurance carrier in the first instance if a firm frequently sues its clients. Depending on the dollars expended by carriers in connection with malpractice counterclaims, such coverage is either quoted at higher rates of insurance or there is a coverage stipulation which limits a carrier's duty to provide a defense in connection with malpractice counterclaims.



Larry C. Russ

The client who makes a sport of not paying all or a significant portion of attorneys fees incurred is regrettably becoming a common phenomenon in our legal landscape. Many of these clients somehow manage to convince firm after firm that the previous lawyers were not paid because the services rendered were somehow inadequate. As a result, the number of fee collection cases filed by attorneys has increased dramatically during the last decade. Sophisticated clients are quite aware that threatening to file or actually filing a malpractice counterclaim against an attorney is a good way to discourage fee collection litigation.

Worse, the experienced litigant who seeks to take advantage of the system knows that the cost of defending nearly any malpractice claim can easily run into the six figures. In order to avoid spending senseless money on defense, malpractice carriers sometimes find themselves in a position of brokering a deal between attorney and ex-client. This is accomplished by the carrier quietly offering money to its own insured in exchange for the insured agreeing to a "walk away" or other acceptable disposition with the ex-client. Unbelievable, you say? Not at all. Frequently the cost of defending even a wholly fabricated malpractice action can exceed the legal fees in dispute. The above scenario is one of the worst kept secrets among the malpractice bar and insurance providers have apparently had enough. We can therefore expect professional liability insurers to do everything in their power to prevent lawyers and disgruntled clients from utilizing professional liability carriers as a guarantor of legal fees.

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## Defectors Beware: The 'Inevitable Disclosure' Doctrine in California

**H**istorically, without an enforceable non-compete agreement, a defecting employee could only be enjoined from actually using or disclosing trade secrets, but could not be foreclosed from working for a competitor altogether. With the advent of the Uniform Trade Secrets Act, and more recently, the "inevitable disclosure" doctrine, this has changed in many jurisdictions, including arguably California.

Under the inevitable disclosure doctrine, a court may enjoin a defecting employee from working for a competitor for a period of



Richard L. Stone

time necessary to render any trade secrets within his knowledge stale, if his new position has such similar duties and responsibilities to his former position that he will "inevitably" resort to his knowledge of trade secrets as opposed to general expertise to fulfill his job duties. Importantly, the doctrine does not require proof that the former employee actually took documents or other materials containing trade secrets with him, or that the employee is actually using or disclosing trade secrets in his new position, or even that he intends to disclose such information. Rather, the court only

needs sufficient evidence to infer from the nature of the employee's new position that his duties and responsibilities will "inevitably" cause him to disclose the former employer's trade secrets, even if acting in good faith. In essence, the inevitable disclosure doctrine is a judicially codified inference drawn by courts to enjoin "threatened misappropriation" as authorized by the Uniform Trade Secrets Act. *See, e.g.,* Cal. Civ. Code § 3426.2(a).

Not surprisingly, as the inevitable disclosure doctrine gains widespread acceptance, it has significantly raised the stakes in litigation between competitors. For example, in the case from which the doctrine sprung, *PepsiCo v. Redmond*, 54 F.3d 1262 (7th Cir. 1995), PepsiCo was able to force its former general manager to sit idle for six months rather than assume his new position as chief operating officer for Quaker Oats' Gatorade division. The inevitable disclosure doctrine has also been at the core of numerous other high profile clashes between industry titans: Campbell Soup Company against H.J. Heinz Company; Procter & Gamble against Clorox; Aetna Inc. against Equitable Life Assurance Society; Dow Chemical Co. against General Electric Co.; and, Advanced Micro Devices, Inc. against Hyundai Electronics America.<sup>1</sup> The doctrine has also caught the attention of Silicon Valley.<sup>2</sup> Interestingly, however, no California published decision has recognized or applied the inevitable disclosure doctrine.

This article, in Part I, describes the contours of the inevitable disclosure doctrine through the sparse case law which has applied it. Part II attempts to predict whether California courts will apply the inevitable disclosure doctrine. Finally, Part III suggests ways for businesses to make the best of the doctrine, whether from the perspective of a company threatened with defections of key employees, or as an employer presented with an opportunity to recruit key employees from a competitor.

### The Contours of the Inevitable Disclosure Doctrine

The inevitable disclosure doctrine derives from the Uniform Trade Secrets Act ("UTSA") adopted by forty-one states including

California. *See MorLife Inc. v. Perry*, 56 Cal. App. 4th 1514, 1520 n.3 (1997). As its name implies, the goal of the UTSA is to create uniformity in the laws regarding trade secrets among the states which adopt it. *See* Cal. Civ. Code § 3426.8. It defines a "trade secret" as "information, including a formula, pattern, compilation, program, device, method, technique, or process" that (1) "[d]erives independent economic value" from not being known to the public or competitors, and (2) that "[i]s the subject of efforts that are reasonable under the circumstances to maintain its secrecy." *See* Cal. Civ. Code § 3426.1(d).<sup>3</sup> The UTSA prohibits "misappropriation" of trade secrets, which it defines as improper acquisition or disclosure of trade secrets. *Id.* § 3426.1(b).

The Act authorizes both recovery of money damages for misappropriation, *see id.* § 3426.3, and injunctive relief. *See id.* § 3426.2. Moreover, under the UTSA the court may enjoin not only actual misappropriation, but also "threatened" misappropriation. *See id.* § 3426.2(a). This is the statutory underpinning of the inevitable disclosure doctrine.

At bottom, the inevitable disclosure doctrine is simply a judicial inference arising from all the circumstances of an employee's defection that misappropriation of trade secrets is threatened. *See National Starch and Chemical Corp. v. Parker Chemical Corp.*, 219 N.J. Super. 158, 530 A.2d 31 (N.J. App. Div. 1987). In *National Starch*, the court rejected a claim that the inevitable disclosure doctrine constituted mere speculation as opposed to a legitimate judicial inference:



David A. Urban

The defendants say that a finding of "inevitability" would be no more than a 'prophecy' here. Nonetheless, in the context of determining whether a threat of disclosure exists, it is but a finding as to the probable future consequences of a course of voluntary action undertaken by the defendants. Courts are frequently called upon to draw such conclusions based on a weighing of the probabilities, and while a conclusion that a certain result will probably follow may not ultimately be vindicated, the courts are nonetheless entitled to decide or "predict" the likely consequences arising from a given set of facts and to grant legal remedies on that basis.

*Id.* at 163.

In the seminal case applying the inevitable disclosure doctrine, *PepsiCo, Inc. v. Redmond*, 54 F.3d at 1269, the court, relying upon the UTSA, affirmed an injunction precluding an employee from working for a competitor based on a finding that what he knew alone presented a "threat" of misappropriation. In that case, PepsiCo sued Mr. Redmond, its former General Manager for non-cola drinks, for misappropriation of trade secrets upon his defection to Quaker Oats, which was PepsiCo's direct competitor for "sports drinks." *See id.* at 1263-64. Concluding that the "threat of misappropriation was real," the district court had issued a preliminary injunction prohibiting Redmond from working with Quaker Oats for six months. *Id.* at 1267.

The factors the Seventh Circuit considered in upholding the injunction were: (1) PepsiCo and Quaker Oats were "fierce" direct competitors; (2) the employee's new position was functionally equivalent to his old one; (3) the employee had access to PepsiCo's "strategic plan," an annual document that contained the company's "plans to compete, its financial goals, and its strategies for manufacturing, production, marketing, packaging, and distribution for the coming three years"; (4) the employee had detailed knowledge of PepsiCo's "pricing architecture" and "margins"; and (5) the employee and Quaker Oats

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## Defectors Beware

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lacked "candor" in the way they handled the employee's recruitment. *Id.* at 1265, 1270, 1271. Taken together these factors presented a sufficient enough threat of misappropriation of trade secrets that the court found injunctive relief necessary. *See id.* at 1271.

Also significant, however, are those factors the *Redmond* court did not consider in reaching its decision. The court issued its injunction without there being (1) any applicable covenant not to compete; (2) evidence of explicit theft of customers; or (3) evidence that Redmond had taken any documents, computer disks, or other tangible material with him from PepsiCo. The court's decision emphasized that the injunction issued merely because of what Redmond knew and the risk he would disclose it:

PepsiCo presented substantial evidence at the preliminary injunction hearing that Redmond possessed extensive and intimate knowledge about PNCA's [i.e. PepsiCo's] strategic goals for 1995 in sports drinks and new age drinks. The district court concluded on the basis of that presentation that unless Redmond possessed an uncanny ability to compartmentalize information, he would necessarily be making decisions about Gatorade and Snapple by relying on his knowledge of PCNA trade secrets.

*Id.* at 1269. The court concluded by stating that Redmond's departure placed PepsiCo "in the position of a coach, one of whose players has left, playbook in hand, to join the opposing team before the big game." *Id.* at 1270.

Consistent with the UTSA and the somewhat ephemeral nature of the trade secrets before it, the *PepsiCo* court limited the injunction to six months. Generally, under the UTSA, the length of an injunction should be limited to the period of time necessary to "eliminate [any] commercial advantage" from the acquisition of trade secrets. Cal. Civ. Code § 3426.2(a). Obviously then, the temporal scope of injunctions will vary industry by industry according to the pace of technological innovation within the industry in question. *See, e.g., DoubleClick, Inc. v. Henderson*, No. 116914/97, 1997 NY Misc. LEXIS 577, at \*23 (N.Y. Co. Ct. Nov. 5, 1997) (One year injunction reduced to six months "[g]iven the speed with which the Internet advertising industry apparently changes....")

A growing number of decisions following *PepsiCo* have applied the inevitable disclosure doctrine to preclude employees from providing services to new employers. As in *PepsiCo*, the doctrine has been applied even though the defecting employees did not take documents or other materials with them to their new employment. *See, e.g., Merck & Co. v. Lyon*, 941 F. Supp. 1443, 1459 (M.D.N.C. 1996) (applying inevitable disclosure doctrine the court observed that "[a]lthough plaintiffs...did not show Lyon took particular documents with him, his memory is sufficient").

In *Uncle B's Bakery v. O'Rourke*, 920 F. Supp. 1405 (N.D. Iowa 1996), the court, applying Iowa's Uniform Trade Secrets Act, enjoined a "fresh, never-frozen" bagel maker's former plant manager from working for any business which competed with his former employer within a 500-mile radius. *Id.* at 1441. The injunction included the plant manager's new employer, a frozen bagel maker. *Id.* Although O'Rourke indisputably had intimate knowledge of plaintiff's unique bagel making process, there was also evidence that O'Rourke's new employer specifically asked that he not disclose any trade secrets, and he testified that he had not disclosed any trade secrets nor could they be used for his new employer because of the significant differences between the two companies' recipes and processes. *See id.* at 1420. Further, there was evidence that, although the bagel making industry was highly competitive in general, the two employers sold in two different, segregated portions of the mar-

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## Bily Update: Shaping Current and Future Suits Against Accountants, Attorneys and Others

The "scope" of liability is one of the most significant issues in suits against attorneys, accountants and other professional advisors and information providers. The "scope" of the professional's liability determines who may sue the professional and the legal theories upon which such a suit may proceed.

*Bily v. Arthur Young & Co.*, 3 Cal.4th 370 (1992) (hereafter "*Bily*"), is the most profound case on the scope of professional liability decided in California in at least the last decade, and it has received significant attention nationally. The *Bily* Court examined the nature of a financial statement audit and created a series of rules governing the scope of an auditor's liability to its client and third parties. The fundamental principle the California Supreme Court applied in *Bily* is to prevent liability which is out of proportion with fault, and the Court stated that this principle would be applied to cases involving other professionals and information providers.

My article in the January, 1995 edition of the ABTL Report entitled "A Case of Shrinking Attorney Liability: Is there Life After *Bily*?" attempted to predict how *Bily* would be applied to future claims, including claims against attorneys. The purpose of this article is to illustrate the profound impact *Bily* has had in its five-year life on litigation against accountants, attorneys and other service providers.



Michael L. Cypers

### Claims Against Auditors

*The Industrial Indemnity Case* — Within one year of the *Bily* decision, the California Court of Appeal had occasion to apply *Bily* to a different set of facts involving an accountant performing an audit of financial statements. *Industrial Indemnity Co. v. Touche Ross & Co.*, 13 Cal.App.4th 1086 (1993). In *Industrial Indemnity*, the Touche Ross & Co. accounting firm ("Touche") performed audits of the financial statements of a publicly traded company known as Buttes Gas & Oil Co. ("Buttes"), which was engaged in the oil drilling and leasing industry. Touche issued an unqualified or "clean" audit opinion on Buttes' 1993 year end financial statements. Plaintiff Industrial Indemnity Co. ("Industrial") served as surety for a lender known as Dimensional Credit Corporation ("DCC"), which provided a line of credit for business financing to Buttes.

Buttes defaulted on the \$10 million it owed under the DCC line of credit. Industrial as surety was required to pay off on the defaulted line of credit.

Industrial filed a lawsuit against Buttes' auditor, the Touche firm, and the case proceeded to jury trial upon four theories: (1) professional negligence; (2) negligent misrepresentation; (3) fraud; and (4) fraudulent concealment. The jury returned a verdict for Industrial of \$1. The trial court granted Industrial's motion for new trial, and Touche filed a "precautionary" cross-appeal requesting the Court of Appeal to reverse the \$1 judgment and reverse the order granting Industrial a new trial.

The *Industrial Indemnity* court reiterated what it termed "*Bily*'s goal of preventing liability out of proportion to fault" and concluded that the goal was "fully consistent" with the retroactive

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application of *Bily*, 13 Cal.App.4th at 1092, even though *Bily* overruled the existing Court of Appeal decision in *International Mortgage Co. v. John P. Butler Accountancy Corp.*, 177 Cal. App.3d 806 (1986). The *Industrial Indemnity* court ruled, based upon *Bily*, that plaintiff Industrial could not assert a general negligence claim against Touche because such a claim may only be asserted by the auditor's client.

The more complex part of the Court's analysis involved whether Industrial had standing to pursue a claim for negligent misrepresentation against Touche under *Bily*. The facts in the case squarely presented the issue because Industrial put forth evidence that it obtained Touche's audit report on Buttes' financial statements and considered the audited financial statements in deciding to act as surety with respect to Buttes' credit. Industrial obtained the audited financial statements from Buttes, not Touche, and Touche did not know that Buttes would give the audited financial statements to Industrial.

The *Industrial Indemnity* court was guided by the following critical passage from *Bily*:

To paraphrase, a supplier of information is liable...to a third party only if he or she intends to supply the information for the benefit of one or more third parties in a specific transaction or type of transaction identified to the supplier.

*Id.* at 1093-1094 (quoting 3 Cal.4th at 392).

The *Industrial Indemnity* court held that Industrial could not pursue Touche on a negligent misrepresentation theory because the evidence did not show that Touche "either consented to or even knew of Buttes' submission of the audit opinion to DCC [Industrial's lender]. At best, it brings Industrial within that 'much larger class [of persons] who might reasonably be expected sooner or later to have access to the information and foreseeably to take some action in reliance upon it.'" *Id.* at 1095, 1096 (citations omitted).

The analysis of the negligent misrepresentation claim became more complicated because Touche did consent to Butte's use of the Touche audit report in connection with a preferred stock offering and a subordinated debenture offering. However, according to the *Industrial Indemnity* court, *Bily* imposes liability only as to "a specific transaction or well defined type of transaction" that the auditor knows about and intends to influence in supplying its report. *Id.* at 1096 (citations omitted). The *Industrial Indemnity* court stated that in order to impose liability, the transaction must be "substantially the same transaction or one substantially similar," and the question is "whether the departure from the contemplated transaction is so major and so significant that it cannot be regarded as essentially the same transaction." *Id.* The *Industrial Indemnity* court concluded that neither Butte's preferred stock offering nor its subordinated debenture offering with respect to which Touche consented to the use of its audit report was sufficiently similar to Industrial's guarantee of DCC's line of credit to Buttes to establish liability.

*Industrial Indemnity* highlights the profound impact of *Bily*. Under the pre-*Bily* rule in California set forth in *International Mortgage*, *Industrial Indemnity* would likely have had "standing" to pursue a claim for negligence or negligent misrepresentation against Touche. That standard simply required that, as a prerequisite to imposing liability upon an auditor, it be reasonably foreseeable that the auditor's report would be received and relied upon by the third party who claims injury.

The *International Mortgage Co.* court stated as follows: "Under a foreseeability standard, the auditor would be liable only to those third parties who reasonably and foreseeably rely on the audited statements. The accountant's lack of control over ultimate users is not prejudicial; the foreseeability standard holds everyone, including accountants, liable only to reasonably foreseeable users." 177 Cal.App.3d at 818. The *International*

*Mortgage* court continued: "An innocent plaintiff who foreseeably relies on an independent auditor's unqualified financial statement should not be made to bear the burden of the professional's malpractice. The risk of such loss is more appropriately placed on the accounting profession which is better able to pass such risk to its customers and the ultimate consuming public." *Id.* at 820.

The plaintiff in *Industrial Indemnity* would likely have satisfied the *International Mortgage* standard because: (1) it is usually foreseeable that an audit client will present its audited financial statements in connection with credit transactions (indeed, that was the factual context in which the *International Mortgage Co.* court permitted a third party to sue the auditor); and (2) Touche knew that Industrial intended to use the Touche audit report to raise capital, albeit in the form of offerings for preferred stock and debentures, as opposed to obtaining working capital through a line of credit.

*Industrial Indemnity* applied the *Bily* rule which imposed liability only as to a "specific transaction or well-defined type of transaction" that the auditor knows about and intends to influence in supplying its report." *Id.* at 1096, (quoting *Bily*, 3 Cal.4th at 414). As a result, Touche was immune from a \$10 million third party claim for negligence and negligent misrepresentation even though the \$10 million was a hard dollar loss and Touche knew that its audit report would be used in connection with its client's attempts to obtain credit.

#### The Standard Chartered Bank Case.

The impact of *Bily* is demonstrated by another high profile auditor liability suit outside California. In *Standard Chartered, PLC v. Price Waterhouse*, 945 P.2d 317, 1996 Ariz. App. Lexis 243, 229 Ariz. Adv. Rep. 26 (Ariz. Ct. App. 1996), the Arizona Court of Appeal relied on *Bily* in large measure in affirming the trial court's order granting Price Waterhouse a new trial after a jury rendered multiple verdicts against Price Waterhouse in the sum of \$338 million.

The *Standard Chartered* court applied *Bily* in a manner even broader than the *Bily* court itself. The *Standard Chartered* court announced that an auditor could not be sued for general negligence by any party, either a client or third party. *Bily* permits a client to sue for negligence and a third party to sue, under appropriate circumstances, upon a theory of negligent misrepresentation only.

The *Standard Chartered* court held that "the gravamen of auditor negligence is negligent misrepresentation, a tort for which the Arizona courts have already adopted the narrower range of risk set forth in Restatement (Second) § 552 (1979)." 945 P.2d at 340. The *Standard Chartered* court relied upon the *Bily* decision in limiting auditor liability to negligent misrepresentation claims as set forth in the Restatement of Torts (Second). The Arizona appellate court stated: "the policy reasons for confining auditor negligence within the liability range set forth in § 552 are stated at length in *Bily v. Arthur Young & Co.* (citation omitted), and we will not reiterate them here." 945 P.2d at 340.

#### Claims Against Attorneys — BLM v. Sabo & Deitsch

In *BLM v. Sabo & Deitsch*, 55 Cal.App.4th 823 (1997) (hearing denied), the California Court of Appeal applied the principles of *Bily* to a claim against attorneys. In *BLM*, a developer was negotiating a proposed transaction with the Redevelopment Agency of the City of Rialto ("Rialto"). The defendants were a law firm and three individual members of the law firm (referred to as "Sabo") who acted as special counsel for Rialto. The plaintiff alleged that as a result of Sabo's refusal to issue an opinion to Sabo's client Rialto in the form desired by the plaintiff, the plaintiff lost the benefit of a proposed development transaction with Rialto. The plaintiff sought damages of over \$400,000 it had expended on the project already, plus a \$3.5 million "lost developer's fee."

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## Defectors Beware

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ket: the former employer sold only fresh, never frozen bagels, while the new employer primarily sold only frozen bagels. *Id.* at 1411-12.

Nevertheless, the court enjoined the former plant manager from working for his new employer altogether because the frozen bagel maker had not foreclosed the possibility of entering the fresh bagel sector. The court reasoned that it was "highly unlikely that O'Rourke would not draw upon processes or solutions employed by Uncle B's Bakery should comparable problems arise either in Brooklyn Bagel Boys' present production system, or in the course of Brooklyn Bagel Boys' independent development [of fresh bagel processes]...should it eventually find that it does want to enter that sector of the market after all." *Id.* at 1435. The Uncle B's Bakery court determined that the hardships balanced in favor of the former employer despite the fact that it was enjoining its plant manager from working at all. The court justified its decision on the basis that the former employee had considerable work experience and ability in other industries and that any harm should be eased by assistance from his current employer, who should have foreseen the harm in hiring away a manager with knowledge of unique manufacturing and packaging processes. *Id.* at 1436-38.

In *Merck & Co., Inc. v. Lyon*, Gary Lyon had been responsible for marketing Merck's Pepcid AC before defecting to Glaxo to be responsible for marketing its Zantac 75, the major competitor to Pepcid AC. *See* 941 F. Supp. at 1447-49. The court found a threat of misappropriation based on the inevitable disclosure doctrine and enjoined Lyon from discussing the competing products with his new employer for a period of two years (and for one year from discussing competing product pricing). *Id.* at 1464-65. In issuing the injunction the court was impressed by the fact that the new employer had not shown any efforts to prevent potential disclosure of trade secrets. *Id.* at 1461. Finally, the Merck court indicated it would have issued a broader injunction prohibiting employment altogether if there had been a "showing of bad faith or underhanded dealing, and that the competitor lacked comparable levels of knowledge and achievement." *Id.* at 1460 n.5.

In *Lumex, Inc. v. Highsmith*, 919 F. Supp. 624 (E.D.N.Y. 1996), the court upheld the reasonableness of a six-month non-compete provision as to the former worldwide marketing manager for the plaintiff exercise equipment manufacturer. *Id.* at 625, 636. The court found that it was inevitable that the former employee would disclose trade secrets immediately upon entering the employment of a competitor because he was a "top-level executive who was an important cog in the Cybex organization, and he was privy to the most confidential trade secrets in an extremely competitive industry, where innovative products are the key to success." *Id.* at 633. Interestingly, the court found disclosure inevitable even though it expressly found that both the former employee and the new employer acted reasonably and in good faith up until the point of the injunction. *Id.* at 633-34.

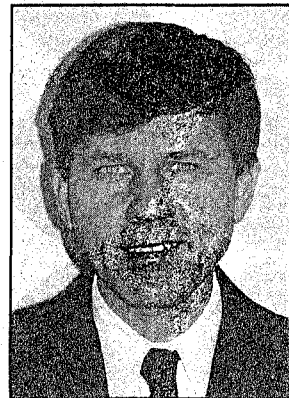
In *DoubleClick, Inc. v. Henderson*, 1997 N.Y. Misc. LEXIS 577 (N.Y. Co. Ct. Nov. 5, 1997), the court used evidence of actual misappropriation to bolster its conclusion that the defecting employees would inevitably disclose all of their former employers' confidential information. The court noted "the actual use of DoubleClick's trade secrets described above, and other actions discussed below, demonstrate defendants' cavalier attitude toward their duties to their former employer. This gives rise to a reasonable inference that they would use DoubleClick's confidential information against it." *Id.* at \*\*16-17. But the court in *DoubleClick* limited the injunction to six months rather than one year because "given the speed with which the Internet advertising industry apparently changes, defendants' knowledge of DoubleClick's operations will likely lose value to such a degree

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## Revisions to Central District Local Rules

Last year, the United States District Court for the Central District of California circulated for public comment significant revisions to its Local Rules. On April 1, 1998, the Central District's Local Rules, as amended, took effect. In most cases, the amendments adopted by the court are identical to the proposed language circulated last year. Some further revisions were made, however, and in some instances these may have been in response to comments submitted by the ABTL.

Many of the changes are matters of detail, clarification, or conformity with the Federal Rules of Civil Procedure. Certain amendments, however, appear intended to reduce perceived burdens on the court. Thus, for example, there are additional requirements before counsel may involve the court in resolving certain issues, including motions and discovery disputes; there is a ten page reduction in the maximum permitted length of memoranda or trial briefs; and additional disclosures are required upon the filing of cases to identify parties in interest and explain related or other pending cases. In particular, the requirement for a conference of counsel prior to the filing of most motions may result in some reduction in the number of motions filed, but it also can be expected to result in some delay and additional expense in most cases. Whether these new requirements provide net benefits in the administration of justice remains to be seen.



Rolf S. Woolner

The more significant revisions to the Local Rules are described below. Space limitations preclude our discussion of all the revisions, so please be sure to review the new rules in connection with all of your pending matters.

### Rule 2.10 — Communications with the Judge

The restriction on communications with the judge unless opposing counsel is present has been expanded to include making telephone calls to chambers.

### Rule 3.4 — Form of Documents Presented to the Court

Documents presented to the court must now contain the facsimile number (as well as the telephone number) of an attorney or party *pro se* on the first page of a document (Rule 3.4.9). Quotations from cases or other authorities more than one sentence in length must be indented and single spaced (Rule 3.4.8). The timing for making a demand for jury trial in cases removed to the district court is slightly modified: for example, in a matter already at issue at the time of removal, the demand for jury trial must be filed within 10 days after the filing of the petition for removal if demand is made by the petitioner, and within 10 days after service of the notice of filing of the petition for removal if demand is made by any other party (Rule 3.4.10.2).

### Rule 3.7.2.1 — Doe Defendants

Doe defendants are now permitted, with a limit of ten. The ABTL supported this change, but suggested that there be no limit

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## Revisions to Central District Local Rules

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and that instead status and pretrial conferences be used to impose limitations as needed in each case.

### Rule 3.7.2.2 — Misjoinder In Copyright, Patent and Trademark Cases

Joinder of copyright, patent or trademark causes of action of different owners is no longer permitted, unless the complaint or petition is accompanied by a declaration of counsel demonstrating that the interests of justice would be advanced and a multiplicity of actions avoided by such joinder. This declaration-of-counsel exception, which was not contained in the proposed rules, may be in response to the ABTL's comment that the rule otherwise might be in conflict with Rule 19 of the Federal Rules of Civil Procedure and would work injustice when multiple owners of multiple intellectual property rights were damaged by the same wrongful act.



Jeffrey W. Kramer

### Rule 3.10 — Page Limitation For Memoranda and Briefs

The page limitation for memoranda of points and authorities and trial briefs has been reduced to 25 rather than 35 pages, absent a court order allowing additional pages.

### Rule 4.3 — Notice of Related Case or Other Pending Action

A notice of related case or notice of pendency of other actions or proceedings now must include a brief factual statement setting forth the basis for the attorney's belief that the action either qualifies for a related case transfer or involves all or a material part of the subject matter of another action or proceeding.

### Rule 4.6 — Certification As To Interested Parties

A Notice of Interested Party must now be filed with each first appearance containing a certification by the party's counsel of record that the notice lists all parties having a direct pecuniary

interest in the outcome of the case. The notice must include all persons, associations of persons, firms, partnerships, corporations and insurance carriers having such an interest. This disclosure requirement is considerably broader than the appellate disclosure rule (Rule 26.1 of the Rules of Appellate Procedure), which requires only identification of parent companies, subsidiaries and affiliates that have issued shares to the public.

### Rule 7.4.1 — Prefiling Conference of Counsel

A prefiling conference of counsel is now required before the filing of any motion, except for discovery motions (which have their own meet-and-confer requirements) and applications for temporary restraining orders. The prefiling conference must be held 5 days before filing a motion to dismiss or other motion where the filing time is prescribed by the Federal Rules of Civil Procedure, and 20 days before the filing of all other motions. If the conference does not eliminate the necessity for a hearing, counsel for the moving party must include in the notice of motion a statement that the prefiling conference took place.

### Rule 7.5.4 — Requiring Presence of Declarants in Pre-Trial Proceedings

The procedure has been clarified for requesting the presence of declarants in connection with motions and orders to show cause regarding preliminary injunctions, motions to be relieved from default, and other motions where an issue of fact is to be determined. The rule sets up a specific schedule regarding producing declarants at the hearing for cross-examination. The request for cross-examination must be served and filed not later than ten days prior to the hearing; an objection, disputing that the declarant is within the subpoena power of the court and reasonably available to the offering party, may be served and filed not later than seven days prior to the hearing. Unless the court grants the request to cross-examine by written order at least three days prior to the hearing, the offering party is under no obligation to produce the declarant. The amended rule notes that the court, as an alternative to requiring the personal presence of a declarant for cross-examination, may order that the cross-examination be done by deposition on two calendar days' notice, with the transcript lodged at least two court days prior to the hearing.

### Rules 7.6, 7.7 — Opposing and Reply Papers on Motions

Opposition to a motion for a new trial is due not later than 10 days after service of the motion, rather than 14 days following service as in all other motions (Rule 7.6). Sur-replies may not be filed, absent prior written order of the court (Rule 7.7).

### Rule 7.15 — Discovery Motions

The meet-and-confer prerequisite for discovery motions has been given added specificity. The rule now prescribes that the pre-filing conference of counsel occur at the office of the moving party's counsel (unless otherwise agreed) and permits the conference to take place telephonically if counsel are not within the same county of the Central District. The letter initiating this conference is now required to identify each issue or discovery request in dispute, to state briefly as to each such issue or request the moving party's position, to provide any legal authority that the moving party believes is dispositive of the dispute, and to specify the terms of the discovery order to be sought. The required joint stipulation describing the unresolved issues may now include an introductory statement not longer than three pages in length from each party. The joint stipulation must also state how each party proposed to resolve each dispute at the conference of counsel. Perhaps in response to the ABTL's comment urging further refinement of the requirement that opposing counsel "promptly" sign the joint stipulation, the rule now requires that opposing counsel sign the joint stipulation and return it, by hand, to counsel for the

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## Revisions to Central District Local Rules

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moving party no later than the end of the next business day. Finally, a supplemental memorandum of points and authorities may now be filed not later than five (rather than four) court days prior to the hearing date and otherwise no other separate memorandum may be filed by either party.

### Rule 8.2.1 — Number of Permitted Interrogatories

The number of permitted interrogatories has been reduced from 30 to 25, absent leave of court for good cause shown. This change conforms the local rule to the limit already set forth in Rule 33 of the Federal Rules of Civil Procedure.

### Rule 13 — Trials and Deadlines

Juries in civil actions shall consist of the "number of jurors provided for in F.R. Civ. P. 48" (i.e., not fewer than six nor more than twelve jurors); the prior version of this local rule called for six jurors in civil cases. Requests for a special verdict or general verdict accompanied by answers to interrogatories are now due five court days, rather than five days, before trial is set to commence (Rule 13.4.1). In non-jury trials, proposed findings of fact and conclusions of law are to be lodged and served at least five, rather than seven, days before trial (Rule 13.5).

### Rule 16.4.6(c) — Items Taxable as Costs

Items taxable as costs have been given some clarification. Expert witness fees in excess of the statutory witness fee are not taxable as costs pursuant to Rule 26(b)(4)(C) of the Federal Rules unless otherwise ordered by the court. The rule now expressly distinguishes between the cost of transcription of oral depositions, which are recoverable as costs, and the cost of videotaped or recorded depositions, which are not recoverable unless ordered by the court. Similarly, the costs of video or audio technicians are not recoverable unless ordered by the court.

### Rule 27 — Sanctions

The sanctions rule now provides that violation of or failure to conform to any of the Local Rules "may" rather than "shall" subject the offending party or counsel to sanctions. The new rule also clarifies when certain sanctions are appropriate: monetary sanctions are appropriate if the conduct was willful, grossly negligent, or reckless; costs-and-attorneys' fees sanctions are appropriate if the court finds the conduct involved bad faith or willful disobedience of a court order.

—Rolf S. Woolner & Jeffrey W. Kramer

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## Defectors Beware

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that the purpose of a preliminary injunction will have evaporated before the year is up." *Id.* at \*23.

In *Solutech Corp. v. Agnew*, 88 Wash. App. 1067, 1997 Wash. App. LEXIS 2130 (Dec. 30, 1997), the court upheld an injunction prohibiting two former employees for six years from competing with their former employer by manufacturing "edible wax used to coat apples before storage." *Id.* at \*1. The court based its inference of threatened misappropriation of trade secrets on the fact that the two employees lacked college level degrees and the fact that they intended to produce edible waxes that competed directly with their former employer's products: "[T]he evidence is that Mr. Agnew and Mr. Ingle intended to produce edible waxes. Other evidence indicates it is highly unlikely that persons without college level degrees in chemistry or chemical engineering could develop high quality, competitive edible apple waxes. Together these facts support a finding that there existed 'a high degree of probability of inevitable' disclosure of trade secrets." *Id.* at \*23. The *Solutech* court also found that a broad injunction was warranted because a narrow injunction would be extremely difficult to police and it would be unduly burdensome and expensive to determine whether a former employer's trade secrets were being used in the new business. *Id.* at \*25-26.

Distilling the case law then, to effectively side-line a former employee for any period of time, proof of the following elements will be required: (1) the two employers are direct competitors in a highly competitive industry; (2) the defecting employee has knowledge of trade secrets that are integral to the products or services of the former employer; (3) the former employee's job duties and responsibilities for the new employer are substantially similar to his old ones; (4) the new employer has not provided adequate assurances or measures to preclude the disclosure of trade secrets; and (5) although perhaps not technically a formal element, as a practical matter, courts will probably want to see circumstantial indicia of an intent to misappropriate such as a lack of candor or actual misappropriation of other trade secrets or confidential information.

### Whether California Courts Will Apply the Inevitable Disclosure Doctrine

No reported California case has recognized the inevitable disclosure doctrine. We predict that California courts will do so when presented with the opportunity. First, California has adopted the UTSA which authorizes courts to enjoin threatened misappropriation and which is the trade secrets statute in effect in the jurisdictions that have applied the doctrine. Second, California law recognizes the principle that direct proof of trade secret misappropriation is unnecessary to establish a "threat" of misappropriation that will warrant injunctive relief. See *Lamb-Weston, Inc. v. McCain Foods, Ltd.*, 941 F.2d 970, 973 (9th Cir. 1991) (preliminary injunction affirmed when based only on "circumstantial evidence" of misappropriation, such as the employee's knowledge of trade secrets and extent to which those trade secrets would prove useful to employee in new position with competitor); *Hollingsworth Solderless Terminal Co. v. Turley*, 622 F.2d 1324, 1328 (9th Cir. 1980) (circumstantial evidence supported finding of misappropriation).

Opponents of the inevitable disclosure doctrine have one strong argument for blocking its recognition in California — California Business and Professions Code Section 16600. That Section provides that "every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void." Some have argued that the "right-to-work" policy effectuated by Section 16600 should pre-

(Continued on page 8)

clude use of the inevitable disclosure doctrine on the ground that it imposes an improper restraint on employment. *See* B. Rubenstein, *supra* note 2.

Such an argument will likely fail for several reasons, however. First, the plain language of Section 16600 does not apply to an "inevitable disclosure" situation. Section 16600 by its own terms applies only to "contracts," and the inevitable disclosure doctrine derives not from any contract or restrictive covenant but from the threat of misappropriation of trade secrets under the UTSA.

Next, the California Legislature enacted the UTSA in 1984, whereas it enacted Section 16600 in 1941. As a matter of statutory construction, the California Legislature's passage of the UTSA, without acknowledging or accommodating the older statute suggests that the legislature considered Section 16600 to have no effect on the operation of the trade secrets laws. *See Schmidt v. Southern Cal. Rapid Transit Dist.*, 14 Cal. App. 4th 23, 27 (1993) ("[I]t is assumed that the Legislature has existing laws in mind at the time that it enacts a new statute."); *see also Rose v. State*, 19 Cal. 2d 713, 724 (1942) ("A specific provision relating to a particular subject will govern in respect to that subject, as against a general provision....").

In addition, to the extent the majority of states adopting the UTSA have recognized the inevitable disclosure doctrine, California needs to adopt the inevitable disclosure doctrine in order to keep California's trade secret law uniform with that of other states. *See* Cal. Civ. Code § 3426.8 ("This title shall be applied and construed to effectuate its general purpose to make uniform the law with respect to the subject of this title among states enacting it.").

**F**inally, on those occasions when the UTSA and Section 16600 have come into conflict, courts have favored the UTSA. In particular, California courts have declined to strike non-competition contracts under Section 16600 if those contracts are designed to protect an employer's trade secrets. *See Metro Traffic Control, Inc. v. Shadow Traffic Network*, 22 Cal. App. 4th 853, 859, 860 (1994) ("Section 16600 has specifically been held to invalidate employment contracts which prohibit an employee from working for a competitor when the employment has terminated, *unless necessary to protect the employer's trade secrets*"; "section 16600 prohibits the enforcement of Metro's noncompete clause *except as is necessary to protect trade secrets*") (emphasis added); *Gordon v. Landau*, 49 Cal. 2d 690, 694 (1958) (same).

### **Confronting the Inevitable**

If a high-level employee with access to sensitive information defects from your company, you should immediately consult counsel. If the company has a meritorious trade secrets case, time will almost always be of the essence. In determining whether to issue injunctive relief, the court will likely consider whether the trade secrets at issue are already disclosed. If the employee has already spent significant time at his or her new job, a court may determine that any "inevitable" disclosure has already taken place and that injunctive relief will do no good. In addition, the promptness of a company's request for injunctive relief will impress the court that the information at issue has true value to the company and that the company has not instituted proceedings (as the other side will no doubt argue) merely as a tactic to restrict competition.

In addition, your company should consult counsel before it hires any key employee from a competitor. Even if the company does not believe the employee actually has access to trade secret information, the employer may be wrong — and if the old employer can make a convincing case of threatened disclosure, a new employer may find itself enjoined from hiring the employee.

Consulting counsel represents the best course of action when confronted with an "inevitable disclosure" situation. In addition, the following are some suggestions for how to make the best of the inevitable disclosure doctrine.

#### *When a Key Employee Defects From Your Company:*

- Conduct an exit interview of the employee, with at least one additional witness present, in which you ask the employee about what he or she considers trade secrets of the company and what assurances, if any, you have that he or she will not use the trade secrets for the new employer.
- As part of the exit interview, also make specific inquiries of the employee as to what his or her new position will be with the competitor. This will help determine whether trade secrets will be compromised, and it also gives the employee the opportunity to demonstrate candor (or lack thereof) which courts find significant in assessing whether a threat of misappropriation exists.
- Immediately interview the departing employee's co-workers to determine whether they have observed the employee removing materials from the office or engaging in other activities that suggest misappropriation of trade secrets. You should also ask whether the employee has attempted to recruit fellow employees to leave work (thereby suggesting a "raid" and enhanced threat to the business) and whether the employee has made any remarks regarding plans to use trade secret information in the new position.
- Ask the new employer what assurances they can provide that the departing employee will not disclose your company's trade secrets in his new position. No response or an inadequate response will provide strong evidence of threatened disclosure.
- As a back-up to the protections of trade secrets law, you should have the employee sign an agreement spelling out what information they will not disclose following termination and acknowledging that certain information is trade secret. You should, of course, not sweep into the definition of "trade secret" general types of information you may later want to contend are not trade secrets (for example, if your company hires someone who will need to use that type of information from their old employer to do their job).
- Promptly decide whether to institute legal action and, if you decide to do so, proceed quickly.
- If you decide not to institute legal action for the time being, write a letter to the employee reminding him or her not to disclose trade secrets and of what you consider to be trade secrets. If you are still considering whether to seek an injunction, make clear that you consider the situation grave and that you are still assessing your legal options.
- If you are a "repeat player" in the forum of employee defections (as in fields like investment management and advice), take the time to have an outside law firm or your internal legal department put together forms to hold on reserve in the event an injunction is needed. Early drafting of portions of the briefs, such as sections describing what constitutes a trade secret and how your business would suffer damage because of disclosure of trade secrets, could save valuable time in the event of a defection, and could be used for a variety of different types of employees who might defect.

#### *When You Wish to Hire A Competitor's Employees:*

For a company about to hire a manager from a competitor, the doctrine represents a potential stumbling block. The company

*(Continued on page 9)*



could find itself — like Quaker Oats in the PepsiCo case — about to incorporate a valuable and highly compensated new manager into its operations only to find it needs to defend itself in an expensive lawsuit and then send the employee on forced vacation. What situations present the highest risk? Obviously, one situation is hiring away a competitor's critical, high-level employee to act as a "turn-coat" who would compete directly with the old employer. Another is if the employee clearly had learned his old employer's trade secrets and would need to perform mental gymnastics in order to perform the new job without using them. Regardless of the risk, the following will help protect against a claim based on the inevitable disclosure doctrine:

- Ask the new employee in writing not to bring to her new job any documents or other materials whatsoever, not to disparage her former employer to customers or anyone else, and (at least for the short term) not to attempt to recruit other employees to leave along with her. Such a letter would help avoid the appearance that you are raiding or exploiting the old employer.
- Behave with the utmost candor, and try to make sure the new employee does as well. The PepsiCo court considered the perceived truthfulness of those involved in making its decision regarding the "threat" of misappropriation.
- Make sure the new employee does not provide services to your company until he has resigned his position with the old employer. Particularly if you are a competitor, the employee's providing services for you while he is employed by the old employer may constitute a serious breach of his duties to his old employer and suggest to the court that there is an improper threat to the old employer's business (as well as encouraging a claim that you induced the employee's breach of duty).
- Refrain from signing an employment agreement with the new employee until the dust settles, or include terms that anticipate the possibility the new employee could be enjoined from working. For example, an employment agreement could provide that the employee will use up his vacation time if for any reason he cannot perform services.
- In recruitment, do not present to the new employee an overly optimistic view of whether the old employer will sue or whether such a suit will succeed. If the employee later suffers an injunction precluding him from accepting his new job (and if the old employer refuses to re-hire him, which is likely), the new employee could be prompted to assert a claim against your company for fraud or estoppel in improperly inducing him to quit his old job.
- Ask the employee to sign a short agreement that he or she will not use the old employer's trade secrets.

<sup>1</sup>See Robert Lenzner & Carrie Shook, *Whose Rolodex is it Anyway*, *Forbes*, Feb. 23, 1998, at 100; William M. Carley, *The Ties That Bind: CEO Gets Hard Lesson in How Not to Keep His Top Lieutenants*, *Wall St. J.*, Feb. 12, 1998, at A1.; Peter Schweizer, *New Spy Law Could Cramp Economy*, *USA Today*, Nov. 20, 1997, at 15A.

<sup>2</sup>Bruce Rubenstein, *Welcome Aboard. Now Take a Vacation: (Microsoft) Woos Competitor's Employees With Million-Dollar Bonuses*, *U.S. Bus. Litig.*, September 1997, at 1; Crista Hardie, *Rights Controversy is Highlighted by LSI Logic Lawsuit*, *Electronic News Cahers Publishing Co.*, March 10, 1997, at 1.

<sup>3</sup>Under California law, courts have, for example, found special customer needs, customer buying and usage patterns, billing rates, profit margins and other customer and financial information to constitute trade secrets under the UTSA. See *Courtesy Temporary Serv., Inc. v. Camacho*, 222 Cal. App. 3d 1278, 1288 (1990); *American Paper & Packaging Prods. Inc. v. Kirgan*, 183 Cal. App. 3d 1318, 1324 (1986).

—Richard L. Stone and David A. Urban

**Evidence**

The Supreme Court held that there is no tort of spoliation of evidence, at least where the spoliation could have been discovered during pendency of the subject litigation, in *Cedars-Sinai Medical Center v. Superior Court*, 98 Daily Journal D.A.R. 4881 (Supreme Court May 11, 1998). The decision overrules a line of authority stretching back 14 years. The Court reasoned that existing non-tort remedies are adequate. In particular, C.C.P. §2023 provides for potent sanctions, including monetary sanctions, contempt sanctions, issue sanctions, evidence sanctions and even terminating sanctions. The Court opined that such remedies are preferable to recognizing a new tort that could spawn endless litigation.

**Sanctions**

The Review Department of the State Bar Court ruled that an attorney is required to report sanctions of \$1,000 or more to the State Bar within 30 days after the attorney learns of the sanction regardless of whether there is a pending appeal. In *the Matter of Respondent Y*, 98 Daily Journal D.A.R. 4889 (State Bar Court, May 5, 1998).



Michael K. Grace

**Insurance**

In *Truck Insurance Exchange v. Superior Court (Peck/ Jones Construction Corporation)*, 98 Daily Journal D.A.R. 3067 (Court of Appeal, March 26, 1998), the Second Appellate District held that a general contractor's commercial general liability policy did not afford coverage for the contractor's negligent failure to meet a contractual deadline for completion of a construction project.

In *Pepperell v. Scottsdale Insurance Co.*, 98 Daily Journal D.A.R. 3270 (Court of Appeal, March 31, 1998), the Fourth District held that a liability insurer had a duty to defend a construction defect suit under a continuous injury trigger even though the injuries did not become manifest until after expiration of the policy period.

In *Davinder Singh v. Allstate Insurance Company*, 98 Daily Journal D.A.R. (April 16, 1998), the Fourth Appellate District held that equitable tolling does not apply to the time period when an insurance company is "reconsidering" an insured's claim which was previously denied.

In *Cheeks v. California Fair Plan Association*, 98 Daily Journal D.A.R. 1363 (February 9, 1998), the Second Appellate District concluded that actual cash value in the insured's policy means "fair market value" and not replacement cost less depreciation. The court noted that if the parties intended to determine actual cash value on the basis of replacement cost less depreciation that policy could have used such words as "actual cash value, with proper deduction for depreciation."

**Collateral Estoppel**

In *Orrick v. San Joaquin Community Hospital*, 98 Daily Journal D.A.R. 3701 (Court of Appeal, April 7, 1998), the Fifth District held that a non-party could not use an arbitration award as collateral estoppel offensively against a party to the arbitration where that non-party objected to being a party to the arbitration. The court held that if the non-party agreed to binding arbitration, he could have reaped the benefits of the arbitrator's decision.

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## Cases of Note

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However, having refused to submit to arbitration it would be fundamentally unfair to allow the non-party to now use the results of that proceeding as a sword against the party to the arbitration.

### Jury Trial

In *Interactive Multimedia Artists, Inc. v. Superior Court*, 98 Daily Journal D.A.R. 3789 (April 14, 1998), the Second Appellate District of the Court of Appeal held that there is no right to a jury trial for an action for breach of fiduciary duty of a board of directors to its shareholders.

### Personal Jurisdiction

In *Panavision International, L.P. v. Toeppen*, Case No. 97-55467 (9th Cir. April 17, 1998), the Ninth Circuit Court of Appeals issued its second decision addressing personal jurisdiction over defendants doing business on the Internet. (See also, *Cybersell v. Cybersell*, 130 F.3d 414 (9th Cir. 1997).



Denise M. Parga

Toeppen was an Illinois "cybersquatter" who registered in his own name the domain names Panavision and Panaflex, well known Panavision registered trademarks, as well as other famous trademarks. Panavision told Toeppen to stop using the domain names, and Toeppen offered to sell the domain name registrations for \$13,000. Panavision refused to

make the payment and sued in California for trademark dilution. Toeppen contested personal jurisdiction in California.

The Court applied the specific jurisdiction test to evaluate Toeppen's jurisdictional challenge. First, the Court found that Toeppen had purposefully availed himself of the benefits of activities occurring in the forum under the effects doctrine. The District Court analogized the case to a tort case, noting that the defendant purposely registered Panavision's trademarks as his own internet domain names to force Panavision to pay him money. The effects doctrine was met because the brunt of the harm to Panavision was felt in California and because the defendant knew that Panavision's principal place of business was in California. As to the second part, requiring that the claim must be one which arises out of, or results from, the defendant's forum-related activities, the Court stated that Panavision was injured in California, and that "but for" the defendant's conduct, the injury would not have occurred.

The Ninth Circuit also affirmed the district court's finding that defendant's registration of Panavision's trademarks as internet domain names diluted those marks within the meaning of the Federal and California anti-dilution statutes. Those statutes require existence of a "famous mark," defendant's commercial use of the mark after the mark had become famous, and defendant's use of the mark in a manner that impaired the mark's capacity to identify and distinguish the registrant's goods or services from those of others. Toeppen did not challenge the fame of the mark or the use in commerce. However, Toeppen argued that his use of the marks was not commercial and that there was no dilution of the marks to continue to identify Panavision's goods and services. The Ninth Circuit gave little weight in those arguments. According to Judge Thompson, Toeppen commercially used Panavision's trademarks in his "business" of registering famous trademarks as domain names and then selling them to the lawful

trademark owners. The Ninth Circuit rejected Toeppen's argument that a domain name is nothing more than an electronic "address" and that Panavision could still use its mark on the internet to identify its goods and services by using other domain names, noting that it is easier to locate companies by using their trademarks identifiers as domain names than to conduct an Internet search of the trademarks.

### Federal Trademark Dilution

In a surprising decision, the District Court ordered a company to pay a \$300 fee to a "cybersquatter" who commandeered trade names in cyberspace. *Avery Dennison Corp. v. Sumpton*, Case No. CV 97-407 JSL (posted on Court's website April 14, 1998).

Sumpton was a "cybersquatter" who registered via Internic, the U.S. internet domain name registration authority, over 12,000 internet domain names for resale. Sumpton's modus operandi was to register multiple variations of famous trademarks on the pretexts that the names also are common proper last names and that the "license" was limited to use as an internet e-mail address and not as a commercial domain name.

Defendants registered "avery.net" and "dennison.net" as domain names. Plaintiff, who owns federal trademark registrations for Avery and Dennison, protested and filed suit for trademark infringement, trademark dilution and unfair competition.

On cross motions for summary judgment, based solely on the federal trademark dilution statute, 15 U.S.C. Section 1125(c), the Court ordered defendants to assign their domain name registrations to plaintiff on the condition that plaintiff pay to defendants \$300 per domain name.

The Court observed that it must consider the equities as between the parties in determining whether to grant injunctive relief. The Court surmised that defendants' business of licensing names for use only as e-mail addresses is "almost certainly not the highest and best use" and might even be a sham, especially since the Court noted that defendants charge only a \$20 setup fee and \$5 annual subscription fee and that on that basis "defendants will never recover their initial investment and will continue to lose money every year thereafter." Because the Court nevertheless was unable to reach the conclusion that defendants' alleged business was merely a front for selling domain names to their trademark owners, the Court fixed a 100% return per annum on defendants' initial \$100 investment in domain name registration and ordered the plaintiff to pay \$300 per name.

—Michael K. Grace, Denise M. Parga and James A. Henricks

## Suing Clients

Continued from page 1

The first shots across our respective bows include new coverage language that places limitations on coverage where an attorney has initiated a fee collection action. To ward off paying its own insured to settle a fee dispute, some new policies contain language to the effect that the insurance carrier is not obligated to and will not pay any sum to the insured in connection with any claim made against the insured. If a firm has a history of filing collection claims, expect some professional liability carriers to decline providing coverage altogether, raise its coverage rates or, alternatively, limit coverage where a malpractice claim is filed in response to a fee collection suit.

Thus, when shopping around for the best rates for coverage next year, one would do well to read the fine print of any quotations. If one insurer's rates are more attractive than another, one should investigate whether, among other things, there are any limitations of coverage based upon fee disputes between lawyer and client.

—Larry C. Russ

An arbitrator awarded the plaintiff \$3.5 million in damages, and Sabo requested a trial *de novo* which was granted. Thereafter, the trial court granted Sabo's motion for summary judgment, concluding that the plaintiff cannot "establish the required duty element in this legal malpractice action, because an attorney-client relationship never existed between plaintiff and defendants." 55 Cal.App.4th at 829.

The *BLM* court drew heavily on the *Bily* decision in determining the scope of the defendants' duty of care. The court concluded that *BLM* had no standing to sue Sabo, either on a theory of negligence, negligent misrepresentation or as a third party beneficiary of Sabo's engagement with Rialto, even though the court acknowledged that *BLM* "stood to benefit from the successful completion of the project..." *Id.* at 832.

Of the potential theories under which *BLM* might assert a claim against Sabo, the court studied the negligent misrepresentation theory the most carefully, indicating that it presented the greatest potential promise. Nonetheless, the court rejected *BLM*'s attempt to state this cause of action on two separate grounds: (1) because Sabo lacked an intent to influence *BLM* by virtue of its legal representation of Rialto, the party on the "other side" of the deal from *BLM*; and (2) the lack of justifiable reliance by *BLM* on Sabo's work.

The *BLM* court drew most heavily on *Bily* in the discussion of the "intent to influence." The *BLM* court quoted *Bily* as follows:

"California courts have consistently required some manifestation on the part of a professional who offers an opinion, information, or advice that he or she is acting for the benefit of a third party or defined group of third parties in a specific and circumscribed transaction." 55 Cal.App.4th at 835 (quoting *Bily*, 3 Cal.4th at 411-412)."

The *BLM* court stated further:

"Intent to influence is a threshold issue. In its absence there is no liability even though a plaintiff has relied on the misrepresentation to his or her detriment, and even if such reliance were reasonably foreseeable." *Id.* at 835 (quoting *Stagen v. Stewart West Coast Title Co.*, 149 Cal.App.3d 114, 121-122 (1983) and *Bily*, 3 Cal.4th at 412).

Based on the facts alleged in the complaint, the *BLM* court concluded that there was no manifestation on the part of the Sabo attorneys of any intent to influence *BLM* by virtue of their representation of Rialto on the "opposite side" of the bargaining table.

The *BLM* court also rejected *BLM*'s claim because the element of reasonable reliance was missing. The court concluded that it would be "anomalous" to hold Sabo liable to the party adverse to Sabo's own client where Sabo would be precluded by the Rules of Professional Conduct from representing the plaintiff in the transaction.

The *BLM* court drew upon the classic California cases involving claims against attorneys, which cases pre-date *Bily*, in reaching its conclusion. The determining factor in these cases is whether the attorney knows that his or her opinion is being provided to the third party and consents to such use. *See, Roberts v. Ball, Hunt, Hart, Brown & Baerwitz*, 57 Cal.App.3d 104 (1976), (plaintiff third party permitted to sue a law firm where firm knew and consented to delivery of its opinion to plaintiff); *Goodman v. Kennedy*, 18 Cal.3d 335 (1976) (third party plaintiff cannot sue attorney where the attorney did not know or intend his opinion to be provided to or relied upon by the plaintiff).

#### Claims Against Real Estate Appraisers.

*Bily* has also been applied to claims against real estate appraisers. In *Soderberg v. McKinney*, 44 Cal.App.4th 1760 (1996), the Court of Appeal summarized the holding in *Bily* and then stated the issue presented as follows:

"In this case, we address whether such liability [to a third party

as discussed in *Bily*] extends to a real estate appraiser who, although retained by a mortgage broker, knows that his report will be used by potential investors in the brokered loan. We hold that it does." *Id.* at 1763.

The *Soderberg* court quoted the following passage from *Bily*:

"Accountants are not unique in their position as suppliers of information and evaluations for the use and benefit of others. Other professionals, including attorneys, architects, engineers, title insurers and abstractors, and others also perform that function. And, like auditors, these professionals may also face suits by third persons claiming reliance on information and opinions generated in a professional capacity." *Id.* at 640 (quoting *Bily*, 3 Cal.4th at 410).

The *Soderberg* court stated that liability may be appropriate where the defendant "knows with substantial certainty that plaintiff, or the particular class persons to which plaintiff belongs, will rely on the representation in the course of the transaction..." *Id.* (quoting *Bily*, 3 Cal.4th at 414). The *Soderberg* court concluded:

"It is enough that the maker of the representation intends to reach and influence either a particular person or persons, known to him, or group or class of persons, distinct from the much larger class who might reasonably be expected sooner or later to have access to the information and foreseeably to take some action in reliance upon it." *Id.* at 640-641.

Accordingly, the *Soderberg* court reversed a summary judgment granted in favor of the defendant real estate appraiser, because the evidence presented to the trial court indicated that the appraiser knew that its client (the mortgage broker) would forward the report to a particular class of persons, consisting of investors (such as the plaintiff) in a mortgage secured by the real property which was the subject of the appraisal.

The *Soderberg* opinion was applied and extended in *Arlington Investment Co. v. Tarcher*, 58 Cal.App.4th 83 (1997). Even though the California Supreme Court has granted review of *Arlington Investment*, and it cannot be cited as authority, it is worth evaluating for purposes of this article. The *Arlington Investment* court held that a real estate appraiser may be liable to a bank which acquired a property by a full credit bid at a non-judicial foreclosure sale in reliance upon an allegedly defective appraisal. The court concluded that the appraiser knew or anticipated that its appraisal on behalf of a loan applicant would ultimately be used by a lender in deciding whether to make a mortgage loan or acquire the real property security at a foreclosure sale.

The *Arlington Investment* court drew upon both *Bily* and *Soderberg* in reaching its conclusion. The *Arlington Investment* court was also presented with the rule that a claim on the part of a lender which acquires property by means of a full credit bid at a non-judicial foreclosure would, absent fraud, be barred from prosecuting a claim against the appraiser. However, relying on the discussion of the tort of negligent misrepresentation in *Bily* as "a species of fraud," the *Arlington Investment* court concluded that the lender could prosecute a negligent misrepresentation claim against the appraiser. *Id.* at 826.

#### Conclusion

The *Bily* decision can be expected to outline the contours of future claims against accountants, not only when they act in the capacity of financial statement auditors, but also when performing the other services which accountants may render, such as tax and accounting services. It is also reasonable to conclude that *Bily* will outline the contours of future claims against other professionals including attorneys, architects, engineers, title insurers and abstractors. To the extent there are predictions of a wave of "year 2000" litigation against computer consultants, software suppliers and parties who disseminate information, *Bily* will undoubtedly have an impact on that litigation as well.

—Michael L. Cypers

## Letter from the President

Continued from page 1

professor because of the simplicity of his house or the make of his car.

The solemnity of the occasion was unmistakable. "The lawyer" addressed my mother and father as Mr. and Mrs. (the title Ms. being then unknown) and they comparably addressed him as Mr. (the notion of a woman lawyer then being almost equally unknown). My parents and their lawyer talked seriously about what had occurred. The lawyer informed my mother what amount would constitute a fair settlement and told us that he would be getting back to us in a few weeks. A few weeks later he advised us that the other side was agreeable to a fair settlement and one was struck. The lawyer received his fee and my family's thanks. The matter was settled and lives resumed.

My parents didn't know this lawyer personally and never expected to. They had no basis upon which to trust him, but they did. One of the reasons they trusted him was because lawyers were supposed to be trusted. They occupied a high position within society, much like doctors, who also were supposed to be trusted. One did not question their views. One listened and accepted.

Was this situation ideal? Undoubtedly no. Lawyers, doctors and others deserve to be questioned and should accept such questioning without resentment. I later learned that my family's lawyer had actually settled for what was, even then, an inadequate sum. It would have been better had my parents been better consumers. However, in those days, we lawyers were so respected that we were entitled to be wrong and were still not questioned. Today, by contrast, even when we are right, when we proceed honestly and faithfully, we are not only questioned, but often sued or at least asked to reduce our fees.

This is not a paean to yesteryear. We lost the past because we willingly drew down on the capital that generations of our predecessors built up. Once we were perceived as part of a heritage that wrote the Constitution and the Bill of Rights, ended racial discrimination, and fought against injustice and fraud. We squandered that legacy by appearing to hide and dissemble, with Watergate, the OJ Simpson trial, and recent revelations about the tobacco industry being examples — quite possibly incorrect examples — of all that lawyers do wrong.

There is more we can do than simply accept low public esteem without objection and cry mea culpa. We must recognize that in an age when parents turn off the radio or television so that their children don't hear discussions about the private conduct of the President of the United States, it is hopeless for lawyers to believe they will be subjected to any less critical scrutiny. We must accept that we will be scrutinized and unfairly criticized. Those realities are part of our landscape. Rather than railing against the critics, we should respond with facts. And the facts demonstrate that not just the law — but, by necessity, lawyers — continue to be the bulwark of freedom. Our society — not only because of its affluence but also because of its commitment to the rule of law — is the envy of the entire world.

The guilty may occasionally go free, civil verdicts may appear too high or too low, but there are few in our society who would not want a lawyer at his or her side when targeted by a prosecutor or the IRS, when damaged by fraud or when victimized by discrimination. Privileges may occasionally be abused, but it well serves the public to be able to confide in a lawyer, doctor or clergyman without fear of disclosure. The rules of criminal procedure and the right to a trial by jury may appear to let the guilty go free — and, at times, they do — but a society without them would be one in which not many of us would want to live.

This does not mean that we should stop laughing at, or even telling, lawyer jokes, and respond to every slight with righteous

indignation. Humor, self-deprecation and a willingness to tolerate criticism, even unfair criticism, can and should co-exist with respect for our calling. However, we can, we should and, for our own well-being and that of our society, we must speak up for our profession. We are ideally positioned to do so, and to make every exertion to assure that our profession, like the rule of law, has not only a proud past, but a bright future.

—David M. Stern

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Wednesday, September 9 Dinner Meeting  
Kicking Off '98-'99 ABTL Year

The Biltmore Hotel

Judges Reception 6:00 p.m. • Dinner Program 7:00 p.m.