

Barth REPORT

NORTHERN CALIFORNIA

Volume 2 No. 2

MARCH '93

The Changing Law on Partial Settlements in Federal Cases

EVERYONE prefers a global settlement. But partial settlements – where fewer than all jointly liable defendants settle with the plaintiffs – do occur. And the possibility of partial settlements is almost always an important consideration in the settlement strategy of both sides. In assessing the impact of a partial settlement, determining the amount of settlement “credit” the non-settling defendants will get at trial is crucial.



Stan G. Roman

Until fairly recently, the law applicable to settlement credits in partial settlements was straightforward. Under California law (except perhaps in cases where Proposition 51 applies), this is still the case: C.C.P. Sections 877 and 877.6 grant a non-settling defendant a credit (or offset) for the amount paid in the partial settlement. In an all-cash settlement, the cash paid is the credit. In a settlement including non-monetary consideration, the non-monetary consideration must be given a dollar value for purposes of the credit. See, e.g., *Abbott Ford, Inc. v. Superior Court*, 43 Cal.3d 858 (1987). This offset determination is called a “*pro tanto*” settlement credit.

Federal law previously had applied the *pro tanto* approach as well, but has become unsettled, particularly in the Ninth Circuit. In *Franklin v. Kaypro Corp.*, 884 F.2d 1222 (9th Cir. 1989), cert. denied, 111 S.Ct. 232 (1990) (“*Kaypro*”), a federal securities case, the Ninth Circuit departed from the *pro tanto* rule and adopted a

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Protecting the Attorney – Client Privilege in Public Offering Litigation

WHILE few things in the securities markets are predictable, there is little doubt that an active market in new issues of securities will be followed by a nearly equally active “market” in new shareholder class actions involving those offerings which have failed to sustain their offering prices. The focus of such litigation is, of course, the public disclosures by the issuer.

This article addresses a recurring and particularly thorny problem for issuers and underwriters and their respective counsel: What is the proper scope of the attorney-client privilege when a client consults counsel concerning a potential disclosure issue; and how can such clients maximize the likelihood that their discussions with counsel will be protected in subsequent litigation involving disclosure issues?

Consider the following scenario: During the prepara-

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Gilbert R. Serota

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"proportional" settlement credit rule. Under it, non-settling defendants receive a settlement credit, not in the amount of the consideration actually paid by the settling defendants, but in an amount equal to the settling defendants' proportionate share of fault, as determined at trial.

Proportional vs. Pro Tanto Rules

The impact of the *Kaypro* rule can be demonstrated by a typical securities fraud action in which a class of plaintiffs sues a corporation's directors, attorneys and accountants. Suppose that the directors agree to settle before trial for \$250,000. The attorneys and accountants do not settle and go to trial. At trial, the jury renders a plaintiffs' verdict of \$1.5 million. Moreover, as required by *Kaypro*, the jury determines the relative culpability of each of the defendants, including those who settled before trial, and finds that the directors, attorneys and accountants were each one-third responsible for plaintiffs' damages.

Under *Kaypro*, the non-settling accountants and attorneys would be credited \$500,000 — the settling directors' one-third share of the liability. Thus, the non-settling defendants would be liable for \$1 million, and the plaintiffs' actual recovery would total only \$1,250,000 — \$250,000 less than the damages assessed by the jury.

Although plaintiffs were made less than whole under this example, *Kaypro* can produce just the opposite result. If the plaintiffs had settled with the directors for \$600,000 — more than the amount that the jury later found to be the directors' proportionate share of the liability — the plaintiffs nonetheless would have obtained a \$1 million judgment against the non-settling accountants and attorneys and, accordingly, would have been made more than whole with a \$1.6 million total recovery. Thus, one evident feature of the *Kaypro* approach is that the risk of a bad settlement — and the potential windfall of a good settlement — rest entirely with the plaintiffs.

If the *pro tanto* rule had been used in this example (where the director defendants settled for \$250,000 and the jury found that total damages were 1.5 million), the non-settling attorney and accounting defendants would be jointly and severally liable for \$1,250,000 — the \$1.5 million in total damages offset only by the \$250,000 actually paid by the settling director defendants. If the settling director defendants had paid \$600,000, the amount of total recovery would still be exactly \$1.5 million because the non-settlers' liability would be offset by precisely that amount. Thus, an evident feature of the *pro tanto* rule is that plaintiffs are always made exactly whole, never more and never less. The risk of a bad settlement and the potential windfall of a generous settlement lie squarely with the non-settling defendants.

The impact of *Kaypro* on settlement strategy is interesting. Where *Kaypro* applies, a "deep pocket" defendant with little culpability need not feel so threatened if the plaintiff makes a low settlement with a very guilty but very poor defendant. A large settlement credit will be obtainable at trial notwithstanding the small settlement amount. Accordingly, the "deep pocket" can take a harder settlement line.

Kaypro thus gives the plaintiff a disincentive to settle first with the culpable-but-poor defendant. Even though such a defendant may offer all of its assets in settlement (and even though those assets may be smaller by the time of trial), the plaintiff may be reluctant to create a settlement credit for the non-settling defendants that substantially exceeds what the plaintiff would actually obtain from the first settlement. This situation is exacerbated for the plaintiff at trial, since the non-settling defendants will emphasize to the jury the relative culpability of the "empty chair." Thus, the plaintiff may deem it preferable to hold the poor defendant in the case, obtain a joint and several judgment at trial, and execute against the wealthier defendant.

Open Issues

It is unclear whether the *Kaypro* settlement credit rule applies to all federal claims or only federal securities claims. The reasoning behind *Kaypro* could be extended to any type of federal claim. While the opinion does not state whether its holding is limited to securities actions, it does specifically mention that the proportional approach is *not* applicable to civil rights actions (where there are no contribution rights), suggesting that it *is* applicable to other types of federal claims. *Kaypro*, 884 F.2d at 1228 n. 10.

However, in *Miller v. Christopher*, 887 F.2d 902 (9th Cir. 1989), a federal maritime case after *Kaypro*, the Ninth Circuit declined the opportunity to affirm categorically that the *Kaypro* rule applies to all federal cases. The *Miller* court, perhaps in an exercise of judicial restraint, decided the contribution issue before it and merely noted that its decision was not inconsistent with either *Kaypro* or other approaches to dealing with partial settlements.

District courts within the Ninth Circuit disagree about the reach of *Kaypro*. In *FDIC v. Anders*, 1991 WL 442874 (unpublished opinion, E.D. Cal. July 2, 1991), the court specifically held that *Kaypro* did not apply to a partial settlement of a non-securities action by the FDIC against a failed thrift's officers and directors. But, in the same kind of case, the court in *FDIC v. Strategic Investment Services, Inc.*, 1990 WL 294245 (unpublished opinion, S.D. Cal. Aug. 1, 1990), reached the opposite conclusion and applied *Kaypro* as a matter of federal common law.

In cases where *Kaypro* does apply, there also remains the question of how the courts will deal with pendent state law claims governed by the traditional *pro tanto* rule. At least one court has suggested that a uniform federal common law standard would pre-empt a diverging state law standard. *MFS Municipal Income Trust v. American Medical International*, 751 F.Supp. 279, 286 (D. Mass. 1990).

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Lawrence R. Katzin

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Perhaps some answers will come from the Supreme Court in view of its grant of *certiorari* in *Employers Insurance of Wausau v. Musick, Peeler & Garrett*, 954 F.2d 575 (9th Cir. 1992). It is anticipated that the Court will rule on the right to contribution in Rule 10b-5 cases. In *Kaypro*, the Ninth Circuit relied heavily on the existence of such a right in propounding the proportional credit rule. If the Court rules that no right to contribution exists, *Kaypro* may no longer be viable. The case may also give the Court an opportunity to comment upon the split among the Circuits on whether to apply *pro tanto* or proportional settlement credit rules.

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La Quinta Resort Beckons ABTL '93 Annual Program

THIS year's ABTL Annual Program is scheduled for October 15-17 at the La Quinta Resort, just outside of Palm Springs. The Annual Program, a combined effort of the Northern and Southern California branches of the ABTL, attracts many judges and the best legal talent in the state.

This year's program will involve trials to the Court, with an emphasis on the differences between state and federal approaches to case management and the effect of the judicial education process on a judge's approach to making critical decisions.

The hallmark of all ABTL programs is the combination of active judicial participation with live demonstrations by respected practitioners. Numerous federal and state judges attend, participate in panel sessions and critique demonstrations. This fall, demonstrations based on a hypothetical complex civil case are planned for preliminary injunctions, summary judgment motions, several elements of a bench trial and appellate argument.

Last year's program in Maui received rave reviews from the Northern California attendees. And, although competition is held to a minimum, many Southern California attorneys expressed appreciation for the opportunity to witness the skills of the Northern California demonstrators.

The '93 program will take place at the beautiful La Quinta Resort. Golf, tennis, horseback riding, swimming and hiking are some of the recreational activities that will be available. The ABTL has reserved 140 rooms at the resort. Based on the attendance at the last two annual programs, it is likely that the program will be a sellout. We expect to begin taking reservations within the next several months, so mark your calendars.

Harold McElhinny is this year's Northern California Program Chair. He welcomes questions and suggestions at (415) 677-7265.

Closing Argument In Perspective

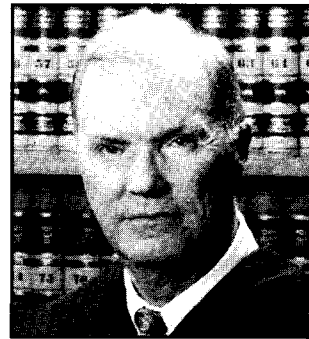
A theme is one of the most important elements of the presentation of your case at trial. It is a thread of logic and motivation that is introduced in your opening statement, drawn through the evidence and confirmed in your closing argument. It is the product of the application of an understanding of human nature to your analysis of the issues and evidence and should be chosen carefully to appeal to the logic and instincts of the jury. Properly selected and presented, it can cause the jury, however carefully it abides by the continuing admonition to form no opinions until the conclusion of the case, to want to accept your side of the issues. Juries, and judges as well, want to be fair and won't be particularly impressed by arguments and evidence that don't cause them to *feel* that the conclusion you are urging is fair. Nevertheless, too many attorneys forget this very human decision-making process and focus on issues and details that fail to appeal to a sense of fairness.

Use your opening statement and use it effectively. It is not limited to a sterile recitation of expected testimony but may be a full discussion of the evidence *and* the issues and, thus, can be an effective introduction to your theme which, in turn, should be the beginning of a process that can predispose the jury to your position.

Advancing Your Theme

Advance your theme through the evidence. Admittedly, most cases are adventures in which the evidence will sometimes alternately disappoint and surprise you but the consistency of your theme should never be an adventure. It's not always possible to present your evidence chronologically, or in an uninterrupted and narrative manner, because of conflicts in the schedules of witnesses and the court. The facts are often complex and the documentary evidence voluminous and the latter is often presented, either by stipulation or by testimony, without sufficient explanation of its relevance. The sheer volume and length of documents may obscure their relevance and importance, but your theme is the lifeline you've given the jury, and if you remain focused in relating your evidence to it, the jury will have a much greater opportunity to progress with you to the desired conclusion.

It may have been at one time that closing arguments were a distinct, and nearly separate, part of the trial process — a show of brilliance by the orators of the day. In today's world of complex litigation, the opportunities



Hon. Wm. A. MacLaughlin

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Closing Argument In Perspective

for oratory may be less, but the opportunities for persuasion are perhaps greater because the knowledge gained through discovery permits greater predictability in the evidence and the opportunity to begin selling the logic and appeal of your theme to the audience from the beginning.

If you believe that juries really do not form any opinions on the merits of the case until it has finally been submitted to them, your closing argument may still represent an isolated and last opportunity to persuade. If you believe, as many do, that juries have at least sensed, if not decided, the outcome they seek, the closing argument becomes the last, albeit highly important, step in the process of persuasion. It is the opportunity for you to provide the logic to the jury which will help it justify what you have caused it to want to do, to assure that the evidence has been received in the proper perspective and to confirm your credibility for having delivered what you promised.

To accomplish this, remember that you must retain the jurors' interest in your case and in what you say. To the extent that you failed to do so in the presentation of the evidence, your client's chances of success are diminished, and to the extent you fail to do so in your closing argument, any chance of success could be lost.

Such lost opportunities are often due to a lack of focus in the argument, a failure to limit the details, and a simple failure to entertain. Don't let the other side cause you to lose the impact of your case — bring the theme to a conclusion. In doing so, remember that juries can't possibly retain the details that you've spent several years mastering. Concentrate on the points important to your theme and the evidence that is important to those points. A few clear and concise well-documented arguments will be far more effective than multiple points that drown in detail.

Selling Your Audience

Above all, however, understand that you have an audience to sell. Attorneys are so often eager for the fight, and driven by the need to prevail over their opponent, that they forget to communicate on levels that have meaning to the jury. As a group, they perform a most difficult function, spending day after day listening, but not participating, and often listening to evidence that is repetitive and not readily understandable. No wonder a jury's collective attention span deteriorates. If your closing argument is more of the same, you may lose the effect of what you attempted to build by the evidence.

Talk with them, not at, or to, them. Entertain while you make your points, and the points will often make themselves. Remember the story of Peck, employed as a dockhand on a ship in Lake Michigan, who disappeared. Had he jumped ship or otherwise, unaccountably, disappeared? His heirs claimed that he had been lost overboard and drowned and, in an action to collect the proceeds of a life insurance policy, presented the testimony of a cook from another ship who testified that he had been down in the galley peeling potatoes when he just happened to

look out the porthole to see his friend Peck floating by. The cook testified that he told his captain about it a day later.

In his closing argument, the attorney for the insurance carrier, knowing that the outcome of the case rested on the cook's credibility, decided against mere argument to attack the veracity of the person who didn't bother to report the mysteriously missing Peck until a day later. Instead, the attorney set out a trash can in front of the jury, took out a potato from his pocket and began to peel it as he whistled a tune. Looking out of an imaginary porthole he exclaimed, "What is this? If it isn't my old friend Peck. I must tell the Captain about that tomorrow. For now, I'll just peel my potatoes." No further argument was necessary.

Confirming Your Theme

At least in general terms, you should have prepared and rehearsed your closing argument before trial as it will assist you in developing the focus on where you're going and how you're going to get there. Throughout the trial, continue to rehearse in your mind the changes and refinements that are necessary to reflect the record so that you make the adjustments necessary to arrive at the conclusions that you gave the jury at the beginning. As you do this, and your argument takes its final form at the conclusion of the evidence, remember that the best argument rarely takes as long as the lawyer thinks it should as your case should have sold itself. Confirm your theme, polish it to give the jury logical reasons to do what you have caused them to want to do, and sit down. Your job is done.

The Hon. William A. MacLaughlin is a judge of the Los Angeles County Superior Court. This article first appeared in the September 1992 issue of ABTL Report for Southern California.



COMING EVENTS

April 14, 1993

MCLE Dinner:
Jury Consultants
Sheraton Palace Hotel
Cocktails at 6:00 p.m.
Dinner at 7:00 p.m.

October 15-17, 1993

Annual Program:
Trials to the Court
La Quinta Resort
near Palm Springs

Call Wendy Cornell (415) 421-6500
for tickets or information.

MARY E. MCCUTCHEON

On INSURANCE

If you represent insureds, it is important to distinguish between what the California Supreme Court decided in *Bank of the West v. Superior Court* (1992) 2 Cal.4th 1254, and what it did not. The Court held that restitutionary claims are not insurable damages. It did not limit the scope of coverage for claims between competitors under a comprehensive general liability ("CGL") policy.

The bank sought coverage for payments to consumers or claims under the Unfair Business Practices Act, Bus. & Prof. Code § 17200 *et seq.* ("the Act"). The consumers had sued for restitution of excessive interest rates and loan fees that allegedly violated the Act. The bank argued that, as these practices constituted "unfair competition" under the Act, they were covered under its CGL policy's definition of "advertising injury," which included "unfair competition" as a covered offense.

Here's what the Supreme Court decided: "...[W]e hold that the CGL policy does not cover claims for advertising injury that arose under [the Act]." *Id.* at 1258. The Court stated that while "unfair competition" in the "abstract" might refer to statutory claims, the term must be interpreted in the "context" of a CGL policy, which covers "damages." *Id.* at 1265. The only nonpunitive monetary relief available under the Act is "the disgorgement of money that has been wrongfully obtained..." *Id.* at 1266. The Court found that this relief is not insurable as "damages," because that would be inconsistent with the Act's deterrent purpose. *Id.* at 1267. Thus, *Bank of the West* construes a statute (*i.e.*, the nature of relief under the act) as much as, and indeed more than, it construes an insurance provision (*i.e.*, the scope of "unfair competition" under the policy).

Here's what the Court did *not* decide: It did not decide that coverage for "unfair competition" is limited to the common law tort of "passing off" one's goods as those of another. Thus, the Court did not decide whether other actionable conduct between competitors, such as misrepresentation or interference with prospective advantage, is covered. It simply stated that "'unfair competition' can only refer to a civil wrong that can support an award of damages." *Id.* at 1265. Furthermore, the Court did *not* decide that all statutory claims for "unfair competition" are not covered. And, the Court made clear that its holding did not address any other issues of coverage or defense obligations. *Id.* at 1258.

Despite this disclaimer, insurers have asserted that *Bank of the West* held that "unfair competition" coverage is limited to the common law tort of "passing off." This is an improper reading of *Bank of the West* and conflicts with established rules of construction.

Insurers rely on the Court's citation to a line of cases holding that "unfair competition" refers to the common

law tort, "rather" than to conduct prohibited by unfair business practice statutes. *Id.* at 1263. The Court's use of the term "rather" is critical because none of these cases addressed claims by competitors. In each, the insurer argued for the narrowest definition of "unfair competition" ("passing off"), while the insureds argued for the broadest ("unreasonable business conduct"). In choosing between two extreme positions, these courts rejected the insured's proffered definition, *without always adopting the carrier's definition.* *E.g.*, *Boggs v. Whittaker, Lipp & Helea, Inc.* (Wash. App. 1990) 784 P.2d 1273, 1276 ("unfair competition" coverage requires allegations of harm to a competitor). And while two courts extended *Bank of the West* to exclude coverage for negligent misrepresentation, they did so in the context of investor claims, *not* claims between competitors. *Chatton v. National Union Fire Ins. Co.* (1992) 10 Cal.App.4th 846; *Standard Fire Ins. Co. v. People's Church of Fresno* (9th Cir. 1993) 93 Daily Jnl. D.A.R. 1385. None of these courts addressed the middle ground — what types of claims between competitors are insurable under a CGL policy?

An insured would reasonably expect that, in the "context" of a CGL policy, "unfair competition" includes a wide range of actionable conduct between competitors, particularly since coverage is conditioned on "offences," not on "torts" or "causes of action." Any more restrictive reading of the term violates the Court's rejection of "technical" definitions in *AIU Ins. Co. v. Superior Court* (1990) 51 Cal.3d 807, 823, 825. Since the policy term is at least ambiguous, applying the more limited meaning would also violate *AIU*'s reaffirmation of the rule that ambiguous policy provisions drafted by insurers must be construed in favor of coverage. *Id.* at 822, 828.

AIU also recognized that a policy could cover liabilities, including newly created statutory liabilities, which did not exist when the policy was drafted:

The sole relevant inquiry in determining whether such types of liability are covered is whether, in view of the reasonable expectations of the insured, policy language can be interpreted to embrace the liability that may accrue under new statutory schemes. *Id.* at 822, n. 8.

Thus, where statutory or decisional law has expanded the reasonable understanding of the term beyond its original meaning, coverage must be afforded.

The commands of *AIU* and *Bank of the West* are clear and reconcilable. In the context of a CGL policy, a reasonable insured should not expect coverage for purely restitutionary relief. "Unfair competition," on the other hand, cannot unambiguously be limited to the common law tort of "passing off." In the areas in between, *AIU* teaches that ambiguities are to be construed in favor of the insured, and thus in favor of coverage and defense.

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Mary E. McCutcheon



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Protecting the Attorney – Client Privilege

tion of a prospectus involving the issuance of securities, the issuer becomes aware of a corporate development which it believes may be material and may require disclosure. The issuer brings that matter to the attention of counsel. Various descriptions of the event and disclosure drafts are prepared and discussed. Based on these discussions and legal research, a final disclosure is prepared and incorporated into the prospectus. Sometime later, litigation is filed over the prospectus, and counsel is subpoenaed to produce all documents concerning the potential disclosure.

Most clients and many counsel would immediately believe that their discussions with counsel and drafts of disclosure language fall squarely within the scope of the attorney-client privilege. As discussed below, however, case law generally does not support that view.

Securities offered to the public are subject to the disclosure rules of state and federal securities laws. Corporate Securities Law of 1968, Cal. Corp. Code §§25000-25804 (West 1979 & Supp. 1992); Securities Act of 1933, 15 U.S.C. §§77a-77aa (1982); Securities Exchange Act of 1934, 15 U.S.C. §§78a-78kk (1982). The rules demand that issuers, underwriters and dealers "make full and fair disclosure of the character of securities sold in interstate and foreign commerce." *Wilko*

v. Swan, 346 U.S. 427, 430 (1953); *Keating v. Superior Court*, 31 Cal. 3d 584, 614 (1982). The fundamental purpose of these rules is to protect investors by providing them with adequate information on which to base investment decisions and by deterring members of the industry from engaging in questionable practices.

The legal profession plays an essential role in the effective execution of these disclosure rules. Attorneys conversant in the securities laws can ask the appropriate questions to ensure proper disclosure, and clients can ask their attorneys *if* and *how* certain corporate developments should be disclosed.

Given the critical role that attorneys play in providing advice about disclosure, one would expect that the attorney-client privilege would apply to *all* confidential information exchanged between attorneys and clients in connection with considering or preparing public disclosures. See Cal. Evid. Code §954 (West 1966) (attorney-client privilege); Cal. Evid. Code §912 (West 1966) (waiver of privilege); Fed. R. Evid. 501 (as to whether the privilege applies, federal common law controls in federal causes of action and state law controls in state causes of action).

Communications Not Privileged

Surprisingly, that is not the case. Only a few decisions have specifically dealt with the precise issue of whether

attorney-client communications concerning public disclosure documents are privileged, but the majority of these cases have held that these communications are not privileged. See *In re Grand Jury Proceedings*, 727 F.2d 1352, 1355-58 (4th Cir. 1984); *United States v. (Under Seal)*, 748 F.2d 871, 875-76 (4th Cir. 1984); *Lovell v. Evergreen Resources, Inc.*, No. C-88-3467 DLJ (JSB), 1990 U.S. Dist. LEXIS 11223, at *12-*21 (N.D. Cal. 1990); *Dudley v. Ski World, Inc.*, [1989 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶94,384, at 92,501 (S.D. Ind. 1989); *In re Micropro Sec. Litig.*, [1988-89 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶93,986, at 90,593 (N.D. Cal. 1988); *Southern Film Extruders, Inc. v. Coca-Cola Co.*, 117 F.R.D. 559, 561-62 (M.D.N.C. 1987). But see *Schenet v. Anderson*, 678 F. Supp. 1280, 1283-84 (E.D. Mich. 1988).

The first such case, *In re Grand Jury*, held that attorney-client communications concerning the content of a private placement prospectus were not privileged. Because the information discussed was intended to be used in a *published* prospectus (which was never actually issued), the Fourth Circuit Court of Appeal reasoned that the client did not intend the information to be confidential and it therefore could not be privileged. *Grand Jury* appears to require attorneys to produce all prospectus drafts and other communications involving a potential public disclosure. *Id.* at 1356, 1358. In *United States v. (Under Seal)*, the Fourth Circuit subsequently modified its rule to hold that, if the client is only seeking advice about the possibility of publication, then communications are privileged. However, once the client decides to publish any information, then the privilege as to all information, published or not, apparently is lost because the decision to publish indicates the client did not intend any information to be confidential. Except for *Schenet*, all cases subsequent to *Grand Jury* have adopted *Grand Jury's* reasoning.

Micropro and Lovell

Micropro and *Lovell*, the two California cases addressing the issue of whether communications relating to public disclosure documents are privileged, have followed *Grand Jury*. *Micropro* involved a discovery dispute in a federal securities case. Plaintiffs moved to compel production of defendant issuer's preliminary drafts of public disclosure documents which the issuer had refused to produce because it claimed they were protected by the attorney-client privilege. Magistrate Brennan held the privilege did not apply and ordered the issuer to produce the preliminary drafts, even though the drafts had not been distributed at due diligence meetings or other drafting meetings and had only been exchanged between the issuer and its attorney. Relying solely on *Grand Jury*, Magistrate Brennan reasoned that the issuer did not intend the drafts to be confidential because they were created with the objective of publication: "MicroPro employees were unquestionably aware that the information they provided in preliminary drafts of the offering materials would ultimately be incorpo-

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Barbara R. Smith

NICOLE A. DILLINGHAM

On ARBITRATION

As a general rule, discovery is not permitted in contractual arbitration. Arbitration is intended to be a quick, informal and cost saving dispute resolution mechanism. These advantages would be lost if arbitration were saddled with pre-hearing discovery as practiced in the state and federal courts. There are, however, significant avenues of discovery open to savvy practitioners.

Agreements for Discovery

The easiest way to provide for pre-hearing discovery is by agreement of the parties before a dispute arises. The California State Arbitration Act provides that discovery will be allowed "if the parties by their agreement so provide." C.C.P. § 1283.1(b). (The Act also permits discovery in cases involving injury or death. This provision has been limited to actions involving physical injury, not business losses.) Where such an agreement exists, after the appointment of the arbitrators, discovery will be allowed "as if the subject matter of the arbitration were pending in a civil action before a superior court." § 1283.05(a). The arbitrators may impose the same discovery sanctions and penalties available in a civil action, except for arrest or imprisonment. § 1283.05(b). The only limitation is that depositions may not be taken unless leave is granted by the arbitrators. § 1283.05(e).

The California Arbitration Act

In the absence of agreement to engage in discovery, there are still many opportunities to secure discovery. One often neglected procedure is contained in C.C.P. § 1282.2(a)(2)(A), which applies to any dispute in excess of \$50,000. Under this section, within 15 days of receipt of the notice of arbitration hearing, a party has the right to demand a list of witnesses, including designation of experts, and a list of documents to be introduced at the hearing. The listed documents are to be made available for inspection and copying prior to the hearing. These provisions are reciprocal; the requesting party must make similar disclosures.

In addition, arbitrators have authority to order the deposition of witnesses to be taken "for use as evidence" if the witness cannot be compelled to attend the hearing. C.C.P. § 1283. More significantly, depositions can be ordered if "exceptional circumstances... make it desirable." *Id.* This test provides an opening to secure discovery in appropriate cases, as arbitrators are given considerable discretion in determining what constitutes an "exceptional circumstance."

Finally, parties have the right to compel attendance of witnesses and the production of "documents and other evidence, at an arbitration proceeding" by subpoena. C.C.P. § 1282.6(a). A comparable provision is contained in the United States Arbitration Act, applicable in cases involving interstate commerce, 9 U.S.C.A. § 7. The line between subpoenas issued for "discovery" and those for "use as evidence" is elusive and often leads to cross-motions to compel compliance and to

quash. In many cases, however, subpoenas undeniably are used to secure "discovery."

One obvious problem with this process is that the subpoenas are only returnable at the arbitration hearing itself. This can lead to serious delays as documents are reviewed for the first time at the hearing. Similarly, it often leads to interminable examinations of witnesses at hearings. These problems can be avoided by mutual consent to exchanges for the first day of the hearing, followed by a recess to permit review of the materials. Unless the recess is scheduled in advance, this interruption could cause substantial delay and inconvenience to parties and witnesses. Arbitrator control over these aspects of the process is extremely important. An experienced arbitrator should be selected in any case where discovery issues are likely to arise.

American Arbitration Association Rules

If an arbitration clause incorporates the rules of the American Arbitration Association ("AAA"), some discovery may also be available under those provisions. The AAA rules are consistent with the California and Federal Acts. However, the AAA Commercial Arbitration Rules provide for a preliminary hearing in any action deemed "complex." Rule 10 provides that at the preliminary hearing, the arbitrator may "consider any other matters that will expedite the arbitration proceedings" and may establish "the extent of and schedule for the production of relevant documents and other information." Similarly, AAA Rule 31 provides that the parties "shall produce such evidence as the arbitrator may deem necessary to an understanding and determination of the dispute." There is growing sentiment that these provisions allow an arbitrator to order discovery in appropriate cases.

Court Aided Discovery

Finally, parties may secure discovery in court proceedings in aid of arbitration in actions involving provisional remedies such as attachment, mechanic's liens and preliminary injunctions. Discovery may also be available in connection with motions to compel or enjoin arbitration. *See e.g., Bigge Crane & Rigging Co. v. Docutel Corp.*, 371 F.Supp. 240 (E.D.N.Y. 1973). Also, where the scope of an arbitration clause is limited, ancillary litigation on non-arbitrable issues may provide an opportunity to conduct discovery.

Most arbitrators recognize that the prohibition against discovery in arbitrations has serious drawbacks, particularly in complex cases. To secure discovery, the best arguments are those which demonstrate that discovery is necessary to allow the arbitrator to fashion complete relief or arrive at a just result. Such persuasion is most likely to succeed if coupled with limited, pointed discovery requests. Wholesale attempts to incorporate civil discovery rules will fail both because of the abuses perceived to exist in traditional discovery and because they conflict with the purposes of arbitration. However, a persistent advocate should be able to conduct at least limited discovery in arbitration through the use of the procedures now available.

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Nicole A. Dillingham



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Protecting the Attorney – Client Privilege

rated into a final draft, which would then be disclosed to the public. Such knowledge is inconsistent with an intent to preserve the secrecy of the attorney-client communication.”

Magistrate Brennan also resolved the discovery dispute in *Lovell*, another federal securities case where plaintiffs sought responses to deposition questions about the preparation of public offering materials by defendants’ attorney. Defendants had refused to respond based on the attorney-client privilege. Magistrate Brennan held that defendants had failed to meet their burden of showing that the communications at issue were intended to be confidential. Therefore, she found the privilege did not apply and ordered defendants to respond.

A strong argument can be made that *Grand Jury* and its progeny are based on a fundamental misperception of the public disclosure process and a fictional view of a client’s intent in seeking counsel’s advice about disclosure. The result undermines counsel’s ability to promote effectively the policies underlying the securities laws.

Do clients seeking advice intend to disclose what they tell their lawyers? To the contrary. In the usual case, clients seek their attorney’s advice as to *whether* disclosure regarding certain information is required and, if so, *how* disclosure of that information should be phrased to best comply with securities laws. Clients intend to convey to the public only as much information as counsel concludes should be. Therefore, a client’s “intent” to publicly disclose is limited to whatever *is finally published*, not what was considered by counsel for publication.

Schenet v. Anderson: Real-World View

Schenet v. Anderson adopted this real-world view in rejecting *Grand Jury*’s view of client intent. The plaintiff, who alleged federal securities laws violations involving a self-tender offer, sought to compel production from outside counsel of drafts of defendants’ self-tender offer and all documents reflecting any portion of those drafts. Recognizing the client’s true intent that any information *not* actually published be confidential, the *Schenet* court held the documents requested were protected by the attorney-client privilege.

Essentially, *Schenet* recognizes the actual attorney-client dynamic in the securities disclosure arena. Attorneys do not act as mechanical conduits of information from their clients to the public, but as advisors in determining whether information must be disclosed, and, if so, how.

Grand Jury and *Schenet* reflect an implicit underlying tension between the disclosure policy of revealing all essential information to protect investors and the privilege policy of protecting communications to encourage candid discussion between attorneys and clients. By refusing to apply the privilege, *Grand Jury* implicitly valued disclosure policies more than privi-

lege policies. While the converse may appear to be true at first glance in *Schenet*, in fact, both the privilege and the disclosure policy rationales support application of the privilege.

The attorney-client privilege is based on the policy of encouraging clients to make full and frank disclosure to their attorneys. See *Upjohn Co. v. United States*, 449 U.S. 383, 389-90 (1981); *Welfare Rights Org. v. Crisan*, 33 Cal. 3d 766, 771 n.2 (1983). Refusing to apply the privilege would impede this policy of free disclosure between clients and attorneys. If clients “were to think that all information given to [their] attorney[s] would lose its confidential status by the act of delivery to [their] attorney[s], the tendency would be to withhold information which [clients], without advice of counsel, would suppose was detrimental.” *Schenet v. Anderson*, 678 F. Supp. at 1282.

Although the *Schenet* analysis and result are clearly preferable to *Grand Jury*, the scope and extent of the privilege in the public offering context can be characterized, at best, as uncertain. As a result, counsel should carefully consider measures designed to maximize the protection of communications with clients concerning public disclosures:

First, counsel, issuers, and underwriters should implement a post-offering document retention policy which retains only essential materials and destroys drafts and notes leading up to the actual disclosures. Taking this prelitigation precaution will insure that bits and pieces of discussions and drafts that are rejected prior to actual disclosure will not inure to the prejudice of the client if litigation ensues.

Second, all drafts and discussion materials exchanged between counsel and client should clearly be labelled as “Attorney-client communication—discussion draft.” This will not only make identification of privileged materials easier, it will also show that the material was not intended for disclosure in the form presented by or to counsel.

Third, sensitive drafts should be discussed, considered, and revised by the client and its counsel before being sent to and discussed by the entire “working group,” which often includes the underwriters, the issuer, the accountants and their respective counsel. Disclosure to the working group may, in and of itself, waive any privilege. See e.g. *In re John Doe Corp.*, 675 F.2d 482, 488-89 (2d Cir. 1982) (disclosure of prospectus draft to underwriter waived attorney-client privilege).

Finally, litigation counsel should withhold from any initial production of documents all draft disclosure documents circulated between attorneys and clients and all notes and records of discussions concerning those matters. Counsel can and should rely on the *Schenet* analysis and vigorously assert that the *Grand Jury* rationale is inapplicable.

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Arbitration of Retail Contract Disputes

ANY system of resolving civil disputes must be measured by its fairness to disputants and its respect for society's resources and values. The measurement is taken on average; no system is proof against the occasional unfair result or undue burden on society. Fortunately, though, fairness to individuals and benefit to society need not be trade-offs. For many civil disputes arbitration is at least as effective as litigation in *both* respects. Certainly this is so for disputes arising from consumer contracts.

For years arbitration has been the standard method for resolving broker-customer disputes in the securities industry. Many state and federal "lemon law" disputes are likewise resolved through arbitrations in which consumers often represent themselves. More recently, two California banks, Bank of America and Wells Fargo — after years of arbitrating and mediating non-consumer disputes — have turned to arbitration and other forms of alternative dispute solution (ADR) in consumer relationships such as deposit accounts and credit card accounts. This article discusses this development, using the Bank of America Program (with which the author is most familiar) for occasional illustrative purposes.

Advantages of Arbitration

A major advantage of arbitration is that it typically proceeds more quickly than litigation from initial filing to resolution of a complaint. One reason for the slow pace of civil litigation is the burgeoning criminal docket. The volume of criminal cases has nearly tripled in California superior courts and more than doubled in the municipal courts. These criminal cases, which take priority and generally require more court time, have exacerbated the civil backlog. For example, of the 15 superior courts in California with 11 or more judicial officers, only Santa Clara County had fewer than 60 cases awaiting trial per judge. In Los Angeles and San Diego, the number of cases awaiting trial per judge exceeds 120.

The backlog affects civil litigants and society perniciously in many ways. It gives an unfair advantage to the litigant (usually not the consumer) who can outwait the other. Overburdened judges lack the time or resources to manage cases adequately; the overload thus feeds on itself, as cases which should have been summarily resolved drift along instead, adding their weight to the burden. By the time a civil case gets to trial, key witnesses are less likely to be available or to have clear memories. And for the vast majority of cases which settle before trial, the settlement conference usually takes place only late in the litigation, conducted by a harried judge, in an atmosphere of intense pressure on the parties to serve the public interest by getting their case off the court's docket, at whatever sacrifice to their private interests.

The delays and inefficiencies of litigation also breed disrespect for the law and its practitioners. Although lawyers have become accustomed to the process, clients are dismayed by their (fortunately) rare glimpses of how the sausage is really made — the month-long preparation for a trial that gets continued or the crucial hearing before a judge who has not had a chance to read the briefs and knows nothing about the dispute. Society lays the blame at the door of the legal profession, which is increasingly suspected of creating and encouraging an unfair and expensive system for reasons of self-aggrandizement.

Clients are also alienated by the complexity of litigation, particularly where the disputes themselves are relatively simple. A typical civil suit features stretches of overbroad and intrusive discovery, interspersed with hearings and conferences, all with separate rules which in turn generate satellite procedural wrangles. Rare is the client who can meaningfully participate in litigation, let alone conduct it unaided, except in Small Claims Court. (When a consumer does elect Small Claims Court, Bank of America's policy is to abide by that choice and not to seek arbitration.) In contrast, arbitration gives the client a greater opportunity to control the case.

The financial burdens imposed by the delays, inefficiency and complexity of litigation, and the disrepute that they bring to the judicial process, are not present to the same degree in arbitration and other forms of ADR. For example, arbitrations and other forms of ADR cost significantly less than litigation; a recent national study found that arbitration costs only 50% to 85% of comparable litigation. One reason is that the longer a dispute goes unresolved, the more billable hours Parkinson's Law predicts and the more attorneys' hands the file is likely to pass through; recent studies confirm that the costs of a lawsuit climb as it matures. Another reason is that arbitration procedures are more streamlined than litigation, both before and during the adjudication. (The American Arbitration Association estimates that over 90% of all arbitrations are concluded within two hearing days.) The savings can be significant. A study by the Center for Public Resources, a nonprofit group that promotes alternatives to litigation, found that 142 companies that resorted to ADR rather than the courts saved collectively more than \$100 million in legal costs for disputes which concluded in 1990.

At one time there was a belief that, unlike everyone else, large corporations preferred litigation to ADR because their batteries of expensive lawyers could make lawsuits unaffordable for consumers. That is certainly not true in retail banking. No bank wants to tie up staff and jack up its already hefty legal bills by litigating forged-check cases to the hilt; the overriding goal is to resolve them on a reasonable basis, expeditiously and with minimal legal expense, and move on to something else.



Arne D. Wagner

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Arbitration of Retail Contract Disputes

Arbitration may also improve access to the justice system by enabling consumers to pursue claims which they could not have afforded to litigate. The ADR provision in Bank of America's deposit account and credit card agreements provides that a dispute will be arbitrated if *either* party so requests (and if nobody does, it remains in litigation). So even if the bank were inclined, say, to out-muscle a consumer in court over a small forged-check case, the consumer could opt instead to have the dispute arbitrated.

Response to Critics

Critics claim that ADR clauses in retail banking agreements unfairly constrict consumers' choices. Not so. To begin with, a consumer unhappy with Bank of America's ADR clause can switch accounts to either Wells Fargo for a different ADR clause or to one of the many other banks whose account agreements do not provide for ADR at all. Of course, a consumer who wishes to stay with Bank of America must accept its ADR provision because the bank — like any other retailer — cannot and will not engage in negotiations with individual consumers over the terms of its account agreement.

The fundamental point, however, is that arbitration provisions in deposit and other consumer contracts are not unfair since the advantages and disadvantages of arbitration — advantages such as economy, efficiency and user-friendliness and possible disadvantages such as limited discovery and appellate review — equally affect both parties to the contract.

Some critics argue that the apparent evenhandedness of arbitration masks inherent unfairness. For example, a few worry that arbitrators will be less pro-consumer than juries. There is, however, no evidence that arbitrators' decisions are less defensible or less unbiased than those of juries. Indeed, even if every case had but one "right" outcome, only the Deity would possess the answer sheet and be in a position to compare the "test scores" of arbitrators and juries. The most mortals can do is to make the mechanics of the arbitration process fair; the outcomes may then likewise be presumed on average to be fair.

Speculation about the differences in outcomes between arbitrations and trials seems particularly idle when it comes to disputes over retail agreements. For example, typical disputes over bank accounts are whether the bank properly paid checks bearing a forged or missing signature or an altered dollar amount; whether the bank failed to credit an account for a deposit; whether the bank permitted an unauthorized withdrawal; whether the bank dishonored a check it should have honored or vice versa; and whether a third party's levy on the account was effective. In such disputes the claimed damages are finite, the range of possible outcomes relatively narrow, the law generally well developed, and the issues straightforward. It is in everyone's interest to get this steady stream of cases decently resolved as expeditiously as possible. Arbitration can do this; litigation often does not. So

long as arbitration operates evenhandedly on average, one cannot reasonably demand more.

Critics also object to the paucity or complete absence of discovery in arbitration on the ground that consumers may be unable to uncover needed evidence. But in retail banking disputes, this hindrance, if it is one, should affect consumers and banks equally on average. For every dispute in which extensive discovery might yield a net gain to the customer — e.g., to show the existence of a personal relationship between the customer's dishonest employee who forged the checks and the bank teller who cashed them — there are probably an equal number of disputes where it would yield a net gain to the bank — e.g., to show that the customer had authorized the employee to issue or endorse checks on the customer's behalf and had received the benefits of the proceeds thereof.

Some critics who do not challenge the fairness of ADR instead assert that jury trials are nevertheless better for society than arbitrations. For instance, it is argued that, even if an arbitration is fair, the consumer might not *perceive* it to be as fair as a trial to twelve peers. Leaving aside the fact that almost no civil cases ever get to a jury anyway, there is simply no evidence for this view of litigants' perceptions. Indeed, Rand Corporation studies found that arbitration procedures were generally acceptable to tort claimants because they were seen as dignified and careful.

A related criticism of ADR is that taking disputes out of the jury system limits public scrutiny and creation of precedents. But disputants are not legally or morally obligated to structure their quarrels as vehicles for public edification. Why should arbitration be faulted for offering what the current system already permits, and indeed rightly encourages: resolution of disputes short of trial (e.g., in a settlement conference), with complete privacy, little or no court involvement, and the option, if the disputants agree, of having an enforceable judgment entered to reflect their out-of-court resolution? The objection seems especially attenuated when applied to retail banking disputes: a defective endorsement seems less pressing a public concern than, say, a defective automobile, and there are already plenty of statutes and other sources of written guidance on negotiable instruments.

Another common objection to ADR is that it is inadequate to deal with the so-called "impact" cases, class actions and other suits by persons representing multiple customers over policies, such as bounced check charges, which have little economic effect on any individual consumer. These cases are not subject to arbitration under Bank of America's ADR clause. They will be determined through judicial reference if either side so requests and through traditional litigation otherwise. Both alternatives permit discovery and yield an appealable judgment.

Accordingly, courts can be expected to continue rejecting claims that arbitration is unfair to consumers or harms society; and arbitration of retail disputes can be expected to win increasing acceptance.

Mr. Wagner is Assistant General Counsel, Bank of America.



CHARLES R. RICE

On SECURITIES

IN complex securities litigation, the outcome frequently depends on the documents. The recollections of witnesses are often hazy and sometimes wrong, especially about the details or sequence of events that occurred years before. Contemporaneous letters, memos or notes are therefore the best evidence of the actions and motivations of the parties. Incriminating documents or inconsistencies with deposition testimony can be used by your adversary to devastating effect in motion practice or at trial. To make your explanation of the events at issue persuasive, you must "connect the dots" provided by the documents. To do so, you must identify and analyze the most important documents as soon as possible and be able to find other relevant documents as issues and questions arise during the litigation.

Creating a Computer Database

In large cases, a computer database can be an indispensable tool for summarizing and retrieving documents. You can use an outside service to develop a document database. This may be the best option if several parties will share the database. Creating an in-house database, however, can give you greater flexibility, focus and efficiency.

I won't address the hardware or software needed for your own database. You will have to work closely with your office's computer specialist to achieve the desired results and avoid unpleasant surprises. If your firm lacks such expertise, you should probably forget about an "in-house" database.

Objective Coding

Much of your document database will consist of objective data recorded by "coders," including the producing party, Bates number, date, document type, sender, recipient, names mentioned, etc. Coders should also note any characteristics, such as marginalia, illegibility, attachments, signatures, or missing pages, that distinguish the various copies of a document. Make arrangements for follow-up coding as depositions proceed in order to record if a document becomes a deposition exhibit or is authenticated, clarified or otherwise discussed.

Objective data can usually be coded and input by clerical staff, but even "objective" data can be hard to extract from many documents. Many hours and dollars can be lost if coders try to understand and code completely every single document, no matter how detailed, difficult to understand or marginally relevant. The key to controlling costs is to eliminate (or at least reduce) the coders "spinning their wheels."

To do so, you must teach your coders about the nature of the case and what you are looking for. Since you can expect turnover during a long case, videotape your initial presentation so you can show it to subsequently hired coders. You should also strongly encourage your coders to seek guidance rather than waste time trying to understand and code difficult documents.

Develop lists of important individuals and entities to standardize spelling. Otherwise, you may be unable to retrieve documents that mention but misspell a name. To insure quality control, samples of the initial coding should be checked by experienced legal assistants.

You can also save money by limiting what is coded. Attorneys should look at the documents before coding in order to decide which documents need not be coded at all or can be "batch coded" by file labels, document type or other broad category. You should take advantage of the flexibility of an in-house database by adjusting the sequence and priority of coding as your needs evolve.

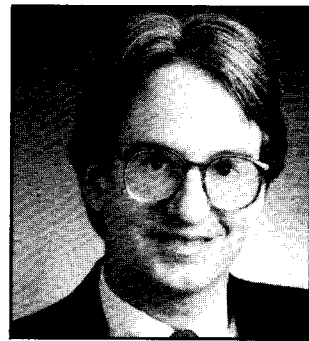
Subjective Coding

A computer database can also include a variety of "subjective" data such as the subject matter, relevant issues or importance of each document. Subjective coding will, among other things, allow you to print out a chronological "narrative" of the documents relating to a particular party or issue. Inputting actual quotations from the documents will preserve the nuances of the particular phrasing. It may also save time and money — at least in the long run — by reducing the need to look at the document itself.

"Subjective" coding can be very expensive because of the time and effort required, but the cost can be limited in several ways. First, only the most important documents should be coded subjectively. Second, subjective coding should be done by an attorney or experienced legal assistant who understands the case as a whole and can glean all the significance of particular documents. Subjective coding by clerical staff will usually not be sufficiently accurate or comprehensive, and urging such coders to be more conscientious and thorough will only result in more irrelevant detail and "wheel spinning." The best approach is for an attorney to select the interesting documents produced by a particular party and then review them in chronological order before beginning subjective coding. Finally, if you can afford to wait, delaying the subjective coding until the issues have been refined and the most important documents have been identified will also save money.

A document database is a valuable tool, but it is no substitute for diligent and thoughtful lawyering. Your database will only be as good as the coding, which will only be as good as the attorney supervision.

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Charles R. Rice



Letter from the President

WITH the Association of Business Trial Lawyers now well into its second year of existence, I thought it appropriate to comment on one of the principal goals of its founders. That goal is enhancing the quality of the professional relationships among business trial lawyers. We hoped and believed that increased social and professional contact outside the courtroom and the adversary process would contribute to the level of civility among lawyers.

The importance of this goal cannot be overstated.

Unfortunately, some misguided litigators think that civility is a sign of weakness or, more exactly, an absence of aggressiveness or strength. When I have been fortunate enough to litigate against people who I believe are among the great litigators of our generation, they almost all share the admirable trait of civility. One never mistakes their courteous and professional behavior for a lack of aggressive and effective advocacy.

Some of this may come simply with age and experience. The pressures on young lawyers to perform aggressively and the natural insecurity of young lawyers who are being required to handle

significant matters creates an atmosphere in which hostile adversary tactics may thrive. Hotly contested matters among competitive lawyers provide ample opportunity for personalizing disputes. The natural frustrations that come from litigation fuel these personal animosities.

Senior lawyers must take responsibility for setting the correct professional tone. Lawyers at all levels of experience must make an effort to deal with adversaries in a professional and polite manner and avoid hostility to the extent possible.

A Call for Civility

Interpersonal hostility rarely advances anything other than the income of the lawyer. Unnecessary disputes and petty problems only protract the resolution of what would otherwise be simple aspects of pretrial litigation. Lawyers who indulge in personal disputes are not serving their clients' interests; they are serving their own egos. This unnecessary conduct ranges from face-to-face exchanges to using briefs to attack the personal integrity of opponents. How frequently do we observe lawyers squabbling before judges who couldn't care less about the dispute, regardless of who started it. Isn't this an indication to us that we must make the extra effort to retain friendly relations with adverse counsel rather than let personal animosities dominate what are in effect business relationships?

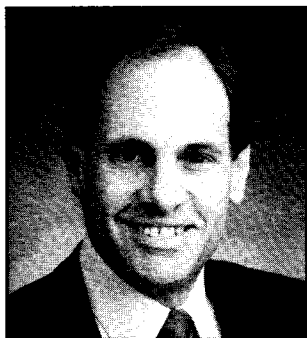
One of the factors that has contributed to the erosion of civility among lawyers is the sheer number of practitioners. In smaller communities where lawyers must coexist and deal with each other on a regular basis,

there is a natural restraint to the unpleasant exchanges that often mark our current practices. The fact that a lawyer at a 500-lawyer firm may never again deal with another lawyer at a different 500-lawyer firm takes away the natural restraints of the community on the behavior of those lawyers.

It is incumbent on us all to make the extra effort to deal with each other in a pleasant and professional manner. With all of the pressures on lawyers, I doubt that any lawyer ever gives anything away because the adversary is unpleasant. In my experience the reverse is true; good relations lead to better results. Cordiality among counsel facilitates rather than impedes communication and keeps time spent on unnecessary lawyer disputes off the client's bill.

What can we do as a profession to strengthen the quality of relations among adversaries? How can we make our own professional lives more pleasant? The quality of our conduct starts with each individual, and lawyers should remain mindful of our ultimate goal, an efficient resolution of disputes that is advantageous for our clients. Lawyer training in both large and small firms should include training in appropriate conduct as well as practice skills and substantive law. This issue may never find its way into the Canons of Ethics, but it affects our daily lives. The more we make an effort to enhance the civility of the practice, the more we will all benefit from those efforts.

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