

Q&A with the Hon. Stephen J. Sundvold
by Leo J. Presiado

Q: For those who do not know you, can you tell us a little about the type of practice you had before taking the bench?

A: When I graduated from law school, I went back to Washington D.C. to the Department of Justice under the Attorney General's Honor Law Graduate Program and did criminal appellate work at the Supreme Court for a couple of years. Then, being anxious to come back to Southern California where I was born and raised, I applied to the U.S. Attorney's Office in San Diego and Los Angeles and various spots like that. In the meantime, a friend of mine was working at a civil defense firm in Long Beach. I interviewed with them, and they made me an offer that I had to respond to right away. So, I -- in my anxiousness to get back to California -- decided it was a good deal. I took that, came back and did civil, personal injury, medical malpractice and defense work for a couple of years there and left that firm to go to a sole practitioner. I worked for him for a year. Finan-

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Legislative Investigations Strengthening the Hand of the Legislature in Public Policy Inquiries

by State Senator Joseph Dunn

Late 2000 brought California a crisis of such epic proportions that the state's economic future has been imperiled for years to come. Known now as the California "energy crisis," at its core the crisis was - and still is - a crisis in economic behavior, not energy.



After months of record prices for natural gas and electricity, the state Senate asked me to lead an investigation into the causes of the crisis, with an eye toward preventive legislation that would keep future crises at bay. This article summarizes the investigation and focuses on the investigative tools currently available to the Legislature. I argue that there is reason for strengthening and expanding the Legislature's abilities to pursue future investigations.

Background of Crisis

"Deregulation" began with a series of decisions on the federal level in the early 1990s. Starting in 1994, California's Public Utilities Commission jumped on the bandwagon of free-market ideology that promised lower rates and free choice for California consumers and small businesses. The state Legislature formalized the march toward a restructured electricity system in 1996 when it passed Assembly Bill 1890.

Restructuring took place over a period of two years. By 1998, the market was up and running, though electric power plants were still being divested by the investor-owned utilities. After what appeared to be a smooth transition into a free

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President's Message: Litigation is Not War

by Michael G. Yoder



I recently attended an interesting presentation given as part of the 2003 Central District Conference (which, by the way, was held this year in Orange County) entitled "The Art of War and Litigation." The speaker — a partner at a well-known Los Angeles firm who took a year sabbatical to study such things — guided us through an historical examination of the Battle of Gettysburg, the 1991 Gulf War and, finally, *Brown v. Board of Education*. Yes, *Brown v. Board of Education*. The point of the presentation was that litigation bears remarkable similarities to war.

Now I am sure that everyone who has ever tried a case (and that includes most everyone who is reading this column) has set up a "war room," "attacked" a witness on cross-examination, and done "battle" with a worthy opponent. But our conference speaker went well beyond clichés in developing his thesis: as in war, litigation is best pursued not by a war of attrition, but by flanking maneuvers.

According to our speaker, a war of attrition typically is a long, drawn out affair costly to both sides. And it is difficult to predict the outcome of a war of attrition, unless one of the combatants is vastly superior to the other. By contrast, flanking maneuvers tend to result in quick victories obtained at little cost. And when such maneuvers are strategically pursued based on full and accurate information, they offer a much higher level of predictability.

Thus, Robert E. Lee lost the Battle of Gettysburg by attempting to win a war of attrition even though substantially outnumbered. In comparison, the United States easily drove Saddam Hussein from Kuwait in the 1991 Gulf War by strategically avoiding direct confrontation with the strength of Saddam's troops in southwestern Iraq, instead bringing U.S. troops down through central Iraq.

Applying these lessons to the litigation arena, our speaker turned to *Brown v. Board of Education*. Tracing the career of Thurgood Marshall, our speaker

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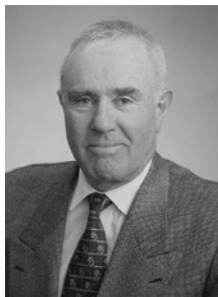
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TRIAL TIP: A Recipe For Winning

by Hon. David Brickner



Here's a recipe for increasing your effectiveness in oral argument before the court or jury by achieving greatest clarity of communication. *Boil it down.*

Having lived with your case for months, maybe even years, you have long since fallen in love with all its factual and legal nuances. This is all well and good but bear in mind, there will come a time when you must boil your argument down to those few, *basic, key points* upon which your case is based. When is that time? During argument, sometimes in law and motion, but, most important, in final argument before a jury.

Why bother to boil down your case to the key issues? Because *simple* points are *understandable* points. Believe me, your judge and jury yearn for an uncomplicated straightforward answer to this incredibly simple question: *What* do you want and *why* should you have it?

In mastering this recipe for a winning oral argument simply ask yourself "What would I say if I had to sum up my case, *in one sentence*?" This invaluable exercise will help you follow the recipe for winning: *Boil it down.*

◆ Hon. David H. Brickner, JAMS

DO YOU HAVE SOMETHING TO SAY?

If you are interested in submitting material for publication in any upcoming issues of the ABTL Orange County Report, please contact the ABTL's Report Editor or submit your material directly to abtl@attbi.com.

ABTL February Dinner Program

"Winning Strategies for Summary Judgment: Playing Under the New Rules"

by Sharina Talbot



At the February ABTL dinner, a panel of local judges and experienced attorneys candidly shared their views and opinions of the recent procedural changes regarding summary judgment motions, as well as what they believed to be the characteristics of successful motions for summary judgment. The Honorable James P. Gray from the Orange County Superior Court and Raymond J. Ikola (formerly of the Superior Court and recently elevated to the Court of Appeal, 4th App. Dist., Div. 3) discussed their respective points of view on the changes, while Thomas Newmeyer of Newmeyer & Dillion represented the perspective of defense counsel and Darren Aitken of Aitken, Aitken & Cohn spoke as an advocate for plaintiff's lawyers.

The change in law, which took effect on January 1 of this year, affects one of the most common tools used by litigators to expose those cases where either the cause of action or the defense has no merit. Most significant among the changes made to CCP §437c, and the one that dominated the discussion at the dinner, is the new 75-day notice requirement. Previously, notice was required 28 days before the hearing. The panel noted that the Legislature failed to address how the change would affect the timing of expert witness disclosures, and that further amendment of the statute might be necessary to require earlier exchanges of expert information.

As expected, since the various panel members held differing viewpoints, a "spirited" discussion ensued. Aitken maintained that the previous requirement was unfair to plaintiffs' attorneys, and that the new 75-day requirement was needed to "level the playing field," and to prevent defendant's counsel from using the summary judgment procedure to direct plaintiff's counsel's attention from expert and trial preparation. On the other hand, Newmeyer and others attending the dinner voiced their collective concern that the extended notice requirement would result in greater delays in getting to trial. Judge Gray

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Throwing SLUSA's Doors Wide Open:
*Federal Preemption of State Securities
Fraud Claims After S.E.C. v. Zandford* ©
by Peter M. Stone & Jay C. Gandhi



Stone



Gandhi

In 1998, Congress enacted the Securities Litigation Uniform Standards Act ("SLUSA"), making federal court the exclusive venue for class action litigation alleging fraud "in connection with" the purchase or sale of a nationally-traded security.¹ SLUSA mandates both removal and dismissal of state law claims of any covered action. The Supreme Court has now thrown those SLUSA doors wide open by expanding the definition of "in connection with." Thus, lurking underneath your run-of-the-mill state breach of fiduciary duty action could very well be a federal securities fraud claim in disguise – a claim subject to SLUSA's powerful preemption provisions.

SLUSA History

SLUSA was the natural outgrowth of the 1995 Private Securities Litigation Reform Act ("PSLRA"). Congress enacted the PSLRA to "eliminate abusive securities litigation," whereby professional plaintiffs and their counsel had mastered the art of "extort[ing] a great deal of undeserved settlement money," thus harming the nation's capital markets.² The PSLRA, among other things, heightened the pleading standards for a plaintiff to allege a securities fraud claim, foreclosed costly discovery until such standards were met, and carved out a safe-harbor for "forward looking" statements.³ In response, many plaintiffs made an end-run around the PSLRA's stringent standards by filing lawsuits in state court, and masking traditional federal securities law claims as state law breach of fiduciary duty or corporate governance claims. SLUSA was squarely aimed to close that loophole.⁴

SLUSA Elements

SLUSA completely preempts⁵ any claim that satisfies the following four criteria: (1) the action is a "covered class action"⁶; (2) the action purports to be

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A WORD FROM OUR SPONSOR

Corporate Governance and the Audit Committee: The Exchanges Weigh-In
by James Skorheim, JD, CPA, CVA, CFE

As a result of several recent and unprecedented business scandals such as Enron, WorldCom and Global Crossing, investor confidence in the financial reports and disclosures of public companies is at an all-time low. Legislators and regulators alike have identified effective audit committees as the centerpiece of their efforts for combating fraud in the disclosures of these companies.

Already Congress, the Securities and Exchange Commission (SEC) and the AICPA have weighed-in on corporate governance and accounting reforms. Not to be outdone, the New York Stock Exchange (NYSE) and the National Association of Securities Dealers (NASD) have also proposed rules aimed at combating future Enron-type abuses.

The NYSE has outlined a number of new requirements for its listed companies that relate to audit committees. The NASD has developed similar provisions for companies listed on the NASDAQ system. The new rules place added responsibilities on audit committee's and their members. Many Commentators believe that these new responsibilities will spawn a raft of new shareholder lawsuits against errant corporate directors.

Independence

The Board of Directors must have a majority of independent directors. However, all directors on the audit committee must be independent. The exchange has tightened its independence requirements. No director qualifies as "independent" unless the board of directors affirmatively determines that the director has no material relationship with the listed company (either directly or as a partner, shareholder or officer of an organization that has a relationship with the company). Companies must disclose these determinations.

For audit committee membership, independence is defined even more narrowly to require that an audit committee member may receive only director's fees from the company.

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cial times were such and the kind of work that he did was such that I was happy there, but I was not making any money. I took the opportunity to get into an in-house counsel operation for a carrier, and I ended up spending 15 years there.

Q: What do you enjoy most about being a jurist on the complex panel?

A: The interaction with a large number of lawyers whose personalities and styles vary and cover the entire spectrum. You never know who is coming in the door on a given day and what interesting interchange will be. I am a people person. I enjoy working with people.

Q: What do you think about the new motion for summary judgment rules? In particular, the 75-day notice period?

A: It's obviously longer than the previous period -- I am not sure ultimately what effect it will have once everyone adjusts to the time frame. I do not see that it will be a major difference. It may put more of a burden on the lawyers to be prepared earlier. I do not think it will have much of an effect on the courts.

Q: Along that same line, do you think parties can stipulate to the old rules, and would you encourage that?

A: Good question. I would suppose they could, and I am not sure I would encourage or discourage it.

Q: A concern is that the issues can get stale when you file a motion, and the motion is not heard until 75 days later. Also, the opposition deadline and the reply deadlines were not adjusted. To respond to the opposition, the moving party has a short amount of time to address what the defending party has had 60 days to think about.

A: Right, and I think the problem really comes down to the fact, with the staleness issue, that you are at a point 90 days before trial, when discovery is in full swing, by the time you get the motion on file -- and 60 days later, you have done a lot more discovery. It is just going to require people to stretch to do all that discovery -- the last minute discovery is going

to be at 90 days before trial, rather than 45 days, right before the 30-day cut-off.

Q: Do you believe that the new rule applies to pending cases?

A: Yes. I know there was a big rush to file lots of motions for summary judgment before the end of the year. I suppose you could create a Machiavellian scenario that if you had a case that was set for trial in the middle of February '03 and you did not file your motion for summary judgment before the end of December '02, you would not have been able to file one — because you would have fallen in a black hole — the difference between the old statute and new statute, and the opportunity to file the Motion disappeared at the turn of the new year.

Q: Do you use technology in your courtroom?

A: I do. I generally keep all of my working status conference notes on every file in my Word Perfect. It is a system that I inherited with my case load from Judge Thomas when he retired, and he had it in there. I continued to use his notes and have obviously supplemented it in the last two years with my new cases and updating his cases. I try to keep a brief snapshot of every status conference and hearing in my notes, so I can look at it and have an idea of what we did the last time. These notes create an agenda for the next status conference — so when the lawyers tell me at the January status conference that they hope to have something done by March, and they come back in March, we can see if it has been done.

Q: With respect to all the new technologies that are in place in the civil complex center, do you encourage attorneys to use those in a trial? Do you have a preference?

A: I do. I think from a standpoint from having all your exhibits done on disk and having them instantly available, because you throw them up on a screen, it beats the heck out of lawyers fumbling in bankers boxes trying to find a piece of paper for 10 or 15 minutes. Technology, frankly, is only as good as the person that is using it. There are lawyers that do a beautiful job of closing arguments where it is magically appearing on the screen, and other times you can see lawyers that are fumbling and bumbling that

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have a difficult time -- so they are not getting the advantage of the technology. I think it is a great system.

Q: How heavily do you rely on your research staff?

A: Heavily. I think I am blessed by having a good staff Research Attorney Bob Becking who does a great job. He was familiar with Judge Thomas' cases and the issues when I inherited those cases. That was a real benefit to be able to keep the flow of the cases generally going in the same direction. After he completes the initial work up of a matter, I will review it, and then we sit down and discuss it back and forth. We disagree on occasion, but generally we see eye-to-eye. We work out our disagreements. Then later, with the benefit of argument on law and motion matters, we both sometimes realize that we were both wrong and change.

Q: What should a lawyer never do when he or she appears before your courtroom?

A: I am pretty easy going. I have a sense of humor. I think I do, anyway, and I enjoy my work. I hate to say "having a good time," but I think all of us in the courtroom, lawyers, judges and staff, can have a good time even under difficult circumstances. I think if you have animosity flowing between the lawyers and the parties, it can be a real ugly experience on occasion, and sometimes that can be avoided. Generally, I think most lawyers can come in, and they can get their work done, and if not have a good time, at least not come out of the courtroom bleeding and bruised. That is it pretty much. I have lawyers run their cases in the manner that they see fit. I like lawyers to get along.

Q: How often do you serve as a mediator or participate in settlement conferences?

A: Almost every day. I think that is the skill that I have. I enjoy probably more than anything else the ability to get in and work out the differences between the parties in the case. There is probably no greater satisfaction than spending a day, or a week or two, or three weeks if necessary, banging out the issues of the case. When you look at the number of trial days that are saved and the number of trips to the appellate

courts that are avoided, it is just a good feeling when everybody leaves having settled the case, and everybody leaves equally happy or equally unhappy.

Q: Do you have or did you have a mentor?

A: That is a good question. I do not think I have had a mentor as such. I think there have been people in my life at varying times that have had ongoing interaction with me. Jack Trotter comes to mind. He actually swore me in when I had my official enrobing as a judge. I had known him for 20 years prior to that when I was a young defense lawyer in a quadriplegic case he had. We recently talked about that case. He did not remember the case, just one of so many major cases. But, I remembered vividly, and he was impressed that I remembered seeing how he litigated that case. I watched him as a new judge, through the court of appeals, and then his mediation career with his involvement in JAMS. Yes, I have held him up as a role model. I think he was a good lawyer -- if not a great lawyer and a great judge. He does what I enjoy doing. I would put him high on the list with numerous other judges that I have worked with over the years that I admired and tried to emulate aspects of what they did.

Q: What do you do in your spare time?

A: Oh, I have three young grandchildren I spend lots of time with. I enjoy gardening. I am a single-action cowboy shooter. We dressed up like a turn-of-the-century cowboys and go out and shoot antique-style firearms. I am a history nut.

Q: The Civil War?

A: Not really just the Civil War. I also like the Civil War to 1900's time frame, the western movement, Teddy Roosevelt, that era as well. I enjoy it all — there is no kind of history, I suppose, I do not enjoy. I like the History Channel. I watch a lot of documentaries and those kinds of things. History fascinates me, really, because I do think it does tend to repeat itself. That is pretty much it. I run occasionally.

Q: And the last question: What advice do you have for young lawyers?

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A: I think the old adages about knowing your case and being prepared for court are probably time worn, but time-tested as well. I think there is a real advantage in seeking a middle ground. Do not let your personality become the issue in a case -- let the facts be the issue in a case, and just work hard. Know the case.

◆ Leo J. Presiado, Rus, Miliband & Smith



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lead us through each of Marshall's series of victories that culminated in the Supreme Court's landmark opinion in *Brown v. Board of Education*, which overturned the separate but equal doctrine established in the Supreme Court's 1924 *Plessey v. Ferguson* opinion (perhaps the low point of Supreme Court jurisprudence). As described by our speaker, Marshall realized early on that if he took on *Plessey v. Ferguson* with a direct attack, i.e., a war of attrition, he would lose and lose badly. So instead, he picked his battles, starting with an attack on Maryland's refusal to admit a black student to the only law school in the state (*University of Maryland v. Murray*, 169 Md. 478, 182 A. 590 (1936), and over the next decade-plus attacking Missouri's attempt to justify its refusal to admit black students to its only law school, by offering to pay tuition at a law school of an adjacent state willing to accept blacks (*State of Missouri ex rel Gaines v. Canada*, 305 U.S. 337 (1938), Oklahoma's attempt to require black students admitted to the University of Oklahoma's graduate school to sit apart from other students at separate desks and tables (*McLaurin v. Oklahoma State Regents*, 339 U.S. 637 (1950), and Texas' two-tier system of legal education, offering the University of Texas Law School for whites, and a newly-created law school (with all of four professors) for blacks (*Sweatt v. Painter*, 339 U.S. 629 (1950)). With each victory, the separate but equal doctrine was further eroded, so much so that by the time Marshall finally took *Plessey v. Ferguson* head on in the landmark *Brown v. Board of Education* case, Chief Justice Earl Warren, writing for a unanimous court, overruled *Plessey v. Ferguson* in an opinion barely reaching nine pages.

Before I get to the real point of this column, let

me say that our speaker's presentation was both thoughtful and thought-provoking. Over the years, I have seen litigants employ a war of attrition strategy, usually with the same result: a costly, drawn-out and inconclusive "surrender" by both sides. As a business trial lawyer, I also have come to appreciate the effectiveness of flanking maneuvers as a litigation strategy. Our speaker was able to articulate what many of us have known for years, and what most of us hopefully utilize in our trial practices.

But let's get real, fellow ABTL members. Litigation is not war. What has been going on in Iraq over the past several weeks is. We trial lawyers engage in battle in the courtroom with established rules and procedures, before a judge who instills order and ensures fairness. We do battle without concern for our safety, much less our lives. And we prosper financially by engaging in such battles. In contrast, our troops, with over 130 now dead or missing in Iraq, risk their lives for our freedom.

I am not saying that what business trial lawyers do has no value — it does, both for our clients and for our society, which truly does offer the best system of justice ever devised by humankind. But we should count our blessings, and use the talents and resources we have been blessed with to bless others. I trust that

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market, we began to see the first signs of the crisis in late spring 2000 when San Diego was the first region of the state to feel the effects of deregulation. San Diego residents watched their energy bills quadruple almost overnight. Not coincidentally, this time also marked the introduction of what I like to call the energy companies' "Evolution of Excuses."

One by one, policymakers, the media and the public began to be inundated with myths intended to explain the high prices, most of them put forward by market participants and the academics who are paid handsomely by the market participants. Each of these explanations has been debunked during our investigation. We were told there was a shortage of electricity (false), that the state was feeling the effects of a drought (false), that the cost of natural gas was responsible for higher prices (natural gas

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indicated that he thought trial dates in Orange County now would be set out 17-18 months from the initial filing date, instead of the current 12-13 months, to accommodate the time changes. Judge Gray also suggested that if plaintiffs appearing before him are eager to go to trial earlier, he would give them the option (assuming all parties stipulate and agree), of waiving the 75-day notice requirement and instituting the old 28-day briefing schedule. According to a recent case, absent the consent of the parties, a trial court lacks the authority to sua sponte or unilaterally shorten the minimum notice period for the hearing of a summary judgment motion. See, *McMahon v. Superior Ct.* (Feb. 7, 2003) 2003 DJDAR 1545.

Justice Ikola felt that, based on his experience, a large proportion of summary judgment motions are either properly denied or unmeritorious. Thus, he believed that the new statutory amendments ultimately would have little impact. Instead, Justice Ikola said that practitioners should focus more on the recent California Supreme Court decision in *Aguilar v. Atlantic Richfield Co.* (2001) 25 Cal.4th 826, 107 Cal.Rptr.2d 841, and its significant impact on the evidentiary burden placed on defendants moving for summary judgment regardless which party bears the initial burden of proof at trial.

The other major changes to the summary judgment statute discussed was the ability of the party opposing summary judgment to make ex parte application with the court for a continuance at any time before the opposition is due in order to conduct additional discovery. Previously, the statute was silent as to whether an opposing party could seek continuance of the summary judgment hearing by way of ex parte application. Generally, a party opposing summary judgment would make the request for a continuance in its opposition papers. The statute now also explicitly authorizes the court to grant additional continuances, or to deny the motion for summary judgment, if the moving party unreasonably fails to allow discovery after the court has granted the first continuance. One panelist suggested that trial judges may be less inclined to grant multiple continuances, absent a showing of good cause, given the fact that the opposing party now has significantly more time to conduct discovery before filing its oppositions papers.

Finally, the recent amendments effectuated a ma-

ior appellate review change. The statute now provides that before affirming summary judgment on a ground not relied upon by the trial court, the reviewing court must afford the parties an opportunity to present supplemental briefings on the new ground. The supplemental briefing may include an argument that additional evidence relating to that ground exists, but that the party has not had an adequate opportunity to present the evidence or to conduct discovery on the issue. The reviewing court may reverse or remand the case based upon the supplemental briefing to allow the parties to present additional evidence or to conduct discovery on the issue. If the trial court thereafter fails to allow supplemental briefing or additional discovery, a rehearing shall be ordered upon the timely petition of any party. As a result of this change, the panel agreed that a party who prevails on a summary judgment motion should take responsibility for preparing the proposed order and judgment. Moreover, any proposed order or judgment should put in all potential grounds or bases that the trial court could have relied upon in granting summary judgment, whether expressly articulated or not in the prevailing party's moving papers.

As usual, the evening was enjoyable and enlightening for all, and everyone was provided with an informative and practical handout outlining the changes in law. Thanks to our panelists, and all those in attendance who made the night a success.

◆ **Sharina I. Talbot, Paul, Hastings, Janofsky & Walker LLP**

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prices were also being manipulated). The list of excuses has evolved, but each of these "explanations" has been refuted by evidence of fraud, malfeasance and market manipulation.

The crisis worsened during the summer and fall of 2000, ultimately peaking that winter. It became clear that the state had almost no defense against the well-oiled public relations machine of the energy companies. The board of the California Independent System Operator voted five times in 2000 to lower price caps on the sale of wholesale electricity, but these actions did nothing to stop an upward,

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unabated climb of natural gas prices. Rome burned while policymakers tried to stop the flow of dollars out of the state. In a disastrous move brought on by the crisis, the state intervened in January 2001 by purchasing power for the credit-strapped utilities.

The Investigation

I was against the decision to begin spending tax payer dollars on energy purchases. It was my belief then, as it is now, that there was something wrong with the market. My calls for an investigation were granted in March 2001, and the Senate created the Select Committee to Investigate Price Manipulation of the Wholesale Energy Market.

The first order of business following the creation of the committee (comprised primarily of lawyers/legislators) was to meet and confer with the energy stakeholders that would be the focus of the investigation. This included merchant generators, energy traders, utilities, municipal electricity systems and other stakeholders. As is often the case with complex litigation, everyone promised to cooperate, and the committee was assured that it would not need to use the heavy hand of its subpoena power. However, it was clear that "cooperation" would not be the hallmark of the investigation - every stakeholder refused (and still refuses two years later) to enter into a voluntary non-destruct agreement for documents relevant to the investigation.

The lack of cooperation was underscored after two months lapsed from our first meetings with no response from the stakeholders to the committee's list of "voluntary" document requests. The committee was forced in June 2001 to issue document subpoenas to the generators and traders as the first focus of the investigation. After an additional six weeks went by, without response of any significance, the committee initiated a step the Legislature had not taken in almost 80 years: It recommended contempt proceedings against the companies that refused to comply. Then, and only then, did the committee begin to receive substantive responses to the document inquiries. This led to the establishment of document depositories in the Sacramento area, maintained by the energy firms, which now hold millions of energy-related documents.

However, every company did not respond

favorably to the subpoena and threat of contempt. Not surprisingly, Enron proved to be the most uncooperative party and employed the most obvious obstructionist methods. When the committee voted to recommend to the full Senate a contempt action against Enron, the company responded by suing the committee in Sacramento County Superior Court. Enron argued in its suit that the Senate had no power to subpoena documents outside California and challenged the very procedures by which the Legislature can pursue investigations, claiming it placed the Legislature in a position of judge, jury and executioner over the entity that refused to respond. The court ultimately ruled in favor of the Senate and the investigation continued. Despite the court ruling, by September 2001, Enron still had not produced relevant documents.

To address Enron's ongoing non-compliance, the committee made a written recommendation to the full Senate - the only body that can find contempt and punish it - that a contempt finding be made against Enron and that it be sanctioned one million dollars per day for every day that Enron remained out of compliance with the legislative subpoena. In addition, to increase the Legislature's leverage over Enron, a Senate resolution was introduced calling for CalPERS and STRS, the state's public employee and state teachers' retirement funds, to divest themselves of any stock holdings in companies that stood in contempt of the Legislature. CalPERS is the world's largest single institutional investor, and at the time it was one of Enron's most significant investors. Divestiture of Enron stock of that quantity in September 2001 probably would have hastened the Enron bankruptcy that was ultimately filed in December 2001.

In an effort to prevent the vote on financial sanctions and divestiture, Enron flew in several corporate executives to negotiate an eleventh-hour settlement with the committee. On the last day of the Legislative session in September 2001, the company dropped its objections to the committee's demands and agreed to comply fully with our document requests. Displaying behavior we now know to be synonymous with the company, Enron continued to defy the Legislature until a new Enron board was installed shortly after the bankruptcy. With the board change and the help of an enlightened assistant

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general counsel to Enron, then, and only then, was the committee given access to the documents it sought almost 10 months earlier.

When the "Enron memos" were released in May 2002, detailing the company's trading strategies such as "Death Star" and "Fat Boy," I was informed by Enron that our investigation, and our dogged pursuit of documents and information, had prompted the Enron board of directors to release the memos to us. The entire industry may never recover from that revelation.

In addition to the aggressive use of its document subpoena power, the committee took another step that to our knowledge had never been done by any state legislature - the committee issued deposition subpoenas. While we believed we were on strong legal grounds with respect to the depositions, we fully expected another legal attack by the stakeholders in the courts. As with the earlier lawsuit, we were fully prepared to defend our actions *and* argue again that court involvement constituted an infringement upon the separation of powers clause of the state Constitution. To our surprise, no challenge occurred to our call for depositions and dozens of such depositions have now been taken.

The investigation has taken us into other uncharted waters. In June 2001, the committee discovered a document written by Perot Systems (in the files of an executive for Reliant Corp.) that promised to exploit the "holes" in the computer systems that Perot Systems built for the ISO. In the wake of the Enron memos just a month before, the committee's work was now being followed closely by federal investigators and the investment community. Our July 2001 hearing with H. Ross Perot demonstrated the seriousness of any allegation made by the committee: The New York Stock Exchange halted trading on Perot System's stock when news of its potential involvement in the energy crisis broke.

The investigation has foreshadowed many of the outcomes and conclusions now being accepted on a national level. In November 2002, the committee granted immunity to a former natural gas trader who testified that it was common practice for traders to

lie to the publishers of natural gas index prices. Lying about the price and volume of the natural gas traded affects the price of rates paid by consumers. Her testimony about the manipulation of these price indices was the first action in the natural gas arena - since that time, federal indictments have been handed down against traders. The committee is currently seeking documents from a price index publisher, McGraw-Hill Companies, which has refused to provide documents to the committee based on first amendment grounds. As of the writing of this article, the investigation continues as to document discovery, depositions and committee hearings.

The Future of Legislative Investigations

The energy investigation by the state Senate was the first public investigation of the crisis and led to several high-profile discoveries, including the Enron memos, the involvement of Perot Systems and the manipulation of published gas prices. The committee's discoveries have both aided and helped spur many other investigations, including one by the U.S. attorney's office, the state attorney general, PUC, FERC, SEC and CFTC. The Senate investigation, however, highlighted certain weaknesses in the Legislature's investigative powers that need to be corrected.

First, the creation of an investigative committee ought to be restricted to those that can be approved only with a 2/3 vote of the Rules Committee, the body that has the power to create an investigative committee. There is a significant risk that a party in voting control of the Legislature may be tempted to engage in future investigations for purely partisan reasons. While our committee was formed with a unanimous vote, a 2/3 requirement will ensure the integrity of future investigations as well as the Legislature itself.

Second, when a finding of contempt is made by the full Senate, its ability to sanction for the contempt needs to be clarified. We believed we had authority to issue financial sanctions for contempt, but this authority is not express, and it should be. In addition, once sanctions are issued, enforcement needs to be assured. For instance, if a one million dollar sanction is issued for contempt, should the Legislature be allowed to enter that as a judgment in court? Should the Legislature be allowed to revoke

the license of any entity that stands in contempt of the Legislature (e.g., its license to do business in California, an attorney's license or a CPA's license)?

Third, to make the investigation effective, the Legislature should be allowed to compel the preservation of all documentary or other evidence it seeks.

These are just the first steps to ensure that future investigations are not clouded by a lack of clarity in the law or marked by partisan politics. The companies implicated in the Legislature's investigation were not prepared for the peculiarities of a legislative investigation, but they learned quickly that the Legislature's authority to investigate was not a power to be taken lightly.

♦ by State Senator Joseph Dunn, D-Garden Grove, Senate District 34

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Written Charter*

The audit committee must have a written charter that addresses the committee's purpose and the duties and responsibilities of the audit committee. At a minimum the charter must describe the purpose of the audit committee as follows:

“(A) Assist board oversight of (1) the integrity of the company’s financial statements, (2) the company’s compliance with legal and regulatory requirements, (3) the independent auditor’s qualifications and independence, and (4) the performance of the company’s internal audit function and independent auditors; and (B) Prepare the report that SEC rules require be included in the company’s annual proxy statement.”

Duties and Responsibilities

At a minimum the charter must describe the duties and responsibilities of the audit committee as follows:

The audit committee is directly responsible for the appointment, compensation, oversight and dismissal of the company's independent auditors, who must report directly to the audit committee.

At least annually the audit committee must obtain

and review a report by the independent auditor describing the firm’s internal quality-control procedures, all material issues raised by the most recent internal quality control-review, or peer review, of the firm, or by any inquiry or investigation by governmental or professional authorities, within the preceding five years, respecting one or more independent audits carried out by the firm, any steps taken to deal with any such issues, and (to assess the auditor’s independence) review all relationships between the independent auditor and the company. The audit committee should present its conclusions with respect to the independent auditor to the full board.

The audit committee must meet with management and the independent auditor to discuss the annual audited financial statements and quarterly financial statements, including the company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations."

The audit committee must discuss earnings press releases, as well as financial information and earnings guidance provided to analysts and rating agencies. Also as appropriate, the audit committee must obtain advice and assistance from outside legal, accounting or other advisers.

The audit committee should discuss the company's major financial risk exposures and the steps management has taken to monitor and control such exposures. The audit committee is not required to be the sole body responsible for risk assessment and management, but the committee must discuss guidelines and policies to govern the process by which risk assessment and management is undertaken.

In order to perform its oversight functions most effectively, the audit committee must have the benefit of separate sessions with management, the independent auditors and those responsible for the internal audit function.

The audit committee must regularly review with the independent auditor any difficulties the auditor encountered in the course of the audit work, including any restrictions on the scope of the independent auditor's activities or on access to requested information, and any significant disagreements with management.

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based on state law; (3) the defendant is alleged to have misrepresented or omitted a material fact (or to have used or employed any manipulative or deceptive device or contrivance); and (4) the defendant's alleged fraud is "in connection with the purchase or sale of a covered security."⁷ It is this fourth element – language borrowed from Section 10(b) of the Securities Exchange Act of 1934 and S.E.C. Rule 10b-5 – by which the Supreme Court has now, and perhaps unintentionally, greatly broadened SLUSA.

"In Connection With"

In the Section 10(b) context, the Supreme Court has stated that the "in connection with" requirement "should be construed not technically and restrictively, but flexibly to effectuate its remedial purposes."⁸ Accordingly, the Supreme Court found this requirement satisfied where the allegations demonstrated the plaintiff suffered an injury as a result of deceptive practices "touching" its sale of securities as an investor.⁹ Despite this ostensibly broad language, courts often discounted this "touching test" as a semantic reiteration of the "in connection with" test, and little more.¹⁰ However, in *S.E.C. v. Zandford*,¹¹ the Supreme Court has unambiguously broadened the test. In so doing, the Supreme Court has not only exposed defendants to more novel Section 10(b) claims, but has also created the collateral effect of greatly expanding the preemptive scope of SLUSA.

S.E.C. v. Zandford

In *Zandford*, Charles Zandford, a securities broker, persuaded William Woods, an elderly man, and his mentally-retarded daughter, to open an investment account. The stated investment objectives of the account were "safety of the principal and income." Zandford was granted discretion to manage the account, and a general power of attorney to engage in securities transactions without their prior approval. Over the next two years and on over 25 separate occasions, Zandford transferred monies from the Wood's account to accounts controlled by him. Zandford was eventually discovered, and indicted for wire fraud.

Following his indictment, the Securities and Exchange Commission ("SEC") also filed a civil complaint against Zandford, alleging that he violated Section 10(b) and Rule 10b-5 by engaging in a scheme to defraud the Woods and by misappropriating their se-

curities without their knowledge or consent. The SEC moved for partial summary judgment after Zandford's criminal conviction. Zandford responded by arguing that the sales of the securities themselves were perfectly lawful and that the subsequent misappropriation of the proceeds, though fraudulent, was not properly viewed as having the requisite connection with a security for purposes of Section 10(b). The district court granted the SEC's motion, and Zandford appealed to the Fourth Circuit.

The Fourth Circuit reversed the district court's grant of partial summary judgment and, moreover, directed that the SEC's civil complaint be dismissed because it failed to allege the requisite nexus between the fraud and the sale of a security. The Fourth Circuit held that the sales of the Woods' securities were merely incidental to a fraud that "lay in absconding with the proceeds of sales that were conducted in a routine and customary fashion." The Fourth Circuit reasoned that Zandford's scheme was simply to steal the Woods' assets; Zandford, for example, did not mislead the Woods about the values of the securities.

The SEC appealed to the Supreme Court, and Justice Stevens, writing for a unanimous Court, reversed. The Supreme Court pointed out that the fraudulent practices were part of a series of transactions over an extended period that allowed Zandford to convert the proceeds from the sale of the victims' securities to his own use. Because the securities transactions and breaches of fiduciary duties "coincided," the Court found that those breaches were therefore "in connection with" securities sales within the meaning of Section 10(b). To leave its point unambiguous, the Court reiterated the "coinciding" language no less than four times in its opinion, and each time there was a conspicuous absence of a supporting cite.

Essential to the Court's holding was two notions. First, addressing the Fourth Circuit, the Court rejected the argument that there must be some misrepresentation about the value of a particular security to constitute securities fraud. Second, the Court recognized that the alleged scheme and the securities transaction "were not independent events," contrasting, for example, to a situation where a broker decided to steal the monies after a lawful securities transaction had already been consummated, or where a thief sim-

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ply invested stolen proceeds in the stock market. The Court reasoned that each sale was made to further Zandford's fraudulent scheme and, thus, the sales were properly viewed as a "course of business" that operated as a fraud or deceit.

Although the Court emphasized that its "analysis does not transform every breach of fiduciary duty into a federal securities violation," the Court's prodigious use of the "coinciding" language leaves little doubt that where a fraud and a securities transaction cross paths, so arises a Section 10(b) claim and, by extension, SLUSA preemption.

SLUSA Fall-Out After S.E.C. v. Zandford

In *Falkowski v. Imation, Corp.*, the Ninth Circuit specifically applied Zandford's broader interpretation of "in connection with" to SLUSA.¹² *Falkowski* involved alleged misrepresentations by Imation Corporation in connection with its acquisition of Cemax-Icon, Inc. The merger agreement between the two companies provided for conversion of Cemax employees' stock options into Imation stock options. Soon thereafter, Imation sold Cemax to Eastman Kodak and announced that Cemax employees must exercise their vested options and they would lose all unvested options. The employees claimed they had been misled because Imation concealed its financial problems as evidenced by a \$200 million earnings write-off shortly after the merger. Accordingly, they brought suit in California state court alleging breach of contract, fraudulent inducement, negligent misrepresentation and California Labor Code violations. Imation removed to federal court and moved to dismiss based on federal preemption under SLUSA. The court granted the motion and later dismissed an amended complaint for federal securities law violations as time-barred.

In affirming the district court's finding that SLUSA preempted any alleged misrepresentations regarding the option plan, the Ninth Circuit applied the broader "in connection with" standard adopted in *Zandford*. Indeed, the court noted that its earlier interpretations in the context of SLUSA "presaged" the Supreme Court standard. In applying the broader meaning, the court held that the "in connection with" requirement under SLUSA is satisfied where the alleged fraud and securities transaction "*coincide or are more than tangentially related.*"¹³ Applying this

standard to Imation's alleged fraud in concealing the write-off and plan to force early exercise of the options, the court found them to be "in connection with" the sale of a security and therefore subject to SLUSA.¹⁴ The court concluded that the alleged misrepresentations about the values of the stock and "the terms on which the plaintiffs [would] be able to purchase the stock" coincided with securities transactions and "are properly subject to uniform federal standards."

The Ninth Circuit is not alone, as a host of other courts are also starting to recognize the broadening effect of *Zandford*, specifically in the context of SLUSA.¹⁵

The Future Effect of Zandford on SLUSA Preemption

Despite the Ninth Circuit's acceptance of *Zandford* – indeed, its own further expansion by announcing a possibly broader "more than tangentially related" standard – other courts have traditionally employed a narrower reading of the "in connection with" requirement. In particular, the Second Circuit, prior to *Zandford*, limited the scope of the "in connection with" language. In *Chemical Bank v. Arthur Anderson & Co.*, for example, the court explained that the "in connection with" requirement exists to "protect persons who are deceived in securities transactions - to make sure that buyers of securities get what they think they are getting and that sellers of securities are not tricked into parting with something for a price known to the buyer to be inadequate."¹⁶ To that end, the Second Circuit held that "the 'in connection with' language requires proof that the defendant's alleged fraud was 'integral to the purchase and sale of the security in question.'"¹⁷ It remains to be seen whether the Second Circuit, and other circuits, will attempt to restrict *Zandford's* application to SLUSA as well, or whether they will follow the Ninth Circuit's approach, particularly in this post-Enron, accounting scandal environment.

In the meantime, however, as a result of *Zandford*, SLUSA's preemptive scope has grown along with the "in connection with" requirement under Section 10 (b). Given *Falkowski's* adoption of the broader standard, a wider range of fraud claims may now be encompassed under SLUSA. And, indeed, because SLUSA provides for "complete" preemption, courts are not confined to the four corners of the complaint,

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but may look well beyond to find that a plaintiff's alleged claims fall within the SLUSA ambit.¹⁸ *Zandford* and *Falkowski* may provide the creative lawyer with a new and powerful weapon under SLUSA for removal to federal court and for dismissal of easier to plead state law causes of action.¹⁹

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1. See H.R. Conf. Rep. No. 105-803, at 15. See also *Lander v. Hartford Life & Annuity Ins. Co.*, 251 F.3d 101, 108 (2^d Cir. 2001).

2. *In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1084 (9th Cir. 2002); *Ranconi v. Larkin*, 253 F.3d 423, 428 (9th Cir. 2001).

3. See *In re Silicon Graphics, Inc. Sec. Litig.*, 183 F.3d 970, 974 (9th Cir. 1999).

4. H.R. Conf. Rep. No. 105-803, at 15. See also *Lander*, 251 F.3d at 108.

5. SLUSA provides for complete federal preemption, *i.e.*, the rare instances where Congress has chosen to regulate an entire field of law. 15 U.S.C. § 78bb(f)(2). Congress may "so completely pre-empt a particular area that any civil complaint raising this select group of claims is necessarily federal in character." See *Metropolitan Life Ins. Co. v. Taylor*, 481 U.S. 58, 63-64, 107 S. Ct. 1542, 95 L. Ed. 2d 55 (1987). See also *Caterpillar Inc. v. Williams*, 482 U.S. 386, 392, 107 S. Ct. 2425, 96 L. Ed. 2d 318 (1987).

6. A "covered class action" is any suit brought by a class of more than 50 persons, or by one or more named parties acting as class representatives, and where "questions of law or fact common to those persons or members of the prospective class predominate over any questions affecting only individual persons or members." 15 U.S.C. § 78bb(f)(5)(B)(i)(II). A "covered security" is a security listed on a stock exchange such as the New York Stock Exchange or the American Stock Exchange, or an exchange with

equivalent listing standards. 15 U.S.C. § 78bb(f)(5) (E).

7. *Green v. Ameritrade, Inc.*, 279 F.3d 591, 596 (8th Cir. 2002). See also 15 U.S.C. §§ 78bb(f)(1)-(2); *Prager v. Knight/Trimark Group, Inc.*, 124 F. Supp. 2d 229, 231 (D.N.J. 2000).

8. *Superintendent of Ins. v. Bankers Life & Cas. Co.*, 404 U.S. 6, 12, 92 S. Ct. 165, 30 L. Ed. 2d 128 (1971). See also *Ambassador Hotel Co., Ltd. v. Wei-Chuan Inv.*, 189 F.3d 1017, 1025 (9th Cir. 1999).

9. *Banker's Life*, 404 U.S. at 12-13. See also *Ambassador Hotel*, 189 F.3d at 1026.

10. *Flickinger v. Harold C. Brown & Co.*, 947 F.2d 595, 598 (2^d Cir. 1991).

11. *SEC v. Zandford*, 535 U.S. 813, 122 S. Ct. 1899, 1904, 153 L. Ed. 2d 1 (2002).

12. 309 F.3d 1123 (9th Cir. 2002).

13. *Falkowski*, 309 F.3d at 1131 (emphasis added).

14. The court had earlier concluded that the granting of an employee option plan is a "sale" of a security within the meaning of the federal securities laws.

15. *Riley v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 292 F.3d 1334, 1343 (11th Cir. 2002). See *Burns v. Prudential Securities, Inc.*, 218 F. Supp. 2d 911, 915-916 (N.D. Ohio 2002); *French v. First Union Securities, Inc.*, 209 F. Supp. 2d 818, 824 (M.D. Tenn. 2002); *Feitelberg v. Merrill Lynch & Co.*, 234 F. Supp. 2d 1043, 1051 (N.D. Cal. 2002).

16. 726 F.2d 930, 943 (2d Cir. 1984).

17. *Flickinger v. Harold C. Brown & Co.*, 947 F.2d 595, 598 (2^d Cir. 1991) (emphasis added).

18. *Parrino v. FHP, Inc.*, 146 F.3d 699, 704 (9th Cir. 1998), *cert. denied*, 525 U.S. 1001, 119 S. Ct. 510, 142 L. Ed. 2d 423 (1998); *Galvez v. Kuhn*, 933 F.2d 773, 780 (9th Cir. 1991).

19. The authors wish to thank Paul *Hastings* associate Michael Rozak for his able research, and Paul *Hastings* partner Donald Morrow for his valuable

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The audit committee should review with the full board any issues that arise with respect to the quality or integrity of the company's financial statements, the company's compliance with legal or regulatory requirements, the performance and independence of the company's independent auditors, or the performance of the internal audit function.

The audit committee must set clear hiring policies for employees or former employees of the independent auditors. Employees or former employees of the independent auditor are often valuable additions to corporate management. However, the audit committee should set hiring policies taking into account the pressures that may exist for auditors, consciously or subconsciously, seeking a job with the company they audit.

Annual Performance Evaluation

The Written Charter must provide for an annual performance evaluation of the audit committee. While the fundamental responsibility for the company's financial statements and disclosures rests with management and the independent auditor, the audit committee must review: (A) major issues regarding accounting principles and financial statement presentations, including any significant changes in the company's selection or application of accounting principles, and major issues as to the adequacy of the company's internal controls and special audit steps adopted in light of material control deficiencies; (B) analyses prepared by management and/or the independent auditor setting forth significant financial reporting issues and judgments made in connection with the preparation of the financial statements, including analyses of the effects of alternative GAAP methods on the financial statements; (C) the effect of regulatory and accounting initiatives, as well as off-balance sheet structures, on the financial statements of the company; and (D) earnings press releases (paying particular attention to any use of "pro forma," or "adjusted" non-GAAP, information), as well as financial information and earnings guidance provided to analysts and rating agencies.

These proposed rules of the NYSE relating to audit committees are currently under review by the SEC. The NYSE provisions are generally consistent with, and supportive of, the requirements of the Sar-

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banes-Oxley corporate governance and accounting oversight act and the SEC rules promulgated thereunder.

It is clear that both legislators and regulators are looking to the audit committee as the first line of attack in combating corporate abuses and returning investor confidence to the financial reports and disclosures of public companies. Many will argue that these initiatives will significantly expand the duties of "reasonable directors" serving public companies and their shareholders. It is more important than ever for corporate counsel and business litigators to stay abreast of these corporate governance developments.

♦ **Jim Skorheim is a Partner with Moss Adams and serves as Director of Litigation Services and Forensic Accounting in Moss Adams' Southern California Consulting Group.**

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