Q&A with Presiding Justice David G. Sills

For this issue, Carole Reagan and I met with Presiding Justice David G. Sills. Among other things, Justice Sills spoke of the dramatic need for more justices, as well as ways practitioners can best present their arguments on appeal.

Q. What are the major changes you are experiencing at the Court of Appeal?

A. Personnel and work load -- and they go hand-in-hand. Justice Wallin has retired, and Justice Sonenshine soon followed. Justice O'Leary just joined us and I'm hopeful that we will fill the other vacancy very soon. Still, however, that leaves us very much understaffed, and just brings us back to where we were one and a half years ago.

Q. Can you give us some idea of the magnitude involved?

A. At this point, each justice authors approximately 170 opinions annually, and each will sit on approximately 500 cases. This is all in addition to the time involved in reviewing writs. There are simply not enough judges for the popula-

Music in Cyberspace—The Copyright Wars Continue

By Ronald P. Oines & Paul V. McLaughlin

I. Introduction

Most people have heard of MP3.com, Napster.com, or both. These companies have had more than their share of press lately, first for their cutting edge technology and, second, for the lawsuits aimed at preventing the use of such technology. This article discusses recent Federal Court decisions involving claims of copyright infringement against these companies and certain developments since those holdings. But first, some background.

II. What is MP3?

An increasing number of consumers and audio professionals are using their computers to create, edit, transmit, and/or store audio files. Prior to MP3 (short for Motion Picture Experts Group, Layer 3), this was difficult because uncompressed audio files are very large. An uncompressed audio file of an average song may be approximately 50 megabytes. MP3 allows an audio file to be shrunk down to between one-tenth and one-twelfth of its original size with little decrease in sound quality. As computer hard drive memory capacity has increased (and become more affordable), and as compression technology, such as MP3, has improved, it has become feasible to store a library of songs in the MP3 format on home computers. Additionally, there are many portable MP3 players on the market which allow a person to listen to MP3 files anywhere.

A concurrent improvement in modem technology and increased use of high-speed DSL or cable lines for internet access has enabled computer users to share MP3 files relatively easily. Computer users can download MP3 files from the internet in minutes, or even seconds. Of course, computer users are also able to upload MP3 files to the internet. The ease with which computer users can access and share MP3 files has made the format extremely popular for downloading music from the internet.

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Charity: Thank You for Helping Us Raise $6,000 for the Public Law Center

Let me start with my personal thanks to all of our sponsors, supporting firms, ABTL members, and guests who attended our June 7th dinner. The dinner was special for a number of reasons. First, it marked, in part, a coming of age for the Orange County Chapter of the ABTL. Founded only three years ago, our little band of nomads has grown under the leadership of former presidents Don Morrow and Tom Malcolm to a group 400 strong, with unprecedented support from the local bench (both State and Federal) and bar. No other group is able to constantly attract so many judges to its events and, in turn, provide the opportunity for the local bar to mingle with our judges. We thank our judges for their continuing support, especially the judicial members of our Board of Governors.

Second, our last dinner was also special because it was not only the largest turnout in our group’s history (with over 250 guests), but we were able to raise $6,000 for the Public Law Center—the second largest single donation, we are told, in the PLC’s history. Charity is thus not wanting with the ABTL. Thank you all, and especially our supporting firms and our sponsors, Esquire Deposition Services, Dispute Dynamics Inc., JAMS/Endispute, Toshiba America, and The Westin, for your generosity. We hope to repeat this event next year.

Justice: The Need for More Justices on Our Court of Appeals

It is often said, “justice delayed is justice denied.” This is sadly the state of affairs in our local state appellate court, the Fourth Appellate District, Division Three. As mentioned by Presiding Justice David G. Sills in his interview in this edition, the average time for a civil appeal from the filing of the Notice of Appeal until a final decision averages 1,241 days—over three years. A three-year timetable is not only justice delayed, but also an odd result in a state that has mandated a “fast track” trail court system that seeks to resolve cases at the trial level in 12–18 months. The cause of this delay is rather simple: too few Justices.

For example, each Justice authors approximately 170 opinions each year (nearly ¾ of an opinion per working day) and sits on approximately 500 cases (nearly two cases per working day). By way of comparison, our Appellate Court has one Justice for every 424,000 people wherein, for example, the First District has one Justice for every 282,000 people—a situation that puts nearly 50% more workload on our local Justices. Absent help, this problem will only grow worse in the days ahead as Orange County not only grows at a rapid rate, but continues to evolve into an ever more complex and high-tech environment, with a resulting complexity (Continued on page 9)
The Most Frequently Asked Questions About Partnership and Shareholder Litigation
By William W. Ravin, Esq.

There is no area of litigation practice that is more fraught with the potential for misunderstanding of the applicable law, conflicts of interest and malpractice liability than "business divorce" litigation that is, litigation among shareholders, partners or members of LLC’s and LLP’s. In many cases, there are no clear cut answers to the questions that arise in this unique and complex area. Simply knowing enough to ask the right questions, however, is often the difference not only between victory and defeat, but between getting paid and getting sued.

What follows are the ten questions asked most frequently by lawyers who do not specialize in this area, but who find themselves embroiled in it periodically. Because managers of limited liability companies are subject to the same fiduciary duties as partners, the discussion below concerning partners applies with equal force to managers of LLC’s.

1. If I represent one partner and want to sue another partner for breach of contract or breach of fiduciary duty, do I also have to sue for an accounting and dissolution?
   
a. Short answer: No.

b. Long answer: This used to be the law, although there were a number of judicially created exceptions which, in the judgment of some, swallowed the rule. However, trial courts still loved to seize upon this general proposition as an excuse to rid themselves of partnership litigation which typically becomes complicated and acrimonious. But when the Uniform Partnership Act of 1994 (Corporations Code Section 16100 et seq.) was passed in 1996, the Legislature specifically provided that causes of action for dissolution and accounting are no longer a prerequisite for one partner to sue another. Corporations Code Section 16405 sub (b) specifically provides "a partner may maintain an action against another partner with or without an accounting. . . ."

2. Can I sue for specific performance of a partnership agreement?
   
a. Short answer: Yes.

b. Long answer: Earlier case law suggested that because partnerships involve matters of discretion, judgment and personal trust, it is not proper for a court to order specific performance of a partnership agreement whether general or limited. However, the Uniform Partnership Act of 1994 specifically provides that a partner may bring a lawsuit in equity for breach of a partnership agreement. Corporations Code § 16405 sub (b) sub (2). Any specific performance claim is subject to the traditional requirements of reasonable specificity, adequacy of consideration, clean hands, etc.

   But the fact that a partnership agreement is at issue does (Continued on page 10)

Pleading Fradulent Conduct in Securities Fraud Cases: Taking the "All Facts" Requirement Seriously

By Thomas S. Jones & James Sabovich

There can be no doubt, the Private Securities Litigation Reform Act of 1995 ("Reform Act") greatly altered the landscape for pleading securities fraud cases in federal court. Both courts and commentators have spilled much ink over the Reform Act requirement that scienter be pled with particularity and rise to the level of a "strong inference" of fraudulent intent. What has received considerably less attention, but is potentially of greater impact, is whether the Reform Act, or courts interpreting its mandate within the Ninth Circuit, have raised the bar for pleading fraudulent conduct itself and the nature of the falsity within complaints. How particular the elements of the fraud must be articulated in a complaint, especially in cases alleging financial reporting errors or accounting misconduct (a class-action staple), is often determinative of the sufficiency of the complaint.

Prior to the enactment of the Reform Act, Federal Rule of Civil Procedure 9(b) governed all fraud pleading in federal court – including fraud involving the sale of securities. Rule 9(b) mandates that "the circumstances constituting fraud or mistake shall be stated with particularity." Before the Reform Act, courts within the Ninth Circuit struggled to articulate a consistent view regarding how much was needed to meet Rule 9(b)'s mandate – particularly in cases involving allegations of fraudulent accounting or sales practices. While some courts required articulation of specific fraudulent transactions, others permitted generalized allegations of "schemes" to suffice. Although the Reform Act mimics Rule 9(b)'s requirement that the specifics of the fraud be pled with "particularity," it also uses additional language somewhat at odds with prior interpretations of Rule 9(b) – particularly in cases involving "information and belief" pleadings which now require disclosure of "all facts" upon which one's belief is based. At a minimum, it now seems clear that a plaintiff seeking to rely upon "information and belief" rather than personal knowledge to plead a complaint of securities fraud must provide "great detail" regarding that information and belief – far more than was required under pre-existing law. In Silicon Graphics, the Ninth Circuit confirmed that the Reform Act requires more by setting a high threshold for the quantity and quality of information that must be pled before a complaint will suffice. Defendants faced with securities fraud (Continued on page 5)
Orange County’s General Counsel Tell Us
What They Want
By Todd A. Green

At April’s ABTL meeting we were treated to the insights of the General Counsel of three of Orange County’s largest corporations. The topic: Shopping for Business Litigators: What Do General Counsel Look For? The panel consisted of Don Gray, General Counsel for Toshiba America, Mike Cornelius, General Counsel for Western Digital, and Dan Hedigan, General Counsel for The Irvine Company. Together, these three individuals have more than half a century of experience on the inside looking out. Their combined annual litigation budget rivals the gross national product of a third-world country. And they know exactly what they want, and what they don’t, in a business litigator.

The discussion was moderated by Peter Zeughauser, Himself a former Senior Vice President and General Counsel for the Irvine Company, Zeughauser is the founder and President of ClientFocus, a company that provides a broad range of consulting services to law firms. Zeughauser is also the author of a regular column on business development and law firm management in The American Lawyer and of the book Lawyers are from Mercury, Clients are from Pluto.

Apparently Mercury and Pluto have one thing in common: Their inhabitants are familiar with The television game show “Who Wants To Be a Millionaire?” Using this game show format to bridge the chasm between lawyer and client, Zeughauser constructed a game board consisting of such categories as Litigation Budgeting 101, Listening Skills, Holding ’em v. Folding ’em, Results and Getting More Business, and Firm Brochures. The panelists had each answered questions from these categories prior to the discussion. Audience members were then called upon to guess the panelists responses to such questions as:

- My outside litigator (a) is a great listener, or (b) is best managed with a two by four to the head.
- I would rather (a) front-end discovery costs to see if I have a good case, or (b) let the discovery play out in due course and settle on the Court House step.
- How important are results? (a) To stay on the short list, you have to win every case, or (b) As long as I’m braced for the loss, you can lose as many cases as you want and stay on the short list.
- Firm brochures (a) sometimes provide useful information about a firm, or (b) are immediately filed in the circular bin.

While none of the panelists sought an outside litigator best managed with a two by four, the panel’s responses were surprisingly divergent on some topics. One recurring message, however, was that our clients, the General Counsel, have clients too: the business people for whom they work. And one of their primary responsibilities is to explain and justify the

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cases are now well advised to scrutinize closely how well the complaint alleges the questionable conduct, particularly why the conduct was fraudulent in the first place. Therein lies the first line of defense.

Prior Standard: A Few Examples and a Pattern

The Ninth Circuit law has long recognized that the circumstances giving rise to a securities fraud -- the "who, what, when and how" -- must meet the "particularity" requirement of Rule 9(b). In all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity. Fed. R. Civ. P. 9(b). Notwithstanding this particularity standard, Ninth Circuit law prior to the Reform Act did not require great specificity in allegations of fraud. The Ninth Circuit saw the purpose behind Rule 9(b) as to ensure adequate notice, not as a procedural barrier to weed out frivolous lawsuits: "Rule 9(b) ensures that allegations of fraud are specific enough to give defendants notice of the particular misconduct which is alleged to constitute the fraud charged so that they can defend against the charge and not just deny that they have done anything wrong." Semegen v. Weidner, 780 F.2d 727, 731 (9th Cir. 1985). As a result of this, certain pre-Reform Act Ninth Circuit cases upheld complaints alleging fraudulent practices which did not specify a single improper transaction and those that alleged only "representative samples" of fraud to satisfy the particularity requirement of Rule 9(b).

In addition to permitting plaintiffs to simply allege isolated examples of fraudulent conduct from which an extrapolation of a course of conduct was left to the Court's imagination, pre-Reform Act Ninth Circuit law provided plaintiffs additional relief to the Rule 9(b) requirement of particularity: Plaintiffs could make conclusory allegations based on "information and belief" so long as the matter was uniquely within the defendant's knowledge and the plaintiff alleged a factual basis for his or her belief. Essentially, this exception meant that a plaintiff could allege fraud, without personal knowledge of the allegedly fraudulent transactions or having to allege the particulars of the transaction, so long as the plaintiff identified some sources of information supporting a suspicion of fraud.

Upping the Ante: The Reform Act's "All Facts" Requirement

In enacting the Reform Act, Congress spoke to these pleading issues. In a subsection dealing with pleading standards, the Reform Act reiterates Rule 9(b)'s particularity requirement with a twist: "If an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularity all facts on which the belief is formed." 15 U.S.C. § 78u-4(b)(1) (2000) (emphasis added). While prior Ninth Circuit cases had required that allegations made on information and belief contain a "factual basis" to support the belief, they did not require the plaintiff to allege "all facts" supporting the belief. This new level of particularity furthered the intent of the Reform Act which was to deter meritless suits. "It is clear from this conference report that Congress sought to reduce the volume of abusive federal securities litigation by erecting procedural barriers to prevent plaintiffs from asserting baseless securities fraud claims."

In Silicon Graphics, the Ninth Circuit affirmed the district court's dismissal of the complaint and employed an exacting reading of the phrase "all facts." "To repeat . . . plaintiffs alleging securities fraud shall 'state with particularity all facts' on which their belief is based." Silicon Graphics, 183 F.3d at 984 (quoting 15 U.S.C. §§ 78u-4(b)(1), (2)). "We read [this] to mean that a plaintiff must provide a list of all relevant circumstances in great detail." Id. (emphasis added). The Ninth Circuit went on to analyze whether plaintiff's allegations met this standard, particularly those made in reliance on "internal reports," and held that it did not. The court did so despite the plaintiff having alleged specific types of internal reports and having generally alleged the content of these reports. Because the plaintiff did not disclose the "source of her information with respect to the reports, how she learned of the reports, who drafted them or which officers received them," and because the plaintiff did not specifically identify the contents of the reports, the court found the internal reports to be an inadequate basis for her allegation of falsity. Id. at 985. In so holding, the court set a high standard for what constitutes a sufficient factual basis for "information and belief" allegations: "[P]laintiff must provide, in great detail, all the relevant facts forming the basis of her belief. It is not sufficient for a plaintiff's pleadings to set forth a belief that certain unspecified sources will reveal, after appropriate discovery, facts that will validate her claim." Id. at 985 (emphasis added).

In interpreting the "all facts" language of the Reform Act in this fashion, the Ninth Circuit imparted an additional level of specificity into the pleading of fraud previously unseen in Ninth Circuit law. No longer is it sufficient to simply articulate facts sufficient to put a defendant on notice regarding the type of transaction or the general time in which the transaction occurred. If the plaintiff pleads on information and belief regarding a particular transaction, "all facts" regarding the belief that the transaction was fraudulent, including the details of that transaction, must be pled. A plaintiff can no longer piece together a customer here, a transaction there and then place a gloss of fraud by citing a later adverse turn in economic events.

Several district court cases have recognized that the Reform Act has heightened pleading standards -- not only for allegations of scienter but for any allegation based upon information and belief. In Hockey v. Medhekar, 30 F. Supp. 2d 1209 (N.D. Cal. 1998), the court specifically held that the Reform Act had heightened the pleading standard for information and belief allegations. In rejecting Cooper's articulation of the pleading standard, the court stated: "[T]he Ninth Circuit [in Cooper] did not specifically require a plaintiff, as the [Reform Act] does . . . , to state all facts upon which a belief is based." Relying on the heightened standard of the Reform Act, the court in Hockey rejected allegations of false financial statements similar to those accepted by the Ninth Circuit in Cooper: "[P]laintiffs plead no factual support for their allegation that [defendant's] customers had a right to return product . . . . There
tion and number of filings, and our district feels it greater than most of the others. For example, our district has one justice for every 424,000 people; the First District, on the other hand, has one justice for every 282,000 people.

**Q.** Is there any hope on the horizon?

A. There’s a bill now before the Legislature to provide more justices state wide, which would include two for our district. I’m not optimistic that it will get through this year, however.

**Q.** Can you get any relief by using assigned judges from Superior Court?

A. We can, and have done so. But, they have only a limited ability to write opinions, because they do not have the staff backup of a sitting Court of Appeal Justice. Our court now employs 30-32 full-time attorneys, all of them experienced practitioners. Nevertheless, in light of the unfilled vacancies, we have fallen further behind in getting opinions out.

**Q.** Need we ask: What is the biggest challenge facing the Court?

A. No, you don’t. The backlog, particularly in civil cases, is substantial. Unfortunately, it now averages 1,241 days (over 3 years) from the filing of the Notice of Appeal to the final Court of Appeal decision in a civil case. Criminal and juvenile matters are faster because of priority, but we still would like to see them move quicker through the system. And, if we don’t add more judges, the problem only will get worse with increasing population.

**Q.** What, if anything, can the Bar do to help deal with the backlog?

A. It would be great if the Bar could help. Thus far, the only remedies have been to add research attorneys, as opposed to dealing with procedures or adding more judges. Personally, I question whether every case should have an automatic right of appeal, or whether there should be some that can have a more streamlined appeal process akin to writs.

**Q.** What advice would you give attorneys appearing before the Court of Appeal for the first time, or any time for that matter?

A. I’ve found that attorneys who do not specialize in appellate work sometimes tend to treat the appellate hearing like a law and motion matter. Attorneys often are unaware of how thoroughly prepared the panel is by the time of the oral argument. We don’t want or need a recitation of the facts or the issues in the case; we’re fully aware of them at the time the matter is called. One bit of advice I would give is to try and observe some oral arguments a month or two before you are scheduled to appear. If you have a big case before us, this time spent would be very valuable.

**Q.** What is the biggest mistake attorneys make before you?

A. Seeking to reargue factual questions. Instead, attorneys should go right to the issues on appeal and use their time wisely.

**Q.** How about with respect to the briefs that are filed?

A. Again, attorneys who do not specialize in appellate matters need to remember to tell us what the case is about as early as possible in the brief. Sometimes I can get halfway through a brief or more before I know what the matter is about.

**Q.** Do you have any advice for trial lawyers to make certain their cases best positioned for appeal?

A. Three things: First, make a record. Second, make a record. Third, make a record. We simply cannot deal with a matter if it is not in the record. This means that practitioners should make sure that objections are on the record and results of discussions in chambers are subsequently put on the record. Lately, I’ve observed that trial courts, given their own backlogs, have been trying to implement a number of shortcuts. Unfortunately, when the matter comes to us with no record, there’s not much we can do about it.

**Q.** What trends have you noticed lately in the business litigation matters before you?

A. The cases are getting bigger and more complex, with more difficult issues.

**Q.** Are you settling many cases after appeal but before argument?

A. Here, again, we could do so much more if we had more justices. In the past, when I’ve had the time to do so, I could look through the cases and pick out the cases with settlement potential. We just haven’t had that kind of time to devote to settlements over the last several years. Justice Scoville came out of retirement and worked for free, but he’s now unavailable. His absence also has affected our ability to settle cases.

**Q.** Finally, we like to close our interviews by asking, if you could choose any job in the world other than your present one, what would it be and why?

A. I’d like to be 30 years old and on the PGA Tour. In all

(Q&A: Continued from page 1)
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seriousness, the Honorable Marcus Kaufman once told me that I have the best job in all of the California judiciary, and he was right.

- Presiding Justice David G. Sills, California Court of Appeal, 4th Appellate District

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is no identification of which customers returned chips and . . . no allegation that these chips were returned pursuant to a non-disclosed right of return."  *Id.* at 1217. While the court noted that plaintiff’s allegations were similar to those upheld in *Cooper*, the court distinguished the case from *Cooper* because *Cooper* "did not consider the heightened pleading standard incorporated into the [Reform Act]." *Id.* at 1216.

A recent case confirmed this analysis in dicta: "The [Reform Act] requires heightened particularity in pleading both the falsity of the statements complained of, and the defendant’s culpable state of mind in making the statements. . . . The Court notes . . . that the ‘particularity’ analysis provided in Silicon Graphics doubtless governs lower courts’ application of the [Reform Act]’s particularity requirement on the issue of falsity as well." *Dalarne Partners, Ltd. v. Sync Research, Inc.*, 2000 WL 642510, at *2 n.2 (C.D. Cal. Jan. 28, 2000).

While the Ninth Circuit has not applied this heightened standard of review in a case attacking the allegations solely on the basis of falsity, it recently suggested that its analysis in *Silicon Graphics* would apply outside of the scienter context. In *Yourish v. California Amplifier*, the Ninth Circuit considered allegations that the complaint failed to articulate sufficiently that a challenged statement was false – traditionally an analysis conducted under Rule 9(b). 10 While the court held that the allegations did not meet even Rule 9(b), it noted that it would, therefore, not apply the "heightened pleading requirements" found in the Reform Act leading to the inescapable conclusion that something greater than Rule 9(b) is required when alleging falsity under the Reform Act, at least when pleading on information and belief.

Plaintiffs have been quick to develop strategies to evade the "all facts" requirement under the Reform Act. Prior to the Reform Act, plaintiffs pled that further facts regarding the fraudulent activities would be revealed by discovery. When the Reform Act removed the prospect of discovery as an excuse for generalized allegations of the elements of a cause of action, plaintiffs resorted to pleading that the complaint was based upon "investigation of counsel" and argued that forcing revelation of the results of that investigation would invade the work product doctrine. While some courts agreed with this argument, the Ninth Circuit squarely rejected it in *Silicon Graphics* by holding that attorney investigation did not remove a complaint from information and belief pleading standards. 11

Other tactics have included reliance upon unnamed "knowledgeable sources," unidentified "ex-employees," or a review of public filings. But, these approaches should fare no better than the reliance on vaguely described "internal reports" used in *Silicon Graphics* because the reasoning in *Silicon Graphics* remains – where a plaintiff fails to have personal knowledge of the facts in a complaint, the defendant is entitled to "all facts" upon which that knowledge is based. Presumably, this will permit defendants the ability to analyze the information cited and respond meaningfully in a motion to dismiss to often scurrilous allegations regarding business management or economics of a corporate enterprise.

The result that information and belief pleading be held to such a high standard is entirely consistent with the purpose of the Reform Act. As the Ninth Circuit has recognized, the Reform Act was designed to curtail the deluge of securities fraud suits which are almost never based upon the personal knowledge of the plaintiffs. It is not particularly burdensome to set the price of admission to federal court as the possession of actual knowledge of fraudulent conduct or the ability to provide a thorough description of the basis of knowledge. Taking the requirement of disclosure of "all facts" seriously, as the Ninth Circuit did in *Silicon Graphics*, furthers the congressional goal of paring down "abusive securities litigation" and "baseless suits" and offers a first line of defense for companies and corporate officers facing such claims. 12

- Thomas S. Jones, Gibson, Dunn & Crutcher LLP
- James Sabovich, UCLA School of Law, Summer Clerk with Gibson, Dunn & Crutcher LLP

1. The view of the law expressed in this article is currently the basis of a motion to dismiss filed on behalf of a Gibson, Dunn client in a Reform Act case pending in federal district court. As of the date of submission of this article, the court has not ruled on the motion.

2. See, e.g., Decker v. Glenfed, Inc. (In re Glenfed Sec. Litig.), 42 F.3d 1541 (9th Cir. 1994).


5. See Glenfeld, 42 F.3d at 1545.

6. See, e.g., Cooper v. Pickett, 137 F.3d 616 (9th Cir. 1996) (holding Rule 9(b) to be satisfied when the complaint alleged specific customers were undercharged during a period, but failed to specify the individual transactions); *In re Wells Fargo Sec. Litig.*, 12 F.3d 922, 926-27 (9th Cir. 1993) (holding Rule 9(b) to be satisfied where the plaintiff alleged a "representative sample," of the loans it believed to be "in jeopardy" and also alleged that the "possible loan losses were understated by at least $400 million and $350 million, respectively.").

7. See Neubronner v. Milken, 6 F.3d 666, 672 (9th Cir. 1993).

8. While *Silicon Graphics* did concentrate on the insufficient allegations of scienter in affirming the district court, the court held in the alternative that the complaint failed to allege the facts sufficiently: "Here, Brody neither states facts with sufficient particularity nor raises a strong inference of deliberate recklessness." *Silicon Graphics*, 183 F.3d at 984 (emphasis added).

According to one survey, 180 million MP3 files are exchanged every week.

III. What is MP3.com?

MP3 is not a proprietary format and is not owned by MP3.com. MP3.com, however, owns and operates one of the most popular MP3 music sites on the internet. MP3.com launched a service called “My.MP3.com,” which enables a subscriber to store, customize, and listen to his or her CD collection from any internet connection. A user must first prove that he or she owns the CD version of the music either by inserting the CD in the user’s computer for a few seconds, or by buying the CD online from one of MP3.com’s cooperating online retailers. Once the subscriber proves that he or she owns the CD in question, MP3.com allows the subscriber to access MP3.com’s copy of the recording via the internet and play it on any computer anywhere in the world. In order to offer this service, MP3.com purchased tens of thousands of CDs and copied them onto its computer servers.

IV. What is Napster?

Napster owns and operates a web site that allows users to share MP3 files with other users who are logged onto the Napster system. Napster charges no fee for this service, or to download the necessary software. Napster provides a searchable index of song titles and artists that makes it convenient to find the desired selection to download from other users. Napster also allows users to play downloaded music using the Napster software.

V. Why do Record Companies (and Some Individual Artists) Dislike MP3.com and Napster.com?

Record companies and artists are understandably disturbed at the ease with which programs such as Napster and MP3.com facilitate the transfer of copyrighted materials. One record industry group estimates that there are one million illegal MP3 files available for download on the internet. All it takes is one purchased CD to generate infinitely many illegal copies on the internet. Troubled by this prospect, the record industry and several prominent artists have initiated lawsuits against both Napster and MP3.com. These suits have met with some initial success.

VI. The Recent Holding in the Lawsuit Against MP3.com

In UMG Recordings, Inc., et al. v. MP3.com, Inc., a group of record companies challenged the My.MP3.com service described above. On February 28, 2000, Judge Jed S. Rakoff of the U.S. District Court for the Southern District of New York granted the record companies’ motion for partial summary judgment, finding that MP3.com’s unauthorized copying of the tens of thousands of CDs constitutes copyright infringement. MP3.com argued that its service was the “functional equivalent” of storing its subscribers’ CDs. The court rejected this argument, noting that MP3.com was actually replaying converted versions of recordings that it had copied (without permission) from CDs. This, the court held, made out a presumptive case of infringement under the Copyright Act of 1976.

Judge Rakoff similarly rejected MP3.com’s argument that its copying was protected by the doctrine of “fair use.” Generally speaking, the fair use doctrine recognizes that, in certain circumstances, people other than the owner of a copyright may use copyrighted material in a reasonable manner without the copyright owner’s consent. Judge Rakoff examined each of the statutorily enumerated factors and found that MP3.com did not meet any of them.

Finally, MP3.com argued that it provided a useful service to consumers that in its absence would be served by “pirates.” Judge Rakoff was not persuaded. He noted that the copyright laws were not enacted for consumer protection or convenience; rather, they were enacted to protect the property interests of the copyright holders. On the basis of these findings, the court granted partial summary judgment holding that MP3.com infringed the record companies’ copyrights.

MP3.com recently announced that it has reached a settlement with Warner Music Group and BMG Entertainment, which includes a licensing agreement that will allow MP3.com to store music owned by those companies.

VII. The Recent Holding in the Lawsuit Against Napster

Unlike MP3.com, Napster took the offensive in A & M Records, Inc., et. al. v. Napster, Inc. The record companies brought suit alleging that Napster was liable for contributory and vicarious federal copyright infringement and related state law violations. In response, Napster moved for summary adjudication.

Napster argued that a safe harbor provision of the newly enacted Digital Millennium Copyright Act (“DMCA”) applied to the Napster system. The safe harbor provision in question, 17 U.S.C. section 512(a), limits liability “for infringement of copyright by reason of the [service] provider’s transmitting, routing, or providing connections for, material through a system or network controlled or operated by or for the service provider,” if five conditions are met. Napster essentially argued that it was nothing more than a “passive conduit.” Chief Judge Marilyn Hall Patel of the U.S. District Court for the Northern District of California denied Napster’s motion, holding that Napster does not meet the requirements of the safe harbor provision because it does not transmit, route, or provide connections for allegedly infringing material through its system.

In a way, the very attribute of the Napster system that makes it attractive to users compelled the court’s decision that the safe harbor provision did not apply. The court focused on the fact that Napster enables and facilitates connections between users’ computers. The individual users then share information with each other using the internet – not the Napster system. Thus, the court concluded that Napster does not meet the requirements of the safe harbor provision because it does not transmit, route, or provide connections for infringing material.

Judge Patel also held that Napster was not entitled to summary adjudication because there were genuine issues of material fact as to whether Napster had met another safe

(Continued on page 9)
harbor requirement; namely, whether Napster had adopted and reasonably implemented a policy that terminates repeat copyright infringers. Napster’s policy was to change the password of repeat infringers so that the user could not log onto the system using that password. Of course, nothing prevented the user from reapplying with a different password and continuing their infringing activity. In addition, the record companies raised a question as to whether Napster’s policy had even been in place before they filed their lawsuit.

On June 12, the record companies in the Napster litigation moved for a preliminary injunction that would effectively shut Napster down pending a final decision.

VIII. Other Pending Lawsuits
Napster now finds itself battling on several, very public, fronts. Not only is its suit with the record companies still ongoing after the denial of its motion for summary adjudication, but high-profile artists such as Metallica and Dr. Dre have publicly criticized Napster for promoting the unauthorized sharing of their music. Metallica filed a lawsuit against Napster.com and also named several universities Metallica claimed facilitated infringement by allowing students to access Napster’s site. Some of the universities responded to the suit by blocking access to Napster from university computers and were subsequently dropped from the suit.

Metallica also delivered to Napster documents identifying over 300,000 Napster users who had allegedly illegally swapped Metallica songs through Napster. (Dr. Dre has recently taken similar action.) On May 10, 2000, Napster responded to Metallica’s action by blocking access to Napster by those users identified by Metallica. In a sign of the difficulty copyright holders will face curbing the spread of files through programs such as Napster, however, Metallica songs remain readily available on Napster.

IX. The Future
Given the proliferation of freely available copyrighted music on the internet, it was inevitable that the record companies would take action. Moreover, the decisions of the courts in the cases against MP3.com and Napster are not surprising. If services like My.MP3.com and Napster are to co-exist with record companies, they will have to do so by mutual agreement, such as through licensing. However, although MP3.com is reportedly in the process of negotiating licenses with the record companies, and Napster will likely have to do the same, we have not likely seen the last of the legal wrangling over music on the internet.

New programs such as Freenet and Gnutella claim to represent the cutting edge in information sharing technology and demonstrate the difficulty the recording industry may face in its attempts to protect copyrighted music. Freenet, for example, claims that its program enables a user to acquire or exchange information anonymously while simultaneously frustrating any attempt to either remove the information from the internet, or to determine its source. Freenet’s genius is in its ability to find and acquire files without reference to a single database. This is a potential nightmare for copyright holders attempting to track down infringers. Freenet also uses encryption technology to cover the tracks of its users. A test version of Freenet was posted on the internet in March of this year, and has been downloaded more than 15,000 times. Thus, there may be thousands of network servers already running Freenet. Moreover, Freenet allows users to exchange any file format; it is not limited to MP3 files.

Record companies and artists will soon learn whether their aggressive legal stances might negatively effect sales. Consumers are not likely to stop buying their favorite artists’ music based on something the artists’ record company does. However, consumer backlash against the artists themselves, such as the reported negative reaction of Metallica fans to Metallica’s action against Napster, could potentially hurt sales. A person who feels strongly about Napster may be more likely to support bands like The Offspring or Limp Bizkit (both of whom publicly support Napster) rather than Metallica.

One thing is certain. Record companies (like any other well-run company) will do whatever they believe will, in the long run, be most beneficial to the bottom line. The biggest challenge will be to figure out what that is.

• Ronald P. Oines, and Paul V. McLaughlin, Morrison & Foerster LLP

(Corporate Counsel: Continued from page 4)
strategic choices made in litigation, as well as the dollars spent, to these business people. For these reasons, sensitivity to the client’s business goals and to the economics of the litigation was a trait valued by all of the panelists.

So how do you get on the short list? Well, you won’t get there with cold calls or mass e-mail distributions of newsletters. These folks don’t have time for cold calls or for junk mail. (They all, however, have visited law firms’ websites and used them as a source of information; so you’d better have a presence on the web). What does it take to stay on the short list? You don’t have to win every case . . . but you’d better win your fair share.

• Todd A. Green, O’Melveny & Myers LLP

(President: Continued from page 2)
in the legal issues presented to our courts.

Sadly, this problem can only be addressed by the Legislature (to allow the appointment of more Justices) and the Governor (to make the actual appointments). So, the next time you are bored, write or call your legislative representative and ask for their help. The next time you bump into Governor Davis at a fundraiser, ask for his help. In short, do what you can; I am sure Justice Sills (and your clients) would appreciate the help.

• Robert E. Palmer, Gibson, Dunn & Crutcher LLP
not in and of itself prevent specific performance.

3. What is the authority for the proposition that partners/shareholders are fiduciaries?

a. Short answer: Case law.

b. Long answer: The statutory law regarding fiduciary relationships, in general, used to be in the Civil Code; and older cases, while holding that partners/controlling shareholders were fiduciaries, frequently cited specific Civil Code sections (now repealed) establishing the relationship as fiduciary in nature and specifying the fiduciary's duties. Over the past several years, as the statutory law of partnerships has been amended, the statutory law of fiduciary relationships has moved from the Civil Code to the Law of Trusts, found in the Probate Code (§ 15000 et seq.). While the statutory law still applies to all fiduciary relationships (see official comments to Probate Code § 15003 sub (b)), the more recent cases typically state the legal principles without reference to any statutory law. See BT-I v. Equitable Life Assurance Society of the United States (1999) 75 Cal. App. 4th 1406; Heckman v. Ahmanson (1985) 168 Cal. App. 3d 119.

4. Who has the burden of proof in a claim for damages based on breach of fiduciary duty?

a. Short answer: Usually the defendant/fiduciary.

b. Long answer: The statutory law applicable to all trust relationships, i.e., the Law of Trusts discussed above, includes the concept that once a fiduciary gains an advantage as a consequence of dealing with a beneficiary, the burden shifts to the fiduciary to prove that he or she is entitled to keep the advantage. Probate Code § 16004 provides that in the event a trustee gains an advantage from a transaction between the trustee and his beneficiary, the transaction is "presumed" to be a violation of the trustee's fiduciary duties. This presumption is one "affecting the burden of proof." (Probate Code § 16004 sub. (c)). Case law again tracks this concept, but typically does so without mentioning the statutory law. A leading case, Efron v. Kalmanovitz (1964) 226 Cal. App. 2d 546, 556, notes: "[T]he burden is on the director or [controlling] stockholder not only to prove the good faith of the transaction but also to show its inherent fairness from the viewpoint of the corporation and those interested therein." In the partnership context, Laux v. Freed (1960), 53 Cal. 2d 512, 522 notes "[T]he burden is on the one [partner] seeking an advantage to show complete good faith and fairness towards the other."

5. Can I bring a class action on behalf of all limited partners against the general partner?

a. Short answer: Yes.

b. Long answer: Class actions, at least class actions by a limited partner on behalf of other similarly situated limited partners, have been more readily accepted in recent years. The Revised Limited Partnership Act specifically states that a limited partner can bring a class action without having to meet the requirement of numerosity. (Corporations Code § 15701). In other words, a limited partner can sue as a representative of a class of all other similarly situated limited partners if he or she can show there are uniform questions of law and fact. Typically, such common questions of law and fact exist, since a wrong committed by a general partner usually has a common effect on all of the limited partners.

6. When a partnership or corporation does business in California, but was organized under the laws of a sister state, which state's law applies to litigation between the co-owners?

a. Short answer: It depends; the law of the state of organization is not necessarily applicable.

b. Long answer: While the "internal affairs" of most entities organized under the law of a particular state will be governed by such state's law, many controversies are not decided by the law of the state of organization. For example, Corporations Code § 16106, part of the Uniform Partnership Act of 1994, provides that the law of the jurisdiction in which a [general] partnership has its chief executive office governs the relations among the partners and between the partners and the partnership. And, when a foreign entity is involved, but a California constituent is seeking to enforce his rights against such entity or other co-owners, California courts may apply a governmental interest analysis approach to conflicts of law principles to conclude that California law governs. As long as the "internal affairs" (a narrowly defined term) are not at issue, California law will apply to transactions which occur in California and involve California residents. See Havlicek v. Coast-to-Coast Analytical Services, Inc. (1995) 39 Cal. App. 4th 1844, 1851-54; Western Air Lines, Inc. v. Sobieski (1961) 191 Cal. App. 2d 399, 410. Thus, for example, a lawyer should not assume that because a Delaware corporation is the subject of his or her lawsuit, Delaware law will necessarily apply.

7. Is proof of irreparable harm required to obtain injunctive relief, such as a temporary restraining order or preliminary injunction?

a. Short answer: Once you establish a partnership/shareholder relationship, the law permits injunctions and restraining orders without a showing of irreparable harm.

b. Long answer: The statutorily enumerated grounds for injunctive relief include well known notions like irreparable injury and inadequate remedy at law; but they also include the right to an injunction "where the obligation arises from a trust." (Code of Civil Procedure § 526 sub. (7)). Furthermore, case law indicates that a trust relationship exists whenever there is a fiduciary relationship such as that between partners or shareholders. Therefore, under a careful reading of California law, a partner or shareholder should not have to demon-

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8. Can the attorney for a partnership or a corporation represent the entity in an action brought by a partner or shareholder?

a. Short answer: It depends.

b. Long answer: Under limited circumstances, i.e., those in which an attorney has made it perfectly clear in writing to all of the partners or shareholders that he or she represents only the entity, the attorney may represent the entity (or other owners) in an action by one of the partners or shareholders. However, as counsel for a partnership or corporation with relatively few partners or shareholders, an attorney can be held to have fiduciary duties to the individual partners or shareholders if the facts suggest that such partners or shareholders had a legitimate expectation of fidelity on the part of the attorney. Johnson v. Superior Court (1995) 38 Cal. App. 4th 463, 475-479. Even where the attorney has attempted to make it clear that he or she represents only the entity, this is an area fraught with jeopardy. The risk is greater where there are few partners or shareholders, where there is extensive contact or confidential communications them and the entity's attorney, or where other similar factors exist. The prudent course is for any attorney who has represented the entity to avoid taking sides in any dispute involving the entity's owners.

9. Are partnership and shareholder suits triable by a jury?

a. Short answer: Maybe.

b. Long answer: Maybe, maybe not. Partnership and shareholder litigation typically involves claims of breach of fiduciary duty and requests for equitable relief.

Equitable causes of action are not triable to a jury. However, a judge has the discretion to empanel an advisory jury, whose decision is typically followed. There is even one case where it is clear that a claim for damages by a shareholder against directors and controlling shareholders that alleges damages based on breach of fiduciary duty is not triable by a jury. Interactive Multimedia Artists, Inc. v. Superior Court (1998) 62 Cal. App. 4th 1546, 1555-56. However, this is a concept with which most judges are not comfortable. The predilection of most judges is to perceive breach of contract, fraud or other legal actions between partners or shareholders in the same light as similar claims pursued against non-fiduciaries, in which the parties are entitled to a jury. Judges tend to be reluctant to find that a fiduciary relationship created in the context of a partnership or corporation should deprive a plaintiff of his or her constitutional right to a jury. But at least in some cases, this appears to be the law and a jury would not be proper.

10. Can a limited partner appear in litigation on behalf of the partnership without exposing himself to personal liability?

a. Short answer: Sometimes.

b. Long answer: Most limited partners do not want to jeopardize their protection against exposure to liability for partnership debts by appearing in a lawsuit on behalf of the partnership. Such an appearance would arguably create this risk. The argument would be that since limited partners do not have management powers, a partner who acts on behalf of the partnership becomes a de facto general partner with the attendant liability for partnership obligations. However, case law provides that a limited partner may "intervene" on behalf of the partnership to defend a claim when the partnership will not do so, without creating the personal liability of a general partner. Linder v. Vogue Investments, Inc. (1966) 239 Cal. App. 2d 338, 341-342.

Whether we are in a shrinking or expanding economy, disputes between and among those with an interest in corporations, partnerships, limited liability partnerships or limited liability companies are common. Each case presents unique facts and requires a careful assessment of the application of the common law of contracts, fiduciary duties and trusts along with the statutory law embodied in the Uniform Partnership Act of 1994, the Revised Limited Partnership Act and the Probate Code. Any lawyer who enters this minefield should be careful to do so with a clear understanding of the legal, ethical and practical problems that are presented. Unfortunately, there is no definitive practice guide or treatise to help a lawyer walk through this area. Only a careful review of each of the applicable areas of the law will assure a successful result and help prevent what we all hope to avoid -- a call to the carrier.

- William W. Ravin, Mazzarella, Dunwoody & Caldarelli LLP

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SEPTEMBER 13, 2000

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6 p.m. Reception/7 p.m. Dinner & Program
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