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Contents

Inside: Guest Editor’s Column, Oct. 2015 4
Starting Your Startup on the Right Foot 6
LLC vs. S-corporation: Eeny, Meeny, Miny, Moe 9
The Ever-changing World of California Franchise Law 12
The Americans with Disabilities Act: Common Myths that Could Hurt B... 15
M&A: How to Assist Your Client in Maximizing the Opportunity 18
Succession/Exit Planning for Family-owned and Other Closely Held Bu... 21
The Looting of California: Bankers, Corruption and Theft 24
Ethics Corner: Who is My Client? 26
Pro Bono Focus: Referral Panel for Artists 28
Get to Know Your Family Law Judges [photos] 30
Register Today for the 2015 MCLE Spectacular 31
Welcome to Our Newest Members! 33
Those of us who practice in the area of business law are pleased to have an opportunity to present several articles which deal with issues that confront our business clients over the life of their business, i.e., from startup to wind up.

We begin with Kent Parr’s article entitled “Starting Your Startup on the Right Foot.” In this article, Kent outlines certain basic issues and concerns that confront individuals contemplating the formation of a new business venture. The article hits on points that were addressed in the CCCBA Business Law Section’s presentation at the 2014 MCLE Spectacular, “Two Entrepreneurs Walk into a Bar,” and will be included in the program presented at this year’s event, “Two Entrepreneurs Walk Out of a Bar.” The emphasis of Kent’s article is that it is paramount that those forming new ventures get legal advice early on.

Once the issues raised in Kent’s article have been addressed and the decision is made to move forward with the venture, one of the next steps in starting the business is deciding on the proper form of entity under which it will operate. In his article entitled “LLC vs. S-corporation: Eeny, Meeny, Miny, Moe,” Jonathan Watts explores pros and cons of each alternative and some of the more important attributes of doing business as an LLC or S-corp. This decision may have significant ramifications to the current and future operations of the business and to the owners themselves. Therefore, as Jonathan explains, careful consideration must be given to this decision at the inception of the venture.

Now that the form of business entity is decided upon, another issue to be addressed is the consideration of the opportunities available to the new venture. For many new companies, the best opportunity may be to conduct business through a franchise arrangement, as either a franchisor or franchisee. In his article entitled “The Ever-changing World of California Franchise Law,” Dominic Signorotti details recent developments in California franchise law, and in out-of-state jurisdictions, which may impact the decision as to whether or not to conduct business through a franchise relationship. Dominic also notes that in those situations where the decision has been made to conduct business through a franchise relationship, attention should be given to the provisions of the agreement in order to minimize the downside exposure to either the franchisee or franchisor.

Even a successful business can encounter difficulties and setbacks during its lifetime. In an article entitled “The Americans with Disabilities Act: Common Myths that Could Hurt Businesses,” Steve Knuppel discusses how the ADA can impact businesses open to the public. In particular, Steve discusses a number of myths surrounding the ADA and why such myths should not be relied upon by business owners or their counsel. Steve also discusses how recent California legislation can be used by businesses in order to limit their exposure to ADA claims.
While the business has been going along smoothly for a number of years, despite an unforeseen ADA claim or two, the owners are now either contemplating a sale of their enterprise or are suddenly faced with an unsolicited offer to purchase the business. Chris Covington's article, "M&A: How to Assist Your Client in Maximizing the Opportunity," discusses key issues which business counsel and their clients should address when exploring a merger or acquisition opportunity in order to achieve the best, or at least the intended, results. Specifically, Chris details the benefits of the selection and respective roles of the “deal team” and the importance of the creation of the team early in the process in order to effectively navigate the transaction negotiations and maximize the sales price of the business.

Perhaps the business owners, who are your clients, have no desire to sell. In fact, they have not considered at all either the succession of the business in their absence or their exit from the business. Should this be a concern? My article entitled “Succession/Exit Planning for Family-owned and Other Closely Held Businesses” sets forth the proposition that such planning is an absolute must for all small business and describes the benefits and potential attributes of such a plan. Accordingly, I believe that counseling our clients with respect to the advisability of a succession/exit plan is not only sound advice, but also is as important to the success of the business and its owners as is the planning at the beginning.

We hope that you find the information contained in this edition of the Contra Costa Lawyer to be interesting and informative.

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Our language is embedded with idioms that recognize the wisdom of a good start: “starting on the right foot,” “getting out on the right side of the bed,” “measure twice and cut once,” and others.

The same wisdom applies to a startup company. A legally sound startup will set a healthy tone for the business’ future and will embed legal protections and practices that will enhance the possibilities of success.

In 2014, the CCCBA Business Law Section presented “Two Entrepreneurs Walk Into a Bar,” a discussion of issues faced by many startups. We hope to present “Two Entrepreneurs Walk Out of a Bar” in 2015. Why the crazy titles? We recognize that many companies are formed in a wide variety of informal settings, including the legendary deals scribbled onto cocktail napkins.

We’d prefer that entrepreneurs not rely upon cocktail napkin agreements.[1] Below is a checklist of issues that are frequently faced by startups. The list is not intended to be comprehensive, but hopefully it will be a useful guide for when those excited entrepreneurs come bounding into your office with their new ideas.

1. Founding Documents and Entity Choice

Clients might bring you excessive detail or no details at all. Be prepared to flesh out the details of the deal if the clients have not done so: What is the company’s purpose? How will it be financed? Who is calling the shots?

Entity selection is a blended business/tax issue. If you are not a tax person, find one you can refer the client to who can advise on entity selection, obtain a federal tax ID number and make a timely subchapter S-election if appropriate. Your fee agreement should be clear as to whether you are performing those responsibilities, and, if not, the written engagement with the tax professional should clarify who is responsible for those tasks.

The tax issues might determine the entity choice, but the business vision might override the initial tax concerns. For example, a subchapter S-corporation might have short term benefits but angel investors might want to avoid them.

2. Be Clear About Who Is the Client

Multiple owners means multiple interests are present. Each owner may have different interests from the other or from the entity itself. Your ethical duty of loyalty runs to the entity itself.[2] Nonetheless, the owners will be looking to you as “their lawyer.” Clarify in writing who is the client. This is typically done in the fee agreement and/or in the written conflict of interest waiver.

Always make it a practice to obtain written conflict of interest waivers when dealing with
multiple owners. The waiver should disclose that the entity is the client and it should address two additional issues: (1) waiver of conflicts; and (2) disclosure of the waiver of the attorney-client privilege as between the signatories. Be sure to flesh out who you need waivers from: Are there owners or investors who are not present at the client meeting? Those who meet with the lawyer might not be the complete cast of characters from whom waivers should be obtained.

The potential for conflicts of interest can arise from the outset. There is at least one instance in which a written waiver will not protect the attorney from conflicted loyalties: Many attorneys will sign the articles of incorporation or the articles of organization in their capacity as the incorporator.

The incorporator has the power, in many cases, to adopt the corporate bylaws and appoint the initial board of directors. If conflicts arise early on, the selection of directors and of the bylaws’ language could become contentious. All eyes will be on you, the attorney-incorporator, to make some impossible choices. The best practice is to not serve as the incorporator (even if you have a written conflict waiver).

3. Protect Your Client’s IP

Are there trade secrets that bring value to the business? If so, what steps are being taken to protect the trade secrets? Are those matters actually being marked confidential? Are steps being taken to limit access to those secrets? Is the business obtaining nondisclosure agreements from “outsiders” who are, out of necessity, granted access to the trade secrets? The failure to protect trade secrets can lead to a costly drain on the business’ value.

If there is value in inventions, consult with a patent lawyer to protect them. If there is to be value in a trademark or a trade name, that should be protected as well. Even if there is little value in the mark, make sure the client is not violating another’s mark or name. Intellectual Property lawyers and many business lawyers deal with this as part of their practice.

Different lawyers approach their trademark searches differently, but some important resources for trademark searches include the database found in the U.S. Patent and Trademark Office, the California Secretary of State’s website (where one can search corporate names registered to do business in California,) commercial name/trademark search services and Google searches.

None of these methods are foolproof, but clearing a name or mark can avoid conflicts that arise after there has been an investment in building goodwill and name recognition through the use of the client’s trade name or trademark.

There are additional startup issues relating to securities, labor and employment, financing, real estate/leasing and more. As issues arise, it is helpful to view them through the lens of the three questions raised above: What is the company’s purpose? How will it be financed? Who is calling the shots?

The implementation of sound legal practices at the outset is an important service to your client. It will enhance the opportunity for both legal compliance and business success.

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of business transactions and corporate formations. Kent chairs the Business Law Section of the Contra Costa County Bar Association, and he sings the baritone part in the award-winning HouseBlend quartet.

[1] Genentech, Inc. is legendary for being started with a cocktail napkin sketch. They did well. No doubt the lawyers stepped in at some point to formalize the documentation. Thanks to Dr. Benjamin Borson, Ph.D., for this information.

If you are reading this article, you have probably been approached by a client, potential client or dinner party acquaintance with some variation on the following question: “Should I use an S-corporation for my business or an LLC?”

A Brief Tour of the Zoo

In the universe of business entity species (C-corporation, S-corporation, LLC, general partnership, limited partnership, limited liability partnership, etc.), the choice for a closely held business usually comes down to LLC vs. S-corporation. Either an LLC or an S-corporation can combine the protection of a “corporate veil” with an income tax efficient structure.

First, a word about S-corporations. An S-corp. is not a weird subspecies of corporation—instead, it is a regular corporation formed under state law that has elected to be taxed under Subchapter S of the Internal Revenue Code (IRC). This election, called the “S-election,” exempts the corporation from paying taxes on its corporate income. If the corporation does not file the S-election, it will be treated by default as a C-corporation—i.e., one that is taxed under Subchapter C of the IRC.

Instead of reporting its taxable income and paying its own taxes like a C-corporation, an S-corporation passes its taxable income (and tax liability) to its shareholders. Each shareholder reports his or her share of the corporation’s income on his or her personal return. For example, if you own 50 percent of the shares of an S-corp. with net income of $10,000, you must add $5,000 to your taxable income.

This “pass-through” tax treatment is often more tax efficient than a C-corporation’s tax structure. The 35 percent corporate tax rate that we hear so much about is paid by C-corporations, not S-corporations. The same is true of so-called “double taxation,” which requires the shareholders of C-corporations to pay tax on any dividends they receive, even though the C-corporation already paid taxes on the same income.

Before going further, a quick caveat. For purposes of this discussion, we are assuming that a pass-through structure will be advantageous to our hypothetical business owner. While this is commonly true, for reasons beyond the scope of this discussion, it is not always the case.

“Pass-through” tax treatment is available for LLCs too. By default, an LLC will be taxed as a partnership under Subchapter K of the IRC[1] which, like Subchapter S, provides for pass-through treatment of the company’s net income. As a result, each owner of the LLC will report his or her share of LLC net income on his or her personal return, while the LLC itself will not pay federal income tax.

But don’t get ready to flip a coin just yet. While both Subchapter K and Subchapter S of the IRC provide a pass-through tax structure, there are important differences in the
details and under California law as well.

**Issue 1.: Who Owns the Company?**

One of the most important distinctions between an S-corp. and an LLC involves ownership. First, an S-corporation may not have more than 100 shareholders. Also, an S-corporation may have only shareholders who are: (1) individuals who are U.S. citizens; (2) individuals who are resident aliens; (3) certain types of trusts; and (4) other S-corporations.[2]

Crucially, a corporation will lose its S-election if it acquires a shareholder who does not fall within one of these categories. This can have negative tax consequences.

**Issue 2.: Does the Company’s Business Require a Professional License?**

In California, an LLC is generally not available to a business or profession that requires a professional license.[3]

**Issue 3.: Will the Gross Receipts Tax be an Issue?**

Another issue to consider is California’s gross receipts tax, which applies only to an LLC, not to an S-corporation. The tax is computed on the LLC’s gross income—not net profits—from California sources. It applies to an LLC with $250,000 or more per year in California-source gross income. The amount of the tax is determined as follows:

<table>
<thead>
<tr>
<th>Amount of California Gross Receipts</th>
<th>Amount of Tax</th>
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<tbody>
<tr>
<td>$250,000 to $500,000</td>
<td>$900</td>
</tr>
<tr>
<td>$500,000 to $1,000,000</td>
<td>$2,500</td>
</tr>
<tr>
<td>$1,000,000 to $5,000,000</td>
<td>$6,000</td>
</tr>
<tr>
<td>$5,000,000 or more</td>
<td>$11,790</td>
</tr>
</tbody>
</table>

While the amount of the tax is not particularly large, it is an extra cost worth considering.
While both Subchapter S and Subchapter K allow favorable pass-through tax treatment, Subchapter S is much less flexible. In addition to meeting the strict ownership rules described above, an S-corporation may not “have more than 1 class of stock.”[4] Preferred stock—such as a class of shares allowing a particular investor to recover his or her investment before the other shareholders begin receiving dividends—is not allowed.

Subchapter K is more flexible. Not only does it lack Subchapter S’s rigid rules about stock ownership—anyone can own a membership interest in an LLC—it also allows the LLC to set up the equivalent of preferred stock and to issue “sweat equity” without adverse tax consequences to the recipient. Also, the new California Revised Uniform Limited Liability Company Act[5] affords a good deal of flexibility in structuring the economic, governance and other aspects of an LLC.

This discussion is intended as a review of some of the major similarities and differences between LLCs and S-corporations. It is not a comprehensive analysis and should not be taken as legal advice for any particular situation. But, it should leave you well-prepared for your next cocktail party.

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The Ever-changing World of California Franchise Law

Thursday, October 01, 2015

Recent years have seen significant changes in the treatment of franchisor-franchisee relationships under California law. If recent judicial decisions are any indication, there is a strong likelihood of more disruption in the near future. The current state of flux may create confusion for franchisors and franchisees operating in California, particularly when it comes to disputes arising out of the termination of a franchise.

This article will provide a brief update on two areas of franchise law receiving attention in the courts: (1) when a franchise may be legally terminated; and (2) the proper venue for franchise disputes.

A Question of “Good Cause”

Not surprisingly, many California cases involve disputes arising out of the termination of a franchise by the franchisor. The California Franchise Relations Act (CFRA)[1] currently provides that a franchise may not be terminated “except for good cause.” Under the CFRA, “[G]ood cause shall include, but not be limited to, the failure of the franchisee to comply with any lawful requirement of the franchise agreement after being given notice thereof and a reasonable opportunity, which in no event need be more than 30 days, to cure the failure.” California courts have traditionally interpreted “good cause” liberally, such that it may include nearly any uncured violation of the subject franchise agreement, no matter how trivial it may be.

This may be about to change. Currently pending in the California Legislature is AB 525 (Holden, Atkins, Dodd and Wilk); a bill, which if enacted, will significantly expand protections afforded to franchisees under the CFRA. As currently written, AB 525 would make it more difficult for franchisors to terminate franchisees who default under their franchise agreements. For example, AB 525 would redefine “good cause” to be limited to the failure of a franchisee to substantially comply with the franchise agreement after 60 days’ notice and a reasonable opportunity to cure. The proposed legislation would also significantly reduce a franchisor’s ability to consent to the sale or transfer of a franchise.

If AB 525 is enacted in its current form, franchisors would be well advised to revise their franchise agreements in order to ensure that they provide adequate safeguards to legally terminate a defaulting franchisee.

Selecting the Proper Forum

In franchisor-franchisee litigation, one issue which often arises is the appropriate venue. For out-of-state franchisors, the franchise agreement will invariably require that any disputes be venued in the franchisor’s home county. The CFRA provides that forum selection clauses in franchise agreements which restrict venue to a forum outside of California are unenforceable. This rule is often attacked by out-of-state franchisors, with varying degrees of success.
For example, in *Maaco Franchising, Inc. v. Richard O. Tainter and Diane E. Tainter*,[2] the Eastern District of Pennsylvania considered the enforceability of the CFRA’s venue selection provision in the context of a Pennsylvania franchisor versus a California franchisee. Although the case is not binding precedent in California, it does provide a blueprint by which franchisors may circumvent the CFRA and litigate disputes with California franchisees in foreign jurisdictions.

In *Maaco*, a California franchisee was sued by the franchisor for the alleged non-payment of franchise fees, among other things. The franchisor filed the case in Pennsylvania District Court, based on the forum selection clause in the franchise agreement. The California franchisee argued that venue was improper in Pennsylvania, based on the CFRA.

The *Maaco* court applied the traditional standard for enforcement of a forum selection clause, namely: (1) whether enforcement of the forum selection clause is invalid for fraud or overreaching; (2) whether enforcement would contravene a strong public policy of the forum in which the suit is brought; or (3) whether enforcement would be "so gravely difficult and inconvenient as to be unreasonable and unjust and that it would deprive the party of its day in court."

The *Maaco* court focused its inquiry on the second element, and explained that the issue was whether the strong public policy of Pennsylvania would be contravened by applying the subject forum selection clause. The court acknowledged California’s strong public policy against having its franchisees subjected to out-of-state forums, but explained that it was irrelevant because the case was filed in Pennsylvania.

*Maaco* suggests that the provisions of the CFRA may be circumvented by out-of-state franchisors who file suit in other states against California franchisees. Such a rule may result in encouraging a “race to the court” by California franchisees and out-of-state franchisors when litigation appears imminent. If the California franchisee is able to file first in California, the California court is liable to conclude that California’s “strong public policy” articulated in the CFRA applies and negates the effect of the forum selection clause. In contrast, if the franchisor is able to file the lawsuit first in the out-of-state forum, that court may well follow the reasoning of *Maaco* and conclude that California’s public policy is irrelevant.

Conversely, a recent California District Court decision in *Frango Grille USA, Inc. v. Pepe’s Franchising Ltd.*,[3] provides some comfort to franchisees that any disputes with foreign franchisors will be venued in California. In *Frango*, a California franchisee entered into a master franchise agreement with an English franchisor. The agreement contained a forum selection clause which provided that any disputes would be governed by English law, and venued in England. The agreement quickly fell apart, and the franchisee sued the franchisor in a California District Court. The franchisor filed a motion to dismiss and move the matter to London. The *Frango* court denied the motion on the ground that the case did not apply because the forum selection clause was presumptively invalid pursuant to the CFRA.

The *Frango* decision, if ultimately upheld, represents a significant victory for California franchisees, as it suggests that any dispute with a foreign franchisor will be venued in California. Taken together, the *Maaco* and *Frango* decisions suggest that notwithstanding the CFRA, venue in franchisor-franchisee disputes may often turn on who files first, and where. Either way, these cases provide further reason for franchisors and franchisees...
doing business in California to ensure that their franchise agreements are consistent with California law, and provide some level of certainty for addressing disputes.

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The Americans with Disabilities Act: Common Myths that Could Hurt B...

Thursday, October 01, 2015

Whether your client owns a restaurant, a wine-tasting room, a retail store, a law office or any other business open to the public, they need to be aware of the impact of the Americans with Disabilities Act (ADA)[1] and related California statutes.[2]

With stringent technical requirements, minimum statutory penalties (at the state level), attorney’s fees provisions and injunctive relief available to compel costly remediation, the pressure to settle can be enormous, even while the settlements seem expensive. Adding to this danger, many business owners are operating under a false sense of security due to some common ADA myths.

The ADA was passed in 1990 and requires, among other things, that all “public accommodations” be accessible to individuals with disabilities.[3] The ADA allows states to pass legislation that provide equal or greater protections for the disabled.[4] California has incorporated the ADA requirements into its Unruh Civil Rights Act, making a violation of the former a per se violation of the latter.[5]

One significant distinction between the state and federal disability laws is that federal law provides for injunctive relief, but not monetary damages,[6] whereas under the state law, a plaintiff may recover actual damages and “in no case less than four thousand dollars ($4,000)” per visit.[7] Attorney’s fees are available to a prevailing plaintiff under both state and federal law.[8] Availability of attorney’s fees to a prevailing defendant is a more complex question.[9] Implementing regulations are found at 28 CFR Part 36.

**ADA Myth 1.: “I’m okay, because my building was built before 1991.”**

While the build date is relevant, it is not the end of the analysis. All new construction must meet the relevant ADA requirements. However, removal of barriers in pre-existing buildings might be required by subsequent alterations.[10] Also, even when a pre-existing building has not undergone any alterations, a barrier still must be removed if it is “readily achievable.”[11] Readily achievable is difficult to define; akin to “reasonable” in a tort action. Thus, seeking such a determination can be risky for a defendant, given the potential for a sizable award of attorney’s fees to the plaintiff.

Another drawback of the defense is that it may place the defendant’s finances into issue because one factor to be considered in the “readily achievable analysis” is the resources available. Many business owners are not comfortable with this disclosure and choose not to pursue this defense.
**ADA Myth 2.: “I’m okay because the local authorities gave me a building permit.”**

Generally speaking, the requirements of the ADA and the requirements of local building codes are two separate matters. Compliance with the local building code is not a defense to ADA claims.

**ADA Myth 3.: “I’m okay because I don’t own the building; I’m the tenant.”**

It doesn’t matter. A landlord and tenant can agree in their lease who will bear financial responsibility for ADA as between each other, but both are jointly and severally liable to the ADA plaintiff.[12] Neither landlord nor tenant may contract away their obligations to a disability plaintiff.

**ADA Myth 4.: “I’m okay because the plaintiff did not even go into that part of my business.”**

That might not matter. As long as the area where the violation exists is open to the public, it does not necessarily matter that the plaintiff did not encounter the violation. In the recent 9th Circuit case of *Chapman v. Pier One*, the court held that so long as an ADA plaintiff can establish standing as to a single ADA violation, he or she also has standing as to all violations that relate to his or her disability; even if the plaintiff did not actually encounter those violations.[13] Because of the stringent nature of the requirements, it is not difficult for a would-be plaintiff to find a single violation.

Until recently, business owners would learn of ADA claims by receiving a letter alleging violations and demanding money. Due to the perception of abuse, in 2012, the California General Assembly passed legislation prohibiting a monetary demand in such letters.[14] In response, some ADA plaintiff counsel have stopped sending such letters. Now, the first notice that business owners receive of alleged violations is typically a summons and complaint, thus compressing the time for defendants to react.

Proactive pre-litigation compliance is the best defense. Under a new program in California, business owners may retain a “Certified Access Specialist” (CASp).[15] The CASp is able to not only identify compliance issues, but by returning the CASp the defendant might qualify for reduced statutory damages if he or she follows through on improvements based upon the inspection.

As an attorney representing an ADA defendant, the first step is to dispel the foregoing misperceptions and impress upon the client the seriousness of the claim, even where the allegations appear frivolous. Second, immediately tender the claim to the client’s insurance carrier and press for a decision (carriers increasingly are not defending ADA claims). Review the lease to determine whether or not it allocates ADA responsibility between landlord and tenant.

Next, immediately retain an ADA expert. These cases are expert driven and you should wait only long enough to see if the carrier will pay for it or whether your landlord or tenant will split the cost. A good expert can evaluate all compliance issues, both alleged and not yet alleged. Identified violations should be remedied as quickly and fully as feasible. While such action may not eliminate liability entirely, it may reduce the client’s damages.
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[2] Unruh Civil Rights Act and the Disabled Persons Act (California Civil Code § 51 et seq. and § 54 et seq., respectively), hereafter cited as “Civil Code” followed by the section number.


[8] ADA §12205; California Civil Code, §55.

[9] In 2012, the California Supreme Court held that prevailing ADA defendants are entitled to attorney’s fees under Civil Code Section 55 in cases that include state claims, even where plaintiff’s case was not frivolous. Jankey v. Lee (2012) 55 Cal.4th 1038. Federal courts have expressed disapproval of Jankey and only allow attorney’s fees to prevailing defendants, in the court’s discretion, where the claim was frivolous. Kohler v. Presidio International, Inc., Case Nos. 13-55808/13-56217 (9th Cir. Mar. 20, 2015).


M&A: How to Assist Your Client in Maximizing the Opportunity

Thursday, October 01, 2015

For many business clients, the sale of their business is the single most important financial event of their lives. Far too often, they introduce their “deal attorney” into the transaction late in the process, after the letter of intent has been signed.

However, if you do have an opportunity to influence your clients before they “go to market,” there are a number of practical steps that can be taken to help them maximize both the sales price and the after tax proceeds.

1. The Deal Team

Recommend that your client assemble a “deal team.” In addition to the seller’s key decision maker (the CEO, CFO or perhaps the controlling shareholder), it should include:

- A financial adviser. Very often this is the CFO, but sometimes it is an outside accountant.
- A tax adviser. Sometimes it’s a company employee, but more often it’s an outside adviser. It is typically more important that the seller have a tax adviser with expertise in mergers and acquisitions (M&A) matters than one who has ongoing responsibility for the company’s tax filings.
- A deal lawyer. The company’s everyday corporate attorney may be the best choice, but, again, expertise in M&A matters is paramount.
- An investment banker.[1] An investment banker is often critical to maximizing the sales price, as their focus is on creating a competitive bidding and sometimes an “auction” environment; their most important work is typically done before the letter of intent is signed.

2. The Investment Banker Engagement Agreement

Assist your client in the negotiation and documentation of their relationship with the investment banker, as that can have important financial ramifications, and many of the terms of an investment banker’s engagement agreement are neither intuitive nor easily understood.

Also enter into those negotiations recognizing that a successful engagement is a win-win—a higher sales price for the seller should result in a higher fee for the investment banker. The lowest priced investment banker is often not the best choice, and focusing on reducing the fee is often not in your client’s best interests.

- Most of an investment banker’s compensation is in the form of a “Success Fee”—meaning their compensation is contingent on a transaction closing—but it is not unusual for a banker to request a “commitment fee” at the beginning of a relationship, or a retainer during the course of the engagement. That may be reasonable, and many bankers will also agree that any such interim fees will be offset against the Success Fee.
• A Success Fee is almost always based on the “size” of the transaction (the Transaction Value), and will typically be either a fixed or variable percentage of the Transaction Value. The percentage can (and should) vary considerably, based on both the overall size of the transaction and perhaps exceptional performance. The larger the transaction, the more flexibility the investment banker will likely bring to the negotiations.

• Transaction Value may seem straightforward, but is not—both what is to be considered part of the transaction and when it is to be received are variables that confuse even sophisticated sellers. For example, most investment bankers will include, the concept of “enterprise value”—that the Transaction Value includes the value of liabilities assumed—and in many transactions that is a significant portion of the total. Equally important, most M&A transactions include non-cash consideration (very often the buyer’s stock), payments to be made over time, and/or earnouts (or some other form of contingent payments). The parties can either agree to a valuation process for each of these alternative forms of payment as of the closing, or agree that the investment banker will be paid only when and if the seller receives such payments and/or a pro rata portion of any non-cash payments.

• Consider including examples of possible Success Fee calculations in the engagement agreement. (Even if not included, insisting on the client and banker working their way through some example calculations during the negotiations is often eye opening.)

3. The Confidentiality Agreement or Non-Disclosure Agreement (NDA)

The first document typically presented to potential buyers or sellers is an NDA. It is commonly used in many kinds of relationships, and, far too often, the parties attempt to adapt an agreement more suited, for example, to a strategic partnership or an employment relationship, and either simply “fill in the blanks” or sign without making changes. That can lead to disastrous results, particularly if the NDA is with one of the client’s competitors (who are very often among the best candidates to be buyers).

The deal attorney should prepare any “standard form” NDA to be used in the sales process, and should also review any requested material modifications. Using a mutual NDA is generally the better alternative. This may seem counter-intuitive, as the seller will typically be providing substantially all the confidential information, particularly early in the process, but a mutual agreement has several benefits:

• There is almost always information that both parties want to remain confidential—for example, their identities and the very fact that discussions have begun.

• The seller will almost always need to conduct some due diligence on the buyer, as few transactions result in full payment of the purchase price at the closing. In most instances, the seller will be receiving payments over time, or perhaps an earnout, and may even agree to accept buyer’s stock in partial payment of the purchase price. As a practical matter, therefore, the seller will do some due diligence on the buyer; obtaining a mutual NDA at the outset will save time later.

• A Mutual NDA is almost always more “balanced.” As parties will typically not “ask” for more than they are prepared to “give,” the result is less negotiation and faster reviews.
If investment bankers are involved, they may have their own suggested form of NDA, and it may seem less comprehensive than the attorney would prefer. Recognize that the investment banker’s interim goal is to get as many buyers interested in the seller as possible to create that competitive bidding process which maximizes the sales price. Accordingly, work with the investment banker to adopt an NDA that both adequately protects the client’s interests and is sufficiently “friendly” to entice multiple potential buyers to participate in the process.

Important decisions affecting the client’s ability to maximize the sales price and the after tax proceeds occur early in the process, before the preparation of the purchase agreement. Creating a deal team, and the deal attorney’s participation in those early decisions, can be critical, and will both reduce the difficulty of crafting a mutually acceptable purchase agreement and facilitate a timely closing.

Chris Covington is a Lafayette based business transactions attorney focused on providing M&A and outside General Counsel services to his diverse corporate clientele, as well as key employment advice to senior executives.

[1] The term “investment banker” is used here broadly; many who perform similar functions in smaller transactions are identified as “brokers,” “M&A advisers,” or perhaps “M&A intermediaries;” they all are third parties whose primary service is creating a market for the company and whose compensation is primarily based on the value of the transaction and contingent on the closing.
As attorneys who represent and counsel family-owned and other closely held businesses, why should we be counseling our clients to concern themselves with succession planning? The answer is relatively simple. Statistically, only about 30 percent of all family businesses survive into the second generation. According to recent data, two-thirds of such businesses reported not being immediately prepared to fill a vacancy at the top of their organization in the event of an unanticipated occurrence (i.e., death, disability, sudden retirement, etc.).

Besides being able to ensure the continuity of the business, are there other reasons for counseling our business clients to engage in and carry out the succession and/or exit planning process? Clearly, the answer is a resounding “yes.” Specifically, planning for the continuing existence of the business has many corollary benefits.

For example, it can be utilized as a means of funding the retirement of an exiting patriarch or matriarch via a liquidation of such individual’s equity ownership in the business. In addition, such planning can serve as means by which to bring the next generation of family members or trusted non-family member employees into the business in a gradual and structured environment, rather than in response to a catastrophic event. Along those lines, clients should be made aware of the fact that many banks, vendors and sureties are requiring succession plans from their patrons as a prerequisite to a continued business relationship.

To the extent that we intend to provide comprehensive counseling and representation to our clients, we seek to look after all of their legal needs, either through the efforts of ourselves and our firms or by referrals to other trusted professionals. Via the succession planning process, we can achieve and obtain, on behalf of our clients, other beneficial goals and objectives and alternative opportunities.

Through the process of transferring ownership in the business, we can facilitate and complement the estate/tax planning and wealth transfer process. And, in circumstances where the continued viability of the business is in doubt for any reason, the succession planning process may actually involve more exit planning than succession planning including, among other things, the preparation of the business for an eventual sale.

As the parties and their advisors make their way through the planning process, other benefits of the process may be recognized. By implementing a well-thought-out succession plan, older generations are able to not only bring younger generations into the business, but are also able to better prepare such younger generations to own and manage the business effectively and without conflict. This, in turn, aids substantially in maintaining the family’s financial interests in the business rather than seeing such
interests fall into the hands of non-family members because of inadequate or incomplete planning.

Once the business client is on board with concept of succession planning, when should it begin? The development and finalization of a comprehensive plan may take as long as 12 to 18 months, or even longer in some instances. Once the plan is agreed upon, it may take another three to five years to implement, depending on the nature of the succession plan itself.

Because of the various concerns and objectives discussed above, the planning process is as important to the development of a plan as is the outcome. It is only through the planning process that we and our clients are able to assess, explore and hopefully resolve the objectives and concerns in relation to the continued financial success of both the business and the exiting owners. For this reason, it is important that clients are counseled to start the planning process as early as they can, and not in response to an emergency.

Well-crafted succession plans typically have similar characteristics. They should outline the manner in which the business will be managed after the retirement, significant disability or death of a managing owner and provide for an orderly transition of the business. The plan should involve a mechanism by which to determine whether and to what extent the business has the ability to support the next generation, and perhaps future generations, of family members. Also, the plan should establish a process for confirming whether, or under what circumstances, the business should be sold either internally to employees or externally to a third party.

There are as many methods and means to accomplish a successful succession plan as there are businesses and individuals for whom they are designed to benefit. The circumstances, desires and needs of each business and its owners are unique. Accordingly, each plan, while having in common certain basic objectives, will be equally unique in the manner in which it is implemented.

The transfer of ownership can be accomplished through a straightforward redemption of ownership interests. The pros and cons of this approach will involve a fairly detailed tax analysis as to the treatment (and desired treatment) of the redemption proceeds (e.g., ordinary income vs. capital gain, built in gain issues, hot assets, etc.).

In conjunction with an estate plan, the transfer may be accomplished via gifting, as either a one-time event or over the course of time. Where employees (either as family members or non-family members) are the intended successors to the business, options or bonuses of ownership interests can be utilized in a manner which not only transfers the business, but does so in a manner which is more likely to accomplish an orderly transition.

While outside the scope of this article, under certain circumstances, an employee stock ownership plan (ESOP) may be an appropriate option for consideration. As referenced above, the only viable option may be to sell the business. If that is the result of the planning process, the next consideration is whether that sale will be to the current employees of the business or a third party (e.g., a competitor, an affiliate, etc.), and whether such sale should take the form of an asset or ownership interest sale.

There are many factors to be considered in deciding upon the details of the development and implementation of a succession plan. What is the motivation and competence of the
next generation to own and operate the business? How should the next generation be compensated during the transition process? To what extent does the exiting owner wish to have control of the business during the transition process? If key employees are to be brought into the business as owners, when and how should that to be accomplished?

While all business attorneys agree that a succession plan is a good idea for any family-owned and/or closely held business, crafting the ideal plan and the method by which it should be implemented is no simple task. In order to assess the ability of the business to support the results desired by the various plan participants, such individuals and their professional advisors need to engage in a thorough process to uncover the relevant facts and pertinent legal issues which will have an impact on the success of the plan. There are no short cuts to that process.

However, once the plan is fully developed and the means of its implementation are determined, the business, its owners, potential owners and employees will be well ahead of the game in preparing for the future and coping with unforeseen events.

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The Looting of California: Bankers, Corruption and Theft

Thursday, October 01, 2015

Along with the gold rush, killers and thieves flooded into California. The worst desperadoes didn’t carry six guns and ride fast horses. They were a band of genial New Englanders who stole more than Joaquin Murrieta or Black Bart could have imagined.

The 1849 state constitution failed to set up a state bank. In the spirit of the times, the 1850 legislature was more concerned about claim jumping than well constructed banking laws. This failure opened the door to unscrupulous financiers. Established in 1849, the banking house of Palmer, Cook & Company (Palmer, Cook) was one of these.

The principle partners were Joseph Palmer, Charles Cook, George Wright and Edward Jones. Palmer had been a tailor in Massachusetts before heading west. Charles Cook initially handled operations on the East Coast. George Wright was a former tavern owner in New England and, like Palmer, was personable but lacked scruples. Edward Jones, another New Englander, was a member of San Francisco city council. He was smart and as crooked as they came.

Without bonding laws, the bank set up its own insurance subsidiary, enhancing its growing power. Through loans and John C. Fremont's poor business sense, the bank obtained control of Fremont’s Las Mariposas Grant. This set the stage for the bank and Fremont to con hundreds of thousands of dollars from unwary mining investors. These investors believed the bank's exaggerated claims of the riches to be made and the legality of Fremont's title.

Failure of the respected Adams and Company Bank in 1855 resulted in a financial panic that reached into every county. It was an opportunity for Palmer, Cook. A crooked receiver for the failed Adams and Company, Alfred Cohen, made a midnight transfer of $400,000 into the coffers of Palmer, Cook. Some of the shifted funds were later paid out to a few special claimants, including Judge Lake, who had quietly approved the cash transfer. He was soon removed from the bench and fled to Peru to avoid arrest. Cohen was arrested for theft, but spent less than two years in prison. Once all the bribes had been paid, Palmer, Cook kept the rest for themselves, ignoring the suffering of the former Adams and Company depositors. Their losses caused a rash of suicides.

Bribes to prominent Democratic state politicians had bought the new bank the right to be the unofficial treasurer for San Francisco and the state. With Senator Broderick and Governor Bigler in their pockets, Palmer, Cook assumed the responsibility for depositing funds in New York for the support of California and San Francisco city bonds. Hoping to cause the bond prices to crash, in 1854, Palmer, Cook purposely delayed providing state funds to support the bonds. They and their cooperating politicians planned to buy the discounted bonds. The bank would then suddenly provide the support funds needed and
then watch the value of their investments soar. But other banks unexpectedly stepped in to support the bonds. Following the scandal, Palmer, Cook lost the right to handle the treasury's business.

However, in 1856, Henry Bates was elected as state treasurer. He was an old friend of Joseph Palmer and George Wright. This set the stage for the most brazen looting of the state treasury in California history. Bates again gave Palmer, Cook the responsibility for depositing funds in New York banks for financing California and San Francisco city bonds. Secret stealing had begun four months before Bates became state treasurer.

All told, Palmer, Jones, Wright and Bates eventually removed $250,000 from the vault of the state treasurer. Some of the gold was immediately shipped east. Part of the treasure ensured that Nathaniel Banks became the Speaker of the House. A portion helped their friend, John Fremont, win the Republican nomination for president. All this vote buying was aimed at passing laws to protect the bank's shady California land claims.

A group of suspicious legislators paid a visit to the state vault. Alerted by friends in the legislature, Palmer, Cook quickly borrowed $124,000 in gold bullion from a friendly banker and placed it in the state vault before the legislators arrived. Once the legislators were satisfied, the bullion was returned to the banker. The other half of the missing gold was accounted for by a phony Wells Fargo shipping receipt.

On July 2, 1856, these thefts prevented Palmer, Cook from sending sufficient funds to New York banks to cover the California and San Francisco city bonds. State Senator Amos Catlin, a distinguished lawyer, launched an official investigation. However, no criminal charges were ever filed. The bank was quickly dissolved. None of the funds were ever recovered. Vague, poorly written banking and embezzlement laws were partly to blame. But more importantly, friends and conspirators in the state legislature succeeding in delaying and blocking further legal action. Henry Bates was impeached and removed from office. He quietly left office a disgraced but wealthy man.

At the beginning of the Civil War, Fremont commanded the Department of the West. Palmer again linked up with Fremont, and together they became wartime profiteers until Fremont was removed in disgrace. Fleeing to New Orleans, Palmer allegedly orchestrated a major insurance fraud involving the mysterious disappearance of his heavily insured cargo ship. Jones died in 1859 and Cook returned to the East Coast. Wright went to Washington, D.C. Once there, he wrangled an expensive contract from the U.S. Navy for designing a new ship. The project failed, costing the Navy a great deal of money.

In summary, one might say that without just laws, a good society is difficult to achieve. A California historian might also observe that it is good to have low friends in high places.

This article was reprinted and edited with permission from the Contra Costa County Historical Society. They are committed to protecting the county's future by preserving the documents and relics of the county's past. For more information, visit their website at www.cocohistory.org. You can view the original article here: http://cocohistory.org/frm-tales.html.
Ethics Corner: Who is My Client?

Thursday, October 01, 2015

The question, "Who is my client?" would be relatively straightforward if it could be answered simply by saying, "It's the entity or organization that hired me." Indeed, Rule of Professional Conduct 3-600 states that in general, the client is "the organization itself acting through its highest authorized officer, employee, body or constituent overseeing the particular engagement."

However, saying that the client is the entity is the beginning, but not the end, of the inquiry. The lawyer for the entity must also ask several other questions, such as: Who within the entity speaks for it? With whom does the attorney have confidential and privileged communications? Has the attorney made it clear whom he or she does not represent?

Let's focus on the last issue. Representing an entity is usually complicated by the fact that a lawyer may have close relationships with many of the organization's management and directors. Particularly in a closely held organization, those individuals may seek to consult the attorney about personal issues including their own potential personal liability, and they may have expectations that communications with "their lawyer" are confidential.

Rule of Professional Conduct 3-600(D) addresses this issue, stating that: "In dealing with an organization's directors, officers, employees, members, shareholders or other constituents, a member shall explain the identity of the client for whom the member acts, whenever it is or becomes apparent that the organization's interests are or may become adverse to those of the constituent(s) with whom the member is dealing."

It also prohibits misleading a constituent into thinking that they can communicate confidential information to the attorney in a way that will not be used in the organization's interest if that is or becomes adverse to the constituent.

Joel Cohen, in “Warning Your Client That You Are Not His Lawyer” (New York Law Journal, November 5, 1993), focuses on the tension for corporate counsel between wanting information from the corporate players but having to "Mirandize" them first. In a lighter vein, he states that the lawyer should consider telling the employee, who wants to "spill" information, the following:

• "I do not represent you. I represent the company.
• "If you tell me that you have done something wrong, I must report it to my client and perhaps recommend to my client that action be taken against you.
• "If you feel more comfortable in talking to your lawyer before talking to me, I would encourage you to do so.
• "In fact, just so you understand, there may come a time when the company may want me to repeat to a prosecutor what you tell me today. That statement could conceivably be used against you.
• "All right? Having heard all of that, are you willing to talk to me now?"
The silence would be deafening.

The case law in California on partnerships is also inconsistent on the issue of identifying the client. For example, three California cases have each come out differently. First, a partnership lawyer does not necessarily represent the individual partners.[1] Second, confidences imparted by one partner to the attorney must be shared with all partners, even limited partners.[2] Third, whether or not the limited partners are considered clients "is of no great moment" since the lawyer for the general partner necessarily owes a "duty to the partnership to look out for all the partners' interests."[3]

To a point, the imprecision and lack of uniformity about entity representation shows that the issues have simply not been thoroughly treated. However, it is also true that this dearth of authority emphasizes the difficulties inherent in grappling with this issue. I cannot say how much comfort this might be to you, but I am confident that you are not alone.

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Pro Bono Focus: Referral Panel for Artists
Thursday, October 01, 2015

As attorneys, we often run into potential clients who cannot afford legal services. One potential resource for your clients in need of legal assistance with their invention or artistic work is the California Lawyers for the Arts (CLA).

CLA is a nonprofit organization dedicated to helping artists utilize and navigate through the legal system. With its four offices throughout California, including Santa Monica, Sacramento, San Francisco and Berkeley, CLA recently celebrated its 40th anniversary and is the third oldest organization of its kind in the United States.

Formerly known as Bay Area Lawyers for Arts, this service started as a group effort between attorneys and artists who saw a need to help artists. Since then, the program has grown substantially and has been instrumental in helping artists throughout California.

CLA’s mission is to “empower the creative community by providing education, representation and dispute resolution.” CLA carries out its mission in a number of different ways, including a lawyer referral service, educational programs and an alternative dispute resolution service named Arts Arbitration and Mediation Services.

Lawyer Referral Service

CLA’s lawyer referral service consists solely of attorneys knowledgeable specifically in arts-related issues such as copyrights, employee/independent contractor rights, organizational taxes and contract drafting, review and organization. Certified by the State Bar of California, CLA’s referral service is able to refer a caller to an attorney anywhere in California, not just within a limited geographical area. According to CLA’s website, this service annually refers approximately 1,200 Californian artists and arts organizations to panel attorneys.

The cost for a referral to an attorney is $35. However, if the client cannot afford this fee, CLA offers a pro bono program that qualified clients can rely on to waive the
administrative cost. Robert Pimm, CLA’s Director of Legal Services, states that the majority of callers need pro bono or Moderate Means services.

Pimm advises that they have a large attorney panel which consists of private attorneys, large firms and even corporate legal departments.

**Educational Programs**

This year alone, CLA has organized over 60 educational workshops. Upcoming programs include topics such as publishing agreements, trademark protection and even the ethical issues for a law firm’s web presence. For a list of upcoming programs, check CLA’s website at [http://www.calawyersforthearts.org/calendar](http://www.calawyersforthearts.org/calendar).

**Mediation Services**

CLA offers mediation services for arts or entertainment related disputes. Pimm advised that although there are numerous mediation services available throughout California, CLA established its own program entitled Arts Arbitration and Mediation Services (AAMS), which focuses solely on artist-related issues. CLA received a grant from the Endowment for the Arts to begin this program because research concluded that traditional programs caused artists severe stress, which hindered their creative abilities.

To be included on the AAMS’s panel of mediators, you do not have to be an attorney, but you are required to attend a special training to learn about mediations that involve artists. Pimm states that mediators have reported back that this training was effective and the ideas learned have helped settle non-AAMS mediation cases.

AAMS mediators are located throughout California. The fee for mediation is determined individually with each party. There are volunteer mediators and fees are based on a sliding scale depending upon the household income or organizational income or budget of a party.

**California Inventors Assistance Program**

In October 2012, a program known as the California Inventors Assistance Program (CIAP) launched as part of a mandate in the America Invents Act. CLA, as well as other companies, were instrumental in the steering committee that was organized to launch this project. This committee worked closely with the United States Patent and Trademark Office (USPTO) to develop this program.

The purpose of the CAIP is to provide pro bono legal services to help financially struggling inventors, entrepreneurs and artists navigate the patent application process. CLA is the program administrator for this initiative in California and is therefore responsible to process the pro bono intakes with the help of the USPTO.

For more information about CLA, or to volunteer as an attorney, visit the website at [http://www.calawyersforthearts.org/](http://www.calawyersforthearts.org/).

*Samantha Sepehr*, Former Director of the Elder Law Center, is a Partner at Steele, George, Schofield and Ramos, LLP, located in Walnut Creek.
Get to Know Your Family Law Judges [photos]

Thursday, October 01, 2015

On July 30, 2015, the CCCBA and its Family Law Section presented the "Get to Know Your Family Law Judges" event at the Contra Costa County Club. Judge Jill Fannin was honored for her years of service on the Contra Costa County Family Law Bench.

Below are photos from the event, and you can check out more on our Facebook page.

[gallery ids="10983,10984,10985,10986,10987,10988,10989,10990,10991"]
Register Today for the 2015 MCLE Spectacular

Thursday, October 01, 2015

Registration is open for CCCBA’s 21st Annual MCLE Spectacular, taking place on Friday, November 20, 2015, at the Walnut Creek Marriott.
Earn up to 8 MCLE credits in one day!

How to Register:
Click here for the brochure and download the interactive registration form.

Speakers
Our speakers this year include:

• Breakfast Kickoff Speaker: CINDY COHN, Executive Director, Electronic Frontier Foundation, presenting "The Fourth Amendment in the Digital Age"

• Luncheon Speaker: MARK DESAULNIER, U.S. Congressman, 11th District of California, presenting "Congressional Update: Legislation and Societal Impacts"

• Afternoon Plenary Speaker: RICHARD P. CARLTON, Acting Director, Lawyer Assistance Program, State Bar of California, presenting "Coping with the Unique Challenges of Legal Practice"

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Welcome to Our Newest Members!

Thursday, October 01, 2015

Please welcome our newest members who have recently joined the CCCBA:
Starting Your Startup on the Right Foot
A useful guide for when those solicited new business cards are binding into your office with their new ideas.

Spotlight:
The Looting of California: Bankers, Contractors and Shell
In the spirit of the times, the 1850 legislature was more concerned about claims jumping than well-constructed banking laws. This failure opened the door to a host of serious financiers.

The Perfect Mediation
The perfect mediation is a goal: the self-determination aspects make the process more satisfying than trial.

More...
Ethics Corner: Who is My Client?
The case law in California on partnerships is inconsiderant on the issue of identifying the client. Is it the entity at the beginning, but not the end, of the inquiry?

Pro Bono Focus: Referral Panel for Artists
California Lawyers for the Arts (CLA) is a nonprofit organization dedicated to helping artists utilize and navigate through the legal system. Specifically for artist-related issues, CLA offers a lawyer referral service.