ASSOCIATION OF BUSINESS TRIAL LAWYERS

abtl REPORT

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Direct or Derivative Shareholder Claims: Determining One from the Other

Whether a shareholder claim is derivative in nature or one that may be brought individually is an issue that has long bedeviled courts in numerous jurisdictions, including California. *Cf. PacLink Communications Int'l, Inc. v. Superior Court*, 90 Cal. App. 4th 958 (2001) with *Jara v. Suprema Meats, Inc.*, 121 Cal. App. 4th 1238 (2004). *See also Agostino v. Hicks*, 845 A.2d 1110 (Del. Ch. Mar. 11, 2004); *Syncor Int'l Corp. S'holder Litig.*, No. Civ. A. 20026, 2004 WL 2158049 (Del. Ch. Sept. 15, 2004). A recent decision by the Delaware Supreme Court in *Tooley v. Donaldson, Lufkin & Jenrette*, 845 A.2d 1031 (Del. 2004), may help bring some clarity to this elusive issue.

Eric S. Waxman

As the Delaware Supreme Court pointed out, the question is more than an academic exercise. *Tooley*, 845 A.2d at 1036. While commenting that "[d]etermining whether an action is derivative or direct is sometimes difficult," the Court noted that the decision "has many legal consequences, some of which may have an expensive impact on the parties to the action." *Id.* at 1036. Indeed, referencing both the demand requirements that derivative plaintiffs must satisfy as well as the requirement that any recovery in a derivative action flow directly to the nominal corporate defendant, the Delaware Supreme Court aptly remarked that "[t]he decision whether a suit is direct or derivative *may be outcome-determinative*." *Id.*

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The Anti-SLAPP Statute: The SLAPP Fights Continue

The tidal wave of litigation generated by California's "Anti-SLAPP Statute" (Cal. *Code Civ. Proc.* § 425.16, enacted in 1992 to combat "strategic lawsuits against public participation") and its companion statute (Cal. *Code Civ. Proc.* § 425.17, enacted in 2003 to alleviate the "disturbing abuse" of that statutory remedy) may have crested, but SLAPP disputes continue to flood the California courts. Recent decisions demonstrate that litigants and their counsel should keep abreast of the latest developments in this rapidly evolving area of the law.

Kent A. Halkett

Supreme Court Decisions

The California Supreme Court has been relatively quiet on SLAPP issues in 2004. In March, it granted review in *Varian Medical System v. Delfino* (S121400) on the issue of "does an appeal from the denial of a special motion to strike under the anti-SLAPP statute…effect an automatic stay of the trial court proceedings?" That case is fully briefed and awaiting oral argument. In April, it rendered a decision in *Zamos v. Stroud*, 32 Cal. 4th 958 (2004) (explaining the "interface" between the Anti-SLAPP Statute and malicious prosecution). In October, it granted review in *S.B. Beach Properties v. Berti* (S127513) on the issue of "does a trial court have jurisdiction to consider a motion for attorneys fees under § 425.16 if the action was voluntarily dismissed before the special motion to strike was filed." Two other cases involving anti-SLAPP motions, *Gates v. Discovery Communications, Inc.* (S115008) and *Barrett v. Rosenthal* (S122953), are pending.

Section 425.17

Section 425.17 survived the initial challenges to it. *See, e.g., Physicians Committee for Responsible Medicine v. Tyson Foods, Inc.*, 119 Cal. App. 4th 120 (2004); *Metcalf v. U-Haul International, Inc.*, 118 Cal. App. 4th 1261 (2004); *Brenton v. Metabolife International, Inc.*, 116 Cal. App. 4th 679 (2004). *Tyson Foods, Metcalf* and *Brenton* all held that Section 425.17 is applicable retroactively to cases filed prior to its effective date (January 1, 2004). That trilogy also held that Section 425.17(c), the commercial speech exemption, was constitutional since it does not violate any protection embodied in the First Amendment (*Brenton* and *Tyson Foods*) and does not violate equal protection principles (*Metcalf*). In *Metcalf*, the Court of

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(emphasis added). Despite the importance of this issue or, perhaps, because of it, courts' decisions in this area can sometimes be difficult to reconcile. *See* Harold Marsh, Jr. *et al*., Marsh's California Corporation Law § 15.11 2003-2 Supplement (recognizing that court decisions in this area "may be influenced by their desire to reach one conclusion or the other"). *Id*. at 15-60.

California's Leading Authority

In California, the leading case, or at least the case most often cited on this point, is the California Supreme Court's seminal decision in *Jones v. H.F. Ahmanson*, 1 Cal. 3d 93 (1969). In *Jones*, plaintiff who owned 25 shares of stock in United Savings and Loan Association ("Association") brought suit against the majority shareholders who had exchanged their shares in Association for shares in a holding company, United Financial Corporation ("UFC"), the majority stockholders had newly created as part of a plan to increase the liquidity and value of their majority interest. *Id*. at 101. As a result of the majority stockholders' exchange, UFC held 85% of Association's outstanding stock and exercised control over Association's operations.

UFC then created a market for its stock through various public offerings, the result of which was a substantial increase in the value of the defendants' UFC shares, an increase in which the minority stockholders of Association did not share because they had been excluded from the earlier exchange. *Id*. at 104-05. Having realized a substantial increase in the value of their UFC shares, defendants then proposed a transaction whereby Association's minority shareholders could exchange their shares for UFC shares, but at an exchange ratio that valued Association shares at substantially less than their book value, a discount attributable to the absence of a market for Association shares. *Id*. at 105.

Plaintiff brought an action for breach of fiduciary duty contending that defendants used their control of Association for their own advantage to the detriment of the minority shareholders, which the trial court dismissed on defendants' demurrer. On appeal, defendants contended that dismissal was proper because plaintiff's claims were derivative in nature, given that any injury suffered was "common to all minority stockholders of the Association." *Id*. at 105. In rejecting defendants' argument, the California Supreme Court held that an action is derivative in nature "if the gravamen of the complaint is injury to the corporation, or to the whole body of its stock and property without any severance or distribution among individual holders, or it seeks to recover assets for the corporation or to prevent the dissipation of assets." *Id*. at 107. In contrast, the stockholder's individual suit "is a suit to enforce a right against the corporation which the stockholder possesses as an individual." *Id*.

Characterization of Injury

Recognizing the common misperception that an injury falling on all shareholders equally must be derivative in nature, the *Jones* court specifically stated that:

> The individual wrong necessary to support a suit by a shareholder need not be unique to that plaintiff. The same injury may affect a substantial number of shareholders. If *the injury is not incidental to an injury to the corporation*, an individual cause of action exists.

Id. (emphasis added). Thus, as the Court tried to make clear, while all shareholders are damaged similarly in a derivative action, that similarity in damage flows from the injury to the corporation; it does not necessarily follow, however, that when all shareholders experience injury it is because of harm to the corporate entity. *See also Tooley*, 845 A.2d at 1037 ("a direct individual claim of stockholders that does not depend on harm to the corporation can also fall on all stockholders equally, without the claim thereby becoming a derivative claim") (emphasis added). *See, e.g., Everest Investors 8 v. McNeil Partners*, 114 Cal. App. 4th 411, 429 (2003) (former limited partners' claim against general partner for structuring merger in a manner alleged to afford benefits to the general partner not shared by the limited partners was individual in nature, not derivative).

Applications of *Jones*

While easy to articulate, the concepts expressed in *Jones* have proven difficult to apply. This is particularly true as courts have recognized that the same facts giving rise to a derivative action may also support an individual claim. *See, e.g., Pareto v. FDIC*, 139 F.3d 696, 699 (9th Cir. 1998) ("We recognize that an action may lie both derivatively and individually based on the same conduct"); *Nelson v. Anderson*, 72 Cal. App. 4th 111, 124-25 (1999) ("in some cases, the same facts regarding injury to the corporation may underlie a personal cause of action"). That by itself, however, does not explain the confusion in decisions subsequent to *Jones*.

Direct Claim Upheld

Crain v. Electronic Memories and Magnetics Corporation, 50 Cal. App. 3d 509 (1975), illustrates this confusion. In *Crain*, plaintiffs who were minority shareholders in DSL brought several causes of action against EMM, the corporation that owned a majority of DSL's stock. Plaintiffs commenced their action after EMM caused DSL's directors, each of whom had been appointed by EMM, to sell DSL's assets to a third party for what plaintiffs believed to be less than DSL's fair value. *Id*. at 515-16. Plaintiffs contended that EMM caused the sale to alleviate its own financial difficulties, and noted that all of the sale proceeds had been promptly loaned to EMM in return for an unsecured note. *Id*. The trial court dismissed plaintiffs' complaint finding that the claims were derivative in nature and could not, therefore, be pursued by plaintiffs in their individual capacity. *Id*. at 519-20.

Relying on *Jones*, the appellate court reversed. In support of its ruling, the appellate court noted that EMM had voted its majority interest both in favor of the transaction and to reduce DSL's board from five to three directors, which eliminated the board seats formally held by DSL's minority stockholders. Noting that the EMM appointed directors then determined plaintiffs' shares to be worthless and excluded from future corporate distributions, the court found that, like the minority stockholders in *Jones*, plaintiffs were locked into a "shell corporation" with no "real assets." *Id*. at 521.

Jones, however, involved no injury to the corporation because the majority stockholders left the Association's assets in place and simply transferred their majority control to another entity. Thus, the liquidity obtained at the expense of the minority shareholders was not "incidental" to any injury to Association, whose business and assets remained intact and profitable regardless of whether plaintiffs had any way to realize that value. 1 Cal. 3d at 107-08. In contrast, *Crain* did involve a transfer of assets to a third party at arguably less than fair value. The proceeds were then loaned to the majority stockholders, a financially distressed entity who provided no security to support the loan.

The subsidiary corporation, therefore, suffered harm at both ends of the transaction. While those same facts might also have given rise to individual claims, the corporate entity was injured and the defendant directors who approved both the sale and loan transactions breached their duty to the corporate entity. *Pareto*, 139 F.3d at 699 ("If a corporation suffers a direct injury to the whole of its assets, any corresponding injury to the value of an individual stockholder's shares…is merely incidental to, or an indirect result of, the direct injury to the corporation's assets"). *Cf. Smith v. Telecomm., Inc.*, 134 Cal. App. 3d 338 (1982) (claim by minority stockholder in subsidiary who received small-

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er distribution due to majority shareholder parent's allocation of tax benefit to itself following sale of subsidiary's assets found to be derivative, as subsidiary, which could not avail itself of tax benefit, not harmed by allocation); *Vega v. Jones, Day, Reavis & Pogue*, 121 Cal. App. 4th at 282, 297 (2004) (shareholder who exchanged stock in one company for stock of another in connection with merger had individual claim based on nondisclosure of "toxic" provisions of financing being undertaken by acquiror in period between the signing of merger agreement and the merger's closing).

No Direct Claim

Faced with facts similar to *Crain*, the court in *PacLink Communications Int'l, Inc. v. Superior Court*, 90 Cal. App. 4th 958 (2001), came to the opposite conclusion. In that case, plaintiffs who held 38% of an LLC sued the remaining members after they transferred the assets of PacLink to another entity in which they had interests to the exclusion of plaintiffs. 90 Cal. App. 4th at 961. Although the defendants received some monies from the sale by means not described by the court, plaintiffs did not share in the sale proceeds and brought suit contending, among other things, that the sale rendered PacLink insolvent. *Id*. In response to defendants' demurrer asserting that the "gravamen of the claim is that [PacLink's] assets and net worth had been diminished," plaintiffs cited *Jones* and argued that "their own primary rights were directly invaded and violated…causing financial injury directly to plaintiffs themselves…." *Id*. at 962. The trial court agreed and overruled the demurrers, finding that "plaintiffs are attempting to recover [for] their personal injury…[not] injury to [PacLink]." *Id*. at 963.

The appellate court reversed. Acknowledging the *Jones* exception for minority shareholders suing majority shareholders for breach of duty, the court found that the exception applies when "the injury was not 'incidental to an injury to the corporation.'" *Id*. at 964 (emphasis added). The court found direct injury to PacLink noting that "members of the LLC hold no direct ownership interest in the company's assets." *Id*. Thus, the court held that plaintiffs could not have been directly injured when PacLink was improperly deprived of those assets, declaring: "the injury was essentially a diminution in the value of [plaintiffs'] membership interest in [PacLink] occasioned by the loss of [its] assets." *Id*.

More Confusion

A similar divergence can be found between the courts' rulings in *Rankin v. Frebank Co.*, 47 Cal. App. 3d 75 (1975) and *Jara v. Suprema Meats, Inc.*, 121 Cal. App. 4th 1238 (2004). In *Rankin*, minority stockholders brought a variety of claims against defendants including the majority shareholder when defendants diverted the manufacturing aspects of a corporation's business to a separate entity they owned to the exclusion of plaintiffs. *Id*. at 79-82. While a factually and legally complicated decision, the court found that a portion of the salaries paid to defendants by the corporation in which plaintiffs had an interest could be challenged by plaintiffs as excessive because defendants were also drawing a salary from the corporation they created to divert improperly the manufacturing aspects of the first corporation's business. 47 Cal. App. 3d at 86-87. Although the claim for excessive salaries was barred by the statute of limitations, the court recognized the derivate nature of the claim notwithstanding plaintiffs' assertion that the excess compensation was being paid for "'the sole purpose of depleting the income of [the first corporation] so that [plaintiffs] [would] not receive their equitable share of dividends.'" *Id*. at 82.

In *Suprema*, which also involved claims of excessive compen-

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New Rules on International Service of Process

In cases involving foreign parties, U.S. counsel must be sensitive to the interplay between U.S. and foreign law. While U.S. procedural law contains rules governing international service of process in U.S. litigation, many foreign countries view service of process within their boundaries as matters of sovereign interest. *See* Gary B. Born, "International Civil Litigation in United States Courts" (3rd ed. 1996). For this reason, improper service can not only jeopardize the enforceability of a U.S. judgment, but could potentially subject the practitioner to civil and criminal sanctions. *See F.T.C. v. Compagnie De Saint-Gobain-Pont-A-Mousson*, 636 F.2d 1300 n.18 (D.C. Cir. 1980) (a transmittal of compulsory subpoenas directly to French citizens inconsistent with French sovereignty and could subject responding party to criminal and civil sanctions); *see also* 4A Wright & A. Miller, Federal Practice & Procedure: Civil 2d Section 1133 (1987) ("A person not qualified by the law of the foreign country to make service may find that he is subject to criminal sanctions or other constraints in that country if he attempts to do so according to American procedures.") Therefore, international treaties and the law of the jurisdiction where service is sought to be effected may be relevant.

Peter S. Selvin

The centerpiece of federal rules governing service abroad is Fed.R.Civ.Proc. 4(f), which sets forth three alternative methods for effectuating service. Recent case authority suggests that these three methods are independent of each other; *i.e.* a party may resort to the mechanisms provided under Rule 4(f)(3) without having made prior attempts at service under (f)(1) or (f)(2). *See, e.g., Rio Properties, Inc. v. Rio International Interlink*, 284 F.3d 1007 (9th Cir. 2002); *but see Ty v. Celle*, 1996 WL 452408 at 3 (S.D.N.Y. 1996) (the three methods set forth in Rule 4(f) are generally understood to be sequential, such that subdivision (f)(2) is to be used only if subdivision (f)(1) cannot be used). Accordingly, service under Rule 4(f)(3) is neither extraordinary nor a last resort.

With the widespread use of email, U.S. courts have been challenged to address this use within the context of international service of process. Many have invoked Rule 4(f)(3), which allows for service "by other means not prohibited by international agreement as may be directed by the court" to allow service by non-traditional means, including by publication in a law journal (*Fed. Home Loan Mortgage Corp. v. Mirchandi*, 1996 WL 534821, at *4 (E.D.N.Y. 1996)), serving the defendant's attorney (*Mayatextil, S.A. v. Liztex USA*, 1994 WL 198696, at *5 (S.D.N.Y. 1994)), telex (*New Eng. Merchs. Nat'l Bank v. Iran Power Generation & Transmission Co.*, 495 F.Supp. 73 (S.D.N.Y. 1980)) and, most recently, email (*Rio Properties, Inc v. Rio International Interlink*, 284 F.3d 1007 (9th Cir. 2002)). Although few cases have interpreted this rule, the Advisory Committee Notes to Rule 4(f) suggest that it could be utilized in cases where the service mechanisms available under the Hague Convention were ineffective.

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In *Rio Properties, Inc v. Rio International Interlink*, 284 F.3d 1007 (9th Cir. 2002), the Ninth Circuit held that a trial court did not abuse its discretion by allowing a plaintiff to serve process on a foreign defendant by email and postal mail. The defendant was a Costa Rican entity. The plaintiff could not find an address in Costa Rica and could only find a U.S. address for the defendant's international courier who was not authorized to accept service of process. After sending a copy of the summons and complaint to the courier, the plaintiff received a call from a California attorney inquiring about the lawsuit, but the attorney declined to accept service. The plaintiff filed a motion requesting permission to serve the defendant by alternate means. The district court granted the motion and the plaintiff served the summons and complaint by mail on the attorney and the courier as well as by email on the defendant.

Melanie J. Lerch

The defendant filed a motion to dismiss for insufficient service of process, claiming that the plaintiff could not resort to alternate means of service under Rule 4(f)(3) because it had not exhausted the means of service enumerated in Rule 4(f)(2). The Ninth Circuit rejected this argument, holding that Rule 4(f) does not create a hierarchy of preferred methods of service. The court ruled that resort to alternate means authorized under 4(f)(3) is permissible for effectuating service of process on an international defendant, and that the plaintiff need only demonstrate that the facts of the case necessitate court intervention.

Although other courts have followed *Rio* in allowing service of process by email — *see, e.g., Ryan v. Brunswick*, 2002 WL 1628933 (W.D.N.Y. 2002) (email service allowed as to Taiwanese defendant in personal injury suit); *Hollow v. Hollow*, 747 N.Y.S.2d 704 (N.Y. Sup. Ct. 2002) (email service of process allowed in divorce action) — the *Rio* decision leaves open several important questions. Among them are whether complementary methods of service are required when process is served electronically, and whether service by email will jeopardize the enforceability of a resulting judgment, where the defendant's assets are located in a forum that does not recognize email as a permitted means of international service of process.

While courts clearly may not permit a method of service under 4(f)(3) that is contrary to the Hague Convention, at least one court has opined that, in the absence of a governing international agreement, service under 4(f)(3) may be authorized even when the chosen method is not recognized in the foreign state. *See, e.g., Mayoral-Amy v. BHI Corp.*, 180 F.R.D. 456 (S.D. Fla. 1998) (declining to authorize facsimile service in Belize under 4(f)(3), but recognizing that court had authority to permit such service "regardless of whether or not such method contravenes Belize's law").

Another issue of current debate is the extent to which the Hague Convention allows service by mail. This implicates Article 10(a), which allows for the "send[ing] [of] judicial documents, by postal channels, directly to persons abroad." It is analogous to many state statutes that provide for extraterritorial service of process by registered mail. *See, e.g.*, Cal. *Civ. Proc. Code* § 415.40. Importantly, the Hague Convention does not recognize transmission by email or other electronic means as the "sending" of documents "by postal channels."

While service of process by this means is more efficient than via the Central Authority mechanism provided in Articles 2 through 7, practitioners should be careful when considering service by mail. Such service is void if the destination country objects to its use. Article 10(a); *see* also *In re Hunt's Pier Assoc.*, 156 B.R. 464 (E.D.Pa. 1993). China, Germany, Norway and Turkey, among others, have objected to transmission by mail as a valid method of service.

A recent Ninth Circuit case held that, while Article 10(a) of the Convention allows service by international first class mail (as opposed to registered or certified mail, which ensures actual receipt), such service must be performed in accordance with the requirements of Rule 4(f). *Brockmeyer v. May*, 383 F.3d 798 (9th Cir. 2004). The *Brockmeyer* court found that Rule 4(f)(2), dealing with service addressed and mailed by the clerk of the federal district court, is the *only* section of Rule 4(f) that explicitly, affirmatively authorizes service by international first class mail. Although Rule 4(f)(3) grants the federal district court the authority to direct any form of service not prohibited by an international agreement (including, potentially, services by international first class mail), the plaintiffs in this case did not seek the approval of the district court, but merely "dropped the complaint and summons in a mailbox in Los Angeles, to be delivered by ordinary, international first class mail."

U.S. courts remain sharply divided as to whether (even as to those countries which have not objected to Article 10(a)) this provision allows for service of process by mail transmission, as opposed to merely sending pleadings or other documents to a party by mail. *See, e.g., Ackerman v. Levine*, 788 F.2d 830 (2nd Cir. 1986) (service by mail authorized); *but see Bankston v. Toyota Motor Corp.*, 889 F.2d 172 (8th Cir. 1989). Absent a definitive U.S. Supreme Court decision, practitioners should consult the controlling law in the district where litigation is pending.

To maximize the likelihood that a default judgment will be enforced in a foreign state, litigants should ensure that service is effected via the Central Authority. Foreign courts may be reluctant to recognize judgments obtained in the U.S. by default where the underlying service was accomplished pursuant to Article 10(a). By contrast, when service is effected through a Central Authority, the certificate of service issued under Article 6 constitutes strong evidence that the foreign defendant was given notice of the suit. Therefore a foreign court maybe more willing to recognize a default judgment entered under U.S. law.

— Peter S. Selvin and Melanie J. Lerch

The Anti-SLAPP Program

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Appeal summarized Section 425.17(c) as follows:

> "[Section 425.17(c)] makes the anti-SLAPP statute inapplicable to any cause of action brought against a person primarily engaged in the business of selling or leasing goods or services…arising from any statement or conduct if the statement or conduct (1) consists of a representation of fact about that person's or a competitor's business operation, goods, or services; (2) is made or engaged in to obtain commercial transactions in the person's goods or services, and (3) is directed to an actual or potential customer."

It concluded that the California Legislature rationally and legitimately created "classifications of litigants who can take advantage of the anti-SLAPP statute" so as to correct the problems caused by commercial defendants improperly "invoking the procedural protections of the anti-SLAPP statute by claiming their advertising impacted the public interest."

The California Legislature also eliminated the immediate right to appeal the denial of an anti-SLAPP motion based upon the exemptions in Section 425.17(b) and (c). Cal. *Code Civ. Proc.* § 425.17(e); *Goldstein v. Ralphs Grocery Company*, 122 Cal. App. 4th 229 (2004). Nonetheless, in *Goldstein*, the Court of Appeal held that "a defendant dissatisfied with a ruling that a

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special motion to strike must be denied pursuant to section 425.17, subdivisions (b) or (c)" may seek immediate writ review.

Discovery

It is well established that Section 425.16(g) "automatically stays all discovery in the action as soon as a SLAPP motion is filed but permits the trial court to lift this ban upon a showing of good cause." *The Garment Workers Center v. Superior Court*, 117 Cal. App. 4th 1156, 1161 (2004). In *Garment Workers*, the Court of Appeal identified several factors that trial courts should consider in determining whether "good cause" exists for lifting the discovery ban, including whether the evidence necessary to establish the opposing party's prima facie case is in the hands of the moving party or a third party, whether the information sought through formal discovery is readily available from other sources or can be obtained through informal discovery, and whether the requested discovery is needed in the context of the issues raised by the anti-SLAPP motion. Significantly, it held that the trial court abused its discretion in allowing the plaintiff to depose two of the defendant's employees with respect to the actual malice element of its libel claim prior to holding a hearing on the defendant's anti-SLAPP motion. The Court of Appeal reasoned that such limited discovery might "turn out to be unnecessary, expensive and burdensome" if the trial court decided the motion in the defendant's favor, as a matter of law, without having to address the malice issue.

Voluntary Dismissal

A successful moving party on an anti-SLAPP motion is entitled to recover attorney's fees and costs. Cal. *Code Civ. Proc.* § 425.16(c). The offending party cannot avoid such sanctions by dismissing the challenged pleading after the anti-SLAPP motion is filed, but before the hearing. *S.B. Beach Properties v. Berti*, 120 Cal. App. 4th 1001, 1003 (2004)(*citing Pfeiffer Venice Properties v. Bernard*, and *Liu v. Moore*). In *S.B. Beach Properties*, the Court of Appeal extended that principle by holding that "an offending plaintiff can [not] avoid sanctions simply by dismissing his complaint before the defendant files his motion" under the Anti-SLAPP Statute. *Id.* at 1005. It reasoned that the purpose of the Anti-SLAPP Statute would not be achieved if a party could file and serve an offensive pleading, but avoid the adverse consequences of doing so by simply dismissing the pleading. The California Supreme Court granted review on October 27, 2004.

Timing

The Anti-SLAPP Statute contains two deadlines for anti-SLAPP motions: (i) the motion must be filed within 60 days after service of the challenged pleading, and (ii) the motion must be noticed for hearing within 30 days after service of the motion, "unless the docket conditions of the court require a later hearing." Cal. *Code Civil. Proc* § 425.16(f). Those statutory deadlines are jurisdictional. *See, e.g., Fair Political Practices Com. v. American Civ. Rights Coalition, Inc.*, 121 Cal. App. 4th 1171, 1175 (2004)(*citing Decker v. U.D. Registry, Inc.*). The California Legislature enacted a strict timeline to avoid prolonged discovery stays. *Id.* In *Fair Political Practices*, the Court of Appeal affirmed the trial court's denial of the defendants' anti-SLAPP motion as untimely, since the hearing was noticed for and held after the 30-day window, even though defense counsel requested a hearing date within the statutory timeframe and settled upon the "earliest available date" given to them by the trial court's clerk. The Court of Appeal explained that defense counsel could and should have asked the trial court for an earlier hearing date by *ex parte* motion or waited to serve the anti-SLAPP motion until less than 30 days before the scheduled hearing.

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A Falling Out Between Attorneys Leads to Tort Liability

A recent California Supreme Court decision has paved the way for employers to recover damages from their competitors for intentional interference with an at-will employment relationship. In *Reeves v. Hanlon*, 33 Cal. 4th 1140 (2004), the California Supreme Court held that a defendant can be held liable for inducing the termination of an at-will employment relationship under the standard applicable to claims for intentional interference with prospective economic advantage. This decision is an attempt to clarify earlier courts of appeal decisions which placed limitations on an employer's ability to assert such claims.

Joshua Z. Feldman

The underlying facts of the case are topical and relevant to both business litigators and to lawyers who are involved in law firm practice management. Plaintiffs Robert L. Reeves and Robert L. Reeves & Associates, A Professional Law Corporation (Reeves) brought suit against defendants Daniel P. Hanlon (Hanlon), Colin T. Greene (Greene) and Hanlon & Greene, A Professional Corporation. Hanlon and Greene were former attorneys in the Reeves law firm. Reeves alleged that Hanlon and Greene improperly persuaded Reeves' employees to join Hanlon and Greene's new firm, that Hanlon and Greene personally solicited Reeves' clients to discharge Reeves and to instead obtain services from Hanlon and Greene, that Hanlon and Greene misappropriated Reeves' trade secrets, destroyed computer files and data, and withheld property of the Reeves firm. *Reeves, supra*, 33 Cal. 4th at 1145.

Reeves' complaint stated fourteen causes of action, including intentional interference with contractual relationships, interference with prospective business opportunity, conspiracy to interfere with prospective economic advantage, and misappropriation of confidential information in violation of the Uniform Trade Secrets Act, unauthorized use of a corporate car, and destruction of corporate property.

Following the presentation of evidence and arguments, the trial court issued a statement of decision concluding that Hanlon and Greene had assumed fiduciary duties to Reeves and that Hanlon and Greene had interfered with contracts and prospective business opportunities, and misappropriated trade secrets. The trial court determined that, for more than five months prior to their departure, Hanlon and Greene had accessed Reeves' password-protected computer database to print out confidential name, address, and phone number information on 2,200 clients and had fomented dissatisfaction among Reeves' personnel. Furthermore, although Greene had been chair of plaintiffs' litigation department and Hanlon had been responsible for over 500 client matters when they abruptly resigned without notice, they left no status reports or list of matters or deadlines on which they had been working. Nor did they attempt to cooperate with plaintiffs on a notice to clients. Shortly before resigning, Greene intentionally erased extensive computer files in Reeves' computer server containing client documents and form files used by Reeves. Lastly, on the evening of their resignations, Hanlon and Greene personally solicited Reeves' key employees. *Id.* at 1146.

The Court of Appeal affirmed the judgment holding that an

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employer may recover for interference with the employment contracts of its at-will employees by a third party when the third party does not show that its conduct in hiring the employees was justifiable or legitimate. The California Supreme Court granted review to primarily address this last issue.

Relying on the case of *GAB Business Services, Inc., v. Lindsey & Newsom Claim Services, Inc*., 83 Cal. App. 4th 409 (2000), Hanlon and Greene argued that California law does not and should not recognize a cause of action in favor of an employer against another employer for interference with contractual relations by virtue of an offer of employment to an at-will employee.

In reaching its decision, the California Supreme Court reflected on decisional and statutory law in the context of claims involving a breach of fiduciary duty. The Court revisited cases that promoted California's public policy of allowing a former employee the right to engage in a competitive business for himself and to enter into competition with his former employer, provided such competition is fairly and legally conducted. The Court reiterated that consistent with this policy favoring competition, decisions involving parties in competition readily indicate that certain competitive conduct is non-actionable. However, such immunity to liability would not be extended when unfair methods are used in interfering with the contractual relations.

Despite the recitation of decisional law in the context of breach of fiduciary claims, the Court held that the same considerations support similar limitations for actions alleging interference with an at-will employment relationship. *Reeves, supra*, 33 Cal. 4th at 1151. Additionally, the Court drew a distinction between the economic relationship of parties to contracts that are terminable at will, and economic relationships between parties to other legally binding contracts. Specifically, the Court held that interference with an at-will contract is properly classified as an interference with a prospective economic advantage as opposed to interference with contract. *Reeves, supra*, 33 Cal. 4th at 1152.

Relying on the case of *Korea Supply Co. v. Lockheed Martin Corp*., 29 Cal. 4th 1134 (2003), the Court observed that these two particular causes of action share the same intent element. Despite these similarities, *Korea Supply* held that a plaintiff seeking to recover for interference with a prospective economic advantage must also plead and prove that the defendant engaged in an independently wrongful act in disrupting the economic relationship. *Id*. at 1158.

Based on the foregoing, the Court expressly held that a defendant can be held liable for inducing the termination of an at-will employment relation under the standard applicable to claims for intentional interference with prospective economic advantage. *Reeves, supra*, 33 Cal. 4th at 1152. Specifically, a plaintiff must plead and prove that the defendant engaged in an independently wrongful act in disrupting the economic relationship. The independently wrongful act must be proscribed by some constitutional, statutory, regulatory, common law or other determinable legal standard. *Id*. at 1153. Under such a standard, an employer would not be subject to liability for merely extending an offer of employment that may or may not induce an employee to terminate his/her current at-will position.

In reaching it decision, the Court stated that it was undisputed that Hanlon and Greene engaged in unlawful and unethical conduct in mounting a campaign to deliberately disrupt Reeves' business. *Reeves, supra*, 33 Cal. 4th at 1154. The Court found that Hanlon and Greene had acted unlawfully in deleting and destroying Reeves' computer files containing client documents and forms, in misappropriating confidential information, improperly soliciting Reeves' clients, and cultivating employee discontent. Further, the Court found that Hanlon and Greene did not simply extend job offers to Reeves' at-will employees. Rather, Hanlon and Greene purposely engaged in unlawful acts that crippled Reeves' business operations and caused Reeves' personnel to terminate their at-will employment contracts. *Id*. at 1155.

As such, the Court rejected the *GAB* case's explicit holding that an employer may never pursue a cause of action against a competitor for intentional interference with its at-will employment relations.

It is clear from a procedural standpoint that in order to prevail on a cause of action for intentional interference, a plaintiff must plead and prove that the defendant engaged in an independently wrongful act in disrupting the economic relationship (*i.e*., whether the defendant's conduct in hiring the employees was not justifiable or legitimate.) However, what remains to be seen is whether this required element will serve as a roadblock for potential plaintiffs in alleging such a cause of action or whether it may allow seasoned trial lawyers to test the boundaries of pleading as to the true meaning of an independently wrongful act. Specifically, must the independent wrongful act be some type of illegal or surreptitious solicitation of an employee? Or, is the wrongful act just an illegal act coupled with the mere solicitation of an employee?

It would appear that the California Supreme Court considered the actions of both Hanlon and Greene to be proscribed by some constitutional, statutory, regulatory, common law or other determinable legal standard. However, one could argue that the conduct of crippling Reeves' business operations was independent of soliciting Reeves' employees. In order to satisfy the element that Hanlon and Greene engaged in an independently wrongful act, it is evident that the Court bootstrapped the unlawful conduct of Hanlon and Greene to their solicitation of Reeves' employees. Specifically, the Court strains to make the argument that Hanlon and Greene's crippling of Reeves' business operations left the employees without any decision but to leave.

Unfortunately, in clarifying the required elements on a cause of action for intentional interference with a prospective economic advantage, the Court may have inadvertently muddied the waters on what constitutes an independent wrongful act.

— Joshua Z. Feldman

The Anti-SLAPP Program

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Opposing Party's Burden

Once the moving party satisfies its burden to show that the case or a particular claim is subject to the Anti-SLAPP Statute, the opposing party must show the "probability" that it will "prevail on the claim." Cal. *Code Civ. Proc.* § 425.16(b)(1); *Zamos*, 32 Cal. 4th at 965 (explaining that the opposing party must "state and substantiate a legally sufficient claim"). In *Zamos*, the California Supreme Court explained that the opposing party must demonstrate that its case or claim is "both legally sufficient and supported by a sufficient prima facie showing of facts to sustain a favorable judgment if the evidence submitted by [it] is credited." *Id*. (quoting its prior decision in *Jarrow Formulas, Inc. v. La Marche*). Significantly, the opposing party must use "admissible evidence" to support its claim. *Fashion 21 v. Coalition for Human Immigrant Rights of Los Angeles*, 117 Cal. App. 4th 1138, 1147 (2004) (explaining that the Anti-SLAPP Statute requires "evidence which is competent, relevant and not barred by a substantive rule").

Frivolous Motions and Appeals

The California Legislature enacted Section 425.17 in response to its finding that there had been "disturbing abuse" in the use of the Anti-SLAPP Statute. Cal. *Code. Civ. Proc.* § 425.17(a). The California courts also attempt to stop such abuses. *See, e.g., Moore v. Shaw*, 116 Cal. App. 4th 182, 200 n.11 (2004) (noting,

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Court OK's *Ex Parte* Contacts with Dissident Director

In *La Jolla Cove Motel and Hotel Apartments Inc. v. Superior Court (Jackman)*, 121 Cal. App. 4th 773 (2004), the California Court of Appeal for the Fourth Appellate District held that Rule 2-100 of the California State Bar Rules of Professional Conduct does not forbid contact between a lawyer suing a corporation and a dissident director, even though the company's attorney opposed the contact, as long as the dissident director's separate counsel has consented to that contact.

This case involved a family business, La Jolla Cove Motel and Hotel Apartments Inc. Helen Jackman owned a one-third interest in the business and, along with her son Lawrence Jackman Jr., she sought to dissolve the business. After filing the dissolution action, the Jackmans applied for appointment of a receiver. In support of the application, their counsel submitted declarations from two directors that the Jackmans had appointed to La Jolla Cove's board. La Jolla Cove filed a motion to disqualify the Jackmans' attorneys, Micheli and Fabiano, contending that the directors' declarations showed that the Jackmans' lawyers had engaged in improper contacts with La Jolla Cove directors without the consent of the corporation's attorney in violation of Rule 2-100. The trial court denied the disqualification motion, and La Jolla Cove sought review.

Michael K. Grace

The Court of Appeal framed the issue as "whether an attorney may contact a director for an opposing corporation when that director's separate counsel gives the attorney permission, but the corporation's counsel has not." California's Rule 2-100 forbids communications with a party known to be represented by another lawyer without the consent of the other lawyer. The rule defines "party" to include a director of a corporation. In construing Rule 2-100, the court found guidance in comment [7] to ABA Model Rule 4.2, which addresses the prohibition of *ex parte* contacts with represented corporations. Comment [7] states: "If a constituent of the organization is represented in the matter by his or her own counsel, the consent by that counsel to a communication will be sufficient for purposes of this Rule." After reviewing the state and ABA rules, the court concluded that although directors ordinarily would be deemed off limits for contact by opposing counsel under Rule 2-100, an exception exists where the directors' separate lawyer consents to the contact.

The court pointed out that once an actual conflict has arisen between a corporation and a director or other constituent, ethics rules forbid corporate counsel from representing both the corporation and the adverse constituent. La Jolla Cove's counsel could not claim to represent the dissident directors, the court reasoned, because that representation would be forbidden by the conflict of interest rules. It would be an anomalous result, the court added, if corporate counsel could prohibit the Jackmans' lawyers from contacting the very directors that their clients had appointed to the board. Claiming automatic representation of a director without an actual attorney-client relationship with that directory solely to prevent informal discovery was unethical, according to the court.

Minority Shareholders with a New Legal Theory

In *Jara v. Suprema Meats, Inc.*, 121 Cal. App. 4th 1238 (2004), the California Court of Appeal for the First Appellate District held that a minority shareholder could bring a personal action alleging a breach of fiduciary duty in an action involving allegations that certain majority shareholders and officers had paid themselves excessive and unauthorized compensation in order to minimize plaintiff's share of profits.

Jara, Sr., a minority shareholder alleged that Jara, Jr., and Rodriquez, majority shareholders and officers of Suprema, a rapidly growing wholesale meat distributor, were paid excessive compensation in contravention of an oral agreement that "no compensation in excess of $800 per week…without the unanimous approval of all three shareholders" (Jara, Sr., Jara, Jr., and Rodriguez). Although the trial court found that this agreement was breached, the court below found that the injury was "suffered by the corporation" rather than by Jara, Sr., because "the corporation [was] deprived of funds which would, except for the acts of Defendants, have remained with the corporation." Such a claim could only be asserted in a derivative action on behalf of the corporation. Damages were awarded solely to Suprema.

Jeanie Kim

The Court of Appeal reversed, finding that since no consideration existed to procure the promise by Jara, Jr., to Jara, Sr., with respect to requiring a unanimous approval of all three shareholders to raise compensation in excess of $800 a week, no enforceable agreement existed. Notably, the appellate court also reinterpreted *Jones v. H. F. Ahmanson & Co.*, 1 Cal. 3d 93 (1969). *Jones* had previously been interpreted to stand for the proposition that a derivative suit is the required means of asserting injury to the corporation resulting from mismanagement of corporate business. *See Avikian v. WTC Financial Corp*., 98 Cal. App. 4th 1108, 1115 (2002) (plaintiffs' "core claim" was that the defendants mismanaged the corporation and entered into "self-serving deals" to sell its assets to third parties amounted to a claim of injury to the corporation that could be recovered only in a derivative suit); *Nelson v. Anderson*, 72 Cal. App. 4th 111 (1999) (minority shareholder had no standing to sue the majority shareholder for mismanagement of the corporation with only two shareholders); *Pareto v. F.D.I.C.*, 139 F.3d 696, 700 (9th Cir. 1998) (plaintiffs lacked standing to assert a claim that the directors of a bank breached their duty of care in arranging the liquidation and merger of the bank with another financial institution because the claim was "clearly derivative.")

In reinterpreting the *Jones* case, the court reasoned that since the salaries of the major shareholders/officers were shown to reduce Jara, Sr.'s profit as a minority shareholder, those payments injured Jara, Sr. as an individual. The Court of Appeal further explained that the traditional policy considerations requiring a derivative action; *i.e.*, to "prevent a multiplicity of actions by each individual shareholder and a preference of some more diligent shareholders over others, and to protect the creditors who have first call on the corporate assets…." had "little or no application" of that principle in this case, "where the defendants constituted the entire complement of the board of directors and all the corporate officers" and where "the policy of preserving corporate assets for the benefit of creditors had, at best, a very weak application where the corporation remains a viable business."

Serving Foreign Defendants by Mail

In *Brockmeyer v. May*, — F.3d —, No. 02-56283, 2004 WL 1936395 (Aug. 31, 2004), the Ninth Circuit held that foreign defendants can be served with a summons and complaint by mail

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only if it is authorized by Federal Rules of Civil Procedure or the foreign forum's law.

In this case, American plaintiffs sued an English defendant for trademark infringement. The plaintiffs sent the summons and complaint by regular mail to the English defendant's post office box. After the defendant failed to respond, the district court entered a default judgment against the defendant. Defendant moved to set aside the default judgment on the ground that service was improper under the Hague Convention, and the district court denied defendant's motion to set aside the default judgment, holding that the Hague Convention permits service of process by mail.

The Ninth Circuit found that service of process by mail under Article 10 of the Hague Convention "is consistent with the purpose of the Convention to facilitate international service of judicial documents." Accordingly, the court held that service by mail is "permitted" under the Hague Convention terms. However, the Ninth Circuit also considered whether Rule 4 of the Federal Rules of Civil Procedure permitted service of process on a foreign corporation by regular mail.

The Ninth Circuit concluded that Rule 4(f)(2)(A) does not permit use of regular mail for service of process on a foreign corporation and, consequently, *reversed* the district court's entry of default judgment against the English defendant. The Ninth Circuit reasoned that whether mail service is permissible by the law of the forum and foreign entity must be considered in addition to the Hague Convention. Because Rule 4(f) does not authorize service by mail on a foreign entity unless a signed receipt is required or is previously authorized by the Court and since the United Kingdom did not authorize mail service, service by international mail was not valid in this case.

Attorney Client Privilege Upheld

In *People ex rel. Lockyer v. Superior Court*, — Cal. Rptr. 3d —, 2004 WL 218034 (Sept. 29, 2004), the California Court of Appeal for the Fourth Appellate District held that a timely assertion of attorney-client and work product privilege, no matter how boilerplate, prevents a court from finding any waiver of this privilege. *Lockyer* also held that a defendant cannot propound discovery on non-party state agencies, even though the plaintiff is the State.

In this case, the plaintiff, the People, filed an action against vision companies for violation of statutes governing the optometry practice. Defendants moved to compel the production of privileged documents on the basis that the People's privilege log was defective and constituted a waiver of the privilege, the People were required to produce documents previously produced in another litigation, and the People were required to produce documents and witnesses in the possession of other state agencies. The People argued that it was not required to produce privileged documents as its objections were timely, not required to produce documents in the possession of or produce witnesses from non-party state agencies, and not required to produce documents produced subject to a protective order in another litigation. The trial court disagreed with the People, and the People appealed the order by way of petition for writ of mandate.

The Court of Appeal held that the People's objections were timely, and the trial court had no basis to find that the People waived this privilege, even if the original objections were deficient or if the People produced these documents in a different litigation. At most, the trial court could order supplemental responses regarding the assertion of privilege, but could not find a waiver.

The Court also held that the trial court erred as a matter of law in ordering the plaintiff to produce witnesses and documents of non-party state agencies, because the plaintiff was deemed not to have possession of, custody or control over documents of non-party state agencies. The Court reasoned that state agencies are separate entities established under various state laws and constitutional provisions, with authority to investigate and bring actions and maintain their own records.

Extrinsic Test for Similarity in Copyright Infringement Revisited

In *Swirsky v. Carey*, No. 03-55033, filed July 12, 2004 and amended August 24, 2004, the Ninth Circuit held that the extrinsic test as applied to infringement of musical compositions could not be limited to numerical or measure-by-measure analysis of melodic note sequences and listed a non-exhaustive list of elements that a court may consider in comparing works for similarity.

In this case, plaintiffs alleged that a song by Mariah Carey, infringed the plaintiffs' copyright in the song, "One of Those Love Songs." Carey moved for summary judgment, contending that the plaintiffs' evidence failed to meet this circuit's threshold "extrinsic test" for substantial similarity. The district court granted the motion, holding that the plaintiffs' expert had failed to show by external, objective criteria that the two songs shared a similarity of ideas and expression. Plaintiffs appealed, and the Ninth Circuit reversed.

In analyzing musical compositions, the Ninth Circuit noted that there are no ready classifications of elements for comparison, but illustratively listed elements courts should consider such as melody, harmony, rhythm, pitch, tempo, phrasing, structure, chord progressions, lyrics, pitch, meter, instrumentation, timbre, tone, spatial organization, consonance, dissonance, accents, note choice, combinations, interplay of instruments, bass lines, and new technologies. The Ninth Circuit held that it was error for the district court to discount these elements and limit its review to a measure-by-measure analysis.

The Ninth Circuit also found that the district court erred in finding certain measures to be unprotectable by reason of the *scenes a faire* doctrine. This doctrine requires the Court to examine whether an element of the musical composition that a plaintiff says was copied can be attributed to commonplace expressions that are naturally associated with the idea expressed by the element. Where the element in question appears in musical compositions from two different fields of music and only in two songs with two different time signatures, it is error to find it to be a *scenes a faire* as a matter of law. The Court also held that the fact that an author had a particular work in his or her head does not demonstrate direct copying of that work, and that it was not error to exclude this evidence.

"Effects Test" Finds Exercise of Jurisdiction over Foreign Corporation Reasonable

In *CE Distribution, LLC v. New Sensor Corporation*, 380 F.3d 1107 (2004), plaintiff, an Arizona corporation, sued defendant, a New York corporation, for intentional interference with contractual relations. Plaintiff alleged that defendant was aware of plaintiff's exclusive distribution agreement with Italian manufacturer SICA to supply Jensen speakers in the U.S. and interfered with plaintiff's exclusive distribution rights by contracting with a foreign distributor to purchase these speakers for sale in the U.S. Defendant moved to quash service on the basis of lack of personal jurisdiction, as defendant's contract with the foreign distributor was not in Arizona. The Ninth Circuit held that the defendant purposefully directed its conduct toward Arizona by entering into purchase transactions knowing that the effect of the out-of-state transactions would "resonate in Arizona." Because defendant purposefully engaged in conduct that it had reason to know would cause harm to plaintiff in Arizona, the Arizona court could exercise jurisdiction over the New York defendant without violating constitutional due process or fairness considerations.

— Michael K. Grace and Jeanie Kim

The Anti-SLAPP Program

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generally, that the "increasing frequency" of anti-SLAPP motions has imposed "an added burden on opposing parties as well as the courts"); *People ex rel. Lockyer v. Brar*, 115 Cal. App. 4th 1315 (2004). In *Moore*, the Court of Appeal directed the trial court to award reasonable attorney fees to the plaintiff, under Section 425.16(c), for having to oppose the defendant's "frivolous" anti-SLAPP motion. In *Brar*, the Court of Appeal expeditiously dismissed the defendant's "patently frivolous" appeal of the denial of his meritless anti-SLAPP motion since he was simply trying to delay the proceedings against him in the trial court.

Conclusion

Litigants and their counsel will have to ride out the storm as the California courts continue to clarify and define the contours of the Anti-SLAPP Statute and Section 425.17.

— Kent A. Halkett

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ABTL October Dinner Program: The 9/11 Commission Report

The ABTL's October dinner program provided those in attendance with unparalleled insight into the work and findings of the 9/11 Commission. The program, entitled "The 9/11 Commission Report: What It Says and How It Affects All of Us," featured as panelists two members of the 9/11 Commission, Ms. Jamie Gorelick, Esq., and Mr. Slade Gorton, Esq., as well as California's Attorney General, Mr. Bill Lockyer. Ms. Beth Wilkinson, Esq., of Latham and Watkins moderated the panel discussion. Both Ms. Gorelick and Mr. Gorton shared a few of their experiences working on the 9/11 Commission and writing the 9/11 Commission Report, and Mr. Lockyer focused his comments on the challenging task of overseeing the safety and security of one of the largest, most-populated states in a post 9/11 society.

James W. Gilliam, Jr.

First, the 9/11 Commission members discussed how they were selected to serve, as well as why they accepted the appointments. Additionally, a substantial portion of the Commission members' discussion centered around the role that the victims and survivors of the 9/11 attacks played in the Commission's research into the facts surrounding the attacks. As was noted, because of Congress's fear of their criticism, the victims and survivors were able to help the Commission get additional funding and time extensions that, otherwise, the Commission could not have gotten on its own. In fact, the victims and survivors played a vital role in persuading President Bush to participate in a lengthy discussion with the Commission, an interview denied previously.

The Commission members also discussed how they were able to create so well-written a Report. Of particular note to ABTL's members, as Ms. Gorelick noted, the legal profession served the Commission well — those with a legal background were able to craft language for the 9/11 Commission Report that captured what everyone on the Commission felt and believed. Additionally, the Commission's goal from the beginning was to write a report that was interesting, comprehendible, and able to stand up as history — goals that seem to have been achieved considering the Report's success on the bestseller lists.

California's Attorney General, Bill Lockyer, discussed the state and federal government responses to the 9/11 Commission and the publication of its Report. He explained that before the formation of the Commission there was no state-federal interaction to fight jointly against terrorism. Further, though he stated that there is communication now between these two levels of Government, the working relationship is still far from perfect. In short, and unfortunately for the United States and the state of California, the political cooperation to protect against terrorism is "not real good." Mr. Lockyer reported also that currently per capita spending in California on defending against terrorism is too low. Moreover, he noted the considerable expense the War on Terrorism has been to the state of California, sharing that every week the nation is on an "Orange" alert means the state will incur

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ABTL October Dinner Program

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at least $3 million in overtime, uncompensated overtime, as Mr. Lockyer labeled it, for the California Highway Patrol, not counting the expenses many other state agencies face.

Moving forward in the War on Terrorism, each panelist offered his or her own hope or concern about what must be done to protect against future terrorist attacks. Ms. Gorelick, for example, noted that currently government spending is not in line with the risks, recommending that the Department of Homeland Security assess more closely the risks and place resources where needed based on that assessment. Mr. Gorton stressed the importance of acting on the Commission's recommendations now, fearing that a year from now, if they have not been implemented, they may be long forgotten. Mr. Lockyer reminded the audience that Government gets the job done better when people do not distrust it.

Finally, the panelists discussed the tension between providing safety and security and protecting civil rights and liberties, expressing the need to justify new laws that appear to encroach upon individual rights and liberties by showing that they work and that there are checks and balances on the process. This theme was especially poignant for the October Dinner Program because the ABTL awarded its first Public Service scholarships to one student from each Los Angeles area ABA-accredited law school, all of whom have devoted substantial time during law school to protecting and advancing individuals' rights.

The ABTL October Dinner Program was both timely and informative, and it provided a rare opportunity to interact with and hear about the experiences of individuals who are part of the nation's history. Though each panelist made clear that eradicating all threats of terrorism does not and will not happen easily, they are to be commended for the work each of them has done to move us toward such a goal. Indeed, those in attendance for this particular dinner program were afforded a rare opportunity to catch a glimpse into the work of one of the most important and influential Commissions ever formed in the United States.

— James W. Gilliam, Jr.

Direct or Derivative Shareholder Claims

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sation, the opposite result followed. After discussing *Nelson, Pareto, Smith* and *Crain*, the court concluded that the minority shareholder in *Suprema*, like the minority shareholder in *Jones*, had an individual action because "the corporation paid bonuses to defendants with the objective of reducing the amount of profit in the corporation that had to be shared with [plaintiff]." *Id*. at 1258. The court concluded, therefore, that the payments "gave rise to an injury to [plaintiff] as an individual." *Id*.

In support of its ruling, the court emphasized that, despite the excessive payments, the corporation did quite well "experience [ing] extraordinary growth while preserving operating reserves and access to credit." *Id*. The court also attempted to distinguish *Rankin*, claiming that *Rankin* relied on pre-*Jones* authority and that *Rankin* inaccurately characterized *Jones* as depending on a stipulation that there was no injury to the corporation. 121 Cal. App. 4th at 1255-56.

While containing an interesting exegesis of the post *Jones* decisions in this area, the court in *Suprema* largely ignored *Jones*' discussion of injury "not incidental to injury to the corporation." *Jones*, 1 Cal. 3d at 107. The *Suprema* court did not seem to recognize that, whether profitable or not, the waste of corporate assets inherent in the claim of excessive compensation must harm the company because its net assets are diminished by the amount of the excess compensation. Moreover, the *Suprema* defendants breached a duty to the corporation not to waste its assets and the excess cash compensation belonged to the corporation, not the individual shareholder. In addition, the discussion of the stipulation the *Suprema* court relied upon to distinguish *Rankin* really dealt with a separate issue, the equitable allocation of a derivative damage award to ensure defendants do not benefit from the award. *Rankin*, 47 Cal. App. 3d at 96. The *Suprema* court simply ignored *Rankin's* prior discussion of *Jones* and its conclusion that the "wrong suffered by plaintiffs is . . . incidental to a loss suffered by the corporation …" *Rankin*, 47 Cal. App. 3d at 95.

Delaware Decisions

Into this fray rides the Delaware Supreme Court's decision in *Tooley*, which involved a claim by minority shareholders for the time value of money based on delay in closing a merger allegedly to benefit the majority shareholder. 845 A.2d 1033-34. The court began by discussing the confusion in Delaware's jurisprudence with regard to whether a stockholder seeking to assert an individual claim had to plead some "special injury" not suffered by other shareholders. 845 A.2d at 1034 ("The Court of Chancery, relying upon our confusing jurisprudence on the direct/derivative dichotomy…[dismissed because the] 'delay affected all DLJ shareholders equally [and] was not [therefore] a special injury.'"). Defining "special injury" to mean "a wrong that 'is separate and distinct from that suffered by other shareholders,…or a wrong involving a contractual right of a shareholder, such as a right to vote…,'" the *Tooley* Court declared that the concept of special injury should no longer play any role in the analysis of whether a claim is direct or derivative. 845 A.2d at 1035. *See also Jones*, 1 Cal. 3d at 107 ("The individual wrong necessary to support a suit by a shareholder need not be unique to that plaintiff."); *Nelson*, 72 Cal. App. 4th at 124 ("[t]he test is not whether Nelson's damages were unique").

The Delaware Standard

Instead, the Delaware Supreme Court instructed that the analysis must be based solely on two questions: 1) "who suffered the alleged harm — the corporation or the suing stockholder individually"[;] and 2) "who would receive the benefit of recovery or other remedy?" *Id*. In assessing the first prong of the analysis, the court suggested inquiry into "whether the stockholder has demonstrated that he or she has suffered an injury that is not dependent on an injury to the corporation." *Id*. at 1036 (citing with approval *Agostino*, 845 A.2d 1110). This question turns in part on determining the person or entity "to whom the relevant duty is owed." 845 A.2d 1036 n.9. Thus, to constitute an individual claim, the Delaware Supreme Court held that the direct inquiry alleged "must be independent of any alleged injury to the corporation." *Id*. at 1039. The court also declared that the stockholder must "demonstrate that the duty breached was owed to the stockholder." *Id*.

Syncor International Corp. Shareholders Litigation, helps illustrate *Tooley's* principles. In that case, Syncor stockholders sued when Cardinal Health Care, Inc. insisted upon and received a reduction in the agreed upon exchange ratio in a stock for stock merger. No. 2004 WL 2158049 at *1-2 (Del. Ch. Sept. 15, 2004). The reduction was agreed to when, after the merger was announced but before closing, Syncor publicly disclosed that it had entered into both a guilty plea with the United States Department of Justice and a civil settlement with the Securities Exchange Commission for violation of the Foreign Corrupt Practices Act ("FCPA"). *Id*. The possible FCPA violations by certain Syncor overseas subsidiaries had been discovered by Cardinal during its due diligence. When brought to the attention of Syncor's board, the board promptly conducted a thorough investigation, the result of which was a favorable settlement with

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the government with respect to those claims. *Id*.

Plaintiffs originally brought derivative claims filed almost immediately after Syncor's announcement that potential FCPA violations had been discovered and that its board was conducting a full investigation. Plaintiff had to change their theory, however, when the settlements resulted in fines that were not material to Syncor. Thus, plaintiffs filed a second amended complaint containing class rather than derivative claims, asserting that the reduced exchange ratio harmed them directly but not the company, which had no interest in the exchange ratio. *Id*. at *2. Applying *Tooley*, the court granted defendant's motion to dismiss finding that the claims were derivative in nature. *Id*. at *1.

In a well-reasoned opinion, Vice Chancellor Lamb pointed out that the duty breached by defendant in violating the FCPA was a duty owed to Syncor. *Id*. at *3 ("All of [defendant's] alleged misconduct was in connection with Syncor's core business activities and, *if proven*, would involve a breach of the duty of loyalty owed to Syncor.") (emphasis added). The court also pointed out that the renegotiated exchange ratio, while it did result in plaintiffs' receiving fewer Cardinal shares, "simply reflected a change in the market value of Syncor resulting from the public disclosure of [defendant's] alleged misconduct…" *Id*. Accordingly, any harm to Syncor stockholders was "merely a coincidental, indirect consequence of [defendant's] acts that resulted from the awkward timing of the disclosure." *Id*.

Conclusions

Applying *Tooley's* simplified two prong test to the post *Jones* decisions cited above would suggest different results, all of which, however, would be consistent with *Jones'* emphasis on "injury [which] is not incidental to an injury to the corporation." 1 Cal. 3d at 107. *See Nelson*, 72 Cal. App. 4th at 124 ("an individual cause of action exists *only if the damages were not incidental* to an injury to the corporation") (emphasis added and citation omitted). Neither *Jones* nor *Smith* involved any individual injury to the corporation. In *Jones*, the Association remained unaffected by the majority stockholders transferring their shares to a new entity. In *Smith*, the subsidiary would not have been able to utilize the parent's loss to decrease taxes owed on the gain realized by the subsidiary in the sale of its assets. Both cases, however, involved direct injury to the minority shareholders as a result of the majority shareholders breaching their fiduciary duty to the minority not to use their control status to obtain benefits for themselves to the exclusion of the minority shareholders. In *Crain*, however, the subsidiary was no less harmed by the transfer of its assets than the LLC was in *PacLink*. In both cases, the directors or managing members owed a duty to the corporation not to diminish the value of the corporation's assets. Moreover, any recovery of that diminishment should have been returned to the corporate entity, not to the individual stockholders. Similarly, the excessive compensation in *Suprema* just like the excessive compensation in *Rankin* harmed the corporation and the reduction in the corporation's assets should have been restored to the corporation.

A focus on the two part test set forth in *Tooley* should lead to more consistent decisions in this area. To the extent courts reached different results because they were concerned with the effect of the demand requirement or that a damage award to a corporation in which the defendants have a majority interest might cause an inequitable result, the law provides ample tools for managing both concerns. Accordingly, the decision as to whether a claim is derivative or direct should not turn on such concerns, however legitimate, and should depend on a consistent application of established legal principles.

— Eric S. Waxman

Benefits of ABTL Membership Cited

There are numerous bar associations vying for your membership and your valuable time. Why the ABTL? It's easy. The ABTL is the preeminent association for business trial lawyers in the State and each chapter provides top quality legal education programs in an atmosphere where there can be a frank exchange between bench and bar. In addition, as stated by Allan Browne, the Founding President of the ABTL, "One of the great byproducts of ABTL is the fact that it has developed wonderful camaraderie amongst [trial lawyers] in commercial and business matters."

Joanne E. Caruso

As the year draws to a close, it's time to renew your membership for 2005. We also urge you to get your colleagues who are not members to join. This year, for the first time, the ABTL- Los Angeles chapter has instituted an early sign up discount program, which provides savings on membership costs for those who renew or join by December 31, 2004.

The Los Angeles chapter has over 950 members and our Board of Governors consists of 34 attorneys and judges from the state and federal courts, including the Honorable Consuelo Marshall, Chief Judge of the District Court, the incoming Presiding Judge of the Superior Court, the Honorable William MacLaughlin, and U.S. Attorney Debra Yang. A complete list of our board members, along with the board members of each of the other four ABTL chapters can be found on our website, www.abtl.org. We are non-partisan and non-political.

Our unique structure provides opportunities for networking and dialogue with members of the bench and bar in the five largest metropolitan areas in California. The ABTL is dedicated to providing high quality MCLE programs and dialogue among the bench and bar relating to business litigation. Our programs are well attended by the local judiciary and our reception/meal program format allows for informal discussion. For example:

• We present five dinner programs every year. Over 300 judges and lawyers recently attended our program on the 9-11 Commission Report and its implications. Our November program is entitled "Meet the New Federal Judges" in which attendees have the opportunity to meet the most recently appointed federal judges in the Central District and learn about their practices, procedures, likes and dislikes.

• We present four to five *members-only* lunch programs a year, covering "nuts and bolts" topics for business lawyers. Previous lunch programs included the new summary judgment statute, preparation of special verdicts and electronic discovery. We also have a "brown-bag" lunch program with judges, where members meet with a judge in his or her chambers for lunch and an informal discussion on issues of interest. Our upcoming December 8 program is entitled: "The Pinocchio Response: How to Spot a Liar."

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Benefits of ABTL Membership Cited

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• Every member receives this ABTL Report which, as is demonstrated by this Report, contains interesting articles written by prominent judges and practitioners on areas of interest.

• We have continued to increase the information available on our website. Not only is the ABTL report available to all members on line, but also we are taking steps to begin posting comprehensive questionnaire responses from federal and state court judges regarding business cases.

Perhaps the most renowned event sponsored by the ABTL is its members-only annual seminar, held in the fall every year. This event features presentations from some of the finest lawyers and judges in the county on topics of critical interest to business trial lawyers. This year, our Annual seminar was held in Hawaii and was entitled "Corporate America on Trial."

• We have a public interest subcommittee that has ongoing initiatives, including the award of scholarships to students from five local law schools.

• Membership applications can be found on our website, www.abtl.org. If you have any questions or would like further information please call or email Joanne Caruso, this year's membership chair at carusoj@howrey.com, 213-892-1800. And don't forget, join by December 31, 2004, and receive an early sign up discount.

— Joanne E. Caruso

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