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REPORT
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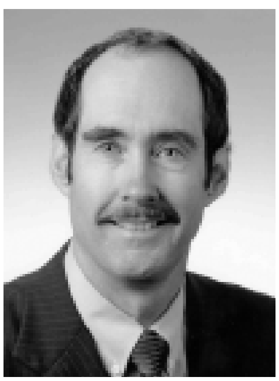
New Opinion Creates Conflict Over Jury Trial Waivers

By Charles A. Bird, Esq. of Luce, Forward, Hamilton & Scripps LLP

Will California courts uphold a jury waiver made in a contract executed before a dispute existed? According to a panel of the First Appellate District, they will not. (*Grafton Partners LP v. Superior Court* (February 6, 2004, No. A102790) 2004 Cal. App. LEXIS 153.) Its answer conflicts with a 1991 opinion of a Second Appellate District panel. (*Trizec Properties, Inc. v. Superior Court* (1991) 229 Cal.App.3d 1616.)


Charles A. Bird

What does the conflict immediately mean to practitioners? Uncertainty and a need to preserve issues. California principles of *stare decisis* do not treat the districts of the Court of Appeal as distinct precedential entities. (*Auto Equity Sales, Inc. v. Superior Court* (1962) 57 Cal.2d 450, 456.) Until the *Grafton-Trizec* conflict is resolved, trial courts throughout the state must consider both decisions and choose the better supported rule. (*Ibid.*) Therefore, a party to pending litigation who wants to resist enforcement of a predispute jury waiver should promptly make a record by demanding jury trial.

Will the California Supreme Court do something? Probably so. The real party in interest in *Grafton* is PricewaterhouseCoopers LLP ("PwC"), and counsel in the case state that PwC will petition for review. The *Grafton-Trizec* conflict is precisely defined and important to effective management of

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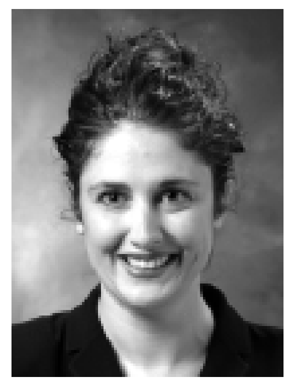
Conflicts of Interest in a Changing World

By Heather L. Rosing, Esq. of Klinedinst PC

Let's say you are representing Acme, Inc. in litigation filed against it. In a completely separate suit, you are representing another long-standing client against a company known as GadgetCo. The next thing you know, you learn that GadgetCo has acquired Acme, and Acme is now a subsidiary of GadgetCo. Is there a conflict?


Heather L. Rosing

Or let's say you represent a doctor in a medical malpractice suit. In a completely separate personal injury action in which you represent the defendant, the plaintiff designates your client as his expert. Is there actually a conflict? Can you depose your own client in his expert capacity and seek to discredit his opinions?

There are no easy answers to these questions, but the rules are slowly but surely evolving to keep up with the times, and it is important for you to

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Inside

President's Column

By Frederick W. Kosmo, Jr. of Wilson Petty Kosmo & Turner LLP

After being actively involved in ABTL for 12 years, I am very proud and honored to assume the role of President of the San Diego Chapter of ABTL for 2004. Over the years, I have witnessed ABTL grow and prosper in San Diego. I am pleased to report that ABTL remains strong and vital in 2004. As an example, our ABTL membership in San Diego in 2004 is currently up by approximately 15% and growing. I believe ABTL's success is largely a result of our long term and consistent commitment to our basic goals. ABTL has been and continues to be focused on improving the legal profession. ABTL continues to be committed to promoting civility, professionalism and ethics through a combination of excellent educational programs and a unique mix of outstanding attorneys and judicial members.

Frederick W. Kosmo, Jr.

In this regard, one of our newest programs that I encourage all members to attend is entitled "Meet the Judge." The program is a simple one-hour brown bag lunch program, where a local judge discusses in an informal setting what he or she believes is important in regard to the conduct in their courtroom.

Recently, I attended the lunch program before the Honorable Kevin A. Enright. Judge Enright discussed with the group how important it was, both to the Court and to juries, for attorneys to be honest and candid with them. While this message is important to all of us, I believe it is especially important for us to foster these simple truths in our younger lawyers. These messages become engrained in younger attorneys when they hear these views stated by respected members of the bar. Thus, I strongly encourage all ABTL members to attend and bring a young lawyer to one of our upcoming brown-bag lunch programs.

Our next "Meet the Judge" program is scheduled for April 20, 2004 featuring the Honorable Judith L. Haller of the California Court of Appeal. I hope to see you there. ■

The Rebirth of the Originality Requirement in Copyright Law

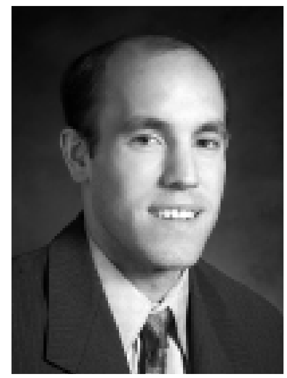
By Jeffrey Bellin, Esq. and Kenneth Fitzgerald, Esq. of Latham & Watkins LLP

Since the Constitution first empowered Congress to grant copyright protection over two hundred years ago, it has been clear that a work must be sufficiently "original" to merit protection. Traditionally, however, the concept of originality in copyright law has presented only a minimal hurdle to those seeking to enforce copyrights in even the most uninspired works. Courts, reluctant to judge the merits of the works brought before them, have extended copyright protection to virtually anything exhibiting the slightest hint of original thought. Litigants and courts alike were free to gracefully step over the hurdle of originality, pausing only briefly to say, "of course this work is original," before joining battle over whether a purportedly infringing item was "substantially similar" to a copyrighted work. This may be changing. Two recent decisions by the Ninth Circuit Court of Appeals suggest that the originality hurdle has been raised.

Originality, the Lowest Hurdle

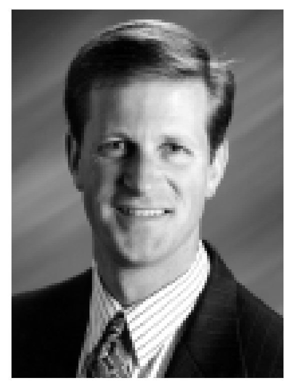
The U.S. Constitution empowers Congress to grant to "authors" the exclusive rights to their "writings." Art. 1 §8, cl. 8. The Supreme Court has interpreted these words to require two facets of originality that must exist before Congress can grant a copyright. First, the requirement of an "author" implies that a work must be an independent creation; it must "owe its origin" to its maker. *Burrow-Giles Lithographic v. Sarony*, 11 U.S. 53, 48 (1884). That is, it cannot simply be copied from another source, as it would then originate from a "copier," rather than an "author." Second, the courts have said, for something to qualify as a "writing" it must exhibit some creative spark; it must represent "the fruits of intellectual labor." *In re Trade-Mark Cases*, 100 U.S. 82, 94 (1879). It is this second requirement, that of originality through creativity, that has been recently rediscovered by the Ninth Circuit.

As the above discussion makes clear, the concept of originality is the product of an ambiguous constitutional text, and therefore, subject to interpretation. This allows the courts tremendous leeway in determining the scope of American copyright protection. Courts generally exercise this discretion by depriving the concept of originality of virtually any meaning. In doing so, they maximize the scope of existing copyright protection in the United States and make it increasingly difficult for new authors to generate (or copy) even the most simplistic works without infringing on an existing copyright.



Jeffrey Bellin

The deconstruction of "originality" can be traced back to the landmark case of *Bleistein v. Donaldson Lithographing Co.* In that case, Justice Oliver Wendell Holmes stated that the act of creation inevitably generates the requisite originality. Referring to circus posters at issue in the case, he artfully wrote:



Kenneth Fitzgerald

> Personality always contains something unique. It expresses its singularity even in handwriting, and a very modest grade of art has in it something irreducible, which is one man's alone. That something he may copyright . . . .

188 U.S. 239, 250 (1903). Demonstrating the way this early case law gathered momentum into an obliteration of the requirement of originality is the leading case of *Alfred Bell v. Catalda Fine Arts*, 191 F.2d 99 (2d Cir. 1951). There the Second Circuit Court of Appeals considered a challenge to the validity of a copyright on mezzotints (stylistic copies of famous artwork). The Court stated that "nothing in the Constitution commands that copyrighted matter be strikingly unique or novel." Rather, citing *Bleistein*, it stated: "Originality in this context 'means little more than a prohibition of actual copying.' No matter how poor artistically the 'author's' addition, it is enough if it be his own." *Id*. at 103-04.

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The Securities Class-and-Derivative Litigation Two-Step

By William S. Freeman, Esq. of Cooley Godward LLP

Your client, a publicly traded company, has just announced that it will miss its quarterly earnings forecast by a significant amount. You are attuned to the possibility of a class action complaint under Section 10(b) of the Securities Exchange Act of 1934, in which it will be alleged that the company defrauded investors by "concealing" the "truth" for many months, only to "shock the market" with the announcement. You have prepared the company for this possibility, and you are disappointed but hardly surprised when the complaint is filed. You reassure the company that under the Private Securities Litigation Reform Act of 1995 ("PSLRA"), the plaintiff will have to meet an exacting pleading standard and will not be able to conduct any discovery until and unless your motion to dismiss is denied. You have a pretty good idea of how the court will analyze that motion, since many of the key provisions of the PSLRA have now been interpreted.

The following week, however, a shareholder derivative complaint is filed in Superior Court, naming all of the company's directors and alleging that they breached their fiduciary duties by permitting the company to publish false information. The allegations concerning the underlying wrongdoing appear to have been lifted word-for-word from the federal complaint, but this new lawsuit is beyond the reach of the PSLRA's procedural safeguards, and it will unfold in a forum in which most judges have had less exposure to these cases. You quickly discover that there are no reported decisions in California that explicitly address this type of suit.

The securities litigation two-step – a federal class action followed closely by a remarkably similar state derivative complaint – is now commonplace. The shareholder derivative suit, a tool traditionally used to attack alleged insider corruption or questionable corporate transactions, is now routinely used as an alternative means to pursue claims of misleading corporate disclosure.

A compelling case can be made that the use of derivative suits to pursue corporate open-market disclosure claims is a fundamental perversion of the derivative device. While that argument should be made, defense counsel also must deal with immediate questions of strategy and tactics. Handling these cases effectively requires careful footwork, complex conflict-of-interest analysis, thoughtful advice, and long-range strategic planning. While attempting to shape the emerging law in state court, counsel must also focus on day-to-day decisions, anticipating multiple possible outcomes at every stage of the litigation, and staying several moves ahead of the game.

How Did We Get Here?

To understand the dynamics of the current situation, it is necessary to review the recent history of the securities class action wars.

A dozen years ago, it seemed that every time a public company announced disappointing news, it was immediately hit with a rash of class action fraud suits under Section 10(b) of the Exchange Act. In response to public outcry over perceived litigation abuses, in 1995 Congress enacted the PSLRA, which, among other things, set forth exacting pleading requirements and imposed an automatic discovery stay until a complaint had survived a motion to dismiss.

The PSLRA did in fact lead to an increased success rate for defendants in motions to dismiss. In response, plaintiffs' counsel sought to avoid the PSLRA altogether by filing class actions in state courts under state securities laws, where they hoped to take advantage of more lenient pleading requirements and immediate discovery. Congress thwarted that tactic in 1998 by enacting the Securities Litigation Uniform Standards Act ("SLUSA"), which provided that most shareholder class actions must be litigated in federal court under the federal securities laws. SLUSA, however, contained a loophole: it provided that shareholder derivative actions could continue to be litigated in state court. The significance of that loophole has been growing ever since.

Differences Between Class Actions and Derivative Cases

Securities class and derivative actions are radically different both in theory and in practice. In a

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Insurance Coverage in Patent Infringement and Antitrust Lawsuits

By Dennis M. Cusack, Esq. of Farella Braun & Martel LLP

Insurance companies have moved aggressively in the past decade to limit liability coverage for intellectual property claims. They have scored some victories in court, successfully challenging coverage under general liability policies for patent infringement. The California Supreme Court also handed carriers a win last year in *Hameid v. National Union Fire Ins.*, 31 Cal.4th 16 (2003), interpreting "advertising" to mean only widespread dissemination to the public at large.

Changes to standard form policies in 1997 and again in 2001 have also limited coverage to narrow intellectual property offenses. Not all carriers have adopted these forms, however, so insureds must continue to review their policies in each instance for possible coverages.

This article focuses on an additional source of coverage in patent infringement litigation: shotgun counterclaims, often including antitrust, Lanham Act and common law causes of action, brought in response to the insured's patent infringement lawsuit. The factual allegations of such counterclaims may trigger coverage under a general liability policy's personal injury and advertising injury coverages. Once the carrier begins defending the counterclaims, moreover, the carrier may find that it cannot distinguish between the work needed to defend the counterclaims and to prosecute the insured's claim. This may result not just in a defense for the counterclaims, but also in substantial funding for the insured's patent infringement suit.

"Sham" Litigation

General liabililty policies typically extend personal injury coverage to "malicious prosecution" claims. Counterclaims in patent litigation rarely state a cause of action for malicious prosecution as such, but often contain allegations that the insured's efforts to protect its patent rights, in that suit or in other suits, amount to "sham" litigation intended to monopolize the market. A subspecies of this claim, a so-called "*Walker Process*" claim, alleges that the insured has attempted to enforce a patent procured through fraud on the Patent Office. These allegations can appear in claims for monopolization under federal and state antitrust laws, interference with prospective economic advantage, and abuse of process. Under California law, such allegations trigger a duty to defend. *CNA Casualty v. Seaboard Surety Co.*, 176 Cal. App. 3d 598 (1986).

Is there coverage without a cause of action as such for malicious prosecution? The answer is yes. California law has long prevented an insurer from "hiding behind the pleadings." *See e.g., Gray v. Zurich Ins. Co*, 65 Cal. 2d 263, 276 (1966)*; CNA v. Seaboard, supra; Atlantic Mutual Ins. Co. v. J. Lamb, Inc.*, 100 Cal. App. 4th 1017, 1034 (2002).

Must the counterclaimant allege that the "sham" litigation was already resolved against the insured (strictly satisfying the elements of a claim for malicious prosecution)? *CNA v. Seaboard* rejected this argument, finding the potential existed because the insured's suit (the allegedly "sham litigation") could potentially be resolved against it. In addition, California law on malicious prosecution does not necessarily require a judgment against the insured to meet the "finality" element. A voluntary dismissal of a suit or of causes of action could satisfy the requirement if it evidences a resolution on the merits. *See e.g., Kennedy v Byrum*, 201 Cal. App. 2d 474, 480 (1962). In addition, the Ninth Circuit has held that allegations amounting to abuse of process (which does not require a final determination) trigger coverage under the malicious prosecution offense. *Lunsford v. American Guar & Liab.*, 18 F.3d 653, 654-56 (9th Cir. 1994).

Defamation and Disparagement

Counterclaims often include allegations that the insured made false statements in the trade press or in the course of soliciting customers that the counterclaimant has infringed on the insured's patents or has stolen trade secrets, or that its product does not work. The allegations may appear within antitrust or Lanham Act claims, or common law causes of action with

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civil cases. The California Supreme Court usually takes some action in such cases. (See Cal. Rules of Court, rule 28(b) [first ground for granting review is securing uniformity of decision].) It can resolve the conflict by depublishing *Grafton* (Cal. Rules of Court, rule 976(c)(2), 977(a)) or ordering review (*id*., rule 28.2).

Can you participate? Yes. After PwC petitions for review, any person may file an *amicus curiae* letter supporting or opposing review. (*Id*., rule 28(g).) Although the rule does not expressly say so, rule 28(g) letters often urge depublication, either as the correct remedy or as an alternative to review. PwC must petition by March 17, 2004. The California Supreme Court tends to act on petitions between 45 and 60 days after they are filed. If the court grants review, the case is likely to be argued between nine and 18 months after the order granting review.

Meanwhile, how should you bet? Probably with *Grafton*. At the base of the conflict lies article I, section 16 of the California Constitution, which provides that trial by jury may be waived in civil actions "by the consent of the parties, expressed as prescribed by statute." *Trizec* bypassed the "by statute" requirement and simply said the constitution "cannot be read to prohibit individuals from waiving, in advance of any pending action, the right to trial by jury in a civil case." (*Trizec v. Superior Court*, *supra*, 229 Cal.App.3d at p. 1618.) No party opposed the petition in *Trizec*, so its lack compelling logic or authority can be explained by lack of thought-provoking advocacy. *Grafton*, in contrast, follows the constitutional language to the only statute that prescribes how to waive jury is Code of Civil Procedure section 631. Subdivision (d)(2) of that statute provides for waiver by "written consent filed with the clerk or judge." Acknowledging the statute does not expressly provide when consent may be given, the court used constitutional history and interpretive authority to hold the statute must be interpreted to imply consent must be given after inception of the civil action to which it applies. A trial judge probably will find *Grafton's* analysis more persuasive, but that does not mean the California Supreme Court will adopt it.

What about arbitration, which necessarily involves jury trial waiver? *Grafton* is irrelevant because the California Arbitration Act and the Federal Arbitration Act validate mandatory arbitration agreements as a nonjudicial form of dispute resolution. *Grafton* itself makes this point and explains that arbitration agreements both have independent public policy support and are not analogous to waiving jury in a judicial proceeding. If you find a need to argue this point, *Grafton* cites all the leading cases. ■

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know what those rules are.

The starting point for any conflict analysis is Rule of Professional Conduct ("RPC") Rule 3-310. Basically, Rule 3-310 requires you, as the attorney, to make disclosures in certain circumstances, and actually obtain your client's consent to continue representation in other circumstances. These disclosures themselves are pretty easy to make. The more difficult task is evaluating when you need to go the extra step and obtain "informed written consent" from your the client, and then going through the process to get that consent.

Federal court litigators need to look one more place: the ABA Model Rules of Professional Conduct ("Model Rules"). Most federal district courts in California require attorneys to consider the Model Rules. The relevant rule is ABA Model Rule 1.7. It basically says that you can't represent someone if the representation involves a "concurrent conflict of interest." A concurrent conflict of interest exists if the representation of one client is directly adverse to another client, or if the representation is risky in the sense that it could materially limit your responsibilities to another client, a former client, a third person, or even your own personal interests.

Why are these conflict rules so complicated? It really comes down to the duty of loyalty and duty of confidentiality that we have as lawyers to our clients. If we have conflicts of interest, one or both of those duties may be violated.

"So," you're now asking, "what are the answers to the hypotheticals posed above? What do I do if my client is acquired by a company that I'm suing in another action? What do I do if my own client is an adverse expert?"

The good news is that these issues have been recognized and discussed by ethical authorities and lawmakers. For example, the ABA, in its comments to the conflict rules, noted the following: "Unforeseeable developments, such as changes in corporate or other organizational affiliations or the addition or realignment of parties in litigation, may

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create conflicts in the midst of a representation,…" The ABA tells us that, depending on the circumstances, a lawyer may have to withdraw from representation of one or both of the clients involved in the conflict situation.

However, the ABA also explicitly recognized that the lawyer who represents a corporation or organization does not, by virtue of that representation, necessarily represent any constituent, or affiliated organization, such as a parent or subsidiary. In other words, the mere fact that GadgetCo acquired Acme does not mean that the attorney is automatically disqualified from being adverse to GadgetCo.

Unfortunately, the case law in this area does not provide a neat, tidy answer. Some cases have held that it is a "*per se*" violation of conflict of interest rules to be adverse to a corporate affiliate of a current client in another matter. *Stratagem Development Corp. v. Heron International* (S.D.N.Y. 1991) 756 F. Supp. 789. Other cases have engaged in highly fact specific analysis. *Colorpix Systems v. Broan Manufacturing Co.* (D.Conn. 2001) 131 F. Supp. 2d 331.

"What about California cases?" you are wondering. Take a look at *Morrison Knudsen Corp. v. Hancock, Rothert & Bunshoft* (1999) 69 Cal.App.4th 223. There, a law firm was asked to represent a water district in a matter against an engineering company. The law firm had represented the engineering company's parent company prior to 1990 as monitoring counsel. The court found a substantial relationship between the prior work for the parent and the present litigation against the subsidiary. The question was whether that substantial relationship triggered a conflict even though it was the subsidiary, not the parent, who was the adverse party in present litigation?

The *Morrison* court basically looked at two different tests that had been tossed around for years – the "unity of interest" test and the "alter ego" test. The court ultimately found that the unity of interest test was the appropriate test to apply. The unity of interest test focuses on "the practical consequences of the attorney's relationship with the corporate family. If that relationship may give the attorney a significant practical advantage in a case against an affiliate, then the attorney can be disqualified from taking the case."

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Copyright

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Though this discussion was unnecessary considering the fact that the mezzotints in question were unquestionably original, the Court continued to expound. Substantial variations differentiating a copy, like a mezzotint, from an original, the Court said were unnecessary: "A copyist's bad eyesight or defective musculature, or a shock caused by a clap of thunder, may yield sufficiently distinguishable variations." *Id*. at 105. This exposition on originality by thunder clap set the tone for the rest of the 20th century.

The erosion of the concept of originality, like a geological record in an ocean cliff, can be traced in the courts' treatment of photographs, a quintessential "copy," that courts could have refused to protect on originality grounds. In its analysis of this genre, the courts instead echoed Justice Holmes' theory of inevitable artistry; "no photograph," the courts say "however simple, can be unaffected by the personal influence of the author." *Jewelers' Circular Pub. Co. v. Keystone Pub. Co*., 274 F. 932, 934 (S.D.N.Y. 1921). This unabashed elimination of any conscious originality in photography expanded to protect even non-artistic photographs, such as the Zapruder film of President Kennedy's assassination. *Time, Inc. v. Bernard Geis Assocs.*, 293 F. Supp. 130 (S.D.N.Y. 1968). The Zapruder film is clearly a valuable work. One would hope, however, that it is utterly devoid of creativity. That it could be deemed sufficiently "original" to merit copyright protection places an exclamation point on the courts' elimination of any required creativity for copyright. In sum, the history of the originality requirement in copyright law is a tale of near total extinction.

The Ninth Circuit Revives Originality

Two recent decisions by the Ninth Circuit stand out in broad contrast to the legal tradition discussed above. In each of these cases the Court refused to enforce copyrights because the works in question (a photograph of a vodka bottle and a glass-in-glass jellyfish sculpture) were not suffi-

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Copyright

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ciently creative to merit protection.

In *Satava v. Lowry*, 323 F.3d 805 (9th Cir. 2003), artist Richard Satava attempted to enforce his copyright in "glass-in-glass" jellyfish sculptures against a competing artist who made similar sculptures. The suit was initially successful, and the district court granted an injunction ordering the competing artist to refrain from producing the sculptures.

The Ninth Circuit reversed, stating that Mr. Satava's sculptures were not protected because they lacked originality. The Court utilized a rigorous method of analysis to reach this conclusion. It began by emphasizing that certain facets of works were not protectable. "[O]bjective 'facts' and ideas are not copyrightable," the Court said, and neither are "expressions that are standard, stock, or common to a particular subject matter or medium." 323 F.3d at 810. The Court then analyzed Satava's work rooting out these unprotectable elements, and determining that the sculptures consisted mainly of "the idea of producing a glass-in-glass jellyfish sculpture" and "elements of expression that naturally follow from th[at] idea." *Id*. The Court found that the sculptures, "though beautiful," simply "combine[d] several unprotectable ideas and standard elements." *Id*. at 811. These sculptures, therefore, lacked sufficient "originality" to merit copyright protection. As a result, Satava's competitor was free to continue copying these sculptures.

The second case, *Ets-Hokin v. Skyy Spirits Inc.*, 323 F.3d 763 (9th Cir. 2003) (Ets-Hokin II), is more complicated, but equally significant. The two published opinions of the Ninth Circuit deciding this case depict the tumultuous legal saga of photographer, Joshua Ets-Hokin. Mr. Ets-Hokin, photographed a Skyy Vodka bottle for use in an advertisement, and had wisely, he thought, retained the rights to those photos. Claiming that his work was unsatisfactory, Skyy Vodka hired other photographers to take similar pictures for their campaign. When Skyy Vodka's advertisements featuring photos of the vodka bottle appeared, Mr. Ets-Hokin sued to enforce his copyright. The district court ruled that Ets-Hokin's photographs of a vodka bottle were not sufficiently original to warrant copyright protection. *Id*. In its first take on the question, the Ninth Circuit reversed. Citing the traditionally minimal requirement of originality, the Court ruled that the product shots were "sufficiently creative, and thus sufficiently original, to merit copyright protection." *Ets-Hokin v. Skyy Spirits*, 225 F.3d 1068, 1077 (9th Cir. 2000) (*Ets-Hokin I*). It sent the case back to the district court.

On remand the district court again dismissed Ets-Hokin's claim on nominally different grounds. Mr. Ets-Hokin again appealed. This time, the Ninth Circuit affirmed. As in *Satava*, the Court took a close look at the works in question, and decided that they were not protected. The Court explained: "When similar features of a work are 'as a practical matter indispensable, or at least standard, in the treatment of a given idea, they are treated like ideas and are therefore not protected by copyright." *Ets-Hokin II* at 765. Viewing Ets-Hokin's photographs in this light, the Court found them lacking. The photographs that Ets-Hokin had taken were admittedly "similar" to those in the advertisements, but the Court noted "their similarity is inevitable, given the shared concept, or idea, of photographing the Skyy bottle." *Id*. at 766. "[S]ubtracting the unoriginal elements, Ets-Hokin is left with only a 'thin' copyright, which protects against only virtually identical copying." *Id*. Thus, because the photos were not identical, Ets-Hokin had no case. While hedging this question because it was constrained by the previous ruling that the photographs were "original," the Court essentially denied their copyrightability on this ground. The Court determined that given the idea of photographing a vodka bottle, Ets-Hokin had added nothing "original." Because he had added nothing, there was nothing, of his, that could be stolen (thus his "thin" copyright). That *Ets-Hokin II* was really talking about originality was not lost on the later Ninth Circuit panel deciding the *Satava* case, which cited the decision in determining that Mr. Satava's jellyfish were unoriginal.

Conclusion: A World With Originality

The Ninth Circuit panels in *Ets-Hokin II* and *Satava*, despite their ultimate conclusions, emphasized that the originality hurdle remains low. They recognized, however, in a way that courts have previously been reluctant to, that some works, though sophisticated, or "beautiful," are simply not "original" (legally speaking).

The dilemma is clear. Given the myriad facets of any work, be it a jellyfish sculpture, a product photo, or a phone book, it is difficult to say that there is nothing "original" about it. The more complex a work, the more difficult it is to comprehend

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Two-Step

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class action, the plaintiffs are shareholders seeking recovery of personal investment losses allegedly caused by misleading disclosure. A judgment or settlement results in a payment that is divided among the shareholders.

The derivative suit is also commenced by a shareholder, but the similarity with the class action ends there. The defendants may include the same officers and directors, but the underlying plaintiff is the corporation itself; the suit is "derivative" because "the rights of the plaintiff shareholders derive from the primary corporate right to redress the wrongs against it." *Desaigoudar v. Meyercord*, 108 Cal.App.4th 173, 183 (2003). (Whether the company has in fact been damaged by the alleged wrongs is highly debatable; plaintiffs resort to arguing that the company will have to spend money to defend the already-filed class action, and that its future ability to raise capital may be impaired.) In theory, at least, any monetary recovery goes not to shareholders, but to the corporate treasury.

Derivative suits have long been brought to contest proposed corporate transactions, generally on the theory that a deal was improperly conceived or structured for the benefit of corporate insiders, or that the directors breached their fiduciary duties by failing to maximize the price paid to shareholders. The use of the derivative suit to re-package class action claims that are already pending in federal court is both innovative and controversial. While it can be expected that California courts will eventually develop a uniform body of law concerning these cases, for now the frontier is largely unregulated, and defense counsel must adapt accordingly.

The Demand Requirement and Plaintiffs' Attempts to Avoid It

The derivative suit is an exception to the rule that the corporation, acting through its board, has the sole right and power to sue for redress of injuries to the corporation. *Burks v. Lasker*, 449 U.S. 471, 487 (1979) (concurring opinion of Stewart, J.). It is, in essence, an attempt to wrest from the board a key mechanism of corporate governance. Both Delaware and California have statutory safeguards to prevent this seizure of power from being routinely or easily accomplished. To establish standing to bring a derivative action, a plaintiff must either make demand on the board that it institute the action itself, or allege "with particularity" her reasons for not doing so. Del. Chancery Ct. R. 23.1; Cal. Corp. Code section 800(b)(2). The presuit demand requirement is rooted in legislative policy discouraging judicial interference with corporate decision-making. *Shields v. Singleton*, 15

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the degree of creativity involved. It is certainly easier to conclude that all works are inevitably original and skip the process altogether. Nevertheless, the Ninth Circuit is increasingly recognizing that any work, no matter how sophisticated, will be composed of borrowed ideas, new ideas, stock expressions and expression intrinsic to the ideas expressed. These facets are not protected by copyright and therefore need not be considered in determining originality. The Ninth Circuit's more rigorous appraisal of legal "originality," then, requires that courts, as they did in *Satava* and *Ets-Hokin*, dissect the aspects of the work at issue, separating protected from non-protected elements. What is left when you have done this, must be "original."

A court employing this rigorous dissection of a work's originality will likely find many otherwise sophisticated works unoriginal. The full implications of this can only be determined as the case law evolves. It is clear, however, that those who hold copyrights in relatively non-creative works will find it increasingly difficult to enforce them against competitors. For example, a recording of ocean waves however it may be packaged, may find itself as unprotected as jellyfish sculptures. Similarly, a dress pattern embroidered with pine cone patterns may be separated into elements, and determined unoriginal. The potential issues for product designers are limited only by their creativity (or lack thereof).

On the other hand, the renewed emphasis on originality frees those at the other end of the copyright chain, potential infringers, to push closer to copying simpler works, as well as works that exhibit sophistication only by employing combinations of stock images and utilitarian ideas. These recent Ninth Circuit cases have the potential to reshape copyright law and, as a result, the rights of those who hold copyrights. District Courts are now free to take a much closer look at works and decide more often than has ever been the case that due to an absence of originality, no copyright protection exists. ■

Two-Step

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Cal.App.4th 1611, 1619 (1993), quoting 1A Ballantine & Sterling, Cal. Corporations Law section 292.03, p. 14-19 (4th ed. 1992).

If the plaintiff makes pre-suit demand on the board and the board determines not to pursue the claim, that determination is accorded considerable deference by the court under the business judgment rule, and constitutes a defense to the suit. *Desaigoudar*, supra, 108 Cal.App.4th at 183-85; *Grimes v. DSC Communications Corp.*, 724 A.2d 561, 565 (Del. Ch. 1998). Perhaps for this reason, plaintiffs routinely attempt to avoid the pre-suit demand requirement.

Instead, plaintiffs allege that demand is "excused" because it would be "futile." The claim of "demand futility" is based on boilerplate allegations that could be made with equal force against any company's board: that since the plaintiff has named all directors as defendants, they cannot be expected impartially to consider suing themselves; that directors "dominate" or "control" each other; and/or that a derivative claim will not seriously be considered because it might not be covered under the company's directors and officers insurance policy.

In both California and Delaware, the demand futility pleading requirements are stringent. Conclusory allegations will not suffice; the plaintiff must allege specific facts as to each individual director that demonstrate the absence of a disinterested majority of directors who could consider a demand. *Rales v. Blasband*, 634 A.2d 927, 934 (Del. 1993); *Oakland Raiders v. Nat'l Football League*, 93 Cal.App.4th 572, 587 (2001); Shields, supra, 15 Cal.App.4th at 1621-23. As a result, one would think that superior courts would uniformly dismiss complaints that employ boilerplate language and make generalized accusations that directors lack impartiality. The reality is that enforcement of these pleading strictures has, thus far, been inconsistent in the trial courts, and the California appellate courts have yet to issue definitive pronouncements about the use of derivative suits to advance claims of corporate non-disclosure. As a result, defense counsel must plan for a number of eventualities.

Managing Discovery in the Derivative Case

To defense attorneys accustomed to the PSLRA's discovery stay, an early set of interrogatories or document requests in a derivative case may come as an unpleasant surprise. But defense counsel is not without weapons.

The first is a possible stay of discovery. On occasion, derivative plaintiff's counsel may determine, for strategic reasons of his own, that a stay would be useful, either to permit the two actions to proceed in tandem if the federal motion to dismiss is denied, or just to avoid the burden of "going it alone" at the early stages. If counsel is not interested in a voluntary stay, there is a basis to seek a stay in federal court. The PSLRA provides that "upon a proper showing," the federal court in which the class action is pending may order a stay of discovery in the derivative suit "as necessary in aid of its jurisdiction …." 15 U.S.C. section 78u-4(b)(3)(D). If it appears that the discovery is being sought in the derivative case for the purpose of evading the federal discovery stay, defense counsel should seriously consider moving for such a stay. (At the very least, counsel should be able to persuade the derivative plaintiff's attorneys to agree not to share discovery with the class plaintiff's counsel.) Another possible basis for a stay is that until the demand futility demurrer is overruled, the plaintiff has not established that she has standing to sue, and therefore should not be permitted to take discovery.

Even if a complete stay is not obtained, you can still negotiate, or apply for an order, for staged discovery in the state court limited initially to demand futility-related issues. Counsel will often agree to restrict early discovery to information that bears directly on the reasons why board members could not evaluate a demand impartially, such as their economic relationships with the company or their financial and personal relationships with each other.

If the case survives demurrer, every effort should be made to manage the discovery process to minimize the burden on the company. Whether this leads counsel to seek a voluntary or involuntary stay of "merits" discovery will depend on, among other factors, the similarity of the allegations in the two cases, the pendency of an internal investigation by the company, and the relative stages of the two cases. All other things being equal, it is hard to imagine that conducting discovery twice would be in anyone's interest.

Motion to Stay Pending Internal Investigation

Because the derivative case implicates corporate governance issues, the defense has available to it a tactic unknown to the securities class action: a

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motion to dismiss based on a board determination that the continued maintenance of the action is not in the best interest of the company.

If the complaint survives demurrer, the company can appoint a disinterested committee to investigate the complaint's allegations and consider whether continued litigation is in the corporation's best interest. If a determination is made that it is not, the company can move to dismiss the complaint. This motion takes on some characteristics of a summary judgment motion, with the court focusing on the investigative process underlying the committee's determination. *Desaigoudar*, supra, 108 Cal.App.4th at 184-90. The most defensible decisions are made only after a thorough investigation by a disinterested committee.

The determination of whether and how the company should undertake such an investigation is complex and highly individualized. It is easiest to make this decision if the board has been properly advised from the outset as to its strategic options in the event the demand futility demurrer is overruled.

Potential Conflicts of Interest

Multi-party representations typically raise potential conflicts of interest, since it is conceivable that the clients' interests, even if unified at the outset, could diverge down the road. Parallel derivative and class action litigation multiplies the number of conflicts that must be considered under California Rule of Professional Conduct 3-310(C). As with all questions of conflicts of interest, any waiver must be given in writing, upon disclosure of the relevant facts and a discussion of "the actual and reasonably foreseeable adverse consequences to the client" of the potential or actual conflict. Id., Rule 3-310(A).

The analysis of conflicts in any particular situation is beyond the scope of this article. The analysis will be highly fact-specific, and the resolution will depend in part, as it should, on client preferences. It is essential, however, that the possible procedural twists and turns of a derivative case be thought through in advance, so that defense counsel can educate their clients concerning the issues they will have to consider at each stage of the proceedings.

When a company and individual officers or directors are faced solely with a class action, it is not uncommon for defense counsel to represent all defendants jointly throughout the case. In the class-derivative two-step scenario, however, matters get far more complicated. To begin with, counsel is confronted by the fact that the corporation, while procedurally aligned with the individuals as a defendant in the class action, is technically aligned (albeit against its will) against them as a putative plaintiff in the derivative suit.

Initially, the company and the individuals share a common interest in having the suit dismissed, although for different reasons. The individuals seek to defeat any claim of personal liability; the company has a powerful interest in thwarting the attempted hijacking of its power to initiate litigation.

The situation gets more complex in the event the "demand futility" demurrer is overruled. The company now has three strategic options. First, it can take a back seat, allowing the plaintiff to proceed with the litigation on its behalf while seeking to protect its personnel from procedural abuse. Second, it can decide to seek a stay of the litigation to conduct its own investigation through a special litigation committee of the board. If that investigation concludes that the suit is meritless, the company can then move for dismissal. Third, it can enter into settlement discussions, also under the supervision of a special committee. Each of these alternatives raises representation issues requiring full consideration.

Case law regarding conflicts of interest in derivative cases is neither well developed nor clear. What is clear, however, is that defense counsel must think carefully at the outset about the possible paths a derivative case can take, and how the interests of the clients can best be served.

Conclusion

The recent emergence of the derivative action as a tool to pursue corporate disclosure claims is an unintended consequence of the effectiveness of the PSLRA, and it may well be a misuse of the derivative device. In contrast to the PSLRA, the law applicable to state law derivative actions is still developing and clear guideposts have yet to emerge. At least until the courts or the Legislature resolve the doctrinal and policy issues raised by these cases, defendants and their counsel must learn to master the class-and-derivative litigation two-step. ■

Coverage

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labels such as defamation, disparagement, trade libel or injurious falsehood. Such allegations also may trigger a duty to defend.

Policy language is important here. Some policies expressly cover both defamation and disparagement claims. Other carriers have attempted to draft policies in such a way as to cover "libel, slander or defamation," but not "disparagement" or "trade libel." Carriers often use this language to argue that in this commercial context, the counterclaims sound in "disparagement," not "defamation," and deny coverage.

The distinctions between "defamation" and "disparagement," or between "libel" and "trade libel," may not be obvious to a lawyer, much less the layperson who provides the standard for interpreting policy language. California courts are now split as to whether a policy providing coverage for "libel, slander or defamation" also extends to disparagement claims. *See CNA v. Seaboard*, 176 Cal. App. 3d at 61112 and n. 7 and *Truck Ins. Exchange v. Bennett*, 53 Cal.App. 4th 75, 83 (1997).

Here again, however, the specific factual allegations may be critical. As a general matter, false statements criticizing a business or its goods are defamatory if they explicitly or implicitly call into question the company's honesty, integrity or competence. *Polygram Records, Inc. v. Superior Court*, 170 Cal. App. 3d 543, 550 (1985). For example, several courts have held that accusations of patent infringement are defamatory. *See e.g., Amerisure Ins. Co. v. Laserage Technology Corp.*, 2 F. Supp. 2d 296, 304 (W.D.N.Y. 1998); *OMI Holdings, Inc. v. Federal Ins. Co. of Canada*, 1997 WL 30861 (D. Kan. 1997). *See also Atlantic Mutual Ins. Co. v. J. Lamb, Inc.*, 100 Cal. App. 4th 1017, 1035 n.13 (2002) (acknowledging that accusations of patent infringement might constitute both "disparagement" and "defamation"). An accusation of "willful" patent infringement should certainly be deemed defamatory. Counterclaims alleging false accusations of theft of trade secrets would also call into question a company's honesty and integrity and may also amount to a covered defamation. Actionable comments criticizing the quality of a company's products, on the other hand, are probably not by themselves defamatory.

Defense Cost Issues

Faced with such allegations in the counterclaims, carriers generally agree to defend under a reservation of rights. This only sets the stage, however, for a ferocious battle over defense costs. Because patent and antitrust litigation of this kind often "bets the company" and sweeps through a wide range of corporate conduct over long periods of time, defense costs will be high. Most carriers will therefore employ a combination of tactics to limit their defense costs. These include: limitations to "panel counsel" rates under Civil Code section 2860; allocation of attorneys' fees and costs between defense of the counterclaims and prosecution of the insured's patent infringement claims; and imposition of "billing guidelines." All of these carrier objections to paying for defense costs are subject to challenge, and should be contested as early and often as possible.

Where the insured is being defended by independent counsel, section 2860 allows a carrier to pay only the rates "actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions in the community where the claim arose or is being defended." The language fits easily with ordinary personal injury or construction defect litigation. But because carriers do not ordinarily defend patent infringement or antitrust lawsuits by themselves, and virtually never do so without a reservation of rights entitling the insured to independent counsel, they may not be able to show that they retain attorneys for these kinds of suits "in the ordinary course of business." The insured, therefore, should insist that the carrier pay the actual rates being charged by defense counsel unless the carrier can prove, through evidence of specific cases, that it has actually paid "panel counsel" for this kind of litigation.

Buss v. Superior Court, 16 Cal.4th 35 (1997), requires a carrier to defend both covered and uncovered claims subject to a right, at the end of the case, to seek reimbursement as to defense costs related solely to the defense of uncovered claims. If the carrier must defend some of the counterclaims, it must defend all of them. Carriers, nonetheless, will usually claim a right to allocate as to the prosecution of the insured's patent claims, because *Buss* on its face does not address this issue. They may then ask the insured to have counsel create separate invoices, or hire an auditor to make an

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allocation, or simply deduct a flat percentage they feel ought to be attributable to work on the insured's "affirmative" claims.

Suppose, though, that the insured has filed a suit for patent infringement, and the counterclaims allege that this and other infringement lawsuits are "sham" litigation. The main defense to the sham litigation claim is for the insured to prove its claim for patent infringement, i.e., that the statements were true. Thus, there is no practical distinction between the work on the insured's infringement claim, and the defense of the counterclaims. (One exception would be work on the insured's damages claim, although even here expert analysis of the particular market in which the parties compete could overlap.) It will be impracticable to segregate the work in invoices, and a carrier's effort to do so after the fact will almost always result in arbitrary reductions in the amounts it reimburses.

The rationale, if not the letter, of *Buss* certainly applies here. Efforts to try to allocate while the case is pending will be difficult at best and risk undermining the insured's defense. From a more practical point of view, too, allocation as to the insured's affirmative claims will often be mooted by an ordinary *Buss* analysis. This is because the counterclaims against the insured will typically include a cause of action for declaratory relief challenging the insured's patents. Under *Buss*, the carrier must defend this claim, along with the covered malicious prosecution and defamation allegations, until the case is concluded.

The insured should challenge the carrier's allocation efforts early and aggressively. Otherwise, the accumulation of allocated and unreimbursed fees and costs will give the carrier excessive and unfair leverage when it comes time to discuss settlement of the litigation and resolution of the coverage disputes.

Finally, billing guidelines can peck an insured to death. These may seek to: limit staffing; avoid payment for certain tasks such as meetings among attorneys; require task billing; and deem certain work by paralegals and other non-attorney staff unreimbursable "overhead." These are often presented as mandatory by the carrier; however, they are not part of the policy and so not within the contractual obligations of the insured to the insurer. The issue is: what is reasonable? Insureds should review such guidelines carefully at the outset, and then negotiate a three-way arrangement with the carrier and defense counsel, so that defense counsel's practices match what the carrier has agreed to pay.

Conclusion

Counterclaims in patent infringement suits, even though often framed in antitrust causes of action, can contain potentially covered allegations triggering a duty to defend. It behooves the insured, who filed the patent infringement suit initially, to study the allegations carefully and seek advice about tendering the defense. In many cases, the carrier's defense obligations may result in the insured obtaining not only a defense to the counterclaims, but also funding for prosecution of the patent infringement suit. On the other side of the coin, a defendant in a patent infringement suit may want to consider carefully the facts it intends to allege in counterclaims, and make an informed choice about whether it wants to trigger coverage for its opponent. ■

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Changing World
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What the heck does all this mean? How do you know if there is a conflict? The *Morrison* court said that you really need to consider every case on an individual basis.

There is also some guidance from the California State Bar. Formal Opinion 1989-113 asks whether it is ethically permissible for an attorney to undertake representation adverse to a wholly owned sub-

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Changing World

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sidiary of an existing corporate client. In that opinion, the State Bar found that such representation was acceptable provided that the parent company is not an alter ego of the subsidiary, and that the subsidiary has imparted no confidential information to the attorney that could be used against the subsidiary. The opinion did warn that prudent counsel may want to disclose to the parent company client that it is intending to take a position adverse to one of its subsidiaries. But the State Bar also pointed out that certain disclosures may not be permissible without the consent of the third party client!

The second hypothetical dilemma was the recent topic of discussion in the case of *Hernandez v. Paicius* (2003) 109 Cal.App.4th 452. In that case, the court chastised the attorney who had aggressively cross-examined a client of her firm in his capacity as an expert witness for the other side. The *Hernandez* case essentially expanded the duty of loyalty beyond prohibiting just suing clients or giving legal advice against a current client. It essentially said it was unacceptable to seek to undermine a current client in his or her capacity as an expert witness in a separate case. The court commented, "The spectacle of an attorney skewering her own client on the witness stand in the interest of defending another client demeans the integrity of the legal profession and undermines confidence in the attorney-client relationship."

So what does this mean? The court in that particular case suggested that the law firm should be running expert witnesses through its conflict system, and should have sought the court's assistance in fashioning some type of remedy to prevent or work around the conflict.

It's definitely a brave new world. These are only a few examples of the conflict issues that we are seeing in today's increasingly complex legal profession. Whenever confronted by a difficult conflict situation, read RPC Rule 3-310, and find out if there is any case law addressing your specific situation. While there may be no clear answers, there is enough guidance to help you protect yourself. ■

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