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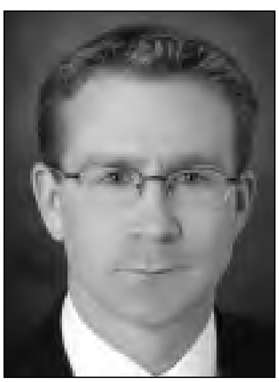
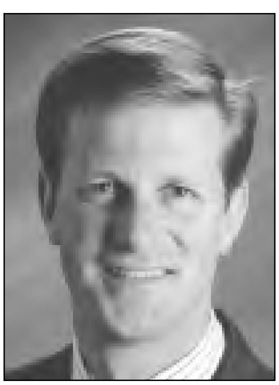
Stevenson v. CB Richard Ellis: The California Court of Appeal Expands the Tort of Interference with Prospective Economic Advantage

By Robert G. Knaier, Esq. and Kenneth M. Fitzgerald, Esq. of Latham & Watkins LLP


Robert G. Knaier


Kenneth M. Fitzgerald

Businesses and their counsel would be well-advised to pay close attention to a recent decision from the California Court of Appeal. In *Stevenson Real Estate Services, Inc. v. CB Richard Ellis Real Estate Services, Inc.*, 138 Cal. App. 4th 1215 (2006), the court held that a plaintiff can state a claim for interference with prospective economic advantage by alleging that a business competitor violated written standards of a trade association. In doing so, the *Stevenson* court arguably exceeded the bounds of the rule set forth in *Korea Supply Co. v. Lockheed Martin Corp.*, 29 Cal. 4th 1134 (2003), in which the Court held that to prevail on a claim of interference with prospective

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A Lunchtime Conversation with Magistrate Judge William McCurine, Jr.

By Alan M. Mansfield, Editor, ABTL Report

As part of the brown bag lunch series sponsored by the San Diego ABTL, on June 15, 2006, U.S. Magistrate Judge William McCurine, Jr. of the Southern District of California took time out of his busy schedule to share with ABTL members numerous valuable insights about how to make the most effective use of the federal magistrate judge process.


William McCurine, Jr.

Magistrate Judge McCurine has been a member of the federal bench since 2000, having spent over 20 years as a civil litigator before joining the bench. He maintains an average civil case

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Inside

President's Column

By Maureen F. Hallahan

I hope most of you will take some time this summer to be with your families and friends, enjoy the longer days and the warm summer nights, and remember what summer vacation used to mean when we were children. Thanks to the authors of the articles in this issue, you also have some interesting, educational and thought provoking reading material for the summer. Then, you will be ready for an exciting fall with ABTL.

Maureen F. Hallahan

As you prepare your fall schedules, be sure to save the date for the ABTL dinner program on September 18, 2006, featuring John Hueston, the lead prosecutor in the trial of Enron's former executives. As you know, Enron, the giant global energy trading business, collapsed in late 2001 after investigators started probing the company's accounting maneuvers. The collapse resulted in the bankruptcy of Enron, leaving 20,000 employees out of work. Enron's workers and retirees lost billions in retirement savings that had been invested in company stock. Following a nationwide search, Mr. Hueston, from the U.S. Attorney's office in Orange County, California, was selected as the lead prosecutor in the fraud and conspiracy trial of Enron's former executives Kenneth Lay and Jeffrey Skilling. The goal of his nationwide team was to win convictions of Mr. Lay and Mr. Skilling. Mr. Hueston received widespread acclaim for his skillful and relentless cross examination of Mr. Lay. Those who observed Mr. Hueston in action marveled at his "cool under pressure" presence in the courtroom in response to often contentious and combative testimony. Mr. Hueston is considered a top talent by his prosecutorial peers. After winning convictions in the Enron Case, Mr. Hueston will soon be back in California. ABTL is very fortunate to have Mr. Hueston, a truly outstanding trial lawyer, as the speaker for our dinner program on September 18, 2006. We will be back at the Wyndham Hotel for this exceptional program.

On September 9, 2006, ABTL will present an all-day seminar entitled, "Masters of the Art, Building to the Close," at the Wyndham Hotel. In this seminar, prominent San Diego lawyers and judges will present a case from opening statements to closing arguments. A jury of San Diego community members will be impaneled to hear and decide the case. Adding to the enjoyment of this seminar, MSI will provide realtime jury reaction to the lawyers and the witnesses throughout the day, providing an opportunity to compare what you think is effective and who you think is credible with reactions of the lay jury. This seminar will offer something to attorneys at every level of practice, and will be particularly good for younger lawyers who have not yet had significant trial experience. The San Diego judges presenting at the seminar are Judge Sammartino, Judge Sabraw, Judge Einhorn, Judge Prager, Judge McCurine and Justice Irion. The lawyer presenters are Craig McClellan, Robert Steiner, Ed Gergosian, Reg Vitek, Virginia Nelson, Scott Metzger, Regina Petty, Mark Hamer and David Noonan. I also have been given the opportunity to be a presenter at the seminar. In addition, Judges Haden and Zvetina will discuss the role of mediation in this process. Many thanks to Judge Haden for initiating this all-day seminar years ago and for leading it ever since. Sign up now and encourage those you know to sign up.

To complete the fall schedule, don't forget the ABTL Annual Seminar, being held at the Grand Wailea Resort in Maui, Hawaii. This program will feature some of ABTL's most talented litigators exploring "what to do when things go wrong." The panelists will confront the unforeseen, the unpredictable and the unpleasant calamities of trial including jury misconduct, witness deceit, technology malfunctions, conflicts and everything in between. You will learn what to do to avoid, avert and roll with the

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How to Negotiate Allocation of Responsibility Issues Under D&O Policies

By Gary Osborne, Esq. and Dominic S. Nesbitt, Esq., Osborne & Nesbitt LLP

Gary Osborne

It is the classic "good news/bad news" scenario. The "good news" is that the D&O insurer for the corporate directors you are defending has acknowledged that coverage is in place. The "bad news" is that the insurer is refusing to pay more than a small "allocated" share of the directors' defense and settlement costs.

"Allocation" in the insurance world refers to the percentage of defense and settlement costs an insurer pays when a lawsuit filed against its insured involves a mix of covered and uncovered claims or parties. Insurers will frequently try to negotiate an allocation agreement at the front end of a claim.

Dominic S. Nesbitt

"Caution" should be the insured's watchword. Any agreement reached with the insurer on allocation can have a substantial impact on how much the insurer ultimately pays to resolve that claim, and how much is deemed uninsured (and thus is the responsibility of the client). A typical strategy for the insurer is

(See "Responsibility Allocation" on page 11)

Client Confidentiality and the Threat of Illegal Conduct: An Impossible Combination?

By Wendy Patrick Mazzarella, Esq., Deputy District Attorney, San Diego County

Attorneys have an obligation to explain the law to their clients. This explanation may include impressions or conclusions with which the client strongly disagrees. Consequently, lawyers often witness client threats and outbursts, even rage. The rules permitting disclosure of client confidential information require the lawyer make a judgment call whether a client's statements or comments are made out of anger, or if they pose a real threat that either fraudulent or criminal conduct may take place. Unless the lawyer has a significant or longstanding relationship with the client, this judgment call may be difficult.

Wendy Patrick Mazzarella

The attorney-client privilege is the oldest privilege protecting confidential communications under common law. *Upjohn Co. v. United States* (1981) 449 U.S. 383, 389 [citing J. Wigmore, Evidence § 2290 (McNaughton rev. 1961)]. "Its purpose is to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice. The privilege recognizes that sound legal advice or advocacy serves public ends and that such advice or advocacy depends upon the lawyer's being fully informed by the client." *Id.*

Client confidentiality is a hallmark of this relationship. However, there are exceptions to the general rule that information imparted within the context of such a relationship must always be kept confidential. Various legal and ethical rules explain the circumstances under which attorneys may reveal confidential information imparted to them by their clients when they threaten to engage in illegal conduct.

I.

CALIFORNIA RULES EXCEPTIONS TO CLIENT CONFIDENTIALITY

A. California Business and Professions Code 6068(e)(1)

The conduct of California lawyers is governed in part by California Business and Professions Code Section 6068, which enumerates the duties of an attorney. Bus. & Prof. Code Section 6068(e)(1) states that one of these duties is "[t]o maintain inviolate the confidence, and at every peril to himself or herself to preserve the secrets, of his or her client." Bus. & Prof. Code Section 6068(e)(2), however, states that "[n]otwithstanding paragraph (1), an attorney may, but is not required to, reveal confidential information relating to the representation of a client to the extent that the attorney reasonably believes the disclosure is necessary to prevent a criminal act that the attorney reasonably believes is likely to result in death of, or substantial bodily harm to, an individual."

B. California Rule of Professional Conduct 3-100

The above exception is further developed in California Rule of Professional Conduct 3-100, Confidential Information of a Client, which states that:

> (A) A member shall not reveal information protected from disclosure by Business and Professions Code section 6068, subdivision (e)(1) without the informed consent of the client, or as provided in paragraph (B) of this rule;
>
> (B) A member may, but is not required to, reveal confidential information relating to the representation of a client to the extent that the member reasonably believes the disclosure is necessary to prevent a criminal act

(See "Impossible Combination" on page 13)

Using Technology to Effectively Tell Your Story During Mediation

By Steven H. Kruis, Esq. and Monty A. McIntyre, Esq.

During a recent business litigation mediation, Mr. Kruis was the mediator and Mr. McIntyre represented one of the parties. During the initial joint session, Mr. McIntyre effectively used demonstrative evidence to present his side of the case, and the parties were able to settle during the mediation.

Steven H. Kruis

After the mediation, the authors discussed the effectiveness of Mr. McIntyre's demonstrative evidence presentation and its use in mediation generally, and how often such an evidentiary presentation is made during the course of a mediation. In our collective experience as advocates and mediators, demonstrative evidence is presented far too seldom in mediation. This article discusses the benefits of effectively presenting demonstrative evidence during a mediation session.

Monty A. McIntyre

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load of approximately 300 cases. Even though these comprise probably 30 percent of his caseload, he devotes close to 70 percent of his workload on civil matters.

As the assigned magistrate judge, Magistrate Judge McCurine is responsible for handling Early Neutral Evaluation, Case Management and Mandatory Settlement Conferences, setting pre-trial schedules and hearing and resolving discovery matters. If all parties stipulate (which takes place about 10% of the time), he also presides over all pre-trial and trial proceedings, although he stressed parties cannot stipulate for him to only address certain pre-trial matters or motions.

He urged counsel to consider stipulating to the use of magistrate judges for all purposes, since (1) they may be able to select him or another available magistrate judge, and (2) parties may be able to get their case to trial by a date certain, without a time clock and in a much faster period than if trial was before the assigned federal district court judge, due to the Court's significant criminal case load. In fact, the Southern District of California is now the second busiest court in the United States, making the magistrate judge assignment for all purposes an alternative counsel should seriously discuss with their clients early on in the litigation.

Early Neutral Evaluation Conferences are an integral part of our local federal court system, as at least 30 percent of all cases settle at the first ENE. Magistrate Judge McCurine holds this conference 40 to 60 days after the first appearance by a defendant. Most of these conferences are set for a morning or afternoon, but if the parties agree he will set aside an entire day to for an ENE Conference. He requires counsel to appear in person, and requires the participation of a representative who has authority to settle the case – in his words, the person who would make a recommendation to a Board of Directors whether to accept a settlement. If the case is particularly complex or unlikely to settle at the first conference and the representatives are from out of town he may let them participate by phone. However, he believes the most effective ENE Conferences take place when all participants are present in person and he can directly discuss with them both monetary and non-monetary settlement options and, if requested by a party, provide his own valuation of the case. In addition, the ENE allows him to assess if counsel understand the factual and legal issues raised by the case, since if they do not he may direct them to address a particular legal or factual issue.

These conferences also allow the magistrate judge to analyze the case and determine if there should be follow-up conferences or if there are threshold issues or discovery that should be the initial focus of the parties, since focusing on a particular issue may help advance the resolution of the case. Thus, if counsel for a party believes there is certain discovery or a motion that is critical, Magistrate Judge McCurine may order the parties to exchange that information or brief that motion immediately and defer other discovery or motions.

He could not stress enough the need for counsel to prepare a detailed ENE Conference Statement that provides a candid case assessment (since he carefully reviews these statements), to understand their case early on, bring the key documents and be fully prepared to discus both the strengths and weaknesses of the case during that conference. These briefs (as well as briefs for the Mandatory Settlement Conference) should not simply be a restatement of a summary judgment motion, but rather should discuss the key issues, obstacles to settlement and what the party is willing to do to settle the case.

If a party presents exhibits for review, they should each be separately tabbed at the bottom of the document (not just page inserts) so Magistrate Judge McCurine can readily locate the reference. If the document is multiple pages, counsel also need to provide a specific page number reference, since he will not presume that what he may be able to locate is what counsel want him to reference.

If the case does not settle during the ENE conference, Magistrate Judge McCurine sets a Case Management Conference and requires the parties to submit in advance a Joint Case Management Conference Statement and a Joint Discovery Plan. This Statement should include

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an estimate of the number of depositions or other discovery that may be necessary so that he can assess the discovery needs for the case. This does not mean the parties need to reach agreement on all discovery and pre-trial dates; rather he wants one document that includes what the parties do and do not agree upon so he can assess the respective positions of the parties. Based on those statements and that conference, he will set a pre-trial schedule and a mandatory settlement conference.

One of Magistrate Judge McCurine primary case management responsibilities is addressing discovery disputes. With the exception of every 9 weeks when he is the assigned magistrate judge on criminal matters (and thus is "on call" 24/7 for that week), or on Tuesday and Thursday mornings or afternoons when he is handling his criminal docket, he is available to address parties' pretrial and discovery concerns. However, before doing so he requires counsel first make a substantive attempt to resolve their disputes by telephone – not merely exchange letters. If they cannot reach agreement, counsel are to contact one of his two clerks (even numbers are one clerk and odd numbers are the other) and provide a neutral statement of the dispute (*e.g.* the parties have a dispute about the timing of a deposition). The court will then set up a telephone conference with Magistrate Judge McCurine to try and resolve the dispute. Over 60 percent of these disputes are resolved during that telephone call without the need for briefing or hearing. If there is an outstanding issue he will ask for letter briefs with advance agreement on length and timing ("I don't want a 20 page opus"), and may set an on the record hearing. Absent unusual circumstances, this will not be a formal 28-day motion — seven days from beginning to end should be enough to resolve the issue. The overriding goal is to ensure discovery is neither expensive nor time consuming, but rather is managed so it will be more efficient for both clients and counsel. ▲

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economic advantage, a plaintiff must plead and prove that the defendant interfered with a legitimate economic expectation through independently "unlawful" means. *Id.* at 1159. This rule recognizes the virtues of ordinary market behavior – permitting interference by lawful, competitive means – while also acknowledging that unlawful behavior clearly exceeds the bounds of legitimate competition. *Stevenson*, however, permits liability even where a defendant's conduct is not independently unlawful. Until the California Supreme Court again addresses the issue, market actors in California face the possibility of incurring tort liability for engaging in lawful – albeit aggressive – competitive behavior.

A. The Evolution of California's Standard

California courts have long held that intentionally interfering with the "prospective economic advantage" of another – even of a business competitor – can bring liability in tort. See *Della Penna v. Toyota Motor Sales, U.S.A., Inc.*, 11 Cal. 4th 376, 381-91 (1995) (discussing the historical lineage of interference with contract and interference with prospective economic advantage). Over thirty years ago, the California Supreme Court established that to state a claim for interference with prospective economic advantage, a plaintiff must, at a minimum, plead "(1) an economic relationship between [the plaintiff] and [a third party] containing the probability of future economic benefit to the [plaintiff], (2) knowledge by the defendant of the existence of the relationship, (3) intentional acts on the part of the defendant designed to disrupt the relationship, (4) actual disruption of the relationship, [and] (5) damages to the plaintiff proximately caused by the acts of the defendant." *Buckaloo v. Johnson*, 14 Cal. 3d 815, 827 (1975).

However, if every interference with a competitor's prospective economic advantage were a tort, then competition itself would be actionable. Thus, through decades of careful refinement, the courts have attempted to safeguard legitimate economic expectancies from unjustified interference – while at the same time prevent the spectre of tort liability from chilling competitive market behavior. Indeed, in *Della Penna*, the Court recognized that "[o]urs is a competitive economy in which business entities vie for economic advantage … [S]uccess goes to him who is able to induce potential customers not to deal with a competitor." 11 Cal. 4th at 389 (quoting *Buckaloo*, 14 Cal. 3d at 828). The Court thus refused to permit liability where a plaintiff pleads merely that the defendant interfered with the plaintiff's prospective business relations with another. Rather, the Court held that a plaintiff seeking to impose liability "has the burden of pleading and proving that the defendant's interference was wrongful by some measure beyond the fact of the interference itself." *Id.* at 393 (quotation marks and citation omitted). In its concluding words, the *Della Penna* Court indicated the sort of "wrongful" conduct that would satisfy the plaintiff's burden: the plaintiff must plead and prove that the defendant "engaged in conduct that was wrongful *by some legal measure* other than the fact of interference itself." *Id.* (emphasis added).

In *Korea Supply*, the Court further clarified this "wrongfulness" requirement, explaining:

> The tort of intentional interference with prospective economic advantage is not intended to punish individuals or commercial entities for their choice of commercial relationships or their pursuit of commercial objectives, unless their interference amounts to independently actionable conduct. We conclude, therefore, that an act is independently wrongful if it is *unlawful*, that is, if it is proscribed by some constitutional, statutory, regulatory, common law, or other determinable legal standard.

29 Cal. 4th at 1159 (citing *Della Penna*, 11 Cal. 4th at 408 (Mosk, J. concurring)) (internal citations omitted). Thus, the California Supreme Court has been clear that a plaintiff seeking to impose liability for interference with prospective economic advantage must plead that the defendant engaged in independently unlawful conduct designed to disrupt the plaintiff's relationship with another. As one court presciently

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explained, "[r]equiring proof that [a] competitor's wrongful conduct is independently actionable will provide a clearer guide to competitors in the conduct of their business affairs. Detached from the concepts of actionable or unlawful, the term 'wrongful' provides little assistance in guiding future activities." *San Francisco Design Ctr. Assocs. v. Portman Cos.*, 41 Cal. App. 4th 29, 43 (1995).

B. An Unwarranted Expansion of Liability?

Despite the California Supreme Court's holding that liability for interference with prospective economic advantage requires a showing that a defendant engaged in independently unlawful conduct, the California Court of Appeal recently endorsed a more permissive standard of liability. In *Stevenson*, plaintiff real estate brokers alleged they had begun assisting a client in procuring a commercial lease, only to have the defendants – also real estate brokers – interfere in that relationship and ultimately secure the lease for the client. 138 Cal. App. 4th at 1218. Plaintiffs brought a claim for interference with prospective economic advantage, alleging, *inter alia*, that the defendants' conduct was "wrongful" insofar as it "violated the Rules of Professional Conduct . . . of the American Industrial Real Estate Association." *Id.* at 1218-19. Defendants prevailed on a motion for judgment on the pleadings, arguing that "a violation of the Association's Rules would not suffice to constitute wrongful conduct." *Id.* at 1221.

The *Stevenson* court reversed. The Court acknowledged that "the crucial issue [was] whether a trade association's written rules are sufficient to constitute a 'determinable legal standard' as required by *Korea Supply*." *Id.* at 1222. The court answered that question in the affirmative, holding that "in certain circumstances, a violation of well-defined, established

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rules or standards of a trade, association or profession may constitute the type of wrongful conduct that will support a cause of action for intentional interference with prospective economic advantage." *Id.* at 1223. The "certain circumstances" to which the court referred are those in which "the rules or standards provide for, or give rise to, a sanction or means of enforcement for a violation of the particular rule or standard that allegedly makes the defendant's conduct wrongful." *Id.* According to *Stevenson*, this requirement satisfies *Korea Supply*'s demand that "wrongful" conduct must "amount to 'independently actionable conduct.'" *Id.* (quoting *Korea Supply*, 29 Cal. 4th at 1159).

The *Stevenson* court justified its decision in part by arguing that it is consistent with the language of *Korea Supply*. As noted above, under *Korea Supply* "an act is independently wrongful if it is unlawful, that is, if it is proscribed by some constitutional, statutory, regulatory, common law, or other determinable legal standard." 29 Cal. 4th at 1159. The *Stevenson* court noted that "[t]he specified sources – constitution, statute, regulation and common law – account for virtually all sources of legal restrictions imposed on a party's conduct." 138 Cal. App. 4th at 1223. The Court thus concluded that *Korea Supply*'s reference to "[o]ther determinable legal standard[s] necessarily refers to some other source of limitations upon behavior by which conduct could be assessed" – and determined that written trade rules are just such an "other source of limitations." *Id.*

C. The Soundness of *Stevenson*

On its face, *Stevenson* appears to be in considerable tension with the language of *Della Penna* and *Korea Supply*. In *Della Penna*, the Court held that a plaintiff must plead and prove that a defendant "engaged in conduct that was wrongful by some *legal measure* other than the fact of interference itself." 11 Cal. 4th at 393 (emphasis added). In *Korea Supply*, the Court further clarified that "an act is independently wrongful if it is *unlawful*." 29 Cal. 4th at 1159 (emphasis added). In contrast, the *Stevenson* court held that where a defendant's violation of written trade association rules or standards might subject that defendant to "*internal remedies* available within the association, such as a right of arbitration between the aggrieved members," that defendant's conduct satisfies the standard set forth in *Della Penna* and *Korea Supply*. 138 Cal. App. 4th at 1223-24 (emphasis added).

However, conduct potentially giving rise to "internal remedies" of a trade association seems a far cry from "unlawful" conduct. Thus, it is arguably the case that *despite* the language of *Della Penna* and *Korea Supply*, the *Stevenson* court held that a plaintiff may state a claim for interference with prospective economic advantage even where a defendant did not engage in "unlawful" conduct.

The *Stevenson* court also suggested that its decision is consistent with "the prevailing rule in other states." *Id.* at 1223. Although the Court correctly noted that "[s]everal states … permit a cause of action based upon a violation of established industry, trade or professional rules or standards" (*id*. at 1222), it is not clear that this fact alone provides sufficient justification for permitting liability absent *Korea Supply*'s requirement of "unlawful" conduct. Further, although the *Stevenson* court noted that *Della Penna* relied on out-of-state authority that endorsed imposition of liability upon violation of trade rules, (*id*. at 1223), that fact does not establish that *Della Penna* – or any other California authority – is consistent with that proposition.

Indeed, a close reading of the non-California case law referred to in *Stevenson* reveals an important difference between that case law and the rule ultimately crafted by the California Supreme Court. Specifically, the case law referred to in *Stevenson* generally permits liability upon a showing that a defendant engaged in conduct "wrongful by reason of a statute or other regulation, or a recognized rule of common law, or *perhaps* an established standard of a trade or profession." *Top Service Body Shop, Inc. v. Allstate Ins. Co.*, 582 P.2d 1365, 1371 (Or. 1978); *see also Anderson Devel. Co. v. Tobias*, *et al.*, 116 P.3d 323, 331 (Utah 2005) ("[A] plaintiff must show that the defendant's means of inter-

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to negotiate an agreement that assigns to it only a limited percentage of the defense and settlement costs calculated so that its allocated share never, or barely, exceeds the policy's self-insured retention.

For example, assume a D&O insurer negotiates a 50% allocation under a policy with a self-insured retention of $100,000. If the insured incurs defense and settlement costs totaling $250,000, the insurer's allocated share of loss would be only $25,000 (i.e., $250,000 X 50% = $125,000 minus the $100,000 self-insured retention = $25,000).

The purpose of this article is to summarize the basic law in California governing allocation under a D&O policy to assist litigators when negotiating allocation agreements with a client's D&O insurer.

1. The "Reasonably Related Test"

The leading precedent in California on the allocation of defense expenses under a D&O policy is *Safeway Stores, Inc. v. National Union Fire Ins. Co.*, 64 F.3d 1282 (1995) (applying California law). In this case, Safeway Stores and its directors and officers were named as defendants in several shareholder lawsuits arising out of a leveraged buy-out. The trial court had allocated 75% of the defense expenses to the insured directors, with the remaining 25% allocable to Safeway, whose corporate liability was not covered by the D&O policy.

The Ninth Circuit Court of Appeals reversed the trial court's allocation, holding that the defense fees should have been allocated 100% to the directors (and thus to the insurer). The court adopted the "reasonably related" test for allocation of defense expenses under a D&O policy, under which "[d]efense costs are … covered by a D&O policy if they are reasonably related to the defense of the insured directors and officers, even though they may also have been useful in defense of the uninsured corporation." *Id.* at 1289. While this test is criticized by insurers as offering a "free ride" to uncovered parties, *Safeway Stores* is the leading case in California on the issue of allocation of defense costs under D&O policies, and is a key tool in negotiating allocation agreements with insurers.

Although *Safeway Stores* involved allocation between covered and uncovered parties, there is a strong argument that the "reasonably related test" discussed in that decision should also apply to allocation between covered and uncov-

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ference were contrary to statutory, regulatory, or common law *or* violated an established standard of a trade or profession."). Thus, the case law on which *Stevenson* relied posits violation of trade standards as an alternative to unlawful conduct. *Korea Supply*, however, clearly held that wrongful conduct is only such conduct as violates a "determinable legal standard." 29 Cal. 4th at 1159.

D. Practical Considerations

Despite *Stevenson*'s apparent inconsistency with California precedent and questionable reliance on non-California authority, it is a decision that participants in any competitive marketplace cannot afford to ignore. Prior to *Stevenson*, California business competitors were free – at least in the eyes of tort law – to use any lawful means to vie for customers and clients not already contractually bound. But in the post-*Stevenson* world, such competitors must pay particular attention to whether the established rules or standards of their trade associations provide for "internal remedies," and whether their conduct could be perceived as violating those rules or standards. Thus, in evaluating how aggressively to compete for business, every member of a trade association wishing to avoid tort liability would do well to either (1) scrupulously hew to the rules of the association, or (2) consider withdrawing from the association altogether, since nothing in *Stevenson* suggests that liability might follow from a violation of trade rules by which a defendant has not agreed to be bound. Until the California Supreme Court revisits the issue, competitors that do otherwise may find themselves determining through costly litigation whether their conduct ran afoul of *Stevenson*. ▲

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ered claims. While no California case has yet squarely addressed this issue, it is notable that one of the two cases cited by the Ninth Circuit in *Safeway Stores* as authority for the reasonably related test involved an allocation between claims, not parties. See, *Continental Cas. Co. v. Bd. of Education of Charles County*, 489 A.2d 536, 545 (Md. 1985) (allocation between tort and contract counts). Furthermore, the "reasonably related" test mirrors other apportionment rules that are applied by California courts in analogous contexts such as attorney fee awards. *See*, *Reynolds Metals Co. v. Alperson*, 25 Cal.3d 124, 129-130 (1979) (attorney fees need not be apportioned when incurred for representation of an issue common to both a cause of action for which fees are proper and one in which they are not allowed).

2. Defense-Cost Audit

Another effective tool in allocating defense costs is a "defense-cost audit." Even where the "reasonably related" test has been brought to an insurer's attention, the insurer may still try to insist upon some arbitrary allocation on the presumptive ground that certain defense fees and costs must surely relate to uninsured parties and claims. A defense-cost audit involves the listing of all defense invoice entries (fees and costs) on an Excel spreadsheet, with a notation from defense counsel next to each entry indicating whether the fee or expense is "reasonably related" to the defense of the insured defendants against covered claims. Such audits will frequently reveal a far higher insured allocation percentage than the arbitrary allocation proposed by the insurer, and leave the insurer with little room to maneuver in its effort to reduce its coverage obligations.

3. Defense and Prosecution

A final point about defense expenses relates to the situation where the insured defendants have filed a cross-claim. Does the insurer have to pay the fees and costs of prosecuting the cross-claim? The general rule is that a liability insurer is not obligated to prosecute a cross-complaint on behalf of its insured. *James 3 Corp. v. Truck Ins. Exch.*, 91 Cal.App.4th 1093, 1104-1105 (2001). However, to the extent any fees and costs associated with the prosecution are reasonably related to the defense, there is a strong argument they should be borne by the insurer pursuant to the "reasonably related" test enunciated in *Safeway Stores*. *See also*, *State of California v. Pacific Indem. Co.*, 63 Cal.App.4th 1535, 1548 (1998) (CGL insurer that breached its duty to defend was responsible for those fees incurred by the insured on its cross-complaint that the insured proved were "related" to the defense).

4. "The Larger Settlement Rule"

In both *Safeway Stores* and another decision that applied Washington law (*Nordstrom, Inc. v. Chubb & Sons, Inc.*, 54 F.3d 1424 (1995)), the Ninth Circuit Court of Appeals addressed how to allocate a settlement under a D&O policy. In each case, the court applied the "Larger Settlement Rule" to a settlement involving both insured directors and uninsured defendants.

Pursuant to the "Larger Settlement Rule," a D&O insurer must pay the entire settlement unless it can demonstrate that: (1) uninsured defendants were potentially liable for a claim for which the insured directors and officers lacked any responsibility; or (2) the settlement was higher by virtue of the uninsured defendants' potential liability.

Application of this rule in *Safeway Stores* meant that no allocation was permissible since neither of the uninsured defendants faced any liability that was independent of the liability faced by the insured directors. Likewise, in *Nordstrom*, the entire settlement was covered since the uninsured defendant did not incur any liability that was not concurrent with that of the insured directors and officers.

As noted above, *Safeway Stores* and *Nordstrom* addressed settlement allocation in the context of a claim involving insured and uninsured parties, and not covered and uncovered claims. Where both covered and uncovered claims are alleged against an insured, it is unresolved what allocation rule would be applied by the California courts. There would seem to be no analytical reason, however, why the "Larger Settlement Rule" should not apply to this situa-

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Responsibility Allocation

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tion as well. Unless the uncovered claims increase the value of the settlement or allege entirely different damages, no allocation should occur.

5. Allocation Clauses

Some D&O policies now contain a provision that purports to address how loss is allocated when uncovered parties or claims are intermingled in the claim. For example, the policy may require that the insured and insurer use their "best efforts" to determine a fair and proper allocation of defense and settlement costs. However, *Safeway Stores* almost entirely undermined the efficacy of such "best efforts" provisions by holding they merely require an allocation analysis be undertaken — not necessarily an actual allocation. *Safeway Stores*, 64 F.3d at 1289.

Other insurance policy provisions mandate allocation based upon a "relative liability exposure" analysis, or may provide for arbitration or other alternative dispute resolution mechanisms to handle allocation disputes while the insurer "advances" what it deems to be an appropriate amount of allocated loss. No California court has yet undertaken to allocate a loss pursuant to such a provision, although a federal trial court recently held an express allocation provision was enforceable. *Commercial Capital Bankcorp, Inc. v. St. Paul Mercury Ins. Co.*, 419 F.Supp.2d 1173 (C.D. Cal. 2006).

The point is that as with any insurance issue, the policy must be thoroughly reviewed to determine whether it contains any provisions that might impact upon an allocation analysis.

6. Subrogation

An insurer is not necessarily without rights against uninsured parties who benefit from either the "reasonably related" test or the "Larger Settlement Rule." Neither of these tests precludes the insurer from pursuing subrogation or equitable indemnity rights against a party who contributed to the loss and who incidentally benefitted from the defense or settlement of a claim. See, *Raychem Corp. v. Federal Ins. Co.*, 853 F.Supp. 1170, 1183 (N.D. Cal. 1994).

Conclusion

D&O insurers frequently try to allocate defense and settlement costs to minimize, or even avoid, liability on a claim. Insureds should reject such efforts on the ground that no allocation is permissible unless the defense or settlement costs are increased by the presence of uncovered claims or parties. ▲

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> that the member reasonably believes is likely to result in death of, or substantial bodily harm to, an individual.

Note, however, that if the lawyer chooses not to do so, even though the lawyer would not be in violation of Rule 3-100, he or she might expose themselves to civil liability. For an analogous situation in the field of psychotherapy, see *Tarasoff v. Regents of the University of California*, (1976) 17 Cal.3d 425.

Subdivision (C) specifies what actions an attorney shall take, if reasonable, to prevent the client from committing a criminal act as described in (B). Subdivision (D) states that when revealing information per (B), "the member's disclosure must be no more than is necessary to prevent the criminal act, given the information known to the member at the time of the disclosure." Subdivision (E) provides that if an attorney decides not to reveal information that would have been permitted under (B), there is no violation of this rule.

C. ABA Model Rule of Professional Conduct 1.6

ABA Model Rule of Professional Conduct 1.6 is similar to California Rule 3-100 in terms of permitting (but not mandating) the lawyer reveal client information. It provides in pertinent part:

> (a) A lawyer shall not reveal information relating to the representation of a client unless the client gives informed consent, the disclosure is impliedly authorized in order to carry out the representation or the disclosure is permitted by paragraph (b).
>
> (b) A lawyer may reveal information

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relating to the representation of a client to the extent the lawyer reasonably believes necessary:

(1) to prevent reasonably certain death or substantial bodily harm;

(2) to prevent the client from committing a crime or fraud that is reasonably certain to result in substantial injury to the financial interests or property of another and in furtherance of which the client has used or is using the lawyer's services;

(3) to prevent, mitigate or rectify substantial injury to the financial interests or property of another that is reasonably certain to result or has resulted from the client's commission of a crime or fraud in furtherance of which the client has used the lawyer's services.

Rule 1.6, however, goes beyond CRPC 3-100 in permitting an attorney to reveal client information in order to prevent the client from causing financial or property damage when the client's action was undertaken in furtherance of the client's past or current use of the lawyer's services. Rule 1.6 also includes "prevent, mitigate or rectify" language in subsection (b)(3) relating to potential financial or property damage of another that is reasonably certain to result or has resulted from the client's actions, again "in furtherance of which of which the client has used the lawyer's services."

C. California Evidence Code Sections 950 et seq.

The client is the holder of the attorney-client privilege per California Evidence Code Section 953, and subject to Section 954, has a privilege to refuse to disclose attorney-client confidential communications. However, Section 956.5 states that:

> "[t]here is no privilege under this article if the lawyer reasonably believes that disclosure of any confidential communication relating to representation of a client is necessary to prevent a criminal act that the lawyer reasonably believes is likely to result in death of, or substantial bodily harm to, an individual."

The attorney-client privilege could also be lost under Evidence Code Section, 956, which states that: "There is no privilege under this article if the services of the lawyer were sought or obtained to enable or aid anyone to commit or plan to commit a crime or a fraud."

II.

THE ATTORNEY'S PERCEPTION

What if your client does not explicitly tell you she intended to harm anyone or commit fraudulent conduct? In some types of cases, a statement such as "don't worry, that witness won't show up for trial" might reasonably be taken as an indication that the defendant knows that the witness had a change of heart and would recant his or her testimony. If your client added that you need not worry about a witness because that witness will not be showing up to testify at trial, it might indicate only that your client properly convinced the witness not to testify. But in a case where the star witness was a stranger to your client, such statements could take on new meaning, depending upon all of the circumstances. A lawyer must be careful and probing when presented with such statements.

The permissible exceptions to the attorney-client privilege have prompted spirited debate regarding what, if any, warnings or disclosures should be given to a client at the beginning of the representation. Should the lawyer tell the client at the inception of the representation that should the client reveal the intent to commit certain criminal or fraudulent acts, the lawyer can reveal the clients' statement to others, including law enforcement or regulatory authorities? Such warnings could suppress the client's willingness to be forthcoming with information and could chill open dialogue about the case. It also could give a competitive advantage to lawyers who choose not to provide such disclosures or warnings, and perhaps even agree in advance not to exercise that option. If a lawyer

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Technology

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A. When To Use Demonstrative Evidence

The joint session, usually at the beginning of the mediation and attended by all parties and counsel, is an ideal setting for counsel to use technology to tell the story of their case or defense for the benefit of the decision-makers on the other side of the case. In mediation, the chances of settling a case will increase with the amount of information exchanged by the parties.

In far too many mediations counsel squander an important opportunity by not presenting demonstrative evidence during the mediation in the form of videotaped deposition clips of critical witness testimony, excerpts of significant documents, charts, photographs, videos and diagrams. Demonstrative evidence makes a powerful impact on the decision makers during mediation, just as it does on jurors and judges during trial. A picture is truly worth a thousand words. Software such as PowerPoint, Trial Director and Summation allow trial lawyers to effectively present demonstrative evidence to tell their story.

The trial lawyer who uses demonstrative evidence avoids being another "talking head." They let the actual evidence tell the story, with a much greater impact on the listeners. Such presentations allow the other parties to understand the theme of the case, and more fully appreciate the strengths of the adversary's case as well as the risks of trying the case. In addition, the other side will understand that counsel knows how to present the most convincing case to the trier of fact, and is prepared to do so at trial.

B. Why Don't Counsel Use Demonstrative Evidence?

Considering these benefits, why isn't demonstrative evidence used more often in mediations? One reason is that counsel often don't think about using this tool early enough. Demonstrative evidence will likely be used during trial in any event. So it makes good sense to prepare the demonstrative evidence early enough to use it during the mediation, as counsel can preliminarily judge its impact. Not only may such evidence help settle the case (hopefully for a better amount), but if the case does go to trial, counsel will be much further along in their trial preparation than they would be otherwise.

Trial lawyers often claim they want to "hold back" critical information during mediation, believing they need the element of surprise in the event the case goes to trial. However, more times than not the information they have but do not want to disclose at the mediation is already known, or at least suspected, by the other side. This is something we've both experienced many times as mediators and advocates.

Even if a critical fact is known only by you, consider whether a tactical advantage is really lost should the other side learn about it. Rarely is opposing counsel able to change a critical uncontrovertable fact after the mediation and before trial. And if they to do so or have a good explanation, that is something you should be prepared to

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were to promise clients in advance that he or she will never elect to reveal the client's confidences, even when permitted, this may not violate the California Rules of Professional Conduct. But a lawyer would be well advised to consider potential civil liability before making such a commitment.

III. CONCLUSION

All attorneys owe a duty of loyalty to their clients. They should work diligently on their cases and engage in zealous advocacy. They must protect their client's rights and keep their communications in the utmost confidence. But when a client engages in or threatens to engage in ongoing illegal activity, a sometimes seemingly impossible conflict arises, and the lawyer's obligations are different. Awareness of the rules and principles cited above will permit attorneys faced with this dilemma to evaluate their options in light of applicable ethical and civil liability concerns. ▲

Wendy Patrick Mazzarella is a San Diego County Deputy District Attorney assigned to the Family Protection Division. Ms. Mazzarella has her own ethics column in the San Diego Daily Transcript, is a regular columnist for Law Enforcement Quarterly, and sits on the editorial board of San Diego Lawyer Magazine. She is a Chair of the San Diego County Bar Association Ethics Committee and lectures on ethics on a regular basis both locally, and around the United States.

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address or rebut. Finally, such a response or explanation may be material to how both client and counsel perceive the case from both a litigation and mediation standpoint. In our view, the advantages of disclosing the critical facts in a compelling demonstrative evidence presentation far outweigh any potential disadvantages.

C. Conclusion

The mediation session is the only opportunity, other than trial or deposition, for lawyers to speak directly to the decision-makers on the other side of the table. An effective presentation in the joint session can help impress the other side with the merits of your case. Failure to compellingly tell your story greatly hinders your chances for a fair settlement, in part because the other side will not be able to assess their risk as accurately as they could with all the relevant information presented in an organized and compelling fashion. Finally, since most cases ultimately settle anyway, it makes sense to tell your story using the most effective method possible when the critical decision makers are present in the same room. To get the best out of a mediation and obtain the best results from their clients, good trial counsel will use demonstrative evidence to persuasively tell their story during the mediation. ▲

Steven H. Kruis, Esq. is a mediator with Markus Kruis Mediation. He mediates disputes involving real property, employment, personal injury, business/commercial, and probate matters. He began mediating disputes in 1993, while a partner with Higgs, Fletcher & Mack LLP. He was with the firm for over 13 years, and served as the Firm's Managing Partner between 1994-1997.

Monty A. McIntyre is a shareholder at Seltzer Caplan McMahon Vitek. He was the 2002 President of the San Diego County Bar Association and is currently a member of the Executive Council of the National Conference of Bar Presidents. Mr. McIntyre is a civil trial lawyer handling business, insurance bad faith, tort (catastrophic personal injury and wrongful death), land use and real property cases, and he also serves as a private mediator. Mr. McIntyre is a member of the American Board of Trial Advocates ("ABOTA"). He has received two Outstanding Trial Lawyer Awards from the Consumer Attorneys of San Diego, has been a speaker at numerous continuing education courses, and has published a considerable number of articles on civil litigation and mediation issues.

President's Column

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punches. The program concludes with war stories and lessons from ABTL's Masters of Disaster. This program is approved for 11.25 hours of MCLE credit and runs from October 18, 2006 to October 22, 2006. The keynote speaker is the Honorable Carol A. Corrigan, Associate Justice of the Supreme Court of California. The hotel is offering great rates ($255 for ocean-view rooms) during the seminar and for a few days prior to and following the seminar. Sign up now because the rooms and reservations are going fast.

We hope you enjoy this issue of the ABTL Report, and I will see you in September. ▲

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Articles of Interest from Current ABTL Newsletter

Orange County

Q&A with the Hon. Thierry Patrick Colaw by James L. Poth and Brian Recor

Marking and Damages for Patent Infringement by J. Scot Kennedy

The Dark Side of Mediated Agreements by William J. Caplan

Evaluation of Alter Ego Liability for LLC, LLP or Limited Partnerships by Jaime C. Holmes

Recent Seventh Circuit Decision Signals Expansion of Federal Computer Fraud Liability In Employment Context by Jesse E.M. Randolph

For access to these and other articles, please visit www.ABTL.org/report

ABTL San Diego's Annual Mini-Seminar "Masters of the Art: Building to the Close"

Date: September 9, 2006 • Time: 8:30 a.m.
Location: The Wyndam Emerald

Watch as ABTL's experts build to the close in a mock trial of an intriguing controversy of patent infringement and trade secret misappropriation. ABTL's Masters of the Art will demonstrate techniques in jury selection, opening statements and witness examinations that lead to a winning closing argument.

Numerous outstanding attorneys will be participating in this program, including Craig McClellan, Regina Petty, Dave Noonan, Reg Vitek, Scott Metzger, and Mark Mazzarella. Our distinguished jurists will include Judges Sammartino, Prager, Haden, Irion, McCurine, Einhorn, and Sabraw.

MCLE: 7.5 hours.

Information packets will soon be mailed out to members, and registration information will be available at www.abtl.org.

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