It is rare for a complex civil case to proceed in state or federal court without an expert witness. Among other advantages, an expert is often permitted to testify to otherwise inadmissible evidence when the proffered opinion is based on that evidence. The advantage is enhanced where alternative methods for introducing this basis evidence are prohibitively expensive or otherwise unattractive.

Assume a lawsuit between a California buyer and an Asian manufacturer-seller of goods, filed in California, in which the buyer must establish the inadequacy of the seller’s quality control procedures. At the deposition of the buyer’s expert, she opines that the seller’s quality control is woefully inadequate. Among other bases for that opinion, the expert relies on the statements of four European and Asian quality control engineers, regarding their own procedures, contained in an article in a prestigious

Introducing Hearsay Through an Expert: Is the Backdoor Closing?

Successful Defense in the Age of the Whistleblower

In 1863, following reports of unscrupulous merchants selling diseased mules to the Union Army, Congress passed the False Claims Act to deter the submission of fraudulent claims for payment to the government. Under the Act’s *qui tam* provisions, private citizens for the first time could institute actions on behalf of the government to recover damages, and were entitled to retain a portion of the recovery. Whistleblower claims have been a part of the American legal landscape ever since.


According to several estimates, the federal government has recovered over $25 billion under the False Claims Act since the statute was strengthened in 1986. SEC officials have stated that they expect the number of whistleblower claims to explode, and plaintiffs’ firms are increasingly promoting their experience in representing whistleblowers.
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Is the Backdoor Closing?

trade journal. Efforts to locate two of these foreign engineers have failed, and the other two will make poor witnesses. Buyer’s counsel is convinced that the wisest course is to present the engineers’ statements through the expert.

What rules of evidence will govern the admissibility of this evidence? And, given that the possibility of an actual trial is remote, why does it matter what the rules of evidence provide? The rules matter because a sensible determination of the case’s settlement value cannot be divorced from an assessment of the risk that significant evidence, like the expert’s testimony, will be admitted. In turn, this assessment requires a sophisticated understanding of the rules of evidence. As explained below, current law favors allowing an expert to testify to otherwise inadmissible out-of-court statements relied on in forming her opinion. But a reconsideration of this approach is beginning in criminal cases, and this process will accelerate due to the United States Supreme Court’s grant of certiorari in Williams v. Illinois, ___ S.Ct. __, 2011 WL 2535081, June 28, 2011 (No. 10-8505). If this reconsideration results in a new rule in criminal cases, there is little reason to doubt that rule will be applied in civil cases as well.

The Law Governing Admissibility of Expert Opinions

California and federal law governing the admissibility of expert opinion evidence are similar. Four different issues commonly arise in challenges to this evidence. First, is the expert qualified to render the opinion? California Evid. Code § 720; Fed. R. Evid. 702. In resolving this question, it is important to recognize that an expert’s qualifications must be specifically tailored to the opinion provided. Miller v. Los Angeles County Flood Control Dist., 8 Cal. 3d 689 (1973); People v. Davenport, 11 Cal. 4th 1171, 1206-07 (1995). Second, is the opinion one that is appropriate for an expert to deliver? Often, the answer to this question hinges on whether the subject matter is beyond common experience (Cal. Evid. 801(a)) or consists of scientific, technical or other specialized knowledge (Fed. R. Evid. 702). Third, is the basis evidence of a type that is reasonably relied upon by experts in the particular field? Id. 801(b); Fed. R. Evid. 703. If so, it may be relied on even if it would not be admissible. Hearsay statements are common examples of such evidence. Finally, and the focus of this article, may the expert inform the jury on direct examination about any inadmissible matter relied upon in forming the opinion?

In answering this question, a trial court balances two important, though antagonistic goals: to improve the jury’s evaluation of the expert’s opinion by providing it with the data and information underlying that opinion; and to minimize the risk the jury will consider that data and information for its truth.

In recognition of the need to balance these goals, the California Evidence Code and the Federal Rules grant sub-

stantial discretion to the trial court. Evidence Code section 802 provides, in pertinent part, “[a] witness testifying in the form of an opinion may state on direct examination the reasons for his opinion and the matter…upon which it is based….” (Emphasis added.) Federal Rule 703 similarly provides a federal judge with discretion to admit facts or data that underlie an opinion and that are “otherwise inadmissible.”

Introduction of Hearsay Through Experts

Predictions as to how state and federal trial judges will rule in a particular case are difficult, but the following observations seem true. First, courts have long been concerned with experts who serve as hearsay conduits, and often bar testimony about the basis of an opinion resting solely on the out-of-court statements of non-testifying declarants. McCormick on Evidence, § 15, at 96, n. 17 (6th ed. 2006). This is particularly true where these statements constitute an opinion by another expert who is never subjected to cross-examination. Id. at 97, n. 22. The admissibility of out-of-court statements relied upon by an expert is enhanced if the proponent establishes some value added by the expert. For example, this evidence is more likely admissible if the expert reinforces it with testimony regarding experiments she has performed or an investigation she has conducted.

Second, even where inadmissible out-of-court statements form only a part of the basis evidence, courts have frequently stated that an expert should not be permitted to testify about them. People v. Coleman, 38 Cal. 3d 69, 92 (1985); Grimshaw v. Ford Motor Co., 119 Cal.App. 3d 757, 788-89 (1981). However, this “rule” is subject to one significant exception: The basis evidence may be admitted to permit the jury to better evaluate the opinion, but not for its truth. Coleman, 38 Cal. 3d at 92; Grimshaw, 119 Cal.App. 3d at 789; McCormick, supra, at § 324.5, p. 418. This exception assumes two different, relevant purposes for the evidence and admits the evidence for only one of them. On request, jurors should be instructed that they may utilize the testimony only for this limited purpose. Coleman, 38 Cal. 3d at 92; Grimshaw, 119 Cal.App. 3d at 789; Genrich v. State of California, 202 Cal.App. 3d 221, 230 (1988).

Third, a court may bar the evidence if it believes the jury will be unable to follow this limiting instruction. Because of differences in the governing statutes, California courts are more likely to admit the evidence than federal courts when the effectiveness of the limiting instruction is in doubt. In California this issue is governed by section 352, which is virtually identical to Federal Rule 403. Section 352, which presumptively admits relevant evidence, provides, “The court in its discretion may exclude evidence if its probative value is substantially outweighed by the probability that its admission will…create substantial danger of undue prejudice….” As the California Supreme Court has observed, a trial court has the discretion “to weigh the probative value of inadmissible evidence relied upon by an expert witness as a partial basis for his opinion against the risk that the jury might
improperly consider it as independent proof of the facts recited therein.’ Coleman, 38 Cal. 3d at 91; People v. Gardeley, 14 Cal. 4th 605, 619 (1996). On the other hand, in 2000, amended Federal Rule of Evidence 703 prescribed a weighing test that presumptively rejects admission of otherwise inadmissible basis evidence on direct examination: ‘Facts or data that are otherwise inadmissible shall not be disclosed to the jury by the proponent of the opinion…unless the court determines that their probative value in assisting the jury to evaluate the expert’s opinion substantially outweighs their prejudicial effect.’ Fed. R. Evid. 703.

California cases are instructive. In Gardeley, a gang expert testified that an assault was gang-related and, as part of the basis evidence, properly testified that one of the assailants admitted to being a gang member. 14 Cal. 4th at 612, 618-19. In People v. Thomas, 130 Cal.App.4th 1202, 1208-10 (2005), after opining the defendant was a member of a gang, the expert testified that in forming his opinion he relied on statements from other members of the gang that the defendant was a member. Thomas, relying in part on Gardeley, concluded it is ‘the established rule that experts can testify to their opinions on relevant matters, and relate the information and sources upon which they rely in forming those opinions. This is so because…the materials on which the expert bases his or her opinion are not elicited for the truth of their contents; they are examined to assess the weight of the expert’s opinion.’ Id. at 1210. In Genrich, a personal injury action, plaintiff’s expert opined that a particular intersection constituted a dangerous condition on public property and based that opinion, in part, on information gleaned from a computerized accident data retrieval system. Genrich upheld the ruling admitting this testimony, concluding that a limiting instruction cures the possibility of juror misuse of the basis evidence except in ‘aggravated situations,’ and the trial court’s failure to give a limiting instruction was excused by the appellant’s failure to request it. Genrich, 202 Cal.App. 3d at 229-30; see also Grimsbaw, 119 Cal. App. 3d at 788-89 (cited with approval in Coleman, 38 Cal. 3d at 92).

In sum, under the current law, California and federal trial courts are vested with wide discretion to admit otherwise inadmissible hearsay, for a limited purpose, when an expert relies on this evidence in forming an opinion. Anecdotally, California trial courts routinely admit this basis evidence and are almost never reversed on appeal for doing so. It appears the same may be true for federal trial courts, even though Federal Rule of Evidence 703 is more restrictive. McCormick, supra, at 417-18.

Recent Developments in Criminal Cases

Two appellate decisions and a growing body of academic commentary have criticized this approach in the con-

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Guarding Privileged Materials: How State Law Offers More Protection

You likely know that California and federal law on the attorney-client privilege and work product protection diverge. You may even be vaguely aware that California law on privilege is generally more protective than federal law. But did you know that the differences are so marked that entire categories of documents are privileged under California law but not under federal law? Some of the ways that California law is more protective than federal law include (1) the scope of the attorney-client privilege and the attorney work product protection are broader under California law; (2) the means of making and resolving challenges to claims of attorney-client privilege are more favorable to privilege claimants in state court; and (3) when privilege has been waived through voluntary disclosure, the extent of the waiver is narrower under California law.

What Is a Privileged Attorney-Client Communication?

Under federal law, a communication is covered by the attorney-client privilege if it meets an eight-part test:

1. Where legal advice of any kind is sought (2) from a professional legal adviser in his capacity as such; (3) the communications relating to that purpose; (4) made in confidence (5) by the client, (6) are at his instance permanently protected (7) from disclosure by himself or by the legal adviser, (8) unless the protection be waived.

United States v. Graf, 610 F.3d 1148, 1156 (9th Cir. 2010) (internal quotations omitted). Federal courts construe the attorney-client privilege strictly because it impedes full discovery. Fisher v. United States, 425 U.S. 391, 403 (1976) (“Since the privilege has the effect of withholding relevant information from the factfinder, it applies only where necessary to achieve its purpose. Accordingly it protects only those disclosures necessary to obtain informed legal advice which might not have been made absent the privilege.”).

Although the requirements for attorney-client privilege are similar under California law, the privilege is applied more broadly. Under California law, all confidential communications made during the course of an attorney-client relationship are privileged unless the communication falls within a statutory exception. Cal. Evid. Code § 954 (“[T]he client, whether or not a party, has a privilege to refuse to disclose, and to prevent another from disclosing, a confidential communication between client and lawyer…..”). Further, once the communication is deemed

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privileged, its content is irrelevant and any factual material conveyed in that communication is also privileged. Costco Wholesale Corp. v. Super. Ct. (Randall), 47 Cal. 4th 725, 734, 736 & 739 (2009) (“[W]hen the communication is a confidential one between attorney and client, the entire communication, including its recitation or summary of factual material, is privileged.”). Mitchell v. Super. Ct. (Shell Oil Co.), 37 Cal. 3d 591, 601 (1984) (“Neither the statutes articulating the attorney-client privilege nor the cases which have interpreted it make any differentiation between ‘factual’ and ‘legal’ information.”).

The broader scope of the attorney-client privilege under California law can be significant. Consider, for example, an attorney who works for a company with a fleet of drivers. The attorney is asked to investigate a driver’s accident and report to the President about the potential liability. If the attorney’s report includes a summary of her factual investigation, a federal court would be more likely to find the factual information not privileged and to require that the report be redacted to protect only any legal advice conveyed. A California court, on the other hand, would be more likely to find the entire report privileged, including the factual information conveyed, provided that the purpose of the investigation was to render legal advice on the potential liability.

What Constitutes Attorney Work Product?

California law also affords greater protection to attorney work product than federal law. Most importantly, under California law, a writing need not be created for purposes of litigation to qualify as work product. State Comp. Ins. Fund v. Super. Ct. (People), 91 Cal. App. 4th 1080, 1091 (2001) (“The work product doctrine applies as well to writings prepared by an attorney while acting in a non-litigation capacity.”) (internal quotations omitted). In contrast, federal law protects only material created in anticipation of litigation: “Ordinarily a party may not discover documents and tangible things that are prepared in anticipation of litigation or for trial by or for another party or its representative.” Fed. R. Civ. Proc. 26(b)(3)(A) (emphasis added). To be created ‘in anticipation of litigation,’ the document must have been prepared or obtained because of the prospect of litigation. Charles Alan Wright, et al., 8 Fed. Prac. & Proc. Civ. § 2024 (3d ed. 2011) & authorities cited therein.

The difference between California and federal law on the scope of work product is significant, particularly for transactional attorneys and for business litigators involved in disputes concerning transactions, because documents prepared by transactional attorneys for purposes of a business deal would be work product under California law, but not under federal law. Additionally, in-house counsel’s notes unrelated to litigation or potential litigation, such as on anticipated prospectus disclosures or on investigations related to a potential business policy, would be work product under California law, but not under federal law.

In addition to having a broader scope, attorney work product is less likely to be discoverable under California law. California law provides absolute protection to work product reflecting an attorney’s mental impressions, opinions, and theories. Under California Code of Civil Procedure § 2018.030(a), “A writing that reflects an attorney’s impressions, conclusions, opinions, or legal research or theories is not discoverable under any circumstances.” The federal rules afford protection to an attorney’s so-called opinion work product only if it relates to litigation. Fed. R. Civ. Proc. 26(b)(3)(B) (where court orders production of work product, “it must protect against disclosure of the mental impressions, conclusions, opinions, or legal theories of a party’s attorney or other representative concerning the litigation”) (emphasis added). But in the Ninth Circuit, even opinion work product concerning the litigation is not absolutely protected; it is discoverable “when mental impressions are at issue in a case and the need for the material is compelling.” Holmgren v. State Farm Mut. Auto. Ins. Co., 976 F.2d 573, 577 (9th Cir. 1992).

For work product not reflecting an attorney’s thinking, California law again provides more protection, providing that it is “not discoverable unless the court determines that denial of discovery will unfairly prejudice the party seeking discovery in preparing that party’s claim or defense or will result in an injustice.” Cal. Civ. Proc. Code § 2018.030(b). In contrast, under federal law, attorney work product is discoverable if the party seeking discovery “shows that it has substantial need for the materials to prepare its case and cannot, without undue hardship, obtain their substantial equivalent by other means.” Fed. R. Civ. Proc. 26(b)(3)(A).

How Are Claims of Attorney-Client Privilege Made and Resolved?

Here again, California law affords more protection to privilege claims than does federal law. Under California law, a party claiming attorney-client privilege need only assert a boilerplate objection; a party does not have to provide a privilege log unless a court orders one. Cal. Civ. Proc. Code § 2031.240(b); Best Prods., Inc. v. Super. Ct. (Granatelli Motorsports, Inc.), 119 Cal. App. 4th 1181, 1187-89 (2004). Then, if the privilege claim is challenged, the party asserting privilege need only show that the communication was made in the course of an attorney-client relationship. See, e.g., Costco Wholesale Corp., 47 Cal. 4th at 733. Once that minimal showing is made, the communication is presumed to have been made in confidence, and the burden shifts to the opposing party to show that the communications were not confidential. Id.; Cal. Evid. Code § 917(a). In resolving a privilege claim, California law prohibits courts from compelling disclosure of allegedly privileged material, even in camera. Cal. Evid. Code § 915(a); Costco Wholesale Corp., 47 Cal. 4th at 739.

By contrast, federal law requires more than a bare privilege objection to preserve the privilege. Burlington N &
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Santa Fe Ry Co. v. U.S. Dist. Ct. for Dist. of Mont., 408 F.3d 1142, 1149 (9th Cir. 2005). A party must expressly make the privilege claim, and also “describe the nature of the documents, communications, or tangible things...in a manner that...will enable other parties to assess the claim.” Fed. R. Civ. Proc. 26(b)(5). This rule essentially requires production of a privilege log. Some federal courts have even found waiver from failure to provide a log in a timely manner. Burlington N & Santa Fe Ry Co., 408 F.3d at 1149-50; Breon v. Coca-Cola Bottling Co. of New Eng., 232 F.R.D. 49, 54-55 (D. Conn. 2005). If the privilege claim is challenged, the party asserting privilege has the burden of proving that the privilege applies. Graf, 610 F.3d at 1156. In resolving the privilege dispute, federal courts may require in camera disclosure of the material. In re Grand Jury Witness, 695 F.2d 359, 362 (9th Cir. 1982).

These procedural differences in how claims of privilege are made and resolved are obviously significant, particularly when laid over the substantive differences in the scope of the privilege. California provides more procedural protections for privileged communications, and, conversely, more barriers to obtaining privileged materials. Under California law, a party seeking allegedly privileged materials either must convince the party claiming privilege to produce a privilege log with details allowing the challenging party to assess the claim or must move to compel a log. Then the party seeking disclosure will have the burden of overcoming the statutory presumption that the communications are confidential, and thus privileged. The burden of overcoming the statutory presumption that the communications are confidential, and thus privileged. California and federal law on attorney-client privilege and work product is beyond the scope of this article, the discussion above illustrates how California law is more protective of privilege claimants than federal law in terms of the broader scope of materials covered, the means of asserting and resolving claims of privilege, and the narrower scope of waiver as the court rules on the privilege claim. Given that a communication merely needs to be confidential and made within an attorney-client relationship to be privileged under California law, communications between counsel and client are afforded much greater protection under both substantive and procedural California law.

**What Is the Extent of the Waiver Where Privilege Has Been Waived by Disclosure?**

Under both federal and California law, a party waives attorney-client privilege or work product protection by voluntarily disclosing or consenting to disclosure of a significant part of the privileged or protected information. However, when such a waiver occurs, the scope of the waiver is narrower under California law.

Under Federal Rule of Evidence 502(a), where a party waives privilege through voluntary disclosure, the waiver extends to undisclosed information and communications concerning the same subject matter if the undisclosed material should in fairness be considered with the disclosed material. See Hernandez v. Tamminen, 604 F.3d 1095, 1100 (9th Cir. 2010) (“Disclosing a privileged communication or raising a claim that requires disclosure of a protected communication results in waiver as to all other communications on the same subject.”).

Unlike federal law, under California law, voluntary disclosure results in waiver only as to the communication or material at issue; the waiver does not extend to undisclosed material on the same subject. Cal. Evid. Code § 912(a); see also Owens v. Palos Verdes Monaco, 142 Cal. App. 3d 855, 870-71 (1983), overruled on other grounds by Applied Equip. Corp. v. Litton Saudi Arabia Ltd., 7 Cal. 4th 503, 521 n.10 (1994). This is because “[t]he scope of either a statutory or implied waiver is narrowly defined and the information required to be disclosed must fit strictly within the confines of the waiver.” Transamerica Title Ins. Co. v. Super Ct. (Bank of the West), 188 Cal.App. 3d 1047, 1052 (1987).

Obviously, this difference in the extent of the waiver could have a dramatic impact — waiving privilege as to a whole subject matter is certainly more significant than waiving privilege as to a particular communication or document.

**What Do These Differences Mean for My Practice?**

Although cataloging all the differences between California and federal law on attorney-client privilege and work product is beyond the scope of this article, the discussion above illustrates how California law is more protective of privilege claimants than federal law in terms of the broader scope of materials covered, the means of asserting and resolving claims of privilege, and the narrower scope of waiver through voluntary disclosure. These differences merit consideration in at least three business litigation scenarios.

First, when deciding whether to file suit in state or federal court, consider whether any tricky privilege issues exist. Notably, in diversity actions, federal law governs work product determinations. Baker v. Gen. Motors Corp., 209 F.3d 1051, 1053 (8th Cir. 2000). So litigators will be stuck with the narrower federal protections on work product unless they can keep their case in state court. Although California substantive law will control questions of attorney-client privilege in diversity actions, id., federal procedural law will apply, including the methods for asserting and resolving claims of privilege discussed above.

Second, if your clients frequently operate or litigate in areas governed by federal substantive law, such as patent, trademark, copyright, antitrust, or employment, make sure that they are aware of the federal limitations on privilege and work product. For example, such clients should be advised that their communications with both in-house and outside counsel will only be considered privileged if they can be traced to the client’s request for legal advice. Likewise, such clients should be informed that writings generated by their in-house and outside counsel will be deemed work product only if they were prepared in anticipation of litigation.

Third and finally, although litigators often will not be able to control which law governs their dispute, these differences must be recognized and considered when asserting claims of privilege and work product. That document you were about to claim is privileged might not be under federal law.

Kelly Woodruff is a partner, and Raechel Turner is an associate, in the San Francisco office of Farella Braun & Martel LLP. kwoodruff@fbm.com; rturner@fbm.com.
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The text of criminal prosecutions. People v. Goldstein, 6 N.Y.3d 119, 843 N.E.2d 727, 732-33 (2005); People v. Hill, 191 Cal.App. 4th 1104, 1129-30 (2011). Kaye, et al., New Wigmore Treatise on Evidence, Expert Evidence, § 3.10.1, p. 59 (2010 Cumulative Supp.). This criticism seems to result from the United States Supreme Court's re-interpretation of the Sixth Amendment's Confrontation Clause in Crawford v. Washington, 541 U.S. 36 (2004). Crawford has focused attention on when an out-of-court statement is admitted for its truth, for only then is it subject to this constitutional provision. If courts begin to conclude that challenged basis evidence is actually admitted for its truth and, thus, subject to the Sixth Amendment in a criminal case, the evidence will also be subject to a hearsay challenge under state or federal evidence rules. Because California and federal definitions of hearsay apply equally to civil and criminal cases, this hearsay challenge will then expand to civil cases, though such cases are not covered by the Confrontation Clause.

In Goldstein, the defendant was charged with murdering a woman by pushing her in front of a subway train. 843 N.E.2d at 729. The prosecution's forensic psychiatrist Hegarty relied upon and testified to certain out-of-court statements that helped form the basis for her opinion refuting an insanity defense. Id. at 729-30. The prosecution argued that the statements were not admitted for their truth, but only to help the jury evaluate Hegarty’s opinion. Goldstein disagreed. “We do not see how the jury could use the statements...to evaluate Hegarty’s opinion without accepting as a premise either that the statements were true or they were false. Since the prosecution’s goal was to buttress Hegarty’s opinion, the prosecution obviously wanted and expected the jury to take the statements as true.... The distinction between a statement offered for its truth and a statement offered to shed light on an expert’s opinion is not meaningful in this context.” Id. at 752-33.

The California Court of Appeal confronted the same basic issue in Hill:

Central to the reasoning in the current law is the implied assumption that the out-of-court statements may help the jury evaluate the expert’s opinion without regard to the truth of the statements. Otherwise, the conclusion that the statements are not admitted for their truth is nonsensical. But this assumption appears to be incorrect.

191 Cal.App. 4th at 1129-30. Before jurors can use hearsay statements to evaluate an expert’s opinion, they must necessarily either assume the truth of the statements, or attempt to determine it. Phrased slightly differently, the jurors' evaluation of the expert's opinion will depend upon whether they believe or disbelieve the out-of-court declarants — they must consider the truth of the matter asserted even while being told not to do so.

The difference between a challenge to the admission of hearsay basis evidence under Gardeley and that same challenge under the reasoning of Goldstein and Hill should not be minimized. Under Gardeley, the trial court has discretion under section 352 and rule 703 to admit otherwise inadmissible basis evidence. However, under Goldstein, the trial court must bar the basis evidence as hearsay, unless an exception applies. Only after finding an applicable exception may the court exercise its discretion under section 352 or rule 703. Absent the creation of a new hearsay exception for basis evidence, or, in federal court, expanded use of the residual hearsay exception found in rule 807, experts would rarely be able to bring in hearsay through the backdoor.

In Williams, the United States Supreme Court will confront the issue considered in Goldstein and Hill. In Williams, a DNA expert relied upon a report by a non-testifying technician, who had compared a DNA sample taken from a rape victim with a sample from the defendant. The expert informed the jury about the technician’s results and opined that the two samples were a match. The Illinois Supreme Court affirmed the conviction, concluding the expert’s testimony about the technician’s report “was not admitted for the truth of the matter asserted...[but] to show the underlying facts and data [the expert] used before rendering an expert opinion in this case.” People v. Williams, 939 N.E.2d 268, 279 (2010). While Williams is pending, cautious trial judges should be more willing to exercise the discretion currently granted by Evidence Code section 352 or Federal Rule 703 to exclude hearsay basis evidence. And if Williams rejects the fiction inherent in the traditional rule, the hearsay backdoor will swing shut.

The Honorable Mark Simons is an Associate Justice of the First District of the California Court of Appeal, and is a member of the Board of Governors for the Northern California chapter of ABTL.

Age of the Whistleblower

Business litigators can play a critical role in helping companies to deal with whistleblower issues. At the outset, they can assist in developing strong compliance policies and procedures to minimize the occurrence of claims and to increase the chances that any complaints will be dealt with internally. Even the best policies, however, will not eliminate whistleblower cases, so counsel will also need to develop effective strategies to defend them.

An Ounce of Prevention

The effort to defeat a whistleblower claim should begin long before a claim arises. Design or revision of the client’s compliance policies and procedures is the most cost-effective approach. Not only will a strong compliance program help reduce the incidence of conduct that could lead to whistleblower activity; it will also benefit the defense of any claims that are made. As will be explained below, it is very advantageous for a company to be able to investigate claims internally, before...
In response to a tender of defense, insurance carriers often take ambivalent positions on whether they will provide a defense, sometimes stating nothing more than that they are “investigating” the claim. Other times, carriers may say they “accept” the defense but then pay nothing, or pay only a small portion of the defense costs after a long delay. These carriers treat these responses as if they satisfy the duty to defend, and they impose clear financial consequences for such breaches, by barring such insurers from exercising statutory rights under Civil Code section 2860.

Under California law, where there is a conflict of interest between the insurer and policyholder because the insurer has reserved its rights under the policy, the insured is entitled to select counsel. San Diego Navy Federal Credit Union v. Cumis Ins. Society, Inc., 162 Cal. App. 3d 358 (1984). Under Cumis, the carrier must pay the fees of this independent “Cumis counsel.” Civil Code section 2860 limits the rates payable to independent counsel, stating the “obligation to pay fees to the independent counsel...is limited to the rates which are actually paid by the insurer to attorneys retained by it in the ordinary course of business in the defense of similar actions...” Civil Code § 2860(c).

Two recent cases held that an insurer may not invoke the section 2860 rate limitation if it has breached its duty to defend. See Seagate Tech. LLC v. National Union Fire Ins. Co. of Pittsburgh, Pa., 737 F. Supp. 2d 1013 (N.D. Cal. 2010); Housing Group v. PMA Capital Ins. Co., 193 Cal. App. 4th 1150 (2011). Neither case involved an outright denial of coverage, but rather ambivalent responses, or breaches through partial or delayed performance.

In Seagate, the insurer acknowledged its duty to defend, but paid “only a small portion of the bills incurred....” 737 F. Supp. 2d at 1016. The court noted that “[t]o take advantage of the provisions of [section] 2860, an insurer must meet its duty to defend...” Id. at 1017 (citations and quotes omitted). The court held that the insurer breached the duty to defend, and lost its rights under section 2860 by paying only a small portion of the defense costs.

In Housing Group, the California Court of Appeal held that the section 2860 fee cap did not apply where the insurer’s reservation of rights letter did not unambiguously accept the defense, but merely stated the insurer would “investigate the duty to defend....” 193 Cal. App. 4th at 1154. The insureds argued that the insurer could not invoke section 2860(c) because the insurer offered no evidence that it agreed to defend the insureds in the underlying litigation. The insurer argued that it satisfied its duty to defend because it sent two reservation of rights letters. The letters acknowledged receipt of the insureds’ tender of the defense and stated that the insurer would “investigate” coverage and that, “if coverage is confirmed,” it would reimburse the insured for independent counsel at rates payable under section 2860(c). Id.

The Court of Appeal held that this was only an “expression of Caliber One’s future intent to comply with its duty to defend, and not an actual acceptance or agreement to provide a defense or to appoint plaintiffs’ chosen counsel as Cumis counsel.” Id. at 1156. The insurer also noted that it had paid defense fees of approximately $36,000, after the insured settled the underlying claims. The Court of Appeal held that section 2860(c) requires that the insurer pay defense costs during the underlying litigation. The carrier’s decision to withhold payment of defense fees until the end of the litigation was “the equivalent of a defense denial.” Id. at 1157.

Other cases finding a breach of duty to defend (but not specifically involving section 2860) show additional circumstances involving a breach of the duty to defend. In Risely v. Interinsurance Exch. of the Auto. Club, 183 Cal. App. 4th 196 (2010), a carrier breached its duty to defend by denying coverage under one policy even though it accepted, and fully performed its duty, under a second policy. While neither case addressed the section 2860 fee cap, both show additional circumstances involving a breach of the duty to defend which would bar the carrier from relying on the section 2860 rate cap.

The Seagate and Housing Group cases are important in establishing that insurers must accept the duty to defend promptly and unambiguously, and perform it fully. More importantly, the cases show that failure to do so has potentially serious financial consequences. Insureds can use these cases to prod carriers into full performance of their duty, or alternatively, can use them after the carrier has breached to obtain recovery of full rates where they would otherwise be reimbursed only at capped rates.

Mr. Green is a partner in the San Francisco office of Farella Braun & Martel LLP. jgreen@fbm.com.
it faces a government inquiry. An effective compliance program works in two ways to increase the likelihood that a whistleblower claim can be investigated internally. First, an employee who is convinced that her complaint will be investigated thoroughly and fairly is more likely to raise her concerns internally. Second, even if the whistleblower goes outside the company, a resource-constrained agency may permit the company to investigate the allegations if the company can convince the agency that it will conduct a credible investigation. The SEC, for example, has made it clear that it is more likely to permit companies with well-developed compliance programs and credible plans to investigate to perform their own investigations of whistleblower claims, so long as they report their findings back to the agency.

A rigorous compliance program is also beneficial when a whistleblower complaint proceeds to trial. The existence of well-established internal procedures may establish a sound basis for challenging the whistleblower’s motivations. Why, for example, did he bypass a time-tested, confidential hotline and go straight to the government? Was he motivated by money or personal animus?

The Benefits of Internal Investigation

If an employee believes misconduct has occurred, it is difficult if not impossible to prevent her from reporting it to the government. The SEC’s new whistleblower rules, for example, forbid companies to use confidentiality agreements or similar devices to keep employees from “reporting out,” although in certain circumstances compliance personnel or in-house counsel may be required to report internally first. 17 C.F.R. §§ 240.21F-4(b)(i)(ii)(B).

In addition, the provisions for a percentage recovery for whistleblowers, either in a False Claims Act qui tam action or the SEC’s whistleblower rules, provide a powerful monetary incentive for employees to take their concerns outside the company instead of relying on internal processes.

Even so, companies should encourage employees to report internally. The benefits to the company of conducting its own investigation are hard to overstate. If the employee reports out and a government agency contacts the company concerning a whistleblower claim, counsel should make every effort to engage agency personnel early on, and to convince them that the company should be permitted to perform its own investigation.

Think of the vast differences between responding to a government investigation and conducting one on your own. The government investigation is out of your control; you probably don’t know what information the government has been provided or the scope of its investigation; you don’t control the timing of the proceedings or the possibility that the government will try to contact former employees without your knowledge; and there is always the possibility that in the course of the inquiry, the investigators may uncover (or think they have uncovered) new areas of concern. By contrast, an internal investigation is one that is ultimately under the control of the board or a board committee, its progress and probable costs can be tracked, and it has a foreseeable end date.

Even when a whistleblower complaint remains internal and the company has not yet decided whether to report the allegations to the government, any internal investigation should be thorough, impartial, and well-documented. The investigative body and the attorneys it retains must be conflict-free. Counsel should plan for the possibility that the company will present the results of the investigation to several key audiences including the board, independent auditors, the government, or even a plaintiff in future litigation. Therefore, process matters greatly, and counsel must be prepared to explain his or her choices at every step of the way. Were all of the potentially critical witnesses interviewed? Were relevant documents collected and reviewed? What search terms were used in the review of electronic data? Counsel should review investigative protocols, in advance, with those who will be briefed at the end of the investigation. Otherwise, the results of the investigation may be open to attack, or critical steps may have to be repeated later.

In conducting an investigation, the company needs to be particularly careful to preserve the attorney-client privilege and attorney work product. Communications between investigating counsel and a government agency are likely to be considered non-privileged, and counsel should be careful when providing written documents, reports or analyses to the government. Even a promise by the government not to claim that a privilege has been waived may not be sufficient to shield the disclosures from a third-party subpoena. Fortunately, most government attorneys understand this issue and are willing to work constructively with companies and their counsel to minimize potential privilege waivers.

Dealing with a Government Investigation

Assume, however, that a company only learns of a whistleblower claim when it is contacted by a government agency, and the agency refuses to suspend its investigation while the company conducts its own inquiry. Even in this situation, counsel should be proactive, and should not simply wait to respond to the government’s requests or subpoenas. Mounting an aggressive defense requires counsel to learn as much as possible about the identity of the whistleblower and the nature of her complaint, and to plan avenues of response and attack at the earliest stages.

At the same time, defense counsel should attempt to engage government attorneys in a constructive manner throughout the process. It may or may not be possible to obtain helpful information directly; False Claims Act cases are kept under seal for months or years, and whistleblower statutes typically require the government to maintain the confidentiality of the informant’s identity. Even so, establishing a relationship of trust and credibility with the agency may open up avenues of discussion that will be
It is rare that bankruptcy court litigation grabs the attention of both the public and the U.S. Supreme Court, but it happened in the long-running dispute between former Playboy playmate Vickie Lynn Marshall (aka Anna Nicole Smith) and Pierce Marshall, son of Vickie's husband J. Howard Marshall II, a wealthy nonagenarian who died a year after marrying Vickie.

Greatly simplified, the dispute was tried in two different fora — Texas probate court and Los Angeles bankruptcy court. Vickie sued Pierce in Texas, claiming Pierce had tortiously prevented J. Howard from providing for Vickie in his inter vivos trust and will. Vickie then filed bankruptcy in Los Angeles, and Pierce filed a claim there alleging defamation for Vickie's public assertions he had defrauded his father into excluding Vickie from the estate. Vickie responded to that claim by counterclaiming with the same tortious interference claim filed in Texas.

The bankruptcy court entered judgment against Pierce on both claim and counterclaim (for $475 million!). Soon after, a Texas jury decided, and the probate court entered judgment on, the fraudulent interference claim in Pierce's favor. In Stern v. Marshall, — U.S. —, 2011 WL 2472792 (June 23, 2011), the Supreme Court concluded, in a 5 — 4 decision, that the bankruptcy court judgment on Vickie's counterclaim — though authorized by the statute classifying such counterclaims as "core" proceedings in which the bankruptcy court could properly enter final judgment — was invalid because bankruptcy judges lack essential Article III constitutional attributes of lifetime tenure and guarantee against reduction in compensation. (An earlier Supreme Court decision, Marshall v. Marshall, 547 U.S. 293 (2006), held that federal court jurisdiction over Vickie's counterclaim was not precluded by a "probate exception," but did not reach whether the bankruptcy court could exercise that jurisdiction.) Hence the first valid judgment was the Texas probate court's; it had preclusive effect and trumped a later judgment for Vickie by a U.S. District Judge, on review of the initial bankruptcy court action (for a smaller but still significant $89 million).

Stern v. Marshall underscores the complexity of the bankruptcy court jurisdictional structure and poses a number of questions for practitioners who thought they understood it. Some background: Bankruptcy court proceedings are divided between "core" and "related-to" matters. In the former — matters central to a bankruptcy case such as confirmation of chapter 11 plans, disposition of estate assets, allowance of creditors' claims, and a debtor's discharge — the bankruptcy judge can enter final judgments and orders, subject only to appellate review. In the latter — proceedings like debtor lawsuits against non-debtor parties for damages for breach of pre-bankruptcy contracts involving no bankruptcy law issues — the bankruptcy judge can conduct a trial and propose findings and judgment, but (absent consent of the parties) cannot enter judgment — a function reserved to the Article III district judge after "de novo" review.

This jurisdictional structure is embodied in 28 U.S.C. § 157, enacted in 1984 to accommodate the Supreme Court's decision in Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982), invalidating — also on Article III grounds — the grant to bankruptcy courts of authority to enter final judgment in all disputes that might arise in a bankruptcy case, including those "related to" the case. Section 157(b)(2) provides a long nonexclusive list of "core" proceedings, including "counterclaims by the estate against persons filing claims against the estate."

Here are some questions raised by Stern v. Marshall:

- Is § 157(b)(2)(C) wholly invalid, or only as to state-law counterclaims, or only some of those? Earlier Supreme Court decisions (Katchen v. Landy, 382 U.S. 323 (1966) and Langenkamp v. Calp, 498 U.S. 42 (1990)) and the Court's discussion in Marshall suggest that the bankruptcy court can still possibly enter judgment if it might be able to decide the necessary elements of the counterclaim to allow the claim (for example, a disputed mutual account with debtor and third party each claiming a balance due from the other).
- Will, or should, there be any change in the calculus whether to consent to final judgment by the bankruptcy judge? Even in "related-to" proceedings, the parties may consent to entry of final judgment by the bankruptcy court, functionally converting them to "core" proceedings. In practice, this happens often, either by express consent or because few parties seek de novo district court review of the bankruptcy court's proposed findings and judgment. [See N.D. Cal. Bankruptcy Local Rule 9033-1, establishing the little-used procedure for de novo review.]
- What is the impact on jury trial rights? Bankruptcy proceedings are "equitable" in nature, hence generally no jury right, but a third party who has not filed a claim is entitled to a jury if sued by the estate for money. Granfinanciera, S.A. v. Nordberg, 492 U.S. 33 (1989). Creditors sometimes choose not to file bankruptcy claims to preserve their jury rights (and obtain withdrawal of the reference) if sued by the estate. Does this logic still apply? Does it turn on how courts answer the question in the first bullet point?
- How much change will the decision actually produce? The majority calls its decision "narrow" and posits minimal impact; the dissent worries that district courts may be inundated with requests for de novo review of "related-to" counterclaims. My personal view: aside from creating additional litigation in the short-run over already complicated jurisdictional questions, the impact will not be all that substantial. Time will tell.

Peter Benvenutti suggests how much change the decision actually produces and the potential impact on jury trial rights. The majority calls its decision "narrow" and posits minimal impact; the dissent worries that district courts may be inundated with requests for de novo review of "related-to" counterclaims. My personal view: aside from creating additional litigation in the short-run over already complicated jurisdictional questions, the impact will not be all that substantial. Time will tell.

Peter Benvenutti is a partner in the San Francisco office of Jones Day.

pjbenvenutti@jonesday.com.
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Age of the Whistleblower

helpful in shaping the direction of the inquiry, or at least in helping the defense understand where the government may be going.

It will certainly be helpful to the company to know the whistleblower’s identity as soon as it can — not solely for the purpose of impeaching her credibility, but also for the purpose of assessing the seriousness of her allegations of misconduct, and the identities and credibility of potential fact witnesses. If the whistleblower is a discharged employee or one with a history of performance or disciplinary problems, those facts will be important to know. Counsel may decide to bring these facts to the attention of the investigating authority at the earliest possible time. Similarly, it will be helpful to know if the whistleblower’s accusations relate to other employees with known performance issues.

The company should not be so single-minded about learning the identity of the whistleblower that it loses sight of the importance of assessing the alleged conduct that is under investigation, however. Even if the government will not postpone its inquiry while the company conducts an internal investigation, the company should get out in front of the issue to the greatest extent possible, looking for documents before the government requires them to be turned over, locating and interviewing witnesses before they are subpoenaed, and developing evidence that will support a defense narrative — the kind of evidence that the government has no incentive to develop, and often overlooks. Even if it turns out that misconduct has occurred, demonstrating that the conduct was isolated or aberrational, or developing mitigating evidence, is vitally important.

Staying abreast of — or even ahead of — the government enables the company to develop an effective defense long before the matter proceeds to a formal accusation or trial. The earlier the company can credibly suggest to the government that there may be problems with the accusations, or can provide an alternative explanation for the events in issue, the better its chances of derailing or limiting an investigation before it acquires a bureaucratic momentum that may make it difficult to stop. At a time when the company wishes to discuss settlement of the potential charges, or to argue for termination of the investigation without any action being taken, it will be necessary for the company to be able to articulate a factually-supported narrative explaining the events that are under scrutiny. The company needs to be able to explain why the conduct under examination was not improper, or why it did not have serious consequences, or why the government’s theory is based on an unreliable informant or dubious information. It is not possible to present these arguments forcefully unless they have been thoroughly developed and tested.

Discovery and Trial Strategies

In some cases, the only way to acquire certain knowledge of the whistleblower’s identity will be to refuse to settle with the government at the investigative stage, resulting in the filing of a complaint and a possible trial. Although doing so will result in negative publicity, the disadvantage may not be as great as it first appears, because settling with the government before formal charges are filed will almost certainly result in a government press release and attendant publicity. The SEC, for example, requires settling parties to agree that they will not deny that the charges have a basis in fact. 17 C.ER. § 202.5(e).

Once the matter proceeds beyond the investigative stage to a formal complaint, the tools available to the defense expand considerably. For one thing, the company can now discover the whistleblower’s identity through formal discovery. Once this information has been secured, subsequent discovery requests should call for all interview notes, testimony transcripts and investigative reports concerning the informants and any information she and other witnesses provided to the government. Third-party subpoenas may help to unearth critical evidence that might not have been possible to obtain during the investigative stage. In civil cases, the deposition of the informant will be a critical event. The defense should be prepared to make the whistleblower a central focus of the case, and the company should consider using all available, lawful means to investigate the whistleblower; her background and any motivation she may have to stretch or distort the truth.

The defense should be careful not to overplay its hand with the whistleblower, however, particularly if she is sympathetic or credible, or her allegations have a solid factual basis. Whether the defense unleashes an all-out attack on the whistleblower’s credibility or merely suggests that she is somehow misguided or misinformed will depend on a careful strategic calculation, but neither possibility should be entirely ruled out as the case is being prepared for trial.

In addition, the defendant company must not ignore the accusations themselves, particularly if they appear to have merit. Where the accusations focus on questionable policies or practices as opposed to alleged rogue employees, it is important to address institutional problems without awaiting a jury verdict. If the company also had a strong culture of compliance prior to the alleged misconduct, it will be important to develop those facts both to increase the factfinder’s sympathy for the entity and to reduce the likelihood of a finding that misconduct resulted from a pervasive culture of unethical behavior.

Business litigators play a critical role in helping companies deal with a predicted surge in whistleblower complaints. They should help companies to focus attention on existing policies in order to create a workplace environment that reduces accusations of misconduct. When a complaint is made, they can assist in conducting a prompt and thorough investigation. If the case ultimately proceeds to trial, they will maximize the client’s chances of success by constructing a defense long before the accusation becomes public.

William S. Freeman is a partner in the Silicon Valley office of Jones Day. wfreeman@jonesday.com
The rise of social media has created many headaches for employers. Recent actions by the National Labor Relations Board ("NLRB") that are inconsistent with its prior guidance have only added to those headaches.

Earlier this year, the NLRB announced that it had reached a settlement with American Medical Response of Connecticut ("AMR") for terminating an employee because she had posted negative comments about her supervisor on her personal Facebook page. AMR terminated the employee for having violated the company’s Blogging and Internet Posting Policy, which prohibited employees from “making disparaging, discriminating or defamatory comments when discussing the Company or the employees’ supervisors, co-workers and/or competitors.”

The case arose when the employee’s supervisor asked her to prepare a written response to several patients’ complaints about her work performance. Upset by this request, the employee logged on to her personal Facebook page and posted, “Love how the company allows a 17 to be a supervisor” referring to the employer’s code for a psychiatric patient, and called her manager a “scumbag as usual.” Her post drew favorable comments from her work colleagues. The employer subsequently fired her.

The NLRB alleged that the employee’s termination violated section 8(a)(1) of the National Labor Relations Act ("NLRA") which prohibits an employer from interfering with, restraining or coercing employees in the exercise of their rights under section 7 of the NLRA. Section 7 permits employees, regardless of whether they are represented by a union, to engage in concerted activities with other co-workers to improve working conditions such as wages and benefits. Section 7 has also been interpreted by the NLRB to include criticisms of management.

According to the NLRB, AMR’s policy, irrespective of the discharge, interfered with employees’ rights to engage in protected concerted activity. As part of the settlement, AMR agreed to revise its policy to allow employees to discuss wages, hours and working conditions. It also agreed not to discipline or fire employees for engaging in such activities.

Since reaching this settlement, the NLRB has continued to aggressively monitor employee terminations resulting from postings on social media sites and has pursued complaints against other companies under similar circumstances. These recent enforcement actions have caused confusion for employers, however, because they are inconsistent with its past guidance.

Less than two years ago, the General Counsel of the NLRB issued an Advice Memorandum in response to a complaint filed by a union seeking to organize Sears Holdings in-home service technicians. The union claimed that the employer’s social media policy restricted its employees’ section 7 rights and, in particular, those of service technicians who communicated with their colleagues on an e-mail listerv.

The General Counsel opined that the prohibition against the “disparagement of company’s or competitor’s products, services, executive leadership, employees, strategy and business prospects” in the policy could not have been reasonably interpreted to prohibit concerted activity protected by section 7. In reaching its decision, the NLRB explained that a rule will only violate section 8(a)(1) upon showing that: (1) employees would reasonably construe the language to prohibit section 7 activity; (2) the rule was promulgated in response to union activity; or (3) the rule has been applied to restrict the exercise of section 7 rights. The Office of the General Counsel reiterated that such an inquiry must begin with a reasonable reading of the rule and cautioned against reading particular phrases in isolation. According to the Advice Memorandum, a policy would not violate the NLRA simply because it could be read to possibly restrict section 7 activity.

It is difficult to reconcile the NLRB’s position in its 2009 Advice Memorandum with its current enforcement activity. There is little difference between “making disparaging, discriminating or defamatory comments when discussing the Company or the employees’ supervisors, co-workers and/or competitors” and the “disparagement of company’s or competitor’s products, services, executive leadership, employees, strategy and business prospects.” Why did the NLRB take issue with the former prohibition while endorsing the latter? The answer is likely political and a result of today’s more pro-employee composition of the NLRB.

In light of the NLRB’s current position on social media policies, employers should ensure their policies do not infringe on their employees’ section 7 rights. To confront the problem head on, employers can state expressly that nothing in a policy prohibits employees from discussing working conditions. In addition to social media policies, employers should review their confidentiality and proprietary information policies and agreements to ensure they also do not prevent employees from discussing working conditions. For example, blanket prohibitions against disclosing work-related information could be found to chill employees’ section 7 rights. In addition, all employers should educate their managers about employees’ section 7 rights to avoid taking actions that conflict with the NLRB’s most recent position on this issue.

Walter Stella is a partner in the San Francisco office of Bingham McCutchen LLP. walter.stella@bingham.com
The Consequences of Court Closures

Court closures caused by budgetary concerns are scheduled to take effect October 1. San Francisco Superior Court has said that it will close 14 of 65 courtrooms — most of them civil — leaving only 11 civil courtrooms open. Other counties have garnered smaller headlines but will also close courtrooms, changing the character of civil justice available in the state. San Joaquin County, for example, is closing one courthouse and one of two courtrooms in another, and has indicated that it will likely close down the small claims department altogether, which would not just delay justice but deny it altogether in some cases. Los Angeles Superior Court reports it avoided closures this year only because it laid off 300 employees and closed 17 courtrooms last year, and expects mounting deficits to result in closure of entire courthouses in 2012 or 2013. ABTL members have begun discussing not just their opposition to court closures, but how civil litigation will be affected.

Venue choices and fights will be re-evaluated. A resistance to federal court by some plaintiff’s attorneys may be overcome in the face of a state court system that could take five years to adjudicate most cases. Counties so far unaffected by the cuts will become more attractive as venues; practitioners may balance their assessment about jury demographics against their desire to get the case to trial.

Parties seeking an early resolution will need to figure out how to drive the case toward decision, while those seeking to avoid resolution have the court’s backlog as an unexpected ally. Motions for preliminary injunction (based on likely success on the merits paired with irreparable harm) or for writ of attachment (based on likely success on the merits paired with expectations of unsecured debt) may become more prevalent as tactics to force an early decision about the likely winner. Every practitioner will become familiar with the statutory preferences for trial-setting. Note that a preference for early resolution is by no means limited to plaintiffs: a five year delay means defendants may face an extra 50% in damages in many business cases, based simply on accrual of prejudgment interest. Meanwhile, a slow moving system leads to inaction and forgetfulness about some cases; twenty years ago, some significant number of cases would run up against the five-year deadline for bringing a case to trial, and motions to dismiss based on the five-year statute, or for failure to prosecute, were more common.

Court closures and lengthy delay do not affect only tactics; they affect the quality of justice. The policy behind statutes of limitations — to avoid loss of memories and evidence, and deliver justice promptly — is compromised when the delay after case filing extends for so long. And a slower system affects clients not only because justice delayed can be justice denied, but because lawyers will have to keep re-learning their cases when case events finally do roll around, and staffing turnover in firms has a greater effect than when cases are resolved promptly. Figuring out how to preserve evidence and effectively preserve one’s thinking as cases go on will be a greater virtue than ever before.

ABTL, along with BASF and others, is doing what it can to speak out against the dismantling of the civil justice system. The deep cuts in the judicial branch budget create an untenable situation for our courts, our communities, and our clients. As lawyers, we are uniquely positioned to advocate for the restoration of adequate funding. But until those efforts succeed, ABTL members face the new challenge of learning how to litigate in a judicial system that is being remade before our eyes.

Thomas Mayhew is a partner in the San Francisco office of Farella Braun & Martel LLP, and is the Co-Editor of the ABTL Northern California Report. tmayhew@fbm.com.